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ECONOMIC INTEGRATION AND THE INTERNATIONALIZATION OF  
PRODUCTION IN LATIN AMERICA AND THE CARIBBEAN \*

\* This study was produced by Eugenio Lahera when he was UNIDO/ECLAC Consultant. The opinions here expressed are not necessarily representative of those of either institution. Document not reviewed as to form or substance.



## INTRODUCTION

The objective of this paper is to review different industrial co-operation and investment policies within the regional and subregional economic integration schemes in Latin America and the Caribbean.

The first part attempts to put some conceptual aspects of the economic integration process within the framework of the theory of the internationalization of production. The second part reviews the current situation of industrial co-operation and investment policies. Lastly, in the third part some suggestions for further research are made.

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## I. SOME CONCEPTUAL ASPECTS

### 1. The analytical context

The subject of economic integration is normally included within the analytical framework of foreign trade. Of course this is correct as far as trade plans are considered, but regional industrial co-operation, investment policies, the promotion of multinational protective enterprises - not only trade-oriented ones - and other related topics do not really belong in the analytical context of foreign trade, but of the process of the internationalization of production (IP).

The current - mistaken - consideration of the aspects of the internationalization of production within the conceptual framework of external trade has very significant theoretical and practical implications. Very often the very specificity of the phenomena is overlooked and its dynamics is not adequately grasped. This, of course, induces descriptions and policy options which are often irrelevant. On the other hand, the lack of an adequate analytical framework forbids the consideration of different ongoing processes: this is the case, for example, of foreign direct investment by private firms within the region and beyond. There is no theoretical or practical justification for the split of the same phenomenon - the internationalization of production - according to whether it takes the form of a purely private initiative or if it is made within some legal and publicly endorsed regime.

## 2. The process of internationalization of production

### a) Agents and characteristics

In simple terms, the internationalization of the productive process is the organization by an economic agent of production across national frontiers. There are three different impulses which further this process: <sup>1</sup>

(i) Private foreign direct investment. Its main agents are the transnational corporations, especially those which have their strategic decision-making centres in the developed market economies countries, but also others where central management is located in developing countries. For some time now foreign direct investment by developing countries has been increasing and this process has evolved with little direct involvement from the Governments. This process has included firms from the NICs, but also from other, smaller countries. Part of this process is reflected in the very incomplete statistics on intra-Latin American investments gathered by INTAL. <sup>2</sup> (see Table 1). According to, again, incomplete figures there were almost 600 cases of direct investment by private firms in other Latin American countries in 1982; more than 200 of them were joint ventures with local firms. <sup>3</sup> It is safe to conclude that there were more than that, although the subsequent economic crisis must have reduced their actual numbers. <sup>4</sup> Another important development in this field is the growing significance of the maquiladoras in Mexico; they are across the border assembly plants that use foreign parts and supplies and export or reexport the finished products to the US. The 1200 in-bond assembly plants generate Mexico's second largest flow of foreign exchange after oil; the number of employees has increased threefold since 1982, to 300,000. <sup>5</sup>

TABLE 1  
 DIRECT FOREIGN INVESTMENT IN LAIA MEMBER COUNTRIES BY 31 DECEMBER, 1982,  
 BY COUNTRY OF ORIGIN (MILLION OF DOLLARS)

Country of origin	Receiving countries											Total	Percentage
	Argentina	Bolivia	Brazil	Colombia	Chile	Ecuador	Mexico	Paraguay	Peru	Uruguay	Venezuela		
Argentina	...	2.9	33.0	1.4	21.2	13.2	1.3	16.2	5.0	10.0	6.6	110.8	16.9
Bolivia	2.6	...	0.1	0.3			7.7		1.7		0.1	12.5	1.9
Brazil	52.6	1.3	...	3.0	44.1	7.7	1.6	52.8	2.8		0.5	166.4	25.4
Colombia	22.0		0.2	...	12.6	21.8	12.1		1.5		1.8	72.0	10.9
Chile	2.7	0.3	1.6	0.2	...	13.9	0.4	2.1	3.0		0.2	24.4	3.7
Ecuador			0.2	20.8		...			1.9			22.9	3.5
Mexico	0.8		13.3	5.7	3.5	5.6	...		3.9		3.0	35.8	5.5
Paraguay					0.2		...				0.1	0.3	0.0
Perú	0.5	0.6	0.1	0.5	0.1	11.3	0.4		...		3.4	16.9	2.9
Uruguay	13.9		35.2	1.6	12.2	0.1	5.8	0.9	5.1	...	2.7	77.5	11.8
Venezuela	11.0		16.8	49.6	5.9	23.7	3.1	1.6	5.2		...	116.9	17.8
Costa Rica					0.5	0.2	0.5				0.6	2.0	0.3
El Salvador			0.2		0.3	0.1	1.2		0.1			1.7	0.3
Guatemala	0.2						0.2				0.1	0.5	0.1
Nicaragua				0.1								0.1	0.0
Total	106.3	5.1	100.7	83.2	100.6	97.6	34.3	73.6	30.2	10.0	19.1	660.7	
Percentage	16.1	0.8	15.2	12.6	15.2	14.8	5.2	11.1	4.6	1.5	2.9		100.0

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(ii) Public economic integration schemes for productive purposes. The systems of complementation of production existing in the Eastern European Countries are important examples of this second case. But it also includes supranational productive arrangements by the public sector or by public enterprises of different countries, like those in Latin America.<sup>6</sup>

(iii) Mixed forms of internationalized production. This third impulse to the IP process stems from the economic integration efforts aiming at some kind of international specialization of the productive system.

The three kinds of IP have important differences among them. They arise mainly from the type of economic agent which is involved - public, private or a mixture of them - and from the characteristics of the economy where the matrix is situated. But all of them aim at international specialization in order to attain higher productivity levels, higher profits, or both.

Regarding private firms participation in the IP process, the starting point of the analysis is the recognition, as a main condition for this process, of the different resource endowment of each enterprise, which includes a better knowledge of production, capacity for product differentiation, underutilization of entrepreneurial and managerial capacity, and other assets - generally intangible - susceptible of generating profits.

This different endowment of some enterprises is associated with that of resources, with the economic cycles and with the features of the markets of the countries of origin. Frequently this is also associated with the size of the enterprise and its performance in oligopolistic markets.

The second condition for this type of internationalization relates to advantages acquired by a firm thanks to production in another country, since if these advantages did not exist there would be a preference for straight forward foreign trade or the

granting of a license, as other ways of entry into foreign markets. The imperfections of the markets are of crucial importance, since they give a powerful impetus to the enterprises able to internationalize their output, thereby avoiding the disadvantages or making use of the advantages of the imperfections existing in the mechanisms of resource allocation.

These imperfections can be due to the type of market in question - barriers against entry, high cost of transactions, or difficulty in achieving economies of interdependent operation (all aspects which affect the resulting system of prices) - or to interventions by the public sector. In the latter case mention may be made of the differences between the economic policies of the different government - as regards taxation or the exchange rate, for example - or the systems of protection of ownership of technological knowledge.

There are undoubtedly other factors which condition the internationalization of production, such as government policies as a whole, both in the countries of origin of the investment, and in the host countries. Some policies have a negative impact, such as exchange control, double taxation, difficulties for profit remittance, etc. However, governments have also been concerned with the promotion of multinational firms, usually joint ventures.

