TRENDS IN INTERNATIONAL ECONOMIC RELATIONS of Central America, Panama, and the Dominican Republic

Trade, tourism, foreign direct investment, and international cooperation

María Cecilia Deza, Lucía Martín,
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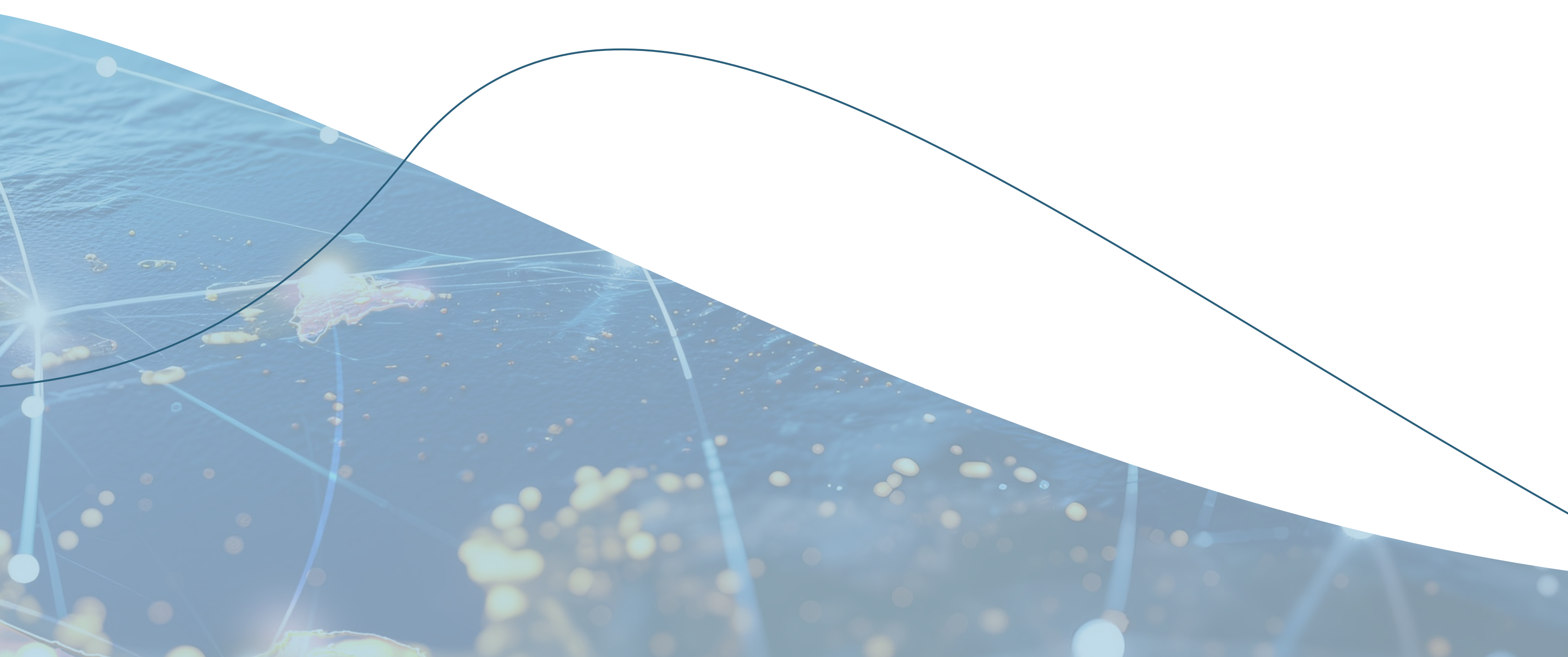
ABSTRACT

This paper analyses the evolution of the international economic relations of the countries in Central America, Panama and the Dominican Republic (CAPADR), in the areas of international trade, tourism, foreign direct investment (FDI) and international cooperation. It also discusses the impact of the post-pandemic context, the reconfiguration of global supply chains, and global geopolitics on these relations.

In recent years, (i) the United States (US) has remained the region's main trading partner in goods and services, FDI and foreign aid for CAPADR; (ii) CAPADR countries and the rest of Latin America have become the second largest economic partners in these areas, which highlights their growing economic and political integration with the rest of the region; (iii) there has been an increase in the participation of the Asian bloc of countries, particularly in terms of FDI from China in countries with diplomatic and strategic ties, although its participation is still limited in relation to other blocs; and (iv) the positioning of the European bloc in CAPADR remains limited and stable over time but stands out in the area of foreign aid, especially regarding issues of sustainable development and the environment. However, there is heterogeneity between countries in each of the aspects under study.



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We are grateful for the excellent research assistance of Melanie Jimenez.

I. INTERNATIONAL TRADE RELATIONS

The US is the main destination market for CAPADR exports, although it has a slightly lower market share than 15 years ago. The rest of the countries in Latin America and the Caribbean (LAC), and in particular the CAPADR countries themselves, are the second most important partner, thus showing the progress of intra-and inter-regional integration. Other blocs, such as European and Asian countries —where China is the main player— portray a smaller role in exports, but a growing role in imports.

The US is the main recipient of CAPADR exports, but in recent years their trading partner base has expanded. Although the US accounts for one third of CAPADR's exports, its share has dropped over time, especially between 2002 and 2007. CAPADR exports to the US reached a peak of 60 percent of the total in 2000, decreasing to 40 percent in 2021 (Figure 1). This is evidence both that CAPADR countries have diversified into other markets and that other blocs, especially Asian countries, increased their importance as suppliers of US manufactures. Between 2000 and 2020, China increased its participation in US imports from 7.2 percent to 20.1 percent, while the Asian bloc increased its share from 36 percent to 43.6 percent. This directly affects CAPADR's access to the North American market, as the region competes in products similar to those manufactured by China, such as textiles and relatively high complexity manufacturing in some countries.

LAC, and in particular the CAPADR countries themselves, are the region's second most important trading partners. CAPADR exports to LAC (including the CAPADR countries themselves) increased from 23.6 percent of total foreign sales in 2002 to 30 percent in 2021. More than 70 percent of the total exports to LAC go to CAPADR countries (Figure 2). In the particular case of Honduras and Panama, their free zones and free trade zones have become more relevant in recent years as a destination for exports to Latin America. This is evidence of the strong inter- and intra-regional integration of LAC countries that has consolidated in recent years, as detailed below.

Figure 1
CAPADR: Exports by market
(Composition)

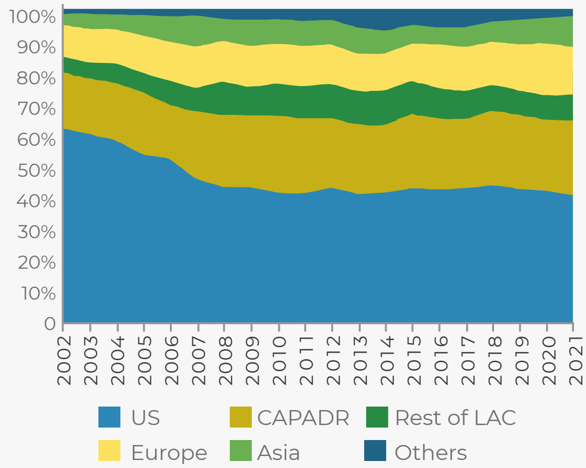
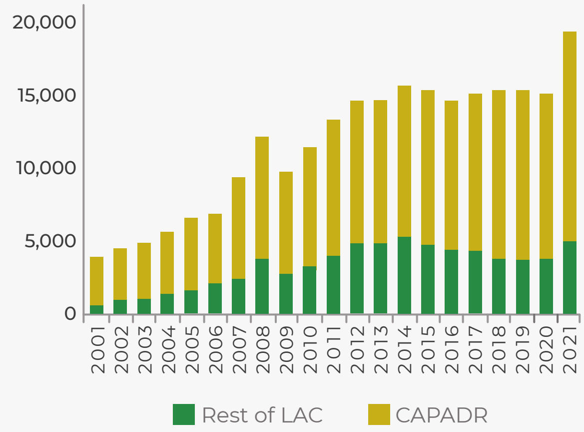


