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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.



FOREIGN INVESTMENT IN LATIN AMERICA AND THE CARIBBEAN

1998 REPORT



UNITED NATIONS



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ABSTRACT

This study approaches foreign direct investment (FDI) in Latin America and the Caribbean from a new perspective by analysing the strategies of transitional corporations in an attempt to overcome the limitations of official FDI statistics (whether from destination countries or the main investor countries). This is achieved through a study of the information obtained from research programmes of the Unit on Investment and Corporate Strategies and from information obtained from secondary sources, mainly from specialized financial journals. This approach affords a better understanding of the nature of the phenomenon, set against the background of international market trends, national policies (of both source and destination countries) and new corporate strategies.

For the eighth consecutive year, FDI flows into the region have increased sharply and have had a very strong impact on the economic performance of countries. In 1997, US\$ 65.2 billion poured into the economies of Latin America and the Caribbean. Approximately 30% of that was concentrated in Brazil, which emerged once again as the principal FDI destination country in the region. According to preliminary estimates for 1998, net FDI inflows will be much the same as in 1997.

This document presents a comprehensive analysis of FDI patterns in terms of amounts, form, geographical and sectoral destination and main agents. It also includes a detailed study of FDI characteristics in the six main destination countries (other than Brazil) and of the emergence of intraregional investment. As the target for the highest levels of inflows in recent times, Brazil is the subject of a chapter in its own right; another chapter is devoted to the investor country that is the source of the largest stock of FDI in the region, namely, the United States; and a third deals with the sector in which the most important foreign firms in terms of sales are to be found: the automotive industry.

This document has thus succeeded in overcoming statistical deficiencies and providing deeper insight into the phenomenon.

FOREWORD

For a number of reasons, the 1998 edition of the report, *Foreign Investment in Latin America and the Caribbean*, represents a significant step forward compared with previous versions. First of all, in this document a new analytic framework has been adopted that provides for a more in-depth examination of the subject and goes beyond statistics on foreign direct investment (FDI) to improve comprehension of the business strategies involved. Beginning with the 1998 edition, the document will contain four basic chapters: one on trends in FDI and the situation in the region's principal destination countries; another on a major destination country; a third on an important source country; and a fourth on a sector in the region that is important internationally to major transnational corporations. In this way, the research programme of the Unit on Investment and Corporate Strategies can add much more to official information on FDI flows and the activities of transnational corporations in Latin America and the Caribbean.

Second, the countries and sector most relevant for FDI in the region have been selected for this edition. The destination country discussed is Brazil, which has received the greatest FDI inflows in recent years. The source country considered is the United States of America, which accounts for the largest amount of FDI. The industrial sector selected is the automotive industry, which has attracted the largest foreign enterprises (in terms of sales) to the region.

Third, this report has been produced within the calendar year following the year of publication of the latest official statistics from international bodies. Moreover, it has been possible to make estimates for 1998 on the basis of official information from national sources for some of the most important FDI destination countries.

In terms of content, this edition shows that Latin America and the Caribbean have, despite the Asian crisis, seen a significant increase in FDI flows, thereby gaining in relative importance among the developing countries.

Thanks to the new approach used, the cases selected and the analysis of the latest information, this 1998 edition of *Foreign Investment in Latin America and the Caribbean* will be an indispensable reference for all persons and organizations interested in the subject.

Joseph Ramos, Director
Division of Production, Productivity and Management

SUMMARY AND CONCLUSIONS

1. A regional survey from a new analytical perspective

In the latter part of this century, foreign direct investment (FDI) —reflecting the international expansion of transnational corporations— has been one of the key elements in the globalization of the world economy. During the 1990s FDI flows worldwide grew strongly, averaging an annual US\$ 245 billion between 1991 and 1996 and leaping to nearly US\$ 400 billion in 1997. Thus, transnational corporations have continued to grow in importance in the economies of most nations, whether developed or developing.

These extraordinary growth figures conceal great differences among and within regions. In the present decade, the developed countries accounted for more than 60% of total inflows and more than 90% of total outflows of FDI. A significant trend in recent years has been the growing share of developing countries in inward FDI, a share that reached 38% of total inflows in 1997. That same year saw major shifts in the distribution of world FDI flows among the developing countries. Latin America and the Caribbean experienced a sharp increase (43%), reaching a share of 44%, while the Asian developing economies maintained but did not improve their lead —53% of FDI flows to developing countries— and Africa lost considerable ground. Overall, the acute financial crisis originating in Asia appears to have improved Latin America's position as a destination for FDI.

The increase in FDI to Latin America and the Caribbean in recent years has been substantial, rising from US\$ 33.006 billion to US\$ 65.199 billion between 1995 and 1997. Moreover, despite the Asian crisis the trend appears to be stabilizing, since estimates for 1998 indicate that FDI inflows will roughly equal those for 1997. Because of this impressive growth, 45% of the stock of FDI in 1997 had accumulated over the previous seven years. In other words, the stock of FDI in Latin America has been renewed during the 1990s, hence the need to reconsider the nature of the phenomenon.

In 1997, FDI flows to the region were heavily concentrated (90%) in the countries of the Latin American Integration Association (LALA), primarily Brazil and Mexico. The remaining 10% was divided between the Caribbean Basin countries (4%) and the Caribbean financial centres (6%). It is curious that the amounts recorded as inflows and subsequently as outflows by the latter are substantially less than the flows recorded as received by the destination countries from the financial centres. This reveals one of the weak points in the statistical data and suggests the distortions that the financial centres produce as a place of transit for investments ultimately destined for third countries within or outside the region. There is thus a need to supplement official data with information from other sources.

Beginning in 1996 Brazil has recovered its position as the chief destination for FDI in Latin America and the Caribbean, replacing Mexico in the number one spot. In 1997, Brazil received 30% of the FDI destined for the region, followed by Mexico and Argentina with 19% and 10%, respectively. Chile, Colombia and Venezuela were also major recipients of FDI, with roughly similar inflows. These six economies plus Peru accounted for 97% of flows to LAIA member countries. The report that follows includes a general analysis of the main characteristics of this group of seven countries accounting for most FDI flows to the region.

The Caribbean Basin countries —excluding the financial centres— attracted 4% of FDI flows to the region. During 1997 the subregion experienced 41% growth in FDI, chiefly concentrated in Trinidad and Tobago in the oil and gas industry and in Costa Rica and the Dominican Republic in the export manufacturing industry, particularly the *maquila* segment. The case of Costa Rica is particularly interesting; there the Government has pursued a selective policy, attempting to encourage FDI flows in the areas of tourism and high-tech manufacturing, and recently succeeded in attracting the establishment of a subsidiary of Intel, the United States microprocessor manufacturer. In addition, a number of countries of the subregion have stepped up their efforts to privatize State-owned companies, basically in the areas of electricity and telecommunications; El Salvador is a notable example.

In the first half of the 1990s, privatization of State-owned assets was the chief mechanism for attracting FDI. During the period 1994-1996, the strong increase in FDI was also boosted by an intensification of greenfield investment and investment in restructuring and modernization by foreign companies already established in the region, together with new investment to restructure and modernize privatized enterprises. In 1997, in a continuation of the trends in recent years, transfers of assets —both public and private— to foreign investors were the chief channel for FDI in Latin America and the Caribbean. The trend was particularly strong in the larger economies, such as Brazil, Argentina, Mexico, Colombia, Venezuela and Chile. In countries in a late stage of their privatization programmes (Argentina, Chile, Mexico and Peru), transactions between private agents were relatively more important. FDI related to acquisitions of fixed assets in the private sector slightly exceeded acquisitions of State-owned assets; the latter, however, increased more proportionally —especially in Brazil and Colombia, whose privatization programmes were in full swing. In 1997, of the three main channels of FDI in the region (acquisition of private assets, privatization of State-owned companies and investment in new assets), the first registered the heaviest flows (US\$ 23 billion), while the other two contributed similar amounts (US\$ 17 billion each).

In these massive new inflows of capital, conventional sales of State-owned assets have been supplemented by a "second wave" of privatizations, involving the transfer to the private sector —under concession— of activities previously reserved to the State and the partial opening of new markets (such as cellular telephony) or of large public enterprises (such as mining and oil and gas development) to foreign private investment. In many instances foreign investors have teamed up with local firms as a way of diversifying the risks associated with these operations. Although such investments do not, at first, increase the production capacity of the destination country, they have helped to improve the quality of services provided (especially in energy

generation and distribution, transportation and telecommunications), thereby enhancing the systemic competitiveness of the destination country.

With more open markets, the owners of many Latin American firms have been obliged to sell for lack of the technology and capital needed to compete. In recent years, many foreign corporations have taken advantage of these opportunities to enter or expand their presence in the region. The process has been especially intense in Mexico —because of the opportunities offered by the North American Free Trade Agreement (NAFTA)— and in Argentina and Brazil —as a way of creating and consolidating subregional production networks in the Southern Common Market (Mercosur).

Along with the expansion and diversification of intraregional trade, there has also been a major increase in recent years in investment between countries of the region, a trend that has assumed significant proportions in the Southern Cone, especially in Chile. Although the process is still in its early stages and is hard to measure because of the difficulty of obtaining the pertinent data, it appears likely that intraregional investment will continue to expand as trade liberalization and regional integration schemes move forward and deepen. The trend reveals a significant shift in the way leading Latin American firms are tackling the challenges of globalization and points to increasing confidence in the way the region's economies are going.

Between 1994 and 1997, foreign firms have increased their presence among the 500 largest companies in the region, raising their share of total sales of the group from 29% to 33%. In 1997 there was heavy concentration (88%) in just three countries —Brazil, Mexico and Argentina— and in just six industries (84%) —motor vehicles (26%), food products, beverages and tobacco (19%), wholesale and retail trade (11%), electronics (10%), petroleum (9%) and chemicals (9%). Around 50% of those foreign firms were based in the United States, 38% in European Union countries.

According to estimates by the ECLAC Unit on Investment and Corporate Strategies, FDI flows to LAIA countries in 1998 should be around US\$ 58.1 billion, nearly identical to the figure for 1997. This suggests that, despite the Asian crisis, the extraordinary growth in FDI since 1994 is beginning to stabilize. As in the previous two years, FDI flows would seem to have been concentrated in Brazil, at levels well above the flows to Mexico, Chile, Colombia, Argentina and Venezuela. This reflects the great interest evidenced by international investors in 1998 in Brazil's privatization programme. In July 1998, for example, the sale of the Telebras system brought Brazil some US\$ 12.620 billion in FDI.

The present report attempts to bring together and systematize all the information available on this process in order to contribute to a better understanding of it. The data obtained by the Unit through its research programme and from the financial press, while not strictly comparable, have been a useful supplement to the official figures (of the destination countries and some of the main source countries) on FDI flows. All this information, together with a cross analysis of the new international market context, national policies and corporate strategies, provides insight into the nature of the new FDI flows and sheds some light on the strategies of foreign investors in the region at the close of the twentieth century.

**FOREIGN DIRECT INVESTMENT FLOWS TO COUNTRIES OF THE LATIN AMERICAN
INTEGRATION ASSOCIATION (LAIA), 1990-1998**

(Millions of dollars)

Country	1990-1994	1995-1997	1996	1997	1998 ^a
Argentina	2 931	5 400	5 090	6 326	5 800
Bolivia	107	489	474	601	660
Brazil	1 703	11 904	11 200	19 652	24 000
Chile	1 207	4 373	4 724	5 417	4 700
Colombia	860	3 828	3 276	5 982	6 000
Ecuador	293	498	447	577	580
Mexico	5 409	10 396	9 185	12 477	8 000
Paraguay	118	151	106	191	210
Peru	785	2 419	3 226	2 030	3 000
Uruguay	69	151	137	160	160
Venezuela	836	2 752	2 183	5 087	5 000
Total	14 318	42 361	40 048	58 500	58 110

Source ECLAC, data base of the Unit on Investment and Corporate Strategies, from information provided by the International Monetary Fund (IMF) or taken from the balance-of-payments data of each country.

^a Estimated.

- The advance of globalization has changed the structure of the world market, the nature of the competitors, the technological demands and the international rules and standards for trade, investment and intellectual property. Companies already operating in the region —as well as newcomers— have been confronted with a new competitive situation that has altered the structure, quality and scope of their investments in Latin America and the Caribbean.
- New national policies: macroeconomic stabilization, trade and financial liberalization, deregulation of the economy, wide-ranging privatization programmes, loosening of the regulatory frameworks applicable to private investment, and regional integration movements have considerably modified the business environment in Latin America and the Caribbean, thereby providing an incentive for companies, both domestic and international, whether already established in the region or newcomers, to invest.
- Transnational corporations have adapted to this new environment and adopted new strategies to take advantage of trends in international markets and national policies. To a greater or lesser extent, these corporations have begun to establish integrated production systems on the international, regional and subregional levels, systems in which some of the economies of Latin America and the Caribbean are gradually being incorporated.

The new patterns of competition —resulting from trade and financial liberalization— have awakened the interest of new entrants and forced the transnational corporations already established in the region to rethink their strategies. Some transnationals with a presence in Latin America have simply withdrawn (deciding to supply local markets through exports); others, with the aim of defending or increasing market share, have *streamlined* (basically through strategies to defend themselves against imports) or *restructured* their operations, making new investments in the light of the new national, subregional (in the case of NAFTA and Mercosur) or international environment. In manufacturing, two basic strategies can be identified, having to do with:

- The search for greater efficiency through internationally integrated production systems of transnational corporations;
- The search for access to national and subregional markets.

The deregulation of Latin American economies has opened up new opportunities for investment in sectors previously off-limits to private enterprise in general and to foreign firms in particular. As a result, there has been a notable influx of new entrants in extractive sectors (mining and hydrocarbons) and services (finance, electricity and telecommunications). Hence, one can identify two other basic strategies pursued by foreign investors in the region:

- The search for raw materials;
- The search for access to domestic markets for services.

The first of the four strategies identified above has been applied most intensively in Mexico, principally in the automotive, auto parts, information technology, electronics and garment industries. In response to the challenge posed by Asian competition in their home market, three major auto makers from the United States (General Motors, Ford and Chrysler —the latter before it was acquired by the German firm of Daimler-Benz) and several from other countries (Volkswagen and Nissan) tried to improve production efficiency by investing in new plants in Mexico with state-of-the-art technology and equipment. Moreover, other foreign firms (from the United States and to a lesser extent Asia), taking advantage of NAFTA and the *maquiladora* regime, decided to invest in plants Mexico to produce consumer electronics (televisions, computers, sound systems and telecommunications equipment) and wearing apparel for export to the North American market.

As in Mexico, many United States firms have invested or gone into partnership with local firms in the Caribbean Basin countries (notably Costa Rica, the Dominican Republic, El Salvador, Honduras and Guatemala) to reap the advantages of export processing zones (*maquila*), low wages and United States tariff preferences, in order to compete more successfully in the North American market. Their investments in the Central American and Caribbean countries in response to the Asian challenge have mainly been in the manufacture of wearing apparel and electrical and electronic appliances.

Other key strategies in manufacturing have been to streamline and modernize for the sake of gaining, defending or increasing share in a domestic or subregional market. Foreign firms with a presence in Argentina and Brazil —and by extension Mercosur— have been obliged to rethink

their strategies in the light of the new patterns of competition resulting from the opening of those economies. The general approach has been to maintain and expand their presence in those markets with products basically designed for the local market but capable of competing with imports. There has been heavy investment, for example, in motor vehicles, food products, chemicals and machinery. The foreign firms with a major presence in the Mercosur automotive industry (Fiat, Volkswagen, Ford and General Motors) are investing in order to defend their market shares and respond to increased demand, especially for the popular compact cars. There are a number of firms which are trying to enter (or pull out of) the subregion (Chrysler, Renault, Peugeot, BMW, Mercedes Benz, Honda, Asia Motors and Hyundai), seeking new "market niches".

However, a good number of transnational corporations already established in the region have adopted a different strategy to improve their position in revitalized regional markets. Some large foreign firms in the food, beverage and tobacco industries in the Mercosur countries and in some other major Latin American markets, such as Mexico and Venezuela, have tried to reduce competition and consolidate their market positions through large local acquisitions.

The third strategy identified above was made possible by the opening up of natural resource-related activities —exploration, development and processing— to foreign capital. The first country to attract the attention of major transnational corporations in this regard was Chile, after it offered extensive guarantees and allowed free access to mineral resources. Later, in the 1990s, other countries, including Argentina, Bolivia and Peru, adopted similar policies and opened the door to extensive new mining investment.

One of the most significant developments of recent years has been the progressive opening of the oil and gas industry —until a few years ago entirely under State control— to allow for increasing participation by foreign investors in areas related to exploration, development, processing, distribution and marketing of petroleum, natural gas and derived products, through bidding on secondary reserves, joint ventures in key activities or, in a few cases, complete privatization of the industry. The most striking examples of this in the region are Venezuela, Colombia, Argentina, Peru and Bolivia. In Venezuela, joint ventures are in the offing between the State oil company, *Petróleos de Venezuela S.A. (PDVSA)* and foreign investors that are expected to bring in more than US\$ 30 billion dollars over the next ten years and double the country's output.

Lastly, service sectors in Latin America and the Caribbean have been opened on a broad scale, so that in most countries service sectors are attracting an increasing proportion of inward FDI. Foreign investors, many of them newcomers, have gained large and increasing shares in the areas of finance, energy (electricity generation and distribution and natural gas distribution) and telecommunications.

In finance, for example, the strategy adopted by Spanish banks, particularly Santander, Bilbao Vizcaya (BBV) and Central Hispano (BCH), is of great interest. Through an aggressive acquisition strategy, these three banks have established a strong presence in the region, especially in Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela. These three Spanish banks, and the same is true for the Hong Kong Shanghai Bank Corp. (HSBC) and a Canadian bank, the

Bank of Nova Scotia, have apparently set out to achieve clear leadership in the Latin American financial sector through their regional positioning.

In recent years, as a result of the privatization of State-owned electricity generating and distribution enterprises, a new contingent of foreign investors has found a foothold in the Latin American energy sector, among them Chilean firms (Enersis, Endesa and Gener), Spanish firms (Endesa and Iberdrola) and a number of pioneering firms based in the United States (AES Corp., Houston Industries Energy Inc., Southern Electric, CEA, Dominion Energy and CMS Energy). The main target of this ambitious strategy of acquisition and investment is the Brazilian target, which suffers from an energy shortage. Given the large amount of money involved, the acquisition of the privatized assets has required the formation of consortiums composed of foreign firms of various origins in association with powerful local groups. Interest first focused on privatizations in Argentina, then shifted to Brazil. Huge projects for transporting and distributing natural gas began to be linked with electricity generation in Brazil. The United States firm of Enron has been especially active, participating on a large scale at all points of the energy delivery chain: in acquiring and developing natural gas deposits, transporting and distributing natural gas (locally and regionally) and generating electricity.

Telecommunications enterprises have been among the favourite targets of foreign investors. Since the end of the 1980s, the main State-owned telecommunications enterprises of Argentina, Bolivia, Chile, Mexico, Peru, Venezuela and more recently Brazil have passed into private hands, and cellular telephony concessions have been auctioned off. The liveliest actors on this new stage have been the Spanish company, Telefónica de España, in fixed-line telecommunications (local and long-distance calls) and the United States firm, BellSouth, in mobile telephony. The recent privatization of the Telebras system demonstrated the great interest of foreign corporations in such assets in the region: the Government of Brazil realized more than double its original expectations in proceeds. As in the markets of other industrialized countries, an increasing tendency is observable in the region towards the integration of telecommunications system with other communications media (network, cable and satellite television, Internet access and the press). This tendency is most clearly marked in Argentina, where an unusual strategic alliance is shaping up between Telefónica de España and the United States banking firm, Citicorp, for the control of a significant share of the market in fixed and cellular telephony, network and cable television, Internet access and other mass communication media.

To sum up, through these four basic strategies transnational corporations have strengthened the linkages of the countries of Latin America and the Caribbean to the global economy and helped them to overcome internal restructuring problems and the effects of outside turbulence. Hence, a number of Latin American countries are beginning to play a part in the integrated production plans of the major transnational corporations, which are launching new investment projects or restructuring old ones owing to the stimulus provided by the new regional scenario.

2. Brazil: the biggest recipient of foreign direct investment in Latin America and the Caribbean

In recent years, coinciding with Brazil's policy of stabilization (the *Real Plan*), openness and liberalization, FDI inflows into the Brazilian economy have increased considerably from US\$ 3 billion in 1994 to more than US\$ 19.6 billion in 1997. In 1998 they are expected to exceed US\$ 24 billion. Brazil has thus regained first place in foreign investors' preferences in Latin America and the Caribbean. This exceptional growth in FDI inflows is mainly due to two different but related factors.

The first of these is the reaction to the new economic situation in Brazil by transnational corporations present in the country for a long time. In 1995 much of the stock of FDI was concentrated in the manufacturing sector (55%), with transnational corporations dominating the high-technology branches. Until the mid-1990s, given the macroeconomic instability prevailing in Brazil, these corporations defended their market share chiefly by *streamlining* their local operations without making major investments, and this caused them to fall further behind the leading edge of technology. With the successful implementation of the stabilization programme and increasing economic openness and liberalization, the transnational corporations present in Brazil had to rethink their business strategies in the country and how they fit into their worldwide integrated production networks. Some *withdrew*, while others felt obliged to restructure and make major investments to defend their market shares. These new investments were designed to support two very different strategies:

- Restructuring and modernization of existing installations or construction of new, modern plants, as was the case with automobile assembly plants, for example. In a number of industries this restructuring and modernization strategy extended throughout the Mercosur area.
- An aggressive strategy of acquisition of the assets of local enterprises, intended to strengthen and extend the transnational corporations' presence in the Brazilian market, concentrating on their core businesses. In recent years foreign corporations have generally diversified less, using acquisitions to eliminate or discourage competition, and betting on the potential of the Brazilian and Mercosur markets.

Also noteworthy is the reaction of foreign investors not established in Brazil to the new opportunities provided by the deregulation of the economy. The massive influx of newcomers is especially significant in the service sector, where there had previously been considerable restrictions on FDI. As a result, services overtook manufacturing as the main destination of FDI, accounting for 57% of FDI stocks as of late 1997. The new opportunities attracted not only major transnational corporations but also others which were smaller, even in their home markets; for these, entry into the Brazilian market was the first step in the globalization process. The basic strategy adopted by these new investors was to purchase existing assets, through two main mechanisms:

- Privatization of State assets, in which foreign investors have been predominant in the purchase of enterprises in the electrical and telecommunications sectors. The modernization of the acquired facilities has brought in considerable FDI flows in the form of new assets.
- Acquisition of local enterprises affected by the new competitive situation in the Brazilian economy, a process which has been particularly intense in the financial industry.

This schematic view draws attention to two new elements in Brazil's recent experience: a significant proportion of FDI flows are *transfers of ownership*, and there is strong concentration in *non-tradables activities*. The consequences for the Brazilian economy are uncertain and have given rise to much debate. On the one hand, the massive arrival of foreign investors —through the purchase of existing assets— could have positive effects in terms of modernization and improvement of services, with the consequent positive impact on the country's systemic competitiveness. Also, new patterns of competition could encourage transnational corporations in manufacturing to link Brazil more closely into their international production networks. Lastly, the considerable size of the domestic market (strengthened by Mercosur) and the improved economic outlook should continue to attract international investors to Brazil.

On the other hand, the huge FDI flows into the Brazilian economy seem to be a short-term phenomenon rather than reflecting a long-term trend, particularly since the privatization programme will taper off in the coming years. Moreover, the preference for services is likely to accentuate the anti-export bias characteristic of Brazil's industrialization process, and this could lead to worsening balance of payments problems in future.

3. The United States: the chief source of direct investment in Latin America and the Caribbean

The Latin American and Caribbean region has become increasingly important in the strategies adopted by United States transnational corporations to meet the new challenges of globalization. Direct United States investment in the region provides an excellent example of the discrepancies between official information on FDI flows from a balance-of-payments perspective and the business strategies applied by corporations to their operations in the region, and this makes it more difficult to get a clear picture of the globalization process. The United States Government provides considerable statistical information on FDI from that point of view, through the *Survey of Current Business* published by the Department of Commerce. Unfortunately, United States investments passing through the region's financial centres distort the aggregate statistics, since they make up 43% of the United States FDI stocks in Latin America and the Caribbean. In other words, a little less than half of FDI in the region goes to a destination other than that recorded. Perceiving the reality of globalization is therefore a matter for intuition, since it is not clearly evident from analysis of these aggregate figures.

The globalization process can be seen much more clearly by analysing certain operations which are representative of United States FDI in the region. The most important sources for

improved understanding of the phenomenon are the data on transactions provided by the United States Government in the *Benchmark Surveys* produced by the Bureau of Economic Analysis of the Department of Commerce, and the results of the research programme conducted by the Unit on Investment and Corporate Strategies of ECLAC. These have shown that the nature of the investments has changed substantially compared with traditional strategies, according to the needs and opportunities arising from globalization and structural reform in the countries of the region.

During the 1990s, Latin America and the Caribbean have become the most attractive developing region for United States investors, which accounts for the fact that the region now represents 20% of that country's total FDI stocks (if financial centres are excluded, the region's share falls to 11%). Between 1990 and 1997, direct United States investment in the region increased by US\$ 10.141 billion to a record level of US\$ 23.784 billion. As a result, the stock of FDI originating in the United States has been renewed in the last few years. Moreover, the region accounts for 8.3% of total sales and 8.5% of exports of majority-owned affiliates of United States transnational corporations present in Latin America and the Caribbean. In manufacturing, total sales and exports amount to 9.9% and 6.2% of worldwide totals for transnational corporations based in the United States. The region is clearly important in the business strategies of those companies.

Analysis of FDI flows in the context of case studies on new concentrations of economic activity has shown that United States companies have focused on manufacturing and services (telecommunications and energy). In manufacturing, they are exploiting certain advantages (such as low wages, geographical proximity and preferential access to the United States market) to increase their capacity to compete in their home market and meet the challenge from Asian companies. This is particularly evident, for example, in the case of the Mexican automotive industry in the context of NAFTA, and the *maquila* industry in the Caribbean Basin, under item 9802 of the Harmonized Tariff Schedule (HTS). In this way, United States companies are seeking to improve the efficiency of their regional integrated production systems in the face of challenges confronting them in their own home market.

In Mexico, Ford, General Motors and Chrysler have managed to compete better with Japanese and Korean vehicles on the United States market thanks to the establishment of new plants, which replaced the old factories that supplied the local market during the industrial import substitution phase. These companies have succeeded to some extent in meeting the Japanese challenge in their own market by investing in these new plants, using modern technology and organizational practices, in order to export competitive vehicles to the United States market. Of their production of passenger cars in Mexico, about three quarters is destined for the North American market. The automotive industry agreement under NAFTA stipulates rules of origin requiring that 62.5% of inputs should come from Canada, the United States or Mexico by 2004, thereby giving temporary competitive advantages to United States assembly plants. Thus, cross analysis of three sets of factors —the Japanese challenge on the international market, the new transition rules and those governing the industry in the context of subregional policy (NAFTA), and the new business strategies of the major United States companies in the industry— gives a clearer picture of the significance of new flows of United States FDI to Mexico.

There situation regarding the garment assembly industry in the Caribbean Basin is similar. United States companies have been faced with a challenge from Chinese products in their own market. The major garment manufacturers, distributors and marketers have found considerable advantages in the export processing zones of the Caribbean Basin that enable them to improve their international competitiveness. The HTS 9802 mechanism favours garment assembly based on United States inputs by collecting tariffs only on value added outside the United States, thereby offering competitive advantages to United States companies and their partners in the export processing zones. In this case, too, analysis of three sets of factors —the Chinese challenge on the international market, the new rules governing free export zones, together with the HTS 9802 rule and the reformulated strategies of United States companies in this industry— reveals the significance of the initiatives by United States companies and their partners in the Caribbean Basin, which is not properly reflected in official figures on FDI flows.

Changes in the competitive situation of United States enterprises in services are much more recent and are not yet fully reflected by official data on transactions. The situation of companies in the energy industries (electric power and gas distribution) and those in telecommunications appear to have a number of common features. The high level of competition in the United States market, which has intensified concentration through mergers and acquisitions by major companies, appears to have forced medium-sized and small companies to expand outside the United States in the context of globalization. New policies implemented in Latin America (deregulation and privatization) have provided good opportunities in these areas to pioneering United States companies. Many of them are currently in a second phase of FDI; that is, they are reducing their acquisitions and broadening their production base. In the telecommunications field, early investments in cellular phone services by United States companies should put them in a good position when the Latin American markets, especially those for local and long-distance telephone services, become more competitive. As in the previous cases, these investments can be understood better as the result of a combination of factors related to the international market, national policies and the business strategies pursued by these United States companies.

To sum up, new strategies on the part of United States companies in Latin America and the Caribbean have been noted in various areas of economic activity during the 1990s. These companies have sought to improve their manufacturing efficiency, particularly through use of the automotive industry in Mexico and garment assembly in the Caribbean Basin, and to gain access to local markets in energy generation and distribution (electric power and natural gas) and telecommunications. Analysis of these new business strategies is a useful complement to official FDI statistics, enabling some of their deficiencies to be overcome.

4. The automotive industry: concentration of major foreign corporations in Latin America and the Caribbean

Foreign investment has been and still is the driving force of the automotive industry in Latin America. Several decades ago, the sudden entry of Japanese companies into the world automobile market and the competitive challenge they posed brought about a change in the global strategies of United States and European companies. Relatively recently, this has enabled certain Latin American countries to become integrated into the fledgling regional or subregional vehicle and engine production systems of United States and European manufacturers. Thus, the new competitive situation in the Latin American automotive industry results not from FDI flows from Japanese companies establishing themselves in the region, but from the reaction of the United States and European producers who invested in Latin America to improve their competitiveness in external markets or to protect their shares in domestic markets which had high growth potential and were at an advanced stage of trade liberalization.

As these changes have been occurring in the world automobile market, the Governments of the region have been adopting radical reforms in the conduct of national economic policies. The market is taking on a central role in resource allocation, and traditional protectionist barriers to international trade are being removed. Governments are abandoning selective industrial policies, abolishing subsidies and eliminating restrictions on private enterprise, whether national or foreign. However, there have been significant temporary exceptions in the automotive industry, in the context of integration schemes. Such schemes have been created over the past decade, basically setting up common protectionist barriers to promote trade within a group of countries. This trade is encouraged by rules of origin favouring subregional production to varying degrees. These measures are intended to encourage investment, production and exports within the subregion.

The most outstanding examples of this trend in Latin America and the Caribbean are NAFTA and Mercosur. Both involve special measures concerning the automotive industry, which provide even for periods of transition towards full implementation of the agreements. Essentially, these transitional measures, together with tariff protection and rules of regional origin, give subregional automobile production preferential treatment. They also define the tariff reduction programme and spread out or limit the elimination of incentives and requirements on national content, foreign exchange generation and exports.

The members of NAFTA and Mercosur include the three economies of the region in which the automotive industry has been most dynamic during the 1990s: Mexico (in NAFTA), Argentina and Brazil (in Mercosur). To varying extents, FDI has transformed and restructured vehicle production capacity in those three countries, improving their competitive position whether in external markets or in relation to vehicle imports in their domestic markets. They vary widely, however, in their transformation of productive capacity, and hence in their position in regional or subregional networks for integrated production of vehicles and engines.

The Mexican experience has been seen as the most positive. At 33 vehicles per employee, productivity is almost double that recorded in Argentina and Brazil. International

competitiveness is also far superior, not only in volume terms (US\$20.8 billion in automobile exports in 1997), but also because the output is destined for a more demanding market —the world's biggest, the United States market, where its share has more than doubled— and because of the large trade surplus that has resulted (US\$ 7.8 billion in 1997). However, in order to achieve its competitive restructuring, Mexican industry has had to lower its national content standards (from 60% to 30% in the case of export models) and to some extent neglect the auto parts industry, formerly the preserve of domestic companies. In this way, it has succeeded in creating a flexible and competitive automotive industry, dedicated to exports and able to increase its external sales when domestic demand falls, as occurred after the peso crisis in December 1994. NAFTA has made it possible to consolidate the changes through the direct investments of the industry's major transnational corporations, without major disputes among the member countries.

The experience of Ford (Mexico) is a very good example of the competitive restructuring of Mexico's automotive industry. To protect its share of the United States market against the Asian challenge, Ford made considerable direct investments in Mexico, establishing plants to produce engines and vehicles for export which were capable of competing on the world market. Thanks to its partnership with Mazda, Ford applied international technology and organizational systems in these plants, with surprising results in terms of increased competitiveness on the North American market even against its Japanese competitors.

Although in Mercosur there have certainly been considerable and very positive changes in the competitiveness of the automotive industry, these achievements are more recent and less profound than those which have taken place in Mexico under NAFTA. This viewpoint also shows more clearly some of the relative deficiencies of the Mercosur automotive industry. Compared with Mexico, productivity in Argentina and Brazil is substantially lower (19.5 and 17.8 vehicles per employee), as is international competitiveness both in terms of amount (automotive exports of US\$ 4.6 billion and US\$ 2.8 billion in 1997) and of the characteristics of the target market (Mercosur). In August 1998, falling demand in Brazil led to the suspension of production in a number of Argentine factories because of their lack of competitiveness for exporting to other more demanding markets. Both countries' automotive industries are also running significant trade deficits owing to low vehicle exports and high imports of auto parts (and of vehicles, in the case of Argentina).

Moreover, there has been some friction between the major Mercosur partners, Argentina and Brazil, owing to the considerable dependence of the automotive industry on the Brazilian market. Such problems became apparent when Brazil imposed import restrictions at times of balance-of-payment difficulties (1995), when it diverted FDI by offering incentives, or when there were disagreements on levels of external protection or rules of origin for the Mercosur automotive industry (1998). In fact, the two countries have different views regarding the place of the automotive industry within the integration system. Brazil's policy has emphasized the domestic market, particularly for the popular compact cars, whereas Argentina has put its faith in consolidating the subregional market.

The experience of Fiat in Argentina and Brazil is an instructive example of the restructuring of the automotive industry in those countries. Fiat has a relatively limited

international production system; its largest investment outside Europe has been in Brazil. Fiat's basic strategy in dealing with the Asian challenge was to defend its market share in Brazil, and it invested in order to specialize in two popular models. Once it had consolidated its position in the biggest segment of the Brazilian domestic market, Fiat considered the opportunities offered by Mercosur. In the early 1980s, Fiat had withdrawn from Argentina, after which it continued to operate under a licensing agreement with the Argentine company Sevel. Its subsequent return to Argentina is basically explained in terms of the specialization encouraged by trade equalization. Thus, the Fiat experience covers the two approaches to Mercosur embodied by Argentina and Brazil.

The influence of national policies has sometimes been more important than subregional policy; they have considerably affected Fiat's direct investments. Furthermore, uncertainty over market access has negative repercussions on investments in plants for export production. Over the past two years, Fiat's operations have produced a large trade deficit in Brazil. The example of Fiat in Mercosur reflects some of the problems which can result from the combination of the competitive situation on the international market, the variability of national and subregional policies and the business strategy of a second-line competitor.

Analysis of examples of the automotive industry of Mexico within NAFTA and those of Argentina and Brazil within Mercosur, such as the specific experiences of Ford and Fiat, shows that a clear understanding of the competitive situation on the international automobile market, combined with an understanding of the corporate strategies of the industry's major actors, provides a better picture of its national and subregional policy goals and a higher probability of success.

INTRODUCTION: A STATISTICAL CHALLENGE

Official figures on foreign direct investment (FDI) abound, but unfortunately they are also inconsistent and their analysis often proves difficult. Naturally, it is impossible to gain a full understanding of FDI as an economic phenomenon if the official information sends out mixed or blurred signals. The three main sources of information on FDI are the International Monetary Fund (IMF), the Organisation for Economic Co-operation and Development (OECD) and the various national agencies of host countries. These organizations use different methodologies and definitions of FDI that are to some extent incompatible (see the box below). Each of these sources contributes elements for analysis and each also has a number of drawbacks.

Despite their limitations, official statistics on FDI are highly important source of data, and international institutions' efforts to promote a methodological convergence in this field should therefore be supported in order to improve the quality of this information.¹ Destination countries can also help by upgrading their national FDI information systems. International institutions and official agencies are working to bring this about, but in the meantime the experts have to interpret the available information with the tools currently at their disposal.

Solutions have to be found for the serious problems affecting official statistics on FDI. Until an appropriate methodological convergence is achieved, part of the solution lies in seeking out supplementary information from other sources in the business community, academic circles and the media (particularly the specialized press). In addition, some sort of conceptual framework or interpretive scheme is needed that will allow us to circumvent the shortcomings of the official statistics. Accordingly, for the purposes of this study, the simple interpretive scheme used by the ECLAC Unit on Investment and Corporate Strategies for its research programme will be applied to the analysis of FDI in Latin America and the Caribbean. The results will be discussed in depth in the following chapters.