Governments have different reasons to promote region-wide multinational firms. One of them is to reap economies of scale. According to this argument the complete structure of average and marginal costs, even if increasing in a static sense, falls as production proceeds. The downward displacement of the cost structure is caused by technological gains, increases in productivity, and improvements in human capital, which can be achieved only through learning by doing and cannot be separated from the production process. An additional element plays an important role: the indivisibility of plant size. Individual country markets may be large enough to ensure efficient primary import substitution, but further import substitution involving



intermediate imports, consumer durables, and capital goods require a larger market if a dynamic comparative advantage is to be attained. The reason is that, in many sectors, minimum plant sizes are a pre-requisite for the start up of production at reasonable costs, and such production in turn requires larger outlets than the individual national markets. Therefore, in their efforts to enlarge the scale of import substitution, developing countries are constrained by limited national markets that do not allow the establishment of plants of a size conducive to subsequent improvements in productivity and competitive production costs. In this view, economic integration is a way of overcoming the limitations of the national market by allowing the establishment of economically efficient plants designed to produce for larger union markets.

This dynamic approach to customs unions does not mean the rejection of the classical doctrine of comparative advantage but rather its application to a protectionist context. Since a vigorous export promotion policy is not discarded, members of the union are expected to specialize in industrial activities in which they have intra-union comparative advantage because of their different resource endowments.

(b) The forms of internationalization

The internationalization of production can take place in two ways: (a) through horizontal expansion of the enterprise to produce mainly the same goods in the country receiving the investment; and (b) through vertical integration - backwards or forward - which incorporates the plant of the host country into the global process of production. The prototype of horizontal integration corresponds to total local production, with local inputs, of a final good. The opposite pole is internationally integrated production, with inputs which are generally imported, of a product that in its turn complements the production on the international plane of a good marketed in different national markets. (see figure).

There are various intermediate types, such as the internationally integrated production of final goods in various countries and the local production, with local inputs, of goods which in turn complement the international production of a final good. There are also combinations of both types of integration, both for the products of a single transnational corporation - some of which may correspond to horizontal integration and others to vertical integration - and by branches of a single transnational corporation, in the case of conglomerates which include various lines and types of products.

The modes of internationalization of production adopted will depend on various factors, such as: (a) the economic sector in which the enterprise operates; (b) the type of resource which gives its superiority over local enterprises; (c) the government policies in the economic area which affect the allocation of resources and the international trade carried out; (d) the greater or lesser degree of specificity of its inputs; and (e) the peculiarities of the different economies in which such corporations work, both as regards the resource endowment and the characteristics of their markets.

(c) The consequences for the host economies

The growing internationalization of production has important effects, - both on the structure and dynamism of various aspects of the international economy, and on the countries - where the transnational productive units operate. Internationalization not only affects the directly productive processes at the national and international level - with all the imaginable consequences regarding resource allocation and international specialization - but also the financial and capital flows, as well as international trade.

Figure

POSSIBLE FORMS OF ORGANIZATION, PRODUCTION  
AND SALES OF INTERNATIONALIZED PRODUCTION

<u>Ownership</u>	<u>Direction</u>	<u>Inputs</u>	<u>Supplier</u>	<u>Productive process</u>
Total	Centralized ) by products Decentralized ) and/or regions	Local	The same firm	Local
Majority		Imported	Another affiliate	Integrated
Shared	National firm		A transnational enterprise  combination	

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<u>Degree of integration</u>	<u>Financing</u>	<u>Product</u>	<u>Market</u>	<u>Purchaser</u>
Complete	Local	Final good	Local	National
Partial	External	Input	External	Another affiliate
Joint	Within the trans-		Combination	Another transnational
with the parent	national enterprise			enterprise
with other affiliate	Outside the trans-			
with other transnational	national enter-			
enterprises	prise			

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The implications for the host economies will vary according to the type of internationalization practiced by the transnational productive units. The different forms and combinations of organization, production and sales they use will have special effects on the host economy and particularly on its foreign trade.

The fact that the imperfections of the market help to foster internationalization means that the transnational firms do not automatically tend to eliminate them, since they are often a source of profit. These enterprises tend to provoke imperfections in the allocation of resources, since they frequently operate in oligopolistic markets, whose characteristics they reproduce, and they have the capacity to overcome the market mechanisms and the restrictions imposed by public regulations. Again, the exploitation of the imperfections of the market by the transnationals means that the ensuing benefits will not necessarily remain in the receiver countries unless the latter apply policies to achieve this end. In the regional or subregional integration initiatives taken by governments it can be seen that very process designed to homogenize the national economic spaces gives preferential treatment to those enterprises which can undertake international specialization, operating from several countries simultaneously. It is another matter, of course, if the firms installed to supply the local market are interested in deepening the process of internationalization of their production.

Certain types of specialization promoted by the transnationals tend to be detrimental to the host countries, along with various aspects of their production, external trade, marketing and technology transfer strategies. They have also been criticized in their countries of origin for their effects on the balance of payments, employment, levels of prices, productivity and income.

With regard to publicly defined IP schemes, there are also significant problems. On the one hand, it is necessary

"to solve the location problem, one of the sources of inequity in the distribution of costs and benefits...

The purpose of industrial planning is to avoid the market process and directly determine the location of new industries. The objective is to maximize the benefits, for the region as a whole, of the establishment of new industries and, at the same time, to distribute those benefits equitably. These two objectives may not be consistent since maximization of benefits presupposes the full exploitation of intra-regional comparative advantage, which may not satisfy regional equity considerations. In addition, industrial planning is largely biased in favour of producers and disregards the implied costs for consumers and the distribution of those costs. If the costs are unevenly distributed, pressures to stall such planning are certain to mount.

The potential conflict between efficiency and distributive equity may threaten the viability of industrial planning. It may be argued that, since the purpose of industrial planning is to assure a more equitable distribution of costs and benefits from integration, the efficiency criterion should be eschewed in favour of higher intra-regional equality. Since such a policy could mean very high costs and a waste of resources, mechanisms that allow the separation of location from ownership may be more appropriate. The new industry could be owned by multinational corporations formed by all the member countries, the distribution of dividends being linked to the level of benefits and to some agreed criteria for distributing them equitably.

Two additional difficulties related to regional industrial planning are the delegation of authority to a multinational entity and labour mobility. With the first,

the difficulty is similar to that with the common external tariff. If the long-term development approaches of the member countries do not coincide, the sectoral priorities of the national development strategies may clash with those of regional industrial planning. Since acceptance of the principles underlying the regional programmes implies the submission of national planning to more global considerations, it also implies the surrender, at least in part, of the power to determine the patterns and characteristics of industrial development. The long-term implications of those considerations make the surrender of power in this area politically impossible".<sup>7</sup>

In a classical-type argument it might be pointed out that a contradiction arises between the development of the productive forces induced by the internationalization of production and the mechanisms of decision-making, appropriation and assignment of the surplus by their agents. The mere geographical expansion of this internationalization increases and gives power to both local and international trade. The imbalances and transfers of resources which it produces are also of great importance.

## II. INDUSTRIAL COOPERATION AND INVESTMENT POLICIES WITHIN THE REGIONAL AND SUBREGIONAL ARRANGEMENTS

### 1. Regional Industrial Programming

Industrial growth is confronted in Latin America by serious problems, both on the demand (size and structure of the markets) and on the supply side (availability of resources, technology and inputs). One way out of these problems which Latin American countries have taken is the integration of the industrial productive sectors. The results have not been very successful so far.

#### (a) Central American Common Market (CACM)

The aim of Central American Common Market on this regard was to promote investments in the "integration industries", designated as such because they needed the expanded Central American Market to reach economies of scale in order to operate under competitive conditions. These industries would benefit from the unrestricted opening of member country markets and from the protection against external competition provided by a common external tariff. <sup>8</sup>

Only four "integration industries" have been selected: caustic soda and chlorinated insecticides in Nicaragua; vehicle tires and tubes in Guatemala; and flat and sheet glass in Honduras. The latter was never materialized. In fact, the Integration Industries Regime lost its attraction when the general Treaty was approved in 1960, since the latter established the commitment to move on within a short period toward the full liberalization of trade and the adoption of a common external tariff.

