What could a new era mean for Latin America?

Current global challenges could usher in a new era. What might this mean for Latin American economies?

by Andres Cadena, Olivia White, and Camillo Lamanna
Current global challenges may feel unprecedented, but there have been similar periods of acute disruption in recent history, each of which gave birth to a new era with its own distinctive landscape. The most recent era bore witness to the expansion of global value chains and the meteoric rise of digital technologies. Billions of people benefited from rapid growth and development, supported by macroeconomic stability.

Latin America did not advance as much as it could have in the most recent era. It remained relatively peripheral to global economic integration, lagged behind in technological adoption, and did not establish itself at the frontier of innovation. And it experienced more muted growth, with some economies affected by the specters of debt and inflation.

What could a new era look like for the world? The old unipolar world is giving way to a multipolar one. New technologies offer both promise and concern. The new era has more elderly people, and perhaps more pangs of inequality. Countries are battling to reduce emissions and to access the resources needed to do so even while facing unprecedented debt and slowing growth.

If a new era is dawning, how will Latin America fare? Can Latin America enhance its global participation in a multipolar world? Can it catch up with the curve of technological innovation and use technology to enhance equity? Can it benefit from its young population, address its entrenched inequalities, and define a new social contract to support long-term growth? Can it harness its natural resources to be an engine of the net-zero transition? Can it finally raise the bar on regional economic growth, investment, and productivity growth?

Many unresolved questions remain, and pivotal choices are yet to be made as the region’s decision makers not only prepare for but seek to shape a new era.
In the past three and a half years, extraordinary events have disrupted societies and businesses, and imposed significant challenges on the world economy. A recent McKinsey Global Institute (MGI) paper asked whether this cluster of significant events could presage a new era for the world and what that new era might look like. MGI drew on history and suggested a global framework based on a historical perspective to analyze the significance of current disruptions and gauge what may come next.¹

This article considers what a global new era might mean for Latin America. Many of these world events have deeply affected the region. The pandemic hit Latin America hard, inflation has raised pressure on the region’s low-income groups, and polarizing political tensions have been escalating. On top of this, there is the pressing question of if, and how, the region might engage with a more multipolar world, and if it can strengthen its position through building regional unity. In Latin America, as in the rest of the world, these are volatile and uncertain times.

In its global research, MGI has identified clusters of disruptions in the relatively recent past. Three stand out: the immediate aftermath of World War II (1944–46), the period around the oil crisis (1971–73), and the breakup of the Soviet Union (1989–92). Each changed the global landscape and ushered in a new era: the Postwar Boom (1944–71), the Era of Contention (1971–89), and the Era of Markets (1989–2019). These prolonged periods bore witness to deep transformation in economies and societies—the world with which we had grown familiar in 2019 had been transformed in the 20 years since the previous bout of disruption, but the underlying terrain was relatively settled.

During the Era of Markets, there was a remarkable increase in global economic interconnectedness and rapid adoption of digital technologies. On both, Latin America fell behind. The region’s trade with the rest of the world increased, but at a slower pace than in countries at similar stages of their development. Latin America largely remained an exporter of primary goods. Many of its constituent economies had weak participation in global value chains. In the 2010s, many developing economies, most notably in East Asia, approached or even surpassed OECD average levels of digital adoption (as measured by mobile phone and fixed broadband subscription rates). In contrast, the gap between Latin America and OECD economies widened.

If the world is entering another era, how could Latin America fare? We look at the new era and its implications for the region through the lens of five domains: (1) world order: the institutions, frameworks, and rules that shape international affairs; (2) technology platforms: platforms and applied sciences enabling development and innovation; (3) demographic forces: demographic trends and socioeconomic contours across populations; (4) resource and energy systems: the systems for transporting and converting energy and materials for use; and (5) capitalization: drivers of global supply and demand, and trajectories of finance and wealth.

This research uses Latin America as its lens, but, of course, Latin America is made up of a diverse mix of economies, peoples, and histories. Indeed, the ties between its constituent parts may not be as strong as the label might imply. Further, the very notion of Latin America may resonate more outside the region than within it. Nevertheless, this paper attempts to pull together questions and potential implications that may apply broadly across the region. We suggest that some common threads do exist, and that a region-wide set of open questions and choices remain to be made (Exhibit 1). The die is not yet cast.

Directions of travel are emerging, but questions abound for Latin America.

