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Navigating the impact of US tariffs in Latin America and the Caribbean: Effectively using FDI

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Trade Uncertainty and Geopolitical Fragmentation

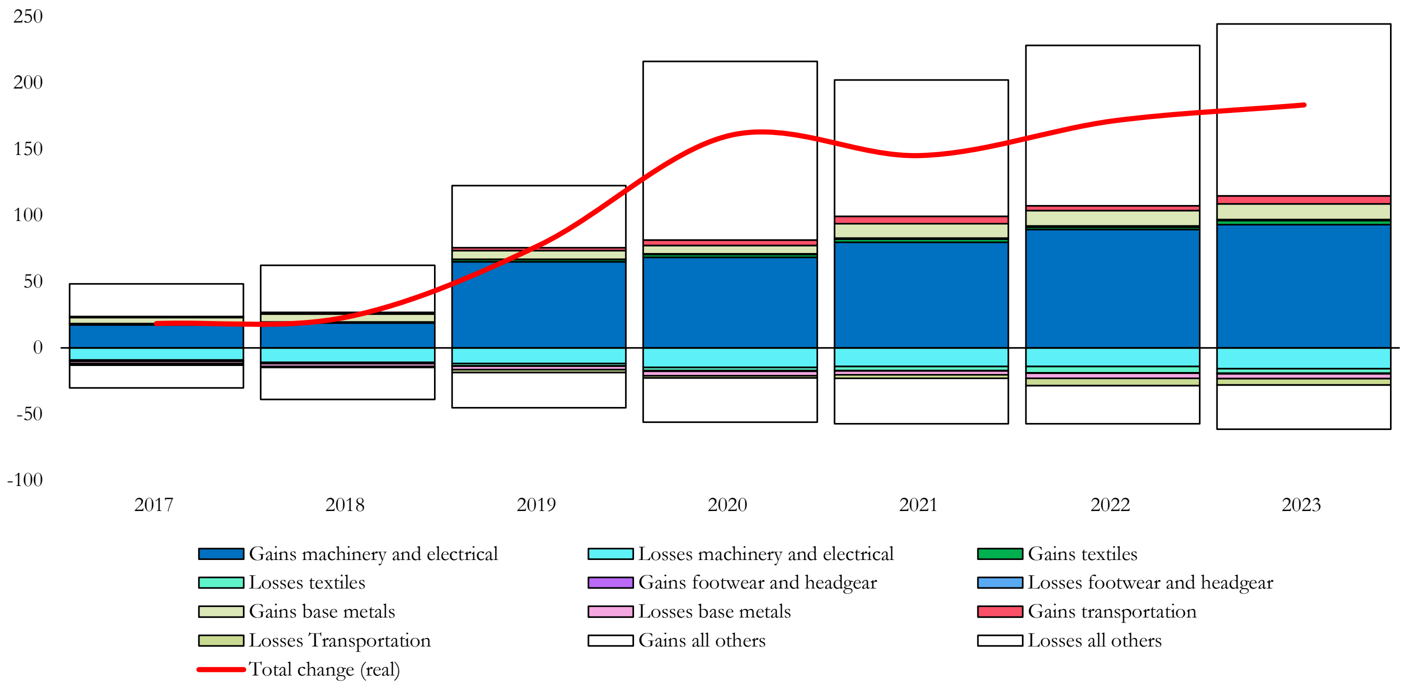
- Global trade landscape marked by uncertainty, driven by ongoing US-China tensions.
- All countries, but China, **are subject to a 10% base tariff**; USMCA exceptions for Mexico and Canada remain intact.
- China and the US initiated a retaliation process by announcing tariffs exceeding 100%, intensifying the trade war. Now they announced negotiations.
- This context presents an **opportunity** for Latin America **to attract FDI and integrate into global value chains** , but this opportunity comes with its own set of **challenges**.

What happened in the first stage of the US-China trade war?

While LAC Benefited with Increased Exports, Growth Was Limited

LAC's Gains due to China's Losses

Changes in real exports to US since 2015, US$ Billions



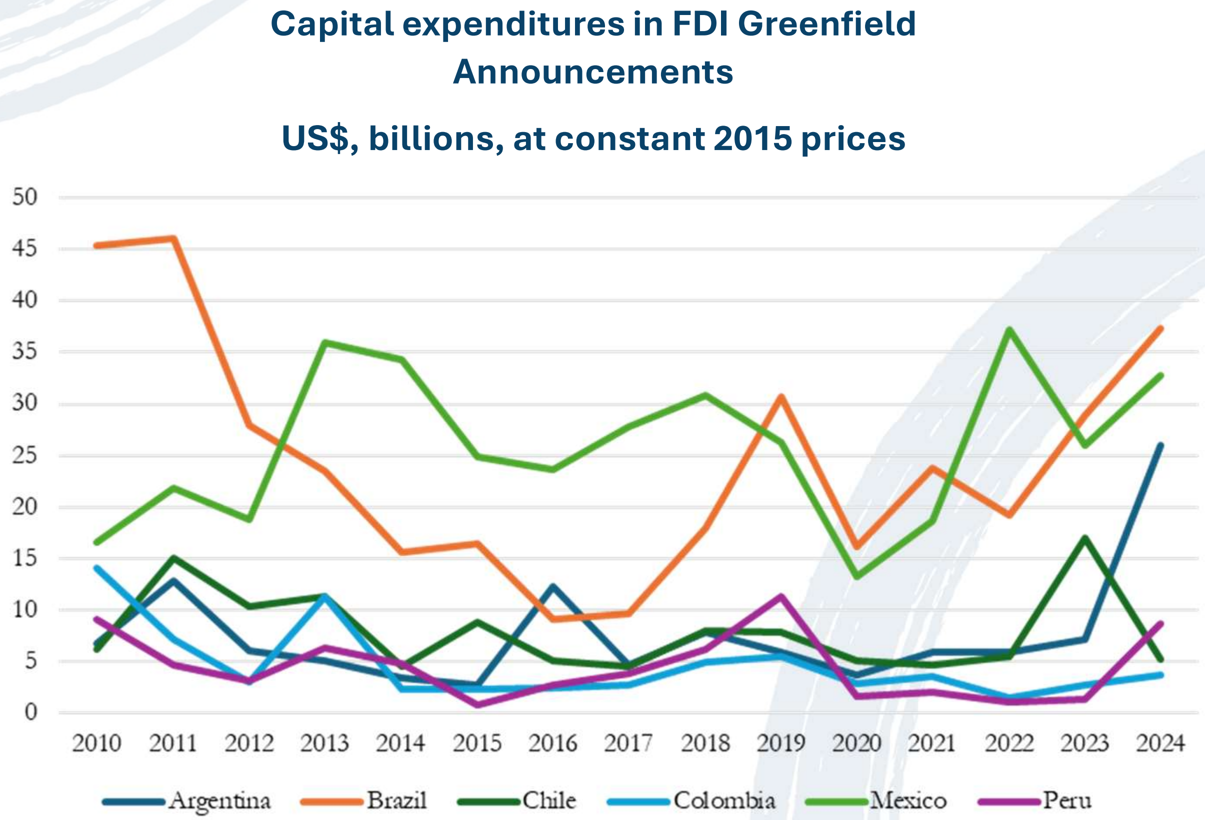
Source: World Bank staff calculations based on data from the United States International Trade Commission (USITC).

Note: To assess real trade dynamics of China and LAC with the United States, the analysis looks at HTS 10-digit US imports. The focus is on products with consistent HTS tariff line definitions between 2015 and 2016, plus a few that can be manually adjusted for consistency. In this way, the analysis accounts for approximately 85 percent of US imports from China in value terms. Real exports are calculated as Qi,t,c * UVi, c, where Q is US import quantity of product i from country c in year t and UVi,c is the weighted average unit value of imports of product i from country c covering the entire period (2015–23). The constant prices are calculated as the weighted average price for each exporting country across the entire observation period (2015–23). HTS = Harmonized Tariff Schedule of the United States.

Nearshoring Opportunities in LAC: Potential Gains from Capitalization

- LAC-10 countries could generate between US$89.3 billion and US$178.6 billion in additional exports to the US over the next decade, representing **between 1.5% and 3% of the region's GDP** (IFC, 2024).
- **To capitalize on this opportunity**, LAC-10 countries would require an investment twice as large.
- **Mexico** could capture around 75% of the additional nearshoring exports due to its established manufacturing base and proximity to the US.
- Automotive, electronics, pharmaceuticals, and industrial machinery are the key sectors with the highest growth potential from nearshoring in LAC.
- Other LAC countries such as **Costa Rica and Panama** are also well-positioned to benefit, especially in electronics and pharmaceuticals.
- What have the trends been until now?

