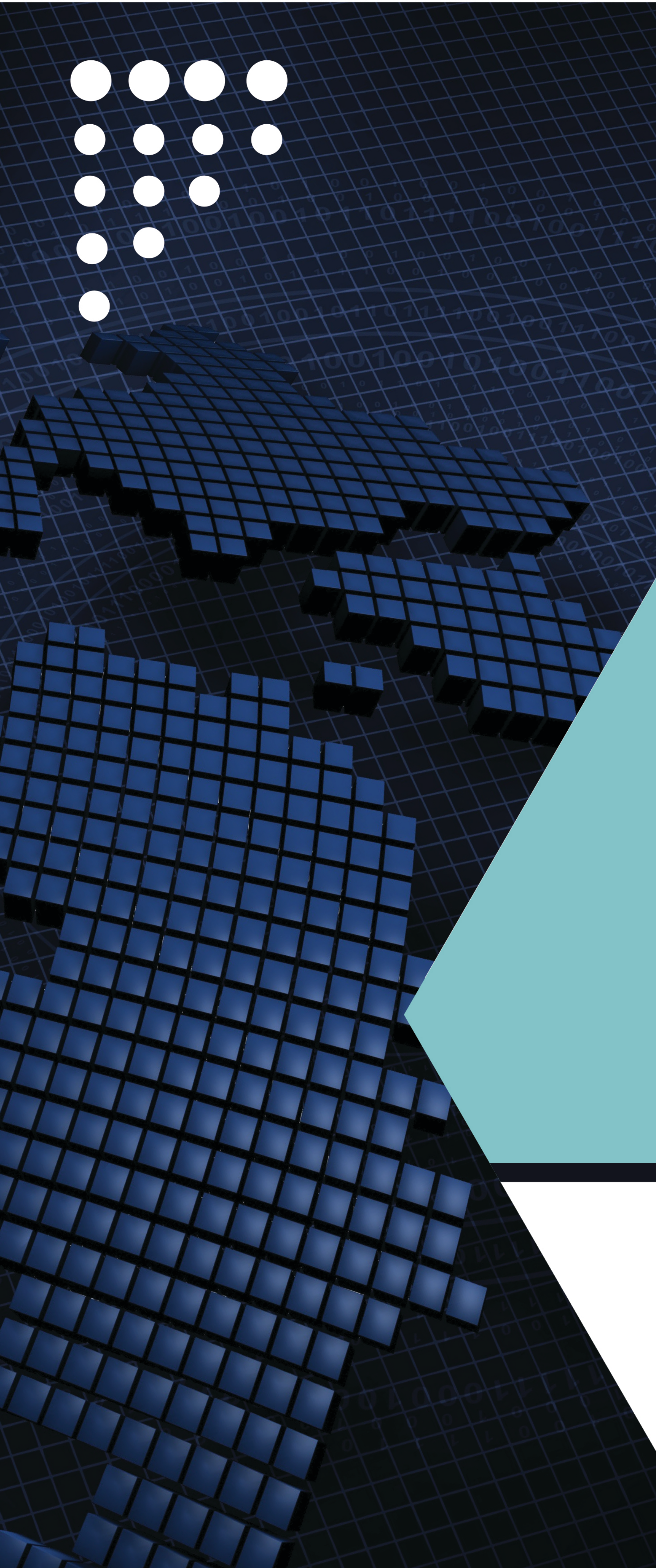

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Chapter 16

Latin America—Facing the Challenges of the Post-pandemic Era

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Introduction

The dramatic global impact of COVID-19 in the economy with negative implications on the quality of life of the population and the stability of democratic institutions is indicative that the world is confronting a dynamic process of change, where the technological and institutional transformations generated by the fourth Industrial Revolution have accelerated the widening of economic and social gaps, intensified nationalistic attitudes and racial conflicts, as well as tensions among the main global powers. Global leaders have scrutinized and even attacked globalization and multilateralism in recent years. This is particularly evident for leaders of countries that were the founders, promoters and defenders of open markets, free trade, integration and multilateralism. In fact, international relations have moved from a cooperative spirit to a competitive one, weakening multilateral institutions and regional integration mechanisms. A clear illustration of the change in the global geopolitical scenario is the tension and growing rivalry between the United States and China.

