

2021

Foreign Direct Investment in Latin America and the Caribbean



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Foreign Direct Investment in Latin America and the Caribbean, 2021



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The 2021 version of *Foreign Direct Investment in Latin America and the Caribbean* is the most recent edition of an annual series produced by the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management of the Economic Commission for Latin America and the Caribbean (ECLAC). This year's edition was prepared by Leandro Cabello, Álvaro Calderón, Mathilde Closset, Filipe Da Silva, Marco Dini, Valeria Jordán, Georgina Núñez, Cecilia Plottier, Edwin Fernando Rojas and Nunzia Saporito, under the coordination of Giovanni Stumpo. The databases were prepared by Leandro Cabello.

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Thanks are due to the government authorities and executives of companies consulted, for their inputs for the preparation of this document.

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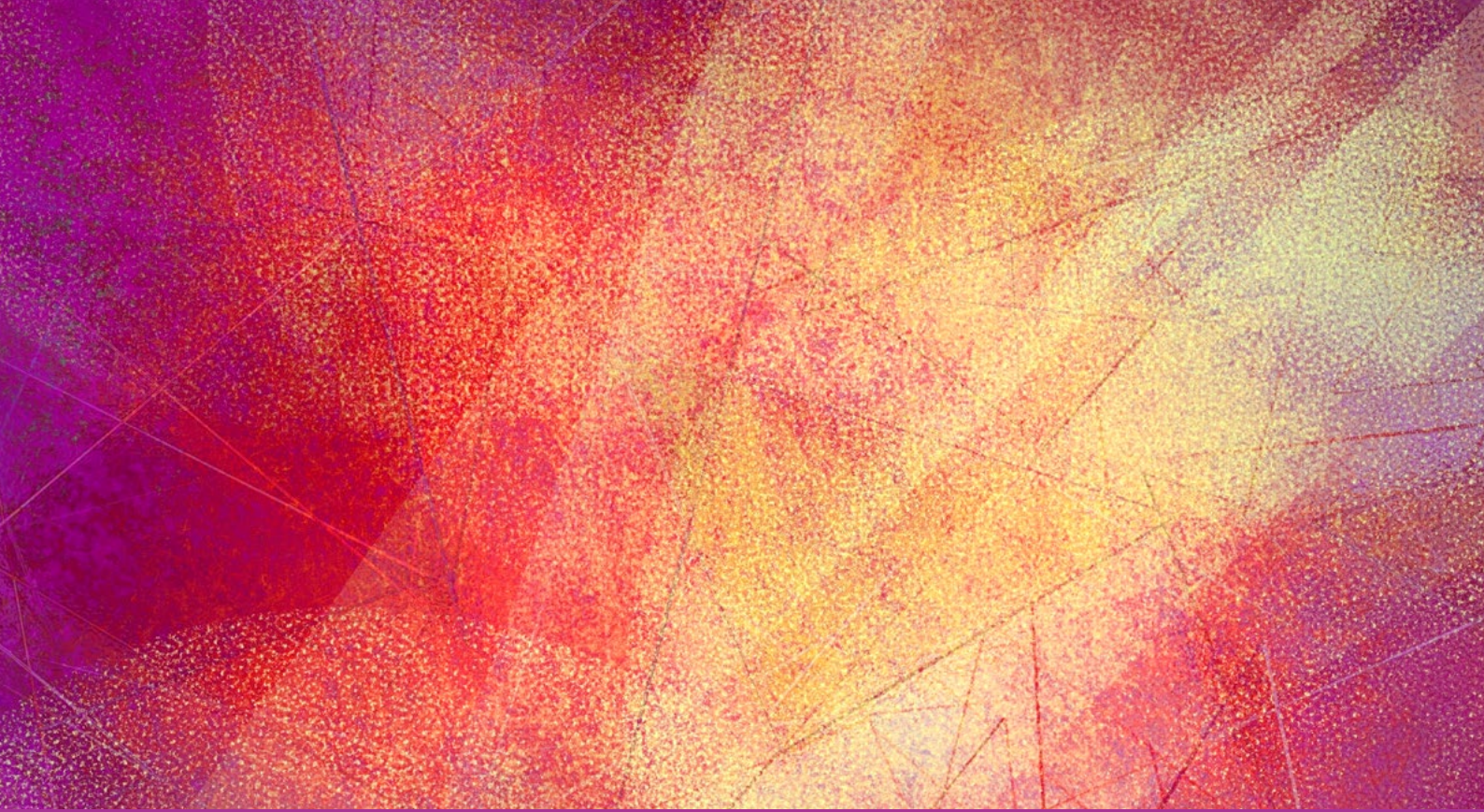
United Nations publication
LC/PUB.2021/9
Distribution: G
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Printed at United Nations, Santiago
S.21-00464