Greenfield Announcements Increase in Brazil, Mexico, and Argentina



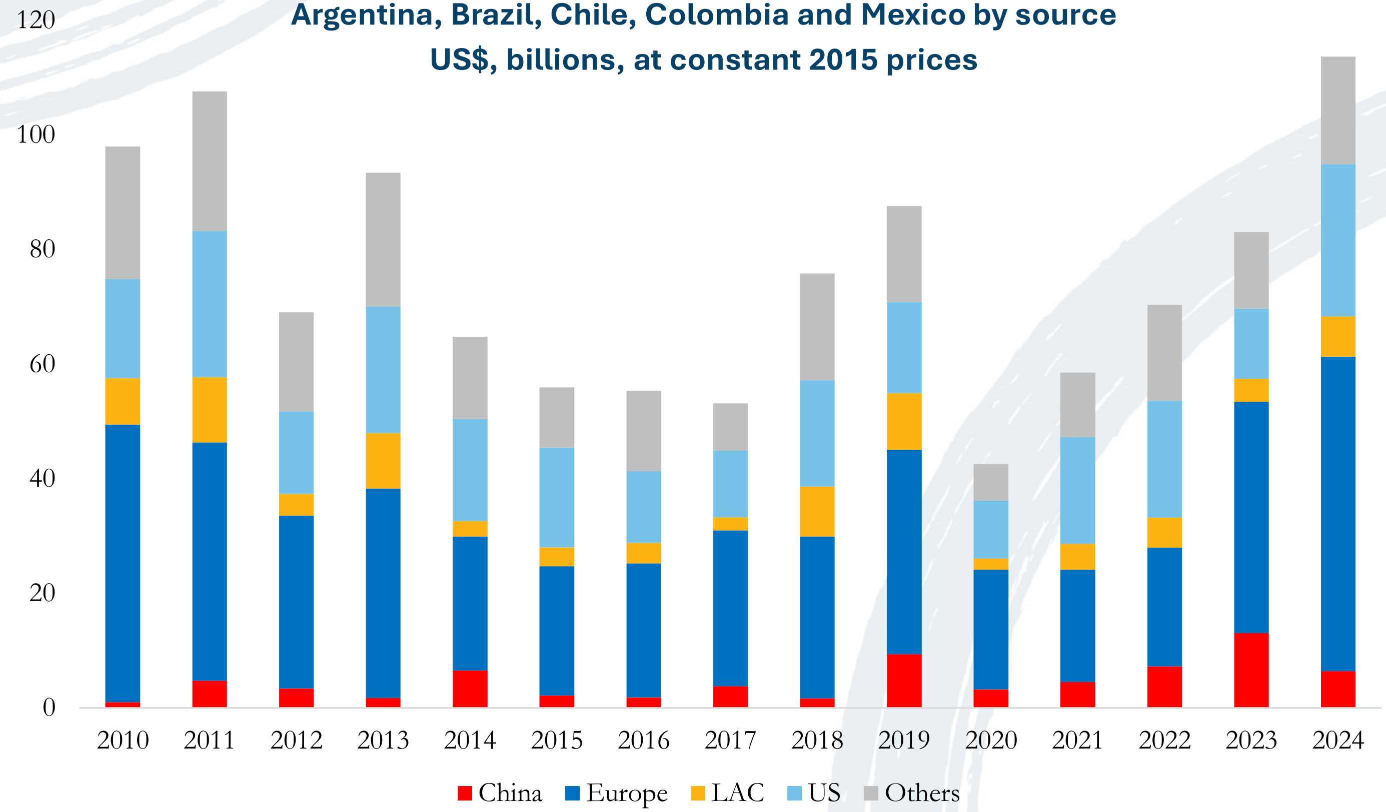
Source: World Bank staff calculations based on fDi Markets database.

Note: Calculations are based on the estimated capital expenditure of greenfield project announcements. The data do not constitute official FDI and are not comprehensive. Converted to real terms with consumer price index (CPI) from the U.S. Bureau of Labor Statistics. FDI = foreign direct investment.

PR0

Positive diversification given the geopolitical context: Europe has consistently been one the main sources of FDI for LAC

Capital expenditures in FDI Greenfield Announcements in Argentina, Brazil, Chile, Colombia and Mexico by source
US$, billions, at constant 2015 prices



Source: World Bank staff calculations based on fDi Markets database.

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Diapositiva 6

PR0 Capaz transformarlo a billones para que todos queden en la misma unidad no? Tambien creo que habria que poner Europe y Others para que quede todo en el mismo idioma

Pilar Ruiz Orrico; 2025-04-18T21:04:21.573

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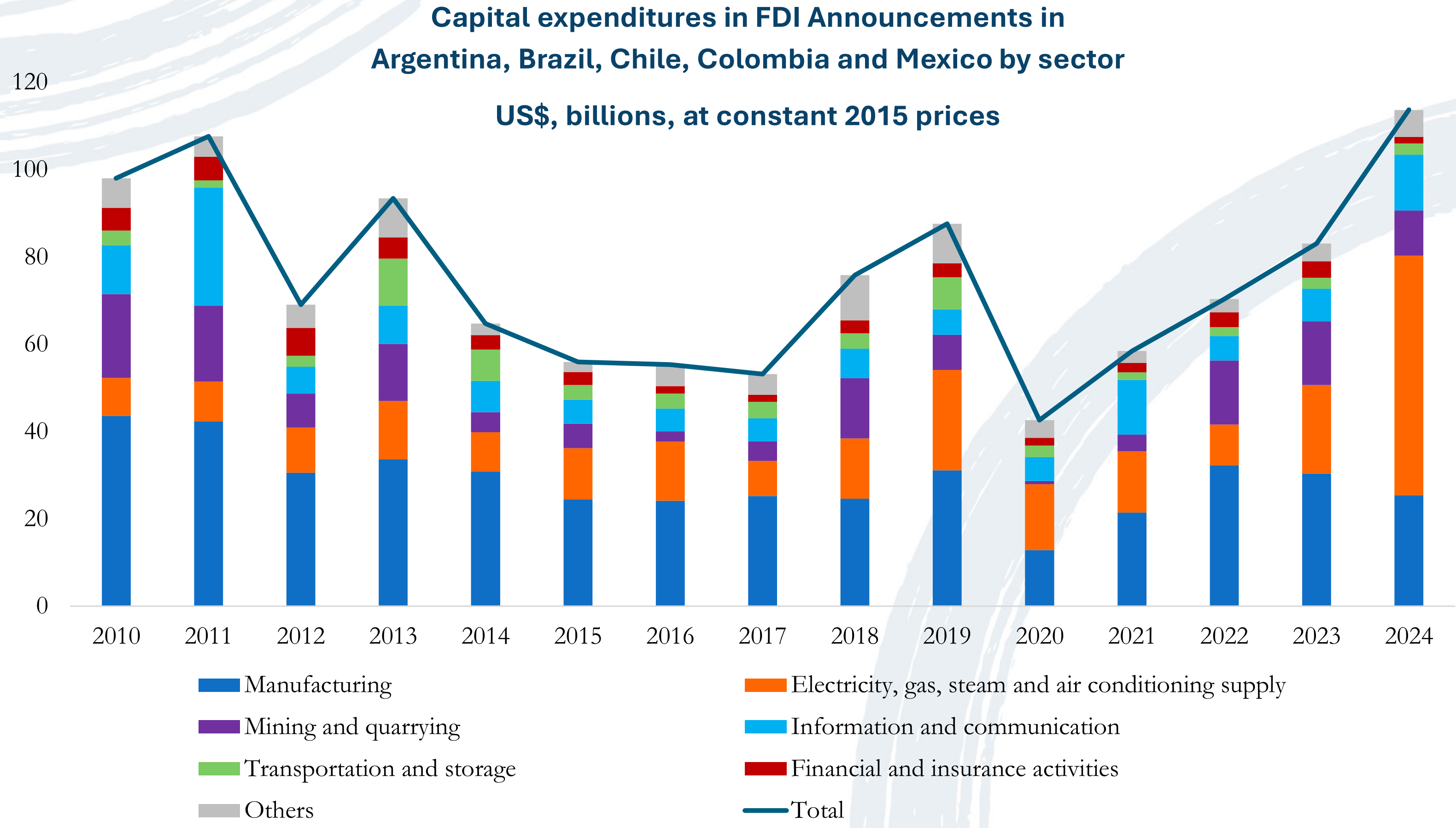
The Distribution of FDI in LAC has been Primarily Concentrated in Manufacturing, Electricity, Gas and Energy Supply, with a Marginal Increase in the Information and Communication Sector in the Last Year



Source: World Bank staff calculations based on fDi Markets database.