#### (b) LAFTA/LAIA

The Treaty of Montevideo included a provision for the coordination of national industrialization policies, although the main aim of LAFTA was to form a free trade zone. Complementation

agreements were established by industrial sectors, as specific programming instruments.

Most of these Complementation Agreements have been nothing else than inter-firm trade specialization by TNCs. Only one of them - No. 6, referring to the petrochemical sector, which was signed by Bolivia, Colombia, Chile and Peru in 1968 - was about new investments and it would serve as a starting point for a Sectoral Industrial programme for the Andean Group.

The LAIA Treaty does not envisage any specific instrument for integration of the industrial sector. The Agreements of Partial Scope are very alike to the old Complementation Agreements and any initiative in the direction of industrial programming within LAIA have to be undertaken through this instrument.

(c) CARIFTA/CARICOM

CARIFTA/CARICOM has a provision for region-wide industrial programming through the selection of industries, but this has not yet been fully defined and the application of it has been very marginal.

Efforts to programme industrial production on a regional basis have been slow and disappointing. the only practical achievement to date has been the allocation by the Eastern Caribbean Common Market (ECCM) of thirty-one industries, of which about seven have come on stream in the subregion; no other achievements were registered in the fields of joint promotion of industrial development. The feasibility study of a regional aluminum complex still awaits final decisions by the Governments concerned. At the wider CARICOM level a technical study outlining a framework for regional industrial programming in pursuit of the objectives of Article 46 of the Common Market Annex to the Treaty has only recently been completed. The policy guidelines which were used for the study are the satisfaction of basic needs, foreign exchange earnings or savings, use of regional raw materials, promotion of employment and strengthening of the domestic and export sectors of the regional economy. <sup>9</sup>



Recently, the CARICOM Council of Ministers has established a Regional Garment and Textile Advisory Committee of eleven persons drawn from the public and private sectors in the Region. The Committee will function as an advisory body to the Common Market Council. It is charged with examining the needs of the industry, in particular in the areas of protection, marketing and technical assistance and with making recommendations to the Common Market Council on what should be done to meet those needs. 10

(d) Andean Group

The Andean Group established two main instruments in this regard: the Rationalization programme, focusing on existing industry (IRP) and the Sectoral Industrial Development programmes (SIDP) for programming new investments.

Not a single IRP has been drawn up in the context of the andean integration process, mainly because of the opposition of existing enterprises.

The SIDPs may be considered sectoral custom unions since they consolidate the expanded market for the products of the programmed sector by fixing the common external tariff for it and liberalizing reciprocal trade with regard to the particular product concerned. They are an attempt to systematically allocate industries among member countries to avoid duplication of production and unnecessary competition. Only selected industries are to be included as programs, and each program will cover one industry, with products within the industry assigned to member countries. Programmes are designed to provide favorable tariff preferences and temporary monopolies and semi-monopolies over the manufacture of the products.

It was hoped that through industrial planning the ANCOM members would develop new specialized industries and improve existing ones, thus reducing the need for imports and increasing the amount of exports and employment to the benefit of overall regional development.

The Board of the Agreement drew up eight proposals for SIDPs: in the petrochemical, metal working, automotive, iron and steel, electronics and telecommunications, chemicals, pharmaceuticals and fertilizer sectors. The country members considered feasible only the first four. However, only the three first have been approved and the automotive has become obsolete as TNCs are going through an intense re-shaping of the industry on a regional and world basis.

The petrochemical and the metal working programs have experienced several technical and economic problems that have complicated their functioning to such an extent that changes in them are currently being negotiated. The first one has suffered from oil price fluctuations; the second one is the only one which has resulted in exchanges of certain relevance, especially from a qualitative point of view.

The participation of the private sector in the planning process of the metal working program was minimal. Indeed, some of the difficulties later encountered in finding domestic entrepreneurs willing to undertake feasibility studies and invest in the manufacture of products assigned under the program can be traced to the lack of involvement of the private sector in the evolution and implementation of the program. Ultimately it would fall to the technical experts of the Board to draft the outlines of what would become the metal working program. <sup>11</sup>

Product assignment had several problems. On the one hand, high technology products were assigned to countries with the lowest technological capabilities in metal working, in order to give them a "big push". So Bolivia and Ecuador were forced to turn to TNCs not only for technology but also as partners. On the other hand, an independent evaluation of the assignments rated quite badly those made to Bolivia and Ecuador, while around half of the assignment made to Colombia, Chile and Peru were rated as positive.<sup>12</sup>

Regarding the petrochemical agreement, TNCs pressures exacerbated interstate conflicts by enhancing the nationalistic bargaining behaviour of Andean negotiators eager to create national petrochemical industries based on domestic natural gas or petroleum resources. The result of this coincidence of interests and technology was a compromise in the rationality of industrial planning efforts in the petrochemical sector. The creation of six wholly integrated petrochemical complexes built in production inefficiencies right from the outset of the programme.

The Andean countries have also designed other instruments for joint industrial development. They are the Intersectoral Industrial Development programmes and the Integral Development Projects, which have not resulted in tangible results yet. The Board of the Agreement put forward a proposal for organizing programs of this kind for the electronics and telecommunications, chemicals and pharmaceutical sectors, but they were not accepted by the countries.

(e) Cauce

The Cauce Treaty between Argentina and Uruguay was signed in 1974. Its main objective is bilateral trade, but it could have some direct consequences for the industrial sector. In fact, one of its goals is to coordinate industrial activities and other, to promote binational enterprises.

In practice, Cauce has been utilized for industrial complementation only by TNCs within the car industry (Fiat and Renault).<sup>13</sup>

The modifying protocol of the Treaty of Cartagena, signed by the Andean countries in May 1987 calls for flexible industrial programming so that national programs can be complementary and also for agricultural and agro-industrial cooperative programs. The Transition Program calls for products to be reserved for industrial programming, but no further detail is available.

## 2. Promotion of Regional Multinational Enterprises

### (a) Andean Group <sup>14</sup>

The countries' interest in encouraging the establishment of some type of multinational enterprise can be traced back to August 1966 when Colombia, Chile, Venezuela, Ecuador and Peru signed the Declaration of Bogota. This document calls for the adoption of projects in which enterprises and capital of several Latin American countries can participate in order to facilitate the process of integration. Later, when the Cartagena Agreement was signed, it contained a provision to approve a uniform regime for multinational enterprises (Article 28); to recommend the establishment of multinational enterprises for the implementation, expansion or complementation of certain industries in the area of industrial programming (Article 38); and to establish multinational enterprises which facilitate the development of infrastructure projects in the fields of energy, transportation and communications (Article 86). The first rules of the Andean Group on this subject were contained in Decision 46 (1971) (see the text in the Annex). However, Decision 46 was unable to stimulate the creation of multinationals: it contained complex and time-consuming rules for the formation and operation of these firms and imposed restrictions on their areas of activity. so in 1982, Decision 169 was approved in an attempt to eliminate some rigidities of Decision 46; the firms are now called Andean Multinational Enterprises. (AME).

The main characteristics of an AME are set forth in Articles 1 and 2 of Decision 169 and include the following:

- (1) AME's must receive contributions from national investors of two or more member countries and they must total more than 80 per cent of the capital of the enterprise.
- (2) Contributions from foreign investors must be less than 20 per cent of the capital of the enterprise.

