

# Mañana Today: A Long View of Economic Value Creation in Latin America

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## Abstract

This commentary concerns the significant opportunities which the global economy's current nearshoring trend offers the Latin American and Caribbean (LAC) region owing to a US–China decoupling. Yet the region, generally, is woefully unprepared. The state of the LAC will make or break the peoples' attempts to exploit the new potential to better themselves. Yet the short-termist myopia and public policy neglect of politicians is the greatest obstacle to the kind of development the region needs the most: high-quality FDI enabling educated innovators to push LAC up the rank of global value chains; or else it will be trapped in middle income, at best.

The future of the Latin American and Caribbean (LAC) region now hangs in the balance. LAC needs to find a path to development that can prevent its peoples falling farther behind the rest of the developing world. Seismic world events – the decoupling of the US and China and the COVID-19 pandemic's acceleration of the digitalization of business – have opened up a window of opportunity for Latin America to unseat some Asian countries as the USA's main suppliers by 'nearshoring' some economic activity. Yet the best positioned region in the world seems the least prepared to turn this moment to its advantage. This discussion will highlight the necessity for speedy action to safeguard LAC's tomorrow and recommend concrete steps for achieving success.

LAC has withstood some of the hardest impacts of COVID-19, imperilling both its health and its development, without receiving any of the attention paid to China, Europe, and the USA. Analysts forecast a –9% economic contraction for 2020 and a *per capita* income freefall to 2009 levels. The pandemic has asymmetrically hit the most vulnerable and worsened a precarious economic outlook in a region where 25 per cent are poor and 37 per cent risk becoming poor. It is a vulnerability compounded by impacts skewed toward the informal sector, which comprises 60 per cent of the regional economy on average, of which 58 per cent are vulnerable (US\$5.50–13.00 per day) or in poverty (less than US\$5.50 per day) (OECD, 2020).

## The nearshoring of global value chains

These drastic figures should surprise no one. LAC has long been participating notably less than other regions in global

value chains (GVCs) and their far-reaching economic opportunities (Blyde and Trachtenberg, 2020). Spanning supply and demand networks that integrate firms, workers, and consumers across all regions, GVCs underlie local as well as global development. They are the constituent motifs organizing world trade, creating unprecedented access for developing countries to developed and developing markets. GVCs make up, however, a complicated and fragile, perhaps overextended web of production that opens and shuts windows of opportunity treacherously fast.

One very treacherous emergence is the US–China trade war now decoupling the world's top two economies, selectively reducing the density of bilateral technology and trade linkages (Wyne, 2020). Beijing had begun decoupling from the US even before; now it is stepping up the pace. Some Chinese observers reckoned too-close linkages a development liability, especially at technology's cutting edge (Wei, 2019).

The decoupling and COVID-19 shocks have exposed the vast scale, yet the thin fragility of the interdependence of producers of multiple continents on consumers elsewhere. Multinational firms that had previously offshored their production are forecast to 'reshore' it back home to their own countries (Ashby, 2016) or 'nearshore' it geographically. McKinsey estimate 16–26 per cent of total global trade worth US\$2.9–4.6 trillion could be reshored, nearshored, or shifted to alternative offshores in the short to medium term (Lund et al., 2020).

US firms in particular have been inclined to nearshore for better regional coordination under changing production dynamics. The latest Reshoring Index indicates US imports

of Chinese manufactures declined 17 per cent in 2019 (US \$90 billion), while imports from Mexico rose US\$13 billion (Van den Bossche et al., 2020). Some sectors are unlikely to be re-/nearshored anytime soon; for example, Asian suppliers of electronics are entrenched by vast economies of scale and the prohibitive costs of duplication elsewhere. But two-thirds of automotive firms are planning to nearshore, and in the consumer and packaged goods sector they are moving to simplify product portfolios and regionalize supply chains. And construction and engineering firms are resorting to dual sourcing to reduce supply disruption exposure (Lund et al., 2020).