The operational objective underlying this interpretive scheme is the attainment of a fuller understanding of FDI flows as a basis for an analysis of the corporate strategies involved (see the figure shown below). Obviously, major investors' corporate strategies are aimed at taking advantage of the opportunities offered by the international market and by the policies of host countries in order to fulfil a particular aim, such as: (a) obtaining raw materials; (b) finding ways of boosting the efficiency of an internationally integrated production system; (c) accessing national or subregional markets; or (d) achieving strategic objectives (technology development,

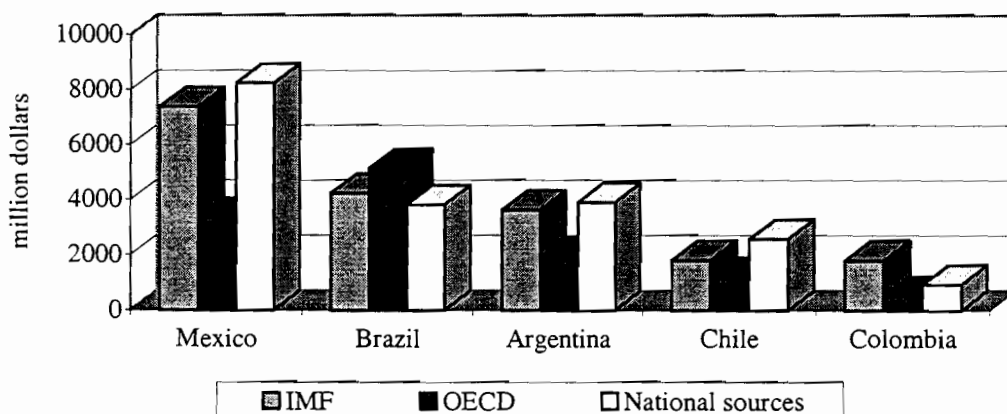
¹ In May 1997 the IMF Committee on Balance of Payments Statistics and the OECD Task Force on Financial Statistics conducted a survey to evaluate the implementation of international methodological standards for direct investment in 113 countries. This initiative is designed to carry forward the previously separate efforts being made in this connection by IMF since 1991 (the Godeaux Report) and by OECD since 1983.

market sharing, etc.). An analysis of the situation in specific sectors which examines the corporate strategies of major investors and how they tie in with those investors' competitive positions in the international market and with the types of national policies in place in the relevant host countries will contribute to a fuller understanding of FDI as an economic phenomenon.

OFFICIAL SOURCES OF INFORMATION ON FDI AND THEIR SHORTCOMINGS

The International Monetary Fund (IMF) compiles information on foreign direct investment (FDI) based on balance-of-payments categories and definitions for the various types of investment flows (equity capital, reinvested earnings and intra-company liabilities). This information is particularly useful since the participation of so many central banks which apply the system used in the IMF *Balance of Payments Manual* means that the statistics are comparable internationally. However, since IMF information is not disaggregated on a geographic or sectoral basis, its analysis is difficult.^a

The Organisation for Economic Co-operation and Development (OECD) prepares statistics on the source and destination by sector of its member countries' FDI flows. This avoids the problems caused by the lack of disaggregation of IMF data by geographical destination and sector, but it creates other difficulties, since the information is confined to OECD members and thus affords only the perspective of investor countries. Moreover, the information is not entirely comparable (for example, some countries do not provide data on reinvested earnings). In addition, there are minor problems associated with the national accounting practices of OECD members (for example, the definition of controlling interest in a company). Although it is true that the bulk of FDI flows do come from OECD countries, recent world trends indicate that a growing percentage of FDI flows originate in countries that are not members of that organization. OECD is making an effort to standardize its statistical information, but much remains to be done in this regard.^b



Many non-OECD countries have their own sources of FDI information, such as central banks, institutions that promote FDI inflows to the country, and some government ministries, which present information chiefly from the point of view of FDI destination countries. Differences in national accounting practices pose major problems which make international comparisons less meaningful, however. Significant differences exist with regard to the registration and inclusion of portfolio investment, syndicated loans, the availability of official data on reinvestment

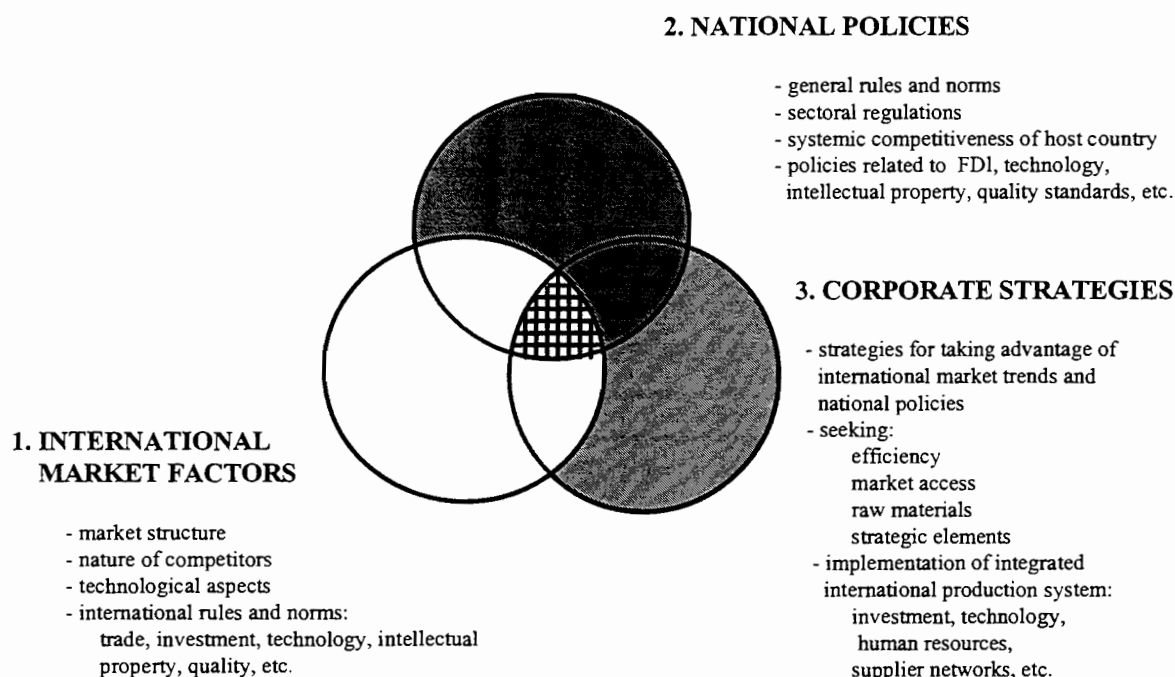
and so forth. A serious problem affecting official information from destination countries (and OECD investor countries) is the use of financial centres or tax havens to channel investments to other countries. A substantial proportion of FDI flows from OECD countries to Latin American countries is routed through financial centres in the Caribbean. Hence, an investment made by a German chemical firm that wishes to set up a plant in Colombia may, for example, be registered in Germany as a financial investment in the Cayman Islands while, in Colombia, it may be registered as a manufacturing investment originating in the Cayman Islands. Thus, both the Colombian and the OECD statistics would be distorted.

The preceding figure shows the extent of distortions in official FDI statistics for some destination countries in Latin America. Methodological problems, different accounting practices and, above all, the statistical influence of regional financial centres lead to wide discrepancies in the amounts recorded. Despite the efforts of international and national bodies to harmonize their methodologies, the results have not yet been fully satisfactory.

^a International Monetary Fund (IMF), *Balance of Payments Statistics Yearbook*, Washington, D.C., 1997.

^b Organisation for Economic Co-operation and Development (OECD), *International Direct Investment Statistics Yearbook*, Paris, 1997.

AN INTERPRETIVE SCHEME: THREE SETS OF FACTORS



The following table illustrates how this general interpretive scheme applies to Latin America and the Caribbean. As may be seen from the table, FDI in the region during the 1990s falls into four main analytical categories based on the main types of corporate strategies used by investors:

- Acquisition of raw materials in the primary sector (petroleum and natural gas in Argentina, Colombia and Venezuela and minerals in Argentina, Chile and Peru);
- Achievement of efficiency gains in investors' internationally integrated manufacturing systems (the automotive, electronics and garment industries in Mexico and the garment and electronics industries in the Caribbean basin);
- Access to domestic markets for manufactures (cement in Colombia, the Dominican Republic and Venezuela) or to subregional markets for manufactures (the automotive, agribusiness and chemical industries in Mercosur); and
- Access to domestic service markets (telecommunications in Argentina, Brazil, Chile and Peru; electrical power in Argentina, Brazil, Colombia and Central America; financial services in Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela; and gas distribution in Argentina, Brazil, Chile and Colombia).

This interpretive scheme overcomes some of the problems associated with existing official FDI statistics. Although it still leaves a great deal of room for improvement, our aim here is to apply this simple version of the scheme to the analysis of FDI in Latin America and the Caribbean while avoiding any unnecessary complications and striving to maintain as high a degree of transparency as possible.

The approach now being employed by the ECLAC Unit on Investment and Corporate Strategies is reflected in the new structure of this edition of the Economic Commission's annual report on foreign investment in Latin America and the Caribbean. Beginning with this year's edition, the report will be divided into four main chapters, in addition to a summary and a section setting forth its principal conclusions.

The first chapter will provide an overview of how FDI flows have changed in the world and in Latin America and the Caribbean and, within that context, will focus on new developments during the most recent year for which information is available. The second chapter will present an analysis of FDI and of the strategies used by transnational corporations in a particular country. The country chosen for this year's report is Brazil, the region's largest FDI destination. The third chapter will examine the FDI behaviour and strategies of the transnational corporations of a specific investor country. This year the United States, which is the main source of FDI in the region, has been selected for analysis. The last chapter in each edition of the report will focus on FDI trends in a particular sector. The 1998 edition examines the automotive industry, where the largest foreign firms (in terms of sales) in Latin America are to be found. The new structure of the report and the relevance of the cases selected for this year's edition make it a very special one.

AN INTERPRETIVE SCHEME FOR LATIN AMERICA AND THE CARIBBEAN

Corporate strategy	Efficiency seeking	Raw materials seeking	Market access seeking (national or regional)	Strategic elements seeking
Sector				
Primary		<ul style="list-style-type: none"> - Petroleum/natural gas: Venezuela, Colombia and Argentina - Minerals: Chile, Argentina and Peru 		
Manufactures	<ul style="list-style-type: none"> - Automotive: Mexico - Electronics: Mexico and Caribbean basin - Clothing: Caribbean Basin and Mexico 		<ul style="list-style-type: none"> - Automotive: Mercosur - Chemicals: Brazil - Agroindustry: Argentina, Brazil and Mexico - Cement: Colombia, Dominican Republic and Venezuela 	
Services			<ul style="list-style-type: none"> - Financial: Brazil, Mexico, Chile, Argentina, Venezuela, Colombia and Peru - Telecommunications: Brazil, Argentina, Chile and Peru - Electricity: Colombia, Brazil, Argentina and Central America - Natural gas distribution: Argentina, Brazil, Chile and Colombia 	

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

Finally, it should be noted that the new format of the first chapter reflects a commitment to presenting the available statistical information in as transparent a manner as possible. To this end, the first section of chapter I is devoted to an examination of FDI flows based on balance-of-payments data, while the information used in the individual analyses of various Latin American countries that are contained in the second section has been drawn from the official reports issued by national agencies, the specialized literature and research findings of the ECLAC Unit on Investment and Corporate Strategies. In addition to the sections on FDI modalities and on the main economic agents in the region, the first chapter also discusses the dearth of information on the important issue of intraregional FDI. This approach allows the greatest possible advantage to be taken of the available official statistics while at the same time taking their weaknesses and drawbacks into account.

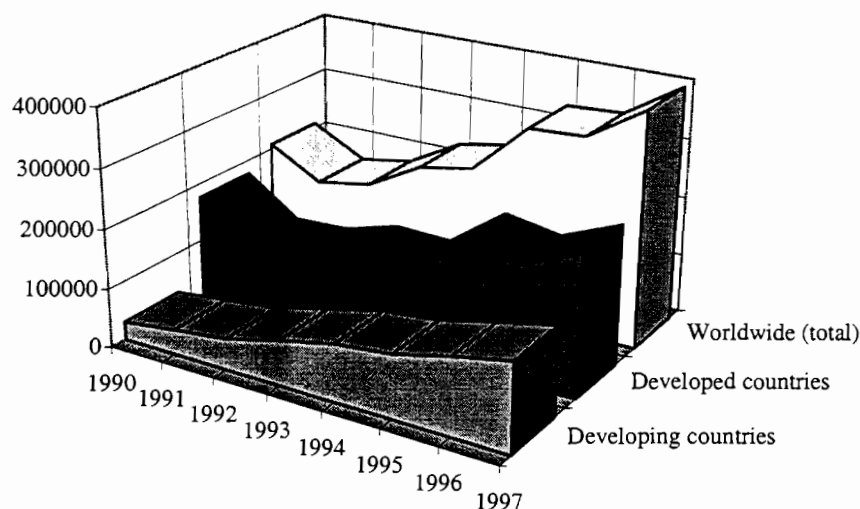
I. REGIONAL OVERVIEW

A. RECENT TRENDS IN FOREIGN DIRECT INVESTMENT (FDI) FLOWS

1. The overall situation

According to information compiled by IMF, in 1997 world FDI flows swelled by 18% —a far higher growth rate than the 7% average recorded for the 1990s— to over US\$ 396 billion. Despite the rapid expansion of net FDI inflows in 1997, the developing countries were unable to improve upon the 38% share of total flows reached in 1996. In other words, in a departure from the sharp upward trend seen during the 1990s as a whole, during which the developing countries have increased their share in world FDI flows from 15% to 38%, in 1997 the developing countries' share remained constant (see figure I.1).

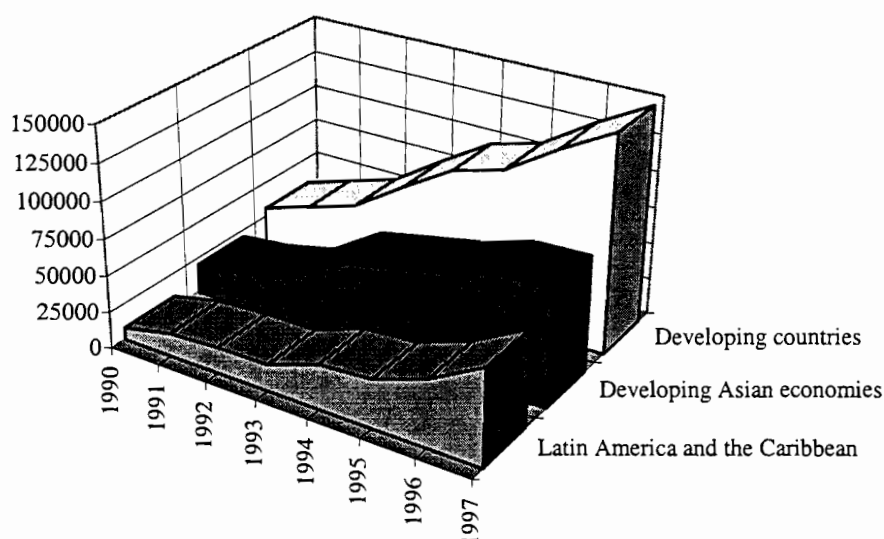
Figure I.1
TOTAL FDI FLOWS, 1990-1997
(Millions of dollars)



Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the International Monetary Fund (IMF).

The most striking change to occur in 1997 was in how world FDI flows to developing countries were distributed. In 1997, net inflows to Latin America and the Caribbean rose by 43% (nearly two and one-half times as much as the world average), whereas inflows to developing Asian countries edged up by a scant 1.5%.¹⁶ The Latin American and Caribbean region's share jumped to 43.9% (as compared to 35.3% in 1996) owing to the relative stagnation of inward FDI to developing Asian economies and the downturn in inflows to Africa (see figure I.2). Changed conditions in the international economy and the outbreak of a major crisis in Asia obviously helped to boost Latin America's share of inward FDI. This is yet another reason why this year's edition is a very special and particularly relevant one.

Figure I.2
FDI TO DEVELOPING REGIONS, 1990-1997
(Millions of dollars)



Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the International Monetary Fund (IMF).

The information on net outward FDI worldwide indicates that, globally, FDI flows totalled US\$ 399 billion in 1997.¹⁷ Outward FDI is even more heavily concentrated in the industrial countries than FDI inflows are. Only 4% of outward FDI originated in developing countries, and the bulk of this came from developing Asian countries (3%) and, to a much lesser extent, from Latin America and the Caribbean (1%). FDI flows within Latin America will be examined in section C of this chapter.

¹⁶ FDI inflows to Africa in 1997 plunged by 24%.

¹⁷ Theoretically, from a balance-of-payments perspective, worldwide FDI inflows and outflows should match each other. Due to differences in methodology and coverage, however, the two figures actually differ a great deal.

2. The situation in Latin America and the Caribbean

FDI inflows to Latin America and the Caribbean reached record levels in 1997 for the second year in a row, totalling (according to balance-of-payments data) US\$ 65.199 billion. This was far more than had been expected at the start of the year, especially since the effects of the 1994-1995 financial crisis on inflows of private external capital to Mexico and Argentina had only recently subsided and since midway through the year the region began to see the first signs of the fallout from the crisis that broke out first in south-east Asia and later in east Asia as well.

The fact that net inward FDI was sharply higher in 1997 than in 1996 signals a further acceleration of the upward trend in FDI inflows to the region during the 1990s. The magnitude of these inflows in 1997 may be more fully understood when it is noted that in 1997 the increase in FDI over 1996 in absolute terms (US\$ 19.75 billion) was actually larger than the total annual average for net FDI inflows in 1990-1994 (US\$ 18.262 billion).

The statistical series on net inward FDI for Latin America and the Caribbean shown in table I.1 groups the countries into three different categories, depending on their geographic location and the role they have played in terms of the financial intermediation of international capital flows. Accordingly, in addition to the traditional distinction made between the countries belonging to the Latin American Integration Association (LAIA) and the countries of Central America and the Caribbean (which together are referred to as the countries of the Caribbean basin), a third category is comprised of countries that serve as financial centres or tax havens; the use of this latter category helps to prevent the figures for these countries from distorting the statistics for the countries of the Caribbean basin as they have in the past, since although they receive large amounts of FDI, most of these funds are then passed on to other countries within the region or elsewhere. It is also interesting to note that the financial streams registered as net outflows by these financial centres are substantially smaller than the sums that are registered as inflows to Latin American and Caribbean countries originating from financial centres (see section B of this chapter).

As in 1996, the surge in FDI inflows to Latin American countries in 1997 was chiefly a result of the growth in net inward FDI recorded by the 11 member countries of LAIA, while the increase in FDI inflows to the countries of the Caribbean basin was considerably smaller. Within the latter group, inflows to Caribbean countries rose substantially more than inflows to the Central American countries; the upturn posted by the Caribbean countries also exceeded the growth rate recorded for countries classified as financial centres. It should be noted that the subtotal for Central America does not include El Salvador's inward FDI; no official figures on those inflows are as yet available but, in view of the privatization programme being implemented by that country, it is thought that they were quite substantial.

Table I.1
LATIN AMERICA AND THE CARIBBEAN: NET BALANCE OF FDI, BY SUBREGION, 1990-1997
(Millions of dollars)

	1990	1991	1992	1993	1994	1995	1996	1997
LAIA countries								
Net inflows	7 297	11 841	13 390	12 783	26 280	28 535	40 048	58 500
Net outflows	-1 289	-1 523	-1 437	-2 122	-3 951	-3 478	-2 750	-4 378
Net balance	6 008	10 318	11 953	10 661	22 329	25 057	37 298	54 122
Countries of the Caribbean Basin (excluding financial centres)								
Net inflows	938	1 244	1 140	1 318	1 726	1 865	2 044	2 892
Net outflows	5	-7	-3	-20	-24	-27	-5	-9
Net balance	943	1 237	1 137	1 298	1 702	1 838	2 039	2 883
Financial centres in the Caribbean Basin								
Net inflows	1 010	2 558	3 306	4 023	2 457	2 606	3 357	3 807
Net outflows	-3 186	1 928	-1 233	-146	-92	60	-296	-2 293
Net balance	-2 176	4 486	2 073	3 877	2 365	2 666	3 061	1 514
Total								
Net inflows	9 245	15 643	17 836	18 124	30 463	33 006	45 449	65 199
Net outflows	-4 470	398	-2 673	-2 288	-4 067	-3 445	-3 051	-6 680
Net balance	4 775	16 041	15 163	15 836	26 396	29 561	42 398	58 519

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from each country's balance of payments.

As a result of the trends in net FDI inflows to Latin America and the Caribbean seen in 1997, the LAIA member countries' share expanded to 90% of the regional total while that of the Caribbean basin countries (Central America, the Caribbean and financial centres) shrank to 10%. This confirms the observation that during the 1990s FDI has increasingly been channeled into the larger economies of the region.

Net outflows of FDI from Latin America and the Caribbean totalled US\$ 6.68 billion in 1997, which was US\$ 3.629 billion more than in 1996. Serious record-keeping problems in relation to net outflows of FDI from Latin America and the Caribbean persist, however, and these figures underestimate the actual flows. As mentioned earlier, the progressive increase in foreign investment by Latin American and Caribbean economic agents has been one of the most striking aspects of the region's FDI trends in recent years (ECLAC, 1998a). If we assume that most of the foreign investments made by Latin American and Caribbean firms are in other countries within the same region, then this would mean that 8% of the net FDI inflows directed to the region are composed of intraregional investments (see section C of this chapter).

(a) FDI in the LAIA member countries

The remarkable increase in net FDI inflows to the LAIA countries seen in 1996 was repeated in 1997, with inward FDI totalling US\$ 58.5 billion, or US\$ 18.452 billion more than the year before (see table I.2). As in 1996, the expansion of the LAIA countries' net inward FDI in 1997 was an across-the-board phenomenon, with the sole exception of Peru, which witnessed a 37% drop.

Table I.2
LAIA COUNTRIES: NET INWARD FDI, 1990-1997
(Millions of dollars)

Countries	1990	1991	1992	1993	1994	1995	1996	1997	1998 ^a	1998 ^b
Argentina ^c	1 836	2 439	4 012	3 261	3 107	4 783	5 090	6 326	2 495	5 800
Bolivia	67	93	122	124	130	393	474	601	...	600
Brazil	989	1 103	2 061	1 292	3 072	4 859	11 200	19 652	11 900	24 000
Chile ^d	661	822	935	1 034	2 583	2 978	4 724	5 417	2 534	4 700
Colombia	501	457	729	959	1 652	2 227	3 276	5 982	3 326	6 000
Ecuador	126	160	178	469	531	470	447	577	300	580
Mexico	2 549	4 742	4 393	4 389	10 973	9 526	9 185	12 477	5 280	8 000
Paraguay	76	84	137	111	180	157	106	191	...	210
Peru	41	-7	136	670	3 084	2 000	3 226	2 030	1 500	3 000
Uruguay	...	32	58	102	155	157	137	160	...	160
Venezuela	451	1 916	629	372	813	985	2 183	5 087	2 207	5 000
Total	7 297	11 841	13 390	12 783	26 280	28 535	40 048	58 500	29 542	58 110

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the International Monetary Fund (IMF) or the relevant country's balance of payments.

^a First half of 1998, on the basis of official figures provided by the countries.

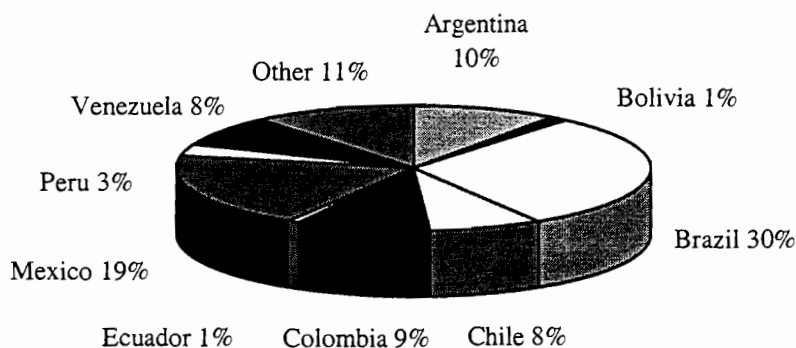
^b Estimates.

^c Figures corrected by the country due to the inclusion of investments in mining.

^d Figures corrected by the country due to the inclusion of reinvested profits.

Over the last two years Brazil has regained its position as the largest FDI recipient in the region. In 1997, net FDI inflows reached a new all-time high of US\$ 19.652 billion, which was an increase of US\$ 8.452 billion over 1996. This means that almost half of the upswing in the region's FDI inflows was accounted for by Brazil, which was the destination of 30% of all FDI flows to Latin America and the Caribbean in 1997 (see figure I.3). This is much higher than the figures for the first half of the 1990s, when Brazil's share ranged between 7% and 15% of the regional total (see chapter II).

Figure I.3
LATIN AMERICA AND THE CARIBBEAN: SHARES OF NET INWARD FDI, 1997
(Percentages)



Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the International Monetary Fund (IMF) or the relevant country's balance of payments.

Mexico and Argentina continued to be major destinations for FDI flows channeled into Latin America and the Caribbean, but their shares of total regional FDI flows have continued to decline (18.7% and 10.3% of the regional total, respectively, in 1997 versus 20% and 11% in 1996) despite the sharp rise in inward FDI.

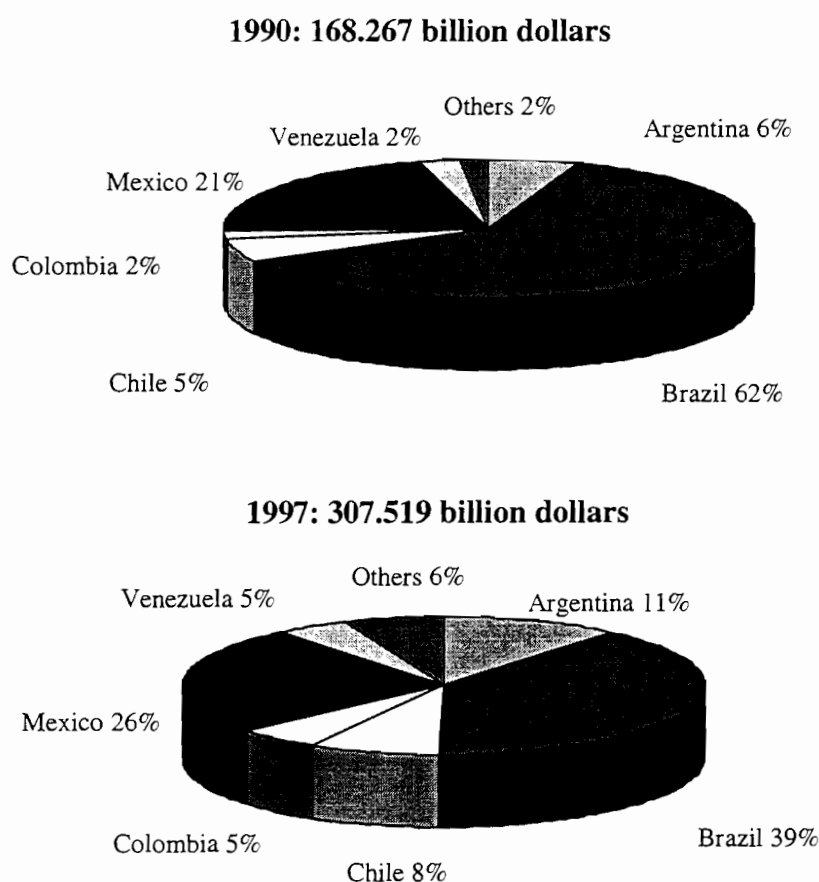
The available information for 1997 indicates that the share of regional FDI inflows received by medium-sized countries, taken as a group, diminished even though Colombia and Venezuela both turned in very strong performances in terms of FDI. The reduction in this group's share is accounted for by the decline in Chile's and Peru's shares, which shrank from 10% and 7% of the regional total, respectively, to 8% and 3%. Venezuela posted the steepest increase, with its share jumping from 5% to 8%, but Colombia had the largest share in this group (9%) and the fourth largest in the region as a whole, after Brazil, Mexico and Argentina. In both Colombia and Venezuela the increase in inward FDI was chiefly attributable to the intensification of the privatization process.

Thus, all in all, the information on FDI trends in 1997 in the member countries of LAIA indicates that Brazil clearly strengthened its position as the leading destination for FDI in the region, while the relative shares of Argentina, Chile and Mexico shrank even though all three (but especially Argentina and Mexico) recorded sizeable increases in FDI inflows in absolute terms. In addition, Colombia and Venezuela proved to be increasingly attractive destinations for foreign investors, but FDI flows to Peru were down sharply.

The strong upturn in direct investment flows to most of the LAIA member countries resulted in a solid increase in their economies' stock of FDI. The total FDI stocks of the LAIA

countries in 1997 are estimated at US\$ 307.519 billion,⁴ or nearly US\$ 46.1 billion more than in 1996. Accordingly, estimates of the net stock of FDI accumulated by the region in the course of the 1990s put the total at the sizeable sum of US\$ 139.2 billion. This means that approximately 47% of the FDI stock existing as of 1997 has entered the region in the last seven years (see figure I.4). In other words, the Latin American and Caribbean region has nearly doubled its FDI stocks during the 1990s, and a reassessment of this phenomenon would therefore be in order.

Figure I.4
MEMBER COUNTRIES OF THE LATIN AMERICAN INTEGRATION ASSOCIATION (LAIA):
FDI STOCKS, 1990-1997
(Percentages)



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

⁴ The methodology used by ECLAC to estimate FDI stocks is described in the second technical note included in *Informe 1997: Inversión Extranjera en América Latina y el Caribe* (ECLAC, 1998a) and in Durán (1997).

The location of FDI stocks in the countries of this group has also changed radically during the 1990s. One of the most striking changes is the sharp decrease in Brazil's share, which fell from 62% in 1990 to 39% in 1997. The other side of the coin is the expansion in the shares of Argentina, Chile, Colombia, Mexico, Peru and Venezuela, while the shares of the smaller economies in this grouping have remained at their existing low levels. These changes in FDI stocks are largely a reflection of the trends in net FDI inflows of recent years, inasmuch as the expansion of Brazil's share of inward FDI flows did not really begin to pick up speed until 1995 (for further information on these trends, see chapter II). In contrast, FDI flows to Argentina, Chile and Mexico have been strong throughout the period (1990-1997). The reasons for these changes in net FDI inflows to the main LAIA member countries are explored in section B of this chapter.

The causes of these changes in net FDI inflows to LAIA member countries will be the focus of section B of this chapter.

(b) *The countries of the Caribbean basin*

Inward FDI flows to the countries of the Caribbean basin (including those classified as financial centres) climbed by 24% in 1997, marking a slight upswing in the growth rate for this group. It bears repeating that the statistical information on FDI in the Caribbean basin is scantier, less reliable and more difficult to interpret due to problems with respect to the quality and processing of these data; a further factor is the presence of a number of financial centres in this area whose record-keeping procedures are far from comprehensive and whose existence makes it difficult to determine the final destination of FDI flows.

The lion's share of FDI flows to the countries of the Caribbean basin are destined for the area's financial centres (57% in 1997). During the 1990s, average annual FDI inflows have totalled US\$ 2.891 billion, but average net FDI inflows to the Central American countries (not counting Panama) have amounted to only US\$ 514 million and those directed to the Caribbean countries to US\$ 1.132 billion. The strongest increase in FDI inflows in 1997 was seen in the Caribbean countries (56%), which outpaced both the Central American subregion (15%) and the area's financial centres (13%).

The expansion of FDI flows to Central America is mainly a reflection of higher levels of foreign investment in Nicaragua and Honduras. Costa Rica registered the smallest increase in net inward FDI but is still the leading FDI destination in Central America (see table I.3)

Table I.3
CENTRAL AMERICAN AND CARIBBEAN COUNTRIES (EXCLUDING FINANCIAL CENTRES):
NET INWARD FDI, 1990-1997
(Millions of dollars)

Countries	1990	1991	1992	1993	1994	1995	1996	1997
Costa Rica	163	178	226	247	298	396	427	446
El Salvador	2	25	15	16	23	38	25	...
Guatemala	48	91	94	143	65	75	77	84
Honduras	44	52	48	27	35	50	91	122
Nicaragua	...	1	15	39	40	75	97	173
Anguilla	11	6	15	6	13	...	...	...
Antigua and Barbuda	61	55	20	15	25	31	19	28
Aruba	131	185	-37	-18	-73	-6	84	196
Barbados	11	7	14	9	13	12	22	18
Belize	17	14	16	9	15	21	17	12
Cuba	1	10	7	3	14	9	12	13
Dominica	13	15	21	13	23	54	18	20
Grenada	13	15	23	20	19	20	18	22
Guyana	8	13	147	70	107	74	81	90
Haiti	...	14	-2	-2	-3	7	4	5
Jamaica	138	133	142	78	170	245	273	137
Montserrat	10	8	5	5	1	...	...	...
Dominican Republic	133	145	180	225	360	404	394	414
Saint Kitts and Nevis	49	21	13	14	15	20	17	25
Saint Lucia	45	58	41	34	32	30	23	45
Saint Vincent and the Grenadines	8	9	15	31	47	31	18	42
Suriname	-77	19	-54	-47	-30	-21	7	...
Trinidad and Tobago	109	169	178	379	516	299	320	1 000
Annual total	938	1 244	1 140	1 318	1 726	1 865	2 044	2 892

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the International Monetary Fund (IMF) or the relevant country's balance of payments.

The steep ascent of FDI flows to Central America in the 1990s is the result of a number of different factors. One is the new business opportunities that are opening up thanks to the political and institutional stability that has accompanied the liberalization of trade and the inroads made by integration schemes involving Central American and other countries. The Central American country that has made the most progress in defining a systemic competition policy based on the selective attraction of FDI is probably Costa Rica, which is trying to target the production of high-technology electronics and tourism. In order to further its efforts in this direction, it has developed a trade policy based on a commitment to further trade liberalization and integration and a technological and industrial policy that includes programmes for promoting productivity and quality standards at both the economy-wide and sectoral levels; in addition, it has worked to improve its educational system and its economy's regulatory systems and

macroeconomic framework. Faced with the options of attracting foreign investment by providing stronger incentives or by reducing its in-country costs through factor-price distortions (especially in wages and public utility rates), the country has chosen to try to become more competitive by providing its labour force with more training and improving its infrastructure (Comex, 1998). As for the success of this policy, the recent arrival in the country of high-technology electronics firms such as Intel (with investments totalling US\$ 500 million) (see box I.1) and Motorola and of leading firms in the tourism industry, such as Marriott and Best Western, speaks for itself.

Box I.1

INTEL IN COSTA RICA: A SUCCESSFUL POLICY FOR ATTRACTING INVESTORS BASED ON COMPETITIVE OPERATING CONDITIONS

In November 1996, the world's leading microchip manufacturer, Intel, announced its plans to build a state-of-the-art facility for assembling and testing semiconductors in Costa Rica. Although Costa Rica has long enjoyed a clear advantage over its equally small neighbours in the Caribbean basin in terms of the attraction of certain types of foreign investments, this was the first time that it had won out over competitor countries such as Brazil, Chile and, above all, Mexico. One of the decisive factors in its triumph was its policy of attracting investment by offering competitive operating conditions for corporate investors.

Intel's outlay of US\$ 500 million was the first investment of this type in Latin America and the largest foreign direct investment in Costa Rica's history. This is Intel's fourth plant of this sort (the other three are located in the United States, the Philippines and Malaysia). Its operations in the country's export processing zone (EPZ) will generate US\$ 3 billion in exports by the year 2000 (in 1998 the country's exports of microchips had already surpassed its traditional exports such as coffee and bananas) and its value-added will represent a sizeable percentage of the EPZ's total (15%). What is more, it may well serve as the core of a new cluster of electronics industries, since it will bring in new investments for approximately 40 Intel suppliers.

This situation marks a sharp contrast with Costa Rica's experiences with other types of activities in the EPZ. The garment industry is one such example. Costa Rica and other assembly sites in the Caribbean basin were caught up in a tax-incentive war that reduced these activities' contribution to government coffers to a minimum.^a Along with its competitors, after 10 or 15 years of experience with this type of production activity, Costa Rica came to realize how limited it is—since it is dependent on low wages, strong incentives and special access to the United States market—and how little of a contribution it was making to the country's industrialization process (see chapter III). Accordingly, Costa Rica began to look for ways to extricate itself from this situation.

Many different factors were involved in Intel's decision to invest in Costa Rica. The three main sets of factors were the competitive situation in the microchip market, Intel's corporate strategy and Costa Rica's national policy. At the international level, competition in this market revolves around the imperative need to cut down the lead time between innovation and production so that manufacturers can realize a profit on their technological developments before competitors drive down the prices of those technologies and convert the new generation of microchips into a mass consumer product. As for the second factor, Intel's strategy called for as rapid a diversification as possible of its integrated production system in order to move part of that system out of Asia and into a country that offered the appropriate operational and competitive conditions to permit a rapid, efficient, high-quality production process. Executives of the firm have stated that the decision-making process focused on such factors as human resources, wages, the promotion of assembly industries, tax provisions and a supportive attitude on the part of the host Government. The importance of the role played by national policy in this respect lies in the existence of these competitive factors in the candidate country and the way in which national authorities handle the negotiations.

Costa Rica's strategy for attracting investment^b reflects all of the main elements of its experience with Intel, although the project was actually begun by the Costa Rican Coalition for Development Initiatives (CINDE) in 1995. The main thrust of the strategy is to promote the formation of clusters of production activities in certain industries, such as electronics. In the case of Intel, CINDE projected an image of Costa Rica that drew attention to

Box I.1 (concl.)

certain aspects of the country's systemic competitiveness that were of interest to Intel, such as its human resources (a literate, fairly inexpensive and well-trained labour force, together with a ready supply of capable, English-speaking engineers), satisfactory infrastructure, an advantageous geographical location, the availability of an appropriate plant site (next to a suitable airport) and the existence of regulations and provisions that facilitate this type of business enterprise (an EPZ with streamlined international trade procedures and tax exemptions). What is more, not only did Costa Rica (like a number of other countries in the region and elsewhere) have what Intel was looking for, but its national authorities were able to bring the negotiations to a successful conclusion.