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Diapositiva 7

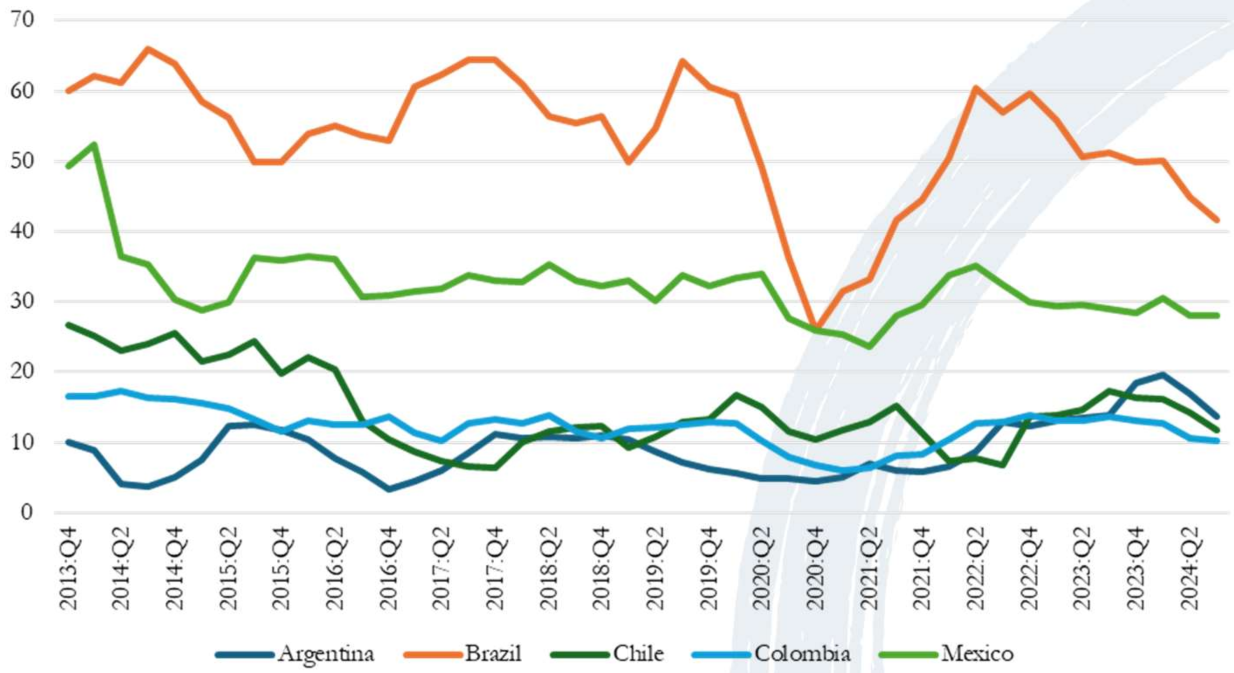
PR0 Aca lo mismo con los millions

Pilar Ruiz Orrico; 2025-04-18T21:04:48.868

Expectations vs. Reality: While Nearshoring Was Expected to Increase FDI Flows to LAC, the Data Does Not Show the Anticipated Surge

Total FDI inward flows (annual moving sum)

US$, billions, at constant 2015 prices



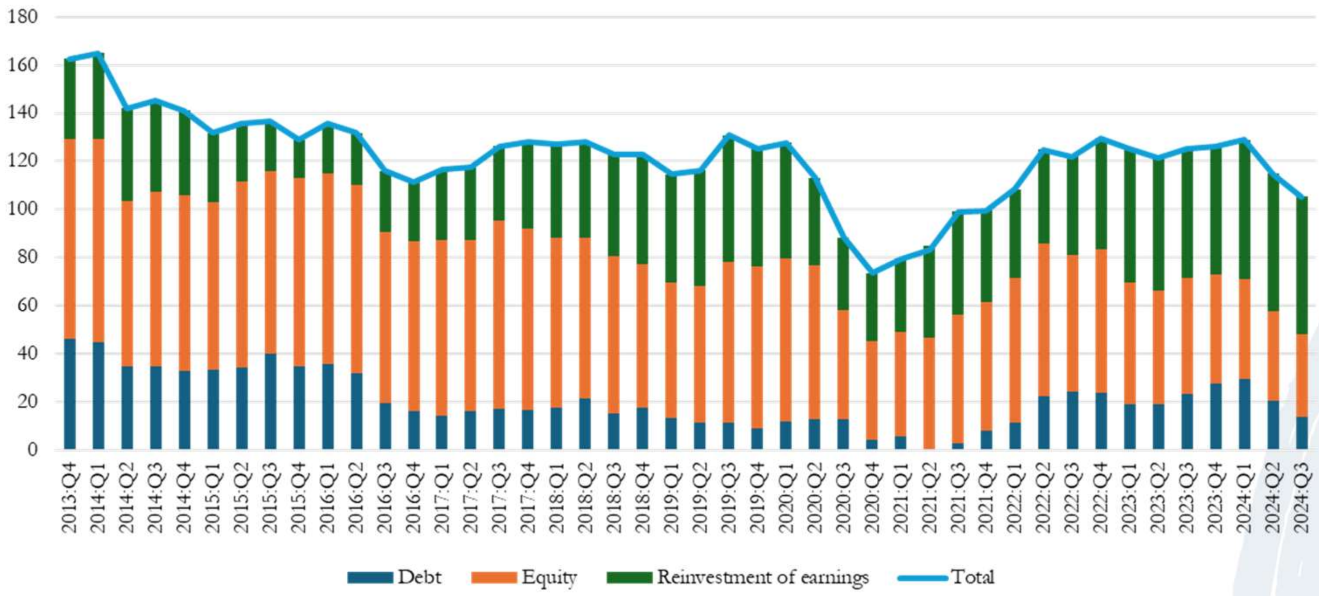
Source: World Bank staff using data from FDI Main Aggregates (OECD).

Note: Converted to real terms with consumer price index (CPI) from the U.S. Bureau of Labor Statistics. FDI = foreign direct investment.

Shift in FDI Composition in LAC's Major Economies: LAC's Major Players Have Been Gradually Reducing Equity in Favor of Reinvestment of Earnings

Composition FDI inward flows in Argentina, Brazil, Chile, Colombia and Mexico (annual moving sum)

US$, billions, at constant 2015 prices



- Companies are increasingly using their own profits to finance the expansion of productive capacity within the country. This indicates a **decline in the country's ability to attract new capital over time.**

Source: World Bank staff using data from FDI Main Aggregates (OECD).

Note: Converted to real terms with consumer price index (CPI) from the U.S. Bureau of Labor Statistics. FDI = foreign direct investment.

Structural Challenges Facing Nearshoring: Obstacles to Investment in LAC

- Countries in Latin America and the Caribbean (LAC) face structural barriers, **such as infrastructure gaps, lack of human capital, high corporate taxes, low institutional capacity and regulatory inefficiencies**.

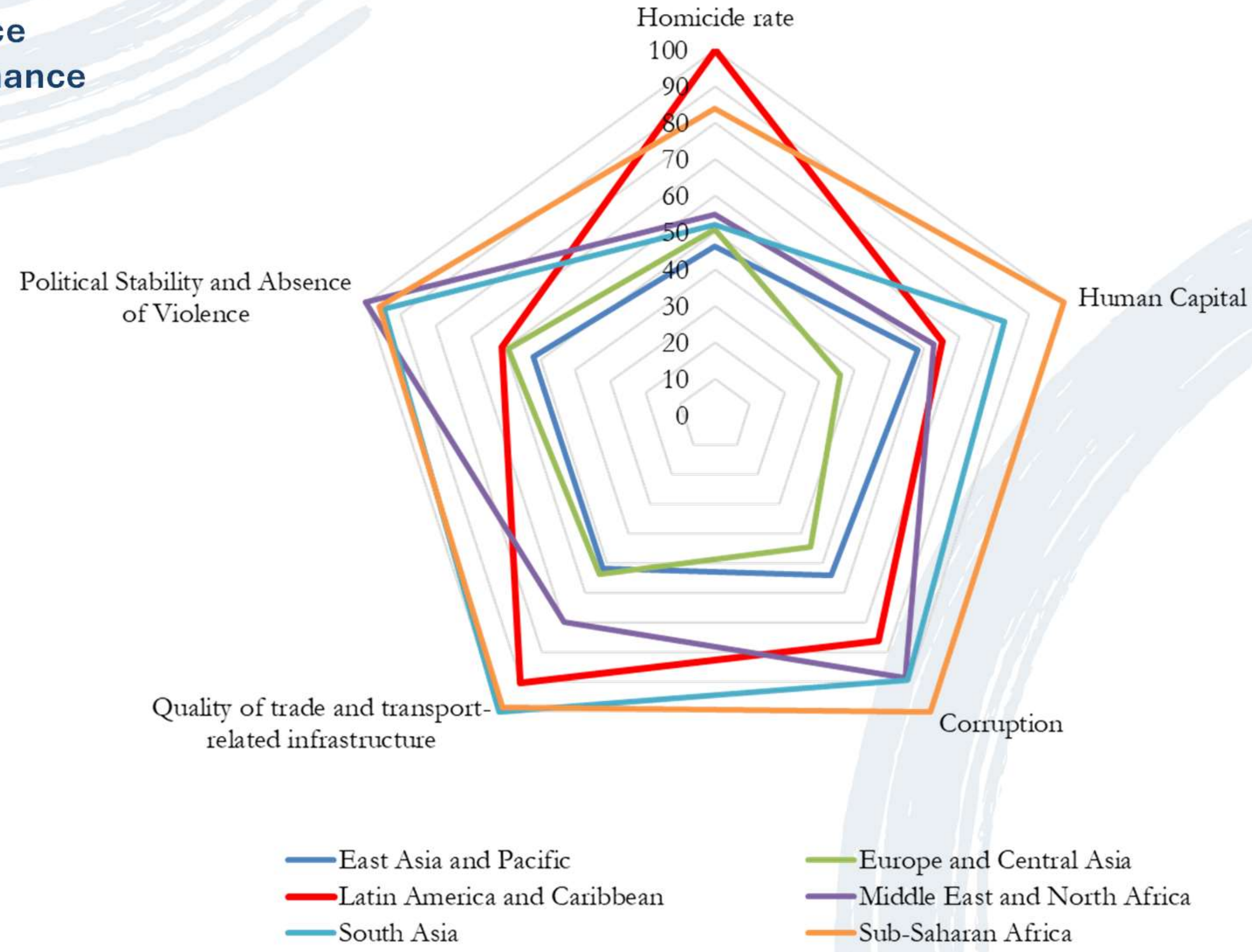
- Despite these obstacles, surveys indicate **that companies anticipate increased benefits from nearshoring in the coming years**, especially 2026.