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- Three dots (...) indicate that data are not available or are not separately reported.
- A dash (-) indicates that the amount is nil or negligible.
- A full stop (.) is used to indicate decimals.
- The word "dollars" refers to United States dollars, unless otherwise specified.
- A slash (/) between years (e.g. 2013/2014) indicates a 12-month period falling between the two years.
- Individual figures and percentages in tables may not always add up to the corresponding total because of rounding.

This publication should be cited as: Economic Commission for Latin America and the Caribbean (ECLAC), *Foreign Direct Investment in Latin America and the Caribbean, 2021. Executive summary* (LC/PUB.2021/9), Santiago, 2021.

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Executive summary

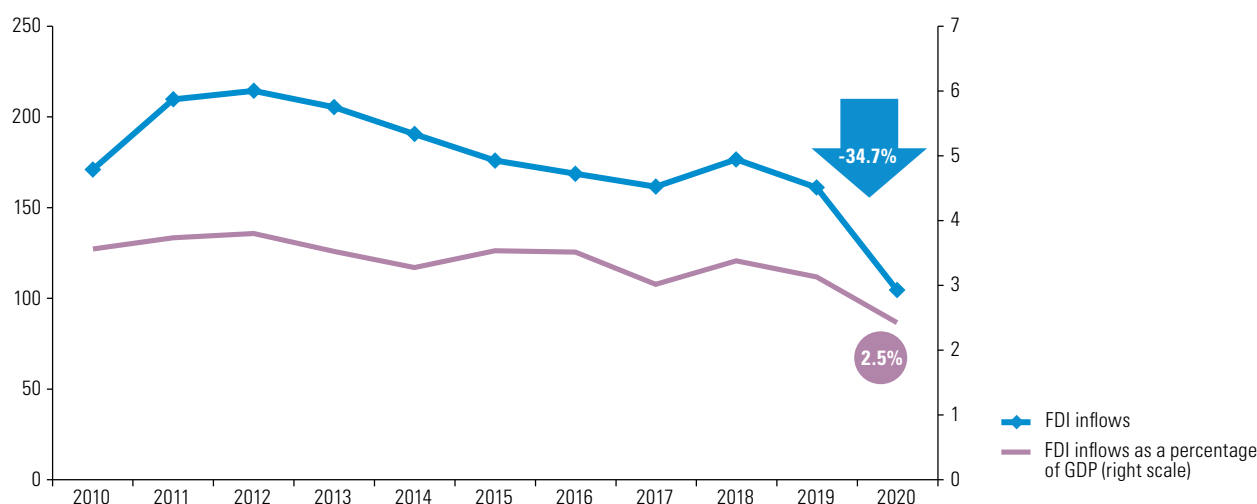
- A. Overview of foreign direct investment in the region
- B. Chinese investment in a changing world: repercussions for the region
- C. Investment strategies in the digital age

A. Overview of foreign direct investment in the region

In 2020 the coronavirus disease pandemic (COVID-19) weighed heavily on the investments of transnational corporations. Foreign direct investment (FDI) inflows into Latin America and the Caribbean amounted to US\$ 105.480 billion, some US\$ 56 billion less than in 2019. Thus, the lowest value in the last decade was recorded in 2020, and the year-on-year decline is comparable only to that of 2009, when inflows fell by 37.1% as a result of the global financial crisis. Moreover, the effect of the pandemic on FDI was more severe than its effect on GDP, reflected in the FDI share of GDP that stood at a mere 2.5% in 2020, down from an average of 3.5% in the 2010s (see figure 1).

Figure 1

Latin America and the Caribbean: foreign direct investment (FDI) inflows, 2010–2020
(Billions of dollars and percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures and estimates as of 27 July 2021.

