Informe Elcano

Why does Latin America matter?

Carlos Malamud, José Juan Ruiz &
Ernesto Talvi (eds.)

Informe 32 | June 2023

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Real Instituto Elcano - Madrid - España
www.realinstitutoelcano.org

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C/ Príncipe de Vergara, 51
28006 Madrid
www.realinstitutoelcano.org

ISSN: 1698-885X
Depósito Legal: M-53423-2004

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EXECUTIVE SUMMARY

EXECUTIVE SUMMARY*

Over the past six months, analysts at the Elcano Royal Institute have consulted and interviewed experts from think tanks, academia, the corporate sector and national governments. In doing so, and with the inevitable caveats and qualifications, we have found that the most prevalent narrative in Europe with regards to Latin America consists of four basic elements:

1. In the economic sphere, the widely held view is that the region has once again squandered its opportunities to take a significant leap forward in development due to its tendency to suffer frequent and deep macroeconomic crises, induced by an unsustainable combination of monetary, exchange rate and fiscal policies.

2. In the political sphere, there is a perception of problems of political instability and poor quality of democratic institutions, combined with a thinly-veiled pessimism with respect to the prospects for democratic regression, which many believe is occurring in the region as a result of political polarisation, the radicalism of some governments, and both left- and right-wing populisms.

3. In the geopolitical sphere, there is a degree of defeatism, deriving from the belief that economic failure and political volatility have led both Europe and the US to wash their hands of the region, opening the door to China, which is –or is very close to becoming– the hegemonic power in the region.

4. Finally, the view is that the companies –particularly Spanish ones– which backed the region in the 1990s, have ceased to view the region as a priority and have sold or at least cut back on their investments in Latin American countries, discouraged by the destruction in value for shareholders.

This report by the Elcano Royal Institute sets out and analyses why these four beliefs are prejudices are not backed by data.

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The report also drew on the work of analysts at other institutions: Juan Carlos Berganza, Rodolfo G. Campos and Jacopo Timini at the Bank of Spain; Alejandro Fiorito at Johns Hopkins University SAIS; and Antoni Estevadeordal and Alejandro Werner at the Georgetown Americas Institute. The opinions expressed in this report are not necessarily endorsed by the institutions to which they are affiliated.
María Dolores de Azategui and Miguel de Avendaño were in charge of the editorial process.
The report's editors, Carlos Malamud, José Juan Ruiz and Ernesto Talvi, would like to express their gratitude to all of them.

The report is not intended to provide a conventional analysis of Latin America. Instead, our objective is to offer a rigorous, fact-based analysis of these economic, political and geostrategic accounts, in an attempt to shift the debate from preconceptions to evidence.

Myth vs reality

The aim here is not to establish a 'new' account, one that is more palatable and optimistic, but rather to alert those who are interested in the strategic, economic or political role of Latin America with regard to the need to challenge the prevailing wisdom.

If focusing on the reality rather than the myth is almost always good advice when seeking to understand the world, in the case of Latin America it is a prerequisite if we are to have a balanced view of the only emerging region that is seeking to pursue a democratic path to development. Our contribution is to show that, in Latin America, the facts challenge the generally accepted narrative.

Is Latin America a political disaster?

The dominant view is that the economic stagnation of the past decade has led people to become disenchanted with democracy, to lose faith with established parties and the traditional political elite, and has driven protest movements and protest voting, leading to the fragmentation and polarisation of the political system, and undermining governability.

This is a partial and biased vision. When political events in Latin America are seen in the context of global trends, what we really see is that the continent is not an exception. Moreover, there are cyclical elements at play in the region's political dynamic, linked to the economic cycle, which are not necessarily permanent in nature.

The evidence suggests that democracy has been consolidated throughout almost the entire region, and that a whole generation of Latin Americans has grown up seeing elections as the only legitimate way to choose a government. In terms of democratic development and respect for human rights, Latin America occupies the pole position among emerging regions.

There is still a clear majority support for democracy as a political system, with 67% of people believing that 'democracy may have problems but is the best system of government'. Moreover, while political alternatives on both the left and right have radicalised political discourse, this is not reflected in how voters perceive their own

political orientation: 68% still claim to be in the centre or on the centre left or centre right.

These four elements –the global and cyclical nature of political setbacks; the prevalence of democracy; solid majority support for democracy; and a majority of voters who identify with the centre– suggest that the setbacks of recent years are situational rather than structural and could be reversed if the global context changes or if the region's economy starts to grow again.

With respect to the rule of law, Latin America is no different from other emerging regions. If we exclude countries in the region that are dictatorships –namely, Cuba, Venezuela and Nicaragua– or autocracies, Latin American countries are in the top third of global ratings with respect to the rule of law.

Is Latin America an economic disaster?

The region has made significant progress in macroeconomic management over the past 20 years, and a sizeable group of Latin American countries has achieved impressive macroeconomic results.

A whole generation has grown up with low and relatively stable inflation, reasonably sustainable public finances, and banking regulation and supervision that means the region now has solid financial systems.

The most symbolic achievement is arguably the reduction in the frequency of balance of payment, debt and financial crises: from an average of four per year from the mid-1970s until the early 2000s, the equivalent figure since then has been an average of less than one crisis per year.

As a consequence of this improved macroeconomic stability, Latin America has gone from being a protagonist –one in every three global crises occurred in the region between 1974 and 2003– to playing only a supporting role: only one of every six global crises occurred in Latin America.

It is true that, during the first two decades of the 21st century, Latin America has not achieved significant progress in the process of convergence with the levels of per capita income in developed countries. But nor have the majority of emerging countries. In the almost three quarters of a century from 1945 to 2018, the jump to per capita income levels of developed countries[1] has only been achieved by 30

1 In 1945, of the 169 economies considered by Angus Maddison, only 39 (23%) had a per capita income greater than 5,000 constant dollars. In 2018 the number of countries with an income greater than US$20,000 was 59. This increase consisted of 30 countries that had a per capita income more than 30% greater than the global average, and 11 countries that were no longer counted among those which had high incomes in 1945. These included Venezuela and Argentina.

countries: four petroleum exporters (Saudi Arabia, Equatorial Guinea, Oman and Bahrain), two countries with a strong tourism sector (Seychelles and Mauritius), two historic European powers that had been destroyed in 1945 after the Second World War (France and Italy), Israel, six Asian tigers (Japan, Korea, Taiwan, Singapore, Malaysia and Hong Kong), 14 European countries (including Spain, Portugal and Greece), and Puerto Rico and Panama.

During the same period, 11 countries classed as high-income lost this classification. Nine were former Soviet republics and two were Latin American: Argentina and Venezuela.

The data show that it is rare for a country to make the jump to income levels associated with development, unless it has been able to take a shortcut (generally speaking, the exploitation of natural resources, a new industry such as tourism or rapid recovery following a historically anomalous shock). This is the reality which underlies the fact that, for the global economy, the income level in 1945 accounted for 70% of the income in 2018. Convergence with the per capita income levels of wealthy countries, in recent world history, is more of an aspiration than a realistic political and economic target.

In addition to the retreat of Venezuela and Argentina, it is clear that Latin American economies have grown little in relative terms: 11 countries (more than half) are further away from achieving real convergence with developed countries, and only seven (Colombia, Ecuador, Mexico, Costa Rica, Brazil, Panama and the Dominican Republic, ordered by least to most progress) have reduced the per capita income gap.

In other words, the challenge for Latin America continues to involve reactivating growth. Not only because faster growth would enable convergence but also, fundamentally, because a lack of growth will inevitably lead to redistributive demands that will create other problems and foment social tension.

Our hope is that the clear political, economic and social progress –ignored or silenced by the traditional narrative– has laid the necessary foundations for inclusive, sustainable growth.

Has the EU (and the US) abandoned Latin America?

There is a widespread perception that the EU and the US have turned their backs on Latin America, and that this has created a vacuum which China has been able to fill, making it the dominant player in the region.

However, once again, the facts paint a different picture. To start with, Mexico and Central America are inextricably tied to the US in all dimensions, not just in economic, trade and investment terms, but also in relation to military ties (arms sales) and human connections (migrants, tourists and students).

The reality in South America is different. While China may be a force to be reckoned with in the strictly limited sphere of trade (as a buyer of natural resources and primary products and an exporter of manufactured goods), South America is far more 'European'.

The EU –unlike China– is an important market for high technology products from South America and, by a long way, the largest investor in the region (20 times more than China). The EU is also the largest supplier of military equipment and the preferred destination of tourists, students and migrants from South America.

Have Spanish companies withdrawn from Latin America?

The prevailing narrative states that Spanish companies seized the opportunity posed by the opening up and economic restructuring of Latin America that followed the region's lost decade. Spain capitalised on its close cultural and historic ties and access to cheap and abundant international finance that came with its accession to the European Economic Community (EEC), allowing the country to internationalise and insert itself into global value chains.

The Argentine convertibility crisis, which reminded businesses of the significant risks associated with investing in emerging countries, led to a shift in focus away from Latin America and towards more developed countries.

The central thesis here is that the volatility and low return on initial investment, together with legal uncertainty and poor economic growth, persuaded companies to limit their exposure in a region where it was difficult to generate value for shareholders.

However, the data does not support the hypothesis of a sudden withdrawal of Spanish investment in Latin America, following the 2001-03 crisis. In fact, the opposite occurred. Between 2007 and 2020, of every €100 invested, €30 were allocated to Latin America, €55 to the US and the remainder to other non-EU developed countries. The EU only accounted for 4% of net Spanish foreign direct investment (FDI).

Nor does the evidence corroborate the belief that, in countries with slow growth and that experience intense and frequent macro-financial shocks, shareholder value is systematically destroyed for investing companies. The comparison between

gross yield on investment and the cost of capital shows that Spanish investment in Latin America created value to the tune of an average of 4.8% of capital invested, compared with the 3.5% yield on investment in developed countries.

The erroneous perception of both the sequence of internationalisation (first Latin America, then developed countries) and the waning interest in the region among Spanish companies (which has not occurred) can probably be explained by one of the most interesting features of the second phase of the internationalisation of Spanish investment: while the first phase was based on large-scale acquisitions and participation in tendering processes as part of the privatisation in Latin America, the second has been based on the reinvestment of profits from the first wave of acquisitions.

In other words, Spanish investors have lived up to their promise of being long-term investors, reinvesting a large part –if not all– of their profits.

The Spanish Presidency

The Spanish Presidency of the EU is a new window of opportunity –as in 2002 and 2010– to transform the links between Europe and Latin America into a true strategic alliance.

There are incentives for both parties. The Russian invasion of Ukraine has led to alliances being reformulated. The rise of China and of other aggressive powers such as Russia has upset the international equilibrium, ushering in a new geopolitical scenario.

This reshaping of alliances is leading Europe to look to Latin America as a key partner in its international leadership and promote a world based on multilateralism, democratic values and sustainable social and environmental development, in addition to being a reliable supplier of strategic raw materials.

This will require huge doses of political commitment on both sides: a commitment to continuing and deepening ties and, above all, the institutionalisation of the relationship so that it no longer depends on the stars to align or on Spanish presidencies but that can instead prosper in its own right, with financial and EU backing and bi-regional involvement.

The institutional and political dimension

The new ties must combine bi-regional and bilateral aspects in a flexible manner. The idea would be to establish a block bringing together the EU and the Community

of Latin American and Caribbean States (CELAC) to act in coordination on the international stage, while at the same time strengthening the relationship with certain regional stakeholders.

To maximise the results of diplomatic efforts, the EU-CELAC summits should be backed by strong bilateral initiatives aimed at the countries with the greatest international potential (the three members of the G20: Brazil, Mexico and Argentina), regional importance (Chile, Uruguay, Peru and Colombia) or interest in strengthening ties with the EU.

The recent intensification of the presence of EU authorities and representatives of European governments is a good sign in this regard

An EU-Latin America Trade and Technology Council

Designed as a high-level bilateral forum, an EU-Latin America and Caribbean Trade and Technology Council (EU-LAC TTC) would be an excellent starting point and would provide a unique platform for organising the bilateral relationship between the EU and Latin America and the Caribbean in the search for strategic agreements to meet global challenges.

The spirit of the EU-LAC TTC would be similar to that of existing bodies between the EU and the US or the EU and India. The aim would be to coordinate and cooperate on issues such as energy security, food and water security, digital governance and connectivity, supply chains, clean and ecological energy technologies, migration, crime and transnational terrorism.

A TTC would mark a significant milestone in relations between the EU and Latin America and the Caribbean and would take them to a higher level. It would be a vital mechanism for both regions to deepen their strategic commitment.

A strategic commitment of the first order: the EU-Mercosur agreement

Ratification of the EU-Mercosur agreement is not an end in itself but rather a starting point for a more ambitious project that will serve the strategic interests of the EU and Latin America.

If the EU-Mercosur agreement is completed, the EU will have agreements covering 94% of Latin American GDP, compared with a figure of 44% for the US and 14% for China. This would be a major achievement, as it would make the EU the global power with the strongest presence and the deepest ties with the region.

The EU-Mercosur agreement would also be a springboard for a more ambitious and deeper integration between the EU and Latin America, an objective that has proved to be elusive for decades.

It is part of a very pragmatic focus, which consists of interconnecting the various EU trade agreements with Latin America, for instance, through the mutual accumulation of rules of origin from the different agreements, the harmonisation of standards and regulatory processes, regulations on digital commerce and customs procedures to enable a greater cross-border circulation of goods, services and investments.

Harmonising the agreements between the EU and Latin American countries would create a vast economic space with a population of 1.1 billion and a GDP of over US$22 trillion, similar to that of the US.

The economic impact would be huge. In the trade dimension alone, trade flows between the EU and Latin America would increase by 70% and intra-regional trade in Latin America would rise by 40%, with negligible adverse effects on trade with other geographical regions.

If such an association were to become a reality, it would entail enormous mutual benefits. The economies of the EU and Latin America are complementary. Latin America has vast energy and mineral resources, sun, wind, water, fertile land, the capacity to produce abundant, cheap, clean energy, and organic food on a vast scale. The EU can provide the region with the capital, technology and know-how indispensable to Latin America's development.

The EU-Mercosur agreement is a huge opportunity for both regions to deepen their cooperation and commitment. The circumstances have never been more favourable. The time is now.

THE GEOPOLITICS AND ECONOMICS OF EU-LATIN AMERICA RELATIONS: FACT VS FICTION

THE GEOPOLITICS AND ECONOMICS OF EU-LATIN AMERICA RELATIONS: FACT VS FICTION

1. Latin America as an economic failure: what the data say

Received wisdom in certain European capitals would have us believe that Latin America is an economic failure: a highly volatile region, prone to recurring crises (currency, banking and sovereign debt) and unable to create and sustain convergence towards the levels of income of advanced economies –all in stark contrast to the Asian Tigers–.[2] To paraphrase a famous saying, 'Latin America is the region of the future... and always will be'.[3]

But does this caricature really stand up to the facts?

First and foremost, the region has made significant progress in macroeconomic management over the past 20 years and the results are plain to see.

Secondly, convergence from underdevelopment to development is actually the exception to a rule of a generalised lack of convergence among all emerging economies. Judging the long-term performance of Latin America by the yardstick of the exceptional convergence processes of post-war Japan, Taiwan, Korea, Singapore and Hong Kong is questionable to say the least.

Latin America's biggest challenge is not economic. Nor does it lie in reaching some unrealistic convergence target. It is about delivering sustainable and inclusive growth. Per capita income in the region has been stagnant for a decade. Inevitably, this lack of growth has led to struggles for the distribution of fixed resources, fuelling social tensions and consuming the valuable political energy of Latin American people. As a result, the focus is currently on managing these tensions instead of creating growth.

2 Hong Kong, Singapore, South Korea and Taiwan.
3 The original phrase is attributed to Charles de Gaulle, inspired by the title of Stefan Zweig's book on Brazil.

1.1. Macroeconomic management

This section evaluates the region's progress and improvement in six key aspects of macroeconomic management in the 21st century.

1.1.1. Exchange rate regimes

The currency crises that once plagued Latin American economies have been largely consigned to the past.[4]

Eight of the region's countries currently have flexible exchange rates (Figure 1).[5] A further 10 use soft pegs, while just six have fixed rates or have systems that lack transparency. This contrasts with 1999, when nearly one-third of the region's countries had fixed systems or lacked transparency.

The prevalence of the different exchange rate regimes in Latin America is broadly in line with global trends. The proportion of countries in the region with floating rates, soft pegs or fixed rates is similar to the rest of the world (Figure 2).

4 Here, Latin America refers to the region as a whole, including the Caribbean. Data have been gathered for the 24 countries shown in Chart 1.1 (Argentina, Belize, Bolivia, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Paraguay, Peru, Panama, Suriname, Trinidad and Tobago, Uruguay and Venezuela). Different samples are used in some parts, depending on the availability of data. The sample excludes the small island states of the Caribbean (with GDPs below US$1 billion) and countries for which no data are available, such as Cuba.
5 These countries make up 76% of regional GDP.

Figure 1. Exchange rate regimes, 2021

Figure 2. Distribution of exchange rate regimes, 2021

	Latin America	Rest of the world
	(% of all countries)	
Flexible	33.3	32.8
Soft peg	41.7	48.0
Other	8.3	5.8
Fixed	16.7	12

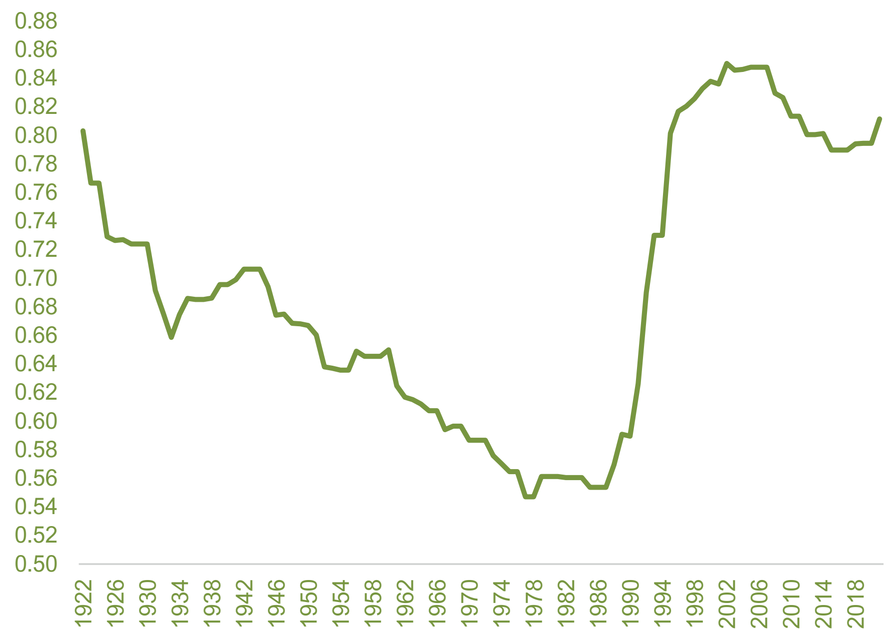
Source: IMF (2021).
Note: 'Flexible' includes floating and free floating systems (depending on the level of intervention in the currency market; in this case generally limited to exceptional circumstances). 'Soft peg' includes (a) crawl-like, where the exchange rate moves within a 2% margin of a trend of at least six months; (b) crawling peg, where parity is fixed to another currency or currencies; and (c) stabilised, where the rate moves within a 2% margin and does not fluctuate for at least six months. 'Other' means the exchange rate model does not meet the criteria for other categories and lacks transparency. 'Fixed' models have a fixed parity or directly adopt a foreign currency.

1.1.2. Central bank independence

The past 30 years have seen a reversal in the loss of central bank independence that dominated the 20th century. Thirteen countries in Latin America currently have independent central banks (Figures 3.1 and 4).[6,7]

Central banks began to win *de facto* operational independence in the 1990s (Figure 4). This was followed by legislation enshrining this progress, consolidating independent monetary policy and the shift away from the monetary financing of fiscal deficits in most countries.[8]

Figure 3.1. Central bank independence over the past century (scale 0-1; 1 = maximum level of independence)



Source: Jácome & Pienknagura (2022) and central banks.

6 These countries make up 79% of regional GDP.
7 Jácome & Pienknagura (2022) and Garriga (2016).
8 Renewed concerns over central bank independence in Latin America underscore the importance of the progress made (see, for instance, Citibank 2022).

Figure 3.2. Central bank independence in 2023[9]

Source: Jácome & Pienknagura (2022) and central banks.

9 *De facto* independence means that it is acknowledged and exercised, regardless of whether legislation exists. For example, Argentina, Bolivia and Venezuela all have legislation on the independence of their central banks, despite the banks not having *de facto* independence. In contrast, while Brazil lacks legislation, its central bank is *de facto* independent. Ecuador and El Salvador both recognise their central banks as independent, despite not having independent currencies and thus less monetary sovereignty. Panama does not have a central bank as such, with the National Bank of Panama performing the functions of a central bank.

Figure 4. Central bank independence criteria (scale 0–1)

	Pre-reform (1980-1989)	**Post-reform** (2021)
Overall score	0.58	0.81
Central bank board	0.39	0.71
Central bank objective	0.29	0.79
Policy formulation	0.71	0.85
Central bank lending	0.7	0.85

Sources: Jácome & Pienknagura (2022) and central banks.
Note: the variable 'central bank board' is defined in terms of: (1) the term of office of the governor; (1) the process for appointing the governor; (3) the term of office of the rest of the board; (4) the process for appointing the rest of the board; (5) government representation on the board; and (6) the process for dismissing board members. 'Central bank objective' refers to the importance given to price and financial system stability and the security of the payments system in the monetary authority mandate. 'Policy formulation' measures central bank independence on monetary policy and the exchange rate. 'Central bank lending' refers to: (1) the capacity to provide advances to the government; (2) the ability to lend on the secondary market; (3) the beneficiaries of central bank lending; (4) the maturity of advances provided by the central bank; and (5) whether the central bank can lend on the primary market.

1.1.3. Inflation targets

In 1998 no countries in Latin American had an explicit inflation target, whereas 11 countries have now adopted this type of regime.[10,11]

Only two countries have monetary aggregate targets, while eight (primarily small and open economies) use an exchange rate anchor (Figure 5).

10 These countries make up 80% of regional GDP.
11 Adoption began with Brazil, Chile and Colombia in 1999, followed by Mexico in 2001, Peru in 2002, Guatemala in 2005, Paraguay in 2011, the Dominican Republic in 2012, Uruguay in 2013, Jamaica in 2017 and Costa Rica in 2018 (see De Gregorio, 2020).

Figure 5. Monetary policy models, 2021

Source: IMF (2021).
Note: an 'inflation-targeting' regime implies the public announcement of an inflation target and an institutional commitment by the monetary authority to achieve it, typically in the medium term. An 'aggregate monetary' model implies the monetary authority aims to achieve a growth target for one of its monetary aggregates (eg, M1 or M2). The 'exchange rate anchor' model implies the monetary authority buys or sells foreign currency to keep the exchange rate at a predetermined level or within a range, such that this variable serves as a nominal anchor and intermediate target for monetary policy. 'Other' implies there is no explicitly established nominal anchor.

1.1.4. Fiscal rules

Fiscal rules first began to be applied in Latin America at the end of the 1990s and the start of the 21st century. Brazil became the first country to adopt a fiscal rule in 1998. However, Chile's structural balance of 2000 is widely regarded as the gold-standard for the region,[12,13] largely due to its institutional design, the country's fiscal surpluses during boom years and its countercyclical policies (unusual not just in Latin America but also more generally in emerging economies).[14]

Chile's fiscal rule has served as an example for other countries in the region, 13 of which currently use fiscal rules in some form or other (Figures 6 and 7).[15]

Figure 6. Adoption of fiscal rules since 1998

12 Brazil adopted a balanced budget rule as part of its constitution and enacted its fiscal responsibility law in 2022 (Pereira, 2016).
13 The rule sets a target of achieving a structural balance. Government budget spending is predicated on the income that would be obtained if the economy were to be performing at full potential and copper and molybdenum prices were at historic averages. These latter components (potential GDP and copper and molybdenum prices) are determined by independent committees (Ffrench Davis, 2016; Gallegos Zuñiga, 2018; and Davoodi *et al.*, 2022).
14 Talvi & Végh (2000).
15 Countries with fiscal rules currently make up 91% of regional GDP.

Figure 7. Types of fiscal rules

	Total	Spending	Balance	Debt
Argentina	1	x	-	-
Brazil	2	x	x	-
Chile	1	-	x	-
Colombia	2	x	x	-
Costa Rica	2	x	x	-
Dominica	2	-	x	x
Ecuador	3	x	x	x
Jamaica	2	-	x	x
Mexico	2	x	x	-
Panama	2	-	x	x
Paraguay	2	x	x	-
Peru	3	x	x	x
Uruguay	2	x	x	-
Countries without fiscal rules	12	Belize, Bolivia, the Dominican Republic, El Salvador, Guatemala, Guyana, Haiti, Honduras, Nicaragua, Suriname, Trinidad and Tobago, Venezuela		

Source: Davoodi *et al*. (2022).
Notes: fiscal rules impose restrictions on fiscal budget aggregates. They can be national, regional or supranational, although in Latin America our focus is on national rules. There are three types of fiscal rules: expenditure or revenue rules (limiting revenue or the use of the fiscal budget); balance rules (which set a fiscal balance target); and debt rules (which establish a debt ceiling or growth limit based on certain factors).

1.1.5. Public debt management

Public debt management has improved significantly in the region, especially in the largest countries of the Southern Cone and the Andean region.[16,17]

Progress has been made in all aspects of debt management, including institutional and governance models, macroeconomic policy coordination, strategies for debt management and sustainability, the availability of data and risk management, and borrowing processes (Figure 8).[18]

16 Chiara & Prats (2022).
17 The countries in these two subregions make up 62% of regional GDP.
18 The only places with weak borrowing processes and debt management and sustainability strategies are the Caribbean, and, to a lesser extent, Central America. The countries of the Southern Cone show some room for improvement on borrowing processes.

Figure 8. Public debt management quality

Subregion	Institutional and governance model	Macroeconomic coordination	Strategy and sustainability	Management and resources	Data and risk management	Borrowing and other activities
Andean region						
Southern Cone						
Central America						
Caribbean						
Average						

Source: Chiara & Prats (2022).
Note: the Andean region includes Bolivia, Colombia and Peru; the Southern Cone includes Argentina, Brazil, Chile, Paraguay and Uruguay; Central America includes Belize, Costa Rica, the Dominican Republic, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua and Panama; the Caribbean region includes the Bahamas, Barbados, Guyana, Jamaica, Suriname and Trinidad & Tobago. Scores are based on the following scale: **0–1** (very low); **1–2** (low: N/A); **2–3** (medium); **3–4** (high); and **4–5** (very high).

1.1.6. Banking regulation and supervision

Seven Latin American countries, including some of the largest (Argentina, Brazil, Chile, Colombia and Mexico) have adopted or are in the process of adopting the Basel III standards (Figures 9 and 10).[19]

The Basel regulatory framework strengthens the supervision of financial systems, sets minimum capital and liquidity requirements, requires stress tests and defines capital buffers that can be used if risks materialise.[20]

Figure 9. Basel standards adoption

19 These countries make up 81% of regional GDP and the vast majority of the region's banking assets.
20 See BIS (2023) and Bank of Spain (2023) for more information. Countercyclical capital buffers are capital requirements that automatically rise during expansion phases to 'curb the growth of systemic risk and bolster institutions' solvency so that they can absorb any losses' and are released during downturns to 'help mitigate the adverse impact of crises on the supply of credit to the real economy'.

Figure 10. Implementation of Basel standards and minimum capital requirements

	Basel regulatory framework	**Minimum capital requirements** (% of total risk-weighted assets)
Argentina	III	8
Bolivia	I	10
Brazil	II	8
Chile	II*	8
Colombia	I*	9
Costa Rica	II*	10
Dominican Republic		
Ecuador	I	9
El Salvador	I	12
Honduras	I	10
Guatemala	I	10
Jamaica	I	10
Mexico	III	8
Nicaragua	II	10
Panama	II*	8
Paraguay	I	12
Peru	II	10
Uruguay	Hybrid	8

Source: Fitch (2022).
Note: countries classed as Basel III include those that have adopted or are in the process of adopting this regulatory framework. Uruguay is recorded as Basel II/Hybrid to reflect its hybrid model, which combines aspects of Basel II and Basel III. The country does not plan to fully adopt Basel III.

1.2. Macroeconomic results

This significant progress on macroeconomic and financial management is reflected in the results that have been achieved and gradually consolidated during the 21st century against a mixed bag of favourable periods interrupted by major shocks.

The century began with the economic stagnation that gripped the region between 1998 and 2003. The period was marked by financial and sovereign debt crises and major economic collapses, Argentina being the most notorious example.

This was followed by the commodity boom and strong capital inflows of 2004-13, ending a decade of prosperity interrupted only by the global financial crisis of 2008-09.

From 2014, much less favourable external conditions saw a return to economic stagnation, which has lasted to the present and has been aggravated by the pandemic.

The region has nonetheless made significant progress on a number of macroeconomic indicators, despite the major fluctuations and challenges posed by the external environment. This section evaluates progress in eight macroeconomic areas during the 21st century.

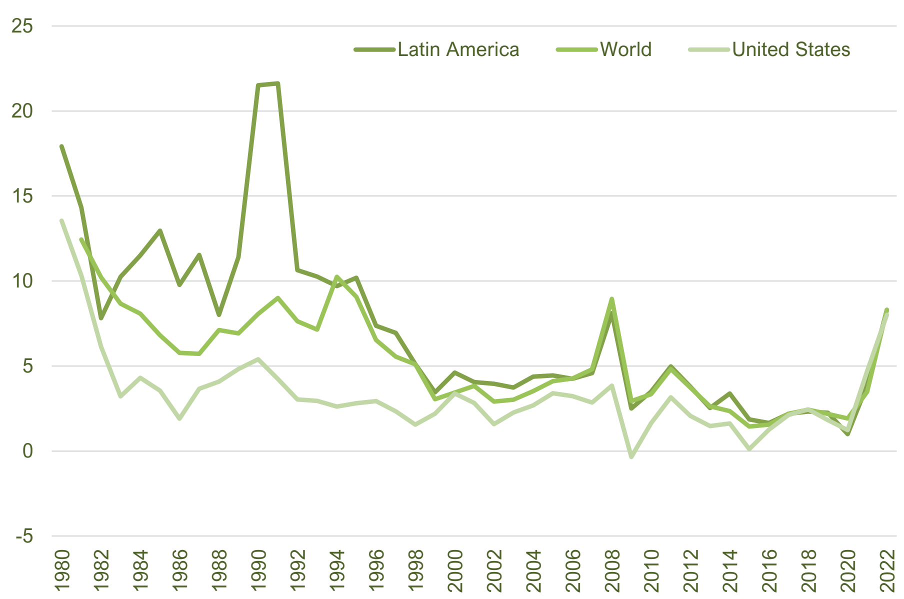
1.2.1. Inflation reduction and convergence

After suffering annual inflation of over 100% in the 1980s and the 1990s, levels have fallen sharply to converge with global and US figures (Figure 11).

The rise in inflation witnessed by the region in the second half of 2021 occurred against the backdrop of higher inflation in the US and EU. However, while many Latin American countries saw double-digit inflation in 2022, central banks are widely acknowledged to have reacted swiftly and decisively, raising rates a year before the US Federal Reserve. As a result, inflation has now started to fall in many Latin American countries.[21]

21 CLAAF (2022).

Figure 11. Weighted annual inflation (%)



Source: World Bank (2023).

1.2.2. Consolidation of fiscal deficits and public debt

Despite major external shocks –the most recent being the pandemic– the IMF forecasts a persistent reduction in fiscal imbalances in Latin America. Alongside Europe and East Asia, it is the only emerging region on track to fiscal consolidation (Figure 12.2).

The persistent moderation of fiscal deficits has led public debt to stabilise at current levels, bringing an end to a decade-old upward trend (Figure 12.2).[22]

22 However, given that levels remain high, the region may require more ambitious fiscal consolidation than envisaged in the IMF forecasts.

Figure 12.1. Fiscal balance (% GDP)

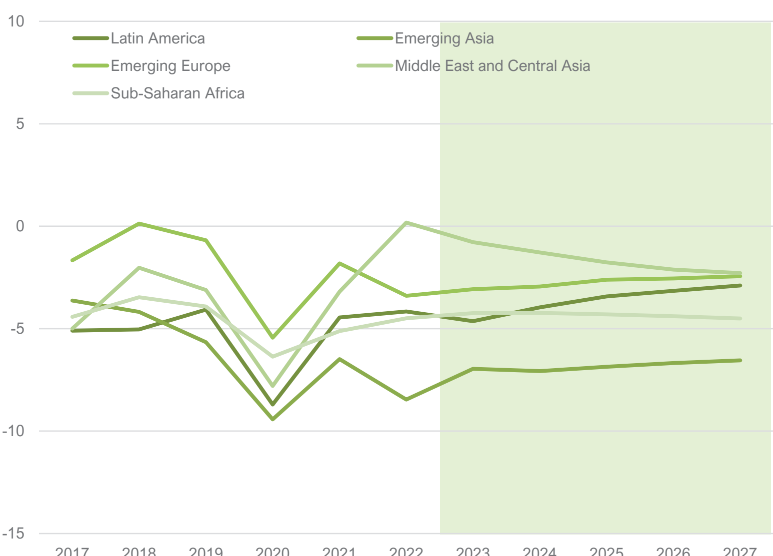
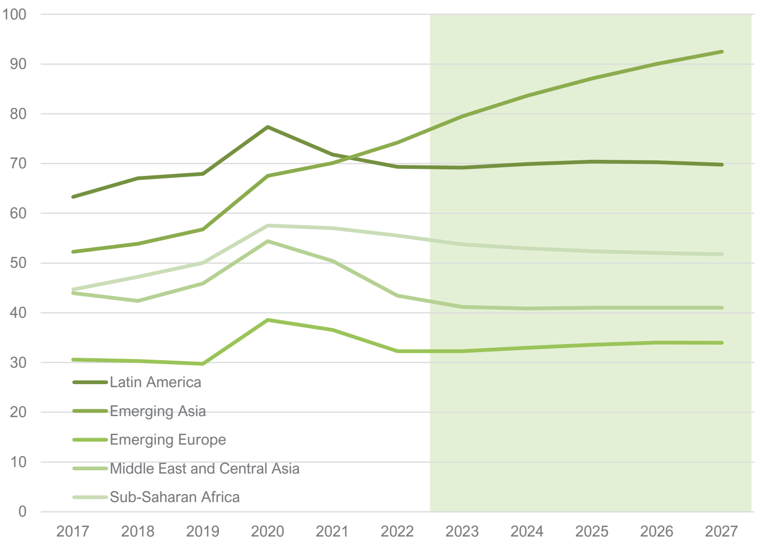


Figure 12.2. Gross public debt (% GDP)



Source: IMF (2022b).
Note: unlike elsewhere, this figure uses the regions of the IMF, not the World Bank. The main difference is in the grouping of the countries of South-East Asia with those of East Asia and the Pacific, and the countries of Central Asia with those of the Middle East, instead of Emerging Europe. This classification does not affect the conclusions.

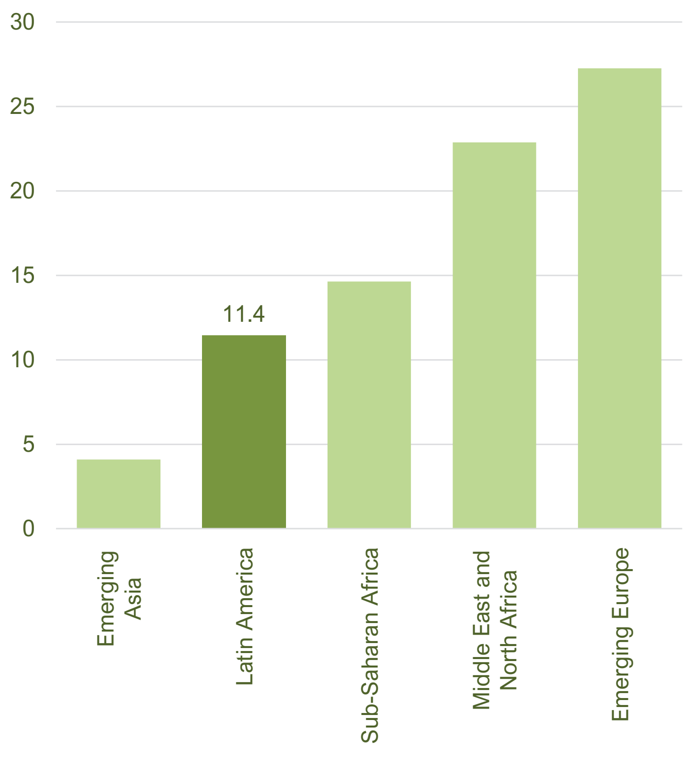
1.2.3. The dedollarisation of public debt

Public debt denominated in foreign currencies has fallen and continues to do so, which reduces external vulnerabilities.

On average, only 11% of borrowing in Latin America between 2017 and 2021 was in foreign currencies, far below other emerging regions (Figure 13.1).[23],[24]

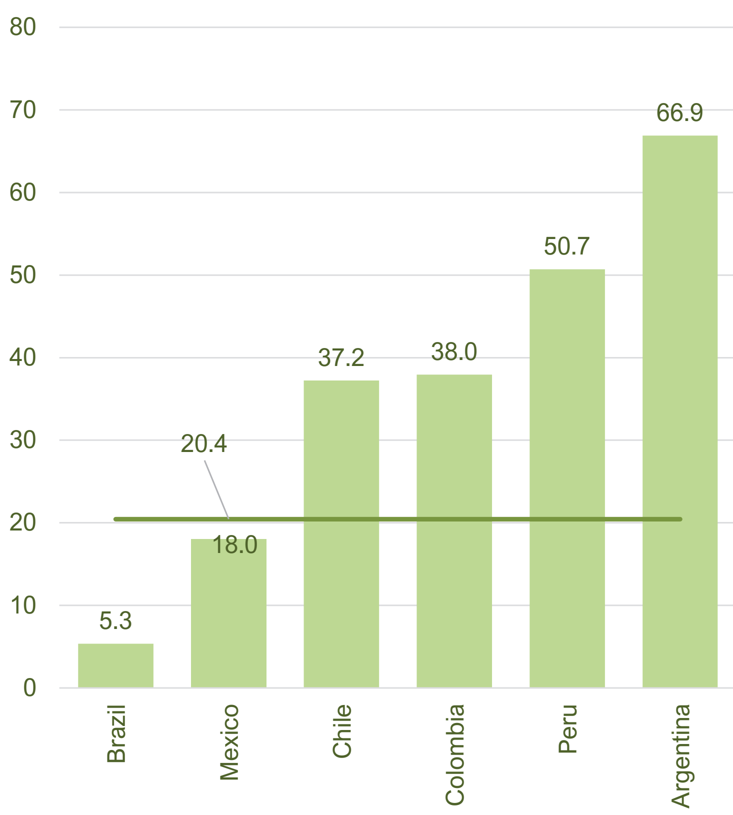
In terms of debt stocks, the most systemically relevant countries in the region have low foreign currency debt ratios (Peru and Argentina are the exceptions) (Figure 13.2).

