Latin American Foreign Direct Investment Outlook: Will Lithium Demand Fuel the Next Investment Boom?

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Background of FDI in Latin America

Latin America is constantly looking for foreign direct investment (FDI) to cover its needs of capital and technology. The region lacks sufficient research and development institutions, both public and private, and in the last years its internal savings are below the world average (World Bank Data Bank). Moreover, some Latin American rely on FDI flows to offset trade deficits. Historically, Latin America has received most capital flows from the USA and Europe but inflows from other countries are increasing rapidly, especially from China and, to a lesser extent, South Korea.

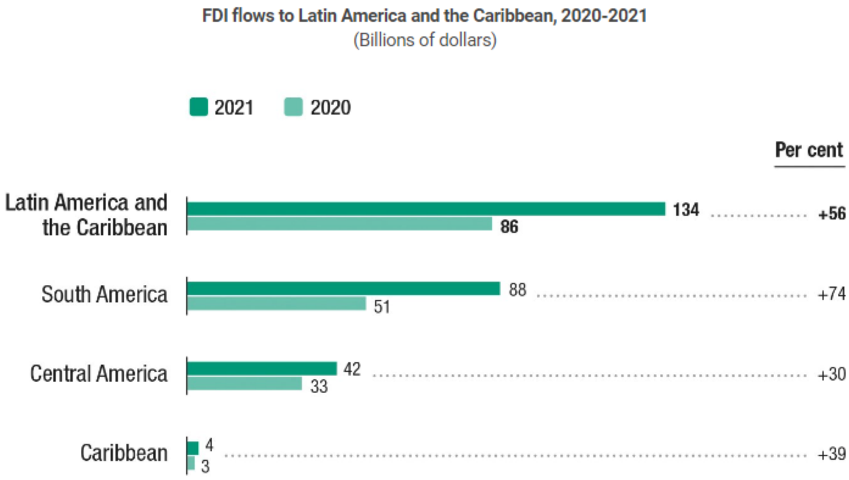
Capital inflows into Latin America pursue different goals (ECLAC 2021). In addition to exploring and extracting natural resources, foreign firms are involved in building strategic infrastructure, running public utilities and in the production of goods and services to serve local markets. Some countries have high tariff barriers, such as Argentina and Brazil (MERCOSUR), what makes foreign investment an appropriate strategy to serve those markets (e.g. in the automobile sector). Efficiency seeking investment is less common South America, as salaries and labour standards are high in comparison to other regions; South America is also far from the biggest markets. The situation is different in Mexico and Central America, regions that have received substantial investment to produce goods or services for the US market.

Although most capital inflows may not go into natural resources, investment in this sector has a strategic importance. Most Latin American exports consist of natural resources and their economies are organized around their extraction. This sector has important linkages with other economic sectors and contributes to defining the social and political landscape in many countries or regions. Natural resources are politically sensitive and several countries have created state-owned companies in the natural resource sector, such as Codelco in Chile (copper), Petrobras in Brazil (oil & gas) and PDVSA in Venezuela (oil). As we discuss below, Chile is considering creating a state-owned lithium company.

There are different views around natural resource dependency and extractivism in Latin America. Those who favour free trade policies tend to highlight the regional potential in this sector and favour focusing on these comparative advantages. However, others see a curse in the abundance of natural resources, as it occludes industrial policies, while environmental activists and indigenous peoples increasingly point at the perils of extraction. The opposition of these groups to new projects has added a new risk factor, which is related to several investor-state arbitrations against Peru, Colombia, El Salvador, Costa Rica and Bolivia.