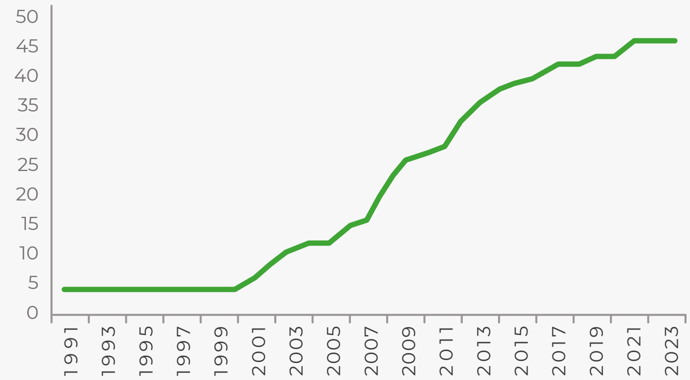
Figure 2
CAPADR: Intra-regional exports and exports to the rest of Latin America and the Caribbean
(millions of USD)



Source: Own elaboration using data from Trade Map, SIECA and Central Banks.

This trend is explained by the willingness of CAPADR countries to formalize and strengthen trade relations with the rest of the LAC countries by means of free trade agreements. Between 1991 and 2023, CAPADR went from having 4 to 46 trade agreements in force, while the Dominican Republic went from none to 5 in the same period (Figure 3).[1] Countries such as Costa Rica, El Salvador, Honduras, Nicaragua and Guatemala are used to negotiating free trade agreements jointly. This is the case with the trading rapprochement with Chile, one of the main economic players in the region today in terms of openness to international trade, which translates into a strong network of trade agreements with more than 60 economies. The free trade agreement between Central America and Chile was signed at the end of 1999, and entered into force in the different countries between 2002 and 2012. Meanwhile, Belize and the Dominican Republic have opted for free trade agreements or preferential trade agreements. Belize has two preferential trade agreements, entered into through the CARICOM community, with Venezuela and Colombia. There is also the case of Panama, which has individually negotiated free trade agreements with other LAC countries, mainly with those of the Pacific Alliance, given that having free trade agreements with its member countries is one of the requirements for joining the Alliance. In addition to its agreement with Mexico, which entered into force in 2015 and is a necessary step to join the Alliance, Panama already has treaties with Chile and Peru, in force since 2006 and 2011, respectively.

Figure 3
CAPADR: Number of regional trade agreements



Source: WTO.

1 Lopez Marmolejo, Eggers and Ruiz-Arranz (2023). Opportunities to Boost Production, Employment and Value Chains. Economic Report on Central America, Panama and the Dominican Republic.

After the US and LAC, Europe is emerging as the third most important product buyer for the CAPADR region, albeit with a stable share over the last two decades. Over the last 20 years, exports to Europe have accounted for 12.8 percent of CAPADR's exports. The main markets in this continent are the European Union, including the Netherlands (23 percent), Belgium and Luxembourg (16 percent), Spain (9 percent), Germany (9 percent), the United Kingdom (9 percent), and Italy (7 percent). However, the relevance of this bloc differs from case to case. This market is particularly important for Belize, whose exports to Europe, mainly to the UK, accounted for 46 percent of the total in 2019, a figure that has been growing. For Costa Rica, Honduras and Panama, sales to Europe accounted for between 21 percent and 26 percent in the same year.

The region's exports to Asia are limited, mainly because CAPADR does not benefit from China's demand for food or minerals like the rest of LAC, especially South America. As a result, the weight of CAPADR's exports to Asia is low, amounting to an average of 6 percent of the region's total exports in the last decade. Panama, Guatemala, and the Dominican Republic are the countries with the largest exports within the CAPADR region (figure 4).[2] In contrast, imports from Asia are significant and have been increasing in recent decades, from 8.4 percent of total imports in 2001 to almost 25 percent in 2019 (Figure 5).

Figure 4
Exports to Asia
(percentage of total CAPADR exports)

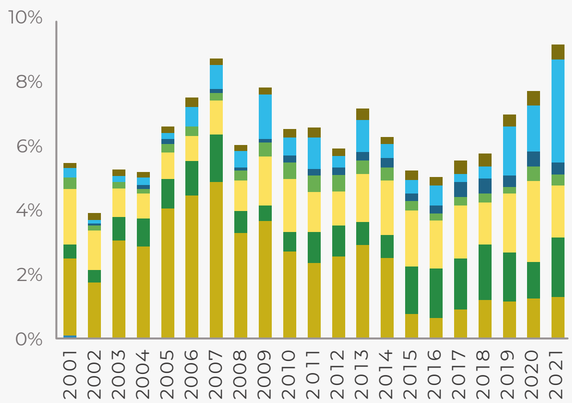
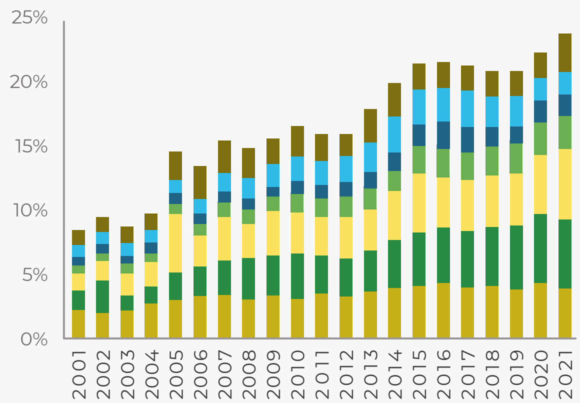


Figure 5
Imports from Asia
(percentage of total CAPADR imports)



Source: Author's elaboration with information from the Atlas of Economic Complexity.

Within Asia, trade with China has been gaining ground at an accelerated pace in most CAPADR countries, especially in imports. In recent years China has become CAPADR's main Asian trading partner, except for Belize, Nicaragua, Honduras, and Haiti. Trade with China has grown at an accelerated pace since the 2000s despite the fact that, with the exception of Costa Rica and Nicaragua, none of these countries has so far signed a free

2 Costa Rica was the region's main seller to Asia until the closure of the INTEL assembly plant in 2014 caused a decline in sales to China, its main buyer.

trade agreement with China.[3] This development is linked to China's accession to the WTO in December 2001, which was crucial in the history of the multilateral trading system as it meant the opening up of such a large economy, with a focus on trade in electronics, data processing technologies, textiles, optical and medical equipment. CAPADR imports from China have risen from less than 5 percent of total imports in 2002 to 15 percent in 2021 (Figure 6); with electrical machinery, appliances, and equipment together with mechanical appliances and devices as the top imported product categories for most CAPADR countries.

As a result, CAPADR's trade balance with China is increasingly negative, compared to the rest of the LAC countries. While 11 percent of China's total exports to LAC are destined for the CAPADR region, only 3 percent of China's imports from LAC come from CAPADR. As a result, the region has recorded an increasingly negative trade balance with China over the last decades (Figure 7). In contrast to the broader LAC region, which experiences a negative trade balance, Peru, Chile, and Brazil maintain positive trade balances. This divergence accounts for the overall positive trade balance observed in these countries. This phenomenon responds to China's growing need for raw materials offered by South American countries, while CAPADR is a net buyer of Chinese goods, and a direct competitor in the global manufacturing market.

