

# Korea and Latin America and the Caribbean:

## Striving for a Diverse and Dynamic Relationship



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# Highlights

- Trade between Korea and Latin America and the Caribbean (LAC) has experienced fast and sustained growth, increasing by 17 percent a year on average since 1990 to reach US\$ 54 billion in 2014
- While Korea-LAC trade shares some similarities with the region's trade with China, there are important differences: LAC's exports to Korea are both more diversified and more weighted towards manufacturing products
- Foreign direct investment (FDI) from Korea to LAC has also grown impressively, increasing ten-fold since 2004, with over 80 percent in manufacturing sectors
- Korea has also entered into free trade agreements (FTAs) with Chile, Peru, and Colombia, as well as diverse cooperation projects with governments throughout the region
- These initiatives are critical to address remaining barriers to trade and investment and realize the greatest possible gains from this dynamic and diverse trans-Pacific relationship



# Introduction

**F**or Latin America and the Caribbean (LAC), Asia has gone from an afterthought to a centerpiece of economic relations over the last decade. Seemingly out of nowhere, fast-growing Asian economies became major trade partners, snapping up the region's mineral and agricultural exports at a breathtaking pace, while providing a steady stream of low-cost manufactures and consumer products to its expanding domestic markets.

The exchange of commodities for manufactures, with attendant concerns over specialization and deindustrialization in the region, has come to define the LAC-Asia relationship for many in the region. But this view overlooks the distinct characteristics of the region's trade and investment with different Asian economies, and in so doing risks missing important opportunities to deepen and diversify LAC's ties to the Asia-Pacific.

Korea is a case in point. Trade between LAC and Korea has experienced fast and sustained growth over the past two-and-a-half decades, increasing by 17 percent a year on average since 1990 to reach over US\$ 54 billion in 2014. While the broad commodities-for-machines pattern can be seen in LAC-Korea trade flows, it would be wrong to simply lump Korea in as another commodity-hungry Asian nation. As this report illustrates, Korea, with a GDP per capita of around US\$ 26,000 and a stable of highly innovative home-grown multinational firms, offers a different set of opportunities for trade and investment ties with the region than do China or other Asian economies.

For one, Korea's high standard of living and advanced manufacturing base create the conditions to absorb a more sophisticated and diverse range of products from the region. LAC's exports to Korea have a higher share of manufactured goods and display less overall concentration than its exports to China or Japan.

In addition, Korea has been an important source of FDI for LAC, with accumulated investment inflows of 10.3 billion since 2003. Critically, over 80 percent of that investment has been in manufacturing, distinguishing Korea's FDI from that of China and providing a solid basis for diversifying the economic relationship. Korean firms employ thousands of workers throughout the region, including high-skilled engineers, designers, and technicians. Their presence allows LAC countries to expand manufacturing

capacity, upgrade marketing and logistics infrastructure, and participate in value chains for some of the world's most innovative and technologically complex products.

Finally, Korea boasts a reservoir of development policy knowledge from its own remarkable experience. Growing at an annual average rate of 7 percent over nearly five decades, Korea rose from one of the poorest countries on the globe to the ranks of the advanced industrialized economies. Korean policymakers have established a robust framework for sharing policy lessons with developing countries, which have benefited a number of LAC countries through government-to-government cooperation.

The fundamentals are thus in place for LAC and Korea to enjoy a diverse, dynamic, and sustainable relationship that builds on numerous existing complementarities. Arriving at that goal, however, requires more than simply putting the economic relationship in auto drive. To underscore this point, the share of manufacturing products in LAC's exports to Korea actually declined in the first several years of this decade compared with the end of the 2000s. While this measure captures only one facet of the manufacturing link between the economies—Korean investment boosts LAC's exports to third markets, for example—the broader message holds: governments must actively steer the LAC-Korea relationship in order to realize the potential gains for both sides.

Fortunately, such efforts are already underway. Korea currently has FTAs with Chile and Peru, agreements that have helped propel bilateral trade and open up important opportunities for Chilean and Peruvian exports. An additional FTA with Colombia is set to enter into force in 2015, and negotiations with Central America and other potential partners are in the works. In addition, Korea has shown interest in joining the Trans-Pacific Partnership (TPP), a multi-regional trade bloc that includes Chile, Peru, and Mexico; and has observer status in the Pacific Alliance, an ambitious regional integration project in LAC. These initiatives ensure that Korea will be an important piece of the region's emerging trade architecture, opening up new opportunities to deepen integration and cooperation.

This report gives a broad overview of trade, investment, and cooperation between LAC and Korea, pointing to the important successes in this growing trans-Pacific relationship, as well as the challenges governments on both sides must address to ensure that these promising links flourish well into the future.

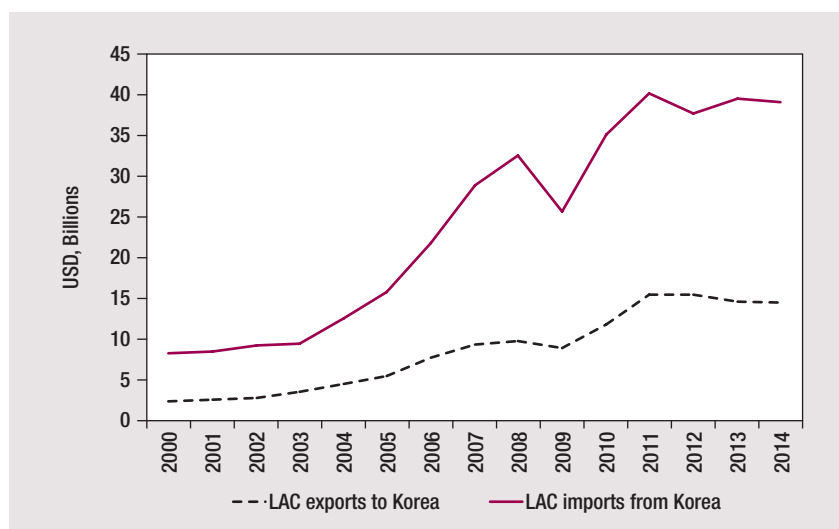
# Trade: the Foundation for a More Nuanced LAC-Asia Relationship

## Part 1

**T**rade between Latin American and the Caribbean (LAC) and Korea has experienced sustained, fast growth over the past two decades, increasing by 17 percent a year on average since 1990. This growth rate exceeded that of LAC's trade with Japan (7 percent) and East Asia<sup>1</sup> (14 percent) over the same period, placing it squarely among LAC's most dynamic trade relationships with the fast-growing Asia-Pacific—despite receiving considerably less attention than the LAC-China trade boom.

The region's exports to Korea have grown slightly faster (16 percent annual average) than its imports from Korea (14 percent) since 2003, although LAC still maintains a considerable trade deficit with Korea (see Figure 1). This steadily expanding trade has turned the region into an important partner for Korea. Since 2010, LAC has accounted for over 5 percent of Korea's total trade, and 7 percent of its total exports, just below the region's share of China's total trade and above that of Japan's (see Figure 2)

The drivers of LAC-Korea trade have been similar to those underlying the broader LAC-Asia relationship. Korea, a net importer of energy, metals, and many agricultural commodities, experienced sustained growth of



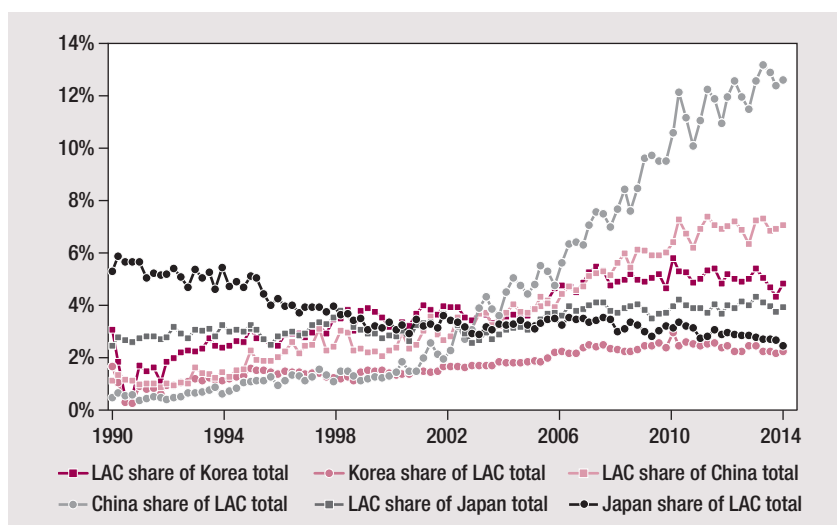
**FIGURE 1/**  
Trade between LAC and Korea

Source: IMF Direction of Trade Statistics (DOTS), as reported by LAC countries.  
Note: Data for 2014 is an estimate.