Note: Information according to International Monetary Fund (IMF), *Balance of Payments and International Investment Position Manual: Sixth Edition (BPM6)*, Washington, D.C., 2009 except in the cases of Bahamas, Barbados, Bolivarian Republic of Venezuela, Guyana, Haiti, Paraguay and Peru. No information has been available for the Bolivarian Republic of Venezuela since 2019. No information is available for 2020 for Haiti.

This trend was generalized in the region, with only five countries receiving more foreign capital in 2020 than in 2019. These countries were the Bahamas and Barbados in the Caribbean, Ecuador and Paraguay in South America, and Mexico. The sharp fall in FDI inflows to Brazil (-35.4%) and the increase in Mexico (6.6%) brought the share of both countries as a destination for FDI closer than at any time in recent years (42% in the case of Brazil and 30% in the case of Mexico). In Central America, FDI inflows declined in all countries. The most notable case in this subregion was Panama: after a decade in which investment increased steadily, in 2020 it registered negative capital inflows in all components of FDI, with negative inflows in intercompany loans accounting for the largest share of the total figure. Inflows in the Caribbean decreased less than the regional average (-25.5%).

The hardest hit investments were those aimed at the natural resources sector, which fell by 47.9% compared to 2019, and those aimed at manufacturing (down by 37.8%). The drop in investment in services was less steep (-11.0%). Almost half of FDI inflows in 2020 went to services and the weight of manufacturing fell to 37%, below the average for the last decade (39%).

In 2020, foreign companies showed less interest in acquiring or investing in existing companies and in announcing new investments. Cross-border mergers and acquisitions, already down in 2019, fell by 21 % in value terms to a total of about US\$ 26 billion, which was slightly higher than the figure recorded in 2009 in the wake of the global financial crisis. The number of deals has been trending down since 2015, with the year-on-year drop in 2020 bringing the number to its lowest level since 2005.

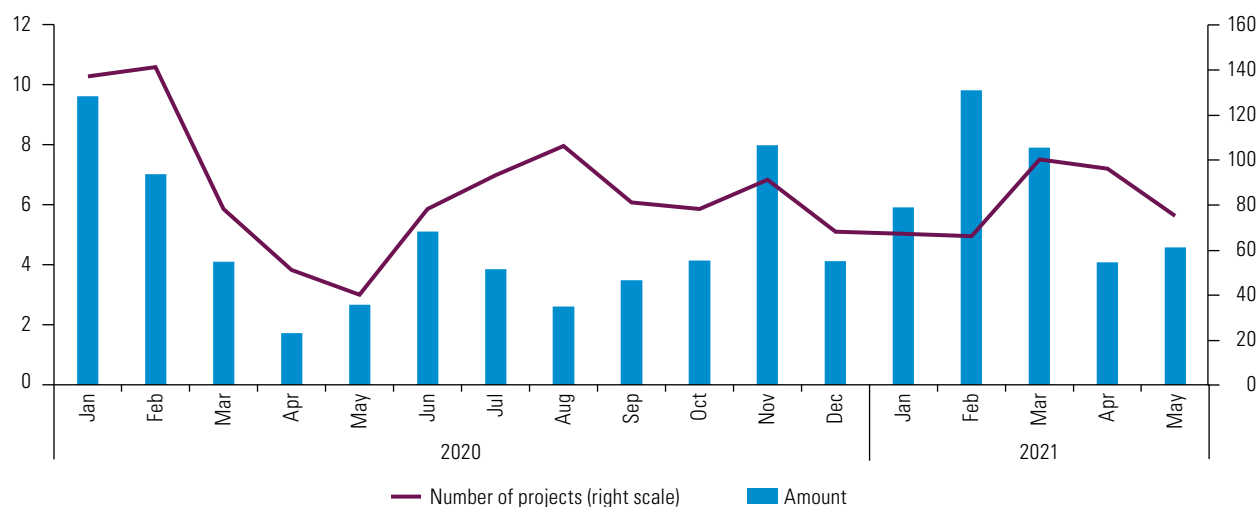
In addition to exacerbating the downward trend in cross-border mergers and acquisitions, the crisis caused by the pandemic had a significant impact on announcements of new investments. In 2020, announced projects slumped to levels seen in the mid-2000s, both in terms of the number of announcements (-45% year-on-year) and investment amounts, which were about half those recorded in 2019, with a total of around US\$ 56 billion. This is the first time that a global crisis has affected the number of project announcements in the region. Following the 2008 global financial crisis, FDI inflows and cross-border mergers and acquisitions fell in 2009 and recovered rapidly the following year. At the time, there was no decline in the number of project announcements and while amounts dropped by 13%, the values remained very high (above US\$ 100 billion). The 2020 crisis, however, had a different impact on the business outlook of transnationals. Project announcements fell to levels not seen in more than 10 years, with the lowest number of announcements since 2007.

