

Despite the opportunities available, foreign investors and developers face notable political and non-economic risks. In South America there was a consensus on embracing liberalization, trade

openness, and democracy in the 1990s (Philip and Panizza 2011). Then, the region experienced substantial benefits from a commodity-price boom in the 2000s (ECLAC 2022). Nevertheless, underlying historical institutional flaws have become more apparent over time. Those, combined with social and political instability have rendered the region increasingly unpredictable for businesses.

## **2. South America's Noneconomic and Political Risks**

What about South America's Foreign Direct Investment (FDI) determinants? The UN's Economic Agency for Latin America, ECLAC, sustains that infrastructure, productive capacity, and skilled workforce are critical (2023). Education also emerges as one of the critical institutional determinants of FDI inflows in the region (Amal et al. 2010). Infrastructure makes the list, too, due to its role in the region's economic and political integration (Nolte and Wehner 2015; Mazzuca 2021). Organized crime, on the other side, seems to discourage FDI (Gual Soler 2012; Garriga and Phillips 2023). Lastly, political polarization (Grechyna 2016) and political instability dissuade investors.

Those academic findings coincide with the analysts. The CEIUC warned in both its 2022 and 2023 *Political Risk in Latin America* about democratic and institutional erosion, the intraregional migration crisis, political polarization, and social unease. Similarly, the World Economic Forum's 2022 Executive Opinion Survey highlighted state collapse as one of the top 5 most probable noneconomic risks for South American countries in 2023<sup>1</sup> (WEF 2023).

In light of this review, we analyze five top risks in South America for the next ten years:

- i. Poor public governance.
- ii. Political instability and polarization.
- iii. Insufficient human capital.
- iv. Organized crime.
- v. Lacking infrastructure.

### **2.1. Poor Public Governance**

The World Bank Governance Indicators (Kaufman and Kraay 2023) offer valuable insights<sup>2</sup>. Except for Chile and Uruguay, South America exhibits low governance indicators. The region's lowest dimensions hover around the 40th world percentile for the Rule of Law and approximately the 41st percentile for Control of Corruption. Due to the region's profoundly historically-rooted institutional framework (Mazzuca 2021), these variables are unlikely to improve in the short to medium term.

Poor governance significantly affects democracy, influencing FDI. The Democracy Index 2022 indicates a continuous deterioration in Latin America's democracy for the seventh consecutive year (EIU 2023). Additionally, the prevalence of presidential multiparty systems, characterized

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<sup>1</sup> The sample included experts from Argentina, Bolivia, Brazil, Colombia, Chile, Ecuador, Paraguay, Peru, Uruguay and Venezuela. The only country where experts did not foresee a state collapse, was Uruguay.

<sup>2</sup> Two indicators were excluded in this section: Voice and Accountability and Political Stability and Absence of Violence. This is because they respond more to political participation and political cycles than long-term governance and state capacities.

by widespread political transfers, particularistic benefits, and cronyism (Melo and Pereira 2012), further contributes to the erosion of democracy. Prone to corruption and warlordism, these practices often prioritize short-term gains over long-term policy, impacting FDI's Return on Investment (ROI) and legislative tendencies influenced by political cycles.

## **2.2. Political Instability and Polarization**

Once the region's 2000s commodity-price boom stabilized in the 2010s, excessive social inequality, lack of social mobility and institutional mistrust resulted in massive social discontent, turning South American voters to the left (Cruz-Infante 2022; De La Mata et al. 2022). That was the case of Alberto Fernández in Argentina, Lula da Silva in Brazil, Gustavo Petro in Colombia, Gabriel Boric in Chile, and Pedro Castillo in Peru. Part of those leaders' rhetoric appeals to the US "imperialist impositions" to the region (Mola and Ament 2013; Dobson 2019), and some have actively sought to revive the old-fashioned Import Substitution Industrialization (ISI) policy (Vásquez 2023; Cedeño 2022).

The "Latin America for the Latin Americans" claim (Hui, Sheng, and Wenwen 2022) has prompted South America to turn to non-West world powers like China, whose pragmatism the regional mandataries value. In 2023 Chile's President Boric declared that "when you talk to Chinese people, they don't talk about the difference between their culture and the United States. (...) they talk about what they can do to have more investment, how they can help on this or that" (Sackur 2023). Indeed, China exerts significant soft power. According to the *China Index*, Peru, Venezuela, Chile, Brazil, and Argentina are among China's top 40 most influenced countries globally (Doublethink Lab 2022). Experts indicate this has significantly worsened South America's corruption and eroded its rule of law (Hui, Sheng, and Wenwen 2022).