<sup>1</sup> East Asia includes Indonesia, Malaysia, Singapore, Thailand, and Taiwan, China.

**FIGURE 2/**

LAC share of trade with  
selected Asian partners



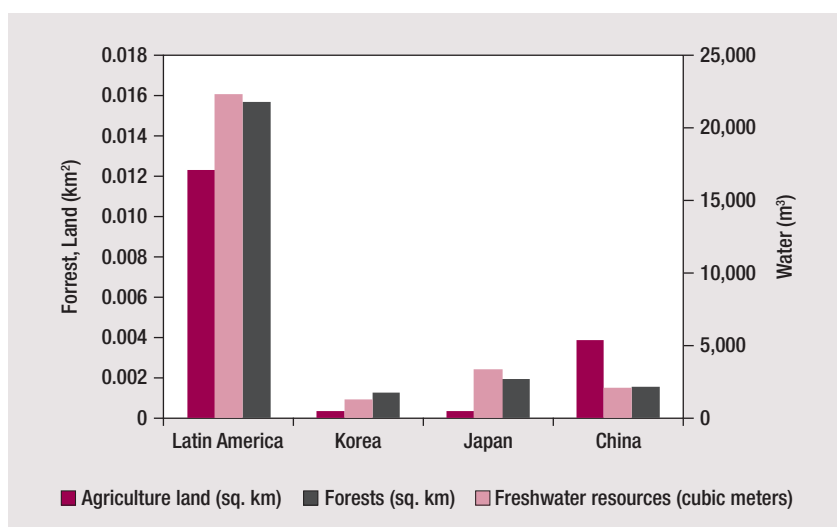
Source: DOTS, as reported by LAC countries.

Note: Data for 2014 is through July.

4.4 percent on average from 2000 to 2013, leading to strong demand for imports of these products. At the same time, commodity prices rose sharply, driven by demand from Asia and China in particular. As Figure 3 underscores, basic differences in endowments make LAC a likely source of natural resource-based exports to Korea.

**FIGURE 3/**

Selected Natural  
Resources Per Capita:  
China, Japan, Korea  
and LAC, 2011



Source: World Bank, World Development Indicators.

**TABLE 1/  
Top LAC Imports from  
Korea, 2010–2013**

Product description	Share (%)	Cumulative share (%)
Vehicles with cylinder capacity between 1500cc and 3000cc	9.46	9.46
Parts for television communications and broadcast equipment	6.92	16.38
Liquid crystal devices and other optical appliances and instruments	6.88	23.26
Light-vessels, fire-floats, floating cranes and other vessels the navigability of which is subsidiary to their main function; floating docks	6.18	29.44
Vessels for the transport of goods and for the transport of both persons and goods	5.75	35.19
Other parts and accessories for motor vehicles	5.23	40.42
Tankers	4.68	45.10
Petroleum oils and oils obtained from bituminous minerals (other than crude) and other preparations, containing by weight 70 % or more of petroleum oils/of oils obtained from bituminous minerals	3.67	48.77
Parts of telephone sets, including for cellular networks and other wireless networks	3.02	51.78
Vehicles for the transport of persons, with spark-ignition internal combustion reciprocating piston engine, of a cylinder capacity between 1000cc and 1500cc	2.57	54.36

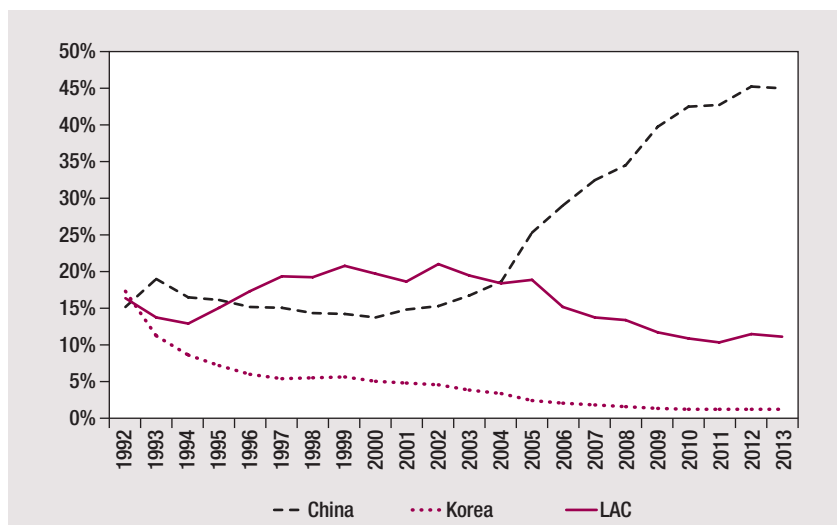
Source: UN Comtrade.

On the import side, Korea, like Asian economies in general, has mostly provided manufactures to the region (see Table 1). However, Korea's specialization in high-tech, capital-intensive industries means that the composition of its manufacturing exports differs from China's, which are more weighted towards labor-intensive sectors (this remains the case even as China has upgraded in recent years). Figure 4 gives a rough indication of the diverging specialization of Korean and Chinese exports, and the implications for LAC manufacturers, by showing the trajectory of each economy's share of US textile and apparel imports—a classic labor-intensive, relatively low-skilled manufacturing sector. LAC clearly lost share to China beginning in the early 2000s, while Korea had already moved into higher value sectors by the mid-1990s.

This pattern of trade implies more complementarity with the region's manufacturing sectors. On the one hand, Korean producers are less likely to pose a direct competitive threat to LAC firms, and therefore create fewer trade frictions; on the other hand, their positioning at the “high-end” of

**FIGURE 4/**

Korea, China, and LAC's  
share of textile and  
apparel exports to US



Source: UN Comtrade.

Note: Textile and apparel defined as HS categories 50–64.

manufacturing value chains could provide opportunities for intra-industry trade with LAC countries.

In terms of geographic composition, Korea's exports to LAC are concentrated in Mexico and Brazil, the region's two largest economies (see Table 2), with Mexico standing out as by far the most important destination for Korean exports. This status reflects both its large domestic market as well as its emergence as a manufacturing hub and export platform to the United States. These trade flows have been reinforced by Korean FDI into Mexico, as large manufacturers in the auto and electronics sectors have undertaken major investments in recent years (see Part 3).

LAC's exports to Korea, meanwhile, are concentrated in a handful of countries and products, reflecting their strong bias towards mineral and

**TABLE 2/**  
Top Five LAC  
Importers from  
Korea, 2007–2014\*

Country	Share (%)
Mexico	41.4
Brazil	23.5
Chile	8.4
Peru	3.6
Colombia	3.1

Source: DOTS, as reported by LAC countries.

\*Data for 2014 through July.



Product description	Share (%)	Cumulative share (%)
Copper ores and concentrates	13.13	13.13
Cathodes and sections of cathodes, of refined copper, unwrought	8.73	21.85
Iron ores and concentrates (excl. roasted iron pyrites), non-agglomerated	7.88	29.73
Iron ores and concentrates (excl. roasted iron pyrites), agglomerated	5.23	34.96
Lead ores and concentrates	4.65	39.61
Maize (corn), other than seed	4.34	43.95
Zinc ores and concentrates	4.30	48.25
Natural gas, liquefied	4.05	52.30
Semi-finished products of iron/non-alloy steel	2.90	55.20
Oil-cake and other solid residues from extraction of soya bean oil	2.89	58.09

Source: UN Comtrade.

agricultural commodities (see Table 3). As Table 4 shows, Chile and Brazil alone account for over 60 percent of LAC exports to Korea since 2007, driven overwhelmingly by a few commodities: copper in the case of Chile, which made up 72 percent of its exports to Korea; and iron ore and related products for Brazil (42 percent of total).