- (3) When the enterprise is capitalized with contributions from only two member countries, the sum of the contributions from the investors of each member country may not be less than 15 per cent of the capital of the enterprise. If there are investors from more than two member countries, the contributions from at least two countries shall meet the above-mentioned requirements. In both cases, investors from the country where the principal place of business is located shall contribute 15 per cent or more of the capital of the enterprise.
- (4) The principal place of business shall be located in one of the member countries.
- (5) The majority of subregional capital shall be reflected in the technical, administrative, financial and commercial operation of the enterprise.
- (6) AME's located in Bolivia and Ecuador may consist of subregional capital contributions amounting to 60 per cent and foreign capital contributions amounting to 40 per cent for a period of ten years from the establishments of the enterprise, or fifteen years from the time Decision 169 becomes effective.

All AME's may enjoy the following benefits:

- (1) The products of an AME shall enjoy all the benefits of the trade liberalization programme.
- (2) The enterprise shall receive the same tax treatment as an equivalent to national enterprise.
- (3) The AME shall have access to domestic credit and the same financial treatment as a national enterprise.
- (4) The enterprise shall not be required to obtain prior authorization from the appropriate national agency to invest or reinvest in the same country as the principal office. Also in such cases, the net profits of the AME's shall be transferable in freely convertible currency.

- (5) AME's may establish branch offices in member countries other than the one where the principal office is located.
- (6) With the authorization of the appropriate national agency, the AME, or its branch, may participate in sectors reserved for national enterprises.
- (7) The branches, with the authorization of the appropriate national agency, may transfer all net profits in freely convertible currency to the principal office.
- (8) Foreign and subregional investors in an AME may transfer abroad, with the authorization of the appropriate national agency, all net profits in freely convertible currency.
- (9) To avoid double taxation, shareholders of an AME will not be required to pay taxes on the profits received from the branch office which are redistributed to them as dividends by the main office, nor will investment companies which are shareholders in AME's be required to pay taxes on the income they derive from the redistribution of the AME's profits.
- (10) Member countries shall treat subregional employees of an AME as national employees for purposes of the application of foreign labour quotas.
- (11) Member countries shall facilitate the entry into their territories of promoters, investors, and executives of such enterprises.
- (12) Member countries shall facilitate the contracting of technology, patents and trademakers within the region where the AME's operate.

(b) SELA <sup>15</sup>

The Sistema Económico Latinoamericano (SELA) is a vast programme of regional cooperation adopted in 1975 by most Latin American countries. The Panama Agreement for the constitution of SELA includes, as one of the objectives of the system, "to

improve the allocation of human, natural, technical and financial resources of the region, through the formation and stimulation of Latin American Multinational Enterprises..... Such enterprises can be created with contributions of State, para-state, private or mixed capital, whose national character is to be granted by the Member States, and whose activities are to be subject to their jurisdiction and control". The mechanisms for the promotion of LMA are based on the SELA "Action Committees" created for a variety of sectors. The origin of MULTIFERT S.A. is the work of the "Action Committee" on fertilizers created by SELA with the purpose of exploring and promoting the creation of a commercialization mechanism jointly owned by the Latin American Countries to deal with the regional demand and supply of fertilizers and their raw materials, with the objectives of rationalizing the trade among the countries and carry out joint imports from third countries on the basis of an increased bargaining power. MULTIFERT was created in 1978 by a treaty among the governments of Bolivia, Costa Rica, Cuba, Guatemala, Mexico, Nicaragua, Panama, Peru and Venezuela. Its headquarters are in Panama and the authorized capital amounts to US\$3.75 million. So far, it is the only LMA.

The basic rationale for the creation of MULTIFERT derived from the critical importance of the agricultural sector in the Latin American economies, and the need to improve its productivity through the increased use of fertilizers. In 1974, Latin American production represented only 46.9 per cent of total consumption. Such external dependence created balance of payments problems and serious vulnerability, in a market characterized by strong price oscillations frequently caused by dumping practices on the part of the industrialized countries.

### 3. Measures for Capital Goods Foreign Trade

#### (a) Latinequip

Latinequip is an incorporated company whose shareholders are public sector financial institutions - the Bank of the Province of Buenos Aires, the Bank of the State of Sao Paulo and the National Financiera of Mexico. Its aim is to provide assistance to the exporters of capital goods in the commercialization, financing and technology transfer operations as well as in the establishment of joint ventures. For services supplied to interested companies Latinequip charges a fee to be agreed upon in accordance with the specific characteristics of each operation.

Latin American exports of capital goods reached 2 per cent of the world total in 1982 while regional imports accounted for 7 per cent of the same total. Intra-regional trade of capital goods, on the other hand, represented something less than 5 per cent of the total market during the same year. Capital goods exports represented 12.5 per cent, 14 per cent and 12.9 per cent of the production of Argentina, Brazil and Mexico during 1982-1983. In the same year, 56 per cent of Argentina, 49 per cent of Brazilian and 8 per cent of Mexican exports of capital goods were shipped to other developing countries.

The services offered by Latinequip officially include the following:

- (i) Periodical services of regional export supply;
- (ii) Search and development of markets through a set of commercial offices and/or representatives;
- (iii) Survey of made to order capital goods demand. This includes projects financed by multilateral credit institutions; development plants and investment programmes of large government enterprises.
- (iv) Constitution of consortia among suppliers;
- (v) Aid to obtain financing at private and public levels;



(vi) Transfer of technology and development of joint ventures;

(vii) Negotiation with relevant authorities

Latinequip entered its operative stage by the end of 1984 and since then only 10 operations for a total value of US\$20 million have been fully concluded and signed. Its project portfolio, however, reaches almost 600 operations, of which only an undetermined proportion will be carried out.

One major weakness of Latinequip is that it does not operate with the "last fund" modality which is often required in order to develop a commercial operation. Potential buyer often do not know what they need and somebody has to finance preliminary studies even at the risk of losing the money if the deal is finally not closed. In order to be competitive with industrialized countries" traders this requisite has to be met.

(b) The Agreement between Argentina and Brazil

The recent Integration and Cooperation Act signed by Argentina and Brazil established a programme for bilateral economic integration which should be characterized by its gradual character, a growing degree of policy harmonization, intersectoral specialization, progressive equilibrium of reciprocal trade and the active participation of private entrepreneurs in both countries.

The programme consists of twelve Protocols and their subjects are the following: 16

1. Creation of a customs union in bilateral trade in capital goods with removal of all trade barriers and promotion of balanced trade.
2. Planned growth in Brazilian wheat purchases from Argentina
3. Promotion of food security in both countries through increased trade in food products to eliminate seasonal shortages.

4. Promotion of overall trade levels between the two countries, with emphasis on eliminating trade imbalances.
5. Promotion of joint ventures between industrialists of both countries.
6. Financial support from central banks to support adjustment to trade imbalances.
7. Investment fund to be created to expand production.
8. Co-operation in energy development to expand oil and gas production in Argentina and joint electricity generation.
9. Promotion of biotechnology.
10. Creation of economic research centres to monitor the integration project.
11. Co-operation in the event of nuclear accidents.
12. Co-operation in aerospace to develop joint export potential.

Most of the Protocols could have an impact on industrial development and co-operation between the two countries. However, all of them need to be defined in a more systematic way. So far only one of them has been implemented, No. 1 on capital goods, although protocol No. 7 is also involved.

