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Spain and Latin America: Why Investment and Aid Ties Need New Strategies Now

Alejandro Fiorito and Amanda Glassman

Over the past few decades, Spain's engagement with Latin America[1] has been inconsistent and improvised, characterized by fluctuating investments, waxing and waning geopolitical ties, shifting aid priorities, abrupt exits, and polemic debates. But the relationship between Spain and Latin America has also been substantial and even prosperous; shaped by the many changes in the 1990s, when the region started to move away from authoritarian regimes and experienced a broad push towards privatization while Spain accelerated its international outreach and the European Union (EU) became a key actor.

Despite ups and downs, Latin America is both a systemic risk and a boon to the Spanish economy.[2] In 2018, a quarter of IBEX 35[3] companies' revenue came from Latin America, and a significant portion of the banking system's earnings are tied to the region. In 2021, a third of Banco Santander's revenue and half of BBVA's originated in Latin America.[4] A potential recession in major Latin American markets would be severely damaging for Spain's financial system. While these concerns are not currently materializing, a further worsening of external conditions—i.e., a significant contraction in advanced economies and/or China—or internal features—i.e., losing inflation expectation anchors and/or sociopolitical turmoil—could trigger new crises in the region.

1 While acknowledging the region's diversity, the note broadly refers to Latin America and the Caribbean. Spain's engagement—in terms of foreign direct investment, aid, and political ties—has been focused on the larger countries, particularly Argentina, Brazil, and Mexico, which is potentially part of the problem. Expanding the outreach to other countries, recognizing the region's diversity, and developing sustainable ties would be crucial to improve current relations along the lines suggested in this note.

2 Indeed Latin America is the only region for which the central bank of Spain publishes biannual reports on the economic situation.

3 Spain's main stock market, composed of its 35 largest companies.

4 31 percent in South America and 3 percent in Mexico for Santander; and 45.6 percent in Mexico and 8.7 percent in South America for.

In Latin America, challenges loom. The COVID pandemic was a massive human and economic hit that highlighted structural deficiencies and set back poverty and education. Firms have substantially decreased investment, and while debt overhang has not been as problematic as many expected, businesses in the region face an accelerated need to digitize, reallocate resources, and recover employment (for a detailed account of firms' and labor markets' situation and recommendations for policymakers see this recent CGD-IDB report). Increased poverty has erased the gains of the last 12 years, taking the region back to 2010 levels (32 percent of people live now in poverty), and extreme poverty has risen to mid-1990s levels. Inequality is also increasing—on average, Latin American children have lost 1.5 years of education, according to a World Bank and UNICEF report. Moreover, a FAO analysis found that hunger has increased by 4 million people since the onset of the pandemic and has doubled since 2015 and an ECLAC study showed that Latin Americans have lost three years of life expectancy due to the pandemic.

Already sluggish growth prospects have deteriorated further, and the IMF now forecasts 2.3 percent average growth for the next 5 years (2023—2027), the lowest amongst emerging and developing regions by at least 1.3 percentage points (with the exception of war-impacted Europe). Productivity challenges have been exacerbated by the pandemic, as firms have decreased in size, investment dropped, human capital was lost, and informality rose.

On the upside, the commodities boom is a positive shock to the region as most countries are net commodity exporters and their external financing needs are low, for now.[5] While the impact will be heterogeneous, and recent experiences suggest that boons are sometimes wasted in Latin America, many countries will still benefit.

In recent times, the relationship between Spain and Latin America—a strong bilateral foreign direct investment-led relationship complemented by multifaceted cultural, migratory, and political ties—has also changed substantially. Shifting geopolitical alliances, the ongoing energy crisis, and the reshaping of global value chains post-COVID only emphasize more the intricacy and importance of Latin America for Spain (and Europe). Further, Spain is leading the preparation of a EU-Latin America summit in the second half of 2023, when it will hold the Presidency of the Council of the EU and hopes to revive stagnant free trade agreements—particularly with Mercosur—and refresh the relationship between the regions.