Figure 13.1. Public debt in foreign currencies by region, 2017-21 (% of total borrowing, average)



23 OCDE (2022).
24 As noted in OECD (2022), the rise in foreign currency financing costs in 2021 saw a shift to domestic currencies.

Figure 13.2. Public debt stock in foreign currencies, 2022 (% of total)



Source: OECD (2022) and IIF (2022).
Note: Emerging Asia excludes China. The classification differs slightly as OECD data is used.

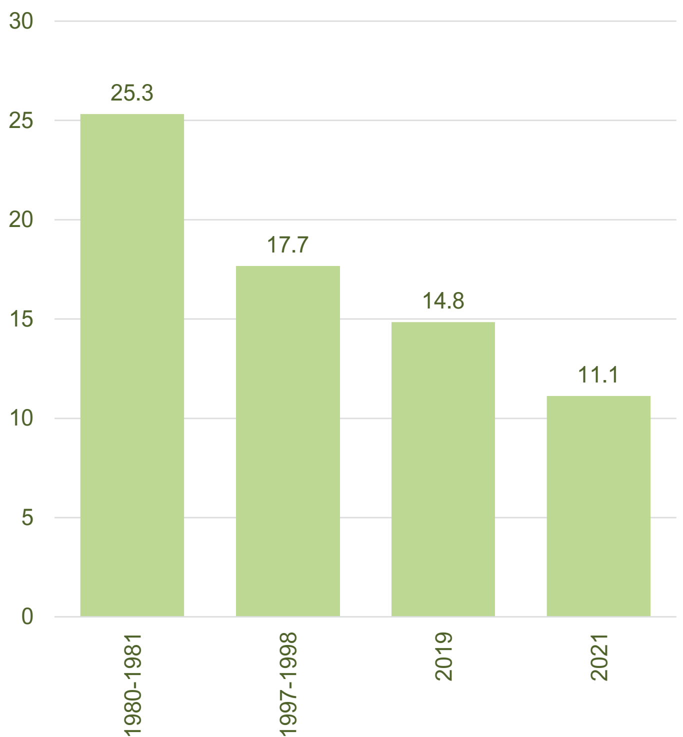
1.2.4. Improved maturity profile of external debt

The maturity profile of external debt has also improved significantly in recent years, avoiding the concentration of short-term maturities.

Short-term external debt as a proportion of total external debt has been falling continuously since the start of the 1980s (Figure 14.1). Short-term external debt currently makes up just 11% of total external debt and less than half of the debt recorded at the start of the 1980s, prior to the debt crisis and Latin America's lost decade.

This phenomenon has significantly reduced roll-over risk and makes Latin America the emerging region with the second lowest percentage of short-term external debt (Figure 14.2).[25]

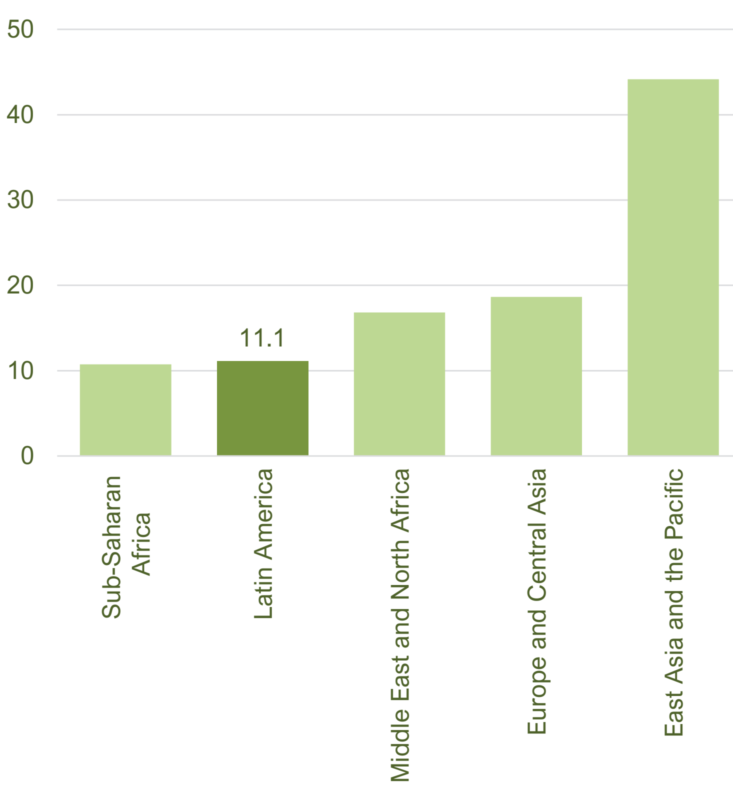
Figure 14.1. Short-term external debt in Latin America (% of total debt)



Source: World Bank (2022).

25 A study by the OECD (2022) shows that maturities of Latin American debt are growing longer. The average maturity increased from five years in 2009 to over seven years in 2019 and 2021.

Figure 14.2. Short-term external debt by region, 2021 (% of total debt)



Source: World Bank (2022).

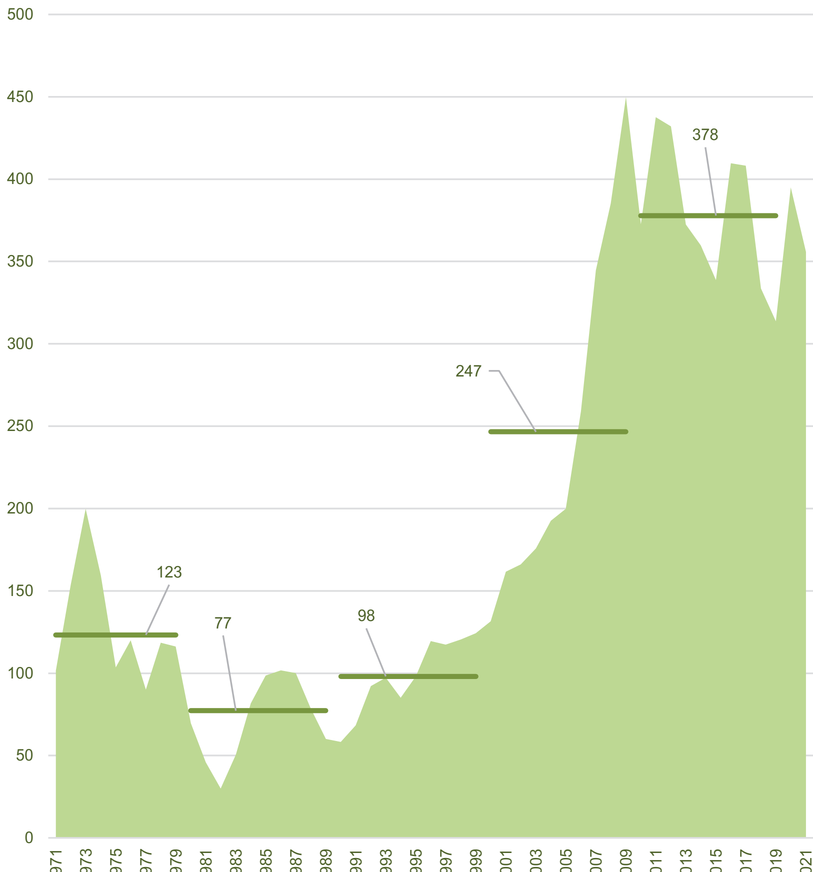
1.2.5. Historic accumulation of international reserves

Latin America has built up significant international reserves over the past 20 years. Reserves (in foreign currencies) rose from 50% of short-term external debt at the start of the 1990s (98% on average for the 1990s) to around 400% at present (Figure 15.1).

Although all emerging regions have built up reserves, Latin America stands out. It has gone from being the emerging region with the lowest level of reserves relative to short-term external debt in the 1990s (only ahead of Sub-Saharan Africa) to the emerging region with the second-largest reserves (second only to the Middle East and North Africa, whose expansion can be explained by their concentration of oil-producing countries) (Figure 15.2).

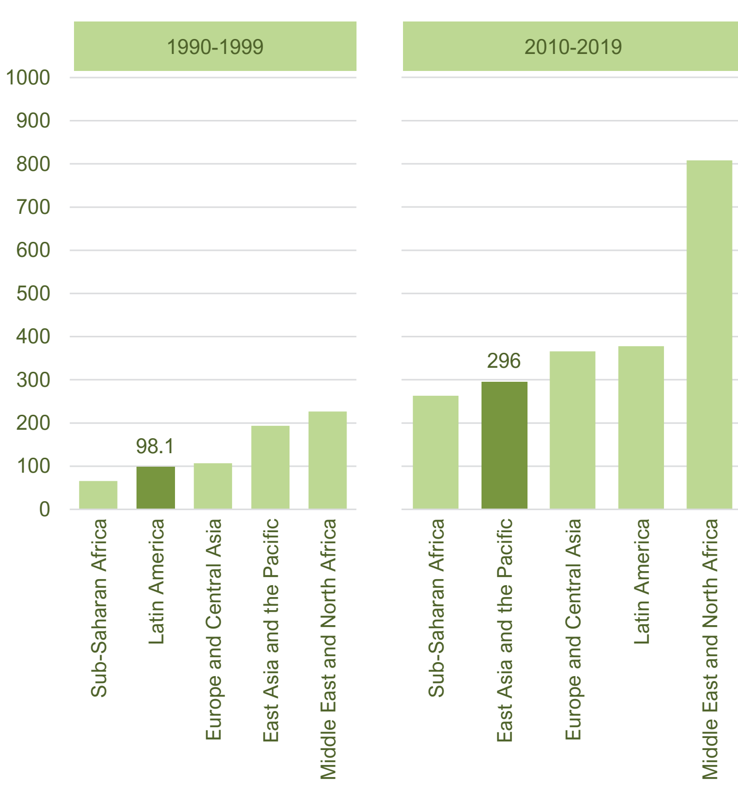
The high level of reserves, together with an improved debt maturity profile (less short-term debt) buffers against sudden interruptions in access to international capital markets, which has been a historic trigger of crises in the region.

Figure 15.1. International reserves in Latin America (% of total debt)



Source: World Bank (2022). See reserves and short-term debt.
Note: the horizontal lines show the average for the 1970s, 1980s, 1990s, 2000s and 2010s, respectively.

Figure 15.2. International reserves of emerging regions, 1990-99 and 2010-19 (% of short-term debt)



Source: World Bank (2022). See reserves and short-term debt.

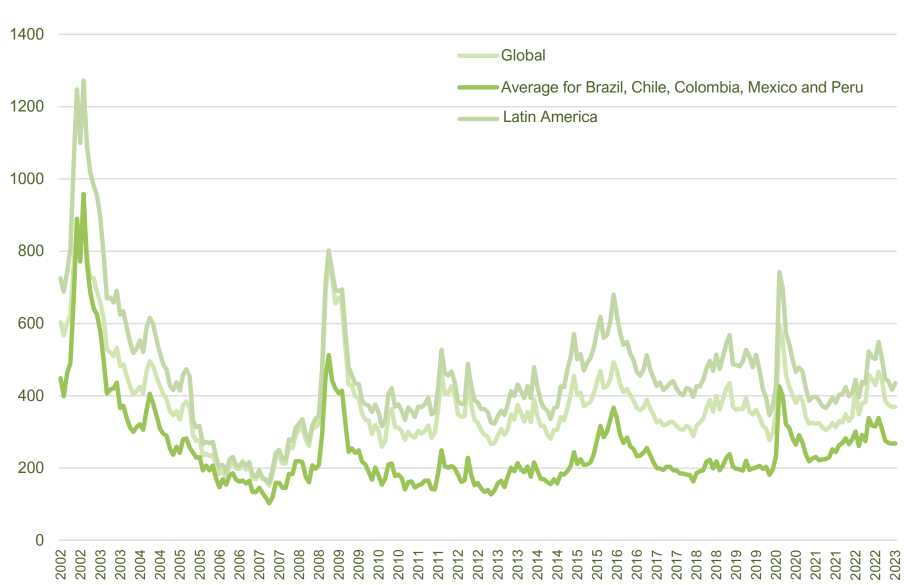
1.2.6. Improved credit risk

Progress on macroeconomic management, fiscal consolidation, debt maturity profiles, reserves and levels of dollarisation (below 50%, except for Argentina and Peru) have led to a general fall in default risk, as measured by Emerging Markets Bonds Index (EMBI) spreads.[26]

Despite the EMBI spread for Latin America as a whole being 60 basis points above the EMBI global, the average spread for the region's main issuers (Brazil, Chile, Colombia, Mexico and Peru) is consistently 100 basis points below the global index (Figure 13.1).

26 Emerging Markets Bonds Index (EMBI) spreads for emerging markets.

Figure 16. EMBI spread in Latin America and emerging countries, 2002-23 (in basis points)



Source: J.P. Morgan (2022).

1.2.7. Expansion of banking systems and high levels of capitalisation

Over the past 20 years, domestic credit to the private sector has risen from just 20% of GDP to 55% (Figure 17.1). Some countries, such as Brazil and Chile, have reached levels similar to the countries of Europe and Central Asia and those of East Asia and the Pacific.

The expansion of the region's banking system has been closely accompanied by improved regulation and supervision and a significant increase in levels of capitalisation. All countries that have adopted the Basel III standards have capital levels comfortably above the minimum recommended requirements of 8% of risk-weighted assets (Figure 17.2) and in line with other emerging regions (Figure 17.3).

Figure 17.1. Credit to the private sector in Latin America, 2002-21 (% of GDP)

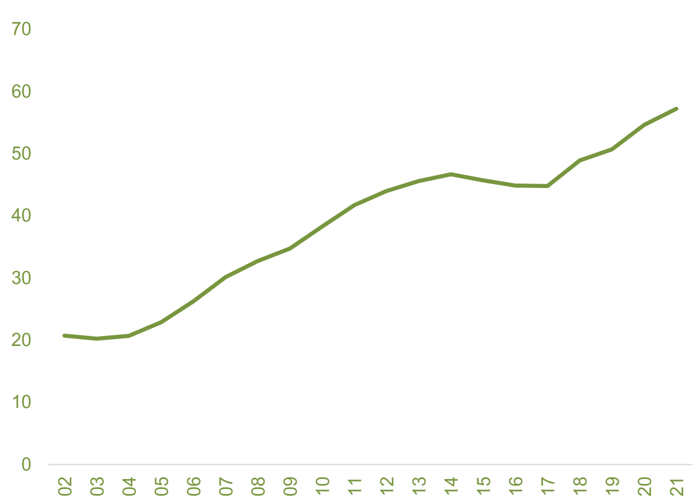


Figure 17.2. Capitalisation levels (% of risk-weighted assets)

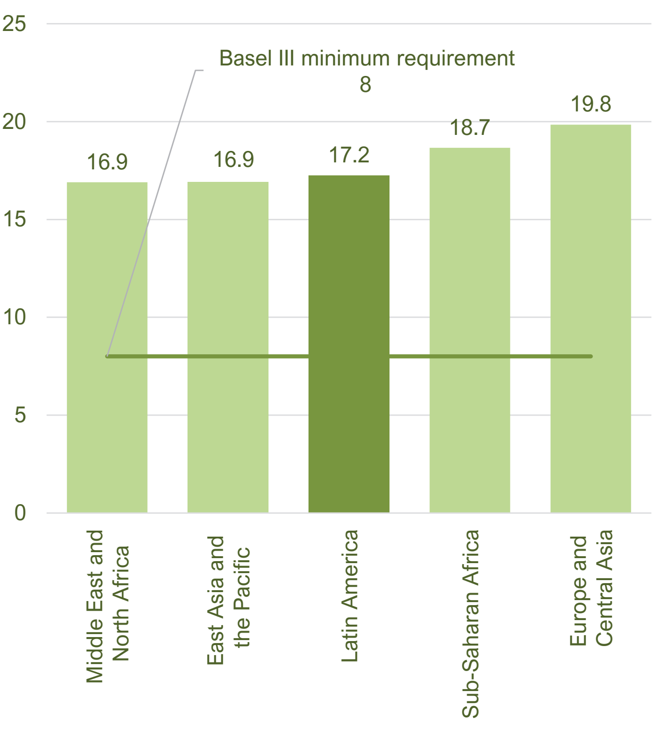
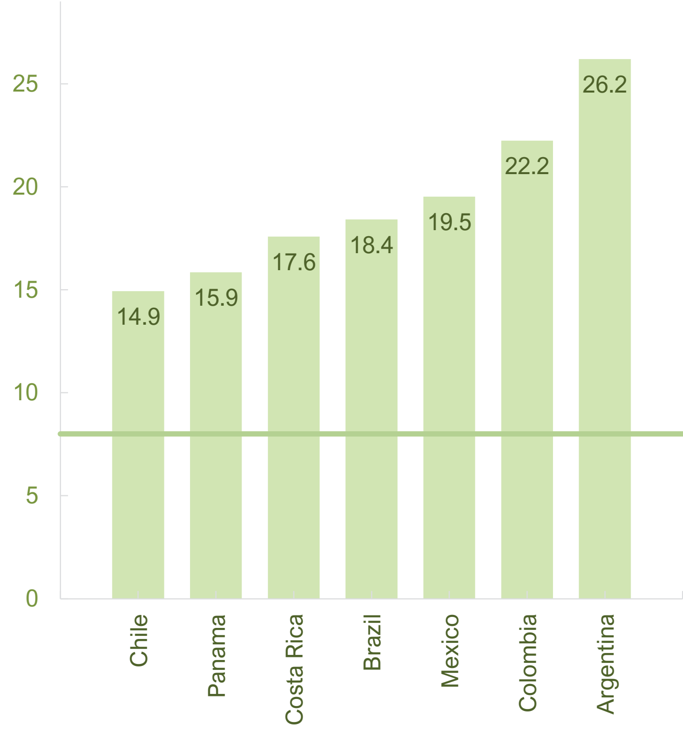


Figure 17.3. Capitalisation of Basel III countries (% of risk-weighted assets)



Sources: IMF (2022a) and World Bank (2023a).
Note: East Asia and the Pacific excludes China, or countries in the process of adopting Basel III.

1.2.8. Less frequent crises

Between 1974 and 2003 –a period that covers two phases of expansion (1974-81 and 1991-97) and two contractions (1982-89 and 1998-2003)– Latin America suffered multiple currency, banking and sovereign debt crises: a total of 108 (an average of four crises per year). This accounts for almost one-third of all the world's crises throughout this period and 42% of crises in emerging and developing markets. Latin America also experienced 73% of all triple crises during this period.[27]

Since 2004, however, this situation has improved substantially, despite the global financial crisis in 2008 and the COVID-19 pandemic. While the number of crises has fallen all across the world, Latin America stands out, with the total number of crises falling from 108 to 12 (from an average of four per year to less than one).

27 Triple crises occur when currency, banking and debt crises occur one year after the other or simultaneously.

During this period, the region accounted for just 16% of global crises (one in six) and 27% of crises in emerging countries (one in three), compared with one in three and one in two, respectively, for 1974-2004. Moreover, the region did not suffer any triple crises during this period (Figure 18).

Figure 18. Currency, banking and sovereign debt crises

	1974-2003	2004-2018
Total crises	**384**	**75**
Crises per year	13.2	5.4
Twin crises[a]	38	5
Triple crises[b]	11	1
Crises in emerging and developing markets	**255**	**45**
% of global total	66.4	60.0
Crises per year	8.8	3.2
Twin crises[a]	38	3
Triple crises[b]	11	1
Crisis en América Latina	**108**	**12**
% of global total	**28.1**	**16.0**
% of total for emerging and developing markets	**42.4**	**26.7**
Crises per year	**3.7**	**0.9**
Twin crises[a]	**6**	**1**
Triple crises[b]	**8**	**0**

Source: Laeven & Valencia (2018).
Note: crises are defined by their start dates and include systemic banking crises, currency crises and sovereign debt crises. Twin crises occur when two of the three types take place in consecutive years and triple crises when all three types occur in consecutive years.

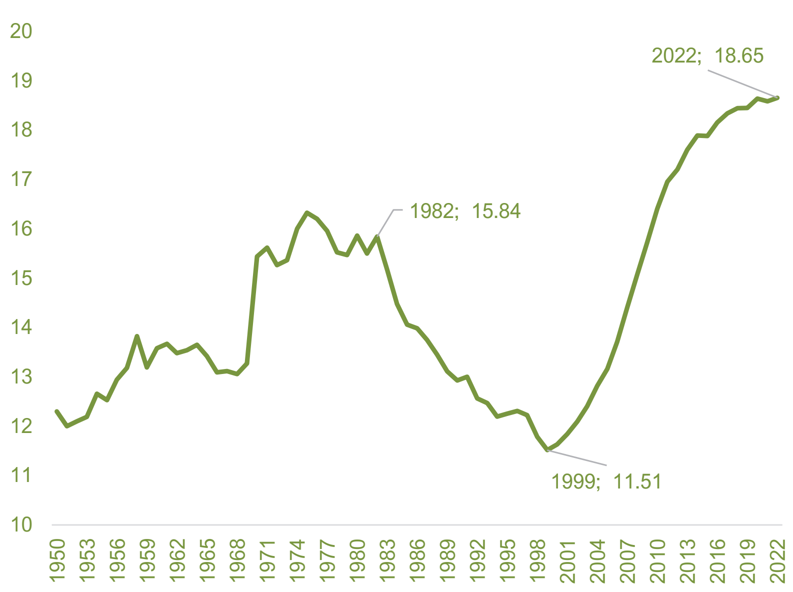
1.3. Development and convergence[28]

1.3.1. Convergence in emerging economies

A picture is worth a thousand words. Figure 19.1 shows the average per capita income at purchasing power parity (PPP) for emerging economies in relation to the US. It clearly shows that something extraordinary has happened since the end of the 1990s, an unprecedented phenomenon in the post-war era, whereby emerging economies have witnessed an exponential process of convergence.

28 Based on Talvi (2016).

Figure 19.1. Convergence in emerging countries, 1950-2022 (% of US per capita GDP at PPP expressed in 2021 constant US$)



Source: the authors, based on Conference Board (2023).

The trend has seen the relative income of emerging economies reach levels that –despite still being low compared to the US– have doubled since the end of the 1990s, reaching a high not seen since the 1950s. If this pace of convergence can be maintained, the average relative per capita income of emerging economies would converge with the average US citizen in just three generations.

Needless to say, such an extraordinary phenomenon has improved the well-being of millions of people in emerging economies. More than 700 million people have been lifted out of poverty and extreme poverty, a phenomenon accompanied by the appearance of the so-called 'emerging middle classes', which have grown at a rate of 150 million people every year.

Something extraordinary seems to be happening in emerging economies. But is this really the case?

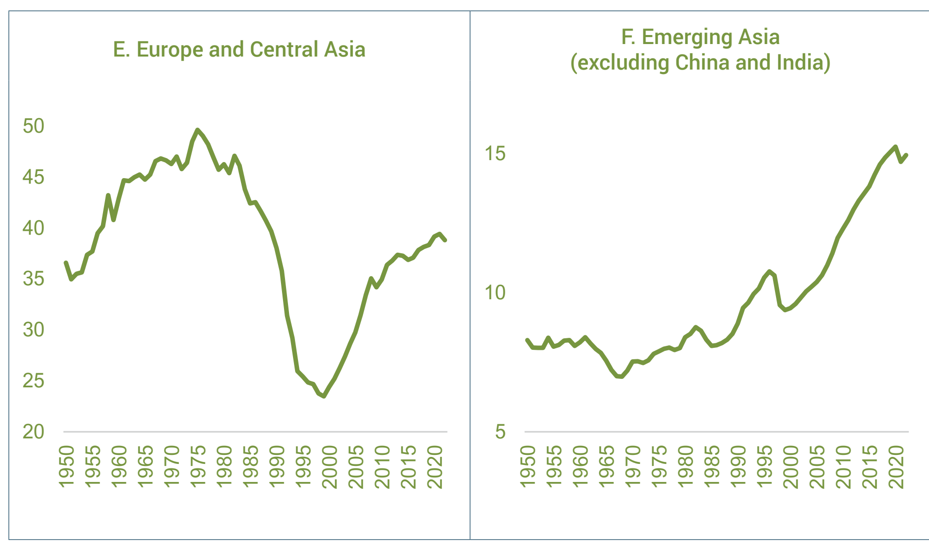
If we exclude China and India from the sample of emerging countries, Figure 19.1 becomes Panel A of Figure 19.2, which shows a period of convergence that began at the end of the 1990s. However, this short episode of convergence was much less impressive –relative income remained far below previous maximums– and came

after a period of divergence beginning in the second half of the 1970s after the first oil crisis. Then, from 2013, stagnation set in.

This pattern in relative income is common across all emerging regions, with the exception of Emerging Asia (see Panels A-F in Figure 19.2). Latin America, Emerging Europe, the Middle East, North Africa and, lastly, Sub-Saharan Africa all exhibit a similar pattern to Panel A in Figure 19.2.

Figure 19.2. Convergence in emerging countries, 1950-2020 (% of US per capita GDP at PPP expressed in 2021 constant US$)

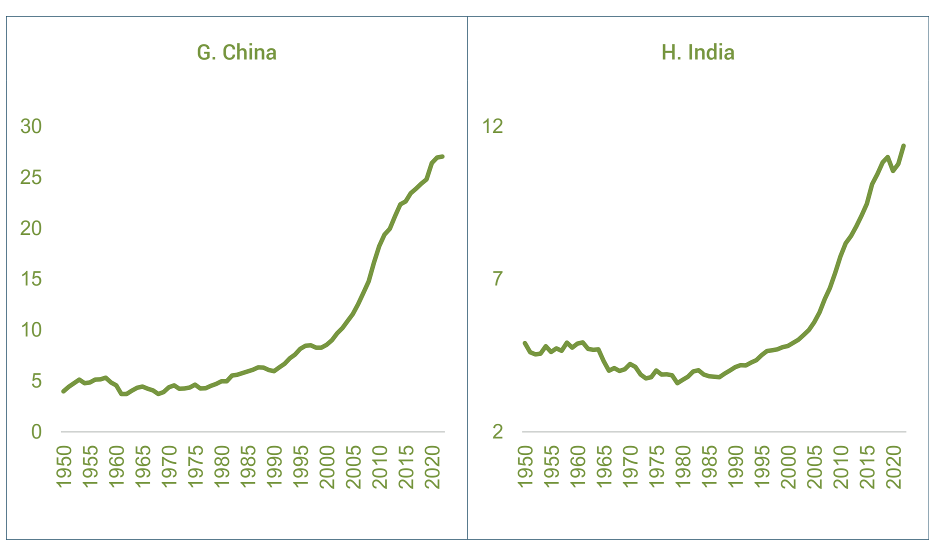
Source: Conference Board (2023).



Source: Conference Board (2023).

Emerging Asia is the only exception to this trend. On the one hand, China and India have witnessed exponential convergence since the end of the 1990s (panels G-H, Figure 19.2). However, while the rest of Emerging Asia has also enjoyed a period of continuous convergence since the second half of the 1960s, the rhythm has been much slower (panel F, Figure 19.2).

Exponential convergence is almost exclusive to China and India. Moreover, given that these two countries are home to 37% of the world's population and 43% of the population of emerging economies, this is of profound importance. If the trend continues, it will have huge consequences for the world. It also shows that grouping the emerging economies together does not reveal the full picture, not least because this fails to capture the dynamic in Latin America.

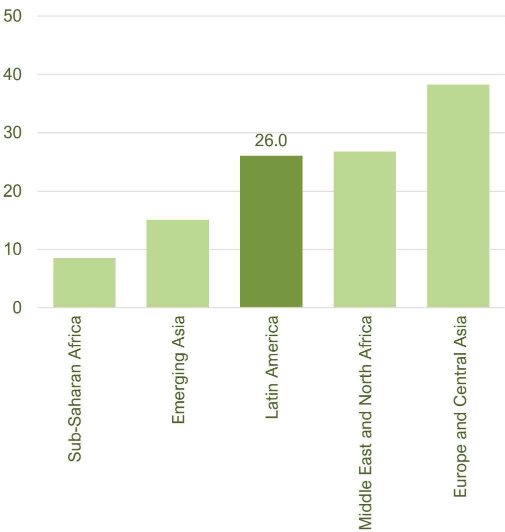


Source: Conference Board (2023).

Despite the formidable rise in relative GDP per capita of China and India and –to a much lesser extent, Emerging Asia– in 2019 and in the run up to the pandemic, Latin America's relative GDP per capita was higher than China, India and Emerging Asia. In fact, it is among the highest of the emerging regions, outperformed by only Emerging Europe and the oil-producing region of the Middle East and North Africa (Figure 19.3).

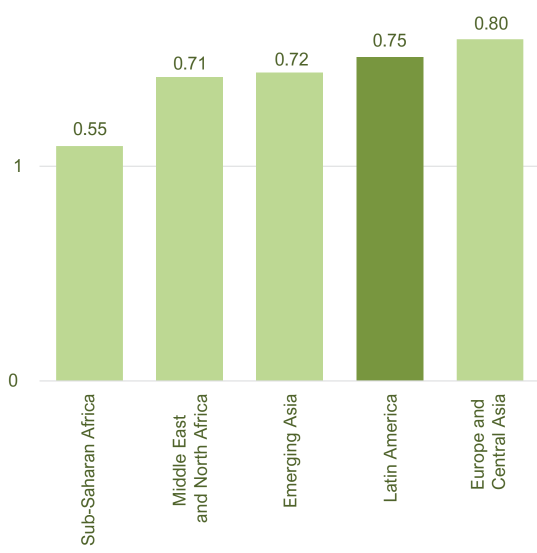
If we include other development indicators in addition to GDP per capita, Latin America is second only to Emerging Europe and both are the only emerging regions classed as having high human development (Figure 19.4).

Figure 19.3. Relative GDP per capita for emerging regions, China and India, 2019 (% of US GDP per capita at PPP expressed in 2021 constant US$)



Source: the authors, based on Conference Board (2023).

Figure 19.4. Human Development Index, 2021 (scale from 0 to 1)



Source: the authors, based on United Nations (2023).

1.3.2. Growth and convergence of the 'Asian miracles'

To accurately define convergence, we first need to define the starting point and the destination. For our purposes, convergence is defined as a process whereby a country's per capita income goes from being less than or equal to one-third of the US per capita income at any point from 1950 to less than or equal to two-thirds of US per capita income.[29]

By this definition, the 'miracles' of development –the countries that have successfully converged on US per capita income levels since 1950– make up just 3% of emerging countries, in line with the current classification used for the IMF's World Economic Outlook. Only five economies have attained this feat: Japan, South Korea, Taiwan, Hong Kong and Singapore. They began the convergence process at levels between 10% and 29% of US per capita income (Korea and Hong Kong, respectively) and took between 16 and 44 years to reach the target (Singapore and South Korea, respectively). Growth rates of per capita income during the convergence period range from a minimum of 6.1% a year (Hong Kong) to a maximum of 8.5% a year (Japan) (Figure 20).

Figure 20. Growth and convergence of the Asian 'miracles'

	Convergence start year	Year convergence achieved	Years of convergence	Relative income in start year (% of US income)	Relative income in 2022 (% of US income)	Growth of GDP per capita during convergence (% annual)
Hong Kong	1967	1987	20	29	93	6.1
Japan	1950	1970	20	21	65	8.5
Singapore	1965	1981	16	25	164	8.1
Korea	1966	2010	44	10	70	6.3
Taiwan	1967	2006	39	14	91	6.1

Source: Talvi (2016).

29 The one-third and the two-thirds of US per capita income represent, respectively, the mean minus one standard deviation and the mean plus one standard deviation of the distribution of per capita income of all countries in our sample compared to the US for 2021. The World Bank uses a much less strict definition of high-income countries for its classification. The World Bank threshold to for classification as a high-income country is a gross national per capita income of US$13,589, equivalent to 20% of the US gross national per capita income.

In other words, convergence towards the levels of per capita income of wealthy countries is extremely rare. Dismissing Latin America –or any other emerging region, for that matter– as an economic failure based on a comparison with a practically impossible target is clearly not a good way to measure success.

1.3.3. The challenge of growth

Looking to the future, the challenge facing Latin America is not the region's macroeconomic management. As the analysis at the start of this chapter shows, the region has made considerable progress in all aspects in this area, with strong results.

Convergence towards the per capita income levels of wealthy countries is more of an aspiration than a realistic political and economic target. Only a handful of Asian economies have achieved this feat in the post-war era.

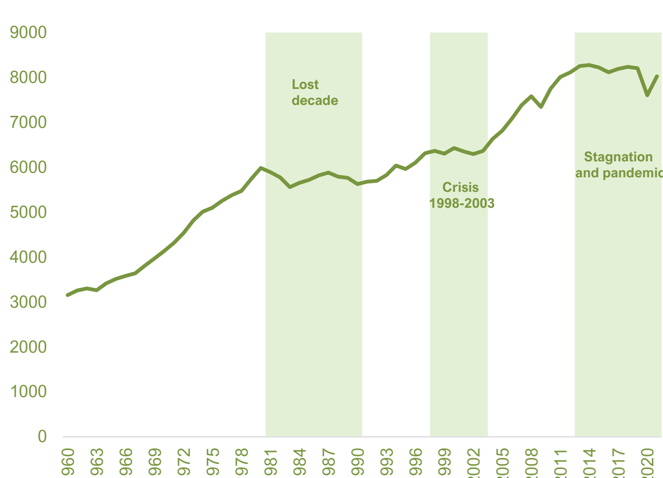
After a decade marked by the stagnation of per capita income, the challenge facing Latin America is to reactivate growth (Figure 21). This prolonged lack of growth has inevitably led to struggles over the distribution of fixed resources, which, in addition to stoking tensions among society, diverts valuable political energy towards neutralising these tensions and away from the goal of growth.

Since the second half of the 1970s the region has only seen high growth when the external context has been highly favourable (high prices of the commodities Latin America produces and exports and abundant inflows of foreign capital). In short, when there has been a strong tailwind.[30] However, when the wind changed direction, these episodes of high growth have been followed by crashes and periods of stagnation.

This has constrained the region's growth since the start of the 1980s. The underlying cause of this malaise is that Latin America has not made meaningful progress on the drivers of growth.

30 See, for example, Izquierdo, Romero & Talvi (2007).

Figure 21. GDP per capita in Latin America (expressed in 2015 constant US$ at PPP)



Source: World Bank (2023).
Note: shaded areas denote episodes of crises or stagnation.

1.3.4. The golden decade: 2004-13

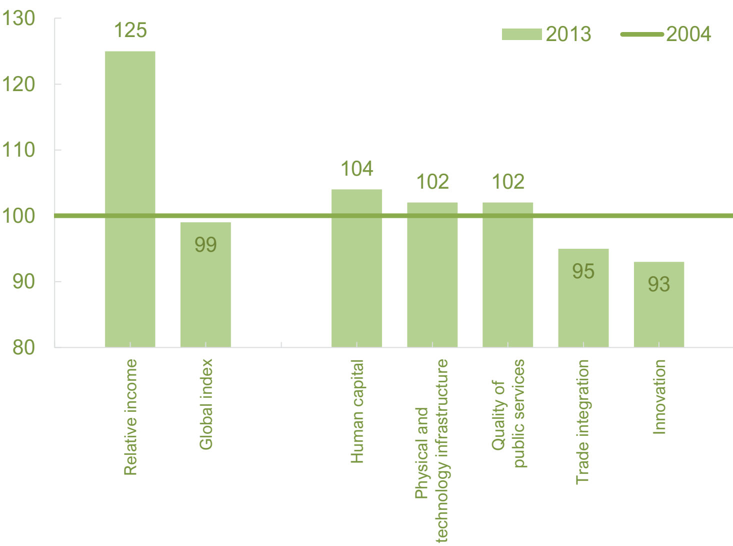
A good example of the previous point is Latin America's 'golden decade', when growth surpassed 5% a year, largely as a result of the commodities super cycle. The period marked a turning point for the region after 25 years of falling relative income, raising hopes that Latin America would finally embark on the path of convergence. However, these hopes proved unfounded and the warning signs were clear to see.

Despite a decade of high growth, progress was not made on its drivers, such as trade integration, physical and technological infrastructure, human capital, innovation and quality public services.[31]

In stark contrast to the growth in relative income during the golden decade, Latin America has failed to make progress on the drivers of growth relative to advanced economies. The global index of growth drivers (the simple average of five sub-indexes) remained unchanged during the golden decade (Figure 22.1).

31 See Barro (1991). For a complete summary of countries' growth setbacks, see Durlauf & Quah (1999) and Durlauf, Johnson & Temple (2005).

Figure 22.1. Change in relative income and growth drivers for Latin America (Index: 2004 = 100, % of US GDP per capita and % of indexes for advanced countries)



Source: Talvi (2016).

A similar phenomenon occurred with export sophistication, an indicator used by the Harvard Growth Lab to predict future growth. Here too, the region failed to make significant progress during the golden decade (Figure 22.2).

Figure 22.2. Change in relative income and export sophistication in Latin America (Index: 2004 = 100, % of US GDP per capita and % of sophistication for advanced countries)

	2013	2004
Income	117.3	100
Sophistication	109.7	100

Sources: the authors, based on Harvard (2023) and Conference Board (2023).

Looking to the future

To deliver sustainable growth, the region must redouble its efforts to deepen integration with the global and intraregional economy, to improve human capital, the pace of innovation and the quality of public services, and to invest in modern physical and technological infrastructure. All these improvements are needed to revitalise growth and ensure Latin America's chances of delivering reasonable levels of growth is not dependent on external factors.

