



OPPORTUNITIES WITH THE NEW LATIN AMERICA

Partnerships for a More Resilient Future



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January 2023

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INTRODUCTION

After the major political shifts that occurred in 2022, Latin America and the Caribbean (LAC) are at a crossroads. In recent years, the region has endured economic instability, growing authoritarianism and devastating effects from the global COVID-19 pandemic. Furthermore, the economic impact of Russia's ongoing war against Ukraine and the increasing spread of authoritarian influences around the world present external challenges to regional stability. As events in Europe offered a sober reminder in 2022 of the fragility of peace and democracy, long standing inequality, reliance on commodity revenues and unequal growth contributed to historic shifts and challenges to democratic governance in LAC. Despite challenges, these shifts have created opportunities for cooperation and engagement among new governments, long established democratic partners and the private sector. For example, the benefits of North American integration for Mexico's economy, now among the top three U.S. trade partners, have made Mexico an attractive location for nearshoring and demonstrated the value of global economic engagement.

Even as LAC continues to deepen ties with China, now South America's largest trading partner, the region is growing its connections with the United States, Japan, and other countries. There is growing awareness that deeper ties with China carry political and economic risks; with the recent wave of elections, new governments will be confronted with choices that could lead to sustained economic growth and democratic stability or economic volatility and autocracy. Strengthening relationships based on shared democratic values with quality, dependable partners is key to unlocking LAC's full potential to create well-being, strengthen rule of law, and generate private sector-led growth. The United States has been a traditional choice for LAC. But Japan, one of the world's most dynamic economies, is equally well suited to partner with the region to attract investment, stimulate innovation and strengthen democratic institutions. A long-standing partner to the region, Japan has a reputation for quality innovation, stability and respect for the rules based international order. Deepening partnerships with Japan as well as the United States will place LAC in a better position to capture a larger share of shifting global supply chains, attract investment and expertise to power growth in the low-carbon energy sector and expand its digital transformation progress and strengthen democracy, thus supporting social development and inclusion. Engagement and cooperation with new governments in LAC will also create opportunities for innovation. Recent political shifts present an opportunity for businesses to reset relations with new leaders to create partnerships for a more resilient future.

SHIFTS IN POLITICAL CONTEXT

At the start of every new administration, leaders transition from campaigning to governing. Governing requires engagement and cooperation with partners to achieve larger economic and social goals. In the years leading up to recent elections, there was no shortage of economic and social challenges in LAC. To know where opportunities lie at this critical juncture in LAC, political context is needed to understand the recent shifts in governments in the region and its implications for foreign investment. Pervasive inequality, corruption, polarization and insecurity in the years leading up to 2020 set the stage for a wave of political change in the Americas. The economic and social toll of the COVID-19 pandemic pressured incumbent governments and established political actors across the region, and 2022 elections in the region were marked by historic shifts to the left.

But initial fears of far left or authoritarian policies by new governments are overblown. In general, governments have moved closer to the center, reflective of the desire for balance, compromise, and moderation by the electorate. It would be an oversimplification to categorize political shifts as a return to the pink tide with associated policies. The election of the recent wave of leaders is more nuanced. The elections, different in each country, represent a desire for change, less about political ideology and more of a rebuke of the incumbent political establishment.

It is true that extreme populism and authoritarianism continue to dominate some countries in the Americas. The illegitimate governments of Nicolas Maduro in Venezuela and Daniel Ortega in Nicaragua highlight the challenges democracy faces in the Western Hemisphere. Cuba's declining economy in the wake of the pandemic and lack of freedom has forced thousands to migrate searching for freedom and better economic opportunities. Former Peruvian President Pedro Castillo's announcement of plans to dissolve congress and rule by decree was an example of the fragility of democracy in a divided country. His subsequent removal from office and imprisonment have set off protests and social unrest in the country.

The implications for these political shifts vary by country but, with purposeful outreach and care, the private sector can find areas of cooperation with new governments searching for economic investment and deeper ties with dependable allies and partners. There are opportunities for engagement and cooperation in many areas for Japan, the United States and other partners. In addition to a growing number of countries with exploitable hydrocarbon resources, LAC has an abundance of

renewable energy sources. There are significant opportunities where the private sector can partner with the region to become a major producer and exporter of green energy, which can help reduce carbon emissions domestically, attract investment and export excess energy to global markets. With increased private sector investment and cooperation, the region can build also on the progress made in financial inclusion and digital transformation in recent years. Continued adoption of innovative technologies and inclusive digital policies have the potential to reduce inequalities, increase economic growth and improve democracy. Meanwhile, LAC is well positioned to gain from companies shifting manufacturing and services to the region.