Finally, in response to the leftist governments, a wave of populist far-right presidential candidates emerged in 2023. That is the case of Argentina's recently elected president, Javier Milei (Oppenheimer 2023), José Antonio Kast and María Fernanda Cabal, who may succeed the Boric and the Petro administrations in Chile and Colombia (Cruz-Infante 2024). If such leaders were to proliferate throughout the region, polarization and political instability would probably intensify even further.

## **2.3. Insufficient human capital development**

The third risk for FDI is South America's lack of human capital to absorb and transfer technology effectively. The region's labour productivity has severely decreased since the 2010s (ILO 2022, 13). Additionally, a long-term education and training policy seems unfeasible due to South American countries' poor governance.

Additionally, South America's labour outcomes echo the outcomes of school years. Its learning-adjusted years of schooling (LAYS) -learning results given a certain quantity of

schooling years- average the same as Rumania's (8.4 learning-adjusted schooling years) and slightly inferior to Bulgaria's (8.7) (World Bank 2020).

*Table 1. Learning-adjusted schooling years (LAYS), 2020<sup>3</sup>*

Country	2020
Argentina	8.4
Brazil	7.9
Chile	9.4
Colombia	8.6
Paraguay	7.0
Peru	8.6
Uruguay	8.6
Ecuador	8.7
<b>Average</b>	<b>8.4</b>

Source: own elaboration based on the World Bank Human Capital Database (2020).

Likewise, the World Economic Forum's Transformation Readiness Index (WEF 2020, 45) shows that the three biggest South American economies are far less prepared than developed countries to update their curricula and expand investment in the skills needed for future jobs. For instance, on a scale from 0 to 100, the Republic of Korea scored 61.2, very similar to Germany (61.4). Instead, Argentina pointed 46.9, Brazil 39.5, and Chile obtained 52.1.

This is critical when considering that "Latin America needs to train 700,000 experts in cybersecurity and biosecurity, as well as grow in high-tech sectors such as semiconductors and quantum computing" (Sánchez 2023). Similarly, some sectors resent low technology absorption more than others. That is the case for agriculture, mining and energy, the manufacturing industry, traditional and knowledge-based services (ILO 2022).

As a side effect, low human capital hinders social mobility and makes inequality persistent (De La Mata et al. 2022). That, in turn, makes crime less costly both economically and sociologically, making illegal activities more appealing than law-abiding jobs (UNDP 2021). That takes the analysis to organized crime.

## **2.4. Organized crime has expanded and consolidated**

According to the Global Organized Crime Index 2023, criminality, criminal markets and criminal actors have strengthened in the Americas since 2021 (Figure 7).

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<sup>3</sup> No available data for Bolivia and Venezuela.

Figure 2. Global Organized Crime Index, Americas (2023)



Source: Global Initiative against Transnational Organized Crime, 2023.

The three most critical areas of organized crime in the region are the cocaine and cannabis trade and arms trafficking. We must add illicit mining, prominently gold, associated with labour exploitation, human trafficking and environmental degradation (UNDP 2021).

Organized crime has gained force since 2021, although to a different extent from country to country. In one group lie Argentina, Chile and Uruguay, scoring relatively low, around the same as Ireland or Portugal. However, those nations have recently categorized organized crime and drug trafficking as national security threats (Biblioteca del Congreso Nacional de Chile 2012; Morales Rins 2018; Rodríguez Cuitiño 2018). Instead, Brazil, Colombia, Ecuador, Paraguay, Peru, and Venezuela all rank in the top 35 countries with the highest organized crime indexes worldwide.

Accordingly, South America's intentional homicide rate per 100,000 inhabitants is the world's second highest, surpassed only by Central America (Arjona 2021 in UNDP 2021).

Organized crime alters the local communities' dynamics and lowers the incentives to upgrade the small and medium mining regulations. At the same time, it is usually accompanied by corruption and money laundering (Palifka and Rose-Ackerman 2016). This parallel currency market, mainly in US Dollars, makes the regional exchange terms more volatile.

