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Trade Logistics and Physical Integration in LAC

Pablo Guerrero

Sponsored by
Inter-American Development Bank
Integration and Trade Sector
Institute for the Integration of Latin American and the Caribbean (INTAL)
Trade logistics and physical integration in Latin America and the Caribbean

Pablo Guerrero
Singapore, July 2009
This Panel will address issues regarding the need to enhance connectivity to deepen regional integration, with particular attention to trade logistics

- Trade logistics in LAC shows a weak performance when compared not just with developed countries but with other developing regions
- Physical integration to facilitate intra-regional trade - even though with some progress, has proved to be difficult to consolidate
  - Due to diverse reasons, like the limitations imposed by geography, the complex international nature of the projects, and financial restrictions in the countries

In this presentation, the following issues will be approached:

- LAC’s logistics performance and challenges
  - Review of recent indicators
- LAC’s physical integration: progress achieved and the challenges ahead
  - In South America (IIRSA initiative) and in Southern Mexico, Central America and Colombia (Mesoamerica Project)
- The challenges the Region faces to improve its connectivity and regional integration, particularly in the trade logistics area
  - The agenda the IDB is focusing on in these areas
**PRESENTATION CONTENTS**

- What are the main strengths and weaknesses concerning trade logistics in LAC?
  - **LOGISTICS PERFORMANCE IN LATIN AMERICA**
    - Performance indicators
    - Assessment of the regional performance

- What are the main achievements in regional physical integration?
  - **LAC’s REGIONAL INITIATIVES FOR PHYSICAL INTEGRATION**
    - IIRSA, the South American initiative
    - The Mesoamerica Plan

- What are the challenges in trade logistics to facilitate regional integration?
  - **REGIONAL AGENDA TO ADVANCE THE INTEGRATION PROCESS**
    - The regional agenda
    - IDB’s contribution
Economic output and international trade in LAC generated a strong pressure on the regional logistics systems

**LAC between 1998 and 2007:**

- **GDP GROWTH**
  - 3%

- **INTERNATIONAL TRADE GROWTH**
  - 6%

- **MARITIME CONTAINER TERMINALS GROWTH**
  - 9%

- New liberal commercial policies and globalization of supply chains
- Restructuring of the production model
- Lower integration in the productive sector (outsourcing)

- Freight containerization
- Empty containers’ flow
- Increased transshipment and new liner routes’ configuration

**International trade in LAC accounted for 30% of GDP in 1998 and 41% in 2007**
Considering several indicators is likely to be the best approach to assess LAC’s logistics performance

- The logistic performance of a country can be measured in several ways:
  - **Macro approach**, based on the national accounts
    - Logistics cost as a percentage of GDP
  - **Micro approach**, based on firms’ surveys
    - Logistics cost as a percentage of sales value
  - **Perception indicators**, based on surveys to qualified stakeholders
    - Less accurate, but easier to obtain and allow to correlate results with other country-level indicators

- This approach presents advantages and disadvantages, since it is an extremely complex measurement:
  - “The logistics of international shipments is a complex combination of services and procedures involving many public and private operations that does not lend itself easily to measurement” (1)
  - “There is no statistical indicator that proxies the performance of the entire supply chain, or even a major part of it” (1)

(1) Measuring Global Connections - 2006
Logistics costs, measured as a percentage of GDP, reflect the relevance of trade logistics in countries competitiveness

**Logistics costs as a % of GDP:**

Source: Kogan & Guasch, 2006

- The estimation of logistic costs as % of GDP demands multiple assumptions
- The analysis of LAC inventory costs yields similar conclusions

LAC logistics costs double - at least - those of OECD countries

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*Source: Kogan & Guasch, 2006*
The database compiled in *Doing Business* includes a category named “Commerce across the borders” that depicts indicators relevant for trade logistics performance assessment.

<table>
<thead>
<tr>
<th>Region</th>
<th>Documents (Number)</th>
<th>Export Time (Days)</th>
<th>Export Cost (US$ container)</th>
<th>Import Documents (Number)</th>
<th>Import Time (Days)</th>
<th>Import Cost (US$ container)</th>
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<td>23.9</td>
<td>884.8</td>
<td>9.3</td>
<td>25.9</td>
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<td>27.9</td>
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<td>35.4</td>
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<td>811</td>
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<td>South Asia</td>
<td>8.1</td>
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<td>1,236.0</td>
<td>12.5</td>
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<td>1,561.1</td>
<td>12.2</td>
<td>51.5</td>
<td>1,946</td>
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</table>

Difference between LAC and OECD countries performance, while other developing regions exhibit better results.