Despite this overall story, LAC's exports to Korea are notably less concentrated than its exports to China, Japan, or the rest of East Asia, as Figure 5 demonstrates using two common measures of export concentration. This diversification reflects the fact that LAC countries have had greater success selling more sophisticated, manufactured goods to Korea than to Japan or China. Figure 6 shows that the share of manufactures in the region's exports to Korea is considerably higher than its share of LAC-China or

**TABLE 3/**  
Top LAC exports to  
Korea, 2010–2013

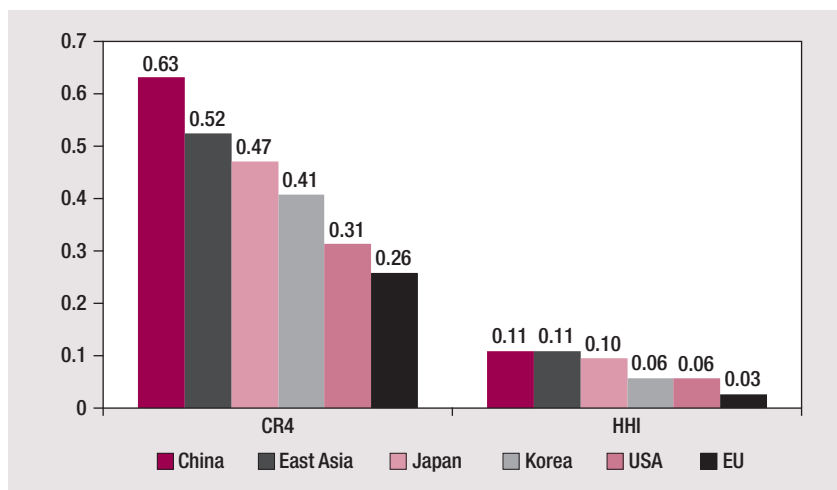
Country	Share (%)
Chile	32.9
Brazil	29.5
Mexico	9.2
Peru	9.1
Argentina	6.6

Source: DOTS, as reported by LAC countries.

\*Data for 2014 through July.

**TABLE 4/**  
Top Five LAC Exporters  
to Korea, 2007–2014\*

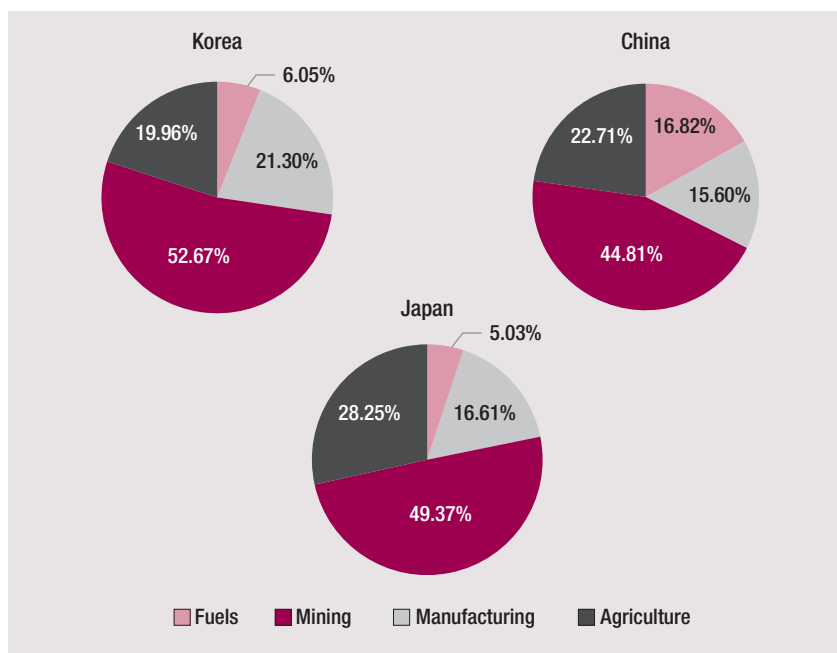
**FIGURE 5/**  
Concentration of LAC's  
Exports, 2010–2013



Source: UN Comtrade.

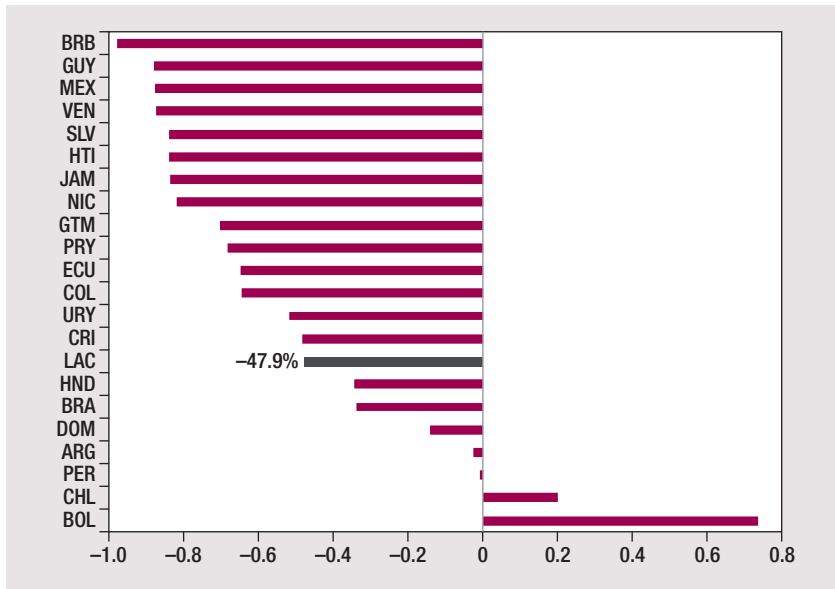
Note: HHI refers to the Herfindahl-Hirschman normalized concentration index, which ranges from 0 (diversified) to 1 (concentrated). CR4 refers to the aggregated share (in decimals) of total exports held by the top 4 exported products. East Asia includes Indonesia, Malaysia, Singapore, Thailand, and Taiwan, China.

**FIGURE 6/**  
Composition of LAC  
exports to selected Asian  
countries, 2010–2013



Source: UN Comtrade.

LAC-Japan exports. In addition, among the region's top ten manufacturing exports to Korea, six are high- or medium-technology products, such as telecommunications equipment, vehicles and vehicle parts, and chemicals.



Source: DOTS.

**FIGURE 7/**  
Accumulated Trade  
Balances as a Share of  
Total Trade, selected  
LAC countries  
(2000–2013)

However, manufacturers have declined somewhat since the late 2000s; their share in LAC’s exports to Korea was 28.7 percent from 2008–2010 versus 21.3 percent between 2010 and 2013.

Still, LAC-Korea trade is based on the “commodities-for-machines” model that characterizes the much-discussed LAC-China trade boom and is a feature of LAC-Asia trade more broadly. Again, deep-seated comparative advantage based on fundamental differences in resource endowments is behind this pattern of trade. Partly as a result, LAC countries have accumulated trade deficits with Korea nearly across the board (see Figure 7). The only countries with surpluses (Chile and Bolivia) combine large commodity exports with small domestic markets that limit their capacity to absorb Korean manufacturing imports.

For LAC, trade with Korea thus provides the opportunity to participate in intra-industry trade with Korea’s world-class high-tech manufacturers, while also adding value to agriculture and mineral-based products, taking advantage of Korea’s high GDP per capita. The region’s trade with Korea has exhibited different characteristics than its trade with China and other East Asian economies, with more diversification throughout the export basket and a higher share of manufactures in particular. At the same time, both diversification as measured by the HHI index and the share of manufactures in total exports have moved in the “wrong” direction since the late 2000s:

manufacturing exports have declined in relative terms while overall export diversification decreased.

While these two measures are by no means the whole story—for example, Korean FDI has increased and diversified in recent years as we will see in Part 3—they do suggest that governments on both sides cannot simply sit back and wait for gains to materialize. Making the most of these opportunities will involve attracting more Korean investment in the region and cooperation between governments to ensure a policy framework that maximizes the benefits of this fast-growing trade relationship and minimizes the externalities. A good place to start is to address trade costs, which, in their various forms, pose obstacles to deeper economic integration.

# Trade Costs: Lingerin

## g Obstacles to Integration

## Part 2

**K**orea and LAC have both taken major steps to liberalize trade over the past decades. On the LAC side, governments slashed average tariffs from 40 percent in the mid-1980s to single digits, while much of the region also joined multilateral trade negotiations in the 1990s and embarked on numerous regional integration agreements. Korea, too, opened up its trade policy considerably over the same period, cutting its average import tariff by more than half and doing away with many non-tariff barriers as well.