## 2.5. Infrastructure

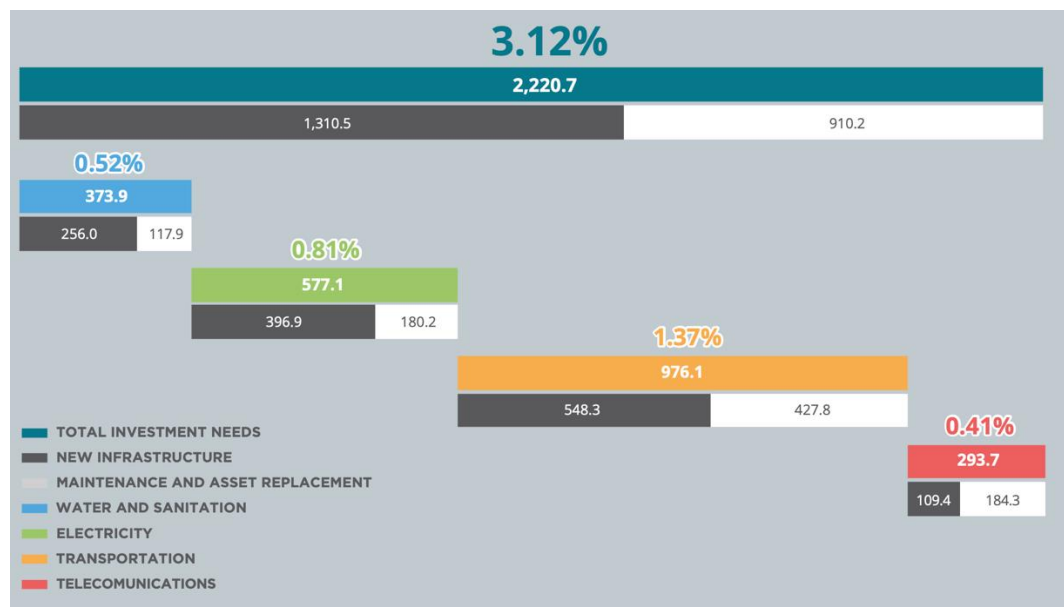
Infrastructure in South America holds critical implications. It not only influences regional politics and economic well-being (Palifka and Rose-Ackerman 2016) but is also indispensable for transporting abundant commodities across vast territories and facilitating exports (Tagziria 2018). Additionally, developed infrastructure, particularly ports, increases vulnerability to organized crime, as observed in countries like Argentina, Chile, and Uruguay, traditionally less susceptible but now facing challenges like drug trafficking (Sampó and Troncoso 2023).

Concerning businesses and trading-related infrastructure, the Liner shipping connectivity index indicates that most South American countries score poorly. Similarly, the Logistics

Performance Index places the region at 2.66. As a benchmark, Europe scores 3.40 and East Asia and the Pacific scores 3.13 (Brichetti et al. 2021, 39).

The IDB confirms this. Latin America must invest US\$2,220.7 billion annually until 2030 to close its infrastructure gap (Brichetti et al. 2021). South America's required infrastructure represents 72% of that budget.

Figure 3. Annual required investment as a percentage of regional GDP, per sector (total investments, 2019–30, USD billion)



Source: Brichetti, Mastronardi, Rivas Amiaassorho, Serebrisky, Solís (2021).

Digital infrastructure gaps persist, with over 230 million people lacking mobile internet access. Disparities in speed and pricing are significant, with Uruguay and Chile leading in both aspects (Hobbs and Torreblanca 2022, 4; Alderete 2022). Latin America is projected to need \$100 billion for digital infrastructure by 2030 (Sánchez 2023).

Adequate digital infrastructure is crucial for the region's economy, with potential competitiveness gains of 700% when integrating European technology (GTAI 2021, 5). The infrastructure deficit hampers productivity, creating opportunities for China to gain more significant sway through initiatives like the Asian Infrastructure Investment Bank (Roy 2023) and Huawei's telecom services (AS/COA 2023).

### 3. Conclusion

South America poses significant challenges for foreign investors, primarily tied to interconnected structural issues. Political instability and polarization have become persistent problems, transitioning from temporary crises to endemic issues. These are closely linked to deficiencies in human capital and infrastructure stemming from poor public governance amid the ongoing political crisis. Implementing systemic educational reforms and developing infrastructure requires long-term policies with delayed returns, leading governments to favour politically advantageous short-term initiatives instead.

Despite these hurdles, there are opportunities for investors within the region. Firstly, South America's relatively neutral stance allows global superpowers to engage in new ventures without disrupting their international policies. Secondly, many South American nations eagerly



adopt new technology, making them ideal for piloting new launches. Thirdly, owing to the relatively limited government capacities, South America boasts an active civil society, offering multiple potential contact points for investors.

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