Indeed, the authorities handled the negotiations admirably. They set up a single "window" for Intel's negotiators by assigning responsibility for the undertaking to the Ministry of Foreign Trade. They settled problems as they arose, such as the adaptation of the educational system to the labour demand that would be generated by the sector, the need to improve a number of roadways and increase the frequency of flights, the need to make a substantial reduction in the electricity rates to be paid by this potential client, etc. The treatment accorded Intel as a preferred client was combined with the direct and active participation of the nation's President in the process. Tax incentives were also a consideration, but they were not a deciding factor.

There are a number of important lessons to be learned from Costa Rica's success in obtaining a major investment such as Intel's. First, it is clear that the country in question needs to have a well-designed, relevant strategy for attracting investors and must then implement that strategy dynamically. "Well-designed" means it should be transparent, broad in scope and internally consistent, as is in fact the case with the country's current strategy for attracting investment, which sets forth national and sectoral goals and specifies the nature of the targeted or special (as opposed to horizontal, or system-wide) incentives to be used. "Relevant" refers to the fact that the strategy should deliver what potential investors need in order to become more competitive (systemic aspects of the country and specific aspects of given sectors or production activities). In short, the promotion programme ceases to be a horizontal one whereby the same incentives are offered to all investors and becomes a limited-scope effort in which individually larger incentives are made available only to the types of investors that are assigned a high priority by the strategy. To draw an analogy with the fishing industry, the idea is to stop trawling (the type of fishing where huge nets are used that catch up everything in their path) and start fly fishing (where a single hook is used that will attract only certain types of large fish).

Source: D. Spair, "Attracting High Technology Investment: Intel's Costa Rican Plant", FIAS occasional paper No. 11, Washington, D.C., World Bank, April 1998; Sergio Bustos, "Costa Rica: paraíso tecnológico", *Latin Trade*, Miami, August 1998; Ministry of Foreign Trade (COMEX), *Estrategia Nacional de Atracción de Inversiones*, San José, Costa Rica, 1998; F. Nehme, "Building partnerships: Intel-Costa Rica", Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 1998, unpublished.

^a M. Mortimore and W. Peres, "Empresas transnacionales e industrialización en economías pequeñas y abiertas: Costa Rica y República Dominicana", *Empresas transnacionales, procesos de reestructuración industrial y políticas económicas en América Latina*, Giovanni Stumpo (comp.), Buenos Aires, Alianza Editorial Argentina, October 1998.

^b Ministry of Foreign Trade of Costa Rica (COMEX), *Estrategia Nacional de Atracción de Inversiones*, San José, 1998.

In the rest of Central America, the privatization of electric companies and telecommunications firms became an increasingly important source of FDI inflows in 1997, although the transfer of such assets to private investors was not always completed during the same year. One of the more recent accomplishments in this connection has been the Government of El Salvador's sale of 80% of four electric power distribution companies for around US\$ 600 million, which introduced a completely unheard-of sum into the statistical series on net FDI inflows for this country. Two of these power companies —Compañía de Alumbrado Eléctrico de San Salvador and Empresa Eléctrica de Oriente— were sold to Electricidad de Caracas, of Venezuela, for nearly US\$ 300 million; the Compañía Eléctrica de Santa Ana went for US\$ 109 million to AES Corporation, a United States power company (see box III.2), and Electricidad de

Centroamérica (a subsidiary of the Chilean firm, Emel, S.A.) paid US\$ 180 million for Distribuidora de Electricidad del Sur (*América Economía*, March 1998, p. 102).⁵

This process is expected to have gained momentum in 1998 as a result of additional sales of power and telecommunications companies in the subregion, which are likely to drive up the subregion's FDI inflows to unusually high levels. The Government of Guatemala has announced its intention to put Teléfonos de Guatemala (Telgua) on offer again in 1998, after it rejected the US\$ 529 million offer made by Teléfonos de México (Telmex) as being too low. The question as to the status of Administración Nacional de Telecomunicaciones (Antel) was also resolved in 1998 by the sale of a 51% interest in the firm to France Telecom.

The bulk of FDI flows to other countries in the Caribbean basin continued to go to Jamaica, the Dominican Republic, and Trinidad and Tobago, whose combined share of the subregion's total FDI for 1997 was actually larger than it had been in 1996, although this time investment flows to Trinidad and Tobago overshadowed those received by the other countries in the subregion.

According to information provided by the Central Bank of Trinidad and Tobago, the steep increase in FDI inflows to that country in 1997 was primarily channeled into the petroleum industry (exploration, production and refining facilities and petrochemical firms), where the privatization of assets brought in US\$ 948 million. In any event, the petroleum sector has been the main FDI destination in the country throughout the 1990s.

In the Dominican Republic, the growth of inward FDI has been a more diversified phenomenon encompassing the development of *maquila* activities in the country's clothing and electronics industries, the privatization of some utility companies and the purchase of an increasing number of local firms by foreign investors. The figures for 1998 are expected to show that FDI inflows to the Dominican Republic have been galvanized by the privatization of more than 30 State-owned enterprises, including the State electric company, several sugar mills, ports and a petroleum processing facility.

In the countries classified as financial centres or tax havens, FDI flows have been fairly stable since 1992, although the amounts of FDI entering Bermuda and Panama were very different in 1997 from what they had been in 1996. Bermuda's FDI inflows in 1997 were about 19% lower (US\$ 400 million less) than the year before, whereas Panama's net level of inward FDI was four times higher in 1997 than in 1996 (see table I.4). Although Panama's classification as a financial centre implies that it primarily serves as an intermediary for FDI flows, there is actually a significant level of investment in fixed assets within the country. The sale of a 49% stake in Instituto Nacional de Telecomunicaciones (Intel), Panama's telecommunications company, to the British firm Cable & Wireless for US\$ 652 million had a huge impact on FDI flows to that country in 1997. In addition, Panama has continued to implement its privatization programme in 1998 and this has brought in further FDI flows. For example, the Instituto de Recursos Hidráulicos y Electrificación (IRHE), Panama's State electric company, was split up

⁵ For some years now it has been possible for private companies to generate electrical power for sale to the national grid, but only one firm, the United States-based Coastal Corporation, operates a plant in the country (Stinson, 1998).

into three generating companies, two distribution companies and one power transmission firm in preparation for their sale in 1998 (*América Economía*, March 1997, p. 96). The Government also announced that in late 1997 or early 1998 it would call for tenders on 51% of the 48 water treatment plants located in Panama City and Colón (*América Economía*, April 1997, p. 91).

Table I.4
FINANCIAL CENTRES: NET INWARD FDI, 1990-1997
(Millions of dollars)

Countries	1990	1991	1992	1993	1994	1995	1996	1997
Netherlands Antilles	8	33	40	11	22	10	11	17
Bahamas	-17	-1	...	27	23	107	88	210
Bermuda	819	2 489	3 231	2 707	1 079	1 350	2 100	1 700
Cayman Islands	49	5	-131	675	532	490	410	350
Virgin Islands	132	-9	27	447	447	470	510	500
Panama	19	41	139	156	354	179	238	1030
Annual total	1 010	2 558	3 306	4 023	2 457	2 606	3 357	3 807

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the International Monetary Fund (IMF) or the relevant country's balance of payments.

This brief overview of FDI trends in the countries of the Caribbean basin in 1997 attests to the wide variety of factors involved in accounting for current inflows of foreign investment to the countries of the subregion. Generally speaking, the available information indicates that there are three main channels for these FDI flows. The first, which has been particularly important in the case of the Central American countries and the Dominican Republic, is the development of *maquila* industries in the export Processing zones (EPZs) created for that purpose. This mechanism has made it possible to build up an export platform for the sale of labour-intensive manufactures on markets in North America, particularly the United States (see chapter III). This has been the result of two different types of factors: on the one hand, the migration of production activities away from high-wage countries in an effort to become more competitive with products made in eastern and south-eastern Asia and, on the other, the investment incentives offered by countries of the subregion as a means of furthering their development.

The second, and more recent, channel is the privatization of telephone companies, electric companies and financial firms, which began to gather momentum during the past year in El Salvador, Guatemala and Panama and, in some cases, of other types of State-owned production enterprises (Dominican Republic and Trinidad and Tobago). In addition, since 1996 a number of manufacturing firms have been purchased by Central American, Chilean and Mexican investors.

The third channel, which is a more delimited mechanism and has been concentrated in Costa Rica, is the establishment of high-technology electronics and computer firms catering to international markets or the construction of hotels and other tourist facilities, which are also a

source of foreign exchange. This channel has been opened up by policies designed to attract selected types of foreign capital and by the development of comparative advantages based on the quality of the relevant factors of production (a trained labour force and appropriate infrastructure). Policy-makers' efforts to attract FDI in the Dominican Republic now appear to be turning in this direction as well (FIAS, 1998).

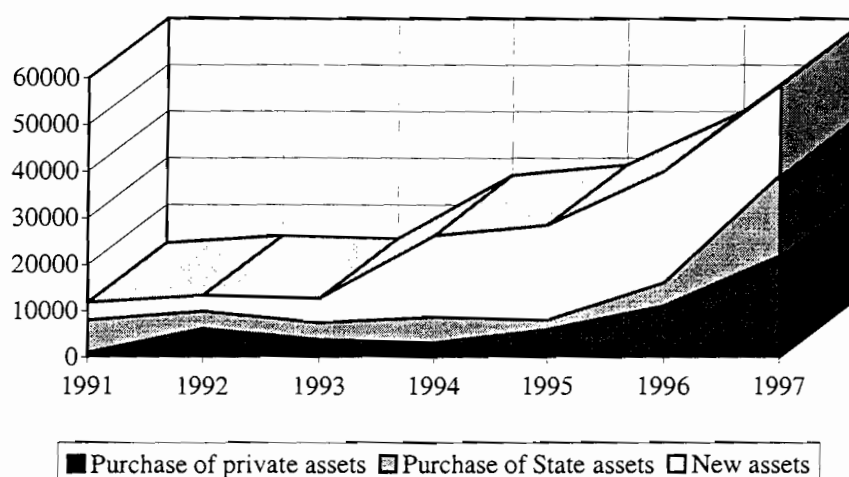
3. FDI modalities

According to recent reports in the Latin American financial press (which should be regarded only as a rough guide), foreign investors took part in the purchase of slightly over US\$ 43 billion in corporate and other assets in 1997, and over half of this sum —US\$ 25 billion— corresponded to private holdings (i.e., acquisitions and mergers). By subtracting the sum corresponding to the purchase of foreign firms by local investors in their home country (around US\$ 944 million), it can be concluded that in 1997 net inflows of FDI generated by the transfer of assets in the region amounted to an estimated US\$ 41.7 billion. This means that in 1997 roughly 70% of the region's inward FDI corresponded to changes in the ownership of existing assets. The methodological approach based on cross-comparisons of the information reported by the specialized press on FDI modalities with the official statistics issued by international agencies has a number of drawbacks, however, since there may be a considerable delay before FDI flows generated by the purchase of assets are registered on the balance of payments. Consequently, the results should be regarded only as a rough indication, rather than as conclusive evidence.

In any event, it is clear that the forms taken by FDI flows to Latin America and the Caribbean have varied during the 1990s (see figure I.5). Until 1993, the purchase of existing fixed assets (whether owned by the State or private agents) was the preferred modality. In 1994-1996, however, the sharp increase in FDI stocks has been associated with a preference for greenfield investments as part of large-scale projects, the restructuring and modernization of existing foreign firms in the region, and greenfield investments linked to the restructuring and modernization of newly privatized enterprises. In 1997 another steep rise was seen in the purchase of existing assets by foreign investors. More FDI entered the region through the purchase of privately-owned fixed assets than via privatizations, although the increase in the latter was more pronounced (especially in Brazil and Colombia).

According to the information compiled on the subject, slightly over one third of the inward FDI in 1997 generated by the transfer of existing assets went to Brazil (US\$ 12,913 billion), which was the region's leading destination for FDI generated by the sale or privatization of State-owned companies and assets as well as a major recipient of FDI generated by the sale of firms owned by local private-sector agents. The above figure represented nearly two thirds of Brazil's total FDI inflows in 1997.

Figure I.5
FDI FLOWS, BY MODALITY, IN THE LAIA COUNTRIES, 1991-1997: AN ESTIMATE
(Millions of dollars)



Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the International Monetary Fund (IMF), KPMG Corporate Finance and the World Bank.

Apart from Brazil, international investors interested in acquiring existing assets in Latin America have primarily focused their attention on Argentina (18.5%), Mexico (13.4%), Colombia (11.2%), Venezuela (10.3%) and Chile (6.8%). The relative percentages corresponding to the various types of transfers differ significantly from one country to the next. In countries that launched their privatization programmes early on, such as Argentina, Chile and Peru, more FDI tends to be generated by transactions between private economic agents than by the sale of State-owned assets. In countries whose privatization programmes are still under way (Brazil, Colombia and Venezuela) the situation is just the opposite.

In summary, two substantive aspects of FDI trends in Latin America and the Caribbean in 1997 stand out when the figures are broken down by investment modality. The first is the growing number of private firms being purchased by foreign investors and the effect this is having on FDI inflows, especially in the cases of Argentina, Brazil, Mexico and Chile. The second is the importance of the privatization of State-owned companies and other assets as a determinant of FDI; this is the main cause of the expansion being seen in foreign investment in Brazil, Colombia and Venezuela. These factors are important considerations in the interpretation of FDI flows and will therefore be examined in some detail.

(a) *Private-sector acquisitions*

The acquisition of local firms by foreign investors has been the main vehicle for inward FDI in a number of the countries in the region, thus mirroring the worldwide boom in FDI transactions involving the purchase of privately-owned assets, which account for 60% of total global FDI flows (UNCTAD, 1998). In a reflection of the importance being taken on by this phenomenon in the Latin American and Caribbean region, during the first half of 1997 mergers and acquisitions of Latin American firms accounted for 13% of the world total, which was more than the corresponding figure for Asian companies even before the crisis broke out in Thailand.

Based on information compiled from the specialized financial press, it can be estimated that in 1997 mergers and acquisitions in Latin America and the Caribbean in which foreign investors obtained a majority interest totalled US\$ 25.3 billion (see table I.5). This means that about 40% of net FDI inflows to the region was generated by mergers and acquisitions, although in various countries the figure is far higher than this regional average. This is especially true of Argentina, where FDI generated by the purchase of private Argentine firms by international investors is thought to make up over 90% of total net inward FDI. These discrepancies may be accounted for by instances in which press reports are inaccurate and by the fact that the proceeds from the sale of a company may not necessarily be brought into the country concerned or, if they are, may come in the form of installments spread out over a considerable period of time.⁶

The relevant data indicate that in 1997, international investors interested in acquiring local firms focused their attention on just four countries, which were consequently the main recipients of FDI inflows generated by these types of asset transfers: Mexico (32%), Argentina (25%), Brazil (22%) and Chile (10%). The portion of total inward FDI generated by the sale of business enterprises was very considerable in Mexico (62%) and Chile (41%); in Brazil and Venezuela the share derived from such operations was smaller than the proportion corresponding to privatizations but was nonetheless quite substantial. This kind of transaction is not yet being undertaken on a comparable scale in the other countries of the region.

⁶ Another consideration in Argentina's case is that some of these transactions involve the acquisition of a controlling interest in local firms by subsidiaries of foreign firms (e.g., the purchase of Pluspetrol Energy, Soldati and EG3 by Astra, an Argentine company in which the Spanish firm Repsol owns a controlling stake, or the purchase of Banco de Crédito Argentino by Banco Francés del Río de la Plata, which is controlled by Banco Bilbao Vizcaya); some of these operations do not necessarily involve the entry of fresh capital into the country, since they may be financed with in-house funds, or the necessary financing may be obtained on the destination country's (in this case, Argentina's) capital market. In addition, in some of these operations payment is made through the transfer of shares, as in the case of Banco Santander, which signed over 6% of Banco Santander-Chile to the Pérez Companc group as part-payment for a major stake in the Argentine Banco Río de la Plata (see the section on Argentina in this chapter).

Table I.5
LATIN AMERICA: CAPITAL INFLOWS ORIGINATING FROM CORPORATE
ACQUISITIONS BY FOREIGN INVESTORS, 1997

(Millions of dollars)

Subregion/Country	Sales ^a	Purchases ^b	Net inflow via M&A	Net inward FDI	Net inflow as % of FDI
	(1)	(2)	(3) = (1) - (2)	(4)	(5) = [(3)/(4)]*100
LAIA countries	25 251	944	24 307	58 500	41.6
Argentina	6 413	244	6 169	6 326	97.5
Bolivia	...	...	...	601	...
Brazil	5 641	155	5 486	19 652	27.9
Chile	2 449	213	2 236	5 417	41.3
Colombia	504	0	504	5 982	8.4
Ecuador	42	0	42	577	7.3
Mexico	8 089	312	7 777	12 477	62.3
Paraguay	4	0	4	191	2.1
Peru	471	0	471	2 030	23.2
Uruguay	...	...	...	160	...
Venezuela	1 638	20	1 618	5 087	31.8
Central America	58	0	58	1 855	3.1
Costa Rica	0	0	0	446	0
El Salvador	12	0	12	...	...
Guatemala	14	0	14	84	16.7
Honduras	0	0	0	122	0
Nicaragua	32	0	32	173	18.5
Panama	0	0	0	1 030	0
Total	25 309	944	24 365	60 355	40.4

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information obtained from *América economía*, *The Wall Street Journal*, *Estrategia*, *Diario financiero*, *Latin Finance*, *Exame*, *Expansión*, *Apertura* and other specialized financial newspapers and magazines.

^a Purchases of private locally-owned firms by foreign investors.

^b Purchases of foreign-owned subsidiaries by local investors.

The listing of the 25 largest transactions conducted in 1997, all of which involve sums in excess of US\$ 250 million (see table I.6), points up the main characteristics of these types of asset transfers in Latin America and the Caribbean. Most of these operations concern the acquisition of banks (see box I.2) or manufacturing enterprises, although some large-scale transactions involving the transfer of oil and mining companies also took place.

Box I.2

THE GLOBALIZATION OF LATIN AMERICAN BANKING

Latin American banking is undergoing a globalization process and is becoming more concentrated as a result of the acquisition of many local banks by transnational investors. Some of the largest such operations have been the investments made by the British bank, Hong Kong Shanghai Bank (HSBC), in Argentina (Banco Roberts), Brazil (Banco Bamerindus), Mexico (Grupo Financiero SERFIN) and Chile (Banco Santiago), which have allowed HSBC to gain a substantial share of the region's main financial markets. Other noteworthy buyers include a number of Spanish banks, particularly Banco Bilbao Vizcaya (BBV), Banco Santander and Banco Centro Hispano (BCH). For example, during 1997 BBV bought a 30% stake in Banco Francés del Río de la Plata in Argentina and, through the latter, became the majority shareholder of Banco de Crédito Argentino. That same year it also acquired a controlling interest in Banco Provincial in Venezuela, thus adding these institutions to the list of firms it acquired in 1996, which includes Banco Ganadero in Colombia, Banco Continental in Peru and the Probusa financial group in Mexico, among others. Early in 1998, BBV bought parts of Banco BHIF in Chile and of Banco Excel Econômico S.A. in Brazil. For its part, Banco Santander's 1997 transactions include the purchase of a 35% interest in Banco Río de la Plata (one of the largest private banks in Argentina), a majority stake in Brazil's Banco Noroeste, and the acquisition of InverMéxico (Mexico) Bancoquía (Colombia), Banco Mercantil e Interandino (Peru), Banco de Venezuela (Venezuela) and Banco Geral do Comercio (Brazil). It is estimated that these two banks have each spent around US\$ 4 billion on their expansion in Latin America.

These three Spanish banks, plus HSBC and Canada's Bank of Nova Scotia, have mounted a major effort over the past two years to position themselves as the undisputed leaders of Latin America's financial sector, especially in the economies of the region's largest countries. These banks began to make their bid for regional leadership just two years ago, when BBV bought a minority interest in Mexico's Probusa financial group. Probusa was in financial trouble, and BBV injected US\$ 350 million to pay off its debts while taking advantage of a reform measure recently approved by the Government of Mexico which permits foreign banks to buy majority stakes in Mexican banks (see the section on Mexico in part B of this chapter).

The swift expansion of this group of banks in 1996-1998 bears witness to the fact that the region's banking industry is in the midst of a thorough-going restructuring. As a result of this process, which is based on privatizations, acquisitions from local corporate groups and mergers, many of the major local banks operating in the region's principal economies have changed hands and become part of the Latin American banking networks that are now beginning to take shape. One of the reasons for this shift is the Latin American banking industry's need to fortify its capital base so that it can deal more efficiently with an increasingly competitive market that has changed radically since the 1995 financial crisis. Another is the adoption by some European (Spanish and British) banks of strategies for expanding their operations in Latin America in response to the high growth rates that this sector has been able to achieve in those Latin American countries that have implemented a stable growth policy and the fact that the returns on investment offered by this industry in Latin America are substantially higher than the rates available in Europe.

In the manufacturing sector, which is the second-largest area of activity in terms of acquisitions involving sums of over US\$ 250 million, these transactions have chiefly involved firms occupying a very strong market position in the country in such industries as beverages (HIT in Venezuela, the Modelo group in Mexico), tobacco (Cigarrera La Moderna and Cigatem in Mexico), cleaning products or cosmetics (Kolynos in Brazil), food products (Kibon in Brazil) or construction materials (Cimentos Serrana and Cisafrá in Brazil, both of which were purchased by the Portuguese firm, Cimpo-Cimentos).

Table I.6
**LATIN AMERICA AND THE CARIBBEAN: PRINCIPAL ACQUISITIONS OF LATIN AMERICAN
 FIRMS BY FOREIGN INVESTORS, 1997 ^a**
 (Millions of dollars)

Firm purchased	Country	Sector	Purchaser	Home country	Sum paid ^a
Iusacell (100%)	Mexico	Telecom.	Bell Atlantic	United States	1 712
Cigarrera La Moderna (50%)	Mexico	Manufactures	British American Tobacco	United Kingdom	1 443
Cifra (50%)	Mexico	Commerce	Wall Mart Stores, Inc.	United States	1 204
Energis (29%)	Chile	Electricity	Endesa-España	Spain	1 179
CEVAL-Alimentos (100%)	Brazil	Foodstuffs	Bunge & Born	Argentina	1 200
HIT de Venezuela (50%)	Venezuela	Manufactures	PANAMCO	Mexico/Panama	1 112
Kolynos	Brazil	Manufactures	Colgate-Palmolive	United States	1 000
Banco Bamerindus (100%)	Brazil	Services	HSBC Holdings	United Kingdom	1 000
Kibon (100%)	Brazil	Manufactures	Unilever	United Kingdom/ Netherlands	930
Cablevisión (67%)	Argentina	Telecom.	CEI-Citicorp / Telefónica de España	United States/ Spain	761
Banco Río de la Plata (35%)	Argentina	Services	Banco Santander	Spain	694
Satélites Mexicanos (75%)	Mexico	Telecom.	Loral Space Communications	United States	692
Banco Roberts (70%) ^b	Argentina	Services	HSBC Holdings	United Kingdom	668
PanamSat	Mexico	Telecom.	Hughes Communications	United States	650
Grupo Modelo (19%) ^c	Mexico	Manufactures	Anheuser-Busch	United States	605
Cointel S.A. (17%)	Argentina	Telecom.	CEI-Citicorp	United States	590
Banco de Crédito Arg. (72%)	Argentina	Services	Banco Bilbao Vizcaya	Spain	560
Unibanco (50%)	Brazil	Services	American International Group (AIG)	United States	500
Banco Noroeste (50%)	Brazil	Services	Banco Santander	Spain	500
Oca-Ocasa (100%)	Argentina	Services	The Exxel Group	United States	450
Soldati - EG3 (100%) ^d	Argentina	Petroleum	Repsol (Astra)	Spain	400
Cigatem (21%) ^e	Mexico	Manufactures	Phillip Morris International	United States	400
Cimentos Serrana y Cisafra	Brazil	Manufactures	Cimpo-Cimentos	Portugal	380
Banco Provincial (40%)	Venezuela	Services	Banco Bilbao Vizcaya	Spain	370
Pluspetrol Energy (45%)	Argentina	Petroleum	Repsol (Astra)	Spain	360
Banco Francés (30%)	Argentina	Services	Banco Bilbao Vizcaya	Spain	350
Video Cable Comunicación, VCC (40%)	Argentina	Telecom.	US West Media Group	United States	340
Cointel S.A. (14%)	Argentina	Telecom.	Telefónica de España	United States	340
Cerrejón Central (50%)	Colombia	Mining	Anglo American Corp.	South Africa	290
Financiera SERFIN (20%)	Mexico	Services	HSBC Holdings	United Kingdom	270
Caemi Mineração e Metalurgia (40%)	Brazil	Mining	Mitsui & Co.	Japan	264
Los Pelambres (40%)	Chile	Mining	Nippon Mining & Met Co. / Mitsubishi Materials	Japan	256
Deutsche Bank Argentina (100%)	Argentina	Services	Boston Bank	United States	250

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information obtained from *América economía*, *The Wall Street Journal*, *Estrategia*, *Diario financiero*, *Latin Finance*, *Exame*, *Expansión*, *Apertura* and other specialized financial newspapers and magazines.

^a Transactions in excess of US\$ 250 million.

^b Roberts S.A. de Inversiones owns Banco Roberts, Docthos, Buenos Aires Seguros, AFJP Máxima, Buenos Aires New York Life-Vida and a minority interest in the Alpargatas group.

^c With this stock purchase, Anheuser-Busch increased its stake in the Modelo group to 37%.

^d Purchase of EG3 (first and second blocks of stock) (*Apertura*, 1998 Guía de Mergers & Acquisitions and Finanzas Corporativas).

^e With this stock purchase, Phillip Morris increased its stake in Cigatem to 50%.

The acquisitions that have taken place in the manufacturing sector differ in a number of ways from those undertaken in the banking industry, where the leading actors and their main objectives are more clearly defined. In the manufacturing sector, leadership roles are not as clearly delimited, and regional leadership is not the only aim. Instead, the participants in these operations have chiefly been transnational corporations that have already established their position as producers of consumer goods in the great majority of the countries in the region and that possess an internationalized structure of long standing within Latin America (e.g., Unilever, British American Tobacco and Philip Morris); these firms' objective appears to be to contest specific segments of the Latin American market, particularly in those countries where high growth rates are projected for the coming years (see box I.3).

Box I.3

UNILEVER'S STRATEGY IN LATIN AMERICA

One of the European conglomerates that has been contesting specific segments of the Latin American market is Unilever, an Anglo-Dutch transnational that has moved into a number of national markets by buying up existing (in most cases locally-owned) companies. In 1997 Unilever bought the Pingüino food company in Ecuador and a Peruvian manufacturer of health products and detergents, Industrias Pacocha, as well as a 50% stake in the Mexican firm Helados Holanda, where it has taken the Quan group as its partner. Late in the year, it acquired Kibon, Brazil's largest ice-cream maker, through its Brazilian subsidiary Gessy Lever in one of the largest transactions to be carried out in the region (see table I.6). At the same time it also bought Monthelado of Argentina, another leading ice-cream producer.

The purchase of Kibon and Monthelado points up another key aspect of the strategy apparently being followed by transnational corporations that have long been active in Latin America. In both cases, the shareholder that sold out to Unilever was Philip Morris, which has been building up its presence in the Mexican tobacco industry and selling off holdings not related to its main line of business. Unilever and other transnational corporations like it have been doing much the same thing. For example, the Chilean subsidiary of British American Tobacco, Compañía Chilena de Tabacos S.A., sold its subsidiary, Consorcio Agrícola de Malloa (a leading manufacturer of various food products) to Unilever so that it could concentrate on its main business activity. By the same token, Lever Chile—a subsidiary of Unilever—has decided to concentrate all its food products in Consorcio Agrícola de Malloa and to focus its production line on the manufacture of cleaning products and toiletries.

Foreign investors thus appear to be acquiring Latin American manufacturing firms for two different reasons. In some cases, investor firms are motivated by the desire to expand their market share in countries where domestic demand seems to be growing rapidly. In others, as part of the restructuring process being pursued by some of the major transnationals that have traditionally been engaged in the production of consumer goods, firms are seeking to increase their degree of specialization in their main line of business. In some instances this has prompted these firms to sell off businesses in areas other than their main field of activity and to increase their territorial diversification within the Latin America market.

(b) Privatizations

During the first half of the 1990s, the privatization programmes launched by various countries in the region had a significant impact in terms of inward FDI. Gradually, the privatization revenues received by Latin American Governments have also begun to be linked to large new investments in the modernization of the firms that have been sold to private agents; this is especially the case in the telecommunications sector, owing to the dizzying pace of technological change in that industry in recent years. As a rule, this type of pattern has arisen as a result of the expansion requirements of firms operating in high-growth economies that are more open to outside competition, which has spurred the entry of new firms that are attracted by rebounding domestic demand and the elimination of special guarantees or exceptions for existing firms.

Now, a massive second wave of privatizations is occurring. Most of these transactions involve the transfer —via concessions— of services to private operators that had previously been supplied by the State (road and port infrastructure, postal services, etc.). Another factor is the opening of new markets, as in the case of the mobile telephone service industry, which has prompted a number of Governments in the region to auction off concessions for the operation of B-band cellular telephone services.

In many cases, foreign investors have joined up with local firms in order to diversify the risk associated with such acquisitions and reduce the start-up costs involved in operating in a new market. Although, at least in the beginning, these investments do not increase the host country's production capacity, they do make it possible to upgrade services (chiefly in the energy, transport and telecommunications sectors), which in turn helps to increase the systemic competitiveness of the host country (Calderón and Vodusek, 1998).

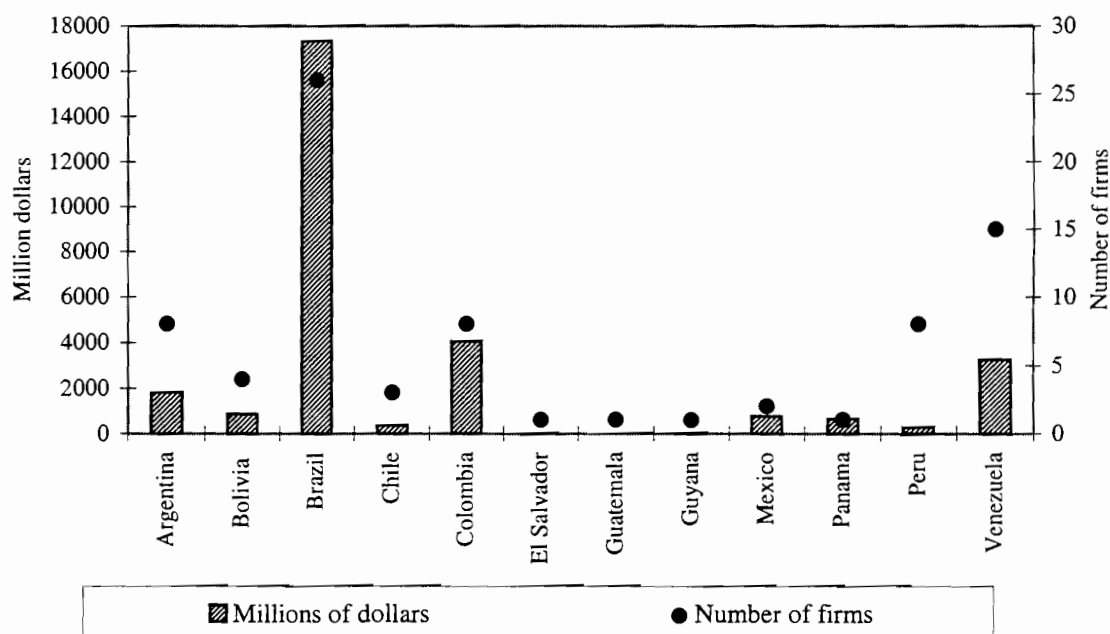
Reports published in the financial press indicate that in 1997 the Governments of the region privatized 78 firms for a total of US\$ 29.513 billion. This was more than double the revenue received from privatizations in 1996 even though the number of such operations increased less sharply. A substantial part of this sum (US\$ 17.328 billion) corresponded to the sale of firms or assets to foreign investors or to consortiums in which foreign investors were major stakeholders.

One of the reasons why the level of privatization revenues in the region was so high in 1997 was the steadily rising prices of the assets in question in recent years. For example, the first electricity company to be privatized by the Government of Brazil was sold in July 1993 for US\$ 145 per megawatt of installed capacity. In contrast, Companhia Centro-Oeste de Distribuição de Energia Elétrica (CCODEE) and Companhia Norte-Nordeste de Distribuição de Energia Elétrica (CNNDEE) were recently sold for US\$ 266 and US\$ 377 per megawatt of installed capacity, respectively, according to Solomon Brothers of New York (Calderón and Vodusek, 1998).

The main reason for the steep increase in the region's total fiscal earnings from the privatization of State firms and assets has been the privatization operations conducted by Brazil, Colombia and Venezuela; the impact of Brazil's programme has been particularly strong (see figure I.6). The implementation of these countries' privatization programmes had been hindered

in past years by domestic opposition and the absence of an appropriate legal framework (for further information on the case of Brazil, see chapter III). Brazil's privatization programme brought in US\$ 65.764 billion between 1991 and July 1998. Of this sum, 26 firms were sold in 1997 alone for a total of US\$ 17.346 billion; this was more than half of the entire region's total privatization revenues (not counting the receipts from the award of concessions). Brazil's earnings were nearly four times as high as Colombia's, which, with receipts of slightly over US\$ 4 billion, had the next largest privatization programme, followed by Venezuela.

Figure I.6
**PRIVATIZATIONS IN LATIN AMERICA, 1997: FISCAL REVENUES AND
 NUMBER OF FIRMS**
 (Millions of dollars and number of firms)



Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information obtained from *América economía*, *The Wall Street Journal*, *Estrategia*, *Diario financiero*, *Latin Finance* and other specialized financial newspapers and magazines.

Many of these privatization operations have concerned the electricity sector, particularly in Brazil and Colombia. The available information indicates that 30 companies in this industry were privatized in 1997 for a total of approximately US\$ 17.4 billion, the largest sum for any one sector. In most of these cases, the purchasers were foreign investors, except in Brazil, where local consortia raised large sums of money for the acquisition of these companies. Some firms in the electrical power industry (especially in Chile, Spain and the United States) have taken advantage of this new phase in the privatization of the region's electricity sector to increase their market share in Latin America and to carry forward the move they have begun to make towards establishing an international presence. This has led to the formation of regional conglomerates of

highly specialized, efficient business enterprises which are concentrated in one main area of activity but are geographically diversified. Some of the major conglomerates of this type are the Chilean Enersis group, Endesa-Spain and Iberdrola in Spain, and AES Corporation and Enron of the United States (see chapter III). For example, Enersis turned in the winning bid in a number of the privatizations of major electrical power companies in Brazil (Centrais Elétricas Cachoeira Dorada (CDSA) and Companhia de Eletricidade do Estado de Rio de Janeiro (CERJ)) and in Colombia (Comercializadora y Distribuidora de Energía de Bogotá (Codensa), Generadora de Energía Eléctrica de Bogotá (Emgesa) and Betania, the hydroelectric company), and has thus added these assets to its holdings in Argentina and Peru. In two of the Colombian sales and in the privatization of CERJ, the Chilean group teamed up with Endesa-Spain (see box I.8).

The Government of Brazil auctioned off various areas of the B-band for cellular telephone service and awarded concessions for some of the country's major railroad routes, which brought in another US\$ 6.523 billion. Brazil has thus moved forward quite boldly in an effort to implement the structural reforms for which the country has been preparing in recent years. Some of these reforms are aimed at downsizing the State's role in the economy and at opening up activities to foreign investors that had previously been reserved for Brazilian firms.

Foreign investors have been taking an increasingly active part in this process over the years (see chapter II). Until 1997, according to reports published in the specialized financial press, a majority of the 26 companies that had been transferred to the private sector were bought by local investors, who paid around US\$ 10 billion for these firms, including two of the main enterprises on the list of assets eligible for privatization: the Companhia Vale do Rio Doce (CVRD) and the Companhia Paulista de Força e Luz (CPFL). In contrast, the sale of State-owned enterprises to foreign investors or to consortia in which foreign companies are major stakeholders (joint ventures formed specifically for this purpose) under the country's privatization programme in 1997 generated US\$ 7.413 billion in fiscal revenues. Foreign investors also partnered up with local firms to form consortia that have bought up a total of US\$ 4.279 billion in concessions. In 1998, with the privatization of the Telebras network and the expansion of plans for the privatization of electricity companies, the presence of foreign investors has increased significantly once again (see chapter II).

Another Latin American country in which privatization played an important role in terms of inward FDI in 1997 was Colombia, where, after obstacles to the sale of major assets in the electrical power and telecommunications industries were surmounted, privatization revenues turned out to be twice as high as in 1996. In 1997, the Government of Colombia sold off eight companies (mostly in the electrical power sector) for a total of US\$ 4.061 billion, with foreign investors paying out around US\$ 3.79 billion of that amount for seven of the eight firms sold to the private sector.

