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Which Strategy for the EU and Belgium in view of the Brussels Summit EU-CELAC? Some thoughts about a Bi-regional Strategic Alliance for facing globalization threats

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Since the years 2000s, Latin America has used to make observers familiar with good news. After the euphoric period of high growth during most of these years, the region has impressed by its capacity for weathering the storm of the global financial crisis, creating even the impression of a decoupling from the industrialized countries cycle. Indeed, the growth performance almost doubled its long run average (excepting the year 2009), reversing the 50 years of relative decline of the region vis-à-vis the U.S: from a level of 50% of the income per capita of the US in the 1950s passing through a low of 23% in 2004, this indicator is now hovering around 30%. Not only growth was impressive but also socio-political progress, with significant reduction in poverty rates (73 million left poverty ranks) - even in the average degree of income inequality measured by a GINI coefficient (decreasing from 54 to 50) – the emergence of 50 million of new "middle-class" persons, the inclusion in the labor market of more than 70 million of women, a clear consolidation in democratic and sound macroeconomic governance, with few exceptions, as deficit, debt, inflation, current account and banking clearly under control in most Latin American countries, which have "graduated" in terms of their policy responses being able to switch to some degree from pro-cyclical to counter-cyclical policy responses.

Wouldn't all these converging positive trends be enough arguments for considering that CELAC area will be part of the world growth locomotive for the coming decade? Therefore shouldn't we gear our policies towards a higher speed and deeper degree of relations between European partners with this emerging region?

The answer proposed in this paper to the first question is that most arguments go towards a NO: the economic growth in the CELAC area is not yet sustainable. However, contrary to superficial views, this NO leads to answer clearly YES to the second question: EU and CELAC weaknesses are additional reasons for spurring a deeper Strategic Alliance between the two regions. Indeed, Latin American success are greatly artificial, as the paper points in Section 1, but adopting a perspective in terms of Global Value Chains (GVCs) in Section 2 allows for identifying the inadequacy of the CELAC insertion in the global economy as the main cause of the poor performance of growth. Section 3 argues that the combined weaknesses and challenges the EU and the CELAC economies are facing open special opportunities for focusing the Brussels Summit CELAC-EU of 2015 upon the definition of cooperative actions for winning together greater competitive presence in value chain segments with higher value added as well as strengthening their respective position with respect to the Mega-regional negotiations. In Section 4, the paper considers that Belgium Diplomacy could play a catalytic role for generating a new dynamics in the Summit Diplomacy by formulating an operational strategy for decentralizing the preparation of the Summits. This broadening of the bi-regional Summit is presented as a proposal for a "Belgian Plan" for the June 2015 Brussels Summit.

Section 1: Are the impressive socio-economic progress of Latin America sustainable?

Unfortunately, the successes registered from 2003 to 2012 are already over, for having been mostly dependent upon exogenous conditions or non-reproducible factors. This though affirmation does not deny the genuine efforts made in governance improvements in several countries (not all !) and the possibility to deepen and broaden them while facing adverse conditions in the future but political economy realities demonstrate that good conditions use to be wasted and rather tend to create potential new difficulties. Policymakers cannot be complacent since they were not able to exploit them for increasing potential output and productivity, being now exposed to illusionary success and new hidden fragilities which will complicate their tasks.

Recent macroeconomic development and new and less favorable global context point to a return to mediocre growth rates in the CELAC region, and all forecasters were excessively optimistic up to summer 2014. This is all clear when seeing the general downward revisions in macroeconomic forecasts during the year 2014 even for the “good bachelors” of the classroom. Although most of Latin America’s slowdown is clearly cyclical after the exceptional boom in commodity prices, the continuous downward revisions in medium-term prospects is an indication that potential output growth used to be overestimated by a euphoric overshooting. This rate appears now under a sharp revision from 4 to 5% towards 2 to 3%, which inevitably would condemn the successes to be turned in tragic failure since the “social fabric” could not resist to such a disillusion in the existing unfair situation of worst income inequalities in the world. Most – if not all - of the social progress were the result of the additional growth. If this growth is not warranted by structural reforms allowing for a higher sustainable growth path but on the contrary explained by non-reproducible factors, the governance difficulties will be even worse for facing popular frustrated expectations while macroeconomic and financial constraints will deteriorated quickly and cumulatively. Another way to formulate the present crossroad is whether it was the higher growth (and the terms of trade windfall bonus) which made possible social and democratic progress or alternatively whether the reforms made possible higher growth and structural changes. Unfortunately, again, most of the indicators flash towards the first option: the social reforms and progress followed the economic bonus and not the reverse. This is why the future is even darker for some countries: when windfall gains are consumed or misused in “populist clientelism”, the social frustrations will increase all the more that the cake shrinks.

Let’s examine more precisely the risks of economic fragility for the CELAC area, first, observing averaged indicators for the region as a whole, and second by identifying three different categories of countries and policies.

The first worrying indicator for the future – and the most synthetic one - is the <u>stagnation of total factor productivity in the CELAC area</u> taken as a whole. Economic output and, hence, income earned depends on both the amount of the factors employed (capital and labor) and the productivity of those inputs, known as total factor productivity (TFP). Growth in income is normally considered sustainable if backed by growth in underlying TFP. According to IDB reports[1] the typical country in the region CELAC has actually had faster factor accumulation relative to the advanced economies (both the physical and human capital gaps were reduced) but the relative productivity of those factors declined from 78% to 53%, again relative to advanced economies. Since 1960, income per capita of the typical country in the region declined by 16% relative to the rest of the world and relative productivity declined by 18%. Relative to the typical East Asian, total factor productivity in CELAC economies was halved and the situation has not improved in spite of the decade of high growth. Therefore the gains observed in income per capita are mostly due to temporary factors (terms of trade, labor supply, cheap capital inflows, activation of unused capacities, consumption of environment capital and not renewable resources) unable to found competitive economies. For the future, the underlying lower growth in productivity will limit potential output to a lower rate of growth which would be unable to sustain simultaneously a resorption of the social debt, the education and R&D investment required for improving relative position in the global specialization ladder, and the higher saving/investment ratio for implementing the infrastructures and logistics for materializing better participation in the global value chains without incurring external imbalances.

[1] See IDB, Andrew Powell, coordinator, *Global recovery and monetary normalization: escaping a chronicle foretold?,* March 2014, Washington DC, and

According to alternative calculations[2] - made from the KLEMS/Conference Board data base - shows that Latin America total productivity was still lower in 2011 than its 1990 level! Total Factor Productivity has not increased in more than 20 years of growth. Such a negative outcome in the key-measure of the long-run determinant of economic development indicates a worrying lack of efficiency in the economies of the whole region. In spite of possible debates about the difficulties to measure with precision the TFP for individual economies, the criticisms are not so valid for the whole area thanks to the probability "*law of the great numbers*" which allows for making up for the measurement errors. Also, other researches at OECD[3] points to the same efficiency issue: on average low productivity is the main factor that is holding back Latin American economies; that is, the efficiency with which factors of production are combined constrains growth more than the availability of plants, equipment and well-educated workers. In other words, "factor-accumulation" strategy, although necessary are not sufficient since it would leave untouched most of the productivity problem in the majority of Latin American countries.

In order to base our diagnostic upon broader indicators, the best method is to follow the Brookings method for analyzing the "economics of convergence" which allows for answering whether Latin America's income convergence was associated with a comparable convergence in growth determinants. The Brookings Institution[4] concludes:"[last decade] *high growth and income convergence were largely the result of an unusually favorable external environment, rather than the result of convergence to advanced-country levels in the key drivers of growth. Fundamentally, the last was a decade of "development-less growth" in Latin America. With the extremely favorable external conditions already behind us, the region is expected to grow at mediocre rates of around 2 percent in per capita terms for the foreseeable future. With this level of growth, the dream of convergence and development is unlikely to be realized any time soon*.

On chart 1, according to the Brookings key drivers of growth (trade integration, physical and technological infrastructure, human capital, innovation, and the quality of public services), during the last decade, LAC-7 countries[5] failed to converge towards advanced country levels in every growth driver. The overall index of growth drivers—the simple average of the five sub-indexes—remained unchanged in the last decade relative to the equivalent index for advanced economies. By and large, the latter holds true for every LAC-7 country with exceptions like Colombia (the only country that improved in every single growth driver in the last decade) and Chile (the country in the region where the levels of growth drivers are closer to those of advanced economies).

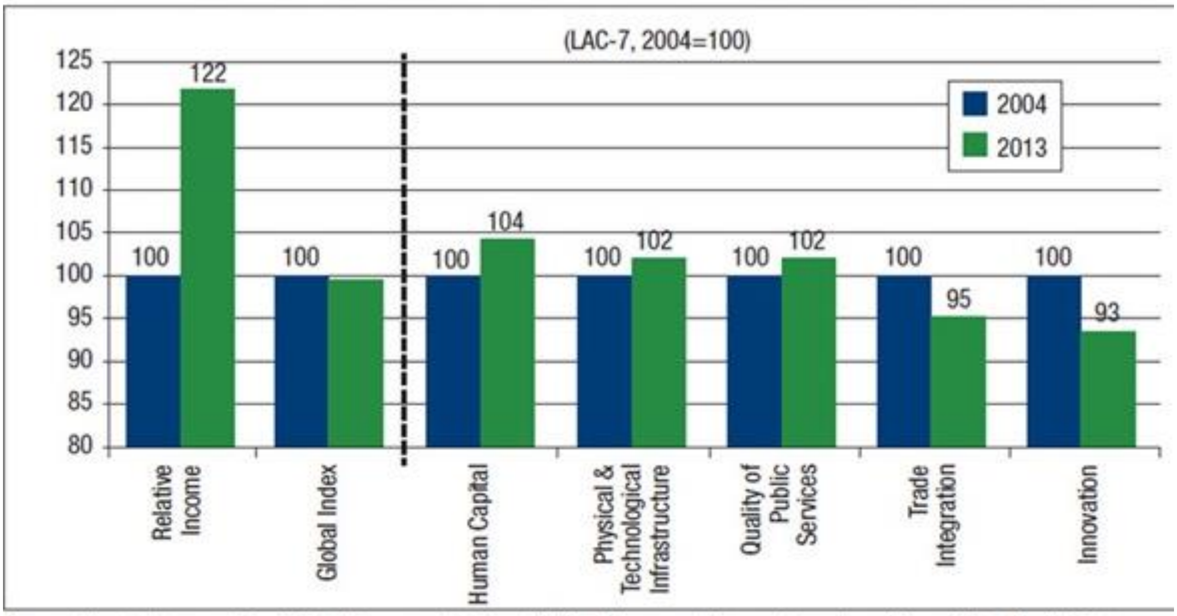
Chart 1: Convergence of income compared to Brookings convergence of growth drivers

