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Notes and explanation of symbols

The following symbols have been used in the tables in this study:

Three dots (...) indicate that data are not available or are not separately reported.

A minus sign (-) indicates a deficit or decrease, unless otherwise indicated.

A full stop (.) is used to indicate decimals.

Use of a hyphen (-) between years, e.g., 1960-1970, signifies an annual average for the calendar years involved, including the beginning and the end years.

The word “dollars” refers to United States dollars, unless otherwise specified.

Figures and percentages in tables may not necessarily add up to the corresponding totals, because of rounding.

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CONTENTS

	<i>Page</i>
ABSTRACT	9
SUMMARY AND CONCLUSIONS	11
I. REGIONAL OVERVIEW	19
A. RECENT TRENDS IN FOREIGN DIRECT INVESTMENT IN LATIN AMERICA AND THE CARIBBEAN	19
1. Foreign direct investment worldwide	20
2. Foreign direct investment in Latin America and the Caribbean: recent inflows and trends	23
B. FDI STRATEGIES, AGENTS AND MODALITIES	35
1. TNC strategies in Latin America	35
2. Foreign investment modalities in Latin America and the Caribbean	44
3. Conclusion	45
Annex	47
Appendix	55
II. THE ANDEAN COMMUNITY: FOREIGN DIRECT INVESTMENT AND CORPORATE STRATEGIES	57
A. FOREIGN CAPITAL IN THE ANDEAN COMMUNITY	58
1. The treatment of foreign capital in the member countries of the Andean Community	58
2. Recent trends in FDI in the Andean Community	62
B. STRATEGIES USED BY TRANSNATIONAL CORPORATIONS IN THE ANDEAN COMMUNITY	67
1. Seeking natural resources for export	67
2. Access to local services and infrastructure markets	78
C. CONCLUSIONS	89
Annex	91
III. INTERNATIONAL BANKS IN LATIN AMERICA: CORPORATE STRATEGIES AND REGIONAL IMPACT	103
INTRODUCTION	103
A. THE LATIN AMERICAN BANKING SECTOR: STRUCTURAL PROBLEMS, CRISES AND RESTRUCTURING	104
1. Structural characteristics and problems of banking systems prior to the 1990s	105
B. UNIVERSALIZATION AND GLOBALIZATION: DETERMINANTS OF THE STRUGGLE FOR NEW MARKETS	110
1. New trends in the international banking market	110
2. The development of new financial instruments	112
3. The banks' strategies for responding to change	114

C.	CORPORATE STRATEGIES IN LATIN AMERICA	120
1.	Strategy for penetrating the Latin American market	122
2.	Corporate strategies, market share and profitability	123
3.	Costs and benefits of expansion in Latin America	129
D.	FOREIGN BANKS: MICROECONOMIC EFFICIENCY VERSUS MACROECONOMIC EFFECTIVENESS	131
1.	Microeconomic efficiency	131
2.	Macroeconomic impact	137
E.	CONCLUSIONS	143
Annex	.....	145
BIBLIOGRAPHY		153

TABLES, FIGURES AND BOXES

Table I.1	Regional distribution of net inward foreign direct investment, 1996-2002	20
Table I.2	Mexico, Central America and the Caribbean: net inward foreign direct investment by country, 1990-2002	25
Table I.3	South America: net inward foreign direct investment, 1990-2002	29
Table I.4	Brazil: sectoral distribution of foreign direct investment, 1996-2002	30
Table I.5	Argentina: foreign public utility firms that declared suspensions of payments in 2002	33
Table I.6	Income sent abroad by foreign firms in Argentina, by sector, 1992-2001	33
Table I.7	Latin America: main brewery groups	40
Table I.8	Latin America: main acquisitions in the brewery sector	41
Table I.9	Latin America and the Caribbean: privatizations by sector and amount, 2002	44
Table II.1	FDI flows to the Andean Community countries, by destination, 1990-2002	62
Table II.2	Member countries of the Andean Community: cumulative FDI flows, by economic sector, 1992-2001	64
Table II.3	Andean Community: cumulative FDI, by country of origin, 1992-2001	66
Table II.4	Andean Community: telecommunications indicators, 1995-2001	81
Table II.5	Andean Community: main mobile telephony operators, december 2001	82
Table II.6	Santander Central Hispano (SCH) and Banco Bilbao Vizcaya Argentaria (BBVA): presence in the banking market of the Andean Community countries, 2001	88
Table III.1	Latin America: first-generation reforms of the financial system	105
Table III.2	Foreign bank share of Latin American banking assets, 1990-2001	108
Table III.3	Indicators of concentration in the banking sector, 1994-2000	109
Table III.4	Money supply (M2) as a percentage of gross domestic product	109
Table III.5	Outstanding stocks of debt securities issued on domestic markets	110
Table III.6	United States: financial market instruments, 1997-2001	113
Table III.7	European Union: comparative share of banking and non-banking activities, 1990-1997	113
Table III.8	Bank concentration: share of the five largest banks in each country's total assets, 1990-1999	114
Table III.9	Latin America: market shares of the three largest international banks in 2001	123

	<i>Page</i>
Table III.10	The importance of BANAMEX to CITIGROUP 125
Table III.11	Composition of foreign bank assets, 2001 129
Table III.12	Profitability in Latin America vs. profitability worldwide, 1999-2001 130
Table III.13	Latin America: indicators of the profitability of local and foreign banks, 1997-2001 132
Table III.14	Latin America: indicators of the efficiency of local and foreign banks, 1997-2001 134
Table III.15	Liquidity indicator: effective availability of loanable funds in relation to total deposits, 1997-2001 135
Table III.16	Latin America (selected countries): variation in lending to the private sector in constant 1998 values, and real interest rates, 1997-2001 138
Table III.17	Latin America (15 countries): bank intermediation spreads, 1997-2002 141
Table III.18	Latin America: ratio between provisions for doubtful loans and non-performing loans, 1997-2001 141
Figure I.1	United States: indicators of stock market trends, 1991-2002 22
Figure I.2	Latin America and the Caribbean: net inward foreign direct investment by subregion, 1990-2002 24
Figure I.3	Mexico: importance of the manufacturing and financial services sectors as destinations for foreign direct investment 26
Figure I.4	Mexico: exports and employment in maquila export industries, 2000-2002 27
Figure I.5	Mexico: reduction in the number of establishments and workers employed in maquila export activities, January 2001-October 2002 36
Figure II.1	Share of the Andean Community in total FDI flows to Latin America and the Caribbean, 1990-2001 62
Figure II.2	FDI flows to the Latin American integration association and the Andean Community, by destination, 1990-2001 63
Figure II.3	Colombia: investment in oil exploration, 1978-2000 69
Figure II.4	Colombia, Peru and Venezuela: share of foreign banks in total assets of local banking systems, 1990-2001 88
Figure III.1	CITIGROUP: performance over the last 10 years, 1991-2001 119
Figure III.2	Largest banks in Latin America by share of regional lending, 2001 120
Figure III.3	International banks: assets in Latin America vs. worldwide assets 121
Figure III.4	Latin America: foreign bank share of total lending by the local banking system, 1998-2001 122
Figure III.5	Banco Santander and Banco Bilbao Vizcaya Argentaria (BBVA) share prices on the New York stock exchange, 1990-2002 127
Figure III.6	Return on assets: trends by country 133
Figure III.7	Trend of liquidity index in each country by type of bank, 1997-2001 136
Figure III.8	Latin America (selected countries): ratio of credit to GDP, 1991-2001 137
Figure III.9	Assets and loans in the Mexican banking system, 1997-2001 139
Figure III.10	Net income of the Mexican banking system, 1997-2001 140
Box I.1	Brazil: local banks lead the way in bank consolidation 31
Box I.2	Latin America and the Caribbean: strategies of transnational corporations in the 1990s 35
Box II.1	Bolivia: the capitalization plan 60
Box II.2	Interconexión Eléctrica S.A. (ISA): a Multi-Andean firm 85

	<i>Page</i>
Box III.1	First- and second-generation financial reforms in Latin America over the past two decades 106
Box III.2	Financial reforms in industrialized countries 112
Box III.3	CITIGROUP: one of the world's largest universal banks 117
Box III.4	Spanish banks in Latin America 124
Box III.5	Foreign bank participation in pension fund management 126
Box III.6	Foreign banks dominate the Mexican banking system, but credit fails to recover 139
 ANNEXES	
Table I-A.1	Latin America and the Caribbean: acquisitions of private firms by foreign investors for over US\$ 100 million, 2002 49
Table I-A.2	Latin America and the Caribbean: largest multinational firms by sales, 2000-2001 50
Table I-A.3	Latin America and the Caribbean: concessions with foreign investor participation, by sector, 2002 51
Table I-A.4	Latin America: top 100 subsidiaries of transnational corporations by net sales, 2001 53
Table II-A.1	Andean Community: main privatizations with participation by foreign firms, 1991-2002 93
Table II-A.2	Andean Community: main mergers and acquisitions with participation by foreign firms, 1992-2002 94
Table II-A.3	Andean Community: largest firms with foreign ownership, by sales, 2001 96
Table II-A.4	Andean Community: international competitiveness in the context of world imports, 1985-2000 97
Table II-A.5	Andean Community: structure of exports and main export products, by country, 1985-2000 98
Figure II-A.1	Andean Community: distribution of oil reserves by member country, 1970-2001 99
Figure II-A.2	Andean Community: distribution of oil production by member country, 1970-2001 101
Figure II-A.3	Andean Community: distribution of natural gas reserves by member country, 1970-2001 101
Figure II-A.4	Andean Community: distribution of natural gas production by member country, 1970-2001 102
Table III-A.1	The 50 largest banks in Latin America, ranked by assets 147
Table III-A.2	Foreign bank share of the leading Latin American financial markets, 2001 148
Table III-A.3	Main acquisitions in the Latin American financial sector 149
Table III-A.4	Banco Bilbao Vizcaya Argentaria (BBVA): main related firms in Latin America, 2001 150
Table III-A.5	Banco Santander Central Hispano (SCH): main related firms in Latin America, 2001 151
Table III-A.6	Ranking of the world's largest banks 152



ABSTRACT



The decline in flows of foreign direct investment (FDI) to Latin America and the Caribbean which began in 2000 grew even sharper in 2002. This trend reflects a major change in the world and regional economies. At the regional level, it is associated with greater instability, slow economic growth and the approaching completion of the privatization process. National crises such as those experienced by Argentina, Uruguay and Venezuela made investors become more risk-averse. Sluggish growth in demand in the United States economy hurt investment in Mexico, Central America and the Caribbean, where the transnational corporations that employ efficiency-seeking strategies are concentrated. The global and regional situations had a less adverse effect on FDI in the countries of the Andean Community, where the primary sector predominates, but instability in the Mercosur countries diminished their attractiveness for transnational corporations implementing market-seeking investment strategies.

This publication is composed of three chapters. The first provides a broad review of FDI trends in Latin America and the Caribbean. The second offers the reader a comprehensive discussion of investment flows to the Andean Community countries. The third analyses flows from transnational banks to the banking sector in the region and assesses what types of effects their strategies are having on the region.

SUMMARY AND CONCLUSIONS

The annual publication *Foreign Investment in Latin America and the Caribbean, 2002 Report* consists of three chapters. The first chapter examines global and regional FDI trends in terms of their geographical and sectoral distribution and looks at the various modalities of such flows, as well as the major foreign companies operating in Latin America and the Caribbean. The principal corporate strategies driving FDI in the region are also analysed. The second chapter focuses on the experience of the Andean Community, a subregion which has, for the most part, maintained existing levels of FDI inflows, while most others have not. The final chapter deals with financial services, interpreting the new situation in the region in the context of changes in the international market, national policy initiatives and the new corporate strategies of the principal transnational banks operating there.

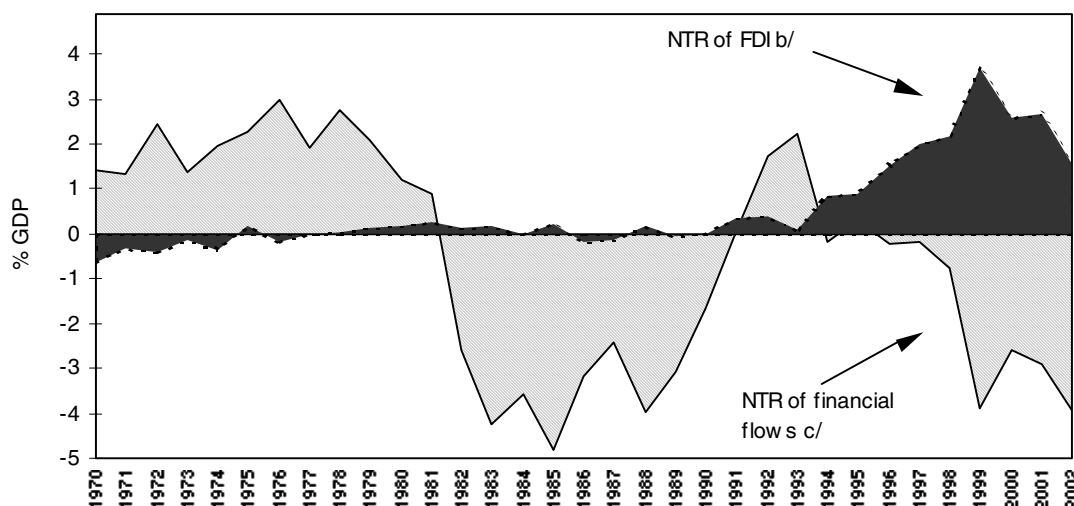
The regional outlook

The worldwide downturn in FDI flows continued in 2002 (-27%). Many factors were involved in this result. Among the more prominent were the sharp decline in the share prices of many transnational corporations (TNCs), mainly those associated with the new economy, the steep drop in privatizations and acquisitions of international assets and the downward spiral in the amount of financing generally available to TNCs. All these factors combined to curb the international expansion of these firms. Their impact on the United

States market and on United States TNCs was particularly detrimental to Latin America.

This time, unlike the situation in 2001, FDI flows to Latin America and the Caribbean slid more sharply than those to other areas (-33%). Moreover, contrary to the pattern observed in 1998-2001, as of 2002 the net transfer of FDI resources would no longer compensate for the negative net transfer of financial resources, as it had since the Asian and Russian crises of 1997-1998. And indeed, the net outward transfer of financial resources swelled to the equivalent of more than 4% of Latin America's GDP in 2002, while the net inward transfer of FDI resources fell to less than 2%.

Figure 1
LATIN AMERICA AND THE CARIBBEAN: NET TRANSFER OF RESOURCES (NTR) ^a



Source: ECLAC, based on official figures.

^a The net transfer of resources equals net inflows of capital (including non-autonomous capital and errors and omissions) minus the balance on the factor income account (net profits and interest). Negative amounts indicate transfers of resources abroad.

^b Equals net foreign direct investment (FDI) inflows minus net profit remittances.

^c Equals the net inflow of capital other than FDI minus net interest payments.

Among the primary causes of this downturn in the region were increased instability, slower economic growth and the apparent end of the cycle of privatizations. Specific crises, such as those in Argentina, Uruguay and Venezuela, were also conducive to increased risk aversion and reduced foreign

investment, all of which tended to heighten uncertainty on the part of foreign investors.

The downward trend in FDI inflows was quite uneven, however, as it varied from one subregion to the next (see table 1) and reflected different factors and corporate strategies.

Table 1
LATIN AMERICA AND THE CARIBBEAN: NET INFLOWS OF FDI, BY SUBREGION, 1990-2002 ^a
(Millions of dollars)

	1990-1994 ^b	1995-1999 ^b	1999	2000	2001	2002 ^c	2002 ^d
1. Mexico and the Caribbean Basin	6 846	15 229	17 984	18 263	29 465	17 753	-40%
2. South America	8 956	45 375	70 236	57 320	39 555	26 649	-33%
- MERCOSUR plus Chile	6 114	35 590	61 881	48 468	30 723	19 420	-37%
- Andean Community	2 843	9 786	8 355	8 852	8 832	7 229	-18%
3. Financial centres	2 506	8 914	19 810	18 855	14 993	11 788	-21%
Total	18 308	69 518	108 030	94 438	84 013	56 190	-33%

Source: ECLAC Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of figures obtained from International Monetary Fund (IMF) balance-of-payments statistics and from national institutions in the countries. The figures for 2002 are estimates based on information from each country's central bank. The information on financial centres was supplied by the United Nations Conference on Trade and Development (UNCTAD), which, in turn, based its figures on the OECD countries' records of outflows to tax havens. The figures are updated annually to reflect governments authorities' own revisions of their statistics. They differ from those given in the ECLAC publication *Preliminary Overview of the Economies of Latin America and the Caribbean, 2002* (LC/G.2153-P), Santiago, Chile. United Nations publication, Sales No: S.01.II.G.182, because the latter considers investment in the reporting economy minus direct investment abroad by residents.

^a Equal to net inflows of direct investment in the reporting economy minus capital outflows from the same foreign firms.

^b Annual average.

^c Estimates.

^d Percentage variation with respect to the preceding year.

Mexico and the Caribbean Basin saw their average annual FDI inflows more than double from US\$ 7 to US\$ 15 billion between the first and second halves of the 1990s; in 2002, inflows were down sharply from the preceding year's level, but were similar to the average for the late 1990s. The huge 2001 inflow of US\$ 29.5 billion was largely accounted for by a single operation (Citicorp's purchase of Banamex for US\$ 12.5 billion). This subregion is where efficiency-seeking strategies on the part of TNCs are most evident in Latin America, and it was therefore adversely impacted by the recession in the United States market, which reduced demand for the goods produced by the subregion's export platforms. This cyclical downturn was most strongly felt in Mexico, whose international competitiveness was also threatened by an appreciating currency, and resulted in the loss of over 200,000 jobs in the maquila industry and the shift of several plants from Mexico to Asia. This attests to the fact that international competitiveness (defined as world import market share) based on efficiency-seeking FDI can be lost just as fast as it is gained. The question is whether the host country is upgrading into higher value-added activities or simply pricing itself out of the market. In Mexico, it was primarily in relatively unsophisticated activities (such as the production of footwear, apparel, furniture and some electrical and electronics goods) that jobs were lost. Elsewhere, such as in the automotive industry, some switching of sales from the United States to the national market took place. Nevertheless, it was mainly new FDI in services –not manufactures– that kept the level of FDI inflows in 2002 at high historical levels. New investment in services was concentrated in financial services, followed –at a distance– by transportation, communications and retail trade.

FDI inflows to Central America and the Caribbean Basin between 2000 and 2002 more or less maintained the levels reached between 1995 and 1999. However, they did decline by 13% in 2002 compared to the previous year. This drop was concentrated more in the Caribbean countries, especially the Dominican Republic, than in Central America, where FDI inflows rose considerably in Costa Rica and fell substantially in Guatemala.

South America's average annual FDI inflows increased by a factor of five between the first and second halves of the 1990s, rising from US\$ 9 to US\$ 45 billion. These inflows peaked in 1999 at over US\$ 70 billion and declined sharply and steadily thereafter, reaching less than US\$ 27 billion in 2002. This subregion is where the use of market-seeking and natural resource-seeking strategies by TNCs is most pronounced in Latin America. The outcomes of these strategies in the Andean Community and in MERCOSUR and Chile differed, however.

In the Andean Community, where natural resource-seeking strategies are more common, this type of FDI –which, by its very nature, is a higher-risk activity– was less affected by the global downturn, since it was linked to improved access to hydrocarbon reserves. Average annual inflows increased more than threefold, from under US\$ 3 billion to almost US\$ 10 billion between the first and second halves of the 1990s, and remained at more than US\$ 8 billion a year thereafter, experiencing a decline in 2002 (-18%, which was considerably less severe than the downturn for the region as a whole), owing primarily to the situation in Venezuela. Most of this investment was in the hydrocarbons industry, as investment in minerals fell off considerably. Thus, natural-resource-centric FDI in the Andean Community did not suffer as big a slump as did other types of FDI in the rest of Latin America.

It was the MERCOSUR countries and Chile that saw the largest increase in average annual FDI inflows –from US\$ 6 billion to almost US\$ 36 billion– between the first and second halves of the 1990s and the sharpest decline in the new millennium, as FDI plunged from over US\$ 60 billion in 1999 to under US\$ 20 billion in 2002. In this subregion, in which the use of market-seeking strategies by TNCs is most pronounced, FDI inflows were stalled by the economic crises in Argentina and Uruguay, the completion of privatization processes and slower growth in Brazil and Chile. There was a steep decline in the acquisition of local assets by TNCs, especially in services such as telecommunications, financial services and retail commerce, which had previously driven FDI inflows. In fact, in some countries, such as Brazil, national firms became more active in acquiring assets in such sectors as the financial services and beer industries. TNCs adapted as best they could by shutting down or by rationalizing or restructuring their operations. In Argentina, some firms (such as Crédito Agrícola and ScotiaBank) left the country, while others (such as a number of subsidiaries operating in infrastructure services) implemented crisis-management measures, including the stoppage of payments. In Brazil, several automotive firms attempted to shift sales from the national or subregional markets to the world market. In general, MERCOSUR lost its attractiveness for market-seeking investors.

In the case of Chile, FDI inflows dropped off steeply as the cycle of mining mega-projects came to an end and the number of acquisitions in services declined. The Chilean authorities sought to give new impetus to foreign investment by way of two initiatives: a policy of presenting Chile as a platform for operations in the rest of South America, and the signing of free trade agreements with

important trading partners such as the European Union, the United States and the Republic of Korea.

Finally, the situation in the region's financial centres was also one of growing uncertainty. As has generally been the case, little is known about the exact significance and final destination of these financial flows. An initiative by the Organisation for Economic Co-operation and Development (OECD) to limit the use of these financial centres for purposes of tax evasion could severely reduce FDI inflows in the near future.

The above considerations suggest that both cyclical and structural factors were involved in the decline in FDI flows to Latin America and the Caribbean. The efficiency-seeking FDI that has normally been channelled into export platforms in Mexico, Central America and the Caribbean was hard hit by cyclical factors, such as the recession in the United States market and, in the case of Mexico, the revaluation of the peso. This led to the postponement of investments, plant closures and massive lay-offs. Some of the more simple assembly activities were relocated to lower-cost sites, especially China and other Asian host countries. This kind of shift does not appear to have occurred in more sophisticated activities, such as the automotive and electronics sectors, that employ more highly skilled labour, however. This more structural aspect suggests that the requisite policy response is not simply to wait for the United States market to recover, but rather to promote a continual upgrading of local assembly and manufacturing processes in order to improve their international competitiveness and thus set the stage for an upward trend in wages. This represents the "high road" in terms of the development strategies of countries hosting components of internationally integrated production systems. The "low road" is to attempt to resist change by way of wage repression, reduced social security benefits, competitive devaluations and over-dimensioned incentives.

Another example is the case of the MERCOSUR countries. Clearly, the outlook for the domestic markets of Brazil, Uruguay and Paraguay deteriorated in line with the deepening of the Argentine crisis. This cyclical downturn has scared off new foreign investments, while existing FDI –both in sectors governed by special arrangements, such as the countertrade provisions established for the automotive industry, and in other manufacturing activities– has tended to shift to export markets beyond MERCOSUR. The sources of existing FDI in services do not usually have that option, and the typical response is either to implement severe cost reduction measures until better times come along or to look for a way out. The second option has become more common in Argentina's financial services sector.

Finally, the natural resource-seeking FDI most commonly found in the Andean Community typically takes the form of long-term higher-risk projects which do not react as fast to cyclical factors once they have been launched. This has been true of a number of hydrocarbons projects in the Andean Community, such as those dealing with gas pipelines in Bolivia, petroleum pipelines in Ecuador, the Camisea gas fields in Peru, etc.

Thus, both cyclical and structural elements help explain the downturn in FDI, with the weight of each of these factors varying according to the corporate strategies that drive the FDI flows in question.

FDI in the Andean Community

One of the defining ideas of the Andean integration scheme in the early 1970s was a common foreign investment code, known as Decision 24. This code embodied a restrictive FDI policy which included an approval process contingent on developmental considerations, sectoral restrictions (especially in certain natural resources and most services), a fade-out mechanism for foreign owners of manufacturing firms, technological provisions favouring national companies in their negotiations with TNCs, limits on payments (profit remittances, interest payments and royalties) and the prohibition of access to local financial markets. This policy eventually evolved into one of the divisive elements in the integration scheme, and in the late 1980s it was set aside by an Andean Community decision that authorized more open and autonomous national policies. The Andean countries are now endeavouring to take a unified stance in their negotiations on the investment chapter of the Free Trade Area of the Americas (FTAA) initiative. It remains to be seen what this will mean in practice, however.

The Andean countries have been relatively successful in attracting FDI more recently, accounting for 13% of the FDI that entered Latin America between 1990 and 2001. Annual inflows stabilized at around US\$ 9 billion during 1998-2002. Those inflows have gone primarily to natural resources (especially hydrocarbons) and services (particularly financial services, telecommunications and transportation) (see table 2). Most of the FDI comes from the United States and Spain, and most of the exports generated by such FDI go to the United States market. The principal owners of the biggest foreign companies, by sales, are Telefónica de España, BellSouth and Telecom Italia in telecommunications, AES Corporation and Endesa-España in electricity, ExxonMobil and ChevronTexaco in petroleum, Grupo Minero México and Newmont Mining Corporation in mining, General Motors, Ford and Toyota in the automotive sector, and Coca-Cola and Danone in food products.

Table 2
ANDEAN COMMUNITY: CUMULATIVE FDI INFLOWS, BY SECTOR, 1992-2001
(Percentages)

	Bolivia	Colombia	Ecuador	Peru	Venezuela	Andean Community
Natural resources	53.6	17.9	81.7	7.8	34.4	30.1
- Mining	5.6	9.4	-	-	-	-
- Petroleum and gas	48.1	7.8	80.7	7.5	33.0	29.3
Manufactures	9.1	21.2	6.2	6.3	28.9	14.4
Services	43.9	60.9	12.0	38.9	24.1	36.4
- Electricity, gas and water	-	17.1	-	9.1	0.8	6.4
- Commerce	-	5.2	4.9	3.5	2.5	3.4
- Transportation and communications	-	10.1	2.3	15.9	2.1	6.7
- Financial services	-	24.3	-	9.1	17.8	15.3
- Other services	-	4.2	4.8	1.3	0.9	4.6
Other	-6.7	-	-	47.0^b	12.5	14.1
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: ECLAC, Information Center of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, on the basis of figures provided by the Andean Community and the member countries' central banks.

^a In Ecuador, Peru and Venezuela, mining and the extraction of hydrocarbons are grouped together in a single category.

^b In Peru, the statistics compiled by the National Commission on Foreign Investment and Technology (CONITE) differ significantly from those of the Central Reserve Bank of Peru. The Andean Community has corrected the CONITE figures so that they reflect actual, as opposed to registered, FDI. One effect of this revision is that almost half of total inflows cannot be classified by sector.

In spite of relatively strong FDI inflows, the international competitiveness of the Andean countries has deteriorated. This trend is associated with the fact, on the one hand, that the sectoral specialization of FDI-related export activities focuses on natural resources, the least dynamic element of international trade, and on the other, that FDI in services has not produced significant exports. The overall world market share of Andean Community exports declined from 1.3% to 0.9% between 1985 and 2000, while the Community's share of the most dynamic part of international trade –non-resource-based manufactures– barely moved at all, edging up from 0.14% to 0.18%. In part, this is because the types of export-oriented FDI that are most attracted to the Andean Community reinforce that area's strong specialization in natural resources and natural-resource-based manufactures, which have traditionally made up over 90% of the value of total exports (petroleum –both crude and refined– alone makes up 60% of the total). This subregional specialization in natural resources varies across the Andean Community, being higher in Venezuela and Ecuador and lower in Colombia. Moreover, the Andean countries have not been able to take advantage of their preferential access to the United States market.

Natural-resource-seeking corporate strategies have traditionally been the type of strategy relied upon the most by TNCs operating in the Andean Community. To

a certain extent, the ambivalent and changing stance on FDI policies adopted by governments in the subregion has been reflected in their experiences with TNCs in natural-resource sectors. Several hydrocarbon TNCs (Exxon, Texaco, Mobil and Royal Dutch Shell) had established a strong presence in the Andean subregion –except in Bolivia, where the State company had controlled activities since the early 1950s– before discontent with the apparently meagre national benefits derived from these activities led to a wave of nationalizations in these countries, with the exception of Colombia. In Colombia, the existence of a policy dating back to 1974 of employing association contracts in the petroleum sector enabled the country to avoid the policy flip-flops of its Andean neighbours. The subsequent Andean experience with State-led hydrocarbons development also entailed a number of problems in relation to State petroleum companies' investment levels and indebtedness in a few countries. Then, in the 1990s a series of privatizations took place (in Peru and Bolivia, in particular), and concessions and contracts of association were used to open the sector up to foreign investors. Two important phenomena have been witnessed in recent years: on the one hand, reserves of both petroleum and natural gas have increased substantially thanks to increased exploration efforts and, on the other, production of petroleum peaked in 1997-1998, whereas the output

of natural gas continues to rise. Both TNCs and State companies have played an important role in hydrocarbons exploration, production and exports in the Andean Community. While the role of TNCs has increased in recent years, State companies continue to be the principal agents in most of these countries, which may explain why subregional projects have not been major recipients of FDI in this sector.

FDI in services grew significantly in the 1990s. While most of the FDI has gone to the same sectors –financial services, telecommunications, transportation and electricity– national experiences in the Andean Community have been varied. The privatization of State assets has produced some of the biggest foreign companies in the subregion, such as CANTV of Venezuela (Verizon and Telefónica de España), Telcel of Venezuela (BellSouth), Telefónica de Perú (Telefónica de España), Electricidad de Caracas of Venezuela (AES Corporation) and EMGESA of Colombia (Endesa-España). The acquisition of local banks by foreign investors has also been a factor in FDI inflows. In very few of these services has the establishment of a subregional strategy been a significant element in this respect, however.

This leads to the surprising conclusion that the integration of the Andean market itself has not proved to be a major inducement for FDI in natural resources, services or, in fact, manufactures. The original integration scheme was based on the idea of restricting FDI to activities not undertaken by local companies. These firms were intended to be the principal beneficiaries of the Andean Pact, and this rationale was what gave content to the Pact's restrictive FDI code. The outcome of the subsequent volte-face of FDI policy was not a single, more liberal regime for the promotion of FDI from a subregional market perspective, but rather five distinct FDI policies which failed to take the widened market explicitly into account. In fact, to this day, the principal attraction of the Andean Community member countries continues to be the oldest corporate strategy in the region, the one that seeks natural resources. FDI in services has a number of diverse determinants. This explains, to a great degree, why FDI has not played a significant role in the industrialization of the subregion or in the improvement of the region's international competitiveness.

FDI in financial services

The 1990s witnessed a strong increase in the presence of foreign banks in financial services in Latin America, which expanded from an average of less than

10% of total assets in 1990 to over 50% in 2001. This is attributable to the interaction of three groups of factors: increased competition in the international market for financial services, national policies that have facilitated the entry of foreign banks and new corporate strategies. The transnational banks that spearheaded the effort to achieve this stronger presence were seeking to improve the competitive position of their universal services (and, hence, their long-term profitability) by means of an international expansion to and throughout the region. Governments of the region, for their part, were seeking to deepen and modernize the financial services available in their economies by improving microeconomic efficiency (profitability, efficiency and liquidity) and macroeconomic efficacy (availability and cost of credit, and systemic stability). In the end, both transnational banks and governments were disappointed to a certain degree. The experience provides some important lessons, however.

The international market factors involved in this expansion included a host of elements, ranging from the initiatives taken to open up and liberalize financial services in the United States and European markets –coupled with the World Trade Organization's Fifth Protocol to the General Agreement on Trade in Services– to the new regulations and norms for supervision promoted by the Bank for International Settlements, technological change and new instruments (securitization and derivatives). This combination of factors spurred global competition among transnational banks.

National policies in Latin America reflected these trends, albeit with some lag. The first generation of reforms in the region was aimed at reducing the role played by State banks in credit allocation, deregulating interest rates, reserve requirements and other credit allocation instruments, and opening up the sector to foreign banks. The second generation of reforms focused more on the new regulatory and supervisory requirements, institutional development and systemic stability.

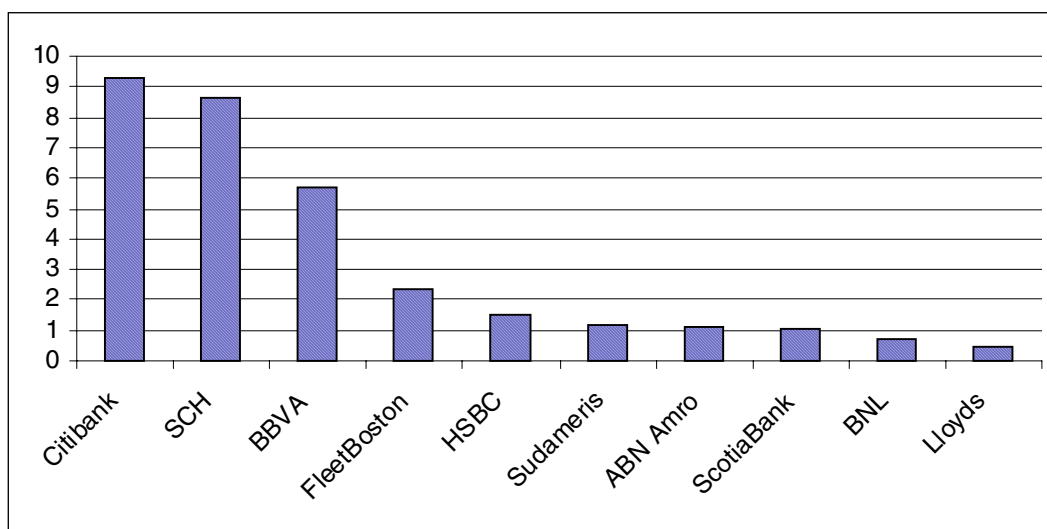
These tendencies in the international market and in Latin America led transnational banks to adopt changes in their corporate strategies. The heightened competition prompted them to search for scale advantages through the provision of universal services (all market segments) and greater global coverage (a broader geographical presence). This played out in a huge wave of acquisitions in the industry and, within that context, Latin America looked very attractive to a number of such investors.

It was primarily a small group of large universal service banks that made these huge investments in the region. SCH (US\$ 16.4 billion), BBVA (US\$ 9.6 billion) and Citigroup (US\$ 12.5 billion just in Mexico) led the

way, mainly by purchasing local banking networks (see figure 2). Others used strategies that called for the establishment of a broad geographical presence solely

in the corporate segment (FleetBoston and Scotiabank) or that restricted their presence to the major markets (HSBC and ABN AMRO).

Figure 2
**MAJOR FOREIGN BANKS IN LATIN AMERICA, BY SHARE
 OF TOTAL LENDING, 2001**
 (Percentages)



Source: Salomon Smith Barney, *Foreign Financial Institutions in Latin America*, 2001; Equity Research, Latin America, and annex table A.III.2.

In terms of results, these foreign banks' entry into financial services in Latin America substantially increased their participation in most countries and allowed them to become the dominant force in several nations (see table 3). In most instances, this contributed significantly to the deepening and modernization of financial services. Nevertheless, these transnational banks were disappointed by the returns on their investments, since the positioning phase was soon followed by a significant downturn in the macroeconomic performance of most of the countries they were operating in. The ultimate impact of this increased foreign participation in the financial services sector is as yet unclear. No doubt this new competition has had a favourable impact on the efficiency of local

banks' operations, since -as local banks were obliged to rise to the standard of efficiency set by the foreign entrants- no statistical differences are to be found between the two in terms of performance. Nevertheless, this greater efficiency and the increased presence of foreign banks have not translated into a reduction in the cost of financial services. Worse still, the presence of foreign banks has not resulted in the availability of more credit or increased stability in these national financial systems. It is still too early to draw definitive conclusions in this regard, but the fact remains that the entry of transnational banks into financial services in Latin America has yet to produce the hoped-for effects -in the quantities desired- for either the transnational bank investors or the host governments.

Table 3
**FOREIGN BANK'S SHARES OF TOTAL ASSETS OF LATIN AMERICAN
 BANKING SYSTEMS**
(Percentages)

	1990	1994	1999	2000	2001
Argentina	10	18	49	49	61
Brazil	6	8	17	23	49
Chile	19	16	54	54	62
Colombia	8	6	18	26	34
Mexico	0	1	19	24	90
Uruguay	4	7	33	40	61
Venezuela	1	1	42	42	59

Source: International Monetary Fund (IMF), *International Capital Markets: Developments, Prospects and Key Policy Issues*, Washington, D.C., 2000; Bank for International Settlements (BIS), "The banking industry in the emerging market economies: competition, consolidation and systemic stability", BIS papers, No. 4, Basel, 2001; Salomon Smith Barney, *Foreign Financial Institutions in Latin America*, November, New York, 2001.

The way forward

The longer-term profile of the downward trend in FDI inflows suggests that FDI policies must be adapted to the new situation and be focused on improving the results. This might be a good time for governments of the region to review their foreign investment policies with that aim in mind. It would appear that the period of plentiful and "easy" FDI has come to an end. During that period, the liberalization, opening and deregulation of the economy were often sufficient to attract huge inflows of FDI. From a macroeconomic perspective, it made sense to follow a policy of "the more FDI, the better". After all, increased inflows of FDI made life easier for economic teams accustomed to foreign-exchange starvation.

The new and harsher environment in which more –and increasingly sophisticated– host countries compete for smaller global FDI flows suggests that the Latin American countries must upgrade their FDI policies and institutions in order to compete more successfully. This

will entail graduating from a "beauty contest" approach designed to attract all potential FDI based on a country's image and moving on to a developmental, targeted approach that calls for the definition of national priorities and the adoption of more active policies to identify, attract and consolidate the types of FDI that will have the desired impact. This will require a shift of focus away from a macroeconomic balance-of-payments approach and towards a more meso- or microeconomic approach directed at improving competitiveness, deepening clusters, integrating industrial processes, extending production linkages, improving human resources and business development skills, etc. In other words, the emphasis must shift from quantity to quality. This will require much more highly sophisticated institutions and more professional staff to successfully identify, attract and consolidate the kinds of FDI that will directly contribute to the attainment of national development goals within an environment marked by stronger competition for smaller overall FDI flows.

I. REGIONAL OVERVIEW

A. RECENT TRENDS IN FOREIGN DIRECT INVESTMENT IN LATIN AMERICA AND THE CARIBBEAN

Global flows of foreign direct investment (FDI) retreated for the second year running in 2002 as a direct result of three main factors: steep falls on world stock markets, which reduced the value of merger and acquisition operations; a drop in the number of cross-border transactions, which had been a major component of FDI during the boom years of the 1990s; and restricted access to enterprise financing. These factors, in turn, are related to the conclusion of an expansionary phase in various activities, especially those with ties to the information and communications technology industries, which had been the powerhouse of worldwide economic growth in recent years. In these new circumstances, many firms made radical changes to their global strategy, slimming down their investment plans and no longer focusing on size and market share instead, they have adopted a strategy based on the strict control of expenditure and investments.

Although these global trends contributed to the reduction in FDI flows to Latin America and the Caribbean (which diminished for the third straight year in 2002), this decline was also compounded by national and regional factors that influenced the investment decisions taken by transnational corporations (TNCs).

When foreign firms were investing in Latin America in the 1990s, international and regional conditions were very different from those which began to emerge around 2000: the world economy was growing, and an intensive

process of international mergers and acquisitions was unfolding; at the regional level, monetary variables were more stable and growth was reviving. Since then the situation has changed radically: growth in the international economy is currently weak, and the region has slipped into recession. Notwithstanding this general picture, the mix of external and domestic factors has had heterogeneous effects on the strategies of foreign firms and on FDI flows in different parts of the region.

In Mexico, despite an overvalued currency which inflates costs for TNCs operating in that country, FDI held steady at about US\$ 14 billion (similar to the average for the second half of the 1990s), as funds channelled into the financial sector compensated for faltering investment in the maquila export industry. TNCs also curtailed their maquila investments in Central America and the Caribbean pending an economic recovery in the United States.

The reasons for dwindling levels of FDI in South America include recession and greater economic and/or political instability. Such factors made themselves felt to varying degrees in the different South American countries. The privatization of public-sector assets in the subregion, which attracted large volumes of FDI in the 1990s, has now run its course, and the few attempts made to privatize State assets in 2002 have encountered fierce political resistance and have been either cancelled or postponed. Against this background of recession and instability,

investors grew more cautious about their enterprises in South America, especially in the case of foreign firms that had invested to gain access to national or subregional markets. This contrasted with investments in natural resource exploitation, primarily in the Andean Community countries, which stayed more or less at their 2001 level except in Venezuela, where they fell considerably.

The following two sections offer an assessment of the trend of global and regional FDI flows in 2002. This is followed by an analysis of the various strategies deployed during the year by TNCs with investments in Latin America and the Caribbean, to provide a complete picture of FDI behaviour in the region.

1. Foreign direct investment worldwide

In 2002 global FDI flows contracted sharply for the second year running. Having experienced their steepest fall in three decades in 2001 (51%), direct investment flows dwindled by a further 27% in 2002 (see table I.1). According to preliminary figures from the United Nations Conference on Trade and Development (UNCTAD), worldwide FDI for 2002 is estimated at US\$ 534 billion. For the first time ever, a developing country (China) heads the list of FDI recipients worldwide, pushing the United States into second place (UNCTAD, 2002a).

As was the case in 2001, the fall was steeper in developed countries than in developing ones (31% compared to 23%), although the general trend also concealed glaring disparities between individual countries. For example, capital inflows plummeted by about 78% in the United Kingdom and 65% in the United

States, whereas increases were recorded in 10 other developed countries. Among developing regions, there were steep falls in Africa (65%) and Latin America (32%), but a more gentle decline in Asia (12%).

According to UNCTAD, this disparity is explained by the fact that the worldwide economic slowdown has pitted TNCs against fierce competition in smaller markets, forcing them to cut production costs. One way they have done so is by geographically redistributing labour-intensive activities—a policy exemplified in Latin America and the Caribbean by the closure of several maquila enterprises in Mexico and their migration to China. Data from the National Institute of Statistics, Geography and Informatics (INEGI) reveal that Mexico's maquila industry shed over 200,000 jobs for this reason.

Table I.1
REGIONAL DISTRIBUTION OF NET INWARD FOREIGN DIRECT INVESTMENT, 1996-2002
(Billions of dollars)

	1990-1995 ^a	1996	1997	1998	1999	2000	2001	2002 ^b
World total	225	386	478	694	1 088	1 492	735	534
Developed countries	145	220	268	484	838	1 227	503	349
Western Europe	87	116	138	275	507	832	336	...
European Union	84	110	128	262	488	809	323	...
Germany	4	7	12	25	55	195	32	...
France	16	22	23	31	47	43	53	...
United Kingdom	17	24	33	74	88	117	54	12
Other European countries	3	5	10	13	19	24	13	...
Other developed economies	58	104	130	210	331	395	167	...
Canada	6	10	12	23	24	67	27	...
United States	41	84	103	174	283	301	124	44
Other countries	11	10	15	12	23	28	15	...
Developing countries and economies ^c	74	153	191	188	225	238	205	158
Latin America and the Caribbean	22	50	73	85	108	94	84	56
Africa	4	6	11	9	13	9	17	6
Asia and the Pacific	48	94	106	96	103	134	102	90
China	19	40	44	44	40	41	47	50
Central and Eastern Europe	6	14	19	23	25	27	27	27

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of figures provided by the United Nations Conference on Trade and Development (UNCTAD). For Latin America and the Caribbean, figures up to 2001 are taken from balance-of-payments statistics published by the International Monetary Fund (IMF). Estimates for 2002 for Latin America and the Caribbean come from national agencies in each country.

^a Annual average. ^b Estimates. ^c The component figures are not consistent with the total because the statistics for Latin America come from a different source.

As stated in ECLAC (2002), the shrinking of global FDI flows in recent years reflects the economic slowdown across the globe, particularly in the United States, which was accompanied by less vigorous investment and a drop in corporate profits. This gave rise to widespread and sustained falls in share prices on financial markets worldwide (a trend that had begun in 2000 but quickly gathered momentum in 2002), together with a substantial reduction in cross-border mergers and acquisitions. It also restricted firms' access to financing – a situation that was later aggravated by bankruptcies and accounting scandals in a number of TNCs that had been leading absorbers of financial resources in the 1990s.

Today, major uncertainties have arisen as to the future course of the United States economy and its ability to continue acting as the powerhouse of worldwide economic growth, as it did throughout the 1990s. As the behaviour of that economy strongly influences future investment decisions, it warrants careful analysis in order to understand it better.

In the 1990s, macroeconomic performance in the United States shattered the paradigms existing up until that time: robust economic growth was shown to be compatible with low levels of inflation and unemployment. Some specialists saw this as fundamentally due to microeconomic factors, reflecting the impact of the latest technological revolution on corporate productivity, which made it possible to maintain profit margins without raising prices. According to this thesis, a twin technological-liberal revolution had given rise to profound industrial change, raising the United States economy's growth potential and giving birth to a "new economy".¹

The conclusions of that analysis were consistent with the presence of another element believed to have made a major contribution to the vigour of the United States economy, namely a sharp rise in the investment rate. This

was fuelled not only by domestic capital, but also by the large volumes of FDI that TNCs channelled into the United States in order to ride the wave of rapid growth in the world's most powerful economy. In the 1990s the United States was the world's leading FDI recipient. In addition, thanks to major technological advances, the information technology and telecommunications sectors became a major focus of investment, absorption of state-of-the-art technologies and job creation, generating powerful forces that stimulated and intensified the ongoing globalization process. Nonetheless, estimates show that productivity increases failed to keep pace with the volume of capital being invested, which led to cumulative over-investment during the period.²

Equity and bond markets played a crucial role in financing this investment boom in the United States, which was boosted by the liberalization of capital flows in the 1990s. The amount of capital raised by firms through share issues, whether quoted on stock markets or not, is estimated at approximately US\$ 270 billion in 2000 in the United States alone – in other words, seven times the amount raised in the late 1980s. A large portion of these funds was channelled into "new economy" sectors. In addition, the share of bonds in firms' liabilities increased at the expense of bank credit.³

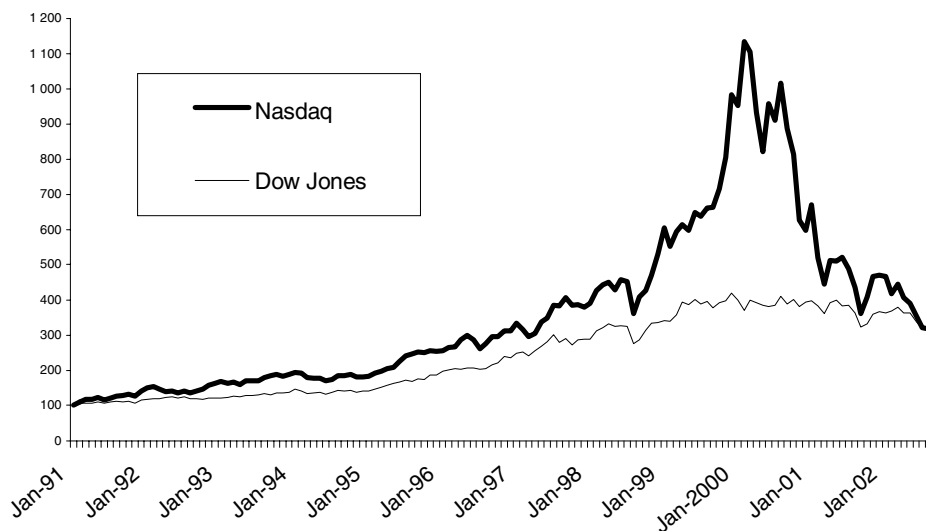
Given that over half of all families in the United States owned shares quoted on the stock market and that such shares accounted for a large proportion of pension fund asset portfolios, burgeoning share indices generated wealth effects, fuelling a consumption boom that outpaced the growth of real wages. Expanding demand encouraged firms to undertake further investment, thereby creating a spiral of rising asset values and financial liquidity that drove up share prices, especially in "new economy" sectors (see figure I.1). Against this backdrop, business modernization and consolidation also continued apace, further boosting FDI flows worldwide.

¹ Fierce controversy continues to rage over this point; see Gordon (2000), Oliner and Sichel (2000) and Jorgenson (2001).

² As Brender and Pisani (1999 and 2001) point out, the structure of these investments revealed an increase in the share of information technology and telecommunications products in firms' capital expenditure. As the prices of such products fell in relation to those of other capital goods, this component probably increased even more substantially in volume terms.

³ Between the early 1980s and the late 1990s, the share of bonds in corporate liabilities grew from 26% to 32%, while bank credit shrank from 27% to 23% (Brender and Pisani, 2001).

Figure I.1
UNITED STATES: INDICATORS OF STOCK MARKET TRENDS, 1991-2002
 (1991=100)



Source: Bloomberg.

Note: Nasdaq: Index of share prices among technology firms. Dow Jones: Index of share prices on the New York Stock Exchange.

While optimists interpreted this rise in share prices as reflecting the vigour of the new economy, more cautious analysts feared that it largely represented a speculative bubble. There was a glaring mismatch between expectations of very high financial yield and the economic return on capital, which trended downward in the United States in the second half of the 1990s.

Nonetheless, the powerful and sustained investment wave forced firms to borrow excessively, and this did not yield good results. Faced with the imperative need to grow share values and keep market expectations high, many firms engaged in accounting manoeuvres to enhance their balance sheets –including corporations such as Enron, Global Crossing, Adelphia, Dynegy, Tyco International, Imclone, Qwest, WorldCom and Xerox. These firms were subsequently indicted for a number of criminal offences, such as the creation of off-balance-sheet entities to conceal multi-million-dollar losses, manipulation of results, accounting fraud, privileged use of internal funds and exploitation of insider information.⁴

The crisis of corporate governance that broke out in the United States extended to “financial watchdogs” such as auditors, banks and regulatory authorities. The most notorious case involved Arthur Andersen LLP –one of

the world’s five biggest accounting firms and auditor to Enron, Global Crossing and WorldCom. The sight of executives from Arthur Andersen LLP being put on trial for obstruction of justice triggered a mass exodus of the firm’s international clients and partners and brought its activities to a halt.⁵ The world’s largest brokerage bank, Merrill Lynch, negotiated an agreement to pay a US\$ 100-million fine in response to allegations that its experts had deceived investors by encouraging investment in stocks which they talked down in private. The firm is currently facing numerous lawsuits filed by investors whose interests were damaged.⁶ Several banks also suffered major credibility crises, especially those which, like Citigroup, had become integrated groups in the late 1990s, capable of providing financial services of all kinds under the “universal bank” model (see chapter III of this report). This prompted the Attorney General of the State of New York, Eliot Spitzer, to negotiate an agreement between the Securities and Exchange Commission (SEC), representatives of stock markets and state regulators, aimed at reforming investment practices and imposing penalties totalling US\$ 1.4 billion on investment banks involved in these activities. The agreement was signed in December 2002 (see OAG, 2002).

⁴ See *The Economist* (2002a), *Le Monde* (2002a and 2002b) and *El País* (2002b), among others.

⁵ See *The Economist* (2002b), *The Economist, Business Special* (2002) and *Le Monde* (2002b).

⁶ The agreement did not put a stop to the lawsuits; see *El País* (2002a) and *Le Monde* (2002b).

These events seriously undermined confidence in the system as a whole. Having originally been confined to information technology and telecommunications stocks, the fall on the stock market began to spread to other sectors in 2002. Share price indices in many developed countries retreated to their levels of four, five or even six years earlier. For example, by September 2002, the Dow Jones industrial index had dropped to August 1998 levels; the Nasdaq, to its level of August 1996; London's FTSE International index (the "Footsie"), to early-1996 levels; the CAC 40 in France, to its mid-1997 level; and Germany's Dax, to where it had been in late 1996.

As their share prices plummeted on the stock market, firms also saw their profits and investment capacity wither. It became harder for them to obtain financing in a climate of strong risk aversion among investors and growing mistrust of the veracity of corporate balance sheets and the forecasts made by financial analysts. Banks, which were also affected by the crisis, tightened restrictions on their loans; investors, alarmed by major bankruptcies and the collapse of the telecommunications sector, demanded increasingly tough conditions on lending to firms.

Until 2000 the main selection criteria used for equity or bond purchases related to the general situation prevailing in the sector and the size or profitability of the firms in question. Today, however, investors are more concerned about a firm's debt status. Previously permissive risk-rating agencies have become very strict. While the most prestigious large corporate groups, with

assured yield and high liquidity, have no great problem in obtaining financing, the situation is much more difficult for other firms, especially those in the communications and information technology industry.

Restricted access to financing, compounded by the global economic slowdown, has radically altered firms' policy: as mentioned above, they have stopped competing on the basis of size and market share and have adopted a policy of strict control over expenditure and investment. One sign of this is the steep decline in FDI flows worldwide, a phenomenon that is largely due to the drying up of mergers and acquisitions (mainly cross-border operations), which were the largest component of FDI in the 1990s. The total value of mergers and acquisitions announced between January and September 2002 was US\$ 902.848 billion –down by 33% from the figure for the same period of the preceding year (see *América Economía*, 2002b).

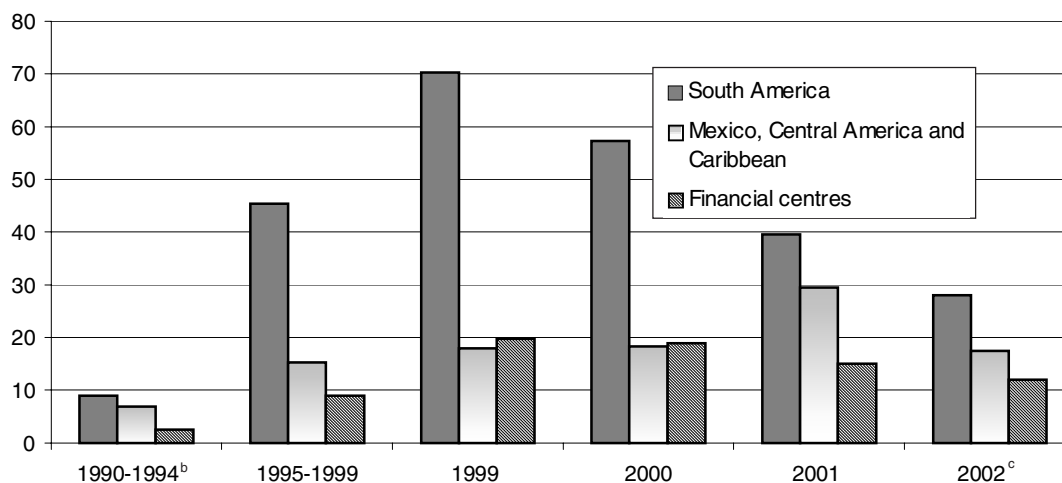
In short, FDI was affected both by short-term factors –mainly the economic slowdown in the United States and other leading industrialized economies– and by structural factors, such as the cyclical downturn in the information technology and communications industry. In addition, the institutional crisis of corporate governance in certain large TNCs undermined confidence among many investors (individual and institutional alike), who are now very cautious about using their savings to fuel a renewed expansion of large corporations. This distrust, combined with the reduced availability of global financing, has further dampened of FDI flows to the region.

2. Foreign direct investment in Latin America and the Caribbean: recent inflows and trends

In 2002 FDI flows to Latin America and the Caribbean fell by 33% in comparison to the 2001 figure, dropping from US\$ 84 billion to US\$ 56.2 billion. This latter figure was below the average for the second half of the 1990s (see table I.1 and figure I.2). In contrast to what had happened in 2001, however, this time the decline

in investment flows to the region was proportionally greater than the one observed worldwide. Thus, the downward trend in the region not only persisted for the third straight year, but became much steeper in relation to the decreases of 12.6% and 11% seen in 2000 and 2001, respectively.

Figure I.2
LATIN AMERICA AND THE CARIBBEAN: NET INWARD FOREIGN DIRECT INVESTMENT
BY SUBREGION, 1990-2002^a
(Billions of dollars)



Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of figures from balance-of-payments statistics published by the International Monetary Fund (IMF) and national agencies in each country. The figures for 2002 are estimates based on information from the countries' central banks. The information on financial centres was provided by the United Nations Conference on Trade and Development (UNCTAD), on the basis of outflows to tax havens reported by members of the Organisation for Economic Co-operation and Development (OECD). For those countries, figures for 2002 are estimates made by the Unit on Investment and Corporate Strategies. The figures presented are updated annually according to government authorities' revisions of their statistics. They differ from the figures given in the *Preliminary overview of the economies of Latin America and the Caribbean, 2002*, published by ECLAC, since in the latter net FDI inflows are taken to be investment in the reporting economy minus direct investment abroad by its residents.

^a Net inflows of direct investment in the reporting economy minus capital taken out of the country by the same foreign firms.

^b Annual average.

^c Estimates.

The context in which FDI flows take place in the world economy continued to have repercussions throughout the region, but with differential effects between countries where TNCs have pursued efficiency-seeking strategies (such as Mexico, Central America and the Caribbean) and those where they have focused on raw materials and market expansion (South America). This is discussed below.

(a) FDI in Mexico, Central America and the Caribbean

In Mexico, Central America and the Caribbean, FDI was hit particularly hard by the slump in United States demand for articles assembled in the subregion. Mexican industry also became less competitive as a result of the peso's revaluation. Nonetheless, a large part of the extraordinary drop in inflows to this country (see table I.2) can be explained by the exceptional level of net inward FDI in 2001 as a result of the US\$ 12.5-billion

purchase of Banamex by Citigroup. This transaction was described in detail in last year's report (see ECLAC, 2002). Had it not been for this exceptional amount, FDI flows to Mexico in 2001 would have broadly matched the levels recorded in recent years.

According to information from Banco de México (BANXICO), FDI inflows in 2002 amounted to US\$ 13.626 billion –down by 45% from the previous year's figure, but above the annual average for 1996-2000. The volume of FDI remained significant, especially in comparison to its levels in many other countries of the region. Nonetheless, the composition of these flows has changed in recent years. After the North American Free Trade Agreement (NAFTA) was signed, FDI tended to target the manufacturing sector, but in the late 1990s the proportion absorbed by this sector began to decline and, despite a slight recovery in 2002, has not managed to regain its level of the 1990s (see figure I.4).

Among manufacturing activities, the assembly industry has been a powerful magnet for FDI since the mid-1990s. The economic slowdown in the United States, compounded by the loss of competitiveness in Mexican industry, hit employment in this sector particularly hard. The number of workers employed in maquila activities, which in October

2000 had risen to a record 1.347 million, had dropped back to 1.089 million by September 2002. Exports from maquila enterprises displayed a similar trend (see figure I.3). Nonetheless, since March 2002 there has been a slight upturn in employment and a more positive trend in exports than in 2001, when sales abroad fell by 3.3%.

Table I.2
MEXICO, CENTRAL AMERICA AND THE CARIBBEAN: NET INWARD FOREIGN DIRECT
INVESTMENT BY COUNTRY, 1990-2002 ^a
(Millions of dollars)

	1990-1994 ^b	1995-1999 ^b	1999	2000	2001	2002 ^c
Mexico	5 430	11 184	12 478	14 192	24 731	13 626
Central America	577	2 039	2 180	1 961	2 018	1 730
Costa Rica	222	481	620	408	454	642
El Salvador	15	282	216	173	268	278
Honduras	41	120	237	282	195	179
Guatemala	88	213	155	230	456	110
Nicaragua	19	166	300	265	132	170
Panama	192	777	652	603	513	350
Caribbean (excluding financial centres)	839	2 006	3 326	2 110	2 716	2 397
Anguilla	10	28	38	39	28	35
Antigua and Barbuda	35	27	37	33	54	41
Aruba	38	150	392	-228	-324	-53
Barbados	11	15	17	19	18	18
Belize	14	23	47	18	34	33
Cuba	7	10	9	-10	5	1
Dominica	17	24	18	11	14	14
Grenada	18	32	42	37	34	38
Guyana	69	63	48	67	56	57
Haiti	0	11	30	13	3	8.0
Jamaica	124	285	524	468	614	535
Montserrat	7	3	8	3	4	5.0
Dominican Republic	171	594	1 338	953	1 198	850
Saint Kitts and Nevis	22	33	58	96	83	79
Saint Lucia	42	53	83	49	51	61
Saint Vincent and the Grenadines	22	62	56	28	36	40
Suriname	-38	-13	-62	-148	-27	-79
Trinidad and Tobago	270	605	643	662	835	713
Mexico, Central America and Caribbean	6 846	15 229	17 984	18 263	29 465	17 753

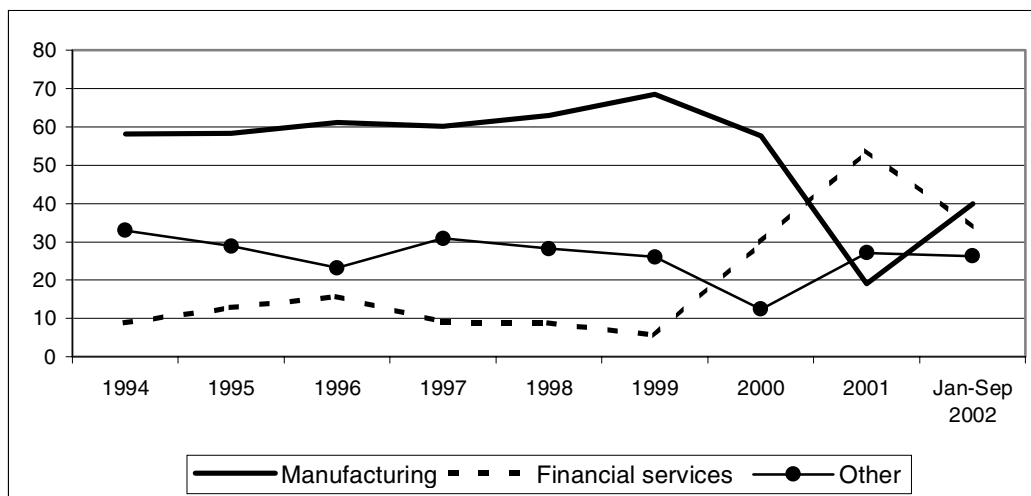
Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of figures from balance-of-payments statistics published by the International Monetary Fund (IMF) and national agencies in each country. The figures for 2002 are estimates based on information from the countries' central banks. The information on financial centres was provided by the United Nations Conference on Trade and Development (UNCTAD), on the basis of outflows to tax havens reported by members of the Organisation for Economic Co-operation and Development (OECD). For those countries, figures for 2002 are estimates made by the Unit on Investment and Corporate Strategies. The figures presented are updated annually according to government authorities' revisions of their statistics. They differ from the figures given in the *Preliminary overview of the economies of Latin America and the Caribbean, 2002*, published by ECLAC, since in the latter net FDI inflows are taken to be investment in the reporting economy minus direct investment abroad by its residents.

^a Net inflows of direct investment in the reporting economy minus capital taken out of the country by the same foreign firms.

^b Annual average.

^c Estimates.