Considering future scenarios is implicit in the challenging megatrends identified in this book; it is urgent that leaders around the world undertake a profound process of responsible reflection on the importance of designing and implementing renewed long-term holistic strategies at the global, regional and national levels, that respond to the trends and realities of the existing new era. With this purpose in mind, strengthening multilateralism becomes, no doubt, a fundamental instrument to restore a genuine and constructive international collaborative atmosphere, consistent with world peace and genuine progress for most of the population.

Latin America in the Global Scenario

From a regional perspective, Latin America is an interesting case to be analysed, not only because it has withstood some of the hardest impacts of COVID-19, imperilling both its health and its development in the 2019–21 period but for the fact that it has lost relative importance at the international level. In fact, considered the most successful developing region of the world in the first half of the twentieth century, it has fallen behind in recent decades; a victim of the so-called ‘mid income trap’, the phenomenon of developing economies getting stuck at a certain level of income. In this regard, even before measuring the dramatic negative impact of COVID-19, indicators clearly show that the region has diminished its relative importance in comparison to the industrialized countries of the world and the successful Asian emerging economies, as highlighted below (WBG, IMF and CEPAL 2021).

- Average GDP growth of Latin America in the 1961–2019 period was 3.6 per cent compared to 8.1 per cent and 7.4 per cent of China and South Korea in the same period. By the same token, while Latin America had an average rate of growth of 2.36 per cent in the 2000–18 period, the Asian Emerging Countries had an average rate of growth of 7.36 per cent.

- Because of low and volatile rates of growth compared to other dynamic emerging regions, Latin America has stagnated in a 5–6 per cent range of global economic output since 1960. By comparison, while China's GDP represented 62 per cent of Latin America's GDP in 1960, it was three times higher than Latin America's GDP in 2020.
- In purchasing parity terms (PPP), per capita GDP of Latin America compared to the United States has remained in the 23–26 per cent range in the last five decades. At the same time, while Latin America's per capita GDP was four times higher than China's in the early sixties, it was 14 per cent lower than China's in 2020. A more dramatic reversal corresponds to South Korea, since its per capita GDP has moved from being three and a half times lower than Latin America's per capita GDP in 1960, to two and one-third times higher than Latin America's in 2020.
- The participation of Latin America in world trade has been reduced from 11 per cent to less than 6 per cent in the period between 1950–2020. By comparison, China's participation in world trade has increased from 1 per cent in 1950 to 14 per cent in 2020.

The Impact of COVID-19 in Latin America

As was mentioned before, Latin America, is the region most severely hit by COVID-19. With 8 per cent of the world population, contagions and diseases in the region represented 28 per cent and 34 per cent of the world totals in 2020. Furthermore, in 2020, the region had a negative rate of GDP growth of 6.4 per cent, the most drastic reduction in output compared to all regions in the world. Notwithstanding a rebound of 6.7 per cent in 2021, projections for 2022 and 2023 indicate rates of GDP growth of 2.6 per cent and 2.7 per cent respectively, which are lower than the rates projected for most of the regions in the world (World Bank 2022). According to CEPAL, in addition to the closure of business and the increment of unemployment and informality, a worrisome evolution in the last three years is the increment of 23 million people in the extreme poverty category, which represents 13.8 per cent of the total population of Latin America (ECLACL 2021).

Structural Factors Affecting Latin America

In order to have an adequate analytical platform to project the future, it is fundamental to go beyond the pandemic's negative impact and objectively recognize the main factors that have influenced the region's mediocre and volatile economic and social performance in the last six decades. For this purpose, the following six factors should be highlighted (WBG, IMF and CEPAL 2021).