Given these prospects and the direct importance of Latin America for Spain's own economy, **it is the ideal time for Spain to develop a new approach across global development tools, i.e., foreign direct investment (FDI), foreign aid, and multilateral engagement and cooperation.** Latin American policymakers, after a wave of discontent and elections, have renewed mandates; and the lack of leadership of the US in the region (too focused on specific topics and with little capacity to successfully convene decisionmakers and achieve substantial commitments) has created a void.

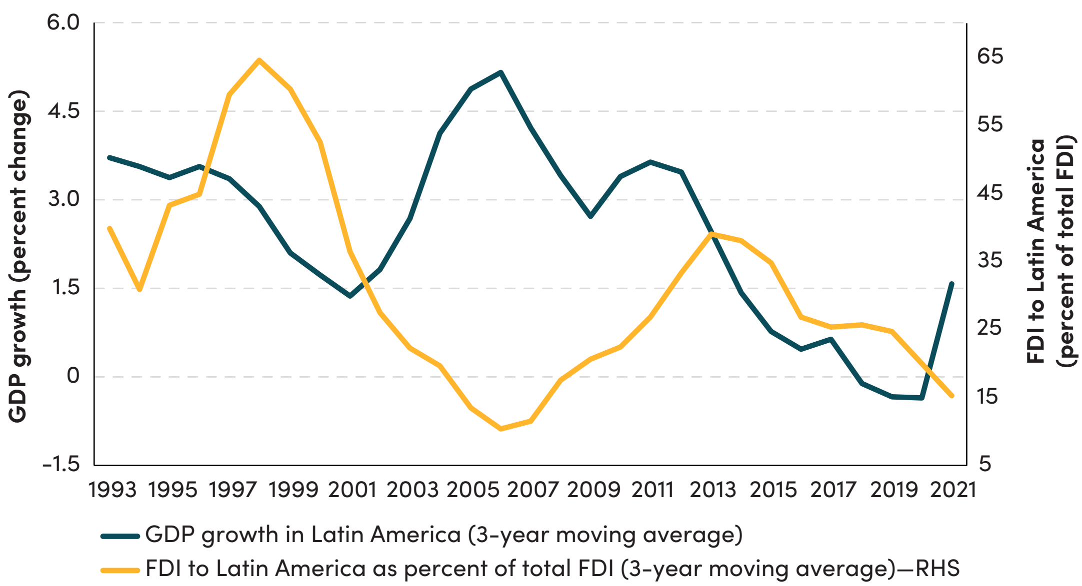
5 With some exceptions like El Salvador.

Stability and growth in Latin America are in Spain's national interest, and relevant for the EU as a whole—new strategies that go beyond historic ties and good intentions can be a win-win in both geographies. This note lays out a brief history of investment and aid flows and suggests new directions for Spain in the coming years.

Spanish direct investment in Latin America: Essential but volatile

Not surprisingly, given the region's history of capital outflows and sudden stops, **Spanish FDI has fluctuated substantially over time**. Figure 1 shows the 3-year moving averages of Spanish FDI in Latin America (as percentage of total Spanish FDI) and the region's GDP growth since 1993. In the last 30 years, there is no clear correlation between the proportion of Spanish FDI and the growth rates in the region. If anything, Spanish FDI has been procyclical with a certain lag, especially in recent years, moving in the same direction as Latin America's—and Spain's—GDP growth.

Figure 1. Latin America's GDP growth and Spanish FDI to Latin America (3-year moving averages; 1993–2021)



Source: IMF (October 2022 World Economic Outlook) and Spain's Ministry of Industry, Trade and Tourism (DataInvex).

On average, over 60 percent of Spanish FDI went to Latin America between 1996 and 2000, which is largely but not entirely driven by Repsol's purchase of YPF in Argentina in 1999 for 16 billion dollars, but only 15 percent of FDI went to the region between 2003 and 2007. Volatility continued during the commodities' boom and a decreasing trend started after a second peak over 40 percent in 2014. In 2021, a mere 14 percent of Spanish FDI went to Latin America.

Despite these major oscillations, Spain's FDI has been significant in the region. In the 1990s, with the expansion and consolidation of democracy and the push for privatization in many countries, large Spanish firms expanded to the region—and most became multinationals in Latin America.[6] **By the late 1990s, Spain was the largest investor in the region and between 2005 and 2020, it has consistently been the second largest country of origin of FDI for the region, behind the US.** Currently, Spanish companies have significant investments in the hospitality business and in the banking sector, where three Spanish banks' subsidiaries are amongst the ten largest banks in Latin America. Moreover, this relationship goes both ways, as Latin America's "multilatinas"[7] are also investing heavily in Spain, their preferred destination behind the US.