Figure I.3
**MEXICO: IMPORTANCE OF THE MANUFACTURING AND FINANCIAL SERVICES SECTORS
 AS DESTINATIONS FOR FOREIGN DIRECT INVESTMENT**
 (Percentages)



Source: Ministry of Economic Affairs, National Foreign Investment Commission, *Informe estadístico sobre el comportamiento de la inversión extranjera directa en México* (January-September 2002).

Given the problems facing the industrial sector in general and maquila businesses in particular, in July 2002 the government of Mexico created a Competitiveness Council with the aim of stabilizing employment and speeding up the creation of new jobs that would generate both greater value added and better productivity, so that wages could be increased.⁷ Special action plans were to be drawn up for 12 branches of production, including the automotive, electronics and maquila export industries, along with the agricultural sector and the textile and clothing industry. In October 2002, the Ministry of Economic Affairs also introduced changes to the temporary merchandise imports, setting out specific requirements that replace the agreement previously in force with the United States. The new rules facilitate maquila operations by allowing the tariff-free importation of inputs on a temporary basis, while extending the term of the agreement.

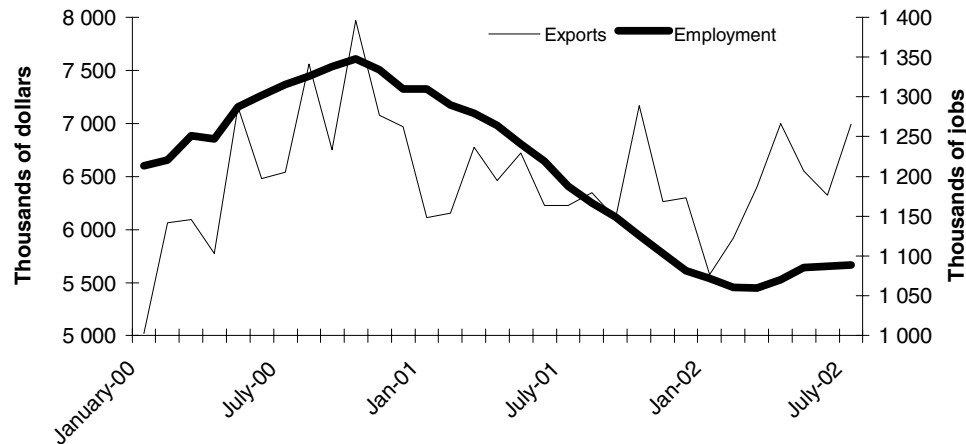
The bulk of FDI in services in 2002 continued to be channelled into the financial sector. The largest such operation was the US\$ 1.131 billion paid by the Hongkong and Shanghai Banking Corporation (HSBC) of the United Kingdom for a 99.2% stake in the Bital Financial Group, Mexico's fifth largest bank. This acquisition raised foreign ownership of the Mexican banking sector to over 90%.⁸

In brief, negative factors notwithstanding, in 2002 FDI in Mexico broadly maintained its level of previous years. As mentioned above, however, the composition of flows has changed, with investment in services overtaking investment in manufacturing. The admission of China into the World Trade Organization (WTO) has further undermined the competitiveness of Mexico's maquila sector, whose productive processes use simple technology, and has forced the remaining sectors (those using more advanced technology) to make up for lost markets and defend the market shares they achieved in Canada and the United States during the 1990s.

⁷ See the statement by Mr. Luis Ernesto Derbez, Mexico's Secretary of the Economy (www.terra.com.mx), 29 July 2002.

⁸ For more information on TNCs' strategies in Mexico, see section B of this chapter.

Figure I.4
MEXICO: EXPORTS AND EMPLOYMENT IN MAQUILA EXPORT INDUSTRIES, 2000-2002



Source: National Institute of Statistics, Geography and Informatics (INEGI).

Foreign direct investment flows to the Central American and Caribbean countries slid by an estimated 13% in 2002 because of the international economic situation and, fundamentally, the sluggish recovery of the United States economy. As in Mexico, these circumstances led to cutbacks in the manufacturing investments being made in the Dominican Republic and several Central American countries, such as El Salvador, Guatemala and Honduras. Investments in the tourism sector (which recently has absorbed large amounts of FDI in the Caribbean countries) receded after the terrorist attacks of 11 September 2001. Financial centres apart, FDI in this subregion is concentrated in just a few countries, the main recipients being the Dominican Republic, Panama, Costa Rica, El Salvador, Guatemala, Trinidad and Tobago, Jamaica and Honduras, in that order.

In 2002 FDI flows to Central America shrank by 14%, with those aimed at manufacturing for the export market falling most sharply. A notable exception to this trend was Costa Rica, which recorded a 29% increase in FDI as inflows to the manufacturing sector doubled, from US\$ 231 million in 2001 to US\$ 484 million in 2002 (Inter-Agency Group on Foreign Direct Investment, 2002). As will be discussed in section B of this chapter, Costa Rica's free zones received some greenfield investments in the manufacture of components and assembly of equipment in the telecommunications and tyre sectors. In El Salvador, a new foreign clothing firm was established.

Over the past decade, FDI in Costa Rica has risen steadily and substantially, turning that country into one of the primary beneficiaries of the Caribbean Basin Initiative (CBI) in terms of FDI flows. Most of these flows go to the manufacturing sector; in fact, between 1995 and 2002, this sector absorbed 65% of the total. In 1997 the tourism sector began to attract a significant amount of FDI, accounting for 12% of such investment between 1995 and 2002. Most manufacturing investment focuses on the free zones, specifically in the electronics, textile and clothing, metallurgical, medical products, agro-industry and jewellery sectors, which offer skilled human resources and free-zone incentives. The United States is the leading direct investor in Costa Rica, followed by Mexico; between 1995 and 2001, these two countries accounted for 66% and 10%, respectively, of Costa Rica's total FDI, although in 2002 the European Union countries supplied 37%, while the United States share fell to 38%. Foreign investment flows have had an evident effect on the structure of Costa Rican exports, since they have facilitated diversification into a wide range of industrial products, including high-technology products, mainly for the United States market.

In the Caribbean countries, FDI shrank by an estimated 12%. Most net inflows of FDI in the Caribbean (excluding financial centres) are concentrated in Jamaica, the Dominican Republic and Trinidad and Tobago. This trend has become more pronounced over time: while these three countries received 67% of net inflows between 1990 and 1994, the percentage rose to 74% between 1995 and 1999 and to 88% between 1999 and 2002 (see table I.2).

FDI in the Dominican Republic has been channelled primarily into the industrial free zones, in response to tax incentives and low-cost labour; the electricity sector, especially since the privatization, in 1999, of a number of generators and distributors; tourism; and telecommunications. In the industrial free zones, the leading sector is clothing; among the Caribbean and Central American countries, the Dominican Republic ranks first in terms of the volume of clothing exports to the United States market.

In Trinidad and Tobago, the hydrocarbon sector has been the major focus of FDI ever since the authorities decided to provide incentives for natural gas exploration and production by private companies. The latter started making sizeable investments in the mid-1990s and discovered large natural gas reserves, which spurred investments in related activities (gas liquefaction plants, petrochemicals, thermoelectric power plants, etc.) (see ECLAC, 2002).

Jamaica has received copious amounts of FDI in the service sector. The 2001 privatization of the electricity and energy firm Jamaica Public Service Company (JPSCo), purchased by Mirant Corporation of the United States, increased the flow of FDI to the electricity sector. The liberalization of telecommunications, which culminated in March 2003 with the abolition of the monopoly previously held by the United Kingdom firm Cable & Wireless in the long-distance segment, has opened up new opportunities in this sector which have recently attracted a number of foreign firms interested in the mobile telephone market. Other foreign companies have positioned themselves as Internet service providers and have installed call centres. In addition, the restructuring of the financial system beginning in 1997 led to the purchase, in 2001, of Union Bank⁹ by RTTB International –Trinidad and Tobago's largest bank– and to the privatization, in March 2002, of National Commercial Bank Jamaica Limited, which was purchased by Advantage Investment Counsel Limited (AIC), a Canadian investment firm.¹⁰ The tourism sector, which had traditionally been run by local businesses, has become one of Jamaica's biggest absorbers of FDI in recent years, largely as a result of generous government incentives. Considerable incentives have also been applied in other areas, such as textiles, agriculture and mining (bauxite and aluminium), and have attracted more FDI in these sectors.

Investment in Caribbean financial centres was also sharply down in 2002 (to US\$ 11 billion, compared to US\$ 15 billion in 2001). Noteworthy in this connection is the initiative launched by the Organisation for Economic Co-operation and Development (OECD),¹¹ urging the countries where these financial centres are located to intensify cooperation on tax matters, restrict distortionary practices and make the tax treatment of capital flows more transparent, thereby enhancing competition in the global financial market. To date, the vast majority of financial centres, both in the Caribbean and elsewhere in the world, have been actively implementing this initiative to eliminate harmful tax practices –as explicitly defined in the initiative– by April 2003.

Some Central American and Caribbean governments are taking special steps to counter the reduction in FDI flows. Guatemala, for example, is implementing a wide-ranging privatization policy, while Costa Rica is trying to boost FDI by developing high-technology and infrastructure industries. El Salvador is attempting to position itself better in sectors such as agriculture, call centres, electronics and apparel. To this end, for the past two years a new agency, the Investment Promotion Office (PROESA), has been promoting the development of new areas of investment, which has resulted in the installation of 58 new firms, creating 20,000 direct jobs. Puerto Rico, meanwhile, is implementing a strategy with similar objectives, involving an investment programme that includes tax concessions.

To summarize, the Central American and Caribbean countries (except Costa Rica) saw FDI flows slacken, especially in the clothing manufacture and tourism sectors. A number of governments have adopted special measures to reverse this trend (including policies on privatization, infrastructure development and new industries), while others have sought to better position themselves in the integrated international systems of TNCs.

(b) FDI in South America

Although the unfavourable international situation aggravated the recessionary climate that had prevailed in South America since the Asian crisis, it was the political and economic upheaval in Argentina that most strongly influenced FDI in this subregion. The deteriorating situation in that country in 2002 had major repercussions

⁹ Union Bank was the result of a merger among five commercial banks, four merchant banks and four finance companies under the restructuring process in the banking system.

¹⁰ AIC paid US\$ 134 million for the State's 75% stake; the remaining 25% is owned by small-scale shareholders (Bloomberg).

¹¹ See OECD (1998).

on the other members and associate members of the Southern Common Market (MERCOSUR). To varying degrees, these countries suffered from sharp contractions in the volume of trade (particularly Brazil, Uruguay and Chile), exchange-rate volatility, heightened country risk and a sharp reduction in migrant remittances (which strongly affected Bolivia and Paraguay).

The recessionary climate, compounded by monetary and exchange-rate instability, made investors more cautious. This was felt especially among foreign firms that had invested to gain access to national or subregional markets –the hardest hit being those with little or no chance of refocusing their activities on extraregional exports.

At the same time, the international economic situation was further disrupted by the protectionist policies emerging in the United States, which led to the imposition of new import restrictions in 2002.¹² On the other hand, the South American countries negotiated new

trade agreements aimed at opening up alternative outlets for their exports. In 2002 Chile signed a free trade agreement with the European Union,¹³ and in December signed a similar accord with the United States. Brazil also negotiated a separate agreement with the United States on trade in textiles, and signed an agreement with Mexico covering the automotive sector.

Privatizations, which fuelled much of the FDI flow to South America throughout the 1990s, are now facing increasingly hardened and sometimes violent political resistance. This has made it difficult to divest the few assets still owned by the State (in Bolivia, Ecuador, Paraguay, Peru and Uruguay).

In sharp contrast to this generally negative FDI growth panorama, investment flows to the Andean Community countries were relatively stable except in Venezuela (see table I.3), largely reflecting the keen interest shown in their oil and gas reserves by the corresponding TNCs, as detailed in chapter II of this report.

Table I.3
SOUTH AMERICA: NET INWARD FOREIGN DIRECT INVESTMENT, 1990-2002^a
(Millions of dollars and percentages)

	1990-1994 ^b	1995-1999 ^b	1999	2000	2001	2002 ^c	Variation 2002/2001 (%)
Argentina	3 027	10 599	23 988	11 657	3 214	1 003	-69
Bolivia	85	711	1 010	725	662	612	-7
Brazil	1 703	19 240	28 576	32 779	22 636	16 566	-27
Chile	1 207	5 402	8 988	3 639	4 476	1 603	-64
Colombia	818	2 788	1 468	2 280	2 328	1 950	-16
Ecuador	303	639	648	720	1 330	1 335	0
Paraguay	99	185	94	119	79	80	1
Peru	801	2 350	1 939	662	1 064	1 943	83
Uruguay	78	164	235	274	318	168	-47
Venezuela	836	3 298	3 290	4 465	3 448	1 389	-59
Total	8 956	45 375	70 236	57 320	39 555	26 649	-33

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of figures from balance-of-payments statistics published by the International Monetary Fund (IMF) and national agencies in each country. The figures for 2002 are estimates based on information from the countries' central banks. The figures presented are updated annually according to government authorities' revisions of their statistics. They differ from the figures given in the *Preliminary overview of the economies of Latin America and the Caribbean, 2002*, published by ECLAC, since in the latter net FDI inflows are taken to be investment in the reporting economy minus direct investment abroad by its residents.

^a Net inflows of direct investment in the reporting economy minus capital taken out of the country by the same foreign firms.

^b Annual average.

^c Estimates.

¹² These include an increase in United States agricultural subsidies, higher tariffs on imported steel and threats of non-renewal of trade agreements with countries of the region involved in disputes with United States TNCs (see the description of Ecuador's case in chapter II), among other measures.

¹³ This agreement has not yet been ratified by the respective legislatures of the 15 countries members of the European Union.

Brazil continued to receive large FDI inflows in 2002, which confirmed its position as the region's leading recipient. These flows remained strong despite fears of possible contagion from the crisis in Argentina –Brazil's main trading partner in MERCOSUR– and despite the uncertainty surrounding the elections, which in October confirmed the Workers' Party candidate as the nation's new president. An estimated US\$ 16 billion entered the country in 2002; although this figure was down by 27% from the previous year, an appreciable proportion corresponded to greenfield investments, as can be inferred from the fact that there were few privatizations, mergers and acquisitions.

While Brazil continues to be viewed by foreign investors as a country with great business potential,

willingness to invest in it over the next few years will depend on a revival of the domestic and MERCOSUR markets and on the country's management of its domestic and external debt, stabilization of monetary variables and enforcement of clear rules of the game for FDI.

The pattern of sectoral flows in the first nine months of 2002 (see table I.4) confirms the persistence of a break in the trend prevailing until 2000, whereby FDI flows were concentrated in the service sector. Thus, having accounted for 81% of the total in 2000, direct investment in services represented only 59% in January-September 2002 –similar to the figure for 2001. The manufacturing sector, meanwhile, continued to expand its share of FDI, accounting for 37% of total flows.

Table I.4
BRAZIL: SECTORAL DISTRIBUTION OF FOREIGN DIRECT INVESTMENT, 1996-2002
(Percentages)

	1996	1997	1998	1999	2000	2001	2002 ^a
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Primary sector	1.4	3.0	0.6	1.5	2.2	7.1	2.9
Petroleum extraction	0.6	0.1	0.1	1.1	1.6	6.5	2.2
Other	0.8	2.9	0.5	0.5	0.6	0.6	0.7
Manufacturing sector	22.7	13.3	11.9	25.4	17.0	33.3	37.2
Food and beverages	2.4	2.1	0.6	4.5	3.3	2.7	11.3
Automobiles	3.7	1.5	4.6	6.6	3.2	7.4	10.6
Chemicals	2.9	2.4	1.5	4.6	3.7	7.3	7.8
Machinery and equipment	2.3	1.3	0.8	0.3	1.9	1.6	1.5
Electronic and communications equipment	0.8	1.2	1.1	1.9	2.2	5.5	0.5
Other	10.5	4.8	3.4	7.4	2.7	8.7	5.5
Service sector	75.9	83.7	87.5	73.1	80.8	59.6	59.9
Postal and telecommunication services	8.0	5.4	11.0	28.3	36.5	19.6	25.6
Electricity, gas and water	21.2	23.2	9.5	10.8	9.9	6.9	9.2
Commerce	8.2	6.2	9.4	10.6	5.5	7.8	8.3
Financial intermediation	5.0	10.4	25.4	8.0	21.4	10.1	6.4
Business services	26.3	34.9	26.7	12.1	2.7	3.3	4.1
Other services	7.2	3.5	5.4	3.3	4.8	12.0	6.3

Source: Central Bank of Brazil.

^a For the period January-September 2002.

Within the manufacturing sector, the automotive industry has been absorbing increasing volumes of investment in recent years.¹⁴ This seems to be related to automotive firms' new strategy of exporting to countries outside the subregion, similar to other industrial segments, especially agro-industry. In the past year, currency devaluation has enabled export firms to lower their wage costs and raise profit margins, thereby providing an additional incentive for their export orientation. In some cases it proved necessary to expand

productive capacity to satisfy demand from new markets (see the discussion of corporate strategies in section B of this chapter). An analysis of target markets for Brazilian exports in 2002 confirms that this new strategy is in operation: in January-September,¹⁵ exports to MERCOSUR countries plummeted by 54%, while those to Mexico increased sharply (26%), as did those to other countries within and outside the region.

The major expansion in Brazil's exports to Mexico represents a trend that is likely to be strengthened by the

¹⁴ According to data from the Central Bank of Brazil, these flows amounted to US\$ 961 million in 2000, US\$ 1.55 billion in 2001 and US\$ 1.568 billion between January and September 2002.

¹⁵ See Secretaria de Comércio Exterior, Balança comercial (trade balance figures published by Brazil's Ministry of External Trade), September 2002.

bilateral agreement signed between the two countries in 2002. A key element of the negotiations was the agreement reached on the automotive sector, under which Brazil will be able to export to Mexico to meet demand in that market for vehicles and parts in the popular consumption segment (small engines).

The drop in the proportion of FDI in the service sector is the result of several factors. Firstly, there is the effect of the devaluation of the real on interest payments by public utility firms that have large debts in dollars; this raises costs in relation to their income in local currency. Secondly, the financial difficulties facing firms were aggravated by crises in their parent companies, which engendered an unfavourable climate for investment. Thirdly, foreign operators have been

dissatisfied with regulation in the electricity sector; this, together with the firms' financial problems, has led several of them to divest all or part of their assets in the subregion (see section B of this chapter). Nonetheless, FDI was more buoyant in the generating segment than in the electricity sector as a whole, thanks to incentives granted in February 2000 under the Priority Programme on Thermoelectric Power (PPT) and strengthened in June 2001 by inter-ministerial resolution PPT 176.¹⁶ Lastly, in the financial sector, the problems international banks face in competing with the local banking system have discouraged foreign investment in this sector, to the point where the leading local banks are now actually acquiring assets from their international competitors (see box I.1).

Box I.1

BRAZIL: LOCAL BANKS LEAD THE WAY IN BANK CONSOLIDATION

In sharp contrast to the trend in the rest of the region, local banks in Brazil are leading the consolidation process in the banking sector. Although numerous acquisitions have been made in this sector in the past two years, foreign banks, which had been very active in this regard five years earlier, have been conspicuously absent from this latest campaign. Some of them have even featured among the sellers.

The implementation of the Real Plan, which defeated hyperinflation and succeeded in stabilizing the economy for a while, was followed by a period of consolidation in the banking sector. Several foreign players, such as the Hongkong and Shanghai Banking Corporation (HSBC) of the United Kingdom, ABN-AMRO Bank of the Netherlands and Banco Bilbao Vizcaya Argentaria (BBVA) of Spain, had made a number of acquisitions, and it was expected that the privatization of Banco do Estado de São Paulo (BANESPA), which was taken over in late 2000 by Spain's Banco Santander Central Hispano (SCH) for US\$ 3.6 billion, would usher in a new era of foreign domination of Brazilian banks. Nonetheless, probably owing to financial instability, foreign banks have not made major acquisitions in Brazil in the last two years. By contrast, local institutions, especially retail consumer banks, have snapped up several recent opportunities.

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management.

Two local banks, Banco Brasileiro de Desconto S.A. (BRADESCO) and Banco Itaú, have embarked upon a race to acquire financial assets in Brazil, at times even buying out their foreign competitors. Among such purchases, early in the year BRADESCO paid US\$ 570 million for Banco Mercantil de São Paulo, in which Citibank had also shown interest, and US\$ 434 million for the automobile loan business belonging to Ford Motor Company in Brazil. It also acquired Investimentos DTVM, the local subsidiary of Deutsche Bank, which handles about US\$ 1.1 billion in investment funds and portfolio management. Lastly, in late January 2002, it made a successful US\$ 76-million bid in the auction of Banco do Estado do Amazonas (BEA).

The main rival of BRADESCO, Banco Itaú, is also pursuing an active acquisitions policy. Having already acquired Banco do Estado de Minas Gerais (BEMGE) in 1998, in late 2000 it was awarded the privatization of Banco do Estado do Paraná (BANESTADO) for US\$ 869 million, fending off competition from two foreign banks: SCH and ABN-AMRO Bank. In December 2001 its US\$ 274-million bid won the battle for Banco do Estado de Goiás (BEG), in which BRADESCO was also interested. In May 2002 it took over the private banking portfolio of the Brazilian subsidiary of Brascan, a Canadian conglomerate. Lastly, in

November 2002, it paid US\$ 922 million for a 97.75% stake in the investment bank BBA Creditanstalt, which included a 47.79% holding owned by Germany's HVB Group. This acquisition made Itaú Brazil's largest investment bank.

These two rivals, BRADESCO and Itaú, are also pursuing other privatizations and have qualified to bid for Banco do Estado do Ceará (BEC) and Banco do Estado do Maranhão (BEM). In addition, Banco Itaú has expressed interest in the privatization of Banco do Estado de Santa Catarina (BESC) and BESC S.A. Crédito Imobiliário (BESCRI). It also recently announced its desire to acquire banking assets in Argentina.

As a result of this lengthy consolidation process, the total number of banks operating in Brazil has shrunk from 240 in 1994 to under 170 today. Consolidation is also taking place in the related businesses of asset management and consumer credit. For example, Deutsche Bank sold its 49.9% stake in its recently launched personal finance business, MaxBlue, to Banco do Brasil. UBS Warburg of Switzerland sold its asset management portfolio to BNP Paribas of France, and Lloyds TSB of the United Kingdom sold its Brazilian asset management business to Itaú.

All these acquisitions were driven by the importance of scale in the banks' strategies and by the defensive tactics they have had to adopt (see chapter III of this report).

¹⁶ The aim of PPT was to convince private operators to build 49 thermal generators, 44 of which would be gas-fired; the programme guaranteed that gas would be supplied at subsidized prices. In view of the disappointing response by private-sector investors, inter-ministerial resolution PPT 176, adopted in June 2001, set a guaranteed price for gas and granted exchange insurance for PPT projects that used Bolivian gas and that came on stream by 30 June 2003 (see *Oil & Gas Journal Latinoamérica*, 2002).

Lastly, FDI in Brazil's primary sector continues to be dominated by oil extraction, which had been partially opened up to foreign capital in 1999. Flows to this sector usually relate to fees for exploration, development or production concessions in petroleum areas auctioned by the National Petroleum Agency (ANP); in addition, some flows represent investment commitments agreed upon with ANP. The reduction in direct investment flows in 2002 compared to the previous year's level does not signal a slowdown in activity by foreign firms in the sector, but reflects the exceptionally large amount of FDI received in 2001. A sizeable proportion of that year's FDI figure was related to the purchase of assets belonging to *Petróleo Brasileiro (Petrobras)* by *Repsol-YPF* of Spain, as part of an asset swap whereby the latter ceded assets it held in Argentina in exchange for *Petrobras* assets in Brazil (see ECLAC, 2002).

In Argentina, FDI inflows shrank for the third straight year, dropping to US\$ 1 billion, which is below the average for 1990-1995. This trend is closely related to the acute economic and political crisis the country has endured for the past few years. The deepening recession, which began in 1999 and culminated in 2001-2002 with financial crisis and the end of the convertibility regime, has radically altered the parameters on which the FDI boom was based in the 1990s.

Insurance against exchange-rate risk –which is what the convertibility regime essentially represented– disappeared when the peso was devalued (by about 70%) and a floating exchange rate was adopted. In response to the economic emergency, privatized public utility charges, which previously had been dollarized and indexed to inflation in the United States, were frozen in local currency terms. Total banking freedom was abruptly ended as tight restrictions were placed on deposit withdrawal. The Central Bank banned the payment of dividends abroad and required exporters to convert their foreign-exchange earnings in Argentina.¹⁷ Lastly, exports, which previously were not taxed, are now subject to a levy to offset the windfall benefit they have received from the change in relative prices caused by devaluation. This measure was also adopted to prevent supply shortages on the domestic market. On top of all this, the size of the domestic market shrank substantially, directly affecting firms' sales.

This panorama, which differed radically from the one prevailing in the 1990s, had repercussions on the

activities and strategies of foreign firms operating in the country. Of these, the worst hit by the crisis were firms serving the domestic market, such as financial and non-financial services; those that had expanded in Argentina during the 1990s largely on the back of foreign-currency borrowing (such as *Repsol-YPF*);¹⁸ and a number of public utility firms. As a result of the crisis, five foreign-bank branches, out of a total of 12, were taken over or brought under the control of local private or State banks,¹⁹ while several privatized public utility firms are no longer receiving support from their respective parent companies and have declared a suspension of payments (see table I.5).

This situation highlights the shortcomings of regulatory bodies and risk-rating firms that failed to perceive the fragility of an expansion financed almost exclusively by borrowing. They mistakenly believed that the prestige and reputation of parent companies offered sufficient guarantees. For example, in January 2001, when the deterioration in Argentina's economic situation was already evident, *Standard & Poor's* rated an unguaranteed syndicated loan of US\$ 108 million for the firm *Aguas Argentinas* as risk-free for investment. In April 2002, however, the firm suspended payments and the loan was downgraded to the worst risk category (default grade "D"). The total external debt of corporations operating in Argentina is currently estimated at US\$ 45 billion, half of which is owed by foreign firms (see *The Economist Intelligence Unit*, 2002c).

Foreign firms that produce tradable goods and are not shackled by a high level of borrowing have been better able to withstand the crisis. Such firms do not have to deal with the expiry of onerous foreign-currency liabilities, and some of them have the option of redirecting their sales to external markets, taking advantage of the changed structure of relative prices produced by the devaluation (see section B of this chapter).

The policy of indiscriminate liberalization applied until 2002, which was accompanied by strong incentives that enabled foreign firms to earn attractive profits, proved to be unsustainable in the long term. Curiously enough, the foreign firms that today are either suspending payments, closing subsidiaries or facing financial difficulties operate in the very sectors that sent the most income abroad in the 1990s: privatized public utilities and petroleum (see table I.6).

¹⁷ In the case of oil companies, this requirement applies to only 30% of their exports.

¹⁸ For details on the problems experienced by *Repsol-YPF* since the Argentine devaluation, see ECLAC, 2002.

¹⁹ *Scotiabank Quilmes*, a subsidiary of Canada's *Bank of Nova Scotia*, was closed down for 20 weeks until September 2002, when its branches were divided between two local banks: *Bansud-Macro* and *Banco Comafi*. France's *Crédit Agricole* owned three banks in Argentina (*Banco Bisel*, *Banco Suquia* and *Banco de Entre Ríos (BERSA)*), which were taken over by the State-owned *Banco de la Nación Argentina (BNA)*. Lastly, in October 2002 an agreement was reached for Argentina's *Banco Patagonia* to take control of *Banco Sudameris Argentina S.A.*, a subsidiary of the Italian group *Intesa BCI*. *Patagonia's* Argentine shareholders will hold 80% of the equity, with *Intesa BCI* retaining the remaining 20%. In contrast to the other two cases, in this case the Italian bank did not totally abandon the business, but remained as a minority partner.

Table I.5
ARGENTINA: FOREIGN PUBLIC UTILITY FIRMS THAT DECLARED SUSPENSIONS OF PAYMENTS IN 2002

Firm	Sector	Foreign investor	Country of origin	Ownership share %
Aguas Argentinas	Sanitation	Suez-Lyonnaise des Eaux	France	39.9
		Aguas de Barcelona	Spain	25.0
		Vivendi	France	7.5
		Anglian Water	United Kingdom	4.3
Autopistas del Sol	Highway infrastructure	Áurea	Spain	45.0
		Impregilo Iglys	Italy	18.3
		Dragados Dycasa	Spain	6.5
		Enron	United States	50.0
CIESA ^a	Gas transportation	EDF Internacional	France	100.0
EASA ^b	Electric power	United Utilities	United Kingdom	45.0
IEBA ^c	Electric power	Morgan Stanley	United States	16.0
IMPSAT ^d	Telecommunications	British Telecom	United Kingdom	20.0
		Crédit Suisse	Switzerland	1.0
		BG Group	United Kingdom	38.3
Metrogas	Gas distribution	Repsol –YPF	Spain	31.7
		Telecom Italia	Italy	27.4
Telecom Argentina	Telecommunications	France Telecom	France	27.4
		TotalFinaElf	France	19.2
TGN	Gas transportation	CMS Energy	United States	12.9
		Petronas	United Kingdom	12.9
		National Grid	United Kingdom	27.6
Transener S.A.	Electric power			

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information published in the specialized press.

^a CIESA: Compañía de Inversiones de Energía, 70% owner of Transportadora Gas del Sur (TGS).

^b EASA: Empresa Electricidad Argentina S.A., 51% owner of Electricidad del Norte (Edenor).

^c IEBA: Inversora Eléctrica de Buenos Aires.

^d IMPSAT ceded its shares to suppliers.

Table I.6
INCOME SENT ABROAD BY FOREIGN FIRMS IN ARGENTINA, BY SECTOR, 1992-2001
(Millions of dollars)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	1992-2001
Petroleum	385	326	465	445	479	376	306	999	2 093	1 164	7 039
Mining	-1	-10	-3	-4	-12	-8	-27	18	31	13	-2
Manufacturing	458	616	820	507	522	903	595	-175	-156	-358	3 734
<i>Agro-food</i>	239	213	272	315	129	290	275	365	229	61	2 387
<i>Automotive</i>	116	173	253	-166	-40	-37	-189	-467	-496	-388	-1 241
<i>Chemicals, rubber and plastic</i>	136	257	288	330	399	399	295	-56	-14	-41	1 993
<i>Other</i>	-33	-26	8	28	34	251	214	-17	125	10	595
Non-financial services	223	461	699	830	696	840	1 068	656	322	206	6 002
<i>Electricity, gas and water</i>	-13	200	297	423	377	500	579	546	570	304	3 784
<i>Commerce</i>	108	107	234	140	105	58	170	37	-76	-87	796
<i>Transport and communications</i>	128	154	168	267	214	282	320	73	-172	-11	1 422
Banks	71	204	-150	164	52	122	229	135	208	242	1 277
Other	60	127	99	25	113	137	209	24	-92	260	959
Total	1 196	1 724	1 930	1 967	1 851	2 369	2 380	1 658	2 406	1 527	19 009

Source: International Accounts Office, Argentine Ministry of Economic Affairs and Public Works and Services.

Of all the South American countries, Chile has shown the greatest macroeconomic stability. Despite the small size of its market, it was one of the largest recipients of foreign investment in the 1990s. In 2002, however, investment flows plummeted to US\$ 1.603 billion, which was 64% lower than the 2001 figure.

The main beneficiary sectors continue to be mining; electricity, gas and water; and financial services. According to official data for the first half of 2002, the United States has regained its status as the main source of investments, accounting for 30% of the total, after several years of dominance by Spanish investors.

In one of the few acquisitions carried out in 2002, Banco Santander Central Hispano (SCH) paid US\$ 680 million to the Central Bank for a 35.4% holding in Banco Santiago. With this acquisition, SCH increased its total stake to 80% and began the process of merging the two banks. This merger, which exemplifies the Spanish banks' aggressive policy of penetration in Latin America, created the biggest financial institution in Chile (see chapter III of this report).

Another major operation was the takeover of Compañía Minera Disputada de Las Condes S.A., owned by ExxonMobil of the United States. This mining company was acquired by Anglo American of South Africa for about US\$ 1.3 billion,²⁰ in a move that significantly increased the scale of Anglo American's operations in Chile – it already owned the Mantos Blancos and Moly-Cop Chile mines, and had a 44% interest in María Inés de Collahuasi.

This operation revived a perennial debate in Chile concerning the role of TNCs and the relevant regulatory frameworks in the non-renewable natural resource sector. This was because ExxonMobil, in all the years it was running the mine, never declared an accounting profit and thus did not pay the corresponding taxes. Under the Chilean tax system, mining companies, like firms in other economic sectors, only pay tax on their accounting profits. This enables them to extract mineral resources and pay dividends abroad without any tax liability until they fully amortize all the capital invested (see Moguillansky, 1999, and Moussa, 2001).

Given the general slackness of FDI flows, the authorities have attempted to distance Chile's image from that of its crisis-stricken neighbours and to shore up the country's ability to attract foreign capital. The measures deployed to achieve this include a programme to attract high-technology investments (see ECLAC, 2002, chapter I), progress in the promulgation of laws on public share offerings, the removal of obstacles to capital entry and the promotion of Chile abroad.

The authorities hope that these policies, in conjunction with the free trade agreements signed in 2002 with the United States (after more than 10 years of negotiations), the European Union and the Republic of Korea, along with other bilateral agreements already in force, will give significant impetus to the materialization of greenfield investment in Chile. In January 2003 the government launched a campaign headed by the Foreign Investment Committee and the Production Development Corporation (CORFO) to promote a programme known

as "Chile: A platform for new markets", aimed at encouraging TNCs to choose Chile as the hub for their operations in the region. For this purpose, it suggests that TNCs could share services, call centres, technical and administrative support facilities and software development, among other activities. Under this same policy, in November 2002 the Chamber of Deputies passed a tax bill granting exemption from income tax to foreign-owned firms that invest from Chile in other countries. Among other aims, the new tax regulations are intended to eliminate double taxation on TNCs that choose Chile as a platform for regional investment.

In contrast to the pattern prevailing in the rest of the region, FDI in the Andean Community countries either fell much more slightly, remained stable or even grew,²¹ except in Venezuela, where FDI flows plummeted by 59% between 2001 and 2002. In Colombia, investments dropped by 16% compared to the previous year's level (which was half the average decline in South America); inflows slipped by 7% in Bolivia, held steady in Ecuador and jumped by 83% in Peru. This performance is mainly attributable to large-scale projects undertaken in the hydrocarbon sector, reflecting the interest shown by transnational oil companies in those countries' extensive hydrocarbon reserves. In the case of Peru, the sharp increase in FDI flows also reflects the purchase of the Backus brewery by Bavaria of Colombia and the Cisneros group of Venezuela (see annex table A.I.1 and chapter II).

To summarize, considering the region as a whole, in 2002 FDI continued on the downward trend it had begun in 1999, only this time the decline was steeper. Investment levels fell particularly sharply in Mexico, Central America and the Caribbean. In Mexico, the extent of the fall largely reflects an exceptionally high inflow in 2001 related to the BANAMEX takeover by Citigroup. The slump in manufacturing investment as a result of the cyclical downturn in maquila production was offset by new acquisitions in the financial sector. Meanwhile, financial centres continued to receive flows of transitory investment, albeit in smaller amounts, in line with the depressed level of transactions in the region. In South America, investment flows dwindled in response to the Argentine crisis and its repercussions throughout MERCOSUR, but this was partly offset by investments in the hydrocarbons industry (especially in Andean Community countries), since the behaviour of this sector tends to be independent of the specific situation in Latin America at any given time.

²⁰ Since this was a transaction between foreign shareholders, it does not affect net FDI inflows.

²¹ See chapter II of this report.

B. FDI STRATEGIES, AGENTS AND MODALITIES

1. TNC strategies in Latin America

As described in previous reports, TNCs deployed three clearly distinguishable strategies in Latin America in the 1990s (see box I.2). Firstly, United States corporations (which account for the majority of TNCs), along with Japanese and European enterprises, pursued an efficiency-seeking strategy in Mexico, Central America and the Caribbean by taking advantage of lower labour costs and the modernization of processes for assembling a variety of goods (automobiles, electrical and electronic products, clothing) for sale in the Canadian and United States markets. As discussed below, in 2002 these firms were hit particularly hard by the slump in United States demand, and this has discouraged the investment process, albeit perhaps only temporarily. As a result, FDI aimed at assembly

manufacture has faltered. In addition, TNCs in South America have maintained their traditional strategy of seeking raw materials and markets. Radically changed circumstances in the subregion compared to those prevailing in the 1990s, and the absence of the factors that fuelled investment during that period (privatizations, confidence in the favourable impact of economic reforms and high growth expectations), confronted firms with new structural conditions and forced them to rethink their investment strategies. As a result, 2002 saw the confirmation of a process that had begun the preceding year, with FDI becoming increasingly oriented towards manufacturing for export outside the region, as a defence mechanism in response to a depressed domestic market.

Box I.2
LATIN AMERICA AND THE CARIBBEAN: STRATEGIES OF TRANSNATIONAL
CORPORATIONS IN THE 1990s

Corporate strategy Sector	Efficiency-seeking	Raw materials-seeking	Market access-seeking (national or subregional)
Primary		Oil/gas: Argentina, Bolivia, Brazil, Colombia, Ecuador, Peru, Trinidad and Tobago and Venezuela Minerals: Argentina, Chile and Peru	
Manufacturing	Automotive industry: Mexico Electronics: Mexico, Central America and Caribbean countries Apparel: Central America and Caribbean countries, Mexico		Automotive industry: Argentina and Brazil Agro-industry: Argentina, Brazil and Mexico Chemicals: Brazil
Services			Financial: Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela Telecommunications: Argentina, Bolivia, Brazil, Chile, Colombia, Mexico, Peru and Venezuela Electric power: Argentina, Brazil, Chile, Colombia and Central American countries Natural gas distribution: Argentina, Brazil, Chile, Colombia and Mexico Retail trade: Argentina, Brazil, Chile and Mexico

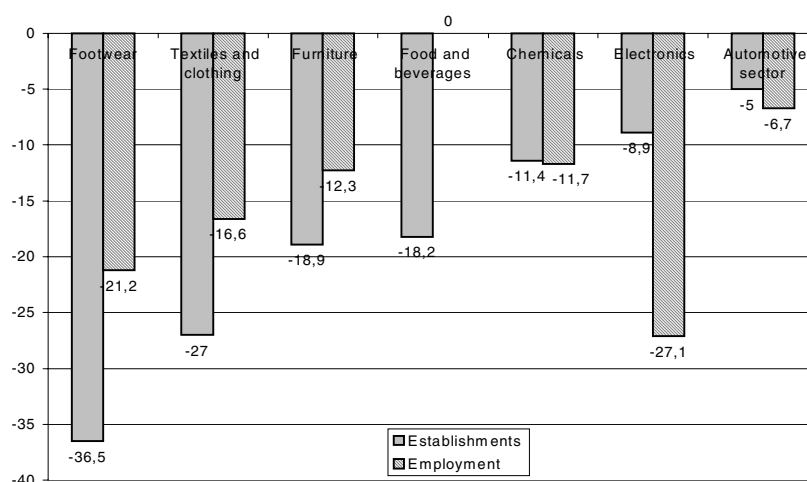
Source: ECLAC, Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management.

(a) Efficiency-seeking firms targeting Mexico, Central America and the Caribbean

In Mexico, TNCs were badly hurt by the slump in demand from the United States (the main destination for Mexican exports), and also by the loss of international competitiveness caused by the revaluation of the local currency. The effect of these factors varied between

sectors, with segments that use relatively low levels of technology and labour skills suffering the most. These included firms making footwear, textiles and clothing, furniture, and certain electrical and electronic products. In response to this situation, many firms cut hours and laid off a large proportion of their workforce, although in some product categories there were a significant number of business closures (see figure I.5).

Figure I.5
**MEXICO: REDUCTION IN THE NUMBER OF ESTABLISHMENTS AND WORKERS EMPLOYED
 IN MAQUILA EXPORT ACTIVITIES, JANUARY 2001-OCTOBER 2002**
 (Percentages)



Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of National Institute of Statistics, Geography and Informatics (INEGI) (www.inegi.gob.mx/difusion/).

Figure I.5 highlights the scale of job losses in the electronics sector compared to the relatively small number of businesses that actually closed down. In this sector there is a clear distinction between enterprises that assemble technologically more complex products and those that manufacture inputs or simpler articles using low-skilled labour. In the first group, the proportion of establishments that closed was 6.6% and there was no overall reduction in employment, which means that some firms pressed ahead with their expansion policy by absorbing laid-off workers. In the second group, the number of establishments shrank by 11% and employment, by 33%.²²

Firms in the electronics sector that were forced to shut down operations in Mexico include Canon (Japan), which moved its Tijuana printer plant to Thailand and Viet Nam, and Philips Electronic N.V. (Netherlands), which in June 2002 announced that it was phasing out its production in Mexico over a three-month period and moving those activities to China. Several other firms followed in their footsteps, including Alps Electronic, which laid off 1,700 workers; Casio Computer, which laid off 700; and Sanyo, which laid off 320 (for further details see *The Economist Intelligence Unit*, 2002g; Reuters, 28 June 2002; and Bloomberg Markets, November 2002).

²² See INEGI (www.inegi.gob.mx/difusion/).

Nonetheless, the comparative advantage of strategic proximity to the United States market continues to entice TNCs that make mid-level- and high-technology final products. Some of these firms adopted the tactic of cutting back production while they waited for the United States economy to recover –examples include Ford Motor, Scientific-Atlanta and Hewlett Packard (see *The Economist Intelligence Unit*, 2002f and 2002g). In the automotive segment, several firms announced new investment projects, including DaimlerChrysler and Toyota (automobiles) and Michelin and Firestone (tyres).²³ Even Ford Motor, which had announced a 17% cut in its production in Mexico in 2002,²⁴ is planning investments of US\$ 1.8 billion to expand operations at its pressing and assembly plant located in the State of Sonora (*El Universal*, 2002d).

The automotive industry in Mexico staged a recovery in 2002, as growing domestic demand took up the slack from weaker exports. Between January and October, the production of automobiles for the domestic market grew by a cumulative 11% compared to the same period of 2001, while production for export fell by 5.3%. This resulted in a 0.4% variation in output overall (AMIA, 2002).

If this trend is confirmed, it will represent a change in the structure of Mexican exports, with labour-intensive product lines declining and those that make more intensive use of technology and human capital increasing.

The Central American countries likewise experienced a downturn in flows to the export manufacturing sector, but there were also greenfield investments in some sectors, including the opening of a subsidiary of the United States-based Merrimac Industries in Costa Rica. This firm designs and manufactures components and assemblies for third-generation wireless telecommunications, which are used in the aerospace and defence industries and for commercial applications. In El Salvador, a new transnational clothing manufacturer, Trims International, is about to set up operations in the Santa Tecla Free Zone,

with the aim of making clothing under the full-package modality.²⁵

(b) Raw materials-seeking TNCs

As mentioned earlier, in contrast to the downward trend in investment flows globally, FDI aimed specifically at raw materials extraction in the region stayed at about the same level recorded the preceding year. This primarily reflected investments in the hydrocarbon sector (oil and natural gas), especially in the Andean Community countries. There were no major investments in the mining sector, in contrast to what had happened in 2001, when development of the Antamina mega-project had been completed. This copper and zinc mine in Peru involved a total disbursement of US\$ 2.25 billion, making it the biggest mining investment worldwide between 1998 and 2001.

FDI in extractive activities is usually aimed at extraregional exports. Natural gas is an exception, however, since its particular transport conditions allow for investments aimed at a local market (see ECLAC, 2002). Investments in extractive activities are capital-intensive and, except in the natural gas segment, have few linkages with local economies. Accordingly, domestic conditions in the host country tend to have little effect on investment decisions.

Moreover, given the strategic nature of hydrocarbons, TNCs tend to invest even in circumstances that would normally be considered hostile to FDI. In Latin America and the Caribbean, such factors include the dominant position held by the incumbent State firm, the requirement to act in partnership with the public sector, the fact that FDI can only enter marginal fields or exploration zones and the existence of political instability or armed conflict. Lastly, the current geopolitical situation in the Persian Gulf, which is heightening the uncertainty of supply and pushing up the price of oil, has strengthened TNCs' interest in investing in other parts of the world with oil potential.

²³ In early 2002 DaimlerChrysler decided to shift production of its PT Cruiser model from Austria to Mexico and to invest some US\$ 300 million in the course of the year to expand its plant in Toluca in central Mexico (*Gestión*, 2002a). Toyota, meanwhile, announced in September 2002 that it would invest US\$ 140 million to install a new assembly line in its Tijuana plant, which would turn out 20,000 Tacoma pick-up trucks a year starting in 2005 (*El Universal*, 2002c). In April 2002 Michelin announced that it would open a tyre production plant in central Mexico, which would manufacture some 6,000 tyres a day for the domestic and external markets, with an investment of US\$ 50 million (*Gestión*, 2002b). Firestone planned to invest US\$ 10 million in new technologies and the expansion of its two Mexican plants in 2002 (*América Economía*, 2002a).

²⁴ This is equivalent to about 40,000 cars a year.

²⁵ This means that the manufacturer provides the full range of services, from the purchase of inputs to the manufacturing process to the timely delivery of the finished merchandise.

FDI in the natural gas sector has remained buoyant, even though the sector's closer linkages with local economies could have represented a liability in this regard, given the economic difficulties being experienced by several countries in the region. This is because firms are eager to cash in on the large reserves discovered in recent years, mainly in Bolivia, in which they have already invested considerable sums. Two other favourable influences should also be noted: firstly, the potential for developing new markets for natural gas, given that this hydrocarbon still represents only a small fraction of the energy mix in the region's countries, except in Argentina; and secondly, the equally interesting potential of projects aimed at exporting liquefied natural gas (LNG) to markets outside the region.

In 2002 several major investments were undertaken in the hydrocarbon sector in Andean Community countries,²⁶ including: (i) projects linked to the export of Bolivian natural gas to Brazil; Bolivia is also about to receive a major capital injection for a project to export LNG to the United States and Mexico (see ECLAC, 2002); (ii) development of the Camisea natural gas project in Peru;²⁷ (iii) investments in oilfield exploration, development and exploitation in Ecuador, and in construction of the heavy crude oil pipeline; (iv) investments in oilfield exploitation in Colombia, where production from the Guando field (which was discovered in 2000 by a consortium led by Petrobras, and is considered the largest find in Colombia since the Cusiana and Cupiagua fields)²⁸ came on stream in July 2002; and (v) investments in oil and gas in Venezuela, where an agreement to develop the Mariscal Sucre project,²⁹ requiring an outlay of US\$ 2.7 billion, was signed in November 2002. The agreement involves Petr leos de Venezuela S.A. (PDVSA), which is expected to put up 60% of the capital, together with Shell Venezuela S.A. (10%), Mitsubishi Venezolana C.A. (8%) and several locally-owned firms (2%).

In addition to projects in the hydrocarbon sector that are currently under study or being developed in Andean Community countries, in Mexico transnational oil companies are jockeying for position in the only segment that is open to private capital, namely downstream activities in natural gas. One of the leading investors is

Gas Natural M xico, a subsidiary of Gas Natural S.D.G. Other firms have also shown interest in investing in LNG regasification projects, under which they plan to transport liquefied gas to terminals along the coast of Baja California, south of the border with the United States. Interested firms include Shell Gas & Power, which intends to build a US\$ 500-million regasification plant in Baja California, and Phillips Petroleum Company, which is planning a joint venture with El Paso Corporation of the United States to transport LNG to the city of Rosarito from gas deposits located under the Timor Sea. In addition, Marathon Oil Company, in partnership with the Indonesian State oil company Pertamina, has announced a plan to build an LNG complex close to Tijuana. Lastly, CMS Energy Inc. and Sempra Energy International have plans to transport LNG from Latin America to a terminal to be located on the outskirts of Ensenada. In August 2002 Sempra announced its intention to invest a total of US\$ 10 billion in Mexico over the next five years. In addition to the regasification terminal, its projects include the construction of gas pipelines and electric power plants (*El Economista*, 2002c).

Mexico's Energy Regulatory Commission is currently reviewing 18 different LNG proposals. Projects in this field generally require large-scale investments, since they entail building port facilities, gas pipelines and regasification plants to deliver the product in gas form to consumers (*The Wall Street Journal Americas*, 2002a).

In Argentina, the crisis has caused major problems for oil companies that have a large proportion of their assets in that country and that also have to service the large foreign-currency debts they used to fund their rapid expansion in the region in the 1990s. This is true of Spain's Repsol-YPF and a number of Argentine enterprises, including P rez Companc (PeCom Energ a). Given the serious financial difficulties PeCom Energ a was facing in 2001, an imminent change of ownership was forecast in last year's report (ECLAC, 2002). In 2002 the firm was duly taken over by Brazil's State-owned Petrobras, making the latter the second-largest oil company in Argentina. Petrobras is apparently also interested in acquiring Argentine assets owned by Repsol-

²⁶ See chapter II of this report.

²⁷ The total cost of this project, up until it comes on stream commercially in mid-2004, is estimated at US\$ 1.6 billion; subsequent costs are expected to add another US\$ 1 billion to this amount.

²⁸ The Cusiana and Cupiagua fields, which contain large reserves of high-quality crude, were discovered in the early 1990s by a consortium led by British Petroleum.

²⁹ This is a natural gas production project that includes: (i) development of offshore gas fields located north of the Paria Peninsula; (ii) processing of the gas in a liquefaction plant to be built onshore; and (iii) export of liquefied gas to Brazil, the eastern seaboard of the United States and Mexico.

YPF, the leading player in the sector in that country (see *La Nación*, 2002, and *Gazeta Mercantil*, 2002). Petrobras currently operates about 600 service stations in Argentina under the brand name Eg3, acquired as part of an asset swap with Repsol-YPF in December 2001 (see ECLAC, 2002). It is currently studying a variety of investment alternatives in Argentina. Its immediate goal is to have service stations operating under its own banner, for which it plans to invest US\$ 140 million between now and 2004 in the refining and marketing areas.

(c) Market-seeking TNCs

Market-seeking strategies are employed by TNCs engaged in a wide range of activities, both manufacturing, where their activities are aimed at local or regional markets, and services. Transnationals pursuing this strategy in the manufacturing sector include firms linked to the automotive sector in MERCOSUR, which, as discussed in the case of Brazil, have been restructuring with a view to expanding their sales beyond the subregion. The same process is taking place in Argentina, though it is still at a very early stage. By contrast, in the Latin American brewing industry, regionally owned firms have been more active than transnationals in fighting for market position. Meanwhile, TNCs that invest in public utilities face adverse conditions both globally and regionally. The sharp deterioration in the South American currencies' purchasing power as against foreign currencies, especially since the Argentine crisis, has significantly eroded TNCs' income in the region. This was compounded by the heavy foreign-currency debts they had contracted to finance their rapid expansion, together with the financial woes of their parent companies. The upshot of these factors was that such firms slashed their investments in the region. Some have declared a suspension of payments, as discussed in connection with Argentina, while others are seeking to sell off their assets in the region. This section examines the situation prevailing in the brewing, automotive and service industries. The situation in the financial sector will be analysed separately in chapter III of this report, given its enormous importance for the economy as a whole and for investment financing in particular.

- The new configuration of the regional brewing industry

In recent years, the brewing industry has witnessed a series of aggressive strategic moves by the region's largest players. Brewing is one of the most advanced sectors of manufacturing in terms of market consolidation, partnerships, acquisitions and the exploitation of synergies between firms. The factors

underlying this development include trade liberalization in the various economies and the overall globalization process. These phenomena, by intensifying competition, have prompted firms to cut costs, enhance efficiency and improve distribution channels. The brewing industry has also forged increasingly close links with the soft drinks sector, and this has boosted profits by exploiting the similarity of activities and synergies between firms in the two segments.

One of the features that distinguish this process from patterns in other industries is that it basically involves large regionally owned firms that compete for market position. Their strategies comprise two phases: one in which they acquire and/or merge with local firms and consolidate their hegemony in the home market, and another in which they expand regionally via strategic acquisitions in other countries for the purpose of strengthening positions in those markets and improving distribution channels.

This has resulted in greater industry concentration and the formation of large regional brewing groups. Although the major transnational brewers, such as Anheuser-Busch, Heineken, Miller Brewing, South African Breweries, Interbrew and Carlsberg, have not claimed a leading role in the new industry structure in the region, they have not been entirely absent, having purchased blocks of shares in the main brewing groups or forged partnerships with them.

Reorganization of the sector began in 1999, when Brahma, the leading Brazilian brewer, merged with its biggest competitor, Antártica, to consolidate its position as the Brazilian market leader, with a share of approximately 80%. The firm that resulted from this merger (AmBev) has since made moves to expand its regional presence, including a recent agreement to take a 37% stake in Quilmes, the main Argentine beer conglomerate, with interests in Bolivia, Paraguay and Uruguay. Although AmBev and Quilmes will maintain separate corporate images, the aim is to establish joint operational management and to merge fully in 2009. Nonetheless, the operation has not yet been carried out, since it has given rise to numerous legal objections filed by competitors and minority shareholders. With this operation and the acquisition of a number of smaller firms in Paraguay and Uruguay, AmBev would become one of the world's largest brewers in terms of sales. In addition to the Brazilian market, it would also gain control of the Argentine, Bolivian, Paraguayan and Uruguayan markets, making it the leading brewery group in the Southern Cone. It should be noted that the headquarters of the group that controls Quilmes is located in Luxembourg, so the acquisition is considered officially as a transaction between foreign firms.

Other firms had to respond rapidly to this newly developing industry landscape. The Colombian brewer Bavaria followed Brahma by consolidating its local presence before embarking on an active internationalization process. In 2000 it acquired Cervecería Leona, its main domestic competitor, and in 2002 it increased its stake in Cervezas Nacionales de Ecuador by 25% and began to expand into Peru and a number of Central American countries. In Peru it bought a 24% interest in Backus, and in Panama it negotiated the takeover of Cervecería Nacional. As a result of these operations, Bavaria has become one of the largest brewers in the region, and it aims to continue expanding its activities in Central America.

The case of Backus is particularly interesting. This icon of the Peruvian brewing industry currently competes with several other companies in the region, having consolidated its status as market leader in Peru over the last decade by taking over a number of smaller firms, including Cervesur in 1999. Its size has made it a strategic takeover target for several large firms in the region, which see the chance to form a regional brewing group to counter the dominant position of AmBev. Consequently, the Polar and Cisneros groups (which during the 1990s had consolidated their position as the main competitors in Venezuela), along with Colombia's Bavaria, have set their sights on the Peruvian firm. Polar, in particular, is very interested in making Backus the cornerstone of its internationalization process, and, following a number of share purchases over the past few years, it now has a 15.6% holding in the company. Bavaria and the Cisneros group have responded by acquiring stakes of their own.

Although the large transnationals have played a somewhat secondary role in changing the shape of the brewing industry, they have also purchased blocks of

shares and have formed alliances with local firms, particularly in Chile and Mexico. Since these two countries have not been included in the main strategic moves by the regional groups, transnational brewing companies have a stronger presence in them. As a result of successive acquisitions, Anheuser-Busch now owns 36% of Chile's Compañía de Cervecerías Unidas (CCU), which dominates about 85% of the domestic market. In the 1990s Anheuser-Busch also bought successive holdings in Mexico's Modelo group, in which it now has a 52% stake. This group has not yet begun to internationalize its activities, its basic strategy being to develop its already established products and increase its exports to the United States. Other large transnationals have also joined the list: Molson of Canada acquired Kaiser, the second-largest brewer in Brazil, and Heineken purchased Panama's Barú, together with 25% of Costa Rica's beverage firm Florida and 100% of Nicaragua's Consorcio Cervecerero Centroamericano. South African Breweries, meanwhile, has made several smaller acquisitions in Honduras and Nicaragua.

In short, the brewery market has been characterized by a succession of strategic moves, mainly by local players. The aim of these acquisitions, partnerships and purchases of ownership stakes is to gain access to new markets, improve distribution channels and build defences against possible hostile takeover bids. The process is leading to greater industry concentration and the establishment of large regional brewing groups. Although the key players in this process have been the leading local firms, TNCs based in Canada, the United States and Europe have also made several acquisitions. Thus, the possibility that they may decide to play a more active role in the future cannot be ruled out.

Table I.7
LATIN AMERICA: MAIN BREWERY GROUPS
(Millions of dollars)

Firm	Country	Ownership ^a	2001 sales
Grupo Modelo	Mexico	Anheuser-Busch (United States, 51%)	3 518
AmBev	Brazil	Investor group ^b	2 812
Femsa Cerveza (Cauhtémoc Moctezuma)	Mexico	Interbrew (30%)	2 183
Grupo Polar	Venezuela	Local groups	1 718 ^c
Quilmes	Argentina	Grupo Bemberg (Argentina, 30%)	938
Bavaria	Colombia	Grupo Santo Domingo (80%)	858
Compañía Cervecerías Unidas	Chile	Anheuser-Busch (United States, 36%) IRSA (Chile, 61.5%)	520
Backus	Peru	Bavaria (Colombia, 24.5%) Grupo Cisneros (Venezuela, 20%) Grupo Polar (Venezuela, 15.6%)	484
Cervecería Regional	Venezuela	Grupo Cisneros (100%)	...

Source: ECLAC, Unit on Investment and Corporate Strategies.

^a The ownership percentage corresponds to the total holding and may differ from the values shown in table I.8, which reflects only individual purchases.

^b AmBev was formed from the merger between the Brazilian brewers Brahma and Antártica.

^c Sales in 2000.

Table I.8
LATIN AMERICA: MAIN ACQUISITIONS IN THE BREWERY SECTOR
 (Millions of dollars and percentages)

Year	Firm sold	Country	Buyer	Country of origin of buyer	(%)	Amount paid
2002	Cervecería Leona ^a	Colombia	Bavaria	Colombia	55.8	350
2002	Cervecería Nacional	Panama	Bavaria	Colombia	91.5	260
2002	Kaiser	Brazil	Molson ^b	Canada	100	765
2002	Quilmes ^a	Argentina	AmBev	Brazil	37.5	346
2002	Backus-Johnston	Peru	Bavaria	Colombia	24.5	420
2002	Backus-Johnston	Peru	Grupo Cisneros	Venezuela	16.0	200
2002	Cervezas Nacionales ^a	Ecuador	Bavaria	Colombia	25.0	152
2002	Barú/Coca-Cola de Panamá ^a	Panama	Heineken/Florida Ice/Pan American Beverages	Netherlands/Costa Rica/ other	100	-
2002	Florida Bebidas S.A.	Costa Rica	Heineken	Netherlands	25.0	230
2002	Kunstmann	Chile	Compañía Cervecerías Unidas	Chile	50.0	-
2001	Backus-Johnston	Peru	Grupo Polar	Venezuela	12.8	110
2001	Cervecería Internacional	Paraguay	AmBev	Brazil	100.0	12
2001	Compañía Cervecerías Unidas	Chile	Anheuser-Busch ^c	United States	36.0	-
2000	Compañía Boliviana Nacional	Bolivia	Quilmes	Argentina	42.0	-
2000	Cervecería Leona	Colombia	Bavaria	Colombia	44.2	.
2000	Cervecería del Sur	Peru	Backus-Johnston	Peru	98.0	164
1999	Compañía Boliviana Nacional	Bolivia	Cervecería Paysandú	Uruguay	24.0	-
1998	Grupo Modelo	Mexico	Anheuser-Busch ^d	United States	13.0	556

Source: ECLAC, Unit on Investment and Corporate Strategies.

^a Pending transactions.

^b Through this operation, Molson obtained a licence to produce Heineken beers in Brazil.

^c In 2001 Anheuser-Busch made three successive share purchases to gain a 36% stake in Compañía Cervecerías Unidas (CCU).

^d This operation gave Anheuser-Busch a 51% stake in the Modelo group; it had made previous purchases in 1993 and 1997.

- The automotive sector in MERCOSUR: reorientation towards extraregional exports

Although the Argentine crisis forced TNCs producing for the MERCOSUR market to refocus their strategy on extraregional exports, the automotive industry's problems had begun earlier. In Brazil, the decline in domestic demand that began in 1998 shifted market shares in favour of firms serving specific niches or segments, while undermining the position of the large manufacturers – Volkswagen, General Motors and Fiat – which between them accounted for over 80% of output and 87% of sales in the domestic market (see monthly bulletin Carta da ANFAVEA No. 197, October 2002). The crisis in Argentina made these problems worse: large firms accumulated excess inventories and were forced to institute measures such as compulsory vacations and lay-offs and the temporary or permanent closure of a number of factories³⁰ (see *The Wall Street Journal*, 2002b, and *The Economist Intelligence Unit*, 2002a, 2002d and 2002e).

In order to counteract these negative factors, Volkswagen is investing in a truck plant with a view to increasing its share of the domestic and external markets.

It expects that within three years, it will be in a position to export 25% of its output, the bulk of which will be sent to Mexico (*The Economist Intelligence Unit*, 2002f).

In 2002 a number of firms with small shares of the domestic vehicle market, such as Honda (1.4%), Toyota (1.5%), Ford (7.8%) and Renault (4.5%), not only took advantage of the prevailing low costs to increase their exports from Brazil to the rest of the world, but also announced their intention to expand their investments in that country in order to gain a larger presence in the domestic market. In June 2002 Ford announced that it was speeding up production at its Taubaté engine, transmission and components plant in order to increase its exports to new markets. In May it launched a new model (Fiesta) in Brazil, which has also helped boost production at that plant. In 2002 it started exporting its new small all-terrain vehicle (Fusion), which is cheaper and aimed at young consumers, to the North American market after it invested US\$ 1.3 billion in its new Bahía plant (*La Prensa*, 2002).

Japanese automotive firms also have expansion projects in the pipeline. The Honda Motor Company plans to produce its compact model Fit in Brazil and to double

³⁰ For example, General Motors shut down its São Paulo truck plant in January 2002, citing the high cost of imported components (*The Economist Intelligence Unit*, 2002a).

its vehicle sales in that country in 2003. Meanwhile, Toyota, following a US\$ 300-million expansion of its factory in the State of São Paulo, announced a policy to stop the import of its Corolla model from Japan and turn Brazil into an export base for selling the model in other Latin American and Caribbean countries (*El Economista*, 2002b).

Lastly, Renault has set up three plants in Brazil over the past five years (one making automobiles, another engines and another pick-up trucks and vans). Having seen its local market share grow from 2.9% in 1999 to 4.5% in 2001, it then suffered a slump in profits as a result of the steep devaluation of the real, which pushed up costs, given the high proportion of imported components in its production. The firm's executives decided that the only way to make the business viable in this situation was to gradually increase production from today's 70,000 units per year to 200,000 by 2005, of which 40% would have to be exported. This strategy requires the local subsidiary to draw up a new schedule of investments in Brazil and to design a new model of car to be built on a large scale for sale in the external market.

In Argentina –Brazil's main trading partner in MERCOSUR– signs of price and exchange-rate stabilization began to emerge in 2002, along with an upturn in the level of activity and spending. This led several automotive firms to reconsider earlier decisions to close down some of their plants. An example is Fiat Iveco, which was planning to transfer its truck plant in Córdoba to Brazil. In April, however, it put those plans on hold and decided to resume its activities, taking advantage of the new cost structure resulting from devaluation. Volkswagen Argentina, which had aired doubts about the future of its Pacheco plant in Buenos Aires, now views this factory as viable, although it is not yet planning any new investments.