Potential direction of travel and unresolved questions

<table>
<thead>
<tr>
<th>World order</th>
<th>Unipolar</th>
<th>Global</th>
<th>Multipolar</th>
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- What role can Latin America play in a multipolar world?
- Will Latin American countries strengthen their interconnections to further their common economic goals?

<table>
<thead>
<tr>
<th>Technology platforms</th>
<th>Digital world</th>
<th>Transversal technologies</th>
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<tr>
<td></td>
<td>Unconstrained growth</td>
<td>Race for AI primacy</td>
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- Will Latin America accelerate equitable access to technology and building the tech skills it needs for today’s digital world?
- Can Latin America catch up with the global technology curve?

<table>
<thead>
<tr>
<th>Demographic forces</th>
<th>Young world</th>
<th>Aging world</th>
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<tr>
<td></td>
<td>Growing within-country inequality</td>
<td>New social contracts</td>
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- Can Latin America find a new growth model before its demographics catch up?
- Will Latin America tackle the region’s entrenched inequalities and define a new social contract for growth?

<table>
<thead>
<tr>
<th>Resource and energy systems</th>
<th>High spend on fossil fuels</th>
<th>High spend on replacement</th>
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<tr>
<td></td>
<td>Climate neglect</td>
<td>Climate priority</td>
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- How will Latin America power itself and reduce greenhouse-gas emissions?
- Can Latin America be an engine of the global net-zero transition?

<table>
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<tr>
<th>Capitalization</th>
<th>1 billion people at hypergrowth</th>
<th>Normalization of growth</th>
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<tr>
<td></td>
<td>Growing leverage and credit</td>
<td>Balance sheet stress</td>
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- How will the region navigate global economic headwinds?
- Will Latin America be able to drive productivity growth?

Source: McKinsey Global Institute analysis

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World order

The Era of Markets witnessed the growth of a more globally integrated economy. The breakup of the Soviet Union left the United States as the unchallenged global political power. Global value chains spread rapidly when more economies opened up to the world’s trading system. China emerged as a global trading hub, becoming the world’s largest importer of primary goods—particularly energy and minerals—and the largest exporter of manufactured goods. How could the world order evolve? Globally, two directions of travel appear evident. First, a unipolar world centered on the United States could yield to multipolarity with the rise of China and emerging economies. Second, this multipolarity could lead to a realignment into more distinct regional blocs.

What role can Latin America play in a multipolar world? The region itself is embracing multipolarity. In 2000, the United States was the largest goods trading partner for almost all countries in Latin America. Between 2000 and 2021, Latin America’s trade with China grew 28-fold—almost twice the rate of growth of trade with emerging-market and middle-income peers—while the region maintained growing trade ties with the United States. In South America, China became the largest extraregional trade partner for almost all of the largest economies. In Central America, the United States remained the largest trade partner, but China rose to become the second largest. And between 2000 and 2021, Mexico witnessed both a 40-fold increase in trade with China and the largest increase in goods trade by value with the United States of any world economy except China. Indeed, in 2019, Mexico overtook China as the largest US trading partner based on economic relationships bolstered by the US–Canada–Mexico Trade Agreement (Exhibit 2). And the region’s multipolarity extends beyond trade. For example, in public opinion, surveys suggest that people view the United States and China equally favorably. In global policy matters, as measured by voting practices at the UN General Assembly, Latin America is the region that is least firmly aligned to either the United States or China.

However, Latin America has generally not leveraged its growing global interconnections to better integrate itself into the global economy. Excluding Mexico, primary goods represent about 56 percent of Latin America’s goods exports, and primary goods account for about 80 percent of the region’s goods exports to China. In emerging-market and middle-income peers, both figures are closer to 30 percent. With the war in Ukraine raising the prominence of geopolitics in trading partnerships, Latin America’s economies could benefit from the shifting political landscape as economies seek to diversify. Focusing more narrowly on trade with North America, “nearshoring” to Latin America could deliver significant economic opportunities.