[2] Ariel Coremberg, "La Productividad de América Latina ante el auge de precios de productos básicos", Cuadernos Económicos de ICE, 84, p. 123-153, ARKLEMS+LAND

[3] Christian Daude

[4] Ernesto Talvi, *Latin America's Decade of Development-less Growth*, Think-tank 20, Brookings Institution & CERES (Centro de Estudios de la Realidad Económica y Social, Montevideo)

[5] LAC-7 is the simple average of Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela, which account for 93 percent of Latin America's GDP

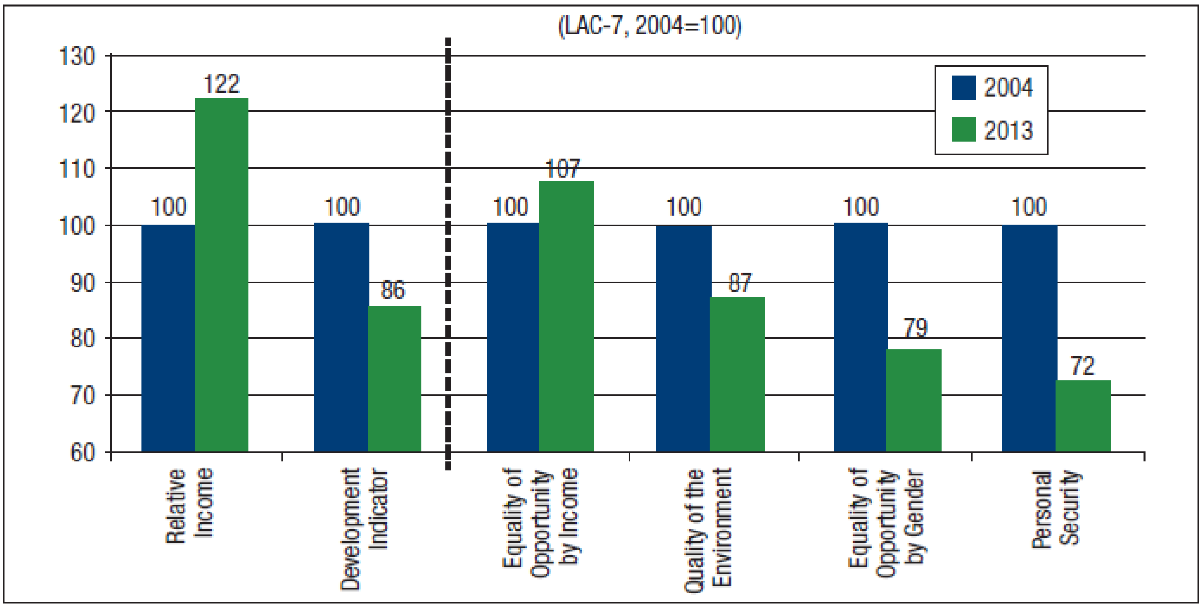


Source: The Conference Board Total Economy Database™, World Economic Forum, Barro-Lee Dataset, The World Bank Development Indicators, NetIndex | Speedtest, OECD-WTO and World Intellectual Property Organization.

Source: Ernesto Talvi, Brookings 2014

Moreover, just as the drivers of growth failed to converge in Latin America in the last decade, nor was income convergence accompanied by any comparable convergence in key indicators of development, such as equality of opportunity by income level and gender, the quality of the environment and personal security. On the contrary, these indicators are all but "equality of opportunity" driven towards further under-development (see Figure 2).

Chart 2: income convergence of income compared to Brookings convergence of development drivers



Note: LAC-7 is the simple average of Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela, which account for 93 percent of Latin America's GDP. For details on the calculation of the indexes see Appendix.
Source: The Conference Board Total Economy Database™, World Economic Forum, Barro-Lee Dataset, The World Bank Development Indicators, NetIndex | Speedtest, OECD-WTO and World Intellectual Property Organization.

Source: Ernesto Talvi, Brookings 2014

Therefore, we must conclude that for the CELAC area as a whole, the recent bout of convergence that started in 2004, after a quarter of a century of relative income decline, is not a break with the past but just a short-lived phenomenon which is vanishing with the less complacent global context marked by the imminent end to China's investment-led, credit-propelled growth model, the slow growth in advanced economies, the resulting softening commodity prices and the gradual increase in the cost of international financing for emerging markets. This first conclusion does not exclude that some economies could reach a genuine convergence, but anyway there will be no automatic convergence, specific policies are required for consolidating the positive advances, essentially by implementing a specific strategy to address low productivity issues as we'll propose in section 2.

Taken as a whole, the CELAC region is exposed to rising risks of fragilities able to reverse the recent progress:

- The terms of trade have started their adjustment after an exceptional improvement for most of the economies; since these relative prices development generated temporary but enormous inflows of additional income, both in external and in fiscal accounts, debt ratios were cut easily; this is now over and the expected negative development of terms of trade will reduce directly and indirectly incomes with multiplied effects (on expenditures and receipts).

- The re-primarization of the economies as they enjoyed a commodity boom which created over valuated exchange rates, biasing the internal terms of trade between primary exports and non-traditional output, attracting resources in the primary sector at the expenses of industrial activities and exports (share of exports of manufactured goods fell from 51% in 2000 to 42% in 2013); furthermore, the export structure tends towards a re-concentration and a high dependency of China in a typical center-periphery dependency. The commodity boom created an investment boom in some economies which cannot be continued, making room for a cyclical recession

- Aggregate regional exports in value have stagnated for more than three years since mid-2011 to 2014) and the fall in commodity export prices has not reverted the general tendency towards concentration in products based on natural resources to the detriment of manufactures

- The demographic dividend of higher activity rate by change in the demographic pyramid and increase in woman participation are reaching an end, they won't contribute anymore to growth but will add progressively to the costs with the ageing

- The fiscal and external rooms for maneuver built during the high growth period are reaching their limits at the moment the cyclical slowdown is affecting incomes and expenditures with a risk of an end to the exceptional easy external financing conditions (US monetary adjustment); thus financing constraints will reappear affecting also banking stability (through the fragility of their loan portfolios) in spite of their sound present positions

- The deterioration of the prospects will affect the investment ratio reducing the embodied technical progress, thus worsening the productivity gap, increasing the social frustrations and the domestic political difficulties at the moment uncertainty towards reform implementation has curbed demand expansion

These fragilities already at work as the CELAC area is growing at a meager 1% in 2014 and expected to recover slightly at only 2%, but the region is differently affected according to the set of policies adopted in the past.

According to Brookings/CERES researches[6] Latin American economies, while affected by common external forces which determines a clear pattern of co-movement in the regional fluctuations, present

[6] Ernesto Talvi, *Latin America Macroeconomic Outlook A Global Perspective, Macroeconomic Vulnerabilities in an Uncertain World: One Region, Three Latin Americas*, Brooking-CERES Economic and Social Policy in Latin America Initiative (ESPLA), Washington, September 2014

different degrees of overall macroeconomic vulnerability, which divides the region into three prototypical clusters: one with sound macroeconomic fundamentals (Chile, Colombia, Mexico and Peru), one with weak fundamentals (Argentina and Venezuela), and the biggest one with mixed fundamentals (Brazil).

Five charts are sufficient to capture the relative positions and the most probable prospects. These Brookings charts represent four indicators of vulnerabilities applied to the LAC 7 countries, plus the macroeconomic forecaster consensus for the years 2014 to 2018. The 4 vulnerability indicators are: for the banking sector (projected bad-loans with respect to loan-loss provisions and bank capita), the international liquidity position (short-term total debts to external reserves), inflation (inflation forecast for 2016 with respect to 4%), and fiscal position (debt ratio in 2030 with respect to 50%)

Charts 3: Brookings/CERES figures 1 to 5,
source: E. Talvi, Economic and Social Policy in Latin America Initiative (ESPLA)

Figure 1. Banking Vulnerability Ratio
(BVR, Mar-2014)