Nonetheless, perhaps the most important development in the Argentine automotive sector concerns Toyota. In October 2002 the Japanese firm unveiled plans to invest US\$ 200 million over the next two years to expand its facilities in the country –the largest amount of FDI for greenfield investment announced since the January 2002 devaluation. Toyota plans to triple its production of light utility vehicles in Argentina, to attain an output level of 60,000 units, of which 75% will be exported to other Latin American countries. These new investments in Argentina are part of a global plan being put in place by Toyota to concentrate its production in

South Africa and in certain Asian and Latin American countries. As mentioned above, it is also expanding its activities in Brazil and Mexico.

- TNCs seeking access to services

The last few years have witnessed large inflows of external capital into sectors such as finance, telecommunications, electric power, computer services and retail trade. FDI in the electric power and telecommunications sectors has recently been much less active than in the 1990s. This is largely explained by the difficulties being experienced by the relevant operators in the international arena, compounded by the problems facing them at the regional level. Here again, there are differences between Mexico and the South American countries.

Whereas in Mexico many public utility assets are still in State hands or under national ownership, and are coveted by a number of TNCs, in South America the privatization process has virtually run its course. Moreover, in view of the worsening economic situation, some TNCs are curtailing their expansion plans, freezing their investments or attempting to leave the subregion –even declaring a suspension of payments in certain cases. As seen in Argentina, parent companies have stopped propping up their subsidiaries, and several firms have suspended payments. This also happened in Colombia in the case of the local subsidiary of the United States electric power utility AES Gener.³¹

In Brazil several foreign-owned electric power utilities are apparently attempting to divest their local assets because of the drop in profits resulting from the steep depreciation of the real, in some cases compounded by financial problems in the respective parent company. Such firms include Enron, AES Corporation, Électricité de France (EDF) and Pennsylvania Power and Light (PP&L). It is interesting to note that the potential buyers that have emerged are not TNCs, but locally owned financial groups, along with the State-owned Petrobras, which is specifically interested in acquiring Enron's gas assets.

Nonetheless, FDI in the Brazilian electric power-generating segment has shown some buoyancy in response to the incentives mentioned earlier. The United States firm El Paso Energy opened two thermoelectric power plants this year and is scheduled to open a third in mid-2003. It also has a project in the pipeline for a new plant in Rio de Janeiro, which is currently on hold pending better market conditions. In January 2002 the electric power group Enersis, controlled by Endesa

³¹ Also in Colombia, six transnational telecommunications firms are demanding a total of US\$ 1.5 billion in compensation from the State-owned Telecom Colombia because their income fell short of the levels projected in joint operation contracts signed in 1993.

España and its subsidiary Endesa Internacional, announced a US\$ 207-million investment to build a thermoelectric power plant in the State of Ceará. Meanwhile, Eletricidade de Portugal (EDP) is planning an investment of US\$ 450 million to construct a thermoelectric power plant in Araraquara (São Paulo).

In the Brazilian telecommunications sector, several subsidiaries of foreign firms that had borrowed heavily in dollar terms in the 1990s have encountered major financial difficulties because of the crisis in the sector worldwide, compounded by the steep devaluation of the real and local financial instability. As a consequence, several operators have tried to divest assets or find new strategic partners. Not all of them have been successful, however, because of the sudden slowdown in the expansion plans of firms in the sector, not only in Brazil but also internationally.

Firms interested in purchasing telecommunications assets in Brazil and expanding their activities include the locally owned Brasil Telecom (BrT)³² and the Mexican firm América Móvil. The former is negotiating to purchase three firms currently under foreign control: MetroRed, an Internet service provider controlled by Fidelity Investments; Globenet, a fibre-optic cable operator; and Intelig, a long-distance telephone service operator controlled by Sprint, France Telecom and National Grid. If these negotiations are successful, BrT will grow from a second-tier firm in the Brazilian market into one of the country's leading long-distance operators and one of the biggest providers of Internet services to large firms.

For its part, América Móvil gained four mobile telephone businesses in Brazil by purchasing shares in Telecom Américas from its partner Bell Canadá Internacional. Once this acquisition is complete, América Móvil is expected to exercise an option to acquire the 11.1% still held by its other partner, Southwestern Bell Communications (SBC) of the United States. In addition, in November 2002 it announced it was studying the possibility of purchasing shares held by BellSouth in two mobile telephone firms:³³ BCP Telecomunicações and BSE S.A. BellSouth was very keen to sell its holdings in these two firms, following the non-payment of a US\$ 375-million debt by BCP.

Among the foreign firms operating in the Brazilian telecommunications sector, Portugal Telecom and Telefónica de España have both made a number of investments in the country. The former decided to reduce the debt of its Telesp Celular Participações (TCP)

subsidiary, Brazil's largest cellular telephone firm, by issuing new shares. It purchased 80.5% of these itself, thereby increasing its stake in TCP from 45.2% to 83.9%. The operation enabled TCP to raise just over US\$ 750 million. Then, in October 2002, Portugal Telecom sold 14.7% of TCP to Telefónica Móviles España, a subsidiary of Telefónica de España, as part of an agreement between the two firms to merge all their mobile telephone businesses in Brazil. For this purpose, a holding company will be set up, with each party having a 50% stake. The resulting corporation will be the largest in the sector in Brazil, with a client base of 13 million.

Spain's Telefónica is also strengthening its position in the mobile telephone segment in Mexico. According to statements made in May 2002 by company president César Alierta, the company plans to invest US\$ 500 million in 2002 and a further US\$ 2.5 billion over the next three years. Telefónica paid US\$ 87 million for the mobile telephone operator Pegaso PCS in 2002, taking on a US\$ 1.23-billion debt in the process. This will make it the second-largest mobile telephone operator in Mexico, with about 2 million customers and a target level of 6 to 7 million subscribers by the end of 2005 (*El Economista*, 2002a).

In the Mexican electricity sector, private generating plants today account for about 10% of electricity output nationwide. The National Congress is currently studying a reform of the sector to enable private generators to sell directly to large consumers without having to go through the Federal Electricity Commission (CFE).³⁴ The reform will divide the electricity market into two segments: one consisting of households and small businesses that consume less than 2,500 MW per year, which will be customers of CFE, and the other comprising large private-sector firms, which will be supplied directly from private generating plants (*The Economist Intelligence Unit*, 2002h). Nonetheless, foreign firms do not seem to be waiting for the reform to be implemented before expanding their investments in the sector. Spain's Iberdrola, for example, is already undertaking major investments and has several projects in the pipeline.

In 2002 Iberdrola acquired 13% of Gas Natural México (GNM), the country's leading natural gas distributor. Through this operation, Iberdrola aims to guarantee natural gas supplies to all its electric power generators—not only the existing ones, but also the ones it is building or planning to build. According to its 2002–2006 strategic plan, the firm intends to invest a total of

³² Brasil Telecom (BrT) is owned in part (65.5%) by Grupo Brasil Telecom Participações. Since August 2002 the latter has been controlled by Opportunity, a local financial group, which increased its share in the firm by acquiring the stake held by Telecom Italia.

³³ BellSouth holds a 45% stake in each of these firms.

³⁴ The sector was partially opened up in 1992 to allow private investment in the generating segment, but only for purposes of self-supply or under 25-year contracts to sell exclusively to CFE.

US\$ 2.35 billion in electric power generation in Mexico, to achieve a total installed capacity of 5,000 MW (*El Universal*, 2002a, 2002b).

Another subject worth touching upon here is Argentina's software industry. This is one of the areas in which firms are trying to adapt their strategy to the country's new circumstances by external markets to take advantage of the new cost structure. Crisis notwithstanding, Oracle Corporation of the United States has decided to set up a computer services centre in Buenos Aires to provide customer support in relation to programming, analysis, applications and databases. Over the next few months it will increase its staff to 550 employees, from 200 in June 2002. Meanwhile, Motorola (United States) and Ericsson (Sweden) are considering

turning their facilities in Argentina into a hub for developing software for their cellular telephones (*The Economist Intelligence Unit*, 2002I).

Lastly, one of the biggest investment projects in the retail trade sector in 2002 was that of Wal-Mart de México (WALMEX), a subsidiary of Wal-Mart Stores, which is the largest chain in the United States in the department store and supermarket segment. Early in the year, WALMEX announced that it would invest about US\$ 670 million over the next 18 months to implement its expansion plan in the country. The company already has 555 commercial outlets in Mexico, including self-service stores, department stores and restaurants, and it plans to open 67 new establishments and increase its sales by 10% (*La Hora*, 2002).

2. Foreign investment modalities in Latin America and the Caribbean

In terms of investment modalities, there were few FDI inflows associated with privatizations in 2002 (see table I.9). As mentioned in ECLAC (2002), there are few assets left to sell in the region, and transactions during the year consisted mainly of sales of minority shareholdings in

firms that had already been privatized, in cases where such shares, for various reasons, had been retained by the public sector. Most of these shares, which were sold on the respective stock markets, belonged to firms in the service sector.³⁵

Table I.9
LATIN AMERICA AND THE CARIBBEAN: PRIVATIZATIONS BY SECTOR AND AMOUNT, 2002
(Millions of dollars and percentages)

Date	Economic activity	Privatized firm	Country	Buyer	Origin of buyer	(%)	Millions of dollars
January 2002	Financial intermediation, apart from the financing of insurance and pension plans	Banco do Estado do Amazonas	Brazil	Banco Brasileiro de Desconto (BRADESCO)	Brazil	100	76
January 2002	Electricity, gas and water supply	Generadora Occidental S.A. (GEOSA)	Nicaragua	Coastal Corporation	United States	95	12
March 2002	Financial intermediation, apart from the financing of insurance and pension plans	National Commerce Bank Jamaica Ltd.	Jamaica	Advantage Investment Counsel	Canada	75	134
April 2002	Electricity, gas, steam and hot water supply	Empresa de Distribución Eléctrica de Lima Norte S.A. (EDELNOR)	Peru	Minority shareholders ^a		9	24
April 2002	Water catchment, purification and distribution	Companhia de Saneamento Básico do Estado de São Paulo (SABESP)	Brazil	Minority shareholders ^a		16	-
May 2002	Electricity, gas, steam and hot water supply	Empresa de Distribución Eléctrica de Lima Norte S.A. (EDELNOR)	Peru	Minority shareholders ^a		27	73
May 2002	Complementary and auxiliary transport activities; travel agency activities	Port of Belize City	Belize	Minority shareholders ^a		100	38
June 2002	Financing of insurance and pension plans, except mandatory social security schemes	Aseguradora Hidalgo S.A. (AHISA)	Mexico	Metropolitan Life Insurance (MetLife Inc.)	United States	100	962
December 2002	Water catchment, purification and distribution	Aguas Andinas (formerly EMOS)	Chile	Minority shareholders ^a		8	96

Source: ECLAC, Information Centre of the Unit on Investments and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information published in the specialized press.

^a Minority shareholders are defined as investors that do not possess control of the firm's management.

³⁵ For the most part, these shares went to minority investors, i.e. individuals or entities that did not have a controlling interest in the company concerned.

Among acquisitions in excess of US\$ 100 million, the amounts paid were significantly lower than in 2001. The biggest purchases at this level involved businesses in the financial sector, which accounted for 42% of all operations, thereby confirming the sector's growing importance as a target for FDI. The manufacturing sector took second place in terms of the amounts paid (29%), in particular reflecting acquisitions by United States TNCs in Mexico, along with those made by Latin American and a number of foreign firms in the brewery sector (see table I.A-1).

The largest acquisition in Mexico was the takeover of Grupo Financiero Bital by the United Kingdom-based holding company HSBC for US\$ 1.74 billion.³⁶ Bital is the country's fifth-largest financial institution, with 1,400 branches, 6 million customers and 15,400 employees. This operation dashed the hopes of Spain's Banco Santander Central Hispano (SCH), which had also been interested in gaining control of the Bital group, as revealed a few months earlier when it had accumulated a 26.6% stake through a succession of purchases – the most recent being a 13.3% holding bought in April. The takeover, which has yet to be approved by the Mexican financial authorities, means that foreign bank penetration in Mexico, which began in the mid-1990s, is now practically complete. As much as 92% of the assets of the country's financial institutions will now be in foreign hands, and there will be only one bank left in the country that is still 100% Mexican-owned – Banorte, based in the northern city of Monterrey.

3. Conclusion

The analysis in this section shows that TNCs have generally reacted in two different ways to the changes that have occurred in the regional context. The first reaction, of a short-term nature, has been displayed particularly by corporations that were seeking efficiency gains in the 1990s. It represents a response, first, to the slump in United States demand for products assembled in Mexico, Central America and the Caribbean; and second, to the decline in competitiveness caused by currency revaluation in Mexico. These firms' strategy has included reducing output, temporarily shutting down assembly plants and increasing productivity, primarily on the basis of considerable reductions in their workforce, while awaiting a recovery in the United States economy,

Another major operation in the Mexican financial sector was the US\$ 962-million purchase of Aseguradora Hidalgo S.A. (AHISA) by Metropolitan Life Insurance (MetLife Inc.) of the United States. In addition, the Mexican State sold a 3% interest in Grupo Financiero Banco Bilbao Vizcaya Argentaria Bancomer (BBVA Bancomer) to Banco Bilbao Vizcaya Argentaria (BBVA) of Spain for US\$ 216 million. Another large transaction in this area (which, however, took place between two foreign parties) was Citigroup's US\$ 1.24-billion purchase of the 48% stake held by Aegon N.V. of the Netherlands in the pension fund manager Afore Banamex.

In Argentina, although the opportunities opened up by lower asset values have thus far failed to attract large investment flows, a number of substantial acquisitions have nonetheless taken place. The largest ones have been carried out by two Brazilian firms. Firstly, the State oil company Petrobras paid US\$ 1.124 billion for a 58.6% holding in Argentina's Pérez Companc (PeCom Energía)³⁷ and US\$ 89.5 million for outright ownership of Santa Fe, a United States oil firm. Secondly, Companhia de Bebidas das Américas (AmBev) agreed to pay US\$ 346 million for a 37.5% stake in the brewer Cervecería y Maltería Quilmes (Quinsa).³⁸ This operation has not yet taken place because competitors of Quilmes have filed legal objections which are delaying approval of the deal by the antitrust authorities. Domestic investors have also taken the opportunity to acquire firms which had been divested by foreign owners, mainly in the financial sector.

which is the main market for these products. This has occurred mainly in production sectors that use low technology (footwear, clothing, furniture, electrical appliances), but it has also been observed in a number of mid-level- and high-technology product lines that employ more highly skilled labour (electronics).

The second reaction, of a structural nature, has a number of different components. Some TNCs have chosen to relocate their plants within their integrated international production systems (see UNCTAD, 2002b). This is happening in activities that involve less complex productive processes and employ lower-skilled labour. As a result, plants are being transferred to countries where wages are lower, with output aimed at markets showing

³⁶ See Expansión Directo (www.expansiondirecto.com), 22 August 2002.

³⁷ Petrobras also took on the external debt of PeCom, estimated at US\$ 2 billion.

³⁸ Both Santa Fe and Quilmes are foreign-owned: Santa Fe Energy belongs to Devon Energy (United States), while Quilmes, owned by the Bemberg family, has its headquarters in Luxembourg.

the greatest growth potential. For these and other reasons, the chosen country has been China, which has also benefited from its admission to WTO. As a result, Mexico is losing its share of these activities, and now faces the challenge of maintaining already established positions or even gaining ground in activities that involve more complex processes and require more highly skilled labour. In this regard, the country's proximity to the United States continues to represent an advantage.

The Argentine crisis had profound repercussions for corporations that had directed their sales towards MERCOSUR. This subregion does not offer good prospects for market growth at the present time, especially in comparison to the expectations that prevailed in the 1990s. This has led firms in a number of sectors to downsize their projects and divert their products to countries outside the subregion. This reorientation is structural and has given rise to a new trend in the geographical distribution of activities and investments. This does not mean that the subregion will suffer a massive outflow of FDI, however. Brazil seems to be the country that foreign investors are bound to favour, because the depreciation of the real will enable them to cut costs significantly. Nonetheless, for the time being investors are waiting to see what policies will be adopted

by the new government. As regards Argentina, TNCs have been cautious, again waiting for clear indications of the course the economy is likely to take. In some cases, however, there is evidence of an incipient strategy of redirecting exports to countries outside the region.

The one strategy that has not altered is that of TNCs that extract raw materials, especially hydrocarbons. Countries possessing such resources have benefited from major gas discoveries, along with new investments in gas pipelines in Bolivia, an oil pipeline in Ecuador and the Camisea gas deposits in Peru. These investments make intensive use of capital. Except in the case of natural gas, they normally have few linkages with the local economy, so domestic conditions in the host country tend to have less influence on investment decisions (see ECLAC, 2002, chapter IV). In 2002 the relatively high price of oil gave an additional boost to these projects, which permanently benefit from the strategic nature of the product. This has led TNCs in the sector to invest in circumstances that would otherwise be considered prohibitive for FDI. The current geopolitical context, involving heightened uncertainty about oil supplies from the Persian Gulf countries, is encouraging transnationals to consider investing in other parts of the world with oil potential.



ANNEX

Table I.A.1
**LATIN AMERICA AND THE CARIBBEAN: ACQUISITIONS OF PRIVATE FIRMS
 BY FOREIGN INVESTORS FOR OVER US\$ 100 MILLION, 2002**
(Millions of dollars and percentages)

Firm sold	Country	Ownership ^a	Buyer	Country	(%)	Amount paid
1. Primary sector						
Cerrejón Zona Norte (CZN) coal mine	Colombia	F	Anglo American Plc. BHP Billiton Plc. Glencore International AG	United Kingdom Australia Switzerland	50.0	200
Pérez Companc (PeCom Energía)	Argentina	L	Petrobras	Brazil	58.6	1 028
Compañía Minera Disputada de Las Condes	Chile	F	Anglo American Plc.	United Kingdom	100.0	1 300
Iberdrola assets ^b	Colombia/Brazil	F	Gas Natural SDG	Spain		137
Gas Natural México (GNM)	Mexico	F	Iberdrola S.A.	Spain	13.3	139
2. Manufacturing sector						
Grupo Embotellador México (Pepsi-Gemex)	Mexico	L	Pepsi Bottling Group (PGB)	United States	99.8	1 132
Fleischmann's	Regional	F	Burns Philp & Co.	Australia	100.0	110
Florida Bebidas S.A.	Costa Rica	L	Heineken	Netherlands	25.0	230
Consorcio Cervecerero Centroamericano	Nicaragua	L	South African Breweries	South Africa	25.0	
Compañía de Cervezas Nacionales ^c	Ecuador	F	Cervecería Bavaria	Colombia	25.0	152
Unión de Cervecerías Backus Johnston	Peru	L	Cervecería Bavaria	Colombia	24.5	420
Unión de Cervecerías Backus Johnston	Peru	L	Grupo Cisneros	Venezuela	16.0	200
Cervecería y Maltería Quilmes ^c	Argentina	L	AmBev	Brazil	37.5	346
Chocolates Garoto	Brazil	L	Nestlé	Switzerland	100.0	250
Kaiser	Brazil	L	Molson	Canada	100.0	765
Cervecería Nacional	Panama	L	Cervecería Bavaria	Colombia	91.5	260
Puerto Rican Cement	Puerto Rico	L	Cemex	Mexico	97.7	180
Masisa S.A.	Chile	L	Inversiones Suizandina	Switzerland	43.2	150
Excelsior	Mexico	L	Foreign investors	United States Canada	100.0	150
Vitromatic (Vitro Enseres Domésticos)	Mexico	L	Whirlpool Corporation	United States	51.0	150
3. Service sector						
TELECOMMUNICATIONS						
Telesp Celular S.A. (TCP)	Brazil	F	Portugal Telecom S.A. (PT)	Portugal	24.0	603
Telesp Celular S.A. (TCP)	Brazil	F	Minority shareholders		5.8	146
Telecom Américas	Brazil	L	América Móvil	Mexico	39.1	366
FINANCE						
Grupo Financiero Serfin ^b	Mexico	F	Bank of America Corp.	United States	24.9	1 600
BBVA Bancomer	Mexico	F	Banco Bilbao Vizcaya Argentaria (BBVA)	Spain	2.5	183
Grupo Financiero Bital	Mexico	L	HSBC Holdings	United Kingdom	99.2	1 131
BBVA Bancomer	Mexico	F	Banco Bilbao Vizcaya Argentaria (BBVA)	Spain	3.0	216
BBVA Bancomer	Mexico	F	Minority shareholders		8.8	634
Banco Santiago	Chile	F	Banco Santander Central Hispano (BSCH)	Spain	35.5	682
Banco Santiago	Chile	F	Minority shareholders		7.0	130
Sul América	Brazil	L	ING	Netherlands	49.0	160
Afore XXI	Mexico	L	Prudential Ins. Co. of America	United States	50.0	128
Afore Banamex (Aegon)/Seguros Banamex (Aegon)	Mexico	F	Citigroup	United States	48.0	1 240
Grupo Cinemex	Mexico	L	Onex Corporation Oaktree Capital Management LLC.	Canada United States	58.0 42.0	125 165
COMMERCE						
Disco Ahold International Holdings N.V.	Argentina	F	Royal Ahold N.V.	Netherlands	44.0	490

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information published in the specialized press.

^a L: Prior to sale, the firm was locally owned. F: Prior to sale, the firm was owned by foreign investors.

^b These assets are: 14.6% Gas Natural E.S.P. (Colombia), 9.9% of Compañía Distribuidora de Gas de Rio de Janeiro (CEG)(Brazil) and 13.2% of CEG Rio (Brazil).

^c Transaction pending.

Table I.A.2
LATIN AMERICA AND THE CARIBBEAN: LARGEST TRANSNATIONAL FIRMS
BY SALES, 2000-2001
(Millions of dollars and percentages)

Rank	Firm	Country	Sector	Sales in 2001	Sales in 2000	Sales 2001/ sales 2000 (%)
1	TELEFÓNICA DE ESPAÑA	Spain	Telecommunications	39 953.7	41 048.1	-2.7
2	THE COCA-COLA CO.	United States	Beverages/beer	14 239.7	13 503.1	5.5
3	VOLKSWAGEN	Germany	Automotive	12 050.6	12 879.2	-6.4
4	DAIMLERCHRYSLER	Germany	Automotive	11 930.0	13 930.4	-14.4
5	ENDESA ESPAÑA	Spain	Electric power	11 147.4	10 914.9	2.1
6	DELPHI	United States	Automobile parts	10 647.5	12 085.0	-11.9
7	GENERAL MOTORS	United States	Automotive	10 378.0	9 934.5	4.5
8	CEMEX	Mexico	Cement	10 249.9	8 722.6	17.5
9	FORD	United States	Automotive	8 626.7	8 799.0	-2.0
10	GENERAL ELECTRIC	United States	Electronics	8 568.4	7 265.3	17.9
11	ESSO	United States	Oil/gas	8 347.6	8 582.0	-2.7
12	REPSOL-YPF	Spain	Oil/gas	9 013.1	9 550.0	-5.6
13	PEPSICO	United States	Beverages/beer	5 675.9	5 141.5	10.4
14	AES CORP.	United States	Electric power	5 274.0	5 188.8	1.6
15	ROYAL DUTCH/SHELL	Netherlands/United Kingdom	Oil/gas	5 093.9	5 266.5	-3.3
16	NISSAN	Japan	Automotive	5 007.4	4 771.0	5.0
17	PROMODÉS	France	Commerce	4 194.9	4 981.5	-15.8
18	PHILIPS	Netherlands	Electronics	4 029.1	3 789.4	6.3
19	NESTLÉ	Switzerland	Food	4 002.8	3 874.7	3.3
20	FRANCE TELECOM	France	Telecommunications	3 960.5	3 891.0	1.8
21	IBM	United States	Computers	3 686.6	3 793.5	-2.8
22	HEWLETT-PACKARD	United States	Computers	3 447.2	3 472.8	-0.7
23	WAL-MART STORES	United States	Commerce	3 383.7	2 836.9	19.3
24	TEXACO	United States	Oil/gas	3 350.2	3 445.1	-2.8
25	FIAT	Italy	Automotive	3 174.8	3 412.4	-7.0
26	PHILIP MORRIS	United States	Tobacco	3 105.4	2 695.0	15.2
27	BELLSOUTH	United States	Telecommunications	2 935.0	2 963.0	-0.9
28	DUPONT EI DE NEMOURS	United States	Chemicals	2 646.6	2 432.1	8.8
29	AHOLD	Netherlands	Commerce	2 594.7	2 670.5	-2.8
30	UNILEVER	United Kingdom/Netherlands	Hygiene/cleaning/food	2 467.8	2 007.9	22.9
31	ERICSSON	Sweden	Electronics	2 407.0	3 153.0	-23.7
32	PROCTER & GAMBLE	United States	Hygiene/cleaning	1 920.5	1 782.7	7.7
33	TELECOM	Italy	Telecommunications	1 802.8	1 479.5	21.9
34	BASF	Germany	Chemicals	1 730.0	1 757.7	-1.6
35	KIMBERLY-CLARK	United States	Pulp/paper	1 710.1	1 661.7	2.9
36	BAT	United Kingdom	Tobacco	1 701.2	1 703.6	-0.1
37	LG ELECTRONICS	Republic of Korea	Electronics	1 659.6	1 590.1	4.4
38	KODAK	United States	Photography	1 628.5	892.0	82.6
39	SIEMENS	Germany	Electronics	1 383.5	1 776.3	-22.1
40	MOTOROLA	United States	Electronics	1 366.4	1 100.0	24.2
41	IBERDROLA	Spain	Electric power	1 293.1	784.4	64.9
42	CAMUZZI	Italy	Oil/gas	1 050.4	1 355.0	-22.5
43	BECKAERT	Belgium	Steel	1 020.9	1 149.5	-11.2
44	XEROX	United States	Electronics	975.9	1 100.5	-11.3
45	MAKRO	Netherlands	Commerce	904.5	913.1	-0.9
46	SEARS ROEBUCK	United States	Commerce	892.3	775.8	15.0
47	EDF	France	Electric power	868.5	897.1	-3.2
48	HONDA MOTORS	Japan	Automobile parts	823.4	602.5	36.7
49	NEC	Japan	Computers	730.9	708.2	3.2
50	ALCOA ALUMINIUM	United States	Aluminium	700.9	780.2	-10.2

Source: *América Economía* magazine, No. 235, 12-25 July 2002.

Table I.A.3
LATIN AMERICA AND THE CARIBBEAN: CONCESSIONS WITH FOREIGN INVESTOR
PARTICIPATION, BY SECTOR, 2002

Date	Economic activity	Project	Country	Firm	Country of origin
PRIMARY SECTOR					
November 2002	Crude oil and natural gas extraction, together with related service activities other than prospecting	Expansion of Cartagena refinery	Colombia	Technip Italy SpA Tipiel	Italy/Colombia
October 2002	Manufacture of coke, refinery by-products and nuclear fuel	Ancap awarded contract for sale of fuel in the future	Uruguay	Vitol	Canada
September 2002	Metal ore extraction	Exploration block B	Venezuela	Hecla Mining Company	United States
September 2002	Production of metal manufactures, except machinery and equipment	Las Cristinas gold project	Venezuela	Crystallex International Corporation	Canada
August 2002	Crude oil and natural gas extraction, together with related service activities other than prospecting	Block 1 – Deltana platform	Venezuela	BP Amoco Plc. (British Petroleum)	United Kingdom
July 2002	Metal ore extraction	Exploration and exploitation	Peru	Vista Continental Río Grande	United States Argentina
June 2002	Crude oil and natural gas extraction, together with related service activities other than prospecting	Exploitation rights	Argentina	ChevronTexaco Corp.	United States
June 2002	Crude oil and natural gas extraction, together with related service activities other than prospecting	Drilling of exploration wells	Mexico	Dowell Schlumberger	United States
May 2002	Crude oil and natural gas extraction, together with related service activities other than prospecting	Bandurria exploration block	Argentina	Wintershall Repsol-YPF TotalFinaElf S.A. Pan American Energy	Germany Spain France Argentina
February 2002	Metal ore extraction	Pueblo Viejo sulphur project	Dominican Republic	Placer Dome Inc.	Canada
February 2002	Crude oil and natural gas extraction, together with related service activities other than prospecting	Modernization of the Talara refinery	Peru	Otepi Cosapi	Venezuela Peru
February 2002	Crude oil and natural gas extraction, together with related service activities other than prospecting	Exploration and exploitation of lot Z-6	Peru	Petrotech	United States
SERVICE SECTOR					
November 2002	Electricity, gas, steam and hot water supply	Sale of energy to Santiago Metro	Chile	Chilectra S.A.	Chile/Spain
November 2002	Other service activities	Technical assistance project	Bolivia	Ente Vasco de la Energía (EVE) Iberdrola Ingeniería y Consultoría (Iberinco)	Spain Bolivia
November 2002	Overland transport; pipeline transport	Installation of control systems in gas pipelines	Peru	Abengoa Transportes de Gas del Perú (TGP)	Spain Peru
November 2002	Postal and telecommunication services	PCS licences	Brazil	Vésper	United States
October 2002	Construction	Isla Margarita airport	Venezuela	IDC Banco Bilbao Vizcaya Argentaria (BBVA) Flughafen Zürich	Chile Spain Switzerland
October 2002	Waste and waste water disposal, sanitation and similar activities	Waste disposal contract	Uruguay	OMB International	Italy
October 2002	Construction	Gas pipeline construction	Mexico	Techint Compañía Técnica Internacional	Argentina
October 2002	Overland transport; pipeline transport	Sale of trains to the Mexico City Metro	Mexico	Bombardier Inc.	Canada
October 2002	Manufacture of machinery and equipment not elsewhere classified	Expansion of the Caracas Metro	Venezuela	Alstom	France
September 2002	Electricity, gas, steam and hot water supply	Etecen and Etesur transmission concessions	Peru	Interconexión Eléctrica S.A. (ISA)	Colombia
September 2002	Waste and waste water disposal, sanitation and similar activities	Trash collection	Brazil	Enterpa Ambiental	Argentina/ United States

Table I.A.3 (concluded)

Date	Economic activity	Project	Country	Firm	Country of origin
September 2002	Electricity, gas, steam and hot water supply	Electric power plant operation and maintenance	Brazil	Alstom	France
September 2002	Electricity, gas, steam and hot water supply	Natural gas transportation services	Chile	Gasoducto GasAndes S.A.	France
September 2002	Complementary and auxiliary transport activities; travel agency activities	Tendering of customs warehouses	Bolivia	GBH Investment	Peru/ Switzerland
August 2002	Diversified	Concession to manage zoological garden	Peru	Ecolatina	Argentina
August 2002	Construction	Prison infrastructure programme	Chile	Besalco Sodexho Alliance Torno	Chile France Italy
July 2002	Postal and telecommunication services	PCS licences	Chile	BellSouth Corporation Telefónica Móviles	United States Spain
July 2002	Overland transport; pipeline transport	Delivery and maintenance of trains for suburban rail service in Valparaíso	Chile	Alstom	France
June 2002	Electricity, gas and water supply	High-tension power lines	Mexico	Asea Brown Boveri (ABB AG)	Switzerland
June 2002	Construction	Construction of Daule River bridge	Ecuador	Andrade Gutiérrez	Brazil
June 2002	Electricity, gas, steam and hot water supply	Construction of transmission network	Chile	Alstom Mitsubishi Corporation	France Japan
May 2002	Water catchment, purification and distribution	Operating contract and sewerage works	Puerto Rico	Ondeo Servies Mitsubishi Corporation	France Japan
May 2002	Electricity, gas, steam and hot water supply	Electric power contract with Edelca	Venezuela	Asea Brown Boveri (ABB AG)	Switzerland
April 2002	Waste and waste water disposal, sanitation and similar activities	Waste control division of CODELCO	Chile	Hidronor Chile	Belgium
April 2002	Other community, social and personal services	Trash collection	Brazil	Consorcio Comapa	Brazil/Argentina
April 2002	Water catchment, purification and distribution	Sanitation services concession	Brazil	Aguas Guariroba	Spain
April 2002	Electricity, gas, steam and hot water supply	Mazar hydroelectric project	Ecuador	Unión Fenosa Consorcio ACS-Cobra-Omegaport	Spain Spain
March 2002	Construction	International Route 60-CH	Chile	Obrascón, Huarte y Laín (OHL) Fomento de Construcciones y Contratas (FCC)	Spain Spain
February 2002	Electricity, gas, steam and hot water supply	Construction of sub-stations for CFE	Mexico	Isolux	Spain
January 2002	Complementary and auxiliary transport activities; travel agency activities	Puerto Caldera concession	Costa Rica	Sociedad Portuaria Regional de Buenaventura (SPRB)	Colombia
January 2002	Construction	Highway construction	Dominican Republic	Grupo Dragados	Spain
January 2002	Electricity, gas and water supply	Emergency energy sales	Brazil	Keppel Corp.	Singapore
January 2002	Electricity, gas and water supply	Maintenance of nuclear plant	Brazil	Iberdrola S.A. Planta nuclear Almirante Álvaro Alberto	Spain Brazil

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information published in the specialized press in Latin America.

Table I.A.4
**LATIN AMERICA: TOP 100 SUBSIDIARIES OF TRANSNATIONAL
 CORPORATIONS BY NET SALES, 2001**
 (Millions of dollars)

Rank	Firm	Country	Activity	Net sales	Current investors	Country of origin
1	Telefónica do Brasil (formerly TELESP S.A.)	Brazil	Telecommunications	27 907.8	Telefónica de España S.A.	Spain
2	General Motors de México S.A. de C.V.	Mexico	Automotive	9 968.9	General Motors Corporation (GM)	United States
3	Wal Mart de Mexico S.A. de C.V. (S.A. - Walmex)	Mexico	Commerce	9 684.7	Wal Mart Stores	United States
4	DaimlerChrysler México	Mexico	Automotive	9 294.6	DaimlerChrysler AG	Germany
5	Yacimientos Petrolíferos Fiscales (YPF)	Argentina	Petroleum	8 162.0	Repsol-YPF	Spain
6	Volkswagen México	Mexico	Automotive	7 004.4	Volkswagen AG	Germany
7	Delphi Automotive Systems	Mexico	Automotive	6 763.5	Delphi Automotive Systems Corporation	United States
8	Ford México	Mexico	Automotive	5 563.1	Ford Motor Company	United States
9	Nissan México	Mexico	Automotive	5 007.4	Nissan Motor	Japan
10	Enersis S.A.	Chile	Electric power	4 497.0	Citigroup	United States
11	Volkswagen Brasil	Brazil	Automotive	4 404.0	Volkswagen AG	Germany
12	Carrefour Brasil	Brazil	Commerce	3 981.3	Carrefour Group	France
13	Delphi Packard Electrics Systems	Mexico	Automotive	3 884.0	Delphi Automotive Systems Corporation	United States
14	Grupo Royal Dutch Shell (Shell Brasil)	Brazil	Petroleum	3 839.0	Royal Dutch/Shell Group	United Kingdom/ Netherlands
15	General Electric México (GE)	Mexico	Electronics	3 711.6	General Electric (GE)	United States
16	Light Serviços de Eletricidade	Brazil	Electric power	3 696.3	Électricité de France (EDF)	France
17	IBM México	Mexico	Electronics	3 686.6	Reliant Energy (Houston Energy) AES Corp.	United States
18	Hewlett-Packard México	Mexico	Electronics	3 447.2	International Business Machines (IBM)	United States
19	MCI Embratel (formerly Empresa Brasileira de Telecomunicações)	Brazil	Telecommunications	3 215.4	Hewlett-Packard (HP) MCI WorldCom	United States
20	General Electric Grupo Industrial	Mexico	Electronics	3 193.5	Société Européenne des Satellites S.A. (SES)	Belgium/ Luxembourg
21	Telecom Argentina	Argentina	Telecommunications	3 049.0	General Electric (GE) France Telecom	United States
22	Compañía Anónima Nacional Teléfonos de Venezuela (CANTV)	Venezuela	Telecommunications	3 011.9	Telecom Italia	France/Italy
23	Esso Brasileiro Petróleo Ltda.	Brazil	Fuel distribution	2 999.3	Telefónica de España S.A. Verizon Communications	Spain
24	Lear Corporation México	Mexico	Automotive	2 825.0	Banco de Desarrollo Económico y Social de Venezuela (BANDES)	United States
25	Telefónica de Argentina S.A. (TASA)	Argentina	Telecommunications	2 797.0	ExxonMobil Corporation	United States
26	Grupo Fiat Brasil	Brazil	Automotive	2 776.3	Lear Corporation	United States
27	GrupoTexaco Brasil	Brazil	Petroleum	2 684.9	Telefónica de España S.A.	Spain
28	The Coca-Cola Company México	Mexico	Food and beverages	2 504.1	Fiat	Italy
29	Visteon México	Mexico	Automotive	2 400.0	Texaco Inc.	United States
30	Nestlé México	Mexico	Food and beverages	2 326.6	The Coca-Cola Company	United States
31	Sistema Pepsicola	Mexico	Food and beverages	2 204.7	Visteon	United States
32	Compañía Energética de Minas Gerais (CEMIG)	Brazil	Electric power	1 978.0	Nestlé	Switzerland
33	Disco S.A.	Argentina	Commerce	1 915.1	General Electric (GE)	United States
34	Sabritas	Mexico	Food and beverages	1 801.7	Procter & Gamble	United States
35	Kimberly Clark México	Mexico	Paper	1 710.1	Ford Motor Company	United States
36	Nestlé Brasil	Brazil	Food and beverages	1 676.2	Royal Philips Electronics (Koninklijke Philips Electronics N.V.)	Netherlands
37	Mabe	Mexico	Electronics	1 663.4	Bunge & Born	United States
38	Procter & Gamble México	Mexico	Chemicals	1 652.3	Sonae de Distribuição	Portugal
39	Ford Brasil	Brazil	Automotive	1 621.7	Whirlpool Corporation	United States
40	Philips Mexicana (Philips Sociedad Exportadora Trasatlántica)	Mexico	Electronics	1 544.0	Siemens AG	Germany
41	Bunge Brasil S.A.	Brazil	Food and beverages	1 505.4	ExxonMobil Corporation	United States
42	Sonae Brasil	Brazil	Commerce	1 470.4	Motorola Inc.	United States
43	Brasmotor S.A.	Brazil	Automotive	1 458.9	Telefónica de España S.A.	Spain
44	Siemens Brasil	Brazil	Machinery	1 407.2	Iberdrola S.A.	Spain
45	ExxonMobil Colombia	Colombia	Fuel distribution	1 396.2	L.M. Ericsson	Sweden
46	Motorola de México S.A. de C.V.	Mexico	Electronics	1 366.4	Philip Morris Companies Inc.	United States
47	Telefónica CTC Chile	Chile	Telecommunications	1 352.4	Unilever	United Kingdom/ Netherlands
48	Consorcio Guaraniana	Brazil	Electric power	1 324.8		
49	Ericsson México	Mexico	Electronics	1 307.0		
50	Philip Morris México	Mexico	Tobacco	1 303.1		
51	Unilever México	Mexico	Chemicals	1 300.0		

Table I.A.4 (concluded)

Rank	Firm	Country	Activity	Net sales	Current investors	Country of origin
52	Telesp Celular S.A. (TCP)	Brazil	Telecommunications	1 269.7	Portugal Telecom S.A. (PT) Telefónica Móviles	Portugal Spain
53	Shell Argentina CAPSA Forestry	Argentina	Petroleum	1 254.9	Royal Dutch/Shell	United Kingdom/ Holland
54	LG Electronics México	Mexico	Electronics	1 239.6	LG Electronics Inc.	Republic of Korea
55	Bompreço Supermercados	Brazil	Commerce	1 195.7	Royal Ahold N.V. (Koninklijke Ahold)	Netherlands
56	Grupo Ericsson Brasil	Brazil	Electronics	1 100.0	L.M. Ericsson	Sweden
57	BASF Brasil	Brazil	Chemicals	1 080.0	BASF AG	Germany
58	Empresa Nacional de Telecomunicaciones S.A. (ENTEL)	Chile	Telecommunications	1 074.7	Telecom Italia Spa	Italy
59	Du Pont	Mexico	Chemicals	1 064.0	E.I. du Pont de Nemours (DuPont)	United States
60	Telefónica del Perú S.A. (formerly Entel Perú)	Peru	Telecommunications	1 033.4	Telefónica de España S.A.	Spain
61	Siemens México	Mexico	Machinery	1 033.2	Siemens AG	Germany
62	Grupo BAT/ Souza Cruz SA	Brazil	Tobacco	1 023.6	British American Tobacco Plc. (BAT)	United Kingdom
63	Grupo Arbed/ Belgó Mineira (CSBM)	Brazil	Metallurgy	1 020.9	Arbed	Belgium/ Luxembourg
64	Solectron de México, S.A. de C.V.	Mexico	Electronics	1 003.0	Solectron Corporation	United States
65	Apasco SA	Mexico	Cement	997.1	Holcim (formerly Holderbank)	Switzerland
66	Ford Argentina	Argentina	Automotive	977.0	Ford Motor Company	United States
67	Xerox Brasil	Brazil	Electronics	975.9	Xerox Corporation	United States
68	Minera Escondida Ltda.	Chile	Mining	959.4	Mitsubishi Corporation Broken Hill Proprietary (BHP) Rio Tinto (RTZ) Nippon Mining & Metal	Japan Australia United Kingdom Japan
69	Grupo Bemberg	Argentina	Food and beverages	938.7	Grupo Bemberg	Luxembourg
70	Grupo Kodak México	Mexico	Photography	928.5	Eastman Kodak Company	United States
71	Makro Atacadista SA	Brazil	Commerce	904.5	Makro	Holland
72	Navistar	Mexico	Automotive	869.0	Navistar International	United States
73	EDENOR (Empresa Distribuidora y Comercializadora Norte Sociedad Anónima)	Argentina	Electric power	868.5	Électricité De France (EDF) Société D Amenagement Urbain et Rural (SAUR) Electricidad Argentina Sociedad Anónima (EASA)	France France Argentina
74	Kemet de México S.A. de C.V.	Mexico	Electronics	830.0	Kemet Corporation	United States
75	Honda México	Mexico	Automotive	823.4	Honda Motor	Japan
76	Pan American Energy	Argentina	Petroleum	806.2	Bridas Energy BP Amoco	United Kingdom United States
77	Electricidad de Caracas (EDC or Elecar)	Venezuela	Electric power	777.9	AES Corp. Brown Brother Harriman & Co.	United States United States
78	Tele Sudeste Celular S.A.	Brazil	Telecommunications	734.1	Itochu Corporation Telefónica de España S.A. Iberdrola S.A.	Japan Spain Spain
79	NEC do Brasil S.A.	Brazil	Electronics	730.9	Nippon Electric Co. (NEC)	Japan
80	Alcoa Brasil	Brazil	Metallurgy	700.9	Alcoa	United States
81	Kodak Export	Mexico	Commerce	700.0	Eastman Kodak Company	United States
82	Compaq México	Mexico	Electronics	699.0	Compaq Computer Corporation	United States
83	PSA Peugeot-Citroen Argentina (SEVEL)	Argentina	Automotive	697.5	PSA Peugeot Citroen S.A.	France
84	Labatt	Mexico	Food and beverages	686.2	Interbrew	Belgium/ Luxembourg
85	Santa Isabel S.A.	Chile	Commerce	679.6	Royal Ahold N.V. (Koninklijke Ahold)	Netherlands
86	Elektro Eletricidade e Serviços	Brazil	Electric power	677.5	Enron Corp.	United States
87	Texaco Colombia	Colombia	Petroleum	665.3	Texaco Inc.	United States
88	Metrogas S.A. Argentina	Argentina	Electric power	657.7	British Gas Repsol YPF	United Kingdom/ Spain
89	Southern Peru Copper Corporation (SPCC)	Peru	Mining	657.5	Grupo Minero México Phelps Dodge Corporation	Mexico United States
90	BASF México	Mexico	Chemicals	650.0	BASF AG	Germany
91	Telefónica Comunicaciones Personales S.A. (TCP)- Unifón	Argentina	Telecommunications	647.0	Telefónica de España	Spain
92	Volkswagen Argentina	Argentina	Automotive	642.2	Volkswagen AG	Germany
93	Wal Mart Brasil	Brazil	Commerce	639.2	Wal Mart Stores	United States
94	Nokia México	Mexico	Electronics	630.0	Nokia Corporation	Finland
95	Vitromatic (Vitro Enseres Domésticos)	Mexico	Electronics	629.0	Whirlpool Corporation	United States
96	Nidera Argentina	Argentina	Food and beverages	625.9	Nidera	Netherlands
97	Cemex Venezuela (formerly Vencemos)	Venezuela	Cement	623.9	Cementos Mexicanos S.A. (CEMEX SA)	Mexico
98	Avon México	Mexico	Chemicals	620.7	Avon Inc.	United States
99	Parmalat Brasil	Brazil	Food and beverages	615.6	Parmalat Finanziaria S.p.A.	Italy
100	Chevron San Jorge	Argentina	Petroleum	611.0	Chevron Texaco Corp.	United States

Source: ECLAC, Information Centre of the Unit on Investments and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information published in the specialized press in Latin America.

APPENDIX

STATISTICS ON FOREIGN DIRECT INVESTMENT

In view of the differences between the figures given in the ECLAC publications *Economic Survey of Latin America and the Caribbean* and *Foreign Investment in Latin America and the Caribbean*, it should be clarified that even though both sets of figures correspond to the

definitions contained in the International Monetary Fund's *Balance of Payments Manual*, they reflect different concepts in terms of balance-of-payments items and cover different numbers of countries in the region.

FOREIGN DIRECT INVESTMENT: COMPARATIVE TABLE
(Millions of dollars)

	1990-1994 ^a	1995-1999 ^a	1999	2000	2001	2002 ^b
Figures given in the <i>Economic Survey of Latin America and the Caribbean</i>:						
A. Net FDI flows	12 983	52 365	79 741	67 711	68 081	38 974
Investment abroad by residents	2 113	5 735	6 286	7 794	380	4 928
B. Net inflows in the reporting economy	15 096	58 100	86 027	75 505	67 702	43 902
Figures given in <i>Foreign Investment in Latin America and the Caribbean</i>						
C. Net inflows in the reporting economy	15 802	60 604	88 220	75 583	69 020	44 402
Financial centres	2 506	8 914	19 810	18 855	14 993	11 788

^a Annual average.

^b Estimates.

The first difference is conceptual:

As the purpose of the *Economic Survey* is to present a macroeconomic analysis of the region's countries, it takes into account net flows of foreign direct investment—that is, net inflows of foreign investment in the reporting economy minus net investment abroad by its residents. These flows are shown in line (A) of the above table.

Conversely, as *Foreign Investment in Latin America and the Caribbean* has the aim of analysing capital inflows in the form of direct investment, their sectoral distribution and the strategies of the transnational corporations that provide them, the report refers only to net inflows in the reporting economy (without subtracting the net amounts that residents invest abroad).

The second difference concerns coverage:

The figures for net inflows of foreign direct investment presented in lines B and C are different because their coverage is different. The foreign investment figures in the *Economic Survey of Latin America and the Caribbean* refer only to countries that are able to supply these statistics prior to publication. *Foreign Investment in Latin America and the Caribbean* includes figures recorded by the Organisation for Economic Co-operation and Development (OECD) as investments in financial centres by its member countries. If the latter figures are omitted, the similarity to the figures in line B becomes apparent.

II. THE ANDEAN COMMUNITY: FOREIGN DIRECT INVESTMENT AND CORPORATE STRATEGIES

This chapter reviews trends in foreign direct investment in the Andean Community, which comprises Bolivia, Colombia, Ecuador, Peru and Venezuela. Ever since the Community was established in the early 1970s, the treatment afforded to foreign capital has been one of the most significant –and controversial– issues to be addressed by this subregional grouping. Initially, the Community’s policy decisions regarding foreign investment were binding in nature and took precedence over any national rules, thereby superseding local foreign investment regulations. A multitude of restrictions were placed on foreign direct investment (FDI) and on the operation of transnational corporations (TNCs). The aim of the restrictions was to ensure that these activities would play a complementary role to local investment which would not constrain the industrialization of the Andean economies.

In the late 1980s, the severe economic crisis that had overtaken Latin America, together with pressures building up within the Andean Community, brought about a rapid shift in the thrust of economic policy and in the prevailing attitude towards foreign capital. These changes in the subregional rules gave more discretion to the individual countries. The process of phasing out the restrictions on foreign capital was also spurred by the appearance of new incentives. The main such incentives were associated with the privatization of State assets and with the opening and liberalization of the great majority

of economic activities, in particular the resource-based industries (hydrocarbons and mining) which are the principal source of wealth for almost all the Andean countries.

With the liberalization of these countries’ resource-based sectors, large volumes of foreign investment began to flow into their economies. Most of these flows were associated with exploration and drilling in the petroleum and natural gas sectors. A number of utilities and infrastructure activities also aroused some interest among foreign investors, particularly those in the process of building up Latin American networks in such areas as telecommunications, electricity, financial services and retail commerce. This trend did not extend to other sectors of the subregion’s economies, however. This was largely attributable to the political and economic instability exhibited by the Andean countries, along with the limited size of their domestic markets and the impossibility of creating a genuine subregional market.

This chapter will look at the main features of FDI flows to the Andean Community countries, including the main factors of attraction, general and specific regulations, the sectoral pattern of allocation, the origin of these capital flows and the most common corporate strategies. Within this context, foreign investors are divided into two clearly differentiated categories based on whether their main strategy is to seek out raw materials or to seek entry into national services markets.

A. FOREIGN CAPITAL IN THE ANDEAN COMMUNITY

1. The treatment of foreign capital in the member countries of the Andean Community

In the mid-twentieth century, the Andean countries were very open to foreign capital, and most of them had no specific legislation on the subject. In many of these nations, the only regulations in this area were a few exchange-rate provisions applying to activities involving foreign capital. With the nationalization of many utilities and companies in the extractive industries (especially in the hydrocarbons sector), however, the scope for foreign investment was sharply curtailed.

Foreign investment began to be considered as a means of supplementing national saving, technology transfer and industrialization in the context of a development model that was based largely on domestic markets. Nonetheless, apprehensions about foreign investment's impact on the balance of payments led the countries to control and restrict FDI. Mechanisms for the authorization, registration and control of FDI were created, and governments were empowered to channel flows according to national economic development priorities. An effort was made to give preference to FDI that would help to increase or diversify exports, prior assessments of its impact on the balance of payments and on employment were encouraged, and foreign capital was denied access to many activities, particularly the financial sector and public utilities. Requirements and limitations were also established regarding the repatriation of earnings and capital.

This was the context in which the Andean integration process was launched with the signing of the Cartagena Agreement in 1969. This was the agreement that established the Andean Pact, which is now known as the Andean Community.¹ The main purpose of this initiative was to expand intraregional trade and stimulate economic growth in the member countries, first by creating a free trade zone and later by means of a customs union (a common external tariff). To this end, it propounded the harmonization of economic policies, particularly in the areas of foreign exchange, monetary and fiscal affairs, external trade and foreign investment. With regard to foreign investment, the integration scheme encouraged the substitution of local and subregional investment for foreign capital, emphasizing the adverse effects of FDI on the generation of foreign exchange and balance-of-

payments equilibria. The idea was to prevent foreign capital from monopolizing the benefits of the regional integration process and transferring them abroad.

June 1971 saw the introduction of a system called the Common Regime of Treatment of Foreign Capital and Trademarks, Patents, Licenses and Royalties (more commonly known as Decision 24), which later took on regulatory force in the countries of what was then the Andean Pact. The intent of this supranational rule was to limit external financial influence and ensure that the local private sector would make a greater contribution to national development. In addition, it provided for various restrictive practices, such as the gradual reduction of foreign stakes in local firms to a minority interest,² the elimination of foreign capital in key sectors and limitations on the right to remit earnings abroad. Other decisions relating to technology transfer, Andean firms and sectoral industrial development programmes also influenced the treatment of foreign capital.

The severe deterioration seen in the terms of trade during the late 1970s and early 1980s had an adverse impact on export earnings and the balance of payments. Economic growth slowed, and import substitution began to show signs of having exhausted its potential. External debt reached unprecedented levels, triggering a crisis throughout Latin America and a steep downturn in external financing. This situation affected all the countries of the subregion and brought the integration process to a standstill.

The crisis prompted the Andean countries to reconsider the role of FDI in development. As a result, after having been in force for 16 years and undergoing a number of amendments, on 11 May 1987 Decision 24 was superseded by Decision 220, which was published on 18 May of that same year. Decision 220 provided greater flexibility in the treatment of foreign capital by eliminating some of the requirements concerning the registration and authorization of investments and profit remittances, doing away with the classification of "reserved sectors" and allowing each member country to formulate its own legislation on foreign investment. Under Decision 220, national regulations were changed substantially as the countries became increasingly more

¹ The original signatories to the Cartagena Agreement were Bolivia, Chile, Colombia, Ecuador and Peru. Later, Chile withdrew and Venezuela joined. Chile's withdrawal from the Cartagena Agreement had a great deal to do with the restrictions that the arrangement placed on FDI, which clearly ran counter to the structural reforms that Chile began to implement in its economy in the second half of the 1970s.

² Under the provisions of conversion contracts, new foreign firms were required to convert to mixed ownership within 15 years.

open to foreign capital, streamlined their administrative procedures and introduced a more promotional regulatory approach. One of the strongest proponents of these reforms was Colombia, which was planning to implement a series of projects in its mining and petroleum sectors (COINVERTIR, 1998).

On 29 March 1991, against a backdrop of sweeping economic reforms driven by the restructuring of national governments and by trade and financial liberalization programmes, the signatories to the Cartagena Agreement once again found it necessary to revise their common legislation. So it was that, in order to stimulate and promote the flow of foreign capital and technology to the Andean economies, the Common Regime was modified through the replacement of Decision 220 by Decision 291.

Decision 291 introduced a number of major changes which were aimed at removing obstacles to foreign investment and encouraging the flow of foreign capital and technology to the Andean economies. All references to prior authorizations were eliminated, leaving only the requirement that investments be registered with the relevant national agency. Legislation on the subject also enshrined the principle of equal treatment for foreign, mixed and local firms, as well as the right to remit profits and capital (without any upper limit being set on the amount of such remittances) and to have access to all applicable tariff benefits within the Andean Community framework.

In addition to increasing the flexibility of their guidelines, the Andean Community countries made major changes in their economic policies. As a result, a number of significant differences in focus of the countries' development strategies began to emerge.

- At one end of the spectrum was Peru, which had embarked upon a far-reaching process of economic reform that included trade and financial liberalization, privatization of State assets and the implementation of one of Latin America's most liberal foreign capital regimes. These changes strained relations between the Peruvian authorities

and the institutions of the Andean integration scheme. The dispute became so heated that threats were made by both sides regarding Peru's possible departure from the Andean Community. Both sides eventually softened their stances, however, and this, together with a gradual erosion of the power of the Community's institutions, kept Peru within the integration scheme, albeit under special rules, particularly in respect of the common external tariff.

- Bolivia, Colombia and Venezuela also launched economic reform plans which, although less radical than the Peruvian programme, included the privatization of some major public enterprises. The Bolivian authorities put in place an innovative programme, known as the Capitalization Plan (see box II.1), to transfer the country's largest public firms to the private sector. This mechanism provided a number of Bolivia's flagship enterprises with fresh resources to finance ambitious investment and modernization plans, while at the same time laying the foundations for the development of a capital market and a private pension fund administration system. In Colombia, electricity firms, financial entities and mining companies were the main assets to be transferred to the private sector. In Venezuela, the government privatized telecommunications companies, air transport and a number of manufacturing firms, but retained control over *Petróleos de Venezuela, S.A. (PDVSA)*, the largest firm in the entire Andean region. Both Venezuela and Bolivia have also pursued a policy of establishing closer relations with other subregional groupings, such as the Southern Common Market (Mercosur) of which Bolivia is actually an associate member, while Colombia and Venezuela are members of the Group of Three, together with Mexico.
- At the other end of the spectrum is Ecuador, where "pro-market" reforms were less ambitious and privatization plans encountered staunch opposition from both political circles and civil society.

Box II.1
BOLIVIA: THE CAPITALIZATION PLAN

In the first half of the 1990s, Bolivia launched an ambitious programme of structural reforms known as the *Plan de Todos* ("plan for all"). As part of these reforms, a vast and innovative privatization process was devised for the purpose of capitalizing large State-owned companies. The objectives of the authorities were to increase the rate of investment to over 20% of GDP and encourage foreign investment. A private pension fund management system was created so that the resources generated by this initiative could be channelled directly to the capitalized companies and to the Bolivian population. The process was also designed to attract the world's leading corporations into the Bolivian market in order to lend solidity to the process and enhance the credibility of the Bolivian State in the eyes of the international community. State-owned enterprises were thus turned into mixed capital corporations, in which Bolivian citizens owned a 50% stake and foreign capital the other 50%.

In 1994 this reform was launched with the creation of the Ministry of Capitalization and the establishment of interdisciplinary groups responsible for overseeing the process in each of the companies. The process also required substantial modifications in the regulatory framework applying to the economic sectors in which the capitalized firms operated. The most significant reforms took place in the hydrocarbons and electrical energy sectors. The Capitalization Plan encompassed the main utilities: Empresa Nacional de Telecomunicaciones (ENTEL), Empresa Nacional de Ferrocarriles (ENFE), Lloyd Aéreo Boliviano (LAB), Empresa Nacional de Electricidad (ENDE), and the transport, exploration and production of hydrocarbons conducted by Yacimientos Petrolíferos Fiscales Bolivianos (YPFB). The Vinto mining concern was finally sold in 2000 because, although it had been included in the original plan, it proved difficult to find an investor willing to run it.

In the early stages of the Capitalization Plan, it exceeded the authorities' expectations. The process raised investments worth more than double the book value of the firms included in the Plan. (The book value was reckoned at US\$ 648 million, while the revenues of the capitalization process amounted to US\$ 1.671 billion, which was equivalent to 257% of the original estimate.) (Cossio, 2001). This investment channel had a strong impact on FDI, as slightly over half of all inflows to the country in the period 1995-2000 were generated by firms privatized under the Plan (ECLAC, 2000). In 2001 and 2002, however, Capitalization Plan funds began to decline markedly as a proportion of total FDI inflows. This decline signalled that the process has run its course, since the firms had discharged 98.4% of their commitments by the end of 2002 (MCEI, 2002). The foreign firms that came out as "winners" in this process included some of the leaders in their respective fields: Royal Dutch Shell Group, Telecom Italia and Enron Corporation.

FDI IN CAPITALIZED FIRMS, 1995-2002^a
(Millions of dollars)

	1995	1996	1997	1998	1999	2000	2001	2002	Total	Shortfall	Additional FDI ^b
Electricity	2.17	23.82	31.09	51.94	45.73	0.56	1.36	1.79	158.45	6.18	24.78
EE Guaracachi	0.62	0.71	4.87	30.13	29.84				66.17		19.04
EE Valle Hermoso	0.31	21.45	12.98	3.96	0.59	0.23	0.14		39.66		5.74
EE Corani	1.24	1.66	13.23	17.86	15.30	0.33	1.22	1.79	52.61	6.18	-
Transport	5.00	40.64	203.95	208.60	217.12	95.31	97.13	2.13	869.88		519.80
FC Andina		2.87	5.78	4.48	0.54				13.67		0.42
FC Oriental		3.90	12.49	15.98	9.15			2.13	43.65		17.80
LAB	5.0	33.87	2.30	2.30	2.30	2.30	1.728		49.81		2.34
Transredes			183.38	185.84	205.12	93.01	95.40		762.75		499.25
Hydrocarbons			162.23	281.17	133.21	64.82	23.87		665.29		93.85
Petrolera Andina			62.23	175.07	60.84	1.09			299.23		34.46
Petrolera Cahaco			100.00	106.10	72.36	63.73	23.87		366.06		59.40
Communications		136.46	148.12	109.65	64.31	49.69	63.12	18.66	590.01		-
ENTEL		136.46	148.12	109.65	64.31	49.69	63.12	18.66	590.01	19.99	-
Total	7.17	200.92	545.38	651.36	460.37	210.38	185.79	22.59	2 228.64	19.99	638.44

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of figures provided by The Department of Private Investment, Office of the Under-Secretary of Exports and Private Investment, Ministry of Foreign Affairs and Investment.

^a Information available up to third quarter of 2002.

^b Additional investments made outside the framework of the Capitalization Plan.

Box II.1 (concluded)

The impact that the capitalization process has had on fiscal revenues through direct transfers and taxes has been mixed. In the cases of ENTEL and LAB, the impact appears to have been negative, but in ENFE, ENDE and particularly YPFB, the results have been positive (Salinas, 2001). Investment commitments were established when capitalization contracts were drawn up in order to secure a capital contribution to modernize the respective firms and enhance the efficiency and coverage of their services. With the exception of ENTEL and Empresa Eléctrica Corani, the privatized companies received investments far in excess of the commitments made by the investors at the time of purchase. Between 1995 and mid-2002, total investments by capitalized firms amounted to US\$ 2.279 billion, which was US\$ 642 million more than the sum originally committed (MCEI, 2002). The most tangible effects of the process have been seen in the sectors of telecommunications, electrical energy and, especially, hydrocarbons.

- Before the capitalization of ENTEL, Bolivia had a telephone density of four lines per 100 inhabitants, had 265,000 lines in service and 65% of its network was digitalized. Given the lag in this subsector, the

capitalization strategy of ENTEL consisted of providing universal access to the telecommunications network by supplying higher quality services and wider coverage. Five years after its capitalization began, the landscape of the sector has changed dramatically. Increases in the penetration rates of local fixed telephony and public telephone service have kept pace with a spectacular expansion in mobile telephony, and the charges for the different services have decreased substantially. Between 1995 and 2001, the number of main telephone lines per 100 inhabitants almost doubled (from 3.33% to 6.22%), and the number of subscribers to mobile telephone services rose from 10,000 to 744,000.

- The capitalization of ENDE has led to a large increase in the generation capacity of the National Interconnected System (SIN). In the last five years, national coverage has expanded from 31% to almost 43% (Cossio, 2001). As in the telecommunications subsector, the expansion of the electric power sector has gone hand in hand with a reduction in real rates (Salinas, 2001).
- Hydrocarbons have been the most dynamic sector since the capitalization of the State energy

firm, YPFB. In fact, investment in exploration and production has expanded sixfold since the time the sector was run by YPFB. This has significantly increased proven reserves of petroleum and natural gas (Cossio, 2001). Between 1997 and 2001, reserves of natural gas increased by 5.7 trillion cubic feet (TCF) to 46.8 TCF, and reserves of petroleum from 201 million to 692 million barrels. Bolivia thus became the second-ranking country in terms of natural gas reserves in South America, after Venezuela (EIA, 2002a). The Bolivian authorities see the development of the natural gas sector and the fiscal revenues it will provide –through taxes and royalties– as a means of achieving rapid growth and reducing poverty levels.

In summary, as well as increasing FDI inflows, the Capitalization Plan has greatly improved the administration of companies that were previously running deficits, and this has helped to reduce the pressure on public finances. As a result of this process, the Bolivian State has also been able to achieve major savings, especially with regard to large infrastructure projects –such as the gas pipeline to Brazil– and the exploration and development of new deposits of hydrocarbons.