Export Concentration in Raw Materials and Low Technology Products

The lower and volatile rates of growth of Latin America compared to other successful emerging regions can be explained, in part, by the fact that most of its countries, have a high dependence on the production and export of raw materials and low technology-based manufactures. Exports in the region, apart from Mexico, which has a relative low participation in commodities (11 per cent), are characterized by a high concentration in commodity exports (35 per cent). In

South America, with 50 per cent of total regional exports, commodity exports represented over 55 per cent of the total in 2017. At the same time, Latin America has a very low level of intra-regional trade (17 per cent compared to 38 per cent in Asia and above 60 per cent in Europe).

Because of the traditional volatility of international commodity prices, economic performance in Latin America has been closely tied up to the continuous changes of those prices. While high commodity prices have been the catalysts of growth and social improvements in a context of macroeconomic stability, low prices have been the trigger to generate high inflation, fiscal and monetary imbalances and excessive external debt. An additional negative factor has been the insufficient efforts made by the region to accelerate a process of productive and technological transformation and export diversification that would generate higher value added.

All these factors have forced countries to periodically adopt severe adjustment programs to re-establish macroeconomic equilibrium, with the consequent recurrent periods of negative or low growth, unemployment and negative social and political effects.

Low Savings and Investment Ratios

In the 2000–16 period, Latin America had an average internal savings ratio of 19 per cent in relation to GDP (savings of governments, enterprises and households). This coefficient compares to 43.3 per cent in emerging Asia. By the same token, total investment (public and private) was on average, 21.9 per cent of GDP in Latin America, compared to 42 per cent in Emerging Asia, in the same period.

Insufficient Productivity Growth

Total factor productivity (TFP) average growth in Latin America has had a marginal rate of 1 per cent growth in the 1960–2019 period compared to 5 per cent in China and 3.5 per cent in Eastern Asia and the Pacific. Similarly, in the 2000–18 period, Latin America's average was 0.33 per cent compared to 2.93 per cent in all emerging and developing countries and 4.0 per cent in emerging Asia.

Low Competitiveness 4.0 Index

The 2019 World Economic Forum Competitiveness 4.0 rankings (WEF 2019) indicate that out of 142 countries included in the survey, Latin America ranked on average, at position 82. Only two countries were below position 50 (Chile 33 and Mexico 48) and eight countries were above position 90. Furthermore, in the twelve pillars assessing competitiveness, that include economic, infrastructure, technology, innovation, education, health, market and institutional criteria, out of a possible maximum 100 per cent performance index for each pillar, the average for all pillars in Latin America was 56.8 per cent, compared to 71.2 per cent in Europe and North America and 69.9 per cent in Eastern Asia.

Wealth and Income Disparities

As was mentioned previously, notwithstanding the substantial reduction in the levels of poverty and extreme poverty as well as the considerable improvement in social indicators in the last three decades, Latin America still presents levels of poverty and extreme poverty above 30 per cent and 10 per cent of the population, respectively. In terms of income distribution, Latin America presents the least favourable indicators worldwide. In fact, the average GINI coefficient in 2019 was 0.48 for Latin America compared with the OECD countries average of 0.33, 0.42 in the Asian developing countries and 0.45 in Sub-Saharan Africa.

A Fragile and Unstable Institutional Framework

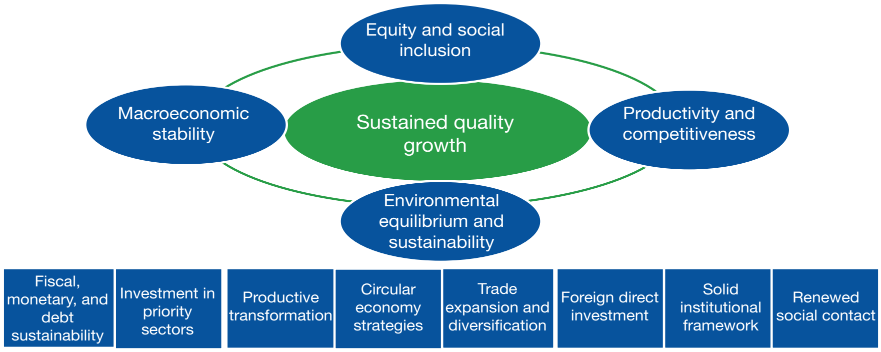
The recurrent political instability and institutional weaknesses observed in Latin America in the last six decades, characterized by dogmatic extreme positions of both democratic and autocratic governments—from the Left or the Right—on issues such as the definition of priority sectors, the role of the state and the private sector, the relevance of foreign investment and the definition of key areas and policies in international relations and regional integration. The lack of continuity and consistency in most countries of the region has been, no doubt, an important obstacle to stimulating the process of development and to close the prevailing economic and social gaps. An additional negative factor has been the high level of corruption that has seriously affected the stability of governments to such an extreme that many heads of State were impeached or forced to resign and many of them, including high-level members of their administrations, are or have been in prison.