These may seem like huge challenges but there are grounds for optimism. Latin America has created solid foundations to drive growth.

First, democracy has been consolidated across most of the region and a generation has grown up with elections as the only legitimate means of choosing a government. Latin America is ranked first among emerging regions for democratic development.

Secondly, many of the main Latin American countries have achieved significant macroeconomic results. Once again, a generation has grown up with low and relatively stable inflation and reasonably healthy public finances. Moreover,

regulation and supervision of the banking system has improved considerably in recent years, meaning the region now has solid financial systems.

Third, Latin America stands on the cusp of further economic integration with the EU. As shown in the section on the opportunities presented by the new outlook, many Latin American countries are now covered by free trade agreements with the EU. If the Association Agreement is ratified, this will mean the EU has free-trade arrangements covering 94% of the region's GDP.

Furthermore, as this section also notes, if these countries could take full advantage of existing bilateral trade agreements with the EU (eg, harmonising standards, rules of origin and customs procedures), this would create a vast economic space: an association between the EU and Latin America that would represent 1.1 billion people and would have a GDP of over US$22 trillion, rivalling the US economy and surpassing China.

If such an association became a reality, it would bring enormous mutual benefits. The EU and Latin America have highly complementary economies. Latin America has an abundance of energy and mineral resources: sun, wind, water and fertile land. For its part, the EU can provide capital, technology and the know-how needed to help Latin America develop its export structure. If the agreement is signed, Latin America's path to development could end up looking more like Spain's or Portugal's than the Asian miracles. For these two countries, it was democratisation that came first, followed by economic integration (with the EU) and then development.

Box 1. Crises in Latin America

One of the main conclusions that can be drawn from the vast body of literature on economic crises is that Latin America is paradigmatic when it comes to macroeconomic crises. It has suffered crises of all sorts and intensities: banking, sovereign debt, balance of payments, currency, inflation and growth.

While this may be the case, as Latin America's economic authorities have learnt to manage their open economies (and other emerging countries have appeared on the scene), the idea that the region serves as a 'template' for crises in emerging countries is outdated.

Ten years ago, a study by Laeven & Valencia found that 108 of the 255 crises occurred in emerging countries in the period 1974-2003 took place in Latin America (42%). Recent studies for 2004-18 identified a total of 60 crises with just 12 taking place in Latin America.

In other words, 80% of the macro crises in emerging countries in the 21st century did not take place in Latin America.

One explanation for the persistence of the idea that Latin America is an economic failure is that analysts and investors perceive more crises than actually occur. Instead of crises per se, it is phases of instability or potential macro risk that really affect their perceptions of how vulnerable countries are.

To test this hypothesis, we created a database with 50 emerging economies, representing a combined GDP of US$100 trillion at PPP, equivalent to 56% of the global economy and 95% of the GDP of the 152 emerging countries followed by the IMF. These economies are divided into five geographic blocks: Asia, Emerging Europe, Latin America, the Middle East and North Africa (MENA), and Sub-Saharan Africa.[32] Each block includes the 10 biggest regional economies and we have analysed the period 2000-23.[33]

Seven macro variables and three currency variables were selected to evaluate the vulnerability of each of these 50 economies: growth, inflation, primary balance of central government, public deficit, gross public debt, percentage of government revenue used for servicing public debt, current account balance of payments, nominal currency appreciations and depreciations, and real effective currency appreciation.

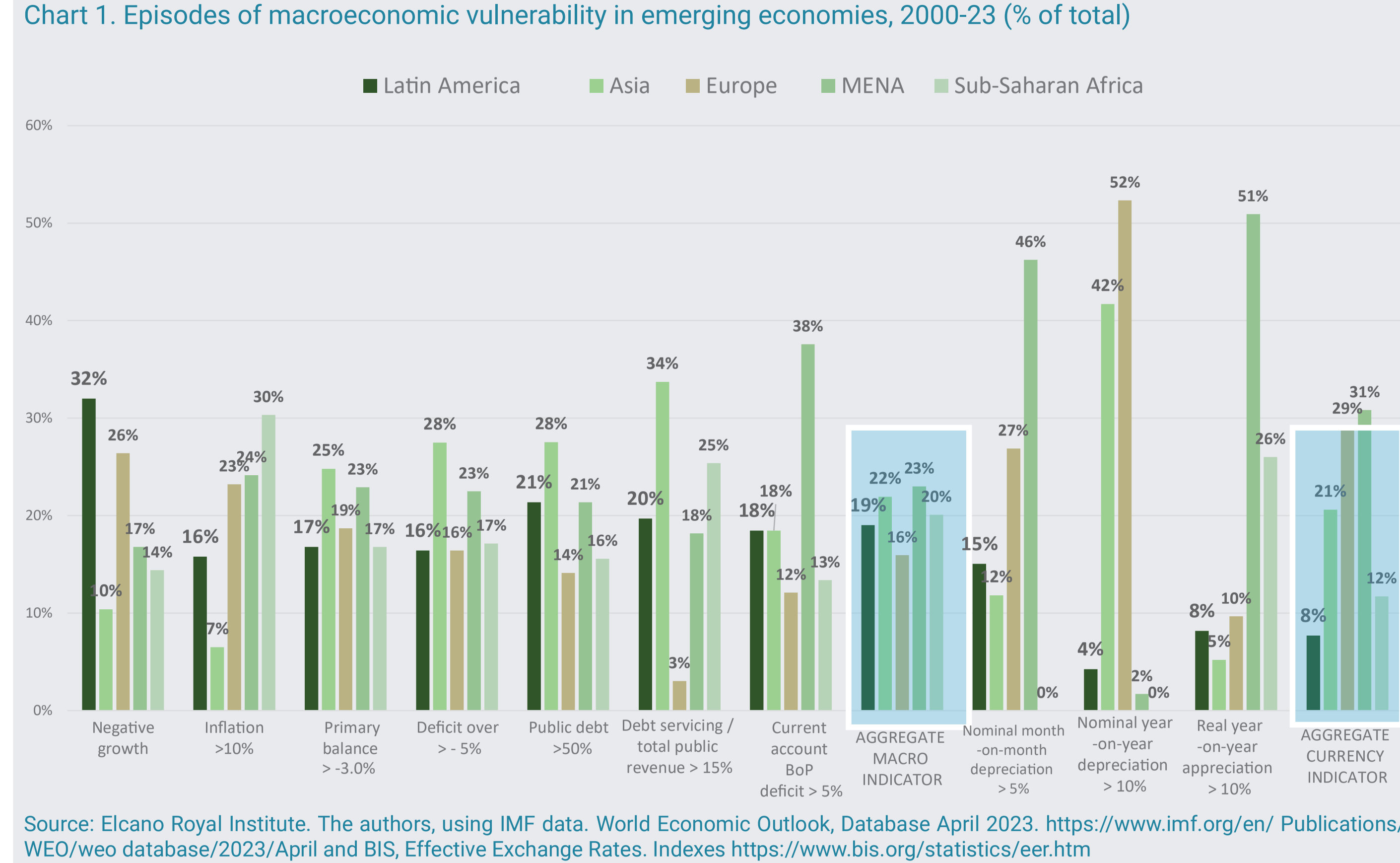
32 Asia: Bangladesh, China, India, Indonesia, Malaysia, Myanmar, the Philippines, Sri Lanka, Thailand, Vietnam. Europe: Belarus, Bosnia and Herzegovina, Bulgaria, Hungary, Poland, Romania, Russia, Serbia, Turkey and Ukraine. Latin America: Argentina, Brazil, Chile, Colombia, the Dominican Republic, Ecuador, Guatemala, Mexico, Peru and Venezuela. The Middle East and North Africa (MENA): Algeria, Egypt, Iran, Iraq, Kazakhstan, Morocco, Pakistan, Saudi Arabia, the United Arab Emirates and Uzbekistan. Sub-Saharan Africa: Angola, Côte d'Ivoire, Democratic Republic of Congo, Ethiopia, Ghana, Kenya, Nigeria, South Africa, Tanzania and Uganda.

33 All data was taken from the April 2023 World Economic Outlook. BIS currency statistics have been used for nominal and real exchange rates.

We have assumed there is a risk of economic vulnerability –a macro 'warning'– when the following occur in any of the years:

- A negative year-on-year change in GDP
- Inflation more than 10%
- Primary balance more than -3% of GDP
- Central government public deficit more than -5% of GDP
- Public debt more than 50% of GDP
- The percentage of public revenue for servicing debt is over 15%
- Current account balance more than -5% of GDP
- Nominal month-on-month depreciation of more than 5%, nominal annual appreciation of more than 10% or real appreciation of more than 10% in a year.

Chart 1. Episodes of macroeconomic vulnerability in emerging economies, 2000-23 (% of total)



Source: Elcano Royal Institute. The authors, using IMF data. World Economic Outlook, Database April 2023. https://www.imf.org/en/ Publications/ WEO/weo database/2023/April and BIS, Effective Exchange Rates. Indexes https://www.bis.org/statistics/eer.htm

Table 1. Episodes of macroeconomic volatility in emerging economies, 2000-23 (% of total)

% Episodes by region	NEGATIVE GROWTH	INFLATION>10%	PRIMARY BALANCE >-3.0%	DEFICIT>-5%	PUBLIC DEBT>50%	DEBT SERVICING/ TOTAL GOVT REVENUE >15%	CURRENT ACCOUNT BoP DEFICIT >5%	AGGREGATE MACRO INDICATOR	Nominal depreciation month-on-month > 5%	Nominal depreciation year-on-year > 10%	Real Year-on-year appreciation >10	AGGREGATE CURRENCY INDICATOR
ASIA	10%	7%	25%	28%	28%	34%	18%	22%	12%	42%	5%	21%
EUROPE	26%	23%	19%	16%	14%	3%	12%	16%	27%	52%	10%	29%
LATIN AMERICA	32%	16%	17%	16%	21%	20%	18%	19%	15%	4%	8%	8%
MENA	17%	24%	23%	23%	21%	18%	38%	23%	46%	2%	51%	31%
SUB-SAHARAN AFRICA	14%	30%	17%	17%	16%	25%	13%	20%	0%	0%	26%	12%
TOTAL EPISODES	125	323	262	280	276	264	157	1687	93	235	269	597

LATIN AMERICA NO. INDIVIDUAL EPISODES	NEGATIVE GROWTH	INFLATION >10%	PRIMARY BALANCE >-3.0%	DEFICIT >-5%	PUBLIC DEBT >50%	DEBT SERVICING/TOTAL GOVT REVENUE >15%	CURRENT ACCOUNT DEFICIT BoP>5%	AGGREGAT MACRO INDICATOR	NominaL Depreciation month-on-month > 5%	Nominal depreciation year-on-year >10%	Real Appreciation year-on-year > 10%	INDICATOR AGGREGATE CURRENCY
Brazil	4	1	3	2	24	15	2	51	2	0	0	2
Chile	3	1	2	3	0	0	0	9	1	5	1	7
Colombia	1	2	3	3	4	6	0	19	3	0	10	13
Dominican Republic	2	3	7	6	2	13	1	34	0	0	0	0
Ecuador	2	3	1	0	3	2	0	11	0	0	0	0
Guatemala	1	1	0	0	0	2	0	4	0	0	0	0
Mexico	5	0	1	1	1	10	0	18	3	0	6	9
Peru	1	0	14	12	0	0	13	40	1	5	4	10
Latin America 8 countries	19	11	31	27	34	48	16	186	10	10	21	41
% of total episodes	15%	3%	12%	10%	12%	18%	10%	11%	11%	4%	8%	7%
Argentina	*10*	*16*	*2*	*9*	*13*	*2*	*0*	52	*4*	*0*	*1*	5
Venezuela	*11*	*24*	*11*	*10*	*12*	*2*	*13*	83	*0*	*0*	*0*	0
Argentina+Venezuela	21	40	13	19	25	4	13	135	4	0	1	5
% of Latin America	53%	78%	30%	41%	42%	8%	45%	42%	29%	0%	5%	11%
% of total episodes	17%	12%	5%	7%	9%	2%	8%	8%	4%	0%	0%	1%
Latin America	40	51	44	46	59	52	29	321	14	10	22	46
% of total episodes	32%	16%	17%	16%	21%	20%	18%	19%	15%	4%	8%	8%

Source: Elcano Royal Institute. The authors, using IMF data. World Economic Outlook, Database April 2023. https://www.imf.org/en/ Publications/ WEO/weo database/2023/April and BIS, Effective Exchange Rates. Indexes https://www.bis.org/statistics/eer.htm

Consolidating the first seven macro vulnerability indicators into a single indicator gives 1,687 observations, meaning the emerging world had around 73 warnings per year (1.4 per country).

In terms of geographic distribution, MENA is the region with the most warnings (23%), followed by Asia (22%), Africa (20%), Latin America (19%) and Emerging Europe (16%). If we add in exchange-rate volatility (an indicator whose use is hampered by the lack of data for nearly half of the countries), the number of warnings rises to 2,064 and Latin America remains the least vulnerable emerging region after Emerging Europe.

If we accept the aggregate indicator as a reasonable measure of the macro vulnerability of emerging countries, Latin America does not appear to have performed worse than the rest over the last 25 years (in fact, it is second best). We must also bear in mind that nearly half of the warnings (47%) are for Argentina and Venezuela. This concentration in two countries is not unique to the region but is particularly intense in Latin America.

The growth indicator is a good example. Latin America has seen below-average growth compared with the other four areas (2.6% vs 3.3% for Europe, 4.6% for MENA, 5.2% for Africa and 5.6% for Asia). However, the aggregate hides the fact that Colombia, Guatemala and Peru are part of a select group of emerging countries that have only experienced one crisis: the COVID-19 pandemic. Moreover, 75% of negative growth episodes are once again concentrated on Argentina and Venezuela.

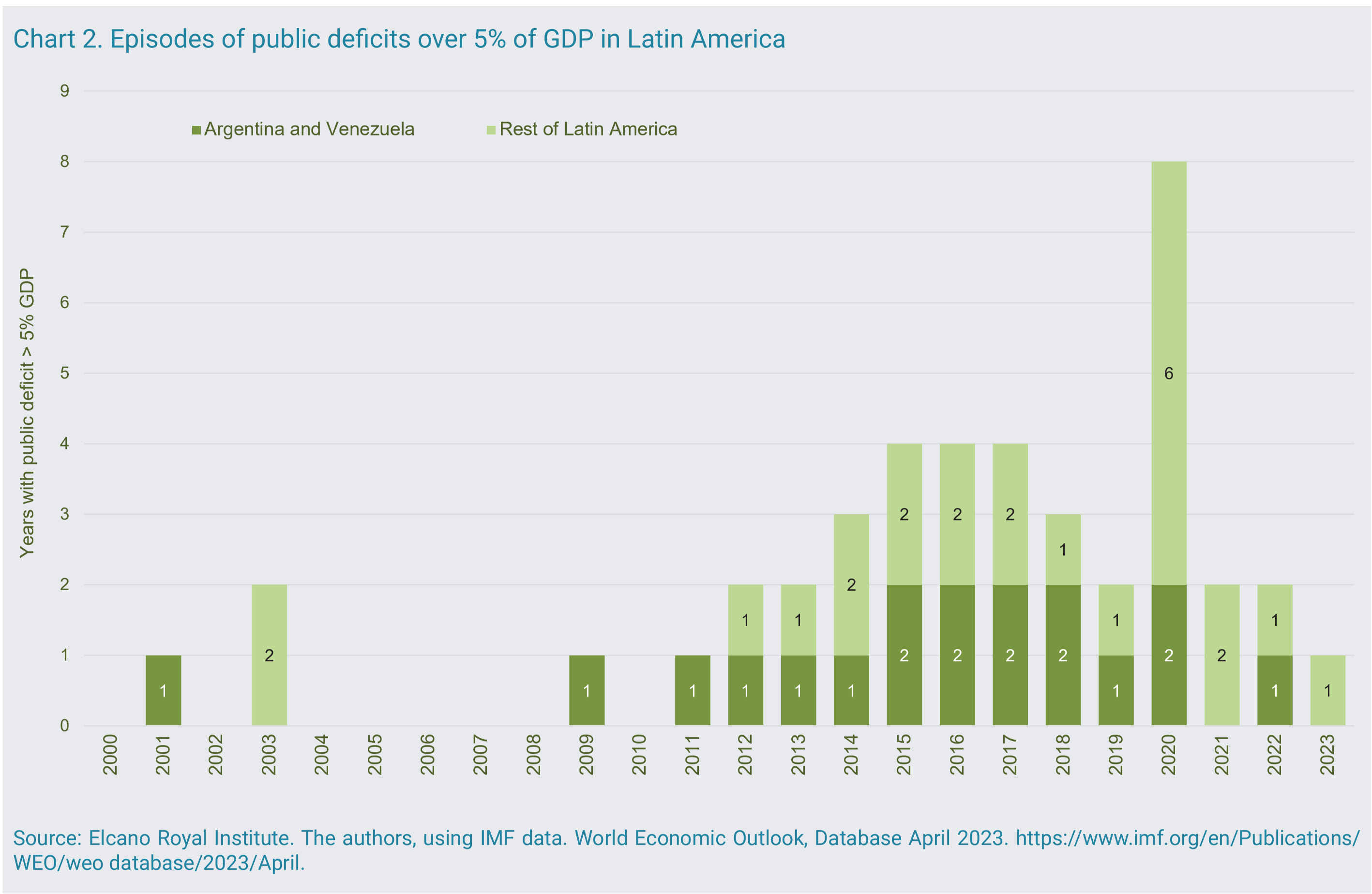
Latin America also enjoys above-average performance on inflation, something that would have been inconceivable 30 years ago. Between 2010 and 2021 none of Latin America's eight most stable countries registered a single episode of inflation over 10%. The explanation for such a dramatic improvement is simple: central bank independence and inflation-targeting monetary policy (with the requirement for flexible exchange rates, the prohibition on monetising public deficits and the free movement of capital), both of which were implemented in the region after poor performance towards the end of the 20th century.

There have also been dramatic changes –in fact, the biggest absolute and relative changes– in the fiscal and budget data for Latin America. Scholars and the markets have both paid particular attention to budgets when evaluating macro vulnerabilities. While Latin America is still perceived as a region prone to fiscal crises, this is not borne out by the facts: for three-quarters of the indicators used, Latin America is among the top two emerging regions.

Latin America accounts for 17% of episodes of primary deficits over 3%, 16% of episodes of public deficits over 5% and 21% of episodes of debt/GDP ratios in excess of 50%. The region's relative performance is even better if Argentina and Venezuela are excluded, which together account for 70% of years with deficits over 5%.

An analysis of episodes of serious budget imbalances over time is even more revealing. The commodities boom of 2003-08 saw these imbalances all but disappear. They only reemerged after the Great Recession and significant international repricing. They then became less pronounced when prices began to recover in 2016 and by 2019 were apparently on course to disappear altogether. Once again, Argentina and Venezuela were the only outliers. The unprecedented fiscal response required by the COVID-19 saw the number of countries with high deficits jump to eight (Mexico and Peru being the exceptions). In 2021 and 2022 the fiscal correction (more on the revenue than the expenditure side) saw a reversal of this trend. In 2022 only Venezuela and Colombia had a public deficit in excess of 5% of GDP.

Chart 2. Episodes of public deficits over 5% of GDP in Latin America



Source: Elcano Royal Institute. The authors, using IMF data. World Economic Outlook, Database April 2023. https://www.imf.org/en/Publications/WEO/weo database/2023/April.

Nor is public debt a differentiating factor when it comes to vulnerability. The IMF's World Economic Outlook only contains data from 2000, when the average debt/GDP ratio for these emerging countries was 54%. Two decades later, the ratio remained at 50%, with the figure for Latin America rising by 20 points from 38% in 2000 to 58% in 2023.

There is no 'critical' debt/GDP ratio. The level of internal savings and the size of the internal capital market are arguably more important than debt/GDP as a leading indicator of stress on the debt market. Brazil has a high ratio (85% in 2022, 57% in net terms), but the country also has internal savings of over US$65 billion at PPP and a deep and well-organised capital market that can comfortably service its public debt. The net position of Brazil's public sector is positive: its assets in US dollars (essentially international reserves) are greater than public external debt –a situation that would have been unthinkable 20 years ago–.

The fifth indicator (percentage of government revenue used to service debt) is probably of greatest relevance when it comes to predicting fiscal vulnerabilities. Against a backdrop of political polarisation and major economic, political and social risk and uncertainty, it could be argued that, above a certain threshold, as this percentage increases, so too do doubts about the simultaneous capacity to service debt and to finance existing and desired public policies that aim to 'improve' people's lives. The trade-offs may even prove irreconcilable.

The ratios of the main countries for each region follow different paths. China has opted to keep a low ratio using a combination of three instruments: moderate growth in public debt (7% between 2000 and 2022), a significant increase in revenue (14%), and a low and falling implied interest rate on its debt (1.3%, compared with 3.2% for 2000). India appears to be comfortable maintaining a high ratio (around 30%), largely because its revenue has seen a cumulative annual increase of 9% and its debt stock of 12%. The third model is Turkey, which has seen its ratio fall alongside borrowing at a cumulative annual rate of 7%. The key has been the reduction of the implied cost from 24% to 6%, largely a product of financial repression. Egypt's model is arguably the most concerning: its ratio has risen sharply (servicing debt now accounts for half of public revenue), combined with an 11%-rise in debt stock, moderate growth in revenue (5%) and a rise in the implied rate from 6.4% to 10%.

In Latin America's medium and large economies, the ratio is stable (the exception being the Dominican Republic, where it has risen from 6% to 21%). It has fallen in five countries, including Venezuela and Argentina, both of which have pursued heterodox policies (the former defaulting and the second increasing revenue and ignoring the implied cost through successive debt restructuring). With the exception of these two countries, the fiscal policies of Latin America are reasonably orderly and sustainable, in contrast to the fiscal nightmare people often imagine. Latin America's sin is not fiscal heterodoxy and a lack of budget control but its regressive and distorted tax systems and the poor quality and equity of public expenditure.

There are a number of potential vulnerabilities in the external sector.

While Latin America is often thought of as being open in terms of trade and finance, according to the World Bank, Argentina and Brazil are two of the world's most closed economies in terms of the weight of their imports and exports as a proportion of GDP. Of the remaining countries, only Mexico and Chile are above the global average.

This lack of openness is the source –and product– of many weaknesses in regional markets for goods, services and factors of production.

The key implication is the difficulty Latin America faces in accessing cash to modernise its economy. The lack of diversification means that the falling price of commodities –the region's primary export– affects the terms of trade and brings capital inflows to a sudden stop. Likewise, it is hard to manage commodity or investment booms, since tight markets lead to credit bubbles, excess demand and real rate appreciations that fuel deindustrialisation and act as a drag on economic diversification.

Growth in Latin America's goods and services imports and exports is poor with respect to the average of the top 50 emerging countries, which explains why its economies are seeking new markets and investment. With the exception of the Dominican Republic (thanks to its strong tourism industry) and Mexico (thanks to trade integration with Canada and the US), the other countries have seen below-average growth in imports and exports: -2% and 1.4%, respectively.

However, despite this behaviour in terms of trade flows, Latin America is no longer synonymous with balance of payment deficits.

Between 2000 and 2023, the top 50 emerging economies experienced 157 episodes of current account deficits over 5% of GDP. However, Latin America (like Asia and Emerging Europe) suffered relatively few episodes (only 29, equivalent to 18%). Balance of payments crises are now more common in the MENA region, which alone accounts for almost 40% of episodes this century.

One of the reasons Latin America has 'graduated' from external crises is the adoption of flexible exchange-rate regimes.

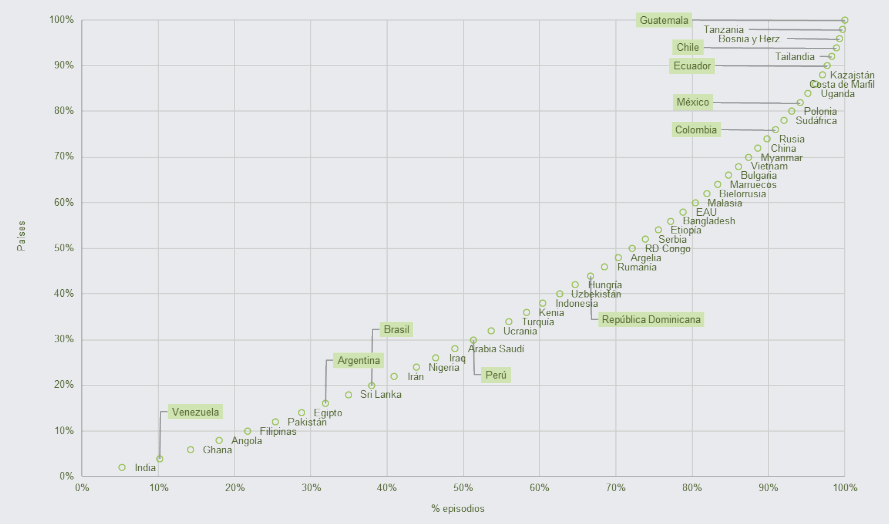
While identifying the real rate of equilibrium and its dynamic is complex, we know that the region no longer suffers from sustained real appreciations that led to nominal currency crises. Exchange rate volatility –both real and nominal– of the main Latin American currencies has fallen since the 1990s and even since the Great Recession in 2008.

With the exception of Argentina and Venezuela, the volatility of Latin American currencies is similar to the EU and Japan, and slightly below the US. The region has seen only 14 annual nominal devaluations above 10%, which represents 4% for the emerging economies for which data is available. A similar phenomenon has occurred with real exchange rate appreciations: 22 episodes, 8% of the total for emerging economies.

Latin America accounts for just 321 of the 1,687 episodes of macro vulnerability and the 597 currency vulnerability episodes in the top 50 emerging markets (19%), the second lowest proportion of the remaining regions after Europe. Asia accounts for 22%, Sub-Saharan Africa for 20% and MENA for 23%.

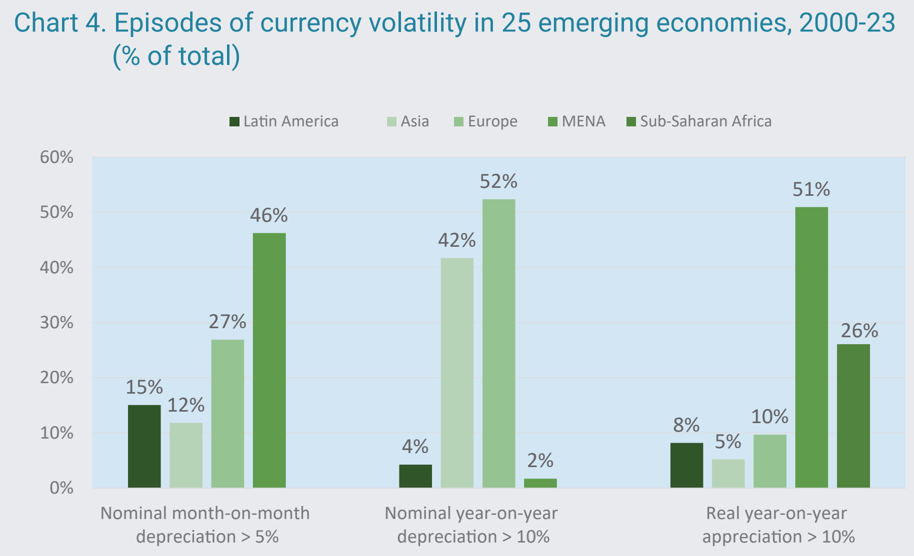
When broken down by country, Latin America (with the exception of the two aforementioned countries) occupies a privileged spot in the ranking. Half of the countries in the region –Colombia, Mexico, Ecuador, Chile and Guatemala– are in the two top deciles of the emerging top 50.

Chart 3. Lorenz curve of episodes of macroeconomic vulnerability in emerging countries, 2000-23



Source: Elcano Royal Institute. The authors, using IMF data. World Economic Outlook, Database April 2023; https://www.imf.org/en/Publications/WEO/weo database/2023/April.

Chart 4. Episodes of currency volatility in 25 emerging economies, 2000-23 (% of total)



Source: Elcano Royal Institute. The authors, using data from BIS, Effective Exchange Rates Indices.

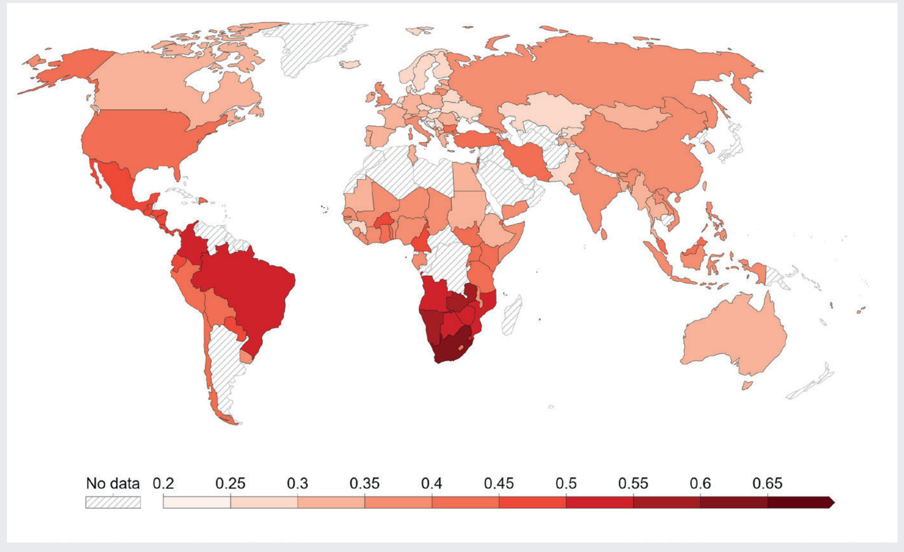
The conclusion is clear: with the notable exceptions of Argentina and Venezuela, since the start of the 21st century, there is no reason to continue to believe that the macroeconomic policies of Latin America result in more macro warnings than the other top 50 emerging economies.

Latin America grows less and exports less than the most dynamic economies in Asia. However, it has also made major strides developing a serious anti-inflationary policy, alongside a relatively prudent fiscal policy that mitigates the risks of fiscal crises and defaults, and a flexible currency policy that has cut the risks of balance of payments crises. If we also take into account tighter banking regulations and supervision, the improvements in capitalisation, liquidity and management, and a well-designed internal and external debt policy (with longer, realistic and feasible maturities), the Latin American 'risk premium' appears unjustified.

Latin America may well be the champion of lost opportunities. However, this is no longer the case for crises and volatility, where the numbers now give much less cause for concern. In short, the facts do not support the narrative.

Box 2. Latin America: inequality, poverty and the middle classes

Map of inequality: Gini Index, 2019

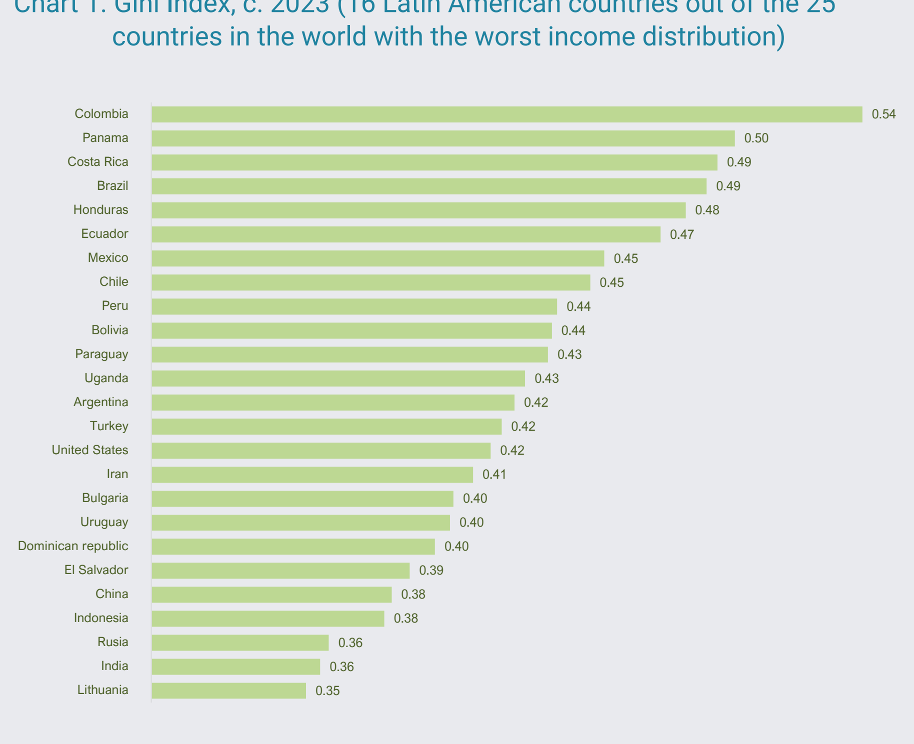


Source: World Bank Poverty and Inequality Platform.
Note: depending on the country and the year, the data refers to disposable income or consumption per capita.

The data show Latin America to be one of the most unequal regions when it comes to income distribution. There is extensive academic literature analysing the historical origins and evolution of this serious moral and political economic problem.

Chart 1 uses data from the World Bank's Our World in Data platform. Of a total of 89 economies, Latin America is home to 16 of the 25 countries with the worst income distribution.

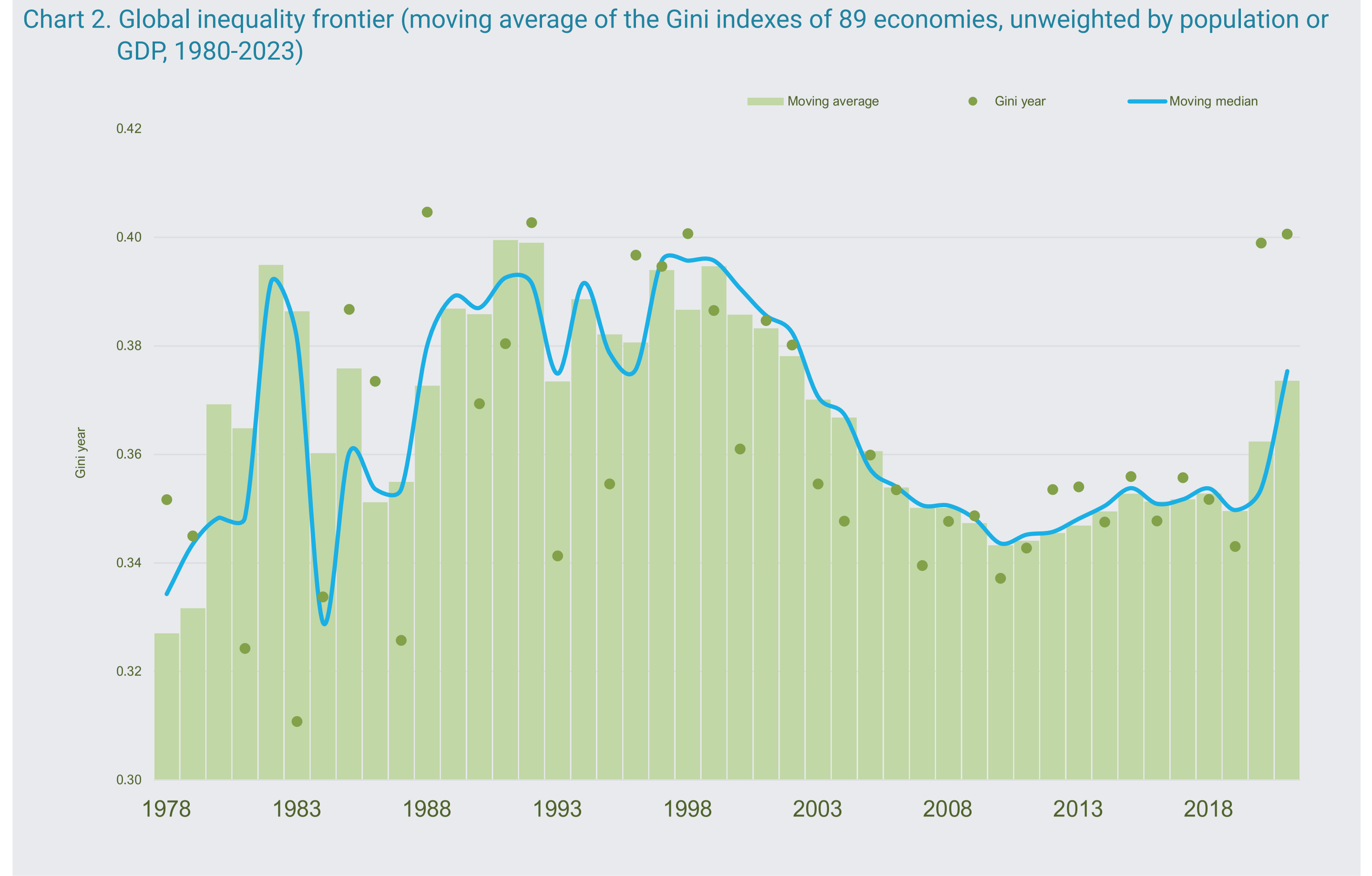
Chart 1. Gini Index, c. 2023 (16 Latin American countries out of the 25 countries in the world with the worst income distribution)



Inequality is serious and pervasive in the region, both in absolute terms and relative to the global economy.

Chart 2 shows the global inequality frontier, as determined by the Gini indexes of these 89 economies. The figures are not weighted by population or GDP. More than a synthetic indicator of global inequality, it shows how successful or unsuccessful these 89 economies have been on their target of reducing the Gini index. Despite its popularity as a measurement of inequality, the index does not fully capture the multiple dimensions of the problem, which include discrimination in accessing healthcare and education, gender biases, racial and intergenerational discrimination, equal opportunities and social mobility.