Agreement could not be reached on other sectors which were also considered; petrochemical, chemical, plastic and electronics industries, as well as the automotive industry. With regard to this latter case, the merger of Ford and Volkswagen in the two countries has forced other firms in that sector to ask for protection and a schism has developed between the manufacturers and part suppliers. No agreement was reached concerning maritime transport either as the respective flag carriers were unable to develop a formula for dividing shipping. 17

Protocol No. 1 on Capital Goods

For the time being the Protocol is a custom union. Both countries agreed to erase tariff and non-tariff restrictions to those goods included in the First Common List (see the Annex for a complete list of the capital goods included). The objective is to reach a bilateral trade of US\$2,000 million between 1987 and 1990, starting with US\$300 million during 1987 (the figure for 1985 was about US\$200 million). They will also have a common external tariff regarding these goods. The national treatment can only be granted to products with less than 20 per cent of imported inputs.

Each semester the list would be increased with new items up to 50 per cent of the universe of agreed capital goods.

The expansion of the universal exchange must be both equilibrated and symmetrical. In practical terms that means that if the Brazilian annual superavit is greater than 20 per cent of the agreed value, some corrective measures are to be put into effect. According to the Protocol No. 7, in that case both countries will increase the Investment Fund for the same amount of this superavit and this new funds will be invested in Argentina, in order to improve its productive and exporting capabilities. If the superavit surpasses 40 per cent of that value, according to the article 10 of Protocol No. 1, "necessary measures will be adopted, which must be compatible with the general trade situation, in order to correct such disequilibrium".

The Ministers of Finance and Economy of both countries must co-ordinate their politics on foreign exchange rate in order to achieve a stable exchange rate between both countries. Exchange rate policy should be neutral with regard to the relative competitiveness of exports and imports.

There are significant differences between incentives, benefits, imports price and protection vis-a-vis third countries in Argentina and Brazil. Both governments would compensate for

their "asymmetries". The idea is to isolate the purely competitive aspects of the final price. This "pampered" trade is a new concept in the region. Another characteristic of the Agreement which is also something new is that the private sector played a very active role in Argentina, although the Brazilian list was made by bureaucrats. The Argentinian list was completely put together by private firms and in fact it has some ad-hoc flair in it.

The main issues involved for the Argentinian firms were the following ones:

- (i) Wage differentiation. Studies specially made confirmed that qualified labor is more expensive in Brazil, while the opposite is true about unqualified labor. On the other hand, wages represent a small fraction of total costs;
- (ii) Financial costs of production. This has not been discussed with Brazil. In the meanwhile, they are higher in Argentina and the government is looking for some way to correct it;
- (iii) Export promotion schemes. Here the Brazilians have a problem because the Argentinian scheme is more favourable than CACEX2s; and
- (iv) Financing of the trade operation. Here some changes are needed in both countries in order to put them in line with each other.

It has been suggested that this Agreement could open a new stage of the Latin American integration process which would be characterized by a slower, more gradualistic approach and by its emphasis on bilateral links. In fact, ALADI led the way already in 1980. What seems really new in the Agreement is the active participation of the private national firms; the emphasis which has been put on the capital good sector and the active participation of Brazil. In the past it has been said that the process of economic integration needed a strong locomotive: maybe Brazil will provide that driving force.

Awkwardly, worries about the future of the industrial aspects of the Protocols are concentrated in the evolution of the Brazilian economy and not on the expectations of the private Argentinian sector.

So far Uruguay has only approved a special agreement with Brazil, which is basically a wheat-and-meat for industrial products exchange. The same country had already signed CAUCE with Argentina in 1974.

One interesting point came out in Argentina with regard to the financing of the compensation for the steel price to be paid to local manufacturers of final products. In the end the Argentinian Chamber of Capital Goods Producers will pay one third of the total and the public sector will pay the rest.

All promotional regimes should not keep going on forever. It remains to be seen how fast could they be withdrawn.

#### 4. Foreign Investment Policies

##### a) The Andean Pact

Since the inception of the Common Regime on Foreign Investment and Technology Transfer - Decision 24- back in December 1970, it has suffered successive changes which tended to liberalize it. In fact, Decision 220 of May 1987 allows each country to establish its own reputations for foreign investors. The Common Regime as such does not exist anymore. The analysis of this experience is, however, very useful.<sup>18</sup>

##### i) Decision 24 (1970-1987)

The Competent National Agencies are responsible for registering and monitoring direct foreign investment and approving contracts on transfer of technology and on patents, as well as for signing and monitoring agreements on the conversion of foreign enterprises as provided in the Common Regime for Foreign Capital and Technology.

One important point which has not been settled in the AP is whether policies of foreign investment should be administered by one single agency which would have thus a multidimensional approach - or by many different agencies. Both alternatives have problems; the first one, because it would require a high degree of specialization and it should be very powerful in order to be efficient. The second one, on the other hand, could reduce the policy of foreign investment to a discrete series of bureaucratic registrations and make the achievement of more general goals impossible.

There are no criteria for restricting the flow of direct foreign investment, other than those established by Decision 24 itself and its related provisions and amendments. The general atmosphere is one of openness to foreign capital and there is clearly a willingness to be flexible or, in some cases, to refrain from applying the rules set forth in the Common Regime.

The member countries have not established a clear set of priorities for authorizing foreign investment. The social and economic impact of a project or of a foreign enterprise is used as a point of reference or for purposes of information, but not as a standard for rejecting direct foreign investment. In this regard, there are no specific standards for restricting the setting up of foreign enterprises whose international operations show deficits, despite the fact that the goal of the Andean Pact is to substitute imports and promote exports.

Most of the member countries have exempted enterprises engaged in the exploitation of basic commodities, insurance, banking, financing, transport, tourism and mass communications media from the scope of the Common Regime. The exceptions allowed for the article 44 of Decision 24 have been made the general rule. In practice, the Regime is mainly and almost only applied to the manufacturing industry.

There is no discrimination as regards incentives to investment according to the source of the capital concerned. In all the member countries, foreign investors receive the same treatment as nationals, and when it comes to taxation and/or exchange arrangements, differences are not taken into account. National agencies have not followed common criteria for the authorization of reinvestment by foreign enterprises.

There is no uniform standard with respect to the positive application of agreements providing for the conversion of foreign enterprises; in practice, the mechanism is hardly ever used. This was considered a fundamental rule of Decision 24 but different developments - not only opposition from the TNCs - have made it almost completely obsolete for new investments.

There are no major differences among member countries as regards the criteria they apply for registration of direct foreign investment. All the countries allow the registration of capital investments in foreign or national currency, capitalization of loans, valuation of tangible goods, reinvestments and capitalization of resources in general. Except

in one country the competent national agencies have issued explicit regulations concerning procedures for registration of direct foreign investment. These lists in detail the documentation which is required for this purpose. In general terms, all the procedures are very similar.

The member countries have not regularly applied restrictions on the granting of medium - and long-term internal credit to foreign enterprises, and there is a tendency to eliminate the restrictions established in the Common Regime on this subject. On the other hand, all countries have specific criteria and mechanisms for regulating the arrangement by foreign corporations of external loans from financing agencies or parent companies and/or subsidiaries. However, the compliance of these regulations leave not been evaluated.

Although, historically, transfers of profits of foreign corporations they have not reached the ceiling of 20 per cent above the amount of investment registered with the competent national agencies, there is a general tendency among the member countries to have the regulation of this aspect up to national legislation.

The member countries have not been fully enforcing the criteria established in Decision 24 with regard to authorization and monitoring of the right to re-export capital.

There are no specific agreements with foreign enterprises in connexion with the purposes, objectives or programmes of global and/or sectoral policies, although some member countries have legal mechanisms for implementing such policies. There are no common mechanisms for regulating new types of contracts with foreign enterprises ("turn-key" contracts, for example). Some member countries have signed documents which violate the provisions of the Common Regime with respect to the application of criteria of extraterritoriality in the settlement of possible conflicts or disputes with foreign corporations.