Source: ECLAC, Unit on Investment and Corporate Strategies.

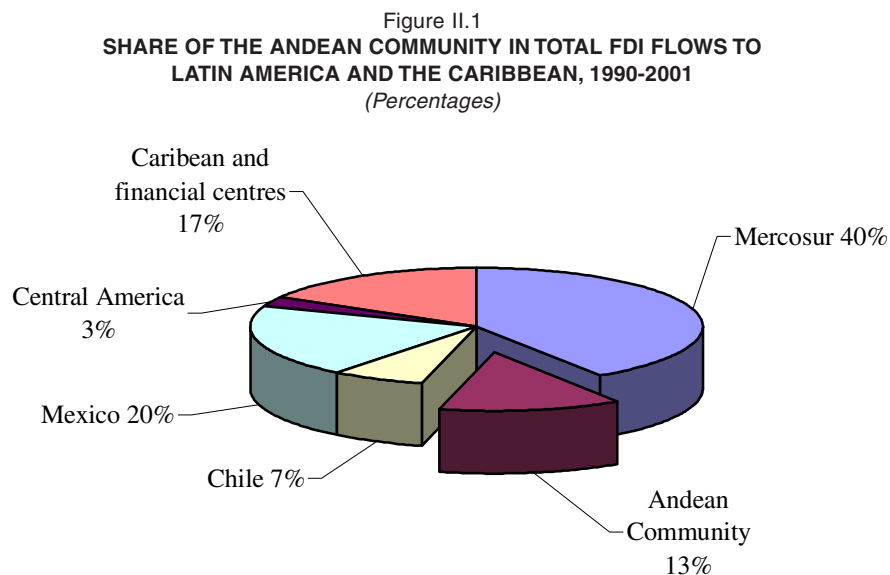
In summary, the supranational rules established by the Andean Community have given member countries increasing degrees of freedom to define their own FDI policies. As a result, the countries have been moving away from the original directives developed within the integration scheme and have been adapting their legislation

to fit in with their own national interests. Today, although their umbrella legislation still exists, the Andean countries each have specific rules on the treatment of FDI. All of these nations' bodies of legislation are liberal in spirit and are conducive to the establishment of a broad presence by foreign capital in their domestic economies.

2. Recent trends in FDI in the Andean Community

The Andean subregion has not been a major destination for the FDI that has been pouring into Latin America and the Caribbean in recent years (see chapter 1). The Andean Community countries together accounted for just over 13%

of total regional inflows, thereby coming in well behind the other Southern American regional grouping, Mercosur, and the region's main recipient economies, Brazil and Mexico (see figure II.1 and table II.1).



Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of balance-of-payments statistics from IMF and national sources.

Table II.1
FDI FLOWS TO THE ANDEAN COMMUNITY COUNTRIES, BY DESTINATION, 1990-2002
(Millions of dollars)

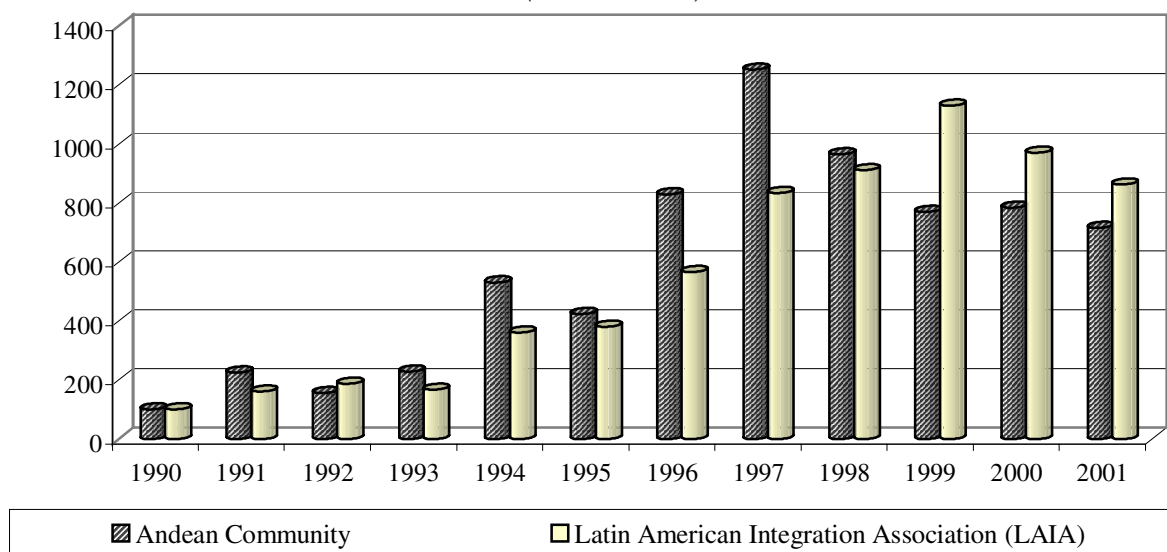
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Bolivia	27	52	93	124	130	393	474	731	949	1 010	725	662	612
- Privatization	...	...	9	12	0	66	31	0	10	148	0	...	...
- Petroleum	...	...	84	66	63	125	53	299	544	449	408	484	...
Colombia	500	457	729	959	1 446	968	3 112	5 562	2 829	1 468	2 280	2 328	1 950
- Privatization	...	...	...	...	...	298	333	2 324	...	...	...	...	...
- Petroleum	270	264	440	557	135	151	778	382	91	-551	-639	347	...
Ecuador	126	160	178	474	576	452	500	724	870	648	720	1 330	1 335
- Privatization	...	...	...	8	92	20	20	58	...	...	...	...	...
- Petroleum	90	124	146	395	368	320	302	555	754	615	680	1 120	...
Perú	41	-7	152	686	3 107	2 558	3 471	2 140	1 644	1 939	662	1 064	1 943
- Privatization	0	0	6	168	2 241	547	1 688	145	60	219	229	267	...
- Petroleum	39	9	119	9	310	173	132	89	141	282	35	3	...
Venezuela	451	1 916	629	372	813	985	2 183	5 536	4 495	3 290	4 465	3 448	1 389
- Privatization	0	1 469	7	0	0	27	12	743	...	...	...	...	...
- Petroleum	0	0	0	0	195	539	1 087	3 164	1 731	2 045	1 354	2 165	...
Andean Community	1 145	2 578	1 781	2 615	6 072	5 356	9 740	14 693	10 787	8 355	8 851	8 832	7 229

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of figures provided by the Andean Community and the central banks of the member countries.

Although the Andean Community represents no more than a small fraction of FDI flows to the region, in relative terms its economies have turned in a similar, or even better, performance than the Latin American Integration Association (LAIA) taken as a whole (see figure II.2). Between 1995 and 2002, the Andean Community received more than three times as much FDI as it had in the first half of the decade, which suggests that foreign investors saw new business opportunities in the subregion and were not deterred by the trying circumstances that have arisen in the Andean countries. In fact, the performance of the Andean Community has been one of the most stable in the region in recent years. Between 1999 and 2002, when the great majority of Latin American countries were experiencing downturns in FDI

inflows, the Andean Community was attracting remarkably regular investment flows of around US\$ 8.8 billion per year. The downside to this stability, however, is that investment has tended to be concentrated in just a few economic activities, mainly those undergoing privatization (Bolivia, Colombia, Peru and Venezuela) and those involved in the gradual opening of the petroleum sector (Bolivia, Colombia, Ecuador, Peru and Venezuela) (see table II.1). The fact that manufacturing industries have attracted a very small percentage of FDI inflows suggests that TNCs have not responded to the supposed benefits of the Andean Community's integration scheme, particularly during periods when one or more of these economies experience serious economic and political problems.

Figure II.2
FDI FLOWS TO THE LATIN AMERICAN INTEGRATION ASSOCIATION
AND THE ANDEAN COMMUNITY, BY DESTINATION, 1990-2001
(Index: 1990=100)



Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of balance-of-payments statistics from IMF and national sources.

Plans for the privatization of public utilities have been specific to each country within the Andean Community and have not reflected any sort of subregional directive. These programmes have targeted public utilities and infrastructure (particularly telecommunications and electricity), financial institutions and extractive industries (mainly mining and oil drilling companies). The intensity, speed and scope of these programmes have varied substantially from one

economy to another. Peru has been at one extreme, with the most extensive and ambitious programme, while Ecuador, which has experienced the most difficulties in carrying forward privatization plans, stands at the other end of the spectrum. Other important, albeit more limited, initiatives have been carried out in Colombia (mainly in electricity, banking and mining) and Venezuela (telecommunications, air transport, iron and steel, and finance).

Privatizations had a particularly strong impact on FDI inflows in 1991 in Venezuela, with the sale of the Compañía Anónima Nacional de Teléfonos de Venezuela (CANTV); between 1994 and 1996 in Peru, with the privatization of the Empresa Nacional de Telecomunicaciones (Entel) and some of the main electricity generation and distribution companies; between 1995 and 1998 in Colombia, with the sale of electricity companies; and since 1996 in Bolivia, with the implementation of the Capitalization Plan (see table II.A-1).

As in other Latin American economies, a number of mergers and acquisitions involving firms that had been privatized in the 1990s took place in the Andean Community countries. This process led to a concentration of ownership among some of the subregion's largest

firms, such as Telefónica del Perú, Electricidad de Caracas and several telecommunications companies, mainly in the mobile telephony segment. In addition, foreign investors bought some of the largest financial institutions in Bolivia, Colombia, Peru and Venezuela, as well as private local firms in the foods, beverages and non-ferrous minerals (cement) sectors in Colombia, Peru and Venezuela (see table II.A-2). The purchase of existing assets thus became one of foreign investors' preferred strategies for gaining entry and positioning themselves in Andean markets, particularly in the utilities, infrastructure and financial sectors. As a result, services accounted for 36.4% of FDI flows into Andean Community countries between 1992 and 2001, and a significantly higher proportion in Colombia, Bolivia and Peru (see table II.2).

Table II.2
MEMBER COUNTRIES OF THE ANDEAN COMMUNITY: CUMULATIVE FDI FLOWS,
BY ECONOMIC SECTOR, 1992-2001
(Percentages)

	Bolivia	Colombia	Ecuador	Peru	Venezuela	Andean Community
Primary	53.6	17.9	81.7	7.8	34.4	30.1
- Mines and quarries	5.6	9.4	-	-	-	-
- Petroleum and gas ^a	48.1	7.8	80.7	7.5	33.0	29.3
Manufactures	9.1	21.2	6.2	6.3	28.9	19.4
Services	43.9	60.9	12.0	38.9	24.1	36.4
- Electricity, gas and water	-	17.1	-	9.1	0.8	6.4
- Commerce	-	5.2	4.9	3.5	2.5	3.4
- Transport and telecommunication	-	10.1	2.3	15.9	2.1	6.7
- Finance	-	24.3	-	9.1	17.8	15.3
- Other services	-	4.2	4.8	1.3	0.9	4.6
Other	-6.7	-	-	47.0 ^b	12.5	14.1
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of figures provided by the Andean Community and the central banks of the member countries.

^a In Ecuador, Peru and Venezuela, mining and petroleum activities are grouped under a single heading.

^b In Peru, the statistics prepared by the National Commission on Foreign Investment and Technology (CONITE) differ considerably from the data supplied by the Central Reserve Bank of Peru. The Andean Community has corrected the CONITE figures on the basis of the balance of payments so that the investment figures will correspond to actual flows rather than registered figures. Consequently, the sectoral destination of a large portion of these FDI flows cannot be determined.

In the hydrocarbons sector, rather than privatizing their public enterprises, the governments of Colombia, Ecuador and Venezuela decided to offer association contracts to foreign investors interested in exploring and exploiting deposits or secondary areas. This mechanism enabled the national authorities to tap resources that otherwise would have been impossible to exploit, either because of a lack of funding or because of the difficulties involved in obtaining and using the requisite technology. The gradual liberalization of activities in the petroleum

and natural gas sectors consequently translated into massive inflows of FDI.

In Venezuela and Colombia, FDI was more highly concentrated in the manufacturing sector than it was in the subregion as a whole owing to the size of these countries' markets and their greater degree of industrial development (see table II.2). Liberalization and reforms made the domestic market more attractive to investors, and this, together with their integration strategy, positioned both countries as potential export platforms,

especially for sales to the rest of the Andean region (COINVERTIR, 1998). The continuation of operations by United States and Japanese subsidiaries in the automotive sector is an important factor in this respect. In addition, a number of manufacturing firms in the food, beverages and tobacco; hygiene and cleaning products, and chemicals and pharmaceuticals sectors cater to the Andean market. In fact, many large firms have chosen to set up manufacturing concerns in Venezuela and Colombia so that they can take advantage of these countries' membership in the Andean Community as a trampoline for exports to other member countries. This has been particularly significant in the automotive industry in Venezuela, where General Motors and Ford Motors (both United States firms), DaimlerChrysler (Germany) and Toyota (Japan) have increased allocations for the production of exports, especially to Colombia and Ecuador. In addition, thanks to the existing degree of specialization among the Andean subsidiaries of vehicle assembly firms, Colombia has also been able to export to Venezuela.³

Extractive industries in the hydrocarbons sector –and, in some cases, metal mining– and access to services markets (mainly through the acquisition of existing assets) have thus accounted for much of the FDI that has flowed into the subregion in the past decade (see tables II.1 and II.2). In the larger economies, the manufacturing sector has received a relatively greater share thanks to the presence of a number of production activities with potential access to a broader subregional market.

With regard to the geographic origin of FDI inflows, the United States is the single largest investor in the Andean Community. Between 1992 and 2001, almost 24% of total flows into the subregion came from United States firms (see table II.3). The next largest investor is the European Union as a whole and, within it, Spain, which is the second most important single-country investor. As in the rest of Latin America, within a quite brief span of time Spanish firms have managed to increase

their presence in most of the Andean countries and especially so in Colombia and Peru, where they have been key players in the privatization of State electricity and telecommunications firms. Other European countries that are high up on the list include Italy, thanks to Telecom Italia's stake in The Bolivian Empresa Nacional de Telecomunicaciones (Entel), and the Netherlands and the United Kingdom, whose oil companies have investments in Bolivia, Colombia, Peru and Venezuela. As part of a general pattern seen throughout Latin America, Japanese investment in the Andean Community is limited to a few mining projects in Peru and Venezuela and a number of vehicle assembly plants in Colombia and Venezuela.

Although the figures indicate that investments from other Latin American countries are significant, these statistics need to be examined very carefully. First, the figures are distorted by the fact that a substantial share of the resources flowing into the Andean Community either has no clear origin –a problem attributable to national registration authorities– or comes from financial centres. These centres are used by foreign investors for tax purposes and conceal large amounts of funds, which come mainly from the industrialized countries. Second, these problems notwithstanding, it is quite clear that intra-subregional investments are very limited. This fact calls into question some of the basic principles underlying the integration process since its inception. Third, some of the largest Latin American investors have been replaced by capital from other sources as a result of the acquisition of Latin American networks previously established by major Argentine and Chilean firms. Examples include the Argentine petroleum firm Yacimientos Petrolíferos Fiscales (YPF), which ran operations in a number of Andean economies before being bought by Repsol of Spain, and the strong presence established by Chilean energy firms in Peru and Colombia before they came under the ownership of extraregional investors –Endesa-España and AES Corporation– following the purchase of their parent companies (Enersis and Gener).

³ The automotive industry received a boost from a purpose-designed programme which Colombia, Ecuador and Venezuela signed in 1993 and updated in 1999. The aim of the programme is to take greater advantage of the Andean market and lay the foundations for the continued development of the automotive sector in the Community. Based on this agreement, the countries have announced plans to expand vehicle production in the subregion from 212,000 to 500,000 units in less than 10 years. The new agreement does away with subregional content rules, in compliance with a provision of the World Trade Organization (WTO), and establishes a specific origin rule, as required by the Andean Community in order for locally assembled vehicles to gain access to the Andean market. This agreement entered into force in January 2000 and will remain in effect until 2010, when it may be extended. The new mechanism has fostered the development of producers of automotive parts and related services in Colombia, Venezuela and, to a lesser extent, Ecuador.

Table II.3
ANDEAN COMMUNITY: CUMULATIVE FDI, BY COUNTRY OF ORIGIN, 1992-2001
(Percentages)

	Bolivia	Colombia	Ecuador	Peru	Venezuela	Andean Community
Developed countries	72.2	45.9	76.3	43.9	61.1	54.4
European Union	30.0	25.9	16.6	34.4	22.4	25.6
- Germany	0.8	2.1	2.0	0.3	1.4	1.4
- Spain	4.0	13.8	4.2	14.1	6.1	9.3
- France	2.8	1.4	1.0	1.3	4.4	2.7
- Italy	10.8	0.6	5.0	0.2	0.6	1.5
- Netherlands	7.6	5.3	1.8	5.0	4.0	4.6
- United Kingdom	2.3	1.0	2.2	12.8	4.8	5.1
North America	41.4	14.6	58.7	8.4	34.8	26.8
- Canada	0.6	4.6	16.5	0.6	1.3	3.1
- United States	40.8	10.0	42.2	7.8	33.5	23.8
Other developed countries	0.9	5.1	1.1	1.1	3.7	2.0
- Japan	0.1	0.5	0.3	0.4	2.7	1.4
Developing countries	32.4	46.9	14.9	8.5	39.0	22.7
Latin America and the Caribbean	32.3	46.7	14.9	7.7	13.6	21.8
- Andean Community	2.6	2.2	1.0	0.7	0.6	1.2
- Mercosur	20.2	0.7	5.3	1.2	2.9	3.3
(Argentina)	(11.9)	(0.1)	(4.0)	(0.4)	(2.9)	(2.3)
- Chile	5.2	1.6	1.6	3.2	0.7	1.8
- Mexico	0.0	0.7	0.6	0.2	0.1	0.3
- Central America and the Caribbean	4.3	41.5 ^a	6.5	2.3	9.3	15.4
Other unclassified	-4.6	7.2	8.8	47.6 ^b	23.8	22.8
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of figures provided by the Andean Community and the central banks of the member countries.

^a In Colombia, a significant portion of FDI comes from financial centres, particularly the Cayman Islands, Bermuda and the Virgin Islands.

^b In Peru, the statistics prepared by the National Commission on Foreign Investment and Technology (CONITE) differ considerably from the data supplied by the Central Reserve Bank of Peru. The Andean Community has corrected the CONITE figures on the basis of the balance of payments so that the investment figures will correspond to actual flows rather than registered figures. Consequently, the sectoral destination of a large portion of these FDI flows cannot be determined.

Foreign firms' pattern of specialization in the Andean Community did not help to overcome the member countries' failings in terms of international competitiveness. Between 1985 and 2000, this regional grouping's share of world imports dropped from 1.3% to 0.9%, while its export structure –which revolves around natural resources and a few resource-based manufactures– remained virtually unchanged. The situation varies from one country to another, however. Colombia, for example, has increased its export diversification and its proportion of non-resource-based exports (see table II-A.5). Nonetheless, as of 2000 the external sector of the Andean countries was still heavily reliant on primary goods, with natural resources accounting for almost 62% of the export basket (84% if resource-based manufactures are included) (see table II-A.4). Hydrocarbons are the main export product of three of the Andean economies –Venezuela, Colombia and Ecuador– and figure among the 10 main exports of the other two (Bolivia and Peru) (see table II-A.5). Certainly, the export figures for the subregion are strongly influenced by Venezuela's strong specialization in oil and by the large volumes it produces and exports, but the fact remains that no technologically sophisticated goods figure among its principal export products (see table II-A.4).

In summary, FDI flows to the Andean Community rose in the second half of the 1990s. Nevertheless, they expanded at substantially lower rates than they did for Latin America as a whole, which suggests that foreign investors have been hesitant to embark upon new undertakings in the subregion. The volume of FDI inflows was largely attributable to privatizations, the reform of the financial sector and the partial liberalization of the hydrocarbons sector, which was accomplished without lessening the relevant States' stake in the ownership and management of their oil companies except in the cases of Peru and Bolivia. Privatization enabled operators that were very active in other Latin American economies to establish advantageous market positions in the Andean countries' utilities and infrastructure sectors (see table II-A.3). Despite significant changes in the ownership structure of many leading Andean companies and the implementation of new mining and drilling projects, the results of the process are still to be seen. The following section investigates this question further by analysing the microeconomic effects of the corporate strategies used by the new agents that are now at the forefront of economic activity in the subregion.

B. STRATEGIES USED BY TRANSNATIONAL CORPORATIONS IN THE ANDEAN COMMUNITY

1. Seeking natural resources for export

The Andean countries possess large reserves of petroleum and mining resources. Over the last 100 years, dominance in these activities has alternated between TNCs and the State. The 1990s saw a series of reforms that allowed private –especially foreign– capital into the different segments of these activities. Not all the Andean Community countries opened up these areas of activity to the same degree, especially in the case of the oil sector. However, in those that did, some of the world's largest TNCs entered the market to launch new projects.

(a) Hydrocarbons: the great wealth of the Andean countries

The Andean countries began to tap their first major oil deposits in the late nineteenth century, and in the 1920s they began to market these resources internationally. This process was largely conducted by foreign firms, which were drawn to the subregion by its national authorities' decision to launch an active policy of concessions. Some of the world's largest oil companies –Exxon Corporation, Texaco, Inc., Mobil Oil Company and Royal Dutch Shell– became market leaders in Colombia, Ecuador and Venezuela. Later, as the Andean governments came to realize how much wealth was buried under their soil, they set up new legal mechanisms that would allow them to reap part of the earnings generated by this activity.

In the period following the Second World War, national governments began to taken on a larger role and to share operations in the oil sector with TNCs. The Empresa Colombiana de Petróleos (ECOPETROL) was founded in 1948 and began operations in 1951, when the Exxon Corporation's De Mares contract came to an end and the concession reverted to the State. In 1953, Bolivia nationalized its hydrocarbons industry, which then began to be administered by Yacimientos Petrolíferos Fiscales Bolivianos (YPFB). Venezuela set up its first public oil company, the Corporación Venezolana de Petróleo (CVP), in 1960. In October 1968, the Peruvian Government nationalized the assets of the International Petroleum Company (IPC) and created Petróleos de Peru (Petroperú). Foreign capital was not

barred from participation, however, and Petroperú operated alongside a number of transnational petroleum companies (Campodónico, 1999).

The shift towards greater State involvement in the oil industry in the Andean countries gathered momentum when international oil prices began to climb in 1973. This trend was particularly strong in Venezuela, which possesses Latin America's largest oil reserves (see figure II-A.1). In 1971 new legislation was passed which reserved for the State –through CVP– the right to operate natural gas interests in Venezuela. In 1975, the Venezuelan Congress approved the Nationalization Act, under which the hydrocarbons industry and trade in these products became the sole reserve of the State, concessions were voided and petroleum resources were transferred to the State. Petróleos de Venezuela (PDVSA) was created in 1976 to administer the national petroleum industry.

Ecuador also adopted a new, strongly nationalist policy on petroleum in the 1970s and went on to found the Compañía Estatal Petrolera Ecuatoriana (CEPE). Contracts with foreign firms were reviewed, and some older concessions reverted to the State, giving it control over 80% of the country's oil industry. Ecuador began to export hydrocarbons following the discovery of large reserves in the Amazonian region of Pañacocha.

Colombia was faced with a difficult situation during this period. For the first time in the country's history, known oil reserves were being depleted faster than new reserves were being discovered. In response to this situation, and in the light of the prevailing trend in the region's other oil-producing countries, the State redefined its policy on petroleum. The largest foreign-owned concessions reverted to State ownership, and many of these firms' assets were acquired by ECOPETROL. At the same time, the government entered into new association contracts⁴ in order to redefine access conditions for foreign firms and give a boost to exploration. These activities led to the discovery of large hydrocarbons deposits in the first half of the 1980s in Caño Limón, Cusiana and Cupiagua, which substantially increased the country's reserves (see figure II-A.1).

⁴ In order to operate in Colombia, foreign oil companies have to negotiate an association contract with ECOPETROL. Contracts usually run for a fixed period of 28 years, which may be extended to 30 years if natural gas is found together with the oil. In the past 30 years, around 93% of Colombia's oil output has been drilled under the terms of association contracts. An association contract is a strategic contractual alliance in which ECOPETROL becomes a partner of a foreign company (or consortium) to drill and develop hydrocarbon deposits and distribute these products after the payment of the corresponding royalties. The partner company usually assumes 100% of the risk and the exploration costs, and ECOPETROL shares past and future expenses once the discovery is declared to be commercially viable (Barrios, 2001).

(i) The gradual return of TNCs to the petroleum industry⁵

In the late 1980s and early 1990s, the lack of public funds for investment in exploration and drilling operations prompted the governments to find ways of encouraging private investors to play a more active role in the hydrocarbons subsector. This led to the elimination of State monopolies in the various phases of the production process. Bolivia and Peru privatized their State monopolies so that private investors could take part in the exploration, operation, marketing and distribution of petroleum and petroleum products. Ecuador and Venezuela introduced or extended mechanisms for establishing partnerships or associations with foreign companies to implement new projects (Moguillansky and Bielschowsky, 2001). Colombia maintained the scheme it had created in 1974.

In the early 1990s the liberalization of the petroleum sector gathered pace in Peru. The process of privatizing PETROPERU⁶ was begun, and a new Hydrocarbons Act was passed that provided greater incentives for foreign firms and put an end to the State-run company's monopoly. The next phase of the privatization programme was postponed several times because the necessary agreements could not be reached. Finally, in late 1996, a new plan was introduced and some prized assets, such as La Pampilla refinery, the Petrolube lubricants plant and some oilfields were sold to the private sector for more than US\$ 700 million plus investment commitments worth US\$ 119 million (Paliza, 2000).

In 1996, production began to decline (see figure II-A.2), turning Peru into a net importer of oil, mainly from Colombia, Ecuador and Venezuela. Today, four companies account for 90% of its oil production: Occidental Petroleum and Petrotech of the United States

and Plupetrol and Pecom (formerly Pérez Companc) of Argentina. There are extensive, largely unexplored regions in the north of Peru, thus the country has enormous potential natural gas reserves. The present Administration hopes to encourage foreign investment in hydrocarbons and is looking into new types of incentives to make the industry more attractive.

In Bolivia, most of the assets of YPFB were sold under the country's Capitalization Plan (see box II.1). In 1997, fields for exploration and production of hydrocarbons began to be tendered on an annual basis.⁷

Colombia maintained its policy of pursuing exploration both directly and through associations, entering into joint ventures, compiling assay data on reserves and opening up new areas under tendering schemes. As the financial situation of Ecopetrol improved, its stake was gradually increased, although most new investments in exploration have been made by partner firms (see figure II.3). At the beginning of 2000, no new finds had followed the major discoveries at Caño Limón, Cusiana and Cupiagua, which translated into a gradual decline in proven reserves, and in their useful life (see figure II-A.2).

As a result of the sharp downturn in Colombian production in the last few years, which threatened to turn it into a hydrocarbon importer by 2004 (see figure II-A.2), Ecopetrol approved major changes in oil policy and in the terms of its association contracts. In September 1999 it introduced attractive incentives to revive foreign companies' interest in exploration and to counteract the risk aversion generated by guerrilla sabotage of oil industry infrastructure.⁸ The main change was the reduction of the State company's stake from 50% to 30% once an exploratory phase has proved to be successful; this allows the partner firm to increase its share of the reserves and recover its costs more quickly.

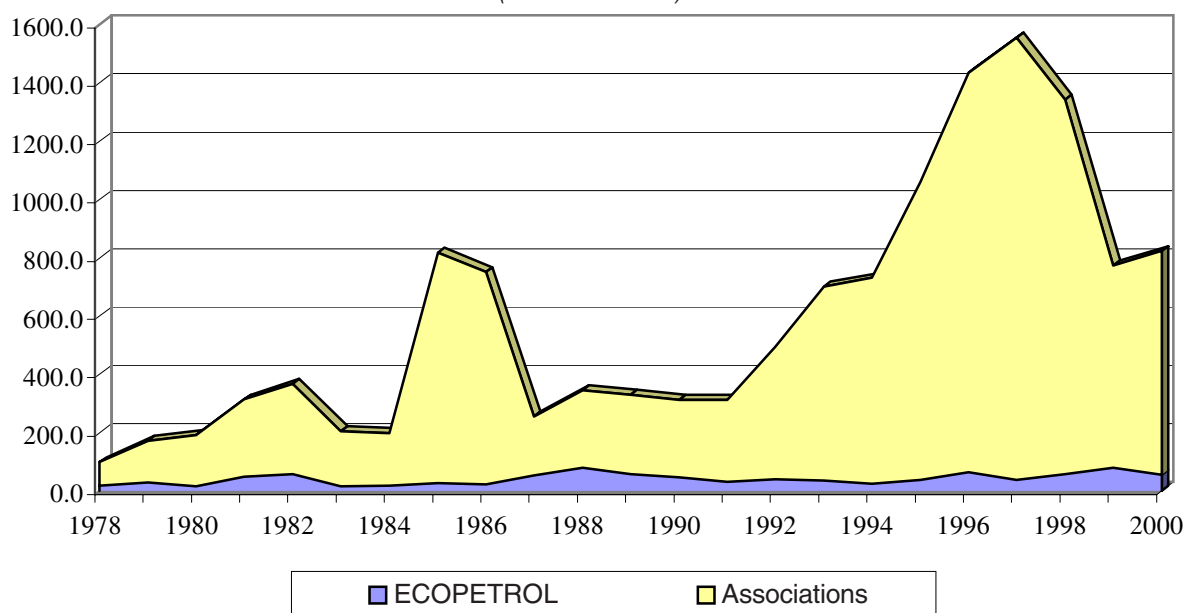
⁵ For further details see ECLAC (2002), chapter IV.

⁶ The total assets of PETROPERU were not included in the first stage of privatization. The main assets at this stage were Compañía Peruana de Gas (Solgas), 83 retail service stations and the shipping company which owned the tankers, Petrolera Transoceánica.

⁷ In 1997, 16 blocks were tendered out, followed by six in 1998 and five in 1999. In 1999, Pluspetrol was the only bidder. In 2000 and 2001, two and four blocks, respectively, were tendered out. In late 2002, YPFB offered concessions on nine blocks; two of these blocks were in non-traditional areas (Rio Beni and Puerto Linares) while the other seven were in traditional petroleum- and gas-producing areas (Cedro, Bato, Ipita, Inau, Irenda, Itaguazurenda and Buena Vista). No bids were entered, however, and the auction was declared void. A new round was scheduled for early 2003 (*Alexander's Gas and Oil Connections*, vol. 7, No. 20, 15 October 2002).

⁸ Between mid-1986 and late 2001, the hydrocarbon transport system had sustained some 900 attacks in which explosives were used. The Caño Limón-Puerto Coveñas pipeline, which services the Caño Limón field, was attacked 170 times during 2001 alone. The government puts the cost of the attacks perpetrated over the last 15 years at a total of US\$ 1.5 billion (EIU, 2002a).

Figure II.3
COLOMBIA: INVESTMENT IN OIL EXPLORATION, 1978-2000
 (Millions of dollars)



Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of figures provided by Empresa Colombiana de Petróleos (ECOPETROL).

These changes rekindled foreign investors' interest in Colombia's hydrocarbons sector, and the authorities viewed the tender round of 2000 as a great success.⁹ ECOPETROL expects the 58 new association contracts signed in 2000 and 2001 –security conditions permitting– to generate investments of close to US\$ 750 million in exploration in 2002-2003. Working within the framework of an association contract, ECOPETROL, the Brazilian firm Petrobras and the Canadian firm Nexen (formerly Canadian Petroleum Company) discovered a field at Guandó, which turned out to be the most important find since Cusiana-Cupiagua. In early 2002, two new fields were found in the western and southern regions of the country, with estimated reserves of 100 million barrels each.¹⁰ With these discoveries, the prospect of Colombia becoming an importer of crude oil has receded, at least for the moment.

In 1992, Venezuela began to liberalize its petroleum industry by offering local and foreign private investors the opportunity to invest in production activities. Three different investment categories were available: (i) operating contracts for mature fields; (ii) development of new

areas through joint venture exploration contracts; and (iii) strategic associations for developing the Orinoco Belt. Since this process began, 20-year operating concessions for a total of 33 fields have been awarded to international consortiums in three different bidding rounds. Eight blocks have been licensed under shared risk and earnings schemes for a total payment of US\$ 800 million.¹¹ There are now four partnerships that are working on projects designed to drill extra heavy crude in the Orinoco Belt at a total investment of around US\$ 13.5 million.

Lately, private firms' move into the petroleum industry has suffered a setback. The current Administration has given repeated assurances that it will respect the terms of existing contracts, but it is unlikely that any new licenses will be awarded in the near future. Moreover, in November 2001 a new Hydrocarbons Act was passed which increases petroleum royalties from 16.7% to 30% and reserves a stake of over 50% for the State in joint ventures that are in the business of exploring for, drilling, transporting or storing crude oil. Some firms have argued that it will be impossible to continue with these projects under such conditions, given the high cost of drilling heavy crude in the Orinoco Belt.

⁹ Thirteen contracts were awarded in this round, five for exploration and eight for incremental production.

¹⁰ This is particularly important because, out of the 167 fields discovered in Colombia in the history of the industry, less than 20 have held more than 100 million barrels of reserves (Ecopetrol press release, 31 May 2002).

¹¹ After six years of exploration, petroleum deposits have been found in four of the eight fields (La Ceiba, East Paria, West Paria and San Carlos), and commercial production is expected to begin in late 2004. At the end of 2001, four of the blocks were returned to PDVSA.

The Ecuadorian Government set up a mechanism for the issuance of petroleum concessions in the mid-1980s. In 1989, the Empresa Estatal de Petr leos del Ecuador (PETROECUADOR) was created out of the former (CEPE). The more active role played by PETROECUADOR and the involvement of private capital led to a major increase in proven petroleum reserves (see figure II-A.1). Underinvestment between 1994 and 2000 led to a year-upon-year decline in the company's output, however (EIU, 2001). In 2000, its share of total production dropped to 60%, with the rest being accounted for by contract arrangements with private firms.

A large number of new discoveries have been made in the past few years, and proven and probable reserves are now estimated at some 6.18 billion barrels. The biggest find has been in the Ishpingo Tambococha Tiputini field in the Amazon region, on the border with Peru, with estimated reserves of 700 million barrels. The State-owned company has sought to attract FDI to the country's major deposits in order to raise its production from about 230,000 barrels per day to 600,000 by 2005¹² (see figures II-A.1 and II-A.2). The firms that are active in Ecuador include Repsol-YPF of Spain, Occidental Petroleum Corp (OXY) and Vintage Petroleum Inc. of the United States and P rez Companc of Argentina.

The biggest constraint on the expansion of the Ecuadorian oil industry is its pipeline network. This has opened up an opportunity for foreign firms to join the consortiums that are building pipelines. In June 2000, work was completed on the extension of the Trans-Ecuadorian Oil Pipeline System (SOTE), which increased its capacity to 390,000 barrels per day. In June 2001, work began on the Heavy Crude Oil Pipeline (OCP), which is being constructed by a consortium formed by Alberta Energy of Canada (31.4%), Repsol-YPF of Spain (25.7%), OXY (12.3%) and Kerr McKee (4%) of the United States, P rez Companc (15%) and Techint (4.1%) of Argentina and Agip of Italy (7.5%). With an investment of US\$ 1.1 billion to build 500 kilometres of pipeline, work is expected to be completed by the end of 2003. The pipeline will transport about 450,000 barrels per day, and OCP will operate it for 20 years. As well as doubling the existing petroleum transport capacity, this project is expected to boost GDP by 2.5%, create 52,000 jobs directly and indirectly, and generate US\$ 800 million in tax revenue (EIU, 2001).

(ii) A booming natural gas industry

After the United States, Venezuela possesses the largest proven reserves of natural gas in the western hemisphere, but it has not been very successful in launching large-scale private initiatives. The Christopher Columbus Project is one example. The passage of the Organic Law on Gaseous Hydrocarbons in September 1999 made Venezuela an interesting prospect for some of the world's largest energy companies. In June 2001, the first steps were taken to tender 11 blocks of non-associated natural gas; 6 of the 11 areas were awarded to such bidders as the French-Belgian group TotalFinalElf, Repsol-YPF of Spain and P rez Companc and Pluspetrol of Argentina.

In November 2002, the government signed an agreement with seven foreign firms to develop five offshore blocks of natural gas in the Deltana Platform to the east of Venezuela, which has proven reserves of 100 trillion cubic feet. All ventures are to be conducted jointly with PDVSA, which holds a stake (60%) in each. Since most of the output will be exported, a liquefied natural gas (LNG) plant will also be built¹³ (EIU, 2002b).

Petroleum production has declined in Peru, but the Camisea deposits in that country are South America's largest natural gas field. In 1984, the British-Netherlands firm Royal Dutch Shell located reserves of natural gas and condensates equivalent to 2.4 billion barrels of oil. This field holds a wealth of resources, but negotiations concerning its operation have run up against a series of complications, such as those encountered by the consortium formed by Shell and Mobil, which abandoned the project in 1998, citing technical, commercial and political problems. After many delays, contracts were finally signed for the development of the Camisea fields in March 2001. The \$2.6-billion Camisea project has been split into a 40-year contract covering exploration and production, and a 33-year contract for transportation and distribution. In February 2000 the upstream (production) phase of Camisea was auctioned off to a consortium formed by Pluspetrol of Argentina (40%), Hunt Oil of the United States (40%) and SK Corporation of the Republic of Korea (20%). The consortium is investing about US\$ 1.6 billion in the exploration phase,

¹² Although the Constitution absolutely prohibits the sale of State-owned petroleum assets, President Noboa's Administration attempted to open up the oil industry to foreign firms in the segments of transport (pipelines), investment in refineries and marketing.

¹³ In February 2002, PDVSA announced that the cost of exploring these fields and bringing them on stream, as well as building a major natural gas processing complex, would amount to some US\$ 4 billion by 2007 (EIU, 2002b). About 4,830 kilometres of gas pipelines already exist, but no pipelines suitable for export purposes are available.

US\$ 400m of which is to be provided by 2003 (EIU, 2002c). The potential market for this project consists of power plants in Lima and the central-north area of the country, as well as large industrial customers. Exporting LNG to the west coast of the United States is also a possibility.

In October 2002 a second auction was held for the downstream (transport and distribution) phase of the Camisea project. The successful (and only) bidder was a consortium led by Argentina's Techint¹⁴, which has made a total investment commitment of US\$ 1.45 billion; US\$ 401 million of this sum is to be used for a gas pipeline from Camisea to the coast, and US\$ 91 million for a natural-gas distribution network in Lima and Callao. Techint has set itself a target of 36-44 months for bring natural gas to the capital city.

In May 2002, the consortium responsible for the development and operation of the downstream phase of the project, Transportadora de Gas del Perú (TGP) selected Belgium-based Tractebel as its strategic partner in the concession for distributing Camisea's natural gas to power plants in Lima and the port of Callao. Once it comes on stream, Camisea is expected to generate between US\$ 5 billion and US\$ 6 billion in royalties and tax revenues for Peru over the next 30 years. The project is progressing as planned; pumping operations are expected to begin in the course of 2003 and natural gas should be reaching Lima some time in 2004 (<http://www.camisea.com.pe/project.asp>). President Toledo has also extended a proposal to the President of Bolivia –which possesses Latin America's second largest gas reserves– that the two countries should join forces to increase the use of natural gas in both. This comes at a time when Peru and Chile are competing to be chosen as the site for transport infrastructure and a processing plant for Bolivian gas.

Bolivia has produced natural gas since the 1960s and began to export it, mainly to Brazil, in the late 1990s. More recently, an active exploration policy has led to many large finds, including Block 20 (Tarija West), San Antonio and San Alberto, El Dorado and Caipipendi. With these discoveries, the country's proven gas reserves amount to five times the level of current domestic demand and projected exports for the next 20 years combined (EIU, 2002d).

Plans are in place to build a number of gas pipelines in order to take Bolivian gas to the most lucrative markets.

Thanks to an investment of over US\$ 2.1 billion involving Enron Corp., Shell, Petrobras, the British Gas (BG) group, TotalFinalElf and El Paso, a pipeline connecting Bolivia to the Brazilian city of Sao Paulo came on stream in 1999 (ECLAC, 2002). Although Brazilian demand for Bolivian gas has declined lately, the consortium operating the Bolivian end of the export pipeline, GasTransBoliviano, has raised financing of US\$ 90 million to expand the pipeline and expected to complete this project in 2003.

Once the potential of the new finds had been confirmed, the government began to seek markets for Bolivian natural gas. Plans to export LNG to North America through a port on the Pacific coast, involving an investment of over US\$ 5 billion, are well advanced.¹⁵ In July 2001, the largest producers in Bolivia –Repsol-YPF (37.5%), British Gas (37.5%) and British Petroleum (25%)– formed a consortium called Pacific Liquefied Natural Gas (Pacific LNG) to export LNG to North America (mainly to the Californian and Mexican coasts). Pacific LNG has signed a memorandum of understanding with the United States firm Sempra Energy for the supply of LNG to the United States. The gas will be delivered to a reception terminal to be built jointly by Sempra Energy and CMS Energy Corp. in the Mexican state of Baja California. The project also involves the construction of a pipeline to connect the Margarita field in southern Bolivia to a port on the Pacific coast of either Chile or Peru. The Chilean option is preferred by the Pacific LNG consortium, but there is strong opposition to it within civil society in Bolivia. If the project comes to fruition, natural gas shipments to the United States should begin in 2006-2007. The initial delivery capacity would amount to about two thirds of the current volume of the pipeline to Brazil. TotalFinalElf –with one of the largest stakes in Bolivia's gas reserves– is therefore studying the possibility of joining the Pacific LNG consortium in order to circumvent the problems it has experienced in operating the gas pipeline to Brazil (EIU, 2002d).

The discoveries at Cusiana and Volcanera in the second half of the 1990s positioned Colombia as the site of Latin America's fourth largest reserves of natural gas. Before 1990, discoveries of natural gas in Colombia were viewed as a problem rather than an opportunity because the infrastructure needed to secure a market for it was not available (Barrios, 2001). Potential reserves in

¹⁴ The consortium Transportadora de Gas del Perú (TGP) comprises Techint and Pluspetrol of Argentina (30% and 19.2%, respectively), Hunt Oil of the United States (19.2%), Sonatrach of Algeria (10%), SK Corp. of the Republic of Korea (9.6%) and the Peruvian Group Grana y Montero (12%).

¹⁵ Efforts are also being made to promote the consumption of natural gas in Bolivia's domestic market. One of the authorities' objectives is to build an urban gas distribution network to connect 250,000 consumers within five years. An effort will also be made to encourage the use of natural gas as a fuel for motor vehicles.

offshore basins along the Caribbean coast are estimated to contain enough gas to cover 150-200 years of consumption. Almost 100% of the natural gas now being used is supplied by Chuchupa, an offshore field with reserves of close to 7 trillion cubic feet which is operated by ChevronTexaco of the United States.

In 1997 an Ecopetrol subsidiary, Ecogas, was created to distribute natural gas. The investment of some US\$ 1 billion made in Ecogas was used primarily to build a 5,632-kilometre network of gas pipelines. In 1998 a gas pipeline linking the central and south-western portions of the country came on stream. This pipeline is being operated under a 20-year concession by a Canadian company.

Ecuador has enough refining capacity to process around 20% of the natural gas produced in the Oriente oilfields and imports are necessary to meet about 50% of domestic demand (EIU, 2001). Energy Development Corporation (EDC), a subsidiary of Noble Energy of the United States, owns 100% of a gas-to-power energy venture. The project includes the Amistad field (9.8 billion cubic metres), which lies in the Gulf of Guayaquil and is tapped from an off-shore platform. The gas from Amistad will supply the Machala power plant. EDC has so far invested about US\$ 70 million in the gas project and US\$ 90 million in the electricity generation plant.

(iii) Strategies of the main transnational oil companies in the Andean region

The liberalization of the hydrocarbons subsector, together with a number of international mergers among major oil companies, has brought about a repositioning of the TNCs most heavily involved in exploration and exploitation of petroleum and natural gas in the Andean countries.

- TNCs that have been industry players for many decades tend to have a smaller stake today. This is the case of the world's two largest oil companies, ExxonMobil and Royal Dutch Shell.¹⁶
- As a result of these international mergers and acquisitions, local firms been sought after as complementary assets, and this has boosted the subregional presence of the newly merged firms. Examples are ChevronTexaco and BP Amoco Plc.
- Firms whose subregional presence has been a key part of their strategy have –without abandoning their Andean operations– started to expand their presence in other parts of the world. Occidental Petroleum is a prime example.

- New entrants –mostly European firms– have rapidly expanded their presence in the region. The most notable of these companies is TotalFinalElf.¹⁷
- Lastly, there are firms with a strong regional presence whose international potential revolves around Latin America. The Spanish firm Repsol-YPF is one example, mainly because of its operations in Argentina, while others include the Argentine firms Pérez Companc (PECOM), Pluspetrol –linked with Repsol-YPF– and Techint.¹⁸

The 2001 edition of this publication contained a detailed analysis of the corporate strategies of Repsol-YPF, TotalFinalElf, Royal Dutch Shell and Pérez Companc (ECLAC, 2002). In order to provide the reader with new information, this section will therefore take a more detailed look at the activities of three firms which have played an important role in the development of the petroleum and natural gas industries in the Andean subregion: Occidental Petroleum, ChevronTexaco and British Petroleum.

(iv) Occidental Petroleum: the largest transnational oil company in the Andean region

Today, the Occidental Petroleum Corporation (OXY) is one of the world's largest so-called “independent” firms engaged in exploring for and extracting petroleum and natural gas (ECLAC, 2002, chapter IV). With operations in the United States, the Middle East, Pakistan, Russia and Latin America, OXY has concentrated on finding and developing new sources of petroleum and natural gas (OXY, 2002b). The success of this strategy is reflected in the fact that the firm has found five of the 50 largest oilfields discovered in the world in the last 50 years (OXY, 2002a). A pivotal element of its corporate growth strategy has been the acquisition of new assets in the regions of the world where its development is centred. Since 1998, OXY has invested some US\$ 7.5 billion in buying petroleum and natural gas fields in the United States alone (OXY, 2002a). These acquisitions have resulted in a huge increase in the company's reserves, output and profitability.

Occidental Petroleum is one of the leading oil companies in Latin America, with production operations in Colombia and Ecuador and exploratory activities in Peru. In fact, since the discovery of over 700 million barrels of oil in the northern Peruvian jungle in 1971, it has become the top transnational oil company in the entire Andean region.

¹⁶ See ECLAC (2002), chapter IV, for further details.

¹⁷ See ECLAC (2002), chapter IV, for further details.

¹⁸ See ECLAC (2002), chapter IV, for further details

In 1983, OXY played a key role in Colombia's transformation from an oil-importing to an oil-exporting country, thanks to the discovery of the Caño Limón oilfield in the Department of Arauca in the north-eastern portion of the country. This was one of the largest oil strikes in the western hemisphere in the last 25 years (OXY, 2002a). The project has been conducted through an association contract with ECOPETROL, which controls about 85%. Its production plant is sizeable and has over 100 producing oil wells. This discovery and Colombia itself became a key component of Occidental's global operations; in fact, in the early 1990s Colombia accounted for around half of the company's world reserves and a similar proportion of its output and investments (Puyana and Dargay, 1996). Later, because of the firm's swift international expansion, Colombia's importance in its operations declined. To date, Caño Limón has produced 910 million barrels, out of estimated reserves of 1.3 billion. The output of this oilfield has dwindled to 100,000 barrels per day (from a peak production level of 208,000 barrels per day in 1990). In addition to the depletion of some of the wells, guerrilla attacks at Caño Limón have also affected production levels. Despite the decline, this deposit continues to supply about a third of Colombia's total oil exports (OXY, 2002a). Occidental's total investment in Caño Limón amounts to US\$ 1.9 billion, including the construction of a 777-kilometre pipeline to Coveñas on the Caribbean coast, which the firm operates jointly with ECOPETROL.

In 1992, OXY signed a contract with the Colombian Government to explore a new oil-bearing area in Samoré. In 1997, seismological studies put potential reserves there at an estimated 1.4 billion barrels of oil. Progress has been slow, however, because of difficult relations with the indigenous Uwa community. Occidental eventually abandoned 75% of its original exploration block and concentrated on a drilling area of just two hectares. In September 1999, the Colombian Government issued OXY a new licence to drill the exploratory well Gibraltar I, which is located outside the Uwa reserve.

Despite the success of its operations in Colombia, since 1964 OXY has had to deal with threats and violence from guerrilla groups. In fact, even though strict security measures are in place, the Revolutionary Armed Forces of Colombia (FARC) and the National Liberation Army (ELN) have attacked the Caño Limón pipeline more than 700 times. Since the start of production at this oilfield, guerrilla attacks have caused the loss of over 2.1 million barrels of oil. What is more, between January 1987 and mid-August 2000, these attacks cost the Colombian Government almost US\$ 13 million in losses, in addition to the cost of repairing the pipeline and the environmental damage that was done.

In 1985, Occidental Petroleum bought the drilling rights to 494,000 acres of Block 15 in the Amazon region, in the north-eastern region of Ecuador. In the early 1990s, OXY discovered six commercially viable deposits in this area, which it brought on stream in 1993. It also built some 20 kilometres of pipeline to join up with SOTE, which is owned by the State oil company PETROECUADOR.

In 1995, OXY and the Ecuadorian Government signed an agreement to explore the remaining portion of Block 15. This led to the discovery of the Eden-Yuturi field, with reserves of over 100 million barrels. The company's exploratory work in these new fields has been quite successful, and it is therefore looking to raise its production level in Ecuador by 30,000 barrels per day (OXY, 2002a). Eden-Yuturi's start-up will coincide with completion of the new transcontinental Heavy Crude Oil Pipeline (OCP), which is scheduled for 2003; OCP will have the capacity to transport 450,000 barrels per day from the Oriente Valley to the Pacific coast. The United States firm plans to spend about US\$ 965 million on the development of oilfields in Ecuador's Amazonian region over the next five years in order to make the most of its stake in OCP. In addition, OXY has invested about US\$ 334 million in the Eden-Yuturi field, US\$ 33 million in the Limoncocha field and US\$ 76 million in Indillana (EIU, 2001). Lastly, Occidental is continuing with its exploratory work in Block 15 and hopes that, with the help of an aggressive use of 3-D seismic technology, its exploratory programme in Ecuador will continue to meet with success (OXY, 2002a).

Three decades ago, Occidental discovered the largest oilfield to be found in Peruvian territory, Block 1-AB, in the Amazon jungle, and began developing it. In early 2000, it sold its stake in this block to Pluspetrol of Argentina, but maintains a presence in Peru with interests in two exploratory fields: Block Z-3 offshore and Block 64, which lies to the south-east of 1-AB.

(v) ChevronTexaco Corporation: high stakes in Venezuela

On 9 October 2001, a merger was completed between the United States oil companies Chevron Corporation and Texaco, Inc. The new firm –ChevronTexaco Corporation– thus became the second largest in the industry in the United States, after ExxonMobil, and the fourteenth largest in the world (*Fortune*, 2002). Today, ChevronTexaco has operations in more than 180 countries focusing on energy activities and the chemical industry (ChevronTexaco, 2002a). In Latin America, ChevronTexaco maintains a presence in Argentina, Brazil, Colombia, Trinidad and Tobago, and Venezuela.

In Venezuela, ChevronTexaco Corporation is the leading private foreign operator in terms of daily output (ChevronTexaco, 2002b). Texaco has been interested in investing in the country, particularly in the deposits of heavy crude oil that lie in the Orinoco Belt (the largest reserves of crude oil in the world), ever since the liberalization of the oil sector began. This is how ChevronTexaco came to have a share in Ameriven, one of the four strategic projects authorized to develop the Hamaca project in the eastern part of the country. A strategic partnership among PDVSA (30%), Phillips Petroleum (40%) and ChevronTexaco (30%) has embarked on a venture to drill and transport 190,000 barrels per day of extra-heavy 8.5 grade API crude and to upgrade it to 26-degree API crude, which brings a higher price on international markets. The Hamaca project became operational on 20 November 2001, after investing almost US\$ 900 million of the US\$ 4 billion earmarked for the project over the next 35 years.

Also in Venezuela, ChevronTexaco operates the Boscan oilfield under an operating service agreement. So far it has drilled 32 wells which produce, on average, 104,800 barrels per day (ChevronTexaco, 2002b). The group also maintains a 27% ownership interest in the LL-652 field, located to the north-east of Lake Maracaibo (estimated reserves of 18 million barrels), which it operates under a risk service agreement.

In Colombia, ChevronTexaco operates and holds an interest in one productive field and three that are at the exploration stage through its subsidiary Texas Petroleum Company (TEXPET). In the Guajira region, TEXPET operates the Chuchupa field under a joint venture agreement with ECOPETROL, with each company holding a 50% stake. The area will revert to the Colombian Government in December 2004, but TEXPET will continue operating the fields until 2016. During 2001, net production averaged 211 million cubic feet of natural gas and approximately 35,000 barrels of oil per day (ChevronTexaco, 2002b). In 2001, ECOPETROL, TexacoChevron and PDVSA signed a memorandum of understanding to build a gas pipeline that will connect Colombia's Caribbean coast with western Venezuela.

(vi) British Petroleum Amoco (BPA): seeking new reserves

On 31 December 1998, British Petroleum (BP) completed the purchase of Amoco, at a cost of US\$ 55 billion, thereby creating the largest oil company in Britain and the third largest in the world: BP Amoco Plc. BP has been in the process of establishing an important presence in Colombia since 1987, following some modest earlier involvement in the country. The company discovered the

oilfields of Cusiana and Cupiagua in the Department of Casanare, which it currently operates as part of a consortium formed by ECOPETROL (50%), BP (19%), TotalFinalElf (19%) and Triton (12%). These fields' production level peaked at 815,000 barrels per day in 1999, of which 516,000 went for export (EIU, 2002a). It also has a 50% holding in a consortium with ECOPETROL that was formed to develop the Piedmonte Block, to the north of Cusiana and Cupiagua. In addition, following its merger with Amoco, BP also has the use of a number of licenses that were formerly controlled by Amoco.

BP entered Venezuela for the first time in 1976 to provide technical services to the then recently nationalized oil industry. In the early 1990s, when PDVSA embarked upon the liberalization of the oil industry, BP became an active participant in the bidding process. With the Amoco merger and its acquisition of ARCO, the new company secured a stake in 11 oilfields located throughout Venezuela. This portfolio has been reorganized into six fields—two in the west and four in the east—producing 550 million barrels of oil. BP is the operator of DZO in Maracaibo and Boquerón in Maturín on behalf of PDVSA, partners TotalFinalElf, Chevron, Statoil and the local companies Polar and Inelectra. BP is now seeking to position itself as the leading gasoline supplier in Venezuela with a network of 98 service stations. In conjunction with Burmah Castrol, BP is in first place in the lubricants market. In August 2002, the Venezuelan Government signed pre-selection agreements with seven foreign firms to develop five offshore natural gas blocks in the Deltana Platform to the east of Venezuela, which has proven reserves of 100 trillion cubic feet. Block 1 was obtained by British Petroleum, Block 2 by British Gas jointly with ChevronTexaco, Block 3 by El Paso and the Norwegian firm Statoil, Block 4 by the Franco-Belgian group TotalFinalElf and Block 5 by ExxonMobil.

In Bolivia, BP owns 30% of Empresa Petrolera Chaco in Santa Cruz, together with Bidas Corporation (20%) and the Bolivian pension funds (50%). This firm's strengths include its existing production levels, significant exploration acreage, mid- and downstream assets, and experienced staff.

BP is also one of the largest private producers and distributors of natural gas in Latin America and the Caribbean. It owns sizeable reserves and maintains a presence in several countries, including Argentina, Brazil, Bolivia, Colombia, Mexico, Trinidad and Tobago, and Venezuela, and has expanded into new natural gas-fired generation projects as well.

BP's Chaco fields in Bolivia produce 15,000 barrels of liquids and 110 million cubic feet of natural gas per day. In the natural gas mid- and downstream markets,

Pan American Energy (PAE) and Chaco¹⁹ have gained extensive development experience in such projects as the 215-kilometre Cruz del Sur Gas Pipeline, which links Argentina and Uruguay, the oil pipeline between Bolivia and Brazil and such power generation projects as the 800-megawatt Central Dock Sud plant near Buenos Aires, the 88 megawatt Buló Buló power plant and the Rio Grande Compression Plant.

In summary, with the gradual opening of the hydrocarbons subsector, some of the leading transnational oil companies have included the Andean region in their global strategy for building up a diversified array of reserves. In these countries, better access was the determining factor in attracting foreign firms, while factors such as macroeconomic stability, political violence and the cost of factors of production have been less influential. The oil companies have tended to move into countries when there is an acceptable degree of certainty that resources can be found and exploited, and they have invested large sums to this end. This pattern has not been uniform across the Andean countries, however. While Peru and Bolivia privatized their oil industries, Venezuela and Ecuador have developed association arrangements between the existing State company and foreign firms to exploit those reserves that have a lower value or higher production costs. The exception is Colombia, since it has been developing its oil industry on a joint basis with foreign firms since the mid-1960s.

(b) Metal mining

Most of the Andean countries have rich mineral deposits. Mining has traditionally been the foremost economic activity in Peru and Bolivia, and it has been growing in importance in Colombia and Venezuela. The endowment of mining resources, as well as the relative size of the industry, varies markedly from one Andean economy to another, however. Peru is the world's seventh largest producer of gold and copper (it possesses 15% of the world's copper reserves) and the second largest producer of silver, as well as accounting for a substantial share of the world's zinc and lead production. Bolivia is the world's largest

producer of tin (which was a major driver of its economy until the crisis of 1985) and has sizeable reserves of gold, silver, copper, zinc and lead. Colombia has the largest proven reserves of coal in Latin America and is the fourth largest coal exporter in the world (after the United States, Australia and South Africa).²⁰ Venezuela has rich endowments of mining resources, including some that are used as raw materials in industry (bauxite for producing aluminium and iron ore for producing steel), and of precious metals, mainly gold. Venezuela is also the third largest coal producer in Latin America, after Colombia and Brazil.

As in the case of hydrocarbons, mining activities have been dominated by foreign capital at some points in the region's history while, at others, the State has been the primary (or sometimes only) agent. With the economic reforms of the early 1990s, a number of important regulatory changes were made in the mining sector. National governments began to withdraw from the activity and to give private (mainly foreign) investors exploration and mining rights. Concessions were made easier to obtain, legal stability was improved and more substantial guarantees and incentives were offered to investors.

In the 1990s, there was an increase in world consumption that stimulated supply (and, therefore, the initiation of new projects). In the end, this brought about major technological changes in the industry –then led by TNCs– which were clearly evidenced in the mining and refining of iron, copper and gold (Moguillansky and Bielschowsky, 2001).

Of all the Andean countries, Peru made the fastest progress in reforming its mining sector. The renewal of the regulatory framework and the sale of State assets in the early 1990s gave a significant boost to this industry. The privatization of Mineró Perú and Centromin operating units and deposits yielded US\$ 276 million and US\$ 291 million, respectively, and generated US\$ 1.592 billion and US\$ 2.829 billion in projects (Paliza, 2000). The Quellaveco and La Granja deposits and the copper firm Cerro Verde, which belonged to Mineró Perú,²¹ were also sold around this time, as were Metal

¹⁹ BP has two significant business ventures in the Southern Cone: PAE, which is owned 60% by BP and 40% by Bidas Corporation of Argentina; and Chaco, which is owned 30% by BP, 20% by Bidas Corporation and 50% by the Bolivian pension funds (<http://www.bpgas-latinamerica.com>).

²⁰ Colombian coal is of very high quality and 95% of its production is exported.

²¹ At the end of 1992, the copper deposit of Quellaveco was bought by Mantos Blancos, a South African firm active in Chile, which paid US\$ 12 million and committed a further US\$ 562 million in investment. In March 1994, La Granja was sold to the Canadian company Cambior, which agreed to invest US\$ 475 million. In November 1993, Cyprus Amax Minerals Co. of the United States bought the copper firm Cerro Verde for US\$ 35 million, with an investment commitment of US\$ 485 million (Paliza, 2000).

Oroya and the Antamina mine, which were owned by Centromin.²² In the past few years, the mining subsector has grown rapidly, thanks to fresh investments and new projects coming on stream. Mining –along with hydrocarbons– has thus become the most attractive activity for foreign investors.

The most recent engine of growth in the Peruvian mining sector has been the development of the Antamina mine (owned by the Canadian firms Noranda, Rio Algom and Teck Corporation), in which US\$ 2.3 billion has been invested. Antamina is thought to hold the largest reserves of copper and zinc in the world (EIU, 2002c). The mine began exporting copper concentrates in July 2001, and by the first semester of 2002, Antamina had surpassed Southern Peru Copper Corporation (SPCC)²³ as the country's largest copper exporter. Antamina was expected to increase Peru's copper exports by 50%, its zinc exports by 30% and its GDP by two percentage points. Persistently low international copper prices have placed a number of large operations in difficulties, however. An example is the Tintaya mine,²⁴ owned by the Anglo-Australian firm BHP Billiton, which shut down operations at the end of 2001. According to information supplied by the company, Tintaya's activities will remain at a standstill until at least mid-2003, although it will continue to produce copper cathodes at full installed capacity (34,000 tons per year).

Gold mining is another major activity in Peru. In 2001, Minera Yanacocha, owned by Newmont Mining Corporation²⁵ of the United States, was Peru's leading gold exporter and the largest gold mine in Latin America. Newmont is planning to invest some US\$ 1 billion in Yanacocha in the next five years. The Yanacocha mine, which now produces 40% of Peru's gold, has the largest reserves and has been the largest single gold exporter

since 1998. Another gold mining venture is Pierina, owned by Barrick of Canada, which recently discovered a vein containing an estimated 3.4 million ounces of gold in northern Peru. Opened in May 1999, Pierina has the world's lowest production costs (EIU, 2002c).

Peru is also a major producer of silver, zinc and lead, in which the main players are local firms (Compañía Minera Buenaventura, Centromin and Compañía Minera Volcán). Other leading lead producers are Compañía Minera Atacocha, which has Peruvian stakeholders, and the metallurgical complex of La Oroya, which is operated by The Doe Run Corporation of the United States.²⁶ The zinc industry includes Empresa Minera Iscaycruz, which is owned by Glencore International AG of Switzerland, and Phelps Dodge Mining Company, which has a 40% share in the San Vicente zinc mine. One of the major silver mining companies is the Canadian firm Pan American Silver Corporation, which operates the Quiruvilca mine.

In Bolivia, the 1985 tin crisis triggered a far-reaching structural reorganization of the mining industry. The operations of the State-owned company Corporación Minera de Bolivia (COMIBOL) were gradually wound down and, in 2000, following the privatization of the Vinto tin and antimony smelter, which was bought by the British firm Allied Deals,²⁷ and the Huanuni and Colquiri mines, the State ceased to be involved in the country's mining activities.²⁸ Mining production has also diversified towards gold and polymetals (copper, silver, zinc and lead). Today the bulk of production is in the hands of private –mostly foreign-owned– companies. These include one of South America's largest mining concerns, the Kori Kollo mine, 88% of which is owned by Newmont Mining Corporation of the United States.

