Executive summary

Countries in the Latin America and the Caribbean (LAC) region have enormous potential to embark on a stronger and more sustainable development trajectory. Yet, to seize that potential, the region needs a more ambitious and comprehensive investment agenda.

LAC needs to improve potential growth and social conditions in a challenging context

After the post-pandemic rebound in growth experienced in 2021 in LAC, external conditions became less favourable, public transfers were reduced, monetary policy tightened and the effects of the reopening of economies dissipated in 2022. The deceleration of economic activity in LAC in 2023 suggests that the region is returning to the low levels of growth seen in the years before the pandemic. Socio-economic conditions remain challenging in LAC, with poverty (29%) and extreme poverty (11.2%) still above pre-pandemic levels in more than half of LAC countries in 2022. One of the main challenges to addressing this situation is labour informality, entailing lower wages and lack of access to social protection networks. On average, 42.8% of the region's population lived in a household that depended only on informal employment. Moreover, purchasing power in LAC has been progressively eroded by increased inflation, with a more severe impact on the most vulnerable populations. In the first six months of 2023, households in extreme poverty confronted an average price increase that was around 4.0 percentage points higher than for average households.

More and better investment to drive sustainable development in LAC

At only 20% of GDP the LAC region exhibits one of the lowest levels of total investment across all regions globally. This can be partly explained by the region's low levels of national savings. Since the year 2000 gross domestic savings averaged 20% of GDP compared to 35% of GDP in East Asia and Pacific economies. The private sector is the largest source of investment in almost every LAC country (78% of total investment in 2019 on average), although private investment remains concentrated in large enterprises. The public sector has a crucial role to play notably by investing in strategic public infrastructure and mobilising private investment. The public sector can also mobilise private investment for example by updating regulatory investment frameworks and implementing well-regulated public-private partnerships (PPPs) under sound institutional frameworks.

FDI represents an opportunity to boost productivity, innovation and create quality jobs

Despite low domestic investment in LAC, the region has attracted relatively high levels of foreign direct investment (FDI). In 2022, it was the region that received relatively the largest FDI flows globally (equivalent to 4% of the region's GDP). To put these FDI inflows into perspective, while the Marshall Plan to promote Europe's recovery after World War II amounted to around 2% of the combined national incomes of the recipient countries between 1948 and 1951 (USD 13 billion in 1948, equivalent to USD 160 billion in 2022), FDI in LAC surpassed 3% of GDP in the periods 2017-19 (USD 464 billion) and 2020-22 (USD 445 billion), reaching 4% of GDP in 2022. Foreign firms tend to be more productive and invest more in product innovation and research and development (R&D) than domestic firms. This suggests a potential for knowledge and technology spillovers from foreign to domestic firms. Moreover, foreign firms in LAC tend to offer higher average wages and employ a higher proportion of unskilled workers, offering them training opportunities that can upgrade their skills and increase their employability. The impact of FDI in terms of job creation varies significantly depending on the country of origin and the sector receiving the investment. FDI from the EU and the United States had a particularly positive impact on the creation of jobs in the manufacturing sector in LAC. Additionally, FDI in renewables creates more jobs than it does in fossil fuels in LAC.

Investment in R&D and emerging sectors can transform the production structure

The production structure in LAC is characterised by low productivity levels. Investments in physical capital, knowledge and innovation, both from domestic and foreign sources, will be a fundamental driver of production transformation. R&D investment has remained low in the past two decades at around 0.65% of GDP on average, well below the OECD average of around 2.7% of GDP in 2022, and nearly 60% is driven by governments. Moreover, investment in strategic sectors will allow the region to harness untapped opportunities, notably those associated with the green transition and digital transformation. These sectors can be grouped into four broad areas, which are interlinked among them and where there are new opportunities for investment and job creation: i) the green transition; ii) the digital transformation; iii) health and the care economy; and iv) sustainable agriculture and food systems. In terms of green job creation, several activities show high potential, including sustainable food manufacturing, public administration (e.g. related to the planning and implementation of sustainable policies); sustainable construction; sustainable transport; and sustainable commerce (e.g. linked to more sustainable and circular business models). As new green occupations are mostly related to advanced scientific knowledge and skills, they are more likely to be assigned to highly educated men and tend to be formal jobs. This means that green jobs have an important potential contribution to increasing formalisation in LAC, particularly if paired with active labour market policies and with policies to improve female employability.

A new investment agenda demands mobilising resources through innovative instruments

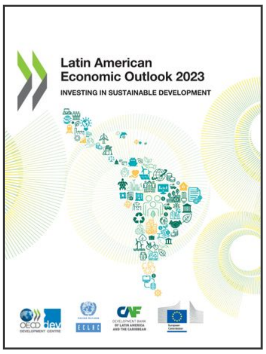
An ambitious and comprehensive investment agenda will require substantially greater involvement both from the public and private sectors. Advancing towards more effective and progressive tax systems, more efficient public spending and debt management, and stronger and more sustainable fiscal frameworks is essential to expand public investment in a context of limited fiscal space. Two promising areas have the potential to improve the flow of both private and public financial resources towards development objectives. First, the role played by development finance institutions (DFIs), which can support access to finance – particularly for MSMEs, given that 75% of their financing needs remain unfunded – and can drive investments in key sectors. The second area is the development of innovative financing instruments, including Green, Social, Sustainability and Sustainability-linked (GSSS) bonds. These bonds represent 32% of total international LAC bond issuance.

Stronger institutions are key to linking investments with countries' and citizens' needs

Favouring dialogue around the investment agenda is key to enabling the implementation of investment and production transformation efforts in LAC by helping increase their legitimacy and thus strengthening the social contract. Building trust is an important goal as more than half of Latin Americans had low trust in national and international companies in 2020, and positive views on FDI have gone down, reaching 53%. Governments must establish mechanisms to promote effective citizen participation, impact assessments, and more equitable distribution of the benefits of investment projects. National development plans (NDPs) can provide the well co-ordinated, long-term and comprehensive policy frameworks needed to advance coherent investment and production transformation strategies. NDPs can also act as a catalyst to attract private investment by enhancing policy predictability and transparency and can include policy guidelines associated with strategic sectors with high development potential in the region.

International partnerships for better investments

International partnerships can create synergies between international organisations, governments, experts, development agencies and private-sector institutions to attract investments that are conducive to LAC's production transformation. These partnerships can attract private investments through innovative mechanisms, such as blended finance, to mobilise additional resources towards sustainable development projects. During the last decade, private finance mobilised by official development finance interventions in LAC, increased from USD 3 billion in 2016 to USD 9 billion in 2021. International partnerships can also help yield greater socio-economic impact of investments by creating an enabling environment for investment; fostering collaboration among institutions, such as multilateral development banks and DFIs, export credit agencies, investment promotion agencies and the private sector; or boosting local development by implementing local content requirements. Regional integration and efforts towards production integration can be an additional source of mobilisation of greater and better investments. Finally, the EU-LAC Global Gateway investment agenda identifies investment opportunities in strategic sectors. This agenda, accompanied by renewed mechanisms of dialogue and co-ordination among the investment, trade and development communities, can further support LAC's reindustrialisation efforts. To achieve this, the agenda should be aligned with national priorities, and ensure investment flows follow a shared criteria on quality, sustainability and inclusiveness.



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