4. Major transnational corporations in the region

In 1997, the combined sales of the 250 largest subsidiaries or affiliates of transnational corporations in the region totalled approximately US\$ 260 billion.²¹ According to reports appearing in *América economía*, the combined sales of the 500 largest firms in the region (including State-run enterprises, local companies and foreign-owned firms) totalled about US\$ 662.085 billion. This means that the 250 largest subsidiaries of transnational corporations operating in the region garnered 40% of the total sales of the 500 largest business enterprises in Latin America, a figure that clearly earns them a place among the region's front-line economic agents.²²

Judging from the available information on corporate sales broken down by country, the transnational corporations operating in the region —whether directly, through subsidiaries, or via a controlling interest in local firms— are highly concentrated. Around 88% of the total sales of the 250 largest subsidiaries or affiliates (US\$ 226.948 billion) were made in just three countries: Brazil, Mexico and Argentina. These are also the economies where the majority (208 out of 250) of these firms are located. Chile's sales volume (6.6%) and number of firms (19) are much smaller, and Colombia's, Peru's and Venezuela's combined share of total sales is a scant 5.6%, according to the same source (see table I.7).

Table I.7
LATIN AMERICA AND THE CARIBBEAN: TOTAL SALES OF THE 250 LARGEST SUBSIDIARIES
OF TRANSNATIONAL CORPORATIONS, BY HOST COUNTRY, 1997
(Millions of dollars and percentages)

Country	Sales		Firms	
	Sum	Percentage	Number	Percentage
Brazil	106 917	41.4	99	39.6
Mexico	67 155	26.0	46	18.4
Argentina	52 877	20.5	63	25.2
Chile	17 022	6.6	19	7.6
Colombia	6 639	2.6	12	4.8
Venezuela	4 406	1.7	6	2.4
Peru	3 404	1.3	5	2.0
Big Three ^a	226 948	87.8	208	83.2
Other	31 471	12.2	42	16.8
Total	258 418	100.0	250	100.0

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information obtained from *América economía* and *Expansión* (Mexico), *Exame* and *Gazeta Mercantil* (Brazil), *Estrategia* (Chile), *Dinero* (Colombia) and other financial publications.

^a Argentina, Brazil and Mexico.

²¹ This sales figure corresponds to the 250 largest subsidiaries having operating incomes of over US\$ 250 million.

²² According to *América economía*, 183 of the region's 500 largest firms are foreign companies accounting for 33% of this group's total sales (*América economía*, 1998c).

From a sectoral perspective (see table I.8), with two thirds of the total, manufacturing accounts for the largest share of the sales made by the 250 largest subsidiaries of transnational corporations in the region, followed by services (22%) and the primary sector (11%). The degree of concentration as measured by the number of firms in each industry is quite similar, with 84% of total sales being concentrated in just six economic activities: the automotive industry (26.2%); food, beverages and tobacco (19.2%); commerce (10.7%); electronics (9.9%); petroleum (9.1%); and chemicals (8.5%). Sales have also been mounting rapidly in a number of other subsectors, especially ones that have recently been privatized, such as telecommunications (4.7%) and energy (3.5%).

Table I.8

LATIN AMERICA AND THE CARIBBEAN: TOTAL SALES OF THE 250 LARGEST SUBSIDIARIES OF TRANSNATIONAL CORPORATIONS, BY SECTOR, 1997

(Millions of dollars and percentages)

Sector	Sales		Firms	
	Sum	Percentage	Number	Percentage
Primary	28 580	11.1	23	9.2
Petroleum/natural gas	23 486	9.1	16	6.4
Mining	5 094	2.0	7	2.8
Manufactures	173 143	66.9	172	68.8
Food, beverages and tobacco	49 555	19.2	57	22.8
Iron and steel	4 718	1.8	8	3.2
Chemicals	21 963	8.5	35	14.0
Motor vehicles	67 657	26.2	38	15.2
Electronics	25 823	9.9	29	11.6
Other ^a	3 427	1.3	5	2.0
Services	56 964	22.0	55	22.0
Construction	2 526	1.0	6	2.4
Commerce	27 761	10.7	23	9.2
Telecommunications	12 148	4.7	10	4.0
Energy	8 940	3.5	10	4.0
Other services ^b	5 319	2.1	6	2.4
Total	258 418	100.0	250	100.0

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information obtained from *América economía* and *Expansión* (Mexico), *Exame* and *Gazeta Mercantil* (Brazil), *Estrategia* (Chile), *Dinero* (Colombia) and other financial publications.

^a Includes paper and pulp, textiles and other unspecified activities.

^b Includes water utilities and tourism (hotels).

Transnational corporations based in industrialized countries account for almost all reported operating income (95.4%), with the bulk of these earnings corresponding to corporations based in the United States (48.5%) and in the European Union (38.4%); at 4.6% of the total, the developing countries' share of operating income is still exceedingly small. One of the reasons for the preponderance of United States-based firms (110 of the 250) is the great strategic importance that many transnational corporations attribute to diversifying their operations in the countries of

the region (see chapter III). As measured by sales, the European Union-based transnational corporations (94 out of 250) include a large proportion of German, Italian and French firms, as well as a growing number of Spanish companies (see table I.9).

Table I.9

LATIN AMERICA AND THE CARIBBEAN: TOTAL SALES OF THE 250 LARGEST SUBSIDIARIES OF TRANSNATIONAL CORPORATIONS, BY HOME COUNTRY AND REGION, 1997

(Millions of dollars and percentages)

Region/Country	Sales		Firms	
	Sum	Percentage	Number	Percentage
Developed countries	246 557	95.4	232	92.8
United States	125 238	48.5	110	44.0
European Union	99 350	38.4	94	37.6
Germany	26 062	10.1	24	9.6
Italy	16 722	6.5	14	5.6
France	14 531	5.6	16	6.4
Spain	12 944	5.0	12	4.8
United Kingdom	12 327	4.8	10	4.0
Netherlands	12 162	4.7	11	4.4
Other ^a	4 602	1.8	7	2.8
Japan	4 501	1.7	7	2.8
Other developed countries ^b	17 468	6.8	21	8.4
Developing countries ^c	11 861	4.6	18	7.2
Total	258 418	100.0	250	100.0

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information obtained from *América economía* and *Expansión* (Mexico), *Exame* and *Gazeta Mercantil* (Brazil), *Estrategia* (Chile), *Dinero* (Colombia) and other financial publications.

^a Includes Belgium, Portugal and Sweden.

^b Includes Australia, Canada, New Zealand, South Africa and Switzerland.

^c Includes Argentina, Chile, Mexico, Panama and other unspecified countries.

Another way of measuring the presence of transnational corporations in Latin America is to analyse their combined sales in all the countries for which information is available. The consolidated sales of the 100 largest transnational corporations operating in the seven Latin American countries for which statistics for 1997 are available (see table I.10)⁹ are heavily concentrated (88.8%) by home country, with 49.6% of them based in the United States and 39.2% in the European Union. Sales locations are also heavily concentrated, with 85.6% of sales being accounted for by just three countries: Brazil (39.2%), Mexico (24.1%) and Argentina (22.3%). When measured in terms of economic activity, 91% of sales are concentrated in just seven industries: the automotive industry, including spare parts (26.7%); food, beverages and tobacco (20.6%); petroleum and mining (11.5%); electronics and electrical machinery (9.9%); chemicals (7.3%); commerce (7%); telecommunications (4.8%); and electricity (3.2%).

⁹ The sample used in computing these estimates was composed of the sales figures for the 500 largest transnational corporations operating in Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela. This analysis differs from the earlier one concerning the 250 largest subsidiaries in the region in that here the available sales figures for subsidiaries or affiliates were used even if they were below the US\$ 250 million cut-off point. The aim here is to present the consolidated corporate data as accurately as possible.

Table I.10

100 LARGEST TRANSNATIONAL CORPORATIONS IN LATIN AMERICA, BY CONSOLIDATED SALES, 1997
(Millions of dollars)

UNCTAD a	ECLAC	Home country	Firm	Sector	Brazil	Mexico	Argentina	Chile	Colombia	Venezuela	Total ^b
5	1	United States	General Motors Corp.	Automotive	5 730	7126	774	525	833	393	15 381
8	2	Germany	Volkswagen AG.	Automotive	6 531	3423	1 348	...	...	...	11 302
3	3	United States	Ford Motor Company	Automotive	3 759	4871	1 866	...	...	704	11 200
2	4	UK/Netherlands	Royal Dutch Shell	Petrol./Mining	6 124	...	2 205	1220	251	...	9 825
17	5	Italy	Fiat Spa	Automotive	5 824	...	3 181	...	...	183	9 188
82	6	United States	Coca Cola Corp. ^c	Beverages	1 495	4191	1 989	936	...	...	8 659
4	7	United States	Exxon Corp.	Petrol./Mining	3 009	...	1 818	1103	1 330	...	7 160
...	8	France	Carrefour Supermarché	Commerce	5 098	...	1 737	...	...	...	6 835
88	9	United States	PepsiCo	Beverages	2 601	3106	1 059	...	...	...	6 766
...	10	Spain	Telefónica de España	Telecom.	...	...	3 893	1437	...	...	6 756
80	11	United States	Chrysler	Automotive	...	6501	171	...	...	...	6 672
11	12	Switzerland	Nestlé AG.	Foodstuffs	3 080	1448	453	807	307	97	6 452
6	13	United States	IBM Co.	Electronics	2 321	2798	580	82	...	...	5 899
18	14	UK/Netherlands	Unilever	Foodstuffs	3 621	650	884	220	194	...	5 569
28	15	United States	Philip Morris Companies	Tobacco	1 478	...	3 446	...	...	...	4 924
...	16	Spain	Endesa-España	Electricity	701	...	869	2815	122	...	4 507
...	17	United States	Wal-Mart Stores, Inc.	Commerce	...	4081	400	...	...	...	4 481
...	18	Argentina	Bunge & Born	Foodstuffs	3 878	...	...	...	...	...	4 311
31	19	United Kingdom	British American Tobacco	Tobacco	1 693	917	879	180	...	497	4 166
...	20	United States	Cargill Incorporated	Foodstuffs	1 791	...	1 687	64	241	...	3 947
...	21	United States	Exxel Group ^d	Various	...	...	3 938	...	...	...	3 938
51	22	United States	Texaco Incorporated	Petroleum	3 144	...	...	...	786	...	3 930
19	23	Germany	Daimler - Benz AG.	Automotive	2 852	...	619	...	...	...	3 471
1	24	United States	General Electric	Electronics	...	3048	...	...	...	93	3 141
...	25	New Zealand	Carter Holt Harvey	Forestry	...	...	...	3048	...	...	3 048
22	26	Germany	Siemens AG.	Electronics	1 649	573	502	...	168	130	3 022
97	27	United States	GTE Corporation	Telecom.	...	...	252	...	...	2148	2 400
16	28	Japan	Nissan Motor Co.	Automotive	...	2153	...	...	187	...	2 397
54	29	United States	Xerox Corporation	Electronics	1 760	468	143	...	...	...	2 382
41	30	United States	Hewlett Packard	Electronics	423	1553	205	...	...	...	2 181
...	31	United States	Kodak	Photography	538	1606	...	...	...	...	2 144
15	32	Germany	Hoescht AG.	Chemicals	685	1193	139	82	...	29	2 143
35	33	Germany	BASF AG.	Chemicals	1 059	782	...	59	...	98	2 010
55	34	Sweden	Ericsson LM	Electronics	1 525	420	...	...	...	...	1 945
...	35	Netherlands	Royal Ahold	Commerce	...	...	1 147	755	...	...	1 922
...	36	United States	AES Corp.	Electricity	1 803	...	...	...	...	...	1 803
...	37	United States	Avon Product Inc.	Toiletries	822	355	311	...	...	70	1 558
...	38	Italy	Stet-Telecom.	Telecom.	...	...	1 175	378	...	...	1 553
59	39	Australia	Broken Hill (BHP)	Mining	...	...	...	1547	...	...	1 547
...	40	United States	Whirlpool	Electronics	1 545	...	...	...	...	...	1 545
...	41	Italy	Pirelli	Tyres	1 237	...	282	...	...	...	1 519
...	42	Switzerland	Glencore Holding	Commerce	504	...	998	...	...	...	1 502
...	43	United States	Anheuser-Bush	Beverages	...	1492	...	...	...	...	1 492
14	44	Germany	Bayer AG.	Chemicals	574	238	540	31	...	98	1 481
64	45	United States	Procter & Gamble	Chemicals	...	1200	...	...	...	...	1 449
...	46	United States	Goodyear Tire & Rubber	Tyres	852	...	151	215	138	...	1 431
32	47	United States	Du Pont de Nemours	Chemicals	576	510	339	...	...	...	1 425
26	48	Switzerland	Novartis ^e	Chemicals	774	161	481	...	...	...	1 416
47	49	Germany	Robert Bosch GmbH	Vehicle parts	1 390	...	...	...	...	...	1 390
7	50	Japan	Toyota Motor Corp.	Automotive	282	...	265	...	462	230	1 337
...	51	Italy	Camuzzi Gazometri SpA	Petroleum	...	...	1 298	...	...	...	1 298
...	52	United States	Asarco Inc.	Mining	...	1293	...	...	...	...	1 293
...	53	United States	Kimberly Clark	Paper and pulp	...	1278	...	...	...	...	1 278
10	54	United States	Mobil Oil Corp.	Mining	...	89	...	...	1165	...	1 273
...	55	Spain	Repsol	Petroleum	...	...	1 272	...	...	...	1 272
30	56	France	Renault	Automotive	...	...	1 264	...	...	...	1 264
...	57	Sweden	Saab-Scania AB	Automotive	962	...	260	...	...	...	1 222

Table I.10 (cont.)

UNCTAD a	ECLAC	Home country	Firm	Sector	Brazil	Mexico	Argentina	Chile	Colombia	Venezuela	Total ^b
...	58	Spain	Iberia	Transport	...	...	1 201	...	...	...	1 216
...	59	United States	Colgate Palmolive	Chemicals	...	700	122	...	390	...	1 212
...	60	France	Dreyfus & Co.	Foodstuffs	739	...	472	...	...	...	1 211
...	61	Netherlands	SHV Makro NV	Commerce	1 182	...	...	...	...	...	1 182
...	62	France	France Telecom.	Telecom.	...	...	1 175	...	...	...	1 175
...	63	United States	Aluminium Co. of America	Metals	1 073	...	...	...	...	...	1 073
56	64	Switzerland	Holderbank Fin. Glarus	Cement	332	554	...	150	...	...	1 063
...	65	Italy	Parmalat S.A.	Foodstuffs	867	...	...	...	...	190	1 057
...	66	United States	Continental Bank	Energy	...	...	405	614	...	...	1 019
...	67	United States	Nabisco	Foodstuffs	654	...	308	...	...	...	1 003
...	68	United States	Praxair Inc.	Chemicals	979	...	...	...	...	...	979
66	69	United States	Amoco Corp.	Petroleum	...	...	923	...	...	...	923
46	70	United States	Dow Chemical Company	Chemicals	651	...	239	...	...	...	890
...	71	Chile	Enersis	Electricity	...	...	869	...	...	...	869
...	72	France	Électricité de France	Electricity	...	...	848	...	...	...	848
...	73	Mexico	Cemex S.A.	Cement	...	...	...	...	370	462	832
...	74	Italy	Cragnotti & Partners	Health/Toiletries	828	...	...	...	...	...	828
...	75	United States	Monsanto Company	Chemicals	296	328	202	...	...	...	826
...	76	United States	Southern Peru Copper	Mining	...	...	...	...	...	...	825
...	77	Chile	Grupo Paulmann	Commerce	...	...	815	...	...	...	815
...	78	France	Alcatel Alsthom	Electronics	463	350	...	...	...	...	813
58	79	France	Compagnie de Saint-Gob.	Construction	807	...	...	...	...	...	807
...	80	United States	American Express Co.	Serv. Financieros	...	800	...	...	...	...	800
89	81	France	Danone	Foodstuffs	334	115	319	...	...	...	768
20	82	Netherlands	N.V. Philips	Electronics	630	...	...	77	...	...	747
62	83	Sweden	Electrolux AB	Electronics	743	...	...	...	...	...	743
68	84	United States	McDonald's	Commerce	719	...	...	...	...	...	719
...	85	France	Peugeot	Automotive	...	...	651	62	...	...	713
...	86	Canada	Nova Corp.	Gas	...	...	687	...	...	...	687
72	87	United States	Johnson & Johnson	Chemicals	474	...	197	...	...	...	683
...	88	United States	Dana Equip's Ltd.	Vehicle parts	665	...	...	...	...	...	665
...	89	United States	Cyprus Amax	Mining	...	...	...	434	...	...	654
...	90	United States	BellSouth	Telecom.	...	...	574	...	...	...	649
87	91	Japan	Bridgestone-Firestone	Tyres	639	...	...	...	...	...	639
...	92	UK/Spain	British Gas/Repsol	Gas distrib.	...	...	628	...	...	...	628
...	93	Netherlands	Heineken N.V.	Beverages/Cerveza	...	...	608	...	...	...	608
21	94	Switzerland	La Roche & Co.	Chemicals	408	...	175	...	...	...	605
...	95	United States	The Gillette Company	Health/Toiletries	377	...	216	...	...	...	604
...	96	Ireland	Smurfit Carton	Paper and pulp	...	200	...	...	254	148	602
...	97	Switzerland	André & Cie.	Chemicals	...	...	601	...	...	...	601
...	98	United States	3M	Commerce	450	...	120	...	...	...	601
...	99	Germany	Paulaner	Foodstuffs	...	...	...	588	...	...	588
...	100	United States	Unisys Corporation	Electronics	583	...	...	...	...	...	583
Total consolidated sales of 100 largest firms					98 583	60 571	57 175	20 565	7 198	5 570	250 855

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information obtained from *América economía* and *Expansión* (Mexico), *Exame* and *Gazeta Mercantil* (Brazil), *Estrategia* (Chile), *Dinero* (Colombia) and other financial publications.

^a Ranking according to value of external assets in 1996 (UNCTAD, 1998a, pp. 36-38).

^b Include Peru

^c Includes sales of subsidiaries and bottling companies.

^d United States investment fund with operations in various sectors of the Argentine economy (see box 1.5).

^e Merger of Ciba Geigy AG and Sandoz AG (April 1996).

The information presented in table I.10 allows a comparison to be made between the ranking of the 100 largest transnational corporations in Latin America in terms of sales and the ranking of the world's 100 largest transnationals in terms of total assets (as published by UNCTAD in *World Investment Report, 1998*). A comparison of this sort yields a number of highly significant results:

- There are two distinct groups of firms that differ substantially in terms of the type of presence they maintain: firms that have a broad-based presence in five or six of the countries studied, such as General Motors, Nestlé, Unilever, British American Tobacco, Siemens, Hoescht and Bayer (which are also some of the world's largest transnational corporations); and companies having a limited presence in a single country, as in the case of many of the lesser-known transnationals, such as Carter Holt Harvey (New Zealand), the Exxel Group (United States), AES Corporation (United States), BHP (Australia), Camuzzi Gazometri (Italy), Repsol (Spain), etc.
- Generally speaking, the corporations based in the United States and Europe maintain a broad-ranging presence in Latin America. This is particularly true of the automotive industry, which includes such leading United States-based firms as General Motors, Ford and Chrysler and major European corporations such as Volkswagen (Germany), Fiat (Italy), Daimler-Benz (Germany), Renault (France), Saab-Scania (Sweden) and Peugeot (France). Japanese firms, on the other hand, have a much lower profile in Latin America than they do worldwide. This is also reflected in the automotive industry, where Nissan and Toyota have a relatively limited presence in the region and other Japanese automotive companies (such as Mazda, Honda and Mitsubishi) are not among the top-ranking firms in terms of sales. Much the same is true of Japan's large electronics firms (Hitachi, Sony, Toshiba, NEC, Canon, Fujitsu and the like).
- There is also a group of firms that maintain a much greater presence in Latin America, relatively speaking, than they do at the international level. These firms can be divided into three categories:
 - (a) Firms whose historical course of development has led them to invest more heavily in the region. For some, over 20% of their worldwide sales in 1997 came from Latin America. Examples include Avon Products (34.3%), Fiat (30.1%), Colgate Palmolive (27%), Whirlpool (21%) and Holderbank Financiere Glarus (21%). For others, the region's share of their total corporate sales worldwide amounted to between 10% and 20%, as in the case of Praxair (19.9%), Nestlé (14.2%), the Aluminum Company of America (13.2%), Goodyear Tire and Rubber (11.9%), Gillette (11.3%), Unilever (11.2%), Coca-Cola (11%), Monsanto (10.2%) and General Electric (10%) (*América economía*, 8 October 1998). For the most part, these are United States-based firms that cater to the local market.
 - (b) Firms from outside the region whose first steps towards internationalization are being taken in the region. There are many Spanish companies in this category, such as Telefónica de Spain, Endesa-Spain, Repsol and Iberia, as well as corporations based in the United States, such as Wal-Mart and AES

Corporation. It is interesting to note that 30% of AES Corporation's total sales were accounted for by its Latin American operations (see box III.2).

- (c) Latin American firms that are beginning to establish an international presence by branching out into neighbouring countries. This category includes such firms as Bunge & Born (Argentina), Enersis (Chile) and Cemex (Mexico) (see chapter I, section C).

The business activity of the 25 leading foreign banks in Latin America (excluding Panama) can be analysed on the basis of their consolidated assets as of the end of June 1997 (see table I.11). These banks' assets are highly concentrated by destination, inasmuch as just three countries account for three fourths of the total: Brazil (42.7%), Argentina (24.1%) and Mexico (15.9%). The distribution of foreign banks is highly concentrated in terms of their home countries as well, with nearly two thirds (65.2%) of them coming from Spain (23.5%), the United Kingdom (16.7%), France (11.6%) and other European countries (13.3%) and one third from North America (29% from the United States and 4% from Canada). As in the production sector, the Japanese are conspicuous for their absence (1.3%).

Thus, foreign banks operating in Latin America can be classified according to the main thrust of their corporate strategies:

- There are banks that maintain a broad-based presence in four or more countries (e.g., Citibank, Banco Santander, BankBoston, BBV, Sudameris, Lloyds, ABN, BCH, Chase Manhattan, J. P. Morgan and ING Bank) and others that operate in just one or two countries (e.g., CCF, Creditanstalt, Bankverein, Bank of Montreal, BNL, Banco Comercial Portugués, Crédit Lyonnais). In general, private European and North American banks maintain a much broader presence than State-owned European (CCF) and Japanese banks.
- Banks maintaining a wide-ranging presence in the region include a number of new entrants that are implementing aggressive expansion plans (Banco Santander, BBV, Banco Central Hispano, HSBC and the Bank of Nova Scotia) and others that have long been active in the region (Citibank, BankBoston, Sudameris, Lloyds, ABN, Chase Manhattan, J.P. Morgan, and others). The new entrants account for the bulk (81.5%) of the US\$ 9.793 billion in mergers and acquisitions carried out in Latin America's financial sector in 1995-1997, with the breakdown being as follows: Banco Santander (28.9%), BBV (22.8%), HSBC (20.2%), Banco Central Hispano (5.2%) and the Bank of Nova Scotia (4.4%).

Table 1.11
25 LARGEST FOREIGN BANKS IN LATIN AMERICA, BY CONSOLIDATED ASSETS, 1997^a
(Millions of dollars)

Ranking	Home country	Bank	Brazil	Argentina	Mexico	Chile	Colombia	Venezuela	Total assets ^b
1	United States	Citibank	7 507	4 761	6 203	2 337	918	438	23 484
2	Spain	Banco Santander	3 545	5 004	5 291	2 131	795	1 257	19 313
3	United States	Bank of Boston N.A.	8 664	7 816	67	991	61	...	18 228
4	United Kingdom	Hong Kong Shanghai Bank Corp., HSBC	11 677	2 623	3 518	...	...	...	18 011
5	Spain	Banco Bilbao de Vizcaya, BBV ^c	...	4 971	4 345	...	1 398	3 422	16 920
6	France	Sudameris	7 304	699	...	279	501	...	9 338
7	France	Crédit Commercial, CCF	8 645	...	...	...	...	...	8 645
8	United Kingdom	Lloyds Bank	6 211	1 134	...	...	328	...	8 151
9	Netherlands	ABN Amro	3 806	1 795	41	549	...	25	6 725
10	Austria	Creditanstalt Bankverein	5 605	222	...	...	...	...	5 827
11	Spain	Banco Central Hispano, BCH	10	...	1 710	2 556	1 196	...	5 569
12	United States	Chase Manhattan	3 099	1 290	206	643	...	...	5 239
13	Germany	Deutsche Bank	928	3 178	...	...	...	...	4 106
14	Canada	Bank of Montreal	...	...	3 955	...	...	...	3 955
15	United States	J.P. Morgan	1 597	1 212	724	...	...	205	3 738
16	United Kingdom	ING Bank	2 113	727	75	113	...	75	3 620
17	Italy	Nazionale del Lavoro, BNL	907	2 477	...	...	...	...	3 384
18	Canada	Bank of Nova Scotia	...	1 870	...	1 062	...	...	3 206
19	Germany	Dresdner Bank	1 363	...	141	471	...	...	1 976
20	United States	Bank of America	...	1 270	131	312	87	...	1 800
21	Portugal	Banco Comercial Português	...	...	1 710	...	...	...	1 710
22	France	Société Générale	1 055	561	89	...	...	...	1 705
23	Japan	Bank of Tokyo - Mitsubishi	961	266	100	79	...	...	1 405
24	France	Crédit Lyonnais	...	955	...	...	...	...	955
25	Japan	Sumitomo	882	...	...	...	...	...	882
Total			75 879	42 832	28 305	11 522	5 285	5 421	177 891

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information obtained from the Research Department of *América economía*, from the publication *Latin Trade*, July 1998 and from the 1998 annual reports of Banco Santander, Banco Bilbao Vizcaya, and Banco Central Hispano.

^a The data given in this table refer to the banks' assets as of the end of June 1997, which were consolidated on the basis of each foreign bank's stake in the local bank it controls. For example, in the case of HSBC, which has an interest in Banca Serfín de Mexico, only 19.9% of the US\$ 17.677 billion in total assets were counted (i.e., US\$ 3.518 billion). The same methodology was used in the other cases as well. In order to determine the exact percentage of shares held, a number of recent studies were used, including Alvaro Calderón and Ziga Vodusek, "La inversión extranjera directa en América Latina y el Caribe: un panorama", *Inversión extranjera directa en América Latina: la perspectiva de los principales inversores*, Madrid, Inter-American Development Bank (IDB)/Institute for European-Latin American Relations (IRELA), 1998; José Elías Durán, "Los determinantes de la inversión extranjera directa en América Latina y el Caribe: su impacto sobre el comercio y la integración regionales", graduate thesis, Barcelona, Universidad de Barcelona, 1998; and *Apertura*, "Guía de Mergers & Acquisitions y Finanzas Corporativas, 1998", special edition, Buenos Aires, April 1998. The case studies prepared for this report, in which fairly detailed estimates of stock holdings were prepared, were also used. Another supplementary source was *Major Companies of Latin America and the Caribbean, 1998*, London, Graham & Whiteside, 1998.

^b Includes data for Bolivia, Costa Rica, Ecuador, Paraguay, Peru and Uruguay.

^c In 1998, BBV took over Banco Excel-Económico (Brazil) and Banco Hipotecario de Fomento BHIF (Chile); these acquisitions greatly increased the value of its Latin American holdings.

5. Conclusions and prospects for 1998

FDI flows increased notably in 1997 to a total of over US\$ 400 billion and have clearly been a pivotal factor in the globalization process, i.e., the long-term trend towards the formation of a single world market. Developing countries as a group maintained their share of net inflows (38%) in 1997, but Latin America received more than in the past. The percentage of net outward FDI coming from Latin America remained smaller than the figure for developing Asian countries.

Latin America's net level of inward FDI was far higher than in previous years; in fact, the increase posted in 1997 was greater than the total inflows registered at the start of the decade. The region's FDI stock has also been renewed, since 44% of its stock of investment as of 1997 has entered the region during the 1990s. FDI is concentrated in Brazil (30%), Mexico (19%), Argentina (10%), Colombia (9%), Chile (8%), Venezuela (8%) and Peru (3%). Much more FDI has been channeled into the LAIA countries (90%) than into the Caribbean basin (10%), and the bulk of what inflows were received by the latter were routed to the financial centres located in that area. Nonetheless, a new, more sophisticated approach to FDI is being taken in the countries of the Caribbean basin, as is evidenced, for example, by Intel's move into Costa Rica.

The transfer of property via mergers and acquisitions of private firms (40%) or the privatization of State assets (30%) are the principal FDI modalities in the LAIA countries. Mergers and acquisitions are the modality of preference in the banking and manufacturing sectors of such countries as Mexico, Argentina, Brazil and Chile, whereas the privatization of assets in the telecommunications and electricity industries and the award of oil leases have been the predominant mode in Brazil, Colombia and Venezuela. Viewed from this standpoint, FDI in new assets has played a relatively secondary role in the wave of FDI that has swept over Latin America during the 1990s.

Transnational corporations have been the principal agents in this latest wave of FDI in the region. The sales of the 250 largest subsidiaries of transnational corporations in the region represent nearly 40% of the total sales of the 500 largest companies in Latin America. These subsidiaries' sales are heavily concentrated in just a few countries—over 80% of the total is accounted for by Brazil, Mexico and Argentina—and activities—chiefly the automotive industry (26.2%), food, beverages and tobacco (19.2%), electronics (9.9%), petroleum and mining (11.1%) and commerce (10.7%)—; the subsidiaries' parent companies are based in just a few countries as well, with the United States being the home country for 49% of them and the countries of the European Union for another 38%. An analysis of the combined sales of the 100 highest-profile transnational corporations in the region yields quite similar results. An analysis of the combined assets of the 25 most important foreign banks in the region, whose market presence has to be measured by different means, shows that European and United States banks are the main actors (Japanese banks are virtually absent from the regional scene) and that a group of new entrants from countries that have not traditionally been involved in this sector (Spain and Canada) are expanding their market position within the region quite notably through mergers and acquisitions.

New FDI in Latin America and the Caribbean is having a strong impact on the region's growth process. The method of analysis used by the Unit on Investment and Corporate Strategies, which approaches the subject of FDI from the standpoint of what transnational corporations are looking for (access to natural resources, an acceptable level of efficiency for the exportation of manufactures, access to the country's domestic markets or to the regional market for manufactures, access to those markets' services sectors), has proven to be highly useful in attaining a fuller understanding of this phenomenon.

In the first half of 1998, inflows amounting to US\$ 29.5 billion were received by the LAIA countries alone (see table I.2). Thus, if this trend holds, inflows to the Latin American and Caribbean region will have totalled approximately US\$ 58 billion for the year as a whole.

During the early months of the year, foreign investors' and, very importantly, transnational corporations' interest in the region showed no signs of waning despite the turmoil in international financial markets. Brazil continued to be the main focus of international investors' attention, chiefly because of its privatization programme and especially the sale of the Telebras network (see chapter II).

Foreign investors' continued interest in the acquisition of private assets, particularly in Argentina, Brazil and Mexico, has continued to galvanize inward FDI.

B. PRINCIPAL DESTINATIONS FOR FDI IN LATIN AMERICA

1. Mexico: productive integration in North America softens the impact of financial crises on FDI

Since the mid-1980s Mexico has been the principal host country for FDI in Latin America and the Caribbean; in fact, it was not until 1996 that it was first surpassed by Brazil (see chapter II). In 1991, its inward FDI flows began to increase even more sharply, reaching an annual average of US\$ 6.808 billion for the first half of the 1990s. Since then, and despite the impact of the crisis in late 1994 and the extent of current international financial turbulence, FDI inflows have risen to record levels, exceeding US\$ 12.4 billion in 1997 (see table I.2).

This performance can be attributed to the profound changes occurring in the Mexican economy since 1988. On the macroeconomic level, a broader perspective has been adopted in the management of inflation and of the fiscal deficit, and decisive steps have been taken to liberalize trade and the financial market. The authorities have encouraged all types of foreign investment inflows, privatized most of the country's public-sector enterprises and its financial system, and abandoned their import substitution strategy as part of an effort to turn private-sector exports into the engine of economic growth. Since 1989, the regulatory framework for FDI has been

substantially liberalized,¹⁰ and additional export incentives have been created, particularly for *maquila* industries. As a result, between 1990 and 1997 Mexico's exports —mostly of manufactured goods— rose from US\$ 40.7 billion to US\$ 123 billion¹¹ (ECLAC, 1997a; ECLAC, 1997b). Transnational corporations and FDI flows have played a key role in this process by helping to intensify the Mexican economy's integration into the North American market. Between 1993 and 1996, foreign enterprises' share in Mexico's total exports increased from 47.8% to 56.2%, primarily through the *maquila* system (Dussel, 1997). In 1994, this process was consolidated when Canada, the United States and Mexico signed the North American Free Trade Agreement (NAFTA).

Data on FDI¹² are now collated jointly by the Ministry of Commerce and Industrial Development (SECOFI) and the Banco de México in accordance with the recommendations contained in the *IMF Balance of Payments Manual* and those of the Organisation for Economic Co-operation and Development (OECD), of which Mexico has been a member since 1994. According to these statistics, over the past 15 years more than half of total FDI flows have gone to the manufacturing sector. Between 1994 and 1996, investments were concentrated in the machinery and equipment sector (24%), particularly the automotive, electronics and electrical equipment industries, all of which are export-oriented. The food, beverages and tobacco sector has also become a major destination for direct investments. In services, the financial sector has been prominent; in particular, there has been a great deal of activity in the stock market and commercial banks, with foreign investors entering the Mexican market through the acquisition of blocks of shares in local banks¹³ (see figure I.7).

¹⁰ The regulatory framework for the activities of foreign companies in Mexico is the Foreign Investment Act, which became law in late 1993. This statute was amended in December 1996 to bring it into line with recent changes relating to the privatization of certain sectors previously controlled by the State (telecommunications, railways and airports). On 8 September 1998 regulations set forth under the Act (originally promulgated in 1989) were amended in order to expedite administrative procedures for foreign investors.

¹¹ Manufacturing accounts for 80% of Mexico's exports of goods and services. The main export sectors are: passenger vehicles (10.1%); heavy and light trucks (3.6%); television sets (3.5%); engines (2.9%); computers (2.8%); vehicle parts and components (2.8%); electrical machinery (2.6%); and electric generators (2.5%) (ECLAC, 1998b).

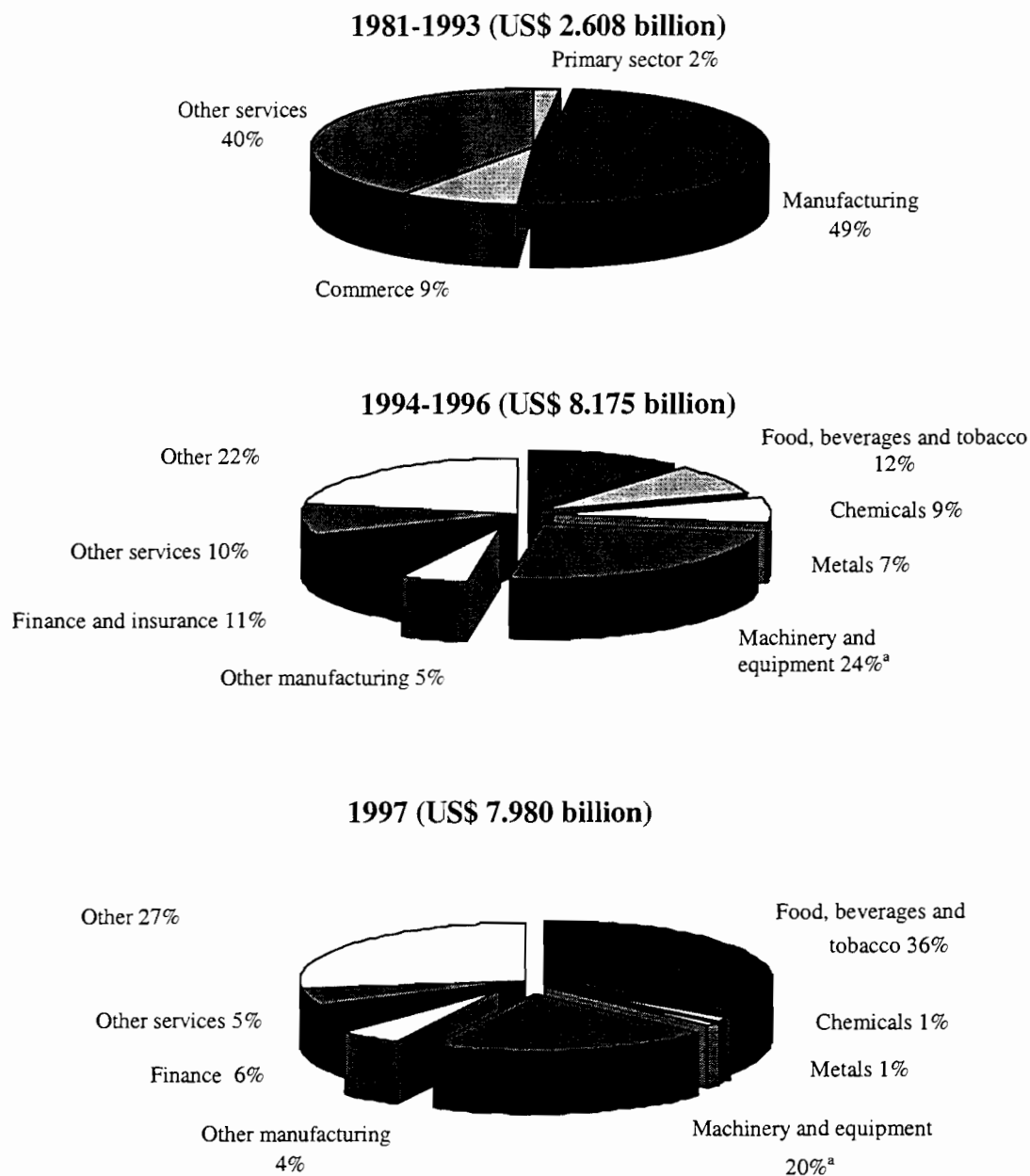
¹² FDI recorded in Mexico includes: (i) amounts reported to the National Registry of Foreign Investment (RNIE); (ii) equity contributions for new enterprises; (iii) foreign investment trusts; (iv) equity transfers from residents to non-residents; (v) imports of capital goods (fixed assets) by *maquila* enterprises (vi) reinvestment of earnings by FDI companies; and (vii) intra-firm accounts (debts and loans) (SECOFI, 1998a). Until 1994, the statistics covered only the amounts recorded under categories (i), (ii) and (iii).