The expansion of Spanish investment was natural, but quickly became a bumpy road. The much-discussed Repsol-YPF case in Argentina is paradigmatic. In 2012, after being majority holder for 13 years, Repsol, which had become one of the ten largest oil producers in the world, lost control of YPF—a previously publicly owned company—when the Argentine government nationalized it amidst claims of lack of investment. In 2014 Repsol and the Argentine government reached an agreement, and Repsol received 5 billion dollars in compensation. The most ambitious expansion by a Spanish company ever almost ended with a diplomatic crisis and a huge shock to the second-largest non-financial corporation in Spain by revenue.

While the Repsol-YPF story is the most well-known, it is not an exception. Iberia also invested heavily in Argentina in the 1990s, buying the main national airline, Aerolíneas Argentinas, only to sell it shortly after to the Spanish Group Marsans. The Argentine government then expropriated Aerolíneas Argentinas, and, as in the YPF case, was ordered to pay compensation in 2019. Telefónica (the largest phone, internet, and TV provider in Spain) sold most of its business in the region in 2019, keeping a significant presence only in its main market, Brazil. Recently, Iberdrola (the third-largest energy company in Spain) has been facing major pressure from the Mexican government, finding itself in the middle of a controversial energy reform.[8] Spanish construction firms have been involved in large infrastructure projects—most notably, the expansion of the Panama Canal or the subway in Lima—that, as of 2021, had resulted in arbitrage litigations for 4.8 billion dollars.[9] Moreover, the fact that six Spanish firms, more than any other OECD country, are "black-listed" by the World Bank for corrupt practices is not particularly encouraging.

Traditionally, international firms in Latin America have been impacted by severe currency depreciations, political instability, and/or lack of judicial safety—a recent paper shows how economic policy uncertainty in Latin America hurts commercial ties and decreases exports and FDI. Now,

6 And some firms' involvement started considerably earlier—Iberia's first flight to Buenos Aires was in 1946, and MAPFRE, the largest Spanish insurer, started its internationalization in Colombia in 1984.

7 Companies that operate in multiple Latin American countries.

8 Spanish firms, like Fenosa in Dominican Republic in the early 2000s, faced complicated exits from the local electricity sector.

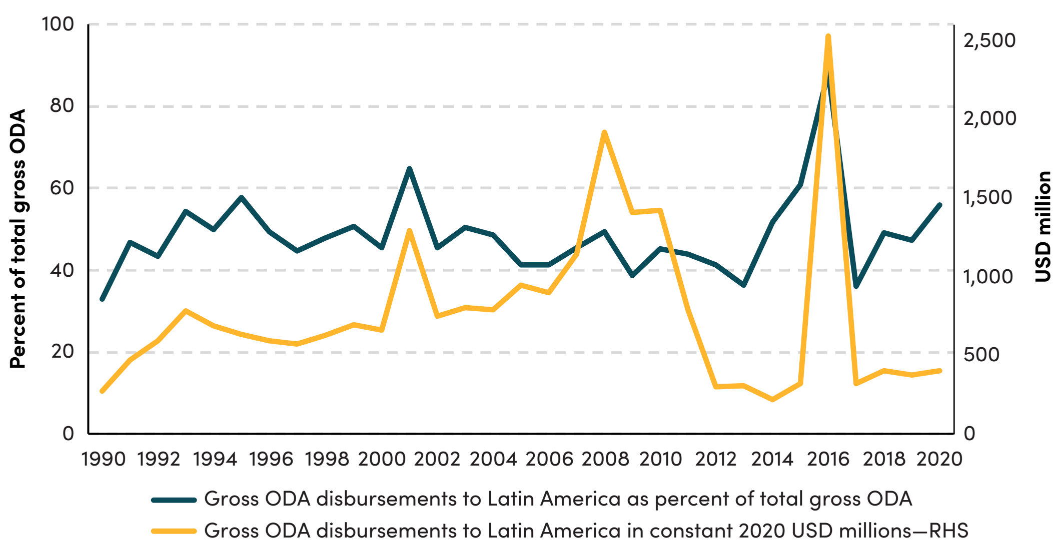
9 Spanish construction firms had around 30 percent of the market share in the region and almost 50 percent of their international revenue come from Latin America in 2019 and 2020.