After the crisis in 2020, the global FDI landscape in 2021 remains fairly complex. Forecasts by the United Nations Conference on Trade and Development (UNCTAD) indicate that an increase of between 10% and 15% is to be expected this year. This would leave global FDI 25% below the 2019 level of US\$ 1.5 trillion, possibly recovering by 2022. However, the magnitude and characteristics of the recovery, both in 2021 and 2022, will depend on the pace of the global economic recovery, the possibility of pandemic relapses and the impact on FDI of the economic stimulus programmes implemented by countries, along with the strategies of transnational corporations in the efforts towards greater resilience of their business models and global supply chains.

In Latin America and the Caribbean, FDI project announcements reflected a recovery between September 2020 and February 2021. However, from February 2021 until May 2021, announcements reflect a further decline in the value of projects (see figure 2).

Figure 2

Latin America and the Caribbean: announced foreign direct investment projects, 2020 and January-May 2021
(Billions of dollars and number of projects)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Financial Times, fDi Markets [online database] <https://www.fdimarkets.com/>.

In addition to the above-mentioned elements, the estimates of the Economic Commission for Latin America and the Caribbean (ECLAC) indicate GDP growth of 5.2% for 2021. This means that the region will not recover the GDP level of 2019 in 2021. In such a scenario, it is difficult to expect FDI inflows into the region to increase by more than 5%.

Latin America and the Caribbean face significant challenges. The economic recovery is likely to be partial and, in parallel, because of better commodity prices and increased demand, some countries are expected to focus on reprimarizing as an option for growth. This means a return to an economic model that has not been able to guarantee a sustained increase in GDP and productivity over time.

Given this situation, a profound transformation process is necessary. Public policies are needed to address the pandemic and to connect the emergency to a transformative recovery with equity and sustainability. To this end, ECLAC has identified eight sectors for the big push for sustainability: the transition to renewable energy, sustainable electromobility in cities, the inclusive digital revolution, the health manufacturing industry, the bioeconomy, the care economy, the circular economy and sustainable tourism.

At present, the challenge is greater given the characteristics and magnitude of the crisis, and FDI must be channelled towards activities that generate greater productivity, innovation and technology and contribute to the development of the eight sectors mentioned. To that end, the countries of the region will need to implement plans to reactivate and transform production. At the same time, both governments and the private sector must use their capacities to ensure that the policy of attracting foreign capital is also incorporated into industrial policy as an instrument for the transformation of the productive structure.

B. Chinese investment in a changing world: repercussions for the region

In a world still in crisis on account of the pandemic, China has continued to make progress towards consolidating its position as a global economic power. Over the course of this forty-year-long process of economic growth and international expansion, China has been able to impose, in part because of its scale, its own terms and conditions on economic opening and has not had to abide strictly to the conditions prevailing in international relations. One example of this is the way in which it has used FDI to close the technology gap.

China is one of the world's leading recipients of FDI, but the conditions it imposed on transnational investments were such that they allowed for technological spillovers and local capacity-building. At the same time, outward FDI from China—including Hong Kong (Special Administrative Region (SAR) of China)—has been growing steadily, rising from 5.5% of total global outward FDI stock in 2000 to 11% in 2020. This has made the country the third largest source of FDI in the world after the European Union and the United States.