¹³ As a result of the financial crisis which broke out in December 1994, many banks had to accept foreign investors in order to boost their capitalization. One of the most active buyers has been Banco Bilbao Vizcaya (BBV), which acquired 69.7% of GF Probusa in March 1995 and bought out the Cremi and Oriente banks in August 1996. Banco Santander and Banco Central Hispano (BCH), both Spanish, bought 75% of Banco Mexicano and 40% of GF Bitel, respectively. Canadian banks have also been active, with the Bank of Montreal and the Bank of Nova Scotia acquiring stakes in Bancomer (16%) and Inverlat (45%).

Figure I.7

**MEXICO: SECTORAL DISTRIBUTION OF FOREIGN
DIRECT INVESTMENT, 1981-1997**

(Percentages based on annual averages)



Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the Ministry of Commerce and Industrial Development of Mexico (SECOFI).

^a Includes investments in the automotive industry.

The *maquila* industry's share in FDI inflows has grown considerably over the past three years. Between 1994 and 1996, about 6% of FDI inflows to the manufacturing sector were destined for *maquila* industries, where the funds were mainly used to import the machinery and equipment needed for production activities (SECOFI, 1998a). About 85% of these inflows came from the United States, followed by the Republic of Korea (8%) and Japan (4%) (Dussel, 1998a).

About 60% of total FDI inflows to Mexico come from the United States. The European Union, taken as a whole, is a distant second; European investments between 1994 and 1996 amounted to 18% of the total, with the Netherlands figuring prominently (8%). Investments from Canada grew significantly during that period, thanks to the positive effects of NAFTA. Another noteworthy participant was India, with investments totalling US\$ 1.555 billion¹⁴ (see figure I.8). Foreign investors have participated only marginally in purchases of State-owned assets, but in recent years they have been very active in acquisitions of privately-owned Mexican enterprises. An added stimulus in this respect has been the reduction in the purchase price of such companies caused by the devaluation of the peso; this was a particularly significant factor in foreign institutions' acquisitions of stakes in a number of banks as they were being privatized in the early 1990s.

In 1997, 62% of FDI inflows went to manufacturing; food, beverages and tobacco industries were the chief destination within that sector, with 58% of those inflows being concentrated there (see figure I.7). Much of this investment activity took the form of the transfer of capital stock from local entrepreneurs to transnational corporations. These operations have included the acquisition of Cigarrera La Moderna by British American Tobacco, the purchase of 37% of Grupo Modelo by Anheuser-Busch and the sale by Grupo Carso of a 21% interest in Cigatam to Philip Morris International (see table I.13). In addition, some of the major transnational corporations in the sector have invested heavily to expand and consolidate their share of the Mexican market (PepsiCo, Coca-Cola and Nestlé).

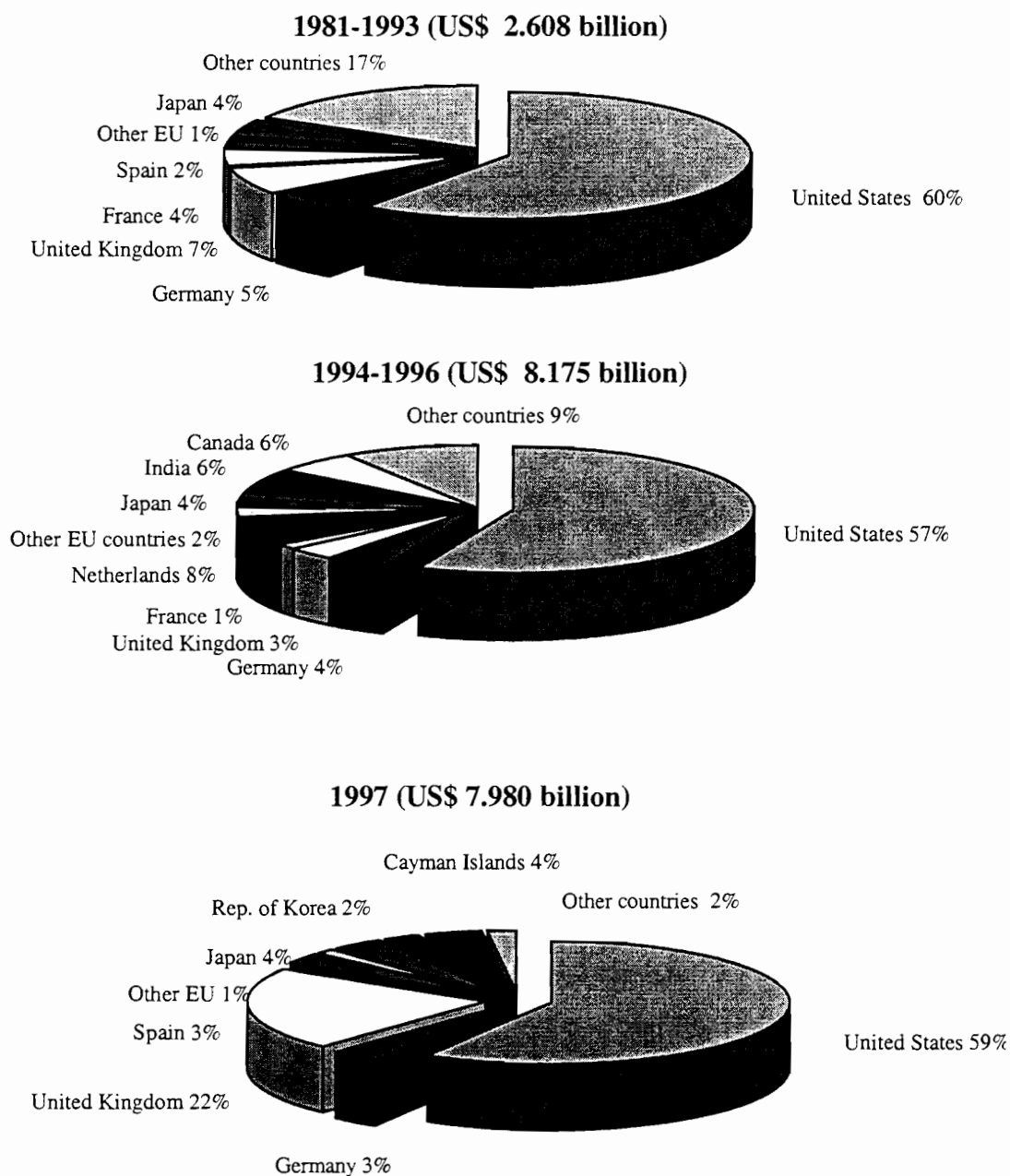
In the service sector, financial activities have continued to predominate, and their importance is likely to increase as various changes are made in the regulatory framework.¹⁵ Currently, foreign investors control 20% of the local banking system (*Business Latin America*, 1998). In 1997, the United Kingdom's Hong Kong Shanghai Bank (HSBC) acquired 19.9% of Grupo Serfin, Mexico's third largest bank after the Banco Nacional de México (Banamex) and the Banco de Comercio (Bancomer), with a 13.4% share of the national market.

In 1997, the United States remained well ahead of other sources of FDI flows to Mexico. The second largest source was the European Union, with the United Kingdom and Spain being particularly active, especially in connection with acquisitions of financial institutions. There was also a considerable level of FDI from Asian countries, particularly Japan and the Republic of Korea, destined for activities connected with the electronics industry.

¹⁴ This sum corresponds to the purchase of Siderúrgica Lázaro Cárdenas Las Truchas S.A. (SICARTA) by the Indian company ISPAT.

¹⁵ Given the difficulties facing the local financial system, it is likely that foreign financial institutions will be allowed to increase their holdings in the sector. For the time being, their shareholdings in local banks having a market share of over 10% may not exceed 49% (*Business Latin America*, 1998).

Figure 1.8
**MEXICO: GEOGRAPHICAL DISTRIBUTION OF SOURCES OF
 FOREIGN DIRECT INVESTMENT, 1981-1997**
(Percentages based on annual averages)



Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the Ministry of Commerce and Industrial Development of Mexico (SECOFI).

Acquisitions remained an important channel for FDI inflows in 1997. According to SECOFI estimates, acquisitions accounted for more than 55% of FDI (SECOFI, 1998a), but the figure may actually be higher now, since data from official sources and financial publications show that transfers of ownership in 1997 totalled US\$ 7.777 billion, or 62.3% of aggregate foreign investment flows into Mexico for that year (see tables I.2 and I.5). Acquisitions were concentrated in telecommunications (38%); beverages and tobacco (30%); commerce (15%); banking and insurance (6%); and others (11%). The majority of these transactions (78%) were carried out by United States companies.

An analysis of the distribution of FDI flows by sector, country of origin and modality reveals some of the main strategic objectives of foreign investors in the Mexican economy:

- To improve the efficiency of transnational corporations' integrated production systems in the North American market. The pursuit of this objective has been particularly noticeable in the automotive, data processing, electronics and clothing sectors, where the need to cut costs and the opportunity to export to the wider NAFTA market¹⁶ have been key factors in attracting productive investments to Mexico.
- To gain access to domestic markets having high growth potential. This has been of particular significance in financial services, telecommunications and certain manufacturing activities, such as the food, beverages and tobacco industries. Access to the Mexican market or expansion within that market have primarily been achieved through the acquisition of existing enterprises.

Between 1994 and 1996 the automotive industry received investments of about US\$ 1.4 billion per year, and the annual figure is expected to remain above US\$ 1 billion during 1997-2001. In response to the Asian challenge in the United States market, that country's three largest automotive companies —General Motors, Chrysler and Ford Motors— have decided to boost their efficiency by investing in new plants in Mexico and equipping them with leading-edge machinery and technology. These companies are currently the three largest foreign corporations operating in Mexico, and their combined sales total about US\$ 18.5 billion, of which approximately US\$ 13.6 billion (74%) are exports, almost entirely (90%) to the United States market¹⁷ (see table I.12). In 1997 the growth rate for the automotive industry's exports was considerably lower than before (6%, as compared to 32% in 1996). The slowdown was attributable to the fact that plants were operating at near full capacity and to the considerable increase in the demand for vehicles on the domestic market (Banco de México, 1998, p. 47).

¹⁶ The development of the *maquila* industry has also been decisive in this context, since it has enabled foreign investors to benefit from major tariff exemptions granted by the United States to *maquila* enterprises assembling products of United States origin. In 1997, the *maquila* industry in Mexico accounted for 40.9% of total exports, and 83.9% of that figure corresponded to exports to the United States.

¹⁷ For a more comprehensive analysis of the Mexican automotive industry, see chapter IV of this study.

Table I.12
MEXICO: MAIN PARTLY OR WHOLLY FOREIGN-OWNED COMPANIES, 1997
(Millions of dollars and percentages)

Company	Sector	Sales	Foreign investor	Foreign capital (%)	Home country	Exports
General Motors of Mexico	Automotive	7 126	General Motor Corp.	100	United States	5 548
Chrysler of Mexico	Automotive	6 501	Chrysler	100	United States	4 862
Ford Motor Co.	Automotive	4 871	Ford Motor Company	100	United States	3 050
Cifra	Commerce	4 081	Wal-Mart Stores, Inc.	50	United States	...
Volkswagen of Mexico	Automotive	3 423	Volkswagen AG	100	Germany	2 600
Fomento Económico Mexicano (Femsa) ^a	Beverages	3 049	Coca-Cola Corp.	50	United States	145
IBM of Mexico	Data processing	2 798	IBM Corporation	100	United States	2 271
Sabritas S.A. ^b	Food	2 601	PepsiCo	100	United States	...
Nissan Mexicana S.A.	Automotive	2 153	Nissan Motor Co.	100	Japan	1 257
General Electric of Mexico	Electronics	2 117	General Electric	100	United States	...
Grupo Kodak	Photography	1 606	Kodak	100	United States	496
Hewlett-Packard of Mexico	Electronics	1 553	Hewlett Packard - Delaware	100	United States	419
Grupo Modelo	Beverages	1 492	Anheuser-Busch	37	United States	...
Hylsamex	Iron and steel	1 456	Alfa S.A.	82	United States	...
Cía. Nestlé	Food	1 448	Nestlé AG	100	Switzerland	153
Femsa-Cerveza ^c	Beverages	1 297	John Labatt Limited	30	Canada	...
Grupo MEXICO	Mining	1 293	Asarco Inc.	26	United States	...
Kimberly-Clark of Mexico	Paper and pulp	1 278	Kimberly-Clark	47	United States	71
Procter & Gamble of Mexico ^b	Chemicals	1 200	Procter & Gamble	100	United States	...
Grupo Celanese	Petrochemicals	1 193	Hoechst AG	51	Germany	484
Coca-Cola/Femsa	Beverages	1 142	Coca-Cola Corp.	30	United States	...
Nadro S.A. Nacional de Drogas	Commerce	996	McKesson Corporation	33	United States	...
Mabe S.A.	Electronics	931	General Electric	48	United States	232
Cigarrera La Moderna	Tobacco	917	British American Tobacco	100	United Kingdom	145
Transportación Marítima Mexicana	Transport	912	Canadian Pacific Ships	50	United Kingdom	375
American Express Co. ^b	Finance	800	American Express Co.	100	United States	...
Grupo BASF in Mexico	Chemicals	782	BASF AG	100	Germany	...
Colgate-Palmolive S.A. ^b	Chemicals	700	Colgate-Palmolive Company	100	United States	...
Unilever of Mexico ^b	Food	650	Unilever	100	United Kingdom / Netherlands	...
Siemens	Electronics	573	Siemens AG	100	Germany	28
Cementos Apasco SA de CV	Cement	554	Holderbank Financière Glaris Ltd.	100	Switzerland	46
Dupont S.A.	Chemicals	510	Du Pont de Nemours and Co.	100	United States	221
Grupo Embotellador de México	Beverages	505	PepsiCo	47	United States	...
Xerox Mexicana	Electronics	468	Xerox Corporation	100	United States	276
Teleindustria México, Ericsson ^b	Electronics	420	Ericsson	94	Sweden	91
Sears Roebuck	Commerce	414	Sears Roebuck and Co.	100	United States	...

Company	Sector	Sales	Foreign investor	Foreign capital (%)	Home country	Exports
Grupo Situr	Hotels	413	...	...	United States	...
Lear Corporation Mexico ^b	Auto parts	390	Lear Corporation	99	United States	...
Motorola of Mexico	Electronics	361	Motorola	100	United States	386
Avon Cosmetics S.A. ^b	Cosmetics	355	Avon Products Inc.	99	United States	...
Alcatel-Indetel ^b	Electronics	350	Alcatel Alsthom	...	France	...
Mexinox and subsidiaries	Iron and steel	332	Grupo Mexinox S.A.	66	Germany/Spain	198
Sistema Argos	Beverages	318	Coca-Cola	...	United States	...
John Deere	Agricultural machinery	283	John Deere	100	United States	...
Dina Camiones	Automotive	277	Coaches Industry International	100	United States	...
Polioles	Petrochemicals	266	Alpek S.A.	50	Germany	...
Grupo Smurfit Mexico ^b	Paper and pulp	200	Smurfit Carton	100	Ireland	...
Nemak	Auto parts	195	...	40	United States/ Italy	...
Pennwalt Chemicals and subsidiaries	Chemicals	188	Delaware Chemicals	40	United States	...
Cía. Industrial de Parras	Textiles	182	...	...	United States	...

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, on the basis of information from *América economía*, 1998 (Special edition, "Las mayores empresas de América Latina"); *Expansión*, "Las 500 empresas más importantes de México 1997 y 1998"; and *Major Companies of Latin America and the Caribbean*, 1998, London, Graham & Whiteside, 1998.

^a Femsa is a joint venture with Coca-Cola.

^b Data for 1996.

^c In September 1994, Cervecería Cuauhtémoc Moctezuma formed a strategic alliance with the Canadian brewery John Labatt Limited, which purchased 22% of Femsa-Cerveza for US\$ 510 million with an option to acquire additional 4% stakes over the following four years. In 1997, it acquired 8% (see table I.13).

Developments in the clothing industry have been very similar¹⁸ (see box I.4). Foreign corporations, particularly United States companies, have been so successful at making use of the comparative advantages offered by NAFTA for forming industrial clusters within the chain of production¹⁹ that Mexico exports far more clothing to the United States than its international competitors, such as Hong Kong, Honduras, the Chinese province of Taiwan and the Dominican Republic (Gereffi and Bair, 1998; USITC, 1997a).

Data processing and electronics has been one of Mexico's fastest-growing sectors and, like the automotive and auto parts industry, its production activities are mainly oriented towards foreign markets. Exports have been stimulated by NAFTA, under which tariffs on office

¹⁸ Chapter III of this document contains more detailed information regarding the clothing industry under the *maquila* system in Mexico.

¹⁹ The alliances that have been set up include joint ventures between DuPont S.A. and Grupo Alfa, and between Burlington Industries and Guilford Mills Inc., whose base, the Nustart complex, is located in the State of Morelos.

equipment, magnetic products, and parts and components for photocopiers were immediately reduced; in addition, tariffs on television sets, computers and telephone equipment were to be reduced by up to 50% before the end of 1998. Furthermore, NAFTA rules of origin will come fully into force in late 2003, and this has generated strong incentives for many of the sector's most dynamic corporations to consider locating their production facilities in Mexico in order to use it as a platform for exports to the United States²⁰ (*The Wall Street Journal Americas*, 1998a). Major United States electronics corporations, such as Compaq, Corning Inc., General Electric and IBM, are also present in Mexico.

Telecommunications has been one of the most attractive fields for foreign capital in the region in recent years. In the case of Mexico, current legislation restricts foreign shareholdings in telecommunications firms to 49% (except for cellular phones), and access to the local market is controlled by Teléfonos de México S.A. (Telmex).²¹ Foreign investors have therefore turned to mobile and long distance telephone services in order to penetrate the Mexican market.

In January 1997 the market for long distance telephone services began to open up to competition. To date, 13 companies —10 of which are partly foreign-owned— have installed about 10,000 kilometres of fibre-optic cables, and it is expected that a further 50,000 kilometres will be added. The main foreign companies operating in this market include AT&T Corp. (Alestra) and MCI Corp. (Avantel). Investments in this sector have now come to a virtual standstill, however, as a result of a heated dispute between the long distance operators and Telmex over interconnection charges. According to MCI Corp., 70% of the long distance operators' receipts end up in the hands of Telmex (Bachelet, 1998a), and it is a fact that 37% of the income of Telmex comes from the long distance market.

In the energy sector, a high level of investment is expected in the next five years. This industry is regulated by the Federal Electricity Commission (CFE), a State-owned company which controls energy transmission and distribution and which, according to executives of foreign electric power companies, is trying to prevent its monopolistic position from being weakened (*The Wall Street Journal Americas*, 1998b). Early signs of the growing presence of foreign companies include two thermoelectric projects, one in Mérida (AES Corp.) and one in Monterrey (Nissho Iwai), and the construction of a new electric power generating plant (GFA) (see table I.14).

²⁰ Many Asian corporations have announced new investments in this sector. They include Daewoo Electronics and Samsung, from the Republic of Korea; Sony, Sharp, Matsushita Electric Industrial Co. and Asahi Glass Co., from Japan; and Computer International Acer, from Taiwan, Province of China. In all these cases, the main objective is to substitute their products for products of North American origin.

²¹ In 1990, Telmex was acquired by a consortium led by the local Carso group, which owns 10.4% of the company's stock. Foreign investment in Telmex is limited to a minority holding of some 10%, of which 5% is owned by the United States company Southwestern Bell and 5% by France Cables et Radio. Under the terms and conditions of the privatization, Telmex has retained its monopoly on local and international telephone calls in exchange for increasing the number of telephone lines in communities of more than 500 inhabitants; it has also made a commitment to implement a number of other measures, such as shortening the waiting period for the installation of new telephones and modernizing its service (Dussel, 1998a).

Box I.4

**THE NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA)
AND THE MAQUILA INDUSTRY IN MEXICO**

Four years after the signing of NAFTA, the competitive position of the *maquila* industry has improved. Although there have been some changes, all the evidence suggests that this sector will continue to be of strategic importance for Mexico and the United States; for Mexico, the *maquila* industry currently represents 45% and 33% of its total exports and imports, while for the United States the corresponding figures are 2.5% and 9.3%.

The performance of export-oriented *maquila* enterprises has been impressive. Between 1980 and 1997 the number of plants rose from 620 to 2,867 and the number of workers jumped from 123,879 to 938,438. The corresponding trade flows also increased: in 1980 they represented 16.1% and 8.3% of total exports and imports, whereas the 1997 figures were 45% and 33% respectively. In 1997, *maquila* activities were centred on the garment industry (786 plants and 182,462 jobs), electronic equipment and appliances (140 plants and 88,392 jobs) and the automotive and auto parts industry (209 plants and 186,838 jobs). Most of the *maquila* industries have located their facilities close to the United States border, with almost a third of them being sited in Baja California, followed by Chihuahua (15%), Tamaulipas (13%), Coahuila (9%) and Sonora (8%).

The influx of FDI to the *maquila* industry has been closely linked with the relevant regulatory systems in the United States and Mexico, as well as with the economic performance of the United States and with exchange-rate and wage policy in Mexico. The deregulation of the sector in 1989 created a favourable environment for unprecedented growth in the industry, and the number of *maquila* plants doubled in the space of just four years. In the early 1990s, the overvaluation of the peso undermined these plants' cost-competitiveness, slowing their expansion. Subsequent devaluations —as in December 1994— have had just the opposite effect. Thus, NAFTA has contributed to the increasing importance of the *maquila* industry in the following ways:

- It has made it possible for increasing quantities of the manufactures produced by *maquila* industries to be sold on the domestic market. This trend, which will continue until the remaining restrictions are lifted in 2001, has encouraged firms to open up new plants and expand existing ones, particularly in non-border areas, so that they can take advantage of the benefits offered by the Mexican market.
- The rules of origin contained in NAFTA have led to an increase in the number of Asian corporations (from Japan, Hong Kong, the Republic of Korea and Taiwan, Province of China) in the *maquila* industry. As a result, companies are using more inputs from North America (Canada, United States and Mexico) in order to keep the taxes applied to components produced outside the NAFTA area to a minimum. Television sets are a case in point. Under the terms of NAFTA, the picture tubes used in television sets must be made in the United States. This has forced Asian television assembly companies to undertake new investments in production facilities in the United States or to substitute United States suppliers for their Asian ones. This trend is illustrated by the strategies adopted by Sony, Mitsubishi, Samsung, Daewoo, Delta Products, LG Electronics and Acer. The largest *maquila* enterprise is currently Sony, with exports of about US\$ 8 billion, and the third largest is the Korean firm Daewoo, with external sales amounting to US\$ 2 billion. Both companies produce monitors and television sets for the United States market.
- NAFTA has also helped the textiles sector, inasmuch as the Agreement for Textiles and Apparel, which had restricted exports, has been terminated since its entry into force. The *maquila* industry in Mexico has also provided United States companies with a site for the relocation of the operations they had in Asia, where they had been subject to constraints that hindered them from increasing their quotas for exports to the United States market.^a As a result, Mexico has overtaken China as the largest exporter of clothing to the United States.

In recent years a tendency has appeared for affiliates of major transnational corporations to take the place of smaller plants devoted to the routine assembly of mature, well-established products. These affiliates generally offer better jobs and working conditions, as well as additional benefits. The State of Baja California is becoming the prime location for the larger, more complex plants of this sort.

^a Gary Gereffi and Jennifer Bair, 'US companies eye NAFTA's prize', *Bobbin Magazine*, special report, vol. 39, No. 7, Mexico City, March 1998.

Table I.13
**MEXICO: PRINCIPAL ACQUISITIONS OF MEXICAN FIRMS BY
 FOREIGN COMPANIES, 1997**
 (Millions of dollars)

Purchaser	Home country	Foreign capital (%)	Seller	Sector	Amount
Bell Atlantic ^a	United States	100	Iusacell	Telecom.	1 712
Wal-Mart Stores, Inc.	United States	50	Cifra S.A.	Commerce	1 204
British American Tobacco	United Kingdom	100	Cigarrera La Moderna	Tobacco	1 443
Loral Space Communications	United States	75	Satélites Mexicanos	Telecom.	692
Hughes Communications	United States	...	PanamSat	Telecom.	650
Anheuser-Busch	United States	37	Grupo Modelo	Beverages	605
Philip Morris International	United States	21	Cigatem	Tobacco	400
Hong Kong Shanghai Bank	United Kingdom	20	Grupo Serfin	Banking	270
Procter & Gamble	United States	100	Loreto y Peña Pobre ^b	Paper and paper	170
Assicurazioni Generali	Italy	49	Grupo Banorte ^c	Insurance	159
Unimin Corp.	United States	100	Vitro	Mining	131
Hicks, Muse, Tate & Furst	United States	20	Grupo MVS	Telecom.	120
Tower	United States	40	Metalsa	Automotive	100
John Labatt Ltd.	Canada	8	Femsa-Cerveza	Beverages	100
Lincoln National	United States	49	Seguros Serfin	Insurance	85
Industrial John Deere	United States	100 ^d	John Deere	Machinery	62
Nextel Communications	United States	77	Corporación Mobilcom	Telecom.	54
Other acquisitions < US\$ 50 million					132
Total acquisitions					8 089

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the Ministry of Commerce and Industrial Development of Mexico (SECOFI); *Expansión*; *América económica*; and other financial publications.

^a In 1993, Bell Atlantic purchased 42% of Iusacell. In February 1997 it took control of the company.

^b The company was part of Grupo Carso.

^c Includes Afore Sólida Banorte, Seguros Banorte and Pensión Banorte.

^d Upon purchasing an additional 51%, it obtained complete control of the company's shareholdings.

According to information from the Banco de México, FDI totalled some US\$ 5.3 billion in the first half of 1998, and estimates for the year as a whole suggest that it may exceed US\$ 8 billion (see table I.2). In addition, judging from foreign investors' announcements concerning future operations in Mexico (see table I.14), it appears that FDI flows will continue to be quite heavy in coming years. Factors contributing to this favourable outlook include: the greater openness of the telecommunications sector, particularly in the case of cellular phones and personal communications systems (PCS); growing domestic demand for energy,²² especially in relation to electric power generation, an activity in which the Government wants the private sector to become involved; the creation of chains of production at the regional level under NAFTA, particularly in the automotive and garment industries, where intra-firm transactions have encouraged the establishment of true industrial clusters of United States and Mexican companies (Dussel, 1998b); increasing integration within the NAFTA area as rules come fully into force under which tariffs must be levied on all non-North American components; and the privatization boom in strategic sectors, including plans to auction off operating concessions for 35 national and international airports, which will give foreign investors the opportunity to bid on 10%-15% stakes.²³

Table I.14
MEXICO: PRINCIPAL FOREIGN INVESTMENTS, 1997-2001
(Millions of dollars)

Company	Source country	Project	Amount
Automotive and auto parts^a			8 601
Chrysler of Mexico	United States	Increased production (1997-2001)	5 000
Volkswagen	Germany	Investment in new "Beetle" model	1 200
Ford Motor Company	United States	New engine plant in Chihuahua	1 000
Nissan Mexicana	Japan	Expansion of installed capacity	800
Navistar	United States	Construction of new truck plant	200
Chrysler of Mexico	United States	Production of light trucks (Saltillo)	170
< US\$ 100 million			231
Energy			2 814
GFA	France	Construction of a new electric power plant	1 600
Nichimen y AES Corp.	United States	Mérida III thermoelectric project	300
Nissho Iwai-ABB Energy	Japan/Switzerland	Construction of Monterrey II hydroelectric plant	300
TransCanada/Gutsa/InterGem	Canada/Mexico/United States	700 km gas pipeline in the Yucatán peninsula	300
Mitsubishi	Japan	Installation of submarine cable (1998-2001)	250
CWS	United States	Electric power cogeneration plant	64

²² According to the Government of Mexico, electric power generation capacity should increase by 13,300 megawatts in the next five years to meet the expected increase in demand. Building this increased capacity will involve investments of more than US\$ 25 billion.

²³ Foreign investors will be allowed to own no more than 49% of the total amount of shares to be sold. However, their stake may be as high as 100% subject to the approval of the National Foreign Investment Commission (CNIE) (*The Economist Intelligence Unit Ltd.*, various issues, 1998; *Latin Law*, 1997).

Company	Source country	Project	Amount
Data processing and Electronics			2 414
Compaq Computer	United States	Expansion of service network	500
Daewoo Electronics	Republic of Korea	TV picture tube plant	500
Sony	Japan	Construction of three industrial plants	390
Samsung/Asahi Glass	Rep. of Korea/Japan	Joint venture to produce TV picture tubes	340
Grupo Acer	Taiwan Prov. of China	Construction of two new plants	230
Samsung Corning	Rep. of Korea/United States	New plant to produce glass for TV picture tubes	150
Selectron of Mexico	United States	Investment in new plants	105
< US\$ 100 million			199
Transport			1 445
Kansas City Southern	United States	Operating concession for a railway line in north-eastern Mexico	1 400
< US\$ 100 million			45
Chemicals and pharmaceuticals			1 258
Tuntex	Taiwan Prov. of China	New plant for production of chemical fibres	559
BASF	Germany	Construction of new plant	200
Celanese	Germany	New plants	171
Bayer	Germany	Aspirin factory	126
< US\$ 100 million			202
Telecommunications			1 241
Bell Canada/WorldTel	Canada	Entering market for local telephone services (next five years)	1 000
MCI Corp.	United States	Expansion of service to 40 towns	100
< US\$ 100 million			141
Petroleum, gas and mining			1 226
Newmont Gold	United States	Expansion of installed capacity	300
Peñoles/Newmont Gold	Mexico/United States	Expansion of installed capacity	300
Mérida Pipeline/TransCanada Pipelines	United States/Canada	Construction of Tabasco-Valladolid gas pipeline (with Gutsa)	300
Kennecott Exploration	United States	New mining project (with Minera Tayahua)	200
< US\$ 100 million			126
Food, beverages and tobacco			970
PepsiCo	United States	Reorienting market strategy	300
British American Tobacco	United Kingdom	Expansion of installed capacity	300
Coca-Cola	United States	Infrastructure investments	270
Nestlé	Switzerland	Construction of a fructose production facility	100
Textiles and garments			874
Burlington Industries	United States	Six industrial plants in Morelos	200
DuPont Nylon	United States	New investments (next two years)	200
Kohap	Republic of Korea	Production of polyester fibres and thread	190
Nien Hsieng	Taiwan Prov. of China	New textile plant	119
< US\$ 100 million			165
Other sectors ^b			750
Kodak	United States	Increase in installed capacity	240
Grupo Gigante/Carrefour	Mexico/France	Opening of four new stores	175

Company	Source country	Project	Amount
ICA/Reichmann International	Mexico/Canada	Construction of the Torre Chapultepec in Mexico City	100
< US\$ 100 million			235
Other manufacturing			576
Industrias John Deere	United States	New factory to produce axles for tractors (1998)	200
Jefferson Smurfit Group	Ireland	Expansion of production	120
< US\$ 100 million			256
Total for all sectors			22 230

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from *Expansión*, *América economía*, *The Wall Street Journal Americas* and financial publications.

^a In 1997, according to reports from the Ministry of Commerce and Industrial Development, planned investments in the automotive industry for the following five years totalled about US\$ 8 billion; auto parts manufacturers announced investments totalling a similar amount. A total of US\$ 16 billion can therefore be expected for the period.

^b Includes photography, commerce, construction and insurance.

2. Argentina: the boom in ownership transfers

Since the beginning of the 1990s, ever larger amounts of foreign direct investment (FDI) have flowed into Argentina (see table I.2). Between 1990 and 1997, according to official balance-of-payments estimates, the aggregate total exceeded US\$ 30 billion, a marked contrast with the slightly under US\$ 6 billion that came into the country during the 1980s (ECLAC, 1998a). The figures are truly impressive, if one considers that by the end of 1997 the stock of FDI reached US\$ 36.303 billion (Ministerio de Economía y Obras y Servicios Públicos, 1998a). The influx for that year was US\$ 6.326 billion in FDI. These recent flows are indications that the FDI process has gone through two distinct phases.

- Between 1990 and 1993, the main mechanism for the influx of FDI was privatization: a significant proportion of public services enterprises and some areas of the petroleum industry (both central and secondary) were privatized. Indeed, 54% of the flow of FDI during this period came from sale of State assets,²⁴ and over 60% of the fiscal revenue generated by the process came from foreign investors. The United States, Spain, Italy, Chile, France, Canada, and the United Kingdom were prominent sources of FDI, which went primarily to non-tradable sectors (telecommunications, energy, and transportation). FDI during these years was dominated by firms coming into the Argentine economy for the first time (new entrants). The period is also notable for the presence of firms of non-traditional origin, many investing in Latin America for the first time.
- Between 1994 and 1998, the acquisition of local private firms by foreign investors became the main channel for FDI. Between 1995 and 1997, such transactions

²⁴ Ownership of the stock of Yacimientos Petrolíferos Fiscales (YPF) was also transferred during the 1990-1993 period, which was registered in the balance of payments as non-resident portfolio investment (not as FDI), given the form the transaction took.

represented 41% of total inflows of direct investment (see table I.5). Starting in 1995, capital investment also began to assume a more important role in the creation of new firms and the modernization of existing ones, constituting 33% of the total flow of FDI (Ministerio de Economía y Obras y Servicios Públicos, 1998b).

In general, the greater flow of FDI into the Argentine economy can be attributed to a number of factors that helped create a more favorable climate in the 1990s for this kind of investment. In addition to structural reform policies (privatization of State assets and enterprises, progressive deregulation of markets and economic activity, and liberalization of trade and finance), other important factors were the stabilization of the economy and the recovery of domestic demand, renegotiation of foreign debt under the Brady Plan, and the increasing strength and the dynamism of the country's economic and trade integration with the other Mercosur countries, a process that has created a virtuous circle, in which an increase of intraregional trade and the ability to attract investment reinforce each other (Kosacoff and Porta, 1997, and Kosacoff, 1998).

Trade liberalization encouraged the use of imported inputs, with their lower cost, and this was an additional incentive to transnational corporations, since it favoured intrafirm trade and specialization by subsidiaries. The elimination of trade barriers among Mercosur countries intensified this process.²⁵

During the 1990s, the pattern of FDI in the Argentine economy has undergone a substantial transformation, with changes in channels of investment and types and origins of investors, and a notable increase in the range of activities open to foreign capital. The usual process of creating subsidiaries has been progressively complemented by the formation of consortiums founded on complex strategic alliances among firms based in different countries, with the addition of local business groups and financial entities of various kinds, especially in relation to privatized firms with their new ownership structures.

Thus, a very interesting phenomenon is appearing in Argentina, one that is unusual elsewhere in the region. With the globalization of capital markets, and as new financial instruments have gained acceptance, there has been a movement, through the purchase of existing assets, to form foreign capital investment funds that centralize firms' activities, which has resulted in the formation of true holding companies linked at the financial level (Bisang, 1998). Examples are the Exxel Group, Inversiones y Representaciones (IRSA) —of which 30% is owned by the Hungarian investor George Soros— and Citibank Equity Investment (CEI) (see box I.5). These new "transnational groups" are becoming an important presence in Argentina's economy today (see table I.15).

²⁵ By liberalizing trade, structural reform policies put in place in the 1990s, along with making it viable for foreign investors to be actively involved in activities that were previously subject to serious barriers and restrictions, led businesses to defend their respective market shares by taking *streamlining* measures aimed at improving the productivity of processes and products at the local level. Though where the production of tradable goods was concerned, some of these measures were a part of efficiency-seeking strategies aiming at incipient economies of scale and some degree of intrafirm specialization, what tended to predominate was the development of product differentiation as a guiding criterion for investment by transnational corporations involving production of "name-brand" food products, cleaning products and toiletries, and household appliances (Kosacoff and Porta, 1997).

Box I.5

ARGENTINA: AN EXPERIMENTAL VENUE FOR A NEW TYPE OF TRANSNATIONAL GROUP?

In the last two years, a new type of foreign investor has entered the Argentine economy with great impact. Three main players stand out: the Exxel Group, Citicorp Equity Investment (CEI) and IRSA. These entities cannot be defined as transnational corporations in the usual sense. Rather, they are foreign capital investment funds —not responsible to a particular parent company— which invest in the country's real economy. In other words, portfolio investment is involved as far as attracting funds is concerned, and direct investment is involved on the placement side. In this way, through aggressive acquisitions, they have taken control of a great number of Argentine firms.