- The long-term sustainability of nearshoring in LAC and its positive effects on growth will depend on **technology absorption, innovation and local spinoffs**.

- To fully unlock the potential gains from nearshoring, LAC countries need to address these barriers.

Obstacles to Investment:
LAC has a Relatively Unfriendly Business Environment

0 -> best performance
100 -> worst performance

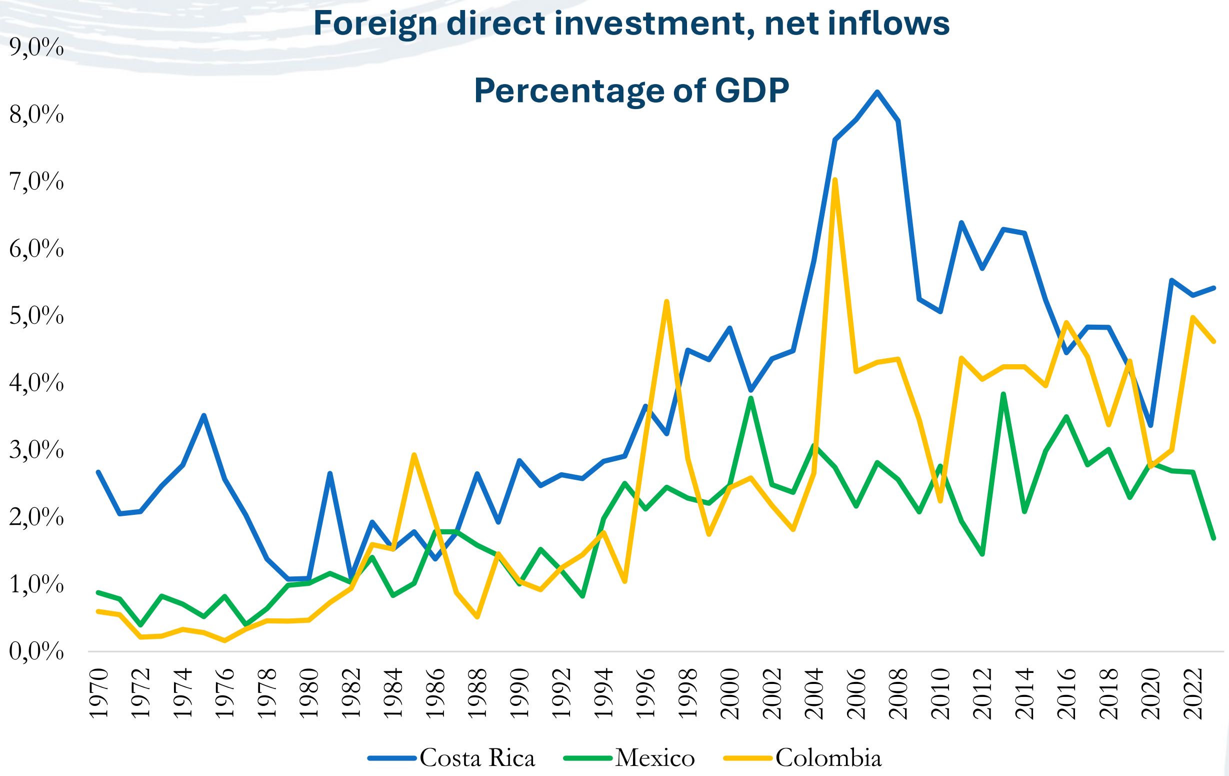


Source: World Bank staff calculations based on World Development Indicators (World Bank) and Logistics Performance Index (World Bank).
Note: Indicators were normalized to range from 0 to 100, with 0 representing the best performance and 100 the worst relative to the world.

A Tale of Three Countries: Costa Rica, Colombia, Mexico

PR1

Historic Evolution of FDI in Costa Rica , Mexico and Colombia



Source: World Bank staff calculations based on International Monetary Fund, International Financial Statistics and Balance of Payments databases, World Bank, International Debt Statistics, and World Bank and OECD GDP estimates.

PR0

- Although nearshoring was expected to boost FDI flows to Mexico and LAC, the data does not reflect the anticipated increase.
- Intel's investment in 1997 led to a substantial increase in FDI in Costa Rica, helping to shift the export structure toward high-tech products.
- In 2005, Colombia received a record US$10.3 billion in FDI, largely due to the acquisition of Bavaria by SABMiller. Other than that, FDI is highly concentrated in energy/mining

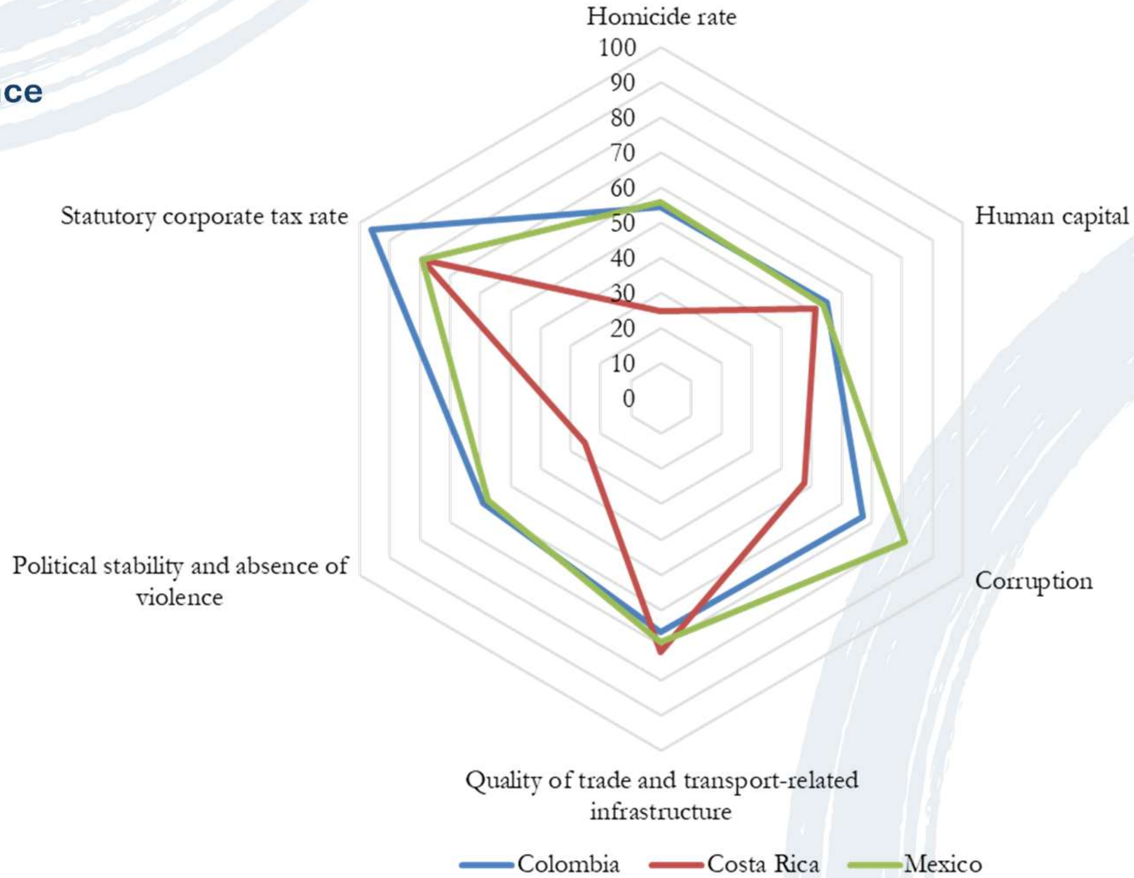
Diapositiva 13

PR0 Source
Pilar Ruiz Orrico; 2025-04-18T21:05:36.659

PR1 Quizas cambiaria por Costa Rica Mexico y Colombia para seguir el mismo formato
Pilar Ruiz Orrico; 2025-04-18T21:06:03.861

Costa Rica's Success Stems from its Strong Institutions, Skilled Labor, and Effective Coordination, while Colombia and Mexico's Shortcomings have Hindered their Nearshoring Potential

0 -> best performance
100 -> worst performance



Source: World Bank staff calculations based on World Development Indicators (World Bank), Logistics Performance Index (World Bank) and Corporate Income Tax Rates Database (OECD).
Note: Indicators were normalized to range from 0 to 100, with 0 representing the best performance and 100 the worst relative to the world.