There are no specific criteria for monitoring the majority participation of national investors in national or mixed enterprises and ensuring that this participation is reflected in the management of production, administration, marketing and finances of these firms.

Changes in Decision 24 made by the Commission of the  
Cartagena Agreement

From its inception Decision 24 has undergone several changes as a result of decisions taken by the Commissions of the Cartagena Agreement. The most significant changes were made in 1976, as the five other signatories tried to prevent Chile from withdrawing from the Andean Group. By Decision 97, the Government of Chile was authorized to sell stock in State enterprises belonging to CORFO to foreign investors. The most important modifications were made by means of Decisions 103, 109 and 110, as follows:

- Creation of special categories of capital: subregional capital is to be considered as national capital when certain specific requirements are met, and neutral capital, in the case of international public financing agencies or governmental agencies concerned with cooperation for economic development. This category of capital is not to be taken into account in determining the nature of the firm.

- Conversion agreements: the date on which the conversion of foreign firms was to begin was postponed from 30 June 1971 to 1 January 1974. Authorization was also given for the incorporation of new direct foreign investment to national or mixed enterprises provided the enterprise remained at least a mixed one.

- Remittance of profits: the ceiling for transfer was raised from 14 per cent to 20 per cent of registered direct foreign investment. Undistributed gains may be invested as direct foreign investment.

- Reinvestment of capital: the rate of reinvestment permitted was increased from 5 per cent to 7 per cent.

- Access to domestic credit: foreign enterprises were allowed access to long and medium-term credit on the local financial market. the provision concerning the regulation of short-term credit by each country was eliminated.

Changes in Decision 24 adapted unilaterally by the countries.

There are significant differences in the way member countries of the Andean Group conceive and apply Decision 24. Several of these differences actually entailed ad hoc amendments to Decision 24.

Conversion agreements are being applied less and less and some countries have stopped signing them and enforcing them. The countries have been more and more willing to accept the idea - even though it is contrary of Decision 24 - that these contracts are to be applied solely to those firms which wish to benefit from the expanded Andean market.

As regards national jurisdiction over disputes relating to direct foreign investment, two countries have signed agreements with OPIC which, in practice, go beyond this principle established in Article 51 of Decision 24.

The ceiling on the remittance of profits established by Article 37 have been overlooked in several countries, either as a general rule or in specific cases.

The principle of not authorizing direct foreign investment in activities for which the demand is already sufficiently covered (Article 3) has not been generally applied.

As regards the existence of sectors to which the access of direct foreign investment is restricted (Articles 40-44), there have been significant exceptions.

The least controversial areas are the registration of direct foreign investment and the transfer of technology, although there are significant differences in the way the relevant rules are applied from one country to another.

### Technology

Decision 24 stipulates that all contracts on the importation of technology and on patents and brands - whether or not they involve payment - must be examined and submitted to the competent national authority for approval. This agency is responsible for evaluating the real contribution of the imported technology by estimating its potential profitability and, the price of goods which incorporate it or establishing some other specific quantification of the impact of the imported technology.

Decision 84 adds some criteria for evaluating applications for the importation of technology, including the following:

- its impact on local technological development;
- its impact on technology in employment;
- its contribution to national or subregional development plan;
- its impact on the balance of payments and on the generation of income;
- its impact on the environment.

Under Decision 24, clauses providing the following information must be included:

- identification of modalities of transfer of technology;
- contractual value of each element involved;
- determination of the period during which it shall be in force.

In addition the authorization of certain types of clauses, is forbidden including those which would entail an obligation to purchase capital goods, intermediate products, raw materials or other technologies from a given source; those which would reserve for sellers the right to fix prices; those which would restrict the volume or structure of production; those which would prohibit the use of competing technologies; those which would establish option to buy - total or partial - in favour of the supplier or the technology, which would require the buyer of technology to

transfer to the supplier any investment or improvement resulting from the use of such technology; those which would make it obligatory to pay royalties for unused patents; and those which would prohibit or limit the export of products made with the technology concerned, except in exceptional cases, excluding those falling within the sphere of subregional trade or the export of similar products to third countries.

A transfer of technology may not be considered a capital contribution and, in an intra-firm transaction, it does not give rise to a right to receive royalties or tax deductions.

Decision 24 provides that contracts for the licensing of brands may not include any restrictive clauses which would for example, prohibit or limit the right to export or sale in certain countries of products made with the brand name; require the use of raw materials, intermediate goods and equipment supplied by the owner of the brand or its affiliates; fix sale or resale prices; require the payment of royalties for unused brands, or require the use, on a permanent basis, of personnel supplied by, or designated by, the owner of the brand.

Not all contracts on the importation of technology are registered. In several countries, public sector contracts are either not registered or only partially registered, despite the large number of contracts involved. The acquisition of technology incorporated into capital goods is not systematically registered, evaluated or controlled in any country of the Andean Group. This type of transfer of technology undoubtedly accounts for the bulk of payments for technology made by these countries.

In general, it may be said that clauses which are expressly prohibited by Decision 24 have been eliminated from contracts, although there are some exceptions. As regards intra-firm payments, there are no uniform criteria in the subregion for establishing the existence of a dependency relationship between a parent company and a subsidiary. The criteria used generally refer to the holding by the parent company of stock in the subsidiary, and this varies from country to country.

There are very few cases in which technology contracts have been rejected. Several countries provide for a domestic recourse vis-a-vis the authority which is responsible for registering contracts.

Countries which do register contracts systematically tend to focus their attention on formal aspects, while they only consider the actual purpose of the contract in vague general terms. Up to now, the emphasis of policies on technology has been more quantitative than qualitative in all the countries which do apply registration. Contracts are normally analyzed in terms of their cost in foreign exchange, while their actual technological content, in connexion with which Decision 24 and 84 establish clear and explicit evaluation guidelines is not analyzed in detail, often because the necessary technical means are not available.

The modalities and magnitudes of payments made abroad for technology contracts vary considerably from country to country. The practice of basing payments on a percentage of net sales, accounts for more than half of all cases in one country and almost two-thirds in other; in a third, it only represents 12 per cent. A second option is that of paying a fixed amount; this has been adopted to varying degrees in the different countries and accounts for one-third of all cases in one country, 19 per cent in other and only 4 per cent in a third. In 1981 these payments ranged from a very low percentage of the countries' exports to 0.6 per cent. This difference may be explained by the different degrees to which the process is centralized in the various countries.

Intra-firm payments for technology imports were not interrupted with Decision 24, although they are prohibited. The publications of the United States Department of Commerce attest to this.

There are no subregional criteria concerning the range of payments allowed in connexion with the various economic sectors. In the case of one country, for example, it amounts to between 2 per cent and 3 per cent for the engineering and metal products sector and 2 per cent for the pharmaceutical sector, whereas payments usually are not authorized for the food sector.

In some cases, larger payments are authorized as a means of promoting exports. There is no technological justification for this criterion.

There is no evidence of regular and systematic monitoring, in any of the countries, of the performance of obligations. This is particularly true in the case of the actual transfer of the technology concerned. This does not mean that some countries do not closely follow the development of a given number of contracts each year, as in Colombia, for example. In general, no fines have been imposed for non-compliance with contracts.

Extensions of contracts show a certain tendency to reduce their duration, although there are a large number of long-term contracts.

None of the Andean Group countries have conducted long-term evaluations of the effectiveness of the andean regime for the transfer of technology.