CEI is made up of Citicorp bank and the Hicks Group, both based in the United States, and the local group República Holding. Over a period of a few months, CEI gained control of various television networks (both broadcast and cable), and it already has a strong investment presence in traditional and cellular telephony, Internet services, and other businesses. As a result, it now has US\$ 15 billion in assets and total annual sales of over US\$ 6 billion.^a CEI consolidated its presence in the telephone subsector by acquiring 50% of Cointel, comprising Telefónica de Argentina, Páginas Doradas, Miniphone, Startel, Radio-llamadas, and Telintar; 50% of Advance, representing Compuserve, Satlink, and Aki; 33% of Cablevision, Datanet, Gala, United International Holdings, and VCC; and 20% of Torneos y Competencias (see table I.16). CEI also has media holdings, including the Atlántida publishing company, Telefé, Continental radio, and seven broadcast television channels in the country's interior. For this aggressive expansion in Argentina, the group created various strategic alliances, notably the one with Telefónica de España. CEI uses a clearly defined formula: it purchases telephony and media firms —areas that it has defined as strategic for reasons of growth potential— and looks for a partner familiar with the industry, the know-how and the technology in question. The contributions the group itself makes, besides synergy with its other investments, are in the areas of management and finance.

The Exxel Group, which operates basically with United States funds (CIBC Oppenheimer, General Motors and others), has invested more than US\$ 2 billion in a wide range of firms, especially supermarkets, food and textile producers, electrical companies and health care firms. In all, it has acquired 38 companies, with aggregate sales estimated at US\$ 3.3 billion.^b The Exxel Group always ensures that it will have control of the companies it invests in, and it does not seek strategic partners. In 1996 it was involved in the largest private transaction in Argentina's history (and the first acquisition in the manner typical of the developed world) when it bought the Norte supermarket chain for US\$ 440 million. Since then, the group has acquired the Musimundo music store chain, the Fargo bread company, the Havana candy brand, a number of textile companies and the SPM medical services company. It also acquired OCA, a private mail firm, and its subsidiary OCASA for US\$ 450 million, in addition to Inversiones y Servicios, an enterprise that sells duty-free items in airports, for approximately US\$ 155 million (see table I.16). The Exxel Group aims to enter the telecommunications sector^c in 1999 and to seek new opportunities for regional expansion.

George Soros's interests in Argentina include three main areas and an emerging fourth one. To begin with, the Soros company IRSA concentrates on real estate (office buildings, land for future construction and a number of hotels). Its strategy is based on rising land values and the construction boom. A second firm, SAMP, is involved primarily with shopping centres, betting that economic growth will mean a major expansion in leisure activity as well as in consumer spending. Currently the Soros group owns the majority of Buenos Aires's shopping centres and a good number of those in the country's interior. Third, in the natural resources sector, is CRESUD —cattle breeding and fattening (33% of its investment), milk production (25%), and tree farming and forestry (42%). CRESUD aims to become the largest food producer in Argentina. (Currently it is the country's second largest land owner, after Benetton.) It also believes that an accumulation of rural land holdings near cities will bring great profits as a result of urban expansion. Finally, a fourth activity, still in the fledgling stage, is tourism and hotels. The price of land owned by CRESUD has doubled in recent years.^d

Thus, through control of large local firms, new economic groups are forming in three basic areas: communications (CEI); merchandising (Exxel Group); and real estate, farming, and construction (Soros). This trend is having a noticeable effect on the concentration of private activity in Argentina.

^a Apertura, "Guía de Mergers & Acquisitions y finanzas corporativas, 1998", special edition, Buenos Aires, April 1998.

^b Latin Trade, August 1998, p. 30.

^c Ibid., p. 34.

^d Claire Pool, "Soros rumbo al sur", Latin Trade, Miami, November 1997.

Table I.15
ARGENTINA: MAIN PARTLY OR WHOLLY FOREIGN-OWNED COMPANIES, 1997
(Millions of dollars)

Company	Sector	Sales	Foreign investor	Foreign capital (%)	Home country	Exports
Telefónica de Argentina S.A.	Telecom.	2 994	Telefónica de España/ Citicorp Equity Investment (CEI) Citicorp ^a	54	Spain/ United States	...
Exxel Group	Various	2 276	The Exxel Group ^b	...	United States	...
Shell Cía. Argentina de Petróleo SA	Petroleum	2 205	Royal Dutch Shell	100	United Kingdom/ Netherlands	60
Telecom Argentina S.A.	Telecom.	2 037	Stet-Telecom, France Telecom ^c	45	Italy/France	...
Ford Argentina	Automotive	1 866	Ford Motor Company	100	United States	748
Esso S.A. Petrolera Argentina	Petroleum	1 818	Exxon Corporation	100	United States	113
Carrefour Argentina	Merchandising	1 737	Carrefour Supermarché S.A.	100	France	...
Fiat Group	Merchandising	1 733	Fiat SpA	100	Italy	...
Phillip Morris Group	Tobacco	1 723	Phillip Morris Companies Inc.	100	United States	...
Cargill S.A.	Agroindustry	1 687	Cargill Inc.	100	United States	1 242
Sistema Coca-Cola	Beverages	1 589	Coca-Cola	...	United States	...
Massalin Particulares S.A.	Tobacco	1 496	Phillip Morris Companies Inc.	100	United States	....
Fiat Auto Argentina	Automotive	1 448	Fiat SpA	100	Italy	530
Volkswagen Argentina	Automotive	1 348	Volkswagen AG	100	Germany	556
Cia. Interamericana de Automóviles S.A. (Ciadea)	Automotive	1 264	Regie Renault	51	France	162
Supermercados Disco S.A.	Merchandising	1 147	Royal Ahold	25	Netherlands	...
Supermercados Norte	Merchandising	1 028	The Exxel Group ^b	100	United States	...
Aerolíneas Argentinas S.A.	Airlines	998	Iberia ^d	84	Spain	80
Unilever de Argentina S.A.	Food	884	Unilever	100	United Kingdom/ Netherlands	...
Nobleza-Piccardo S.A.	Tobacco	879	British American Tobacco	100	United Kingdom	...
Empresa de Electricidad de la Zona Sur (Edesur)	Electricity	869	Enersis (28%), Chilectra (30%), Entergy Corp (5%)	65	Chile/ United States	...
Empresa de Electricidad de la Zona Norte (Edenor)	Electricity	48	Electricité de France (27%); Endesa-España (10%)	37	France/ Spain	...
Hipermercados Jumbo (Cencosud)	Merchandising	815	Paulmann Group	100	Chile	...
General Motors	Automotive	774	General Motors Corp.	100	United States	106
Camuzzi Argentina	Petroleum/natural gas	720	Camuzzi Gazometri SpA	100	Italy	...
Sistema Pepsi-Cola	Beverages	720	PepsiCo	100	United States	...
Sevel Argentina S.A.	Automotive	651	Peugeot - Citroën	50	France	160
MetroGas	Gas distribution	628	British Gas (38.3%), Repsol (31.7%)	70	United Kingdom/ Spain	...
Mercedes Benz Argentina S.A.	Automotive	619	Daimler Benz AG	100	Germany	64
Cervecerías y Malterías Quilmes	Beverages	608	Heineken NV	15	Netherlands	...

Company	Sector	Sales	Foreign investor	Foreign capital (%)	Home country	Exports
La Plata Cereal	Food	601	André & Cie.	93	Switzerland	...
PanAmerican Energy LLC	Petroleum	594	Amoco Corporation	60	United States	229
IBM Argentina S.A.	Computers	580	IBM Corporation	100	United States	4
Movicom CRM	Telecom.	574	BellSouth (65%), Motorola (25%)	90	United States	...
Bayer Argentina	Chemical	540	Bayer AG	100	Germany	45
Astra	Petroleum	521	Repsol SA (57%)	57	Spain	55
Telintar	Telecom.	510	Telefónica de España, France Telecom, Stet-Telecom	...	Spain/France/Italy	...
EG3	Petroleum	509	Repsol SA	100	Spain	...
Equitel S.A. (Siemens)	Electronics	502	Siemens AG	100	Germany	77
Louis Dreyfus	Food	472	Louis Dreyfus & Cie. S.A.	100	France	274
Nestlé Argentina S.A.	Food	453	Nestlé AG	100	Switzerland	51
Aguas Argentinas	Utilities	420	Lyonnaisse des Eaux (27%), Aguas de Barcelona (13%), SCP (22%)	62	France/ Spain	...
Transportadora Gas del Sur (TGS)	Gas distribution	412	Enron	50	United States	....
Compañía Continental S.A.	Food	405	Continental Grains Co.	100	United States	221
Femsa	Beverages	400	Femsa-Coca-Cola/The Coca-Cola Company	100	Mexico/ United States	...
Wal-Mart Stores Argentina	Merchandising	400	Wal-Mart Stores, Inc	100	United States	...
Gas Natural BAN	Gas distribution	389	Gas Natural	70	Spain	...
Oleaginosa Oeste	Food	389	Glencore Holding	100	Switzerland	...
Central Costanera	Electricity	377	Endesa (45%), KLT Power Inc. (12%), Entergy (6%)	63	Chile/ United States	...
Hipermercados Libertad	Merchandising	376	Casino	75	France	...

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the magazine *Mercado*, 1998, various issues; *América economía*, 1998, various issues; *Major Companies of Latin America and the Caribbean*, 1998, London, Graham & Whiteside, 1998; and other international financial publications.

^a COINTEL SA, owned in equal shares by Telefónica de España and CEI Citicorp Holding, owns 54% of Telefónica de Argentina.

^b The Exxel Group is not really a "foreign firm" in conventional terms; though it is an investment fund essentially based on United States funds and the majority of its capital is foreign, it does not have a parent company in another country. In 1992, the Exxel Group began its activities administering five independent funds brought together under the umbrella of Banco Oppenheimer.

^c The consortium that owns 60% of Telecom Argentina is made up of Stet-Telecom Italy, with 32.5%; France Cables et Radio (France Telecom), with 32.5%; Compañía Naviera Pérez Companc, with 25%; and J.P. Morgan, with the remaining 10%.

^d 83.5% of the shares of Aerolíneas Argentinas are in the hands of the Interinvest consortium, made up of Iberia (10%), the Government of Spain (32%), American Airlines (10%), Bankers Trust (12%), and Merrill Lynch (36%). In the case of Austral, Interinvest owns 90%.

In this decade, transnational corporations' share in the sales of Argentina's 500 largest companies has ballooned, from 34% to 51% between 1990 and 1995. In 1990 there were 116 transnational corporations among the 500 largest industrial firms, a figure that reached 212 in 1995 (Porta, 1997). In that year, transnational corporations were especially important in areas such as food, beverages and tobacco (51%), cellulose and paper (62%), chemicals and petrochemicals (82%), cleaning products and toiletries (91%), rubber products (78%), electronics

(76%), and the automotive and auto parts industries (45%) (Chudnovsky and López, 1998). The share of transnational corporations in 160 major industrial firms taken as a sample in a recent study increased from 53.4% to 65.2% of total sales between 1995 and 1997 (Kulfas and Hecker, 1998). In 1997, as a result of the process of privatization and the wave of mergers and acquisitions —and because of the entry of new foreign companies— the importance of transnational corporations increased significantly (see tables I.15 and I.16).

Moreover, the pace of expansion of exports accounted for by transnational corporations has been higher than that of total Argentine exports in recent years. Between 1993 and 1996, the latter rose by more than 80%, exports of national firms by 67%, and exports of subsidiaries of transnational corporations by 105%. This dynamism is even more marked in the case of sales to Mercosur countries: exports by foreign-owned firms grew at almost double the pace of exports by locally-owned firms (149% compared to 78%). The fact is that 50% of Argentina's Mercosur exports in 1996 were by transnational corporations (Chudnovsky and López, 1998). Most of the main exporting firms of foreign origin also have subsidiaries in Brazil, which is an indication of strong intra-firm trade (see table I.10). The most striking example is the automotive industry (see chapter IV).

Between 1992 and 1996, according to statistics from the Department of Economic Policy of the Ministry of Economic Affairs and Public Works and Services,²⁶ the relative importance of the manufacturing industry as the primary recipient of FDI has declined. Foreign investors have begun to concentrate on the service sector, largely as a result of the privatization of telecommunications and energy (generation and distribution of electricity). It is also evident that there is growing interest in economic activities connected with access to and exploitation of natural resources (agriculture, mining, petroleum, and natural gas).

In the manufacturing industry, FDI has primarily targeted agro-industry; food, beverages and tobacco; metal-working (particularly the automotive industry); and chemicals and petrochemicals (see table I.15). With respect to food and beverages, FDI has concentrated on lines where the most dynamic markets are to be found. In this segment, the majority of new investment represents projects undertaken by firms new to the country (new entrants). In the chemical and petrochemical subsector, on the other hand, two clearly differentiated processes can be seen at work: first, new investment in the cleaning products and toiletries industry; second, FDI related to privatization of petrochemical firms. In the automotive sector, most FDI goes to vehicle producing or assembly plants, though investment in the auto parts industry has begun to pick up. This is occurring in the context of the profound sectoral restructuring initiated by trade liberalization and the creation of Mercosur (Kosacoff, 1997; ECLAC, 1998a).

²⁶ Since Argentina does not require that direct investment operations be registered, there are no reliable official statistics on the phenomenon and its features. In 1996, the Ministry of Economic Affairs and Public Works and Services began a systematic study for the purpose of estimating, based on direct questioning, the flows of FDI reflected in the balance of payments (Ministry of Economic Affairs and Public Works and Services, 1996 and 1998b).

Table I.16
**ARGENTINA: PRINCIPAL MERGERS AND ACQUISITIONS OF ARGENTINE FIRMS
 BY FOREIGN COMPANIES, 1997**
(Millions of dollars)

Company	Purchaser	Home country	Amount
Petroleum/natural gas			1 403
Bridas S.A.	Amoco ^a	United States	...
EG3 (95%)	Repsol S.A.	Spain	400
Pluspetrol S.A. (45%)	Repsol S.A.	Spain	360
Mexpetrol Argentina (34%) ^b	Repsol S.A.	Spain	200
Algas S.A. (100%)	Repsol S.A.	Spain	70
Argon S.A. (100%)	Total	France	130
Compañías Asociadas Petroleras S.A. (CAPSA) (40%)	El Paso Energy	United States	243
Telecommunications			2 769
Video Cable Comunicación (VCC) (40%)	US West Media Group ^c	United States	340
Cablevisión (67%)	CEI-Citicorp, Telefónica de España	United States/Spain	761
Cablevisión (20%)	Tele Communs Intl (TCI)	United States	200
Cointel S.A. (17%) ^d	CEI-Citicorp	United States	590
Cointel S.A. (14%) ^d	Telefónica de España	Spain	340
Canal 9 (50%)	Prime Television Ltd.	Australia	150
Imagen Satelital	Cisneros Group	Venezuela	114
Torneos y Competencias (TyC)	Telefónica (20%), CEI-Citicorp (20%)	Spain/United States	80
Atlántida Group (60%) ^e	Telefónica (30%), CEI-Citicorp (30%)	Spain/United States	194
Finance			2 828
Banco Río de la Plata (35%)	Banco Santander	Spain	694
Roberts Inversiones S.A. ^f	HSBC	United Kingdom	668
Banco Crédito Argentino (100%)	BBV	Spain	560
Banco de Tres Arroyos (100%)	Lloyds Bank	United Kingdom	80
Banco Quilmes (70%)	Bank of Nova Scotia	Canada	188
Banco Unión Comercial e Industrial (BUCI) (100%)	Saiegh Group	Chile	118
Siembra Group (51%) ^g	Citibank NA	United States	240
Siembra Group ^g	Argentaria	Spain	280
Merchandising			1 603
Oca-Ocasa (100%)	The Exxel Group	United States	450
Inversiones y Servicios	The Exxel Group	United States	155
Musimundo (100%)	The Exxel Group	United States	217
Disco (25%) and Sta. Isabel (19%)	Royal Ahold	Netherlands	368
Hipermercados Libertad (75%)	Casino	France	203
Supermercado Vea (100%)	Velox Group	Uruguay	210

Company	Purchaser	Home country	Amount
Manufacturing			543
Fargo	The Exxel Group	United States	200
CIADEA ^h	Regie Renault	France	168
Celulosa Argentina	Citibank	United States	76
Coca-Cola Export Corp. ⁱ	Femsa/Coca-Cola	Mexico	99

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from *Apertura*, "Guía de Mergers & Acquisitions y finanzas corporativas, 1998," special edition, Buenos Aires, April 1998; *América economía*, various issues.

^a Amoco Corp. and the local group Brigas combined their operations and formed the new firm Panamerican Energy, in which Amoco holds 60% and Brigas the remaining 40%.

^b Repsol S.A. already owned 33% of Mexpetrol, and with this acquisition the Spanish firm gained 66.5% ownership.

^c In June 1997, US West Media Group acquired 40% of VCC in addition to the 50% it already owned. In October of 1997, US West sold its interest in VCC—along with the 10% that was in the hands of Samuel Liberman—to the consortium formed by CEI-Citicorp and Telefónica de España for US\$ 765 million. The new owners in turn transferred 50% of VCC to the Argentine group Clarín, owner of another cable television network (Multicanal) for US\$ 367.5 million.

^d Cointel S.A. controls 54% of Telefónica de Argentina. Currently CEI-Citicorp and Telefónica de España hold equal interests in Cointel S.A.

^e This group, through the Atlántida Comunicaciones holding company, controls 95% of Editorial Atlántida, which publishes *Gente*, *El Gráfico*, and *Cosmopolitan*, among other magazines. It also owns 70% of *Telefé*, 100% of Radio Continental, and 70% of Televisión Federal, owner of the 11 channels of Red Federal.

^f With this transaction, HSBC acquired 70% of Banco Roberts (it already held 30%) and 100% of Holding Roberts S.A. de Inversiones.

^g The Siembra Group manages Siembra AFJP, Siembra Compañía de Retirom, and Sur Seguros de Vida. In June of 1997, Citibank bought 51% of Siembra to bring its ownership to 100%. In April of 1998, it transferred part of Siembra to the Spanish bank Argentaria.

^h Renault returned to Argentina to acquire 70% control of CIADEA.

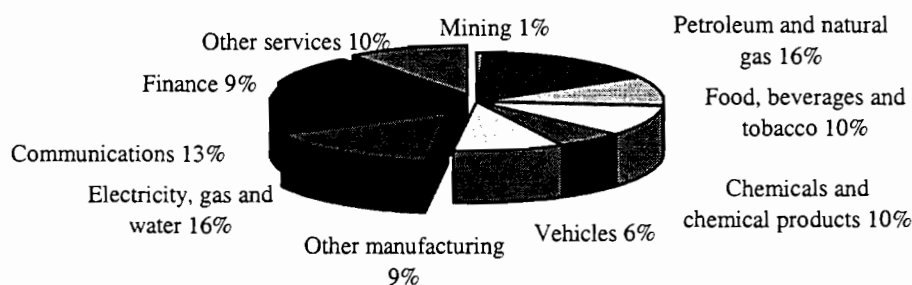
ⁱ Fomento Económico Mexicano S.A. (Femsa) bought the last 25% of the bottling company Coca-Cola Export Corp., thus acquiring 100% ownership, and changed the name to Femsa-Coca-Cola.

As the pace of privatization slows, the manufacturing sector has been regaining its importance as a recipient of foreign investment, particularly as a result of the boom in acquisitions in evidence since 1994. Between 1992 and 1996, FDI in the manufacturing sector was concentrated in chemicals, rubber and plastics (36%), food, beverages and tobacco (33%), and automobiles (16%) (see figure I.9). In the first two cases, the dominant mode of FDI has been a change in the ownership of existing assets, while in the case of the automotive industry, FDI is related to restructuring and modernization (see chapter IV). According to the Production Research Centre (CEP), 30% of these flows represent greenfield investment and expansion of capacity (CEP, 1997).

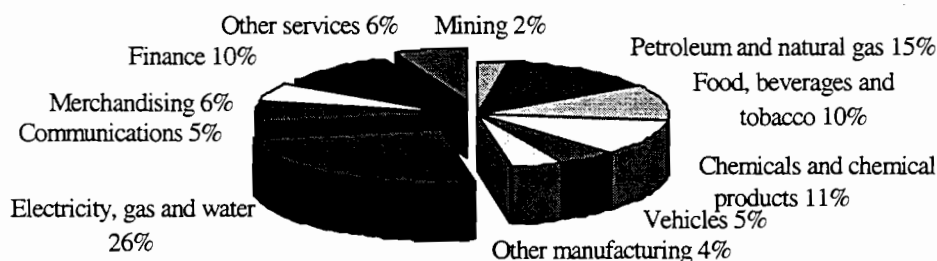
Between 1992 and 1996, the United States was the chief source country for foreign investment (close to a third of the total). This was especially true in the manufacturing sector (see figure I.10). Somewhat less than 30% of the influx of FDI came from European countries and was due basically to privatization and recent acquisitions of oil companies and banking institutions. Notable among the European investments were those originating in France, Spain and the Netherlands. In the last three years, Chile has become the second largest country of origin for FDI flows, exceeded only by the United States. Chilean firms have increased their presence in manufacturing, real estate, and electricity, gas and water (Ministerio de Economía y Obras y Servicios Públicos, 1998b).

Figure I.9
**ARGENTINA: SECTORAL DISTRIBUTION OF FOREIGN DIRECT INVESTMENT,
 1992-1997**
 (Percentages)

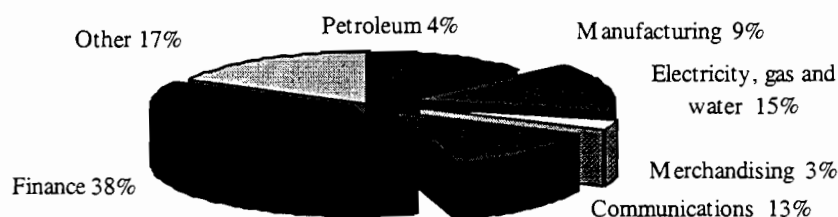
Stock of FDI in 1992 (US\$ 14.845 billion)



1990-1996 (US\$ 3.904 billion)^a



1997 (US\$ 6.647 billion)^b

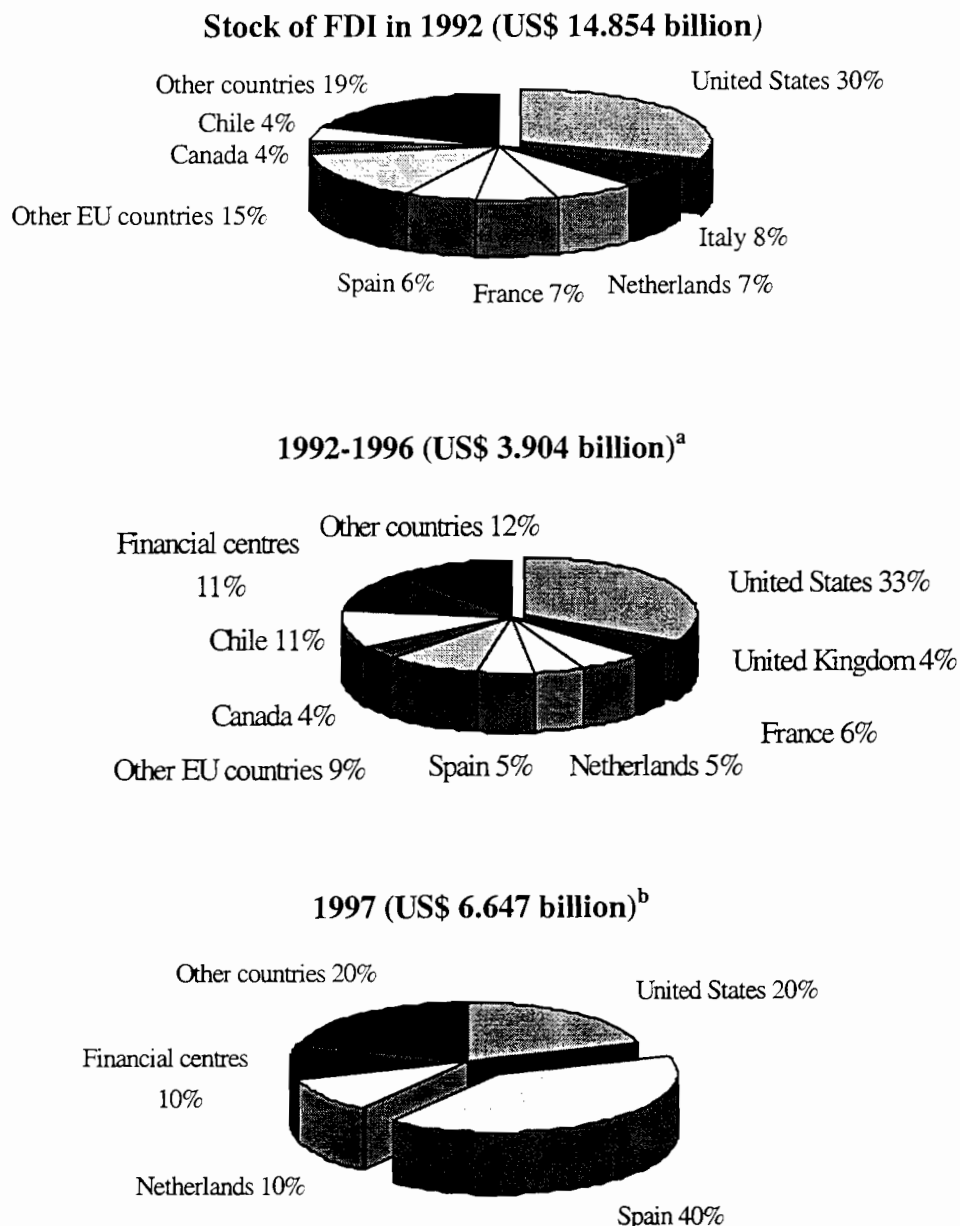


Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the Department of Economic Policy of the Ministry of Economic Affairs and Public Works and Services of Argentina.

^a Average annual flows.

^b For 1997, the estimates of sectoral distribution do not take into account US\$ 805 million in reinvested earnings (Ministerio de Economía y Obras y Servicios Públicos), *Inversión extranjera directa en Argentina, 1992-1997*, Buenos Aires, 1998b, p. 8).

Figure I.10
**ARGENTINA: GEOGRAPHICAL DISTRIBUTION OF SOURCES OF FOREIGN
 DIRECT INVESTMENT, 1992-1997**
(Percentages)



Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the Department of Economic Policy of Argentina's Ministry of Economic Affairs and Public Works and Services.

^a Average annual flows.

^b For 1997, the estimated distribution by source country includes capital investment (excluding the financial system) and total ownership transfers, and excludes reinvested earnings. This accounts for some US\$ 5 billion of the year's estimated US\$ 6.647 billion.

In 1997, FDI inflows were concentrated in the service sector —basically in banking, electric power generation and distribution, and telecommunications. The financial area became the main recipient as a result of the acquisition of some of the major local banks by foreign investors, and also as a result of significant increases in capital in other subsidiaries of foreign banks in response to the entry of the Spanish banks Santander and Bilbao Vizcaya (BBV), the British-owned Hong Kong and Shanghai Bank (HSBC) and other banking institutions (see table I.16). The electricity, gas and water area also received a considerable share as a result of some privatizations by regional governments (Ministerio de Economía y Obras y Servicios Públicos, 1998b). In the telecommunications area, factors such as investment in privatized firms, enlargement of the cellular telephone network, retooling in view of the deregulation of fixed-line telephony, and numerous changes in ownership of cable television firms and their possible complementarity and integration into the telecommunications market, together with the entry of new investors in broadcast and cable television, explain most of this flow of investment, with mergers and acquisitions as an added factor (CEP, 1998a).

Also in 1997, as a result of the sectoral changes described above, roughly 40% of the flow of FDI came from Spain. This can be attributed to the aggressive acquisitions strategy of some banks, such as Santander and BBV, and other firms, such as Telefónica de España, Repsol and Endesa-España (see table I.16). Indeed, acquisitions of local firms generated 45% of the FDI flow for the year. There was also an appreciable decline in proceeds from privatization during the period —since the process was playing itself out— and only 11% of the FDI flow came from this source (Ministerio de Economía y Obras y Servicios Públicos, 1998a).

Against this background, the general goals of the strategic approaches being taken by Argentina's foreign investors can be discerned:

- To ensure access to the domestic and regional (Mercosur) markets, which have great growth potential. This trend is particularly manifest in service activities such as banking and telecommunications, and in certain manufacturing industries, including food products, beverages and tobacco, and, above all, in the automotive industry.
- To obtain access to natural resources with significant comparative advantages. As a result of liberalization, foreign investors have been able to enter previously restricted areas of economic activity, particularly in mining and fossil fuels (petroleum and natural gas).

The move to take advantage of the larger markets created when Mercosur began to operate is particularly clear in the case of investment in the automotive and auto parts industry (see chapter IV), though it has begun to manifest itself in energy- and communications-related activities as well (see box I.6). Here, a tendency to approach the market on a regional scale is beginning to be typical, and it is increasingly possible to put together an entire production process without being bound by the geographical location of the components.

Box I.6

ARGENTINA: ENERGY EXPORTING COUNTRY

In the 1940s, the Argentine State was a pioneer in the production and use of natural gas as an energy source. In the 1990s, exploration, production, transport and distribution were privatized. Currently, Argentina gets 46% of its energy from natural gas, a percentage exceeded only by Russia (50%) and the Netherlands (47%). With the domestic market close to the saturation point, the export of gas to neighbouring countries has been one of the salient aspects of the Argentine economy in the last few years. Abundant natural gas reserves, the energy problems of its neighbours (especially Brazil), and the increasing trend towards using gas as an energy source have made Argentina very attractive for the main transnational corporations in the field.

MAIN GAS PIPELINES BETWEEN ARGENTINA AND NEIGHBOURING COUNTRIES

Destination	Cities	Consortium	Investment ^a
Uruguay	Paraná-Paysandú ^b	Unión Fenosa (Spain), Pacific Enterprises (United States)	110
Uruguay	Buenos Aires-Montevideo ^b	Amoco (United States) and British Gas (United Kingdom)	110
Brazil	Paraná-Uruguayana ^b	CMS Energy (United States) and Nova Gas (Canada)	100
Brazil	Salta-São Paulo ^c	Alberta Energy Co., Mobil, and Marubeni (Japan)	1 500
Chile	Tierra del Fuego ^d	Nova Corporation	27
Chile	Mendoza-Santiago ^d	Nova Corp., CGC, and Gener (Chile)	325
Chile	Cornejo-Mejillones ^b	Endesa (Chile), CMS Energy, and Repsol	230
Chile	Lota-Concepción ^c	Nova Corp., El Paso Energy (United States) Gasco (Chile) and Yacimientos Petrolíferos Fiscales (YPF)	330

Source: ECLAC database developed by Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from Production Research Centre (CEP), "Sector energético: gasoductos desde Argentina hacia sus vecinos", *Síntesis de la economía real*, No. 12, Buenos Aires, March 1998.

^a Millions of dollars. ^b In construction ^c Under study. ^d In operation.

Strategies formulated to help transnational corporations take advantage of the regional market while making coordinated use of their investments in subsidiaries elsewhere are being put into practice mainly where Brazil is concerned. In the particular case of the automotive industry, the strategy adopted by the larger firms in the field tends to involve a high degree of specialization with regard to production, accompanied by a capacity for export, and the use of imports to expand the range of products offered on the domestic market. Local plants are retooled to manufacture and export parts, components and certain vehicles to other subsidiaries of the corporation within the framework of a more integrated production and marketing network (Porta, 1997) (see table I.17).

Table I.17
ARGENTINA: PRINCIPAL NEW INVESTMENTS BY FOREIGN FIRMS, 1997
(Millions of dollars)

Company	Source country	Sector	Project	Amount
Invested during the year ^a				2 093
MIM Holding/North Ltd./ Río Algom	Australia/Canada	Mining	La Alumbrera mining project (gold and copper)	500
Nova Corp./Gener	Canada/Chile	Energy	GasAndes gas pipeline	325
Renault	France	Automotive	Modernization and new production line	280
Volkswagen	Germany	Automotive	Plant retooling and new production line	270
General Motors	United States	Automotive	New plant	150
Fiat	Italy	Automotive	New plant	146
Monsanto	United States	Chemicals	Herbicide production plant	136
ACBL	United States	Automotive	Construction of a waterway (Paraná River)	110
André & Cie.	Switzerland	Food	Agro-industrial complex and port	105
AngloAmerican Corp.	South Africa	Mining	Cerro Vanguardia mining project (gold)	71
In development ^b				5 715
Impreaila	Italy	Airport	Plan to remodel airports	2 000
Broken Hill Proprietary (BHP)	Australia	Mining	Agua Rica mining project	1 200
Agrium	Canada	Chemicals	Fertilizer production plant	600
General Motors	United States	Automotive	Expansion of production capacity	580
Ford	United States	Automotive	Development of new production lines	550
Dow Chemical/Petrobrás	United States/Brazil	Chemicals	Mega project	430
Wal-Mart	United States	Merchandising	Opening new supermarkets	230
Compañía Cervecerías Unidas (CCU)	Chile	Beverages	New brewery	125

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the Production Research Centre (CEP), Department of Industry, Commerce, and Mining.

^a The amount does not represent the project total, but the approximate amount disbursed during 1997.

^b The amount represents the project total.

In recent years large investments have begun to be made in activities related to extracting and processing minerals and fossil fuels, and in the areas of forestation and cellulose pulp production. This range of investments is in addition to prior FDI targeted at the petrochemical industry and at the commodities segment of the food industry, in particular oils and meat. In these categories, availability and cost of raw materials are both the main advantage of operating locally and the most important factor in the decision to invest. The increase in the scale of production and the guaranteed supply of raw materials are the competitive factors that shape the strategy followed by the transnational corporation, whether the result is achieved by links in the

production chain or long-term contracts. Most of these activities —except for petrochemicals— are aimed at foreign markets.

During the first half of 1998, FDI flows were US\$ 2.495 billion, and initial estimates for the entire year put them at around US\$ 5.8 billion. Despite the effects of the international crisis, foreign firms have continued making large acquisitions and have also moved forward with their plans to invest in projects that are in the development stage, primarily in energy, mining and the automotive industry.

Between 1998 and the year 2000, according to the Production Research Centre of the Department of Industry, Commerce and Mining, foreign investment will be concentrated in the following areas: telecommunications (13%), construction (9%), electrical energy (8%), mining (8%), transportation (6%), automobiles and auto parts (6%), petrochemicals (6%), and petroleum and gas (6%).²⁷

The recent behaviour of foreign investors in Argentina and projections for the immediate future suggest that the flow of investment has not been diminished by the Asian crisis. The explanation for this may lie in the comparative advantages of Argentine investments and in the high rates of return they offer over the long term. More specifically, in the context of a general price decline in international markets, a slowdown in exportation should not be thought of as being linked to structural losses of competitiveness in the economy. The Argentine export sector has shown its solidity by maintaining a rapid pace of expansion in its volume of foreign sales. Accordingly, new investments can be expected to ensure greater competitiveness for new Argentine exports, since a majority of them will directly increase the exportable supply (62%), while another large fraction (19%) will expand export infrastructure or diminish costs. In fact, in most export activities, vigorous investment has been evident (Ministerio de Economía y Obras y Servicios Públicos, 1998c).

Nonetheless, there are concerns on this front, since most new FDI coming into the sectors that produce exportable goods appears to be in activities related to natural resources or products that have commodities characteristics. In other words, FDI does not appear to be transforming Argentina's export pattern in the direction of producing goods with greater value added.

3. Colombia: from an open policy on natural resources to the privatization of utilities

According to balance-of-payment statistics, Colombia's inward FDI was up sharply in 1997, with net inflows rising to US\$ 5.962 billion. This unprecedented level strengthened the upward trend seen in foreign investment in the country during the 1990s, which has resulted in a nearly 12-fold increase in net FDI inflows over the course of the decade (see table I.2).

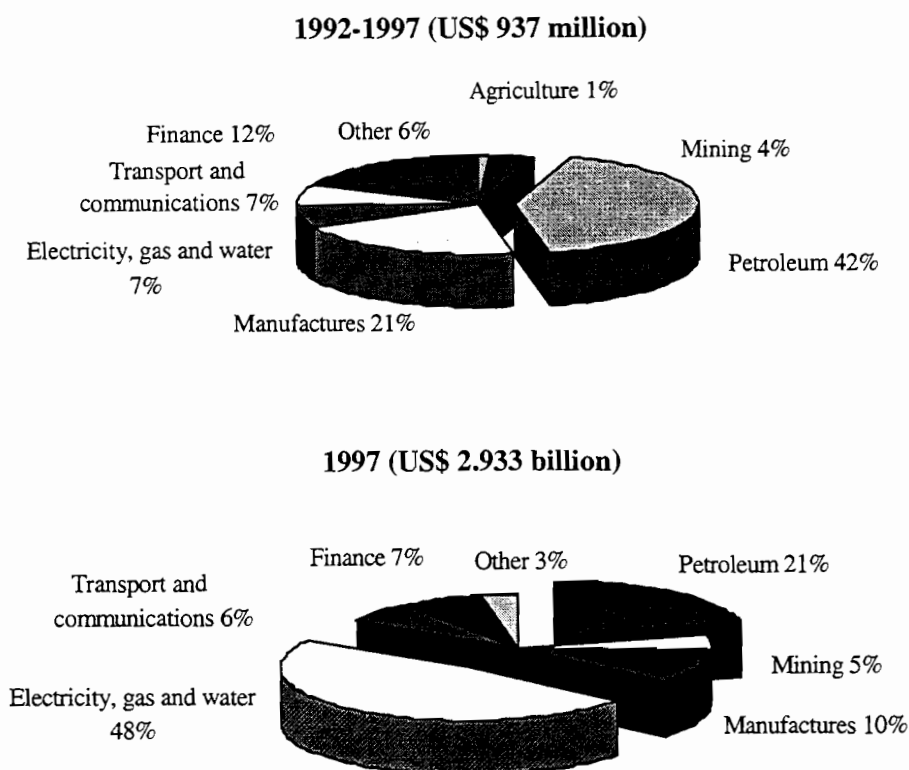
According to information from the Banco de la República and the National Planning Department, during the period 1992-1996 FDI was channelled mainly into the development of oilfields (68%) and, to a lesser extent, finance (10%), mining (8%) and manufacturing (8%) (see

²⁷ These projections represent the investments of FDI firms, not FDI flows on the balance of payments.

figure I.11). In 1997, on the other hand, the country's substantial FDI inflows were concentrated in electricity, gas and water (25%), oil (23%), manufacturing (17%), finance (12%) and communications (9%). An analysis of the overall distribution of FDI flows by destination thus reveals a major shift towards services and away from the pattern previously observed in the 1990s. Indeed, the pattern of FDI flows in the 1990s has differed significantly from what it was in the 1980s, when such flows were associated primarily with industries geared to import substitution, and, later, to industrial modernization and restructuring (Mortimore, 1985; Misas, 1993; Urrutia, 1996; and Garay and others, 1998).