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5 UN Comtrade, 2022; McKinsey Global Institute analysis.
3 Juan Carlos Gachúz Maya, “Mexico’s trade relationship with China in the context of the United States–China trade war,” *Journal of Current Chinese Affairs*, volume 51, issue 1, October 2021.
5 McKinsey Global Institute analysis of UN General Assembly votes between 2000 and 2021. Resolutions with a vote that were designated as “Important Actions” by the US Department of State were included in the analysis.
6 Based on UN Comtrade data. Intermediate and final goods are classified as “primary” in line with the Basic Economic Classification (Revision 5). Emerging-market and middle-income group countries are defined by the International Monetary Fund’s Fiscal Monitor; those in Europe and Asia–Pacific have been included in the peer analysis.
7 “Nearshoring can add annual $78 bln in exports from Latin America and Caribbean,” Inter-American Development Bank, June 7, 2022.
Increasing trade with China and the rest of the world has shifted the balance away from the United States.

Largest extraregional trading partners, by total value of goods trade

Real increase in total goods trade value between 2000 and 2021, % of 2021 GDP

Mexico 18 2 9 17 44
Chile 7 21 17 45
Peru 5 10 21 43
Brazil 2 7 12 24
Colombia 4 4 12 22
Argentina 0 2 9 13

LAC¹ 7 10 14 31
Other EMs² 2 9 29 40

¹GDP-weighted average for 23 Latin American and Caribbean economies. Country-level chart represents only the 6 largest economies.
²GDP-weighted average for all emerging-market and middle-income economies in Europe and Asia (IMF definition).
Note: The boundaries and names shown on maps do not imply official endorsement or acceptance by McKinsey & Company. Totals may not sum due to rounding.
Source: UN Comtrade (2022); World Bank (2022); McKinsey Global Institute analysis

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Will Latin America’s countries strengthen their interconnections to further their common economic goals? Latin America is home to more than 600 million people, and it is unusual in that the vast majority of them (about 95 percent) have at least one of two official languages: Spanish or Portuguese. In comparison, other regions have many languages that can create barriers to interconnectedness. Yet by some measures, Latin America’s constituent countries enjoy weaker cohesion than those in other regions. The quality of intraregional road transportation links is the lowest of any region other than sub-Saharan Africa. Intraregional exports in Latin America account for around 14 percent of total exports, a significantly lower proportion than most other regions, and commitments to building regional trade integration have not always delivered in their implementation. In Europe, the majority of students who study abroad do so in another European country despite the barriers imposed by the continent’s many languages. In Latin America, most study-abroad students travel outside the region. In a more multipolar world, Latin America may have greater opportunities if it can build connections despite the specific challenges of its topology.

Technology platforms

During the Era of Markets, the World Wide Web and a plunge in the cost of processing drove a digital revolution. From nearly zero at the start of the era, by 2019 the proportion of the world’s population that had a mobile phone was 67 percent, and 54 percent used the internet. Almost 99 percent of data had been stored on analog media; almost all data are now stored digitally. Renewed momentum may come from new and emerging technologies, such as applied AI. Geopolitics may influence the technological sphere as more fractured geopolitics make strategic autonomy a greater priority.

Will Latin America accelerate equitable access to technology and building the tech skills it needs for today’s digital world? In the 2010s, the number of internet users in Latin America doubled to about two-thirds of the population. But by some measures, the region fell behind. In the 2010s, developing economies in East Asia, for example, closed the gap with OECD peers in fixed broadband subscription rates and overtook the OECD average for mobile subscription rates. However, in Latin America, the gap with the OECD average widened on both measures. Moreover, there are substantial differences in access and use across countries, income quintiles, and the rural-urban divide. For example, while internet use in Uruguay is close to the OECD average, in El Salvador it is almost 40 percentage points lower. Another striking example is Peru, where about 75 percent of top-quintile earners are regular internet users, versus 15 percent in the bottom quintile; this 60-percentage-point gap is four times the average in OECD economies. The increasingly digital world risks entrenching...
inequalities, particularly given skills shortages. Less than half of Latin Americans have sufficient skills to use computers for basic professional tasks, which likely undermines the productivity of firms, particularly small ones.\textsuperscript{15} The region has a clear imperative to address education and skills development.\textsuperscript{16}