²² In July 1996, the firm Metal Oroya –owner of the metallurgical complex of La Oroya– was sold to The Doe Run Corporation of the United States for US\$ 122 million, with an investment commitment of US\$ 127 million. At the same time, rights to exploit the Antamina mine were awarded to Rio Algom Ltd. and Inmet Mining Corp. of Canada, at a price of US\$ 20 million plus investment commitments of US\$ 2.52 billion over five years (Paliza, 2000).

²³ At the end of 2001, SPCC was considered to be one of the world's top 10 copper producers. It is owned by Grupo México of Mexico (54.2%) and The Marmon Group (14.2%) and Phelps Dodge Corporation (14%), both of the United States.

²⁴ In October 1994, the Tintaya deposit was auctioned off to the United States firm Magna Koper Corporation for US\$ 277 million plus US\$ 104 million in investment commitments. In January 1996, Tintaya was bought by the then Australian firm The Broken Hill Proprietary Co. Ltd. (BHP).

²⁵ Newmont Mining operates Minera Yanacocha jointly with the Peruvian firm Compañía de Minas Buenaventura.

²⁶ The Doe Run Corporation bought the complex at La Oroya from Centromin in 1997.

²⁷ In early 2002, Allied Deals went into involuntary provisional liquidation amid accusations of financial mismanagement. Huanuni came under temporary control of COMIBOL, while Vinto was sold to Empresa Minera Colquiri, a joint-venture subsidiary of Bolivia's largest mining company Compañía Minera del Sur (COMSUR, 51%) and British investment fund CDC Capital Partners (49%). The majority shareholder in COMSUR is Bolivia's President, Gonzalo Sánchez de Lozada.

²⁸ COMIBOL signed a 30-year shared-risk lease contract agreement with Allied Deals to operate the Huanuni mining centre, which was physically transferred on 16 March 2000. The investment commitment for the first two years of the contract is US\$ 10.25 million. In April 2000, the Colquiri mine was leased for 30 years to Compañía Minera del Sur (COMSUR), with an investment commitment of US\$ 2 million in the first two years.

In Venezuela, the State controls all mining reserves, but the authorities have taken steps to attract private investment to a number of large-scale projects. In 2000 the regulatory framework that had been in place since 1941 was reformed in order to streamline concession procedures and offer investors greater legal security.

With its rich endowment of iron ore and bauxite deposits, Venezuela has been developing large iron and steel and aluminium industries for some time now. Ferrominera del Orinoco, a subsidiary of Corporación Venezolana de Guyana (CVG), is the largest firm involved in mining iron ore. An ambitious strategy to attract private investment has yielded mixed results, however. In 2001, a US\$ 900 million joint venture of BHP Billiton and Siderúrgica Venezolana S.A. (SIVENSA)²⁹ was suspended when the Anglo-Australian firm pulled out. A second project, involving an investment of close to US\$ 400 million that is being financed mainly by Phang Steel of Korea, was launched in June 2000. In 1997, Corporación Aluminios de Venezuela (CAV) was set up with a view to privatizing the activity, but that plan has not borne fruit. The Administration of President Chávez has not pursued the idea of privatization, but it has continued to seek strategic partnerships. In 2001 an agreement was signed with the French firm Pechiney to expand the production capacity of Bauxilum, a subsidiary of CVG.³⁰ CVG also plans to develop two new large bauxite deposits (El Palmar and Pijiguaos), regarding which discussions have reportedly been held with BHP Billiton.

Venezuela possesses vast gold reserves. The Ministry of Energy and Mines has awarded some 350 exploration and mining concessions. In 2001, the largest producer was La Camorra, owned by the United States firm Hecla Mining, followed by the State-run firm CVG Minerven. Other major projects now underway are Las Cristinas (US\$ 575 million) and Brisas del Cuyuni (US\$ 300 million).

In September 2002, the Canadian-owned Crystallex International Corporation was selected by CVG to operate the Las Cristinas gold mine, which is considered to be one of the world's largest undeveloped gold deposits³¹ (<http://www.vanessaventures.com>). Crystallex

announced it would invest about US\$ 500 million to develop the mine, which should have come on stream in 2004-2005. This operation took Vanessa Venture Ltd. by surprise, however, after it had bought a controlling stake in the operation in late 2001 for a "token price" of US\$ 50 million, from Placer Dome³² (both companies are Canadian). After putting the project on hold in 1998 because of low world gold prices, Placer Dome sold its share in Minera Las Cristinas (MINCA) over the objections of CVG. The Venezuelan authorities refused to recognize the transaction and argued that Placer Dome had violated the terms of the original concession contract, which specified that CVG had to be consulted regarding the sale of stock by any of the partners. This situation has given rise to a legal battle between MINCA and CVG. As a result of all this, the project has been set back by more than five years. At the end of 2002, Vanessa was still asserting ownership rights over Las Cristinas, despite the agreement between CVG and Crystallex.³³

Colombia's large coal deposits have aroused the interest of both local and foreign firms. In mid-1999, at the time of the creation of Empresa Nacional Minera Ltda. (MINERCOL) from the merger of two existing firms, Ecocarbón and Mineralco, the government established a policy regarding the country's coal resources. A new regulatory framework, the Mining Code, was approved in June 2001 with a view to making the Colombian mining industry more competitive by providing investors with better contractual stability and more favourable conditions. All mining contracts with Minercol are 30-year concessions.

Almost 60% of Colombia's coal output comes from El Cerrejón, one of the largest open-pit mines in the world. In 2002 it was bought by Consorcio Cerrejón Zona Norte (CZLN), formed by Glencore of Switzerland and the two British firms Anglo American and BHP Billiton. El Cerrejón had previously been operated by Interior, a subsidiary of Exxon Corporation of the United States, jointly with the State company Sociedad Carbones de Colombia (CARBOCOL). In October 2000, the British-Swiss consortium paid CARBOCOL US\$ 437 million

²⁹ SIVENSA is also a shareholder in Siderúrgica del Orinoco (SIDOR). In 1998, the government sold a stake in SIDOR to the consortium Sierurgia Amazonia, formed by several Latin American firms including Techint, Hylsamex and Usiminas.

³⁰ CVG operates four companies in the aluminium segment: two smelters, Venalum and Alcasa; a carbon anode plant, Carbonorca; and a bauxite production plant, Bauxilum. Up to January 2002, those four firms has been vertically integrated in Corporación Aluminios de Venezuela (CAV), which had suffered from mismanagement and had run up substantial debts.

³¹ In 1997, Placer Dome estimated the gold reserves at Las Cristinas to be 11.8 million ounces (www.vanessaventures.com).

³² In 1997, Placer Dome suspended construction of the mine because of low gold prices. Then, in June 2000, it made a new investment of US\$ 116 million.

³³ Vanessa Venture is still awaiting a final ruling on an appeal it lodged with Tribunal Supremo de Justicia (TSJ, the supreme court). It has also said that it will seek international arbitration for redress under an investment protection agreement between Canada and Venezuela. Vanessa estimates that it has spent around US\$ 170 million on exploration and preparatory work at the site (EIU, 2002b).

for its stake in El Cerrejón and, in early 2002, bought Exxon Corporation's share for a sum of between US\$ 550 and US\$ 600 million, which will enable it to operate the mine until 2033 (*La Nota*, 27 December 2002). The southern and central zones (Cerrejón Zona Sur and Cerrejón Zona Central) are controlled by the consortium Carbones del Cerrejón (CDC), which is formed by Anglo American Plc., BHP Billiton and Glencore. In early 2002, CZN won the bidding to begin exploring the Patilla field, which has estimated reserves of 65 million tons. In mid-2002, CDC was absorbed by CZN, which moved it up from position 26 to position 17 in the ranking of the country's largest firms by sales (US\$ 825 million) (*La Nota*, 23 August 2002).

In 1995 the La Loma mine –a project managed by a United States company Drummond– came on stream. The mine yielded over 12 million tons in 2001, and its output is expected to continue increasing over the next five years. The government predicts that recent developments in the industry will allow coal exports to double in 2005-2010 (EIU, 2002a).

Thanks to the discovery of the high-grade Cerro Matoso deposit in 1956, Colombia also has large reserves of nickel and is currently among the top 10 nickel producers in the world.³⁴ Cerro Matoso was privatized

in 1996, when it was sold to Glencore for US\$ 375 million.

Ecuador opened its mining sector to foreign investment in the 1980s in an effort to find alternatives to petroleum, but development in the sector has been scant because of continuous regulatory changes and uncertainty over the enforcement of property and exploration rights. The 1991 Mining Act provides better protection to local and foreign investors than they previously enjoyed, and in 2000 further reforms were enacted to increase the sector's attractiveness.

In summary, regulatory changes and TNC strategies have brought large flows of foreign investment into the Andean Community countries for the development of new mining ventures. The most active companies in the subregion include Newmont Mining Corporation of the United States, which operates gold mines in Peru and Bolivia; the Anglo-Australian corporation BHP Billiton, which mines copper in Peru and coal in Colombia; Noranda, Rio Algom and Teck Corporation of Canada, which are all in the copper industry in Peru; and Glencore of Switzerland, which mines coal and nickel in Colombia. This overview gives an indication of the geographical and product diversification of the modern TNCs operating in the mining sector.

2. Access to local services and infrastructure markets

In the early 1990s, a series of reforms were implemented which permitted and, in many cases, encouraged foreign investors to move into basic services provision and infrastructure activities. The mechanism that was most commonly used –although with widely varying outcomes– was the privatization of public assets. The pioneers in this area were Peru and Venezuela, followed by Colombia and Bolivia. Ecuador, by contrast, has had a great deal of difficulty carrying forward some of its initiatives for downsizing the State's role in the economy.

In Peru, at the start of the 1990s, the Administration of President Alberto Fujimori embarked upon a plan to reduce the State's involvement in the economy to a minimum. The government eliminated all the monopoly privileges enjoyed by State enterprises, lifted all restrictions and prohibitions on external trade, and established non-discriminatory treatment for foreign investment. The purpose of the privatization process was to scale back State participation in economic activities or to eliminate it altogether.

This programme was launched in 1992 with the sale of the steel producer Hierroperú and continued with the divestment of the airline Aeroperú and part of two telephone companies. Subsequent privatizations in the telecommunications, energy, banking, tourism and manufacturing sectors were completed in 1998, but the programme then began to languish, particularly in the areas of electrical energy and road infrastructure. Between 1991 and 1998, more than 180 privatizations were carried through, generating revenues of US\$ 7.72 billion and US\$ 7.935 billion in investment projects (Paliza, 2000).

Today, President Alejandro Toledo's Administration has made privatizations and concessions one of the cornerstones of its economic policy. In February 2002, Peru made a commitment to the International Monetary Fund (IMF) to take in US\$ 700 million from sales and concessions in 2002 and US\$ 1 billion in 2003. Up to June 2002, the government had raised around US\$ 400 million through privatizations, chiefly thanks to the sale

³⁴ In 2001, Colombia was the eighth largest nickel producer in the world, after Russian, Australia, Canada, New Caledonia, Indonesia, Cuba and China (World Bureau of Metal Statistics, 2002).

and concession of power generation and distribution companies. It has become very difficult to take the privatization process further, however, because of mounting public dissent. The greatest setback so far came in mid-2002, when the authorities capitulated to protests against the sale of electricity assets in the south of the country.

Even though the government has altered its policy on controversial privatizations, it remains optimistic with regard to the sale of some of the State's flagship enterprises. These firms include the Servicio de Abastecimiento de Agua Potable y Alcantarillado de Lima (SEDAPAL), the Mantaro hydroelectric plant—which is worth an estimated US\$ 1.5 billion—and some of the lesser assets of the State oil company, PETROPERU.

Venezuela began a privatization programme in 1991, but its implementation was hesitant and short-lived. Under this initiative, 45% of the State-owned airline and the telephone company Compañía Anónima Nacional de Teléfonos de Venezuela (CANTV) were sold to foreign investors, but the process then ground to a halt. Venezuela remains an economy in which the State has a major hand. A sharp turnaround in privatization policy came in December 1998, with the election of President Hugo Chávez. The new Administration made it clear that strategic economic assets such as oil production, electricity transmission and hydroelectric power generation would not be sold, but it did offer some shared-risk ventures in certain areas.

Colombia began its programme of privatizations and concessions in 1994, which focused primarily on the areas of electrical energy, banking and telecommunications. These initiatives stalled in 1999, but have picked up their pace somewhat in the last three years. The public sector continues to be a major supplier of electric power, is still the largest provider of telecommunications services—though the Empresa Nacional de Telecomunicaciones (TELECOM) and other municipal firms—and maintains a monopoly in petroleum and natural gas through ECOPETROL. The Colombian authorities have no plans to privatize either ECOPETROL or TELECOM any time soon. A key factor for the future of the privatization process is the outcome of the peace negotiations with guerrilla groups, which are staunchly opposed to the sale of State assets to foreign investors.

During Bolivian President Gonzalo Sánchez de Lozada's first term in office, his Administration used an innovative privatization programme involving five major

State-owned enterprises to further the economic liberalization process and downsize the State's role in the economy. Rather than paying the government for these assets, investors received a 50% share in the firms and signed an agreement which committed them to making certain investments over a set period of time. The remaining 50% went to a Collective Capitalization Fund (FCC), whose dividends were administered by two pension funds (see box II.1).

In Ecuador, the authorities have recently been moving away from the protectionist models based on heavy State involvement in the economy that characterized a number of past Administrations. In 1998 important amendments were made to the Constitution with a view to facilitating private-sector engagement in the economy. Under the new provisions, the State is responsible for supplying public services such as drinking water, electric power, telecommunications, road-building, and road and port maintenance. However, the authorities are empowered to delegate this responsibility to the private sector by means of concessions, capitalization or the sale of shares in such assets. The Administration of President Gustavo Noboa made a strong move in this direction, seeking to separate the political responsibility of the government from the economic activities of the production sector by actively encouraging the sale of State assets.³⁵ In 2000, the government sponsored a number of bills directed towards this objective, but failed to garner sufficient support for them in Congress. The most significant change in this connection has been the passage of the Economic Transformation Act, under which private investors may acquire up to 51% of the shares in electricity and telecommunications companies.

(a) Telecommunications: burgeoning growth in mobile telephony

In the early 1990s, telecommunications infrastructure in the Andean countries suffered from many shortcomings due to under-investment and technological lags. During that period, national authorities introduced a number of reforms to attract private capital and, with it, investment and competition. In the first half of the 1990s, Venezuela and Peru privatized their public telecommunications companies and gave foreign operators a monopoly position in the market for a fixed period of time. In 1995, Bolivia did something similar when it capitalized Empresa Nacional de Telecomunicaciones (ENTEL). At the other end of the spectrum are Colombia and Ecuador, where fixed

³⁵ At the end of 2002, the Ecuadorian State had a stake in about 190 concerns in the sectors of agriculture, telecommunications, energy, finances, industry, mining, storage, transport and tourism.

telephony continues to be controlled by the State. At around this same time, all the Andean countries opened up other segments of the telecommunications market to competition, particularly mobile telephony, in which a small number of international operators have become the main players. Telecommunications has thus been one of the more dynamic subsectors of the Andean economies, attracting large investments and bringing about substantial improvements in infrastructure.

With the beginning of these privatization programmes, the largest telecommunications operator in Latin America, Telefónica of Spain, became one of the most important actors in the Andean subregion. Telefónica has been the winning bidder in two of the three privatizations of fixed telephony utilities held in the subregion so far. In 1991, it formed part of a consortium led by GTE Corporation –now Verizon Communications– which gained control of *Compañía Anónima Nacional de Teléfonos de Venezuela (CANTV)* with an investment of close to US\$ 1.89 billion. Although the Spanish firm holds a minority interest, there has been speculation that it has tried to increase its stake in CANTV. In fact, it is thought Telefónica may have been one of the leading forces behind the recent public tender offer (PTO) for CANTV announced by *Electricidad de Caracas*, which is controlled by AES Corporation.³⁶ In early 1994, Telefónica bought 40% of the Peruvian companies *Empresa Nacional de Telecomunicaciones (ENTEL)*, a national and international long distance monopoly, and *Compañía Peruana de Teléfonos (CPT, or COPERTEL)*, Lima's telephone company. Telefónica surprised its rival bidders by offering close to US\$ 2 billion and then merging the two firms to form *Telefónica del Perú*. In 2000, as part of "Operation Veronica", Telefónica paid US\$ 3.218 billion to gain outright control of its Peruvian subsidiary (ECLAC, 2001).

In Venezuela and Peru, the winning consortiums maintained a monopoly in the fixed telephony market, which placed them at a great advantage in dealing with the new technological challenges arising in the telecommunications sector.³⁷ At that same time, two other firms –BellSouth of the United States and Telecom Italia Mobile (TIM) of Italy– which were emerging as major players in the mobile telephony market began to compete with Telefónica in the fixed telephony market. Then, in

mid-1999, BellSouth was awarded a concession to provide fixed telephony services in Peru and later, in 2001, won a similar contract in Venezuela. Telecom Italia had also gained experience in this segment of the subregional market, having bid successfully in the capitalization of Bolivia's State-run company, ENTEL. Under the terms of the privatization agreement, ENTEL retained a monopoly over local, long distance and international service, with an investment of US\$ 626 million. TIM then began to invest heavily in the fixed telephony market in Venezuela. Neither BellSouth nor TIM has achieved a significant market share in Peru and Venezuela, however.

The Colombian and Ecuadorian authorities have not privatized their basic telephony companies, which has limited foreign investors' access to these markets. In Colombia, a number of joint ventures were undertaken with foreign firms to expand local telephone service, and while public utilities continue to control the market, competition among them has increased sharply.³⁸ In 2000, the municipal authorities abandoned an attempt to privatize 51% of *Empresa de Telecomunicaciones de Bogotá (ETB)* –valued at US\$ 710 million– because of investor concerns about security in the country. In Ecuador, since 1992 successive Administrations have tried to privatize the State telecommunications companies *Andinatel* and *Pacifictel*. Following an unsuccessful attempt to privatize 35% of these two firms in 1997 and 1998, subsequent regulatory modifications enabled the government to divest itself of a 51% share of both *Andinatel* and *Pacifictel*. This privatization operation may be completed in 2003, depending on the economic policy stance adopted by the new Administration. In this regard, the government has asked the firms' current management to undertake competitive and transparent selection processes –under the supervision of the competent institution– to find operators interested in administering them. In 2002 a second attempt to privatize the administration of *Pacifictel* met with failure when no valid bids were received.³⁹ The only bid was made by the Swedish firm *Telia*, but it did not include the US\$ 10 million guarantee required under the conditions of the call to tender (www.bsteam.telecomindice7.htm).

In general, the limited volume of foreign investment being made, particularly in the less developed countries,

³⁶ In the event of a successful takeover, AES proposed to sell the mobile telephony subsidiary (*Movinet*), and is believed to have entered into discussions with Telefónica in this connection.

³⁷ *Telefónica del Perú's* monopoly in fixed telephony expired in August 1998, and *CANTV's* in November 2000.

³⁸ *Empresas Colombiana de Telecomunicaciones (TELECOM)*, *Empresa de Telecomunicaciones de Bogotá (ETB)* and *Empresas Públicas de Medellín (EPM)* controlled 79% of local telephone services.

³⁹ The tender offered a five-year concession to administer the company, which, to date, has 587,000 clients (44% of the country's fixed lines).

has translated into slower progress in improving basic telephony services than in other Latin American countries (see table II.4). At the same time, the deferral of investments in fixed telephony has helped the mobile telephony market to flourish. Between 1995 and 2001, the number of mobile telephony subscribers in the Andean Community countries as a group jumped from 816,300 to almost 13 million (see table II.4). The

case of Venezuela is most notable, where mobile telephones accounted for over 70% of total telephones in service and the number of cellular phone users per 1,000 inhabitants reached 26.4% in 2001 (see table II.4). The same operators that maintain a major presence in fixed telephony also dominate the cellular segment, although their shares of the two markets differ markedly.

Table II.4
ANDEAN COMMUNITY: TELECOMMUNICATIONS INDICATORS, 1995-2001

	Fixed telephony				Mobile telephony				Internet		
	No. of main lines (thousands)		Main lines per 100 inhabitants (percentages)		Celular telephone subscribers (thousands)		Celular telephone subscribers per 100 inhabitants (percentages)		Percentage of total tele-phones	Internet users per 100 inhabitants (percent-ages)	Personal computers per 1,000 inhab-itants
	1995	2001	1995	2001	1995	2001	2001	2001	2001	2001	
Bolivia	246.9	514.8	3.33	6.22	10.0	744.0	8.99	59.1	...	...
Colombia	3 872.8	7 300.0	10.05	17.05	274.6	3 265.3	7.63	30.9	4.16	55.25	
Ecuador	679.9	1 335.8	6.09	10.37	54.4	859.2	6.67	39.1	1.61	19.08	
Peru	1 109.2	2 022.3	4.71	7.75	73.5	1 545.0	5.92	43.3	2.16	36.40	
Venezuela	2 463.2	2 758.3	11.38	11.20	403.8	6 489.9	26.35	70.7	4.66	60.90	
Argentina	5 622.5	8 108.0	16.17	21.63	340.7	6 974.9	19.26	46.2	7.26	80.20	
Brazil	13 263.0	37 430.8	8.51	21.78	1 285.5	28 745.8	16.73	43.4	5.30	68.84	
Chile	1 818.0	3 703.3	12.74	23.90	197.3	5 271.6	34.23	59.5	7.93	78.23	
Mexico	8 801.0	13 773.0	9.39	13.72	688.5	21 757.0	21.68	61.2	5.59	71.74	

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of figures provided by the International Telecommunication Union (ITU) (www.itu.int).

The United States firm BellSouth is the leading mobile telephony operator in three of the five Andean countries (Venezuela, Colombia and Ecuador) and is the second largest in the Peruvian market (see table II.5). In Venezuela, BellSouth's subsidiary TELCEL has secured about 60% of the market and plans to invest around US\$ 1.5 billion by 2005. In June 2000 it invested US\$ 295 million to buy 33.8% of Celumóvil S.A., which operates in six of Colombia's 10 largest cities. A few days later, the United States firm bought a further 16.6%, increasing its stake in Celumóvil to 54.4%. Through this newly acquired firm, BellSouth then negotiated an agreement with the owners of Compañía Celular de Colombia (COCELCO), for which it paid US\$ 414 million. This operation enabled BellSouth to increase its stake in Celumóvil to 66% and obtain control of the company. This, together with the purchase of COCELCO, gave

BellSouth the largest share of the Colombian mobile telephony market (ECLAC, 2001). In Peru, in January 1997, BellSouth bought 58.7% of Tele 2000, a multi-service telecommunications company. Since then it has increased its stake in this firm to 97%, has begun to operate its own fibre optics network in Lima and the surrounding area, and has adopted the BellSouth brand name.

Using its solid position in the Bolivian market as a trampoline, TIM has become one of the three principal firms in the mobile telephony segment in any Andean country (see table II.5). In November 1996, Entel switched its cellular telephony service to Time Division Multiple Access (TDMA) technology and then, in late 2000, incorporated the Global System for Mobile Communication (GSM) standard.⁴⁰ That same year, TIM moved into the Peruvian market with an initial investment

⁴⁰ Entel's Móvil competes in the Bolivian market with private firms TELECEL (majority owned by Millicom of Luxembourg) and VIVA (majority owned by Western Wireless of the United States). between 1991 and 1996, TELCEL had a monopoly of the market.

of US\$ 250 million, and later paid US\$ 180 million to obtain a PCS (Personal Communication System) licence and offer GSM technology, thus becoming the third-largest mobile telephony operator in Peru (ECLAC, 2001). In November 2000, TIM bought 57% of the Venezuelan mobile telephony firm Digitel for US\$ 600 million (www.americaeconomica.com/numeros/70/

noticias/fitamovil.htm) and, early in 2003, injected an investment of US\$ 352 million into the firm. Between 2003 and 2005, Digitel plans to invest some US\$ 485 million in expanding its network and developing new technology (*Gestión*, 15 November 2002). As of mid-2002, the firm had some 800,000 clients, compared with 450,000 the year before.

Table II.5
ANDEAN COMMUNITY: MAIN MOBILE TELEPHONY OPERATORS, DECEMBER 2001

		Bolivia	Colombia	Ecuador	Peru	Venezuela
BellSouth	Year of entry	-	2000	1997	1997	1991
	Subsidiary	-	Celumóvil	BellSouth Ecuador	BellSouth Peru (formerly Tele 2000)	TELCEL
	Stake in subsidiary (percentage)	-	66.0	89.4	100.0	78.0
	Number of users	-	859 366	225 180	361 367	3 234 972
TIM	Year in of entry	1995	-	-	2000	2000
	Subsidiary	ENTEL Móvil	-	-	TIM Perú	Digitel
	Stake in subsidiary (percentage)	100.0	-	-	100.0	56.6
	Number of users	280 000	-	-	173 000	667 000
Telefónica of Spain	Year of entry	-	-	-	1994	1991
	Subsidiary	-	-	-	Telefónica Móviles Perú	CANTV
	Stake in subsidiary (percentage)	-	-	-	100.0	6.4
	Number of users	-	-	-	1 087 000	2 461 500

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of data provided by the firms (www.bellsouth.com; www.tim.com; www.telefonica.es).

Finally, Telefónica of Spain took advantage of the monopoly it had built up during much of the 1990s in fixed telephony in Peru and Venezuela –with a minority stake in CANTV– to consolidate its position as one of the leading mobile telephony operator in both markets. In Peru it has maintained this position, but in Venezuela it lost a large part of its market share with the liberalization of the subsector and the expansionist strategy of BellSouth (see table II.5).

With the consolidation of the leading operators, the Andean countries have received large inflows of resources in the last few years. According to the Peruvian authorities, up to 2001 the telecommunications subsector had received some US\$ 4 billion in private investment and agreements had been signed with two foreign firms (Telefónica of Spain and AT&T of the United States)⁴¹ for investments of about US\$ 5 billion over the next few years. A similar situation has developed in Venezuela, where approximately US\$ 5 billion in investments were made in the telecommunications industry between 1997 and 2001.

Market liberalization and the rapid incorporation of new technologies has also brought new market entrants. The Peruvian Government has awarded a total of 252 concessions in the area of telecommunications, bringing firms such as Nextel and Americatel⁴² of the United States into the market. In Venezuela, the award of 15 licences in a Wireless Local Loop (WLL) technology auction generated US\$ 20.2 million in revenues for the government. TELCEL and Genesis Telecom –and joint venture formed by Bell Canada and Telmex of Mexico– were the largest winners, with five licences each, but TIM of Italy, Millicom of Luxembourg and Entel of Chile were also successful bidders. Investments in telecommunications fell off sharply in 2001, however, as the companies in the sector await the Venezuelan Government's announcement of auctions for LMDS (Local Multipoint Distribution System) licences and the third round of WLL technology.

⁴¹ AT&T entered the Peruvian market in mid-2000 after having formed a partnership with FirstCom.

⁴² In mid-2000, AT&T arrived in Peru after forming a partnership with FirstCom.

In Colombia and Ecuador, the situation has developed rather differently. In Colombia, the concession of three new PCS licences was delayed by pressure from the firms already holding such licences (BellSouth and COMCEL, a subsidiary of América Móvil of Mexico). Finally, in January 2003, Colombia Móvil – a consortium of the Colombian firms Empresas Públicas de Medellín (EPM) and ETB – obtained the right to operate the three new licenses. EPM is owned by the City of Medellín and is the leading public services provider in Colombia, while ETB is owned by the Colombian Government and is the country's second-largest fixed telephony company. In late 2002, the Government of Ecuador announced it would auction off a third mobile telephone license – licenses are currently held by BellSouth and Porta (a subsidiary of América Móvil), but the auction was postponed at Porta's request.⁴³ This development is of particular interest, since it seems to indicate that América Móvil is beginning to emerge as an important new operator in the Andean subregion. This conglomerate, in which SBC Communications, Teléfonos de México and Bell Canada all have an interest, has obtained a share of the market in Colombia, Ecuador and, recently, Venezuela. It also was involved in the unsuccessful attempt to privatize Ecuador's State-owned Pacifictel.

In summary, the telecommunications subsector has been the recipient of sizeable amounts of foreign investment, particularly in those of the Andean countries whose markets have been opened up to competition. After the first few privatization operations, the major international operators have concentrated their efforts on expanding their shares in the mobile telephony market. In fact, cellular telephone penetration rates in the Andean countries are quite high. Competition, the entry of new operators and the ongoing introduction of state-of-the-art technology have brought about significant improvements in service, coverage and prices which have enabled leading firms such as BellSouth to meet the challenge posed by new entrants despite the fact that they do not have a subregional network of their own.

(b) Electric power: towards an Andean duopoly?

As in the telecommunications industry, most Andean countries have encouraged private investment in the three segments of the electric power subsector (generation, transmission and distribution) as a means of improving and expanding available energy infrastructure. Outcomes have varied widely, however.

Nearly all the countries have amended their sectoral regulations and devised mechanisms for transferring the main public enterprises to private ownership. Nonetheless, the ambitious privatization and concession schemes put in place in Bolivia, Colombia and Peru faced opposition from civil society, and this tended to erode interest among potential foreign investors. In Ecuador and Venezuela, several attempts at privatization have also been abandoned, either as a result of political opposition in Congress or as new authorities take office. In countries where privatizations did take place, assets have tended to gravitate into the hands of a few Spanish, United States and Chilean firms, such as Endesa-España and AES Corporation.

In Peru, a legal framework allowing the sale of all State firms in the subsector was established in 1992. This led to privatization of the restructured business divisions of ELECTROLIMA,⁴⁴ together with the distribution and generation units of ELECTROPERU.⁴⁵ In the mid-1990s, the authorities in Bolivia carried out a far-reaching reform of the subsector, which allowed three of the main generating units of the State-owned Empresa Nacional de Electricidad to be included in its Capitalization Plan.⁴⁶ In 1996, the Colombian Government unblocked the sale of major electric power assets and embarked upon a privatization policy that resulted in about half of the country's generating and distribution capacity passing into private ownership. The process attracted investments of about US\$ 6 billion into the electric power subsector.

The initial enthusiasm engendered by privatizations in Peru and Colombia faded rapidly, however. The population in Peru associated the sale of State assets with

⁴³ In March 2000, the Mexican firm TELMEX acquired a 60% equity interest in Concel S.A. as part of an investment programme aimed at strengthening Porta's coverage and modernizing its network.

⁴⁴ To facilitate its privatization, ELECTROLIMA was split into five independent businesses: one generating firm – Empresa de Generación Eléctrica de Lima (EDEGEL), and four distributors – Luz del Sur, Empresa de Distribución Eléctrica de Lima Norte S.A. (EDELNOR), Ede-Chancay and Ede-Cañete.

⁴⁵ The Government retained a 40% stake in these assets to be sold subsequently; 10% was reserved for employees.

⁴⁶ After making a contribution of US\$ 140 million, 50% of the ownership and management of these companies was sold to United States investors: Duke Energy (Empresa Eléctrica Conari S.A., US\$ 59 million), Energy Initiatives (Empresa Eléctrica Guaracachi S.A., US\$ 47 million) and the Constellation Energy Group consortium (Empresa Eléctrica Valle Hermoso, US\$ 34 million). In 1998, the country's largest generator, Compañía Boliviana de Energía Eléctrica (COBEE), was acquired by NRG Energy Inc. also of the United States.

an increase in unemployment and utility-rate hikes, which generated strong popular opposition. In June 2002, the Government cancelled the US\$ 167 million sale of two electric power generators (EGASA and EGESUR) to the Belgian firm Tractebel in the wake of serious protests; it then suspended the remainder of its privatization programme indefinitely. In Colombia, plans to increase private-sector participation were discontinued in view of the scant interest shown by foreign investors in electricity distribution firms that had been experiencing financial difficulties (in addition to being involved in legal disputes), compounded by continuous guerrilla attacks. The sale of ISAGEN de Generación y Comercialización de Energía (valued at US\$ 415 million) was postponed indefinitely, having failed to attract foreign investors. Privatization of Interconexión Eléctrica S.A. (ISA) has also been held back; in order to capitalize the firm, a 24% stake was instead sold directly to the public between November and December 2000. This operation raised a total of US\$ 74 million. Despite terrorist attacks (numbering 194 in 2001), the ISA management has striven to double profits and project itself abroad through projects in Ecuador, Peru and Venezuela (see box II.2).

Although these programmes have been very short-lived, there has been one major winner: the Spanish firm Endesa – firstly, as a member of the consortia that submitted the winning bids for some of the most attractive assets, and then by acquiring a controlling interest in the Chilean group Enersis, which was also an active participant in Andean privatizations. Even before this acquisition, Endesa and Enersis had been working together to form consortia to bid on the different assets being privatized. In Colombia, Endesa-España acquired control of Comercializadora y Distribuidora de Energía S.A. (CODENSA) and Empresa Generadora de Energía S.A. (EMGESA), both of Bogotá, and later added Central Hidroeléctrica de Betania, which had been acquired by an Enersis subsidiary. In Peru, the Spanish transnational participated in the consortia that acquired Empresa de Distribución Eléctrica de Lima Norte S.A. (EDELNOR), Empresa de Generación Termoeléctrica de Ventanilla (ETEVENSA) and Empresa Eléctrica de Piura (EEPSA), in addition to several other assets acquired by Enersis and its subsidiaries.

With its acquisition of Enersis, Endesa-España consolidated its position as the leading energy group in Latin America (Calderón, 2003); this also, however, created a number of problems for it with regulatory authorities, especially in Peru. In mid-1997, Endesa-España was already displaying a degree of horizontal concentration in the generation market (ETEVENSA and EEPSA), but its acquisition of assets owned by Enersis – Empresa de Generación Eléctrica de Lima (EDEGEL)

and the distributor Edelnor – not only increased this, but also gave the firm a high degree of vertical concentration (generation-distribution), which was expressly prohibited under Peruvian energy regulations. In November 1997, in an unprecedented decision, the Peruvian Congress passed an anti-trust act for the electric power subsector which, curiously enough, allowed vertical integration of up to 5% and horizontal concentration of up to 15%, if requested in advance. Despite this, the National Institute for the Defence of Competition and Protection of Intellectual Property (INDECOPI) accepted the petition filed by ENDESA, which presented its 31% concentration in both cases as a *fait accompli*.

In Venezuela, the electric power subsector is made up of both State-owned firms (which account for the majority of assets) and a number of private operators. The State infrastructure is substantially degraded, and an estimated US\$ 12 billion in investment is required (EIU, 2002b). In September 1999, a new regulatory framework was approved which allows private investment in State firms and divides electric power activities into separate generation, distribution and transmission segments in preparation for the opening of the subsector. To date, however, progress in this direction has been very slow, and in 2001 the government departed still further from these objectives by declaring that the largest State firms – the generator Empresa de Electrificación del Caroní (EDELCA), and the distributor Compañía Anónima de Administración y Fomento Eléctrico (CADAFE) – were strategic assets and would therefore not be privatized. The authorities have also done an about-turn regarding the privatization of Energía Eléctrica de Venezuela (ENELVEN); Energía Eléctrica de la Costa Oriental (ENELCO); Energía Eléctrica de Barquisimeto (ENELBAR); and Sistema Eléctrico de Monagas y Delta Amacuro (SEMDA).

It was against this backdrop that one of the most ambitious strategies implemented in Latin America began to unfold, as the United States firm AES Corporation employed an aggressive acquisitions programme to position itself among the leaders in the region's electric power subsector. One of the epicentres of this process was the Andean Community, and particularly Venezuela. In June 2000, Venezuela's regulatory system was put to the test by a hostile takeover bid for the country's largest private electric power firm, Electricidad de Caracas (EDC), for which AES Corporation offered US\$ 1.6 billion. The National Securities and Exchange Commission (CNV) suspended the AES bid on two occasions, arguing in support of the rights of minority shareholders. Pressure from CNV forced the firm to broaden its bid to include all EDC shares wishing to participate, thereby benefiting minority interests. In the

Box II.2

INTERCONEXIÓN ELÉCTRICA S.A. (ISA): A MULTI-ANDEAN FIRM

Interconexión Eléctrica (ISA) is Colombia's leading power transmission firm. Although its main activity is the transportation of high-voltage power, the firm is noteworthy for its use in recent years of a growth strategy based on two central pillars: (i) internationalization of its activities in Andean Community countries and exploitation of network synergies; and (ii) incipient diversification of activities towards the telecommunications sector. The ISA business group consists of its subsidiaries Transelca and ISA-Perú in the electric power sector, and Internexa and Flycom Comunicaciones in telecommunications. One of the key strategic moves made by ISA in Colombia was its 1998 acquisition of 65% of Transelca, the country's second-largest power transmitter. In 2000, ISA became the leading Colombian mixed public-private enterprise, although the State continues to hold a majority interest.

As part of its regionalization process and its diversification towards the telecommunications sector, in 2000 ISA set up its Internexa subsidiary and began operations in fibre-optic networks. Internexa provides a carrier's carrier service for power and

telecommunications firms. Recently it teamed up with the Ecuadorian firm Transelec to form Transnexa, which will operate the fibre-optic network joining the two countries; it hopes to start operations in Ecuador through this partnership early in 2003. In addition, Internexa entered a joint venture with New World Network to develop a land-based station for the use of the submarine cable that interconnects Colombia, the United States and several Central American and Caribbean countries. Meanwhile, Flycom Comunicaciones will operate the local access licence in Colombia to provide wireless broadband services regionwide with a view to supplying its clients with network interconnectivity for voice and data, high-speed Internet and other services.

In Peru, the regionalization of electric power activities began in 2001 with the creation of the subsidiaries ISA-Perú and Red de Energía del Perú. This step was made possible by the award of several tenders to ISA, including a concession for the design, construction, exploitation and operation of a set of substations (Oroya, Carhuamayo and Vizcarra, among others), together with the electric

power interconnection systems of the Government of Peru (Etecen and Etesur) in 2002. This made ISA the largest energy carrier in the country. In recent months, the firm has shown interest in deepening its position within the Andean Community and strengthening the interconnections it already possesses with Venezuela and Ecuador; specifically, it has declared its intention to participate in new tenders for energy transmission concessions in Bolivia and Ecuador. ISA has set itself the objective of providing electric power connectivity among Colombia, Ecuador, Peru and Venezuela in 2004; it is also evaluating the possibility of joining a future integrated market in Central America.

ISA is thus a good example of a largely State-owned firm that has found fertile ground for expansion in Andean Community countries. Its success may also be associated with the relative stagnation of activities and operations among the large TNCs, presumably due to financing difficulties. The firm's expansion has been based on diversification of its activities towards telecommunications and the implementation of a common energy strategy in the subregion.

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, on the basis of information provided by Interconexión Eléctrica (ISA) (<http://www.isa.com.co>).

end, the takeover was authorized, since this was seen as a means of sending out a positive signal to foreign investment. Once the acquisition was accomplished, AES sold off a number of unprofitable EDC assets in Colombia to the Spanish firm Unión Fenosa. Like Endesa-España, AES further expanded its presence in the Andean countries in 2000 by acquiring the Chilean firm, Gener, which had assets in Peru and Colombia. It then also attempted to use a PTO to purchase the telecommunications firm CANTV, but this operation was ultimately aborted.

In Ecuador the government's privatization plan for the electric power subsector has run into difficulties. In 1999, the State-owned Instituto Ecuatoriano de Electrificación (INECEL) was divided into seven separate entities as a means of making it more attractive to

potential foreign buyers.⁴⁷ The plan was to sell 51% of the equity in 17 distribution firms.⁴⁸ In late 2001, three international corporations were showing interest in participating in this privatization: Unión Fenosa of Spain, AES Corporation of the United States, and Pérez Compans of Argentina. The Ecuadorian authorities subsequently planned to sell off the transmission firm and six generators during 2002. In the case of Hidropaute, the country's largest generator, 49% of its equity was to be sold to the private sector. In early 2002, the government was also intending to offer a concession for electric power distribution in the City of Guayaquil, where 30% of all the country's consumers reside. Nonetheless, in March and April of that year its privatization plans broke down because of the low valuation obtained by the 17 distribution firms (about

⁴⁷ One transmission firm, Transelectric S.A., and six generators, Hidropaute S.A., Hidroagoyán S.A., Hidropucará S.A., Termoesmeraldas S.A., Termopichincha S.A. and Electroguayas S.A. In early 2001, Hidroagoyán took over Hidropucará.

⁴⁸ Of the other 49% the workers would receive 10%, with the remainder going to the beneficiaries of popular capitalism.

US\$ 380 million), the municipal and provincial governments' refusal to put their shares in the distribution firms up for auction and widespread popular protest. In May 2002, the concession of Empresa Eléctrica del Ecuador (EMELEC), which supplies Guayaquil, also fell through, after Unión Fenosa and AES Corporation had shown interest in taking over the company. As a result, 100% of EMELEC passed into the hands of the Deposits Guarantee Agency (AGD), under the supervision of the National Electricity Council, until such time as it can be transferred to a private investor.

The electric power subsector in Andean countries has clearly undergone major changes in recent years. In most cases –albeit with differing results– the national authorities have encouraged participation by private capital as a way of upgrading and expanding their countries' electricity infrastructure, which has degraded over time due to a lack of public investment. These privatization programmes began with a great deal of optimism in Peru and Colombia, but social pressure and other difficulties steadily undermined foreign firms' interest. The Andean countries were no exception to the Latin American trend, however, and two of the largest TNCs in the subsector, Endesa-España and AES Corporation, managed to acquire several of the most important assets. Furthermore, unlike the great majority of the other TNCs present in the subregion, these two firms, together with ISA, are also notable for the fact that they have displayed what could be described as a pan-Andean vision.

(c) Other infrastructure sectors

The authorities in Andean countries see concession programmes as a way of overcoming the infrastructural shortcomings from which many of their economies suffer, and they have been using such mechanisms to transfer the construction, maintenance and administration of highways, ports and airports to private investors.

During the first half of the 1990s, the Colombian Government implemented a system of highway concessions aimed at encouraging participation by private investors, both local and foreign, in the construction of infrastructure. The programme included contracts to rehabilitate, build or maintain, as appropriate, different segments of various roadways. These contracts have been awarded in three stages. The first lasted from 1994 to 1997, the second from 1997 to 1999, and the third round began in 2000. Between 1994 and 1999, the government granted 13 highway concessions, for a total value of US\$ 985 million, to rehabilitate 1,220 km of roads and build another 306 km. The largest of these have been the Armenia-Pereira-Manizales expressway, under

concession to Autopistas del Café S.A., and the Tobia Grande–Puerto Salgar expressway, which was awarded to Concesionaria del Magdalena Medio S.A. Construction work on the latter is currently suspended owing to a legal dispute between the government and the concession holder. The third phase of the concessions programme was launched in 2000 with the aim of strengthening export promotion policies by providing better links between the interior of the country and its border areas. This phase, which is designed to cover 3,840 km of highways, encompasses eight projects spread across the country having a total value of US\$ 2.146 billion. These projects include construction of the La Línea tunnel (US\$ 222 million), which forms part of the improvement plan for the Bogotá-Buenaventura corridor (US\$ 950 million); rehabilitation of the Atlántico–Bolívar–Córdoba–Sucre highway system, involving an investment estimated at US\$ 220 million; and rehabilitation and expansion of the Zipaquirá–Santa María highway, which is expected to require an investment of around US\$ 167 million (CONFIS, 2001; DNP, 2001). In addition, the authorities in Peru are implementing a concessions scheme to upgrade and operate 11 expressway extension projects, the first of which was awarded in May 2002. Similar programmes have been implemented in Ecuador, where 1,212 km of highways have been placed under concession to private investors.

The remodelling and management of airports is another activity that has kindled interest among foreign investors. In 2000 an international tender was held for the concession of the Jorge Chávez Airport in the City of Lima; this contract was won by a consortium led by the German firm Flughafen Frankfurt Main, which runs the Frankfurt airport and another five airports in various countries. To obtain the 30-year concession, the successful bidders made a US\$ 1.2 billion investment commitment and agreed to pay 46.51% of their profits to the State (EIU, 2002c). During the first year of operations, the concession-holder paid US\$ 43 million to the Peruvian Treasury. In 2001, a decree was signed empowering the municipalities of Quito and Guayaquil to award a concession to build new airports in those cities. In November 2002, the Mariscal Sucre International Airport in Quito was transferred to a privately-owned export contracting agency, the Canadian Commercial Corporation (CCC). This consortium also signed a US\$ 300 million contract to build a new terminal.⁴⁹ In addition, agreement was reached on a 35-year concession for the operation and maintenance of both the existing airport and the new one (Puembo) with a view to their eventual merger.

⁴⁹ The Canadian firm will operate Mariscal Sucre until the new Quito airport is finished.

Mention should also be made of the 30-year concession to operate and manage the water and sewerage system in the City of Guayaquil, which was won by International Water Supply (IWS). This consortium consists of the British firm United Utilities (one of the leading public service providers in Europe), the United States firm Bechtel (one of the world's largest engineering and construction firms) and Edison SpA (Italy's largest private energy supplier).

(d) The banking sector: the early bird gets the worm?

In the wake of the debt crisis of the 1980s, the Andean countries' banking systems suffered from problems of insolvency and inadequate supervision. In the early 1990s, most Andean Community countries began to introduce far-reaching reforms in their financial systems. These reforms entailed such measures as the privatization of State entities, the liberalization of operating rules, the elimination of most controls on interest rates, the establishment of capital requirements and expenditure limits, the reinforcement of prudential supervision measures and the lifting of restrictions on foreign participation in local financial institutions. Two of the pioneers in this process were Peru and Colombia (the latter was in a particularly strong position thanks to the banking supervision measures it implemented, which were second only to those of Chile among the Latin America countries). Bolivia, Ecuador and Venezuela followed close behind, and banking activity grew strongly against this backdrop while the presence of foreign players in local financial systems also expanded.⁵⁰

Nonetheless, this new state of affairs did not last long; between 1994 and 1998, one by one, the Andean countries' banking systems began to run into difficulties.

- In 1994-1995, the Venezuelan financial system slipped into a crisis that engulfed half of the country's banks and cost the State around US\$ 11 billion (EIU, 2002b). Today, although the situation has improved, the banking sector in that country still suffers from serious problems of decapitalization and inefficiency.
- In Colombia, the situation worsened in 1998. The economic recession, together with depreciating asset values and high interest rates, undermined the strength of the banking system. Regulatory agencies had to intervene in the management of several institutions, and some of the smaller ones merged or closed their doors; a US\$ 4.2 billion bailout package was put together, and those institutions that continued operating did so under strict oversight and supervision measures.

- In Peru, the effects of El Niño, compounded by external shocks and the devaluation of the local currency, created serious problems for the financial system in 1998. Although there was no risk of outright collapse, the government intervened with a bailout package in order to restore the payments chain. The banking sector avoided default, but it has been faced with serious difficulties due to the high proportion of non-performing loans in its portfolio. As a result of this instability, about 70% of deposits in the Peruvian banking system are held in dollars.
- In Ecuador, the banking system was on the verge of total collapse in 1999, and the authorities had to issue US\$ 862 million in bonds to reimburse clients who had held deposits in the State banks that closed down. In 1999, the authorities had to intervene in the management of Ecuador's largest bank in terms of assets, Filanbanco, and the bank was eventually forced to close down following the July 2001 liquidity crisis and the government's failure to find a buyer for the bank's most attractive assets.⁵¹ Filanbanco's collapse sent shockwaves throughout the financial system; between 1998 and 1999, the State took control of 16 banks, four of which were merged into two units, while the remaining 12 were closed down.

During this turbulent period, the presence of foreign institutions in the Andean countries' banking systems grew substantially (see figure II.4). Despite the risk associated with these economies, international firms that were striving to consolidate and expand their presence in Latin America took advantage of the opportunities opened up by the banking crisis in the subregion. The Spanish banks Banco Bilbao Vizcaya Argentaria (BBVA) and Santander Central Hispano (SCH) warrant special mention in this connection.

These two Spanish banks are the largest foreign institutions currently operating in Andean financial markets. In the mid-1990s, SCH and BBVA engaged in fierce competition to secure the best banking assets throughout Latin America, and the Andean Community was no exception (Calderón, 2002). SCH rapidly succeeded in its bid to establish a strong and homogeneous regional presence, first in the countries of the Southern Cone, then in the Andean economies, and finally in the largest and most developed markets (Brazil and Mexico) (see table II.6). Like its rival, BBVA first consolidated its presence in the medium-sized markets (including Colombia, Peru and Venezuela) before turning to the larger ones.

⁵⁰ See chapter III of this report.

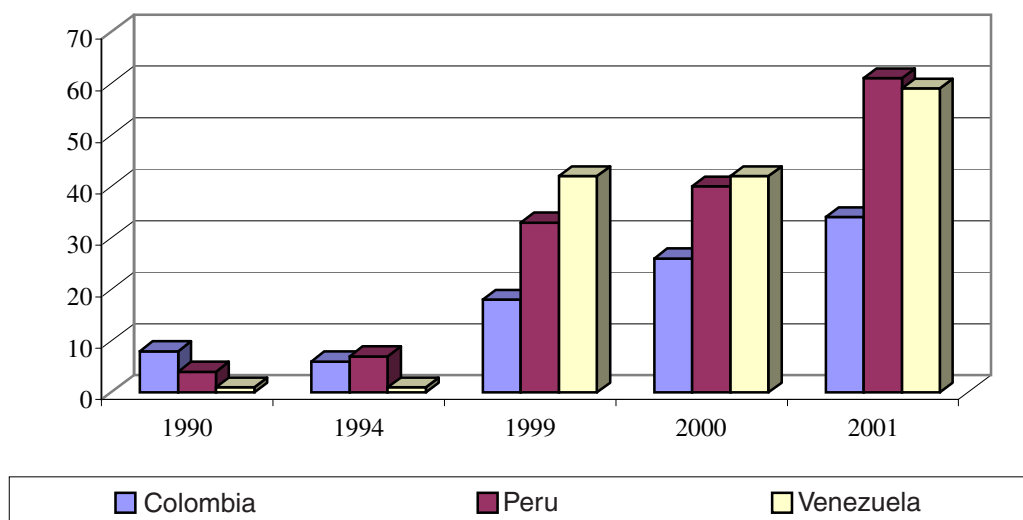
⁵¹ Non-performing loans amounted to 62% of Filanbanco's total portfolio (EIU, 2001).

Table II.6
SANTANDER CENTRAL HISPANO (SCH) AND BANCO BILBAO VIZCAYA ARGENTARIA (BBVA): PRESENCE IN THE BANKING MARKET OF THE ANDEAN COMMUNITY COUNTRIES, 2001
(Percentages and millions of dollars)

Local bank	Percentage owned	Ranking in the local banking system, by assets	Value of total assets, December 2001	Market share		Year of entry	
				Lending (percentage)	Deposits (percentage)		
SANTANDER CENTRAL HISPANO							
Bolivia	Banco Santa Cruz	90	2	634	13.13	15.76	1998
Colombia	Banco Santander Colombia	60	12	1 265	2.63	2.68	1997
Peru	Banco Santander Perú	100	6	1 312	7.08	5.75	1995
Venezuela	Banco de Venezuela	98	3	3 700	12.94	12.31	1997
BANCO BILBAO VIZCAYA ARGENTARIA							
Colombia	BBVA Ganadero	99	3	2 557	7.44	9.46	1996
Peru	BBVA Continental	50	3	2 999	13.83	19.41	1995
Venezuela	Banco Provincial	53	1	4 255	16.61	16.03	1997

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of figures provided in Álvaro Calderón, *Spanish Banks in Latin America: Do they need each other?*, document presented at the Conference on Spanish Investment in Latin America, Transnational and Comparative Studies Center, Florida International University (Miami, Florida, 18-19 October 2002).

Figure II.4
COLOMBIA, PERU AND VENEZUELA: SHARE OF FOREIGN BANKS IN TOTAL ASSETS OF LOCAL BANKING SYSTEMS, 1990-2001
(Percentages)



Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, on the basis of information presented in chapter III of this report.

The Spanish banks also viewed pension-fund management as an attractive alternative for diversification and expansion, given its strong growth potential in the different regional environments. By late 1998, BBVA had become the second-largest pension-fund manager in the region, with an average weighted market share of 25% in the countries where it was present, and market leadership in Bolivia, Colombia and Peru. In May 1999, BBVA consolidated its leadership in Latin America with the indirect purchase of 40.7% of Provida, the largest pension-fund manager in Chile. Thus, having begun its activities in Ecuador, it then went on to strengthen its position in Colombia and Peru.

In general, the market strategies pursued by foreign-owned banks have focused on attracting savers' deposits, thereby introducing new patterns of competition in the industry. Greater competition has not led to lower costs, however (see chapter III of this report).

(e) Retail trade

In Colombia, the supermarket business underwent profound changes during the 1990s. The entry of international retail chains fuelled competition, and supermarkets increased their share of total retail sales.

The consumer boom of the early 1990s also stimulated foreign investment: in 1996 the Dutch firm Makro entered the subregion, and this was followed in 1998 by the arrival of the French chain Carrefour. In September 2001, Carrefour invested US\$ 26 million to open four new hypermarkets in Bogotá. The French chain currently plans to open two new hypermarkets in Colombia every year (EIU, 2002a). Its operations in the country are part of a joint venture in which Carrefour has a 55% stake, Grupo Empresarial Bavaria has a 35% share and Grupo Sigla holds a 10% interest.

In recent years, retail trade has burgeoned in Peru, both in the supermarket segment and among large department stores (the Chilean firms Ripley and Saga-Falabella are examples). These retail establishments have spread rapidly both in Lima and in other cities in the interior of the country. In 2001, Ripley was the country's largest importer of consumer goods, with total imports exceeding US\$ 36 million. Over the last three years, the Santa Isabel supermarket chain (a subsidiary of Royal Ahold of the Netherlands and Disco of Argentina) has doubled its number of outlets in Lima, in addition to operating the Plaza Veja chain. Santa Isabel has 20 stores at the present time, and it was planning to add a further five during 2002.

C. CONCLUSIONS

During the last 50 years, ownership of major production assets in the Andean countries has undergone striking changes. In some periods the dominant players have been TNCs, while at other times national governments have exercised strong monopoly power. Since the mid-1980s, and especially since the early 1990s, the Andean economies have been carrying forward sweeping economic reforms that have resulted in the withdrawal of the State from most production activities –with the partial exception of the hydrocarbons sector– and the lifting of restrictions on foreign investment.

This new regulatory context attracted large FDI inflows into the Andean Community. Despite serious economic and political difficulties in several countries, the subregion took in nearly 13% of total FDI in the region and maintained high and stable levels of foreign investment throughout 1998-2002. In fact, FDI flows have grown faster in the Andean Community than in Latin America overall. Nonetheless, investment has been heavily concentrated in a few activities which, by their very nature, have little to do with specific policies, the macroeconomic situation, market conditions or other traditionally important

factors. In such cases, the relevant question has been whether or not transnational firms could participate in the activities concerned. The pro-market reforms introduced in the early 1990s were decisive, and this was particularly true of the countries' privatization programmes and the decision to grant partial access for exploration and exploitation of hydrocarbons in association with State oil companies in Andean countries.

FDI has tended to target the exploration and production of natural resources –hydrocarbons and metal ores– together with the basic services and infrastructure sectors. As a result of private investment in new mining and drilling projects, exports have increased considerably and these sectors' share of the world market has grown. The fact remains that, although the international competitiveness of the Andean subregion has improved on the whole, this has not occurred in activities that are gaining ground in world trade flows. On the other hand, the arrival of foreign investors has brought major improvements in the coverage and quality of public services and infrastructure, and hence an increase in the subregion's systemic competitiveness.

The fact that Bolivia, Colombia, Ecuador, Peru and Venezuela are involved in a process of economic integration does not seem to have had much impact on decisions taken by TNCs. An analysis of the types of activities that are of greatest interest to foreign investors makes it quite clear that the potential of an expanded market is not one of the main determinants for them. Firms seeking natural resources go where they have access to them, while the new transnational service providers include Andean Community countries within their strategies for Latin America as a whole, seeking to gain market access wherever favourable conditions exist. Examples include the strategies pursued by BellSouth and TIM in telecommunications; Endesa-España, AES Corporation and ISA in electric power; and BBVA and SCH in financial services (banking and pension-fund management). Given the size of local markets, FDI in manufacturing is found only on a very minor scale and is concentrated in the larger and relatively more developed countries (Colombia and Venezuela). The possibility of exporting to other Andean Community countries has been a major location factor only for a few very specific types of manufacturing activities,

such as the automotive sector and the chemical-pharmaceutical industry in Colombia and Venezuela.

Undoubtedly, the improvement that has taken place in political and economic conditions in Andean Community countries will be a decisive factor in maintaining and, wherever possible, increasing their attractiveness for foreign investors. In addition, the possibility of deepening subregional integration agreements, while extending and diffusing this process throughout civil society and, in particular, the Andean business sector, could be an important additional factor in attracting FDI in the future. This could enhance the strategic nature of the Andean Community's geographic location for trade with the United States, Europe, Asia-Pacific and Latin America. Nonetheless, it is clear that an effort also needs to be made to ensure that foreign investment effectively contributes to the productive development of the subregion. Given the characteristics of FDI in the Andean Community economies, the lack of production linkages, weak demand for skilled human capital and low levels of value-added are some of the key challenges to be addressed in the years to come.



ANNEX

Table II-A.1
ANDEAN COMMUNITY: MAIN PRIVATIZATIONS WITH PARTICIPATION BY FOREIGN FIRMS, 1991-2002
(Percentages and millions of dollars)

Recipient country	Activity	Date	Firm	Buyer	Investing country	Percentage	Amount paid
Bolivia	Oil	1997	Empresa Petrolera Chaco S.A.	Amoco	United States	50.0	307
Bolivia	Oil	1997	Empresa Petrolera Andina	YPF/Pérez Companc	Argentina	50.0	265
Bolivia	Oil	1997	Transredes	Enron Corp.	United States	50.0	264
Bolivia	Telecoms	1996	Empresa Nacional de Telecomunicaciones (ENTEL)	Royal Dutch-Shell Group Telecom. Italia	Netherlands Italy	50.0	610
Colombia	Electric power	1998	Corporación Eléctrica de la Costa Atlántica (CORELCA)– Electrocosta y Electrocaribe	Reliant Energy	United States	32.5	658
Colombia	Electric power	1997	Codensa S.A.	Endesa España (26.4%)/ Enersis (12.5%)/ Chilectra (9.1%)	Spain	48.0	1 085
Colombia	Electric power	1997	Central Hidroeléctrica Chivor	Gener S.A.	Chile	99.9	646
Colombia	Electric power	1997	Gas Natural E.S.P.	Gas Natural SDG	Spain	53.7	155
Colombia	Electric power	1997	Empresa de Energía del Pacífico S.A. (EPSA)	Reliant Energy	United States	28.2	150
Colombia	Electric power	1996	Central Hidroeléctrica de Betania	Endesa Chile	Chile	100.0	489
Colombia	Electric power	1996	Promigas	Enron Corp.	United States	39.0	101
Colombia	Mining	2000	Mina de Carbón Cerrejón Zona Norte (CZN)	Anglo American Plc. Billiton Plc. Glencore International	United Kingdom United Kingdom Switzerland	50.0	384
Colombia	Mining	1997	Cerro Matoso	Billiton Plc.	United Kingdom	46.6	166
Peru	Electric power	2001	Electroandes	Public Services Enterprise Group (PSEG)	United States	100.0	227
Peru	Electric power	2000	Empresa de Generación Eléctrica Norte (EGENOR)	Duke Energy	United States	30.0	112
Peru	Electric power	1995	Empresa de Generación Eléctrica de Lima (EDEGEL)	Endesa Chile (32.6%) Entergy Power Group (EPG) (27.4%)	Chile United States	60.0	525
Peru	Electric power	1995	Empresa de Generación Eléctrica Norte (EGENOR)	Dominion Resources	United States	60.0	228
Peru	Electric power	1995	ETEVENSA	Endesa España	Spain	60.0	120
Peru	Electric power	1994	Empresa de Distribución Eléctrica de Lima Sur (EDEL SUR)	Chilquinta S.A. (36%) HydroOne Inc. (24%)	Chile Canada	60.0	212
Peru	Electric power	1994	Empresa de Distribución Eléctrica de Lima Norte S.A. (EDELNOR)	Chilectra/Enersis Endesa España	Chile Spain	60.0	176
Peru	Finance	1995	Banco Continental	Banco Bilbao Vizcaya Argentaria (BBVA) (30%) Grupo Brescia (30%)	Spain Peru	60.0	287
Peru	Metallurgy	1995	Refinería de Zinc Cajamarquilla	Cominco Ltd. (82%) Marubeni Corporation (17%)	Canada Japan	100.0	191
Peru	Mining	1994	Yacimiento Tintaya	Broken Hill Proprietary	Australia	100.0	277
Peru	Oil	1996	Refinería La Pampilla (RELAPSA)	Repsol-YPF (48%) Mobil Oil (3%)	Spain United States	60.0	181
Peru	Telecoms	1994	Telefónica del Perú S.A.	Telefónica de España	Spain	40.0	2 000
Venezuela	Finance	1997	BBVA Banco Provincial	Banco Bilbao Vizcaya Argentaria (BBVA)	Spain	40.0	299
Venezuela	Finance	1996	Banco de Venezuela	Santander Central Hispano (SCH)	Spain	90.0	338
Venezuela	Metallurgy	1997	Siderúrgica del Orinoco (SIDOR)	Consorcio Siderurgia Amazonia	Argentina	70.0	1 800
Venezuela	Telecoms	1991	Compañía Anónima Nacional Teléfonos de Venezuela (CANTV)	GTE Corporation Telefónica de España American Telephone and Telegraph (AT&T)	United States Spain United States	40.0	1 900
Venezuela	Transport	1991	Víasas	Iberia Líneas Aéreas de España S.A.	Spain	60.0	146

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management.