Figure 6
CAPADR: Imports from China and the United States
(percentage of total imports)

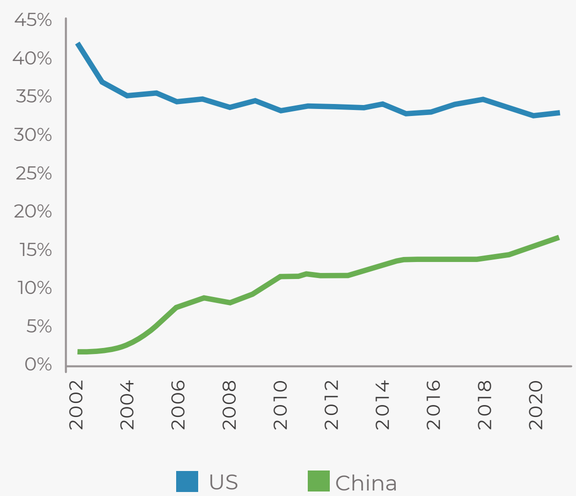
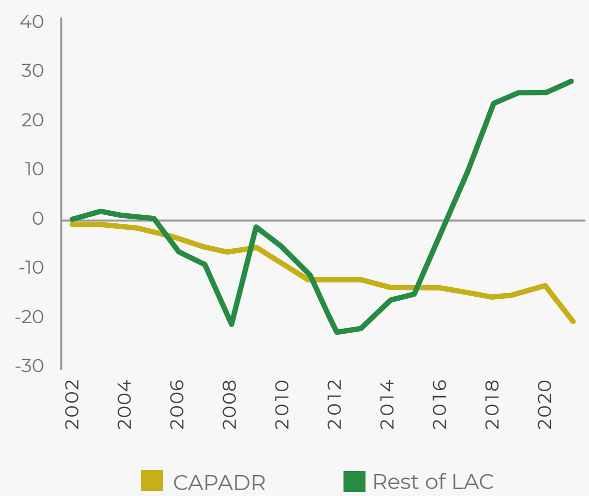


Figure 7
Trade balance with China
(Billions of dollars)



Source: Author's elaboration with information from the Atlas of Economic Complexity.

Although international trade flows in CAPADR slowed down during the pandemic and recovered afterwards, the structure of trading partners remained largely unchanged. recovery of international trade has taken place in a context of global dynamism following the opening of economic activities after confinement, and the progressive increase in the international prices of the main export and import products, which had different impacts

3 Of the CAPADR countries, only Costa Rica and Nicaragua have signed an FTA with China, while Panama and China advanced through five rounds of negotiations for a trade agreement, which stalled in 2019. For their part, El Salvador and Honduras have initiated talks to enter into free trade agreements with China.

on the different sub-regions. While South America benefited from higher oil and mineral prices, for CAPADR, the increase in oil and mineral prices, and more recently in food and food input prices, resulted in higher import prices. Apart from international trade trends, the profile of trading partners remained largely unchanged.

Three years after the covid-19 pandemic, there is no clear evidence that the realignment of global value chains has significantly favoured the CAPADR region. Mesquita-Moreira et al. (2022) argue that the realignment of global value chains has not been abrupt after the pandemic, but a gradual process that started earlier and whose impacts on LAC are not conclusive in the short or long term. They also argue that US policies aimed at reducing dependence on China did not translate into benefits for LAC, apart from Mexico, and did not have positive effects on FDI relocation, at least in CAPADR. Recent authors and research, however, do not rule out sector-specific effects. Along these lines, the recent IDB economic report[4] identifies specific sectors that could be developed through nearshoring.[5]

In recent years, progress has been reported on the intra- and inter-regional integration agenda, meaning that the relevance of LAC as a trading partner for CAPADR will intensify in the near future. In 2021, CAPADR's exports to LAC grew by 30 percent compared to 2020, indicating that regional integration is becoming stronger, underpinned by continued efforts to formalize different initiatives. Examples of this are the advances in the Process of Deep Integration between El Salvador, Honduras and Guatemala, the cooperation between the Secretariat for Central American Economic Integration and the Andean Community, the extension of the Partial Scope Agreement (PSA) between Guatemala and Ecuador, the incorporation of Costa Rica into the Pacific Alliance and the Trans-Pacific Partnership Agreement, the launch of negotiations for a PSA between Belize and El Salvador, among others.

4 Lopez Marmolejo, Eggers and Ruiz-Arranz (2023). Opportunities to Boost Production, Employment and Value Chains. Economic Report on Central America, Panama and the Dominican Republic.

5 The arrival of the COVID-19 pandemic sparked a debate about the potential benefits of rethinking supply chains and relocating them to closer destinations. However, the Russia-Ukraine conflict, which began in early 2022, has cast doubt on this concept. It has highlighted the adverse impacts that crises in a supplier country can have on its nearest markets and their primary trading partners. (Cárdenas and Hernández, 2022).

II. INTERNATIONAL RELATIONS IN TOURISM AND REMITTANCES

Remittances and tourism are the main sources of foreign exchange income for most CAPADR countries, also contributing to finance trade deficits. The main sources of tourists visiting CAPADR are the USA and countries within the LAC region. Remittances account for more than 10 percent of GDP in some cases. Given the geographical proximity and the economic and social conditions in the Northern Triangle countries, the US is the preferred country of emigration and therefore the main source of remittances.

The largest tourism flows to CAPADR countries come from the US and LAC. These two blocks contribute more than 70 percent of visitors to the CAPADR region, where the direct contribution of tourism accounts for between 5 percent and 15 percent of GDP, and the indirect contribution ranges between 8 percent and 40 percent of GDP, depending on the country. However, there are some differences. In Belize, most tourists come from the US, whereas in the rest of CAPADR, the US accounts for 20 to 60 percent of visitors (Figure 8). Panama has become an important destination for travellers from LAC, due to its geographical location closer to South American countries, and its relevance as a city for business and logistics services. Between 2011 and 2019, the number of visitors (not only tourists)[6] from Latin America reached 64.6 percent of the total. Similarly, in the same period, the majority of tourists visiting the Northern Triangle and Nicaragua, were from Latin America, with Guatemala receiving the most Latin American visitors (70.4 percent of total tourists), followed by Nicaragua (68.3 percent) and El Salvador (63.0 percent). It is important to note that the majority of Latin American visitors to these countries come from Central America.

6 In the case of Panama, in order to have a breakdown by nationality, it was only possible to obtain the total number of visits, which includes tourists as well as excursionists and people entering for reasons other than tourism.

Europe has a smaller share of tourism to CAPADR, especially in the Northern Triangle countries. Compared to the other economic blocs, European tourist visits to the region stand out in the Dominican Republic, Belize and are much lower in the Northern Triangle countries. For the other countries in the region, the inflow of European tourists ranks third, after Latin America and the United States.

Remittances inflows constitute one of the most significant sources of foreign exchange for the region, mainly for the Northern Triangle, Nicaragua, and the Dominican Republic, and given the hight emigration rates to the US,[7] the US is the main source of remittances. In 2021, remittance inflows accounted for 22 percent of GDP for the Northern Triangle, 14.4 percent for Nicaragua and 11.6 percent for the Dominican Republic, according to balance of payments data. For the rest of the CAPADR countries these represent 0.9 percent of GDP. Between 75 percent and 90 percent of remittances received by the Northern Triangle countries come from the US, while this share was lower for Nicaragua (42 percent) (figure 9). The importance of remittances for CAPADR households is significant, enabling many people in a sample of countries to rise above the poverty line and reducing income inequality, as it is the lowest income households that receive the most remittances. For the poorest households, remittances are the main source of income. The impact of remittances on the socio-economic conditions of households is even greater than that of government social programmes, constituting a strong social safety net against a variety of risks.[8]

Figure 8
US tourist arrivals in 2022
(percentage of total)