— **Can Latin America catch up with the global technology curve?** Latin America has often been a latecomer to technologies. Mechanized farming is one prosaic example. Adoption of tractors in the region is about one-fifth of that in East Asia and Southeast Asia, although the technology has existed for more than two centuries.\textsuperscript{17} In the case of digital technology, while mobile money adoption soared in Africa in the 2010s, Latin America’s adoption reached only 2 percent by 2019, about eight times lower than the rate in Africa.\textsuperscript{18} However, the pandemic triggered a boom in the adoption of technology, including digital payments and e-commerce. In Brazil, for instance, over half the population joined the Pix digital payment system in less than a year.\textsuperscript{19} Technology adoption has been supported by the rise of new, innovative firms: four-fifths of Latin America’s start-up “unicorns” focus on fintech and e-commerce.\textsuperscript{20} This rapid rise in technology adoption is remarkable, and it demonstrates the potential to scale existing technologies more rapidly than in regions with more established value chains. However, whether Latin America can establish itself as a leader in cutting-edge technologies is less clear. At about 0.6 percent of GDP, regional investment in research and development is less than one-quarter of the average in the OECD and China. The region accounts for less than 2 percent of the world’s patent applications; of these, less than one-fifth are filed by Latin Americans.\textsuperscript{21} Latin America imports about eight times more intellectual property than it exports, the highest ratio of any region outside Africa.\textsuperscript{22} As frontier technologies such as AI take off, the region risks lagging behind once again. For example, estimates suggest that AI’s impact on Latin America’s economy will be three to five times lower than in North America and China.\textsuperscript{23} Latin America’s future will depend on its ability both to continue to integrate existing technologies and to find pockets of opportunity to drive the frontier.

Estimates suggest that AI’s impact on Latin America’s economy will be three to five times lower than in North America and China.


\textsuperscript{16} During the pandemic, Latin American students lost about a year and a half of education. See Two years after: Saving a generation, International Bank for Reconstruction and Development and World Bank, 2022.

\textsuperscript{17} Note that the reported data for tractor use is historical and may not capture recent trends. See State of food and agriculture 2022, Food and Agriculture Organization of the United Nations, 2022.

\textsuperscript{18} GSMA Mobile Money Dataset, 2022.

\textsuperscript{19} David Feliba, “Pix breaks ground in Brazil, shakes up payments market,” S&P Global Market Intelligence, December 29, 2021.

\textsuperscript{20} A digital path for sustainable development in Latin America and the Caribbean, Economic Commission for Latin America and the Caribbean, 2022.


\textsuperscript{22} OECD Balanced Trade Statistics in Services, 2022. Overseas territories have been excluded from the analysis.

\textsuperscript{23} Seizing the opportunity: The future of AI in Latin America, Economist Impact, 2022.
Latin America imports about eight times as much intellectual property by value as it exports.

Cross-regional intangibles flows, US $ billion
IP charges,¹ % of total cross-regional exports/imports, 2019, total exports = US $218 billion

Only flows with value of >$100 million shown on chart. Overseas territories have been excluded from the analysis.

Source: OECD Balanced Trade in Services (2022); McKinsey Global Institute analysis
Demographic forces

Sweeping urbanization, decreasing fertility rates, aging, rising educational access, and falling poverty marked the Era of Markets. But imbalances remained. Wealth and income inequality within countries rose across the world. In the next era, many economies are likely to experience stagnant or even shrinking pools of working-age people and a rapid rise in the share of older people in overall populations. Within-country inequality has risen to its highest level since its peak at the beginning of the 20th century, and in the new era, social cohesion may be under ever-increasing pressure.

— Can Latin America find a new growth model before its demographics catch up? An estimated 75 percent of Latin America’s GDP growth in 2000–19 was due to people entering the workforce, and only 25 percent attributable to productivity gains. For comparison, in China, more than 95 percent of growth during the same period was due to productivity gains. This labor-led growth model is complemented by Latin America’s young working-age population—about one-quarter of its population is aged between 15 and 30, the second highest share of young adults, behind Africa. The region’s relative youth is particularly marked in many Central American countries. It may deliver a suite of benefits, particularly because young Latin Americans are among the most entrepreneurial globally.

But Latin America’s ability to rely on workforce expansion to drive growth will not last much longer. The region is aging fast as birth rates fall and life expectancy rises (Exhibit 4). In the next 30 years, the absolute number of people aged over 60 in Latin America will more than double to near 200 million or over 25 percent of the population, placing increasing pressure on pension, healthcare, and social-support systems. The working-age share of the population in large Latin American economies such as Brazil, Chile, and Colombia has already peaked and is now falling, while Mexico and most of Central America could reach this tipping point within a decade. Without a shift to a new growth paradigm, such as one spurred by investment and innovation, Latin America’s changing demographics could herald a regional slowdown.