Despite these advances, trade costs continue to pose a considerable barrier to LAC-Korea integration, especially in areas where important gains could be had for both sides. As Table 5 shows, bilateral tariffs remain high and even prohibitive in certain sectors. Several LAC countries must pay double-digit tariffs on agricultural exports to Korea, while facing the additional burden of tariff escalation (meaning higher rates are applied to higher levels of processing), which undermines efforts to add value to natural resource-based exports. Meanwhile, Korea’s manufacturers and agricultural producers face high duties in several important markets in the region (Table 6).

Non-tariff barriers (NTB) create additional costs for exporters on both sides of the relationship. One example is tariff-rate quotas, where exporters pay a higher rate after a certain level of quantity, or quota, is reached. As Table 7 shows, LAC exporters to Korea face very high “out of quota” rates on many agricultural goods where the region enjoys a comparative advantage such as fruits, coffee, and animal products.

Unlike tariffs, which at least have the advantage of being generally consistent and transparent, NTBs are often “hidden” in provisions such as sanitary and phytosanitary requirements and other product regulations,

Sector	Argentina	Brazil	Colombia	Mexico	Peru
Overall	13.32	8.15	8.76	7.91	4.63
Agriculture	15.62	9.23	11.67	25.85	8.30
Manufacturing	7.23	7.69	5.09	7.24	9.29
Mining	2.06	2.23	0.03	1.89	2.64

**TABLE 5/**  
**Average tariff on LAC**  
**Exports to Korea,**  
**Selected Countries**

Source: TRAINS and COMTRADE.

Note: Averages are weighted by exports to the world. Trade and tariff data are for 2010.

**TABLE 6/**  
Average Tariffs on  
Korean Imports,  
Selected LAC Countries

Sector	Argentina	Brazil	Colombia	Mexico	Peru
Overall	10.69	12.90	4.19	3.53	1.51
Agriculture	14.40	14.69	11.76	18.69	1.59
Manufacturing	10.74	12.98	4.24	3.45	1.55
Mining	8.57	9.62	2.69	1.46	0.01

Source: TRAINS and COMTRADE.

Note: Averages are weighted by exports to the world. Trade and tariff data are for 2012 (Argentina, Brazil, Colombia), 2011 (Peru), 2010 (Mexico).

**TABLE 7/**  
Korean tariff quotas on  
agricultural products,  
2011

Products	In-quota rate (%)	Out-of-quota rate (%)	Quota levels (tonnes)
Live animals <sup>a</sup>	0.0	50.6	927,051.0
Dairy; eggs; honey; edible products	26.6	86.2	786,412.8
Products of animal origin	6.5	21.8	467.6
Live trees and other plants	8.0	18.0	198,350.0
Edible vegetables	29.1	455.1	282,212.8
Edible fruit and nuts; peel of citrus fruit or melons	46.4	311.0	70,369.8
Coffee, tea, mate and spices	34.3	385.6	19,965.6
Cereals	8.2	397.7	96,894.0
Products of the milling industry	9.6	431.2	278,050.3
Oil seeds; miscellaneous grains, medicinal plants; straw and fodder	17.7	497.1	214,574.1
Lac; gums, resins	20.0	754.3	170.4
Animal or vegetable fats and oils	40.0	630.0	668.0
Sugars and sugar confectionery	20.0	114.0	18,806.0
Preparations of vegetables, fruit, nuts, etc	40.0	63.9	4,907.3
Miscellaneous edible preparations	20.0	754.3	113.6
Beverages, spirits and vinegar <sup>b</sup>	30.0	270.0	10,333,800.0
Residues from the food industries; animal fodder	4.9	49.0	52867.9
Oils and resinoids; perfumery, cosmetic or toilet preparations	20.0	754.3	56.8
Albuminoidal substances; starches; glues; enzymes	8.0	201.2	456,920.0
Silk	6.8	51.1	10,159.0

Source: Trade Policy Review Korea 2012, WTO.

<sup>a</sup> units are heads or birds.

<sup>b</sup> units are litres.

creating an additional barrier to exports that is hard to quantify. LAC countries, for example, have had to go through lengthy, product-by-product negotiations in order to gain sanitary approval for fresh fruits—a potentially

Argentina	1992 (2) 2002 (1)	1993 (1) 2004 (2)	1994 (2) 2010 (2)	1995 (1) 2012 (1)	1998 (1) 2013 (1)	1999 (2)	2000 (1)	2001 (3)
Brazil	1993 (1) 2013 (3)	2000 (2)	2001 (1)	2004 (1)	2007 (1)	2010 (3)	2011 (2)	2012 (5)
Chile	2000 (3)							
Colombia	1995 (1)	1998 (1)	2001 (1)	2013 (1)				
Mexico	1992 (3)	1993 (4)	1999 (1)	2000 (1)	2012 (1)			
Peru	1994 (1)	1995 (1)						

Source: World Bank Global Antidumping Database.

**TABLE 8/  
Year and number  
of antidumping  
investigations launched  
against Korea. Selected  
LAC countries**

important group of products where LAC could add value to its natural resource exports.

Governments in LAC, meanwhile, have at times made use of import licensing requirements and special taxes against Asian imports, as well as anti-dumping measures. The latter, however, have become less common over the past decade, and only continue to be used in a couple of the region's major economies (see Table 8).

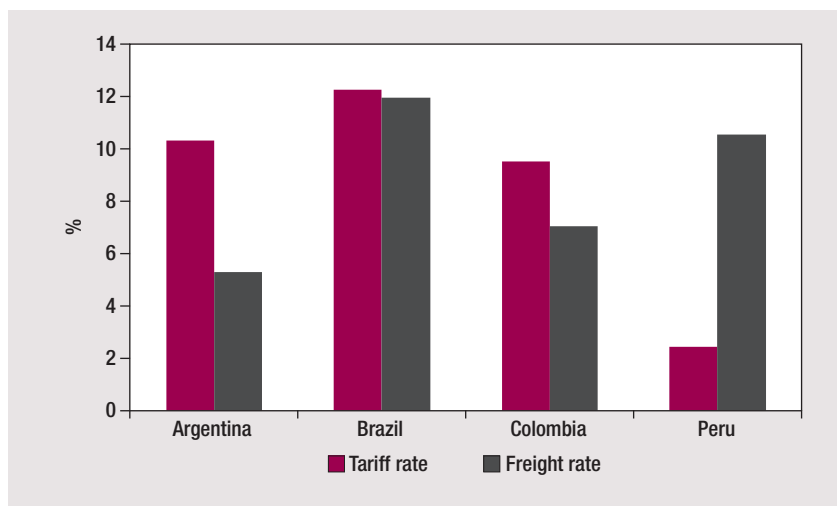
However, tariffs and non-tariff barriers are only part of the trade costs story. It has been well-documented that transportation costs represent a major trade barrier for LAC due to a combination of poor quality domestic infrastructure, inefficient ports, lack of competition in transportation services sectors, and the high weight-to-value ratio of the region's main commodity exports<sup>2</sup> As a result, freight rates exceed tariff levels for many of the region's trading relationships.

It is likely that transportation costs are an especially relevant barrier to LAC-Korea trade given the large distance between the economies and the fact that the region's exports to Korea are highly concentrated in precisely the kind of "heavy" goods—mineral and agricultural commodities—where freight makes up a considerable portion of their delivery price, and thus eats into the margins of exporting firms.

While more recent and comprehensive data is unavailable, Figure 8 shows that freight rates on LAC's imports from Korea have in fact been high, especially in the cases of Brazil and Peru. For the latter, they are several times greater than tariff costs. While some of these issues will require major, long-term investment in infrastructure, governments can do much to improve the situation in the short run through mechanisms such as open skies agreements that would facilitate transport connections between the regions (see Part 4).

<sup>2</sup> Mesquita Moreira et al *Unclogging the Arteries: The Impact of Transport Costs on Latin American and Caribbean Trade*. Inter-American Development Bank, 2008 and Mesquita Moreira et al *Too Far to Export: Domestic Transport Costs and Regional Export Disparities in Latin America and the Caribbean*. Inter-American Development Bank, 2013.