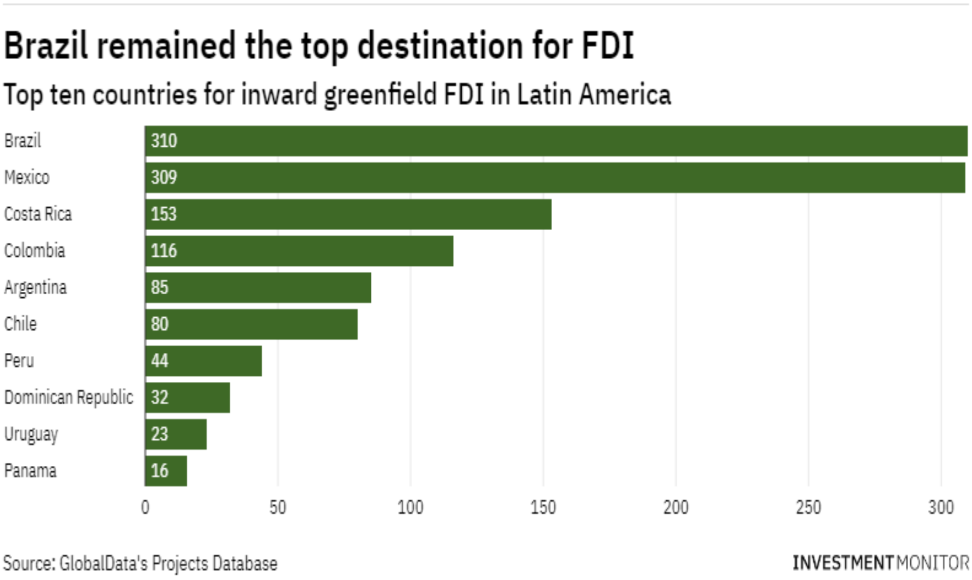
Recent Foreign Direct Investment (FDI) Flows in Latin America

FDI in Latin America and the Caribbean has rebounded from the pandemic-induced slump, increasing by 56% to $134 billion in 2021, according to UNCTAD's World Investment Report 2022. As indicated in the graph below, investment flows to the region reached $134 billion last year (2021), up from $88 billion in 2020.

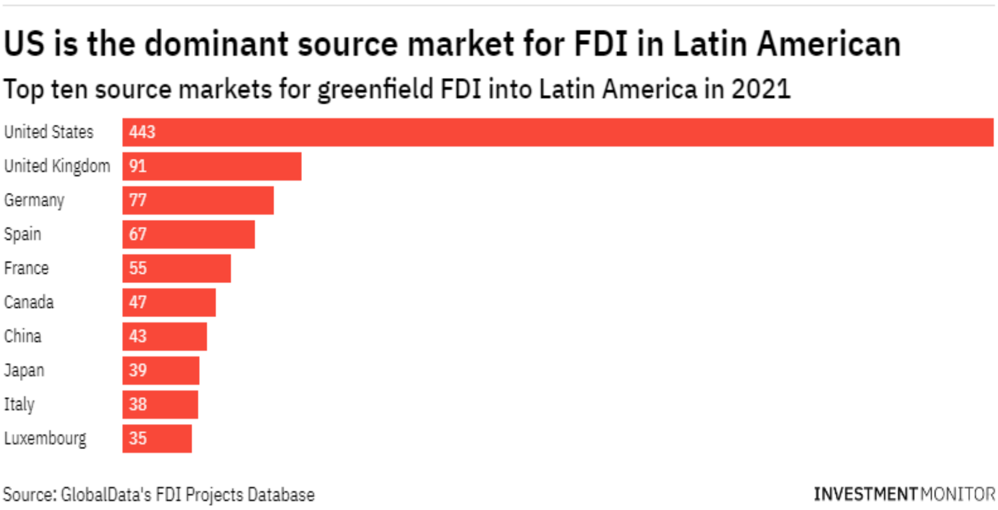


Source: Source: UNCTAD's World Investment Report 2022

As shown in the graph below (Lyttle & Aggarwal 2022), Brazil and Mexico were the leading FDI destinations in Latin America in 2021, receiving 310 and 309 projects, respectively. Brazil, which also ranked first for Latin American FDI in 2020, saw project numbers increase by just one, while Mexico benefited from a 14% growth, closing the gap between the two countries.



According to the Global FDI Projects database (Lyttle & Aggarwal 2022), the USA and Western Europe remained the major source of investment to Latin America in 2021.