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26 Citi Foundation, Accelerating pathways: Global youth survey 2015, 2015. Latin America had the highest proportion (89 percent) of respondents who “want to work for themselves, or to start or grow a business” globally.
27 “IDB and IDB Lab launch challenge on silver economy in Latin America and the Caribbean,” Inter-American Development Bank, June 16, 2021.
29 Calculations based on World population prospects 2022, UN Population Division, 2022.
Will Latin America tackle entrenched inequalities and define a new social contract for growth?

Inequality is a deeply rooted challenge in the region. Sixteen of the 30 most unequal countries in the world (measured by income distribution) are in Latin America. But inequality extends beyond income. For example, women’s labor-force participation is about 25 percentage points lower than men’s. Almost one-quarter of rural inhabitants do not have access to piped water, compared with less than 5 percent without access in urban areas. And intergenerational mobility is low, propagating inequalities through generations. In Brazil and Colombia, it could take about ten generations for a low-income family to achieve an average income, compared with between four and five generations, on average, in OECD economies. In addition, about 50 percent of the region’s labor is informal, and about 25 percent of urban dwellers live in informal settlements. Persistent inequality and a perceived lack of opportunity have likely contributed to growing unrest. Indeed, the prospect of tightening economic conditions and relatively weak governance in the region suggest that some economies may be vulnerable to falling into state fragility.

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\*Ratio of people aged 65 or over to people of working age (i.e., 15–64), UN Department of Economic and Social Affairs definition. Source: UN World Population Prospects (2022), medium projection; McKinsey Global Institute analysis

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31 Gini Index, World Bank, 2022.
32 Employment situation in Latin America and the Caribbean: Real wages during the pandemic: Trends and challenges, ECLAC/ ILO, June 2022.
34 A broken social elevator? How to promote social mobility, OECD, June 2018.
36 Olusegun Ayodele Akanbi et al., Avoid a fall or fly again: Turning points of state fragility, IMF, May 2021.
2010 and 2021, Latin America witnessed the largest relative decline of any world region in indexes of government effectiveness, rule of law, and control of corruption.37 Fragility can often be exacerbated by natural resource wealth.38 Several of the largest economies in the region are grappling with social reforms relating to health, social security, and labor. Whether a new social contract can emerge, delivering high-quality employment and opportunity to the region’s citizens, is unclear.

Resource and energy systems

During the Era of Markets, global consumption of increasingly abundant fossil fuels continued to rise, but this broader access to energy resources came with rising awareness of the damage being done to the climate. Many countries have committed to striving to achieve net-zero carbon emissions, and attention has shifted from investment in fossil fuels to investment in replacing them. However, in the new era, countries may well need to grapple with a paradox: the current pace of investment in renewable energy is too slow to meet ambitions for carbon abatement, but investment in fossil fuels may be too low to make up the shortfall in energy supply. By 2019, 72 percent of net new annual electricity-generating capacity globally came from renewables.39 However, 84 percent of the global gigajoules consumed still came from fossil energy sources—a figure that has been broadly stable for 30 years.40 Global investment in energy supply had stagnated; in 2022, global spending on energy supply infrastructure was well below the 2014 peak. Achieving net zero will require a significant ramp-up in global energy investment, but the war in Ukraine and tightening global financial conditions could challenge the velocity of the transition.

— How will Latin America power itself and reduce its greenhouse-gas emissions?

Latin America faces three idiosyncrasies that may shape its path to decarbonization.

- First, many economies in the region rely on fossil fuels for income and foreign exchange.41 At the same time, the region enjoys some of the best conditions globally for renewable power generation, including hydro, wind, and solar power; the Andes have the highest photovoltaic power potential of any region in the world.42 In the near term, higher energy commodity prices may encourage fossil fuel exports and add momentum for the domestic shift to renewables. Between 2018 and 2022, Latin America’s solar power capacity grew by around 35 percent every year. This was well over double the global average growth rate, and the fastest of any world region.43