These trends continuing will offer immense opportunities for LAC to reset its place in North American GVCs, which Asia had taken away in the 1990s. LAC is nearer, its labour is cheaper than in the US, and intellectual property risk is less than Asia's (Piatanesi and Arauzo-Carod, 2019). This unique opportunity will not last; LAC's public and private sectors must exploit it now. And nearshoring can only boost; alone it cannot suffice. Rapid regional improvements in education, productivity, competitiveness, connectivity, integration alone can attract *and/or substitute* for quality foreign direct investment (FDI); transient windfalls have never led LAC up the value chain and out of its endless labour-intensive, low-income development trap.

### GVCs and development: lessons from the region

Participation in GVCs is nothing new for LAC, whose countries have responded to openings before, in contrasting ways. Costa Rica and Mexico exemplify the do's and don'ts of capitalizing on GVC reorganization, joining US value chains with differing visions that serve as regional benchmarks. Mexican politicians felt obliged to steer their economy to the automotive sector to create employment, but Costa Rica preferred ICT investment to move up the value-added ladder to knowledge-intensive, higher-valued production (Lee et al., 2020).

Ironically, Mexico has always had enormous nearshoring potential. Its robust intellectual property regime and electronic manufacturing experience make it attractive to tech giants. The UMCA trade agreement with the US and Canada, successor to NAFTA, facilitates this. Yet even decades of experience with FDI have yielded decidedly mixed outcomes. Since the 1970s and with NAFTA's boost since 1994, Mexico has been fetching labour-intensive export production. This model represented 3 per cent of domestic GDP and 20 per cent of manufacturing GDP by 2017. From 1980 to 2017, the sectoral labour force grew 650 per cent. Higher-value supply chains, unfortunately, are *not* relocating to Mexico; on the contrary, the domestic value-added trend is down (Crossa and Ebner, 2020). Mexico and all of the LAC region *must* facilitate entrepreneurship. The latest World Bank report, *Doing Business 2020*, ranked not even one LAC country among the top 50 whose public policies unburden entrepreneurs (World Bank, 2020a).

Costa Rica became a hub of electronic assembly *and* innovation after 1996, when it won the worldwide competition

to host Intel's semiconductor operations by offering quality human capital and a package of concessions from initial tax exemptions to improved infrastructure provision (Bailey and Warby, 2019). Costa Rica shows that local comparative advantages can attract quality FDI. In 2014, Intel moved assembly and testing to Asia, leaving engineering and design in Costa Rica, a repositioning that drove it *up* the value chain by adding more domestic value to exports, raising average wages, and potentiating productivity linkages to innovation and expertise spillover to other sectors. The International Labour Organization (ILO) said Costa Rica is ending its dependence on timeworn, low-skilled, mostly agricultural GVCs like bananas, sugar, coffee, and textiles for an economy thriving on high qualifications and quality jobs, with robust integration into high-value GVCs (Monge-González, 2017).

### What can LAC do?

Mexico compared to Costa Rica shows that LAC must develop domestic capabilities to add higher value to all its productive activities. LAC overall is like Mexico, but isolated pockets of excellence like Costa Rica dot the region and can be capitalised on if sound public policies prevailed, like public investment in training and earnest commitment to R&D. Such reforms will help countries like Brazil, overdependent on commodity exports and stuck in a middle-income trap, repositioning them from commodity production to higher value added wares (Paus, 2020). How should LAC renovate its development strategy? Here follow five interrelated recommendations which the region urgently needs to act on.

(1) LAC must focus like a laser on productivity: LAC's labour productivity growth slowed to a crawl (0.4 per cent) from 2013 to 2018, the least-improved emerging market and developing economy (EMDE) anywhere (World Bank, 2020b). The public sector must invest in technology, especially digitalisation to raise productivity. Public-private partnerships are needed to rationalise FDI, combined with a determination to increase investment in R&D, which is abysmally low. Private spending on R&D tends to follow public, as businesses move in to claim their share of the largesse, but governments are not there to be exploited. Subsidised firms must be held to correspondingly raise their stake in innovation. This is how it is done in the North's advanced economies (Mazzucato, 2013; Zúñiga-Vicente et al., 2014), and in a few cases in LAC too, as Chile illustrates (Guimón et al., 2018).