**FIGURE 8/**  
**Tariffs and Ad Valorem**  
**Freight Expenditures**  
**on LAC's Imports from**  
**Korea, 2009**



Source: INT-BID using data from UN Comtrade and INTrade.

All this is not to say that policymakers have been ignoring the opportunities. After LAC-Asia trade took off in the early 2000s, governments on both sides looked to make the most of burgeoning commercial relations by seeking formal integration agreements. Korea was at the forefront of this trend, signing the first LAC-Asia FTA with Chile in February 2003.

The FTA called for the elimination of most tariffs by both parties within a relatively short time frame, although Korea refused to grant tariff reductions on certain agricultural products including apples, pears, and rice, while Chile exempted important Korean imports such as refrigerators and washing machines. In addition, Chile has faced lengthy approval processes—in some cases as long as 8 years—in order to export certain meat, poultry, and fruit products included in the FTA.

Despite these barriers, Chilean exporters faced zero tariffs on a full 96 percent of tariff lines in 2013, which corresponded to over 99 percent of total exports to Korea in that year.<sup>3</sup> Trade between the two economies grew at an impressive annual average rate of 22.3 percent in the five years after the agreement entered into force, far outstripping overall trade growth for each side.

Peru and Korea followed suit, with the Peru-Korea FTA entering into force in 2011. This agreement, like the Chile-Korea FTA, calls for widespread and fast tariff liberalization. Tariffs on all products will be eliminated by 2021 (ten years after entry into force) with the exception of just over 100 “sensitive” products such as rice, beef, and other agricultural products.

<sup>3</sup> DIRECON, “Evaluación TLC Chile y Corea del Sur—A 10 años de entrada en vigencia”.



Importantly, the agreement also features robust provisions in disciplines such as trade in services, investment protections, and rules of origin, which go beyond the measures included in the agreement with Chile.<sup>4</sup>

Taken together, the two Korea FTAs have some of the fastest liberalization schedules of Asia-LAC agreements. The challenge now is to continue to expand the geographic scope of Korea's agreements with LAC beyond two relatively small, specialized economies. Fortunately, there is cause for optimism on this front. Colombia and Korea inked an FTA in February 2013, and only confirmation by Colombia's Constitutional Court is needed for the deal to enter into force. The agreement is estimated to increase Colombia's exports to Korea by 8.25 percent and Colombia's GDP by 0.52 percent<sup>5</sup> and also includes provisions covering investment protection, trade in services, competition policy, procurement, and electronic commerce.

In early 2015, Korea announced its intention to pursue an FTA with the Central American Integration System (SICA), which brings together Belize, Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua and Panama in an economic bloc. The Central American countries had been interested in starting trade negotiations with Korea for several years.

Korea has also been in talks with the region's largest economies, although the prospects here are less certain. Discussions of a trade agreement with Mercosur, which includes Argentina, Brazil, Paraguay, Uruguay, and Venezuela, began in 2004 but have failed to prosper. Korea and Mexico, meanwhile, opened FTA negotiations in 2008, but formal talks were discontinued after two rounds of negotiations.

Instead, Korean trade officials are pursuing a strategy to gain better access to the Mexican market via plurilateral negotiations. Korea's interest in the Trans-Pacific Partnership (TPP), a mega-regional deal involving 12 countries from the Asia-Pacific, Latin America, and North America, as well as the Pacific Alliance, where it has observer status, is largely driven by Korean manufacturers' desire to expand their presence in Mexico. Korea's participation in these forums ensures that the country will be an important player in the region's emerging trade architecture.

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<sup>4</sup> See Inter-American Development Bank, *Shaping the Future of the Asia-Latin America and the Caribbean Relationship*, 2012.

<sup>5</sup> Análisis de Factibilidad de un Acuerdo de Libre Comercio entre Colombia y la República de Corea. Fedesarrollo 2009.



# Investment: the Key to Deepening and Diversifying LAC-Korea Integration

## Part 3

**D**irect investment from Korea in LAC has played a central role in the growing economic relationship between the two economies. The trade boom witnessed over the past decade has been followed by strong growth in FDI inflows from Korea, which increased more than ten-fold from 2004 to 2013. This investment is critical in pushing the economic relationship beyond the commodities-for-manufactures exchange that has characterized the region's trade with Asia and making the most of the additional complementarities discussed earlier. It also distinguishes Korea from the region's experience with China, where, according to official figures, investment has lagged well behind booming trade flows. Despite a brief uptick in 2012, Chinese FDI inflows have been lower than Korea's for most of the last decade (see Figure 9).

In fact, the region has become an increasingly relevant destination for Korean investors. LAC's share of total outward FDI from Korea, as measured by official statistics, stood at 5.4 percent in 2013 and reached 8.1 percent during the first nine months of 2014—up from only 2.4 percent in 2004. This trend has been driven by Korean manufacturers' growing footprint in Brazil and Mexico, which have accounted for over 80 percent of the total FDI inflows from Korea between 2010 and 2014. These economies boast large domestic markets with growing middle classes and, in the case of Mexico, dense links to North American value chains.

While this pattern has remained consistent over the course of the decade, there are two sub-regional trends worth noting. The first is the significant rise in Mexico's share of Korean FDI from 17.5 percent between 2006 and 2010 to 27.0 percent over the past four years.<sup>6</sup> The second is an increase in geographic dispersion of Korean investments in LAC beyond the two largest economies. Figure 10 shows the sub-regional distribution of announced Greenfield investments over the past decade.<sup>7</sup> The data suggest that Korean firms have initiated increasingly more investment projects in Argentina, Central America, the Caribbean, and Venezuela since 2007, which should help spread the benefits of FDI to more countries in the region.

Importantly, Korea's investments in LAC have been overwhelmingly in manufacturing, helping balance the bilateral relationship by boosting the region's productive capacity, technology, and employment in sectors such

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<sup>6</sup> Based on official statistics from the Korea Export-Import Bank.

<sup>7</sup> While announced investments often overstate actual investment levels, they should give a good indication of general country- and sector-level trends. Because the amounts corresponding to announced investments are necessarily speculative, we use number of deals for this part of the analysis. A Greenfield investment is a form of FDI in which the investing company builds new operational facilities or expands existing ones.

**BOX 1/****Hyundai wins over the  
Brazilian car buyer**

Hyundai Motors Group is the world's fourth-largest automaker, with sales of nearly US\$ 80 billion across 193 countries in 2013. In the past several years, Latin America has emerged as a key and fast-growing market for the company, especially Brazil where it has quickly increased its share of one of the world's most dynamic auto markets.

The company's manufacturing presence in Brazil dates back to 2004, with the opening of plants to build trucks in Goiás and Minas Gerais states. However, its passenger vehicles became increasingly popular as demand for high-quality yet affordable cars in Brazil took off in the ensuing years. Its exports to Brazil increased quickly in the late 2000s, growing by 19 percent in 2010 alone.

To capitalize on its growing success in the Brazilian car market, Hyundai made a major push to consolidate its presence in Brazil. The company inaugurated a major production plant in Piracicaba, São Paulo with a US\$ 700 million investment in 2012. The factory produces a model developed especially for Brazil, the HB20, which quickly gained a reputation for excellent quality and value as a "premium" brand.

Before the launch of the HB20, Hyundai was the ninth-largest carmaker in the Brazilian market, which was dominated by Volkswagen, General Motors, Fiat and Ford. By 2013, the company jumped to number five. Building on this success, in July 2014 Hyundai announced an expansion its São Paulo plant, largely buoyed by the soaring demand for the HB20. The expanded capacity will allow the plant to turn out an additional 5,000 cars a year to reach an annual total of 185,000 vehicles, up from an initial capacity of 150,000.