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37 Analysis based on Worldwide Governance Indicators. Note that the reported findings hold if Venezuela is excluded from the analysis. See Daniel Kaufmann, Aart Kraay, and Massimo Mastruzzi, The Worldwide Governance Indicators: Methodology and analytical issues, World Bank, September 2010.
38 Paul Collier and Anthony J. Venables, Natural resources and state fragility, European University Institute, 2010.
39 Renewable totals include hydropower, wind, solar, bioenergy, and geothermal. They do not include nuclear power. See Renewable capacity highlights, International Renewable Energy Agency, March 2020.
40 BP, Statistical review of world energy, 71st edition, 2022. Figures represent primary energy consumption and use the substitution method to adjust for inefficiencies in fossil fuel use, to improve comparability to renewable energy sources. Note that these figures do not include traditional biomass in total global energy use.
41 “Climate change challenges in Latin America and the Caribbean,” in Regional economic outlook: Western Hemisphere, IMF, October 2021.
42 Global photovoltaic power potential by country, World Bank, June 2020.
43 IRENA, 2023.
• Second, even though electricity production is relatively decarbonized by global standards, electrifying and decarbonizing energy as a whole is still a formidable task that will require significant shifts and investment. About 60 percent of electricity in Latin America is from renewable sources—twice the global average.\textsuperscript{44} But only about 20 percent of final energy use in Latin America is from electricity, a figure similar to the global average.\textsuperscript{45} Decarbonization of sectors such as transportation and industry could be accelerated by making further use of the region’s potential for solar, wind, biomethane, and biofuels as well as existing hydroelectric power.\textsuperscript{46} Latin America could also become a significant low-cost producer of hydrogen, not only supporting domestic decarbonization but also potentially supplying a growing global market.\textsuperscript{47}

• Third, Latin America will need to address land-use emissions more than most other regions. Energy accounts for only 43 percent of greenhouse-gas emissions in Latin America, versus a global average of about 74 percent. Agriculture, land-use change, and forestry contribute 45 percent of its emissions, versus a global average of about 14 percent.\textsuperscript{48} Decarbonization will create domestic trade-offs. McKinsey research found that the region would have to allocate just under 10 percent of its GDP on physical assets to supporting the net-zero transition, about two percentage points above the world average.\textsuperscript{49} Delivering on domestic decarbonization will require overcoming challenges such as securing financing and unlocking permitting and approvals, and addressing talent and infrastructure gaps.

— Can Latin America be an engine of the global net-zero transition? Many critical resources needed for the net-zero transition are abundant in the region (Exhibit 5). Latin America holds about half of the world’s lithium, 36 percent of its copper, and 16 percent of its nickel. Brazil is estimated to have one of the largest reserves of rare earths outside China.\textsuperscript{50} Moreover, Latin America also contains about 50 percent of the world’s biodiversity and 23 percent of its forests—key elements of global climate stability and broader sustainability, and a crucial complement to the energy transition.\textsuperscript{51} The region therefore has a unique opportunity to support global decarbonization, from renewable value chains to forest carbon sequestration. However, there are potential tensions between the needs of local communities and the global requirements of the transition. The debate over lithium mining in Chile is an example.\textsuperscript{52} Similarly, reducing deforestation and practicing afforestation would need to be carefully managed in order to ensure that forest-border communities benefit.\textsuperscript{53}

\textsuperscript{44} Yearly electricity data, Ember, March 2023.
\textsuperscript{47} International Energy Agency, Hydrogen in Latin America, August 2021.
\textsuperscript{48} “Climate change challenges in Latin America and the Caribbean,” in Regional economic outlook: Western Hemisphere, IMF, October 2021.
\textsuperscript{49} The net-zero transition: What it would cost, what it could bring, McKinsey Global Institute, January 2022.
\textsuperscript{50} Mineral commodity summaries, US Geological Survey, January 2023. Stated proportions are of world reserves.
\textsuperscript{51} The outlook for agriculture and rural development in the Americas: A perspective on Latin America and the Caribbean, ECLAC, FAO, and IICA, 2019. This publication does not specify the metric of biodiversity used.
\textsuperscript{52} John Bartlett, “Mining of lithium, key to the climate fight, faces new scrutiny in Chile,” New York Times, January 6, 2022.
\textsuperscript{53} The net-zero transition: What it would cost, what it could bring, McKinsey Global Institute, January 2022.
Exhibit 5

Latin America holds a disproportionate share of the world’s resources.