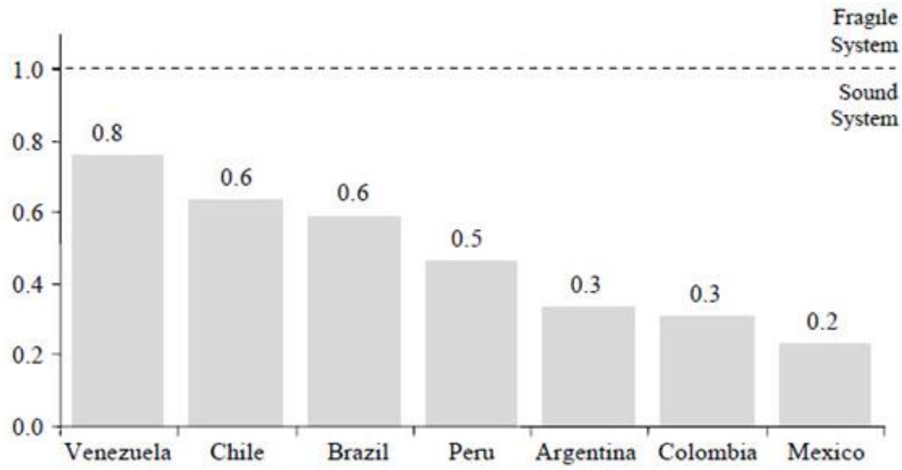
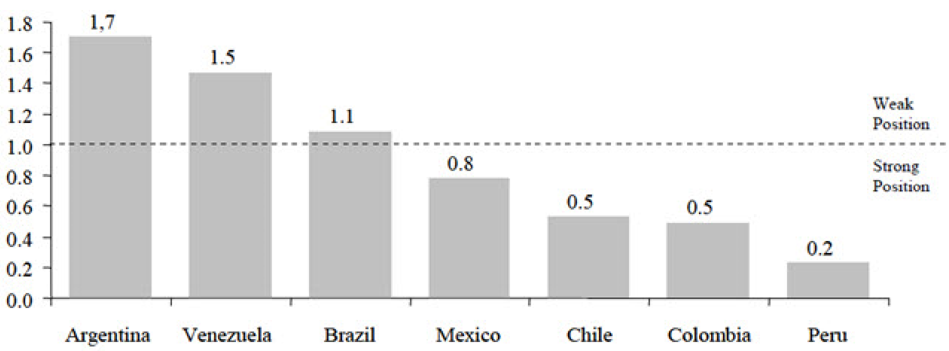
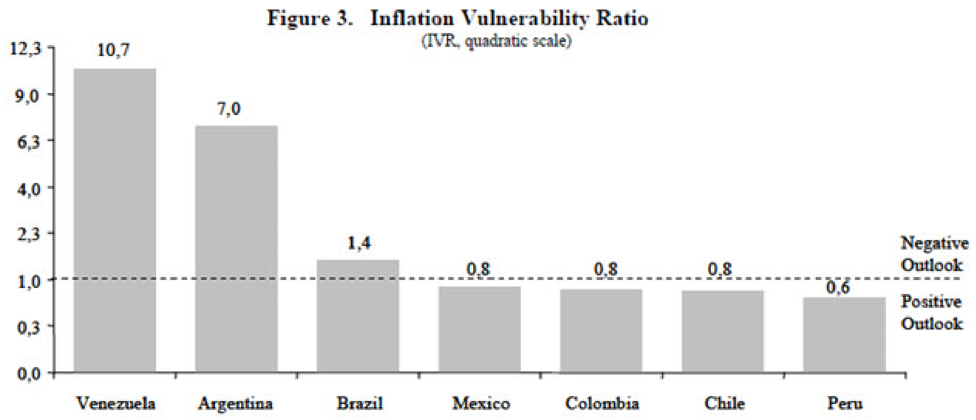
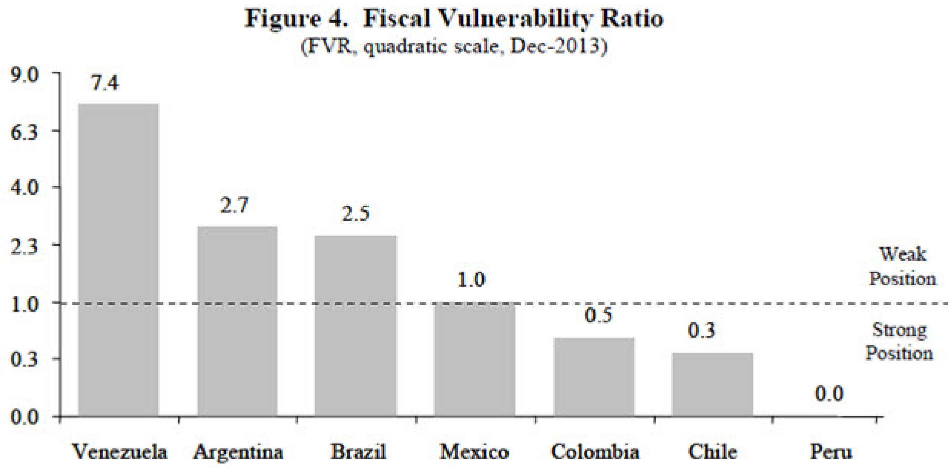


Figure 2. International Liquidity Ratio
(ILR, Dec-13)







Not surprisingly market consensus forecasts confirm the picture given by the vulnerabilities rating and the Brookings groups in three categories of economies. Interestingly, the four best economies belong to the Pacific Alliance (PA), while the three lagging others are from Mercosur. The main difference between the two regional schemes is the economic set of policies. The PA members enjoy full access to international markets and multilateral financing and strong macroeconomic fundamentals, while it is not the same in the Mercosur case, where the members remain very protectionist and reluctant to market oriented principles, although at differentiated degree and for different reasons. Brazil, although having realized important reforms, remains fragile for having a weaker fiscal position and less market access which hinders its competitiveness in global value chains.

Mexico and Brazil, which together represent two third of GDP and population of the CELAC, are contrasting examples of development policies and what can be done to reduce poverty and inequality. According to the World Bank[7], "*fiscal reforms in Mexico are creating a favorable atmosphere for entrepreneurs and are focused on reducing inequality through economic growth," …"Brazil, on the other hand, has opted for social protection programs, focused on reducing inequality through public investment*." Our vision is that the difference between the two development models relies more in the industrial strategies as Mexico (and PA) tries to bet on market openness and industrial restructuration along international production chains while Brazil is more inclined to stick to the old-fashion import-substitution route for creating national industrial clusters and export of basic commodities. Although Brazil is able to get a very high ratio of value added contend in its exports, the contribution of this value added to GDP is half of the Mexican ratio and one third of the Chinese one[8].

It is still impossible to forecast who the winner will be because both giants still faces other common tremendous socio-political issues and governance weaknesses, but economic laws are very heavy and empirical facts from Asia (and Chile, the precursor in Latin America) show that joining supply chains is drastically faster and surer than the old way which in fact impedes acceding in competitive conditions to dynamic part of the global value chains. The developing nations that adopted coherently this new strategy - the "*new join-instead-of-build development paradigm*" (Baldwyn) - were all successful up to now. More recently, Brazil performance are not so convincing as, for example, China's procurement policies with Brazil has limited its ability to add value to raw material exports, making Brazil to fall to the lowest rungs of the value-added ladder in its trade with China in recent decades[9].

Furthermore, the prospect for a (much) less dynamic global context for several years, combined to negotiation run on "mega-treaties" both on the Atlantic (TTIP) and Pacific (TPP, RCEPT) rims expose Brazilian (and Argentinian) options for Mercosur to let their economies out, discriminating against themselves much more than the Members of PA - which all opted for integrating better into "global value chains" and took measures inside the PA[10] – and which are already integrated to NAFTA and EU Associations, and even for 3 of them into Asian trade negotiations. In such a prospect, Mercosur would probably be forced to adjust in the strategic self-interest of its members. The sake of the whole CELAC area will depend upon the way both models – PA global option and Mercosur protectionist option (and their two Latin giants) - will find out for converging in the two years to come. But time is running…globalization gives to policy decisions more consequences and faster effects than what it used to be in the past.

[7] George Gray Molina's interview, chief economist of the development program from the United Nations Office for Latin America

[8] RUTA, Michele, & Mika SAITO (2014), « Chained Value » in Finance & Development, vol. 51, n° 1, mars.

[9] Gary Gereffi and Timothy Sturgeon, "Global value chain-oriented industrial policy: the role of emerging economies", in *Global value chains in a changing world*, Edited by Deborah K. Elms and Patrick Low, WTO, Switzerland, 2013

[10] The PA Trade Protocol signed in February 2014 established an agreement on rules of origin which includes a cumulation mechanism aimed at enhancing international production chains. This innovation, already in place in the Mexico-Central America Free Trade Agreement of 2011, contributes to the convergence of preexisting Preferential Trade Agreements. In addition, the PA members are promoting integration in coherence with GVCs through the elimination of restrictions on trade in services and on capital movements

This is why the EU might bring significant contribution through the bi-regional Summit diplomacy, and Belgium diplomacy could actively play its historic go-between and "compromise-finder" roles. Before to present this strategy, it is important to overview some features of the international insertion of the CELAC economies which are the roots of the vulnerabilities of the whole region..

Section 2: The genuine cause of the weak growth path of CELAC economies: their weak insertion in international trade and their insufficient regional integration

The theoretical foundation of the positions taken in the present work relies merely upon the implications of the new round of far-reaching transformation at work behind the so-called "globalization" that R. Baldwyn coined the "**second unbundling**". It explains the supply chain fractionalization – the functional unbundling of production processes – which is governed by a fundamental trade-off between specialization and coordination costs. This globalization of supply chains - or the fact that production stages previously performed in close proximity are now dispersed geographically - shifts the locus of international competition from sectors or goods to stages of production or specialized tasks. So, the old Ricardian principle of comparative advantages still applies but to tasks and not to goods and faster than before. The supply chains also internationalize the complex two-way flows of goods, information, investment, training, technology and people that used to take place previously only within factories or between domestic plants.

Today's global economy is characterized by **global value chains (GVCs)**, in which intermediate goods and services are traded in fragmented and internationally dispersed production processes. In particular, advances in technology and an enabling policy environment have allowed businesses to internationalize their operations across multiple locations in order to increase efficiency, lower costs and speed up production. Businesses today look to add value in production where it makes most sense to do so. Analysis of GVCs implies to identify "value-added trade". This has shown two important features: (i) deep regional integration is necessary for deeper participation in GVCs with third partners, (ii) services account for almost half of world trade – considerably more than traditionally estimated using only gross flows statistics. The issue is not just quantitative. The nature of the contribution of services is also important. Services are often produced in conjunction with goods and represent crucial production components for competitiveness and potential sources of innovation and value-added. Global investment and trade are inextricably intertwined through the international production networks of firms investing in productive assets worldwide and trading inputs and outputs in cross-border value chains of various degrees of complexity. Such value chains (intra-firm or inter-firm, regional or global in nature, and commonly referred to as Global Value Chains or GVCs) shaped by TNCs account for some 80% of global trade.