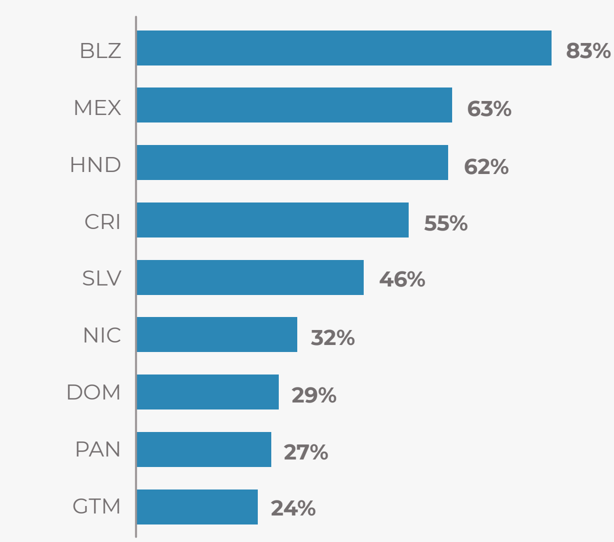
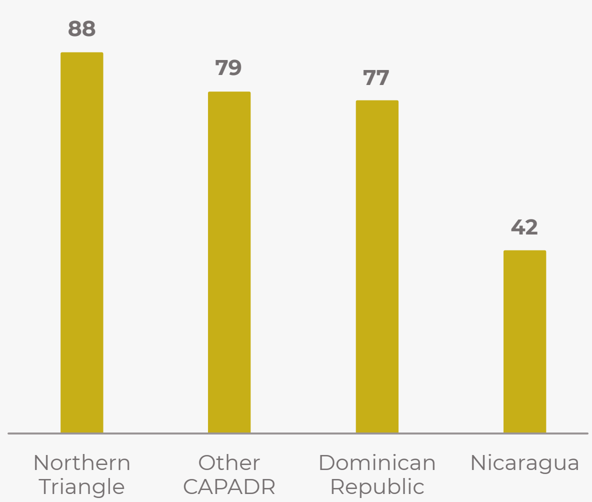


Figure 9
Remittance inflows from the US in 2021
(percentage of total)



Source: Own elaboration with data from SECMA, the Migration Policy Institute and the World Travel and Tourism Council.

7 On average, 3 out of 4 migrants from Central America, the Dominican Republic, Mexico and Haiti live in the United States. "*Migration and Remittances in Central America, Haiti, Mexico, Panama and the Dominican Republic*" (2021).

8 See more information here: https://blogs.iadb.org/migracion/es/el-papel-de-las-remesas-en-centroamerica-mexico-y-republica-dominicana-en-el-alivio-a-la-pobreza/

III.
GLOBAL RELATIONS IN FOREIGN DIRECT INVESTMENT (FDI)

LAC is the second most important source of FDI for CAPADR. Latin American companies account for almost a third of the investment flow to the region in the last decade, in the context of the growth of the so-called "Multilatinas" firms and their integration into global value chains. The US remains the region's most important partner, but there is heterogeneity among countries. European and Asian investment is less significant. Chinese investment has accelerated in the last decade since the entry into force of the Belt and Road Initiative (BRI), which has been joined by four CAPADR countries to this date.

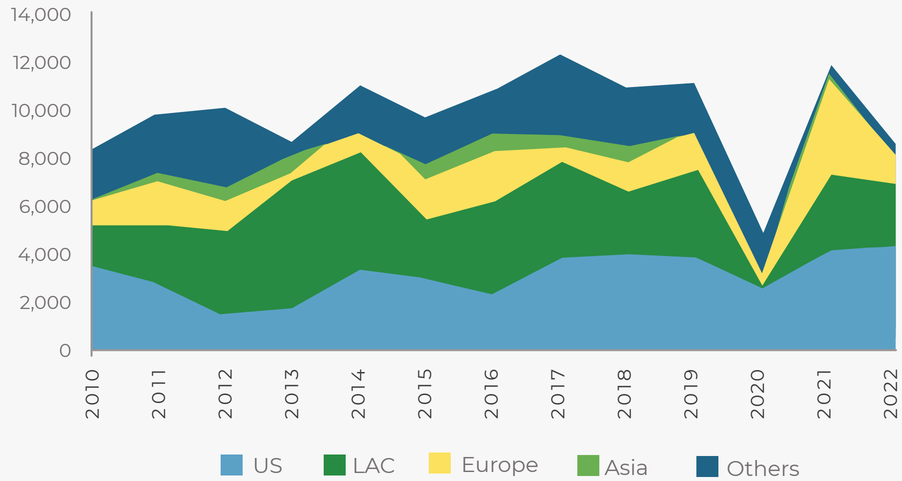
Latin America and the US are CAPADR's main investors. For the period 2010-2019,[9] FDI flows from the US to CAPADR were second only to the Latin American bloc,[10] with an amount equivalent to 32 percent of total FDI recorded (Figure 10). The growth of the "Multilatinas", mostly established in countries such as Brazil, Chile, Colombia, and Argentina, is one possible reason for the considerable inflows of FDI from these countries to the Latin American region. In addition, the integration of the global value chains of multinational companies[11] which are present in different Latin American countries, including CAPADR, also contributes to the growing integration and expansion between these markets. LAC participation dropped significantly during the pandemic, and although it has recovered, it has not yet reached the pre-covid-19 level of participation.

9 The period for which all CAPADR countries have data disaggregated by investment origin (except Belize and Nicaragua).

10 Caribbean countries are included in the "Other" category.

11 "Multilatinas" firms are companies domiciled in Latin American countries, with a clear strategy of internationalisation and expansion beyond their borders. This presence in other countries in the region can be materialized acquisitions, mergers and the creation of value chains that cross borders to other countries in the region.

Figure 10
CAPADR: FDI flows by origin
(millions of USD)



Source: Own elaboration based on official statistics of each country.

However, FDI dependence on Latin American varies by country. Investment from Latin America has been particularly important for the Northern Triangle countries and Panama (Figure 11). In addition, several countries are significantly dependent on FDI from the same CAPADR region. FDI flows from CAPADR accounted for 64 percent of total FDI from Latin America to El Salvador, 57 percent to Honduras, more than 30 percent to Costa Rica and Guatemala, and less than 15 percent to Panama and the Dominican Republic[12] (Figure 12), where regional FDI comes mostly from South American countries. In the case of Panama, FDI flows come mainly from Colombia, while Brazil and Mexico have been the main Latin American investors in the Dominican Republic in the last decade.

Figure 11
CAPADR: FDI flows from Latin America
(millions of USD)

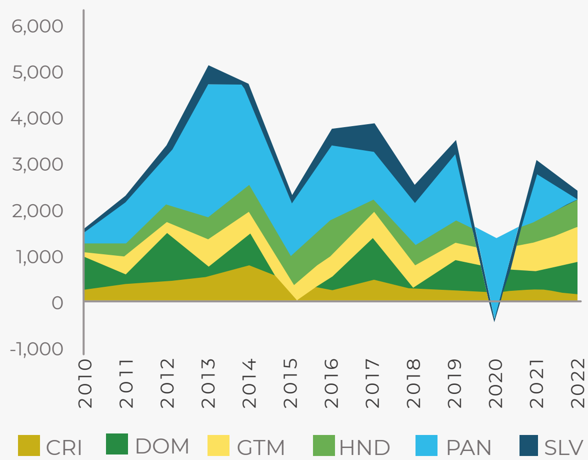
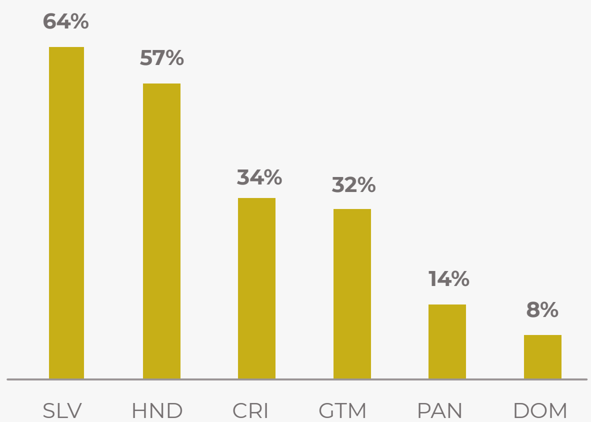