Intel’s Impact on Costa Rica: A Successful FDI Case Study

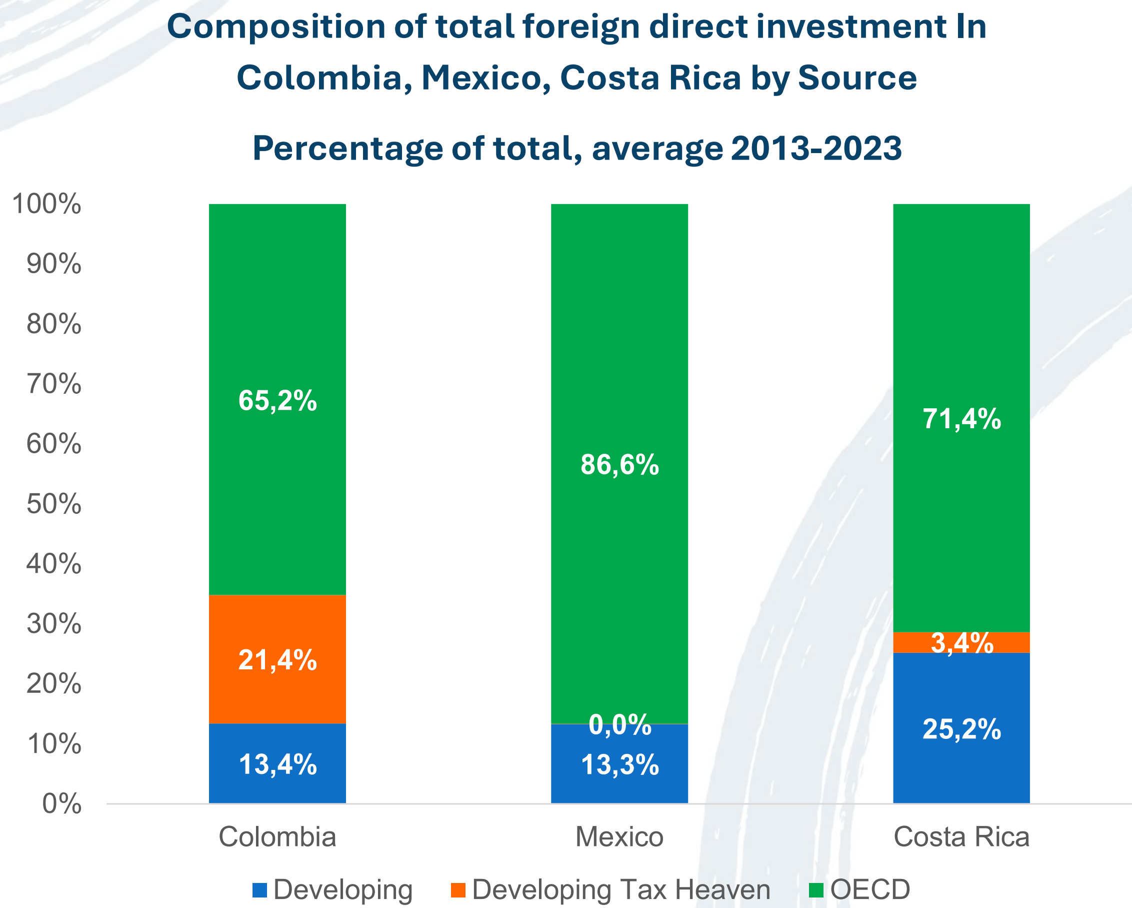
- Intel established a microprocessor assembly and testing plant in Costa Rica in 1997, despite competition from regional peers like Mexico and Brazil.

- **Key Drivers of Success:**
  - Stable democratic institutions.
  - A well-educated labor force, particularly in technical and managerial fields.
  - Favorable fiscal incentives through the free-zone regime.
  - Strong coordination among public agencies (e.g., CINDE).

- **Economic Impact (Rodriguez-Clare; 2000):**
  - Contributed 5 percentage points to Costa Rica’s 8% GDP growth in 1999.
  - Intel’s exports represented nearly 39% of total national exports, achieving Costa Rica’s first trade surplus in 50 years.
  - Played a central role in shifting Costa Rica’s export profile towards high-tech goods and expanding trade links with Asia and Europe.

- Domestic firms in Costa Rica experience a **26% increase in employment** and a 4% to 9% rise in total factor productivity (TFP) four years after becoming suppliers to multinational corporations like Intel (Alfaro-Urena, A., Manelici, I., & Vasquez, J. P. ; 2022).

In Colombia, the share of tax havens in FDI is too high



Source: World Bank staff calculations based on Central Bank of Costa Rica, Central Banck of Colombia and OECD .

Zooming on Colombian firms

- In ongoing work in Akcigit et al. (2025), we distinguish between **"internationally" and "domestically" productive firms** with different measures of productivity

Internationally Productive:

- Open to international trade
- Higher FDI access
- FDI from productive countries and multinational firms
- Larger market shares
- Labor reallocates towards them
- Higher board connections across sectors and foreign board members

Domestically Productive:

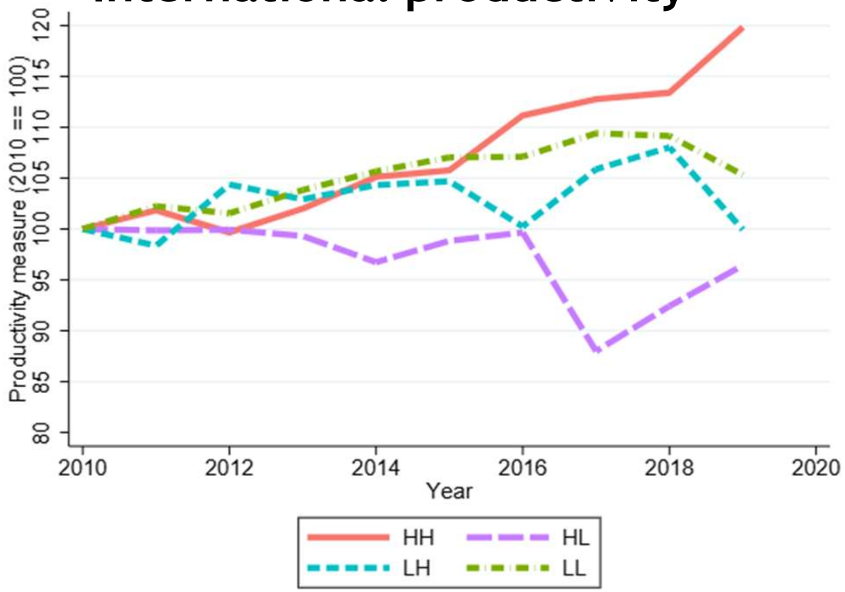
- Open to international trade
- Better access to domestic credit
- FDI mostly from tax heavens
- More market power
- Smaller market shares
- Labor reallocates away from them
- Higher board connections within sectors

- "Good" FDI helps to create **virtuous cycles**

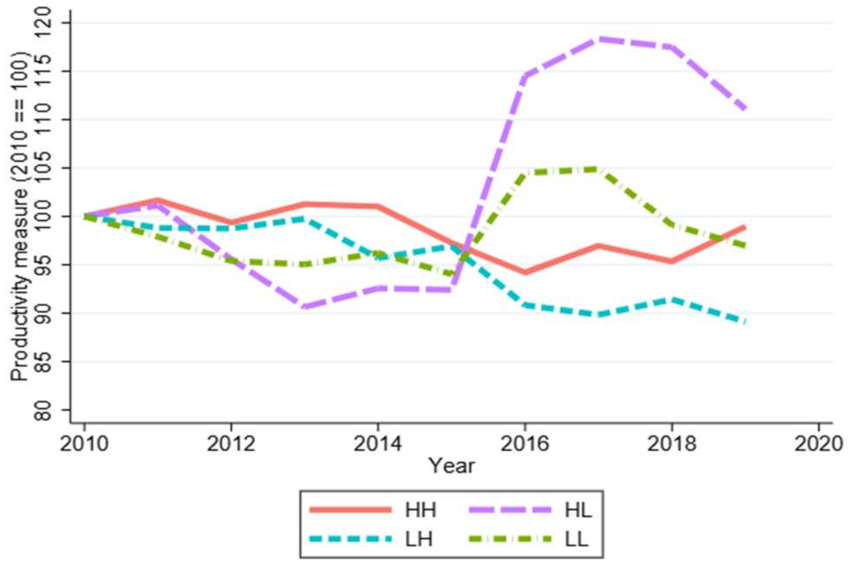
Zooming on Colombian firms (2)

- Stars keep growing over time
- But initially internationally productive and not domestically (HL), learn how to be domestically productive and become less competitive internationally

International productivity



Domestic productivity



Mexico’s Barriers to FDI Attraction and its Utilization

- Significant barriers to investment, **including insecurity, weak governance, and infrastructure bottlenecks.**