The Road Towards a Renewed Long-term Development Strategy

Considering the structural weaknesses and bottlenecks described in the preceding sections and the world's geopolitical, economic, social and environmental scenario generated by the fourth Industrial Revolution and the pandemic, it is crucial that countries of Latin America, recognize that in order to promote actions to overcome those obstacles, it is imperative and unavoidable to make some necessary institutional adjustments. This will provide the platform to advance in political dialogues conducive to a negotiated, pragmatic and non-dogmatic consensus on the nature of the fundamental pillars of a long-term sustainable development strategy. For this purpose, the main political actors and representative sectors of society should be aware that non-dogmatic and flexible positions are required.

The following scheme illustrates the holistic approach required to design a sustainable long-term strategy of development (Figure 16.1). In essence, it implies linking economic, social and environmental objectives, sectors, and priorities in an integral and comprehensive way. This

Figure 16.1 A holistic approach for development



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avoids the analysis of issues, challenges, and priorities in an individual and isolated way, as is common practice, not only in Latin America but at the international level. Cases in point are the ambitious goals (SDGs) in reduction of poverty, hunger and other social and environmental issues set for 2030 in the United Nations Sustainable Development Agreement signed in Paris in 2015 and ratified in 2017 by over 170 countries. In fact, there is no clear linkage between the social and environmental goals to be accomplished by 2030 and the feasibility of counting on the necessary financial resources and institutional mechanisms that would be required.

A Holistic Approach for Development

Main Priorities

A key element in the suggested holistic strategy is the urgency for the region to implement policy and institutional actions that, in addition to controlling COVID-19 in the immediate future, proceed to design a solid-long term development strategy that would accelerate the transition from a traditional comparative advantage model, highly dependent on the production and export of raw materials and low technology, to a model of dynamic comparative and competitive advantage. This implies the productive transformation of the economy triggered by technology, digitalization, innovation and solid principles of environmental sustainability. The central idea is to develop sectors and competitive activities that would have the capacity to generate relevant value added and insert the region to international production and trade value chains.

With this purpose in mind, the region should give high priority to the following key areas:

Control of COVID-19

Governments of the region, as governments around the world, will have to continue financing the necessary actions to control the pandemic. This implies the temporary generation of fiscal deficits, monetary expansions and public internal and external debt. Access to multilateral and bilateral financing with favourable long-term conditions, becomes a fundamental requirement for successfully accomplishing the following short- and medium-term objectives:

- Speed up vaccinations, particularly in the rural areas;
- Expedite universal access to vaccines and medicine;
- Strengthen logistic for emergencies and vaccination campaigns;
- Improve hospital facilities and provide the necessary medical equipment;
- Compensate unemployed and more seriously impacted social sectors.

Macroeconomic Equilibrium and Financial Stability

Considering the delicate and risky macroeconomic scenario generated by COVID-19 that might jeopardize the implementation of a successful long-term development strategy, governments of the region must adopt progressive coherent actions in the fiscal, monetary, exchange rate, debt and institutional areas to re-establish macroeconomic equilibrium, in a maximum period of two to three years. The preservation of sound and stable financial systems is an important component of this effort. The IMF, World Bank, Inter-American Development Bank, CAF-Development Bank of Latin America and other regional and sub-regional multilateral financial institutions can play very important technical and financial roles in this process.