The US maintained its leading position as the largest global outbound FDI investor with a 34.5% market share, followed by the UK with 7.1%, and Germany with 6%. Asia-Pacific was the source of 11.5% FDI projects into Latin America in 2021, with most investment sourced from China (43 projects), Japan (39) and India (20). Outbound FDI from China into the region grew faster than that of any other country, led by investments in the electronics and automotive sectors.

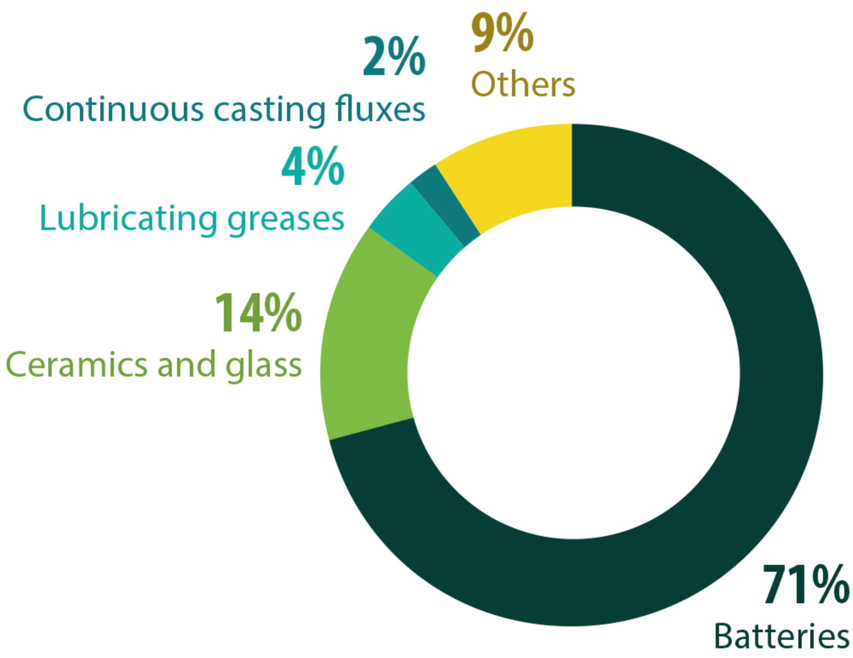
Lithium and its Importance for Major Industries

Lithium is the lightest solid element at ambient temperature, indeed the lightest metal. It has numerous uses including in medical applications, ceramics, glass, lubricants and nuclear technology. Also used in glass products, lithium increases the durability, corrosion resistance, and thermal resistance for use at extreme temperatures. Most importantly lithium is a key component of long life, rechargeable lithium-ion batteries, used to power mobile devices (phones, laptops and other consumer electronics). Lithium-ion batteries are lighter and can store three times more energy than nickel-hydride and lead-acid batteries.

Recently, battery manufacturing has accelerated in response to the burgeoning demand in automotive applications (electric vehicles – EVs), and also energy storage systems (ESS) to better utilise renewable energy supply, particularly solar and wind generated power. Their unit cost continues to fall with technological improvements, adding further to demand and improving competitiveness. Demand for lithium batteries has grown significantly in recent years, driving global exploration and enabling new lithium projects to be considered. Batteries accounted for 71% of total demand in 2020.

Lithium is a critical mineral for the green energy transition, and net-zero emissions require higher reliance on both new and recycled sources of lithium for batteries.

Table 4: Lithium, global uses in 2020 ([Canada 2022])



Source: Government of Canada, Lithium Facts Report

Lithium's Potential Investment Boom and Concerns in Latin America

The largest reserves of lithium are located in the South of the Andes region ([Canada 2022]). Chile and Argentina have more than 65% of the world reserves. Bolivia and Peru also have important deposits. The importance of this mineral prompted the [Washington Post] to support the Rejection of the Project of Chilean Constitution, under the argument that the new constitution "could recast the legal framework for mining in the South American nation". South American governments are aware of the strategic nature of this mineral, also known as "white gold", but they also know that lithium poses pose serious challenges too.