*Source: Doing Business Report, 2007. Adapted from “Latin America: High Logistics Costs and Poor Infrastructure for Merchandise Transportation” Copenhagen Consensus – Consulta de San Jose - 2007*
The *Global Enabling Trade Report* allows the comparison of LAC with other regions of the world, confirming a weak performance, particularly in managing trade at the borders.

- WEF with the support of international institutions and multilateral organizations
- 10 pillars, four sub-indexes, summarized in the Enabling Trade Index 2008 (ETI 08)
- Based on interviews (perception) and data
The Logistics Perception Index measures countries’ trade logistics performance.

A 150 countries logistics index allows for its correlation with other indicators at the country level.

- Relevant correlation with governance indicators: corruption control (0.54), governance effectiveness (0.57), rule of law (0.54).
- Partial correlation with infrastructure indicators less conclusive: infrastructure quality (0.48), port infrastructure (0.42), roads infrastructure (0.12), airport infrastructure quality (0.01).
The diverse indicators concur in a common message: a considerable gap exists between LAC’s logistics performance and developed countries, and even with East Asia emergent countries

- Logistics costs, measured as a % of GDP, are 50% to 100% higher in LAC than in the OECD countries
  - The estimate of inventory costs – one of the key determinants of logistics costs – exhibits a similar proportion
  - Logistics costs measured at the firm level, even when they are hardly expandable to the whole economy, show a gap of the same magnitude
- The Global Enabling Trade Report indicates that LAC’s performance is below that of US and Canada, Western Europe countries (EU27), Central and Eastern Europe countries, the Middle East and the Northern African countries
- Relatively low LAC countries position in the LPI – the most specific logistics indicator
  - With the exception of two, all countries in the region are below the rank of 50, in a 150 countries universe

Logistics performance indicators may be subject to a myriad of observations partly because inaccuracies, biases or lack of representativeness, but the message is clear and consistent, there is ample room for improvement in LAC
**PRESENTATION CONTENTS**

**What are the main strengths and weaknesses concerning trade logistics in LAC?**

- **LOGISTICS PERFORMANCE IN LATIN AMERICA**
  - Performance indicators
  - Assessment of the regional performance

**What are the main achievements in regional physical integration?**

- **LAC’s REGIONAL INITIATIVES FOR PHYSICAL INTEGRATION**
  - IIRSA, the South American initiative
  - The Mesoamerica Plan

**What are the challenges in trade logistics to facilitate regional integration?**

- **REGIONAL AGENDA TO ADVANCE THE INTEGRATION PROCESS**
  - The regional agenda
  - IDB’s contribution
LAC has gone through a long-lasting process of commercial and political integration, that has encouraged physical integration initiatives to assure the connectivity of the infrastructure networks.

Several attempts to integrate trading blocks (Mercosur, CAN, MCCA) which faced political and economic challenges.

Commercial integration has yielded relevant results; although intra-regional trade has decreased in relative terms, due to a substantial growth in absolute terms and the diversification of trade destinations.

### South American exports – US$ billions

<table>
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<tr>
<th>Region/Country</th>
<th>95-96</th>
<th>03-04</th>
<th>06-07</th>
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<tbody>
<tr>
<td>South America</td>
<td>32.2</td>
<td>37.8</td>
<td>77.2</td>
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<td>USA</td>
<td>31.5</td>
<td>52.2</td>
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</tr>
<tr>
<td>Mexico</td>
<td>1.4</td>
<td>6.6</td>
<td>9.8</td>
</tr>
<tr>
<td>EU (25)</td>
<td>29.7</td>
<td>42.6</td>
<td>74.5</td>
</tr>
<tr>
<td>China</td>
<td>2.5</td>
<td>11.5</td>
<td>25.0</td>
</tr>
<tr>
<td>Others</td>
<td>33.0</td>
<td>57.0</td>
<td>106.8</td>
</tr>
<tr>
<td>TOTAL</td>
<td>103.3</td>
<td>207.7</td>
<td>373.3</td>
</tr>
</tbody>
</table>