Product Transformation and Trade Expansion

For Latin America to thrive, it will need to accelerate the transition toward a higher value-added paradigm. This implies an effective process of productive transformation that would expand natural resource manufactures and other medium- and high-technology exports, not only to traditional markets but also to new destinations.

As part of this strategy, intra-regional trade should be expanded to serve as a catalytic vehicle to support small- and medium sized enterprises that produce low and medium technology goods and services. This would make it possible to insert the region in value chains with a global perspective.

The decoupling of the USA–China in recent years and the pandemic-related acceleration of the digitalization of business, is an important example of a new window of opportunity for Latin America to substitute some Asian countries as the main suppliers for USA by near shoring economic activity for better regional coordination under changing production and supply dynamics. Unfortunately, Latin America, as the best positioned region in the world, is the least prepared to turn this moment to its advantage.

In terms of global production and trade value chains (GVC), Mexico and Costa Rica's experiences in recent decades illustrate two different approaches that should be taken as reference for the future (García and Méndez 2021). Mexico, as part of the trade agreements with the USA and Canada (UMCA and its predecessor NAFTA) has stirred its productive and trade strategy fundamentally to the automotive industry, following a more traditional labour-intensive productive process that is not taking full advantage of the opportunities implicit in the new digital era. On the contrary, Costa Rica has followed a strategy that connects much better with the realities of the fourth Industrial Revolution. In fact, it started by becoming a hub of electronic assembly and innovation after 1996, when it won a world competition to host INTEL's semiconductor operations by offering qualified human resources, tax incentives and stable rules of the game. One step further, in 2014, Intel moved assembly and testing to Asia, leaving design and engineering in Costa Rica, repositioning it up the value chain by increasing domestic value added to exports, raising average wages, productivity and linkages to innovation and expertise spillover to other sectors. This is, indeed, the approach that should be taken by Latin America in the future.

Infrastructure and Logistics

Latin America suffers from an important gap in economic and social infrastructure. On average, it invests around 3 per cent of GDP in this sector, compared to over 7 per cent in Asian emerging countries. Considering the key role of infrastructure in stimulating development, it is critical for the region to at least duplicate the level of investment in infrastructure. This effort requires the coordinated participation of both the public and private sectors and the support of multilateral and bilateral institutions, capital markets, wealth funds and other relevant actors at the international level. The introduction of innovative financial instruments, that go beyond the more traditional forms of financing, is something that must be stimulated.

The definition of sectoral and individual project priorities, the elaboration of comprehensive feasibility and design studies, and the transparent procurement and financing mechanisms, are elements that are necessary to ensure a positive impact of infrastructure in development. Furthermore, care must be taken to ensure that in the process of selection and implementation of specific projects, not only in infrastructure but in all sectors, a holistic appraisal methodology is applied. This means that starting at the pre-feasibility and feasibility stages, technical, financial, economic, social, environmental and institutional aspects are considered simultaneously. Particular attention must be given to the early evaluation of the environmental impact of alternative technical options so that the one chosen is coherent with the sound principles of sustainability.

In logistics, priority must be given to solve some critical administrative bottlenecks, especially those related to the existing high freight and duty costs and cumbersome administrative procedures. With this objective in mind, countries should make the necessary corrections to create an efficient and friendly administrative platform that would facilitate trade.

Technology and Digital Platforms

Investment in the creation, expansion and strengthening of information and communication technologies (ITC) and digital platforms, is a key component of the strategic approach required for Latin America to accelerate the process of productive transformation to facilitate the transition from the prevailing comparative advantage model—anchored in the production and export of raw materials—to a model of competitive advantage not so dependent on low salaries and other labour costs. It is also necessary to incorporate technological and logistic systems that are compatible with the principles of environmental sustainability, as those contemplated in circular economy processes.