Chinese companies have used different types of investment depending on the destination region and sector. Greenfield investments have allowed the penetration of new markets in sectors where Chinese companies have established capacities. For example, the Belt and Road Initiative, which focuses on infrastructure development and targets mainly Eurasia—and, to a lesser extent, Africa—explains the preponderance of project announcements in those areas. Mergers and acquisitions, on the one hand, have ensured the supply of natural resources and, on the other, have secured access

to cutting-edge technologies in core economies. Europe and North America have been the main destinations of this type of investment. As a destination for Chinese investment, Latin America and the Caribbean reflected a similar share in both types of investment. Between 2005 and 2020, the region accounted for 8.9% of the total amount of mergers and acquisitions by companies from China and Hong Kong (SAR) and 8.1% of the amount of project announcements.

For Latin America and the Caribbean, meanwhile, the relative importance of China has been greater, mainly in terms of mergers and acquisitions. According to official balance-of-payments statistics for the countries of the region, a period of great dynamism began in 2010, when FDI inflows from China rose to more than US\$ 1 billion per year and reached a peak of close to US\$ 3 billion in 2011. With this rate of growth, China accounted for 1.6% of the region's total FDI inflows in 2018, but that share was still low compared to traditional sources such as the European Union (50%) or the United States (22%). However, official balance-of-payments statistics record only the capital entering directly from China, so they underestimate the presence of Chinese companies in the region. The use of complementary data sources indicates a greater share for Chinese companies.

China was among the main investors in Latin America and the Caribbean in terms of cross-border mergers and acquisitions: in 2020 it was the country whose deals accounted for the largest amount. The share of Chinese companies in the region's total amount of mergers and acquisitions rose from 1.7% between 2005 and 2009 to 16.3% between 2015 and 2019. Among project announcements, in contrast, the weight of Chinese companies in the total amount has been more stable and the maximum was reached between 2015 and 2019, with a share of 6.4%. With regard to the sectors targeted by Chinese investments, it is possible to distinguish two phases. The first phase of Chinese investment in the region, which lasted from the start of the century until early 2010, was characterized by investments in hydrocarbons, metal mining, agriculture and fisheries. In the second phase, from 2010 onward, a gradual process of diversification began, with Chinese companies embarking on investments in electricity, the construction of transport infrastructure (mainly ports) and, to a lesser extent, manufacturing, the financial sector and information and communications technologies. China's investment in the telecommunications and high-tech sectors has increased in recent years, reflecting the country's digital expansion strategy and the growing global importance of its digital companies. Although Chinese FDI in these sectors in the region is limited, the presence of Chinese technology companies as suppliers has increased in Latin America and the Caribbean through contracts in the digital infrastructure sector, in areas such as 5G technology and submarine cables, and also in the quest to create smart cities.

Certain characteristics of China's progress towards becoming a world power differentiate it from other leading countries. These include the strong presence of State-owned enterprises, which accounted for 82% of the total value of mergers and acquisitions by Chinese companies in Latin America and the Caribbean between 2005 and 2020. In addition to FDI, construction contracts and infrastructure projects are another important component of Chinese companies' internationalization drive. Infrastructure projects under different forms of contracts have particularly been used in the framework of the Belt and Road Initiative, and they represent a growing form of participation by Chinese companies and technologies in the region, amounting to roughly US\$ 77 billion between 2005 and 2019. In many cases, China also provides the region's governments with financing to carry out these projects. Thus, between 2005 and 2020, Latin America and the Caribbean registered some 99 loans for a total amount of some US\$ 137 billion.

The growth in Chinese investment in the region was shaped by the country's strategic internationalization decisions. The change that has taken place in the pattern of Chinese investments in Latin America and the Caribbean over the past 10 years does not coincide with the country's process of technological sophistication or the evolution of its companies in the world, as these investments remain concentrated in a small number of activities, mainly mining, energy and transport infrastructure.

Latin America and the Caribbean's recovery process from the COVID-19 pandemic is an opportunity to embark on a new stage in economic relations with China and to develop policies that ensure that China's investments contribute to building productive capacities in the recipient countries, establishing links with local suppliers, generating employment and promoting sustainable development. Moreover, with regard to relations between China and Latin America and the Caribbean, there is a need to promote greater regional cooperation to give the countries of the region more leeway in defining their investment and trade policies.