Two-year median. Source: CINDES

Two initiatives have taken on this challenge: IIRSA in South America, and the Mesoamerican Plan in Colombia, Central America and Southern Mexico.
The Initiative for the Integration of Regional Infrastructure in South America – IIRSA aims at promoting physical integration

- Originated in the year 2000 in order to advance their physical integration
- It is an institutional mechanism for intergovernmental coordination
- Incorporates novel methodological approaches, developing a strategic vision to align the regional portfolio
- **Identifying corridors of integration and development, that organize the portfolio**
  - The projects are linked to key initiatives, unleashing potential synergies
  - The initiative emphasizes monitoring and evaluation procedures
- IIRSA also allowed to identify **key processes for integration** that require normative harmonization
  - e.g., regulations in the transport or energy markets, TICs, and border crossing management

*Incorporating innovative methodological criteria and institutional mechanisms*
IIRSA has identified ten development integration axis: *corridors* framing a large investment portfolio.
IIRSA's portfolio includes more than 500 investment projects, most of them related to the transport sector

- IIRSA’s portfolio by the end of 2008 included 514 infrastructure projects, (organized in 47 groups), totaling **US$69 billion**

- The multilateral institutions backing IIRSA (IDB, CAF and FONPLATA) support more than 25% of the total investment demanded by the 247 projects already finished or in progress (US$ 9.729 million)
70% of IIRSA's portfolio is showing progress, based on public and private financing

- A sub-set of the investment portfolio - 31 projects - are considered as having “implementation consensus” (AIC), being executed in a fast track process in order to have them completed by 2010
  - The AIC map gives a picture of the physical integration priorities

Almost 70% of the portfolio shows substantial progress

<table>
<thead>
<tr>
<th>Project status</th>
<th>Projects (#)</th>
<th>US$ MM</th>
<th>%</th>
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</thead>
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<tr>
<td>Completed *</td>
<td>190</td>
<td>7,506</td>
<td>10%</td>
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<tr>
<td>In execution *</td>
<td>29</td>
<td>30,728</td>
<td>38%</td>
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<tr>
<td>In preparation</td>
<td>28</td>
<td>17,383</td>
<td>20%</td>
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</table>

Financing structure of projects *

<table>
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<th>Financing</th>
<th>Projects (#)</th>
<th>US$ MM</th>
<th>%</th>
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</thead>
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<tr>
<td>Public</td>
<td>190</td>
<td>17,641</td>
<td>46%</td>
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<td>PPP</td>
<td>29</td>
<td>52.2</td>
<td>35%</td>
</tr>
<tr>
<td>Private</td>
<td>28</td>
<td>6.6</td>
<td>19%</td>
</tr>
<tr>
<td>TOTAL</td>
<td>247</td>
<td>38,234</td>
<td>100%</td>
</tr>
</tbody>
</table>

*Almost 70% of the portfolio shows substantial progress
Capricorn Axis: example of integration and development axis

- Comprises five groups of projects, including 78 initiatives located in five countries.
- Projects include:
  - border crossings, highways, bridges
  - ports, multi-modal freight transfer centers,
  - railways, electric transmission lines, hydroelectric generation
Border crossings’ and trade facilitation analysis: example of an integration process

- Border crossings in South America have developed a high level of activity
  - there are more than 100 border crossings in South America
  - some crossings have more than 1,000 trucks per day, mainly in the Southern Cone
  - critical segments in the logistics chain (risk for increasing delays and costs)
- IIRSA carried on a detailed border crossing analysis, defining a typology
  - a systematic analysis of infrastructure, control processes, public and private stakeholders, documentation, information systems, and control mechanisms
  - aiming at the adoption of best practices in integrated border management
  - generated a series of recommendations to be financed by the initiative
- Border crossings are relevant not only for the main trade corridors: they are also of great interest for border towns and its population
IIRSA has developed several methodologies and information systems...