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To increase resiliency, companies can benefit from diversifying of their operations to LAC. For example, the region’s automotive exports have more than tripled over the last 20 years, rising from an average of around US\$ 45 billion per year in 2000–2002 to just over US\$ 142 billion per year in 2019–2021.¹ Japan’s increased investment in Mexico’s automotive sector is responsible for significant export growth, helping Mexico to cement a leading export position in the region, becoming the fifth largest exporter in the world.² With deeper trade engagement and development, Central America and the Caribbean could likewise benefit more from nearshoring. LAC needs long term, committed partners willing to reset relations in key areas to capitalize on the progress already made in the region. To solve their most pressing problems, new leaders, allies, and the private sector must work closely to achieve common objectives for a more resilient future.

AREAS OF COOPERATION FOR SUSTAINABLE ECONOMIC DEVELOPMENT AND DEMOCRACY

As a mature democratic ally of the United States and other democracies, Japan is a natural partner for cooperation with LAC. The country is a reliable source of development expertise and assistance, supports a rules based international order, and has a reputation as a technological leader in numerous industries, with products known for their innovation, dependability and quality. The country has a long history of trade and investment in the region and shares democratic values and significant

¹ ECLAC: International Trade Outlook for Latin America and the Caribbean 2022.

² ECLAC.

cultural ties, making the country an attractive partner for the region’s sustainable economic development and social inclusion efforts.

Japanese companies are also interested in investing in technology startups and digital transformation in the region. Japan, with an interest in energy security, has identified low-carbon hydrogen as one of its energy sources to power its future, and LAC, with its abundance of renewable energy resources, is well positioned to cooperate and partner with Japan to secure its future energy needs. Nearshoring, green energy development and technological and digital transformation are key areas for exploration for cooperation and engagement. Cooperation in these areas can spark investment and development to the benefit of LAC, Japan and the United States. Successful cooperation can result in the creation of sustainable jobs, strengthen local and regional economies, and contribute to long term climate security.

NEARSHORING AND REGIONAL INTEGRATION TO CAPTURE A GREATER SHARE OF SHIFTING SUPPLY CHAINS

Beyond Mexico, there are opportunities for other countries in the region to benefit from shifting global supply chains and nearshoring. The COVID-19 pandemic exposed the fragility of global supply chains, disrupting the flow of trade around the world. Companies’ overreliance on China as a manufacturing hub became obvious with China’s extended pandemic-related shutdown through 2022. China’s previous zero COVID policy and geopolitical uncertainty caused by its strained relationship with the United States have convinced more companies to move their supply chains to dependable and more resilient locations benefitting from proximity to their largest markets. LAC, given geographic proximity to North America, is well positioned to

capture a greater share of shifting supply chains and investment. According to estimates by the Inter-American Development Bank (IDB), nearshoring could add an annual \$78 billion in additional exports of goods (64 billion) and services (14 billion) in LAC in the near and medium term.³ All countries in the region would benefit from nearshoring. Countries in Central America and elsewhere could most readily benefit from increased integration with the United States-Mexico-Canada Agreement (USMCA).

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³ Inter-American Development Bank: Nearshoring can add annual \$78 billion in exports from Latin America and Caribbean.

Although the region faces many challenges in creating the right conditions to take advantage of shifting supply chains, countries can start by resetting and recommitting to improving regional integration. Mercosur and even more so the Pacific Alliance have been modestly successful in integrating countries in the region. Other LAC economic and commercial integration bodies like the Andean Community of Nations have lagged in significantly increasing interregional trade and investment. According to the Development Bank of Latin America (CAF), the level of intraregional trade in Latin America, which represents 15% of total exports, lags far behind other blocs such as the EU (60%), USMCA (45%), or Asean+3 (35%).⁴

More cooperation is needed to modernize, deepen, converge and standardize LAC's diverse and expansive trade agreements at the highest possible level. Deeper alignment and standardization could result in an increase in intraregional trade of nearly 12%.⁵ Driven by best practices, corrective policies can help reduce trade friction and increase regional competitiveness, which supports the regions deeper integration into global value chains, thus providing more access to economic opportunities for countries and companies looking to increase investments in LAC.

DIGITAL TRANSFORMATION AND FINANCIAL INCLUSION AS DRIVERS FOR ECONOMIC GROWTH

As a telecommunications and investment leader, Japan has the experience and expertise to support continued digital transformation growth in the Americas. Japan, like the United States, is well suited to work with development banks to support digital transformation and the expansion of fintech in the region, a bright spot.

Cooperation on digital transformation is key to increasing economic growth and social development in LAC. According to the IDB, the number of fintech platforms reached 2,482 in 2021, growing 112 percent from 2018 to 2021. Nearly a quarter of fintech platforms globally – 22.6 percent – are based in LAC.⁶ Access to digital financial services, often through smart phones and devices, have facilitated trade in goods and services in LAC. The adoption of digital technology via fintech has enabled millions of people to have access to financial services in an innovative and accessible manner. Despite growth however, the region still lags in recent measures of financial inclusion including paying bills and using digital payments.