Figure I.11

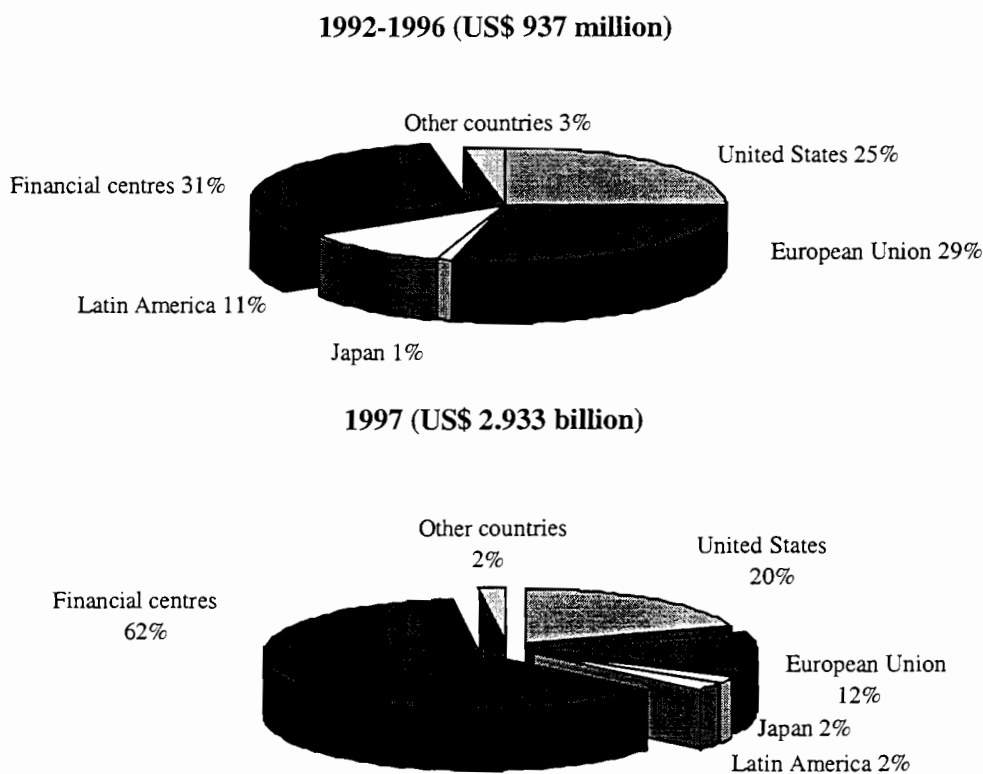
COLOMBIA: SECTORAL DISTRIBUTION OF FOREIGN DIRECT INVESTMENT, 1992-1997
(Percentages)



Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from Corporación Invertir (Coinvertir).

The geographic distribution of FDI by source also reflects major changes. Unfortunately, official statistics do not include FDI in the oil industry, but even without that information, it is clear that there has been a definite change in the way these investments are channelled (see figure I.12). Financial centres were used twice as much in 1997 (62% of the total) as they were in the period 1992-1996. The main financial centres are, in descending order of importance: the Cayman Islands (31.7%), the British Virgin Islands (12.2%), Panama (9.2%) and Bermuda (6.2%). Many of the operations associated with the privatization of State assets have been routed through these financial centres, and Colombia therefore provides a clearer example than other countries in the region of how much the practice of funnelling FDI through financial centres can distort the statistics on such investments and their subsequent analysis in terms of geographic origin. Moreover, these statistics suggest that, when compared with the figures for 1992-1996, both the European Union and the United States saw their shares decline in 1997 (from 29% to 12% and from 25% to 20%, respectively).

Figure I.12
**COLOMBIA: GEOGRAPHICAL DISTRIBUTION OF SOURCES OF FOREIGN
 DIRECT INVESTMENT, 1992-1997 ^a**
(Percentages)



Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from Corporación Invertir (Coinvertir).

^a The information from Coinvertir does not include foreign investment in the oil industry, which may significantly alter the distribution.

A major portion of the increase in FDI seems to have been generated by the entry of companies from countries that have not traditionally played an important role as FDI sources. In addition to the Spanish banking system and the investments made in the electricity subsector, Chilean and Mexican companies have also been quite active. This not only constitutes an important change with respect to the source of FDI flows, but also signals an appreciable upswing in intraregional investment, particularly in terms of flows routed through financial centres.

Various factors have influenced the more recent trends in FDI flows into Colombia. Some of those factors are as follows:

- Regulatory changes at both the national and regional levels. These have included various modifications in national regulations (Act 9a of 1991) and in those in force for member countries of the Andean Community. These changes have included the elimination or relaxation of a number of restrictions applying to foreign investors. As a result, such investors have gained access to previously restricted areas and have been able to undertake investment projects without having to meet most of the performance requirements established under the original legislation.
- Privatizations. Another element that has helped to increase FDI flows into Colombia has been the vigorous policy adopted by the Government of Colombia in the mid-1990s with the aim of selling or transferring State assets. This process has included, in particular, the privatization of mining companies and of electricity generation and distribution facilities, and the auctioning of natural gas and coal concessions.
- Internationalization of Latin American and Spanish companies. The speed with which Spanish, Chilean, Mexican and Venezuelan companies have internationalized their operations as part of an effort to position themselves in the various local markets within Latin America has also contributed to the spectacular surge in FDI flows into Colombia (see section C of this chapter).

Accordingly, the following new objectives can be discerned in the strategies applied by foreign investors in the Colombian economy in the 1990s:

- To gain access to the development, processing and marketing of natural resources and their derivatives, especially in connection with the exploration and production of oil, natural gas and coal; another access route has been the purchase of State enterprises (e.g., Promigas, a natural gas distributor; Terpel,²⁸ a fuel marketing company; and Cerro Matoso, a nickel producer).
- To ensure access to specific domestic markets, especially markets linked to the services sector (electricity and gas, finance and telecommunications). In these areas, acquisitions of State assets and private local companies have played a very important part.

²⁸ The domestic market is also important for many export-oriented companies; for example, the local fuel market in Colombia is dominated by four foreign oil companies: Terpel (30%), Mobil (30%), Esso (23%) and Texaco (17%) (*Dinero*, 30 June 1998).

The situation in the petroleum subsector has been a decisive factor in relation to investment in the development of natural resources. According to the National Planning Department, FDI flows into this activity amounted to US\$ 880 million in 1997, a significantly higher amount than the average annual figure of US\$ 630 million recorded between 1992 and 1996. As a result of the investments made in this industry both by the State-owned oil company, Empresa Colombiana de Petróleos (Ecopetrol) and by foreign firms, the production of crude oil rose from 438,400 barrels per day in 1992 to 652,200 barrels in 1997, and known reserves increased from 1.991 billion barrels in 1990 to 2.952 billion in 1997. Ecopetrol teamed up with British Petroleum, Total of France and Triton Energy of the United States to build a US\$ 2 billion gas pipeline linking the Cusiana fields with the country's Atlantic coastline. In addition, at the beginning of 1996, the decision of the State-owned company to sell off its share in eight gas and energy companies—including Promigas, Gas Natural del Oriente, Colgas, Invercolsa and Terpel de Antioquia—yielded fiscal receipts on the order of US\$ 319 million (Coinvertir/CEDE, 1997, p. 16). For international companies, these events have been a clear signal of the Colombian authorities' greater willingness to allow investors to enter sectors from which they had previously been excluded. With this opening of the hydrocarbons sector, British Petroleum's Colombian subsidiary has launched a US\$ 600 million investment project in the Piedmonte oil fields and is implementing the second phase of the its project in the Cusiana and Cupiagua fields. Other examples of the privatization of export-oriented companies in Colombia include the sale of Cerro Matoso, a nickel producer (see table I.18).

With respect to utilities serving the domestic market, the State has had an important role to play in devising new business options to attract foreign investors. In fact, the privatizations of electric companies undertaken during 1997 became the single most important vehicle for FDI flows into the Colombian economy for that year. Thus, once the Government cleared away obstacles to the sale of major assets in the electricity and telecommunications industries, Colombia was added to the list of Latin American countries where privatizations have fulfilled a significant role in attracting foreign investment in 1997. As a result, tax receipts under this heading were double what they had been in 1996. The Government took in US\$ 4.061 billion in 1997 from the sale of eight companies, most of which were in the electricity subsector; the bulk of these revenues came from bids won by foreign investors, who paid out some US\$ 4 billion for six of the eight companies offered to the private sector (see table I.18). Privately-owned electric power generating capacity increased to 6,000 MW in 1997, whereas State capacity fell to 5,000 MW.

A group of companies made up primarily of Spanish and Chilean firms, but which includes some United States and Venezuelan corporations as well, has figured prominently in this process. ENDESA-Spain headed up the two consortia that won the bidding in the most important privatization tenders (EEB-Codensa and EEB-Emgesa), in which it teamed up with the Chilean companies Endesa and Enersis, and then later acquired a substantial interest in each of these two companies (see box I.8). In turn, the two Chilean companies, one of which holds a sizeable stake in the other, bought Hidroeléctrica Betania for US\$ 302 million. In addition, another Chilean company, Gener, paid out US\$ 644 million for the Chivor hydroelectric plant. Meanwhile, the Venezuelan company, Electricidad de Caracas, S.A., bought stakes in two of the privatized companies: Energía del Pacífico S.A., (in partnership with the United States company, Houston Energy Industries) and Termocartagena.

Table I.18
COLOMBIA: STATE ENTERPRISES PURCHASED BY FOREIGN INVESTORS, 1997 ^a
(Millions of dollars)

Company	Sector	Foreign capital (%)	Amount	Purchaser
Empresa de Energía de Bogotá (EEB)/Comercializadora y Distribuidora de Energía de Bogotá (Codensa)	Electricity	48.5	1 230	Endesa-España, Enersis, Endesa-Chile, others
EEB/Generadora de Energía Eléctrica de Bogotá (Emgesa)	Electricity	48.5	952	Endesa-España, Endesa-Chile
Central Hidroeléctrica de Chivor	Electricity	99.0	644	Gener (Chile)
Empresa de Energía del Pacífico S.A. (EPSA)	Electricity	56.7	535	Houston Energy Industries (United States), Electricidad de Caracas (Venezuela)
Central Hidroeléctrica de Betania S.A. (CHB)	Electricity	99.9	302	Endesa-Chile, Corporación Financiera del Valle
Cerro Matoso	Nickel	47.0 ^b	179	Gencor (South Africa)
Gas Natural	Energy	50.3	160	Repsol, Iberdrola (Spain)
Total			4 002	

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from *América economía, Estrategia, Diario Financiero, The Wall Street Journal, Latin Finance* and other specialized financial publications.

^a Operations involving a sum in excess of US\$ 50 million.

^b The purchase of this block of shares raised Gencor's stake in Cerro Matoso to 99%.

The active role played by Spanish and Chilean companies in the privatization of a large part of the electricity subsector in Colombia suggests that they are working to establish a strong regional position in this sector so that their increasingly internationalized operations in Latin America will permit a greater geographic diversification of their profits, which will presumably be boosted by efficiently-run operations in markets that are protected against newcomers by natural barriers and have highly inelastic demand. The same sort of interpretation applies to the acquisition by Repsol, a Spanish firm whose presence in a number of Latin American countries has been growing, of a 50.3% interest in Gas Natural S.A. for US\$ 148 million through Gas Natural Latinoamericana in partnership with another Spanish company, Iberdrola. In this case, however, Repsol's objective appears to be not only to globalize its operations through the geographic diversification of its receipts, but also to make inroads into different branches of the energy sector.

The way in which Spanish banks have acquired an interest in some of the leading financial institutions in Colombia differs from the approach used in the case of electricity companies. In mid-1996, Banco Bilbao Vizcaya (BBV) acquired 45% of Banco Ganadero, the Colombia's largest bank, in an operation that represented an inflow of US\$ 300 million. For its part, Banco Central Hispano bought a 26% interest in Banco de Colombia for approximately US\$ 200 million. In 1997, Banco Santander acquired 55% of Banco Comercial Antioqueño (Bancoquía) for US\$ 155 million and a US\$ 93 million majority stake in Invercrédito, the country's largest consumer loan institution. These are not recent transfers of firms to the private sector, as in the cases of the telecommunications, electricity and oil industries. The linkages between the Spanish banks and the destination economy in this instance is much more complex and has to do with the increasing globalization of financial intermediation; as a result of this process, only some of their activities will be directly related to domestic demand and to the differentiation of financial products, while others will relate to a more supranational form of financial activity. Thus, their competitiveness in this sector is based less on locational advantages (that are of importance in the case of the electric power industry) and more on ownership-related advantages (financial capacity and operations that are closely linked to the parent company).

A third group of domestic market-oriented activities that have received substantial amounts of FDI in the 1990s are found in the manufacturing sector. The subsectors attracting the bulk of these FDI inflows in 1992-1997 were chemicals (13.5%), food, beverages and tobacco (7.7%) and metal products, machinery and equipment (7.7%) (Coinvertir, 1998), thus carrying forward a trend that first emerged in the mid-1960s. FDI flows into these areas have been used to modernize and diversify their industrial production structure through the introduction of new products and processes (Misas, 1993).

The activities of the major non-financial foreign companies reflect the various phases of FDI activity in Colombia (see table I.19). The main such enterprises are devoted to the production and export of oil and minerals and to manufacturing. Resource-based industries have attained some degree of international competitiveness (Puyana and Dargay, 1996), but this has not been the case with manufacturers (Garay and others, 1998; Misas, 1993; Mortimore, 1985; Ramírez and Núñez, 1998), which indicates that much remains to be done in the area of corporate restructuring and that national and regional policy efforts have not been forceful enough to improve the systemic competitiveness of the Colombian economy (Acosta, 1997; Office of the President of the Republic of Colombia and Universidad del Valle, 1998). In the case of services, some of the firms involved in the privatization process, such as the electricity company Generadora de Energía Eléctrica de Bogotá (Emgesa), have recently begun to appear on the list of the most important foreign companies in terms of sales.

Table I.19
COLOMBIA: MAIN PARTLY OR WHOLLY FOREIGN-OWNED COMPANIES, 1997
 (Millions of dollars)

Company	Sector	Sales	Foreign investor	Foreign capital (%)	Home country	Exports
Mobil de Colombia	Petroleum	1 165	Mobil Oil Corporation	100	United States	...
Esso Colombiana Ltd.	Petroleum	946	Exxon Corporation	100	United States	...
General Motors Colmotores S.A.	Automotive	833	General Motor Corp.	77	United States	55
Texas	Petroleum	786	Texaco Inc.	100	United States	...
Compañía Colombiana Automotriz	Automotive	413	Mazda	100	Japan	30
Sofasa	Automotive	462	Toyota Motor Corp.	53	Japan	50
Colgate-Palmolive S.A.	Hygiene	390	Colgate-Palmolive Co.	...	United States	...
Carcafé S.A. (Associate Colcafé)	Commerce	390	...	...	...	301
Diamante-Samper	Cement	370	Cemex	100	Mexico	...
Nestlé de Colombia S.A.	Food	307	Nestlé AG	100	Switzerland	...
Industrias Alimenticias Noel S.A.	Food	292	...	...	...	24
Intercor	Mining	284	Exxon Corporation	...	United States	238
Comcel	Telecom.	262	Bell Canada	51	Canada	...
Occidental de Colombia Inc.	Petroleum	256	Occidental Corp.	...	United States	211
Smurfit Cartón Colombia S.A.	Paper	254	Smurfit Carton	66	Ireland	5 ^a
Shell-Colombia	Petroleum	251	Royal Dutch Shell	100	United Kingdom/ Netherlands	203
Cargill Cafetera de Manizales S.A.	Food	241	Cargill Incorporated	100	United States	137
Drummond	Mining	208	Drummond Co. Inc.	100	United States	168
Monómeros Colombo Venezolanos	Chemicals	204 ^b	D.S.M., I.V.P.	66	Netherlands/ Venezuela	32
Enka de Colombia S.A.	Chemicals	200	N.V. Ind. Bezit (Akzo)	49	Netherlands	59
Cerro Matoso S.A.	Mining	197	Gencor	47	South Africa	153
Purina Colombiana	Food	195	Ralston Purina	...	United States	...
Unilever Andina	Food	194	Unilever	...	United Kingdom/ Netherlands	...
Distribuidora Nissan Ltda.	Automotive	187	Nissan Motor Co.	...	Japan	...
Productora de Papeles S.A. (Propal)	Paper	176	International Paper Co.	100	United States	37
Siemens	Manufacturing	168	Siemens A.G.	71	Germany	...
Alpina Productos Alimenticios S.A.	Food	157 ^b	Latin American Int'l Trading	35	Panama	...
Hocol S.A.	Petroleum	131	Nimir	100	Kuwait	127
S.K.N. del Tolima Ltda.	Food	128 ^b	...	100	Germany	56
Generadora de Energía Eléctrica de Bogotá (Emgesa)	Electric power	122	Endesa, Enersis	...	Spain/Chile	...

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from *América economía*, 1995, 1996, 1997 and 1998; *Revista Semana*, April 1998 (25 leading private, State-run and foreign firms); *Dinero*, April 1998; and *Major Companies of Latin America and the Caribbean*, 1998, London, Graham & Whiteside, 1998.

^a Information relating to 1996.

^b Information relating to 1994.

An analysis of probable trends in FDI in Colombia in 1998 based on the available data for the first half of the year suggests that there may be another upsurge in inward FDI, since, even without counting investment in the oil industry, some US\$ 3.326 billion are estimated to have poured into the country between January and June 1998; this could mean that investment could amount to around US\$ 6 billion for the year as a whole.²⁹ Almost half of these inflows have entered Colombia via financial centres (especially Panama and the Cayman Islands). Three quarters of the total was invested in financial services (42.1%), electricity, gas and water (25.9%) and non-metallic minerals (7.8%) (Convertir, 1998). This signals a continuation of recent trends in FDI in Colombia, in that such funds tend to be channelled through financial centres and to be concentrated in services and natural resources rather than manufacturing. With the exception of investment in oil and gas, there does not appear to be any clear-cut relationship among new FDI, the expansion of production capacity and the export activity of foreign companies.

4. Chile: strengthening natural resource-based comparative advantages and initiating new activities

In recent years, Chile has become one of the main destination countries for FDI flows into Latin America and the Caribbean. The annual average inflow of FDI into the Chilean economy increased from US\$ 530 million in the 1980s to US\$ 1.7 billion during the first half of the 1990s and to more than US\$ 5 billion in the last two years (see table I.2).

The favourable trend in FDI—more than could be accounted for by the return on the projects—has been directly attributable to the reduction of risk and the macroeconomic stability of the country. Moreover, the institution of the foreign-debt conversion programme (known as “Chapter XIX”) in 1985, under very difficult circumstances, re-established foreign investor confidence in the country’s economy. Subsequently, with economic recovery, the mechanism died a “natural death” (Calderón, 1993). In addition, the regulatory framework governing foreign investment, Decree Law 600, has remained very stable since its promulgation in 1974. DL 600, especially the provisions regarding legal contracts with the State of Chile—which guarantee the rights and establish the obligations of foreign investors—has undoubtedly been a decisive factor in the trend of FDI flows in recent years.

From 1974 to 1996, according to statistics of the Foreign Investment Committee (CIE),³⁰ mining activities, chiefly in copper and gold, received nearly 50% of FDI inflows. In addition, while the relative importance of manufacturing in FDI has decreased, that of services has increased (see figure I.13). Companies based in North America (United States and Canada) have

²⁹ The level of portfolio investment recorded by Coinvertir plummeted to just US\$ 50 million in 1997, as compared to inflows of US\$ 271 million and US\$ 175 million, respectively, in 1995 and 1996. The distortion introduced by this variable in earlier years will therefore probably not be present in 1998 (a cumulative figure of US\$ 1.732 billion between 1992 and 1997).

³⁰ CIE information is based on the investments made under DL 600. These figures differ from the figures reported previously, which were based on the balance of payments. The Committee’s statistics do not deduct for amounts of capital repatriated by the foreign company to its country of origin after liquidating or decreasing its investments in Chile; moreover, they include credits associated with the execution of investment projects. These statistics do not include inflows under Chapter XIX.

been the chief source of FDI, primarily in large-scale mining projects (see box I.7). Also important have been investments from sources uncommon for the region (Australia, New Zealand and Saudi Arabia) in natural resource-based industrial activities (paper and pulp, agro-industry and cement) and from European (especially Spanish) companies in the service sector (see figure I.14). This new capital has helped to spur the growth process, with the resulting positive effects on production capacity, employment and, especially, exports (Agosin et al., 1993 and 1996; Behrens, 1992; Calderón and Griffith-Jones, 1995; Desormeaux, 1989; Riveros and Vatter, 1994; Rozas, 1992).

According to some estimates, industries that produce tradables have received more than 75% of FDI in recent years (Riveros and Vatter, 1994). Thus, during the first half of the 1990s, companies with foreign investment generated 40% of total exports. Foreign sales of these companies have grown at an average annual rate of 19%, exceeding the growth rate of total exports, which was 11% annually. As a percentage of total sales, their exports increased from 24% to 31% from 1991 to 1995; today, that figure should be even higher (Cid, Calderón and Mortimore, 1998). According to other estimates, the ratio of exports to sales of foreign-owned companies is even greater, over 50% (Calderón and Griffith-Jones, 1995).

Given the great mining potential of Chile, the tendency, unlike that in other countries in Latin America, has been for FDI flows to go into new projects rather than acquisitions of existing enterprises.³¹ Moreover, the favourable outlook of the country's economy has made reinvestment of profits one of the chief channels of direct investment³² (Banco Central de Chile, 1998a). Nevertheless, transfers of assets, which were very substantial in the late 1980s as a result of privatization and foreign-debt conversion programmes,³³ have started to show renewed growth in the last two years.

In 1997, nearly 40% of FDI was in mergers and acquisitions. Continuing a trend that had begun the year before (CIE, 1997; ECLAC, 1998a), the service sector accounted for more than 50% of FDI flows, especially in the areas of electric power, telecommunications and financial services (see figure I.13).

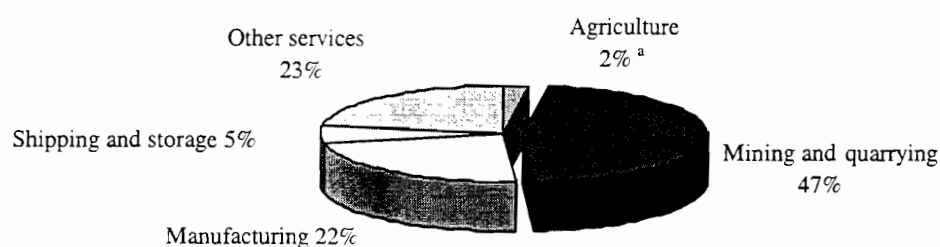
³¹ Moreover, unlike other Latin American countries, Chile has not experienced substantial inflows as a result of privatization of State enterprises. After a wave of privatization in the 1970s and 1980s, the country's share in the region's total privatization proceeds dropped to just 3% from 1990 to 1997 (Santiago Chamber of Commerce, 1998a).

³² From 1990 to 1997, profits from direct investment that were actually repatriated reached US\$ 755 million per year, in net terms, while average net profits earned were US\$ 1.326 billion.

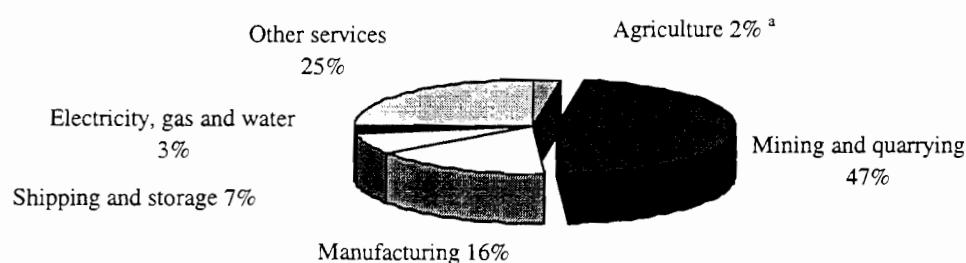
³³ From 1985 to 1989, US\$ 3.23 billion entered the country under Chapter XIX. Most of those funds were used to purchase industrial (40%), agricultural, forestry and fishing (21%) and service enterprises (Rozas, 1992).

Figure I.13
CHILE: SECTORAL DISTRIBUTION OF FOREIGN DIRECT INVESTMENT, 1974-1997
(Percentages)

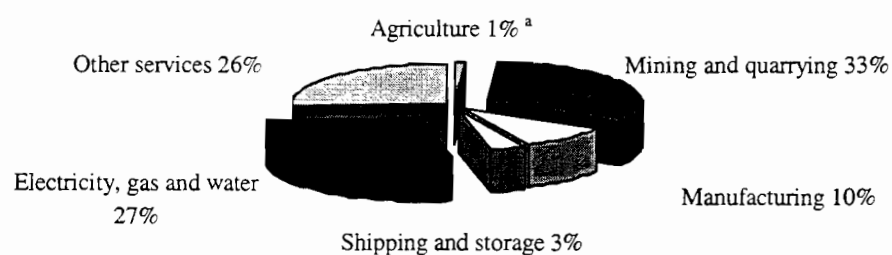
1974-1989 (US\$ 319 million)



1990-1996 (US\$ 2.199 billion)



1997 (5.041 billion)



Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the Foreign Investment Committee of Chile.

^a Includes agriculture, fishing and forestry.

Box I.7

CANADIAN INVESTMENT IN MINING IN CHILE

In 1997, according to official statistics,^a Latin America and the Caribbean strengthened their position as the main focus of interest in the developing world for Canadian transnational corporations; nearly 15% of all Canadian foreign investment is concentrated in the region. Flows from this source have two main characteristics.

- They are heavily concentrated in the Caribbean countries, especially the “tax havens”, to take advantage of tax benefits that they offer. In most cases, the funds are then channelled to other destinations, inside or outside the region.
- Investments in extraction activities (mining, oil and gas) in countries that have eliminated restrictions on the presence of foreign capital in such activities are on the increase.

Currently, there are Canadian investments underway or planned totalling more than US\$ 7 billion in Chile,^b which has become one of the main destination countries in the region. The participation of companies such as Falconbridge, Placer Dome, Rio Algom, Cominco and Teck Corp. in mining exploration projects (for copper and gold) is substantially altering the structure of the sector and, especially, its export capacity. According to studies of the National Mining Society of Chile (SONAMI), 43% of Chilean exports of mining products come from Canadian companies.

MAIN CANADIAN COMPANIES ACTIVE IN MINING IN CHILE^c

Project	Canadian company	Value of investment	Start of production
Doña Inés de Collahuasi	Falconbridge (40%)	1 760	1998
Cerro Casale	Arizona Star Resources/Placer Dome	1 300	2001
Zaldívar	Placer Dome	600	1995
Cerro Colorado	Rio Algom	550	1994
Pascua	Barrick Gold Corp.	500	2000
Spence	Rio Algom	500	2001
Quebrada Blanca	Cominco Ltd. / Teck Corp. (77%)	375	1994
Lobo y Marte	Teck Corp. (60%)	350	not available

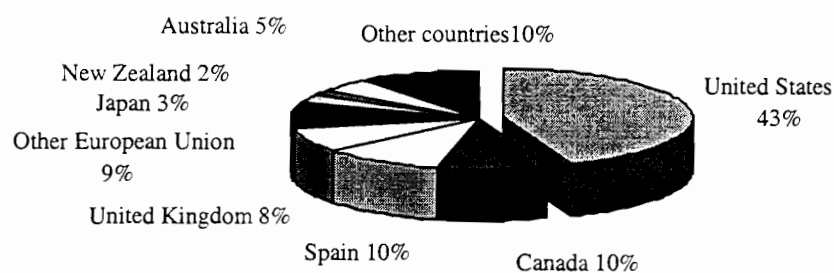
^a Statistics Canada.

^b CIBS (Canada's International Business Strategy), *Geographic Overview*, Latin America and the Caribbean, 1998. [<http://dfait-maeci.gc.ca/english/trade/cibs/english/overview/overgla.htm>].

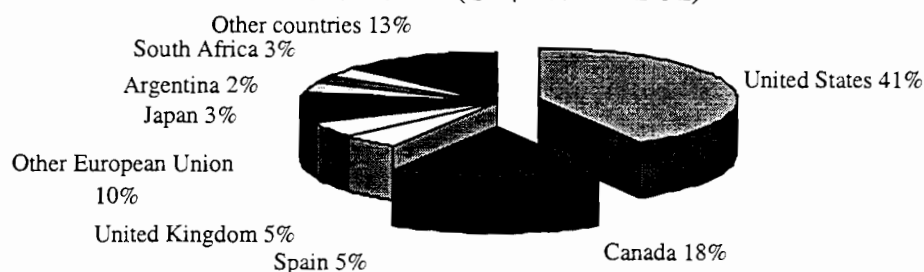
^c Comisión Chilena del Cobre, *Inversión extranjera en la minería chilena 1997*, Santiago, Chile, May 1998.

Figure I.14
CHILE: GEOGRAPHICAL DISTRIBUTION OF SOURCES OF FOREIGN DIRECT INVESTMENT, 1974-1997

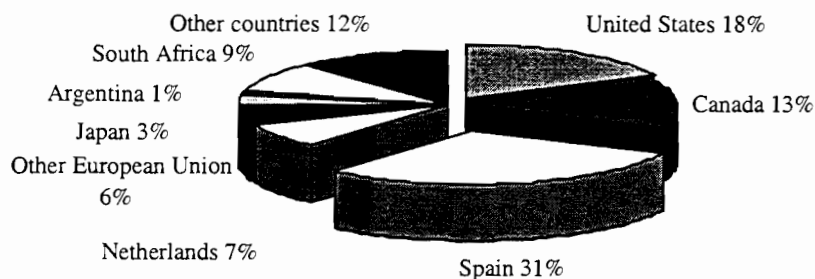
1974-1989 (US\$ 319 million)



1990-1996 (US\$2.199 billion)



1997 (US\$ 5.041 billion)



Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the Foreign Investment Committee of Chile.

In 1997 there were major changes not only in the sectoral destination but also in the sources of investment. Spain became the main country investing in the Chilean economy, replacing—for the first time since 1974—the United States, which dropped to second place (see figure I.14). However, that change was due primarily to just one transaction: Endesa-España's acquisition of 29% of the stock of Enersis, the Chilean electric holding company (see box I.8). The United States maintained its primacy with respect to its share of the total stock of FDI (36%), followed by Canada (16%) and Spain (11%). Moreover, excluding mining investments, the European Union as a whole was the main foreign investor in the Chilean economy, ahead of the United States.

Box I.8

ENDESA-ESPAÑA'S ACQUISITION OF THE ENERSIS GROUP: STRATEGIC ALLIANCE OR MERGER?

In late 1997, using US\$ 1.179 billion out of a total of US\$ 1.5 billion authorized by the Government of Chile for this transaction, Endesa-España bought four of the five investment companies which owned approximately 29% of the capital stock of the Enersis electricity generation and distribution holding company. In recent years, the Chilean company had been engaged in an active process of internationalization in other Latin American countries; as a result it had a major presence in the energy markets of Argentina (Costanera/CBA, El Chocón, Edesur), Brazil (CERJ and Cachoeira), Colombia (Betania, Codesa and Emgesa) and Peru (Edelgel, Edelnor). Enersis thereby became the sector's largest conglomerate in Latin America, valued at US\$ 4.8 billion. Before entering into partnership with Enersis, Endesa-España had already acquired several companies in Argentina, Peru, Venezuela and the Dominican Republic.

The deal grew out of the constraints the Enersis group was experiencing in its strategy of expansion in Latin America. In 1997, the group's debt had increased by 20%, after the acquisition of CERJ, the Rio de Janeiro electric company. Although it believed it could increase its debt by another US\$ 1 billion, that would not be enough to gain it a stake in the privatization of other companies in the sector, which could amount to some US\$ 20 billion.^a Enersis is considering a capital increase of approximately US\$ 600 million—US\$ 400 million through a capital subscription and US\$ 200 million through an issue of bonds convertible into shares—to refinance its foreign expansion plan.^b As the Chilean executives see it, the alliance with Endesa-España—whose capitalization is five times greater—will enable the group to intensify its expansion strategy, primarily in Brazil.

Two weeks after that strategic alliance was concluded, a consortium led by the two companies was awarded a contract by the Brazilian electricity distribution company Companhia Energética do Ceará (COELCE) worth US\$ 868 million. Under the agreement that was struck between the two parties, Enersis and Endesa-España kept an equal stake (41.4%) in COELCE. The deal was especially important to the Spanish company, because it enabled it, in the bidding on COELCE, to beat out another Spanish company, Iberdrola, which also has a major presence in Brazil, through its investment in COELBA. Endesa-España also bolstered its position as one of the main players in Latin America.

^a Pablo Bachelet, "Eléctricas: espaldas anchas", *América economía*, Santiago, Chile, September 1997.

^b *El Mercurio*, 3 April 1998.

In this overall picture, it is possible to discern the main strategic orientations of foreign investors in the Chilean economy (see table I.20):

- Traditional activities involving exploitation of natural resources for export. The interest of foreign investors has centred on the production of commodities.³⁴
 - Companies formed to exploit mining resources (Minera Escondida, El Abra, Candelaria, Compañía Minera Disputada de Las Condes and Mantos Blancos). In most cases, foreign interests have a majority stake.
 - Natural resource-based manufacturing companies, primarily paper and pulp (Forestal Santa Fe and Compañía de Petróleos de Chile (Copec)). In many of these cases, the foreign investor has a minority stake.
- Emerging activities, which so far account for relatively little of the stock of FDI. Investors endeavour to gain access to segments of the domestic or regional market that have high growth potential, primarily in services and in some manufacturing activities. In some cases, they seek strategic elements (know-how) through partnerships or alliances with local companies.
 - Service companies that are the legacy of the foreign-debt conversion programmes and privatizations (Compañía de Teléfonos de Chile (CTC) and Empresa Nacional de Telecomunicaciones (Entel)) that took place in the 1980s. Foreign investors generally do not have majority stakes in these firms (see table I.20).
 - Manufacturing companies that also owe their present status to debt-conversion or the return to the private sector of companies that had to be placed under government supervision during the 1982 financial crisis (Industria Azucarera Nacional (IANS),³⁵ Compañía Cervecerías Unidas (CCU), Copec). In several instances, the domestic groups took the initiative in seeking partnerships with foreign investors.
 - Subsidiaries of transnational corporations that have maintained operations in Chile, focusing on one core activity and becoming more closely integrated with the parent company at the global level and with other subsidiaries at the regional level (Nestlé, Unilever and General Motors).
 - Heavily internationalized companies acquired by foreign investors in the wave of acquisitions of private companies that has swept the Chilean economy for the past two years (Enersis, Embotelladora Andina and Supermercados Santa Isabel).

³⁴ The main products exported by foreign-owned companies include: copper ore, pulp, fishmeal, methanol, gold, grapes and wood. These products represent 70% of total exports of this group of companies. In 1997, the four largest foreign-owned mining companies (La Escondida, Disputada, Candelaria and Mantos Blancos) generated 37% of total exports of copper and increased the proportion of ore refined in the country (Comisión Chilena del Cobre, 1998a).

³⁵ In the early 1990s, Continental Bank ceased to be a shareholder of IANS. Currently, the company has no foreign owner.