This second unbundling – initiated by Asian economies and to which the region CELAC participates badly - revolutionized development options faced by less-developed nations. Before the rise of global supply chains, nations had to build a deep and wide industrial base before becoming competitive. This is the way the United States, Germany, Japan and the four first Asian tigers did it. With the second unbundling, nations could industrialize better by joining international supply chains (Baldwin, 2011b). Joining supply chains is drastically faster and surer than the old import-substitution route and the "cluster vision". This new reality also transformed the political economy of policy reform, shifting the attention towards the "*trade-investment-services-IP nexus*" (Baldwyn) which implies specific policies for effective regional integration, trade facilitation and free access to the best inputs (including services) and technologies, better governance, infrastructure and logistic efforts, competition regulation, and R&D strategies. As formulated by R. Baldwyn[11], "*The 21st Century regionalism is not primarily about preferential market access as was the case for 20th Century regionalism; it is about disciplines that underpin the trade-investment-service nexus. This means that 21st Century*

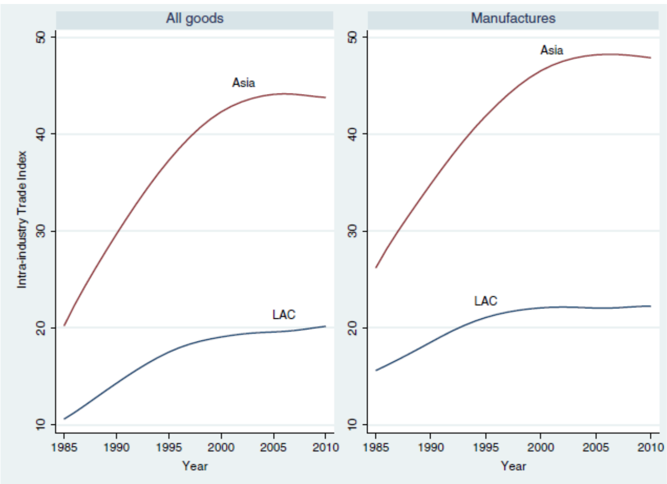
[11] Richard Baldwyn, "21st century regionalism and global trade governance», on VOX CEPR's Policy Portal, May 2011.See also Baldwin, R., 21st Century Regionalism: Filling the gap between 21st century trade and 20th century trade rules, CEPR Policy Insight N°56, London, May 2011.

regionalism is driven by a different set of political economy forces; the basic bargain is "foreign factories for domestic reforms" not "exchange of market access". Strategic links are created between companies regardless of territory and distance ("de-verticalization"), which questions the interest on simple tariff unions and protectionism based on the concept of vertical industrial "clusters". In turn, GVCs reinforces the importance of services, infrastructures, and governance, and thus of a deeper regional integration, that is, one that isn't limited to the trade of goods but also of services, and the harmonization of rules and policies. The reality of trade development in terms of GVC makes import liberalization regimes the key to the success for sustainable exports.

Latin American economies have always participated to GVCs but any analysis of Latin America trade (taken as a whole) shows - whatever the criteria - that this participation has not been so favorable to its own economic development. The old structuralism doctrine used to blame the market system and trade itself, advocating for protection and creation of national clusters. The failure of this "inward-looking" strategy and the counter-example of Asian successes with "outward-looking" policies demonstrate that international insertion quality and its impact upon development depend mainly from domestic policy choices. The participation of Latin America to GVCs indicates resilient weaknesses: low degree of trade openness and bad quality of trade structure by products, by destination and by firms. This region is clearly lagging behind other emerging countries, especially the Asian region, for its participation in GVCs. Furthermore, Latin America is trapped in a center-periphery dependency even with other emerging economies like China, showing counterproductive effects of protectionist strategies.

One of the illustrating measures of this inadequacy of the region participation to GVCs is the intra-trade indicator (chart 4) since a deeper integration to international production networks implies specialization in intra-sectorial goods rather than inter-sectorial.

Chart 4: Index of intra-industry trade as a proxy for sequential output links (index Grubel-Lloyd at 4 digits); <u>source</u>: IDB[12], 2014



The CELAC region has largely missed the recent surge in the international fragmentation of production although it has always been participant in GVCs but mainly as a supplier of raw materials and basic inputs. This region – excepting partially Mexico and Central America - has not been able to capitalize on the recent surge of production fragmentation. Indeed, the various available indicators[13] confirm the general perception that Latin America tends to participate less than other regions in global value chains, particularly in value chain segments related to the manufacturing sector. Latin American

[12] Juan S. Blyde Editor, Synchronized Factories Latin America and the Caribbean in the Era of Global Value Chains IDB, Washington, 2014.
[13] Juan S. Blyde *Synchronized Factories ….op. cit.;*
Deborah K. Elms and Patrick Low *Global value chains in a changing world*, 2013, op. cit.

countries participate more than Europe and Asia in international value chains as suppliers of primary inputs, while Europe and Asia participate more than Latin America as suppliers of manufacturing inputs with high, medium, or low technological content.

Chart 5: Blyde's Indicator of participation to GVCs: Foreign value added (blue) and domestic value added used in third countries' exports (green) as a share in value added generating sector; average 2003-2007; source: J. Blyde, IDB[14]

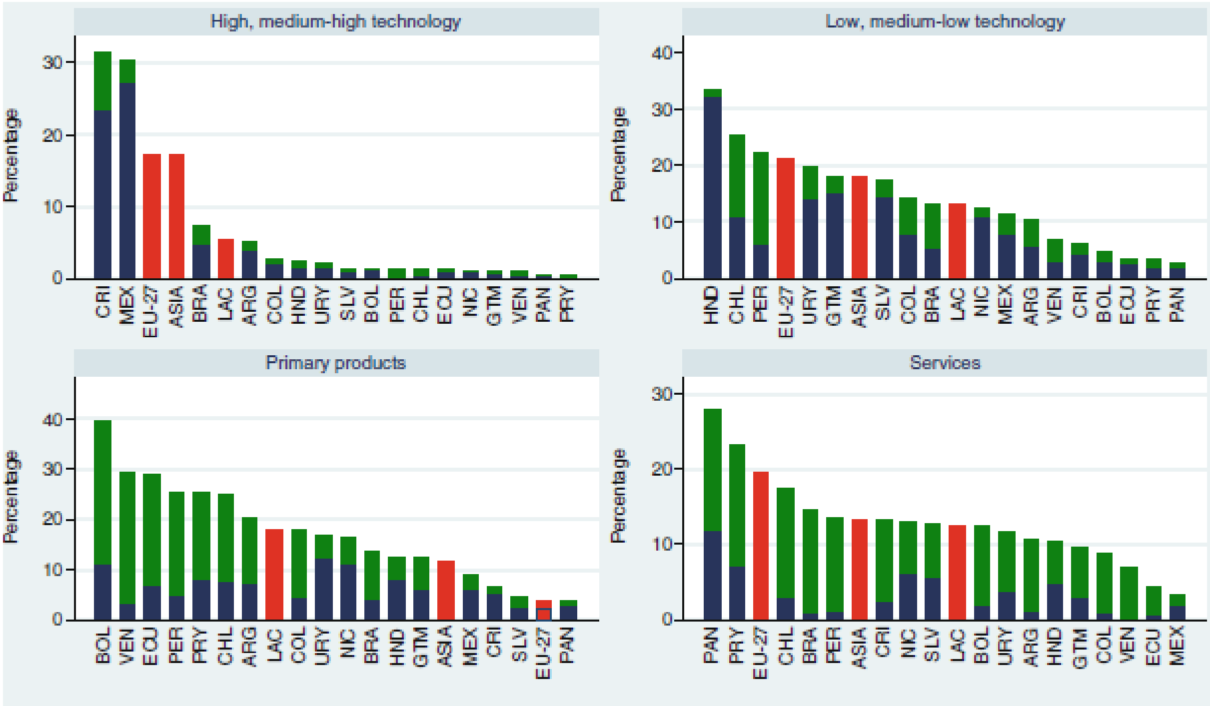
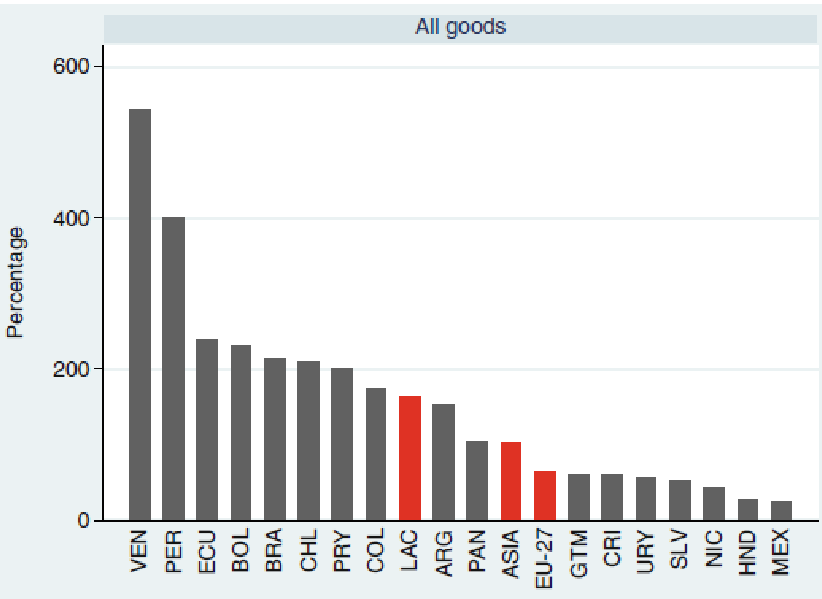


Chart 6 : Koopman's Indicator of GVC position, average 2003–2007: percentage of a country's exports used as inputs in the exports of other countries, divided by the foreign value added of the country's exports, Source: J. Blyde, IDB



[14]Juan Blyde, IDB, op. cit.

Mexico and Central America are more at the end of supply chains and South America more at the beginning. However, as a whole, Latin America is positioned more upstream in global supply chains than the EU and Asia due to the average specialization of the region towards natural resource intensive sectors. Furthermore, even for those at the downstream end their share of the value added inside the GVCs has not increased or even has decreased, indicating a weak market power making difficult their upgrading along the GVCs. In particular they are more confronted with Asian competitive pressure on their export markets.

While the proportion of respective value added in trade is a sign of production integration between countries, intensive trade in natural-resource-based manufactured goods tends to denote a low quality degree of such integration. As explained by ECLAC/CEPAL, "*it is thus not just a matter of joining value chains. The challenge is to increase the share of value added generated locally and to move up the chain hierarchy from simple to more complex activities. This process is neither straightforward nor spontaneous*"….. "*A key objective for Mexico and the Central American countries is to position themselves in more sophisticated links higher up value chains —whether in industrial goods or services— in which they are already present. For South America the main challenge would appear to lie in incorporating links with greater value added into natural-resource-based exports and in promoting networks and chains in the manufacturing and service sectors*"[15].