#### Decision 220 (May 1987)

In May 1987 the Andean Pact nations agreed on important changes in the Treaty of Cartagena and they modified Decision 24. The new Decision 220 in fact consolidates some changes already in force in different countries.<sup>19</sup> Each country now has broader latitude to regulate foreign investment in accordance with its own regulations. The most significant changes are the following:

- transformation from foreign to mixed or national ownership is no longer required, except for investors wishing to benefit

from intra-Andean tariff and other trade benefits; in these cases, the transformation period has been expanded from 15 to 30 years (37 years in Bolivia and Ecuador);

- annual earnings remittances will no longer necessarily be limited to 20 percent of net registered capital, as individual countries may authorize higher percentages at their discretion;

- reinvestments no longer require prior authorization regardless of the amount reinvested;

- interest rates on loans from abroad to foreign firms are no longer subject to a limit of 3 percent over prime or LIBOR (the London Inter Bank Offer Rate); interest rates are left to individual countries' discretion;

- expanded access to local credit markets for foreign investors;

- shares in local companies may be sold to foreign investors, subject to local approval;

- prohibitions on investments in certain sectors are still in force; each government must determine which sectors will be restricted in accordance with Article 3 of Decision 220, which provides: "The member countries will not authorize direct foreign investment in activities considered properly managed by local existing companies";

- restrictions on international arbitration of investment disputes are left to the discretion of individual countries.

Decision 220 keeps controls and certain restrictions relating to the technology transfer and licensing. However, it has eliminated the prohibition on royalty payments between branches and their head offices or affiliates.

#### b) Caricom

The Common Market Annex of the Treaty of Chaguaramas includes an article calling for a regional policy on foreign investment. According to article 44 market states "recognize the need for continuing inflows of extra-regional capital and the urgent necessity to promote development in the less developed

countries" and declare that they "shall keep under review the question of ownership and control of their resources with a view to increasing the extent of national participation in their economies and working toward the adoption as far as possible of common policy on foreign investment".

A Draft Agreement on foreign investment and the development of technology - inspired on Decision 24 of the Andean Group - was proposed for adoption at the Special Heads of Governments Conference held in St. Lucia in July 1974, but it was not accepted.

c) Central America Common Market.

The 1960 Treaty does not contain any reference to the treatment of FI within the CACM. In 1976, a High Level Committee submitted to the different Governments of the area a draft of the Central America Economic and Social Community, which included specific regulations on foreign investment. However, this new treaty has not been approved as of today.



## 5. Investment Financing

There are four multinational development banks in the region. The Inter American Development Bank (IDB), the Central American Bank for Economic Integration (CABEI), the Andean Development Corporation (CAF) and the Caribbean Development Bank (CDB).

### CAF

The CAF has approved credit operations for US\$572 millions since 1971, when it initiated its activities, up to December 1985. It is by far the most important channel for joint subregional investment and its authorized capital has been recently increased from US\$400 to US\$1,000 million. During 1983 the CAF approved credits for US\$121 millions corresponding to 20 operations. With regard to the project distribution by sectors, to industry corresponded something less than a third of the total. The rest of it went to energy (30 per cent), agriculture (16 per cent), transportation (14 per cent) and mining (10 per cent).

### CABEI

The Constitutive Agreement of CABEI went into effect in 1961. The CABEI went through a liquidity crisis during the past years and also had political problems, as the country members would not agree on the person of the President of the Bank. In fact, at the end of the 1982-1983 period was not possible to finance the meeting of the Board of Governors. In February 1985 the Ordinary Assembly decided to create a Fund for the Economic and Development of Central America, with capital for US\$250 million.

### CDB

The CDB operations declined in 1985 up to the 1978 level and the total approved lending reached only US\$41 millions, all of them to the public sector and 90 per cent for the development of infrastructure. The industrial sector got 18.5 per cent of that total. Additionally the CDB lent US\$7.8 million for new projects in the LDCs of Caricom.

IDB 20

In 1983 the IDB decided to create the Inter-American Investment Corporation, thus providing the region with a complementary mechanism to supply the necessary investment for the private sector's production activities.

Since 1969 the IDB has undertaken a variety of initiatives to implement such a mechanism. At its XXII Annual Meeting, held in 1981, the IDB Board of governors considered Venezuela's proposal to establish a Multinational Trust Fund for equity investments, and the Board Committee was asked to study the plan and consult with member countries interested in the initiative.

Since then the Committee has met several times, because a large number of member countries demonstrated their willingness to participate in the initiative. The negotiations culminated in a meeting of interested parties held in Rome on November 3-4, 1983, during which the text of the Constitutive Agreement of the Inter-American Investment Corporation was signed. All IDB borrowing countries signed the document, as did the United States and Italy, among the Bank's developed member countries. The other member countries had until 29 February, 1984, to sign the document if they wished to be included as founding members of the Corporation.

The purpose of the Corporation is to promote the economic development of its developing regional member countries by stimulating the establishment, expansion, and modernization of private enterprise, giving priority to small and medium-scale operations, in a manner that will complement the activities of the Inter-American Development Bank. Also eligible for financing are enterprises whose shareholders include the government or other public entities with activities that strengthen the private sectors of the economy.

In order to do this, the Corporation will exercise the following role: to help finance the establishment, expansion and modernization of enterprises; to stimulate investment

opportunities; to provide technical cooperation; and to promote the development of Latin America's capital markets.

In addition, the Corporation will encourage participation by other sources of financing and/or technology, recurring to the most appropriate modes - among which are consortia for obtaining loans and the acquisition of stock by the Corporation in such companies, as well as joint enterprise, and other forms of association, such as licensing agreements, marketing or management contracts, and the like. The Corporation will also attempt to cofinance local financial institutions and, in general, work together with them and other international and bilateral investment institutions.

The goals of the Corporation will be the following: project identification; direct investment in viable private enterprise; financing and strengthening of development financing entities that serve small enterprises; the creation of interest in direct investment opportunities in Latin American enterprises; the promotion of capital-market expansion; and the provision of advisory assistance on ways of encouraging a healthy climate for the expansion of private investment.

The Corporation's principal financial instruments will be long-term loans (from five to twelve years) with grace periods, equity investments in suitable enterprises, and the concession of partial or total guarantees when appropriate.

The investment activities of the Corporation will concentrate chiefly on medium-sized enterprises. The size of these firms, measures by such criteria a total asset, net worth, number of employees, and so forth, will vary from one country to another, and over time. Investment may be made in association with local, regional, and international financial institutions and may be carried out through consortium operations or other catalyzing mechanisms, as deemed appropriate. This focus on medium-sized enterprises what distinguishes the Corporation from other similar international financial institutions that operate in the region.

The Corporation also considers the promotion of small-scale enterprises in the developing countries as a matter of prime importance in terms of social and economic development. However, the experience of other international financial institutions and the evaluation of other forms of operation applicable to the small-scale enterprise indicate that it is not possible to provide backing for these businesses directly or individually from Corporation headquarters. The activities of the Corporation in this respect would primarily consist of financing (debt or equity) and/or providing technical cooperation to private or semi-private financial intermediaries, funds, or programmes designed to promote small-scale enterprises. With this goal in mind, the Corporation will also attempt to coordinate its activities with respect to small-scale enterprises and cofinance these projects with other international, regional or subregional institutions that can commit themselves to providing assistance to such enterprises.

One of the basic criteria for determining the possibility for investment will be a consideration of the economic impact of the eligible projects and enterprises. Project sponsors will provide a considerable part of the capital for the enterprises and, generally speaking, the Corporation's financing through equity capital, quasi-equity capital, and/or debt instruments should complement local resources and be utilized, insofar as possible, to mobilize additional funding from other sources.