the pandemic has accelerated a retreat in FDI (Figure 1) and the mismanagement of the multiple resulting crisis has not made the business environment more attractive, despite the unusual appreciation of many Latin American currencies in 2022. **Yet, Spain's presence in Latin America remains significant, and opportunities abound as economic activity recovers post-pandemic, digitalization efforts foster financial inclusion, and the tourism industry picks up strongly.** Further policy action to improve business climate and reduce risks would be welcomed by both governments and private firms.

Spanish aid in Latin America: An odd and old special relationship

Official development assistance (ODA) provided by Spain has not been as volatile as FDI, at least when measured in terms of the proportion destined to Latin America relative to other regions, but **the lack of a clear strategy and a significant budgetary reduction post 2008 crisis (Figure 2) have stifled Spain's public involvement in the region.** The fluctuations in absolute terms are considerable and suggest deeper structural issues with the way aid is managed in Spain. In relative terms, the country has been historically among the last in Europe in aid provision as a percentage of GDP—and ODA almost disappeared during the Global Financial Crisis.

Figure 2. Spain's gross ODA disbursements to Latin America (1990–2020)



Source: OECD (International Development Statistics).
Note: 2016 is such an extreme outlier because of a 1.5 USD billion debt relief operation in Cuba.

In addition, priorities and the way in which aid is disbursed have changed. A report by the Real Instituto El Cano discusses a renewed emphasis on northern Africa, the increase in ODA channeled through the European Union (EU), and new areas of focus like security. Indeed, when including Spanish aid that is channeled through and managed by EU institutions into the calculation, Latin America only received 23 percent of total aid in 2019 (compared to the 47 percent of the total disbursed through Spanish institutions).

However, the ties remain relevant and Spain's cooperation with Latin America has a historic basis. Out of the ten countries that received the most Spanish aid in 2020, six were Latin American (Colombia, Venezuela, El Salvador, Peru, Guatemala, and Honduras) **and Spanish cooperation in the region even precedes the establishment of a dedicated global aid agency**. The origin of this relationship shows how Spanish international cooperation and development aid are intrinsically linked to Latin America. The history of international development in democratic Spain dates to 1977 when the current Spanish Agency for International Cooperation and Development (AECID, Agencia Española de Cooperación Internacional y Desarrollo) was the Ibero-American Center for Cooperation (CIC, Centro Iberoamericano de Cooperación), which later was renamed Institute for Ibero-American Cooperation (ICI, Instituto de Cooperación Iberoamericana). In 1988 the ICI became the AECI (the development "D" would only be added to its name in 2007). **But amid all these acronyms, the Latin American (or Ibero-American) component of Spain's aid program was diluted.**

Now, a new law for "cooperation, sustainable development, and global solidarity" to replace the current one from 1998, is being discussed in the parliament. This review of Spain's priorities and goals in development aid could change the AECID's by-laws, allow the creation of a Spanish fund for sustainable development, and establish a legislative mandate to devote 0.7 percent of GNI to aid. These are much needed changes and a positive step forward, but the proposed legislation has flaws. As Gonzalo Fanjul argues, no one can say this is an "audacious" law: it does not renew the governance structure, it ignores decentralized cooperation, and, so far, it has lacked broad-based support in the parliament. In addition, aggregate numbers do not fully back up this apparent interest in more and better ODA; in its 2022 Development Cooperation Peer Review, the OECD criticized Spain for not having achieved the goal of allocating 0.4 percent of its GNI to ODA by 2020 (it only provided 0.2 percent) as well as several aspects of the proposed law. The 2023 budget improves this number to 0.34 percent but remains below targets. Others have also decried the lack of a comprehensive reform to the current aid system and the scarce interaction with other actors, including a disregard of the private sector role.