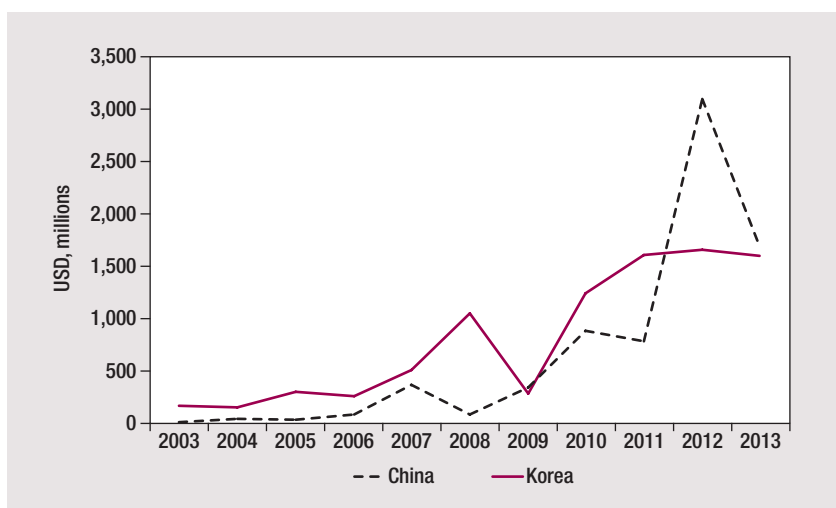
The plant uses advanced production processes, such as a "one-kit" supply system, where a full kit containing all the parts necessary to build a whole model moves along with the vehicle on the assembly line. This prevents errors in the assembly process.

In 2014, the company took advantage of the FIFA World Cup to enhance its brand image and recognition in Brazil. As an official sponsor, the company held a series of marketing activities, including building large outdoor "fan parks" for spectators outside the stadium.

Hyundai has also fostered broader links with the Brazilian economy by supporting the Science Without Borders project, a government program that sends thousands of engineering students abroad for education and training, including to South Korea. Hyundai has sponsored internships for participants in this program and plans to expand its involvement in the coming years.

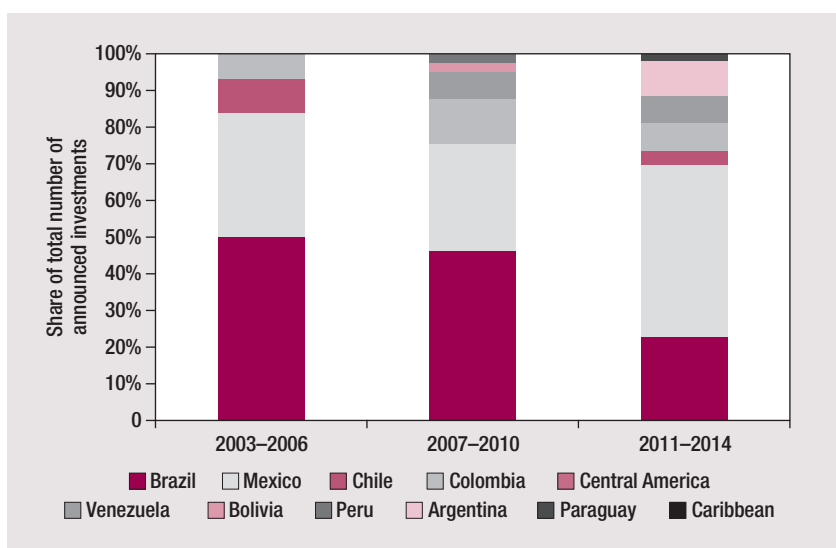
Moving forward, Hyundai aims to diversify its presence in Brazil beyond trucks and its popular passenger cars. It recently announced plans to build a US\$ 40 million train plant to supply São Paulo's regional transit system as well as commuter railway being constructed in Salvador through its subsidiary Hyundai Rotem. The train factory is poised to become the world's second-largest and will employ around 400 workers. While initially focused on the domestic market, it looks to eventually serve the broader region.

*Sources:* Company website and media.



**FIGURE 9/**  
Korea's and China's FDI  
inflows in LAC,  
2003–2013

Sources: Korea Ex-Im Bank and China MOFCOM.



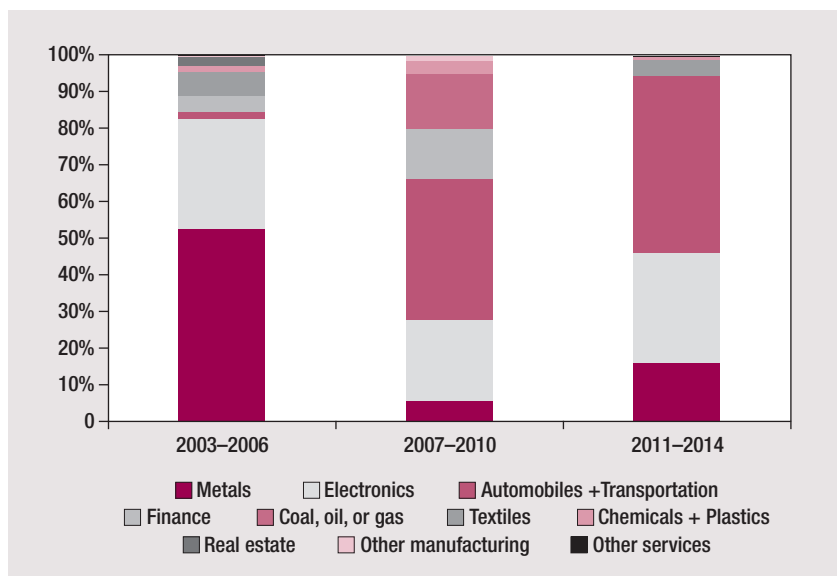
**FIGURE 10/**  
Sub-regional  
distribution of Korean  
investments in LAC,  
2003–2014

Source: FDI Intelligence.

as automobiles, high-end electronics, and industrial machinery. Data on announced Greenfield investments since 2003 show that a full 83 percent of this investment corresponds to the manufacturing sector, compared to only around 6 percent in primary activities. Korea's FDI in LAC is thus practically a mirror image of China's, where between 85 to 90 percent of investments go to the primary sector.<sup>8</sup> The strong manufacturing component to Korea's

<sup>8</sup> Based on analysis of investment projects in the Heritage Foundation's China Investment Tracker.

**FIGURE 11/**  
**Sub-sector distribution**  
**of Korea's FDI in LAC,**  
**2003–2014**



Source: FDI Intelligence.

FDI enables LAC countries to absorb technology and generate employment in high-tech sectors, while giving Korean firms a foothold in the region's large and growing consumer markets. It also creates more opportunities for linkages to upstream and downstream activities in increasingly fragmented production processes.

Looking at a more disaggregated level, we can see that the main business sectors targeted by Korean investors have been metals, electronics, and—especially since 2007—automobiles. As Figure 11 shows, the share of the automotive and transportation sector has grown steadily; metals have declined, although they still represent an important sector for Korean firms.<sup>9</sup> It is difficult to observe additional strong sector-level trends from this data.

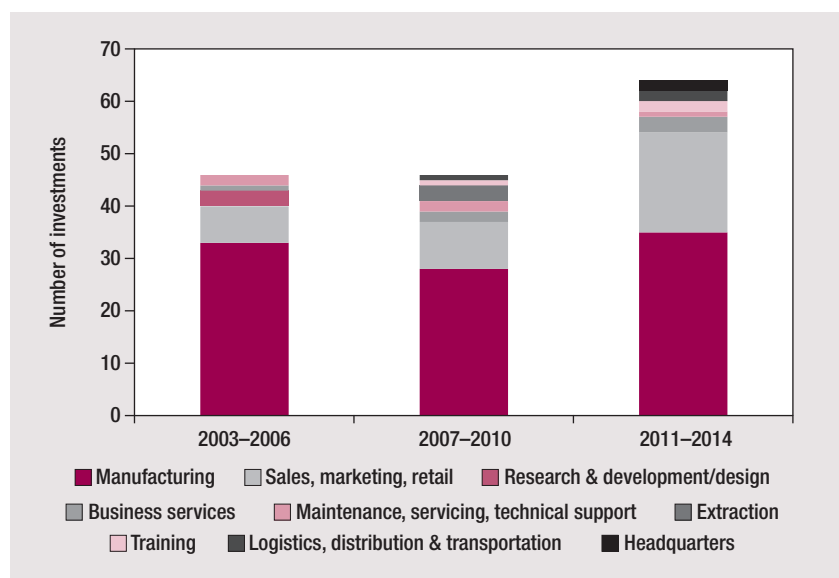
To really understand the nature of Korean FDI in LAC, however, it is useful to look at the type of activities firms choose to carry out in the region. Given the complex and diverse nature of MNCs, a manufacturing firm such as a car-maker generally also performs research and design, distribution, retail, and other service activities tied to its core manufacturing business. This is especially true for Korea's largest firms, which are well-known for their diversified structure. Choices about where to locate these different activities thus affect the type of employment opportunities and potential to transfer technology and know-how to the host country.