Latin America’s share of global total, 2023 or latest available, %

<table>
<thead>
<tr>
<th>Category</th>
<th>Share</th>
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<td>Solar irradiation</td>
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<td>Terrestrial CO₂</td>
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</table>

Source: UN World Population Prospects (2022); IMF World Economic Outlook (October 2022); World Bank Indicators; UNEP state of biodiversity in Latin America and the Caribbean (2016); Mineral Commodity Summaries, US Geological Survey (2023); Global Solar Atlas (2022); Global Carbon Project (2022); BP statistical review of world energy (2022); McKinsey Global Institute analysis
Capitalization

As its name suggests, the Era of Markets saw the rise of market economies around the world. Hypergrowth in China—at close to 10 percent annually throughout the era—as well as growth in India and some Southeast Asian economies propelled a shift in global GDP growth from high-income to low- and middle-income economies. In advanced economies, the productivity boom of the late 1990s started tapering off in the mid-2000s. But the Era of Markets also witnessed a record rise in household, nonfinancial corporate, and government debt. Total debt in advanced economies is at its highest level since the end of World War II. In a new era, whose start is marked by a spike in inflation and rising interest rates, the global balance sheet seems exposed. Accelerating productivity growth will be badly needed.

— How will the region navigate global economic headwinds? The region appears to be recovering from the pandemic-induced shock. Consumption, employment, and economic activity are all above prepandemic levels. But inflation remains high despite the fact that the region’s central banks moved faster and more aggressively than most advanced economies in raising rates. Public debt jumped to over 70 percent of GDP during the pandemic, which could prove to be a drag on future growth and raise questions about debt sustainability if economic conditions were to deteriorate (Exhibit 6). Ongoing US monetary tightening could have a negative impact on Latin America’s economies. Slower global growth could remove the recent counterbalancing effect of higher commodity prices. Given that Latin American governments and corporations have a high proportion of debt denominated in US dollars relative to others, the region’s ability to service its debt is particularly exposed to exchange-rate risk. This risk is exacerbated as the US dollar continues to appreciate relative to many local currencies.

Slower global growth could remove the recent counterbalancing effect of higher commodity prices.

54 See, for example, The productivity puzzle, McKinsey Global Institute, March 2017.
55 In G-20 countries, the ratio of total debt to GDP is over 300 percent. From 2000 to 2021, the world created $2 in new debt for each $1 in net new investment. Asset prices soared, supporting an accumulation of “paper wealth.” Net worth grew by 170 percentage points relative to GDP, yet three-quarters of wealth growth stemmed from asset price inflation rather than saving and investing. See Global balance sheet 2022: Enter volatility, McKinsey Global Institute, December 2022.
56 Regional economic outlook: Western Hemisphere, IMF, October 2022.
59 “Background paper 1: Spillovers of US monetary tightening to Latin America,” in Regional economic outlook: Western Hemisphere, IMF, October 2022.
60 Ian Giraldo and Philip Turner, The dollar debt of companies in Latin America: The warning signs, Fondo Latinamericano de Reservas, February 2022; and Paulina Restrepo-Echavarria and Praew Grittayaphong, Dollar-denominated public debt in Asia and Latin America, Federal Reserve Bank of St. Louis, August 2021.
The specters of inflation and debt have returned.

Consumer price index, annualized change to January 2023, %

Central government debt, share of GDP, %

1GDP-weighted average of CPI inflation in Brazil, Chile, Colombia, Mexico, and Peru. CPI data available for Colombia from 2004 and Chile from 2011.

2GDP-weighted average for all countries in the region for which data are available.

Source: IBGE (Brazil); DANE (Colombia); INEGI (Mexico); INEI (Peru); INE (Chile); European Central Bank; Federal Reserve Bank of St. Louis; IMF Global Debt Database (2022); McKinsey Global Institute analysis.
Will Latin America be able to drive productivity growth? Since the early 1980s, Latin America’s productivity growth rate has averaged only 0.4 percent each year—about one-fifth of the average in developing economies globally. While comparable emerging Asian and Eastern European economies have experienced rapid real per capita economic growth, Latin America has not (Exhibit 7). There are wide-ranging reasons for this, including higher barriers to doing business as well as gaps in human, technological, and infrastructural capital. The competitive dynamics of the region contribute, too. Firms are polarized into large incumbents and a long tail of small, unproductive, and often informal firms, with a “missing middle” of dynamic midsize companies that can challenge incumbents, innovate, and drive growth. In particular, midsize firms face challenges accessing capital to enable growth; about 30 percent of them report finance as a major constraint. This picture appeared to be changing. For example, private capital investment more than quadrupled between 2015 and 2022. But the future trajectory is less certain given tightening global economic conditions and changing investor risk appetites that appear to be curtailing the rise in investment.