Chart 2. Global inequality frontier (moving average of the Gini indexes of 89 economies, unweighted by population or GDP, 1980-2023)

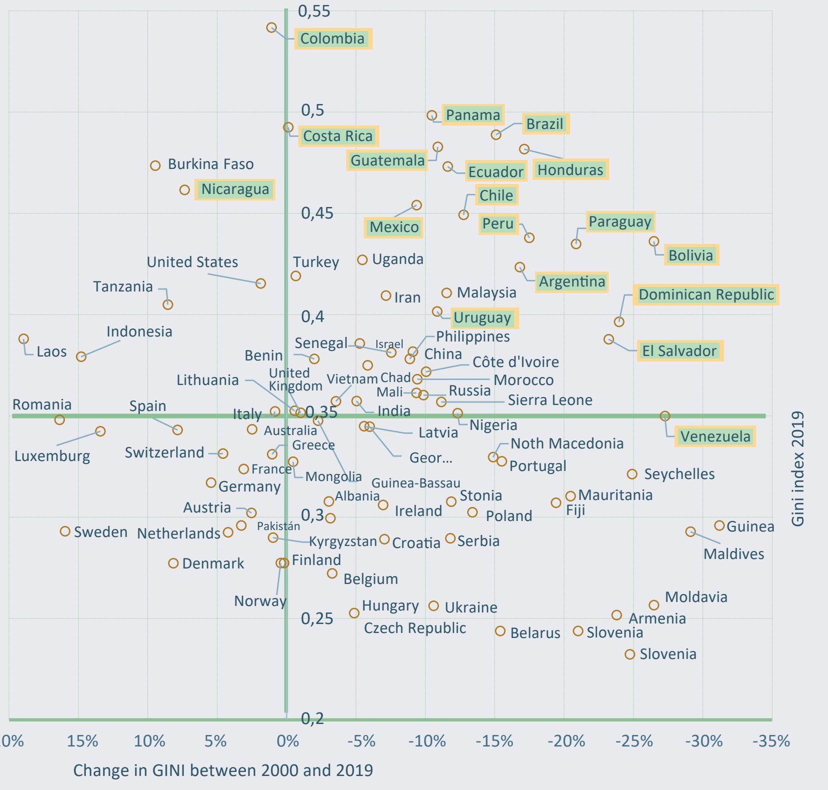


The Gini indexes peaked in the 1980s and 1990s. In the 21st century there had been a significant and sustained reduction in this indicator up to the pandemic. The lowest value was recorded in 2011, from which point the aggregate indicator once again began to rise. The average for the period is an overall Gini score of 0.36, with a 7% reduction between 2001 and 2019.

This data have been used to produce Chart 3, which shows the most recent Gini indexes for these 89 economies (y axis), alongside the cumulative changes over the two decades.

The chart is divided into four quadrants: (1) countries with an above-average Gini and an above-average reduction over the last 20 years; (2) countries with a below-average Gini and an above-average reduction; (3) countries with a below-average Gini but with an increase; (4) and countries with above-average inequality where the gap has continued to rise.

Chart 3. Change in the Gini index over the 21st century (14 Latin American countries in the quadrant with high but falling Gini indexes)

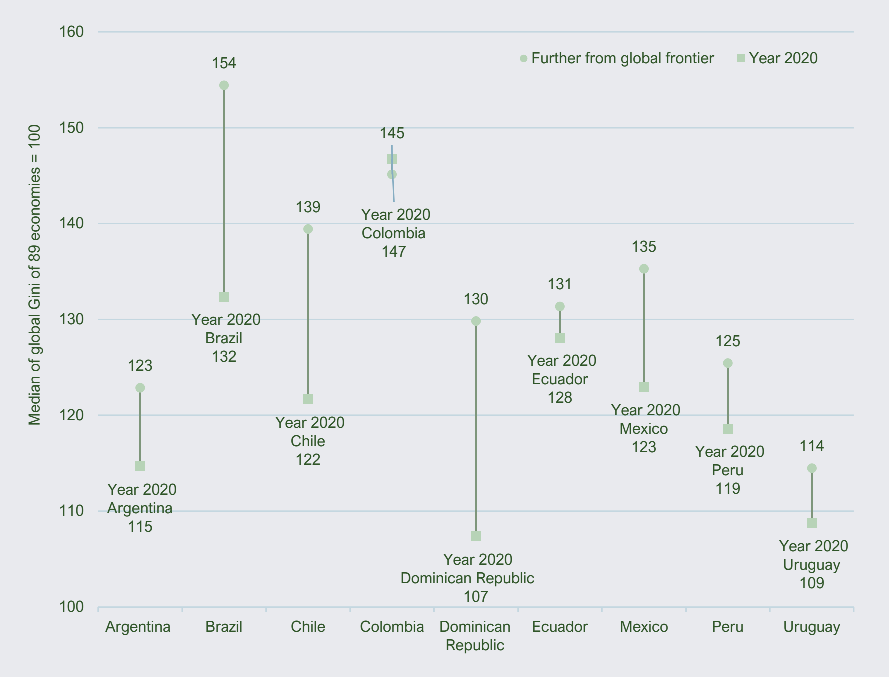


Most Latin American countries (14) are in quadrant one. The two below-average countries (El Salvador and Venezuela –with data up to 2006–) are in quadrant two, and Colombia, Costa Rica and Nicaragua (above the global average) have seen inequality worsen over the two decades. They are grouped alongside developed economies (the US), African countries (Tanzania and Burkina Faso), Asian countries (Laos and Indonesia) and emerging European countries (Romania).

These failures notwithstanding, most Latin American countries have been relatively successful in their attempts –explicit or implicit– to reduce this dimension of inequality.

Chart 4 shows that eight of the region's nine largest economies (Colombia is the exception) had achieved the lowest gap with respect to the global average by 2020.[34] The performance of the Dominican Republic and Uruguay is particularly noteworthy, two countries that are now extremely close to the global frontier. Brazil has been the most successful country, followed by Mexico. This is all the more noteworthy since they are Latin America's two largest economies and make up 60% of the region's GDP.

Chart 4. Reduction of the gap with respect to the global inequality frontier (except Colombia, all Latin American countries are at minimum distances from the frontier)



34 The country's Gini index for 2006 was 0.45, 22% above the global average.

The multiple factors involved make correctly interpreting the reasons for this change extremely complex.

They include an improved macroeconomic outlook, fewer systemic crises, openness to the outside world and the concomitant weakening of the power of income-capturing of groups, as well as specific public policies, such as the cumulative effect of increased public spending on education, health and other social policies.

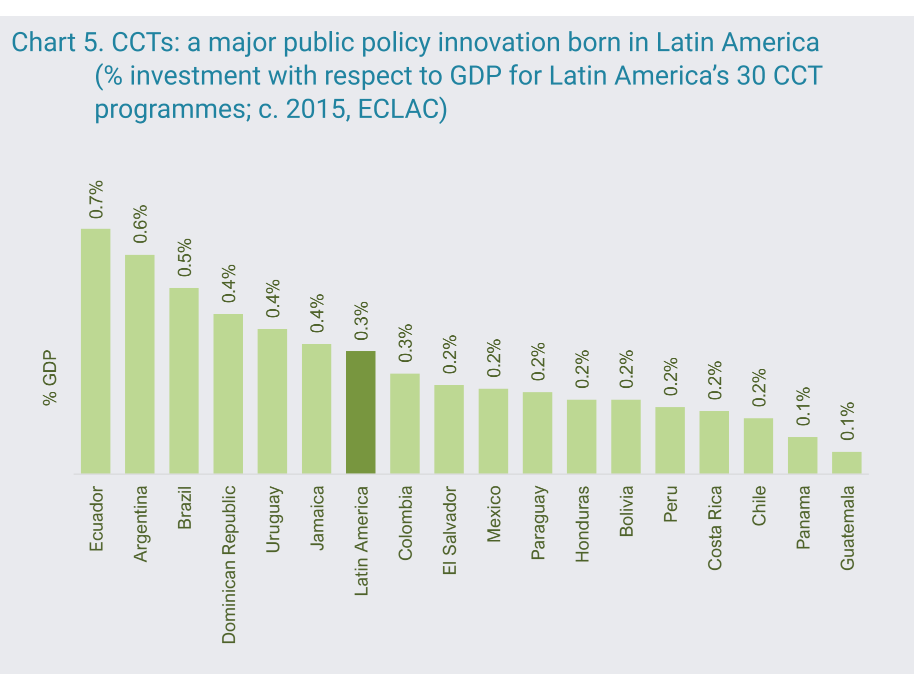
These include the new generation of 'conditional transfer' policies (conditional cash transfers, or CCTs), which stand out for their innovative nature and capacity.

The first was Mexico's *Progreso* initiative in 1997 (subsequently rebranded as *México Oportunidades*). However, the most famous has been Brazil's family payment (*Bolsa Familia*).

Over this 20-year period, 30 CCT programmes have been implemented in 20 countries throughout the region, turning Latin America into the world's biggest social policy laboratory. According to the Economic Commission for Latin America and the Caribbean (ECLAC), coverage of these programmes has ballooned from less than 1 million people in 1996 to 132 million in 2015 (20.9% of the region's population). In terms of households, this represents an increase from fewer than 300,000 households in 1997 to 29.8 million in 2015 (17.5% of all households in Latin America).

Chart 5 uses ECLAC data to measure the CCT investment of individual countries. In 2015 the total investment for Latin America as a whole accounted for 0.33% of GDP, although the figure was over 0.5% of GDP for Ecuador, Argentina and Brazil.

Chart 5. CCTs: a major public policy innovation born in Latin America (% investment with respect to GDP for Latin America's 30 CCT programmes; c. 2015, ECLAC)

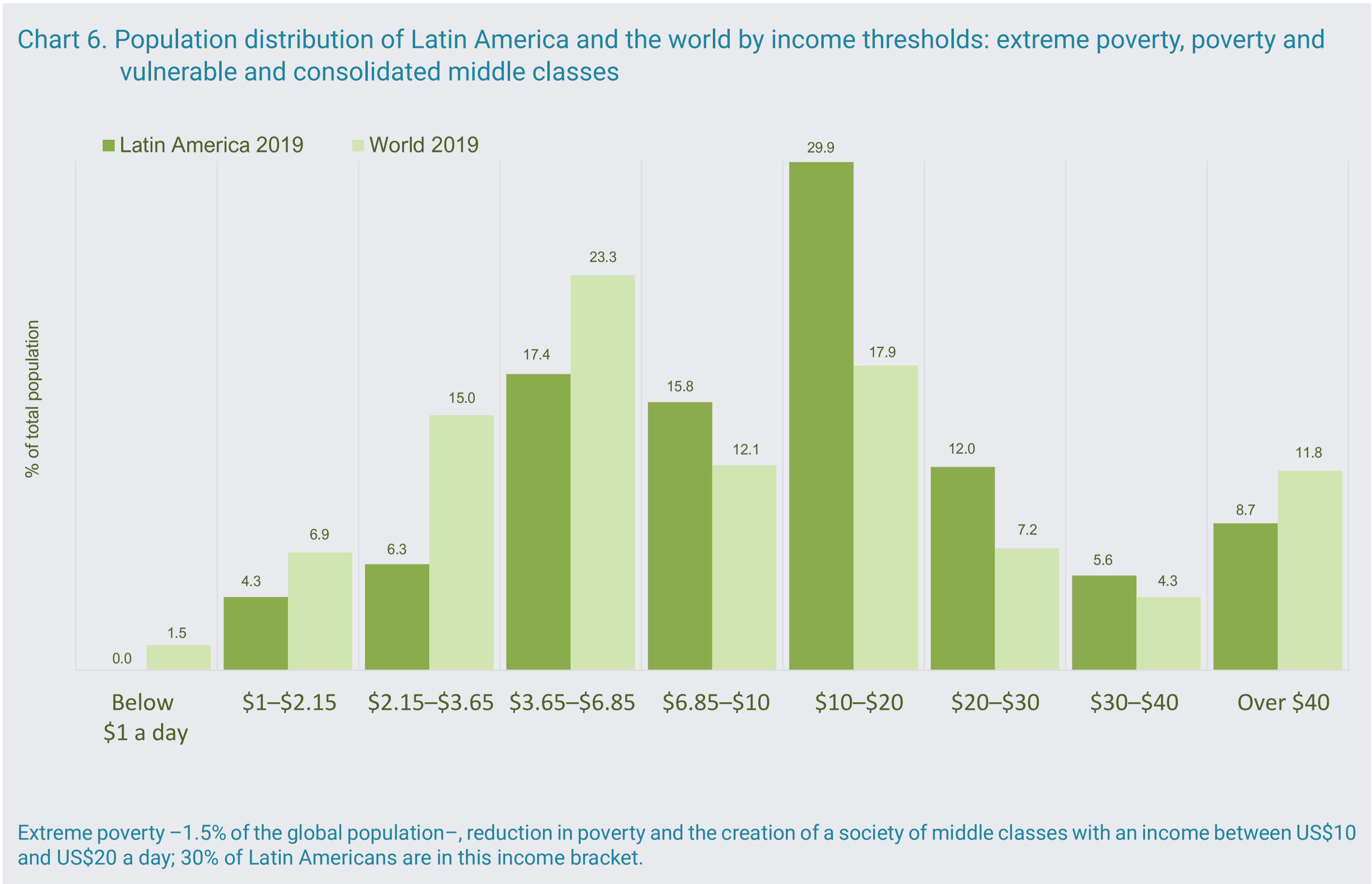


Although CCTs were designed to address poverty (as opposed to inequality), and notwithstanding their undesired side effects on political and economic incentives, they have marked the dawn of a new era in the history of the region's social policies.

Furthermore, in addition to the region's progress –albeit insufficient– combatting inequality, it has also made strides reducing poverty, especially extreme poverty.

Chart 6 compares the change in poverty in Latin America with the global economy using the standard bands for income distribution in the academic literature.

Chart 6. Population distribution of Latin America and the world by income thresholds: extreme poverty, poverty and vulnerable and consolidated middle classes



Extreme poverty –1.5% of the global population–, reduction in poverty and the creation of a society of middle classes with an income between US$10 and US$20 a day; 30% of Latin Americans are in this income bracket.

The key takeaway from the graph is the disappearance of extreme poverty in Latin America (the percentage of people living on less than one dollar a day). In 2019, despite the commitments for 2030, there were still 115 million people condemned to misery in the world. However, Latin America had managed to lift 24 million people out of this situation of poverty with respect to 1990.

Similarly, the number of people living on between US$1 and US$2.15 a day fell from 46 million to 25 million, while the number of people living on between US$2.15 and US$3.65 stabilised at 100 million. At the same time, the number of people living on between US$6.85 and US$10 almost doubled (from 59 to 93 million) and 200 million people were added to the segment living on between US$10 and US$20 a day.

This is an extraordinary feat in the history of emerging countries.

All this meant that by 2019 Latin America had become a middle-income society: 56% of Latin Americans had a daily income of over US$10, compared with 41% of the global population. Furthermore, 30% had a daily income of between US$10 and US$20, almost double the figure for the global population. Two decades before, this figure was just 12%, compared with 8% for the world.

While daily per capita income is not the only measure of the middle classes (especially if this income is subject to uncertainty and volatility that make people vulnerable to falling back into poverty), there has clearly been a positive –and highly disruptive– change in people's expectations in Latin America.

Managing these expectations is now key to the future of democracy and well-being. It is every bit as important as convincing people in the past that there was no Latin American curse that condemned them to a series of crises and military coups.

Leaving aside expectation management –which will undoubtedly be a highly complex politico-economic process– it is simply untenable to pretend nothing has changed when it comes to combatting inequality and poverty in Latin America.

The ground has shifted and many of the changes have been positive. Once again, the myth does not hold up to the facts. There is no lack of interest in problems of distribution or evidence that initiatives have failed. The only documented failure is that of the pessimists.

2. Is Latin America really a political disaster? An alternative narrative

The aim of the analysis in this section is twofold:[35]

The first is to use all the available information to determine whether the prevailing narrative of the socioeconomic and political dynamics in Latin America over the last decade (the cornerstone of perceptions of the region as a 'political disaster') holds up to the facts.

The second is to offer an alternative narrative –one of many possible accounts– that invites the reader to consider a different perspective.

This alternative is based on four key elements: (i) the global nature of political setbacks; (ii) the cyclical nature of political setbacks in the region, associated with the economic cycle; (iii) the prevalence of democracy as a political regime; and (iv) a majority of solid support for democracy and voters who identify with the centre ground.

Together, these four elements suggest that the reversal of recent setbacks will depend on changes in the global political context, which are already visible, and on the region's economy returning to growth after another decade of stagnation.

2.1. The prevailing narrative

Since 2019 –perhaps even before– the region has seen protest movements of varying levels of intensity and organisation in a number of countries. These movements include an attempt to occupy the buildings of the executive, legislative and judicial powers in Brazil; protests in Peru at the removal from office of President Castillo following a failed self-coup; Colombia's frustrated fiscal reform; rejection of the programme of adjustments agreed with the IMF in Ecuador; and protests following the rise in transport prices in Chile.

35 Our analysis follows the methodology of Izquierdo & Talvi (2007) in adopting a regional perspective. There are two main reasons why this regional abstraction is useful. First, because it emphasises common trends and patterns, which can be easily lost when analysing individual countries –the economic and sociopolitical performance of Latin American countries clearly has enough commonalities for this abstraction to make sense–. Secondly, despite the fact that not all countries perfectly fit the regional pattern in all dimensions (both similarities and contrasts), this abstraction provides a baseline for evaluating and analysing the behaviour of individual countries.

Of course, there are local reasons for specific protests in individual countries. However, there also appears to be a common denominator: the economic stagnation that followed the end of the commodities super cycle in 2013 and has been aggravated by the pandemic and rising inflation.

This has fuelled the portrayal of Latin America as stuck in a self-perpetuating socioeconomic and political decline –trapped in a vicious circle–. In broad terms, the process is characterised by the following features:

- Prolonged economic stagnation.
- Frustrated expectations, fuelling public discontent and unrest.
- Disenchantment with democracy, established political parties and the traditional political elite.
- Social protest movements.
- Protest votes and the fragmentation and polarisation of the political system.
- Fragile governability, instability and the inability to follow through on reform agendas.
- Low investment and persistent economic stagnation.

2.1.1. A decade of stagnation and frustration

Almost a decade on from the 2004-13 boom, when the region grew at an average of nearly 5% a year, GDP per capita has flatlined. The region's economy has performed worse than even the most pessimistic forecasts, including in the run up to the pandemic. Over the six-year period 2014-19, Latin America eked out average annual growth of just 1% (Figure 23a).

Figure 23. The socioeconomic dynamics of Latin America

Note: Latin America includes Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru, Uruguay, Costa Rica, El Salvador, Mexico, Guatemala, Honduras, Panama, the Dominican Republic, Venezuela, Nicaragua and Cuba. Venezuela, Nicaragua and Cuba are not included in the economic or electoral figures.
Figure 23b: 2021 data not available for Argentina, Paraguay and Uruguay.
Figure 23d: Based on data from Moody's.
Figure 23f: Data for the middle class for 2002, 2014 and 2019. Some countries vary in line with the availability of data for the year in question.
Source:
Figure 23a and 23b: World Economic Outlook, April 2023, IMF.
Figure 23c: World Economic Outlook, April 2023, IMF; and World Bank Data.
Figure 23d: Expansion.com.
Figure 23e: CEPALSTAT, United Nations.
Figure 23f: CEPALSTAT (United Nations) and *The Gradual Rise and Rapid Decline of the Middle Class in Latin America and the Caribbean* (World Bank).

This stagnation has led to a partial reversal of progress on poverty during the commodities boom. Moreover, millions of people who accessed the middle classes for the first time and glimpsed a brighter future for their children are now fearful at the prospect of losing the economic and social progress they have made (Figure 23f).

Based on a central economic scenario for the next five-year period characterised by a growth outlook of 2%, significantly higher international and internal interest rates and a high level of public debt (Figure 23c), there is limited scope for income redistribution and poverty reduction programmes on the same scale as during the boom years. Nor is there room for crucial public investment in physical and digital infrastructure to modernise Latin American economies and support their transition to a more sustainable productive model.

For millions of people, the future is now quite different to the one they imagined in 2013.

All this can be seen by comparing the GDP per capita forecast for 2021 if the region had continued to grow at the same rate as during the boom with the real observed value. On this measure, GDP per capita currently stands 20% below the 2013 forecast (Figure 23e).

The difference between the imagined level and reality has frustrated people's expectations and fuelled public discontent: one of the manifestations of this malaise has been a growing propensity to take to the streets (at least where this is possible).

Figure 24. Political dynamics in Latin America, 2013-22

Note:
Figure 24c: Latin America not available separate from the Caribbean. Does not include Mexico.
Source:
Figure 24a: Latinobarómetro.
Figure 24b: Latinobarómetro.
Figure 24c: 'The Age of Mass Protests: Understanding an Escalating Global Trend', Center for Strategic & International Studies.
Figure 24d: the authors.
Figure 24e: the authors.
Figure 24f: Worldwide Governance Indicators, World Bank.

2.1.2. Economic stagnation and dissatisfaction with democracy

Economic stagnation and public discontent are clearly reflected in the political arena. Since 2014 support for democracy as a political regime and satisfaction with its performance have fallen considerably. Support has fallen 10 points and satisfaction now averages just 27% across the region (Figure 24a).

a) Economic stagnation and protest votes

Protest votes have shown no mercy towards ruling parties. In the period 2018-22, opposition parties won 13 of the 19 presidential elections without suspicions of electoral fraud. This stands in stark contrast to the boom years, which saw incumbents largely re-elected. Kirchnerism in Argentina, the Workers' Party in Brazil, Uruguay's Broad Front, Evo Morales' MAS in Bolivia, Rafael Correa in Ecuador, Álvaro Uribe in Colombia and –albeit with an interregnum– Michelle Bachelet in Chile all mark the end of an era in which Presidents or their parties (where incumbents were not up for re-election) saw their mandates renewed (Figure 24d).

The protest vote explains the region's shift to the left since 2018. After four years of stagnation, most large countries had right-wing governments: Michel Temer in Brazil; Enrique Peña Nieto in Mexico; Iván Duque in Colombia; Mauricio Macri in Argentina; Martín Vizcarra (who succeeded Pedro Pablo Kuczynski) in Peru; and Sebastián Piñera in Chile. In contrast, countries with left-wing governments, such as Ecuador in 2018 and Uruguay in 2019, saw the election of right-wing or centre-right governments. The protest vote has been directed against ruling parties and does not represent an ideological shift among the electorate. While democracy is clearly no guarantee of good governments, it has certainly lived up to its promise of allowing the replacement of those that fail to live up to voters' expectations.

b) Fragmentation and polarisation

The long period of stagnation –which is now into its 10th year and spans two government terms– has sowed the seeds of disenchantment with establishment parties (where these still enjoy public support) and traditional political elites.

Latinobarómetro has found that trust in Presidents, governments and political parties has plummeted since the start of this phase, reaching the lowest levels on record (Figure 24b).

Faced with this situation, voters have also taken to the streets to express their discontent. The Centre for Strategic and International Studies (CSIS) estimates a five-fold increase in large-scale protests between 2009 and 2019 (Figure 24c). Similarly, since 2017 the Global Protest Tracker has recorded large-scale or violent protests in Bolivia, Brazil, Chile, Colombia, Ecuador, Haiti, Honduras, Nicaragua, Peru and Venezuela.

In addition to using large-scale protests to vent their frustrations, voters are also seeking political alternatives and have been tempted by new political platforms on both the left and the right.

Examples of this phenomenon include Jair Bolsonaro in Brazil, Nayib Bukele in El Salvador, Gabriel Boric and José Antonio Kast in Chile, Rodolfo Hernández and Gustavo Petro in Colombia, Pedro Castillo in Peru and Javier Milei in Argentina. All these figures have run on anti-establishment platforms. In some cases, they have even shown a penchant for authoritarianism and distain for the institutions of liberal democracy.

The flight towards alternative political parties has fragmented the political system, increasing the number of presidential candidates and the range of parties in parliament. This is clearly illustrated by the significant drop in the percentage of votes electing the winning presidential candidate in the first round of elections since the boom period (Figure 24e).

The flight from establishment parties represents a shift from the centre to the extremes of the political spectrum, inevitably resulting in the polarisation of the political system and the public, driving an ideological wedge between blocks with enough support to form a government.

This polarisation can be clearly seen in where voters see themselves on the political spectrum. Support for options outside the centre has grown since stagnation began (Figure 27d).

c) *Fragmentation, polarisation and governability*

If governability is the State's capacity to govern effectively and legitimately, its foundations are being eroded by rising fragmentation and polarisation, coupled with social protest movements (Figure 24f).

On the one hand, fragmentation means elected Presidents start their term with less political capital. This hinders their ability to build stable coalitions and reach agreements on legislation, making the task of governing harder.

One the other, polarisation creates a climate of permanent tension and conflict in the functioning of the political system, hampering the consensus-building needed to implement policies. Large-scale protests often tend to have a paralysing effect on the government's agenda.

As Malamud & Nuñez (2021) note, fragile governability means governments are unable to swiftly and effectively respond to public frustration and the lack of political and financial capital means they struggle to live up to the expectations of change they have generated.

d) Stagnation, governability and the investment climate

The combination of economic stagnation, high levels of debt, public discontent and fragile governability has affected credit ratings and the investment climate.

On average, Latin American countries were classed as 'investment grade' at the peak of the boom, whereas many have now been downgraded to 'speculative' (Figure 23d). This deterioration can also be seen in trends in investment. Since the onset of stagnation, investment has fallen by 1.4 points of GDP (Figure 23b), entrenching low expectations of growth and creating a vicious circle.

All this suggests that the prevailing narrative would appear to fit the facts.

However, an alternative explanation is also possible.

2.2. A different narrative

As explained at the start of this section, our alternative narrative is founded on four elements:

- The global nature of political setbacks.
- The cyclical nature of political setbacks, associated with the economic cycle.
- The prevalence of democracy as a political regime in Latin America.
- Solid and majority support for democracy in Latin America, backed by voters who identify with the centre ground.

2.2.1. Global trends

Figure 25 shows that political setbacks are not confined to Latin America. They take place against a backdrop of similar trends across all emerging regions, even in the US and Europe. This means it is impossible to understand what is happening in the region in isolation from the international context.

Without exceptions, the economic slowdown of the last decade has hit all emerging regions and investment has slowed or contracted in relation to GDP (Figures 25a and 25b). The economic slowdown and the pandemic have caused a rise in public debt and a deterioration in credit ratings across all emerging regions (Figures 25c and 25d).

Poor economic performance has not eroded support for democracy, with the exception of Emerging Europe, where, paradoxically, we have seen the rise of authoritarian governments in Turkey, Poland and Hungary (Figure 25e).

Disenchantment and dissatisfaction with democracy have fuelled protest movements in all emerging regions (Figure 25f), alongside political fragmentation and a deterioration in governability.

Figure 25. Global socioeconomic and political trends, 2013-22

Note:
Figure 25d: Based on the ratings of Moody's (or Fitch/S&P, where data is not available).
Figure 25e: Values are distributed based on a normal mean = 0 and variation = 1.
Figure 25f: Separate data not available for Eastern Europe.
Figure 25g: The 'fragmentation of the elites' is defined as the fragmentation of the State institutions based on ethnic, racial, religious or class factors, in addition to the use of nationalist rhetoric or xenophobia by these elites.
Source:
Figures 25a, 25b and 25c: World Economic Outlook, April 2023, IMF.
Figure 25d: Expansion.com.
Figure 25e: C. Claassen. Extracted from Our World in Data.
Figure 25f: 'The Age of Mass Protests: Understanding an Escalating Global Trend', CSIS.
Figure 25g: Fragilestatesindex.org.

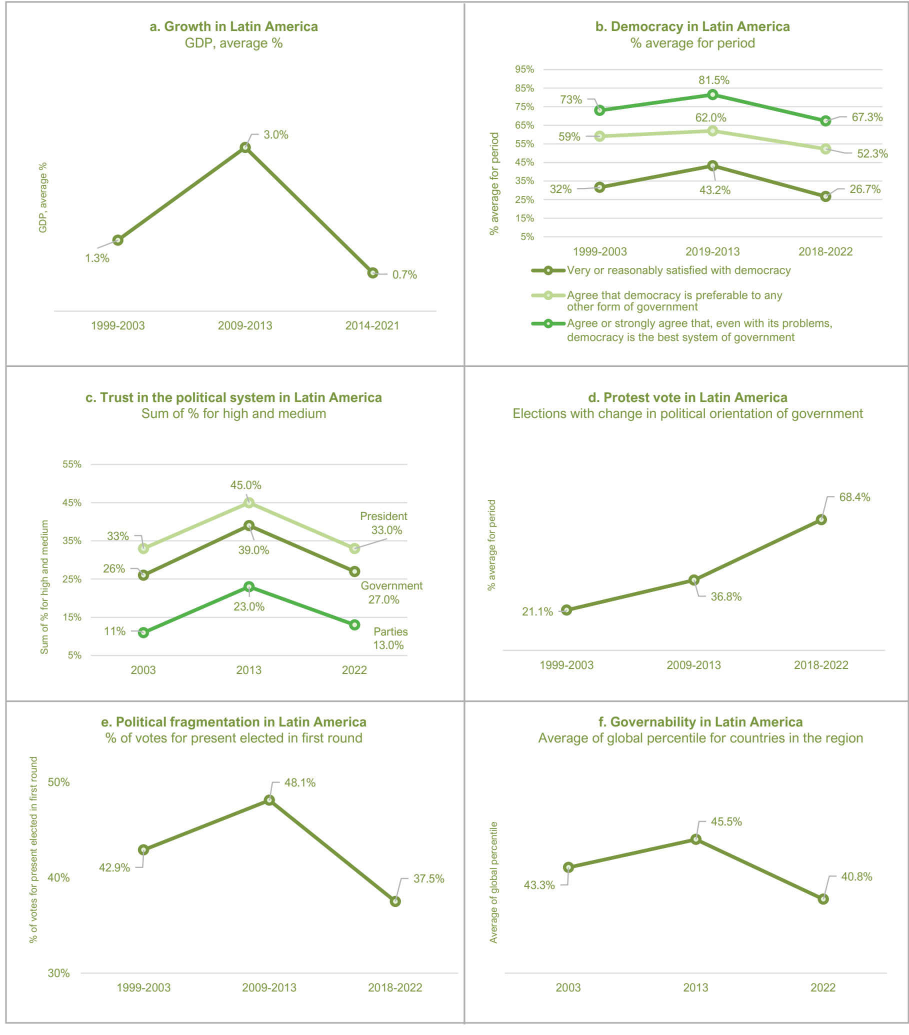
2.2.2. The economic and political cycles in Latin America

Not only do the political setbacks observed in Latin America form part of similar global trends, they also have a strong cyclical component related to the economic cycle. The poor economic growth of the last decade has resulted in average GDP growth similar to the previous period of stagnation between 1999 and 2003 (Figure 26a). Public support for and satisfaction with democracy conforms to a similar cycle, with levels slightly above those recorded during the stagnation of 1999-2003 (Figure 26b).

This cycle can also be observed in the levels of trust in the political system (parties, presidents and governments), which have fallen sharply since the boom years to levels similar to the previous period of economic stagnation (Figure 26c). While the protest vote has tended towards structural deterioration –a phenomenon of significant interest in its own right and one that goes beyond the economic cycle (Figure 26d)– rising political fragmentation and deteriorating governability exhibit a cyclical behaviour similar to the economy. Current levels of fragmentation and governability are on a par with those of 1999-2003 (Figures 26e and 26f).

In short, the current setbacks are not only related to the economic cycle but also reflect those observed during the previous period five-year episode of stagnation between 1999 and 2003. This suggests that, in fact, circumstances are to blame and the phenomenon will be reversed when the region's economy returns to health.

Figure 26. Latin American socioeconomic and political cycles, 2003/2013/2022



Source:
Figure 26a: World Economic Outlook, April 2023, IMF.
Figure 26b: Latinobarómetro.
Figure 26c: Latinobarómetro.
Figure 26d: the authors.
Figure 26e: the authors.
Figure 26f: Worldwide Governance Indicators, World Bank.

2.2.3. Latin America's democratic credentials

Despite setbacks in recent years, Latin America remains the world's most democratic emerging region.

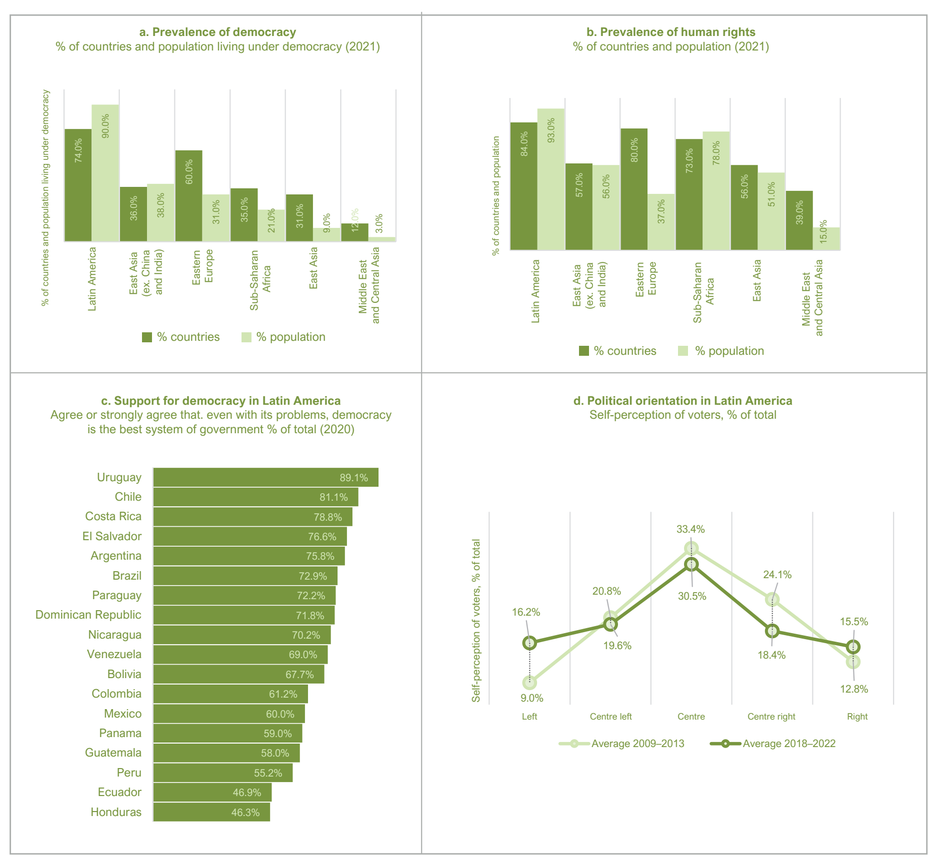
In terms of numbers, 74% of its countries –home to 90% of the region's population– are democracies (Figure 27a). It is also the emerging region with the largest proportion of countries that respect human rights and respect for human rights is also high in absolute terms: they are respected in 84% of countries, home to 93% of the region's population –the highest level across all emerging regions (Figure 27b)–.

Despite the cyclical setbacks of recent years, there is still majority support for democracy as a political system. Latinobarómetro found that 67% of people believe 'democracy may have problems but is the best system of government' (Figure 26b), with over 50% of respondents agreeing with this statement in 16 out of the 18 countries surveyed (Figure 27c).

While alternative non-mainstream political ideas have emerged on both the left and the right, radicalising political discourse, this change is not reflected among voters.

Most voters see themselves as in the centre of the political spectrum (68%) (Figure 27d). This suggests that the real reason for the electoral successes of more radical platforms is not their radical nature but their anti-establishment message. The triumph of Boric in the Chilean elections of 2020 and the subsequent loss of the referendum on the new constitution (backed by the government) is a telling example.

Figure 27. Democracy in Latin America: a comparative perspective



Note:
Figure 27b: Based on countries scoring over 0.5 on a scale of 0 to 1, where 1 implies the maximum level of respect for human rights.
Figure 27c: Values are distributed based on a normal mean = 0 and variation = 1.
Sources:
Figure 27a: V-Dem Institute. Extract from Our World in Data. Figure 27b: V-Dem Institute. Extract from Our World in Data. Figure 27c: Latinobarómetro.
Figure 27d: Latinobarómetro.

Conclusions

In contrast to the prevailing narrative, this alternative analysis has sought to frame the changes in Latin America in the context of global trends. The evidence shows that the dynamic in the region is similar to that of other emerging and developed countries. In other words, Latin America is not an exception in the global context. Far from it.

Many of the political setbacks observed in the region since 2013 are more cyclical than structural in nature and may not be permanent. Despite the cyclical setbacks of recent years, there is still majority support for democracy as a political system. Latinobarómetro has found that 67% of people believe 'democracy may have problems but is the best system of government', with over 50% of respondents agreeing with this statement in 16 out of the 18 countries surveyed. Moreover, while political alternatives on both the left and right have radicalised political discourse, this is not reflected in how voters perceive their political orientation: 68% still claim to be in the centre or on the centre left or centre right.

These four elements (the global and cyclical nature of political setbacks; the prevalence of democracy; solid majority support for democracy; and a majority of voters who identify with the political centre) suggests that the setbacks of recent years will be reversed when the global context changes and the region's economy recovers.

First, the global context has changed since Russia's invasion of Ukraine and authoritarianisms have begun to lose their sheen, resulting in a boost for Western democracies.

Secondly, we cannot rule out Latin America entering an expansionary phase over the coming years. During the last 50 years, growth rates have only topped 3% when commodity prices or capital inflows –or both– have been high. Since the invasion of Ukraine, the prices of certain commodities have risen sharply, in some cases reaching levels not seen since 2014. As US inflation has begun to ease –and despite the financial turbulence caused by the collapse of Silicon Valley Bank (SVB)– capital inflows to Latin America have recovered, although international interest rates are forecast to remain high.

Nor can we rule out the new geopolitical scenario created by Russia's invasion of Ukraine generating wealth for the continent, with its fertile land, sun, wind and water, and the capacity to produce clean, abundant and cheap energy. This would allow countries in the region to make a leap forward, building up the sophistication and complexity of their productive structure, laying the foundations for high and sustainable levels of growth and breaking from the dependence on favourable external conditions.

However, as is always the case when facing complex challenges, a major dose of democratic, outward-looking, pragmatic and intelligent political leadership is needed in order to seize this opportunity.