Globalized trade opens the opportunity for changes in the economy, increasing productivity through the diversification of exports, accompanied by better links with the local economy and its services, specifically through innovative SMEs, and a better distribution of income, many times associated to the development of female entrepreneurship. However, although it is true that globalization and its "unbundling" wave offer the region opportunities for quick development, it also exposes it to new risks. The first is that it directly penalizes the protected or less developed economies, which lack the response capacity of its production apparatus, and also proper institutions to clear the obstacles to trade, which would allow a sustainable insertion in GVCs. These countries pay a "competitiveness penalty" caused by border segmentations due to tariffs, non-tariff barriers, inadequate regulations and bureaucracies, which hinder not only trade but also the flow of information, knowledge and technology, as well as direct investments. The second is the risk of new asymmetries through the relation of power that could manifest in the capture of added value within each global chain, benefitting the more advanced companies, to the detriment of the smaller ones that operate in more heterogeneous economies that are less integrated with their neighbors (as is the case of many CELAC countries). Globalization thus increases the penalties over economies characterized by a low level of real regional integration, creating a vicious circle that could worsen an already backward situation, if there isn't a proper regional (and bi-regional and multilateral) cooperation strategy.

The ECLAC works for mapping the GVCs in the CELAC area show this inadequate quality of insertion according to several indicators. For example, intermediate goods[16] account for a significantly larger share of exports in the North American, European and Asian value chains than they do in CELAC area and the proportion of semi-finished goods (versus more elaborated industrial goods according to the technology content) in these intermediate exchanges is also significantly larger (66% when taken Mexico out of the region) than in the three other regions (around 30% and even 20% for ASEAN +3). Also other CEPAL indicators[17] show a general regression in the participation of the CELAC region in the intermediary goods exported both to the region itself and to the world. The same negative evolution in the years 2000 appears in the market share for services exports and in the exports of parts and component, both indicators of participation in GVCs. Furthermore, CEPAL shows that the deepness of the production chains are lower than the other regions, they have a lower degree of

[15] ECLAC/CEPAL, Regional integration: towards an inclusive value chain strategy, Santiago de Chile, May 2014
[16] ECLAC/CEPAL, *Latin America and the Caribbean in the World Economy in 2013*, Santiago de Chile, 2013
[17] ECLAC/CEPAL, *Comercio internacional y desarrollo inclusivo : Construyendo sinergias*, Santiago de Chile, April 2013

linkages in the domestic economies[18]. First, the proportion of firms that export is very low, at less than 1% in most of the countries for which information is available. Second, exports are heavily concentrated among a small number of highly internationalized large firms, usually associated with natural resources. The top percentile of exporting firms account for over 70% of all shipments in Argentina, Venezuela, Chile, Colombia, Mexico, Paraguay, Peru and Bolivia. Turnover among the region's exporting firms is high, one reason being their heavy reliance on a small number of products and destination markets. Another example of the lack of adequate integration due to domestic policies is the fact that Brazil imports little of intermediate goods from other countries in the region (only 5% of its industrial inputs are imported[19]).

Another pattern of the GVCs is the dominant regional weight in the composition of the chains: participation to international production networks is more intense among countries of the same region than with other regions. The within-region participation in the EU, Asia-Pacific, and LAC is 51 %, 47 %, and 29 %, respectively. LAC area is clearly part of the "North-America fabric", and adds also a similar share with its own regional chains, giving to the Americas half of the networks. The EU share (blue) inside LAC takes a slightly more important weight than Asia (red). Inside the European GVCs, LAC is more important than Asia while in Asian GVCs LAC is the smallest partner, reflecting a LAC-Asia trade pattern that is markedly inter-industry. Since regions take an important weight in value added trade, it is all clear that in LAC the lower weight of regional contribution to GVCs is a handicap for a better position in GVCs, both being due to the low regional integration in LAC. The same conclusion comes about the LAC-Asian trade relations which are less favorable to LAC development (see chart 8 from CEPAL where the highest distance from the center indicates a better degree of inclusive trade)

Chart 7: Regional contribution to foreign value added average 2003–2007; source: J. Blyde IDB

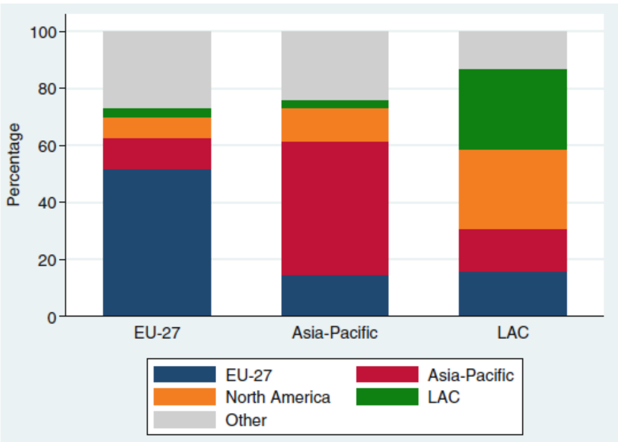
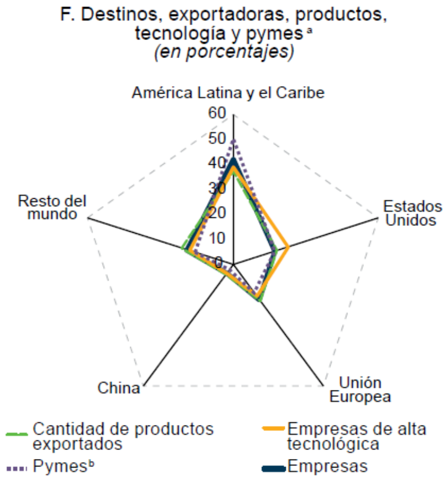


Chart 8: quality of trade pattern for being pro-development (source: ECLAC/CEPAL) [20]



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[18] Ibid

[19] ECLAC, *Latin America and the Caribbean*…. Op. Cit.

[20] ECLAC/CEPAL, ECLAC/CEPAL, *Comercio internacional y desarrollo inclusivo : Construyendo sinergias*, Santiago de Chile, April 2013

Chart 8: quality of trade pattern for being pro-development (source: ECLAC/CEPAL)[21]

The analysis of value added trade and GVCs dynamics are still in progress and the results of the existing data remain difficult to interpret as they are influenced by contradictory factors as the degree of openness, the size of the economy, the nature and degree of participation in GVCs with respect to the degree of their value added in exports by third countries etc…The key question is whether the growth of global value chains is generating wealth in the countries that make up the chain. The answer is clearly yes, but positive results are not automatic and require specific policies.

Anyway, empirical works allow for identifying a link between fast economic development and poverty reduction with increasing participation into GVCs. Even though some countries take on low-value-added assembly tasks, their exports still generate a substantial portion of their income—that is, they have a high ratio of value-added exports to GDP[22], and these economies are also those that have been growing relatively fast since the mid-1990s. This suggests that there are important learning effects and other kinds of positive spillovers on the rest of the economy that come from anchoring a country to global value chains. For example, local firms in countries that specialize in assembly may indirectly benefit from exposure to new technology used by foreign firms or the improved business environment associated with foreign investment.

As demonstrated by the UNCTAD[23], for the developing country as a whole, their share in global value added trade increased from 20% in 1990 to 30% in 2000 to over 40% today. In this development the role of Transnational Corporations (TNCs) is instrumental, as countries with a higher presence of FDI relative to the size of their economies tend to have a higher level of participation in GVCs and a greater relative share in global value added trade compared to their share in global exports. In all developing countries value added trade contributes some 28% to countries' GDP on average, as compared with 18% for developed countries. Furthermore, there appears to be a positive correlation between participation in GVCs and GDP per capita growth rates. Economies with the fastest growing GVC participation have GDP per capita growth rates some 2 percentage points above the average. It is clear that LAC region is still lagging in adopting this strategy with respect to other emerging economies.

The conclusion is that for the CELAC area, trade patterns and especially the kind of insertion in global trade imply asymmetries which impede a faster growth. This conclusion is not new as largely developed by the "structuralist school" of Latin-American economists[24], but the substitution of imports proposed by this doctrine as a remedy to asymmetries led to a worsening of the under-developed insertion of this region. Therefore, as shown by the evolution of the CEPAL school towards a new structuralism[25] based upon the theories of endogenous growth and the open regionalism, the key is to change domestic traditional protectionist policies based upon static "geographic cluster" strategies for spurring a better participation in global trade based upon trade openness and effective regional integration. Achieving a production transformation that helps to reduce inequalities requires more and better-quality productive employment and a greater presence of SMEs, manufactures and services in exports. These are better represented in intraregional trade than in any other kind of trade. Consequently, there is a direct link between a strategy of growth with equality and the strengthening of the regional economic space

[21] ECLAC/CEPAL, ECLAC/CEPAL, *Comercio internacional y desarrollo inclusivo : Construyendo sinergias*, Santiago de Chile, April 2013

[22] RUTA, Michele, & Mika SAITO (2014), « Chained Value » in Finance & Development, IMF, vol. 51, n° 1, mars.

[23] UNCTAD, *Global Value Chains and Development: Investment and Value Added Trade in the Global Economy*, Geneva, December 2013.

[24] For examples ECLAC's authors like R. Prebisch, C. Furtado, O. Sunkel, A. Pinto

[25] Neo-structuralism launched with the doctrine of "Productive Transformation with Equity Policy", see ECLAC's authors like R. FFrench-Davis, J. A. Ocampo, F. Fajnzyilber

In fact, the productivity gap between the modern export sector and the rest of the economy reveals a heterogeneity in the sector, called "internal gap" given the low productivity that affects most of the economy; this generates social inequalities, which in turn slows down progress in productivity and innovation, leading to the so called "external gap", or lack of structural competitiveness, due to exports with low impact on growth and social progress (less inclusive exports and international insertion). Large internal gaps reinforce the external gap, and partially feed on it. Thus, vicious circles are created, not only in terms of poverty and low growth, but also slow in learning and weak structural changes, all of which hinder regional integration and reinforce their handicap in competitiveness, to be able insert themselves to value chains under good conditions. Since low productivity sectors have great difficulties for innovating, adopting technology, and driving learning processes, the internal heterogeneity worsens systemic competitiveness issues, poor international insertion, and social exclusion.

This complex vicious circle, which slows down the region's development, is evident in the fact that even a boom in exports and foreign opening doesn't sufficiently translate into an internal chain of activities linked to exports, thus explaining the lack of progress in the total potential output of the domestic sector and the stagnation of total productivity. In that way, non-inclusive growth doesn't change the structure of the economy and its competitiveness that doesn't move forward CELAC economies in the "international hierarchy" of their global insertion.