Figure 12
FDI flows from CAPADR, 2010-*circa* 2022
(percent of FDI from Latin American countries)

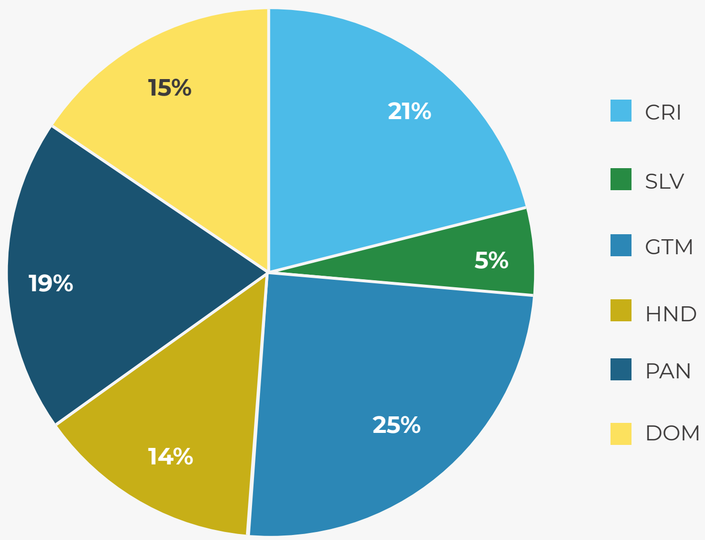


Source: Own elaboration with information from central banks and INEC.

12 However, FDI from Latin America to the Dominican Republic may be underestimated because the published country breakdown is limited to a few Latin American countries.

As in trade, the significance of FDI from Europe to CAPADR is lower compared to the US and Latin America. FDI from Europe to CAPADR is equivalent to almost half of the FDI made by the US and LAC between 2010 and 2021. Investment flows from Europe in the same period went to the Northern Triangle, followed by Costa Rica, Panama, and the Dominican Republic (Figure 13). European FDI in CAPADR has been channelled to the ICT and Internet Infrastructure sector (23 percent of total announcements), followed by the electricity sector (17.6 percent), logistics, distribution, and transport (17 percent), and construction (14.5 percent).

Figure 13
CAPADR: FDI flows from Europe, 2010-2021
(percent of total by reporting country)



Source: Own elaboration with information from central banks and INEC.

FDI from Asia in the CAPADR region is considerably lower than that from other regions but is particularly important in Panama. In the last decade, FDI from Asian countries to CAPADR represented only 3 percent of the total investment received by the region, on average, peaking at 7.3 percent of the total in 2016. The main recipient of Asian investment in CAPADR has been Panama, accounting for 75 percent of the total investment received from Asia between 2010 and 2020. The biggest Asian investors in Panama in this period have been Chinese Taipei,[13] Singapore, and China. According to data compiled by the *Financial Times Intelligence*, which tracks public announcements by companies and foreign investment agencies, Chinese Taipei's investments focus on the renewable energy sector, while Singapore's have been in the transport sector. Similarly, Chinese investments are concentrated in the renewable energy and transport, distribution and logistics sectors.

13 The use of the phrase "Chinese Taipei" does not in any way reflect the position of the IDB Group or any of its member countries regarding issues of national sovereignty or diplomatic recognition.

China has emerged as a major Asian investor in the CAPADR region, although its importance is limited compared to the rest of LAC.[14] According to the *China Global Investment Tracker* published by the *American Enterprise Institute*, 351 Chinese investment projects have been registered in LAC between 2005 and 2023 (table 1), for a total of USD 226.37 billion. Brazil is the main recipient of investment from Chinese companies with 83 projects worth USD 70.27 billion, well above Peru, the second largest recipient, with USD 31.09 billion. Meanwhile, the CAPADR region hosts only 17 investment projects totalling USD 5.13 billion (less than 3 percent of total Chinese investment in LAC).

Table 1
Investments by Chinese companies by country in LAC, 2005-2023 (in millions of dollars)

Region	Country	Amount (usd billion)	Number of projects
CAPADR	Honduras	350	1
	Dom. Rep	490	2
	Nicaragua	530	2
	Guatemala	700	1
	Costa Rica	810	3
	Panama	2,250	8
	Mexico	7,420	28
South America	Uruguay	180	1
	Bolivia	6,440	19
	Colombia	9,390	12
	Ecuador	13,840	28
	Venezuela	18,150	27
	Chile	19,210	22
	Argentina	26,720	37
	Peru	31,090	26
	Brazil	76,680	95
Caribbean	Barbados	610	4
	Cuba	740	3
	Ant. and Barbuda	1,000	2
	Trinidad and Tobago	2,280	9
	Jamaica	3,090	8
	Guyana	4,400	13
	TOTAL	**226,370**	**351**

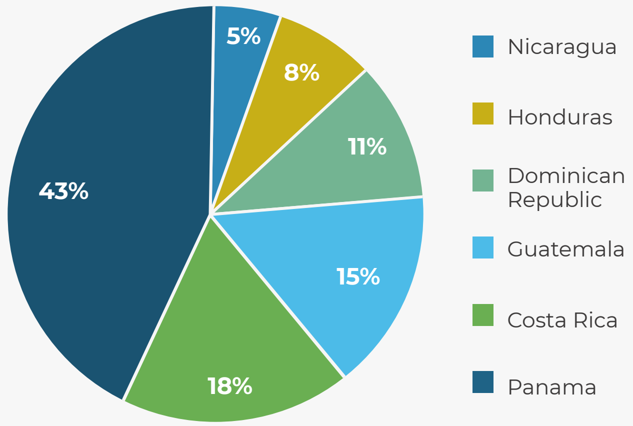
Source: own elaboration with data from China Global Investment Tracker published by the American Enterprise Institute.

14 Having a clear picture of the presence of Chinese investment in the region is no easy task. One of the challenges in accounting for FDI flows from China is that official statistics reflect the immediate origin of the capital and many of the flows come to the region via third countries, so it is not possible to identify them in the national accounts. This is particularly relevant in the case of Chinese investments, which tend to be under-represented in official statistics on inward FDI by origin. For example, historical outward FDI from China to tax havens accounted for almost 78 percent of the value of Chinese outward FDI between 1980 and 2016 —Hong Kong (57.5 percent), the Cayman Islands (7.7 percent), the British Virgin Islands (6.5 percent), and Singapore (2.5 percent) were the top destinations (Deng et al. 2019). Chinese companies can establish their holdings in Hong Kong. These companies can use Hong Kong as a springboard and invest in a third destination. Chinese investors can use Hong Kong as a bridge for "round-trip" investments to the Chinese mainland market given the favourable corporate tax treatment that foreign and Hong Kong investors receive in the Chinese mainland market (Buckley et al. 2015). Chinese companies choose Singapore and Macao because of their geographical proximity and strong ethnic ties. The Cayman Islands and the British Virgin Islands are preferred —particularly after China took control of the UK's administrative power over Hong Kong in 1997— because of their historical connections with Hong Kong (Deng et al. 2019).

Chinese investments in CAPADR are concentrated primarily in Panama and, to a lesser extent, in the Northern Triangle. Although Panama established diplomatic relations with Beijing in 2017, Chinese investment projects have been registered since 2015. Panama accounts for 43 percent of Chinese investment in the CAPADR region (figure 14) with eight projects in real estate development, transport, and energy (table 2). Guatemala and Honduras are the beneficiaries of two Chinese investment projects in the energy and technology sectors.

Table 2 - Figure 14
Investment by Chinese companies, by sector and country in the CAPADR region, 2005-2023
(in billions of USD and percentage)

Industry	Amount (USD billion)
Transport	2,520
Energy	1,160
Technology	240
Real estate development	450
Public services	130
Entertainment	100
GRAND TOTAL	**4,600**



Source: own elaboration with data from China Global Investment Tracker published by the American Enterprise Institute.