Table II-A.2
ANDEAN COMMUNITY: MAIN MERGERS AND ACQUISITIONS WITH PARTICIPATION BY FOREIGN FIRMS, 1992-2002
(Percentages and millions of dollars)

Recipient country	Activity	Date	Firm	Buyer	Investing country	Percentage	Amount paid
Bolivia	Electric power	2002	Transmisora Eléctrica Boliviana (TDE)	Red Eléctrica de España (REE)	Spain	99.0	88
Bolivia	Electric power	2000	Emp. de Luz y Fuerza Eléctrica Cochabamba	Pennsylvania Power & Light (PP&L)	United States	91.9	49
Bolivia	Finance	1998	Banco Santa Cruz	Santander Central Hispano	Spain	90.0	180
Colombia	Food	1998	Productos Klim	Nestlé	Switzerland	100.0	313
Colombia	Cement	1998	Diamante Samper	Valenciana de Cementos	Spain	90.0	346
Colombia	Commerce	1999	Almacenes Éxito	Casino Guichard-Perrachon	France	25.0	205
Colombia	Electric power	2000	Corporación Eléctrica de la Costa Atlántica	Unión Fenosa	Spain	32.6	135
Colombia	Electric power	2000	Empresa de Energía del Pacífico	Unión Fenosa	Spain	28.2	100
Colombia	Electric power	2000	Empresa de Energía del Pacífico	Unión Fenosa	Spain	36.1	225
Colombia	Finance	2001	Banco Ganadero	Banco Bilbao Vizcaya Argentaria	Spain	10.0	44
Colombia	Finance	2000	Banco Ganadero	Banco Bilbao Vizcaya Argentaria	Spain	^a	260
Colombia	Finance	1998	Banco Ganadero	Banco Bilbao Vizcaya Argentaria	Spain	15.0	177
Colombia	Finance	1997	Banco Santander Colombia (ex Bancoquía)	Santander Central Hispano	Spain	60.0	155
Colombia	Finance	1996	Banco Ganadero	Banco Bilbao Vizcaya Argentaria	Spain	40.0	329
Colombia	Mining	2002	Intercor (50% Cerrejón Zona Norte)	Anglo American BHP Billiton Glencore	United Kingdom Australia Switzerland	50.0	200
Colombia	Oil	2000	CIT Colombiana	Enbridge	Canada	50.0	117
Colombia	Telecoms	2002	Celcaribe	América Móvil	Mexico	95.0	100
Colombia	Telecoms	2002	Comunicación Celular	América Móvil	Mexico	13.8	52
Colombia	Telecoms	2000	Compañía Celular de Colombia (COCELCO)	Celumóvil	Colombia	100.0	414
Colombia	Telecoms	2000	Celumóvil	BellSouth Corporation	United States	33.8	295
Colombia	Telecoms	1998	Occidente y Caribe Celular (OCCEL)	BellSouth Corporation Bell Canada	United States Canada	68.4	302
Ecuador	Food	2002	Compañía de Cervezas Nacionales	Cervecería Bavaria	Colombia	25.0	152
Ecuador	Oil	2000	CMS Oil Ecuador	Crestar Energy Inc.	Canada	100.0	142
Ecuador	Oil	1999	Villano Oilfield	AGIP	Italy	60.0	214
Ecuador	Telecoms	2000	Consorcio Ecuatoriano de Telecom.	Teléfonos de México (Telmex)	Mexico	60.0	153
Ecuador	Telecoms	1996	Conecell	FirstCom Corporation	United States	53.0	100
Peru	Food and beverages	2002	Unión de Cervecerías Backus Johnston	Cervecería Bavaria	Colombia	27.0	568
Peru	Food and beverages	2002	Unión de Cervecerías Backus Johnston	Cervecería Bavaria	Colombia	24.5	420
Peru	Food and beverages	2002	Unión de Cervecerías Backus Johnston	Cervecería Regional	Venezuela	16.0	200
Peru	Food and beverages	2002	Unión de Cervecerías Backus Johnston	Grupo Polar	Venezuela	...	77
Peru	Food and beverages	2001	Unión de Cervecerías Backus Johnston	Grupo Polar	Venezuela	12.8	110
Peru	Food and beverages	1999	Inca Kola	The Coca-Cola Company	United States	50.0	200
Peru	Food and beverages	1999	Embotelladoras Coca-Cola Perú	Coca-Cola Embonor S.A.	Chile	100.0	186
Peru	Food and beverages	1997	Industrias Pacocha	Unilever	United Kingdom	50.0	72
Peru	Electric power	2000	Emp. de Generación Eléctrica de Cahua y Pariac	Skanska BOT AB/ Nordic Power	Sweden	60.0	48
Peru	Electric power	1999	Empresa de Generación Eléctrica Norperú	Duke Energy	United States	29.4	92

Table II-A.2 (concluded)

Recipient country	Activity	Date	Firm	Buyer	Investing country	Percentage	Amount paid
Peru	Electric power	1999	Luz del Sur S.A.	Sempra Energy	United States	37.0	90
Peru	Electric power	1997	Inversiones Dominion Perú	AES Gener S.A.	Chile	49.0	123
Peru	Electric power	1997	Planta Termoeléctrica de Ilo	Power Fin	Belgium-Luxembourg	100.0	44
Peru	Finance	1999	Banco Wiese Sudameris	Banco Sudameris	France	64.8	180
Peru	Pension funds	1999	AFP Unión	Santander Central Hispano (via AFP Nueva Vida) ^a	Spain	100.0	135
Peru	Mining	1992	Hierro Perú	Shougang	China	100.0	162
Peru	Telecoms	2000	Telefónica del Perú (formerly ENTEL)	Telefónica de España	Spain	56.7	3 218
Peru	Telecoms	1999	BellSouth Perú (Tele 2000)	BellSouth Corporation	United States	15.6	167
Peru	Telecoms	1997	BellSouth Perú (Tele 2000)	BellSouth Corporation	United States	58.7	112
Venezuela	Food	1998	Grandes Molinos de Venezuela	Cargill Incorporated	United States	60.0	140
Venezuela	Food and beverages	1997	Panamco Venezuela	Panamerican Beverages Inc. (Panamco)	Mexico	100.0	1 112
Venezuela	Cement	1994	Vencemos	Cementos Mexicanos (Cemex)	Mexico	51.0	300
Venezuela	Commerce	2000	Cadena de Tiendas Venezolanas	Casino Guichard-Perrachon	France	50.0	48
Venezuela	Electric power	2000	Electricidad de Caracas	AES Corp.	United States	81.3	1 658
Venezuela	Electric power	1999	Electricidad de Caracas	Brown Brother Harriman & Co.	United States	13.0	158
Venezuela	Finance	2000	Banco Caracas	Santander Central Hispano (via Banco de Venezuela)	Spain	93.0	316
Venezuela	Finance	2000	Interbank Venezuela	Banco Mercantil Argentaria	Venezuela Spain	97.0	218
Venezuela	Finance	1997	Banco del Caribe	Bank of Nova Scotia (Scotiabank)	Canada	26.6	88
Venezuela	Mining	2001	Mina Las Cristinas	Vannessa Ventures	Canada	70.0	100
Venezuela	Telecoms	2001	Rodven	Telefónica Media	Spain	100.0	48
Venezuela	Telecoms	2000	Corporación Digicel	Telecom Italia	Italy	56.6	600
Venezuela	Telecoms	1998	Comtel Comunicaciones	BellSouth Corporation	United States	60.0	210
Venezuela	Telecoms	1991	Telcel Venezuela	BellSouth Corporation	United States	78.0	98

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management.

^a Through a capital increase of US\$ 260 million, Banco Bilbao Vizcaya Argentaria became the owner of 85.12% of the equity of Banco Ganadero.

Table II-A.3
ANDEAN COMMUNITY: LARGEST FIRMS WITH FOREIGN OWNERSHIP, BY SALES, 2001
(Millions of dollars)

	Firm	Country	Activity	Sales	Investors	Foreign capital (%)	Country of origin	Exports
1	Compañía Anónima Nacional de Teléfonos de Venezuela (CANTV)	Venezuela	Telecoms	3 012	Verizon Communications (28.5%) / Telefónica de España (6.9%)	35.4	United States	-
2	ExxonMobil de Colombia	Colombia	Oil	1 396	ExxonMobil	100.0	United States	...
3	Telcel BellSouth	Venezuela	Telecoms	1 261 ^a	BellSouth Corporation	78.2	United States	-
4	Telefónica del Perú	Peru	Telecoms	1 033	Telefónica de España S.A.	96.7	Spain	-
5	Siderúrgica del Orinoco (SIDOR)	Venezuela	Metals	957 ^a	Hylsamex (35%)/Tubos de Acero de México S.A. (TAMSA) (12.5%)/Siderar (17.5%)/Techint (5%)	70.0	Mexico/Argentina	...
6	Electricidad de Caracas (EDC)	Venezuela	Electric power	778	AES Corporation	82.4	United States	-
7	Comercializadora Makro	Venezuela	Commerce	679 ^a	Makro Atacadista	100.0	Brazil	-
8	General Motors de Venezuela	Venezuela	Automotive	676 ^a	General Motors	100.0	United States	...
9	Texaco Colombia	Colombia	Oil	665	ChevronTexaco Corporation	100.0	United States	...
10	Southern Peru Copper Corp.	Peru	Mining	658	Grupo Minero México (54.2%)/Phelps Dodge Corp. (14%)	100.0	Mexico/ United States	611
11	Cemex Venezuela S.A.C.A.	Venezuela	Cement	624	Cemex	51.0	Mexico	...
12	Cigarrera Bigott C.A.	Venezuela	Tobacco	579 ^a	British American Tobacco Plc. (BAT)	100.0	United Kingdom	...
13	Panamco de Venezuela	Venezuela	Food and beverages	557	Panamerican Beverages Inc. (PANAMCO) (The Coca-Cola Company)	100.0	Mexico/ United States	...
14	Minera Yanacocha	Peru	Mining	529	Newmont Mining Corporation	51.4	United States	529
15	Proctor & Gamble Venezuela	Venezuela	Chemicals	427 ^a	Proctor & Gamble	100.0	United States	...
16	General Motors Colmotores	Colombia	Automotive	409	General Motors	100.0	United States	...
17	Industrias Alimenticias Noel	Colombia	Food and beverages	400	Danone	...	France	...
18	Sofasa-Renault	Colombia	Automotive	385	Renault (24%)/Toyota Motors (24%)	49.0	France/Japan	...
19	Panamco de Colombia	Colombia	Food and beverages	385	Panamerican Beverages Inc. (PANAMCO) (The Coca-Cola Company)	100.0	United States	...
20	Refinería La Oroya	Peru	Metals	371	The Doe Run Company	51.0	United States	371
21	Drummond	Colombia	Mining	370	Drummond Company Inc.	100.0	United States	363
22	Empresa Generadora de Energía Eléctrica (EMGESA)	Colombia	Electric power	360	Endesa Chile (24%)/Endesa España (24%)	49.0	Spain/Chile	-
23	Ford Motors de Venezuela	Venezuela	Automotive	353 ^a	Ford Motors	100.0	United States	...
24	BellSouth Colombia	Colombia	Telecoms	334	BellSouth Corporation	66.0	United States	-
25	International Colombia Resources Corporation (INTERCOR)	Colombia	Mining	330	Exxon Corporation	100.0	United States	326
26	Toyota Venezuela	Venezuela	Automotive	287 ^a	Toyota	100.0	Japan	...
27	Comunicación Celular S.A. (Comcel)	Colombia	Telecoms	287	América Móvil	91.0	Mexico	-
28	Mitsubishi Venezuela C.A.	Venezuela	Automotive	286 ^a	Mitsubishi Corporation	100.0	Japan	...

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, on the basis of figures published in *América Economía*, "500 mayores empresas de América Latina", 12-25 July 2002; *Semana* "Las 100 empresas más grandes de Colombia", 22-19 April 2002; and *Dinero* "200 empresas líderes de Venezuela", September 2001.

^a Figures corresponding to 2000.

Table II-A.4
ANDEAN COMMUNITY: INTERNATIONAL COMPETITIVENESS
IN THE CONTEXT OF WORLD IMPORTS, 1985-2000
(Percentages)

	1985	1990	1995	2000
I. Market share	1.30	0.91	0.89	0.89
Natural resources ^a	3.31	3.15	3.66	4.05
Manufactures based on natural resources ^b	2.23	1.56	1.34	1.39
Manufactures not based on natural resources ^c	0.14	0.15	0.20	0.18
- Low technology ^d	0.26	0.31	0.35	0.36
- Medium technology ^e	0.13	0.13	0.21	0.19
- High technology ^f	0.03	0.02	0.04	0.04
Other ^g	0.60	0.41	0.48	0.55
II. Structure of exports	100.0	100.0	100.0	100.0
Natural resources ^a	61.3	59.9	60.5	61.7
Manufactures based on natural resources ^b	31.3	28.2	22.9	22.1
Manufactures not based on natural resources ^c	6.0	10.4	14.8	13.7
- Low technology ^d	2.8	5.6	6.5	6.3
- Medium technology ^e	2.9	4.4	7.4	6.4
- High technology ^f	0.3	0.4	0.8	0.9
Other ^g	1.4	1.5	1.8	2.4
III. Top 10 exports by share	78.4	72.9	67.0	69.2
333 Petroleum oils, crude	+	32.2	29.8	30.5
334 Petroleum products, refined	-	22.9	18.1	11.4
057 Fruit and nuts (not including oil nuts), fresh or dried	+	3.3	4.9	4.9
071 Coffee and coffee substitutes	-	12.0	7.0	7.0
322 Briquettes, lignite and peat	+	0.4	2.0	2.3
081 Feeding stuff for animals (not including unmilled cereals)	+	0.6	1.6	2.2
036 Crustaceans and molluscs, whether in shell or not	-	1.5	2.3	2.5
684 Aluminium	*	1.8	2.8	2.3
292 Crude vegetable materials	+	1.0	1.4	1.7
287 Ores and concentrates of base metals	-	2.7	3.0	2.2

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, on the basis of the computer programme TradeCAN 2002 Edition, ECLAC. Product groups based on the Standard International Trade Classification (SITC, Rev. 2).

^a Contains 45 basic simple manufactured products; include concentrates.

^b Contain 65 groups: 35 agriculture/forestry and 30 others (mostly metals – except steel – petroleum products, cement, glass, etc.).

^c Contains 120 groups representing the sum of ^d + ^e + ^f.

^d Contains 44 groups: 20 from the textiles and clothing sector, plus 24 others (paper products, glass and steel, jewellery).

^e Contains 58 groups: five from the automotive industry, 22 from the processing industry, and 31 from the engineering industry.

^f Contains 18 groups: 11 from the electronics sector, plus seven others (pharmaceutical products, turbines, aircraft, instruments).

^g Contains nine unclassified groups (mostly from section 9).

^h (*) Groups corresponding to the 50 most products dynamic in terms of world imports, 1985-2000.

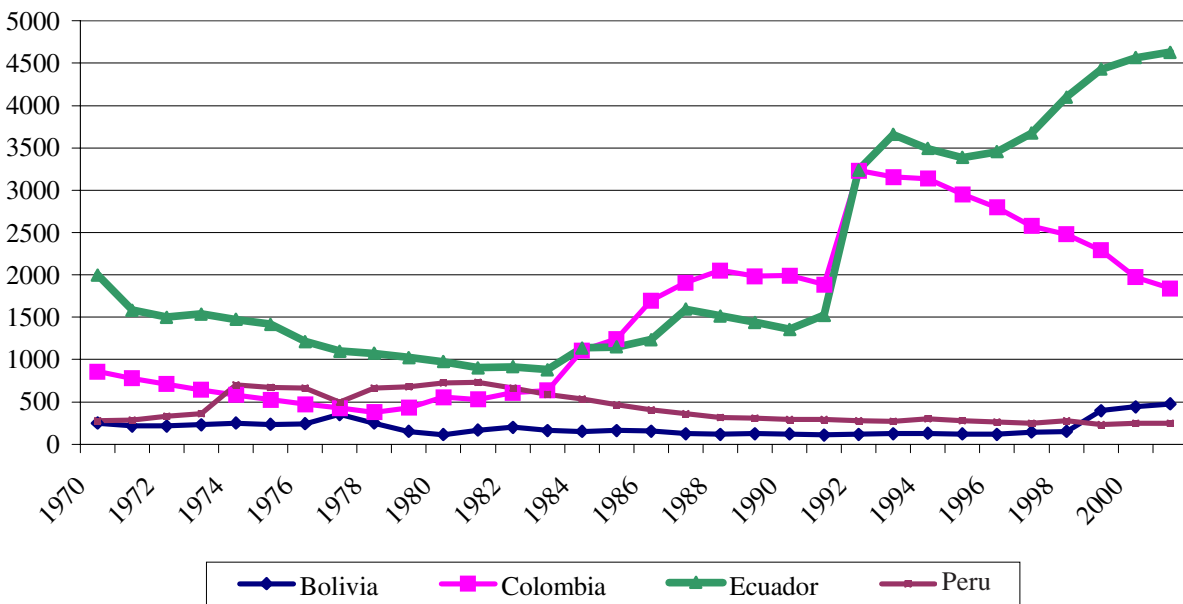
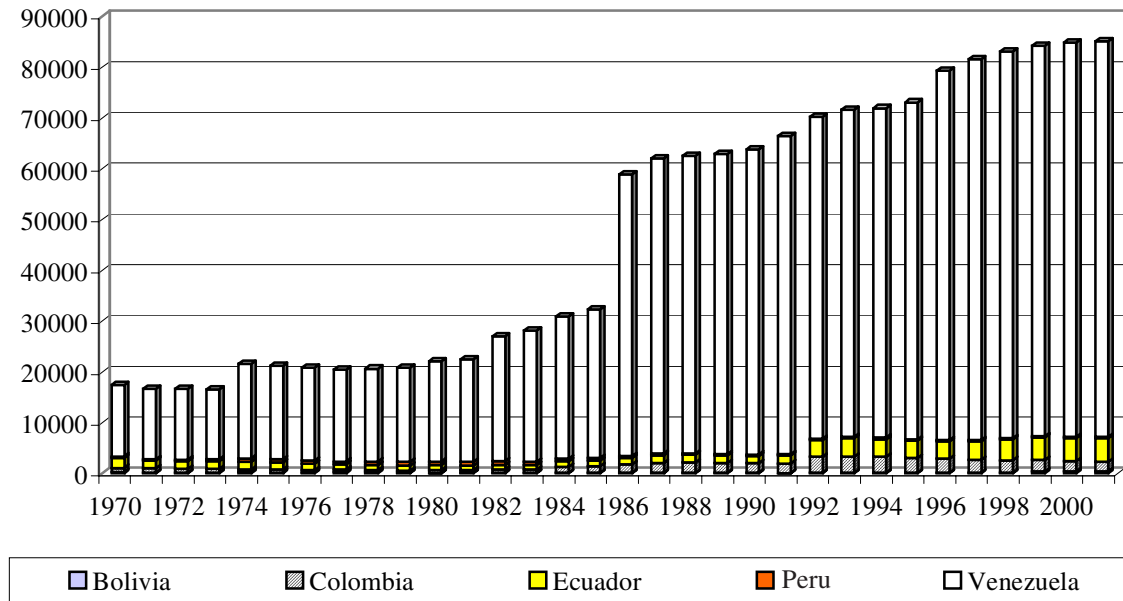
ⁱ Groups in which the Andean Community gained (+) or lost (-) market share in world imports, 1985-2000.

Table II-A.5
ANDEAN COMMUNITY: STRUCTURE OF EXPORTS AND MAIN EXPORT PRODUCTS,
BY COUNTRY, 1985-2000
(Percentages)

		1985	1990	1995	2000
Bolivia	I. Export structure	100.0	100.0	100.0	100.0
	Natural resources	74.2	52.8	46.0	52.1
	Manufactures based on natural resources	14.9	30.2	32.9	28.6
	Manufactures not based on natural resources	2.6	7.7	17.1	15.4
	Other	8.3	9.3	4.0	3.8
	II. Top five exports by share	65.5	53.5	40.6	48.1
	081 Feeding stuff for animals (not including unmilled cereals)	0.9	2.6	7.1	15.6
	341 Natural gas	53.9	30.1	9.2	10.2
	287 Ores and concentrates of base metals	10.6	17.8	11.2	9.7
	423 Fixed vegetable fats and oils	0.0	0.5	2.9	7.2
897 Jewellery, goldsmiths' and silversmiths' wares, and other articles	0.1	2.5	10.2	5.4	
Colombia	I. Export structure	100.0	100.0	100.0	100.0
	Natural resources	73.7	67.3	60.3	59.7
	Manufactures based on natural resources	13.7	14.5	13.6	13.0
	Manufactures not based on natural resources	10.4	15.5	21.9	22.8
	Other	2.2	2.7	4.2	4.5
	II. Top five exports by share	70.8	63.5	55.7	57.7
	333 Petroleum oils, crude	3.0	19.4	17.5	28.5
	071 Coffee and coffee substitutes	51.9	24.9	21.6	11.2
	322 Briquettes, lignite and peat	2.3	6.7	6.7	7.6
	057 Fruit and nuts (not including oil nuts), fresh or dried	7.2	6.9	6.5	6.0
334 Petroleum products, refined	6.4	5.6	3.4	4.4	
Ecuador	I. Export structure	100.0	100.0	100.0	100.0
	Natural resources	88.0	87.8	81.7	76.2
	Manufactures based on natural resources	9.3	9.0	11.3	15.2
	Manufactures not based on natural resources	2.3	2.7	5.8	7.2
	Other	0.4	0.5	1.1	1.3
	II. Top five exports by share	76.9	80.2	72.1	73.2
	333 Petroleum oils, crude	48.9	30.4	26.7	31.6
	057 Fruit and nuts (not including oil nuts), fresh or dried	14.4	28.2	23.7	22.8
	036 Crustaceans and molluscs, whether in shell or not	8.1	15.7	15.1	9.8
	037 Fish, crustaceans, molluscs, prepared or preserved	0.9	1.3	3.3	5.1
334 Petroleum products, refined	4.6	4.6	3.3	3.9	
Peru	I. Export structure	100.0	100.0	100.0	100.0
	Natural resources	48.4	48.3	54.0	51.7
	Manufactures based on natural resources	38.1	33.5	29.5	25.7
	Manufactures not based on natural resources	11.5	16.2	14.7	17.5
	Other	2.0	2.1	1.7	5.1
	II. Top five exports by share	39.6	52.3	50.9	46.2
	682 Copper	13.9	18.5	14.4	13.3
	081 Feeding stuff for animals (not including unmilled cereals)	2.9	11.0	15.3	12.8
	287 Ores and concentrates of base metals	16.0	18.0	14.3	11.2
	071 Coffee and coffee substitutes	6.5	3.5	4.8	4.6
845 Articles of apparel and clothing accessories	0.3	1.3	2.1	4.3	
Venezuela	I. Export structure	100.0	100.0	100.0	100.0
	Natural resources	52.6	53.6	57.3	62.2
	Manufactures based on natural resources	42.4	37.5	28.9	27.5
	Manufactures not based on natural resources	4.1	8.3	13.1	9.2
	Other	0.9	0.6	0.7	0.7
	II. Top five exports by share	88.9	82.0	75.2	81.1
	333 Petroleum oils, crude	46.9	43.8	47.4	53.5
	334 Petroleum products, refined	37.6	31.1	21.1	21.7
	684 Aluminium	3.5	5.5	4.9	3.2
	341 Natural gas	0.8	0.8	0.9	1.4
278 Other crude minerals	0.1	0.8	0.9	1.3	

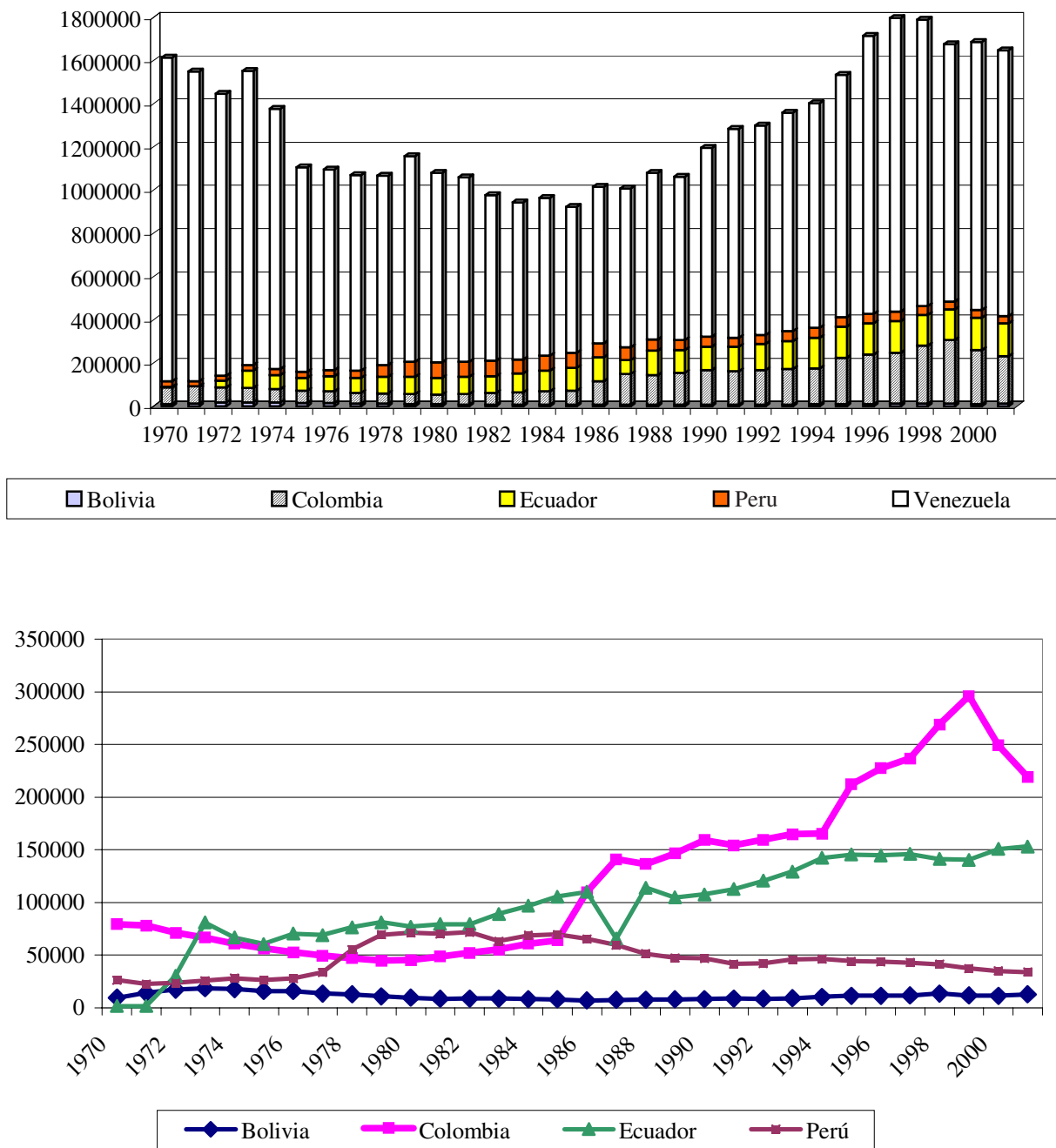
Source: ECLAC, on the basis of the computer programme TradeCAN 2002 Edition. Product groups based on the Standard International Trade Classification (SITC, Rev. 2).

Figure II-A.1
ANDEAN COMMUNITY: DISTRIBUTION OF OIL RESERVES BY MEMBER COUNTRY, 1970-2001
(Millions of barrels, 10⁶ bbl)



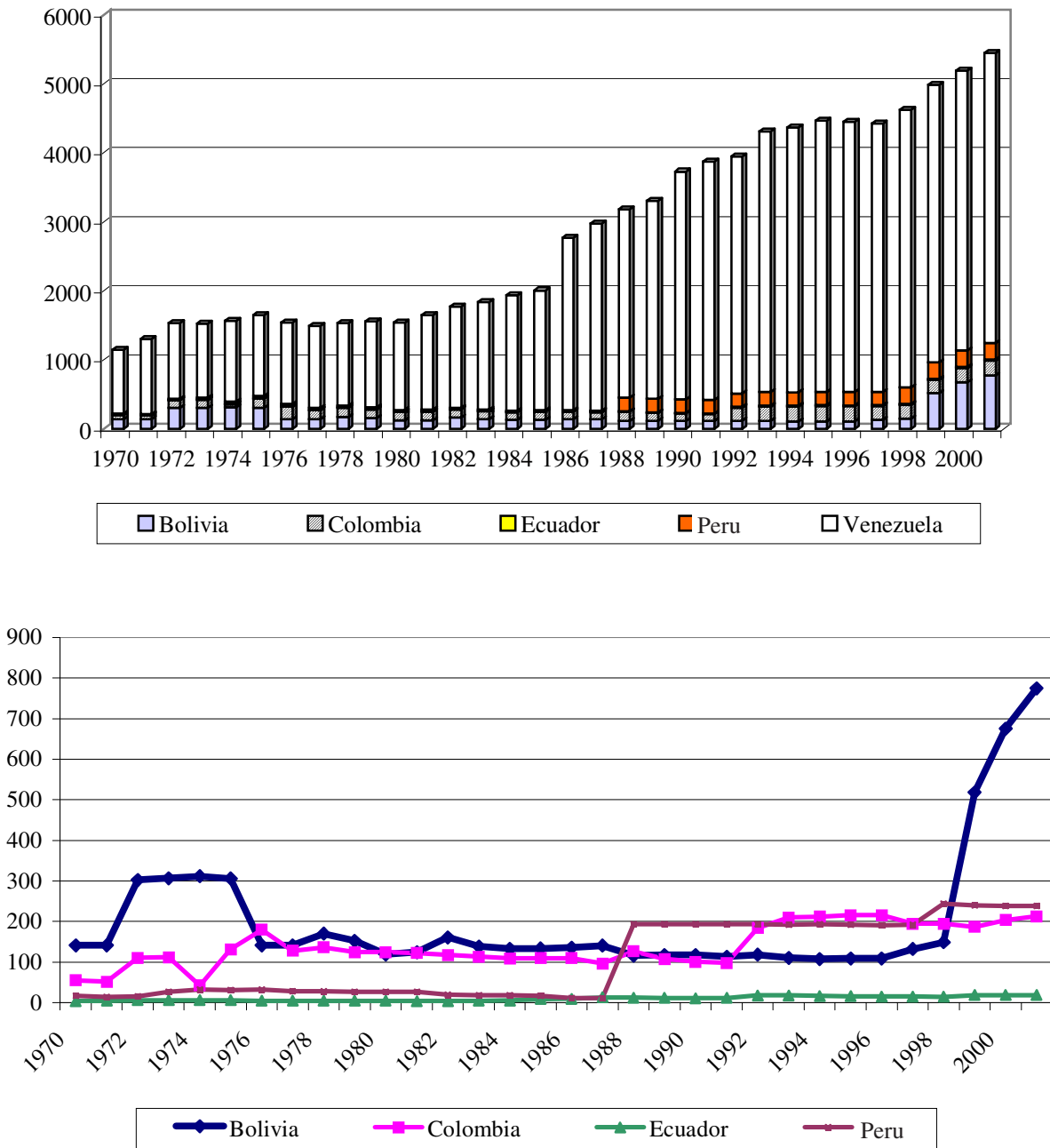
Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, on the basis of figures provided by the Latin American Energy Organization (OLADE).

Figure II-A.2
ANDEAN COMMUNITY: DISTRIBUTION OF OIL PRODUCTION BY MEMBER COUNTRY, 1970-2001
(Thousands of barrels of oil equivalent, kBOE)



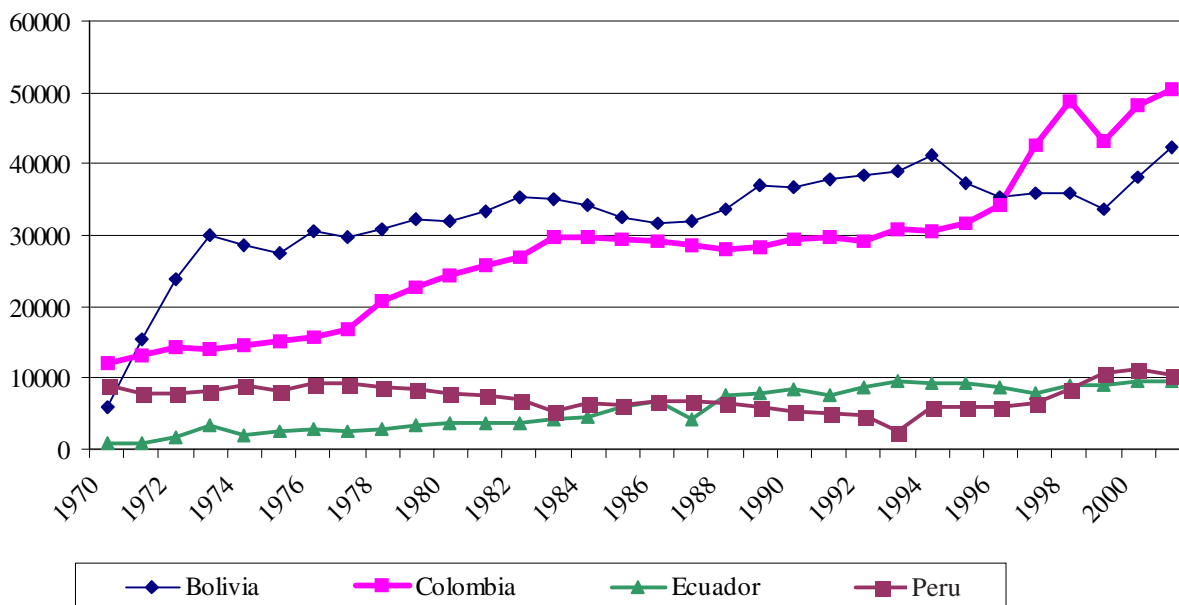
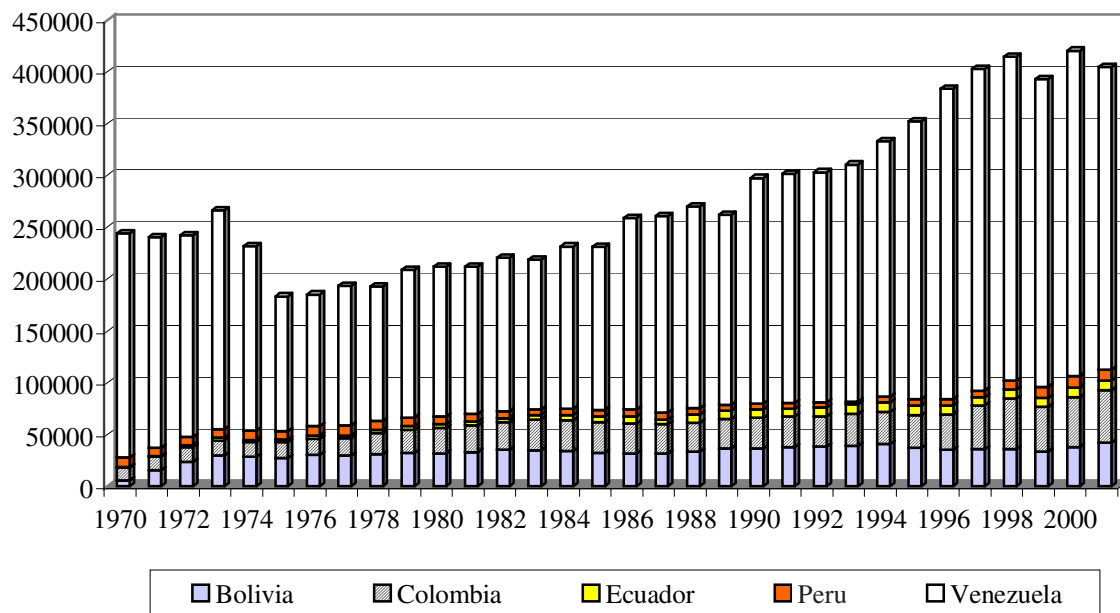
Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, on the basis of figures provided by the Latin American Energy Organization (OLADE).

Figure II-A.3
ANDEAN COMMUNITY: DISTRIBUTION OF NATURAL GAS RESERVES BY MEMBER COUNTRY, 1970-2001
(Millions of barrels, 10⁶ bbl)



Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, on the basis of figures provided by the Latin American Energy Organization (OLADE).

Figure II-A.4
ANDEAN COMMUNITY: DISTRIBUTION OF NATURAL GAS PRODUCTION BY MEMBER COUNTRY, 1970-2001
(Thousands of barrels of oil equivalent, kBOE)



Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, on the basis of figures provided by the Latin American Energy Organization (OLADE).



III. TRANSNATIONAL BANKS IN LATIN AMERICA: CORPORATE STRATEGIES AND REGIONAL IMPACT



INTRODUCTION

This chapter will examine the corporate strategies pursued by transnational banks and the impact they have had on the region's financial system. The analysis does not include offshore financial centres and banks, which have only indirect effects on the Latin American countries' financial structures and on the macroeconomic impact of those structures. The analysis therefore has a dual purpose: to review the factors that have triggered changes in business strategies –factors impinging on the microeconomic domain– and to evaluate the macroeconomic consequences of those changes.

The major presence that foreign banks had gained in Latin America by the late 1990s was the outcome of both domestic and international forces. Domestically, financial crises and subsequent bank restructuring processes, which unfolded in an institutional setting favourable to the entry of foreign banks, undoubtedly played a key role. Regulatory changes allowed banks to operate not only in traditional commercial banking, but also in other

segments of the financial market.¹ Another decisive factor was the political climate, which was also more favourable to the entry of other banks.

Governments in Latin American countries also had high hopes that the entry of foreign players would help solve the structural problems that had long afflicted domestic financial systems. These included a significant credit squeeze, low levels of bank

¹ This freedom of action attracted foreign banks to Latin America because it coincided with the way they operate in their own countries. Even though regulatory changes have a major impact on the decision to enter a country, they are made by the domestic authorities, and should thus be classified among the "domestic or local determinants".

penetration in the system, high borrowing costs and very short maturities.

International determinants, on the other hand, include the tendency of large banks in developed countries to expand into other markets. This trend was driven by changes in the world macroeconomic climate, innovations in information and communication technologies, and liberalization and deregulation in developed-country financial markets. Such changes promoted fierce competition to capture new market segments. At the same time, the quest for economies of scale prompted banks to increase both their size and the number of their customers, and thus to expand into emerging markets.

Not all transnational banks responded in the same way to the incentives being generated in the region, however, nor did they all expand to the same extent or in the same market segments. Accordingly, it is necessary to analyse the specific features of corporate strategies. For example, the leading role currently being played by Spanish banks in Latin America –unforeseen a decade ago– reflects, among other important factors, their response to competitive challenges in the European Union and the cultural ties that exist between Spain and Latin America. Maintaining a presence in Latin America entails costs and benefits, which each bank evaluates differently before adopting a specific strategy in each case.

Once the reasons why transnational banks entered the Latin American market have been considered, the next step is to ask what effects their presence has had on the performance of the local banking system and on the macroeconomic situation in general. The microeconomic impacts can be measured through indicators of the banks'

operational efficiency, lending and risk management. The macroeconomic impact, on the other hand, can be measured in terms of effects on the supply and cost of credit and on the stability of the system. The analysis will be incomplete, however, unless it first considers the situation financial markets were in when foreign banks entered the host country, in addition to the institutional framework in which they have operated and the way they have adapted to the new market. Given that foreign-bank penetration in Latin America is a relatively recent phenomenon, the evaluation presented here is only preliminary, and the longer-term impact of this development cannot yet be projected.

The chapter is therefore divided into four sections. The first begins by analysing the structural problems of the region's banking systems, together with the regulatory changes and banking crises that have occurred, with a view to understanding how they engendered a more propitious environment for the entry of foreign banks into the region. The second section describes the factors that led transnational banks to seek new markets and the way these banks adapted to the new conditions in the international financial market. The third section analyses the strategies deployed by transnational banks in Latin America and the consequences of those strategies for their financial results, considering both costs and benefits. The fourth section discusses various indicators that measure the impact of foreign-bank participation in the region, comparing their performance with that of the local banking system and assessing their macroeconomic effects. The chapter ends by drawing together the conclusions of each section, and is followed by a number of tables included as an annex.

A. THE LATIN AMERICAN BANKING SECTOR: STRUCTURAL PROBLEMS, CRISES AND RESTRUCTURING

The domestic banking crises of the 1990s and the bank restructuring processes that ensued engendered a favourable attitude in Latin America towards foreign banks' entering the region. The local economic authorities hoped this would have positive effects on the long-standing structural problems persisting in the region's financial systems. These included a significant credit squeeze, low levels of bank penetration in the system, high borrowing costs and the predominance of short maturities.

Accordingly, this section starts by giving a brief description of the Latin American banking system in the early 1990s, drawing attention to its main structural problems. It then analyses the financial liberalization processes and subsequent banking crises that occurred, with a view to identifying the local factors that encouraged a more receptive attitude towards foreign banks, and the government expectations and regulatory changes that facilitated their entry.

1. Structural characteristics and problems of banking systems prior to the 1990s

For the purpose of this analysis, attention needs to be drawn to four basic characteristics of the Latin American financial system, which have been present throughout its history and in some cases still persist today:

- Firstly, the region's banks have predominantly focused on traditional commercial-banking activities, while the securities market remained very poorly developed or even non-existent in many countries;
- Secondly, despite the systemic importance of banks, the volume of lending in relation to GDP was and is very small;
- Thirdly, the State has traditionally played a major role in the financial sector, and this has been associated (albeit with no proven causal connection) with a concentration of private-sector banking activity in the short-term credit segment. Public-sector financing institutions have tended to specialize in long-term funding, generally linked to the national development plans that were commonplace until the 1970s and to certain areas regarded as high priorities, such as agriculture and the export sector;
- Lastly, the region's banking systems have always been characterized by their low degree of financial deepening and narrow coverage.² This has meant that a significant fraction of firms and families have little or no access to credit. With the liberalization of the financial system, the credit subsidies³ formerly provided were replaced with large spreads, and thus high interest rates, on loans and very short maturities for private financing.

Government policy to attract foreign banks stemmed directly from the need to solve these structural problems in the banking sector. So-called "first-generation" financial reforms (see table III.1 and box III.1) represented an attempt to increase the sector's competitiveness and efficiency by liberalizing its operations and reducing State intervention -both directly (downsizing of the public financial sector) and indirectly (lower reserve requirements, together with deregulation of interest rates and directed credit mechanisms).

Table III.1
LATIN AMERICA: FIRST-GENERATION REFORMS OF THE FINANCIAL SYSTEM

	Liberalization of interest rates	Start of an intensive period of privatization	Adoption of capital adequacy requirements	Bank reserves (%)		Tension (1) or systemic crises following reform (2)
				1990	2000	
Argentina	1989	1995	1991	24	4	1995 (2)
Bolivia	1985	1992	1995	25	9	1985 (1)
Brazil	1989	1997	1995	15	12	1994 (1)
Chile	1974 ^a	1974 and 1987	1989	6	5	1982 (2)
Colombia	1979	1993	1992	38	8	1998 (2)
Costa Rica	1995	1984	1995	43	18	1994 (1)
Mexico	1988	1992	1994	5	7	1994 (2)
Paraguay	1990	1984	1991	33	26	1995 (1)
Peru	1991	1993	1993	31	26	1995 (1)
Uruguay	1974	1974	1992	45	22	1982 (2)
Venezuela	1989	1996	1993	18	29	1994 (2)

Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of ECLAC, *Reformas económicas en América Latina: una síntesis de la experiencia en once países* (LC/R.1606), Santiago, Chile, 1995; and *Strengthening development: the interplay of macro- and microeconomics* (LC/G.1898(SES.26/3)), Santiago, Chile, July 1996.

^a The authorities intervened in the banks between 1982 and 1984; the system was reliberalized starting in 1985.

² This refers to the proportion of businesses and families with access to credit.

³ In the literature on Latin America, this phenomenon is called "financial repression".

The structural reforms created a new macroeconomic environment which, in turn, affected the way banks operated. In many cases, this interaction between the performance of the banking system and the new macroeconomic climate generated tensions or banking crises that had two broad consequences: firstly, the

introduction of a new wave of "second-generation" reforms aimed at strengthening the institutional framework (through new regulation and supervision); and secondly, the adoption of an explicit policy to attract transnational banks, which led to privatization and acquisition processes.

Box III.1
**FIRST- AND SECOND-GENERATION FINANCIAL REFORMS IN LATIN AMERICA
 OVER THE PAST TWO DECADES**

The financial reforms introduced in Latin America over the past two decades have differed from country to country, not only in terms of when the reforms were implemented but also in their intensity and scope. To simplify the analysis, however, they can be divided into two phases, in some cases overlapping in time. The first phase, which can be described as first-generation reforms, entailed dismantling State controls on the returns to financial assets (especially interest rates), the allocation of financial resources and the entry of agents into the system (lowering of entry barriers). All of this was accompanied by a process of opening the financial system to foreign participation.

In terms of regulatory reform, this phase also included the adoption of capital requirements in compliance with the Basel Agreement of 1988. As shown in table III.1, this process took place between 1989 and 1995 in many countries, and it was often followed by economic crises, frequently stemming from the exponential growth in bank lending that had occurred earlier.

Given the problems of stability that emerged from the mid-1990s onward, many countries began to implement second-generation reforms aimed at enhancing regulatory and supervisory mechanisms, in order to make their

domestic banking systems sounder. These reforms were particularly intensive following the "tequila" crisis, which in many countries had destabilized the financial system, and in others had triggered an outright banking crisis.

This second wave of reforms required banks to maintain a level of capital that was adequate in relation to the risk attached to their banking assets; to evaluate and rate their loan portfolios more carefully according to the structure of those risks; and to provide more transparent information to supervisory bodies.

The pace and depth of regulatory and supervisory reform in each country were directly related to the strength of the effect of the "tequila" crisis on the banking sector in question and to the domestic authorities' desire to rapidly restore "business as usual" in institutions and markets. For example, while the regulatory adjustments made in Chile in the second half of the 1990s were minimal, the earlier ones made in Argentina, Brazil and Mexico were much more far-reaching.

In most of the countries hit by the crisis, reform began with a restructuring of the domestic banking sector; this process was accompanied by State guarantees, and usually included an injection of liquidity into the system, all of which facilitated bank

mergers and acquisitions. In this process, providing incentives for the entry of foreign banks became an overt policy. The State guarantees extended to the financial system were generally accompanied by stipulations relating to deposit insurance, capital requirements and greater liquidity (Stallings and Studart, 2001).

The financial reforms of the 1990s openly encouraged the entry of foreign banks. First-generation reforms had allowed banks to operate in markets that had previously been off-limits -providing services such as factoring and leasing, for example- and had also facilitated stock-market operations, particularly brokerage, underwriting and pension fund management. As will be discussed below, these additional freedoms and broader scope of action were fundamental for the operations of international banks, particularly as their strategy had now shifted towards universalization.

In aiming to grant equivalent legal status to all nations, second-generation reforms created a regulatory and supervisory environment similar to that prevailing in developed economies, thereby opening the door to foreign banks. In this respect, as will be seen in sections B and C of this chapter, the two generations of reforms complemented each other to create a climate more suited to the expansion strategies of international banks.

Source: ECLAC, Unit on Investment and Corporate Strategies.

(a) Financial-market liberalization, crisis and restructuring: from the "tequila" crisis to 1997

An essential bit of background for understanding the current development of the Latin American banking system is the financial liberalization that took place between the 1970s and the 1990s, both locally and internationally. While only a few countries -among them Argentina, Chile, Colombia and Uruguay- introduced financial liberalization, to varying degrees, as early as the 1970s, the processes triggered by liberalization, especially the financial crises of the early 1980s,⁴ were the reason behind the subsequent push for tighter banking regulation and supervision. The sequence of liberalization, crisis and improved supervision and regulation was nonetheless repeated in countries that did not begin the process until the 1990s.

Starting from a system in which State authorities set the interest rate, directed credit and required a high proportion of bank deposits to be held as reserve requirements, commercial banks were then given freedom to decide how much to lend to whom and at what price. More or less at the same time, capital-market liberalization enabled local banks to borrow in foreign currency and allowed foreign banks to operate in the local market. Frequently, these changes were implemented without an adequate system of banking regulation and supervision in place, which in several instances led to problems in regional banks whose executives had little or no experience in analysing local credit, let alone the international market.

The initial financial deregulation also affected business goals. Existing institutions could now engage in new activities and become "universal banks". This allowed them to operate in securities and insurance markets, provide asset-management services and hold equity positions in non-financial firms. The process to some extent mirrored what was happening in the industrialized countries, but with the difference that the securities market in the region remained very underdeveloped. Accordingly, despite greater diversification, bank portfolios were restricted to short-term securities dealing, insurance products and real-estate activities.

Financial liberalization and deregulation did not yield the expected results, however. Instead, they gave rise in many cases to credit booms, mismatches between currencies and maturities and, ultimately, banking crises. As had happened in Chile and Argentina during the

external debt crisis and then in Mexico in 1994, South-East Asia in 1998 and Argentina in 2001, mistakes made by local actors were serious enough in themselves to trigger crises, but when they were compounded by external shocks, the situation became much worse (Held and Jiménez, 2001).

In a reprise of the pattern already observed in the early 1980s, banking crises and subsequent bailouts by governments had become commonplace in Latin America by the mid-1990s. Initially, these operations were limited to non-recoverable portfolios, but this was later followed by bank recapitalization, then liquidation or mergers and acquisitions by foreign banks. Subsequently, in order to avert future crises, banking regulation and supervision were introduced, greater information and transparency were required, and in some cases deposit insurance was put in place, although some countries had already begun using this instrument after the crisis of the early 1980s.

As a result of these crises, the initial expectations raised by financial reform changed: financial liberalization was and still is a condition for long-term market development, but the latter cannot be achieved without stability in the system. This aim gave rise to a debate which clearly highlighted two specific needs: firstly, to regulate and supervise the sector, and secondly, to attract foreign banks.

(b) The macroeconomic environment

In contrast to what had happened in the preceding decade, the macroeconomic climate of the 1990s (prior to the Asian crisis) was one of accelerating growth, which fostered the rapid expansion of short-term lending to consumers and firms. Capital-market liberalization, at a time of abundant liquidity in the international financial market, attracted foreign capital inflows, thereby removing the traditional external constraint on the expansion of demand and imports. This facilitated low-inflation growth, particularly in countries that had adopted stabilization programmes based on an exchange-rate anchor. In this situation, the banks encountered strong demand for short-term credit and were able to expand their operations merely by accommodating it.

Furthermore, international conditions allowed all banks, local and foreign alike, to increase their external financing. This phenomenon was related to more stable exchange rates and the development of the international derivatives market, which enabled financial investors to partially hedge exchange-rate risk and uncertainty.

⁴ See the now-classic article by Díaz-Alejandro (1985).

(c) From changes in financial regulation and supervision to the entry of international banks

A major obstacle to the development of the financial system in the Latin American countries, and particularly to efforts to attract foreign banks, was the absence of appropriate institutions for regulation and supervision –a key element for the development of market infrastructure– in most of the region's countries. This shortcoming had discouraged foreign banks from engaging in credit transactions with local consumers or firms. Laws on guarantees were ineffective or non-existent, for example, and legal rulings could be indefinitely postponed or arbitrarily overturned once adopted. The Anglo-Saxon laws that applied to the international financial market were not implemented in the region, and in general there were no legal precedents in this area, which made the outcome of litigation unpredictable.

Given that the development of certain segments of the financial system generally requires the conclusion

of long-term contracts, regulatory shortcomings prevented such development –and in many cases still prevent it– by leaving foreign banks permanently exposed to the risk of contracts being breached. This undermined their competitive advantages because, in the absence of appropriate legislation, the use of information and the knowledge of potential clients and of the authorities become particularly important, and local institutions clearly had an advantage in these areas.

The reforms of financial regulations formally or informally removed the entry barriers facing foreign banks, enabling them to move into the region and gain an increasingly large market share (see table III.2). Three vehicles were used in this process: privatizations, mergers and acquisitions, and greenfield investments driven by the expansion needs of individual corporations. As a result, within a few years foreign banks owned over half of the region's largest banks, measured by the amount of their assets (see annex table III.A.1).

Table III.2
FOREIGN BANK SHARE OF LATIN AMERICAN BANKING ASSETS, 1990-2001
(Percentages)

	1990	1994	1999	2000	2001
Argentina	10	18	49	49	61
Brazil	6	8	17	23	49
Chile	19	16	54	54	62
Colombia	8	6	18	26	34
Mexico	-	1	19	24	90
Peru	4	7	33	40	61
Venezuela	1	1	42	42	59

Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of International Monetary Fund (IMF), *International Capital Markets: Developments, Prospects and Key Policy Issues*, Washington, D.C., 2000; Bank for International Settlements (BIS), "The Banking Industry in the Emerging Market Economies: Competition, Consolidation and Systemic Stability", BIS Papers, No. 4, Basel, 2001; and Salomon Smith Barney, *Foreign Financial Institutions in Latin America, 2001 Update*, New York, November 2001.

Another change stemming from the liberalization policy was the acceptance of greater concentration in the banking industry, since the number of banks decreased as a result of privatizations, mergers and acquisitions. As shown in table III.3, this phenomenon has not been exclusive to the region, since Asia and, to a lesser degree, Central Europe have experienced a similar trend, albeit with certain differences. Whereas concentration has generally declined in Asia and Central Europe, in Latin America the market shares of the three largest and 10 largest banks have increased, with numerous smaller institutions disappearing altogether.

(d) The environment in which foreign banks entered the region in the 1990s

In contrast to the pattern in industrialized countries, the financial sector in Latin America continues to be dominated by banks, with little development of other types of financial institutions. Nonetheless, significant changes have occurred in recent years.

Firstly, markets have become broader and deeper. This was made possible in part by the spectacular reduction in inflation rates throughout the region. As a result, families and firms are now more willing to hold

Table III.3
INDICATORS OF CONCENTRATION IN THE BANKING SECTOR, 1994-2000
(Share of total deposits)

	1994			2000		
	Number of banks	3 largest banks (%)	10 largest banks (%)	Number of banks	3 largest banks (%)	10 largest banks (%)
Latin America						
Argentina	206	39.1	73.1	113	39.8	80.7
Brazil	245	49.9	78.8	193	55.2	85.6
Chile	37	39.5	79.1	29	39.5	82.0
Mexico	36	48.3	80.8	23	56.3	94.5
Venezuela	43	43.9	78.6	42	46.7	75.7
Asia						
Republic of Korea	30	52.8	86.9	13	43.5	77.7
Malaysia	25	44.7	78.3	10	43.4	82.2
Philippines	41	39.0	80.3	27	39.6	73.3
Thailand	15	47.5	83.5	13	41.7	79.4
Central Europe						
Czech Republic	55	72.0	97.0	42	69.7	90.3
Hungary	40	57.9	84.7	39	51.5	80.7
Poland	82	52.8	86.7	77	43.5	77.7
Turkey	72	40.7	79.1	79	35.9	72.0

Source: Barbara Stallings and Rogério Studart, "Financial Regulation and Supervision in Emerging Markets: The Experience of Latin America since the Tequila Crisis", *WIDER Discussion Paper*, No. 2002/45, Helsinki, United Nations University (UNU), 2001; on the basis of International Monetary Fund (IMF), *International Capital Markets: Developments, Prospects and Key Policy Issues*, Washington, D.C., 2001, p. 11.

money and other financial assets in the system, thereby fulfilling a basic requirement for the system's development. The strengthening of the institutional framework through financial regulation and supervision complements the behaviour of individual agents.

Table III.4 gives an idea of the trend of market deepening, as measured by the ratio of money supply

(M2) to GDP. The table records a significant increase in four of the six most financially developed countries in Latin America between 1992 and 2000. In contrast, the Asian countries display higher levels of M2, and also higher rates of increase in all cases.

Table III.4
MONEY SUPPLY (M2) AS A PERCENTAGE OF GROSS DOMESTIC PRODUCT

	1992	1994	1996	1998	2000
Latin America					
Argentina	14	21	23	29	32
Brazil	...	...	28	31	29
Chile	38	37	43	46	50
Colombia	20	20	20	24	26
Costa Rica	32	32	33	33	35
México	29	28	26	28	21
Asia					
Republic of Korea	39	41	43	58	80
Malaysia	72	80	92	95	103
Philippines	36	47	56	61	62
Thailand	75	78	81	103	106

Source: Barbara Stallings and Rogério Studart, "Financial Regulation and Supervision in Emerging Markets: The Experience of Latin America since the Tequila Crisis", *WIDER Discussion Paper*, No. 2002/45, Helsinki, United Nations University (UNU), 2001; on the basis of International Monetary Fund (IMF), *International Financial Statistics*, Washington, D.C., June 2002.

Some diversification has also taken place in the capital market, in response to multiple factors: increased capital flows up to 1998, privatization of social security and deregulation of institutional investors, which led to increased investment in securitized instruments and generated a virtuous circle in several of the region's

economies. Table III.5 presents an indicator of this process, namely the value of debt securities traded on local markets (in absolute terms and as a proportion of the world total) between 1989 and 2000. As shown in the table, this value expanded rapidly in Latin America during the period, more than doubling between 1992 and 2000.

Table III.5
OUTSTANDING STOCKS OF DEBT SECURITIES ISSUED ON DOMESTIC MARKETS
(Billions of dollars and percentages)

	Billions of dollars				Percentage of total			
	1989	1993	1997	2000	1989	1993	1997	2000
United States	6 682.8	9 226.7	1 205.9	14 545.9	47.6	44.9	47.4	48.9
Japan	2 626.7	4 010.1	4 399.3	6 072.3	18.7	19.5	17.3	20.4
France	557.6	995.7	1 102.5	1 068.1	4.0	4.8	4.3	3.6
Germany	668.4	1 458.4	1 732.1	1 711.6	4.8	7.1	6.8	5.8
United Kingdom	332.9	446.1	777.7	895.9	2.4	2.2	3.1	3.0
Latin America	172.1	296.7	490.6	482.8	1.2	1.4	1.9	1.6
Argentina	113.5	39.0	70.1	85.2	0.8	0.2	0.3	0.3
Brazil	-	189.9	344.5	292.5	....	0.9	1.4	1.0
Chile	7.5	19.2	36.5	34.2	0.1	0.1	0.1	0.1
Mexico	51.1	47.9	37.6	67.3	0.4	0.2	0.1	0.2
All issuers	14 042	20 565	25 464	29 733	100	100	100	100
OECD ^a	13 559	19 967	24 452	28 580	96.6	97.1	96.0	96.1

Source: Barbara Stallings and Rogério Studart, "Financial Regulation and Supervision in Emerging Markets: The Experience of Latin America since the Tequila Crisis", *WIDER Discussion Paper*, No. 2002/45, Helsinki, United Nations University (UNU), 2001; on the basis of data provided by the Bank for International Settlements (BIS).

^a Organisation for Economic Co-operation and Development.

B. UNIVERSALIZATION AND GLOBALIZATION: DETERMINANTS OF THE STRUGGLE FOR NEW MARKETS

A decision by a bank to operate in new market segments, whether in its own country or elsewhere, should be seen as an element of its competitive strategy, equivalent to launching a new product on the market or exploring original technologies. According to Schumpeter (1964), opening

up to new markets is no less an innovation than new products or production processes. From this standpoint, the processes of universalization and globalization⁵ should be viewed as financial innovations that set the predominant trend in the banking sector in the 1990s.

1. New trends in the international banking market

Although universalization and globalization emerged strongly in the 1990s, their roots stretch back further than this. It should be recalled that security and soundness

have traditionally been considered the prime virtues of the banking business. Prudent evaluation of risk when granting loans, together with efforts to maintain long-

⁵ Universalization consists of participation by commercial banks in more segments pertaining to the capital market, such as trading in bonds, equities and securities of all types, participation in investment funds and asset management. Globalization, on the other hand, refers to the geographical diversification of the banking business.

term relationships with clients, represented a bank's seal of quality.⁶ Nonetheless, a few decades ago, factors emerged that helped to alter the relatively conservative attitude that banks had historically shown towards innovation (Carvalho, 1997; BIS, 1996a; *The Economist*, 1993a, 1993b, 1994a, 1997 and 2002). Three of these are particularly important: heightened instability in the economic climate; technological progress; and greater deregulation and liberalization of the financial and capital markets.

(a) Heightened instability in the economic climate

The exceptionally unstable economic environment that prevailed in the world from the 1970s onward had a direct effect on the performance of the financial system. The main sources of that instability were rising inflation in the United States, the abandonment of the Bretton Woods rules, successive oil crises and the macroeconomic policies adopted by industrialized countries. Together, these phenomena had a decisive impact on the strategy of the banking sector by generating sharp volatility in the exchange rates of developed-country currencies and destabilizing interest rates. The volatility of these key prices not only rendered obsolete the risk-management knowledge previously accumulated by financial institutions, but also generated new risks that had to be considered in banking activities. The virtual bankruptcy of Latin American debtors in the early 1980s, which hit the large United States banks and weakened them for a decade, illustrates the high cost of the credit risk caused by interest-rate instability. The banking system's response was to securitize its loan portfolio and develop derivative instruments, as discussed below.

(b) Progress in information and communication technologies (ICT)

Advances in ICT have changed the financial sector's competitive functioning for producer and distributor alike, by generating incentives for greater efficiency. The new technologies have drastically and systematically

reduced transaction costs, provided wider access to financial services and enhanced the liquidity of the assets traded in the system.⁷ As a result, markets in different countries and continents can now connect to each other in real time, with consequences for the structure and complexity of contracts. This process has led to global interconnections between financial markets and clients.

In addition, the availability of more productive information management tools has made it possible to monitor the different services and products and focus on specific clients. This has led to the development of strategies based on the marketing and mass distribution of standardized products, thereby giving retail consumers and small businesses access to such services. In these market segments, electronic channels such as the Internet have multiplied the capacity to provide services without the need for a physical presence, and banks have been investing large sums in e-business to adapt their services to this medium.

(c) Liberalization and deregulation of financial and capital markets

The third force behind the banks' change of attitude was the liberalization and deregulation of the international financial market, the main consequence of which was to give banks greater freedom to pursue their own strategies. The most important initiative in terms of international banking regulation was the Basel Agreement, adopted in 1988.⁸

The Basel Committee on Banking Supervision, made up of specialists from all the industrialized countries, was formed to adopt an agreement among the signatory countries on convergence towards a common regulatory system. The Committee pursued two objectives: to create common regulatory rules of the game for all banks operating internationally, and to devise a new regulatory strategy to replace the one prevailing up until that time, which had become obsolete.

Once these changes had been agreed upon, financial supervision, instead of focusing on specific balance-sheet items, concentrated more on the overall risk assumed by

⁶ An example of the traditional attitude taken by commercial banks until recently is provided by J.P. Morgan. As described in *Euromoney* (2000), the traditional Morgan strategy was to serve an elite group of clients. It was assumed that these clients would approach the bank to obtain its financial services, not that the bank would have to seek clients. In fact, one of the reasons for J.P. Morgan's merger with Chase Manhattan was precisely the fact that it had problems in expanding its client base.

⁷ The spread of automated teller machines (ATMs) reduced operating costs significantly, making it possible to multiply the volume of business. Direct funds transfer at point of sale (POS), access to the banking system from home, remote banking and smart cards paved the way for the virtual banking revolution. Nonetheless, these changes did not always gain immediate acceptance (see *The Economist*, 21 November 1998).

⁸ The Agreement, though currently under review, is still in force. The text of the original Agreement and the most recent version released for comment can be found on the web site of the Bank for International Settlements (BIS) (www.bis.org).

banks, thereby affording them greater autonomy. In addition, such supervision only covered the tools of traditional commercial banking; in other words, intermediation between depositors and borrowers. As there were no regulations on capital-market risk, banks began to focus on their dealings in this market and also to shift their portfolio risk onto other investors, thereby

reducing their capital requirements. In short, following the 1988 Basel Agreement, the banks began to develop a series of highly sophisticated financial instruments, partly as a strategy to elude regulation and partly to lobby for greater liberalization of national financial systems. The result was that the rules of the Agreement were rapidly overtaken by events (see box III.2).

Box III.2

FINANCIAL REFORMS IN INDUSTRIALIZED COUNTRIES

Over the past few decades, but most intensively in the 1990s, the United States, Japan and the European Union introduced reforms that had profound effects on the strategies of transnational banks.