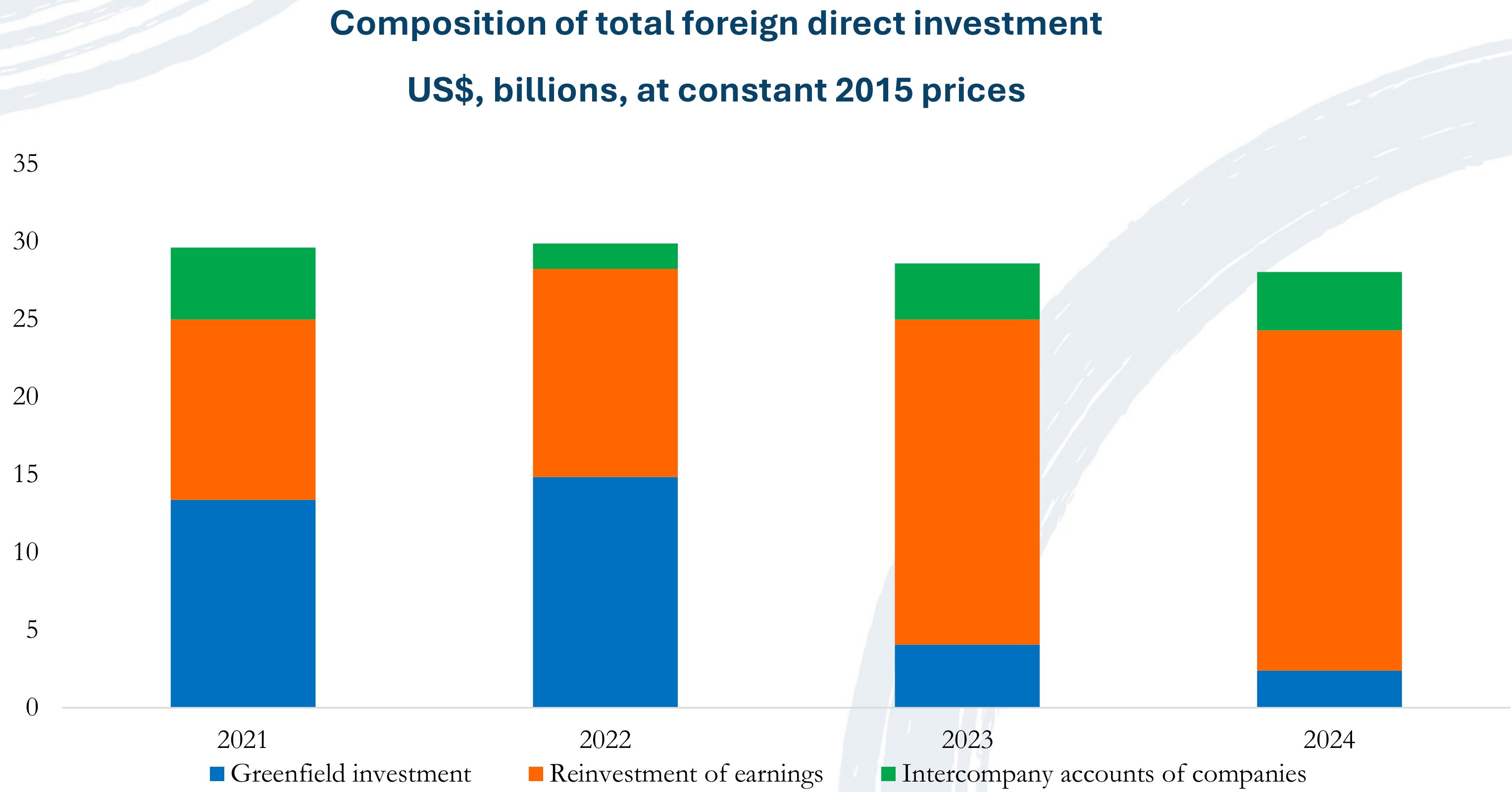
- Multinationals tend to use tax incentives, relocating plants and hiring low skill labor, but **do not transfer technology and thus do not spur innovation**

- **Inability to Capitalize on Nearshoring:**

    - Mexico struggles to create a **favorable environment** for investment and FDI retention compared to Costa Rica, despite its proximity to the US.

    - But it also does **not create in-house ideas that could foster further growth**.

In Mexico, Companies are Increasingly Using Their Own Profits for Expansion, Signaling a Decline in the Country's Ability to Attract New Foreign Capital



Source: World Bank staff calculations based on Central Bank of Mexico (Banxico) .

Note: Converted to real terms with consumer price index (CPI) from the U.S. Bureau of Labor Statistics.

Mexico: Rising Announcements, Falling Executed Projects

Capital expenditures in FDI Greenfield Announcements and Executed FDI Greenfield Projects

US$, billions, at constant 2015 prices

Source: World Bank staff calculations based on fDi Markets database and Central Bank of Mexico (Banxico)

Note: Calculations are based on the estimated capital expenditure of greenfield project announcements and data on official executed greenfield projects. The announcements data do not constitute official FDI and are not comprehensive. Converted to real terms with consumer price index (CPI) from the U.S. Bureau of Labor Statistics. FDI = foreign direct investment.

Conclusions

- The current geopolitical context is costly but presents **opportunities** to reshape international integration worldwide

- LAC is in a particular position to take advantage of it but **faces internal barriers** that need to be fixed

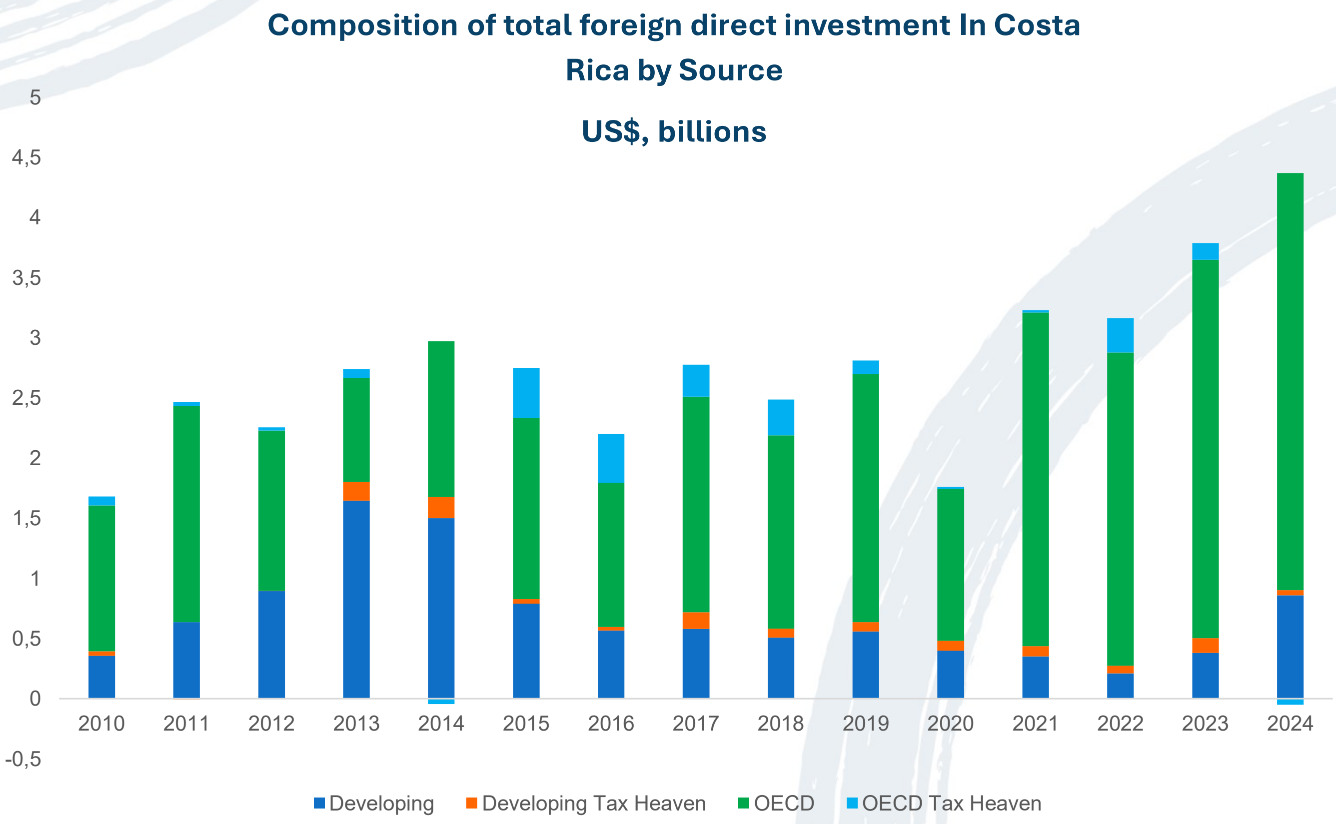
    - **The FDI announcements have increased lately**, it has diversified towards more neutral partners like Europe

    - **But realized FDI has not increased** and there are barriers to attract new investment and to take advantage of it