China's investment in LAC started to gain momentum in 2014, following the launch of the Belt and Road Initiative (BRI) in 2013. BRI is one of the world's most ambitious infrastructure projects with a vast array of development and investment initiatives. One of its main objectives is to expand China's economic and political influence, which coincides with the need to fill the infrastructure gaps in the countries of the region. The BRI initiative has been a continuation of the efforts initiated in 1999 by the Chinese government with the *Go Out Policy* strategy to promote international investment. In 2018, the initiative was sealed as a new platform for China-LAC cooperation, whereby the Latin American region would be seen as a "natural extension" of the BRI's maritime route.

Four CAPADR countries have joined the BRI initiative as of 2017[15] but no projects are yet registered under this scheme. In the CAPADR region, Panama signed a Memorandum of Understanding to join BRI in 2017, while Costa Rica and El Salvador signed in 2018, and the Dominican Republic in 2019. While the Chinese government reports contracts of Chinese companies in CAPADR over the last 10 years (table 3), none of them have the BRI label. In 2019, Panama announced the first BRI project in the region, a freight and passenger train from Panama City to Chiriquí on the border with Costa Rica, for an estimated value of USD 5.5 billion, but the project was set aside due to its high cost. Although no projects have been registered in El Salvador since the establishment of diplomatic relations with Beijing, in May 2021 the Salvadoran Assembly approved the framework agreement for unconditional economic and technical assistance for USD 500 million in non-reimbursable public investment.

15 In 2017, the BRI was enshrined in the Constitution of the Communist Party of China, profiling the country as a major source of foreign direct investment and development assistance in the world. In the same year, the State Council of the People's Republic of China defined new guiding principles for Chinese FDI, encouraging companies to make foreign investments aimed at modernising domestic research and manufacturing industries, as well as in the energy sector and infrastructure construction in BRI projects.

Table 3
Value of China's foreign contracts in CAPADR, 2011-2020
(in millions of dollars)

Country	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Panama	32	123	144	149	146	352	21	2 676	182	190
Rep. Dom.	15	3	65	1	238	5	32	81	146	21
Costa Rica	98	25	613	66	250	132	41	47	10	15
TOTAL	**145**	**151**	**822**	**216**	**634**	**489**	**94**	**2 804**	**338**	**226**
LAC	**16,672**	**14,657**	**18,322**	**16,468**	**18,163**	**19,124**	**15,859**	**18,227**	**19,872**	**14,838**

Source: Author's work based on data from MOFCOM, 2020.

In some countries, Chinese investment could grow in the coming years, but with a shift in focus, in line with China's new growth strategy. El Salvador could see a number of projects materialise with the approval of the above-mentioned framework agreement. This possibility is also open to Nicaragua, which has signed cooperation agreements with China to develop energy, health and infrastructure projects from 2021. Recently, the BRI initiative, characterised by large-scale infrastructure in transport, energy and other sectors, has lost relevance vis-à-vis emerging industries that represent the Chinese government's new economic development goals, such as ICT, clean and renewable energy, and innovation. The new focus on these new sectors is also part of an effort to address some of the criticisms of the initiative as being at odds with environmental objectives, among others.[16] Although FDI flows from China to LAC have slowed from the average of the last five years, the share of the ICT and renewable energy component in the total number of projects from China to LAC has increased from 25 percent on average between 2013-17 to 40 percent between 2018 and 2023.[17] However, investment in these new industries is not yet significant in CAPADR.

Other regions, such as the European Union and the US also seek to support the closure of the infrastructure gap through other initiatives. On the one hand, the US seeks to support the region in closing infrastructure gaps by implementing projects that meet strict environmental and labor standards and transparent financing conditions. In 2021, the US and the G7 economies, discussed a coordinated initiative under the name *Build Back Better for the World*, which plans to fund climate, health, digital transformation, gender and equality projects. Some CAPADR countries, such as El Salvador, have been considered as beneficiaries.

16 Although it has potential benefits in terms of attracting infrastructure to close gaps, the BRI scheme has been questioned on several grounds. While the BRI initiative would help attract infrastructure investment in times of shrinking international financing and weak public finances, the literature has raised some potential risks of BRI investments, such as debt sustainability in BRI countries that already have high levels of debt (Ruta et al, 2019; Huley et al., 2018); the low possibility of benefiting from knowledge transfer given the employment model generally used by Chinese investments where labor is imported; and environmental risks, such as the affectation of biodiversity areas and emissions originating from infrastructure projects under BRI.

17Myers, M., Melguizo, A., and Y. Wang. "New Infrastructure" Emerging Trends in Chinese Foreign Direct Investment in Latin America and the Caribbean. The Dialogue, China-LAC Report. January 2024

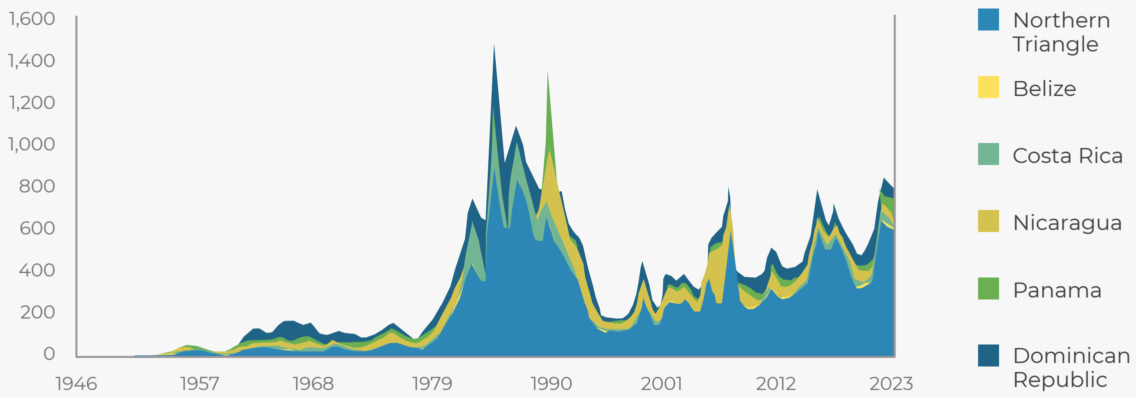
IV. RELATIONS IN FOREIGN AID

In terms of foreign aid, US assistance to CAPADR is long-standing and was further strengthened during the pandemic with the donation of vaccines. Cooperation with CAPADR from other Latin American countries has primarily focused on migration and health issues, with Mexico playing a prominent role. The European Union plays an important role in terms of sustainable development and the environment. For its part, Asia has focused its cooperation efforts in CAPADR on infrastructure and logistics, energy, mining, among other sectors.

US foreign aid to LAC is mainly focused on the Northern Triangle and its contribution during the pandemic allowed the CAPADR countries to accelerate their vaccination processes and begin the process of economic recovery. Within the CAPADR region, the Northern Triangle is the beneficiary of the largest proportion of aid commitments, representing 70 percent of the total between 2010-2023 (Figure 15), exceeding the nominal amounts of the aid committed to Mexico, which increased considerably from 2008-2009 with the Merida initiative.[18] Most of the disbursed funds have gone to programmes supporting economic development, democracy, human rights and governance, health, and peace and safety. The pandemic opened a new area for cooperation between the US and the region, with the donation of vaccines. One third of the vaccines committed by the US to LAC went to CAPADR, where an acceleration of the vaccination led to the reopening of economies.