Three types of financial institution existed in the United States: banks that performed intermediation operations between deposits and loans; institutions dealing in securities; and insurance companies. The law originally prevented any of these institutions from participating in all three markets simultaneously. Between 1980 and 1990, this restrictive legislation was progressively weakened, however, as the United States Federal Reserve Bank began to grant permits for specific mergers between commercial and investment banks. Restrictions were removed completely when the Glass-Steagall Act was repealed and replaced with the Gramm-Leach-Bliley Act, passed in 1999.

Other restrictions in force at the state level were also eliminated through the reform of the

Riegle-Neal Interstate Banking and Branching Efficiency Act. This made it possible to unify the regulations under federal law, which in turn stimulated an intensive process of interstate bank mergers and acquisitions aimed at creating national banks similar to those existing in other countries (Rhoades, 2000).

In Japan, another important regulatory change, known as the "big bang", removed a number of financial restrictions similar to those established in the Glass-Steagall Act. This change made it possible to form universal banks by facilitating mergers and acquisitions between financial institutions and introducing new rules to promote greater competition in the market. The most notable operation of this type produced the world's largest bank in terms of financial assets, belonging to the Mizuho financial group. Nonetheless, the mergers and acquisitions process in Japan was on a

smaller scale than the one in the United States, given the unfavourable economic situation prevailing in that country in the 1990s.

Lastly, the European Union took an initiative that should have had effects similar to those of the reforms that eliminated barriers to interstate banking in the United States. This was the "European passport" legislation entitling banks in one European country to operate in any other member country. In contrast to what had happened in the United States, however, the new regulation did not lead to a major geographical expansion of banks within the Union because differences between the countries' legal and tax systems, compounded by cultural barriers, proved to be too strong. The hurdles faced by each European Union member in trying to enter other member countries encouraged large European banks that wanted to grow globally to target the emerging economies, and this partly explains the presence of Spanish banks in Latin America.

Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of Fernando J. Carvim de Carvalho, *International Expansion and the Transformation of Modern Banking*, 2002.

2. The development of new financial instruments

Financial intermediaries were hard hit by the heightened volatility in asset prices, interest rates and exchange rates, which exposed them not only to credit risk but also to specific financial and exchange-rate risk. The desire to find safer ways to operate was a key reason for the introduction of two major changes in the system: the development of securitization⁹ and the derivatives market.

The term "securitization" refers to the transformation of assets that previously had not been generally tradable –such as the loan portfolio of the banking system– into instruments that could be purchased by third parties. Securitization gave banks a way to shift credit risk to other investors. Moreover, by becoming securities dealers, banks were able to replace their income at risk with commissions.

⁹ According to BIS (1996b), about 60% of financial-market growth in 1995 stemmed from banks' acceptance of securities, somewhat to the neglect of the traditional component of bank liabilities, namely deposit-taking.

Increased volatility and risk gave rise to another major innovation in the financial market, namely derivative contracts. Derivatives originated some time ago in commodity transactions, but their use in the financial market enabled investors to identify the portion of portfolio risk they could manage and shift the rest on to third parties. There are as many different ways of doing this as there are types of instruments on the market. Nonetheless, a distinction can be made between relatively simple instruments with varying degrees of flexibility (forwards, swaps, options) and more complex structures based on combinations of these.

As in the case of securitized instruments, the supply of these new securities tended to be restricted to a select group of large banks. Mastery of the relevant technology, the specific nature of the business and contacts with large transnational corporations (the main users of these instruments) contributed to the high degree of concentration in this market.

Market deregulation and the emergence of new financial instruments fostered the development of institutional investors, which became new competitors in financial segments that were increasingly coveted by the banks. The mere fact that the new legislation allowed heavyweight players (investment banks, mutual funds and institutional investors) to invest in securitized instruments rapidly forced up prices on the secondary market. This created a virtuous circle of rising asset prices and expanding markets: as financial wealth increased and agents' expectations were fulfilled, this in turn encouraged further financial investments.

Table III.6 reveals a steady decline in the importance of bank loans as a means of financing. In the United States, for example, public and corporate debt bonds grew substantially between 1997 and 2001, while bank credit fell in both absolute and relative terms; figures for the European Union in 1990-1997 show a similar trend (see table III.7).

Table III.6
UNITED STATES: FINANCIAL MARKET INSTRUMENTS, 1997-2001
(Billions of dollars)

	1997	1998	1999	2000	2001
Open-market operations	184.1	193.1	229.9	207.6	-164.4
United States government bonds	236.0	418.3	520.7	137.6	623.8
Municipal bonds	71.4	96.8	68.2	35.3	117.6
Corporate and foreign bonds	430.8	563.7	462.2	400.8	653.4
Bank loans	128.2	145.0	69.0	112.8	-75.8
Other loans and advances	93.2	166.3	158.5	142.7	50.3
Mortgages	337.2	514.6	570.0	565.6	705.6
Consumer credit	57.5	75.0	99.5	139.0	110.2
Total	1 538.5	2 172.8	2 178.0	1 741.3	2 020.7

Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of Board of Governors of the Federal Reserve System, *Flow of Funds*, 16 September 2002, and "Statistics, Releases and Historical Data" (www.federalreserve.gov), 16 September 2002.

Table III.7
EUROPEAN UNION: COMPARATIVE SHARE OF BANKING AND NON-BANKING ACTIVITIES, 1990-1997
(Percentages)

		1990	1997
Percentage of total assets	Loans	51	44
	Securities	13	22
	Other	36	34
Percentage of total income	Interest income	70	58
	Other income	30	42

Source: Organisation for Economic Co-operation and Development (OECD), *Private Bank Profitability: Financial Statements of Banks, Edition 2000* (www.oecd.org), 2000.

These changes have had major consequences for the banking business. In an environment characterized by higher risk and strong competition from non-bank financial institutions, together with new corporate financing mechanisms, the banks expanded their operations into the provision of new financial services

and risk management. In this situation, the ability to take on investment-banking business became an essential survival skill for large banks. As will be seen in the following subsection, attaining the scale needed to operate in multiple markets and with different types of clients became a fundamental part of the banks' strategy.

3. The banks' strategies for responding to change

Open competition between banks, and between them and non-bank financial institutions, to capture new segments of the financial market gave rise to two trends in developed-country financial systems: a trend towards high market concentration and the predominance of large

institutions (see table III.8), and a trend towards the emergence of a select group of banks which, with a view to expanding, conquering new markets or both, pursued a global strategy to establish a presence in a large number of countries in different regions and continents.

Table III.8
**BANK CONCENTRATION: SHARE OF THE FIVE LARGEST BANKS IN EACH COUNTRY'S
TOTAL ASSETS, 1990-1999**
(Percentages)

	1990	1995	1999
United States	11.3	16.6	26.6
Canada	60.2	73.4	77.1
Belgium	48.0	59.9	71.6
France	51.9	68.1	69.3
Italy	46.0	58.4	65.0
Netherlands	73.7	76.1	69.1
Spain	38.3	48.2	-

Source: Group of 10, *Report on Consolidation in the Financial Sector*, Basel (www.bis.org), 2001.

Most of the mergers that took place in the United States in the 1990s involved commercial banks. Several studies explain this by noting that the banks saw mergers as a means of achieving economies of scale.¹⁰

The geographical expansion of large banks was driven by the need either to generate economies of scale or to diversify financial activities into segments that were becoming increasingly profitable, especially when such diversification was restricted by regulations prevailing in the country of origin: in this case, operating in other countries made diversification possible. The behaviour of United States banks prior to regulatory reform is a good example of this.

Having opted for globalization, the banks had to choose between two alternatives: entering new countries by making equity investments and setting up subsidiaries, or operating merely through a representation office of the bank's headquarters. Generally speaking, it has been shown that investment banks selling securitized products do not need a local presence, even when large sums of money are involved. It is sufficient for executives to visit their clients in specific cases as necessary. In contrast, a commercial bank targeting the retail segment does require frequent contact with its customers, so local branches become essential. Although online and telephone banking may play a complementary role in this segment, media

¹⁰ Berger and Mester (1997 and 2001) claim that economies of scale improved efficiency by enhancing revenues, while the effect of mergers on cost reduction is less clear. This seems to be due to the fact that large banks developed higher-quality and more profitable financial products which, however, were also more costly. Bassett and Brady (2002) argue that the large banks' advantages are not sufficient to drive small banks out of the market.

of this type have so far been unable to replace the physical presence of the branch. The same is true in highly lucrative businesses such as asset management and private banking.

As the pursuit of larger size and business diversification became indispensable strategies for competing in the market, expansion began to develop into a defensive tactic –to pre-empt potential disadvantages stemming from a failure to act. This factor was also operative in the case of expansion into emerging markets.

Nonetheless, recent studies (Berger, Ongena and Smith, 2002; Group of 10, 2001) show that the financial services industry in general, and commercial banking in particular, are a long way from achieving the levels of globalization attained by firms operating in other markets. This is true both in the United States and in Europe, despite the incentives generated by the new institutional framework.

The factors hindering greater globalization of banking in developed countries consisted mainly of entry barriers of a cultural nature and information asymmetries between foreign and local banks that put the latter in an advantageous position, especially in relation to small and medium-sized firms. In addition to those obstacles, transnational firms show a clear preference for local banks,¹¹ given their interest in having a large number of branches spread throughout the country, which entails large sunk costs. Statistics on mergers and acquisitions (Group of 10, 2001) also show that the financial services industry's consolidation and greater concentration are largely the result of transactions between local banks or institutions operating in different segments of the financial market in the same country. Mergers and acquisitions between institutions from different countries represent a minority.

The opposite is true in emerging economies, where the entry of foreign banks was encouraged by factors such as their greater prestige (bearing in mind the inefficiency of local banks in some countries); lack of risk-management experience in local banks; the existence of segments of the financial market, such as asset management and private banking, from which local banks were virtually absent; and the privatization of State banks.

Nonetheless, there are major differences between the main transnational banks in terms of their regional distribution and the segments in which they operate. With respect to the financial market segments preferred by

different types of institutions, four basic strategies can be clearly identified: those followed by large commercial banks, investment banks, universal banks and niche banks, respectively.

(a) Large commercial banks

The rapid development of capital markets in the mid-1990s convinced executives of commercial banks (those basically operating in the credit market) that they had to innovate to avoid being driven from the market. To this end, many commercial banks focused on achieving economies of scale by expanding in the same business segment beyond their national borders. This process involved banks in the United States and also in Europe, where Spanish banks are the leading exponents. Other banks sought economies of scope by diversifying their products and services into new segments of the credit market.

The area of commercial banking that has been most successful is consumer finance. This market segment has been developing a capacity to cater to low- and middle-income groups, thanks to the creation of mass-market instruments. Consumer finance currently generates the largest margins in the market. The commercial banks engaged in this business have raised their efficiency substantially, particularly as a result of the development of information technology and risk-rating models that use standardized information.

In addition to consumer finance, commercial and universal banks have successfully exploited the credit-card segment, which has become an even more profitable line of business than consumer loans, with the added advantage of minimal risk. Moreover, credit-card holders tend to procure a variety of other services while making their deposits, which has led commercial banks into new areas such as mutual-fund management and mortgage instruments.

(b) Investment banks

The leading players in the investment-banking segment also aspired to become global banks. Size became essential in this industry because of the need to enhance the institution's prestige and defend a leading position in the international market, since these are the most powerful competitive weapons. Some investment banks have specialized in specific segments and activities,

¹¹ According to Berger, Ongena and Smith (2002), multinational firms operating in Europe show a preference for local banks that provide basic financial services, such as short-term deposits, treasury dealings and current accounts, because their executives are familiar with the market culture, language and regulatory framework of the host country.

such as mergers and acquisitions and the bond and equity markets. Nonetheless, to avoid excessive earnings volatility, banks need to diversify their portfolio into the largest possible number of segments and activities. Here again, size is crucial, since it allows banks to maintain teams of specialists in each business area.

As a result of the 2001 recession in the United States, the country's investment banks have been less profitable than they were in the 1990s. At the same time, their inability to offer integrated service packages has placed them at a disadvantage in relation to their universal-bank competitors. Clear evidence of this has been their scant participation in mergers and acquisitions involving big corporations. The impossibility of operating with bridge loans initially, and later in bond placement, has often left them outside the major transactions. Although universal banks are in a significantly better position in this respect, not all investment banks have been able to universalize. An outstanding example is Merrill Lynch, which only managed to create a small business entity, following a failed attempt to forge a partnership with the Hongkong and Shanghai Banking Corporation (HSBC) with a view to operating outside the United States.¹²

(c) Large universal banks

Securities transactions were the new frontier to which the large financial institutions aspired. Banks throughout the world began to respond to the strategic challenge of replacing their traditional income from loans with revenues obtained from the sale of insurance and investment products, foreign currency trading and derivative operations such as swaps, futures and options.

The reorientation of commercial banks towards investment banking activities was not easy. In some countries the process was hindered by legislation. As mentioned above, however, in the United States the Federal Reserve began in the 1990s to interpret the legal restrictions in a more flexible manner, until they were ultimately lifted altogether. In Western Europe, on the other hand, the difficulty arose from the fact that there were no large investment banks in existence, so foreign institutions had to be acquired.

Specialization by traditional commercial banks in investment-banking activities also encountered a variety of other problems, including lack of experience, scarcity of specialized professional staff and clients' perception

that these banks were not leaders in this area. This obliged the banks to take over investment banks with a pre-established reputation, or else to merge. Universal banks were the fruit of these processes.

Universal banks currently embrace a wide variety of institutional types. In most cases the term refers to banks that engage in commercial and investment banking activities simultaneously. Such institutions can receive deposits, extend credit and deal in asset-backed products. Nonetheless, the term "universal bank" can also refer to institutions that supply services other than traditional banking, such as asset management, financial advice, custody, mortgage financing and insurance. This is because universal banks are often identified with the German rather than the United States banking model, which the Glass-Steagall Act had restricted to a single segment of the financial market.

The existence of two different cultures within a single financial institution has not made it easy for this new modality to survive. Problems have basically centred on investment banks' need for highly specialized staff, which complicates the task of reconciling differences between the hierarchical structures that characterize the two types of banks.¹³ Nonetheless, the imperative of survival in a market where the investment-banking segment was growing at an exponential rate explains the high degree of co-penetration that occurred between commercial and investment banking, particularly in the second half of the 1990s, through mergers and acquisitions.

The rationale for universal banking is premised on the synergy that is assumed to exist between the supply of credit and securities trading. Universal banks can make profits by cross-subsidizing either activity, since this enables them to supply services at a very low cost which is offset by earnings from other services. Most importantly, however, this also enables them to offer service packages, such as a combination of financial advice and bridge loans, before bonds are floated or a merger or acquisition is completed.

Growth in size is essential for universal banks because, like investment banks, they have to be big enough to gain the reputation they need to compete in the market; in addition, they must be in a position to offer the largest possible number of services, anticipating their clients' needs (see box III.3 and figure III.1).

¹² See *Euromoney* (2001) and *The Economist* (2001b).

¹³ These conflicts are related to differences between the two modalities in terms of the treatment of clients (commercial banking favours long-term relationships, whereas investment banking seeks specific short-term relationships); attitudes towards risk (investment banking operates in much more volatile market segments); remuneration schemes, etc.

Box III.3

CITIGROUP: ONE OF THE WORLD'S LARGEST UNIVERSAL BANKS

Citigroup is currently one of the world's largest financial groups, ranked first in terms of equity capital and second in terms of assets. Attaining this status entailed a major U-turn in its strategy, which occurred in 1998 when the commercial-banking-oriented Citibank merged with Travelers Group. The latter was focused on investment banking and on share and insurance brokerage through its subsidiaries Salomon Smith Barney, Primerica and Travelers Life and Annuity. The merger gave birth to Citigroup and afforded it a leading position in the international capital market, enabling it to supply the full range of financial services worldwide. Today it is the world's most highly internationalized financial corporation, with 270,000 employees working in subsidiaries distributed across more than 100 countries.

In recent years the growth of Citigroup has been based on the development of new products and services and on the operation of a cutting-edge technology platform. Above all, however, it has been driven by mergers and acquisitions involving leading institutions in market segments that are crucial for the group's future expansion. In the years following the merger with Travelers, the firm merged Salomon Smith Barney with Schroders to create the Pan-European Investment Bank, which gave the group a presence in the European capital market. Its subsequent takeover of Associates First Capital enabled it to consolidate its consumer financing segment in Japan and Europe. It also took over Bank Handlowy, the leading bank in Poland, to gain a springboard for expansion in Central and Eastern Europe; and it merged with the Fubon Group in order to enter the insurance market in Taiwan Province of China and create a platform for later expansion of this segment in Asia. It participated in privatizations and the acquisition of

pension fund managers in Argentina, Colombia and Mexico, to position itself as a leader in this segment in Latin America. It forged a strategic joint venture with State Street Bank and Trust Company to supply management services for pension, health insurance and other benefit plans worldwide. Lastly, it acquired the assets of Mexico's Banamex-Accival financial group (Banacci), in the biggest-ever foreign investment transaction carried out in Latin America. This gave it control of 25% of consumer and corporate banking in Mexico, the largest financial market in the region.

The merger between Citibank and Travelers boosted the activities of both groups. Placing the two businesses on a single platform required organizational restructuring, not only to reduce costs but also to take maximum advantage of progress in information technology, to turn the company into a universal provider of financial services on all continents.

This not only added value to the corporation; it also raised the latter's return on equity from 14% in 1998 to 22% in 2000 (19.7% in 2001) –in the midst of recession in the United States economy and slow growth in Europe and Japan. In the second quarter of 2002, the firm posted the highest profitability in the capital market with a pre-tax profit margin of 36.7%, surpassing all its main banking competitors (Merrill Lynch, Lehman Brothers, J.P. Morgan, Goldman Sachs and Morgan Stanley).^a In August 2002, Citigroup was ranked in first place by the risk-raters Moody's and Fitch; this enabled it to raise funds at one of the lowest rates on the international market.

The restructuring that followed the merger between Citigroup's commercial and investment banking arms was aimed at consolidating four business segments, grouped

according to the type of client being targeted by the corresponding services. This makes it possible to spread the risk of activities among different types of clients and to reduce costs by using a common client database for all products and services. The first segment (see diagram) is structured around a core consumer financing business called "Global Consumer", which mainly involves credit card management, all types of consumer financing products and services and elements pertaining to retail banking in general. In 2001 this segment contributed 50% of the group's profits. The second segment, known as "Global Corporate", encompasses investment and corporate banking, and aims to satisfy all the financial needs of transnational corporations in relation to capital markets, service transaction and private clients. This segment contributed 40% of profits. The third segment, "Global Investment Management and Private Banking", is aimed at large private and government institutions, including pension fund managers. This segment, which contributed 10% of profits in 2001, specializes in life insurance, private banking and asset management. The fourth and final segment consists of the group's own investment activities. The first three segments cover Citigroup's original market (the United States), along with all the branches in Europe, Japan, Asia, Latin America and Central and Eastern Europe.

Although this strategy has yielded high profits for Citigroup, it has also engendered major problems stemming from the difficulties inherent in managing a corporation that has grown so quickly. Moreover, the cases of Enron and the telecommunications giant WorldCom have raised doubts as to the benefits of mergers between commercial and investment banks.

Box III.3 (concluded)

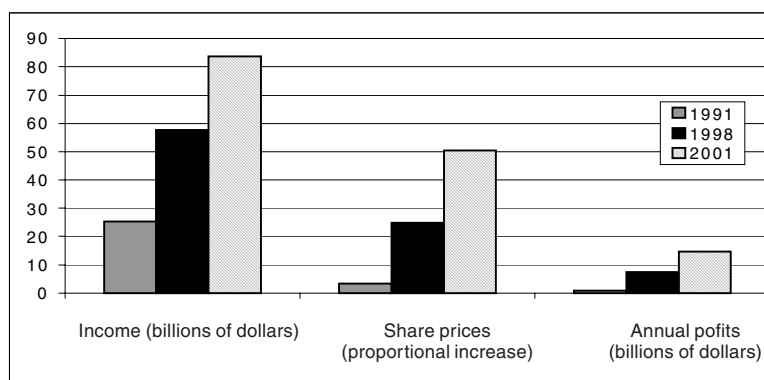
CITIGROUP: NEW ORGANIZATIONAL STRUCTURE

Global consumer segment		Global corporate segment		Global investment management and private banking	
CITIBANKING NORTH AMERICA	Commercial bank products and services	CORPORATE AND INVESTMENT BANKING	Underwriting and distribution of fixed-income and equity securities	TRAVELERS LIFE AND ANNUITY	Life insurance and individual and group annuities through firms Mutual funds Investment companies
MORTGAGE BANKING	Mortgage and student loans		Capital-raising, advisory and brokerage services for clients	CITIGROUP PRIVATE BANKING	Personalized asset-management services
NORTH AMERICA CARDS	- Diners Club - CitiCards - Master Card - Visa - Others		Transactions in stock and commodity futures		Pension management
CitiFinancial	- Community loans with guarantees - Property and casualty insurance - Life insurance - Annuities - Mutual funds		Foreign exchange Over-the-counter market Derivatives Leasing		Custody services Customized services Traditional banking
e-consumer	Development of online products and services	CORPORATE BANKING IN EMERGING MARKETS AND GLOBAL SERVICE TRANSACTIONS	Financial products and services aimed at transnational corporations in emerging markets	CITIGROUP ASSET MANAGEMENT Smith Barney Asset Management	Public and private retirement plans Foundations Trusts
International unit Asia Western Europe Central and Eastern Europe Africa and Middle East Latin America	Banking services - Community loans - Credit cards - Investment services	COMMERCIAL INSURANCE	Commercial property and casualty insurance	Salomon Brothers Asset Management Citibank Asset Management	Central banks Insurance companies Government bodies

Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of Citigroup, "Quarterly and Annual Earnings Releases", www.citigroup.com; and Business Week, 9 September 2002.

^a SEC filings, press release (www.citigroup.com).

Figure III.1
CITIGROUP: PERFORMANCE OVER THE LAST 10 YEARS, 1991-2001



Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of Citigroup, "Quarterly and Annual Earnings Releases", www.citigroup.com.

In 2002, however, the universal banking model was increasingly called into question, since several such institutions had become embroiled in the scandals surrounding Enron, WorldCom and other United States telecommunications firms that year. The banks were accused of having lent them millions of dollars in order to secure their asset-management business, from which the banks earn large commissions, and also came under fire for the conflict of interest this created between their commercial and investment-banking businesses. This has led the United States authorities to reconsider the current rules of financial regulation and supervision, raising the question of whether the barrier that formerly existed between commercial and investment banking should be re-erected.

(d) Niche banks

The effectiveness of the banks described above stems from their size. Commercial banks seek economies of scale to compensate for declining profit margins. Universal banks have to grow larger in order to gain a leading position in the international market, either as an investment bank or as a commercial bank. Nonetheless, unlike these banks, some institutions operate in market niches (defined in terms of geography, activity or specific product) where they can survive even while remaining small. Commercial banks can prosper perfectly well in geographical niches, provided that they avoid attracting the attention of large competitors. Examples are local commercial banks in developing countries, where, thanks

to their location in certain niches, they have been able to survive in an increasingly competitive market. Product niches, on the other hand, are sustainable in cases where clients value individualized treatment over general services. Research, advisory services and private-banking services are examples of activities that meet this criterion.

An analysis of the typology described above reveals that each segment is best suited to certain areas. Universal banks are at their best dealing with large firms rather than consumers, whereas commercial banks obtain higher profits by concentrating on the latter. Nonetheless, the current development of new services –for which commissions are charged, often without risk– has added value to both of these market segments (large firms and consumers). In practice, the large international banks nowadays tie their lending to commitments by clients to purchase other services, even though this procedure may attract hostility from regulators in some countries.

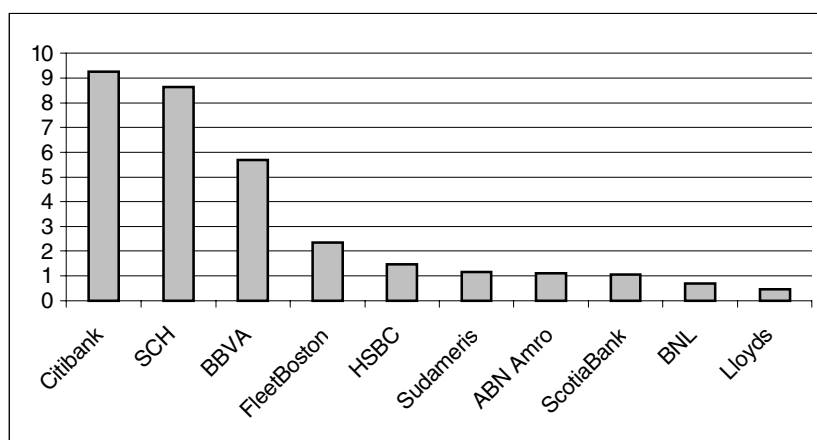
To summarize, the keen competition prevailing in the financial market today has prompted banks to seek economies of scale as never before. As a result, some banks have grown very large (through mergers or acquisitions or through internationalization), while others have taken refuge in market niches where specialization and efficiency are the secrets of success. In both cases, emerging countries have become strong magnets for transnational banks' investments. Latin America has been no exception to this trend, which was also stimulated and made viable by the profound economic changes implemented in the region in the 1990s.

C. CORPORATE STRATEGIES IN LATIN AMERICA

In pursuing new markets and rapid growth, international banks expanded into the emerging economies of Asia, Central and Eastern Europe and Latin America. In contrast to the situation in the first two regions, however, the transnational banks that currently have a relatively strong presence Latin America are few (see figure III.2)

and are not among the world's largest banks, with the exception of Citigroup¹⁴ and, since 2001, Banco Santander Central Hispano (SCH), commonly known as Banco Santander, which now ranks 24th in terms of capital (see annex table III.A.6).

Figure III.2
LARGEST BANKS IN LATIN AMERICA BY SHARE OF REGIONAL LENDING, 2001
(Percentages)



Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of Salomon Smith Barney, *Foreign Financial Institutions in Latin America, 2001 Update*, New York, November 2001.

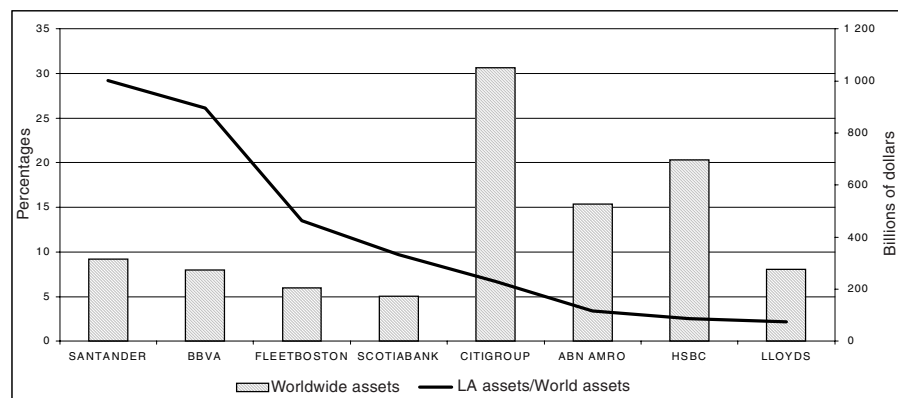
In the past, foreign financial entities –particularly those from the United States– entered the region through representation offices and/or small branches, without making an equity investment. They generally restricted their services to satisfying the particular needs of clients from their countries of origin –especially transnational firms– or operating in market niches, such as large export firms in the host country, in order to facilitate their foreign-trade activities. Over time, foreign banks steadily expanded their operations in countries where the regulatory framework allowed, bringing in capital and finally becoming commercial banks, albeit with limited services essentially aimed at a select clientele.

As mentioned earlier, the changes that took place in the macroeconomic climate and in the Latin American financial system in the 1990s coincided with the start of global expansion by universal banks, as they sought new markets in pursuit of economies of scale and/or specialization.

One of the more remarkable aspects of this phenomenon was the fact that, for various reasons, United States banks were less interested than their European counterparts, especially Spanish ones, in expanding into Latin America –at least until the late 1990s, when Citigroup began to adopt a more aggressive attitude (see figure III.3).

¹⁴ Citigroup's presence in the region jumped significantly in late 2000.

Figure III.3
TRANSNATIONAL BANKS: ASSETS IN LATIN AMERICA VS. WORLDWIDE ASSETS, 2001



Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of *The Banker*, "Top 1000 World Banks", London, July 2002; and *Latin Banking Guide & Directory* (www.latinfinance.com), August 2002.

This behaviour can be attributed to a number of factors. In the first place, banks in the United States underwent an intensive process of consolidation in the 1990s that clearly absorbed a large part of the resources and energies of the leading banks. The main United States banking institutions –which had been operating in Latin America throughout the twentieth century– were involved in a series of mergers. Examples included Citibank, Chase Manhattan, Bank of Boston and Bank of America, all of which were restructured in the 1990s following the lifting of restrictions on interstate activities, and they began to aim at universalization.

Secondly, these banks expanded primarily into countries whose financial markets were more developed than those of Latin America. The opportunities that European monetary union had opened up for universal and investment banking were much more attractive than those offered by emerging markets. In addition, the European countries' financial system was undergoing a reform process similar to the one in the United States, so banks from the latter country were able to gain leading positions in markets much larger than those of emerging countries. Consequently, Latin America –apart from Mexico, given its status as a party to the North American Free Trade Agreement (NAFTA)– was of marginal importance in their overall strategy of expansion into developed-economy markets.

A large contingent of European banks also took this road. Deutsche Bank and UBS Bank, for example, have

focused on entering the United States market. Others preferred to expand into Latin America, having found it virtually impossible to break into countries with developed financial markets, even when this only meant crossing borders within the European Union.

Thirdly, United States banks may have been wary of the prospects offered by Latin America, given the knowledge they had acquired through long experience in the region. As the debt crisis of the early 1980s had affected a large part of the United States banking system, heightened risk aversion caused these banks to shy away from further involvement in the region's problems, with which European banks had no experience. The recent Argentine crisis may have confirmed this apprehension. Given their deeper knowledge of the institutional weakness of the Latin American financial system, banks such as Citicorp, Bank of Boston and Chase opted to restrict their participation to the corporate and high-income consumer niches, which are normally safer.

This stands in contrast to the behaviour of the Spanish banks. Their expansion, which followed a process of concentration of the financial system in Spain, was driven by an urgent need to grow; and they chose Latin America because of obstacles to expansion in the European market. Their strategy was motivated by the need to strengthen their competitive position and defend themselves against possible hostile takeover bids from their competitors, especially bigger banks in the European Union.

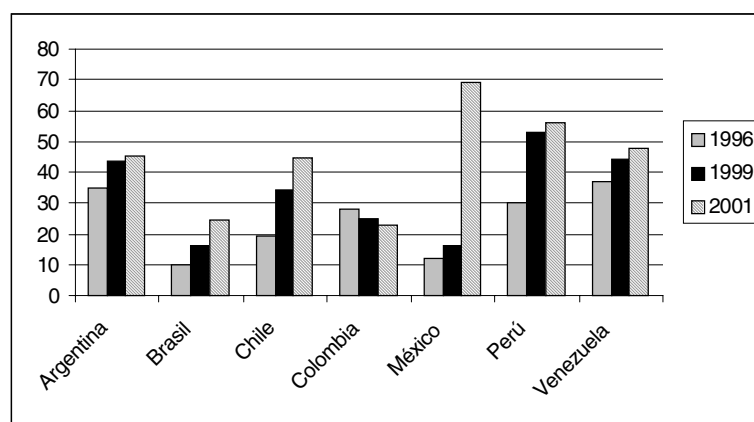
1. Strategy for penetrating the Latin American market

Foreign banks entered the region mainly by acquiring equity holdings in strategic partnerships with local banks (see annex table III.A.3). Some banks were more aggressive than others, acquiring a 100% interest in order to rapidly gain management control. These included SCH, HSBC, FleetBoston and Citibank. In contrast, Banco Bilbao Vizcaya Argentaria (BBVA) has moved slowly in terms of ownership control, although, like SCH, it entered the region aggressively, gaining a major presence in the main financial markets.

While transnational banks have expanded mainly into the larger Latin American countries (see figure III.4),

they are also present in the smaller economies, albeit in limited segments. There are significant differences between the main banks in terms of regional distribution and the segments in which they operate. These differences reflect the banks' global strategy, the types of risk they are willing to assume in the region, their historical participation and opportunities that have arisen in the host countries –such as financial crises resulting in asset sales or the need for rapid capitalization, all of which have been taken advantage of by foreign banks.

Figure III.4
LATIN AMERICA: FOREIGN BANK SHARE OF TOTAL LENDING BY THE LOCAL BANKING SYSTEM, 1996-2001
 (Percentages)



Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of Salomon Smith Barney, *Foreign Financial Institutions in Latin America, 2001 Update*, New York, November 2001.

Another factor to be borne in mind is the major growth potential of traditional commercial banking –and not just investment banking– in most Latin American countries. Large segments of the population have no access to financial products, which, as mentioned above, requires a local presence and physical proximity to the customer.

The tardy penetration of foreign banks in the region's largest and most developed financial markets, such as

Mexico and Brazil, was the result of regulatory obstacles which those countries gradually lifted following the "tequila" crisis. But, whereas foreign banks acquired a majority share of the Mexican banking system between 2000 and 2001, in Brazil the strength of the local banking sector, which had its own brand of development and competitiveness, prevented foreign banks from gaining dominant market positions.

2. Corporate strategies, market share and profitability

Universal banks have generally entered the region using one of two strategies, which partly determine the scale of their expansion. One of these is based on size, when this is one of the entity's main competitive advantages. This strategy forces the bank to expand steadily and to maintain a presence not only in the main markets, but also in the largest possible number of their constituent segments. The other strategy is based on specific technological know-how and the use of specialized instruments. In this case, banks opt to participate in niche segments. In Latin America, this type of strategy has been used mainly in treasury management and corporate banking in large markets. As some banks combine these two modalities, however, three categories can be distinguished in the region: banks with a broad regional

presence and universal orientation in the local market; those that have broad regional dispersion but are concentrated in the corporate segment, though they may, in some cases, offer limited consumer banking services; and entities operating exclusively in large markets, mainly in the corporate banking segment.

(a) Entities with a broad regional presence as universal banks

Banks that expanded into more countries and most of the segments of the Latin American financial market in the 1990s included the three transnational ones with the biggest market shares in the region: SCH, BBVA and Citibank (see table III.9).

Table III.9
LATIN AMERICA: MARKET SHARES OF THE THREE LARGEST TRANSNATIONAL BANKS IN 2001
(Percentages)

	SCH	BBVA ^a	Citigroup	Total share of foreign banks
Loans	10.4	9.3	9.1	63.8
Deposits	10.5	12.0	8.5	64.4
Investment funds	7.9	4.5	7.1	...
Pension funds	12.1	27.6	16.7	84.0

Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of Salomon Smith Barney, *Foreign Financial Institutions in Latin America, 2001 Update*, New York, November 2001; and Federal Reserve Bank of Atlanta, *Economic Review*, 2002.

^a Banco Bilbao Vizcaya Argentaria.

The Spanish firms SCH and BBVA were the financial entities with the most successful expansion strategy over the last decade. They began by entering the market segment where they had the greatest experience and strength in their country of origin: consumer banking (also known as retail banking), which was seen as having the highest growth potential in the region.

They achieved their rapid penetration by acquiring large, locally consolidated firms (see box III.4 and annex tables III.A.4 and III.A.5). They supported this with a revolutionary strategy for marketing their products and services, which not only offered attractive rates, but also incorporated new products and made use of highly aggressive marketing methods that included prize drawings for automobiles, trips to Europe and other prizes, in countries where this was allowed by law.

Entering new markets required major investments. For example, by late 2001 SCH had invested US\$ 16.4 billion, of which 76% was concentrated in Brazil, Argentina and Mexico, in that order. Meanwhile, BBVA had spent a total of US\$ 9 billion to acquire share holdings in the region's financial entities (see box III.4).

Citigroup (as Citibank) had been providing corporate and private banking services -in other words, focusing on high-income clients- in the region for at least a century when, in 2001, it made the big leap into consumer banking by acquiring Banco Nacional de México (BANAMEX) for US\$ 12.5 billion. This policy forms part of Citigroup's global strategy, which in recent years has involved restructuring, with major emphasis on its Global Consumer group in emerging markets.

Box III.4

SPANISH BANKS IN LATIN AMERICA

Spanish banks have been embarked on an internationalization drive since the mid-1990s. This process, which was triggered by the changes that occurred in the Spanish financial system two decades ago, intensified as from 1985 following Spain's entry into the European Community.

The creation of the single European market removed obstacles to the free circulation of capital between member countries and gave freedom to establish and provide banking services. In 1993 the Council of Europe unified regulations governing credit institutions and provided for the free circulation of capital and for the creation of Community-wide financial institutions requiring only a single banking licence. The Spanish government incorporated these provisions into its financial legislation by Royal Decree in 1995. As a result, Spain's financial sector began to develop new growth and concentration strategies in order to adapt to the new competitive environment. The changes in the structure and strategies of financial entities became more radical in anticipation of the arrival of the single

currency, the euro. These circumstances compelled banking institutions either to achieve the necessary economies of scale (size) or to offer a competitive advantage in a specific market segment (specialization).

Private Spanish banks were forced to redefine their strategy to focus on meeting the demands and needs of their clients (individuals, firms and institutions). As a result, the focus of the banking system moved from products to clients, mirroring the pattern of financial innovation internationally. In this context, banks sought primarily to maintain their profit levels, for which purpose they made significant cuts in operating costs. Measures included staff downsizing, a reduction in the number of banks—as concentration was increased through mergers—and cuts in the number of branches in their local networks. This process gathered momentum when Banco Santander launched a high-yield current account known as "Súper Cuenta", an initiative that other banks were quick to copy.^a

Acquisitions by Spanish banks were

concentrated in France, Italy, Morocco, Portugal and especially Latin America.^b At the same time, these banks intensified the signing of cooperation agreements with entities from different European Union countries, in order to defend themselves against competition from larger banks that had consolidated as genuinely European entities.

The Latin American countries offered attractive new business opportunities, given their high degree of openness and deregulation. Accordingly, the financial institutions' strategy was to expand their core activity, namely commercial banking, in order to gain a presence in as many markets as possible. This is reflected in the acquisitions process illustrated in the table below.

As in their country of origin, Banco Santander and BBVA pursued strategies aimed at universalization, with a view to diversifying the market segments in which they operated and entering new businesses. These included investment banking, insurance and, especially, pension fund management

Source: ECLAC, Unit on Investment and Corporate Strategies.

^a The Súper Cuenta was the first current account to pay interest on credit balances, and it enabled Banco Santander to increase its market share by 50%. This product was followed by others such as "Súper Depósitos" and "Súper Hipotecas", which forced the larger Spanish banks to intensify their competition in terms of products and market share.

^b It is important to note that many large European banks have not opted for an internationalization strategy, but have focused basically on consolidating their position in their countries of origin.

Box III-4 (conclusion)

Table
**BANCO SANTANDER CENTRAL HISPANO (SCH) AND BANCO BILBAO VIZCAYA ARGENTARIA (BBVA)
IN LATIN AMERICA**

	SCH				BBVA			
	Local bank	Owner-ship%	Local ranking	Year of entry	Local bank	Owner-ship%	Local ranking	Year of entry
Argentina	Banco Río de la Plata	98	4	1997	BBVA Banco Francés	67	5	1996
	Banco de Galicia y Buenos Aires	10	3	1998	Corporación Banca Argentina	100	...	1999
Bolivia	Banco Santa Cruz	90	2	1998				
Brazil	Banco do Estado de São Paulo (Banespa)	98		2000	Banco Excel-Económico (now BBVA Brasil)	100	16	1998
	Banco Santander Brasil (formerly Banco Geral do Comercio)	100	5	1997				
	Banco Noroeste ^a	76	18	1998				
Chile	Banco Santander Chile	90	2	1996	Banco Hipotecario de Fomento (BHIF), now BBVA Banco BHIF	56	10	1998
	Banco Santiago ^b	79	3	1991				
Colombia	Banco Santander Colombia	60	12	1997	BBVA Ganadero	99	3	1996
Mexico	Grupo Financiero Serfin	100	3	2000	BBVA México (formerly Probusa)	68		1995
	Grupo Financiero Bital (included Banco Internacional de México)	8	4	1993	BBVA Bancomer	35	1	2000
	Banco Santander Mexicano	100	5	1996				
Paraguay	Banco Asunción	39	9	1996				
Peru	Banco Santander Perú	100	6	1995	BBVA Continental	50	3	1995
Puerto Rico	Banco Santander Puerto Rico	100			BBVA Puerto Rico	100	3	
Uruguay	Banco Santander Uruguay	100	10	1997	BBVA Banco Francés	100	5	1995
Venezuela	Banco de Venezuela	98	3		Banco Provincial	53	1	1997

Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of Banco Santander Central Hispano (SCH), *Informe Anual 2001*, 2001; *Latin Trade magazine*, "Top 100 banks", September 2002; and *Latin Banking Guide & Directory, 2002*, supplement of *Latin Finance Magazine* (www.latinfinance.com), August 2002.

^a In 1998 the various Santander subsidiaries in Brazil began a merger process.

^b Currently in the process of merging with Banco Santander.

By taking over BANAMEX, Citigroup achieved an extraordinary increase in its income in the region and in its number of client accounts (see table III.10). As a result, income (net of interest paid) in 2001 was up by 59% on the 2000 figure, having risen from US\$ 2.2 billion to

US\$ 3.5 billion. At the same time, the total number of client accounts expanded from 7 million to 23 million for the whole of Latin America, thanks to the addition of 16 million BANAMEX accounts.

Table III.10
THE IMPORTANCE OF BANAMEX TO CITIGROUP

	Total net income (millions of dollars)		Number of clients (millions)		Average loans (billions of dollars)	
	Rest of Latin America	Mexico	Rest of Latin America	Mexico	Rest of Latin America	Mexico
1999	1 638	531	7.6	1.4	7.7	3.9
2000	1 656	603	7.2	1.7	7.2	3.7
2001	1 380	2 117	7.1	16.1	7.1	11.3

Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of Citigroup, 2001 *Annual Report* (www.citigroup.com), 2002.

The importance attached to consumer banking by SCH, BBVA and Citigroup in Latin America led them to compete with each other for a market that had major development potential, and also with local banks, which until recently had been the leading players in that market. Accordingly, they made a vigorous entry into new segments, such as credit cards (one of the highest-yielding instruments in emerging countries), mortgage banking (which was in its infancy in some Latin American countries), consumer finance instruments aimed at specific segments (such as young people or students), personal banking (for the high-income private client), loans for the purchase of automobiles, and insurance products of all types.

While these institutions place major emphasis on retail banking, they are not neglecting their corporate-banking activities, where they provide a wide variety of financial services and products. These include investment advice, financial planning, brokerage services for stock and commodity futures, underwriting and marketing of fixed-income and equity securities for transnational

corporations, and structured and derivative products, under a strategy aimed at the continuous development of new products and services.

Citibank remains the leader in this area with its traditional orientation towards this market segment. By combining that orientation with its new strategy, however, it has now integrated the organization of its corporate and consumer-banking businesses. The Spanish banks, meanwhile, as part of their corporate banking activities, have been developing special instruments tailored to the needs of small and medium-sized businesses.

Pension-system reforms created the institutional conditions needed to enable foreign banks to enter this market also, which they did by taking blocks of shares in local pension fund management holding companies. The fact that regional pension funds are not very large has not prevented foreign banks from perceiving profit potential in this business and seeking rapid penetration. In this market, BBVA is the leading player (see box III.5 and figure III.5).

Box III.5

FOREIGN BANK PARTICIPATION IN PENSION FUND MANAGEMENT

Pension funds have played a major role in the provision of long-term financial resources in developed countries. Intermediation takes place through mechanisms that vary widely according to the depth and robustness of the respective markets. In the United States, for example, pension fund managers acquire long-term securities, either directly or indirectly, thereby simultaneously stimulating both primary and secondary intermediation in the capital market. As a result, these institutions play a key role in enhancing the maturity of financial instruments,

thereby contributing to investment financing.

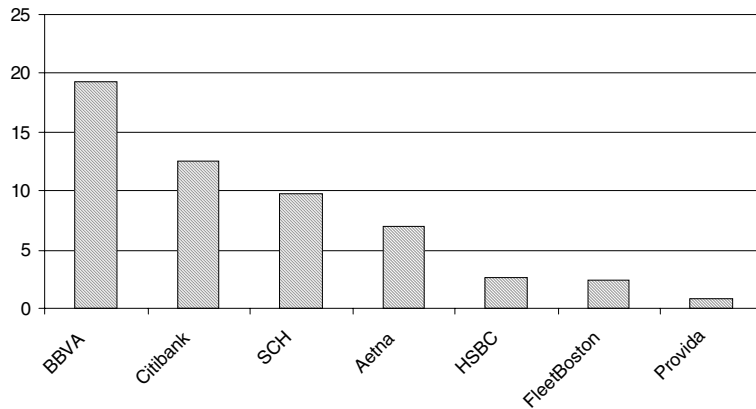
The situation is very different in Latin America. Firstly, pension reform in the region did not take place until the 1990s (except in Chile, where it dates back to the early 1980s); moreover, reform was often only partial, which reduced the potential size of the corresponding funds. Secondly, the lack of capital-market development, together with the weakness and instability of private firms, represent a major risk for investors that purchase the instruments issued by these firms. Thirdly, the institutional framework in the sector has matured only slowly, and serious regulatory

problems persist in several countries of the region -even Chile, which boasts the highest level of institutional development.

The leading player in this sector has been BBVA (see figure below); it is present in nearly all countries where the pension system has been reformed, managing 25% of total funds, or US\$ 14 billion. BBVA is currently followed by Citibank, which, having acquired the assets of Banacci in Mexico, manages a total of US\$ 11.4 billion. The figure below also shows the share of other foreign players in the pension industry, which by mid-2001 jointly accounted for 55% of all pension funds in the region.

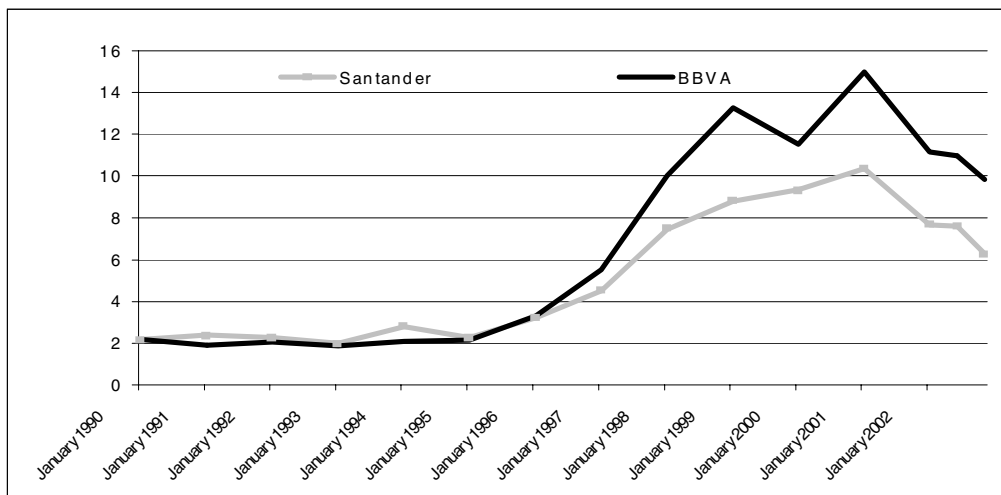
Box III.5 (conclusion)

Figure
LATIN AMERICA: SHARE OF FOREIGN BANKS IN PENSION FUND MANAGEMENT, JUNE 2001
 (Percentages)



Source: Salomon Smith Barney, Foreign Financial Institutions in Latin America, 2001 Update, New York, November 2001.

Figure III.5
BANCO SANTANDER AND BANCO BILBAO VIZCAYA ARGENTARIA (BBVA) SHARE PRICES ON THE NEW YORK STOCK EXCHANGE, 1990-2002
 (Dollars)



Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of Bloomberg.

(b) Entities that have broad regional dispersion but are concentrated in the corporate segment

Among the financial institutions that increased their share of the Latin American market in the 1990s, covering a broad range of countries but concentrating their activities in limited market segments, the standouts are FleetBoston (outcome of the merger between FleetBoston and BankBoston in the United States) and the Canadian-owned Scotiabank.

FleetBoston was one of the first international banks to establish itself in Latin America, opening a Buenos Aires office in 1917 to assist New England merchants in administering their businesses. Today it maintains a significant presence in the region, with operations in Argentina, Brazil, Chile, Colombia, Mexico, Panama, Peru and Uruguay. Overall, FleetBoston controls about 2% of the loans and deposits of the region's most important financial markets, and about 3% of total assets.

The bank has aimed its products and services at transnationals, large domestic corporations and high-income individuals. Initially, most of its operations involved banking, which today represents FleetBoston's core business in Latin America. More recently, however, it has gradually expanded into other high-growth areas, offering new financial services such as insurance, brokerage, leasing, factoring and pension fund management.

Scotiabank, meanwhile, has been operating in the region for over 100 years. Although initially concentrated in the Caribbean, it began activities in South America 40 years ago. Its internationalization strategy focuses on the fastest-growing markets and economies with low bank penetration and favourable demographic conditions. In 2000 it was planning to develop a financial hub operated and managed jointly in Chile and Argentina –countries in which it had been building up its assets. The crisis in Argentina, however, persuaded the bank to withdraw its capital from that country, and it has since been intensifying its operations in Mexico, for which purpose it took a controlling 55% interest in Inverlat in 2001. In 2002 it maintained a relatively significant presence in Chile, Costa Rica, El Salvador, Mexico, Panama and Puerto Rico, through subsidiaries, representation offices and partnerships with local banks. In 2001 it strengthened its activities in emerging markets, mainly in Latin America and in small market niches in Asia. Like FleetBoston, its expansion strategy includes mutual fund management, insurance and electronic banking.

(c) Entities operating exclusively in large markets

The remaining foreign banks are concentrated in a few countries and operate mainly in the corporate segment. Nonetheless, they too have followed the pattern of integrating businesses that until recently were independent (investment funds, pension funds and insurance companies).

The Hongkong and Shanghai Banking Corporation (HSBC) is one of the biggest financial institutions in the world, with operations in over 80 countries. Although its activities in Latin America are on a small scale, since the mid-1990s HSBC has been strengthening its presence in the region. Initially, this strategic reorientation resulted in three acquisitions: 10% of Banco del Sur in Peru, 19.9% of the Serfin financial group in Mexico and various assets belonging to Banco Bamerindus do Brasil. These operations were complemented by some smaller-scale activities in Argentina and Chile.

The firm's business areas are subdivided so as to provide a full range of banking, financial and insurance services to different market segments. These areas include personal banking, commercial banking, private banking and corporate banking (including investment banking). At the present time, HSBC operates mainly in five regions or territories: Europe, Hong Kong SAR, the rest of Asia-Pacific (in addition to Africa and the Middle East), North America and Latin America. The group's current strategy aims at cost-cutting, the development of new sources of income and commissions in developing countries, the development of a single corporate image, and alignment of its corporate and investment banking arms.

In terms of assets, liabilities and profits, the most important regions or territories for the firm's global position are Europe and Hong Kong SAR, in each of which over 37% of the group's assets are concentrated. In contrast, Latin America accounts for only a minimal fraction of its global activities. It is interesting to note how profits are distributed across regions and lines of business. In Europe, profits are sourced as follows: personal banking, 16%; commercial banking, 28%; and corporate and investment banking, 37%. In Hong Kong SAR and North America, the firm's main activity is personal banking, which accounts for 45% and 51% of profits in these markets, respectively. In Latin America, on the other hand, earnings are heavily concentrated in corporate and investment banking (52%), followed by commercial banking (33%) and personal banking (11%).

The firm's main business in the region consists of banking and financial services for large firms (corporate banking), with recent diversification into services for

medium-sized firms and consumer banking. In addition, HSBC engages in some activities in the insurance sector and, to a lesser extent, in pension funds.

Another transnational bank that operates in just a few of the region's markets, but with a significant share of their total assets, is ABN AMRO of the Netherlands. This bank has an overt corporate-client focus, having

recently defined a global strategy of vigorously pursuing a major banking presence in three markets, namely the Netherlands, the United States and Brazil, in that order. Like other global banks in the region, ABN AMRO provides services that include financial intermediation, leasing, insurance and private pension saving, in addition to commercial banking.

3. Costs and benefits of expansion in Latin America

The costs and benefits of expansion in Latin America depend on the relative importance of a foreign bank's business in the region within its global strategy (see table III.11). At one extreme are the Spanish banks, whose Latin American assets account for a high proportion of the total, 29% in the case of SCH and just over 26% for BBVA as of late 2001. At the other extreme are banks

that expanded in the investment-banking segment only, with the result that they have hardly any assets in the region. The intermediate range runs from 13% in the case of FleetBoston to nearly 7% in the case of Citibank, and about 2% among banks whose strategies target niche segments (including corporate banking, for example, given its orientation towards large markets).

Table III.11
COMPOSITION OF FOREIGN BANK ASSETS, 2001
(Millions of dollars and percentages)

	Assets in Latin America	Global assets	Latin America/total	Argentina/Latin America	Argentina/Total
SCH	92 067	315 623	29.2	10.1	3.0
BBVA	71 171	272 535	26.1	11.8	3.1
FLEETBOSTON	27 453	203 638	13.5	30	4.0
SCOTIABANK	16 881	173 394	9.7	16.2	1.6
CITIGROUP	70 418	1 051 450	6.7	10.2	0.7
ABN AMRO	17 910	526 450	3.4	0	0.0
HSBC	17 419	696 381	2.5	27	0.7
LLOYDS	5 919	275 780	2.2	13.5	0.3

Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of data from The Banker, "Top 1000 World Banks", London, July 2002; and *Latin Banking Guide & Directory* (www.latinfinance.com), August 2002.

In the late 1990s, expectations of rapid growth in Latin America were rudely disappointed, and the region's economies are now either stalled or in outright recession. In addition, they have been rendered more vulnerable by the reversal of net capital flows and the resulting increase in exchange-rate volatility. In a context of domestic stagnation and external vulnerability, pessimism arose as to the future profitability of investments, and hopes of continuing to attract capital to the region, and particularly to the financial sector, quickly faded.

Argentina's recent experience has had a profound effect on banks' strategies in the region. The abandonment

of convertibility and the way in which dollarization was unwound in Argentina changed the rules of the game in the business world, generating a crisis in the financial system from which the country has yet to recover. This situation also stirred fears for the future of investments in neighbouring countries.

The consequences of this crisis, which hit a large number of banks, cannot yet be fully evaluated, but one result is certain to be that foreign firms in future will be much more cautious about investing in the region, since the risk appears to be much greater and less manageable than previously imagined. Such fears cause investors to

mistrust corporations with high volumes of assets in the region. Figure III.5 shows the extent to which SCH and BBVA share prices have suffered for that reason, even though their rates of return on assets held up well in 2001 (in both cases profits were the same or higher than at the start of the expansion; see table III.12).

In addition, given that shareholders tend to prize profitability above any other criterion, a number of banks hurt by the Argentine crisis and oriented mainly towards niche segments drastically altered their strategy.

In general, this resulted in their withdrawal from Argentina and in some cases from the region as a whole. Banks that pulled out of Argentina include Canada's Scotiabank (formerly the owner of Banco Quilmes), France's *Crédit Agricole* and the Republic of Korea's *Kookmin*. In addition, Italy's *IntesaBci* group, one of the most powerful financial institutions in its home country and owner of the *Sudameris* banks in Argentina and Brazil. At the end of 2002, it sold 80% of its subsidiary in Argentina.

Table III.12
PROFITABILITY IN LATIN AMERICA VS. PROFITABILITY WORLDWIDE, 1999-2001
(Percentages)

	Return on assets worldwide	Return on assets in Latin America	Return on equity worldwide	Return on equity in Latin America
December 1999				
SCH	1.1	1.1	12.0	11.6
BBVA	1.2	0.9	11.3	11.1
CITIGROUP	2.2	1.6	12.4	14.6
BANKBOSTON	1.8	0.6	11.4	9.4
ABN AMRO	0.9	1.1	10.9	10.1
HSBC	1.4	0.8	13.2	15.8
SCOTIABANK	1.2	0.2	11.9	3.0
LLOYDS	2.4	2.1	15.1	15.4
December 2001				
SCH	1.2	1.3	12.8	13.4
BBVA	1.2	0.9	12.6	7.6
CITIGROUP	2.1	1.8	10.9	16.7
BANKBOSTON	0.8	0.8	11.0	10.0
ABN AMRO	0.6	1.2	10.9	17.2
HSBC	1.2	0.4	13.0	6.6
SCOTIABANK	1.2	1.0	13.0	11.0
LLOYDS	1.9	-0.1	9.2	-3.9

Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of data from *The Banker*, "Top 1000 World Banks", London, July 2002; and *Latin Banking Guide & Directory* (www.latinfinance.com), August 2002.

Following the outbreak of the Argentine crisis, the banks that had been most active in penetrating the Latin American market in the 1990s embarked upon a consolidation strategy based, among other things, on the decision to invest only in projects perceived as having great market and profit potential. For example, executives of BBVA, one of the most dynamic players in recent years, state that the bank's expansion in Latin America is now virtually complete, with the region currently accounting for 27% of the group's earnings. While it is still planning further expansion in Mexico, this is only because of that country's strategic importance, in view of NAFTA, to the bank's medium-

term expansion to the United States. The same is true of SCH, which was hard hit by the Argentine crisis and now intends only to consolidate its activities in Latin America –especially in Brazil, Chile, Colombia, Mexico, Puerto Rico and Venezuela (the region currently provides 37% of its earnings). The group plans to redirect its investments towards the United States and Europe in order to achieve greater geographical diversification of its assets and reduce its exposure in Latin America. This aim became clear when it cancelled its participation in the takeover of the Mexican bank *Bital*, which was finally purchased by HSBC.

Citigroup's problems with its global strategy in the second half of 2002 and its losses in Argentina, which produced a negative result at the regional level,¹⁵ have led it to view the future with great caution, putting its investments in Brazil on hold while it awaits greater regional stability.

The biggest financial market in the region that has been penetrated the least by foreign banks, even though it offers the greatest potential, is Brazil. Yet there are two major obstacles to any such initiatives in the short run: firstly, the line to be taken by the newly elected government; and secondly, strong competition from the large local banks. The foreign banks that have entered the country in the past five years, such as HSBC, BBVA

and ABN AMRO, have found it hard to compete and carve out an identity in the market. Nonetheless, analysts claim that there are highly profitable niches available.¹⁶

The recent crisis involving large United States corporations has generated uncertainty as to the future of universal banking in developed countries, but has not yet affected the strategy of such institutions in Latin America. Nonetheless, the region's capital market cannot fulfil its development potential at present because the international financial market has yet to regain the level of liquidity it enjoyed in the 1990s. This is likely to result in a period of consolidation (concentration and possible retrenchment) in the region's financial market, as well as a reorientation towards commercial banking.

D. FOREIGN BANKS: MICROECONOMIC EFFICIENCY VERSUS MACROECONOMIC EFFECTIVENESS

The foregoing sections analysed the forces that led foreign banks to expand into the region and the effects of their strategies on corporate performance. This section analyses the impact that foreign banks have had at the microeconomic and macroeconomic levels, particularly in terms of solving the problems that have traditionally afflicted the Latin American financial system. This obviously has implications for the financial constraints facing firms and the stability of the regional banking system.

The microeconomic indicators presented here are not very different from those used in other studies, since they compare the performance of foreign and local banks in terms of profitability, efficiency and liquidity. To simplify, this is referred to here as the *microeconomic efficiency* of the banking system. Despite their limitations, these indicators are often used to evaluate the way in

which banks are operating and their degree of risk exposure. The counterpart at the aggregate level would be *macroeconomic effectiveness*. This aspect will be studied by means of an analysis of access to credit by the productive sector and families, together with the corresponding interest rates and spreads, and the banking system's contribution to stability.

As is true of most economic analyses, the step from micro- to macroeconomic performance is not a direct one. Nonetheless, some of the results presented below suggest that the microeconomic efficiency of the regional banking system increased during the 1990s, thanks partly to the role played by foreign banks. In the macroeconomic domain, however, the cost and accessibility of credit failed to improve, as did macroeconomic stability. The analysis in this section attempts to explain this paradox.

1. Microeconomic efficiency

Three indicators in particular can be used to compare the performance of banking institutions: *profitability, efficiency and liquidity*. Given that foreign banks did not gain a strong presence in Latin America until the late 1990s, the analysis covers the period 1997-2001. The data refer to the 20 largest banks in terms of total assets

in the countries where the operations of transnational banks were concentrated: Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela. Overall, these 20 banks encompass more than 80% of the system.

In evaluating microeconomic performance, it must be borne in mind that the local banking system has faced

¹⁵ For more information, see Citigroup (undated) and *Business Week* (2002).

¹⁶ For further information, see *Latin Finance* (2000).

strong competition from foreign banks in their drive to gain market share. This has certainly forced the local players, especially the larger ones, to become more efficient. In this regard, it is interesting to consider not only the average performance trend for the two groups, but also deviations from the mean, since they may indicate cases where small entities, too, may have demonstrated a capacity to incorporate new technologies and enhance their performance in a more competitive environment.

(a) Indicators of profitability

For Latin America as a whole, local and foreign banks show no statistically significant differences in profitability¹⁷ (see table III.13), whether measured as the return on assets (ROA) (see figure III.6) or the return on equity (ROE). A similar analysis for each individual country confirms this result.

Table III.13
LATIN AMERICA: INDICATORS OF THE PROFITABILITY OF LOCAL AND FOREIGN BANKS, 1997-2001
(Percentages)

Country	Return on assets						Return on equity					
	Local banks			Foreign banks			Local banks			Foreign banks		
	1997-2001	1997	2001	1997-2001	1997	2001	1997-2001	1997	2001	1997-2001	1997	2001
Argentina	0.8	0.3	1.8	0.3	-0.7	0.3	3.1	2.5	5.9	6.0	2.1	7.4
Brazil	0.9	1.0	0.5	0.7	0.2	0.6	12.3	13.1	5.3	8.5	6.0	7.2
Chile	0.8	1.9	1.0	0.6	0.4	0.7	13.1	12.4	15.8	10.5	6.3	14.2
Colombia	-0.1	1.3	1.0	-0.6	-0.1	0.2	7.4	8.2	9.8	1.4	-2.7	0.2
Mexico	1.2	0.6	2.5	1.2	1.1	1.8	6.9	0.5	9.4	11.2	7.6	14.7
Peru	0.8	0.7	1.2	0.4	-0.2	0.2	7.8	10.6	6.9	4.5	11.0	5.1
Venezuela	2.2	2.2	2.2	1.9	2.1	-	14.9	20.7	2.6	16.2	15.7	.
Average for Latin America	0.9	1.0	1.5	0.6	0.4	0.6	9.4	9.7	7.9	8.3	6.6	8.1

Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of *Latin Banking Guide & Directory* (www.latinfinance.com), August 2002.

After acquiring local institutions, foreign banks took a series of measures which will undoubtedly enhance efficiency and profitability in the future, though they may have raised costs in the short run. In strategic terms, these banks are just beginning to progress from a positioning phase to an increase in profitability.