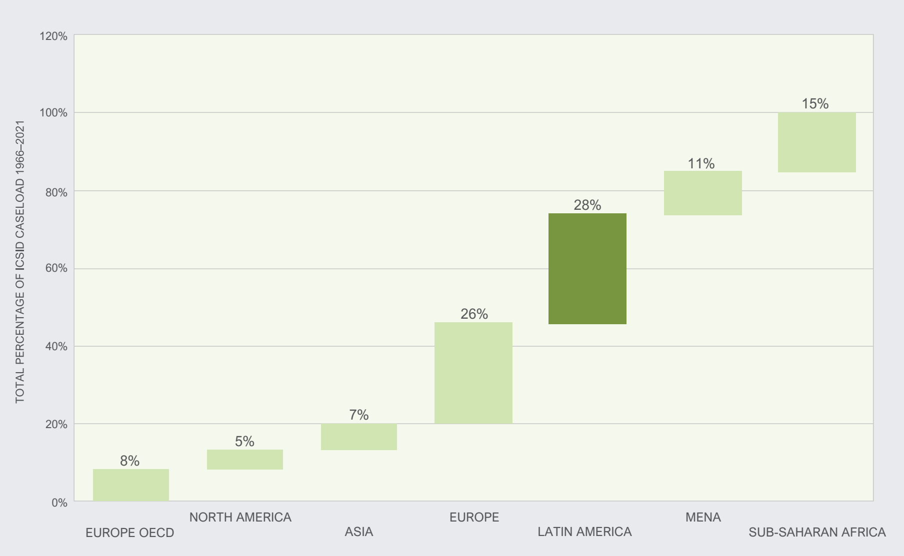
Beyond the background noise and the exceptions that confirm the rule, Latin America has many talented leaders on both sides of the political spectrum.

Box 3. Legal certainty in Latin America

It is often assumed that the main consequences of Latin America's economic failure –based on the tendency to achieve limited economic growth between major crises and the poor quality of its democracy– are centred on systematic violations of the rule of law, legal instability and failure to uphold the ownership rights of investors.

Latin America tops the list of foreign investor claims brought before the World Bank's International Centre for Settlement of Investment Disputes (ICSID): South America made up 22% of its caseload between 1966 and 2021 and Central America 6%. The combined total of 28% is two percentage points higher than all the cases generated by Eastern Europe and Central Asia and double those of Sub-Saharan Africa.

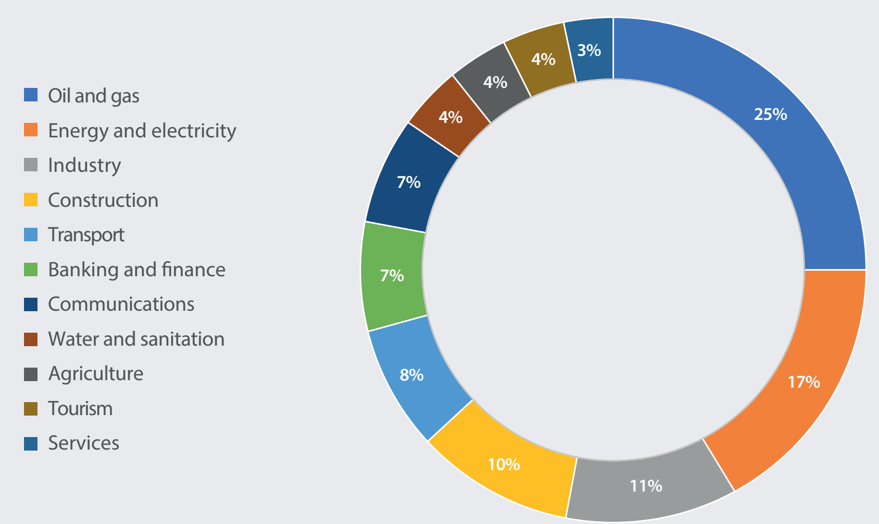
Chart 1. % of ICSID caseload, 1966-2021



Source: Elcano Royal Institute. The authors, using ICSID data, World Bank.

The breakdown of these figures is telling. Investments in mining, gas, electricity, transport and banking and finance make up 71% of all cases brought before ICSID. These sectors make up the bulk of FDI in Latin America. While investors in the region have brought more cases before ICSID than in other regions, there is a compound effect of the supposed legal uncertainty that plagues the region.

Chart 2. Distribution of ICSID caseload by sector, 1966-2021 (%)



Source: Elcano Royal Institute. The authors, using data from ICSID, World Bank. https://icsid.worldbank.org/es/node/12451.

For a more nuanced analysis of the alleged legal uncertainty in Latin America, we have used the World Bank's World Governance Indicators, last updated in 2021. Chart 3 shows respect for the rule of law in the main Latin American countries and their relative position among the 113 countries of the global economy. The indicator measures the decile in which each country is situated, estimating an average and minimum value for the period 1996-2021.

Chart 3. Legal certainty in Latin America: the range of the World Bank's rule of law indicator

Source: Elcano Royal Institute. The authors, using data from the World Bank's Worldwide Governance Indicators. https://info.worldbank.org/governance/wgi/.

Chile, Uruguay and Costa Rica are among the top 25% of countries (including developed ones) when it comes to respect for the rule of law. In contrast, Bolivia, Guatemala, Haiti and Venezuela are among the worst. There are no surprises when it comes to the region's biggest economies. Brazil tops the ranking (halfway down the global table), followed by Colombia, Mexico, Argentina and Peru. The most interesting observation is the range for countries like Argentina, which has a 34-percentile gap between the high and low, implying that for almost 20 years regulatory improvement has alternated with deterioration.

The heat map in Chart 4 allows us to further explore this idea. The map represents the deviations of each country throughout history, in line with their position in the global ranking. Green is used to signal that the year is above average and red shows a deterioration.

Chart 4. Latin America: heat map of the rule of law indicator: deviation from the mean, 1996-2021

COLOUR CODE: GREEN. IMPROVEMENT. RED. DETERIORATION

	DECILE 1996	1996	1998	2000	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	DECILE 2021	Change 2021-1996
Chile	85	0.1	-0.1	0.4	0.5	0.0	0.4	0.5	0.7	0.6	0.7	0.4	0.6	0.4	0.4	0.4	0.4	0.1	-1.0	-0.9	-1.2	-1.2	-1.2	-1.0	81	-5
Uruguay	66	-0.6	-0.4	-0.5	-0.3	-0.2	-1.1	-1.1	-0.6	-0.2	0.0	0.1	0.5	0.1	-0.1	-0.4	0.9	0.7	0.5	0.2	0.4	0.7	0.5	0.9	76	10
Costa Rica	68	0.3	0.4	-0.3	0.0	-0.1	-0.3	-0.4	-0.6	-1.0	-0.5	0.0	-0.2	-0.5	0.0	0.0	1.0	0.5	0.1	0.1	0.4	0.7	0.3	0.0	66	-2
Dom. Rep.	35	0.0	-0.1	-0.2	-0.3	-0.3	-0.3	-0.2	0.0	-0.2	-0.4	-0.8	-0.8	-0.7	-0.4	0.1	0.5	0.0	0.3	0.3	0.5	0.7	1.1	1.2	50	15
Panama	47	-0.6	-0.5	-0.9	-0.2	-0.2	0.0	0.0	0.0	-0.1	-0.1	0.3	0.3	1.0	-0.1	-0.5	1.1	0.7	1.0	0.6	0.1	-0.3	-0.8	-0.9	45	-2
Brazil	44	-0.3	-0.2	-0.5	-0.3	-0.4	-0.6	-0.8	-0.4	-0.5	0.0	0.4	0.9	1.0	0.6	0.6	1.1	0.5	0.0	-0.3	-0.3	0.0	0.0	-0.5	42	-2
Ecuador	38	0.9	0.7	0.5	0.3	0.1	0.2	0.1	-0.5	-0.6	-0.7	-0.9	-0.8	-0.7	-0.6	-0.2	-0.6	-0.5	0.4	0.2	0.3	0.6	0.6	1.1	41	3
Cuba	16	-0.7	-0.6	-0.5	-0.9	-0.9	-0.7	-0.7	0.0	0.2	-0.2	0.1	0.1	0.2	0.2	0.2	0.2	0.1	0.5	0.5	0.5	1.0	1.1	0.7	38	22
Colombia	26	-0.9	-0.5	-1.1	-0.7	-0.8	-0.6	-0.4	0.1	0.2	0.3	0.4	0.7	0.8	0.5	0.3	0.6	0.7	0.6	0.2	0.1	0.2	-0.3	-0.2	36	10
Argentina	54	1.1	0.9	0.5	-0.5	-0.5	-0.6	0.0	0.0	-0.1	-0.4	-0.3	-0.1	-0.1	-0.2	-0.2	-0.9	-0.4	0.4	0.7	0.7	0.2	0.0	0.0	35	-19
Peru	28	-0.6	-0.6	-0.4	0.6	0.2	0.5	-0.3	-0.7	-0.9	-0.9	-0.1	0.3	0.0	0.3	0.3	0.2	0.7	0.2	0.0	0.0	0.1	1.1	0.1	33	5
Paraguay	29	0.3	-0.1	-0.3	-0.9	-0.7	-0.6	-0.5	-0.5	-0.6	-0.4	-0.3	0.0	0.0	0.0	0.1	0.6	0.5	0.2	0.3	0.5	0.5	1.1	0.6	32	3
Mexico	27	-0.8	0.0	0.3	0.6	0.8	0.6	0.7	0.6	0.1	-0.6	0.0	0.1	0.0	0.3	0.1	0.5	0.5	-0.3	-0.3	-0.6	-0.8	-0.7	-1.2	23	-4
El Salvador	22	-0.6	0.1	-0.1	0.7	1.0	0.9	1.0	0.2	-0.1	0.0	-0.2	-0.6	-0.2	0.1	0.6	0.9	0.3	-0.3	-0.8	-1.0	-0.8	-0.5	-0.7	22	0
Honduras	21	0.3	0.5	0.2	0.5	0.1	0.4	1.1	-0.1	0.2	0.1	0.2	0.5	0.2	-0.9	-0.8	-0.2	0.0	-0.7	-0.5	-0.3	-0.4	-0.1	-0.3	15	-6
Guatemala	17	0.2	0.3	1.4	0.4	-0.1	0.2	0.1	-0.4	-0.4	-0.6	0.3	0.6	0.0	-0.3	-0.3	0.0	0.2	0.0	-0.4	-0.2	-0.4	-0.4	-0.2	14	-3
Bolivia	43	1.2	1.2	1.0	1.0	1.0	0.6	0.4	0.1	0.1	-0.2	-0.4	-0.4	-0.2	-0.3	-0.3	-0.5	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6	-0.5	12	-31
Haiti	8	0.0	-0.2	-0.5	-0.8	-0.8	-0.8	-0.7	-0.3	-0.1	0.1	-0.3	-0.3	-0.3	-0.1	-0.1	0.1	0.2	1.0	0.6	0.9	1.1	1.0	0.2	9	1
Nicaragua	35	0.7	0.5	0.1	0.5	0.7	-0.1	0.6	0.1	-0.1	-0.1	0.0	-0.1	0.2	0.2	0.4	0.1	0.1	0.3	0.3	-0.8	-1.1	-1.1	-1.3	7	-28
Venezuela	26	1.3	1.4	1.2	0.4	0.1	0.2	0.2	0.0	-0.2	-0.3	-0.2	-0.3	-0.3	-0.4	-0.3	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	0	-26
AVERAGE	37	0.1	0.1	0.0	0.0	-0.1	-0.1	0.0	-0.1	-0.2	-0.2	-0.1	0.1	0.0	0.0	0.0	0.3	0.2	0.1	0.0	0.0	0.0	0.0	-0.1	34	-3
MEDIAN	32	0.1	0.0	-0.2	0.1	-0.1	-0.1	0.0	0.0	-0.1	-0.2	0.0	0.0	0.0	-0.1	0.0	0.3	0.2	0.2	0.2	0.0	0.1	-0.1	-0.2	34	-2

Source: Elcano Royal Institute. The authors, based on data from the World Bank's Worldwide Governance Indicators

3. The EU and the US have abandoned Latin America

There is a widespread perception that the EU and –to a certain extent– the US have turned their back on Latin America. In doing so, they are alleged to have left a void that has been filled by China, transforming the Asian giant into the dominant force in the region when it comes to imports of the products produced and exported by Latin America, investment in infrastructure and actively providing loans on a par with multilateral institutions like the IMF and the World Bank.

However, once again, the facts paint a different picture.

Mexico and Central America are inextricably tied to the US in all dimensions, not just economic, trade and investment, but also in relation to military ties (arms sales) and human connections (migrants, tourists and students).

The picture in South America is different: while China may be a force to be reckoned with in the strictly limited sphere of trade (as a buyer of natural resources and primary products and an exporter of manufactured goods), South America is much more 'European' in its ties, whether it on investment, military or human relations.

3.1. A giant is born

In barely 30 years, China has gone from irrelevance to become a global economic giant. It now accounts for 18% of global GDP, compared with just 3% in 1990, slightly less than the US and on a par with the EU (Figure 28a).

Figure 28. The phenomenon of China

Note: all calculations exclude intra-community trade.
Source: the authors, based on data from UNCTADstat, United Nations Conference on Trade and Development.

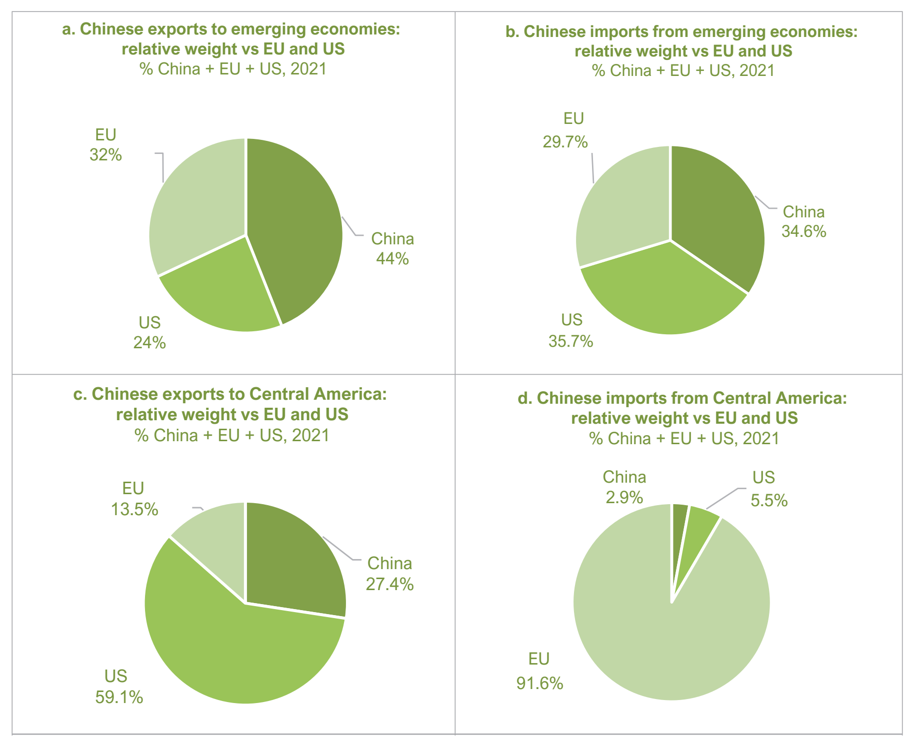
Naturally, its share of the global economy has increased as its own economy has grown (Figure 28b). China now makes up 18% of global exports, making it the world's biggest global exporter, ahead of the EU and the US. It also makes up 14% of global imports, on a par with the EU and the US (Figure 28d and 28e).

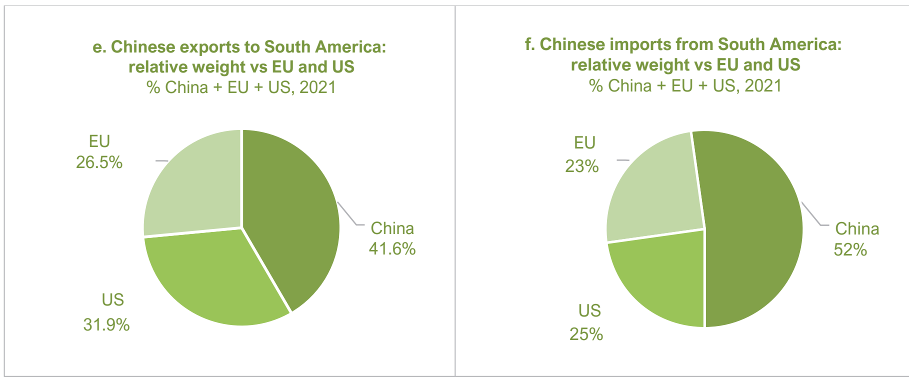
It is interesting to note that, of the world's three main economic blocs (the US, the EU and China), only the EU has grown above its relative weight when it comes to global trade (excluding intra-community trade). The EU also has the most open economy in relation to its economic dimensions (Figure 28f).

3.2. China as a competitor and a market

China has become a formidable competitor when it comes to emerging economies. Its exports to emerging countries are almost equal to the combined total for the US and the EU (Figure 29a).

Figure 29. China as a competitor and a market





Source: the authors, based on data from UNCTADstat, United Nations Conference on Trade and Development.

However, the EU and the US remain the main export markets for emerging economies.

The combined total of US and EU imports from emerging economies is almost double the figure for China. Moreover, taken separately, US and EU imports are similar and comparable to China (Figure 29b).

However, as a competitor and a market for Latin America, China presents two different realities.

China is an extremely small export market for Mexico and Central America, compared with the dominant player (the US). A total of 92% of Mexico and Central America's exports to the three main economic blocs (the US, the EU and China) are destined for the US (Figure 29c).

The opposite is true in South America. China is the main export destination, outstripping the combined total for the EU and the US (Figure 29e).

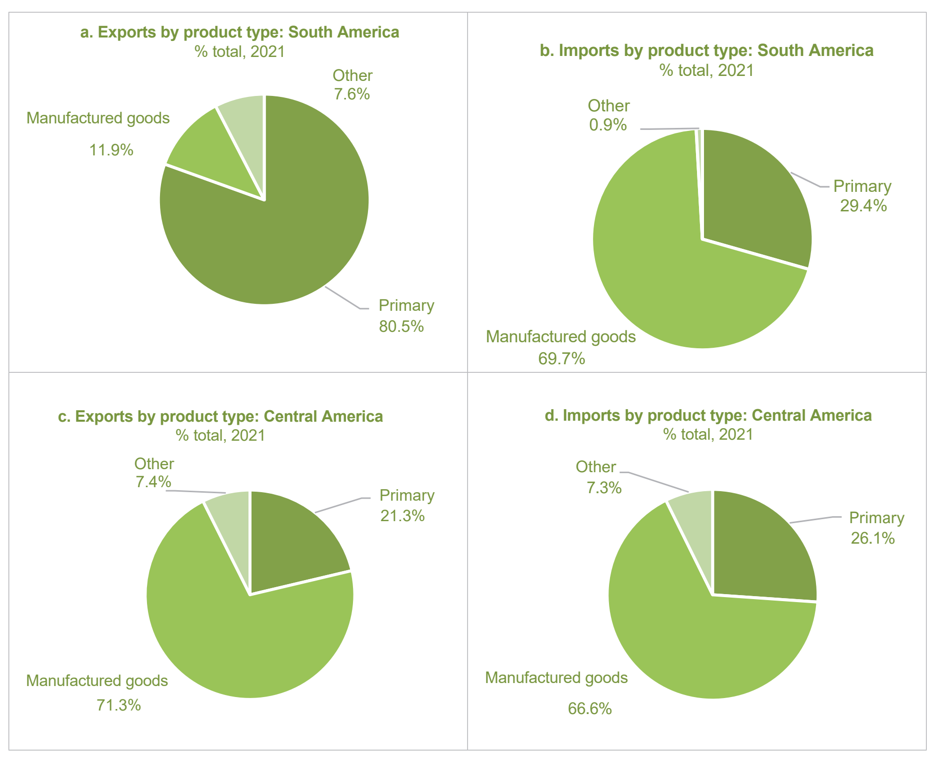
In terms of imports from China, participation is more balanced for Mexico and Central America and shares a similar pattern to Chinese imports in South America (Figures 29d and 29f).

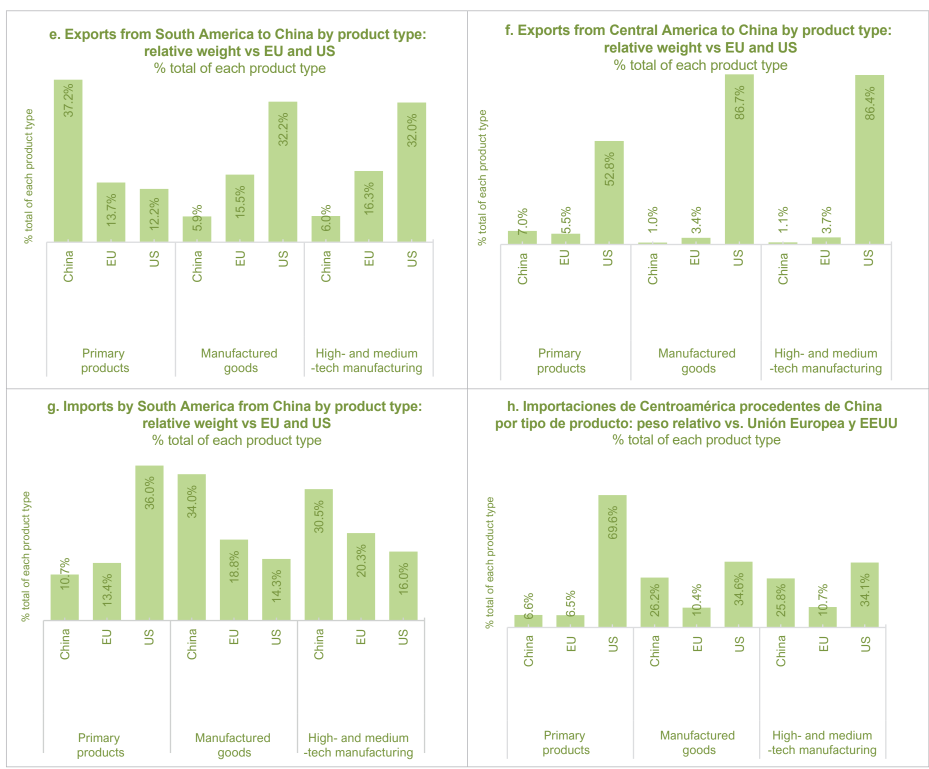
3.3. China as a buyer and seller of primary and manufactured goods

Given the limited scale of China's trade with Mexico and Central America in relation to the US, this section will focus on South America, where the situation is markedly different.

What does China buy from South America and what does it sell? The region is a major exporter of natural resources and commodities, manufactured products derived from natural resources and in the agro-industry sector. These make up 80% of the region's total exports (Figure 30a) and China is the main buyer (37% of the total), above the combined total for the EU and the US (Figure 30e).

Figure 30. China as a buyer and seller of primary and manufactured goods





Note: primary products include agro-industry and products from natural resources; manufactured goods include all goods with a technology component (high, medium or low).
Source: the authors, based on data from UNCTADstat, United Nations Conference on Trade and Development.

South America is a major importer of manufactured goods (70% of the total), most of which come from China (35%), whose share is equal to the combined total for the EU and the US (Figures 30b and 30g). China is the main exporter of high-tech manufactured goods to South America, making up 30% of the total (also higher than the combined total for the EU and the US).

The trade relationship between South America and China is highly asymmetric: the former sells natural resources and primary products (and associated manufactured goods) and buys medium- and high-tech manufactured goods.[36] Even though the agro-industrial chain and the industrialisation of natural resources contain segments with high value-added and highly sophisticated manufactured goods, these chains primarily produce and export commodities, whose prices are determined on the global market.

36 Even Mexico and Central America, which primarily export industrial products to the US, import a quarter of their medium- and high-tech manufactured goods from China.

South America exports a small amount of high value-added and highly sophisticated manufactured goods. But where do these exports go? Half are sold to the US and the EU, while just 6% are destined for China (Figure 30e).

This last dimension is key to understanding trade relations with China. Harvard University's Growth Lab has found export sophistication to be a good predictor of future growth: tell me where you export and I will tell you how much you will grow.

This means that, despite its balanced geopolitical position with respect to the EU and China, South America –especially Brazil– prioritises the former on trade.

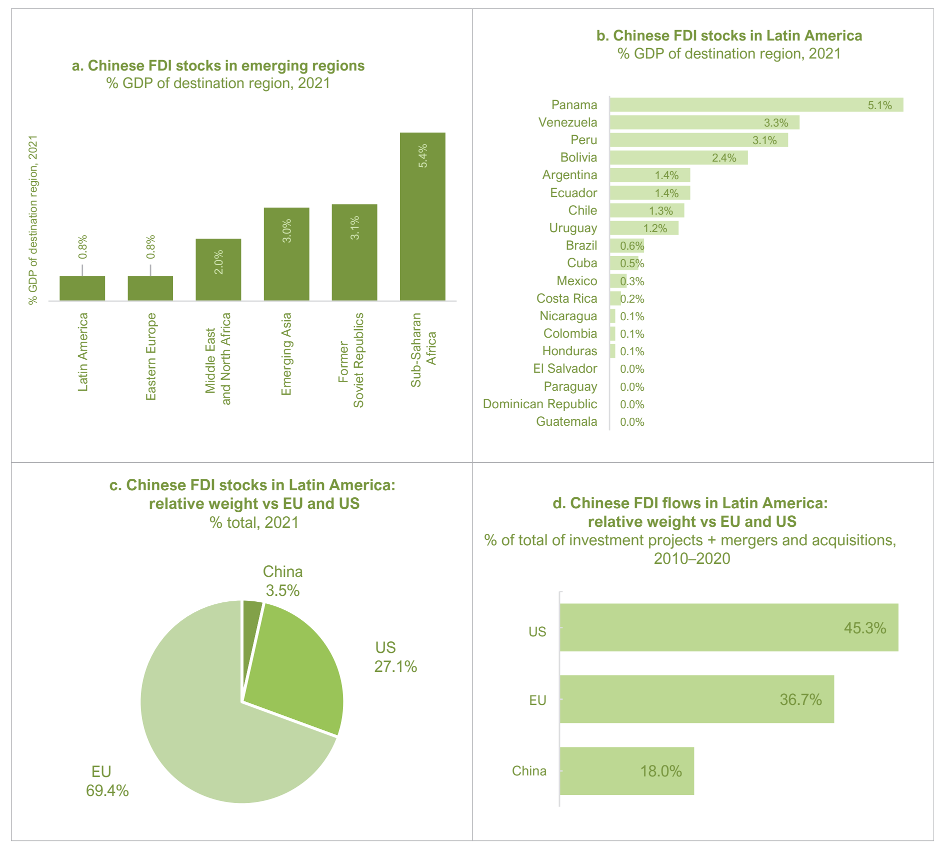
The logic is clear: a deeper trade relationship with China (eg, a free trade agreement), would mean making it easier to sell what it already sells (natural resources and primary products) in return for greater access to Latin America's markets for medium and high-tech manufactured goods, whose local production –if done competitively– could contribute to development.

3.4. China as an investor

While anecdotal evidence suggests Latin America is on the receiving end of an avalanche of Chinese investment in infrastructure and other strategic areas in order to secure a ready supply of natural resources and food, the data paint a different picture.

First, Latin America is the emerging region with the lowest direct investment from China, whose stock of FDI amounts to little over 1% of GDP (Figure 31a).

Figure 31. Chinese FDI in Latin America



Note: investments over US$50 billion from international investment platforms (Hong Kong, the Virgin Islands, the Cayman Islands, Bermuda and the Isle of Man) have been proportionally distributed across the rest of the world.
Source: the authors, based on the IMF's Coordinated Direct Investment Survey.
Figure 31d: The authors, based on ECLAC.

Secondly, the stock of Chinese investment only exceeds 5% of GDP in one country: Panama (Figure 31b).

Third, total EU and US investment stock in Latin America is 20 times the figure for China (Figure 31c).

One possible objection to this analysis is that cumulative stocks reflect the past, not the present or the future. Figure 31d shows FDI flows between 2010 and 2020. The bulk of all investment projects and mergers and acquisitions originated

in the US and EU. Moreover, while China's share of FDI flows is higher than for investment stocks, the figures for the EU and the US are five times higher.[37]

3.5. China as a lender

Just like on investment, the narrative suggests that not only does China dominate the provision of bilateral loans to countries in the region, it is also competing with multilateral institutions like the IMF and the World Bank as a source of finance.

But once again, the data tell a different story.

First, together with South Asia, Latin America is the emerging region with the lowest levels of indebtedness to China (Figure 32a).

Secondly, the stock of bilateral loans from China –including the figures for its development banks (its main source of foreign financing)– only exceeds 5% of GDP in Venezuela, Ecuador, Bolivia, Suriname, Guyana, Jamaica, the Bahamas and Dominica (Figure 32b).

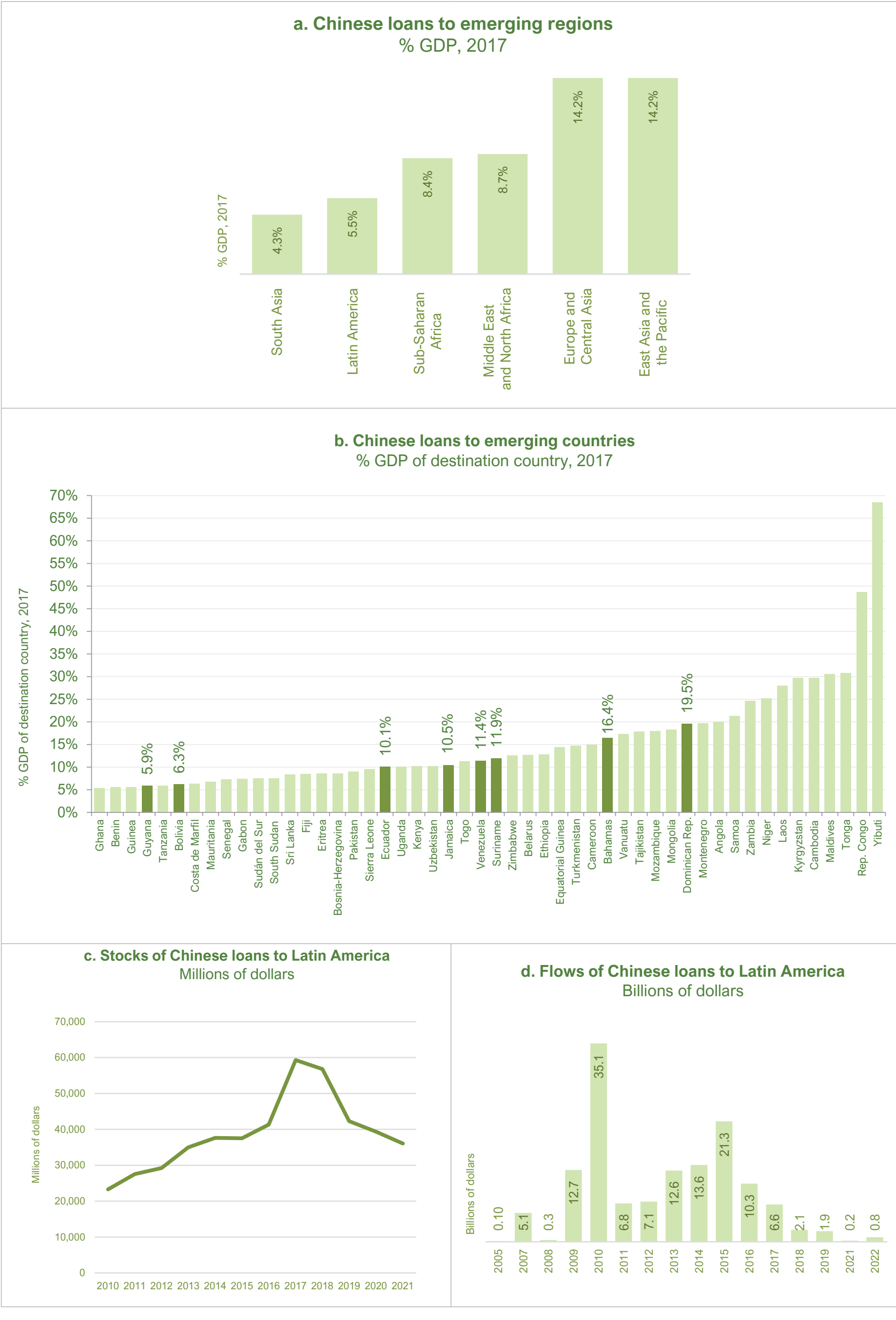
Third, flows and stocks of bilateral Chinese loans have fallen sharply since 2017, following the sharp slowdown in China's growth, and payment difficulties in debtor states have forced the country to repeatedly restructure and cancel loans (Figures 32c and 32d).

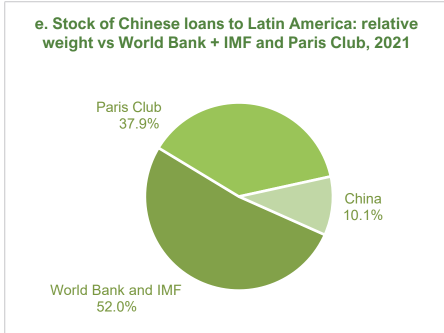
The fall in Chinese loans to Latin America, coupled with the rise in loans from the IMF and the World Bank during the pandemic, has reduced its share as a creditor to just 11% of all loans to the region from the IMF, the World Bank, the Paris Club and China (Figure 32e).

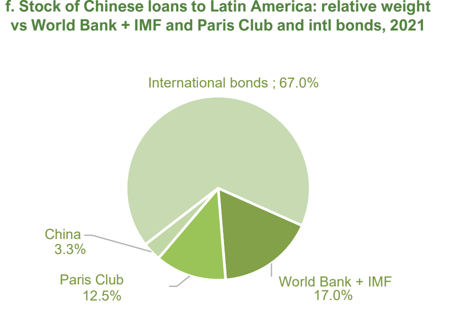
If we include bonds issued by Latin America under international jurisdictions (85% of which are Western jurisdictions, primarily New York and London), China's share of total credit to the region is just 3% (Figure 32f).

37 FDI flows over the last 10 years also show an increase in the share of the US relative to the EU.

Figure 32. Chinese bilateral loans to Latin America







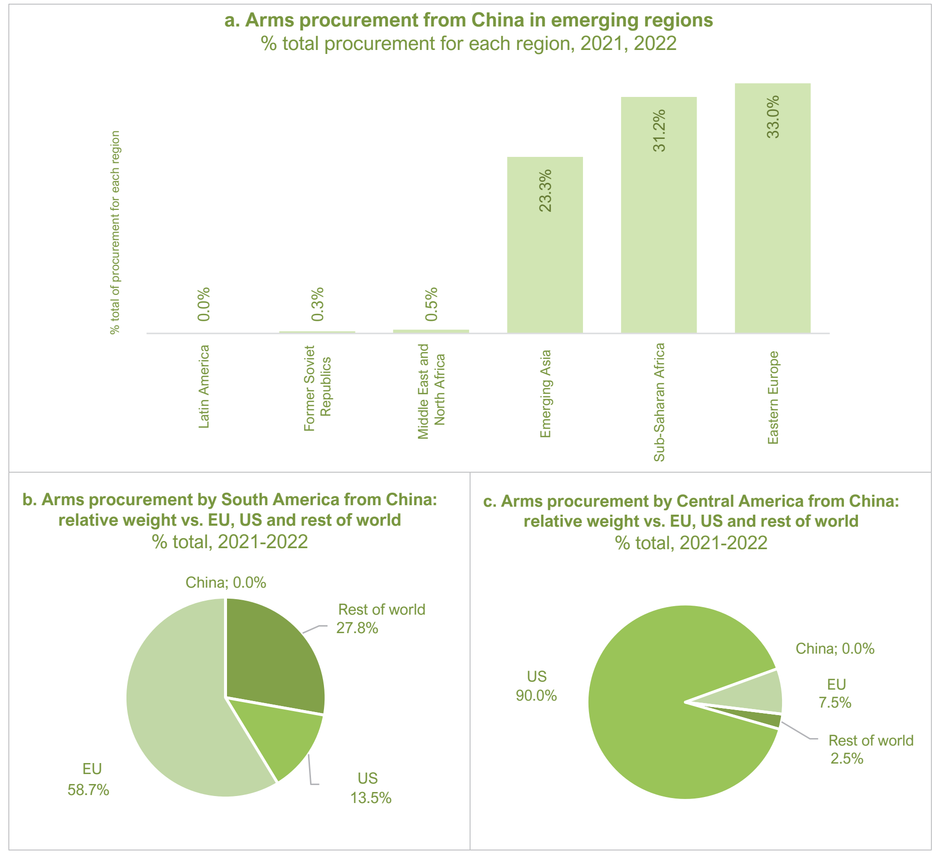
Note:
Figure 32a: The regions have been restructured to align with those used by the World Bank.
Figure 32b: Countries with a percentage over 5%.
Figure 32d: The data shows the flow of agreed loans from the China Development Bank and the Export-Import Bank of China. This data does not represent actual amounts dispersed and can include any form of loan or investment classified by Chinese development banks as 'loans for development'.
Source:
Figures 32a, b, c, e, f: the authors, based on Horn *et al*. (2019a) and World Bank (2021). Figure 32d: Myers & Ray (2023).

3.6. China in the military sphere

China has almost no influence in the military sphere.

Not only are Chinese arms sales to Latin America the lowest across all emerging regions, no sales were recorded in 2020 and 2021 (Figure 33a). During these two years, the region's arms purchases were from the EU and the US, with South America favouring the former and Mexico and Central America favouring the latter. A total of 90% of arms purchases by Mexico and Central America were from the US, while almost 60% of sales in South America came from the EU –a ratio of four to one–.

Figure 33. Military ties with China



Source: the authors, based on the Arms Transfers Database of the Stockholm International Peace Research Institute.