18 The Merida Initiative is the US-Mexico cooperation agreement —signed in 2007 and in force since 2008— designed to fight drug trafficking and organised crime. Although the agreement, entered into by Presidents George Bush and Felipe Calderón in the city of Merida, Mexico, was supposed to last three years, both countries agreed to extend it and it is still in force. Negotiations began in March 2007, when Calderón requested more cooperation from the United States to combat criminal organisations and trafficking along the border. Between 2011 and 2017, during Barack Obama's and Enrique Peña Nieto's administrations in the United States and in Mexico (from 2012), respectively, the scope of the agreement was broadened to incorporate four pillars: (i) fighting transnational criminal organisations; (ii) institutionalising the rule of law and protection of human rights; (iii) creating a '21st century' border between the two countries; and (iv) building strong and resilient communities. During Donald Trump's administration in the United States, there was a shift in the Merida Initiative's priorities, to focus on border and port control and the fight against synthetic drug production. However, the COVID-19 pandemic that broke out in 2020 hampered bilateral cooperation. After Joe Biden's arrival in the White House, the focus shifted yet again, this time to immigration issues and back to the four pillars promoted during Obama's administration.

Figure 15
CAPADR: Foreign aid committed by the US
(millions of USD)



Source: Author's work based on data from ForeignAssistance.gov

Latin American foreign aid to CAPADR focuses on social and safety-related issues. The most outstanding social issues are migration and health. Waves of migration are putting pressure on transit and receiving countries in Latin America to take in growing numbers of migrants and refugees. This has led to significant levels of cooperation on this issue in both South and Central America over the past thirty years, including the Cartagena Declaration on Refugees (1984), the San José Declaration on Refugees and Displaced Persons (1994), and the South American Conference on Migration (2000). In addition, Mexico and the United States jointly announced the implementation of the *Sembrando Oportunidades* programme, a new development cooperation framework to address the root causes of irregular migration from the northern portion of Central America. In the area of health, cooperation has taken place through the Pan American Health Organisation (PAHO), which functions as a health extension of the OAS and as a regional office of the WHO. Regarding safety, the vast majority of cooperation schemes are anchored within defence ministries, including information sharing, training and border surveillance, often involving informal and discreet coordination mechanisms. Colombia's experience in fighting drug trafficking, paramilitary and guerrilla organisations has been valuable in assisting its CAPADR counterparts, offering training and sharing best practices and expertise on issues including surveillance, money laundering and infiltration of drug traffickers.

Mexico's cooperation in the area of regional integration and development programmes has made it a key player in CAPADR. The Mexican Agency for International Development Cooperation (AMEXCID) is one of the main donors in the CAPADR region, offering bilateral technical and financial cooperation programmes, regional facilities, and triangular cooperation initiatives in partnership with other donors, the private sector, and the civil society. One of the main programmes is the Infrastructure Fund for Mesoamerica and Caribbean (Yucatan Fund), in through which USD 129.7 million have been approved since 2012 for 16 projects in 11 LAC countries.[19] Accordingly, 78 percent of the funding for Central America has been allocated to the rehabilitation and modernization of sections of the International Network of Mesoamerican Roads (RICAM, for its Spanish acronym), which is part of the Mesoamerica Integration and Development Project, which aims for a more

19 Mexico has approved USD 53.76 million for three projects in the Northern Triangle countries, one in Honduras and two in El Salvador.

interconnected region. Mexico has also sought closer ties with the Northern Triangle countries and Belize, promoting its *Sembrando Vidas and Jóvenes Construyendo el Futuro* programmes, which focus on reducing migration flows by creating opportunities.

The European Union has positioned itself as one of the region's main cooperation and foreign aid partners, especially in the areas of environment and sustainable development. Between 2007 and 2021, the main donors to CAPADR were the European Commission (providing 28 percent of the funds disbursed), Spain (27 percent), Germany (12 percent), and France (9 percent). EU funding has been directed at the Northern Triangle and Nicaragua, the latter receiving the largest contributions (Figure 16), while countries such as Costa Rica and Panama, considered upper middle-income and high-income, have received fewer resources. Cooperation provided by the European Union increased significantly during the pandemic and until 2021 (Figure 17). For the CAPADR region, the main sectors receiving co-operation funds between 2007-2022 were Governance and Civil Society, Education, and Water and Sanitation (Figure 18).

Figure 16
CAPADR: Foreign aid from Europe, 2007-2021

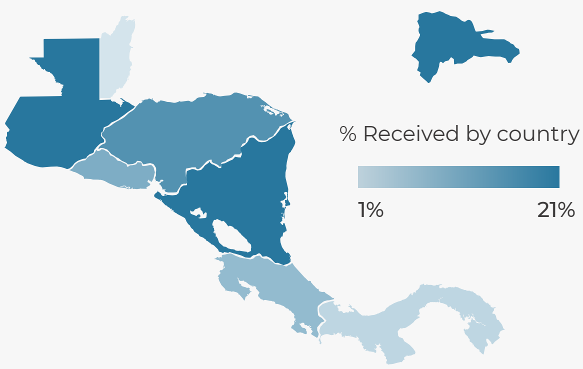
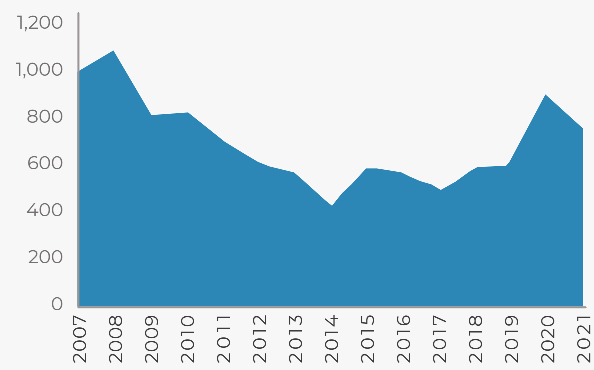
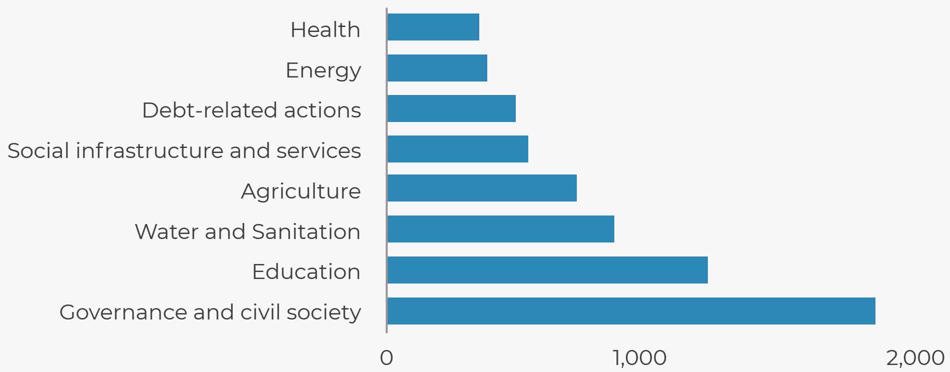


Figure 17
Foreign aid received by CAPADR from Europe 2007-2021 (millions of euros)



Source: European Commission.

Figure 18
CAPADR: Foreign aid from Europe by main sectors
(millions of euros)



Source: European Commission.

In Asia, Japan and China are the countries with the largest share of CAPADR's economic and social development funding. In the case of Japan, funding is provided through the Japan International Cooperation Agency (JICA), whose areas of cooperation in Latin America include infrastructure development, disaster risk reduction, climate change measures and inequality reduction. JICA's work is also focused on developing human resources that promote knowledge of Japan and strengthen ties with Nikkei communities.

JICA has contributed to regional connectivity, transport, and logistics. Examples of JICA's work include technical assistance to improve regional connectivity and the transfer of technologies for demand forecasting and transport and logistics planning. In the area of migration, JICA has provided technical assistance to implement the Japanese model of a community policing system. Through joint co-financing with the IDB and CABEI, it has promoted renewable energy and energy efficiency in Central America. In addition, JICA collaborates with the Central American Integration System (SICA) to solve regional environmental, logistics, gender and disaster management challenges. The cost of JICA's programmes in CAPADR amounts to USD 27.7 million, of which El Salvador (USD 4.8 million), Honduras (USD 3.5 million) and Dominican Republic (USD3.4 million) are the main beneficiaries. As a point of comparison, JICA's portfolio in South America amounts to USD 200 million, with Brazil and Paraguay as the main beneficiaries.