Technical studies by ECLAC on the region's low quality of international insertion reinforce the interest that the new (neo-structuralist) approach poses for Latin America and the Caribbean. Several ECLAC studies have evaluated the quality of exports and the specialization patterns, as well as the types of insertion of the region, and conclude that "*the traditional comparative advantages based on the export of natural resources are increasing again, and the progress made is still unsatisfactory, since in several cases trade has not reduced imbalances or structural heterogeneity*".104 This "re-primarization" is more than the price-effect, it is also a step backwards for some products that were displaced by China. ECLAC also highlights "*the little participation in global value chains and the limited depth of internal linkages".* Indeed, as demonstrated by ECLAC[26], the asymmetries are evidences of integration failures in the periphery areas, both internally (heterogeneities between sectors, income-earners and workers, sub-regions and economies) and externally (national market segmentation together with low competitiveness and poor productivity). The underdevelopment vicious circle is explained by a productivity gap between the export sector and the rest of the economy, which means sectorial heterogeneities creating an "internal gap", leading to rising social inequalities, in turn these inequalities impede labor mobility, education, innovation and productivity progress, leading to worsening the "external gap" in productivity with the developed areas, maintaining unfavorable asymmetries with an export structure less beneficial for domestic economies and less inclusive, maintaining internal gaps. Such a vicious circle impeding changes and endogenous growth is visible in the absence of progress in total productivity, reinforcing the internal and external gaps and impeding structural change in the external sector and upgrading in the GVCs participation.

In particular, the poor LAC performance in total productivity is a symptom of the perverse effects of policies which explain the inadequate participation to and upgrading along GVCs. Thus, it is clear that an external opening – although necessary – is not in itself sufficient to achieve a quality international insertion. Proper strategies and policies are also required, to accelerate both regional integration and the insertion in global chains. It is precisely this double and simultaneous dimension what can foster the strategic alliance of CELAC with the EU, if CELAC coordinates itself effectively vis-à-vis this double target in conformity with its new slogan "*Convergence in diversity*".

Therefore, the slow growth of LAC could be tackled through a specific strategy combining a deep regional integration together with an upgrading inside GVCs, both ingredients that characterize the EU

[26] ECLAC/CEPAL, Comercio internacional y desarrollo inclusivo : Construyendo sinergias, Santiago de Chile, April 2013

cooperation and external policy, because these elements are also in the EU interests, making possible a nice win-win geo-political game.

Section 3: Which strategy the EU should adopt with the CELAC economies?

The few facts and explanations given in section 2 about the GVCs impacts upon the international economy indicate the crucial importance and the urgent need for the CELAC area to design and implement quickly a coherent strategy for tackling its poor insertion in the global economy. This section 3 presents the paradoxical thesis that the cyclical growth slowdown and the unresolved governance difficulties affecting the CELAC partners, are not obstacles for making them ideal candidates for a deep Strategic Alliance with the EU which is also facing difficult times with stagnant growth and poor productivity performance threatening their own position in GVCs..

In fact, rather than being an obstacle to cooperative strategies, difficulties and challenges facing by both regions are on the contrary driving forces for strengthening their cooperation. CELAC economies' handicaps in global insertion and in governance represent additional reasons for launching a new cooperative alliance with the EU: the fundamental reason is the dynamic convergence of interests in both regions that could be put in motion for reaping the benefits of their complementarities…if adequate instrument of coordination and cooperation are in place. The historical chance is precisely that with the 15 years of Summit Diplomacy the required coordination instrument is at hands at the very moment policymakers of both regions are facing serious challenges. For both regions these challenges call for a change in their international bargaining positions for upgrading their insertion in GVCs as well as for facing on better foot the Mega-regional-trade negotiations the other global powers are presently managing. There is a need for bi-regional policy cooperation for improving the respective insertions in GVCs which tend to be led by the Pacific Rim powers and reverting the growing gap disfavoring the Atlantic Rim (see chart 9). This cooperation betting upon mutually attractive complementariness in the kind of international insertion in global competition could tackle two closely related issues: the respective poor productivity performances in CELAC and EU regions, and the required upgrading along GVCs which implies taking part to Mega-regional-trade negotiations for ensuring a stronger position in the Pacific Rim growth factory, as well as progressing in the regional integration in CELAC area.

Chart 9: The Pacific growth factory (source: the Economist, 15th November 2014)

Respective competitiveness of both CELAC and EU economies are about to be affected by the ongoing negotiations towards “Mega-regional-free-trade agreements” which are deeper agreements that change the conditions for spurring GVCs development. The dominance of GVCs in shaping trade, investment, technology transfers and productivity growth made competitiveness dependent more upon a lot of non-trade barriers and other domestic factors as legal security and business climate. Therefore, the kind of new trade rules required by GVCs are often negotiated within these Mega trade agreements out of the multilateral scheme of the World Trade Organization. These deep agreements often include legally enforceable provisions that tend to establish disciplines that are broader in scope than under multilateral agreements. Deep agreements, moreover, often contain legally binding obligations on a range of issues not currently regulated by WTO that are relevant to the functioning of value chains. These include the treatment of foreign investment, competition policy, government procurement, capital flows, environmental and labor regulations, measures relating to the granting of visas and regulatory convergence.

In a survey of 96 free trade agreements covering 90 percent of world trade, the WTO[27] found that the core rules introduced in these agreements govern competition policy, intellectual property rights, investment, and movement of capital. For instance, 73 percent of agreements in this survey contain obligations on competition policy outside the current WTO mandate. Therefore, the pattern of these Mega-trade agreements will change competitiveness of insiders with respect to outsiders to these agreements, forcing latecomers to adopt rules negotiated by others, and giving to leaders of these Mega-agreements decisive “first-in” competitive advantages. It appears that both regions CELAC and EU face a risk of regulatory fragmentation or even exclusion. Hence, they have mutual interests in coordinating their positions in order to try to have a say through their respective involvements in these agreements. In particular, since some members of CELAC are not part – directly or indirectly – to TTIP, TTP, RCEP, while the EU is not part of Pacific Rim negotiations, an obvious common concern deserves to be considered for the agenda of the CELAC-EU Summits. Also they could together have a crucial weight for finding ways to “multilateralize” these free trade agreements and make them coherent across countries.

In fact, the present world configuration of GVCs is schematically divided in three major production networks (“factories”): Factory Europe (Germany being the hub), Factory North America (based in the United States) and Factory Asia (originally centered in Japan and more recently in China). The functioning of the GVCs requires some discipline and regulation, creating a demand for governance that the impasse at the WTO Doha Round has increasingly forced to be satisfied by separated deep trade and investment agreements between Mega-regions. The competition between the three factory-centers leads presently to a competition between negotiations on regulations for imposing their own standards. CELAC area which belongs mainly to the North America factory, offers the peculiarity to get access to the two other global factories, although the quality of exchanges is better with the EU than with Asia (with which the degree of inter-sectorial trade is higher). This should attract CELAC more towards the EU than towards Asia.

The existence of EU growth difficulties tends to make EU policymakers more inclined to look for better access to new markets while CELAC policymakers are more in need for getting better access to GVCs and technology transfers by benefitting from the experiences and cooperation of their European partners. The contribution from EU cooperation to CELAC is especially important for contributing to the virtuous relationship between competitiveness and internationalization. Improving competitiveness implies for both regions to improve education and innovation, two key-aspects in which bi-regional cooperation can make a difference for both sides. Research needs diversification for increasing innovation capacity, especially for SMEs which represent the bulk of the productivity gaps with the two other factories and between EU and CELAC as well as inside both regions. Only a specific set of coordinated policies at the bi-regional level (which supposes previously an effective intra-regional

[27] World Trade Organization (WTO), World Trade Report: The WTO and Preferential Trade Agreements: From Co-existence to Coherence, Geneva, 2011.

coordination) could enable SMEs to internationalize and reach new markets. In turn, internationalization stimulates the competitiveness of SMEs by making them operate in more complex markets and giving them access to new technologies, business practices, networks and market information, among other resources. This internationalization could be faster for both regions in the context of their bi-regional cooperation for acceding to GVCs. Indeed, participation in GVCs is also a powerful tool for the internationalization of SMEs, which can gain access to these chains through direct or indirect exports, that is, by supplying goods or services to larger export firms. Experiences from ASEAN countries[28] show that the highest rates of SMEs participation in production networks were in countries that are more fully integrated in such networks.

The fact that the Pacific Rim has become the driving force of the world economy justifies a specific interest from both regions in getting privileged access to these markets through better participation in GVCs. Joining their complementarities would make more competitive CELAC and EU economies together in the global competition, allowing them to improve their participation in common GVCs for competing in the Pacific Rim. This strategy means to spur the evolution from an inter-industry trade pattern to a more intra-trade structure, with an upgrading mainly for CELAC economies but contributing to improve their joined participation to whole GVCs in mutual interests. Such an objective requires a specific cooperation in education in science & technology for spurring innovation, one of the priority topics of the bi-regional cooperation.

The Summit Diplomacy has reached effective results for making more explicit the mutual interests as well as for stimulating intra-CELAC coordination. It provides the optimal instrument for upgrading the existing bi-regional cooperation in order to face common threats. These risks come from the new global economy with Mega-regional negotiations which expose both regions to a Pacific Rim led by two dominants powers. The EU external policy offers to the CELAC partners the kind of instruments, experiences, like-minded perspectives and mutual respect they ask for and that the two other powers do not provide to the same degree. In particular, the shared objective to create a “common higher education space” is part of the purpose of the Strategic Alliance.