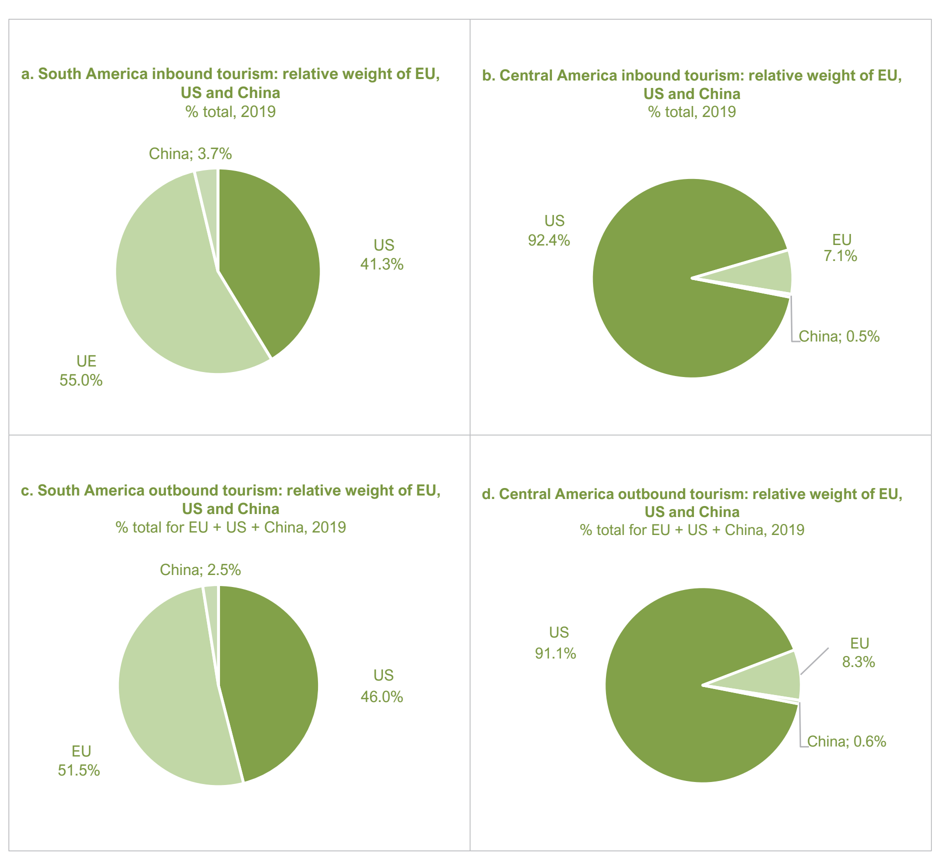
3.7. China and Latin America: tourism, higher education migration

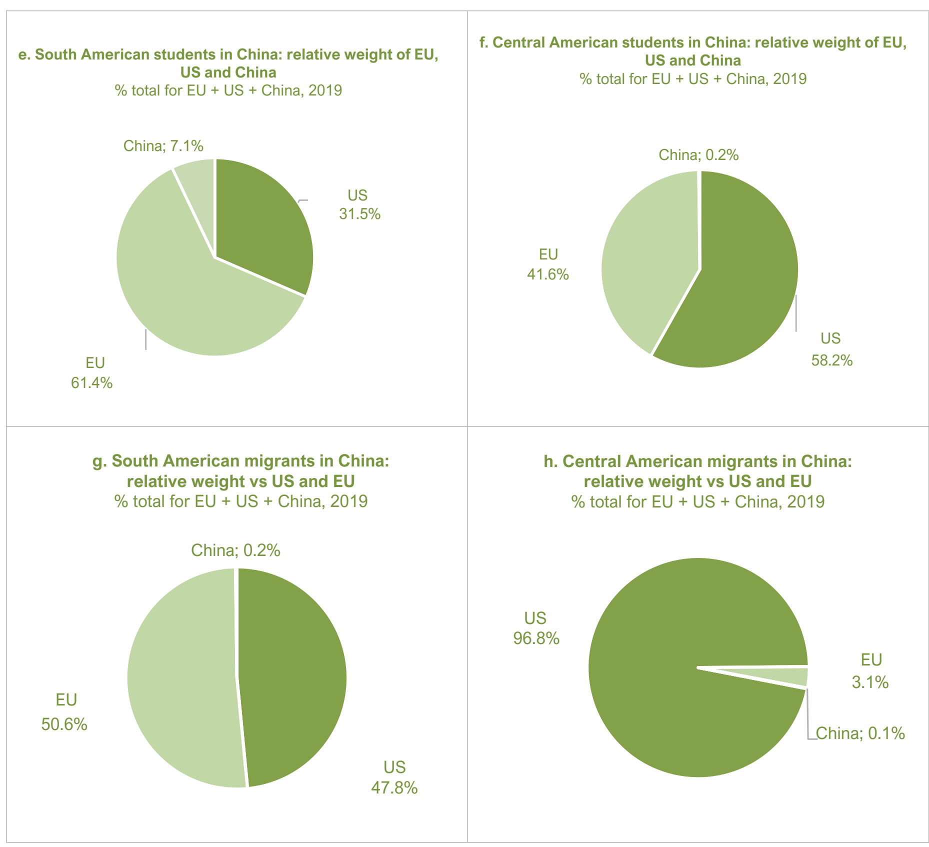
In terms of human ties with Latin America, there is a huge gulf between the West and China.

The US predominates almost exclusively in Mexico and Central America. Over 90% of tourism involves the US (Figures 34b and 34d). Similarly, 60% of Mexican and Central American students who study abroad do so at US universities (Figure 34f), 97% of migrants live in the US (Figure 34h) and 97% of international transfers from Mexican and Central American immigrants come from the same country of origin.

In contrast the EU is the main partner in South America. The former accounts for 56% of the latter's inbound tourism and 52% of outbound tourism (Figures 34a and 34c). A total of 60% of South American students who study abroad do so at European universities (Figure 34e) and 50% of South American migrants live in the EU (Figure 34g). This dynamic means that a similar percentage of international transfers originate from EU countries.

Figure 34. Human ties with Latin America





Note:
Figures 34e and 34f: Data on Chinese students is estimated based on the number of Chinese students in South America and Central America.
Figure 34. Figures are estimated for China as data are unavailable.
Source:
Figures 34a, 34b, 34c and 34d: the authors, based on the World Tourism Organization's Yearbook of Tourism Statistics 2022.
Figures 34e and 34f: the authors, based on the UNESCO Institute for Statistics.
Figures 34g and 34h: the authors, based on the United Nations Population Division International Migrant Stock 2020.

Conclusions

In barely 30 years, China has risen to become a global economic giant whose size is on a par with the US and the EU. It is only natural that its share of global trade has increased. Yet despite the formidable increase in its share of global GDP and trade, China is underrepresented across all three areas: as an export market for products of medium or high sophistication; FDI; and financial, human and military relations.

The EU and the US remain the dominant forces in Latin America: Mexico and Central America have strong ties to the latter in all areas, while South America can be regarded as 'more European' in all areas except for trade.

Once again, careful analysis of the data challenges the received wisdom: neither the EU nor the US have abandoned Latin America and nor has China become the dominant force in the region.

4. Spanish companies are withdrawing from Latin America

In January 1992, FDI from Spanish companies stood at just €43 billion. Fast forward three decades and this figure had ballooned to €570 billion. The increase in Spanish investment in the global economy is one of the most intense and rapid transformations experienced by the Spanish economy over the last five decades. It has also been one of the most far-reaching. It has driven a dramatic change in Spain's international nature and projection, as well as in its corporate sector.

The prevailing narrative states that Spanish companies seized on the opening up and economic restructuring of Latin America that followed the region's lost decade. Spain capitalised on its close cultural and historic ties and access to cheap and abundant international finance that came with its accession to the European Economic Community, allowing the country to internationalise and insert itself into global value chains.

After first gaining a foothold in Latin America, Spanish companies then began to diversify their foreign investment, entering other markets, primarily Europe and the US. This second phase of internationalisation saw Spain's role shrink in Latin America, a trend that was accelerated by Argentina's convertibility crisis, which reminded businesses of the significant risks associated with investing in emerging countries.

However, like all simplifications, this narrative contains both elements of truth and misrepresentations.

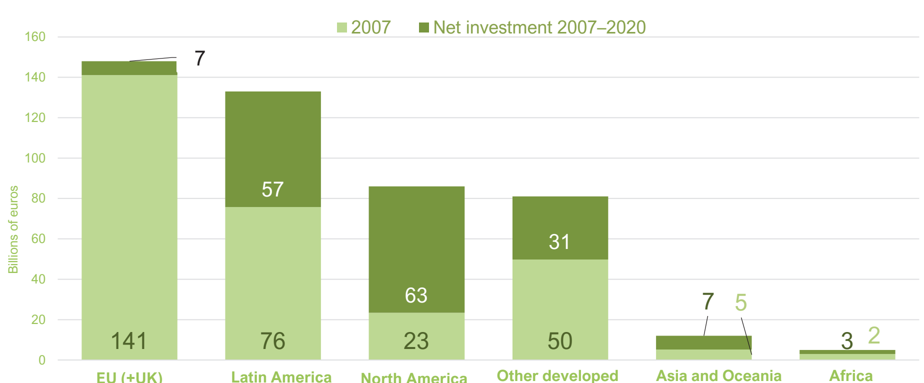
Figure 35 shows that investment by Spanish companies can be divided into two main periods.

1) From the 1990s to 2007, up to the Great Recession of 2008.
2) Net investment between 2008 and 2020 (the last year for which data is available).

Investment stocks have been grouped into seven geographic areas: the EU; non-EU developed countries; all developed countries; Latin America; other emerging markets; all emerging markets; and all Spanish foreign investment.[38]

38 Data on investment stocks, profits, volume and employment are taken from Spain's Datainvex and Globalinvex databases, maintained by the Ministry of Industry, Trade and Tourism's Subdirectorate-General of Foreign Investment. The first database provides data on flows and stocks of Spanish FDI and foreign investment in Spain since 1993. The second provides data on flows and stocks of both since 2007, broken down by country, sector and autonomous community, complemented by data on equity, volume, profit and the use of foreign subsidiaries. Our thanks to the team responsible for generating and managing this data, especially Deputy Director Ignacio Mezquita Pérez-Andújar, Fernando Carballada Díaz and Eduardo Pietro Kessler.

Figure 35. The two phases of foreign investment by Spanish companies (€ bn)



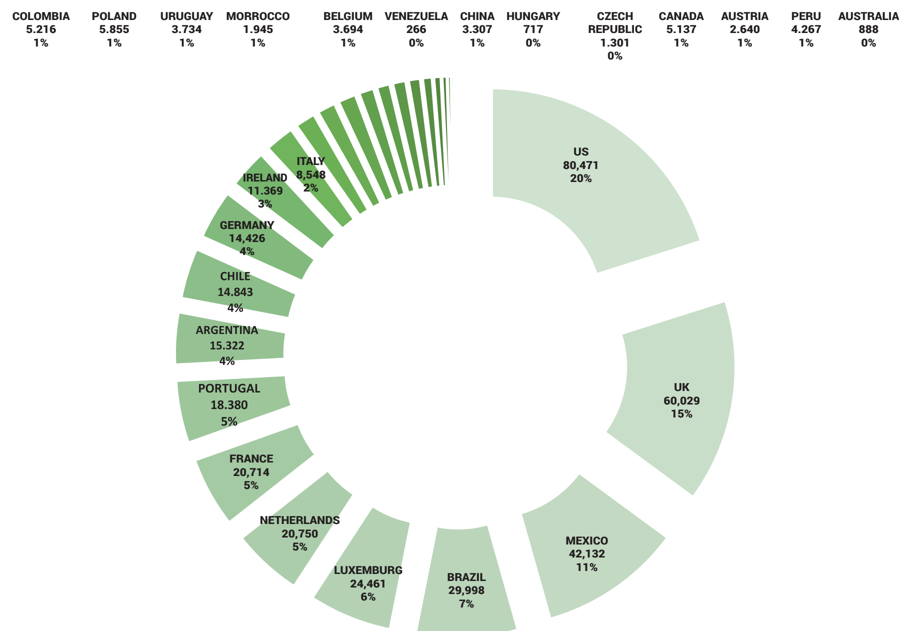
A closer look at investment prior to 2007 challenges the assumption that Spain's foreign investment began in Latin America. In 2007 EU investment stock was double the net cumulative investment in Latin America. If we add the investment stock for other developed countries, the proportion becomes three to one.

Nor does the data support the hypothesis of a sudden stop in Spanish investment in Latin America after the 2001-03 crisis. On the contrary, while investment slowed down in the EU, it grew in Latin America, fuelled by the golden years of the 2003-14 supercycle, driven by China's integration into the global economy. Between 2007 and 2020, of every €100 invested €30 went to Latin America, while €55 went to the US and the remainder to other developed countries. The EU only accounted for 4% of net Spanish FDI.

The map of Spanish foreign investment stock clearly shows two key features of the investment process. The first is that Spanish companies have tended to prioritise developed markets, which make up two-thirds of the net assets of their subsidiaries. The second is that investment by Spanish companies in emerging markets is concentrated on Latin America. Africa and Emerging Asia make up just 3% of Spanish FDI.

A more detailed analysis shows that, even though Spanish companies have investments in 82 in economies, 95% of investment is concentrated in 26 countries: 12 are developed, nine are in Latin America, and five are in emerging countries in Europe, Africa and Asia.

Figure 36. Capital stock of Spain, 2020 (€ bn)



The US is the top investment destination, followed by the UK. The EU comes third on the list, followed by Latin America, with 27%. The shares of China and Morrocco are negligible. In the EU, the Netherlands, Luxembourg and Ireland account for half of all investment (probably because Spanish subsidiaries in these countries play a key role in investing in other economies).

Between 2007 and 2020, Spanish subsidiaries in these 26 economies generated profits of €500 billion: €259 billion from developed countries and €226 billion from emerging countries. Latin America's contribution is €218 billion (45% of the total).

The overall rate of return for the period is 9.3%. The corresponding figure for developed countries is 7.3%, whereas for emerging countries (in other words, Latin America) it is 13.6%.

The gap of over four percentage points reflects the different levels of macro and political risk of investing in mature economies and developing countries.

This data also clash with claims of the withdrawal of Spanish investment from Latin America (which has not been the case).

The central thesis is that the volatility and low return on initial investment, together with legal uncertainty and poor economic growth, have led companies to limit their exposure.

Rigorous analysis of the return on investment decisions taken by thousands of companies over three decades would be highly complex.[39] This perhaps explains the lack of studies exploring whether such investment has created or destroyed value for shareholders.

The aggregate nature of our analysis means it is subject to certain limitations.

The first is obvious: assessing value creation for shareholders of a company that invests abroad must be done on a case-by-case basis. While the country in which the subsidiary is created matters, value can also be created in a host country with poor and volatile macroeconomic conditions because a company's sector and management capacity are also important. Indeed, they are often decisive. The estimated returns presented here and grouped by country are merely a simplification of the central scenario faced by companies in their destination countries.

The second caveat is that while the average rate of return (where data on equity invested and profitability are available) is immediate, this does not indicate whether value has been created –or destroyed– for the shareholder of the parent company nor, for that matter, the subsidiary.

Estimating value creation requires us to deduce the cost of capital from nominal returns (ie, the financial resources required to make the investment). The cost of capital is also specific to individual companies. It depends on the structure of their finance (the combination of debt and equity with which companies finance investment), their position in the market, the sector in which they operate, idiosyncratic risk premiums, ratings and corporate tax.

39 This section forms part of a study being prepared by the Elcano Royal Institute for the Ministry of Industry, Tourism and Trade's Directorate-General of Investment. This note only seeks to provide an initial approximation to aggregate returns on Spanish investment in the 26 economies that make up 95% of Spanish FDI.

It is a complex variable to calculate and is not readily available for most emerging countries. Assumptions (not always shared) must be made when estimating the cost of capital and these have a material impact on the final result.

Our analysis makes three main assumptions:

- First, all Spanish FDI has been financed with 20% capital and 80% debt, leveraged with a 5:1 ratio. We have subjected the results to sensitivity analysis using alternative assumptions on the structuring of finance and the main conclusions do not change significantly.[40]

- Secondly, the cost of debt is given by adding the average annual values of the US 10-year Treasury bond, the risk premium for each economy plus an individual component that seeks to quantify the risk of corporate default and a risk premium based on the country's rating.

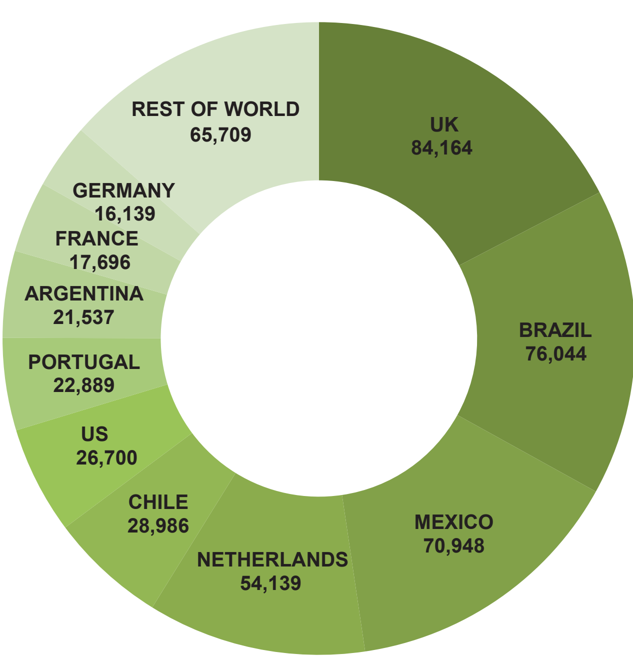
- Third, the cost of capital of equity is estimated by adding a fixed risk premium of 600 basis points to the cost of the bond for each country.

These assumptions were used to estimate the aggregate cost of capital (Figure 37). Regional aggregates were obtained by weighting the results of the countries in each bloc by the volume of Spanish investment in each economy.

The average spread of the cost of capital between investment in the average developed country and countries in Latin America is around 500 basis points. This figure has increased over time, from 200 basis points before the Great Recession to over 1,000 in 2020, largely driven by the crises in Argentina and Venezuela. If both countries are excluded, the spread for 2020 falls to 850 basis points.

40 Although the cost of equity is higher than the cost of corporate debt, at this level of aggregation it is normally estimated by adding a fixed risk premium of 600 basis points to the rate of the risk-free asset (the US 10-year Treasury bond). In our estimates, we have adopted a cautious approach, substituting the risk-free asset for the long-term bonds of the different countries, whose values are significantly higher in the case of Latin America. However, the reduction in risk premiums in Latin America –and also developed countries– from the unique monetary conditions of the last decade and the improved macro outlook mean that on average the weighting of this fixed premium in the total cost of financing has fallen over time. We estimate that the equity premium makes up around 18% of the total cost. The sensitivity analysis of the financing structure shows that the total cost of a project financed with 20% equity and 80% equity in the region increases to 12%, compared with 11.9% for a project financed with 80% debt and 20% equity. This change does not alter our findings on the creation of value for Spanish investment in the region.

Figure 37. Cumulative profits, 2007-20 (€ mn)



Source: Elcano Royal Institute. The authors, using data from the Directorate-General of Investment, Secretary of State for Trade, Ministry of Industry, Trade and Tourism. Datainvex; http://datainvex.comercio.es/ and https://globalinvex.comercio.gob.es/.

The comparison of the gross return on equity and the cost of capital supports the claim that on average Spanish foreign investment has created value: 3.3% in developed countries (3.4% in the EU), 2.1% in Latin America and 2.1% overall.

Figure 39 shows the difference between the annual and average rates of value creation for each country. It shows the volatility of value creation rates and also that value destruction has taken place in some years.

Three episodes of value destruction can be identified for developed countries: 2008, 2009 and 2020. Latin America has just one –albeit highly significant– episode: the pandemic in 2020. In terms of volatility, the annual results for Latin America have been negative by over one standard deviation on seven occasions.

Figure 40 shows the individual countries that have made the greatest contribution to returns and volatility in Latin America, repeating the calculations carried out for the different economic blocs.

The best performing countries are Chile and Peru, where the median value creation of Spanish investment is double the level for developing countries. Brazil is in line with the rate for developed countries. However, the remaining countries have below-average performance: Uruguay, with a rate of 2.6%; Colombia at 0.5%; Argentina at 0% (with high volatility); and Venezuela, which has destroyed over 90% of the value of investments made.

The panel on the left in Figure 40 gives the absolute values for value creation and the right shows the volatility of these rates with respect to the average value for the period. In other words, the panel on the left orders countries by their relative performance, while the one on the right shows the prevalence of crises and boom phases.

The panel shows that under favourable circumstances, Brazil can perform 2.5 standard deviations above the average, which is an extraordinary feat (even statistically speaking). Colombia is at the opposite end of the spectrum: value destruction in 2020 is over three standard deviations. This is all the more extraordinary if we take into account that its capital stock stands at just €5 billion.

Mexico and Chile are examples of countries with high and stable rates of value creation.

Neither has seen value destruction, a situation we believe to be closely related to the macro stability of both countries and their reputations on the markets, factors that have helped them to control rises in the cost of capital. The rate in Chile has always been in double digits, except in five years (2010, 2013, 2015, 2018 and 2020).

Peru has a similar profile to Chile, although the trend ends in 2015, which marks the start of value destruction. This has happened in half of the last six years. Uruguay is similar to Peru (two years of value destruction in the last six years) but with more moderate boom phases; the figure has only been in double digits on two occasions.

Argentina is evenly split, destroying value during half the period and creating value during the other. The net result (the median) is neither destruction nor creation. Argentina and Venezuela hold the record value for destruction in a single year: -33% in 2020. Venezuela has systematically destroyed shareholder value since 2014.

Figure 41 shows that the strong performance of Spanish foreign investment can be explained by the fact that there are few 'errors' at this level of aggregation.

There is a strong concentration in quadrant one, where all countries have high levels of gross profitability and positive value creation (i.e. the good quadrant). These include five of the eight Latin American countries from our analysis. In the worst quadrant (three in a clockwise direction), there are six countries, although five are close to quadrant two (value creation with moderate gross nominal profitability rates, provided the cost of capital also remains low). If the period had not included the Great Recession of 2008-09, the European crisis of 2012-15 (largely responsible for the position of Portugal and, above all, Italy) and the pandemic, the majority of these countries would have been in quadrant two. Venezuela is a clear exception to this trend, since the origin of its problems is not the global macroeconomic outlook.

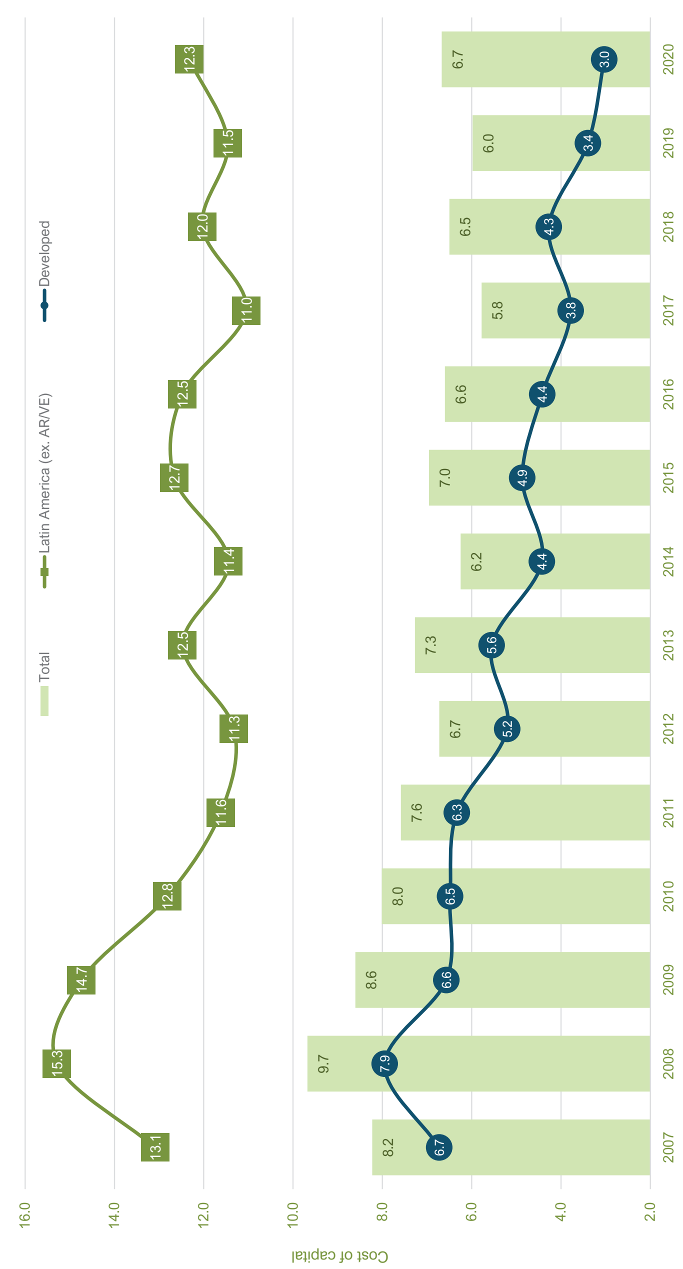
Figure 42 attempts to quantify the value created by the process that began at the end of the 1990s, putting the figure at €100 billion.

Latin America accounts for 25% of value creation (€27 billion net), slightly below its relative weight in total investment stock. This can be explained by the fact that the region has been responsible for one-third of value destroyed, a fact that can be attributed to Argentina and, above all, Venezuela: over €15 billion of losses, which can be attributed not to poor investment projects but to the macro and regulatory volatility suffered by both countries over the last two decades.

Brazil and Mexico account for 73% of gross value creation, rising to 93% if we add Chile. These three countries are at the heart of the success of Spanish foreign investment between 2007 and 2020.

It should be noted that the aggregate data for the period as a whole is affected by the shock caused by the pandemic in 2020, the last year for which data is currently available. If we exclude this last year for the US, value creation is positive and stands at around 2%.

Figure 38. Regionally weighted cost of capital of Spanish foreign investment



Source: Elcano Royal Institute. The authors, using data from FRED, Federal Reserve St Louis, https://fred.stlouisfed. J.P. Morgan Emerging Market Bond Index (EMBI); https://www.jpmorgan.com/insights/research/indices/product and Damoran, Stern New York University, http://www.damodaran.com and http://www.stern.nyu.edu/~adamodar/pc/implprem/ERPbymonth.xls.

A solid and rigorous hypothesis will not be possible until we complete the disaggregated analysis by sector and subsidiary size. The distribution of this value creation may be concentrated on a few sectors or on larger companies. However, without data, we do not know for sure.

The erroneous perception of both the sequence of internationalisation (first Latin America, then developed countries) and the waning interest in the region among Spanish companies (which has not occurred) can probably be explained by one of the most interesting features of the second phase of the internationalisation of Spanish investment: while the first phase was based on large-scale acquisitions and participation in auctions carried out as part of privatisation in Latin America, the second has been based on the reinvestment of profits from this first wave of acquisitions.

In other words, Spanish investors have lived up to their promise of being 'long-term investors', reinvesting a large part –if not all– of their profits.

Erroneous perceptions of poor returns when adjusted to reflect the cost of capital of Latin American investments can be almost entirely attributed to Argentina and Venezuela. The crises of these countries has captured the attention of both the business community and Spanish and European society.

However, the evidence for the remaining emerging countries shows the opposite. Countries can have limited and faltering growth (meaning they can appear to be growing when they are in fact just making up for ground lost during the last crisis) but still have a less severe impact –at least temporarily– on the profits of companies operating in broad and deep markets.

Examples of this phenomenon include Brazil and Mexico, two countries in which a number of major Spanish companies are strongly positioned in sectors like banking, telecommunications, and electricity generation and distribution.

The continued presence of Spanish companies in these markets –in good times and in bad– may have resulted in deep and loyal customer bases, allowing continued growth without needing to seek new pastures when clouds gather on the macro horizon and risk grows.

This aspect, which can be wholly attributed to the customer-centric approach of certain companies, is responsible for a significant part of the value creation achieved by Spanish subsidiaries in Latin America.

Figure 39. Estimate of shareholder value creation and destruction for Spanish foreign investment, 2007-20

CREACION/DESTRUCCION DE VALOR NETA

%	Desarrollados no UE	UE	Desarrollados	América Latina	América Latina (ex. AR/VE)	Emergentes	Total	Desarrollados no UE	UE	Desarrollados	AMERICA LATINA	América Latina (ex. AR/VE)	EMERGENTES	TOTAL
2007	4,9	7,6	4,6	2,2	0,8	2,3	5,2	0,9	0,8	0,3	0,0	-0,2	0,1	0,9
2008	-5,1	-7,6	0,7	-1,3	-3,9	-1,0	-5,2	-1,4	-2,0	-0,7	-1,0	-1,6	-1,0	-2,1
2009	-0,9	-3,0	0,3	-0,4	-1,8	-0,2	-1,3	-0,4	-1,2	-0,7	-0,7	-1,0	-0,7	-1,0
2010	0,8	2,4	9,9	3,4	1,6	3,7	2,6	-0,1	-0,2	1,6	0,4	0,0	0,5	0,1
2011	8,6	-2,5	10,3	4,4	2,2	4,6	3,8	1,7	-1,1	1,7	0,7	0,2	0,7	0,5
2012	1,4	1,8	8,5	2,5	0,3	2,7	2,4	0,1	-0,3	1,3	0,1	-0,4	0,2	0,1
2013	2,9	2,2	6,8	0,5	-0,9	0,7	2,1	0,4	-0,2	0,9	-0,5	-0,7	-0,4	0,0
2014	3,9	0,8	3,6	3,1	1,6	3,2	2,7	0,6	-0,5	0,1	0,3	0,0	0,3	0,2
2015	0,7	4,6	-1,9	-0,4	-1,7	-0,5	1,4	-0,1	0,2	-1,3	-0,8	-1,0	-0,8	-0,2
2016	-3,0	8,0	0,4	8,2	8,1	7,9	3,7	-0,9	0,8	-0,7	1,8	2,0	1,8	0,4
2017	3,3	9,0	2,1	6,1	5,9	6,0	5,7	0,5	1,0	-0,3	1,2	1,3	1,2	1,0
2018	2,8	10,8	0,8	4,2	5,1	4,0	5,5	0,4	1,4	-0,6	0,6	1,1	0,6	1,0
2019	4,3	10,7	0,0	1,9	4,4	1,8	5,5	0,7	1,3	-0,8	-0,1	0,9	-0,1	1,0
2020	-8,9	2,3	0,3	-5,2	-0,2	-5,1	-4,2	-2,3	-0,2	-0,8	-2,2	-0,5	-2,2	-1,8
PROMEDIO	*1,1*	*3,4*	*3,3*	*2,1*	*1,5*	*2,2*	*2,1*							
MEDIANA	*2,1*	*2,4*	*1,5*	*2,3*	*1,2*	*2,5*	*2,7*							
MIN	*-8,9*	*-7,6*	*-1,9*	*-5,2*	*-3,9*	*-5,1*	*-5,2*	*-2,3*	*-1,1*	*-1,3*	*-2,2*	*-1,0*	*-2,2*	*-1,8*
MAX	*8,6*	*10,8*	*10,3*	*8,2*	*8,1*	*7,9*	*5,7*	*1,7*	*1,4*	*1,7*	*1,8*	*2,0*	*1,8*	*1,0*
DECIL 20%	*-1,7*	*-0,5*	*0,3*	*-0,4*	*-1,3*	*-0,3*	*0,3*	*-0,1*	*-0,3*	*-0,8*	*-0,5*	*-0,5*	*-0,4*	*0,0*
DECIL 80%	*4,0*	*8,4*	*7,5*	*4,3*	*4,7*	*4,2*	*5,3*	*0,6*	*0,9*	*1,0*	*0,7*	*0,9*	*0,6*	*0,9*

Note: net value creation/destruction (levels); net value creation/destruction (in standard deviations from the mean).
Source: Elcano Royal Institute. The authors, based on the aforementioned sources.

Figure 40. Levels and rates of value creation for Spanish foreign investment

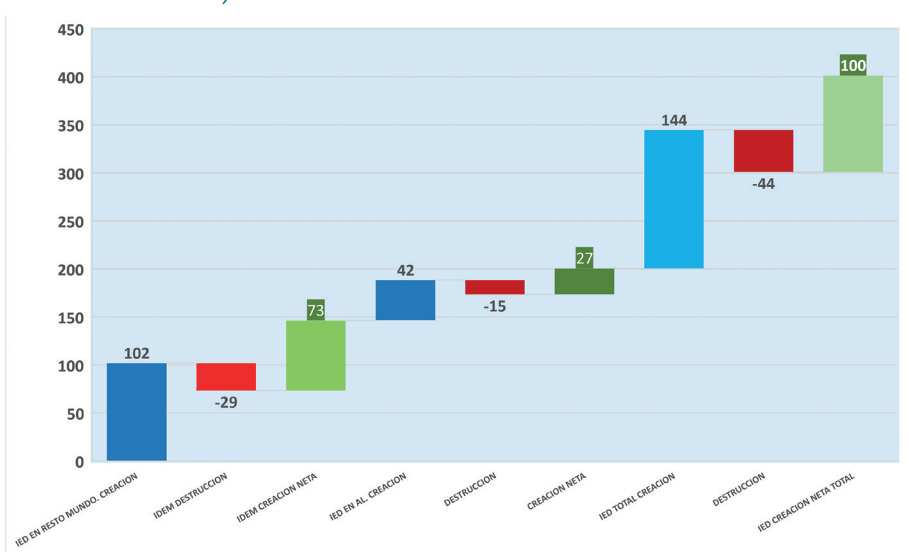
	VALUE CREATION/DESTRUCTION (levels)								NET VALUE CREATION/DESTRUCTION (deviations from the mean)							
	ARGENTINA	BRAZIL	CHILE	COLOMBIA	MEXICO	PERU	URUGUAY	VENEZUELA	ARGENTINA	BRAZIL	CHILE	COLOMBIA	MEXICO	PERU	URUGUAY	VENEZUELA
Year																
2007	-8.0	3.2	11.4	-3.1	1.3	6.0	4.8	-0.7	0.0	0.1	0.6	0.1	-1.3	0.0	0.5	0.7
2008	-11.2	-4.5	9.5	-1.9	0.7	3.9	4.4	-3.8	-0.3	-1.3	0.2	0.2	-1.5	-0.4	0.5	0.7
2009	-11.9	-1.3	14.3	-4.8	0.2	15.2	-2.9	-11.8	-0.4	-0.8	1.1	0.0	-1.6	1.4	-0.7	0.5
2010	0.9	1.4	13.7	-3.6	5.5	13.8	-5.5	-7.2	0.7	-0.3	1.0	0.1	-0.2	1.2	-1.2	0.6
2011	3.5	0.9	19.1	2.1	5.0	12.9	-2.5	0.9	0.9	-0.3	2.0	0.6	-0.3	1.1	-0.7	0.8
2012	-4.3	-1.1	9.6	4.9	6.5	9.9	-4.1	1.1	0.3	-0.7	0.2	0.9	0.1	0.6	-0.9	0.8
2013	-16.4	-0.4	-0.2	1.2	6.6	11.8	-0.5	-1.2	-0.7	-0.6	-1.6	0.6	0.1	0.9	-0.3	0.7
2014	3.3	1.4	6.3	-2.1	7.8	6.1	0.5	-26.0	0.9	-0.2	-0.4	0.2	0.4	0.0	-0.2	0.3
2015	4.5	-2.4	2.5	-9.1	6.4	-3.9	-4.6	-61.9	1.0	-1.0	-1.1	-0.5	0.1	-1.7	-1.0	-0.4
2016	1.0	16.2	3.1	-4.8	9.8	7.2	-3.3	-53.1	0.7	2.5	-1.0	0.0	1.0	0.1	-0.8	-0.2
2017	3.5	3.3	10.3	-2.1	12.8	6.5	9.6	-61.8	0.9	0.1	0.4	0.2	1.8	0.0	1.3	-0.4
2018	-11.4	5.5	5.3	-2.6	10.8	3.8	14.6	-63.3	-0.3	0.5	-0.6	0.2	1.3	-0.4	2.2	-0.4
2019	-22.6	8.8	9.2	1.5	6.7	-2.5	6.8	-99.1	-1.2	1.1	0.1	0.6	0.2	-1.4	0.9	-1.0
2020	-36.9	7.5	3.5	-37.5	6.0	-2.6	4.4	-196.6	-2.4	0.9	-0.9	-3.3	-0.1	-1.4	0.5	-2.8
AVERAGE	-7.6	2.8	8.4	-4.4	6.2	6.3	1.6	-41.7								
MEDIAN	-6.1	1.4	9.4	-2.4	6.5	6.3	0.0	-18.9								
MIN	-36.9	-4.5	-0.2	-37.5	0.2	-3.9	-5.5	-196.6	-2.4	-1.0	-1.6	-3.3	-0.3	-1.7	-1.2	-2.8
MAX	4.5	16.2	19.1	4.9	12.8	15.2	14.6	1.1	1.0	2.5	2.0	0.9	1.8	1.2	2.2	0.8
DECILE 20%	-13.7	-1.2	3.3	-4.8	3.5	1.2	-3.6	-62.4	-0.7	-0.6	-1.0	0.0	-0.1	-1.4	-0.9	-0.4
DECILE 80%	4.5	16.2	19.1	4.9	12.8	15.2	14.6	1.1	0.9	0.7	0.7	0.6	0.7	1.0	0.7	0.7

Source: Elcano Royal Institute. The authors, based on the aforementioned sources.

Figure 41. Profitability and value creation of Spanish foreign investment, 2007-20 (data normalised to the mean)

Source: Elcano Royal Institute. The authors, based on the aforementioned sources.

Figure 42. Value creation and destruction of Spanish foreign investment (€ bn, 2007-20)



Source: Elcano Royal Institute. The authors, based on the aforementioned sources.

OPPORTUNITIES OF THE NEW SITUATION: AN EU-LATIN AMERICA AGENDA

OPPORTUNITIES OF THE NEW SITUATION: AN EU-LATIN AMERICA AGENDA

1. The priorities in relations between the EU and Latin America, according to the participants

As in other fields, relationships between Europe and Latin America are framed by realities, interests and dreams. A commitment to dialogue and the willingness to negotiate may not be enough to strike effective agreements. That depends on how each participant views the economic and geostrategic importance of the other, and the values and pillars on which any potential partnership might be based.

One explanation of the interminable negotiations is that each party believes it knows what the other really wants.

In the complex negotiations between Latin America and the EU, cultural, economic and political differences and the historical background create a fertile soil for misconceptions and misunderstandings that can cause negotiations to fail.

To illustrate the need for dialogue between parties, we have surveyed Ambassadors from Latin American and EU countries in Madrid. They were presented with a list of 10 priorities and asked to select five and order them by preference. There was also the option of adding other items if deemed necessary.