- **FDI can generate virtuous cycles, but LAC must be better prepared**

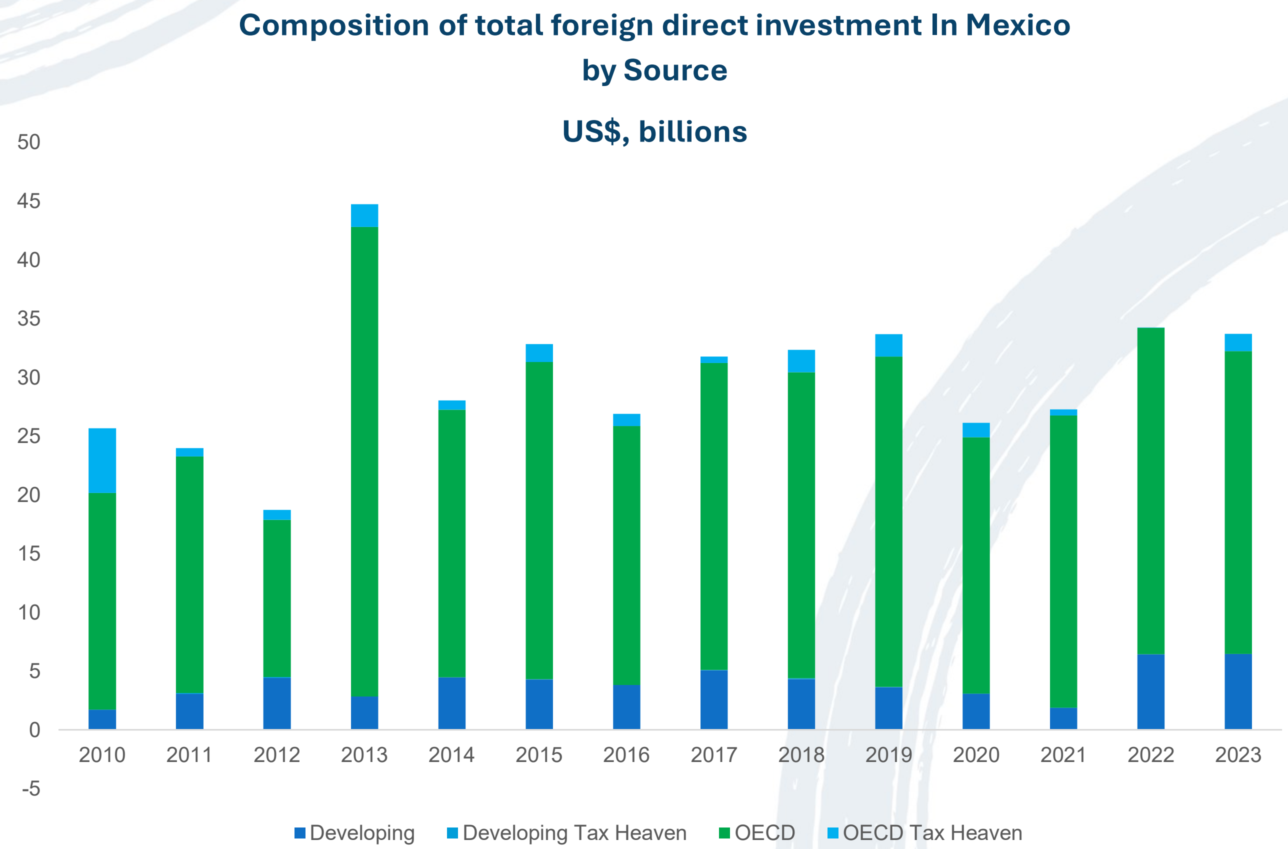
Annex

Composition of total foreign direct investment In Costa



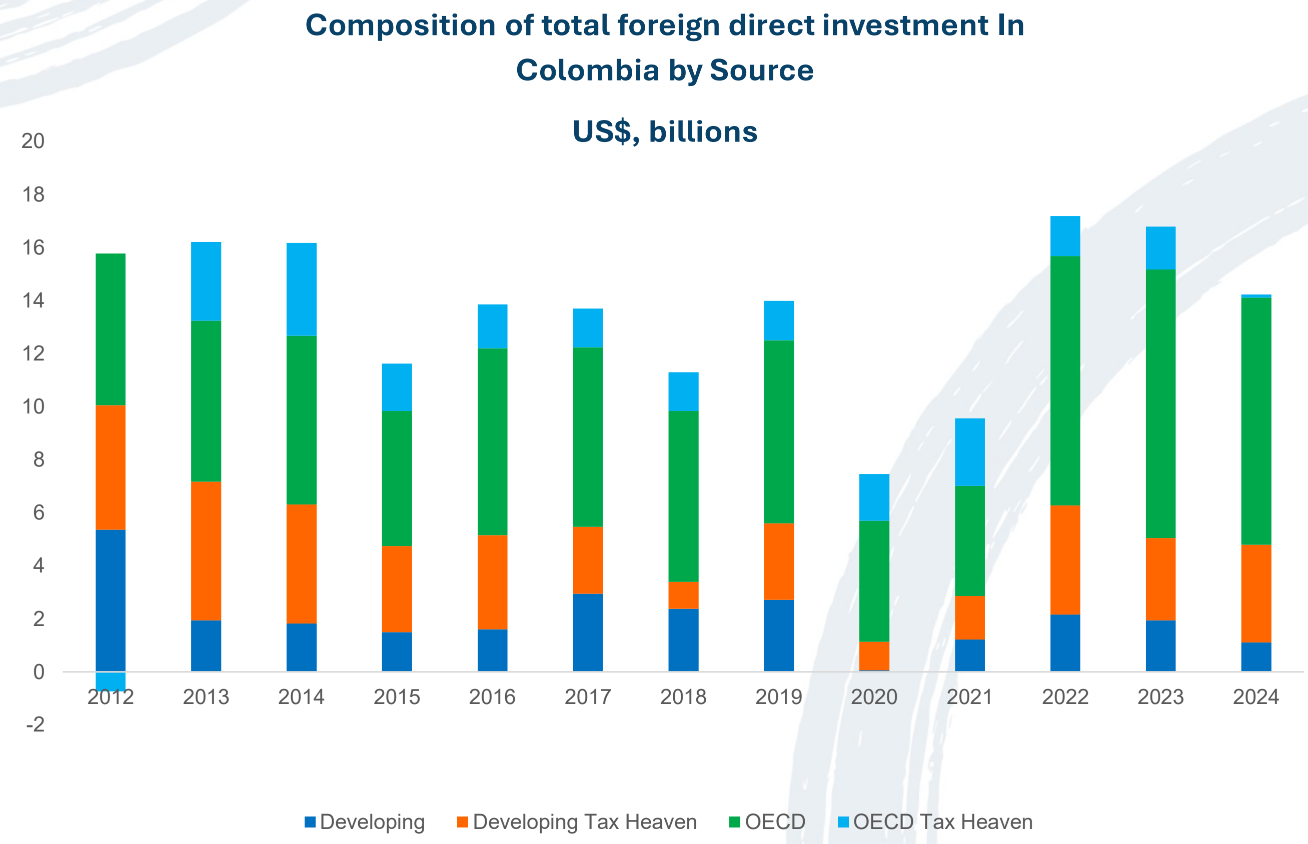
Source: World Bank staff calculations based on Central Bank of Costa Rica.

Composition of total foreign direct investment In Mexico



Source: World Bank staff calculations based on OECD FDI database.

Composition of total foreign direct investment In Colombia



Source: World Bank staff calculations based on Central Bank of Colombia.

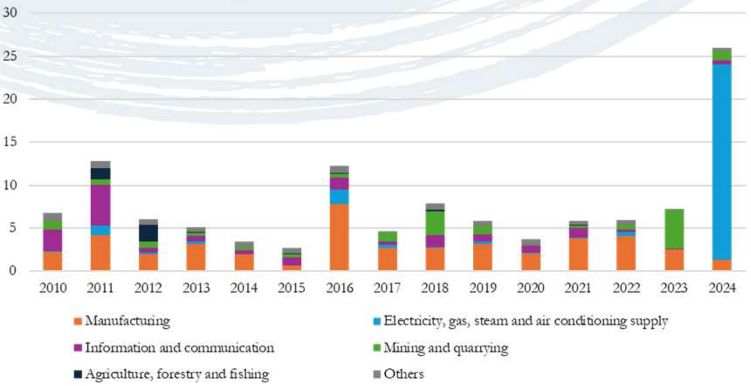
Alternative hypothesis: Nearshoring Model Shifts Could Mask True Economic Impact

- Foreign companies often use the **shelter company** model to operate in Mexico, allowing them to avoid regulatory risks and the need to own facilities.
- This model enables companies to relocate operations without being recorded as foreign direct investment (FDI) in official data, impacting FDI statistics.
- **Outsourcing** is another growing trend, where US companies outsource production to Mexican suppliers without significant foreign capital investment.
- This has led to an increase in Mexican exports to the US, but it does not necessarily translate into substantial foreign investment in Mexico.
- The shift toward outsourcing helps boost exports but may not drive the desired inflow of FDI into Mexico.

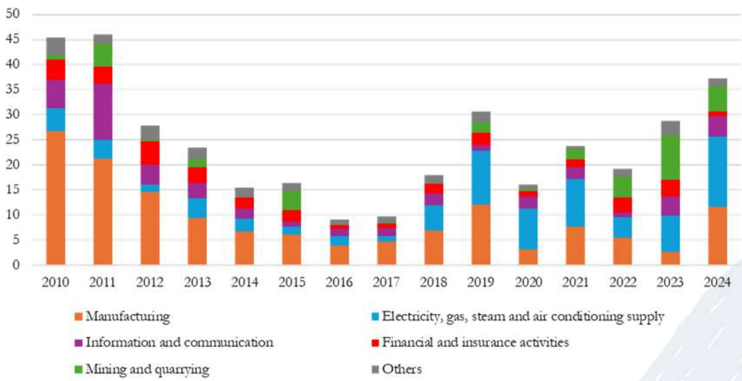
LAC-6 Greenfield Announcements in 2024: Electricity, Gas, Steam and Air Conditioning; Manufacturing; and ICT Lead with Country-Specific Trends

Capital expenditures in FDI Greenfield Announcements by ISIC sector in LAC-6 (US$, billions, at constant 2015 prices)