Building a Strategic Alliance CELAC-EU for strengthening their mutual competitive insertion in dynamic GVCs should be the priority for the Brussels Summit of 2015. <u>The operational foundations</u> rely in the conjunction of several features and pragmatic considerations when considering the CELAC region with respect to alternative partners:

- The shared values and the common society objectives of both regions, that no other region could offer with the same degree of affinity; this provides a worthy asset for integrating GVCs since a crucial part of the costs of coordination depend upon trust by sharing some common identities and cultural links
- The structural weakness of CELAC region’s involvement in GVCs offers enormous potential complementarities in their mutual interests for improving their respective productivity thanks to specialization along common “global value chains” offering an effective strategy for facing global competition by strengthening joined competitiveness of both partners in a cooperative win-win-game. This cooperation
- The accumulated experience in LAC-EU cooperation and instruments which combines reciprocal cooperation, trade openness and regional integration, all the more with the recent creation of the CELAC for Latin American and Caribbean countries speaking with a single-voice, and the EU-crisis which rebalances the bi-regional relation by making more symmetric the dialogue between both partners;
- The CELAC-EU cooperation provides a broader range of tools and experiences than it might be the case with other regions for tackling the urgent need for the CELAC area and its sub-regions in their efforts to integrate their economies for improving their efficiency and being

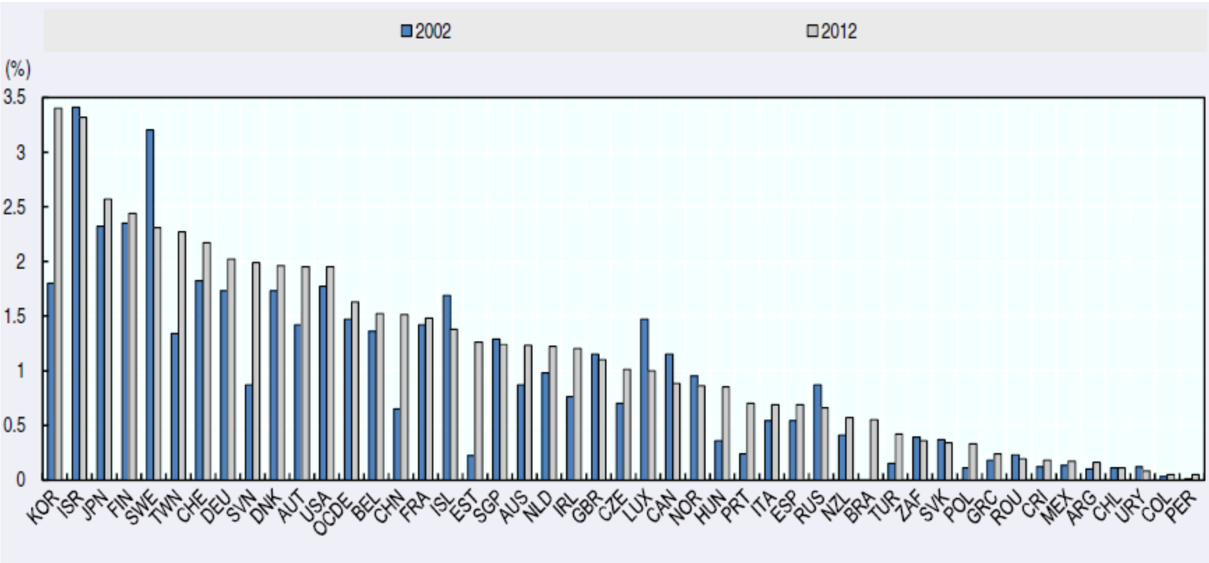
[28] Ganeshan Wignaraja, “Engaging small and medium enterprises in production networks: firm-level analysis of five ASEAN economies”, ADBI Working Paper Series, No. 361, Tokyo, Asian Development Bank Institute

able to upgrade their participation into GVCs. This is particularly the case in EU cooperation with its priority given to regional integration, to SMEs development and to education and social cohesion; also the trend in developing “Aid-for-trade” instruments and the existing availability of this kind of instruments with positive recent experiences; the EU cooperation could answer to the urgent need to internationalize SMEs of both regions for breaking the productivity gap of SMEs; CELAC area’s SMEs could reap faster and higher gains from joint-ventures with EU’ SMEs integrating them into business networks in a Single Market of 500 million of consumers, favoring their upgrading inside GVCs; the existence of EU experiences should orientate the existing tools available for the EU-CELAC cooperation policy towards SMEs support.

- The fact that European FDI and “Translatin” firms have already built business networks and some starting bases for integrated production chains.
- The present strength and momentum of the Pacific Alliance (PA) model of growth which will allow for the Pacific coast recovering a more attractive growth for EU firms participating actively through exports, FDI and joint-ventures,
- The urgency and logical reasons for expecting soon some convergence between this PA model and the Mercosur one, taken on board the geo-political dynamics in a fast moving global competition.

These factual reasons associated with the global forces driving the new economy along GVCs open an attractive road of mutual interests based upon complementarity needs of both regions for breaking vicious circles of low internationalization, low SMEs productivity and low innovation capacity in order to increase their stagnant total factor productivity and the potential output. Adopting an ambitious active cooperation strategy at micro level between firms, at research level in building a common space in Education, Science & technology as well as at macroeconomic level through a policy dialogue, is the fastest way to meet the social challenges of globalization. The simple picture of the relative poor performance in R & D efforts in both EU and CELAC economies with respect to Pacific powers indicate (see Chart 10) the need and urgency for common action for drawing upon the new knowledge economy.

Chart 10: Business Expenditure on R&D (BERD) as a percentage of GDP, 2002 & 2012



Sources: OECD, ECLAC, CAF, *Latin American Economic Outlook 2015*, Paris, 2014

Of course, upgrading the agenda for the Brussels Summit still requires further works from diplomatic, academic and policymakers. Deep and intensive research on both regional sides for identifying concrete common actions and for adapting existing cooperation instruments and budgets should be launched in the context of the preparation of the Brussels Summits (not only the Heads of State and Government but also the parallel Academic, Business and Civil Society Summits. However, the most important step is to make policymakers aware there is no time for procrastination: the Brussels Summit offers the right tool in the right moment for designing the multi-annual road-map for a building a new partnership with this CELAC region which is the EU genuine allied for the XXI century globalization.

4. The Belgian potential role: to broaden participation to the Summit Diplomacy through a Belgian Plan based upon a bottom-up, multi-sector, public-private cooperation

The next CELAC-EU Summits (Heads of State and Government, Business, Academic, Civil societies, Justice) offer to the Belgian diplomacy a nice opportunity to use its well-known capacity of "common sense" for working out "Belgian compromises" i.e. to identify the consensual common interests and the enormous value added of a cooperative approach in the present global economy. Belgium, at the historical crossroad of Northern and Southern cultures which compose Europe, is endowed with a unique pragmatic capacity and concrete training for combining the Latin and Germanic idiosyncrasies. France and Germany are now the two countries with the most powerful strategies and the highest budgets for cooperation with the CELAC area and Belgium has easy access to both and could play a go-between role. In addition, the fact that Belgium is precisely not a major actor in CELAC-EU relations gives to our Diplomacy and policymakers an effective credibility for proposing innovating objectives with pragmatic Belgian methods able to give operational content to the still imprecise purpose of the strategic Alliance.

Without pretending to own the single way, this paper formulates concrete means that Belgium could propose for contributing to trigger quickly a new dynamics in the preparation of the Summits. Drawing upon concrete experiences of cooperation between Latin American countries, the Plan consists in a set of three complementary initiatives able to change the routine and free innovation capacities:

1. To organize a specific group for consulting the <u>small and medium Member States</u> from both CELAC and EU about the worrying issue of the insufficient growth (or even stagnation) of total factor productivity in both regions and the probable link with the issue of their international insertion; the purpose is to give a louder voice to the majority of Member States with respect to the big countries in the preparation and during the Summits. This additional channel could make a difference by challenging the routine of usual practices in the already rigid way to work which has been adopted at bi-regional level for fifteen years.
2. To propose – ideally on behalf of all the small and medium countries - to all Summit participants the development of a "<u>bottom-up method" for broadening the process of defining the content of the Strategic Alliance</u> and the inputs for selecting cooperative ideas and projects to the Summit agenda. This "peer pressure" method[29] consists in launching a two-sector (public policies and private firms) two-tier (regional and bi-regional levels) system of broad informal networks gathering basic actors for expressing their views and needs of regional and bi-regional cooperation:
   - 2.1. first, to create (with incentives) in CELAC and EU informal civil-servant networks between national administrations and experts, one network per technical issue or policy;
   - 2.2. second, to do the same for the business sectors, using the national Chambers of Commerce and SMEs associations as well as company or sector representations;
   - 2.3. third to connect each regional network (public policies and private firms) for developing at bi-regional level a direct mean of exchanges and cooperation, giving so a voice to the peers in charge of policies and trade/investment/production/employment.

[29] This method is based upon the CEPAL experiments made in the REDIMA project for dealing with macroeconomic cooperation inside Latin American countries. For more information, see C. Ghymers *Fostering Economic Policy Coordination in Latin America: The REDIMA Approach to Escaping the Prisoner's Dilemma*, ECLAC, N° 82(LC/ G.2270-P/I), Santiago de Chile, 2005).

2.4. Fourth step is to collect the results at official level for processing them at Ministerial level for bringing them in the Summit agenda and taking actions in bi-regional cooperation programs.

These autonomous networks managed by the basic actors allow for direct trans-regional consultations first, followed by extending consultations and exchanges to the bi-regional level between these basic actors. Autonomous networks permit a genuine technical democratization which gives a voice and stimulate initiative and innovation from civil servant experts and private firms. Experiences in Africa[30] and Latin America[31] show that encouraging and warranting the informal and free nature (open competition between participants speaking on their own and not in the name of their institution) of the exchanges, ensure a powerful dynamics and an endogenous development of structured networks. An emulation among technicians spurs the use of this tool in the own interest of the participants and their hierarchies, with a mechanism of self-selection from them to the EU/CELAC procedures, through incentives created by each countries (and/or sub-region) in favor of the people in charge of each national administration (regional rewards, scholarships, missions, etc…).

By organizing incentives for making each separated technical network to report systematically to the decision-maker levels (Ministers of both region and Summit participants) they provide them with a spontaneous generation of ideas and projects which offer an extraordinary flow of innovations and contributions to regional integration and bi-regional cooperation. In exchange, the participants can express their voice and transmit their views and advices to policymakers for reaching consensual positions successively at regional and bi-regional levels, about the main issues for which these actors consider that regional cooperation would be beneficial for them.