<sup>9</sup> Based on announced investments.

Figure 12 sheds some light on this issue, showing the announced investments of Korean firms in LAC disaggregated by activity. The first relevant finding is that announced deals increased considerably between 2011–2014 compared with the two previous four-year periods, suggesting that FDI might renew its upward trajectory in the near future. In addition, the aim of most investments has been to set up manufacturing plants in each time period, reflecting Korean firms' strategic objective of establishing a production base in the region to better serve LAC markets and, in the case of Mexico in particular, create an export platform to the United States.

At the same time, manufacturing facilities have made up a progressively smaller share of total investments, as firms increasingly looked to provide services linked to their manufacturing presence. The clear driver here was the sales, marketing, and retail category, with major Korean MNCs opening 19 sales and retail offices in nine LAC countries since 2011.

This trend surely reflects these companies' efforts to tap into the region's growing consumer markets. On the other hand, Korean firms have only opened three research and development (R&D) or product design facilities in LAC over the past decade—and none since 2006. While it is risky to generalize too much from this sample, LAC economies should aim to participate in the high value-added research and product development stages—in addition to the production and marketing of goods.



**FIGURE 12/**  
Activities of Korean  
firms in LAC,  
2003–2014

Source: FDI Intelligence.

**BOX 2/****LG Moving up the Value Chain in Mexico**

LG Electronics is a Korean electronics firm that makes a wide range of products from flat screen TVs to air conditioners to auto components. With a presence in 113 countries and global sales of US\$ 53.1 billion in 2013, LG is one of the world's largest and most global companies. Latin America has been an important market for LG, providing 15 percent of its sales in recent years.

The company has established a major manufacturing presence in Mexico, which it uses both to serve growing demand from Mexico's middle class and to tap into North American production chains. In addition, LG's presence in Mexico has evolved over nearly three decades, expanding into higher-technology product lines and services to support its manufacturing operations.

The company's presence in Mexico dates back to 1988, when it established a plant to make televisions in Mexicali, Baja California Norte. Several years later, LG increased its manufacturing capacity in Mexico with the acquisition of Zenith Electronics' television production plant in Tamaulipas, while expanding its sales and marketing infrastructure throughout the country.

In 2000 LG set up a new Mexican subsidiary, LG Electronics Monterrey, to launch a home appliances production line. A new US\$ 100 million facility to produce refrigerators in Apodaca, Nuevo Leon began production in 2002. That plant has grown steadily through additional investments of around US\$ 100 million to initiate washing machine and air conditioner production and later in 2006 with an additional US\$ 40 million to expand refrigerator production and in 2008 to start a line of microwave production. The state-of-the-art facility includes a railway spur to facilitate loading and unloading and enhance connectivity to destination markets.

Beginning in 2008 LG ramped up its presence in Mexico as an export platform and production hub for both the United States and the rest of Latin America, building another production facility in Nuevo León with an investment of US\$ 65 million for washing and drying machines. In all of these investments, Mexico offered the dual advantages of proximity to the United States, allowing LG to serve North American consumers better, and a foothold in Mexico's own growing market for electronics and white goods.

The Mexican facilities have advanced technologically as the company continues to innovate. LG recently announced it would produce Google TV (internet-connected TV) in Mexico, a product with great potential in the US market. The manufacturing base has also created demand for services, which in this case are provided by other LG companies given the firm's wide range of activities. Its subsidiary Hi-Logistics invested in a logistics system to better connect its various operations in Northern Mexico, with a base in Tamaulipas. In addition, its presence requires skilled technicians to service the products through its network of retail and support outlets in the country. To meet this demand, LG has also opened a service training center in Nuevo Leon for mechanics that helps develop skilled technicians in Mexico.

*Sources:* Company website and media.



Country	(Million USD)
Uruguay	22.8
Mexico	18.9
Chile	10.8
Paraguay	6.2
Brazil	4.9
Venezuela	1.5
Peru	1.2
Total	64.1
% of LAC's outflows	0.02
% of Korea's inflows	0.08

Source: OECDstat and WIR2012. Tax heavens are excluded from totals.

**TABLE 9/**  
Accumulated OFDI flows  
to Korea, 2000–2012

Still, we can point to encouraging signs that the strong presence in LAC of Korean blue-chip manufacturers is having spillovers to other sectors and activities. Korean financial institutions, for example, are increasing their involvement in the region, with a handful of banks opening offices or subsidiaries in Brazil, Chile, and Mexico starting in the late 2000s.<sup>10</sup> In other cases, firms such as LG, Samsung, Hyundai, and others have invested in distribution and logistical capacity as well as education and training programs for workers (see Boxes 1 and 2). By fostering linkages across sectors and activities, such investments create additional employment opportunities and productive capacities in the region.

While the discussion so far has focused on Korean FDI in LAC, Latin American firms have also established themselves in Korea over the past decade. As Table 9 shows, however, FDI inflows from LAC to Korea totaled only 64.1 million between 2000 and 2012 according to official statistics. This outcome likely reflects a number of factors including the challenge of penetrating a mature market with strong domestic and multinational incumbents, lack of cultural familiarity, and geographic distance, as well as the fact that many *multi-Latinas* have been focused on the Chinese market.

However, as mentioned above, Korea's high GDP per capita and advanced manufacturing base create opportunities for LAC firms to sell high value-added products and services. A direct presence in a foreign market can give firms an important competitive edge by increasing brand recognition, establishing direct ties with local distributors and retailers, and in some cases making products tailored to that market.

<sup>10</sup> Park, Jack. "Korean banks turning eye towards Latin America," *Business Korea*. January 14, 2015.

Several LAC firms have made inroads in Korea through such strategies. In the auto sector, the Mexican-owned firm Katcon Global established a production plant in Daegu, Korea in 2012, to supply exhaust systems and catalytic converters for Korea's automotive industry, the world's fifth-largest. Brazil's BRF, one of the world's biggest producers of meats, dairy products, and frozen foods, set up an office in Korea in 2013 as part of an effort to identify new clients and expand its presence in the country. Overall, East Asia accounts for a third of the company's exports.

Finally, Kidzania, a Mexican company that operates entertainment centers where children role-play in "adult" professions, has a location in Seoul, which attracted 2,400 daily visitors on average in its first two years. The firm is currently building another center in Busan, Korea. The experience of Kidzania shows that LAC firms can have success in Korea outside of traditional sectors.

# Cooperation: Fertile Ground for Strengthening LAC-Korea Relations

## Part 4

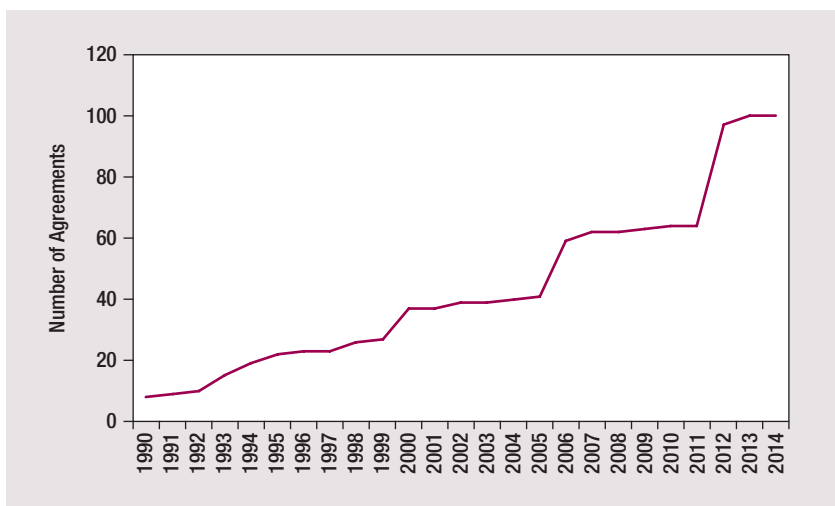
Cooperation between governments—to share knowledge, build capacities, and finance development projects—can help maximize the gains from economic integration and spread its benefits more widely. This is especially true for LAC-Korea relations. Korea’s remarkable transformation from a war-torn, impoverished country in the 1950s to one of the world’s most advanced and prosperous economies undoubtedly holds lessons for LAC. Reflecting these economic gains, Korea is now a major provider of development cooperation, which has benefitted many countries in the region with loans, grants, technical assistance, and knowledge-sharing programs. No account of LAC-Korea ties, and their potential moving forward, would be complete without discussing government-to-government cooperation.