4 Development Bank of Latin America: Pathways to Integration.

5 Inter-American Development Bank.

6 Fintech in Latin America and the Caribbean: A Consolidated Ecosystem for Recovery.

“Expanding the development of digital infrastructure, access to education, credit and financial tools can reduce inequality when tackled with the private sector and quality, experienced partners.”

Digital trade, like the traditional trade of goods and services, can transform communities and lives. Expanding the development of digital infrastructure, access to education, credit and financial tools can reduce inequality when tackled with the private sector and quality, experienced partners. As the LAC startup scene continues to grow and develop, opportunities for Japanese and other companies increase.

RENEWABLE ENERGY AND THE POTENTIAL OF LOW-CARBON HYDROGEN DEVELOPMENT

Allied countries and the private sector are uniquely positioned to partner with LAC in reducing its carbon emissions output. According to a joint report from the Development Bank of Latin America (CAF) and other organizations, LAC is endowed with high potential for renewable energy resources; at present, renewables account for 33% of total energy supply in the region, compared to just 13% globally.⁷ Nonetheless, despite its abundance of renewable energy resources, LAC lacks investment in developing its potential for domestic use and international export. Meantime, companies are looking for cleaner methods to power manufacturing and other industries. As a result, investing in renewable energy plays an integral part in attracting a larger share of global supply chains. In addition to aligning with the low-carbon goals of companies looking to incorporate renewables in their production methods, the low-carbon hydrogen sector is ripe for exploration and development.

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Almost 90% of the region’s hydrogen demand in 2019 was concentrated in the region’s five largest economies (Argentina, Brazil, Chile, Colombia and Mexico), and in Trinidad and Tobago, which alone accounted for more than 40% of total demand according to the report on low-carbon hydrogen in Latin America.⁸ Low-carbon hydrogen can help support domestic energy consumption while reducing carbon emissions. Low-carbon hydrogen can also potentially be exported to satisfy regional and growing global demand in Japan and other countries. Many obstacles exist before this dual

⁷ Latin American Economic Outlook 2022: Towards a green and just transition.

⁸ Shearman and Sterling: The growing importance of low-carbon hydrogen in Latin America.

**TOTAL NEARSHORING
OPPORTUNITIES BY COUNTRY
ADDITIONAL EXPORTS OF GOODS**
(M: US\$, B: US\$ BILLIONS)



Source: IDB

opportunity can be fully realized, including a lack of comprehensive, integrated regulation and regulatory strategies for the production and commercialization of low-carbon hydrogen. The adoption and commercialization of low-carbon hydrogen is also complicated by the slow pace of development of strategic infrastructure, particularly for hydrogen transportation, which is key to the export sector.⁹ Strategic cooperation with the private sector will be critical to realizing the full potential of the export sector.

Fortuitously, Japan is investing heavily in hydrogen to secure its own energy security, industrial competitiveness and reduced carbon emissions. In 2017 the Japanese government became the first in the world to formulate a national hydrogen strategy. To achieve its goals, Japan will need to import hydrogen. LAC, with its abundance of renewable energy resources, can partner with Japan and others to commercialize its nascent hydrogen export sector. As a leader in hydrogen related technologies, ample investment opportunities exist for Japanese companies to partner with LAC for a more resilient, mutually beneficial future.

CONCLUSION

LAC continues to face economic and social challenges from COVID-19, polarization and worldwide geopolitical events. The region has plenty to offer and with support

from trusted partners and the private sector, will be well positioned to make progress on attracting nearshoring investments in manufacturing, clean energy and digital services to become a larger regional player in the world's economy. These challenges can only be overcome with a renewed commitment to interregional cooperation, improving investment relationships and working with international partners like Japan and the United States that share the values of democracy, economic openness, freedom and a commitment to improving investment conditions. For governments across the region, the opportunity is now to start a new chapter with dependable partners and the private sector to achieve economic growth and build a more resilient future in the Americas.

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⁹ Shearman and Sterling.

Americas Society is the premier forum dedicated to education, debate, and dialogue in the Americas. Its mission is to foster an understanding of the contemporary political, social, and economic issues confronting Latin America, the Caribbean, and Canada, and to increase public awareness and appreciation of the diverse cultural heritage of the Americas and the importance of the inter-American relationship.

Council of the Americas is the premier international business organization whose members share a common commitment to economic and social development, open markets, the rule of law, and democracy throughout the Western Hemisphere. The Council's membership consists of leading international companies representing a broad spectrum of sectors, including banking and finance, consulting services, consumer products, energy and mining, manufacturing, media, technology, and transportation.



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