The need to maximize the interests of basic actors in the bi-regional cooperation moves them in favor of cooperative actions, both among peers in the public sector and for SMEs or for other interested firms. Thus, these networks – if sufficiently autonomous - have the potential to decentralize and to trigger a competition among actors which stimulates the efforts for identifying and selecting concrete bi-regional cooperation in their own interests in their area of technical responsibilities. Not for taking decisions but just for emulating regional and bi-regional cooperation at technical levels of public policies and firms. This “peer selection” mechanism is very powerful when it enjoys sufficient autonomy for freeing technical competences in a competitive run for identifying common interests according to pure technical or scientific criteria by the technicians who participate to each network. The role of governments is only active at the two ends of the networks: at the starting point by deciding their administrations to launch the networks allowing civil servants to participate actively since national administrations and ministers are the beneficiaries of the works of the networks, and at the end of the works for collecting the results with conclusions, proposals, ideas or merely information on what the partners think, are doing or planning to do (exchanges of best practices or failures).

The final step of this Belgian Plan for renewing the bi-regional agenda and working methods, is to organize at official level (Ministers and Heads of State or Government) a decision making process. It would merely consist in creating “Bi-regional Minister Councils” for deciding the ranking of priorities for common action and cooperation, as well as the organization and monitoring of the implementation of the Summit decisions.

3. To focus the work of these free public and private networks upon the issue of innovation and the international insertion of both regions in GVCs; the purpose of the bottom-up works of these networks is to identify cases of converging interests and concrete ways for exploiting complementarities in order to create synergies for increasing competitiveness in common GVCs. As explained before in sections 2 and 3 of this paper, the purpose is to upgrade the participation

[30] C. Ghymers, “Piste pour une initiative…., in De Pecunia, ICHEC, Brussels 1994
[31] C. Ghymers, op. cit. Redima…., CEPAL, 2005

of firms from both regions (especially SMEs) in the value added chains in a cooperative way (between countries as well as private-public partnerships) mobilizing the policy instruments and available budgets for solving common difficulties in global competition.

The philosophy of the proposed “Belgian method” for implementing this kind of bi-cooperation is based upon opening a permanent and free dialogue among the national administrations and business interests. These technical exchanges are able to incorporate a regional dimension in the national politics and besides to benefit the needed decentralization, mobilization of initiatives and participative energies. These national policies become – under what could be called an emulation of a “cooperative-competition” – more compatibles among them in a regional “win-win game” in a first stage and bi-regional in a second stage. It is absolutely not about trying of coordinate centrally, but to encourage the cooperation in two sequential stages: first decentralized and informal exchanges (without taking decisions) among national administrations (and local) and firms through technical networks, specialized by topics. In this way, the “exchanges of best practices”, the identification of common challenges, ideas and instruments, also the searching of emulation generation between civil servants and experts, and the creation of synergies of “expertise” and the human and technical capital in the region. EU and CELAC will come into play only to check out the results of the exchanges among experts, to pull out and formulate proposals of decisions to national governments under the frame of their own Plans of Action. In a second stage, these proposals should serve as a base to initiate the same type of networks between the national administrations of CELAC (and its sub-regions) and the EU (national and from the European Commission), in a bi-regional dialogue towards the real negotiations and decisions.

5. Conclusion

The years from the beginning of the 2000s were the region best for 40 years. However, the resulting gains observed in income per capita for the CELAC economies are mostly due to temporary factors (terms of trade, labor supply, cheap capital inflows, activation of unused capacities, consumption of environment capital and not renewable resources) and were not used for improving the total factor productivity, for upgrading the trade insertion in global economy or for reducing the shortcomings in physical or logistical infrastructures and in innovation national systems. Therefore, without radical changes, the still limited potential output condemn the region to a lower rate of growth which would be unable to sustain simultaneously a resorption of the social debt, the education and R&D investment required for improving relative position in the global specialization ladder, and the higher saving/investment ratio for implementing the infrastructures and logistics for materializing better participation in the global value chains without incurring external imbalances or excessive technology dependency.

The main causes of this worrying prospect are the “vicious circles” provoked by an inadequate insertion in the global economy blocking the whole region in a periphery position dependent upon the centers of the three dominant world factories (mainly the North American one, but also the European and the Asian ones). From an economic point of views, the CELAC area is divided in two main integration schemes reflecting two different sets of policies and international insertion. This division has disincentivized the development of regional or sub-regional value chains, making more difficult to be competitive and to upgrade into dynamic Global Value Chains (GVCs). The embryonic national systems of innovation are not integrated and cannot be sufficient to fil the technology gap.

Mexico, Central America and the Caribbean, are an integral part of manufacturing value chains centered on the United States and their integration goes far beyond traditional trade and is fully institutionalized. South American countries have lower levels of intraregional trade and productive integration between its economies; they are also less integrated to manufacturing GVCs and have less homogeneous institutionalization degree, the main ones being centered upon old-fashion tariff obstacles and obsolete inward-looking policies. The extension of the first kind of international insertion to three South American countries (Chile, Colombia and Peru) with the formation of the Pacific Alliance represents an important step towards more adequate agreements for upgrading participation in GVCs by focusing more on regulatory convergence towards deep integration by covering issues such as trade in services, investment, competition policy and public procurement. This integration scheme groups the present best performers which are also perceived as enjoying the highest rate of growth for the next future. However, this is clearly insufficient: neither the Atlantic nor the Pacific coast can do without the other in the global economy. Both sides of the region have specific advantages and should coordinate to maximize their potential access to GVCs. As claimed by President Dilma Rousseff, "*Our continent has the fortune of standing between two oceans. The future of Latin America depends on our ability to bring these seas together*"[32].

In the new configuration of global competition along complex, growing international networks of production influencing directly Mega-regional trade agreements, the CELAC economies have no other choices than spurring first their own regional integration in a way compatible with an upgrading in their respective positions on the GVCs by structuring them around the two largest economies, Brazil and Mexico. Indeed, intraregional trade has characteristics that make it qualitatively superior to exporting to other markets since Latin American market is the most conducive to export diversification, to SMEs participation and to structural change. Nevertheless, both largest economies require diversifying rapidly their insertion in the global economy.

Mega regionalism poses a challenge to CELAC policymakers to deepen their own integration process as a tool for improving their economies' participation in the world economy. This strategy implies that the two main economic integration schemes - the Mercosur and the Pacific Alliance - converge rapidly together with an involvement in the ongoing Mega-regional negotiations and especially the conclusion of a Mercosur-EU association agreement. It is especially crucial for preventing Mercosur members not to suffer too much discriminatory effects from the regulatory impacts of other mega-regional negotiations.

Therefore, the slow growth of CELAC could be tackled through a specific strategy combining a deep regional integration together with innovation policies for upgrading their value added inside GVCs, both ingredients that characterize the EU association agreements with its cooperation and external policy. The reason is merely that these elements are also in the EU interests, making possible a nice win-win geo-political game. Indeed, changes linked to "unbundling tasks" give both regions the possibility to aim at a greater complementarity of their companies in several sectors, generating common comparative advantages before third parties, such as China and the United States. This industrial recombination in both regions – associated to the development of investments between both regions, which since the Santiago Summit became a new chapter in bi-regional Lines of Action – would have more chances for success if it were part of the CELAC-EU bi-regional cooperation framework, than with any other regional strategic alternative, since it is based on shared cultural and "societal" values compared to other regions or third powers. Likewise, the interest of Europe is to find complementary business partners in a cultural environment with shared values, in a zone of relatively fast sustainable growth and along the path of integration, where its companies can continue expanding, offering applied technologies in exchange. This would allow the economies of CELAC countries to move forward regarding the productivity of their SMEs, as well as establish links with the regional and international economies, while counteracting the trends towards re-primarization that affect several economies in the region.

Drawing upon their 15 years of bi-regional Summit Diplomacy, the next Brussels Summit of June 2015 offers a historic chance to the CELAC and EU policymakers for creating a coalition of interest for competitiveness improvement in both regions by upgrading their mutual GVCs participation with technology transfer in exchange for joint ventures, crossing FDI and other production and research

[32] President Dilma Rousseff at the first regional meeting of the Clinton Global Initiative, 9 December 2013,Rio de Janeiro.

partnerships. Indeed, for CELAC economies, the cooperation with the EU for getting better access to their markets and activities (acceding directly to higher technologies, addressing directly 500 million persons and the bigger exporter of the world) and to the EU cooperation tools and experiences (on regional integration, SMEs support and internalization, training and education, science & technology, aid-for-trade, social cohesion, better partnership in their technologic advances in their existing GVCs) constitute the best option they could get in comparison with the two other global fabrics and the kind of alternative agreements they might offer. For the EU facing stagnant domestic economies and too low productivity development, accessing to a deeper integrated market of 600 million persons and benefitting from complementary position of CELAC economies in GVCs as well as a platform towards the Pacific Rim, represent also the best option for consolidating the European competitiveness in the global economy while making stronger their best geo-political allied countries.

Such a strategy is not a naïve cooperative proposal but a very realistic combination of mutual interests based upon complementarities for resisting to third power competitiveness and the urgent needs to make compatible the regulation implications of the competition between mega regional negotiations. These challenges cannot be meet alone, neither for CELAC nor for the EU. What really makes the difference favorable to a CELAC-EU strategic partnership for GVCs upgrading is the balanced dialogue provided by the Summit Diplomacy for focusing EU cooperation tools and budgetary resources upon a common GVCs strategy for exploiting complementarities and upgrading international insertions. This target must become the top priority for giving an operational content to the bi-regional Strategic Alliance.

Belgium, with inner faculty for finding compromise and its experiences as a mixture of Germanic and Latin cultures, is ideally placed in the present diplomatic game between the EU and the CELAC for triggering a new dynamics in the Summit Diplomacy with a pragmatic “Belgian Plan” for decentralizing and broadening the preparation of the Summits. By gathering support from a large coalition of small and medium size EU and CELAC Member States, Belgian Diplomacy could propose a new bottom-up method able to activate informal regional and bi-regional networks of national administrations, experts, and firms. These free networks will trigger a powerful participation game, stimulating direct exchanges of ideas, generating synergies across the Atlantic that policymakers could select in a cooperative competition for identifying a concrete content for the Strategic Alliance between the two regions. The Belgian Plan for activating the preparation of the Brussels Summit of June 2015 should focus upon using these networks for dealing in priority with the issue of upgrading both regions’ insertion to global economy.

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