- IIRSA has deepened the development of methodologies for integration projects: economic assessment of transnational projects, strategic environmental assessment, **productive and logistic integration**, and development of digital maps and GIS
- Productive integration (linkages, clusters) and the development of logistic services of high added value stream-lined in a single methodology:
  - **The potential of productive integration**: physical barriers removal will facilitate physical and financial integration, extending the scale of production and markets, promoting competitiveness and taking advantage of agglomeration economies
  - **The potential of logistic services development**: they will allow to add value to IIRSA projects and to improve local and regional competitiveness

![Analysis of the corridor and project’s group area of influence](image-url)
... emphasizing the analysis of productive integration and value-added logistics projects

- The methodologies are based on mapping the productive and logistic chains, and on interviews to qualified stakeholders at different levels
- They also include training courses for local officials and for project preparation

*Group 5 IP-Lg. Chile’s exports from the port of Arica*

![Table showing Chile's exports from the port of Arica](image)

*Group 5 IP-Lg. Data on Chilean and Peruvian exports on the area of influence*

![Chart showing Chilean and Peruvian exports](image)
The Mesoamerica Project – MP is aimed at the regional development from southern Mexico to Colombia, coordinating regional integration projects

- In 2001 the Puebla Panamá Plan started combining a strategy for the modernization of Central America with a development agenda for southern Mexico. It looked not just for integration, but for regional sustainable development
  - Continued as MP, currently nine countries from México-Belize to Colombia
- There are strong synergies in the integration projects, particularly in the smaller countries, where infrastructure has been one of the traditional bottlenecks
- The MP includes a trade facilitation activity lead by SIECA (Central America Economic Integration Agency) oriented towards commercial integration
- It also includes ambitious social and territorial development initiatives
The initiative comprises a portfolio of +100 projects and US$ 8 billion in infrastructure investment..

- Integration of the regional **energy market**
- Development of 13,000 km of **highways**
  - Pacific and Atlantic corridors
  - Implementing common technical road standards (currently lacking)
…with trade facilitation being one of the centers of attention

- Border crossings and customs’ facilities modernization
- Mesoamerican International Road Network (five corridors)
- Mesoamerican Process for international cargo transportation
What are the main strengths and weaknesses concerning trade logistics in LAC?

- Performance indicators
- Assessment of the regional performance

What are the main achievements in regional physical integration?

- IIRSA, the South American initiative
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What are the challenges in trade logistics to facilitate regional integration?

- The regional agenda
- IDB’s contribution
The logistics gap is the result of low performance of the multiple components participating in the logistics chain, presenting great heterogeneity across LAC countries

- The logistics components that appear weaker in LAC are:
  - **Border crossing services**, including inspection processes (mostly in ports and border crossings) and IT systems integration
  - **Transport infrastructure** (mostly roads and highways)
  - **Land transportation services** (mostly trucking) and logistics operators

- **Performance across countries is uneven**: facing different problems, including demand-related obstacles (like freight imbalances or seasonality) and the way each one has managed to organize the factors determining the logistics service supply

- **High heterogeneity within countries** (particularly in large countries) with some regions lagging behind

- **SMES logistics performance is weaker than larger firms**, not only because economies of scale, but to cultural and managerial reasons

- **Room to improve** logistics operators’ performance and to modernize the trucking industry
The agenda includes actions at national and regional level, demanding program and project coordination

- **In trade logistics**
  - The provision of basic infrastructure, particularly the road network
  - Improve services and regulations that facilitate PPPs, like in ports and railroads
  - Improve services delivered by the State, like customs management, border crossings, and security
  - Support logistic management development SMEs, operators and intermediaries
  - Implement institutional organization for high quality logistics

- **In physical integration**
  - Agendas between countries, including integration and “axis-based” infrastructure development criteria, prioritizing projects of greater impact
  - Develop financial mechanisms

- **In the areas where both agendas converge**
  - Emphasize the key processes for integration, as it is the case of border crossings, the regulation and harmonization in the diverse transport modes
  - Continue developing the agenda for productive integration and logistic services, supporting national and sub-national organizations
IDB contributes in several ways to trade logistics and physical integration in the Region

- **Regional coordination**
  - As an efficient vehicle for policy, projects and regional coordination

- **Institutional strengthening**
  - The Bank has developed skill in strengthen institutional capacity – a clear deficit – for countries and sub-national entities as well

- **Coordination of thematic agendas**
  - Subjects tend to converge, and the coordination of the different agendas is a major value added:
    - State modernization and private sector development
    - Joint approach considering territorial planning, spatial economics and transport planning

- **Knowledge**
  - To aid decision making processes and dissemination of initiatives within client countries

- **Financing**
  - Public and private investment, coordinating with other lenders
Thank you!

pablogu@iadb.org
The inventories size allows to evaluate the performance of the transport system: the less reliable it is, the larger the inventories and the logistic costs will be.