The 10 priorities were:

1) Reliable access to raw materials (food, fuel, minerals).
2) Opening up new markets.
3) Increased trade in goods and services.
4) Greater investment opportunities.
5) Green deal, fight against climate change, and transformation of the energy industry (renewable energy).
6) Environment and biodiversity.
7) Culture, education, science and technology.
8) Digitalisation.

9) Community of values (western culture, democracy, freedom and human rights).
10) Increased strategic autonomy and advantageous alliances in multilateral bodies.

The diplomats' response was positive. Countries participating in the exercise represented more than 80% of the GDP or population of Latin America and the EU. The only representative of the non Spanish-speaking Caribbean was Haiti.

Responses were weighted by each country's GDP. Two types of response were tabulated:

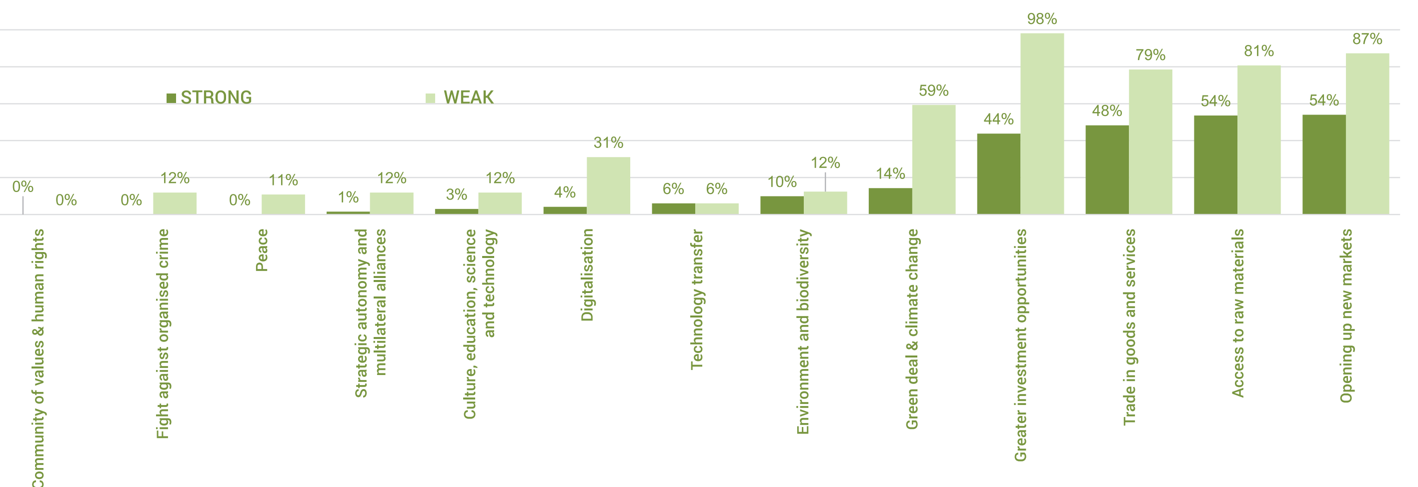
i) 'Weak preferences', in which all priorities had the same value.
ii) 'Strong preferences', where a value of 40% was assigned to priority 1, 30% to priority 2, 15% to priority 3, 10% to priority 4 and 5% to priority 5.

Priorities were grouped into three categories: economic and technological; climate sustainability; and geopolitical.

Figure 43 shows the aggregated priorities of Latin America (the maximum value is 100%).

If we look at weak preferences, the majority of countries see the EU as a priority partner for obtaining greater investment opportunities. When order of preferences is taken into account, the preferred objective is the opening of new markets. Whichever criterion we use, geopolitical objectives have the lowest preference.

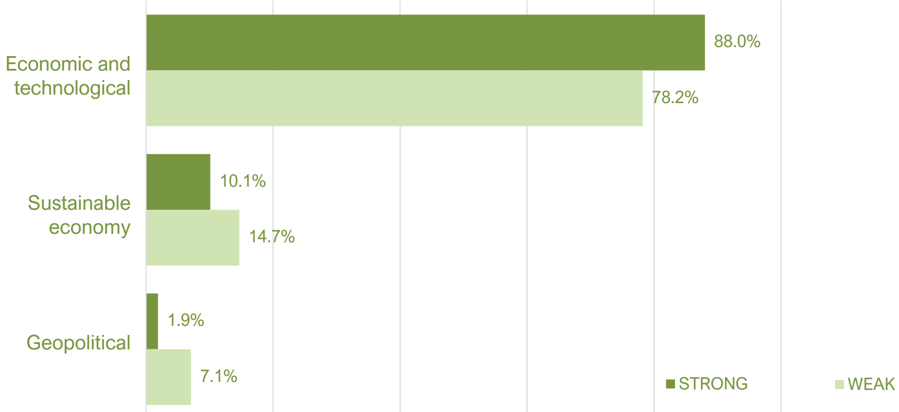
Figure 43. Latin American preferences



Source: Elcano Royal Institute. Data based on responses to survey of EU and Latin American Ambassadors accredited in Madrid.

If we consolidate the preferences into the three categories (Figure 44) we see that for Latin America the EU is fundamentally an economic and technological partner.[41]

Figure 44. Consolidated Latin American preferences



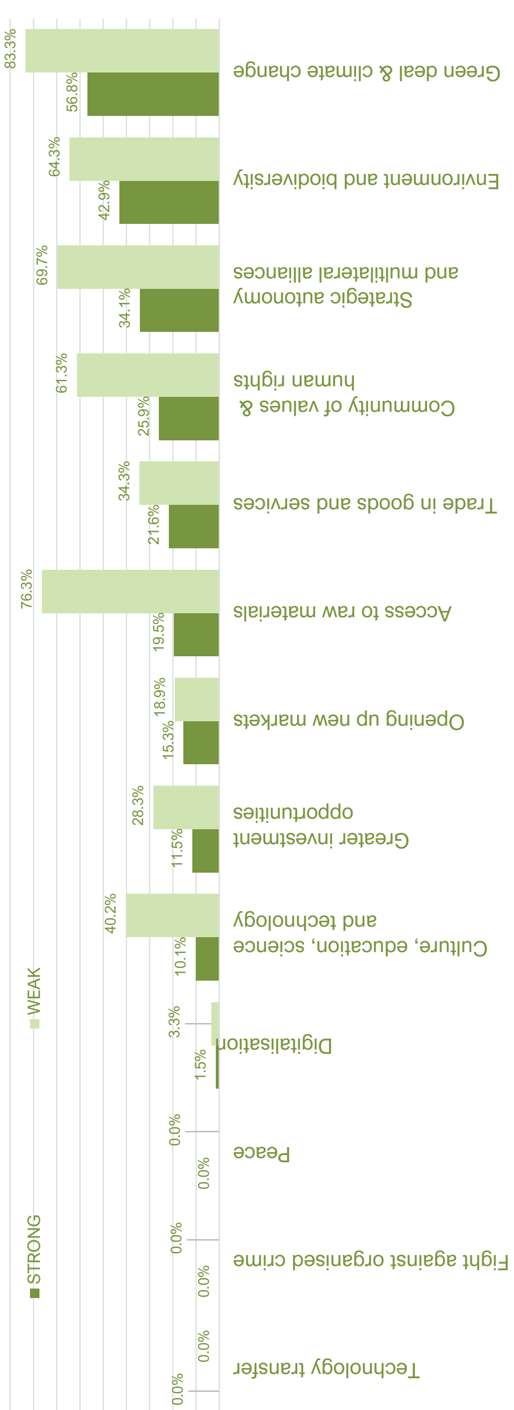
Source: Elcano Royal Institute. Data based on responses to survey of EU and Latin American Ambassadors accredited in Madrid.

The results for the EU are shown in Figures 45 and 46. For the EU, the weak priorities focus on access to raw materials while the strong ones are headed by the climate pact, followed by the environment and diversity. The weight of 'green' concerns means that their consolidated preferences are dominated by the search for accomplices, allies and partners in a sustainable transition.

The European responses reveal an interest in Latin America that is more diverse than in the region itself: geopolitics and the economy account for 60% of the responses, fairly equally distributed between them, at around 30% each.

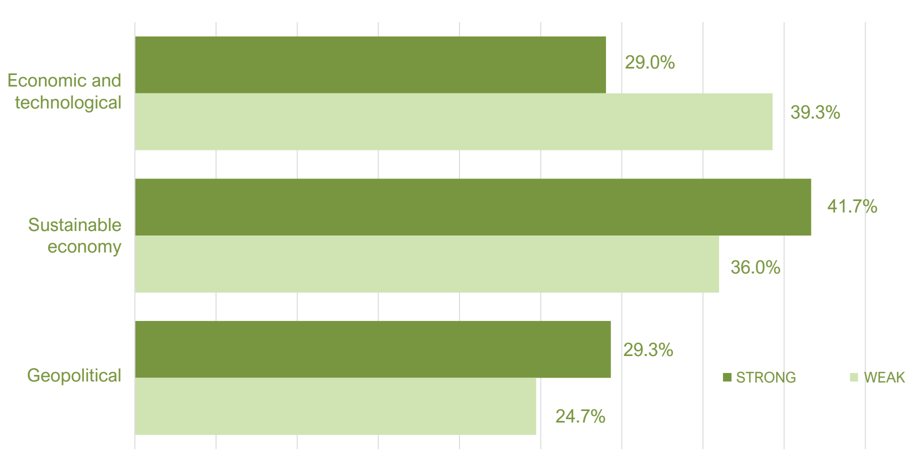
41 Economy and technology includes six priorities: greater investment opportunities; digitalisation; trade in goods and services; opening up new markets; access to raw materials; and technology transfer. Sustainability includes two: green pact and climate change; and the environment and biodiversity. Geopolitics contains five: culture, education, science and technology; community of values and human rights; strategic autonomy and multilateral alliances; the fight against organised crime; and peace.

Figure 45. EU preferences



Source: Elcano Royal Institute. Data based on responses to survey of EU and Latin American ambassadors accredited in Madrid.

Figure 46. Consolidated EU preferences



Source: Elcano Royal Institute. Data based on responses to survey of EU and Latin American Ambassadors accredited in Madrid.

Given the limited size of the sample, the representativeness of the results can obviously be questioned. However, it seems reasonable to conclude that the two blocks share broadly similar goals but differ significantly as to how to achieve these and in the intensity of their preferences.

While economic priorities (greater access to European markets, greater investment opportunities and technology transfer) dominate the Latin American agenda, the EU has a more balanced focus and sees Latin America as a partner with whom progress can simultaneously be made in economic cooperation, the fight against climate change, and strengthening political and institutional alliances to defend the liberal democratic order.

The possibilities and opportunities for both parties appear to be important enough to justify intense diplomatic and political work to achieve the convergence of agendas and to reach strategic agreements. But the starting point is complicated (Figure 47).

Figure 47. Strong preferences of the EU and Latin America

Source: Elcano Royal Institute. Data based on responses to survey of EU and Latin American Ambassadors accredited in Madrid.

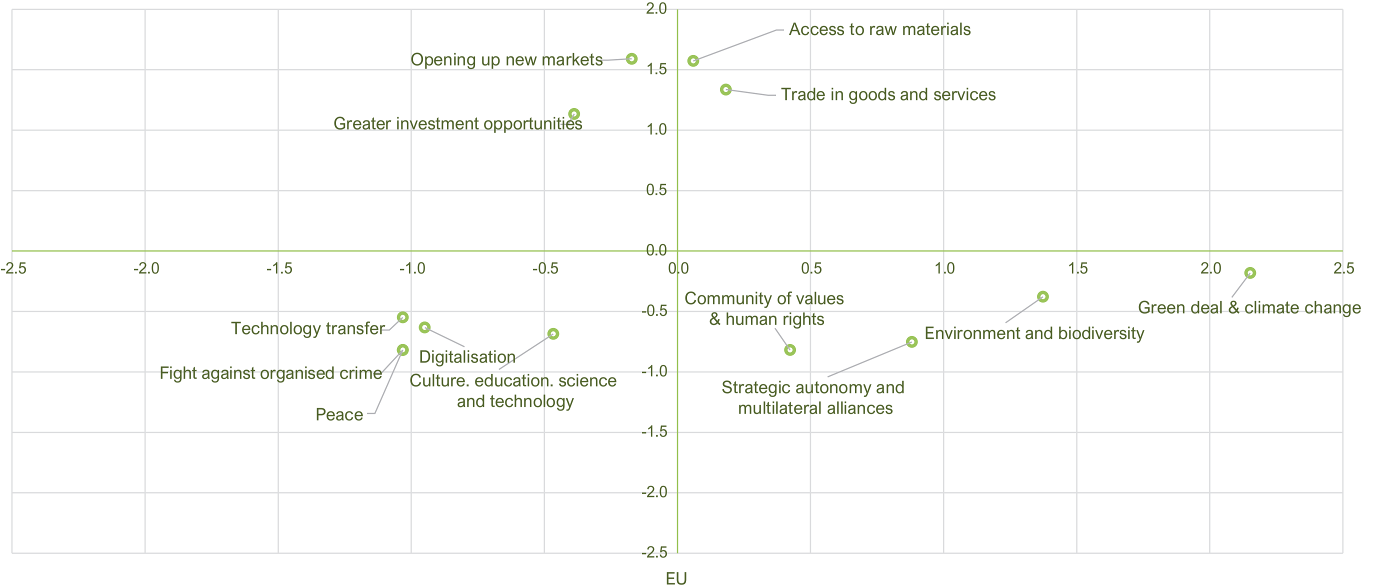
When the preferences are weighted by the order in which they were classified, Quadrant 1 (where strategic overlap should appear) shows that the EU is lukewarm towards two of the most intensely held Latin American preferences –access to raw materials and trade in goods and services– and less than enthusiastic regarding Latin America's next two priorities –opening up new markets and greater investment opportunities–.[42]

For its part, Latin America does not assign strategic value to the EU's two major priorities: the environment and biodiversity; and strategic autonomy. For Latin America, these European priorities are at the same level as shared values and the fight against organised crime. When the five priorities are evaluated equally, the convergence of objectives is clearer.

Europe's interest in signing a Green Deal agreement is shared by Latin America. Both partners have the common objective of ensuring the supply of raw materials. In other words, there is a space for negotiation and agreement. The elements of negotiation are identified in Figure 48.

42 The axes show typical deviations from the median distribution of priorities in each block. The median is zero and the typical deviation is 1. Above the value 1, the distance between positions is substantial.

Figure 48. Weak preferences of EU and Latin America



Source: Elcano Royal Institute. Data based on responses to survey of EU and Latin American Ambassadors accredited in Madrid.

Both parties need to modulate their extreme differences and preferences.

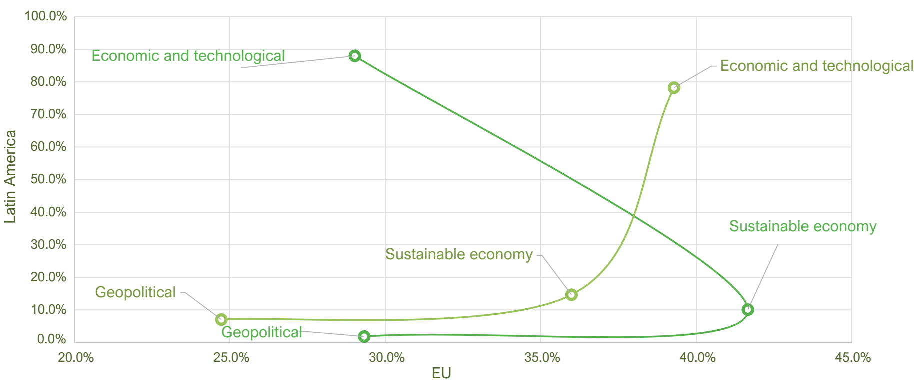
The EU needs to place more emphasis on the areas of digitalisation, technology transfer, peace and the fight against organised crime, and to define the framework of its aspirations in strategic autonomy, the environment, and values and human rights more clearly.

Latin America needs to balance its agenda, with a more global and geopolitical vision of the negotiations.

The agreements on economic priorities are 'easy pickings' that the EU can offer to accelerate Latin American economic development.

Progress in this field most likely requires Latin America's commitment to be a reliable partner, contributing to global progress in climate sustainability and human rights.

Figure 49. The sequence of the encounter between the EU and Latin America



Source: Elcano Royal Institute. Data based on responses to survey of EU and Latin American Ambassadors accredited in Madrid.

Figure 49 shows the interaction of this triangle. While the hard criterion of preferences points to the distance between the positions of the two blocks, the soft criterion (the delimitation of the issues that each party wishes to address) shows a more hopeful profile. It even suggests the optimal sequence to arrive at an agreement: starting with the economy, continuing with sustainability and concluding with geopolitical issues. Let us hope that, in this new phase, all parties follow this course in good faith.

2. An EU-Latin America and the Caribbean Trade and Technology Council

The creation of an EU-Latin America and the Caribbean Trade and Technology Council (EU-LAC TTC) is an excellent starting point –one that is executive, pragmatic and results-focused– from which to provide broad institutional support for negotiation and cooperation. Designed as a high-level bilateral forum, it would concentrate on cutting-edge technology and the global challenges that are not always addressed in certain multilateral contexts. It would provide a unique platform to organise bi-regional cooperation. The EU-LAC TTC could serve as a tool for the EU and Latin America and the Caribbean to speak with one voice at international forums on certain agreed issues.

The spirit of the EU-LAC TTC would be similar to that of existing bodies between the EU and the US or the EU and India. The aim would be to coordinate and cooperate on issues such as energy security, food and water security, digital governance and connectivity, supply chains, clean and ecological energy technologies, migration, crime and transnational terrorism.

The EU-LAC TTC would be co-chaired by high-level representatives of the EU and Latin America and the Caribbean and would be organised into working groups on specific issues, which would be composed of specialists and officials of the EU and Latin America and the Caribbean, who would combine forces to draw up recommendations and proposals, which would then be submitted to the co-chairs.

These could work together to set the agenda of each working group, facilitate discussions, conduct regular evaluations to determine progress, ensure that the group met its objectives and make any adjustments to the programme, as required. Working groups could have technical support teams to deal with more specialised tasks.

The working groups would examine a series of global issues that are important to the EU and Latin America and the Caribbean.

2.1. Energy security

Latin America has considerable reserves of hydrocarbons (petroleum and natural gas) and abundant sources of renewable energy (wind, solar and hydro-electric) that could guarantee the energy security of the EU.

2.1.1. Fossil fuels

The Russian invasion of Ukraine and the diversification initiatives of the EU and its Member States has coincided with the stagnation of relations between the EU and

Latin America with respect to fossil fuels. In contrast to other traditional exporting regions, the energy crisis and consequent high prices do not appear to have revived European interest in Latin American fossil fuel resources.

A decade ago, European investment was concentrated in the exploration and production of unconventional fossil fuels (pre-salt reserves in Brazil, deep water reserves in Guyana and, to a lesser degree, shale oil in Vaca Muerta in Argentina). This contrasts with the crisis of Venezuelan petroleum and the slow but ongoing fall in production in Ecuador, Colombia and Mexico, in a business climate that is less attractive to foreign investment. Collaboration in gas and petroleum could serve to draw up rules and criteria for the exploitation of fossil fuels (upstream, midstream and downstream) to guarantee sustainability and efficiency.

2.1.2. Transitional minerals

Guaranteeing access to critical minerals and rare earth elements is a huge challenge in the dual energy and digital transition. Latin America should be able to satisfy the EU's demand for transitional minerals due both to its existing production and its reserves of niobium, silver, copper, lithium, cobalt, tin, iron, molybdenum and rare earth elements. The expectations generated in Latin America around industrialisation associated with mining must be balanced by the growing need for environmental sustainability. The challenge for the EU is to differentiate itself from other investors and importers (principally China). To do this, it must offer sustainable guidelines for interdependence, based on the effective generation and distribution of mining activities and profits throughout the value chain, so that sustainability is not in conflict with competitiveness.

This situation places Latin America and the Caribbean in a dominant position to lead the new low-carbon emission value chains, as shown by the importance of copper and lithium in the most recent update of the EU-Chile Association Agreement, which could be replicated with Mercosur: lithium (Argentina) and rare earth elements (Brazil).

2.1.3. Cooperation in renewable energies

Latin America is one of the regions with the greatest potential to develop the external aspects of the European Green Deal. Since 2011 foreign direct investment (FDI) in renewable energy has exceeded investment in fossil fuels. These projects already account for 33% of the region's total energy supply, compared with a global figure of 13%. European companies (particularly Spanish, Italian and French electricity companies) have driven this trend, with 75% of FDI in renewables.

European FDI has been characterised by high employment, social and environmental standards, and a high level of technology transfer (as seen in the wind-turbine factories in Mexico and Brazil) in contrast with other investors such as China and the US. Latin America competes in a climate that is less favourable to international

investment and, combined with rising interest rates, the NextGenerationEU plan and the Inflation Reduction Act (IRA) in the US, this could cause investment in renewables to disappear from Latin America. To maintain the level of FDI and dynamism in the sector, more attractive conditions will be necessary.

2.1.4. Cooperation in energy integration

Latin American energy integration remains at an impasse, paralysed by two decades of mistrust and interruptions to regional projects, and with little room for multilateral cooperation with the EU. The energy crisis unleashed by the invasion of Ukraine has highlighted the cost of not investing in the integration of European gas and electricity markets. The EU's errors illustrate the strategic importance of regional integration in the energy transition: an integrated framework, both physical and normative, delivers benefits in terms of efficiency, speed and security. The EU and Latin America could cooperate to exchange experiences (successes and failures) in energy integration and the funding of new infrastructures via the Global Gateway.[43]

2.2. Food security

Latin America is a major producer of agricultural products. It has an annual surplus of more than US$127 billion, some US$200 per capita, higher than any other region apart from Oceania. However, most countries in the region are exposed to problems of production and distribution, and have also been affected by the price rises caused by the war in Ukraine, as they are net importers of wheat, maize, vegetable oils and almost 85% of the fertilisers they use. No other region in the world is so dependent on their import.

Food security continues to be a source of concern for the region. The UN Food and Agriculture Organization (FAO) calculates that between 2019 and 2020 (in the context of the pandemic) the number of people suffering from hunger in Latin America and the Caribbean rose by 13.8 million to 59.7 million (9.1% of the population). And four in every 10 people experienced moderate or serious food insecurity in 2020, 60 million more than in 2019 (the largest increase in the world). Food inflation increases the risk of hunger.

Cooperation with the EU on food security and sustainable agriculture could help guarantee the supply of foodstuffs in both regions, contributing to global food security. The areas of collaboration could include the following issues:

i. Measures to promote the adoption of sustainable agricultural practices.

43 The Global Gateway is an EU strategy to invest in infrastructure projects and establish economic partnerships based on its principles. It forms part of its strategic autonomy plans. It is sometimes considered an alternative to the Belt and Road Initiative.

ii. Management of value chains.

iii. Rural development.

iv. Cooperation in food safety and quality standards.

v. Bi-directional cooperation in agricultural technology.

2.3. Water security

Water scarcity and the degradation of water resources are critical challenges throughout the world and are expected to worsen due to demographic growth, urbanisation and climate change. The EU, as a principal provider of technology and development aid, can help Latin America to confront these challenges and promote sustainable water management practices.

i. Water management and governance: provide technical assistance and fund governance and management reforms designed to improve the effectiveness and efficiency of institutions responsible for water management.

ii. Planning and development of water resources: help to draw up management plans for available resources that are compatible with the needs of users and guarantee their sustainable use.

iii. Adaptation and mitigation of climate change: support to adapt and mitigate its effects on water resources. This includes investing in infrastructure, drought monitoring systems and water-saving technologies.

2.4. Clean energy and ecological technologies and industries

2.4.1. Exchange of best practice on climate governance

A satisfactory ecological transition requires clear objectives, safeguarded from political cycles and the changing priorities of government. Integrating objectives into national legislation is a powerful weapon to prevent political setbacks in climate change and ecological transition. Europe and Latin America have been in the legislative vanguard in this respect. Both regions can learn a lot from each other to strengthen climate governance through exchanging knowledge on legislation and climate policies with respect to institutions, scientific consultancy bodies and citizens' assemblies.

2.4.2. Support for industrial decarbonisation and the integration of supply chains through renewable hydrogen

Renewable hydrogen has captured the attention of investors and European cooperation in Latin America (including the Global Gateway), particularly following the publication in 2020 of Chile's green hydrogen strategy. The central role that

REPowerEU assigns to low carbon emission hydrogen in European energy diplomacy complements the potential of Latin America to develop a new industrial sector. Renewable hydrogen could help soften the impact of the Carbon Border Adjustment Mechanism (CBAM).[44] The first phase of CBAM will affect steel, fertilisers, aluminium, cement, electricity and hydrogen products.

Renewable hydrogen will be fundamental to decarbonise the value chains subject to CBAM and is a promising opportunity for industrial activity in Latin America. Renewable hydrogen offers a range of possibilities to increase food security in the region by reducing the agricultural sector's dependence on imported fertilisers.

2.4.3. Support for the transition towards post-carbon transport systems, promotion of electrification and active development of sustainable public transport systems

In Latin America 35% of greenhouse gas emissions are produced by burning fuel for transport, a figure far higher than the global average of 22%. Emissions will continue to rise more quickly than other sectors given ongoing motorisation: the number of private vehicles in Latin America is growing faster than in any other region and is expected to treble between now and 2050.

Latin America benefits from a good clean energy network. This means that environmental arguments in favour of electrified transport are particularly solid. Latin American cities are affected by problems of traffic congestion and air quality which require public transport systems to be expanded, the efficiency of informal transport to be increased, and priority to be given to non-motorised mobility. The countries of the EU and Latin America can exchange experiences of developing urban transport and success stories about electrification, while also cooperating on battery supply chains for electric vehicles, including essential transitional minerals such as lithium.

2.4.4. Promote sustainable, inclusive development, adopt the principles of the circular economy, improve the efficiency of resources, reduce waste and recycle in production and consumption

Thanks to their huge potential in renewable energy, Latin American countries are well placed to drive industrial policies that generate green jobs and help to diversify economic reprimarisation. To do this, it is necessary to invest in new technologies and tools, retraining, the expansion of employment policies and social protection systems specifically designed to help workers affected by the transition. The EU is the principal provider of sustainable and inclusive development funds to Latin America and the Caribbean, with almost €3.4 billion for bilateral and regional

44 The Carbon Border Adjustment Mechanism (CBAM) is a duty on carbon-intensive products imported by the EU. Approved as part of the European Green Deal, it comes into force in 2026, although reports and registration begin in 2023.

programmes through IVCDCI-Europa Global[45] from 2021 to 2027. Latin America will also have access to the European Fund for Sustainable Development Plus (EFSD+).

For more than 10 years, the EUROCLIMA and EUROCLIMA+ programmes have supported ecological, climate and environmental measures in collaboration with 18 Latin American and Caribbean member countries, the Member States of the EU and United Nations bodies. Climate action is also promoted in bilateral commercial treaties such as those with Colombia and Peru, and the Partnership Agreement with Central America, to promote trade and foreign investment in ecological technologies.

2.5. Digital governance, connectivity, infrastructure, health and education

By creating a partnership around digital initiatives, the EU and Latin America can reduce the digital divide and provide wider access to technology and the Internet, while also helping companies to be more competitive in the global market. Digital threats to security are a key part of the agenda. Collaboration in the joint assessment of security risks, the screening of investments and multilateral export control systems would represent ambitious progress towards greater cooperation in the partnership between the EU and Latin America and the Caribbean.

2.5.1. Digital governance

Regulatory convergence is one of the top priorities of the EU when developing technological partnerships with other countries. That is why the EU has implemented technical assistance projects at its delegations in several Latin American and Caribbean countries. However, the EU's decision on data compliance, which determines whether non-EU countries have an adequate level of data protection to allow cooperation, has only been satisfied in Argentina and Uruguay. The TTC should provide the opportunity to make more progress in this area, not only through decisions on data compliance but also through the training and exchange of staff, supporting the integration of the approaches of both parties with respect to data protection in areas such as privacy, artificial intelligence and cybersecurity.

With respect to digital rights, the EU presented its first Declaration on Digital Rights and Principles in 2022, and the Ibero-American Summit followed suit with its own Charter of Digital Rights in 2023. These documents are not compulsory or binding, although they could provide a basis for raising the global agendas of both regions in international organisations such as the UN Digital Global Compact.

45 Global Europe: Neighbourhood, Development and International Cooperation Instrument (NDICI–Global Europe).

2.5.2. Electronic governance

The digitalisation of government services is a pillar of socioeconomic development and the effective provision of public services, which underpins democratic legitimacy. Digital government also makes it possible to use information and communication technologies in the best way to adopt principles of good government and achieve public targets, and to aid anti-corruption activities and support the integrity of the public sector in a transparent manner. Four EU Member States are among the 10 countries with the most mature digital governance: Denmark, Spain, Portugal and France. One Latin American country, Colombia, is in third position, ahead of these Member States. The next Latin American country is Brazil, in 15th place.

The level of maturity varies according to the indicator used, and there is thus an opportunity for EU countries and those in Latin America and the Caribbean to exchange information and best practice on proactiveness, user-driven activities, the 'open by default' principle, government as a platform, the data-driven public sector and the concept of 'digital by design'. This electronic governance has so far evolved at the national level, on a country-by-country basis, and cooperation between the EU and Latin America and the Caribbean should thus be guided by an inter-governmental initiative based on the desire of all EU countries to participate.

2.5.3. Digital health

According to the Inter-American Development Bank (IDB), 30% of avoidable deaths in Latin America and the Caribbean are due to a lack of access to health services, while the remaining 70% are due to the poor quality of these services. Digital health is thus an important aspect of health care, to provide a better basis for diagnosis, to facilitate access to health care by people in remote and rural areas and to optimise the preparation of effective health systems when the cost of these is high.

The EU is developing the European Health Data Space, whose objective is to help individuals take control of their own health data and to support improvements in care, research, innovation and the development of health standards, and to promote the safe use and reuse of health data.

Any potential bi-regional collaboration requires the need to exchange technical practices to support data spaces (platforms which gather data anonymously and which certified users can employ to improve their public or private services) among countries in Latin America and the Caribbean, and to guarantee data protection and their efficient use in the provision of public services. This also includes cooperation between countries of the same region. That is why bi-regional cooperation is more important than ever in the context of the challenges and opportunities of digitalisation.

2.5.4. Digital enterprise

There are 1,005 technology companies founded in Latin America and the Caribbean with turnovers of more than US$1 million. The number of 'unicorns' –companies valued at more than US$1 billion that are not listed on the stock market – rose from nine in 2017 to 28 in 2020. Over the past decade, their value multiplied by 32, from an estimated US$7 billion in 2010 to US$221 billion in 2020.

The vast majority of emerging Latin American companies operate in the international arena, although they typically take their first steps in neighbouring markets or via Brazil or Mexico. These countries are followed in importance by the US, while the European market is more limited, although it is expanding, with a particular emphasis on Spain. All this means that emerging companies are increasingly important in Latin America and the Caribbean, a fact that the EU should take note of. At the same time, Latin American start-ups are increasingly investing in Europe. Along with e-commerce and financial technology (which account for 72% of the value of the ecosystem, 50% of the capital raised and 29% of the emerging companies), another opportunity for companies in the EU and in Latin America and the Caribbean lies in the added value and social impact of educational, agricultural and health technology and electronic mobility.

2.5.5. Digital literacy programmes

Digital literacy is equally important to both the EU and Latin America and the Caribbean. However, it can refer to different levels of action: primary education, advanced skills for workers with existing digital knowledge, or retraining for the unemployed and for workers who lack digital competencies. The EU-CELAC Action Plan in 2015 highlighted science, research, innovation and technology as its first pillar, and considered talent and digital literacy a key priority. However, these training initiatives have been occasional and there has been a lack of continuity in all countries.

The Trade and Technology Council (TTC) should promote technical assistance activities along with ambitious initiatives such as creating a shared group of specialists and establishing a working group on talent for growth –similar to the TTC with the US– to promote shared taxonomies in the curriculum planning of training programmes, certification and recognition of qualifications in both directions, incentives to opt for the technology sector in the public and private spheres, and programmes to include under-represented communities and to help small and medium enterprises (SMEs) to include digital literacy for staff, processes and products.

2.6. Migration

Europe is the destination for almost 5.5 million Latin American immigrants. To date, European management has depended primarily on Spanish initiatives, as this country is the main EU destination, with 2.8 million immigrants from Latin America. With the exception of academic emigration to the UK and middle-class Venezuelans, the majority of Latin American migrants to Europe have low or intermediate levels of education and find work primarily in the service sectors and domestic care. This low level of education makes Latin American migrants very vulnerable to technological transformations and changes in the economic cycle, and in times of crisis this leads to high levels of unemployment.

2.6.1. Attracting highly qualified migrants

Europe should develop policies to attract students and university graduates from Latin America. Many of these travel to the US in pursuit of a high-quality education. Attracting them would allow Europe to benefit from more highly qualified immigrants, who are in demand in the developed world in a context of international competition to attract innovative and talented individuals.

Since English is and will continue to be the dominant language in science, technology and international business, the EU could strengthen and capitalise on the expanding range of degree and postgraduate qualifications on offer in Member States to attract the best Latin American students. At the same time, programmes in other European languages such as Spanish, Portuguese, French, German and Italian are all highly valued by students from Latin America.

With this objective (attracting undergraduate and postgraduate students), a postgraduate work and residence permit could be designed to allow students to stay in Europe for a certain period after completion of their studies. To prevent a brain-drain and promote mutual enrichment, these work and residence permits should have time limits to encourage holders to return to their country of origin, leaving the door open to regular returns to Europe to increase the bi-regional mobility of professionals.

In order to promote this skilled migration, procedures for validating Latin American university degrees should be streamlined and speeded up, without neglecting quality guarantees, particularly in the regulated professions (such as engineering, medicine and law), and educational bridges should also be built to enable those graduates who cannot validate their degrees to complete their university education up to the level required in the EU.

Scientific-academic cooperation between European and Latin American universities and research centres is insufficient, and in many countries it is almost non-existent. Apart from the potential to generate scientific or technological results,

this cooperation should also be strengthened to consolidate the community of ideas, interests and international perspectives.

Latin American immigrants usually arrive in Europe legally (primarily through visa exemption) but this does not prevent it from becoming irregular after several months. In this respect, there should be regular reviews of visa exemption, a measure that has already demonstrated its effectiveness in reducing irregular immigration.

Europe continues to need seasonal migrant agricultural workers, as local workers are generally not prepared to work in this sector. The EU should promote circular migration agreements, particularly for agricultural work, along the same lines as Spain's successful arrangements with various Latin American and African countries.

Talent partnerships provide a framework within which to create mutually beneficial migration ties and are sufficiently flexible to be adapted to the particular needs of the countries of origin and of destination. However, this new instrument of European migration policy has not been used to date with any country in Latin America and the Caribbean. Strengthening the development of talent and competencies in countries of origin could be one of the principal objectives of such partnerships in the case of Latin America and the Caribbean, by promoting the training of professionals capable of adapting to the ever more exacting demands of the labour market.

2.7. Transnational crime and terrorism

Cooperation between the European and Latin America and the Caribbean in security is asymmetrical because the majority of the benefits accrue to Latin America and the Caribbean. From the perspective of its own security interests, the EU does not expect significant direct pay-offs but hopes for improvements through cooperation programmes. Despite sharing global security risks, the EU and Latin America and the Caribbean differ with respect to their degree of resilience and the number of tools at their disposal, and this creates problems when it comes to establishing symmetrical security partnerships. Various EU institutions and agencies, such as the European External Action Service (EEAS), Europol, Eurojust and others, are driving national, regional and –to a lesser degree– bilateral cooperation in security. And the EU also funds delegated cooperation mechanisms between EU and Latin America and Caribbean organisations (such as COPOLAD, the cooperation programme on drug policy).

Security cooperation between the EU and Latin America and the Caribbean revolves around institutional awareness-raising, creating capacities, exchanging information, funding security mechanisms and the provision of technical assistance. The creation of the Latin America Internal Security Committee (CLASI), similar to the EU's Standing Committee on Operational Cooperation on Internal Security (COSI),

as a forum for cooperation around internal security –both multilateral between Latin America and the Caribbean countries, and bilateral with the EU– is a result of the EU's focus on cooperation.

This agreement was supported by the Assistance Programme Against Transnational Organised Crime (PAcCTO), co-funded by the EU and Latin America and the Caribbean, which promotes cooperation between Latin American and European countries to provide technical assistance to the police, justice and prison systems, and to support operations and joint research teams in the Andean region, Central America and the Southern Cone. Along the same lines, the EU-LAC Security Cooperation Mechanism, funded by the EU and directed by EEAS, supports European cooperation with Latin America and the Caribbean. Areas of cooperation include drugs, border control, migration, organised crime, cybersecurity and terrorism.

Cooperation between the two regions has crystallised in programmes to treat drug addiction in Latin American cities (*Alianza de Ciudades para la Prevención y el Tratamiento de Drogas*), to prevent the movement of narcotics and border control (EU-LAC Cocaine Route Programme) and to organise conferences on migration (EU-LAC structured dialogue on bilateral migration and the Regional Conference on Migration or the South American Conference on Migrations, regional) together with joint declarations (such as the EU-Mexico dialogue on migration, mobility and security). The EU-LAC Working Group on Cybersecurity since 2018 and the Centre for Cybernetics Competency for Latin America and the Caribbean (2023) funded by the EU, help to consolidate regional and bilateral cooperation in cybersecurity.

Finally, cooperation efforts against terrorism have been channelled through the EU-LAC Security Cooperation Mechanism, and a range of initiatives have been adopted to increase capacities for the fight against terrorism in Latin America and the Caribbean, including providing technical assistance and delivering training programmes for security forces, supporting the development of national anti-terrorism strategies and supplying equipment and technology. Progress has also been made in establishing safe channels to exchange information and adopt measures to prevent and punish the funding of terrorism, often connected to drug trafficking. This activity is addressed through initiatives promoted along with the PAcCTO programme. At the same time, the proliferation of extremist content and terrorist propaganda on the Internet, aimed at Spanish speakers, offers an opportunity to eliminate this content and create campaigns to prevent violent radicalisation. In this regard, European experiences using EU Regulation 2021/784 to tackle extremist content or the Radicalisation Awareness Network could serve as a model for progress in Latin America.