(2) LAC must find new ways to educate and train on the job: performance is poor on international standardized tests, compared to the OECD and Asia, reflecting LAC's low-quality education – well documented as one reason why labour productivity shows near-zero growth (Mendoza, 2020). An obsolete education establishment unresponsive to business demand burdens young labour market entrants. Alternatives to education-as-usual must adapt to the Fourth Industrial Revolution. The best place to look is at advanced and most-successful developing economies. LAC must learn how to learn from its betters (Garcia, 2020).

(3) The region must integrate: intra-regional trade and complementarity could integrate LAC into better GVCs, yet regional trade openness is lacking. Dependency is inevitable if intra-regional trade ekes out just 15.5 per cent of total exports, near the lowest in the world (ECLAC, 2019). If only intermediate manufacturing content is added in, bilateral, sub-regional and regional trade agreements can then insert more value added into GVCs, opening up global markets to small and medium-sized enterprises to reap the multiplier effects on employment and welfare. The prospect of a hemispheric trading bloc of 1 billion consumers could make LAC very appealing to US firms wondering where to nearshore. It will require mature political will to critically revise existing models to answer today's realities, while respecting ideological differences (Moreno, 2020).

(4) LAC sorely needs infrastructure: infrastructure is the hardware of meaningful integration, but LAC has some of the world's worst, even while elites obsess over free trade agreements (FTAs). Bilateral FTAs do little for the region without intra-regional connectivity to move the production factors and serve the consumer demand that generates wealth. Infrastructure is essential to purposes besides resource extraction for China or the Global North (Mendez, 2019). LAC cannot continue to invest a mere 3 per cent of GDP annually, compared to over 7 per cent in Asia. The World Bank and LAC development banks are unanimous that LAC must at least double its investment in roads, energy, telecommunications, drinking water, education, healthcare, and other goods, both public and marketed (García, 2020).

(5) Support LAC's multi-national enterprises (MNEs) or 'Multilatinas' in creating regional wealth: what LAC needs most is 'regional champions' like the national champions of South Korea or China, who can move beyond just serving and supplying foreign MNEs, to eventually compete with them in the global economy. But they must be 'unleashed' to create income through intra-regional trade growth (Fornes and Mendez, 2018), to furnish the commercial basis for ever higher value added. The problem LAC must solve is this: that World Bank experts find that Multilatinas are not innovative, poorly managed, and less productive than other regions' multinationals (Lederman et al., 2014).

Multilatinas must completely revamp their commercial strategies. Dependency on extraction of natural resources is poison. Exploitative foreign capital must be replaced by home-grown determination to raise productivity. In this, public policy will play a pivotal role, especially fostering productive factors tributary to growth like entrepreneurship, innovation, human capital (Bianchi et al., 2019) and *proaction* above all, not *mañana*.

## Conclusion

This policy discussion has endeavoured to warn LAC against repeating its worst mistakes. Its recommendations stress public-private partnership and collaboration, because the reshoring LAC could attract without the constructive role of the state will have no long-lasting impact on development.

Public policy concertation that would dare support entrepreneurship must build up a network of cross-sectoral strategic managers who know how to couple private interests to the national interest in the medium to long run (Mazzucato, 2013). LAC must wilfully choose innovation, skills-improvement and sectoral diversification as a way of life until it *becomes* 'business as usual' in LAC.

LAC may put off acting till *mañana* no longer. Short-term political objectives will not do. The scorched-earth politics of discrediting at all costs the achievements of political rivals vitiates LAC public policy. Every new administration angles its rear-view mirror to accentuate its predecessors' negatives, mindlessly junking their best achievements. No one builds political consensus to underpin long-term development strategy. Procrastinating its own future has been LAC's downfall. It must embrace self-denial for the sake of long-term goals *now*.

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