However, the capacity and potential for collaboration are there—Spain was the seventh largest donor of COVID vaccines in the world and the second to Latin America, and has supported Latin America in initiatives like COVAX—**which makes the lack of ambition for reform and the absence of specific goals and plans for broader more intense engagement with Latin America all the more frustrating**.

Next, we further discuss why this is a unique opportunity to strengthen this relationship and outline some actions to increase and improve FDI and ODA, which should be considered state policies that are agreed and supported by both the government and opposition parties.

More and better investment and cooperation: Why now?

A structured and strategic engagement to channel investment and aid: leveraging the EU and international financial institutions

Developing a long-term view about how to engage with Latin America that aligns private interests, improves ODA disbursements, and solidifies economic and commercial ties is paramount for Spain. But, again, signals about the intent and capacity of doing so are mixed: the current Spanish strategy for foreign action for 2021–24 does not take a deep look at the region and, yet, reviving the relationship between the two regions by hosting a EU-Latin America summits—which have not taken place since 2015[10]—is one of the main international goals of Spain for 2023.

This strategy has two cornerstones that are already in place and that should be key for advancing any FDI and ODA policy: the European Union and international financial institutions (IFIs).

The European Union component should be naturally forefront in any strategy of international engagement. **Spain should champion Latin America in Europe, emphasize its role as a gateway to the European market, and facilitate the channeling of European investment and aid to Latin America.** The same way that Spanish firms became international firms in Latin America, many Latin American firms could see Spain as their first step towards expanding in other regions. Spain has been vocal about the European slowdown in the development and enaction of free trade agreements, particularly with Mercosur (Argentina, Brazil, Paraguay, and Uruguay) and with Chile and Mexico. Continuing to push for these types of agreements should be a policy priority for Spain. Indeed, Latin America has recently proven to be a valuable ally, partially compensating the supply chain disruption of the war in Ukraine by increasing its grain exports to Spain. Further, Europe can be a less controversial partner for the region, as it is somewhat apart from the geopolitical tensions associated with Chinese investments.

Beyond the EU-Latin America summit, broadly reinvigorating other recurrent multilateral meetings with Latin America, including the Ibero-American Summits, is low hanging fruit for Spain. The Spanish government has an opportunity to lead in the organization of such international meetings—especially after the US has experienced difficulties in doing so. And Spain should incorporate lessons learned from the EU-Africa summit earlier this year. Notwithstanding, it is often not clear what the goal of such meetings is—a good approach could be to have dedicated summits

10 And were supposed to occur every two years.

on topics in which Spain might have a comparative advantage, like global health where Spain has a major biotech and epidemiology offer, and a health system with much to teach the rest of the world. These should not be just photo-ops for policymakers but help develop new and improve existing channels for sharing knowledge. Without political support and coordination these conferences always risk being disappointing, but they can be critical in certain areas. A good example was the creation of the Ibero-American Epidemiological Observatory in the 2021 summit. Concrete action in all these meetings should be the number one priority for all the actors involved.

In addition, **IFIs can help Spain effectively channel FDI and ODA**.[11] Spain ought to take advantage of the full potential of the IFIs, organizations with know-how, research capabilities, experience building public and private alliances, and substantial funding capabilities.

In the Inter-American Development Bank (IDB), the main multilateral institution in the region, Spain has a mere 1.96 percent of the voting share (just 0.1 percentage points more than France and Germany). But, given shared history and evident self-interest in Latin America, Spain should lead the European block in the IDB, perhaps spearheading a new corporate strategy and a capital replenishment to meet the moment of overlapping crises and stagnation in structural reforms needed to galvanize growth and human capital, and to address global challenges like climate change and pandemic preparedness.

Further, the head of the private sector arm of IDB (IDB Lab) and the director for Latin America of the International Finance Corporation (IFC) of the World Bank Group are Spanish nationals. Again, the human capital and the common interest is there, but a push from the corresponding authorities is needed.