Education and Skills

The weak link between the abilities demanded by potential employers and the actual skills of workers looking for a job, is an obstacle for the insertion of young generations in the labour market and clearly a factor that introduces a high degree of uncertainty around job stability at firms in many sectors.

Looking ahead, it will be necessary for countries to revolutionize the human resource, education and training systems in order to adapt to the demands of the new era. The strategy should be to go beyond the traditional educational framework of universities and technical schools. This implies implementing innovative schemes of continuous specialization and training, both at formal educational institutions and at the workplace itself. This change would have the positive effect of creating a qualified labour force, capable of responding to the profound transformations that are taking place in the productive, logistics and distribution processes.

Reduction of Greenhouse Carbon Emissions

The continuous rise in temperature worldwide is affecting all aspects of human life. Latin America, with abundant fossil energy resources—oil, gas and carbon—and rich in tropical forests, must act responsibly to advance in the reduction of greenhouse carbon emissions, as agreed at the United Nations Sustainable Development Summit in Paris in 2015 and in the Climate Change Summit that took place in Glasgow in 2021.

To this effect, concrete actions must be taken to transit to a renewable energy matrix that would substitute fossil-generated energy with hydroelectricity, renewable natural gas (RNG) and wind and solar panel energy systems. Similarly, deforestation—that is advancing in a disorderly manner—must be managed and regulated by governments in a way that is consistent with sound environmental principles. Priority should also be assigned to the introduction of circular economy technologies and practices in production and distribution processes.

Regional Integration and Cooperation

If countries in the region take the necessary actions to increase quality investment, accelerate productive and technological transformation and advance in renewed bilateral and regional trade negotiations, it would be possible to diversify exports, both in products and destinies. In this scenario, regional integration is, no doubt, an important instrument to increase intra-regional trade and to insert the region into production and trade value chains at the hemispheric and global levels. This approach has the additional benefit of opening opportunities for small- and medium-sized firms to participate in international production and trade schemes and contribute effectively to employment creation and other development externalities.

With this purpose in mind, now is the time to restore the excellent regional cooperation attitude that existed during the last decade of the twentieth century and the first one of this millennium. That positive scenario permitted advancing in the consolidation of workable cooperation schemes in the region.

An example of this trend is the high level of cooperation that was accomplished in South America between the two relevant sub-regional groups at that time—the Andean Community and Mercosur. In this context, the South American Infrastructure Integration Program (IRSA), launched in 2001 in Brasilia during the first Summit of Heads of State of South America, was successfully implemented in the first decade of this century with the main technical and financial support of CAF-Development Bank of Latin America and the Inter-American Development Bank (IDB). Other positive events that should be highlighted are the creation of the Union of South American Countries (UNASUR) and, on a broader regional geographic scenario (South America, Central America, Mexico and the Caribbean), the founding of the Community of Latin American and Caribbean States (CELAC).

All these events illustrate what is possible to accomplish when regional leaders have the will and non-dogmatic attitude that facilitates the construction of regional mechanisms, independently of their political and ideological differences. Unfortunately, this constructive spirit has been lost in recent years with the consequence of weakening these institutions and trying, instead, to substitute them with new institutions and mechanisms, integrated by group of countries, based on ideology. The Bolivarian Alliance for the Peoples of Our America (ALBA), the Forum for the Progress of South America (PROSUR), the Group of Lima and the Group of Puebla are specific examples of this trend. The consequence has been deepening regional fragmentation and the consequent loss of relevance of the region in the global scenario.

Thinking in terms of the future, it must be recognized that restoring the friendly and cooperative attitude of the late nineties and first decade of this millennium is an essential condition to re-launch viable regional integration and cooperation mechanisms. This is, no doubt, one of the preconditions for Latin America to regain a relevant and unified voice internationally, and to avoid being affected by the tensions between China and the United States. In this regard, it is of the utmost importance for the region to preserve a balanced and prudent geopolitical and economic relation with the main world powers.