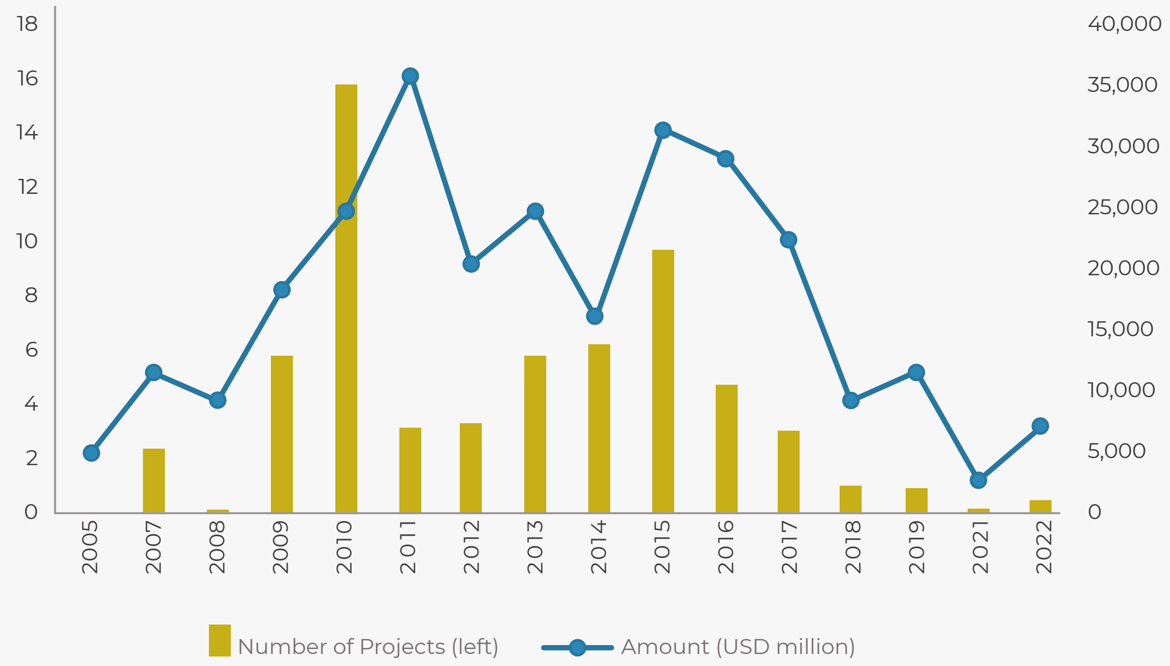
China, in turn, has provided resources for development projects through loans under bilateral cooperation agreements. According to the *First White Paper on Chinese Cooperation* (Information Office of the State Council of the People's Republic of China, 2011), the financial resources provided for foreign aid are mainly divided into three types: grants (non-reimbursable cooperation), interest-free loans[20] and concessional loans[21] (soft loans). The first two come from state finances, while concessional loans are provided by policy banks, namely the Export-Import Bank of China (Eximbank) and the China Development Bank (CDB). Between 2005 and 2022, the amounts of concessional lending to LAC have been variable, and they have been following a decreasing pattern since 2015. Following data from the *China-Latin America Finance Database* (Gallagher and Myers, 2021) in LAC, between 2005 and 2022, Chinese policy banks have lent about USD 137 billion for infrastructure, energy, mining, and other discretionary lending projects[22] under the concessional lending scheme, with a declining trend since 2015 in both amounts and number of loans. Between 2021 and 2022, less than five new loans were registered under this modality (Figure 19).

20 Interest-free loans are mainly used to help beneficiary countries build public facilities and projects that will improve people's quality of life. The term of such loans is usually 20 years, including five years of use, five years of grace and ten years for repayment. Currently, interest-free loans are mainly awarded to developing countries with relatively good economic conditions.

21 Concessional loans are mainly used to help beneficiary countries undertake productive projects that generate economic and social benefits and large and medium-sized infrastructure projects, or to provide complete facilities, mechanical and electrical products, technical services and other materials. The Export-Import Bank of China obtains concessional loans on the financial market and, since the interest on the loan is lower than the reference interest rate of the People's Bank of China, the government makes up for the difference in the form of financial subsidies.

22 It includes loans for projects of social interest such as housing, education, health, safety, air transport, environment and credit facilities for trade, among others.

Figure 19
China: Concessional lending to LAC by policy banks, 2005-2022



Source: author's own calculations based on data from China-Latin America Finance Database (Gallagher and Myers, 2021).

In the CAPADR region, only a few countries have concessional loans. In the last 10 years, CAPADR has received only two concessional loans, one to Costa Rica and the other one to the Dominican Republic, for the expansion of National Route 32[23] and the improvement of the power transmission system,[24] respectively (Table 4). It is worth noting that in the case of Panama and El Salvador, no loans from Chinese banks have been reported since the establishment of diplomatic relations in 2017 and 2018, respectively.

23 The contract for the expansion of National Route 32 is a public-private partnership. The company in charge of the works is the China Harbour Engineering Company (CHEC). The project was initially estimated at USD 465 million, of which USD 295 million is financed through the Eximbank loan and a USD 100 million contribution from the Chinese government, the remainder being covered by the Costa Rican government. Due to the delays in the works, an extension of the contract with CHEC and a loan extension with Eximbank for USD 100 million are currently being processed.

24 The *Corporación Dominicana de Empresas Eléctricas Estatales* (CDEEE) received a USD 600 million soft loan through Eximbank to improve the electric power distribution system.

Table 4
Lending commitments by country and sector, 2005-2022
(in millions of dollars)

Country	Number of projects	Total commitments (USD billions)	Infrastructure	Energy	Mining	Others
CAPADR and Mexico						
Costa Rica	2	435	395	0	0	40
Dominican Republic	1	600	0	600	0	0
Mexico	1	1,000	0	1,000	0	0
South America						
Ecuador	24	18,185	252	5,335	0	12,599
Venezuela	16	59,971	0	19,516	1,700	38,755
Brazil	14	30,991	1,300	26,781	0	2,910
Argentina	13	16,969	13,649	3,031	0	290
Bolivia	9	3,168	1,4690	1,000	0	699
Peru	1	50	0	0	0	50
Caribbean						
Jamaica	11	2,074	1,750	0	0	324
Guyana	7	519	370	39	0	110
Suriname	6	773	393	0	0	380
Trinidad and Tobago	5	695	0	0	0	695
Bahamas	2	99	58	0	0	41
Barbados	2	291	121	0	0	170
TOTAL	**114**	**135,820**	**19,756**	**57,301**	**1,700**	**57,063**
		Sector distribution	**14.5%**	**42.2%**	**1.3%**	**42.0%**

Source: author's own calculations based on data from China-Latin America Finance Database (Gallagher and Myers, 2021).

The trend towards regional trade and integration is beneficial and a key pillar for sustainable and inclusive growth in LAC and CAPADR. Deepening regional integration in trade, services, investment, and foreign aid supported the CAPADR countries' recovery from the effects of the pandemic and has the potential to sustain robust growth in the medium term in the context of new global developments. There are potential areas where LAC and Central America can be global leaders, such as clean energy and food production. Costa Rica has developed one of the best climate action strategies in the world,[25] and Central America has a clean energy matrix that could potentially attract investments with environmental sustainability objectives that benefit them and their supply chains. For its part, Central America is a net exporter of food, and can help mitigate the increase in global food insecurity that began during the pandemic and has been exacerbated by rising international food prices.

25 According to the *Climate Action Tracker*

IDB

Improving lives