Engaging with other regional institutions should also be on the agenda. The Latin American Reserve Fund (FLAR) is growing, and Spain should support this kind of initiative in any way possible. While Latin American countries have improved central bank independence, supervisory quality, and some countries have even implemented Basel III protocols to improve macrofinancial stability, much work lies ahead—and the COVID pandemic was a reminder of the importance of buffers in a region with very limited fiscal space. Helping implement countercyclical policies should always be on the agenda. Similarly, generating better and more relevant evidence for policy reforms and program adjustments to enhance efficiency is also sorely needed—a regional consortium for evidence and evaluation backed by the IDB could be part of the agenda ahead.

Spain should develop and implement action plans for FDI and ODA that align operational measures with strategic goals regarding Latin America—leveraging the EU and its bilateral relation with the region and the IFIs capabilities is a must to make these plans successful and sustainable.

11 Partnerships with other development finance institutions can also be a powerful tool.

Foreign direct investment

The first and foremost goal of FDI policy should be to focus on sustainable projects and initiatives that can have structural impacts—and, thus, change lives generationally. Long-term projects in strategic industries will strengthen ties and reduce the volatility that has characterized FDI in the region.

It has been reported that the EU could announce an investment package of about 8 billion dollars in the 2023 summit. Where should these funds go? There are multiple sectors of common interest, and the Spanish government has recently been pushing for Spanish firms to lead in crucial industries that could be particularly appealing for Latin America. **The mix of a strong public initiative, the European financial power, and solid private capabilities could have many positive spillovers in Latin America.** Three areas of particular relevance are green hydrogen, gas distribution, and semiconductors. For instance, on green hydrogen, the EU has partnered with Chile to improve investment opportunities on this field, noting that Chile could become a global leader in green hydrogen production and Spain is planning a 7 billion dollar investment in this area; and, on semiconductors, the Spanish government will have an investment of about 11 billion dollars based on European funds to strengthen and develop this industry. The ongoing energy crisis in Europe and the always present climate emergency make such efforts a no brainer.

Exchange programs to share knowledge across Latin American and Spanish/European firms and facilitating SMEs investment could consolidate this relationship. So far, large firms have led the international expansion of the Spanish private sector, and IFIs like the IDB have continued to focus on these types of companies. While large firms are crucial and valuable partners, programs that foster SMEs cooperation and investment, helping medium-size firms internationalize in Latin America would solidify economic ties.

ODA and development policy

According to the most recent Commitment to Development Index (CDI) from CGD, and out of 40 advanced economies, Spain ranks 20th overall, being in the top-10 in the investment and environmental policy categories. However, the CDI notes that the development finance component is lagging and that Spain's finance for international development was only 0.18 percent of GNI (the CDI average is 0.29). At the current pace, it will take 4 more years to reach the goal of devoting 0.5 percent of GNI to ODA that the government set for 2023, and the government would be barely on track to reach the objective of 0.7 percent by 2030.

While these meager numbers depict the broader issue of lack of "investment in development, the focus should be on quality over quantity. The 2022 OECD-DAC peer review noted that Spain needed to "streamline financial cooperation modalities," and refocus on multi-year funding along with shorter approval and reporting processes and more focus on outcomes than inputs.

A revamping of Spanish ODA priorities can start by focusing policy on global public goods and aiming to strengthen partnerships between Spain and Latin America. On global public goods, IFIs have taken the lead, and their efforts in climate change mitigation (where the Amazon is key) and pandemic preparedness should be commended and supported. However, Spain—and Europe—should look at Latin America not as mere aid recipients but as crucial allies on these issues. Not one Latin American country had completed a self-assessment of pandemic preparedness with the World Health Organization or with the the Pan American Health Organization prior to COVID, despite dealing with the earlier Zika outbreak poorly, illustrating the need for further work in this area. In addition, Spanish ODA could support vaccine and medicine manufacturing in the region, aim to coordinate scientific and technology exchanges, and focus on sustainable investments to fight climate change.

To conclude, Spain's relationship with Latin America can be mutually beneficial or stale and insignificant. There is already a shared background and multiple ties that have constructed a complicated but potentially positive connection. **Now, the timing is right for Spain to launch new strategies and a new framework of bilateral, multilateral, and multiregional engagement with Latin America, in which Spain should embrace its dual role as bridge and protagonist.**

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ALEJANDRO FIORITO was previously research associate at the Center for Global Development.
AMANDA GLASSMAN is executive vice president and a senior fellow at the Center for Global Development.

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