Addressing low productivity growth will be essential to enabling the region to succeed, especially as its historical main driver of growth—the demographic dividend—tapers away. For emerging markets in other regions, outperformance has historically been enabled by factors such as domestic investment as well as openness to foreign capital inflows, integration with global export markets, and a business environment that fosters competition and the growth of large companies. As Latin American economies navigate the current turmoil, finding approaches that can deliver productivity boosts and enable outperformance will be key.
Exhibit 7

Latin America’s productivity continues to lag behind that of other emerging markets.

Productivity across regions, change in real GDP per hour worked relative to US baseline,¹ %

Productivity within Latin America,¹ %

India
China
CESEE²,³
ASEAN³
Latin America and the Caribbean³

Brazil
Colombia
Mexico

¹Change in GDP (PPP-adjusted, in constant 2017 $) per hour worked since 1995, relative to US change in GDP per hour worked since 1995.
²Central, Eastern, and Southeastern European states (IMF classification).
³GDP-weighted average across all economies for which data are available.

Source: Penn World Table (version 10.0); World Bank; McKinsey Global Institute analysis

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How can leaders in Latin America think about the road ahead?

Responding to today’s turbulence and major challenges—including slowing economic growth, inflation, energy security, climate change, political tensions, and stress on social cohesion—may appear to be overwhelming, but there are grounds for optimism.

In the postwar period, despite intermittent periods of significant disruption, the world as a whole has been transformed. New majorities emerged. The share of the world’s population connected through their mobile phones and the internet soared above 50 percent. By 2019, 53 percent of the world’s population had income above the World Bank’s highest poverty line of $6.85 per day. The share of global GDP growth coming from low- and middle-income countries rose above 50 percent.

Latin America has been lifted by this wave but still operates well below its full potential both as a region and at the level of its constituent countries. It has remarkable intrinsic strengths: a population of more than 600 million with a high share of young adults, enormous reserves of minerals and abundant energy resources, and extensive biodiversity. However, the region has historically not always succeeded in harnessing its strengths. Its development has been restrained by a range of limiting factors, including lower levels of human capital, an underdeveloped financial sector, and a relative lack of infrastructure investment. Weaker public institutions and limitations in governance have contributed, too. These issues are not new, but the prospect of a new era in the coming years makes their resolution all the more urgent. Can Latin America mobilize its strengths—collectively and within its individual economies—not only to weather the current turbulence but to thrive in a new era as it unfolds? Can the region overcome its fragmentation in order to work toward common goals—setting integration goals, including structuring integrative infrastructure projects, and strengthening regional institutions?

The transition to a new era is a fork in the road for Latin America. If the transition is handled well, the region’s abundance of critical resources for the net-zero transition could spur investment in infrastructure and human capital, and could catalyze both technology transfer and innovation. Shifting globalization could help Latin America become more connected: to financing, markets, and global corporations. Its population is young, supporting growth opportunities and new ways of doing things. A virtuous circle could emerge whereby investment and innovation raise productivity, boost private and public income, and build the capital stock, human and otherwise, to enable further growth. This could be the region’s opportunity to experience the booming economic expansion seen in outperforming middle-income countries elsewhere. Conversely, if the transition is handled poorly, the region could find itself with rising inequality, increasing social tensions, and economic stagnation.

Latin America has remarkable intrinsic strengths: a population of more than 600 million with a high share of young adults, enormous reserves of minerals and abundant energy resources, and extensive biodiversity.
If the world is indeed in the early throes of a seismic shift—as the evidence appears to suggest—what questions should Latin America’s leaders be asking themselves? They need both to prepare for the possibility of a new era and to position themselves to shape it.

In *Memoirs*, the Chilean poet Pablo Neruda wrote, “Latin America is very fond of the word ‘hope.’ We like to be called the ‘continent of hope.’ … This hope is really something like a promise of heaven, an IOU whose payment is always being put off. It is put off until the next legislative campaign, until next year, until the next century.” We might borrow Neruda’s metaphor and ask whether now is Latin America’s opportunity to translate its hope and promise into action—to cash out its IOU.

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