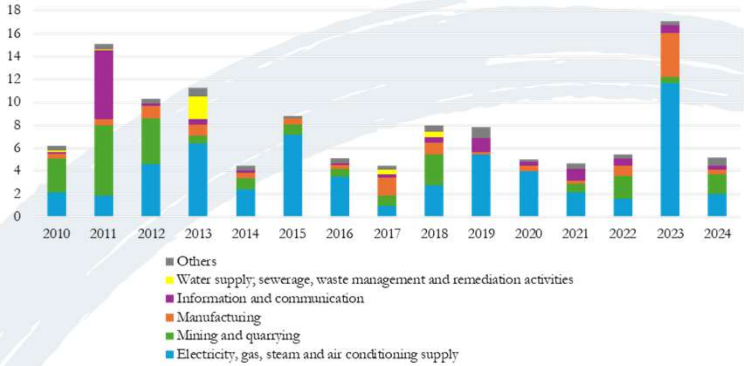
Argentina



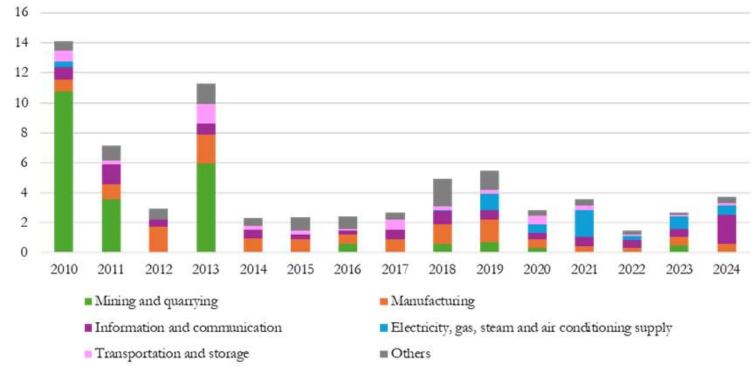
Brazil



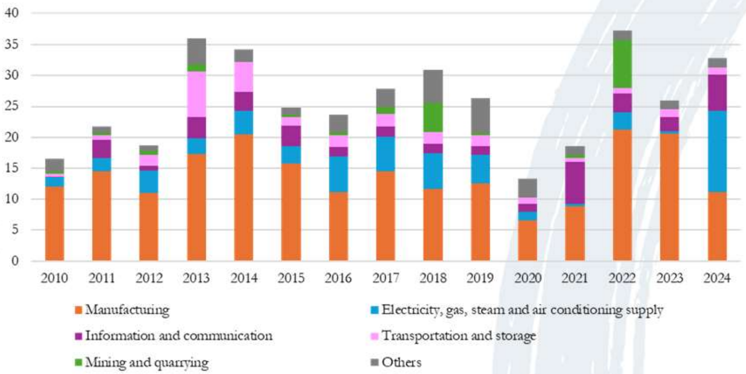
Chile



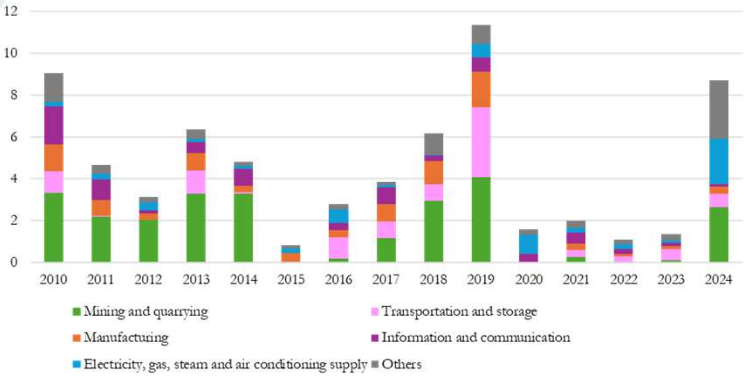
Colombia



Mexico



Peru



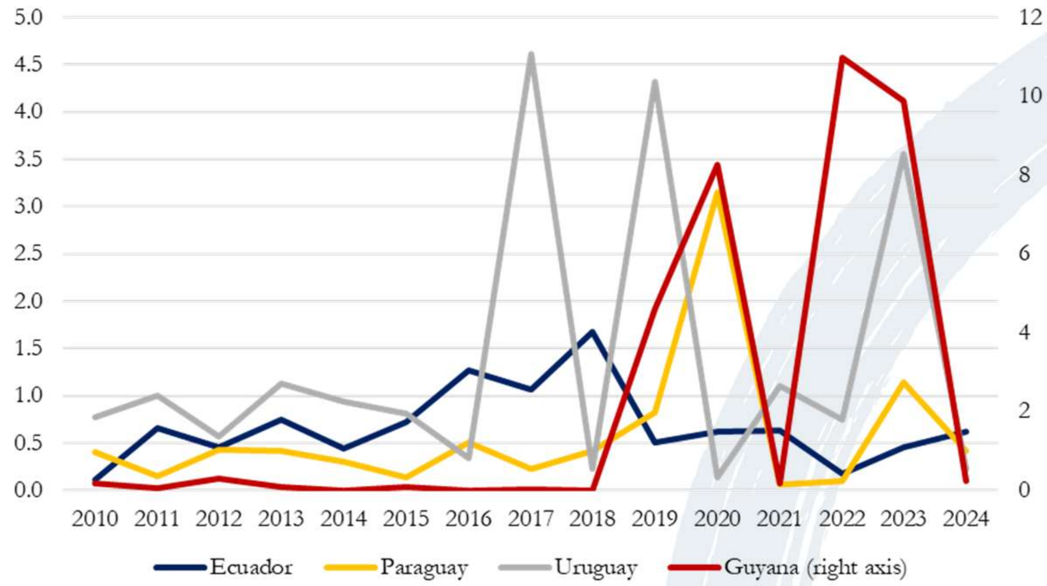
Source: World Bank staff calculations based on fDi Markets database.

Note: Calculations are based on the estimated capital expenditure of greenfield project announcements. The data do not constitute official FDI and are not comprehensive. Converted to real terms with consumer price index (CPI) from the U.S. Bureau of Labor Statistics. FDI = foreign direct investment. LAC-6 includes Argentina, Brazil, Chile, Colombia, Mexico and Peru. ISIC = International Standard Industrial Classification.

Greenfield Announcements Decline in Uruguay and Guyana in 2024 from Recent Peaks

Capital expenditures in FDI Greenfield Announcements

US$, billions, at constant 2015 prices



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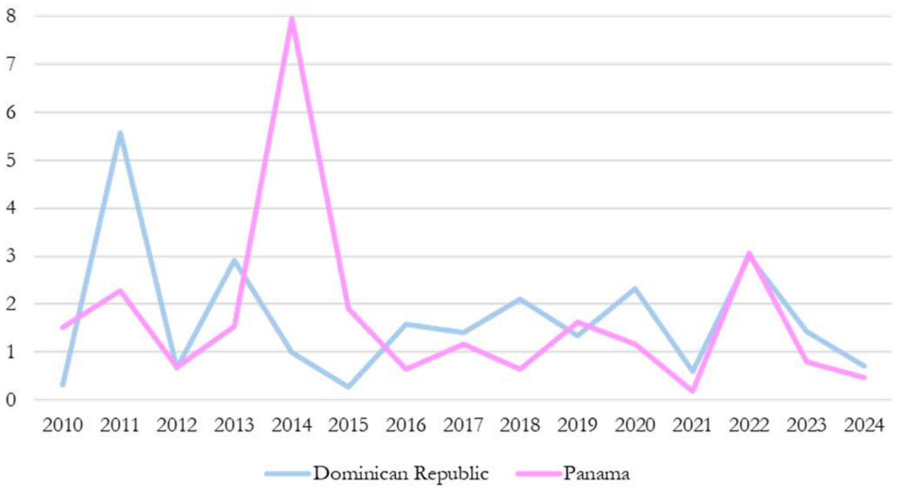
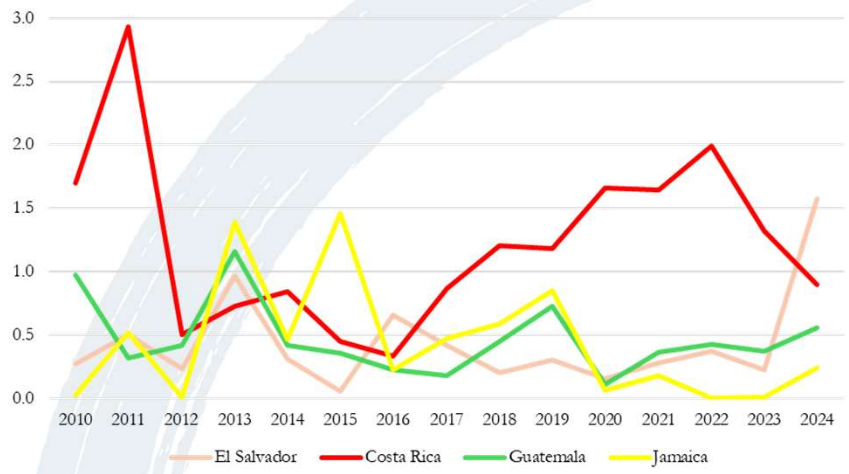
Greenfield Announcements Decrease in Dominican Republic, Panama, and Costa Rica Since Their Post-Pandemic Peak

Capital expenditures in FDI Greenfield Announcements

US$, billions, at constant 2015 prices





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