Cooperation between Korea and the region takes various forms. The Korea International Cooperation Agency (KOICA) provides grants for development projects, technical assistance, and capacity building in developing countries. During 2012, 11 percent of KOICA’s total aid went to Latin America, with Peru (US\$ 7.9 million, representing 16.1 percent of KOICA’s total aid to the region) the largest recipient, followed by Paraguay (US\$ 7.0 million, 14.4 percent), Ecuador (US\$ 6.9 million, 14.3 percent), Bolivia (US\$ 5.2 million, 10.7 percent) and Guatemala (US\$ 4.6 million, 9.4 percent).

Korea also provides development assistance through the Korea Export-Import Bank, which manages and operates the Economic Development Cooperation Fund (EDCF) to provide concessional loans for infrastructure projects. Through the EDCF, the region has received nearly US\$ 600 million in financing for projects in seven countries as of 2013, amounting to just over 6 percent of total EDCF lending.

In 2013, the EDCF approved a loan to build solar panels in Honduras that are expected to provide electricity to around 19,000 households, schools, and hospitals in rural parts of the country. In contrast with lending by other export-import banks to developing countries, only about half of EDCF loans are “tied” loans, meaning they must be used for deals with the donor country’s firms. As these results show, cooperation projects help diversify the range of LAC countries involved in relations with Korea.

**FIGURE 13/**  
UN-Registered  
agreements between  
LAC and Korea

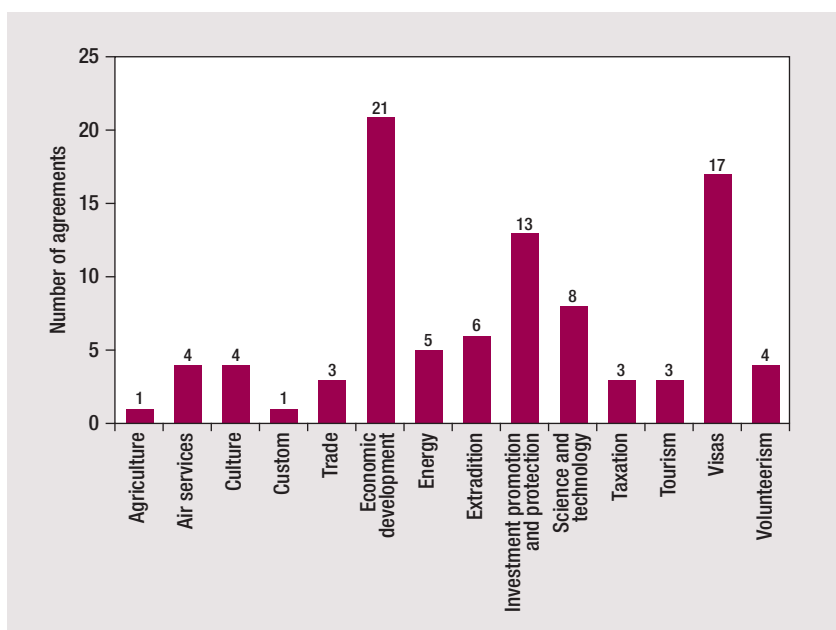


Source: UN Treaties Collection database.

Development financing is only one mode of cooperation between countries. Agreements in specific policy areas—ranging from promoting tourism to facilitating educational exchanges to collaborating on scientific research—can also yield considerable development dividends and foster new trade and investment opportunities. These initiatives can also go a long way towards addressing barriers to integration—for example through transportation services agreements and customs cooperation—without embarking on the lengthy and often politically-sensitive path of FTA negotiations.

LAC governments and Korea have entered into dozens of such agreements, and these seem to be increasing as the economies have grown more integrated through trade and FDI. Figure 13 shows the number of treaties between LAC and Korea registered at the UN beginning in 1990. These data only capture a subset of cooperation initiatives (because not all agreements are notified to the UN), but they clearly indicate that the trend is towards more cooperation.

These agreements have covered a wide range of policy areas (see Figure 14). Agreements aimed at promoting economic ties (economic development cooperation and investment protection) have predominated, but governments have also made important efforts to facilitate people-to-people exchanges and promote cultural affinity by easing visa processes and encouraging tourism and volunteering among countries.



**FIGURE 14/**  
Policy Areas of Selected  
LAC-Korea Agreements,  
1990–2014

Source: UN Treaties Collection database.

## Knowledge sharing

Reflecting its status as one of the 20<sup>th</sup> Century’s foremost “growth miracles,” Korea has developed a robust framework for sharing its development experiences through Knowledge Sharing Programs (KSP), a mechanism launched by the Ministry of Finance in 2004.

Projects are carried out at the bilateral and multilateral levels. In the first case, the Korea Development Institute (KDI), a think tank, is the lead agency, providing a structured program that includes ongoing consultations to share development knowledge with partner countries facing a particular policy challenge, analysis and evaluation of policies, and research to distill relevant lessons from the Korean experience.

In recent years KDI has carried out programs with seven LAC countries on topics ranging from capacity building for SMEs in Peru to designing a medium-term fiscal stability plan for Bolivia to helping the Honduran government create an ICT infrastructure.

Korea also conducts multilateral KSPs which involve collaboration with third parties, including international organizations (IOs). These engagements are implemented by the Korea Ex-Im Bank and consist of joint

consulting to share Korean experiences with IOs and other agencies. The aim is to improve the development effectiveness of KSP by working with organizations with regional knowledge and networks in order to produce customized programs for each partner country.

The Inter-American Development Bank (IDB) has partnered with Korea on several KSP programs in the region. In 2013, the Korea Ex-Im Bank and the IDB carried out the following joint projects, each with a budget of US\$ 250,000: Design for the Integrated Operating Control Center for City Management in Montego Bay, Jamaica; National Policies for Fostering Broadband-Applied Services for Inclusive Economic and Social Development in Nicaragua; Smart Grid Studies in Ecuador; Support for Public-Private Partnership Infrastructure in Colombia; and New Advances in Identity Management System in Chile.

Cooperation between Korea and LAC thus touches on diverse policy areas and reaches a wide range of countries in the region. It is certainly an important pillar of Korea-LAC relations; looking forward, governments could enhance the gains from cooperation by prioritizing issues such as transportation links and trade facilitation that would propel trade and investment.

# Conclusion

**E**conomic relations between LAC and Korea saw enormous growth over the past decade, with considerable benefits flowing in both directions. As with the region's other Asian trading partners, Korea has turned to LAC's mineral and agricultural producers to fuel its fast growth in the face of a limited natural resource endowment, while LAC has proved an eager market for highly competitive Korean manufactured goods. However, LAC-Korea relations are more nuanced and complex than this commodities-for-manufacturing exchange driven by factor endowments.

LAC's exports to Korea have been more diversified and sophisticated than is the case for other Asian economies, reflecting Korea's higher per capita income and positioning in the high-tech segments of manufacturing value chains. At the same time, Korea has been a major source of manufacturing FDI in LAC, meaning Korea's technological sophistication and industrial prowess need not be just a source of competition for the region. Instead, the presence of world-class Korean firms helps transfer technology, develop capacities in new productive sectors, and employ skilled workers in the region.

For Korean firms, LAC offers a growing consumer base as well as a strategic production platform to serve the US market. Not surprisingly then, Korea is keen to forge closer ties with the region, as seen in new trade negotiations initiated between Korea and LAC both bilaterally and in the context of emerging regional and inter-regional blocs. Of course, the scope for government action to deepen ties goes beyond FTAs. Korea is an active provider of financial assistance, capacity building, and knowledge sharing to support development, and countries throughout LAC have benefitted from such programs.

The fast growth of trade, investment, and cooperation over the past decade has laid the groundwork for a sustainable, diversified, and mutually beneficial relationship between Korea and LAC, although challenges remain—especially in the areas of non-tariff barriers, transportation costs, and logistics. Governments on both sides must seize the opportunity to overcome the lingering barriers and build on this strong foundation.