The maximum financial commitment from the Corporation for a given project or enterprise will not exceed 40 per cent of the total cost, or this same percentage of the company's total stock. The total of these commitments may not exceed 10 per cent of the net capital of the Corporation in any given case. For equity investment, the Corporation's share in the total capital of a business may not exceed 33 per cent nor be less than 15 per cent.

The initial authorized capital of the Corporation will be US\$200 million, distributed in 20,000 shares of US\$10,000 each, underwritten by the IDB member countries that have agreed to join

the institution. This capital may be increased by the Corporation's Board of Governors. Once the authorized capital has been totally paid in, the Board may also authorize the issue of callable capital. The Latin American countries, as a group, have stated their intention to underwrite 45 per cent of the capital. The other 45 per cent would be supplied by the United States, Italy, and other developed member nations of the IDB.

Other funding for this entity will be derived from bond issues, debt papers and stock certificates; dividend income, commissions, interest and other funds derived from the Corporation's investments; loan recovery; sales of business investments; and any other contributions and funds entrusted to its administrations.

The Corporation will be a separate and distinct entity from the IDB. Therefore, its resources and operations will remain autonomous and its basic organization will be independent. However, it is hoped that the Corporation will reach agreement with the IDB regarding the use of certain Bank facilities.

## 6. Technological cooperation 21

The Cartagena Agreement covers technological policy for the subregion and provides for the establishment of the Andean system of Technological Information (SAIT) and the andean programmes of Technological Development (PADT). SAIT functions as a clearing house in the subregion for the exchange of technological information whereas PADT aims at promoting assimilation and development of technology relevant to or appropriate for the subregion.

PADT has since developed a few significant technological programmes for the subregion. First, the Andean Project for Technological Development in Copper Hydrometallurgy was approved. This was designed to step up the transfer and adaptation of technologies for copper extraction by acid solution and by bacterian-acid process, and recuperation through ion exchange and electrode position. The project was also involved in the training of qualified personnel as well as in adapting and integrating the advances equipment and technology from the transnational corporations for regional applications. The main beneficiaries of this project are the copper-producing members, Bolivia and Peru.

Secondly, the Andean Forest Project was set up with a view to conducting research and disseminating knowledge in regard to the timber and other forest resources in the subregion. Work on testing various forest species has been carried out and new technology for timber exploitation has been developed. Specifically the Andean Laboratory of Wood Engineering was founded in Lima and the Andean system of Classification of Structural Wood was developed.

Thirdly, the Andean Project of Food Technology was approved by Decision 126 of the Agreement. The project has five programmes designed to carry out research on the production, marketing and

consumption of food in the subregion with a view to developing food of high nutritional value and low cost for groups such as children and pregnant women.

Finally, a programme for promoting social and economic development of the rural environment has been set by PADT. The programme with the generation and transfer of technology related to the development of a sound rural environment.

Apart from activities within the two formal organizations, SAIT and PADT, regional technological cooperation as provided by the Cartagena Agreement also includes appropriate legislations for marketing technology, patent rights and the legal aspects of technology transfer from outside the subregion.

## III. IMPLICATIONS FOR UNIDO AND ECLAC PROGRAMMES

1. The need for research on the subject

A thorough examination of the process of internationalization of production in Latin America has never been attempted, mainly because of the traditional split of the subject between TNCs, on the one hand, and economic integration, on the other. The first - TNCs within the industrial sector - has not been systematically researched for the region <sup>22</sup> and the latter is usually visualized as a derivative from foreign trade. Completely lost in the analysis is the private foreign direct investment made by local firms.

There is no doubt that UNIDO and ECLAC are the logic agencies to do the necessary research on this important subject.



## 2. A tentative outline of the study

The research should include the following aspects:

### I. THE INTERNATIONALIZATION OF INDUSTRIAL PRODUCTION

1. The concept of the internationalization of production
2. Economic integration efforts aiming at some form of international specialization of the productive system;
3. Foreign direct investment by local investors: characteristics, dynamics, preconditions and results. The special case of joint ventures;
4. Foreign direct investment by TNCs within the industrial sector in Latin America and the Caribbean

### II. CONCLUSIONS AND POLICY OPTIONS

1. Similarities and differences among the diverse channels for the internationalization of production;
2. Differential success of private and public promotion of this process. Some explanations for it;
3. Convergency of divergence of these channels? What governments could do, different options.

Notes

1/ See E. Lahera, "The transnational corporations and Latin America's international trade", CEPAL Review, No. 23, 1983.

2/ The same source explains that "for several reasons, it is very difficult to determine the magnitude and relevance of these capital flows. First, direct foreign investment statistics leave much to be desired, since in many cases there are neither official records nor contracts showing government involvement. Second, the records that do exist lack homogeneity; thus, some countries count authorized investments, while others count investments recorded or investments actually carried out, etc. While producing similar statistics, these different definitions of direct foreign investment make comparative studies difficult. Third, estimation of direct foreign investment involves determination of the national origin of the capital, since investments by transnational subsidiaries with capital from different countries may be classified in various ways... (These figures) do not include unrecorded investments, which have been very important in some countries, for example, in the real estate sector in Uruguay. In general, investments by private individuals are recorded only in countries that practice strict exchange control, which makes inter-country comparisons more difficult". INTAL, Economic and Social (Progress in Latin America, 1984 Report, 1985, p. 137.

3/ Bruno Raddaverro, "Posibilidad de empresas conjuntas en el ámbito iberoamericano", Comercio Exterior, February 1985. Jaime Campos, Guillermo Ondarts and Eduardo White, Las empresas conjuntas latinoamericanas, INTAL, 1978. Field research was ended by December 1976.

4/ This field of research remains unexplored, except for INTAL's figures. The research for the last good study related to this subject was made more than a decade ago and, besides, it only deals with the joint venture of foreign direct investment. So far, no comprehensive study on the subject has been ever attempted. It is my conviction that the explanation of this fact is to be found in a wrong approach to the subject which has been hitherto predominant. These conceptual problems have to be cleared in order to get a sharper focus on the problem. See Jaime Campos, Guillermo Ondarts and Eduardo White, Las empresas conjuntas latinoamericanas, INTAL 1978. Field research was ended

by December 1976.

5/ On this subject see "The magnet of growth in Mexico's North" Business Week, 6 June 1988 p. 48-50 and David Garner, "The rich pickings in america's backyard", Financial Times, 31 July 1987, A.B. Gonzalez, N. Fuentes and R. Barajas "Proteccionismo en Estados Unidos y maquiladoras en México. Un debate internacional". Comercio exterior, volume 37, No. 11, Mexico, November 1987, p. 907-925.

6/ A complete survey can be found in Enrique Saravia "Empresas públicas multinacionais: o caso da America Latina e do Caribe", Revista de Administracao Publica, Rio de Janeiro, January-March 1987, p. 67-105.

7/ Mario Blejer "Economic integration: an analytical overview" in INTAL, Economic and Social Progress in Latin america, 1984, Report, 1985.

8/ See also "La complementaridad industrial en Centroamérica", Cuadernos de la SIECA, No. 16, 1986.

9/ The Caribbean Community in the 1980s, Guyana, 1981 and Caribbean Development Bank Annual Report 1985.

10/ Caricom Perspective, November-December 1985.

11/ Lynn Mytelka, Regional Development in a Global Economy, Yale, 1979.

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22/ One important exception is Jan Křákal s La presencia de las empresas transnacionales en la industria manufacturera de América Latina, CEPAL, mimeografiado, November 1975.