The integration of these initiatives and programmes into the Trade and Technology Council working group on security would enable the EU and Latin America and the Caribbean to evaluate and plan cooperation in a more advanced fashion, would

generate synergies and economies of scale between the different instruments, and would help to prioritise new initiatives.

In conclusion

The creation of a Trade and Technology Council would mark a significant milestone in relations between the EU and Latin America and the Caribbean, and would take them to a higher level. It would be a huge opportunity for both regions to deepen their strategic commitment.

3. EU-Mercosur Partnership Agreement: a strategic opportunity for the EU and Latin America

The 2020s could be a period that we recall as the start of a new phase of economic integration for Latin America and the Caribbean. The parallels with the mid-1990s are important, as the region could be facing a similar moment 30 years later.

The architecture of global trade was already undergoing fundamental changes before the pandemic and the geopolitical tensions arising from Russia's invasion of Ukraine. Following the global financial crisis, there was debate as to whether the world was entering a new phase of deglobalisation. This debate turned on the political consequences of, among other factors, the rise of China, the reduction of the salary gap between developed and developing countries, the political effects of the unequal distribution of the benefits of trade and integration and, finally, the digitalisation and automation of manufacturing processes. The pandemic and geopolitical tensions accelerated these tendencies, and focused attention on the need to have resilient, fast, safe value chains, to locate the production of goods, services and strategic raw materials in reliable regions, and to ensure the supply of basic goods.

Governments are reacting to these trends by adjusting their economic integration strategies to reflect their key geopolitical and security objectives. The major economic powers are adapting their trade policy instruments, from the 'strategic autonomy' of the EU to a 'worker-centred trade policy' in the US, while China is reorienting towards a 'national economy focused on the domestic market'.

With the weakening of multilateralism (the World Trade Organisation is one of its victims), the architecture of global trade is being transformed into a more fragmented scenario for trade and investment agreements. This has generated a lot of expectation around the reconfiguration of global value chains, with the reshoring and nearshoring of manufacturing and service jobs. A concern with national security has added terms such as friendshoring and alliedshoring to the discourse around global value chains, designed to reduce to a minimum the risk of possible interruptions and to avoid problems related to intellectual property.

Latin America's main trade partners have proposed new initiatives for the region. At the Summit of the Americas in 2022, held in Los Angeles, President Joe Biden presented the American Partnership for Economic Prosperity (APEP), and the US senate is currently considering the Americas Act.

The EU has included a 'New agenda for Latin America and the Caribbean' among its initiatives for 2023, in the context of 'A stronger Europe in the world'. Meanwhile, China has continued to expand, opening up to new trade agreements.

In a world that is increasingly defined by regional and geopolitical alliances, which are more protectionist and hostile, the geopolitical dimension could become a driver of regional and global integration in Latin America and the Caribbean. Latin America could become a leading player in this new context. However, the region lacks a coherent vision to promote a strategy for integration within the Western Hemisphere and globally. In this section, we argue that the EU-Mercosur Partnership Agreement could act as a catalyst to transform the dynamic of regional integration.

3.1. The EU-Mercosur Partnership Agreement: situation report[46]

After the partnership agreement negotiations stalled in 2006 and again in 2012, the EU and Mercosur reactivated them in 2016. On 28 June 2019, after almost 20 years of negotiations, Mercosur and the EU reached an 'agreement in principle' to establish a wide-ranging trade treaty, and a year later they agreed the pillars of political dialogue and cooperation.

Although the negotiations have finished, obstacles to its signature and ratification remain. The majority of these come from the European side, particularly with respect to environmental issues and the competitive threat of Mercosur exports to agricultural producers. Although the EU-Mercosur trade agreement includes a detailed, binding chapter with updated provisions on sustainable development, the environmental rules recently adopted by the EU could introduce standards that would require new discussions with Mercosur partners.

Numerous political and legal issues regarding the approval and ratification process remain unresolved. The EU-Mercosur Partnership Agreement is a mixed agreement, which includes both a trade component and political and cooperation elements. It thus covers both competencies that are exclusive to the EU and competencies that are shared between the Commission and Member States. This second type of competency requires ratification by the European Parliament and Member States. By contrast, trade is the exclusive competency of the EU, and in principle the trade agreement could enter into provisional application as soon as it is ratified by the European Parliament. Likewise, the trade pillar of the agreement provides for the

46 The Agreement between the EU and Mercosur has a long history which goes all the way back to the 1990s, when Latin America and the Caribbean was considering a range of options for its regional and global integration strategies. This debate led, in 1995, to the selection of various parallel paths by Latin America and the Caribbean: globally, the creation of the WTO offered a multilateral framework to negotiate and regulate international trade rules; at the continental level, the creation of the Free Trade Area of the Americas (FTAA) pointed towards a Western Hemisphere free trade area; at the subregional level, the Ouro Preto protocol meant that Mercosur ceased to be only a free trade area and become a customs union; at the bilateral level, in North America, NAFTA was a pioneering agreement, the first to be agreed between a developing Latin America and Caribbean country and its developed neighbours to the north; and, finally, at the inter-regional level, the EU and Mercosur signed the inter-regional framework cooperation agreement, which continues to govern economic relations between the two blocks.

possibility of bilateral application, which means that the agreement could come into force as soon as it is approved by the European Parliament and the congress or parliament of at least one Mercosur country.

Despite these obstacles and critical voices, most observers concur that the agreement has gathered momentum thanks to the political willingness of both parties. Among the factors that have reopened a window of opportunity are the Spanish Presidency of the Council of the EU in the second half of 2023, one of whose objectives is to strengthen ties with Latin America; the new government of Lula (Brazil will hold the Presidency of Mercosur in the second half of 2023) with its focus on deforestation in the Amazon and the promise to comply with international commitments established in the agreement, including those of the Paris Agreement; and, finally, the geopolitical ramifications of the invasion of Ukraine. The next EU-CELAC summit, to be held in Brussels in July, will be the first test of the political will to capitalise on this opportunity.

Promoting the EU-Mercosur Partnership Agreement is important for two reasons. First, because it is one of the few possible trade agreements with a great potential to create trade, as Mercosur tariffs remain high in many areas (manufacturing, chemical products, pharmaceutical products, agriculture) and the same is true in some EU sectors (in particular, agriculture). There are not many opportunities still available for generating strong trade development on the basis of a bilateral agreement (see Box 4).

Secondly, the environmental and social arguments of some European countries with food and agriculture interests, such as France, the Netherlands, Austria and Ireland, will not lead to improvements if the agreement is not completed. In fact, it seems likely that the agreement is the best guarantee of respect for the Paris Agreement and compliance with commitments regarding sustainable development, respect for labour rights, indigenous communities and active control by civil society.

Rejecting the agreement means rejecting a great economic opportunity and numerous environmental and social guarantees which would not otherwise exist. In addition to these economic, social and environmental advantages, the EU-Mercosur Partnership Agreement could serve as a catalyst for a renewed vision of the Latin America and Caribbean integration strategy.

3.2. The EU-Mercosur Partnership Agreement as a strategic advantage for the EU: the early bird gets the worm

If the EU-Mercosur Agreement is completed successfully, the EU would have agreements with every Latin American and Caribbean country apart from Bolivia and Venezuela, and would be the first to have the advantage of accessing the Latin

America and Caribbean regional market in its entirety (Figure 50). This would be a far from negligible achievement, as it would make the EU the global power with the strongest presence and the deepest ties with the region. By contrast, the US and China have not even opened negotiations with Mercosur.

The agreements between the EU and Latin American and the Caribbean would be the first to include the pillars of political and cooperation dialogue, which are not included in similar agreements with the US and China.[47] The simultaneous implementation of trade, political and cooperation pillars will send a strong message to the rest of Latin America and the Caribbean that trade liberalisation is a necessary but not a sufficient condition to reap the benefits of economic integration.

The EU-Mercosur Agreement would create a market between the EU and Latin America with more than 770 million people, greater than that created by the EU-Japan agreement signed in 2018 (630 million) and a combined GDP of €18 trillion, just below the equivalent figure for the EU and Japan (€19.5 trillion). Moreover, it could provide a route towards a more ambitious intra-regional integration, an objective that has proved elusive for several decades. The presence of an external partner like the EU could prove fundamental in the task of developing this unfinished business. The network of trade agreements in Latin America and the Caribbean is a hidden treasure, waiting only for the arrival of an external partner to reveal its location.

47 China has also used free trade agreements to include cooperation mechanisms within the framework of the 'Belt and Road' initiative.

Figure 50. LAC trade agreements with EU-USA-China

	Partner countries	Type of agreement	Year	Status	% of GDP of LAC
EU	Mexico	EPA	2000*	Under negotiation	55%
	Chile	EPA	2002*	Under negotiation	
	CARIFORUM	EA	2008	In force	
	Central America	AA	2012	In force	
	Colombia	FTA	2013	In force	
	Ecuador	FTA	2013	In force	
	Peru	FTA	2013	In force	
	MERCOSUR	AA	2019	Under negotiation	
USA	Chile	FTA	2004	In force	44%
	CAFTA-DR	FTA	2004	In force	
	Peru	TPA	2009	In force	
	Colombia	TPA	2012	In force	
	Panama	TPA	2012	In force	
	USMCA	FTA	2018	In force	
China	Chile	FTA	2005	In force	14%
	Peru	FTA	2009	In force	
	Costa Rica	FTA	2011	In force	
	El Salvador	FTA	2023	Under consideration	
	Ecuador	FTA	2023	Under rectification	

Note: [*] Modernisation agreement at negotiation phase (EU-Mexico) and ratification (EU-Chile).
EAA: economic association agreement.
AA: association agreement.
FTA: free trade agreement.
TPA: trade promotion agreement.
CARIFORUM includes the Bahamas, Barbados, Belize, Dominica, Granada, Guyana, Jamaica, Dominican Republic, Saint Kitts and Nevis, Saint Vincent and the Grenadines, Santa Lucía, Surinam, and Trinidad & Tobago.
Mercosur includes Argentina, Brazil, Paraguay and Uruguay.
Central America includes Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama.
DR-CAFTA includes Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and the Dominican Republic.

T-MEC (Mexico, US and Canada): agreement to modernise NAFTA (in force since 1994).

3.3. The EU-Mercosur Partnership Agreement as a fundamental support for intra-regional integration of Latin America and the Caribbean

A coherent regional strategy, focused on deepening integration between EU countries and countries in Latin America and the Caribbean linked, through a free trade agreement, is the best way to channel the momentum that would be generated

by an EU-Mercosur Agreement to mobilise Latin American and Caribbean countries to a convergence of existing FTAs.[48] This agenda is not ideological but profoundly pragmatic, building as it does on the progress of the last 20 years towards a more coherent system which promotes the development of modern, sophisticated value chains and reduces the cost and uncertainty of trade.

Many countries in Latin America and the Caribbean are small, but as part of a wider and more integrated regional economy they could attract investment and participate in value chains, as well as benefiting from the successes of the region in general. A pragmatic focus would entail interconnecting and increasing the efficiency of the network of trade agreements that already exist in the region.

There are many technical routes for working on the convergence and harmonisation of existing trade rules in the EU's agreements with Caribbean, Central American, Andean and (in the future) Mercosur countries. For example, promoting the mutual accumulation of rules of origin from the different agreements, with special emphasis on the harmonisation of standards and implementing more transparent and predictable regulatory processes, on trade facilitation procedures to enable greater cross-border circulation of goods and services, and in the new spheres of digital commerce regulations. The key to driving this agenda forward lies in Brazil and Mexico being convinced that continuing in this direction will be to their mutual benefit. It is also important to note that, in the meantime, other regions are exploring similar mega-regional integration strategies, such as the RCEP or CPTPP in Asia and the Pacific or the AfCFTA in Africa.[49]

3.4. The EU-Mercosur Partnership Agreement as an external anchor to modernise and strengthen the Mercosur project

The Mercosur Summit of 2021, which celebrated its 30th anniversary, clearly revealed the differing visions of the Presidents of member countries with respect to integration and future possibilities. Two questions proved particularly divisive: on the one hand, the external agenda and the possibility of negotiating bilateral agreements; and on the other hand, reform of the Common External Tariff.

The EU-Mercosur Agreement could act as an anchor to resolve these differences and strengthen the Mercosur project by providing flexibility to negotiate with future partners and modernising the instruments of the Mercosur so that they can function as an effective integration mechanism for members. An alternative to bilateral negotiations would be to focus on achieving 'unity with flexibility'. In the context of

48 In line with the proposal of Estevadeordal & Talvi (2016), 'Towards a New Trans-American Partnership', brookings.edu, Brookings Institution.
49 RCEP (Regional Comprehensive Economic Partnership); CPTTP (Comprehensive and Progressive Agreement for Trans-Pacific Partnership); and AfCFTA (African Continental Free Trade Area).

the agreement, this could mean that each member of Mercosur could choose the moment at which the agreement would come into force at a bilateral level (subject to the corresponding parliamentary or congressional approval). At the same time, the agreement could act as a lever and an opportunity to modernise Mercosur by incorporating some rules from the agreement with the EU.

3.5. The EU-Mercosur Partnership Agreement as an opportunity to strengthen strategic negotiating capacity with the US and China

By generating competition between trade rivals (US, EU and China), an EU-Mercosur Agreement would strengthen Latin America's power in trade negotiations. A strategic advance by the EU in the region to promote greater economic integration and greater access to the Latin America and Caribbean markets could provide leverage for Latin America in negotiations, as potential partners would seek to offer improved conditions to achieve a trade agreement with the region.

This advantage could be useful when negotiating more favourable conditions for Latin American countries, such as reducing trade barriers and increasing access to markets. In particular, it could be possible to speed up the consolidation of a political consensus in the US in favour of deeper integration with Latin America and the Caribbean or to provide fresh impetus to APEP, while recognising that this mechanism will not be sufficient to transform the US into Latin America's principal strategic partner, which would require a more ambitious platform of trade and economic integration.

The EU's strategic advance in Latin America and the Caribbean could be particularly important to the region itself, given China's recent proposals to open negotiations over a free trade agreement with some Latin American countries in the near future (among them, members of Mercosur). As has been argued, an EU-Mercosur Partnership Agreement would also help to strengthen regional integration in Latin America. By creating a larger and more interconnected market, the region would become a more attractive trade partner with more negotiating power to set the conditions of any agreements.

Conclusions

As geopolitics displaces multilateralism and a new global trade architecture emerges, the culmination of the EU-Mercosur Agreement could ultimately – and paradoxically after 20 years of negotiations– produce a fantastic strategic opportunity both for the EU and for Latin America and the Caribbean, and would undoubtedly represent significant progress by taking EU-LAC relations to another level. First, the EU-Mercosur Agreement would give the EU an initial advantage in Latin America and the Caribbean, making it the global power with the largest

presence and strongest ties in the region. Secondly, the EU-Mercosur Partnership Agreement would be fundamental to turn the elusive intra-regional integration of Latin America and the Caribbean into a reality, by committing its countries to a process of convergence between the different FTAs with the EU. The presence of an external partner like the EU could prove fundamental in weaving together the network of trade agreements in Latin America and the Caribbean. This prize is waiting only for an external partner to take the first step. Thirdly, the EU-Mercosur Agreement would act as an external anchor to strengthen and modernise the Mercosur project. Finally, the EU-Mercosur Agreement would strengthen the negotiating power of Latin America and the Caribbean in a world characterised by geopolitical competition between the main powers. It is a huge opportunity for both regions to deepen their cooperation and commitment. The situation and the timing are right.

Box 4. The EU-Mercosur Partnership Agreement: quantifying the impact

This box presents a quantitative simulation of the impact of greater trade integration between Latin America and the Caribbean and the EU. To do this, three scenarios were simulated, reflecting a rising degree of integration.

The first quantifies the gains expected from an EU-Mercosur Partnership Agreement.[50] The gains from trade in this scenario come from the elimination of barriers, both tariff and non-tariff, for bilateral trade flows between members of Mercosur and members of the EU.

The other two scenarios compare the impact of trade agreements of differing scope. The most far-reaching are those which stipulate more provisions related to trade or other aspects of the bilateral relations between signatories. According to the three-group classification by Fontagné *et al*., the Treaty of the EU is a trade treaty with 'high' scope, the treaties between the EU and Latin America and the Caribbean (including the one with Mercosur)[51] have 'medium' scope, and the existing treaties between Latin America and the Caribbean countries, such as Mercosur and the Pacific Alliance, have 'low' scope.

According to this classification, the second scenario assumes that, in addition to the EU-Mercosur Agreement, trade flows between Latin America and the Caribbean countries, such as Mercosur and the Pacific Alliance, would see a reduction in the costs of trade equivalent to moving from a 'low' level agreement to a 'medium' level one. This difference attempts to quantify the effect on trade of a reduction in non-tariff barriers[52] (adoption of homogenous rules for international trade for all Latin American and Caribbean countries that have signed an agreement with the EU).

Finally, the third scenario quantifies the trade gains deriving from a deeper level of integration. In this scenario, trade barriers –tariff and non-tariff– between Latin American and Caribbean countries are similar to those within the EU. This modifies the second scenario with the assumption that trade barriers between Latin American and Caribbean countries and also between those countries and the EU are reduced to the level of a 'high' scope trade agreement instead of a 'medium' scope agreement.[53]

50 The ex ante quantification of the trade benefits uses the empirical estimates of Timini and Viani (2022). The ex post trade benefits for Mercosur countries were quantified by Campos and Timini (2022).
51 As the EU-Mercosur Agreement has not yet been completed, it is not included in the classification by Fontagné *et al*. (2023). However, among the trade agreements identified by Timini & Viani (2022) as similar to the EU-Mercosur Agreement, the majority are in the 'medium' category.
52 The elimination of non-tariff barriers between countries in Latin America and the Caribbean is simulated using estimates by Fontagné *et al*. (2023).
53 Note that the 'high' scope category covers various treaties in addition to the EU. This means that the final scenario reduces trade barriers according to the average of all the treaties in this group and not necessarily in line with the Treaty of the EU. This treaty is probably the most far-reaching of the treaties in this group, and this means that the increase in trade in this scenario is less than in a scenario in which relations between Latin America and the Caribbean countries fully converge to EU levels.

Table 1. Change in trade flows between geographic regions (average exports and imports)

Scenario 1

	MERCOSUR	EU	Rest of LAC	Rest of world
MERCOSUR	-0.4			
EU	37.0	-0.1		
Rest of LAC	-0.2	-0.1	0.0	
Rest of world	-0.2	-0.1	0.0	0.0

Scenario 2

	MERCOSUR	EU	Rest of LAC	Rest of world
MERCOSUR	12.5			
EU	36.9	-0.1		
Rest of LAC	12.4	-0.3	12.3	
Rest of world	-0.3	-0.1	-0.2	0.0

Scenario 3

	MERCOSUR	EU	Rest of LAC	Rest of world
MERCOSUR	39.4			
EU	70.3	-0.3		
Rest of LAC	38.0	23.5	37.5	
Rest of world	-0.8	-0.3	-0.8	-0.1

Note: the table shows the percentage increase in trade flows between regions of the world. Mercosur with Argentina, Brazil, Paraguay and Uruguay. EU with 27 Member States. The rest of Latin America and the Caribbean does not include Mercosur, Bolivia, Cuba and Venezuela. The rest of the world excludes the countries that belong to one of these groups. Trade flows are calculated as the average of exports and imports. Calculations are made for all countries for which data are available for 2019. See Campos *et al.* (2023) for more details on country samples.

Table 1 shows the results for trade flows between geographic regions in these three scenarios.[54] [55]

In the first scenario, trade flows between Mercosur and the EU increase, with a limited negative impact on trade with other geographic regions. Over the long term, trade flows (calculated as the average of exports and imports) between Mercosur and the EU are forecast to rise by 37%.

54 The simulations use an Armington model of standard general trade equilibrium with positive demand elasticity, as described by Allen *et al*. (2020). It is calibrated as in Campos *et al*. (2023) and the same database and general methodology are used as in that document.
55 All scenarios show the predicted changes in trade flows in relation to a shared central scenario which uses data for 2019. Trade flows are calculated as the average of exports and imports. The results of Scenario 1 are comparable to those of Timini & Viani (2022).

As in the first scenario, in the second scenario trade flows between Mercosur and the EU would rise by 37% with respect to the baseline scenario, but this scenario also predicts a significant rise in trade flows between Latin American and Caribbean countries of around 12%, which would have a limited negative impact on trade with other countries or regions.

Finally, in the third scenario, the predicted increase in trade flows with respect to the baseline is approximately double, at 70%, for EU-Mercosur trade, and more than double for trade between other Latin America and the Caribbean countries, at 38%. Trade between countries in Latin America and the Caribbean which are not part of Mercosur and the EU is predicted to rise by 23.5%.

Chart 1 shows the increase in trade flows between the EU and Latin America and the Caribbean in each scenario, with respect to the baseline scenario.

Chart 1. LAC trade flows with EU, China and the US (US$ bn)

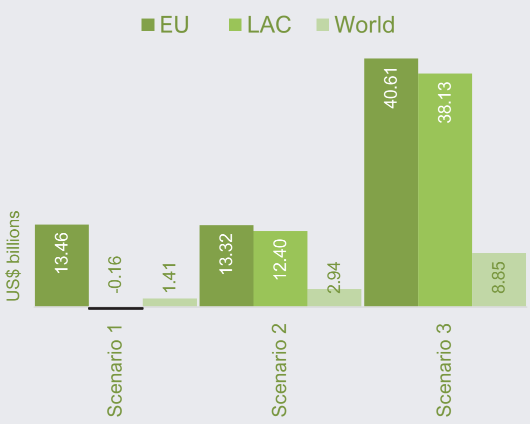
Note: trade flows are calculated as the average of exports and imports. The data from the central scenario refer to 2019.

Panel a of Chart 1 includes all Latin America and Caribbean countries and panel b excludes Mexico, whose main trade partner is the US, due to its geographic proximity and the FTA which they share (T-MEC). Trade with Mexico accounts for almost 55% of total combined EU, Chinese and US trade with Latin America and the Caribbean. When all Latin American and Caribbean countries are included, the EU is the third largest extra-regional trade partner, behind the US and China (panel a). The importance of the EU increases when more far-reaching scenarios are considered. In the third and most ambitious of these, the EU almost equals China in second place.

Panel b excludes trade with Mexico. In it, China is the main trading partner of Latin America and the Caribbean, followed by the US and the EU. Again, the importance of the EU increases if we consider more ambitious integration scenarios. The most far-reaching scenario predicts that the EU catches up with the US and considerably narrows the gap with China.

Chart 2 analyses the scenarios from the perspective of Latin America and the Caribbean. The signature of the EU-Mercosur Agreement increases trade between the parties, while the reduction in non-tariff barriers in scenario 2 primarily benefits intra-LAC trade, while trade between the EU and Mercosur is unchanged with respect to scenario 1. In the most ambitious scenario, trade with the EU and intra-LAC trade is forecast to rise by 40.6% and 38.1%, respectively.[56] These are significant figures, which quantitatively demonstrate the strategic importance of the EU-Mercosur Partnership Agreement as a catalyst of a more ambitious integration between the EU and Latin America.

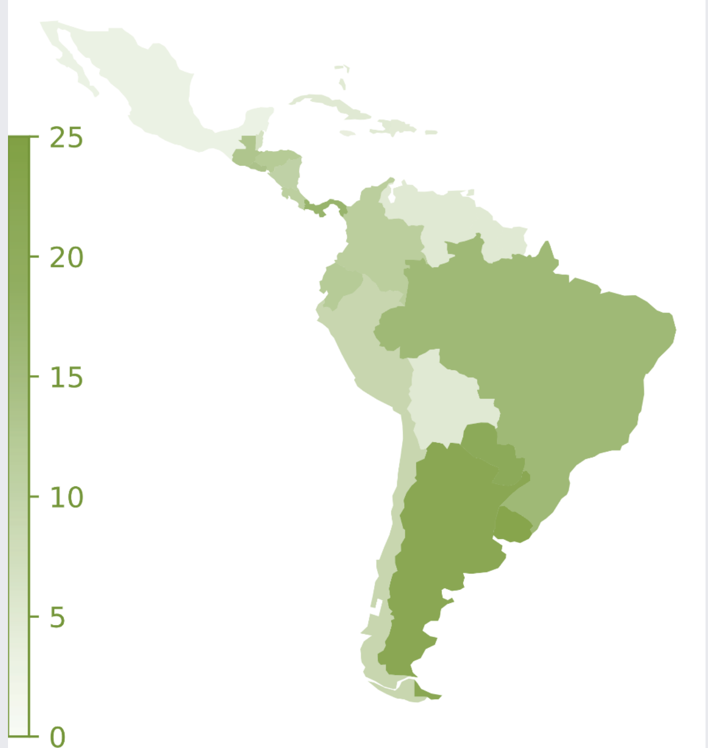
Chart 2. Percentage increase of international trade of LAC countries with EU, with other LAC countries and with the world



Note: trade flows are calculated as the average of exports and imports. Variations are calculated with respect to values for 2019.

56 After deducting the fall in trade flows with other regions, there is a net increase in total trade between Latin America and the Caribbean countries of 8.8%.

Chart 3. Percentage increase of international trade of LAC countries in the third scenario



Note: trade flows are calculated as the average of exports and imports. Variations are calculated with respect to values for 2019.

LATIN AMERICA AND THE OBJECTIVES OF THE SPANISH PRESIDENCY

LATIN AMERICA AND THE OBJECTIVES OF THE SPANISH PRESIDENCY

In the second half of 2023, Spain will hold the rotating Presidency of the Council of the EU. As on past occasions, Latin America will occupy a central position on the agenda of these six months and the European Commission not only looks favourably upon this initiative but is actively encouraging it. After so long, it seems that Brussels has finally begun to realise that the relationship with Latin America is important.

The Commission believes that the future of Europe must encompass a reformulation of its relations with Latin America, and that these could be one of the keys to the EU's international influence in the future. This can be seen in the support for the EU-CELAC summit in July 2023 and the fact that several high-ranking officials visited numerous countries in the region as part of the preparations. This requires a new agenda for Latin America, to drive the political conversation between the parties. And the European External Action Service (EEAS) is committed to this endeavour.

Faced with what feels like a rising tide of isolationism, particularly among countries of the Global South, many argue that the only major region of the globe able to help Europe is Latin America. And this idea has only grown in importance as the 27 Member States have confronted a whole range of threats (military, political and ideological) along with the environmental and technological challenges that our societies face.

1. Previous experiences: effort without continuity (1989, 1995, 2002 and 2010)

Since Spain joined the European Common Market in 1986, relations between the EU and Latin America have been framed to a large degree by the objectives proposed by Spanish governments. However, this has meant that over the past 40 years the bi-regional link has had its ups and downs, with its high points generally linked to Madrid's efforts to deepen the transatlantic relationship. The Spanish drive of the 1980s and 90s enjoyed a degree of continuity thanks to the country's Presidency of the EU in 1989 and again in 1995, both of which were important for advancing the ties between Europe and Latin America. However, during Spain's most recent Presidencies (2002 and 2010), the project of strengthening the relationship between the EU and Latin America and the Caribbean has run out of steam, particularly since 2010.

During Spain's first Presidency (1989), three years after the country joined the EC, with Felipe González as Prime Minister, there was a qualitative leap in strengthening relations with Latin America, particularly in the political and economic spheres and in aid. Spain promoted dialogue with the region but did not achieve the Latin American debt forgiveness deal that González had sought. However, Spain continued to play a dynamic role and in 1994, with Manuel Marín as European Commissioner for External Relations and Cooperation, a new strategy for the relationship with Latin America was developed, based on a 'bi-regional partnership', on the existing third-generation agreements and on progress in new fourth-generation agreements to establish free trade areas. As a result, negotiations were opened with Mercosur, Mexico and Chile to sign partnership agreements.

During the second Presidency (1995) new general guidelines for cooperation with Latin America were established, and for the first time these proposed an exclusive policy for the region, distinct from Asia. Moreover, the EU signed fourth-generation framework agreements with Mercosur (1995), Chile (1996) and Mexico (1997). At the 1st EU Latin America and Caribbean Summit (EULAC), held in Río de Janeiro in 1999, the EU launched the 'bi-regional strategic partnership' project, based on what was understood to be a community of shared values. However, 25 years later it is clear that this strategic partnership has failed to move beyond the rhetorical.

The new century and the changes to the global geopolitical scenario modified the general dynamic. The Spanish Presidencies enabled some progress in the relationship with Latin America, as attempts were made to strengthen ties in certain areas. However, as soon as the Spanish Presidency was over, the momentum it generated was lost and the European-Latin American project began to languish. The relationship depended not only on the institutional structure but also on the role of certain individuals (Felipe González and José María Aznar) and countries (Spain and Portugal in particular).

During the third Presidency (2002) unprecedented agreements were reached. The EULAC Summit was held in Madrid, and a Partnership Treaty was signed with Chile. However, during the summit some Latin American leaders made clear their unease at the negative impact of the EU's agricultural and trade policies on their economies. This hindered the negotiations with Mercosur, which had begun in 1999.

The last Spanish Presidency, in 2010, once again had a marked emphasis on Latin America. In May of that year, the 6th EULAC Summit was held. Partnership Associations were signed with Central America, and the negotiations with Mercosur were relaunched. Sealing the strategic partnership appeared to be within reach but once again complications with Mercosur and the end of the Spanish Presidency put everything back to square one.

2. EU-CELAC: eight years of a neglected relationship

After the Spanish Presidency of 2010, EU-CELAC went into decline, and mutual interest faded. During the 1990s the EU had focused on Latin America but, particularly after 2001, with the emergence of new geopolitical challenges in other regions of the world and the appearance of serious internal problems, the relationship was neglected, to the point that there has not been a summit since 2015 and the process of finalising the agreement with Mercosur was subject to constant delays.

After the emphasis on the struggle against global terrorism, the economic crisis of 2008, which left the EU badly weakened, the new scenarios of conflict for Europe (destabilisation in Africa, the migration crisis and Brexit), and the political and institutional crisis in Spain (2016-18), Latin America became marginalised. The situation was further complicated by Latin American fragmentation.

In parallel, China began to pursue a more active strategy. Its most recent summit with CELAC was held in 2018. Between 2000 and 2020 its investment in the region multiplied by a factor of 26, making it the largest or second-largest trading partner of countries in Latin America and the Caribbean, displacing the EU and the US. It even succeeded in persuading 21 of the region’s 33 countries to join the new Silk Road.

3. The three axes of the Spanish Presidency for Latin America

The estrangement between Europe and Latin America could be reversed both by European and Latin American initiatives. The invasion of Ukraine is a decisive factor, but not the only one. The EU, at Spain’s urging, wants to make Latin America one of the pillars of its international presence.

There are multiple reasons for this strategy. One of these concerns global changes since the fall of the Berlin Wall, which has created a more uncertain world, with the growing importance of new powers such as China and Russia, and a decline in the influence of the US and western Europe. The pandemic and the war in Ukraine have accelerated this geopolitical transformation.

In 2023 Brussels launched a diplomatic and trade counteroffensive to regain its position in Latin America and halt the advance of China and Russia. An EEAS document in 2022 warned that the EU was gradually losing ground in countries that, because of their natural resources, are essential in the supply of raw materials, some of which are key to the current technological revolution. In the medium term, Latin America could be an alternative which would enable the EU to end its dependency on Russia in the energy sector.

In this context, the EU-CELAC summit in Brussels in July was of particular significance. In contrast with other Spanish Presidencies, such as in 2002 and 2010, the summit was held not in Madrid but in the EU capital. The decision sent a message to the EU's Latin American partners: the summit is backed by an EU-wide commitment to strengthen ties and raise the bi-regional partnership to a strategic level.

Today, when it comes to relaunching its partnership with Latin America, Brussels can count on geopolitical and economic incentives and political muscle, and also on financial backing. The Global Gateway programme aims to mobilise €300 billion in investment until 2027. It is above all a geopolitical project that seeks to position Europe in a competitive world, promoting sustainable development, strengthening the EU as a global player and promoting European values. Latin America could be a prime recipient for these projects. These are designed to provide key investments in diverse sectors to promote digital connectivity, increase the production of renewable energy with solar plants and windfarms, and increase production of and access to vaccines, medicines and health technologies.

The EU's global investment strategy seeks to avoid creating or deepening dependency, and instead strives to generate greater strategic autonomy for both parties. Its objectives focus on three major deficits from which Latin America suffers: human capital (education), physical capital (infrastructure) and technology. It is a sustainable, reliable alternative that the EU offers its partners to support progress in the dual technological and green transition, and to address the deficiencies in physical and digital infrastructures and logistics that affect Latin American countries.

Lula da Silva's return to the Presidency of Brazil, in a Latin America where the majority of governments are on the left or centre-left, is an opportunity for the EU to strengthen the bi-regional relationship. Lula is seeking to develop a more independent role with respect to the US and China. His strategy includes preserving the environment, particularly in the Amazon, in line with the EU. But he has less room for manoeuvre than during his two previous terms of office. Some of the left-wing governments (with the exception of Bolivia, Cuba, Nicaragua and Venezuela), theoretically more favourable to a closer relationship with the EU, are broad-based and appear to be coming to the end of their political life cycle, as a result of social unrest, political fragmentation and economic problems.

If the EU is to become a leading player in Latin America and deploy an effective strategy in the face of the Chinese presence, it needs to redesign the relationship, taking it beyond trade ties to include political, economic, social and geopolitical components that go beyond the rhetoric of the past. This requires a paradigm shift for both parties, for the EU and also for Latin America, which must redefine –or, rather, rediscover– its role as an international player.

If this strategy is not to be reduced to an expression of good intentions, the EU must make every effort to ensure that the summit is a success. First, no Latin American country should be excluded, however much resistance there might be to its presence. What happened at the 9th Summit of the Americas, held in Los Angeles, after the Biden Administration vetoed the presence of certain Latin American governments, provides an important lesson, given the solidarity displayed by Mexico and other governments in the region. There also has to be a comprehensive, inclusive agenda, allowing discussion of everything that separates the two regions, in order to find the most direct route to solving differences. What is required is a non-eurocentric approach, one that avoids the paternalistic gestures which so antagonise our partners. If this agenda is to compete with the initiatives of Beijing and Washington, it must be bi-continental and bi-directional. It cannot be an exclusively European proposal but must instead emerge out of dialogue between those on both sides of the Atlantic.

Unblocking the Mercosur negotiation would send a powerful signal. In 2019, an agreement in principle was reached, creating a market of more than 800 million people. Three years later, the deal remains frozen due to the opposition of France, Austria, Ireland and Belgium, who resist suppressing the tariff barriers that protect their farmers. Secondly, it is vital to complete the process of updating the partnership agreements with Mexico and Chile. At the same time, the EU and Latin America can be strategic partners in two key areas: protecting democratic institutions and promoting the technological revolution.

In this context, Latin America can be an ally of Europe in the task of preserving democracy. Since the 1980s most of the region's governments have been democratic and these democracies have consolidated their position over recent decades, overcoming successive crises, economic stagnation and social decline. While Uruguay and Costa Rica are full democracies, there are only four authoritarian regimes: Haiti, Nicaragua, Cuba and Venezuela.

The future of western democracy is at stake not just in Europe and the US but also in Latin America, where, over the past decade, there has been a significant decline in the levels of freedom in some countries, in parallel with the global crisis that democratic systems are experiencing. As in the rest of the world, there is polarisation, the emergence of new populisms, fragmentation, a crisis of the party system and authoritarian tendencies. As a result, trust in democracy has fallen from 68.9% in 2008 to 57.8% in 2017.

The global economy of the 21st century cannot be built without Latin America. Its natural resources are a window of opportunity, particularly given the global change in technology and energy systems. The continent has abundant commodities for the energy transition which will be led by the EU and the US as they construct more sustainable, green economies. Latin America is one of the regions with greatest

biodiversity. According to the United Nations Environment Programme (UNEP), almost 60% of the world's land-dwelling lifeforms and many freshwater and marine species are to be found in Latin America and the Caribbean.

With respect to renewable energies, Latin American countries are well endowed with hydroelectric, wind and solar production. The region possesses more than 30% of the world's fresh water, has abundant hours of sunlight, and the capacity to generate green and grey hydrogen. It also has 86% of the planet's lithium reserves. The EU's plans with respect to sustainability and the development of new energy sources depend on Latin America. Indeed, Europe is already looking across the Atlantic. As a result of the Ukraine crisis, Brussels is seeking alternative sources of energy.

The Spanish Presidency of the Council of the EU is a new window of opportunity –as in 2002 and 2010– to transform the links between Europe and Latin America into a true strategic alliance. There are incentives for both parties. The Russian invasion has led to alliances being reformulated. The rise of China and of other aggressive powers such as Russia upsets the international equilibrium, creating a new geopolitical scenario.

This reshaping of alliances leads Europe to look to Latin America as a key partner in its international leadership and design a world based on multilateralism, democratic values and sustainable social and environmental development, in addition to being a reliable supplier of strategic raw materials. That will require huge doses of political commitment on both sides, a commitment to continuing and deepening ties and, above all, the institutionalisation of the relationship so that it no longer depends on the stars to align or on Spanish presidencies but instead can prosper in its own right, with financial and EU backing and bi-regional involvement. The establishment of an EU-LAC Trade and Technology Council proposed here, and sealing the EU-Mercosur agreement would strengthen the strategic partnership with real content and continuity.

The new ties must combine bi-regional and bilateral aspects in a flexible manner. The idea would be to establish an EU-CELAC block to act in coordination on the international stage, while at the same time strengthening the relationship with certain regional stakeholders. It is important to take as the starting point the negative impact of regional fragmentation and also the Chinese experience, which backed its summits with CELAC with a strong bilateral commitment, or the recent US initiative, APEP. This is why it is important to focus on those countries distinguished by their international potential (the three members of the G20: Brazil, Mexico and Argentina), their regional importance (Chile, Uruguay, Peru and Colombia) or their interest in strengthening ties with Europe.

Latin America and the Caribbean can build on the economic partnership with the EU to increase their participation in global value chains. The pandemic, the Ukraine crisis and the trade war between the US and China create an opportunity for the region to transform regional supply chains, linking them to the EU's through integrated, multi-sector strategic actions.

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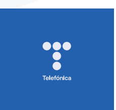

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