To the risks of Dutch disease, environmental concerns and local community opposition, it is necessary to add geopolitical concerns (Perrone 2022). Foreign firms and South American states may have a common interest in developing the lithium sector. However, most investors want to explore and extract lithium, adding little value added, while governments want to make the best of these resources. To make things worse for policy makers, trade agreements, particularly in the case of Chile and Peru, may complicate the use of performance, technology transfer or research and development requirements. Chile is considering establishing a National Lithium Corporation that may associate with foreign firm for the exploration, extraction and processing of lithium.

Environmental concerns and local communities add another layer of complexity. Investors ask for certainty about environmental licences and community consent, but this certainty is difficult to provide in a sector that is intensive in water and will have significant effects on communities. The inconsistency of governmental agencies is not uncommon, as environmental and mining officers have different incentives, and this can lead to conflict and litigation.

Lastly, Chile, Argentina, Peru and Bolivia may see themselves immersed in geopolitical tensions as the large economies struggle to control strategic natural resources. On the one hand, the increasing appetite for lithium should give these states an opportunity to negotiate good deals, obtain good royalties and ask for performance requirements or more social investment. The negotiating skills of the public sector would be central in this regard. But on the other hand the growing tensions between the USA and China may push these countries to use their political power to either help their firms or block the projects of their competitors.

Laws and Regulations

The Law in Latin America is quite favourable to the circulation of capital and the establishment of investment projects. Domestic legal systems in Latin America rarely pose obstacles to the entry of foreign investment. Screening or approving procedures are simple and rarely present serious barriers to FDI. However, natural resource or infrastructure projects are increasingly the exception, as investors need to secure environmental and social licences, sometimes even community's consent, to move from the exploration to the extraction phase. Recently, Chile's economics minister admitted that this situation constitutes an obstacle to new investment projects. The Council of the Americas has similarly observed that the need for fewer permits and licences in Argentina makes this country an ideal destination for FDI in lithium.

A dense network of international treaties facilitates FDI into some Latin America countries. Chile, Peru, Colombia, Mexico, Costa Rica have FTAs and investment treaties with the major economies. Chile, Peru and Mexico have also signed the

TPP-11 (Chile has still not ratified the agreement). On the other hand, MERCOSUR countries (Argentina, Brazil, Paraguay and Uruguay) have negotiated some agreements, with the EU for instance, but still have not entered into any significant FTA.

Except for Brazil, Latin American countries have entered into investment treaties or FTAs that include investment chapters with standards of protection and investor-state dispute settlement clauses (ISDS). Although support for these agreements remains high, there are voices in the new Chilean and Colombian administration calling for their modernization. The investment chapters, especially the use of ISDS, are among the most controversial provisions. Latin America is the region that has been sued the most under ISDS.

The negotiation of investment facilitation agreements does not seem affected by this trend. Some Latin American countries, especially Brazil, have promoted the negotiation of an investment provision in the WTO. Brazil has also signed an investment facilitation agreement with the Pacific Alliance (Chile, Colombia, Mexico and Peru). Investment facilitation consists of promoting coordination mechanisms, a single window, aftercare to investors, stakeholder dialogue, transparency, dispute prevention and responsible business conduct. In its 2011 publication on foreign investment, ECLAC observed that investment facilitation may serve a central role to attract FDI that support the achievement of the 2030 Sustainable Development Goals.

Conclusion

Latin America keeps attracting Foreign Direct Investments (FDI) to the region. During the global COVID-19 pandemic, FDI inflows to Latin America decreased significantly. However, starting from the last year (2021) FDI inflows started increasing again. Major investment opportunities remain in minerals and raw materials. Recently, lithium shows increasing demand in the global market. Latin America region has nearly 65% of the world lithium reserves. Many global corporations and national governments are investing lithium extraction. Since countries in East Asia such as South Korea, Japan and China have great consumption rate, this area could be interesting investment opportunities. But we should note that companies should take into consideration of regulations, environmental concerns and accountability with local communities there.

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