C. Investment strategies in the digital age

The digital revolution is giving rise to a new age characterized by the transformation of consumption, business and production models by the adoption and combined integration of advanced digital technologies, namely fifth-generation (5G) mobile networks, the Internet of Things (IoT), cloud computing, artificial intelligence, big data analytics and robotics, among others. The current situation is one of transition from a hyperconnected society to a world which is digitized in the economic and social dimensions and where the organizational, production and governance methods of the traditional economy coexist with the business, production and governance models arising from the new technological paradigm and adopt their innovations. This is beginning to result in the consolidation of a new, digitally interwoven system in which models from the two spheres are integrated and interact, giving rise to more complex ecosystems that are currently in the throes of organizational, institutional and regulatory transformation.

In order to interpret and analyse the progress of the digital transformation, ECLAC proposes a conceptual model structured in three dimensions. The first of these is the connected economy, characterized by the deployment of broadband networks and the mass use of the Internet. The second is the digital economy, understood as that part of economic production derived mainly from business models centring on the supply of digital goods and services, which has accelerated sharply with the more widespread use of digital platforms as business models. Finally, the digitized economy refers to the incorporation of digital technologies (and, in particular, artificial intelligence solutions) into the production, organization and consumption models of the economy as a whole, especially in traditional industries. These dimensions of digital development are constantly evolving in a process that is both synergistic, with advances in one area driving progress in another, and systemic, in that the activities of society, the productive apparatus and the State alike are being transformed.

This process is generating structural changes in the global economy. The initial strong growth of sectors linked to the connected economy resulted in a revolution in communications and the generation of information and knowledge, prompting the unprecedented development of the digital economy. Digitally enabled innovations are radically changing the value proposition of the goods and services on offer from a variety of industries, with a disruptive effect on the economy as a whole, and accelerating the incorporation of digital technologies in traditional industries. In the last decade, the digital ecosystem, which encompasses the connected and digital economy dimensions, has

experienced dramatic growth. Between 2010 and 2021, the digital technology industry increased its share of the market value of the world's 5,000 largest companies from 14% to 28%. Over the same period, the share of the digital economy increased from 3% to 15%, while the connected economy experienced more modest growth, from 11% to 13%. However, although telecommunications operators are no longer as important as they used to be, they remain crucial for the roll-out of digital infrastructure, especially in the case of the new 5G networks.

Latin America and the Caribbean reflect the same trend, albeit with less dynamism. Operators are reworking their business strategies, focusing on their strongest activities and on higher value added business segments with a view to taking advantage of opportunities that may open up through future investments, particularly in 5G technology, among other motives. Between 2019 and 2025, US\$ 99 billion is projected to be invested in the development of network infrastructure. Currently, over 50% of total connections in the region are 4G, while 5G coverage could reach around 10% by 2025. Amid this backdrop, digital companies in the region have become much more important. One example of this dynamic has been the dramatic increase in the market value of the Argentine e-commerce company Mercado Libre, which is the region's second-largest company by market value. This has led to an upsurge of investment in digital sectors—both the connected economy and the digital economy—, particularly in terms of mergers and acquisitions. However, a striking new feature of the digital economy in the region is the growing importance of venture capital investment. In fact, because of the relative immaturity of the Latin American digital sector, investment in digital economy companies is increasingly coming through venture capital. Finally, the digitization of the economy has advanced at a slower pace in the region. While mature technology is widespread, when consideration is given to more complex technologies the picture changes dramatically and significant gaps are evident, especially in rural areas and smaller enterprises.

Moreover, the digitization of the economy requires a review of the existing regulatory and institutional frameworks. This need has been highlighted by the rise of digital platforms and new business models based on the management of large amounts of information and cross-border data movements. The increasing datafication of the economy, in which digital platforms play a central role, is influencing the behaviour of the vast majority of companies. In this context, the impact of the platform model is more complex to assess when the pillars of competition are directly affected.

Large technology companies can exert control over market dynamics, especially through mergers and acquisitions. In this scenario, the value of data and pricing strategies in data marketplaces pose significant challenges. An integral part of the value of data relates to their protection and privacy, a factor that may become a significant barrier to entry for new companies seeking to participate in the sector. Lastly, business models in the digital economy pose significant challenges to countries' tax policy. This has made it necessary to adapt traditional tax arrangements and to launch what are still incipient initiatives for the creation of ad hoc forms of digital taxation, the presence of which has increased in countries of the region.

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