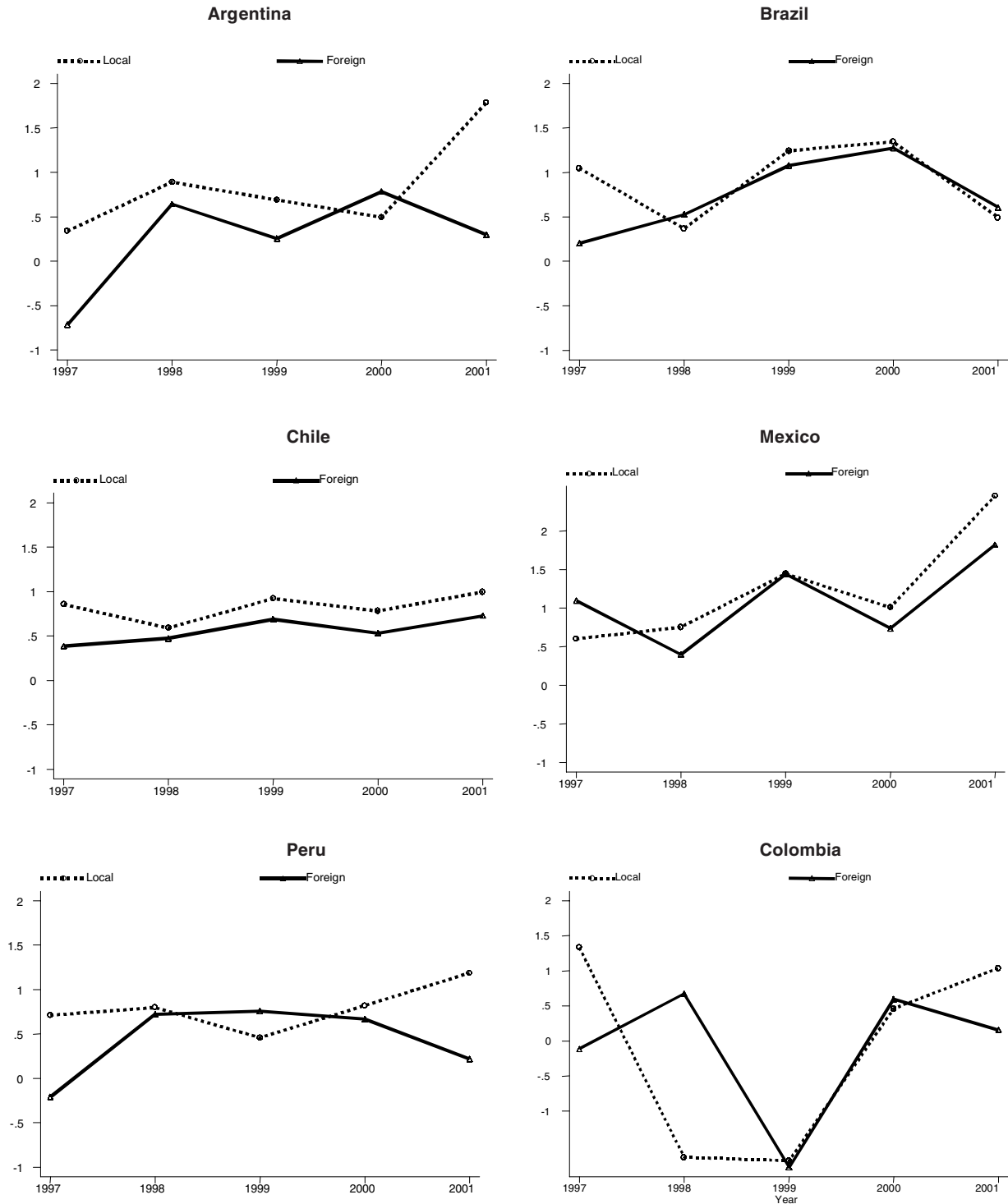
Additional confirmation of the scant difference in profitability between local and foreign banks, whether measured in relation to assets or capital, is found in their similar period-to-period trends, which display a very high

correlation -0.74 on average for the entire set of countries. Nonetheless, variance analysis reveals that there is less dispersion among foreign banks than among local ones; in other words, profitability varies more among local institutions than among their foreign competitors, as is borne out by the available statistics, especially in Argentina, Chile and Mexico. This is probably because local banks are considerably more heterogeneous than their foreign counterparts in terms of size, liquidity, target markets and managerial and technological structures.

¹⁷ This is measured by the probability of overlap between the confidence intervals of the means. The confidence interval considers the standard deviation with respect to the mean for each group, so that the comparison takes into account not only the mean value, but also its dispersion.

¹⁸ At the country level, however, the correlation is very low for Argentina and negative for Peru. Brazil, Chile, Colombia, Mexico and Venezuela, meanwhile, register correlations ranging from 0.46 to 0.92.

Figure III.6
RETURN ON ASSETS: TRENDS BY COUNTRY
(Percentages)



Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of Latin Banking Guide & Directory 2002.

(b) Indicators of efficiency

The analysis in this case is based on two indicators normally used by banking regulators: (i) operating expenses in relation to total income, and (ii) overdue loans

as a percentage of the total loan portfolio. The first of these indicators measures operational efficiency, while the second is a fairly crude approximation to the quality of risk management (see table III.14).

Table III.14
LATIN AMERICA: INDICATORS OF THE EFFICIENCY OF LOCAL AND FOREIGN BANKS, 1997-2001
(Percentages)

Country	Overdue loans/total loans						Operating expenses/total income					
	Local banks			Foreign banks			Local banks			Foreign banks		
	1997-2001	1997	2001	1997-2001	1997	2001	1997-2001	1997	2001	1997-2001	1997	2001
Argentina ^a	10.9	13.0	12.1	5.9	5.8	6.0	79.9	102.1	21.9	85.1	163.9	19.1
Brazil	10.3	5.8	14.1	4.7	1.9	7.4	79.7	84.4	76.3	93.1	115.9	67.2
Chile	1.6	1.0	1.8	1.0	0.4	1.3	82.8	77.9	69.8	65.0	63.7	62.9
Colombia	8.0	5.5	4.0	6.1	4.9	3.7	102.8	82.1	64.6	125.3	92.4	74.5
Mexico	6.2	6.2	6.4	2.0	1.5	2.1	108.6	102.4	73.2	90.3	86.0	63.7
Peru	6.8	4.6	7.7	6.4	4.9	6.4	91.7	83.7	78.2	114.8	106.4	84.9
Venezuela	7.0	3.4	12.2	6.6	2.1	-	73.9	65.3	70.9	75.3	72.0	-
Average for Latin America	7.2	5.7	8.3	4.7	3.1	4.5	88.5	85.4	65.0	92.7	100.0	62.0

Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of *Latin Banking Guide & Directory* (<http://www.latinfinance.com>), August 2002.

^a In the case of Argentina, the figures are for 2000.

Analysis of the data reveals an interesting initial result, namely a general improvement in the operational efficiency of banks during the period studied. In six of the seven countries, both foreign and local banks significantly reduced their ratio of operating expenses to total expenditure.¹⁹ Most of this efficiency improvement has occurred since 2000, which suggests that it may be linked to the banking industry's current processes of rationalizing operations, optimizing human resources and incorporating new technologies and technological platforms. In Argentina, notwithstanding the current financial crisis, local and foreign banks alike achieved steady gains in efficiency between 1997 and 2001. In Brazil, on the other hand, the efficiency of local banks remained relatively unchanged, with only a slight increase in 1999-2001, while foreign banks registered a more substantial improvement. In Colombia, Mexico and Peru, efficiency trended steadily upward in both types of bank starting in 1999.

Although there are no statistically significant differences in risk management between local and foreign banks in terms of overlapping confidence intervals, the coefficient is always lower among the latter. Unlike their local counterparts, foreign banks maintained a relatively healthy loan portfolio on average throughout the period under analysis. This should not be surprising, because most foreign banks were embarked upon an aggressive policy of loan restructuring when they began activities in Latin America, as a key element of their positioning strategy in the region. The policies of SCH and BBVA in Argentina, Brazil, Chile and Mexico are clear examples of this.

When the data are compared over time, however, the percentage of overdue loans in each country's total portfolio shows no sign of decreasing. This is true of national and foreign banks alike and is explained by the region's worsening macroeconomic situation, as a result of which many firms and families have fallen into payment arrears, despite the banks' efforts to improve risk management.

¹⁹ In Chile, foreign banks have been much more efficient than their local counterparts. Nonetheless, competition in the market has forced local banks to cut costs, with the result that this indicator has shown a persistent narrowing of the gap in recent years, to the point where the difference in 2001 was no longer statistically significant.

(c) Indicators of liquidity

The liquidity indicator chosen here is the effective availability of loanable funds as a percentage of total deposits, where effective availability is understood to mean the difference between gross loans and loan loss reserves. The larger this percentage, the greater the risk being incurred by the bank; conversely, the smaller the percentage, the more cautious the strategy being pursued. This is because the indicator serves to measure the bank's level of indebtedness. A larger reserve against loan loss reduces the indicator's numerator, suggesting either that the bank is subject to more stringent regulatory constraints or simply that it expects loan recovery to be more difficult.

The liquidity situation differs across countries (see figure III.7). In Brazil, for example, foreign banks were more liquid than local ones throughout the

period, and increasingly so in 2000 and 2001. The opposite is true in Chile and Mexico, since local banks have a liquidity index that is both higher and more stable (smaller standard deviation) than that of foreign banks.

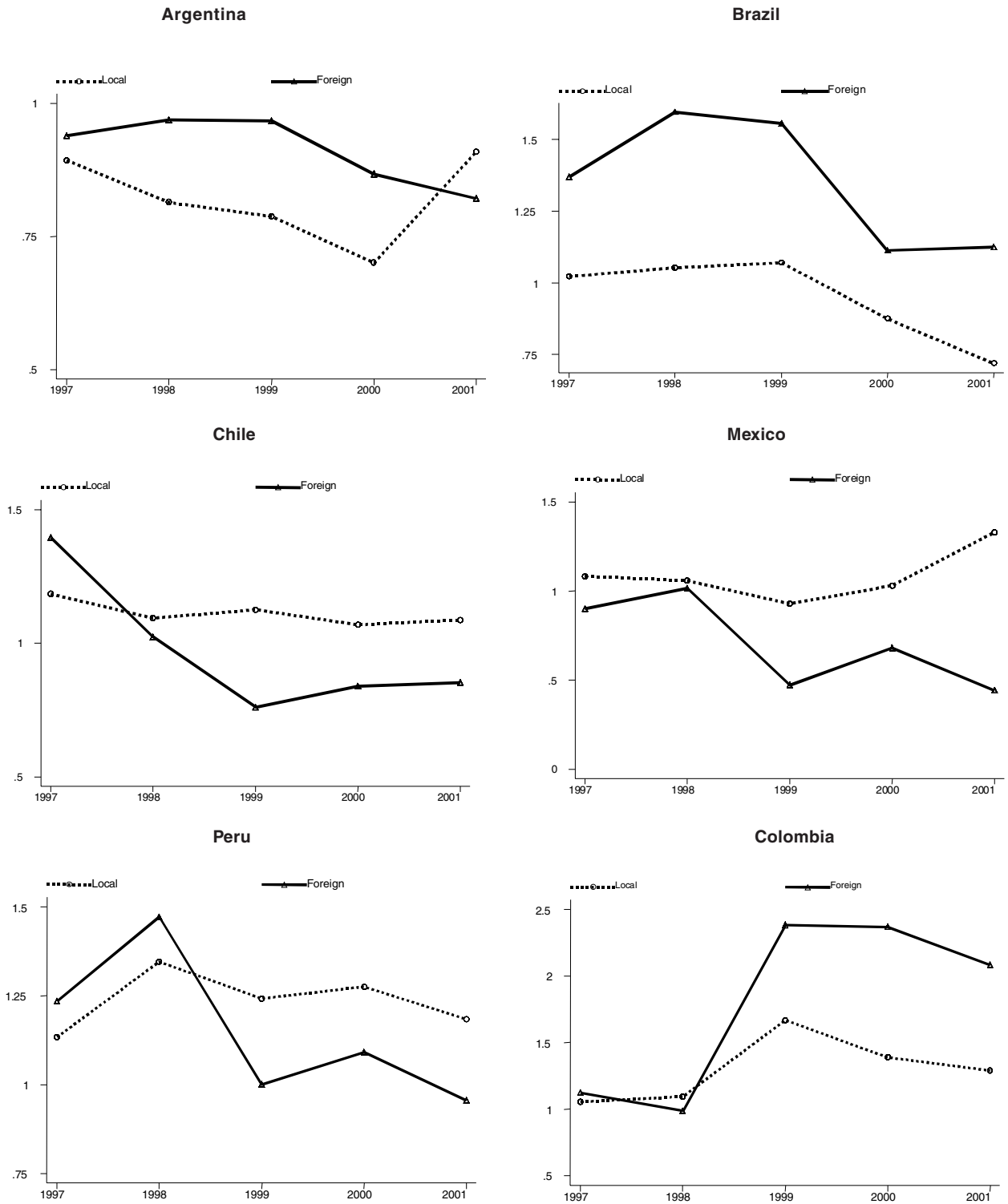
Another interesting phenomenon is the sharp drop in liquidity registered among foreign banks following the Asian and Russian crises (see table III.15). In Argentina the liquidity indicator for all banks declined steadily between 1997 and 1999, and the trend continued until 2001 in the case of foreign banks. Given that, in general, all banks have seen their loan portfolios deteriorate, it is hardly surprising that they have adopted a more prudent policy. Rather than changes in ownership, this attitude seems to reflect a more uncertain economic climate. This leads up to the final point in the analysis, namely the macroeconomic effectiveness of foreign banks in the region.

Table III.15
LIQUIDITY INDICATOR: EFFECTIVE AVAILABILITY OF LOANABLE FUNDS IN RELATION TO TOTAL DEPOSITS, 1997-2001
(Ratio)

	Local banks			Foreign banks		
	1997-2001	1997	2001	1997-2001	1997	2001
Argentina	0.8	0.9	0.9	0.9	0.9	0.8
Brazil	1.0	1.0	0.7	1.4	1.4	1.1
Chile	1.1	1.2	1.1	1.0	1.4	0.9
Colombia	1.3	1.1	1.3	1.9	1.1	2.1
Mexico	1.1	1.1	1.3	0.7	0.9	0.4
Peru	1.2	1.1	1.2	1.1	1.2	1.0
Venezuela	0.7	0.7	1.1	0.7	0.7	-
Average for Latin America	1.0	1.0	1.1	1.1	1.1	1.0

Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of *Latin Banking Guide & Directory* (www.latinfinance.com), August 2002.

Figure III.7
TREND OF LIQUIDITY INDEX IN EACH COUNTRY BY TYPE OF BANK, 1997-2001



Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of *Latin Banking Guide & Directory*, 2002.

2. Macroeconomic impact

The microeconomic analysis shows that, while foreign banks do not differ significantly from local ones in an operational sense, they do act much more prudently in assessing and managing risk, as shown by the fact that they make significantly higher provision against losses than local banks. This is a genuine benefit for the region. Nonetheless, a microeconomically sounder banking system is not necessarily more conducive to economic development. Greater macroeconomic effectiveness would serve this purpose only if foreign banks were indeed helping to improve (or mitigate) bad credit conditions in other words, if they improved the existing supply, cost and maturity conditions of financing. Despite constraints in relation to the availability of data and the period of analysis, an attempt will be made to evaluate this in the present section.

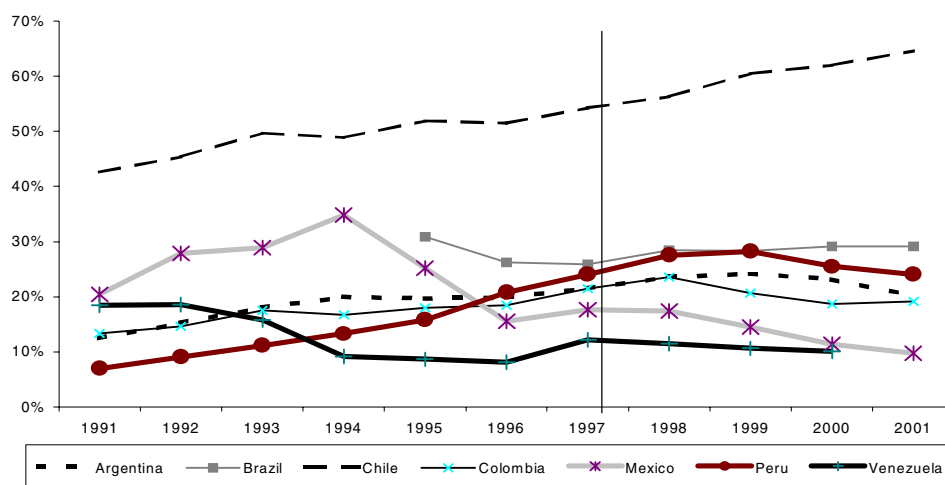
(a) Foreign banks and the aggregate supply of credit

The late 1990s, when international banks strengthened their position in Latin America, were

particularly inhospitable years for the expansion of banking activities as a result of the slower growth and instability that followed in the wake of the Asian crisis. Powerful external shocks (financial problems and a loss of trade momentum), compounded by the corresponding domestic responses, nearly always resulted in monetary tightening. Given the wider spreads and higher capital costs that such policies usually entail, a vicious circle tends to be generated in terms of credit risk (because of greater insolvency) and the attitude taken by the banks, which necessarily become more conservative. In some countries, such as Argentina and Ecuador, the period was also characterized by banking crises.

It is no surprise, therefore, that in many Latin American countries the process of credit deepening (extension of higher volumes to broader sectors of the population) has stalled since 1997. As shown in figure III.8, which considers seven countries, in all of them except Chile the ratio of private credit to GDP was lower in 2001 than it had been in 1998, when it was already quite low.

Figure III.8
LATIN AMERICA (SELECTED COUNTRIES): RATIO OF CREDIT TO GDP,
1991-2001
(Percentages)



Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of International Monetary Fund (IMF), *International Financial Statistics*, Washington, D.C., June 2002.

In fact, the credit standstill seems even more troubling in view of the average interest rates being charged on loans in those countries (see table III.16), because part of the variation in loans is accounted for by the renewal of existing credit (rollover). A situation where the rate of variation in loans is less than the average interest rate charged in the system could suggest that the

supply of credit has effectively contracted; in other words, the volume being rolled over does not include the payment needed for debt service, so the effective availability of financing for expenditure is correspondingly less. In 2001 there were signs of this phenomenon in several countries of the region (see ECLAC, 2002).

Table III.16
LATIN AMERICA (SELECTED COUNTRIES): VARIATION IN LENDING TO THE PRIVATE SECTOR IN CONSTANT 1998 VALUES, AND REAL INTEREST RATES, 1997-2001
(Percentages)

	Real variation in credit		Real interest rates on loans		
	1997-2000	2000-2001	1997-2000	2000	2001
Argentina	1.4	-17.6	11.0	12.7	29.0
Brazil	11.4	14.4	66.6	48.1	46.4
Chile	6.8	9.1	11.0	9.7	9.5
Colombia	-1.5	12.9	16.1	9.5	11.9
Mexico	-4.2	-7.5	9.6	9.4	8.6
Peru	4.2	-2.6	23.8	23.2	21.4
Venezuela	0.2	26.4	6.1	11.2	9.0

Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of International Monetary Fund (IMF), *International Financial Statistics*, Washington, D.C., June 2002.

In some countries the situation is particularly alarming. In Mexico, for example, the real supply of credit has fallen almost continuously since the "tequila" crisis of 1994, dropping from 35% of GDP in that year to about 10% in 2001, as the banks have been engaged in an ongoing process of writing off the large number of impaired loans (see IMF, 2001, pp. 29-45). A substantial proportion of the financing for domestic activity in

Mexico consists of supplier credits and external loans. Moreover, the restructuring of the banking system led to the vigorous entry of foreign banks (see box III.6), with the result that foreign banks now have a bigger share of the market in Mexico than in any other country of the region. Even so, given the negative impact of the retrenchment in the United States economy, bank credit has not yet shown signs of recovery.

Box III.6
**FOREIGN BANKS DOMINATE THE MEXICAN BANKING SYSTEM,
 BUT CREDIT FAILS TO RECOVER**

The Mexican banking sector was reprivatized in the early 1990s, in a process that involved Mexican shareholders. As foreign ownership of banks was limited by law to no more than 20% at that time, transnational financial corporations chose to maintain a presence exclusively through representation offices. The new owners of the banks came from the management of Mexican stock market firms, and had virtually no experience in lending and risk analysis. This, combined with regulatory and supervisory shortcomings, magnified the financial crisis and economic recession that befell the country in late 1994 and 1995.

The need to recapitalize the banking system, together with the signing of NAFTA, prompted major institutional changes in the Mexican financial system, including the removal of obstacles to the entry of foreign banks. By signing NAFTA, Mexico had undertaken to open up the financial sector to international competition (albeit in different ways for different intermediaries), and this meant allowing participation by foreign capital in local banking institutions. The process occurred in two stages: up to 1998, foreign ownership of a bank's

equity was limited to 50%, but the limit was completely lifted thereafter, fully liberalizing the sector.

This liberalization occurred as part of an overall restructuring of the banking sector, which had been severely weakened by the "tequila" crisis and by a massive non-performing portfolio. To promote capitalization of the banking sector, the State took over the non-performing portfolio, amounting to some US\$ 120 billion. This was managed by the Bank Savings Protection Fund (FOBAPROA), which later became the Bank Savings Protection Institute (IPAB). The fund was recognized as public debt guaranteed by the State, on which the latter has paid interest on the order of 40% a year up to the present time –first to local banks and then to foreign ones.

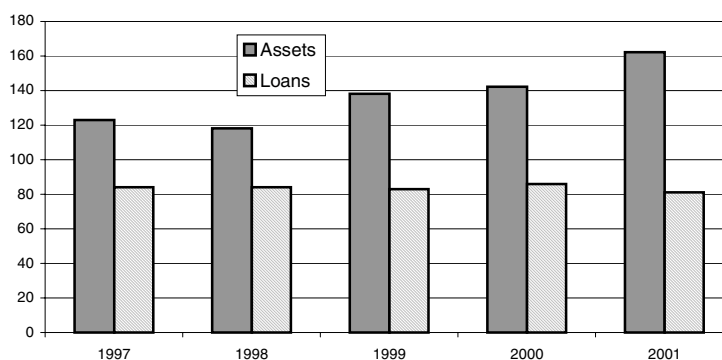
The sale of local banks to foreign banks involved large sums of money. In 2000, BBVA paid US\$ 1.75 billion to acquire Bancomer. Its rival SCH purchased Serfin for US\$ 1.56 billion in 2001, and Citigroup paid a colossal US\$ 12.5 billion for Banco Nacional de México (BANAMEX). The final entrant, HSBC Holdings, paid US\$ 1.14 billion in August 2002 for the Bital financial group, the fourth-largest player in the Mexican financial system. As these

amounts went straight into the hands of the banks' former shareholders, the process did nothing to reduce the banks' debt, which the State had to assume in order to bail out the system.

Foreign banks have had access to cheaper funds than local banks, but this has not resulted in a credit expansion or lower costs for Mexican firms. The fact that domestic banks have been acquired by foreign ones has not altered their oligopolistic position or their risk aversion, and they continue mainly to live off the high yields obtained on risk-free assets such as public bonds. This means that their rent-seeking relationship with the State has not changed.

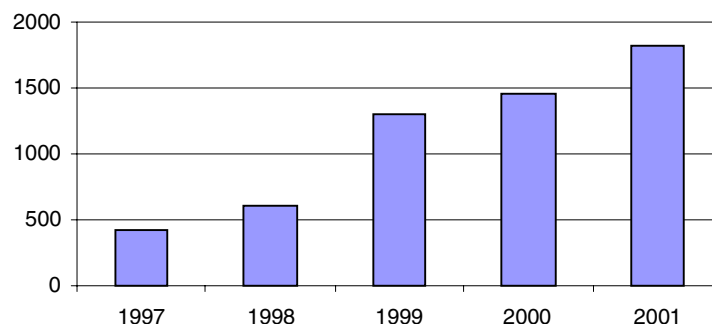
The banks' profits grew rapidly following their acquisition by foreign institutions (see figures III.9 and III.10). Although the yield on public bonds has fallen sharply (in 2002 it dropped below 10%), the banks, instead of lending to firms or families, have raised their service commissions to shore up their profitability. Their unwillingness to expand credit is based on their fear of bankruptcies and their doubts that bankruptcy legislation will be effectively enforced.

Figure III.9
ASSETS AND LOANS IN THE MEXICAN BANKING SYSTEM, 1997-2001
 (Billions of dollars)



Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of *Latin Finance*, September 2002; and *Latin Banking Guide & Directory* (www.latinfinance.com), September 2002.

Figure III.10
NET INCOME OF THE MEXICAN BANKING SYSTEM, 1997-2001
(Millions of dollars)



Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of *Latin Finance*, September 2002; and *Latin Banking Guide & Directory* (www.latinfinance.com), September 2002.

The situation in Argentina was highly unsatisfactory even before the upheaval of 2001. Lending began to stall in the period between the Asian and Russian crises, and the situation worsened in the ensuing years. Between 2000 and 2001 lending fell by nearly 18%, and the system collapsed completely following the abolition of the convertibility regime and the implementation of the freeze on bank deposits known as the “corralito” (little fence).

In general, the credit standstill is directly related to the more cautious attitude being taken by banks, especially foreign ones. Viewed in the light of the portfolio distribution of banks in the region, the credit crunch is not surprising: in three countries (Argentina, Brazil and Chile), there has been a reduction in the share of loans in total bank assets, local and foreign alike, reflecting the fact that banks have sought lower-risk assets, such as government bonds. In Mexico and Colombia, loans declined in relation to total assets in local banks, but not in their foreign counterparts.

(b) Spreads and the cost of credit

With regard to bank intermediation, although spreads narrowed between 1997 and 2002 in nearly all the Latin American countries (see table III.17), spreads have remained large, resulting in average interest rates that are far above international levels. In Brazil, for example, spreads remain above 30%, with lending rates of over 40%, even though the Central Bank has implemented an explicit policy since 1999 to reduce spreads through lower compulsory reserve requirements and measures to increase competitiveness and transparency, among others. Despite the significant increase in foreign-bank participation in the region, only two of the seven countries analysed (Chile and Venezuela) had spreads of 6% or less in 2002, but even this was far above the average in OECD and Asian countries (see table III.17).

Table III.17
LATIN AMERICA (15 COUNTRIES): BANK INTERMEDIATION SPREADS, 1997-2002
 (Percentages)

	Deposit rates		Spreads		Lending rates	
	1997	2002	1997	2002	1997	2002
Argentina	7.0	40.9	2.1	10.8	9.2	56.2
Bolivia	14.7	9.3	30.8	10.5	50.1	20.8
Brazil	24.4	18.6	43.3	36.2	78.2	61.5
Chile	12.0	3.9	3.3	3.8	15.7	7.9
Colombia	24.1	9.2	8.1	6.8	34.2	16.5
Costa Rica	13.0	11.3	8.4	13.5	22.5	26.3
Ecuador	28.1	5.4	11.7	9.2	43.0	15.1
Guatemala	5.8	7.0	12.1	9.3	18.6	16.9
Honduras	21.3	14.1	8.9	7.7	32.1	22.9
Mexico	14.7	2.9	8.6	6.3	24.5	9.3
Panama	7.0	5.0	3.4	5.2	10.6	10.5
Paraguay	13.0	22.5	13.1	9.4	27.8	34.0
Peru	15.0	4.1	13.0	10.2	30.0	14.7
Uruguay	19.6	33.5	43.3	64.9	71.6	120.1
Venezuela	14.7	29.3	7.8	5.9	23.7	36.9
Simple average						
Latin America	15.6	14.5	14.5	14.0	32.8	31.3
Weighted average						
Latin America	18.6	14.6	21.6	18.4	45.0	36.3
Simple average OECD ^a		0.1		3.7		3.8
Simple average Asia ^b		1.9		3.5		5.4

Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of International Monetary Fund (IMF) *International Financial Statistics*, Washington, D.C., June 2002.

^a Sample consists of Germany, Italy, Japan, Netherlands, Spain, Switzerland and United States.

^b Sample consists of Indonesia, Malaysia, Philippines, Republic of Korea, Singapore and Thailand.

Except in the case of Brazil, there are no available data that distinguish between foreign and local banks in terms of spreads, although there are signs that they are quite similar. In Brazil, the spreads of local and foreign banks not only are very similar, but also follow the same trend over time.

While it is significant that spreads have tended to narrow in recent years, their magnitude is still out of

proportion to changes in costs as a result of portfolio risk. One indicator of this –the ratio between provisions for doubtful loans and non-performing loans– rose only slightly (by 0.5 percentage points, on average) between 1997 and 2001, despite the Argentine crisis and its potential for spreading contagion.

Table III.18
LATIN AMERICA: RATIO BETWEEN PROVISIONS FOR DOUBTFUL LOANS AND NON-PERFORMING LOANS, 1997-2001
 (Percentages)

	Local banks			Foreign banks		
	1997-2001	1997	2001	1997-2001	1997	2001
Argentina	2.7	0.7	4.2	1.9	0.8	5.1
Brazil	1.4	1.7	0.7	1.6	1.8	0.6
Chile	2.1	2.7	1.8	2.7	2.9	1.6
Colombia	0.8	0.5	2.1	1.0	0.5	1.8
Mexico	1.8	1.3	2.8	2.5	1.0	1.6
Peru	1.2	1.4	1.4	1.2	1.0	1.4
Venezuela	1.7	2.5	1.4	1.8	2.0	-
Average for Latin America	1.7	1.5	2.0	1.8	1.4	2.0

Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of *Latin Banking Guide & Directory* (www.latinfinance.com), 2002.

To summarize, the entry of foreign banks has not had a significant effect on the cost of capital, since, in all banks, this cost responds more to the macroeconomic climate than to differences in cost management. Foreign banks seem to be adapting to regional circumstances rather than imposing their own dynamic on the determination of capital costs.

(c) Stability of the banking sector

In evaluating the impact of foreign banks on the macroeconomic effectiveness of the region's banking systems, it is also useful to employ a different criterion, namely the variable represented by stability. Before the arrival of foreign banks, much was said about their probable benefits in terms of making the local financial system less fragile. At least three arguments were deployed: (i) foreign banks would have more sophisticated risk-management systems as a result of the more rigorous supervision in force in their countries of origin; (ii) they would be less vulnerable to domestic cycles in the region because their effective exposure to them would be relatively small in relation to their broad global diversification; and (iii) local subsidiaries of foreign banks could always rely on their parent companies in the event of abrupt swings in liquidity.

Considering only indicators of risk management and provision against losses, it is clear that the foreign banks have helped to create a sounder banking system. Nonetheless, as Stallings and Studart (2001) argue, the violent macroeconomic shocks of recent years rendered even the most sophisticated monitoring and risk management systems ineffective. In fact, in highly unstable macroeconomic situations, such systems may even aggravate risk, given their well-known procyclical properties.²⁰ Accordingly, it is not surprising that foreign banks, which generally have more sophisticated (and more conservative) risk evaluation systems than their local counterparts, have reacted much more strongly than the latter to economic cycles.

As regards the argument that the global diversification of foreign banks has a positive effect on stability, the other side of the coin is that these banks are much more sensitive than local ones to expectation shocks originating in the advanced economies. For this

reason, to the extent that transnational banks have increased their exposure to the region's economies (BIS, 2000), their local subsidiaries have adopted an increasingly cautious stance.

Lastly, in response to the argument that foreign banks can count on unconditional support from their parent companies at times of liquidity loss, two comments need to be made. Firstly, the parent company's capacity to support its subsidiaries is compromised by the fact that it has to maintain, in its country of origin, a level of capital compatible with the weighted risk of its assets. This is because episodes of financial crisis in an emerging country are usually reflected in its "country-risk" rating, and any contribution from the parent company has to represent an expansion of its global capital. As seen recently in the Argentine crisis, this severely restricts the ability of parent companies to supply funds at times of major macroeconomic uncertainty and/or liquidity crisis in emerging economies.

Secondly, there are provisions in financial system regulations that do not allow banks to support the liquidity of an ailing subsidiary under certain circumstances. For example, United States legislation, provides that a bank is not required to repay any deposit made in a foreign branch of the bank if the branch cannot do so due to: (i) an act of war, insurrection or civil strife; or (ii) an action by the government of the host country, unless the bank has expressly agreed in writing to repay the deposit under those circumstances. This law was added to existing legislation in 1994, after Citibank was taken to court by depositors in the Philippines and Vietnam and lost the respective cases.

In short, the banking system's macroeconomic effectiveness has been profoundly impaired by the current macroeconomic climate, which is extremely unfavourable for banking activity. This climate has given rise to a more cautious attitude on the part of the banks, which, in turn, has led to a credit standstill, the maintenance of very large spreads and a shortening of loan maturities. In order to avoid greater losses as a result of macroeconomic instability in the region (especially in countries that have suffered currency crises similar to that of Argentina), foreign banks have adopted a more conservative stance, as shown by their maintenance of high liquidity and, therefore, relatively low lending levels.

²⁰ As Borio, Farfine and Lowe (2001) show, the banking system's procyclical nature stems from the fact that most risk evaluation systems work with a time horizon that is too short to allow them to accurately determine default risks and correctly value the financial and real assets used as collateral. Accordingly, at times of economic retrenchment, risk indicators tend to rise very sharply, while the value of assets posted in guarantee declines. As a result of these two movements, the banking system as a whole tends to behave more cautiously, giving rise to a contraction in credit or a slowdown in its growth, which, in turn, ultimately generates a vicious circle. As the macroeconomic situation becomes more volatile, credit risk is evaluated more cautiously, so that the system's procyclical nature is intensified.

E. CONCLUSIONS

The major presence of transnational banks in Latin America in the 1990s was due partly to their strategy of seeking markets throughout the world and partly to changes in the region's economic climate and institutional context. Regional penetration has produced costs and benefits for both investor banks and the financial systems concerned.

The macroeconomic stability prevailing in the region in the first half of the 1990s, together with low rates of inflation and first-generation reforms, especially in the financial system and the capital market, attracted banks that needed to generate economies of scale and grow on a global basis. In addition, the "tequila" crisis and its contagion to several of the region's countries forced governments to tighten regulation and supervision. This led to the establishment of regulatory frameworks that were similar to those existing in developed countries, thereby facilitating dialogue between the authorities and foreign banks.

Governments believed the entry of foreign banks would afford an opportunity to capitalize the system and, at the same time, would act as a bulwark against systemic risk. Foreign banks were thought to be better equipped than local ones to face future crises or contagion processes because they had portfolios that were diversified across different regions and continents, together with strong capital support from the parent companies. They would also give greater security to depositors, who would flock to them in a "flight to quality" in times of crisis. Of course, technological advances, both in management and in dealing with risk, were also considered important for enhancing the efficiency of the region's financial system.

This liberalization process coincided with the globalization on which transnational banks were already embarked, under either universalization or investment-banking strategies. Although the regional capital market was extremely underdeveloped, the reform and privatization process of the 1990s lured transnational financial firms, which created a demand for new products (such as securitized instruments and derivatives). In addition, pension-system reforms generated excellent profit opportunities in fund management.

This new climate encouraged the entry of foreign banks, which came to dominate the region's financial markets within the short span of five years. The global institutions that expanded in the region were not those that had historical roots there, however. A notable feature of the process was the scant interest shown by United

States banks in entering the region –in contrast to European banks, particularly Spanish ones. Several factors help explain this: firstly, the consolidation process in which the United States banking system was engaged; secondly, the emphasis placed on expansion strategies in the European Union; and thirdly, the uncertainty caused by the region's historical instability. This contrasted with the Spanish banks' urgent need to expand in order to strengthen their competitive capacity, take advantage of economies of scale and defend themselves against hostile attacks from rival banks. Entry barriers prevented them from achieving this in Europe, but Latin America gave them the opportunity they needed.

Nonetheless, the aggressive entry of Spanish banks and the success of their incursions into new market segments that had not yet been explored by the local banking system encouraged banks from the United States, especially Citigroup, to expand their participation in the region. This process began in 2001 with the acquisition of BANAMEX, one of Mexico's largest banks.

By early 2002, three large foreign players –SCH, BBVA and Citigroup– were operating in the medium-sized and large countries of the region, covering all segments of the financial market by providing universal services, and jointly accounting for 64% of foreign-bank activity in Latin America. The remaining firms were concentrated solely in large markets, or else operated exclusively in the corporate segment and the capital market.

Regional expansion yielded numerous benefits for foreign banks, but it also entailed costs. In terms of benefits, up until 2001, when the Argentine crisis broke out, foreign banks grew steadily and gained a significant share of local banking systems, which ranged from 34% in Colombia to 90% in Mexico in 2001. A decade earlier, Chile had been the country with the greatest foreign participation, which, however, had accounted for less than 20% of the market at that time. In addition, the profitability of foreign banks' activities in the region, whether measured by the return on assets or the return on equity, grew steadily and in some cases exceeded the bank's overall profitability. At the same time, foreign banks expanded their participation in the capital market, especially in pension fund management, one of the most attractive businesses for financial institutions.

Costs arose from various sources, including the region's instability and its vulnerability to external shocks and currency crises. Moreover, in many cases, notably that of Brazil, foreign banks underestimated the local

competition. The Argentine crisis clearly marked a turning point in foreign banks' expansion strategy, although the cost of this crisis for each bank depended on the importance of Latin America, and particularly Argentina, in its global business. At one extreme were the Spanish banks, whose interests in the region represented between 26% and 29% of their total assets; at the other were banks that only expanded in the treasury management or corporate banking segments; and in the middle was Citigroup, whose global diversification prevented it from being seriously affected by the deterioration in regional conditions, even though its interests in the region amounted to a not insignificant 7% of its total assets.

Excluding losses in Argentina, which cannot be evaluated as yet, the deterioration in regional conditions has had a series of consequences for foreign banks, which can be measured by a number of factors. In the first place, there was a drop in profitability, although it was only significant in banks that had major investments in Argentina and little regional diversification. Secondly, future business prospects changed drastically; as expectations of rapid growth faded and exchange rates became more volatile, projections of future profitability slumped. This effect was compounded by political instability in several countries of the region. Lastly, Argentina's difficulties led to a breakdown in the rules of the game in that country and raised the spectre of regional contagion, all of which served to heighten investment risk.

This prompted banks to exercise much more caution in taking decisions or, in extreme cases -particularly those of banks without major investments in the region- to pull out of Latin America entirely. Nonetheless, the large investors, especially SCH, BBVA and Citigroup, maintain a long-term vision whose prospects have persuaded them to defend the market positions they have gained thus far by rationalizing spending (for which purpose, in particular, they have pressed ahead in implementing regional technological platforms) and awaiting the consolidation and greater concentration of the regional banking system. All of this reflects their conviction that expansion in Latin America, crises notwithstanding, has been positive for their global growth strategy.

The analysis also shows that, while foreign banks do not differ significantly from local ones in terms of operational efficiency, they do act more cautiously in evaluating and managing risk. Nonetheless, the fact that there is no statistically significant efficiency gap between local and foreign banks does not mean that the latter have had no positive impact in the region. Clearly, the

competition generated by the entry of foreign banks has galvanized efforts by local banks to cut costs and enhance profitability in order to protect themselves from being driven out of the market. In fact, despite the oligopolistic nature of the industry, competition nowadays between large local banks and foreign ones is very strong. An interesting feature of the financial sector is that all competitors have access to state-of-the-art technology. Because it is relatively cheap, it is not exclusive to foreign banks, thanks to the progress made in information and communication technology, which the financial system uses particularly intensively. Nonetheless, in all but a few countries -Chile, for example- the cost reduction generated by technological progress has not been passed on in the form of cheaper financial services for either firms or individuals. Worse still, it has not given firms easier access to credit.

Accordingly, the positive outcome for the region in terms of microeconomic efficiency stands in contrast to the macroeconomic impact -i.e., the effectiveness of foreign-bank participation in the system-, as measured by the conditions under which credit is extended, the availability of business financing and the stability of the system. From this analysis, it may be concluded that foreign banks have not had a significant effect in this regard: they are more cautious than their local counterparts when extending credit, and their response to crises is clearly procyclical, all of which intensifies the effects of monetary tightening. Despite these banks' managerial efficiency, interest-rate spreads narrowed in only four of the seven countries analysed, and even in those four they remained extremely high -far above those in Asia and, of course, those in the OECD countries. Spreads have reacted more to the macroeconomic environment than to differences in cost management, and foreign banks seem to be adapting to regional circumstances in this regard, rather than imposing their own dynamic on the processes that determine the cost of capital.

Lastly, in terms of reactions to systemic crises, the experience of recent years has shown that the behaviour of transnational corporations towards their subsidiaries and branches depends on a number of factors: the institutional framework in the corporation's country of origin, the institutional framework in the host country and the steps taken by local authorities to deal with crises. In practice, the parent companies of foreign banks cannot be considered lenders of last resort; their behaviour in times of crisis has depended on the nature of the problems faced by banks in the host country and the type of establishment in question.



ANNEX

Table III.A.1
THE 50 LARGEST BANKS IN LATIN AMERICA, RANKED BY ASSETS, 2001
 (Percentages)

	Country	Ownership	Return/ assets	Return/ equity	Non- performing loans/total portfolio	
1	BANCO DO BRASIL	Brazil	State	0.7	12.4	5.6
2	BRADESCO	Brazil	Local private	2.0	22.2	3.9
3	BANCOMER BBVA	Mexico	Foreign private	1.4	40.8	4.8
4	CAIXA ECONÓMICA FEDERAL	Brazil	State	-4.6	-120.5	12.5
5	BANAMEX CITIBANK	Mexico	Foreign private	0.1	3.3	5.5
6	ITÁU	Brazil	Local private	2.9	31.5	5.0
7	SANTANDER/(SCH)	Chile	Foreign private	0.7	25.5	1.4
8	UNIBANCO	Brazil	Local private	1.7	16.0	5.9
9	NACIÓN	Argentina	State	-0.2	-1.9	27.7
10	SERFIN SANTANDER	Mexico	Foreign private	2.4	30.2	0.7
11	BITAL	Mexico	Foreign private	0.3	27.3	7.3
12	SANTIAGO	Chile	Foreign private	1.3	28.3	1.4
13	REAL ABN-AMRO	Brazil	Foreign private	2.5	20.8	4.3
14	BANCOESTADO	Chile	State	0.4	11.0	1.7
15	PROVINCIA DE BUENOS AIRES	Argentina	State	0.1	0.9	0.4
16	SANTANDER BANESPA	Brazil	Foreign private	3.7	36.4	15.0
17	SAFRA	Brazil	Local private	1.4	22.2	2.5
18	J.P. MORGAN CHASE BANK	Chile	Foreign private	0.0	0.7	...
19	SANTANDER MEXICANO	Mexico	Foreign private	1.4	15.3	0.5
20	MERCANTIL DEL NORTE (BANORTE)	Mexico	Local private	0.5	9.2	3.1
21	GALICIA Y BUENOS AIRES	Argentina	Foreign private	1.2	9.1	6.8
22	CHILE	Chile	Local private	1.2	27.9	2.4
23	SANTANDER BRASIL	Brazil	Foreign private	-0.3	-5.1	5.7
24	BANKBOSTON	Chile	Foreign private	0.1	8.5	...
25	HSBC	Brazil	Foreign private	0.4	8.5	9.6
26	CITIBANK N.A	Brazil	Foreign private	2.7	21.1	3.9
27	NOSSA CAIXA	Brazil	State	1.4	22.5	5.8
28	RÍO DE LA PLATA, SANTANDER	Argentina	Foreign private	-0.1	-1.0	2.4
29	SCOTIABANK INVERLAT	Mexico	Foreign private	0.7	22.7	9.8
30	BCI	Chile	Local private	0.9	23.8	1.5
31	CITIBANK	Chile	Foreign private	0.6	15.1	...
32	FRANCÉS BBVA	Argentina	Foreign private	-0.1	-0.9	4.0
33	SUDAMERIS	Brazil	Foreign private	0.9	13.9	8.6
34	CITIBANK S.A.	Brazil	Foreign private	0.8	10.8	1.1
35	CRÉDITO NACIONAL	Brazil	Local private	1.6	22.2	...
36	BANKBOSTON	Argentina	Foreign private	-0.3	-3.6	8.2
37	CITIBANK	Argentina	Foreign private	0.0	0.4	16.2
38	A. EDWARDS	Chile	Local private	0.2	4.4	...
39	BBA-CREDINTANSTALT	Brazil	Local private	1.3	16.3	1.9
40	BANKBOSTON S.A	Brazil	Foreign private	3.5	36.6	2.6
41	BLADEX	Panama	Local private	0.0	0.4	8.9
42	BBVA	Brazil	Foreign private	0.2	2.4	3.6
43	INBURSA	Mexico	Local private	2.2	9.1	2.4
44	BBVA (BHIF)	Chile	Foreign private	0.4	6.5	2.1
45	VOTORANTIM	Brazil	Local private	1.4	24.8	0.0
46	HSBC	Argentina	Foreign private	-0.7	-10.6	12.5
47	BANCO DE CRÉDITO	Peru	Local private	1.1	9.8	7.2
48	ABN AMRO	Chile	Foreign private	0.5	28.4	...
49	BANKBOSTON N.A	Brazil	Foreign private	1.8	37.9	0.8
50	BANCO DO NORDESTE, BNB	Brazil	State	-24.3	-247.1	39.2

Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of *Latin Trade* magazine, September 2002 (figures as of 31 December 2001), as regards the ratio between profits and assets and between profits and equity; and on the basis of *América Economía* magazine, 1-14 November 2002 (data as of June 2002), as regards the ratio between non-performing loans and the total loan portfolio.

Table III.A.2
FOREIGN BANK SHARE OF THE LEADING LATIN AMERICAN FINANCIAL MARKETS, 2001
(Percentages)

	CITIBANK	SANTANDER	BBVA	SCOTIABANK	FLEET- BOSTON	HSBC	ABN	AMRO SUDAMERIS	OTHER	TOTAL FOREIGN
SHARE OF TOTAL FINANCIAL ASSETS										
Argentina	6.2	8.2	7.0	2.6	7.6	4.3		1.6	23.9	61.3
Brazil	2.0	3.8	2.3		1.5	3.0	3.6	0.1	32.2	48.5
Chile	5.1	11.6	4.3	2.3	6.2	0.5	2.4	0.6	29.3	62.3
Colombia	5.0	4.2	7.5		1.2		1.2		13.3	33.6
Mexico	25.5	14.6	25.9	2.7	0.8	0.3	0.0		20.1	90.0
Peru	3.9	6.7	14.7	3.1	1.6			21.4	9.6	61.0
Venezuela	3.0	22.3	14.4	3.1					15.9	58.7
Average (7 countries)	7.3	10.2	10.9	2.8	3.2	2.0	1.8	5.0	20.6	63.6
SHARE OF TOTAL LOANS										
Argentina	6.2	8.3	4.3	2.2	5.8	0.0		1.8	14.3	42.8
Brazil	1.2	2.5	1.2		1.8	2.5	4.0	2.0	9.3	24.6
Chile	3.9	17.8	3.7	3.4	1.7	0.2	0.9	0.3	4.2	36.0
Colombia	5.5	0.0	6.2		0.7		0.9	1.4	4.8	19.6
Mexico	25.0	14.5	13.7	0.6	0.2	0.1	0.0		1.7	55.8
Peru	4.4	7.4	5.5	1.2	1.9			9.5	8.0	37.9
Venezuela	5.0	17.0	9.5	1.2					5.3	37.9
Average (7 countries)	7.3	9.6	6.3	1.7	2.0	0.7	1.5	3.0	6.8	39.0
SHARE OF TOTAL DEPOSITS										
Argentina	5.0	8.6	5.9	2.1	5.7	3.6		2.0	10.0	42.8
Brazil	0.0	3.0	1.2		0.0	2.8	2.4	1.3	5.9	16.5
Chile	3.8	18.2	3.2	3.2	1.8	0.2	0.9	0.4	7.8	39.6
Colombia	4.4	2.0	6.1		0.6		0.9	0.6	2.5	17.1
Mexico	25.7	14.5	14.1	0.3	0.9	0.3	0.0		2.5	58.4
Peru	3.6	5.7	7.9	0.7	1.0			9.7	8.62	37.2
Venezuela	0.0	18.8	9.1	1.0					7.5	36.4
Average (7 countries)	6.1	10.1	6.3	1.5	1.7	1.7	1.1	2.8	6.3	37.6
SHARE OF TOTAL CAPITAL										
Argentina	4.7	7.3	4.5	1.1	4.6	2.4		1.4	14.2	40.3
Brazil	0.7	5.8	0.8		0.5	1.7	0.4	1.4	18.5	29.8
Chile	6.6	16.8	0.0	2.6	2.1	0.8	2.5	0.6	14.4	46.4
Colombia	5.9	2.1	7.5		0.9		0.8	0.7	3.7	21.5
Mexico	31.5	9.8	12.9	3.6	0.5	0.5	0.0		4.7	63.5
Peru	0.5	6.4	5.3	0.7	1.3			10.1	12.1	36.4
Venezuela	3.8	22.1	8.2	0.9					6.3	41.3
Average (7 countries)	7.7	10.0	5.6	1.8	1.2	0.7	1.0	2.8	10.6	41.3

Source: Salomon Smith Barney, *Foreign Financial Institutions in Latin America, 2001 Update*, New York, November 2001.

Table III.A.3
MAIN ACQUISITIONS IN THE LATIN AMERICAN FINANCIAL SECTOR
(Percentages and millions of dollars)

Date	Bank acquired	Country	%	Amount
ABN AMRO Bank, Netherlands				
1998	Banco Real	Brazil	40	2 100
1998	Banco Mercantil de Pernambuco	Brazil	100	153.6
Banco Bilbao Vizcaya Argentaria (BBVA), Spain				
2002	Grupo Financiero Banco Bilbao Vizcaya Argentaria Bancomer (BBVA Bancomer)	Mexico	3	216
2002	BBVA Banco Uruguay (BBVA Banco Francés Uruguay)	Uruguay	60	55
2001	Grupo Financiero Banco Bilbao Vizcaya Argentaria Bancomer (BBVA Bancomer)	Mexico	7	546
2001	BBVA Banco Ganadero	Colombia	14.4	70
2001	Grupo Financiero Banco Bilbao Vizcaya Argentaria Bancomer (BBVA Bancomer)	Mexico	9	548
2000	Grupo Financiero Banco Bilbao Vizcaya Argentaria Bancomer (BBVA Bancomer)	Mexico	32.2	1 850
1999	CorpBanca Argentina	Argentina	100	84
1998	BBV Excel Económico	Brazil	100	878
1998	BBVA Banco BHIF	Chile	55.52	350
1998	BBVA Banco Ganadero	Colombia	15	177
1998	Banco Providencial SAICA	Venezuela	100	103.2
1997	Banco de Crédito Argentino	Argentina	72	560
1996	BBVA Banco Francés	Argentina	30	350
1995	BBVA-Probursa	Mexico	47.9	350
1993	BBVA-Probursa	Mexico	10	53
1992	BBVA-Probursa	Mexico	10	71
Banco Santander Central Hispano (SCH), Spain				
2002	Grupo Financiero Bital	Mexico	4.7	...
2002	Banco Santiago	Chile	35.45	682
2002	Grupo Financiero Bital	Mexico	13.3	85
2001	Banco do Estado de São Paulo S.A. (BANESPA)	Brazil	63.72	1 160.7
2000	Banco Caracas	Venezuela	27.09	116
2000	Banco Caracas	Venezuela	66	200
2000	Conglomerado Financiero Meridional	Brazil	97	1 000
2000	Banco Santander Mexicano	Mexico	16	76
2000	Banco Río de la Plata	Argentina	28.2	975
2000	Grupo Financiero Serfin	Mexico	100	1 560
2000	Banco do Estado de São Paulo S.A. (BANESPA)	Brazil	30	3 580.5
1999	Banco Santiago	Chile	21.75	600
1999	Banco Tornquist	Argentina	50	...
1999	Banco de Asunción	Paraguay	38.5	...
1999	O'Higgins Central Hispano	Chile	100	600
1999	Banco del Sur (Bancosur)	Peru	44	...
1998	Banco Noroeste S.A.	Brazil	76	564
1998	Banco Santander Brasil (formerly Banco Geral do Comercio)	Brazil	50	216
1998	Banco Santa Cruz	Bolivia	90	180
1998	Banco Río de la Plata	Argentina	16	180
1998	Banco de Galicia y Buenos Aires S.A.	Argentina	9.97	100
1998	Banco Santander Chile	Chile	12	168
1997	Banco Río de la Plata	Argentina	35	656
1997	Banco Santander Chile	Chile	3.5	62
1997	Banco Santander Brasil (formerly Banco Geral do Comercio)	Brazil	50	150
1997	Banco Santander Colombia (formerly Bancoquia)	Colombia	60	155
1996	Banco Santander Chile	Chile	24.7	438
1996	Banco del Sur (Bancosur)	Peru	44	...
Banco Sudameris, France				
1999	Banco Wiese Sudameris Perú	Peru	64.8	180
1998	Banco America do Sul	Brazil	26.8	191
BankBoston Corp., United States				
1997	Deutsche Bank Argentina S.A.	Argentina	100	255
Scotiabank, Canada				
2001	Scotiabank (formerly Sudamericano)	Chile	0.03	...
2000	Scotiabank (formerly Sudamericano)	Chile	9.9	28
2000	Scotiabank (formerly Sudamericano)	Chile	16.4	...
2000	Scotiabank (formerly Sudamericano)	Chile	11.6	...
2000	Grupo Financiero Scotiabank Inverlat	Mexico	45	40
1999	Scotiabank (formerly Sudamericano)	Chile	33	116
1998	Banco del Caribe	Venezuela	26.6	87.9
1997	Banco Sudamericano	Peru	100	14.6
Citibank, United States				
2001	Grupo Financiero Banamex Accival (Banacci)	Mexico	100	12 500
2000	Afore Garante	Mexico	9	33
2000	Afore Garante	Mexico	51	179
1998	Banco Confia	Mexico	100	199
Crédit Suisse First Boston, United States				
1998	CSFB Garantia (formerly Banco de Investimentos Garantia)	Brazil	100	675
Hongkong and Shanghai Banking Corp. Holdings, United Kingdom				
2000	Chase Manhattan Bank Panamá	Panama	100	...
1997	HSBC Brasil Multiplo	Brazil	100	1 000

Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of information published in the specialized press in Latin America.

Table III.A.4
BANCO BILBAO VIZCAYA ARGENTARIA (BBVA): PRINCIPAL FINANCIAL AFFILIATES
IN LATIN AMERICA, 2001
(Millions of dollars and percentages)

Country	Firm	Sector	Partners	Ownership			Year of entry
				Direct	Indirect	Total	
Argentina	BBVA Banco Francés	Banking	...	67.0	0.0	67.0	1996
	AFPJ Consolidar	Pensions and insurance	BBVA Banco Francés	45.9	35.6	81.5	
	CorpBanca	Banking	Chase Manhattan	90.0	0.0	90.0	1999
	Banco Exterior de América	Banking	...	100.0	...	100.0	
	Banco de Crédito Argentino	Banking	...	72.0	0.0	72.0	
Bolivia	Previsión BBVA	Pensions and insurance	...	72.0	0.0	72.0	
	Futuro de Bolivia	Pensions and insurance	...	57.0	0.0	57.0	
Brazil	BBVA Brasil	Banking	...	100.0	0.0	100.0	
	BBVA Banco BHIF	Banking (30%)	Grupo Said-Massú	55.5	0.0	55.5	
Chile	AFP Provida	Pensions and insurance	...	49.8	0.0	49.8	
Colombia	Banco Ganadero	Banking	...	99.5	0.0	99.5	1996
	AFP Porvenir	Pensions and insurance	AFP Provida (20%)	0	10.0	10.0	
Mexico	BBVA Probursa	Banking	...	67.9	0.0	67.9	1995
	BBVA Bancomer	Banking (13%)	BBV Probursa (41%);	7.0	28.0	35.0	2000
Peru	BBVA Banco Continental	Banking	...	50.0	0.0	50.0	1995
	AFP Horizonte	Pensions and insurance	AFP Provida (16%); Banco Continental (54%)	24.8	35.1	59.9	
Puerto Rico	BBVA Puerto Rico	Banking	...	100.0	0.0	100.0	...
Uruguay	BBVA Banco Uruguay (Banco Francés)	Banking	...	100.0	0.0	100.0	1995
Venezuela	Banco Provincial	Banking	...	53.4	0.0	53.4	1997
	Previsión	Pensions and insurance	...	100.0	0.0	100.0	
El Salvador	Porvenir	Pensions and insurance	...	100.0	0.0	100.0	
	Máxima	Pensions and insurance	...	100.0	0.0	100.0	
Ecuador	AFP Génesis	Pensions and insurance	AFP Provida (100%)	0.0	49.0	49.0	

Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of Banco Bilbao Vizcaya Argentaria (BBVA), *Informe anual 2001* (www.bbva.es), 2002; and Alvaro Calderón Hoffmann and Ramón Casilda Béjar, "The Spanish banks' strategies in Latin America", *CEPAL Review*, No. 70 (LC/G.2095-P), Santiago, Chile, April 2000.

Table III.A.5
BANCO SANTANDER CENTRAL HISPANO (SCH): PRINCIPAL FINANCIAL AFFILIATES
IN LATIN AMERICA, 2001
(Millions of dollars and percentages)

Country	Firm	Sector	Partners	Ownership			Year of entry
				Direct	Indirect	Total	
Argentina	Banco Tornquist	Banking	Banco Río de la Plata (100%)	0.0	97.8	97.8	
	Banco Río de la Plata	Banking	...	97.7	0.0	97.7	1997
	AFJP Orígenes	Banking	...	49.0	0.0	49.0	...
	Banco de Galicia y Buenos Aires	Banking	Grupo Financiero Galicia (90%)	10.0	0.0	10.0	1998
Bolivia	AFJP Previnter	Pensions and insurance	AFJP Orígenes (55%); BankBoston (45%)	0.0	27.0	27.0	...
	Banco Santa Cruz	Banking	...	90.0	0.0	90.0	1998
	BANESPA	Banking	...	97.1	0.0	97.1	2000
	Banco Santander Brasil	Banking	...	100.0	0.0	100.0	1997
Brazil	Banco Noroeste	Banking	Banco Santander Brasil (100%)	0.0	76.0	76.0	
	Conglomerado Finan. Meridional	Banking	Banco Santander Brasil (97%)	0.0	97.0	97.0	
	Banco Santander Chile	Banking	...	90.2	0.0	90.2	
	Banco Santiago	Banking	Morgan Guaranty Trust (4%); others (7%)	79.0	0.0	79.0	
Chile	AFP Summa Bansander	Pensions and insurance	...	99.9	0.0	99.9	1998
	Banespa Chile	Banking	BANESPA (100%)	0.0	97.2	97.2	
	Fondo de Pens. Santander	Pensions and insurance	...	100.0	0.0	100.0	2000
Colombia	Banco Santander Colombia	Banking	...	60.0	0.0	60.0	1997
	Grupo Financiero Serfín	Banking	...	100.0	0.0	100.0	2000
Mexico	Banco Santander Mexicano	Banking	...	100.0	0.0	100.0	1996
	Grupo Financiero Bital	Banking	ING (18%); Banco Com. Portugués (13%)	12.7	0.0	12.7	1993
	Banco Santander Perú	Banking	...	100.0	0.0	100.0	1997
Peru	AFP Nueva Vida	Pensions and insurance	...	100.0	0.0	100.0	
	Bancosur	Banking	Banco Santander Perú (100%)		99.8	99.8	
	AFP Unión	Pensions and insurance	AFP Nueva Vida (100%)		100.0	100.0	
Uruguay	Banco Santander Uruguay	Banking	...	100.0	0.0	100.0	
	Eurobanco	Banking	...	100.0	0.0	100.0	
Venezuela	Banco de Venezuela	Banking	...	97.6	0.0	97.6	
	Banco Caracas	Banking	Banco de Venezuela (93%)		90.9	90.9	

Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of Banco Santander Central Hispano (SCH), *Informe Anual 2001* (www.gruposantander.com/es/grupo/inversores/), 2002; and Alvaro Calderón Hoffmann and Ramón Casilda Béjar, "The Spanish banks' strategies in Latin America", CEPAL Review, No. 70 (LC/G.2095-P), Santiago, Chile, April 2000.

Table III.A.6
RANKING OF THE WORLD'S LARGEST BANKS, 2001
(Millions of dollars)

TOP 25 BY CAPITAL				TOP 25 BY TOTAL ASSETS			
Rank	Bank	Country	First-tier capital	Rank	Bank	Country	Total assets
1	Citigroup	USA	58 448	1	Mizuho Financial Group	Japan	1 178 285
2	Bank of America Corp.	USA	41 972	2	Citigroup	USA	1 051 450
3	Mizuho Financial Group	Japan	40 498	3	Sumitomo Mitsui Banking Corporation	Japan	840 281
4	J.P. Morgan Chase Co.	USA	37 713	4	Deutsche Bank	Germany	809 220
5	UFJ Holding	Japan	23 815	5	Mitsubishi Tokyo Financial Group	Japan	751 480
6	Sumitomo Mitsui Banking Corporation	Japan	29 952	6	UBS	Switzerland	747 211
7	Crédit Agricole	France	28 876	7	BNP Paribas	France	727 325
8	Mitsubishi Tokyo Financial Group	Japan	25 673	8	HSBC Holdings	UK	696 381
9	UFJ Holding	Japan	23 815	9	J.P. Morgan Chase Co.	USA	693 575
10	Industrial and Commercial Bank of China	China	23 107	10	HypoVereinsbank	Germany	641 729
11	Bank of China	China	22 085	11	Bank of America Corp.	USA	621 764
12	Deutsche Bank	Germany	21 859	12	UFJ Holding	Japan	616 485
13	Royal Bank of Scotland	UK	21 830	13	Crédit Suisse Group	Switzerland	609 618
14	Bank One Corporation	USA	21 749	14	ABN AMRO	Netherlands	526 450
15	BNP Paribas	France	21 748	15	Industrial and Commercial Bank of China	China	524 235
16	HypoVereinsbank	Germany	19 154	16	Royal Bank of Scotland	UK	519 991
17	Wachovia Corporation	USA	18 999	17	Barclays Bank	UK	505 408
18	Wells Fargo Co.	USA	18 247	18	Crédit Suisse Group	France	496 421
19	HBOS	UK	18 086	19	Norinchukin Bank	Japan	462 593
20	Barclays Bank	UK	18 046	20	Société Générale	France	451 660
21	UBS	Switzerland	17 482	21	Dresdner Bank	Germany	446 535
22	ABN AMRO	Netherlands	16 942	22	Commerzbank	Germany	441 801
23	Agricultural Bank of China	China	15 971	23	Bank of China	China	406 150
24	Santander Central Hispano	Spain	15 209	24	HBOS	UK	401 268
25	ING Bank	Netherlands	15 070	25	ING Bank	Netherlands	390 725

Source: *The Banker*, "Top 1000 World Banks", London, July 2002.

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