**Inventory level in Latin America: ratio with US inventories (mean)**

<table>
<thead>
<tr>
<th>Country</th>
<th>Raw material</th>
<th>Finished products</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chile</td>
<td>2.17</td>
<td>1.76</td>
</tr>
<tr>
<td>Venezuela</td>
<td>2.82</td>
<td>1.63</td>
</tr>
<tr>
<td>Peru</td>
<td>4.19</td>
<td>1.65</td>
</tr>
<tr>
<td>Bolivia</td>
<td>4.20</td>
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<td>Colombia</td>
<td>2.22</td>
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<tr>
<td>Ecuador</td>
<td>5.06</td>
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</tr>
<tr>
<td>Mexico</td>
<td>1.58</td>
<td>1.46</td>
</tr>
<tr>
<td>Brazil</td>
<td>2.98</td>
<td>1.98</td>
</tr>
</tbody>
</table>

- *Studies carried on in 2001 (when interest rates were relatively high) showed that incremental inventory - due to the weaknesses of the logistics system – represented around 2% of GDP*
- *Inventory value is in the range of 15% of GDP in OECD countries, and around twice in Latin America and the Caribbean*

*Based on Guasch and Kogan, 2006*
Logistics perception indicators show that LAC lags well behind developed countries

<table>
<thead>
<tr>
<th>EXAMPLES</th>
<th>LPI GENERAL</th>
<th>CUSTOMS</th>
<th>INFRASTRUCTURE</th>
<th>INTERNATL. SHIPMENTS</th>
<th>LOGISTICS COMPET.</th>
<th>TRACKING &amp; TRACING</th>
<th>DOMESTIC LOGISTICS COSTS</th>
<th>TIMELINESS</th>
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</table>

*Position in the LPI General ranking and its seven sub-indexes*
The *Enabling Trade Index* allows the identification of the most fragile components in the trade facilitation performance

<table>
<thead>
<tr>
<th>Country</th>
<th>ETI08</th>
<th>Customs efficiency</th>
<th>Exp Imp processes efficiency</th>
<th>Customs transparency</th>
<th>Transport infrastructure</th>
<th>Transport services</th>
<th>TICs</th>
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</table>
AIC’s 31 consensus projects
First completed project: Arce River bridge, linking Bolivia and Brazil (2006)
### IDB’s vision for trade logistics infrastructure improvement in LAC

<table>
<thead>
<tr>
<th>Priority action areas</th>
<th>Typical sectors and problems</th>
<th>Priorities for low-middle income countries</th>
<th>Priorities for high-middle income countries</th>
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<tbody>
<tr>
<td>Basic infrastructure development</td>
<td><em>Trunk highways, rural roads, maintenance</em></td>
<td>▸ Basic infrastructure (main and rural roads)</td>
<td>▸ Increase capacity</td>
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<td></td>
<td>▸ Roads maintenance</td>
<td>▸ By passes in urban areas</td>
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<td>Transport services and regulation</td>
<td><em>Ports, railways</em></td>
<td>▸ First generation reforms</td>
<td>▸ Second generation reforms</td>
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<td>Services provided by the State</td>
<td><em>Customs, border crossings</em></td>
<td>▸ Increase operational efficiency</td>
<td>▸ Regulations adjustment.</td>
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<td>Private sector development support</td>
<td><em>SMES, transport and logistics operators, logistics parks, HR</em></td>
<td>▸ Customs procedures</td>
<td>▸ Increase investment, PPPs</td>
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<td>Institutional strengthening</td>
<td><em>Logistics councils and freight transport observatories</em></td>
<td>▸ Dispatch time</td>
<td>▸ Integrated control</td>
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<td>▸ Domestic security</td>
<td>▸ Unified paperless inspection</td>
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<td>▸ Transport operators and freight forwarders professionalization</td>
<td>▸ Increase security, corruption</td>
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<td>▸ Access to technology</td>
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<td>▸ Strengthening and coordination of government offices</td>
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<td>▸ Coordination among areas and jurisdictions</td>
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<td>▸ Public officials training</td>
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*IDB’s agenda emphasizes the need of public agencies involvement, training and analysis*