External Financing and Direct Foreign Investment

Access to diverse sources of external financing and direct investment is crucial, considering the relatively low internal savings capacity of Latin America (below 20 per cent of GDP and reduced to below a 15 per cent average because of the pandemic), compared to a minimum investment ratio of 25 per cent of GDP that is required to sustain a reasonable and stable rate of GDP growth above 5 per cent to 6 per cent. These rates are necessary to reduce and eventually close the existing economic and social gaps that separate the region from the advanced and more dynamic emerging economies of the world.

To move in that direction, countries must have a permanent and constructive non-ideological relationship with the International Monetary Fund (IMF), the World Bank Group, the Inter-American Development Bank (IDB), CAF-Development Bank of Latin America, the other sub-regional financial institutions, the bilateral mechanisms worldwide and with the international capital markets. The role of the multilateral financial institutions is quite relevant, not only for the long- and medium-term financial resources they can provide to the region at favourable terms, but for the catalytic role they can play in attracting additional resources from bilateral and private financial sector institutions, international capital markets, wealth funds and other private investors. This catalytic role is possible thanks to the strict criteria applied by multilateral financial institutions in project appraisal, follow-up during the implementation phase and subsequent ex post evaluation to measure objectively the holistic impact of the financed programs and projects. Of special relevance are the transparent and competitive procurement and bidding procedures applied by these institutions.

It is also quite important that countries make the necessary efforts to establish and maintain adequate ratings, investment grade or close to it, from the main international rating agencies (Standard and Poor's and Moody's and Fitch), to ensure competitive access to international capital markets.

Finally, direct foreign investment is an area that deserves special attention not only for the financial resources it can bring to the region, but for the relevant role it can play in productive transformation, technological innovation, logistics and improvement of management and marketing practices. Moreover, it can be an important trigger to expand and diversify exports and stimulate a more relevant presence of the region internationally. China, an example of successfully attracting foreign investment in the last fifty years, is clear evidence of the remarkable positive impact foreign investment can have on a country's development.

It is required that countries maintain an efficient and transparent institutional framework with clear and long-lasting policies and procedures in order to attract good quality foreign investment.

Strong Democratic Institutions

Evidence shows that historically, Latin America has had a relatively weak and unstable institutional framework. It is of the utmost importance for the region to undertake the necessary reforms and policy actions to correct, this weakness, considering that it has been one of the main causes for the region falling behind, compared to other successful regions of the world.

To move in the right direction, the reforms should include measures that ensure the effective adoption of the following democratic principles:

- Transparent democratic elections;
- Limits on terms for heads of State;

- Separation of powers between the executive, legislative and judiciary branches;
- Clear definition of roles and responsibilities of the public and private sectors;
- Selection of public servants based on merit and not on political affiliations;
- Fair and stable policies for the attraction of foreign investment;
- Strict policies, norms and sanctions to fight corruption.

Concluding Remarks

The analysis presented in this chapter corroborates that economic and social disparities worldwide are one of the main causes of the political, racial and migration tensions and of the weakening of democracy, particularly in Latin America. This is a clear message to political leaders on the urgency of undertaking the necessary reforms to consolidate a solid and transparent political and institutional setting as a condition to overcome the structural bottlenecks responsible for the relatively mediocre performance of the region in recent decades. In this regard, triumphalism, dogmatism, revisionism, corruption and weak democratic institutions are some of the critical issues that must be corrected in order to facilitate the implementation of long-term strategies, that go beyond the four- to five-year electoral cycles and, in this way, become instrumental in reversing past negative trends and opening the door for a positive and stable regional future.

An important condition for this to happen is for leaders of the region to recognize the importance of renewing the existing social contract. This means, in essence, creating mechanisms of dialogue between the main representative sectors of society—government, political parties, private sector, labour and civil society—to establish a constructive atmosphere that would permit setting principles and norms to define holistic strategies and priorities that are consistent with economic, social and environmental sustainability criteria. Transparency and the adherence to ethical values are critical conditions to ensure satisfactory results in this process.

The strengthening of multilateralism and, more concretely, the world and regional monetary and developmental multilateral institutions is, no doubt, another high priority area that demands urgent actions at the global and regional levels.