Table I.20
CHILE: MAIN PARTLY OR WHOLLY FOREIGN-OWNED COMPANIES, 1997
(Millions of dollars)

Company	Sector	Sales	Foreign investor	Foreign capital (%)	Home country	Exports
Cía de Petróleos de Chile (Copec)	Merchandising	3 048	Carter Holt Harvey	27	New Zealand	...
Enersis	Energy	2 815	Endesa-España	29	Spain	...
Escondida Ltda.	Mining	1 547	BHP, RTZ, JECO	100	Australia, United Kingdom, Japan	1 547
Telecomunicaciones de Chile (CTC)	Telecom.	1 437	Telefónica de España S.A.	44	Spain	...
Shell-Chile	Merchandising	1 046	Royal Dutch Shell	100	United Kingdom/Netherlands	2
Embotelladora Andina	Food	890	Coca-Cola Corp.	11	United States	0
Supermercados Sta. Isabel	Merchandising	755	Grupo Vélox (21%), Royal Ahold (16%)	37	Uruguay/Netherlands	0
Esso-Chile	Merchandising	700	Exxon Corporation	100	United States	1
Nestlé-Chile S.A.	Food	644	Nestlé AG	100	Switzerland	39
Gener Energy	Electrical Energy	614	Continental Bank Security Pacific	16	United States	0
Cía. Cervecerías Unidas (CCU)	Beverages	588	Paulaner	32	Germany	3
General Motors	Automotive	525	General Motors Corp.	100	United States	101
Minera El Abra	Mining	434	Cyprus Amax	51	United States	447
Disputada de Las Condes	Mining	403	Exxon Corporation	100	United States	278
Empresa Nacional de Telecomunicaciones (Entel)	Telecom.	378	Stet Telecom, Samsung	30	Italy/South Korea	272
Cía. Minera Candelaria	Mining	327	Phelps Dodge, Sumitomo	100	United States/Japan	327
Methanex Chile C. Ltda.	Chemistry	300	Methanex Corp.	100	Canada	285
Soprole	Food	295	Dairy Board	51	New Zealand	2
Mantos Blancos	Mining	276	Mininco	75	Luxembourg	276
Malloa Food ^a	Food	220	Unilever	100	United Kingdom/Netherlands	23
Minera Zaldívar	Mining	217	Placer Dome (50%), Outokumpu (50%)	100	Canada/Finland	217
Goodyear de Chile Saic	Tyres	215	The Goodyear Tyre & Rubber Co.	100	United States	57
Chile Tabacos	Tobacco	180	British American Tobacco	70	United Kingdom	30
Forestal Santa Fe	Paper and pulp	174	Royal Dutch Shell	100	United Kingdom/Netherlands	0
Cemento Melón	Cement	170	Blue Circle Ind. PLC	98	United Kingdom	0

Company	Sector	Sales	Foreign investor	Foreign capital (%)	Home country	Exports
CATECU	Footwear	156	Bata S.A.C.	100	Canada	2
Cemento Polpaico	Cement	150	Holderbank Financière Glaris Ltd.	54	Switzerland	0
Quebrada Blanca S.A.	Mining	149	Cominco, Teck Corp.	80	Canada	149
Mantos de Oro	Mining	133	Placer Dome	100	Canada	133
El Indio	Mining	120	Barrick Gold Corp.	100	Canada	88

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from *América economía*, 1997 and 1998; *The Chile Sourcebook*, 1994; *Major Companies of Latin America and the Caribbean*, 1998, London, Graham & Whiteside, 1998, and information from the companies themselves.

^a As of 1997, Unilever merged all its food companies into Malloa Alimentos S.A., except for ice cream.

The existence of abundant mining deposits in production and considerable reserves of ore has been the decisive factor in explaining the foreign investment inflows. Currently, more than 43% of the stock of FDI corresponds to mining investment. In 1997, approximately US\$ 1.63 billion was invested in mining, 33% of total investment (see figure I.13). Although mining has lost some of its relative importance, inflows recorded in 1997 were equivalent to those in 1994 and 1995, when investments in the sector reached record levels. From 1998 to 2000, that investment should translate into a 30% increase in production from foreign-owned copper deposit mining projects³⁶ (Comisión Chilena del Cobre, 1998b).

At present, in an economic climate with a sustained decline in international prices,³⁷ there has been no proliferation of new projects, and the foreign companies with operations in Chile have been forced to cut operating costs and at the same time increase efficiency to stay competitive. In this context, mining continued to receive substantial inflows of FDI, chiefly owing to the expansion of ongoing projects.

Nevertheless, mining companies such as Escondida, Candelaria and Cerro Colorado, currently in operation, have undertaken ambitious projects with a view to expansion. Construction of three large projects, Doña Inés de Collahuasi, Lomas Bayas and Pelambres (Moguillansky, 1998) has continued. Apparently these investors have incorporated the cyclic behaviour of copper prices into their investment programmes, utilizing periods of low prices to carry out the phases of financing and construction (or expansion) of plants and thereby causing the actual mining of the ore to coincide with periods of higher prices. The main projects currently underway include:

³⁶ Chile is currently the foremost exporter of copper ore, and with the projects in development, the country will generate two thirds of the increase in world copper production.

³⁷ In the mid-1980s, copper prices began to rise substantially and in 1988 exceeded the historical barrier of one dollar per pound. In that favourable international climate, a great many new mining projects were undertaken. In mid-1997, prices entered a period of steady decline, due to problems connected with the Asian crisis and the increase in the supply of ore once new projects had come on line.

- The Doña Inés de Collahuasi project, which after many changes of ownership began its present phase of development in mid-1996. It is believed that approximately US\$ 1.76 billion will be invested in it and that it will start operations in late 1998.
- Los Pelambres, an ore deposit that the Chilean group Luksic had mined on a medium scale until March 1998. Given the characteristics of the deposit, it was decided to expand production significantly; for that purpose the group entered into partnership with Japanese investors (see table I.21), who paid approximately US\$ 256 million for a 40% stake in the company. The project—in which approximately US\$ 1.3 million will be invested—entered the construction phase in the second half of 1997 and is expected to start commercial production in late 1999.
- Construction of the Lomas Bayas project began in January 1997 and was scheduled for commercial production to start in mid-1998, with an estimated investment of US\$ 224 million.

Table I.21
CHILE: PRINCIPAL FOREIGN INVESTMENTS, 1997
(Millions of dollars)

Company	Source country	Project	Amount
Mining			1 627
AngloAmerican/Falconbridge/Mitsui	South Africa/ Canada/Japan	Construction of project Doña Inés de Collahuasi	646
Broken Hill Proprietary (BHP) / Río Tinto Zinc (RTZ) / Mitsubishi	Australia/United Kingdom/Japan	Expansion of Minera Escondida	285
Westmin Resources Ltd.	Canada	Construction of Lomas Bayas project	162
Rio Algom Ltd.	Canada	Expansion of Cerro Colorado	142
Nippon Mining/Mitsubishi	Japan	Construction of Los Pelambres project	64
Other investments under US\$ 50 million			328
Electricity, gas and water			1 378
Endesa-España	Spain	Purchase of 29% of Enersis holding company	1 179
Power Market Development Company (PMDC) ^a	United States	Purchase of 25% of EMEL	119
Other investments under US\$ 50 million			80
Other services^b			1 487
Grupo Velox	Uruguay	Purchase of stake in Supermercados Santa Isabel	180
Banco Santander	Spain	Purchase of stake in Santander Chile Holding ^c	168
ING Latin American Holdings	Netherlands	Purchase of Cruz Blanca Seguros de Vida S.A.	125
Hong Kong & Shanghai Banking Co. (HSBC)	United Kingdom	Purchase of additional stake in Banco Santiago	79
American Life Insurance Co.	United States	Capital increase in Chilean subsidiary	63
ABN AMRO Bank	Netherlands	Capital increase in Chilean subsidiary	60
Other investments under US\$ 50 million			812

Company	Source country	Project	Amount
Manufacturing			495
Coca-Cola Corp.	United States	Purchase of 11% of Embotelladora Andina	98
Storrow Drive Corp. N.V./Rabobank	Netherlands	Establishment of agribusiness	50
Other investments under US\$ 50 million			347
Other sectors^d			54
Total FDI under Decree Law 600			5 041

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from Foreign Investment Committee of Chile, the Manufacturers' Association and financial publications.

^a PMDC is a subsidiary of Pennsylvania Power & Light Co. (PP&L).

^b Includes merchandising, construction, transport and communications.

^c Santander Chile Holding includes Banco Santander Chile, Santander Leasing, Santander Factoring, Fiscalex Ltda. and Bansander AFP.

^d Includes agriculture, fishing, forestry, construction, transport and communications.

In addition to mining, major investments have also been made in other natural-resource processing activities, especially agriculture, fishing and forestry. A substantial number of the foreign companies engaged in natural resource-based industrial activities entered the country in the late 1980s, taking advantage of debt conversion programmes. From 1985 to 1990, 40% of inflows under Chapter XIX were directed at the industrial sector, basically paper and pulp. Another 25% went towards primary activities related to agriculture, forestry, wood and fishing (Calderón and Griffith-Jones, 1995; Agosin, 1996).

Beginning in 1995, FDI in service activities showed a sharp increase³⁸ (see figure I.13). Through mergers and acquisitions, foreign investors increased their presence in the segments of the domestic market undergoing strong development and modernization, particularly financial services. An example of this strategy was the purchase of Banco Osorno by Banco Santander, which resulted in the country's largest bank (ECLAC, 1998a), and the acquisitions of Banco de Santiago and Cruz Blanca Seguros de Vida, and the sale of a 40% share in Seguros La Construcción to the British firm Royal & Sun Alliance for US\$ 122 million (see table I.21 and Cámara de Comercio de Santiago, 1998a). Moreover, due to the heavy concentration that is occurring in these markets, some of the foreign companies active in them have been forced to increase their capitalization.

In the case of telecommunications, a field in which the foreign presence dates back some years, technological advances and growing competition have forced operators to undertake ambitious investment programmes, in local as well as long-distance and cellular telephony. This is the case of Compañía de Teléfonos de Chile (CTC), a subsidiary of Telefónica de España, which plans to invest approximately US\$ 2.6 billion before the year 2000 to expand service and incorporate digital technology through a fibre optics system (SFF, 1998). Sharp

³⁸ Many of the investments recorded as FDI in the service sector corresponds to foreign capital investment funds and investment companies and are actually portfolio investments, but are included in CIE statistics because they enter the country under Decree Law 600.

competition in cellular telephony has forced the main operating companies to introduce new technologies —such as PCS (digital cellular)— with investments in excess of US\$ 300 million in the case of BellSouth (see chapter III).

In manufacturing, companies long active in the Chilean economy —since the era of import substitution— attempted to maintain their market share in the new economic climate of openness. In many cases, they focused their operation on one core business and became distributors of imported products.

Lastly, in 1997, a new phenomenon emerged: acquisition of large percentages of the capital stock of local companies with a presence in other markets of the region (Enersis, Supermercados Santa Isabel and Embotelladora Andina). This not only enabled the acquiring companies simultaneously to obtain a dominant position in different markets —which probably would have taken more time had they pursued a different expansion strategy— and attractive intangible assets (supplier networks, an established clientele, trademarks, technology and the like), but also to neutralize expanding competitors. In turn, the acquired company obtained greater financial backing and was incorporated into more complex and better developed international production networks (see box I.8). In 1997, 65% of the funds committed in mergers and acquisitions of Chilean companies came from foreign companies (Cámara de Comercio de Santiago, 1998a).

For 1998, foreign investment is expected to experience a slight increase, primarily due to the continuation of projects such as Collahuasi, Lomas Bayas and Pelambres. Concurrently, companies such as Escondida, Candelaria and Cerro Colorado, currently in operation, are in the process of expanding their facilities. In 1998, foreign investment in the mining sector is expected to be nearly US\$ 1.8 billion (Comisión Chilena del Cobre, 1998b).

According to figures from the Central Bank of Chile, approximately US\$ 2.534 billion entered the country in the first six months of 1998, representing a 31% increase over the US\$ 1.932 billion that entered during the same period a year earlier. If that trend continues, inflows could reach nearly US\$ 4.7 billion.

This trend is confirmed by the most recent estimates, which quantify FDI inflows at approximately US\$ 4.2 billion in the first eight months of 1998 (CEP, 1998d). Of these flows, 66% reportedly corresponds to acquisitions of local companies by foreign companies, 12% to privatizations of State-owned enterprises, 11% to expansions and another 11% to greenfield investment.³⁹ Most prominent among the acquisitions are the purchase of the Prosan company (toiletries and hygiene products) by Procter & Gamble, of the United States, for US\$ 375 million; the take-over of Banco BHIF by BBV with an investment of US\$ 350 million; and the acquisition of the food company Dos en Uno by the Argentine firm Arcor, for US\$ 200 million.

³⁹ In the first six months of 1998, 79% of the funds committed in mergers and acquisitions of Chilean companies came from foreign companies (Cámara de Comercio de Santiago, 1998).

5. Venezuela: from nationalization to the partial privatization of the petroleum industry

During the 1990s, FDI flows into the Venezuelan economy have been relatively abundant, albeit uneven. Between 1990 and 1996, an annual average inflow of approximately US\$ 1 billion was recorded, but it was not until 1994 that a sustained increase in these flows began to be seen. In 1997, FDI flows into Venezuela increased at an extraordinarily fast rate (133%) —the highest in the region— and totalled over US\$ 5.087 billion dollars (see table I.2).

Since the early 1990s, Venezuela has experienced major macroeconomic disequilibria and has had serious difficulties with its financial system, and this has affected inward FDI. In 1996, the economic authorities embarked upon a stabilization and structural reform programme (*Agenda Venezuela*). With the resulting improvement in the macroeconomic climate and in expectations, along with a notable expansion of the petroleum sector, economic growth reached 5.6% (ECLAC, 1998c).⁴⁰

According to official figures issued by the Superintendency of Foreign Investment (SIEX),⁴¹ which is the only source of information broken down by sector and geographical area, FDI began to be concentrated in the manufacturing sector in the mid-1970s owing to the attractiveness of the advantages offered by the country's import substitution strategy and the fact that investors were barred from many other activities (in particular those linked to the oil industry, which was nationalized in 1976). When the privatization programme was launched in 1991, the services sector started to take on greater importance (see figure I.15). During this period foreign investors acquired sizeable stakes in Compañía Anónima Nacional de Teléfonos de Venezuela (CANTV) and Venezolana Internacional de Aviación S.A. (VIASA).⁴²

Since the mid-1990s, the petroleum industry has been the main destination for FDI, although the statistics compiled by the Superintendency do not provide information on that sector. In 1992, increasing difficulties affecting the State-owned Petróleos de Venezuela (PDVSA) led the Government to open up this branch of activity.⁴³ Thus, 20 years after the

⁴⁰ FDI has had a significant impact on Venezuela's balance of payments position. Owing to the centralization of the external accounts of the State oil company and the treasury, it has also had a significant effect on public finances.

⁴¹ The FDI statistics recorded by SIEX differ significantly from those shown on the balance of payments as prepared by the central bank, particularly for the last three years. Even accounting for the fact that SIEX statistics do not include FDI in oil operations, they still appear to underestimate actual FDI inflows to Venezuela for the last few years.

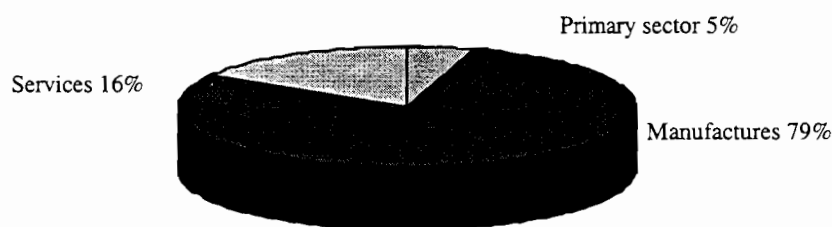
⁴² On 15 November 1991, a consortium formed by AT&T and GTE Corp. (both of the United States), Electricidad de Caracas, Telefónica de España and the Banco Mercantil won the bidding for a 40% stake in CANTV, for which it paid close to US\$ 1.86 billion. That same year, the Spanish company Iberia paid US\$ 60 million for a 60% share in VIASA. In 1997, the financially troubled VIASA had to be liquidated.

⁴³ Since its nationalization PDVSA has formulated a two-tier strategy aimed at internationalizing its production activities and expanding its domestic production capacity through an ambitious oil prospecting plan that was launched in 1985. Efforts to attain both these objectives were to be financed by the company's cash flow and through long-term borrowings on international markets. Since the mid-1980s, however, the fiscal crisis affecting the Venezuelan State has led it to cut back on the funding for this plan. Accordingly, the discontinuation of the tax

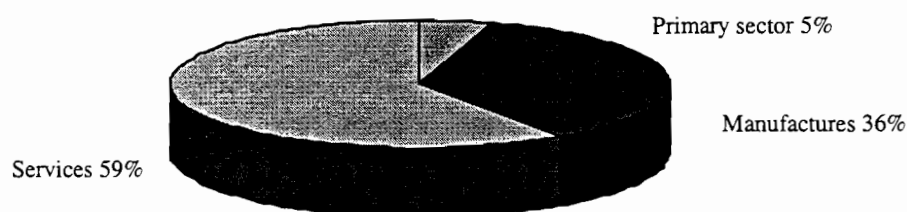
nationalization of the oil industry, the Venezuelan authorities are seeking to attract private capital, especially from foreign investors, to finance an ambitious 10-year expansion plan.⁴⁴

Figure I.15
VENEZUELA: SECTORAL DISTRIBUTION OF FOREIGN DIRECT INVESTMENT,
1979-1997
(Percentages)

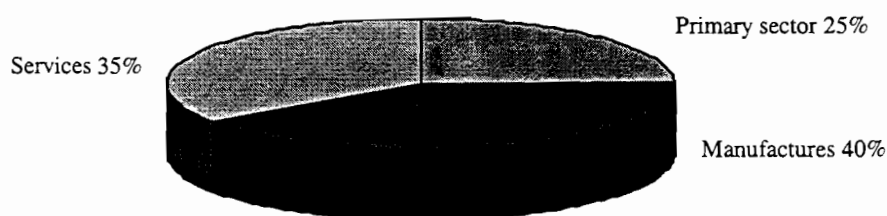
1979-1991 (US\$ 315 million)^a



1992-1996 (US\$ 760 million)^a



1997 (US\$ 665 million)



Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the Superintendency of Foreign Investment (SIEX).

^a Average annual flows. Not including oil investments.

scheme applying to the petroleum industry and the technological requirements associated with the exploration and development of new reserves prompted the authorities to begin opening up the petroleum sector.

⁴⁴ The oil industry accounts for 25% of GDP, 50% of fiscal revenues and 80% of exports.

In 1995, Venezuela was in the throes of a serious financial crisis and numerous banking institutions failed. In response to this situation, the Government facilitated the sale of some of the major Venezuelan banks to foreign financial institutions either through privatization (in the case of banks that had been placed in receivership) or by direct purchase from local entrepreneurs. This restructuring of the financial system, especially in the case of commercial banks, has played a fundamental role in the recent recovery of FDI flows into Venezuela.

The United States has been the principal source of inward FDI for the Venezuelan economy, at first in manufacturing, then in financial services and telecommunications (GTE Corp. and AT&T in CANTV) and, more recently, in the oil industry. Although the statistics on FDI suffer from a number of flaws, the available figures indicate that between 1992 and 1996 approximately 40% of inward FDI came from United States corporations (see figure 1.16), and this trend has probably strengthened further in recent years as a result of investment activity in the oil industry. European countries have concentrated on the financial sector and on some manufactures, while Japanese companies have poured most of their investments into metal manufactures. In addition, there has been a significant increase in investments from other Latin American countries.

In 1997, FDI flows were stimulated by the positive results of the stabilization programme, the revitalization of the privatization programme and, above all, the steps taken to open up the oil sector.⁴⁵ Privatization operations included the sale of 70% of Siderúrgica del Orinoco (Sidor) for US\$ 2.3 billion to a consortium made up, *inter alia*, of Hylsamex (Mexico), Siderar, Tamsa⁴⁶ and Techint (Argentina), and Usiminas (Brazil). In addition, in a trend similar to that seen in other Latin American countries, foreign investors have begun to acquire some Venezuelan companies.

In this context, the following strategic approaches seem to be characteristic of the recent pattern of foreign investors' involvement in the Venezuelan economy:

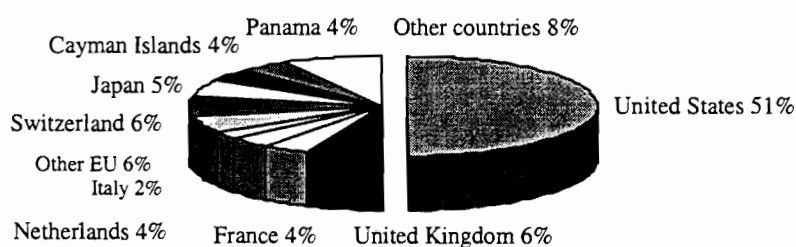
- Access to the exploration, development and processing of natural resources, mainly hydrocarbons (oil and natural gas), and some metallic minerals such as gold and nickel. Similarly, the availability of natural resources and energy and the country's proximity to the United States market make Venezuela an attractive location for the aluminium and the iron and steel industries.
- Access to the domestic market, particularly for service activities such as telecommunications and banking and for some oil-industry services. From a regional perspective and given the country's close relationship with Colombia, in particular, some manufacturing industries have concentrated their operations in Venezuela, notably in the case of vehicle assembly plants (see table I.22 and box IV.1).

⁴⁵ Some analysts have suggested that, above and beyond their effect on the capital account, recent FDI inflows will also have a strong impact on the trade balance by virtue of the substantial contribution they are making to the development of Venezuela's main foreign-exchange earner (Banco Central de Venezuela, 1997). Moreover, as stated previously, FDI in the oil industry is expected to have a major impact on public finances.

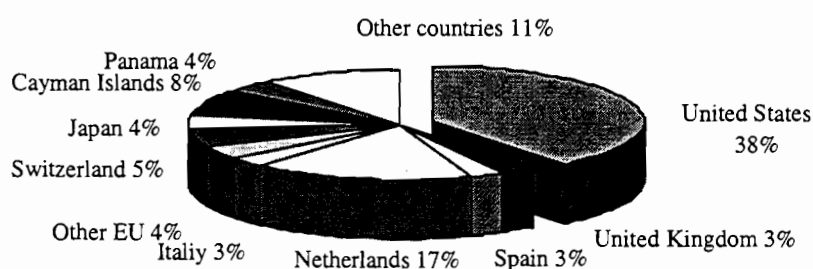
⁴⁶ Tamsa is a Mexican company belonging to the Techint group of Argentina.

Figure I.16
**VENEZUELA: GEOGRAPHICAL DISTRIBUTION OF SOURCES OF FOREIGN
 DIRECT INVESTMENT, 1979-1997**
(Percentages)

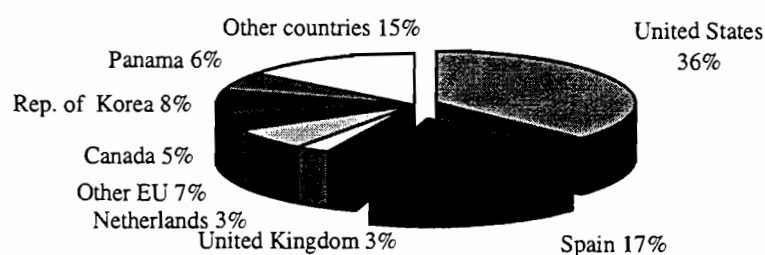
1979-1991 (US\$ 315 million)^a



1992-1996 (US\$ 760 million)^a



1997 (US\$ 665 million)^a



Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the Superintendency of Foreign Investment (SIEX).

^a Average annual flows. Not including oil investments.

Table I.22
VENEZUELA: MAIN PARTLY OR WHOLLY FOREIGN-OWNED COMPANIES, 1997
(Millions of dollars)

Company	Sector	Sales	Foreign investor	Foreign capital (%)	Home country	Exports
Compañía Anónima Nacional de Teléfonos de Venezuela (CANTV)	Telecom.	2 148	GTE Corp.	20	United States	...
Ford Motors de Venezuela	Automotive	704	Ford Motor Company	100	United States	157
Corporación Venezolana de Cementos SA (Vencemos)	Cement	462	Cemex S.A.	100	Mexico	...
Cigarrera Bigott Sucesores	Tobacco	410	British American Tobacco	100	United Kingdom	...
General Motors de Venezuela ^a	Automotive	393	General Motor Corp.	100	United States	79
Molinos Nacionales CA (Monaca)	Food	289	Multifoods Inc.	98	United States	...
Toyota	Automotive	230	Toyota Motor Corp.	100	Japan	...
Proagro	Food	209	Grupo Mendoza	...	Mexico	...
Parmalat	Food	190	Parmalat	100	Italy	...
Fiat Automóviles Venezuela	Automotive	183	Fiat Auto Spa.	100	Italy	...
Plumrose ^a	Food	170	The East Asiatic Company (EAC)	100	Denmark/ Singapore	...
Smurfit Cartón de Venezuela a	Paper and pulp	148	Smurfit Carton	100	Ireland	...
Siemens Niexdorf CA ^a	Electronics	130	Siemens AG	100	Germany	...
Nacional de Cementos	Cement	106	...	...	...	...
Bayer	Chemicals	98	Bayer AG	100	Germany	10
Nestlé Venezuela S.A. ^a	Food	97	Nestlé AG	100	Switzerland	...
Madosa	Electrical appliances	93	General Electric	...	United States	...
Tabacalera Nacional (Catana)	Tobacco	87	British American Tobacco	...	United Kingdom	...
Cervecera Nacional ^a	Beverages	40	...	...	...	...
Hoesch de Venezuela ^a	Chemicals	29	Hoesch AG	100	Germany	...

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management on the basis of information from the journal *América Economía* 1998; and *Major Companies of Latin America and the Caribbean*, 1998, London, Graham & Whiteside, 1998.

^a Information for 1996.

The measures adopted to open up the petroleum subsector have aroused great interest among international investors, and Venezuela thus hopes to attract over US\$ 30 billion in private investment over the next 10 years to finance close to 50% of the State petroleum company's investment programme (Bowen and Colitt, 1997). According to this plan, PDVSA will nearly double its output (6.5 million barrels per day) by the year 2005⁴⁷ in order to consolidate the

⁴⁷ Currently, Venezuela produces approximately 3.5 million barrels per day.

country's position as one of the world's leading oil producers. Venezuela has already supplanted Saudi Arabia as the leading supplier of petroleum to the United States. A number of different vehicles have been used for foreign investment in the petroleum industry during the 1990s based on the options offered by the PDVSA-led policy for opening up the subsector:

- Operating contracts for exploration and production in existing fields owned by PDVSA;
- Strategic associations for the production of crude and heavy oil in the Orinoco Belt; and
- Profit-sharing ventures for the exploration of new areas.

In 1992, the PDVSA Oilfield Reactivation Programme was launched to enable private (especially foreign) investors to bid on concessions to put abandoned oilfields in the Orinoco Belt back into production. Participants in this first round of bidding for operating contracts included the United States companies Chevron and Occidental, which to date have not reported encouraging results.

In 1995, PDVSA announced a new, ambitious 10-year expansion plan calling for a total investment of US\$ 65 billion; the aim of the plan is to raise output to 6.5 million barrels per day by the year 2005 (Castro, 1998). To achieve this goal, PDVSA has placed emphasis on the need to establish strategic alliances with the major transnational corporations in the industry. This led to the passage of the Petroleum Industry Liberalization Act, under which PDVSA is empowered to undertake profit-sharing joint ventures with private enterprises for the exploration, drilling and marketing of petroleum.

In January 1996, 10 oil concessions covering potential reserves totalling close to 7 billion barrels of high-grade medium and light crudes were put out to tender. Eight of the 10 oilfields on offer were awarded to 13 foreign firms and one Venezuelan company. The foreign companies included Mobil, Dupont-Conoco, Enron and Amoco (United States), Maxus Energy and Pérez Companc (Argentina), Veba Oel AG (Germany), Nippon Oil Exploration (Japan), Elf Aquitaine (France) and British Petroleum (United Kingdom).

In the third round of bidding, held in mid-1997, major oil transnationals paid out US\$ 2.06 billion dollars for operating contracts for 17 of the 20 oilfields placed on offer. The successful bidders included companies from the United States, United Kingdom, China, Saudi Arabia, Germany, Spain, Norway, Canada, Argentina and Venezuela.⁴⁸ The highest bids came from the British firm Lasmo PLC for the Dación oilfield (US\$ 453 million) and from Repsol, a Spanish company, for Mene Grande (US\$ 330 million). The winning consortia are expected to invest some US\$ 5 billion in the development of these fields between 1998 and 2002.

Among the other options proposed by PDVSA, foreign corporations have been especially active in negotiating profit-sharing arrangements for exploration and production of conventional crudes and in the formation of strategic associations to produce and upgrade heavy crudes in the

⁴⁸ Foreign companies that were awarded operating concessions include Pennzoil Exploration and Production, Chevron, Atlantic Richfield Company (ARCO), Phillips Petroleum, Union Texas Petroleum and Williams Companies (all of the United States); Pan Canadian Petroleum Limited and Carmanach Resources (Canada); Compañía General de Combustibles (CGC) and Pérez Companc (Argentina); Prevssag Energic (Germany); Repsol (Spain); Nimir Petroleum Co. (Saudi Arabia); Statoil (Norway); China National Petroleum Corporation (China); and Lasmo PLC (United Kingdom).

Orinoco Belt. The Government has approved six joint ventures with foreign firms to tap additional reserves of heavy crudes in that area for a total of US\$ 17 billion.⁴⁹ The largest such agreement led to the establishment of a joint venture by Corpoven (a subsidiary of PDVSA) and the United States companies ARCO, Phillips Petroleum and Texaco (Bowen and Colitt, 1997).

Some foreign companies have taken advantage of the recent opening of the domestic oil market and the opportunities offered by the outsourcing policy being pursued by PDVSA. As part of this policy, PDVSA is entering into subcontracting agreements with outside firms under which non-core activities (e.g., information systems infrastructure) are being transferred to the private sector.

Currently, oil production accounts for about 25% of GDP and, indirectly, another 9% also depends on the petroleum industry⁵⁰ (Colitt, 1998). More specifically, the buoyancy of the oil industry has started to spread to other sectors of the economy in which demand is directly or indirectly related to its performance. For example, the expansion of the oil industry has spurred various service activities (e.g., the hotel industry)⁵¹ and manufacturing industries (e.g., iron and steel and petrochemicals), thereby arousing the interest of foreign investors in acquiring a stake in these activities as well.

Venezuela's mining industry, which was the economy's most important sector until it was superseded by the petroleum industry (Venezuela used to be the world's leading gold producer), has shown signs of a strong revival with the start-up of the Las Cristinas project.⁵² This project involves an estimated investment of US\$ 600 million and could pave the way for other large-scale projects. The Mining Commission of the Venezuelan-American Chamber of Commerce estimates that investments in the mining sector may total between US\$ 3 billion and US\$ 4 billion. For example, through its Luxembourg subsidiary, Minorco, the South African transnational Anglo American Corporation recently launched a US\$ 450 million nickel-mining project.

Lured by the availability of inexpensive raw materials and electric power, several transnational corporations active in the petrochemical and iron and steel industries have decided to set up operations in Venezuela.⁵³

⁴⁹ The foreign companies which have teamed up with PDVSA include: Total S.A. (France), Exxon Corp., Atlantic Richfield Corp. and Coastal Corp. (United States), Veba Oel AG (Germany) and Statoil (Norway).

⁵⁰ For example, the State-owned PDVSA purchases 75% of its inputs and 90% of its services on the domestic market; 85% of the expenditures of Shell's Venezuelan subsidiary are also made locally (Colitt, 1998).

⁵¹ The United States hotel chain Embassy Suites estimates that in 1999, cities such as Maturín, Puerto Ordaz and Maracaibo, which have started to reap the benefits of the new oil boom, will need 15, 000 hotel rooms for business executives. It also forecasts a 73% occupancy rate at its new hotel in Caracas (Colitt, 1998).

⁵² The Las Cristinas gold mine is one of the largest projects in South America and is run by the Canadian company Placer Dome and the State-owned holding company, Corporación Venezolana de Guayana (CVG).

⁵³ The mining sector, iron and steel industry and petrochemical industry boast projects valued at over US\$ 10 billion.

- In the petrochemical industry, several of the major chemical transnationals, availing themselves of options offered by PDVSA, have appeared on the scene. For example, Mobil Chemical Co. has teamed up with Pequiven, a subsidiary of PDVSA, to undertake a US\$ 1.6 billion investment project for the construction of an olefins complex on the Caribbean coast. Koch Nitrogen Company, the Italian company Snam Progetti and the Venezuelan Empresas Polar will join with Pequiven in building and operating a US\$ 900 million fertilizer plant in the north-eastern portion of the country which should come on stream in the year 2000 (Colitt, 1998).
- In the iron and steel industry, the situation is very similar. A joint venture formed by Corporación Venezolana de Guayana (CVG) and a consortium led by the Japanese company Kobe Steel, along with Korean and Mexican investors, is constructing an iron reduction plant with an annual production capacity of 1 million tons at an estimated cost of US\$ 256 million. Production started in August 1998. A joint venture formed by the Australian company Broken Hill Proprietary (BHP) (50%), a privately-owned local company, Sivensa (30%), and the State-owned Ferro Minera Orinoco (20%) is investing US\$ 650 million in the construction of an iron briquette production facility that is to have a capacity of 2.2 million metric tons per year. All of this was in addition to the sale of Sidor to a consortium of Argentine, Brazilian, Mexican and Venezuelan investors.

The automotive industry is one of the main manufacturing activities. Given the country's low fuel prices (the lowest on the continent) and its excellent road system, several of the world's leading auto makers operate plants in Venezuela.⁵⁴ In the last few years, the automotive and auto-parts industries have grown so rapidly that Venezuela is now the largest producer of motor vehicles in the Andean Community.

Between 1996 and 1997, sales of vehicles assembled in Venezuela increased from 55,200 units to 131,121 units and imports jumped from 6,382 to 24,491 units. In 1997, General Motors had close to 30% of the market, followed by Ford, Toyota and Chrysler. Although production is intended mainly for the domestic market, exports —chiefly to Colombia and Ecuador— climbed by 34% in 1997, from 14,723 to 19,801 units.⁵⁵

The telecommunications industry is Venezuela's second-largest growth industry, after petroleum, contributing almost 4% to GDP. In 1997, telecommunications companies invested about US\$ 1 billion, and this trend is expected to continue over the coming years, since the largest firm in the sector (CANTV) is investing heavily in order to complete a national fibre-optics system before its national service monopoly ends in October 2000. Between 1991 and 2000, CANTV plans to have invested approximately US\$ 6 billion.⁵⁶ The cellular telephone

⁵⁴ Eight companies currently assemble vehicles in Venezuela: Chrysler, Fiat, Ford, General Motors, Hyundai, Mack, Mitsubishi and Toyota.

⁵⁵ In 1997 Ford was the leading exporter, accounting for about 50% of the industry's total exports (9,687 units), followed by General Motors (4,150 units) and Fiat (2,706 units).

⁵⁶ This process has intensified in the last few years. In 1997, CANTV invested some US\$ 593 million, or

market is dominated by Telcel Celular CA, which is owned by the United States company BellSouth. In 1997, this firm invested some US\$ 180 million in order to defend its market share, which is estimated at 65%.

Banking has been another important FDI destination. In fact, between late 1996 and 1997, foreign investors purchased 60% of this subsector. The privatization of Banco de Venezuela, Banco Consolidado and Banco Tequendama,⁵⁷ along with the purchase of private commercial banks by foreign investors, marked the entry of some of the region's most active banks into Venezuela's financial system (see table I.23).

Table I.23
**VENEZUELA: PRINCIPAL ACQUISITIONS OF LOCAL PRIVATE-SECTOR FIRMS BY
 FOREIGN COMPANIES, 1997**
 (Millions of dollars)

Company	Purchaser	Home country	Foreign capital (%)	Amount
Manufacturing				1 060
HIT de Venezuela	Panamerican Beverage Inc. (Panamco)	Mexico/ Panama	50	1 000
Brasme-Venezuela Timber	Sterling Worldwide Corp.	United States	...	40
Yukery	Novartis	Switzerland	100	20
Finance				428
Banco Provincial	Banco Bilbao Vizcaya (BBV)	Spain	40	370
Banco Mercantil	J.P. Morgan	United States	10	30
Seguros La Seguridad	Grupo Mapfre	Spain	...	28
Communications				150
Comunicaciones Telefónicas	Argenta Finance	Virgin Islands	...	150
Cellular Trading 3	Brightpoint	United States	100	...
Mining				...
Fesilven	Autlán	Mexico	70	...
Other services				...
P&T Servicios Petroleros CA	NQL Drilling Tools Inc	Canada	...	8
AJL Publicidad	Foote, Cone & Belding	United States	...	...

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from *América economía*, *The Wall Street Journal*, *Estrategia*, *Diario financiero*, *Latin Finance*, *Latin Trade* and other specialized journals.

In view of the above developments, it is reasonable to assume that the upswing in the Venezuelan economy's inward FDI flows will continue in 1998, thanks mainly to the level of investment that will be required for the operation of the oil concession awarded in mid-1997 and its positive impact on the rest of the economy. In fact, SIEX recorded US\$ 1.5 billion in FDI inflows to sectors other than the petroleum industry between January and August, which was

90% more than in 1996. For 1998, it plans to invest a total of US\$ 700 million.

⁵⁷ A 90% stake in Banco de Venezuela was bought by Banco Santander for US\$ 338 million; Banco Consolidado was acquired by a Chilean group, INFISA, for US\$ 154 million and Banco Tequendama went to Banco de Crédito del Perú for US\$ 100 million.

twice as much as was recorded for the entire year in 1997. Moreover, for the first half of 1998, the Banco Central de Venezuela published a figure of US\$ 2.207 billion, i.e., which is substantially higher than the US\$ 1.613 billion that entered the country during that period in 1997. Accordingly, inflows for 1998 on the order of US\$ 5 billion are expected to sustain the upward trend that began in 1996.

6. Peru: in search of more stable FDI flows

In recent years, Peru's FDI inflows have increased sharply, rising from an annual average of US\$ 30 million in the 1980s to more than US\$ 1.1 billion during the first half of the 1990s. Since 1994, annual inflows have exceeded US\$ 2.6 billion (see table I.2).

This significant upturn is attributable to the positive results of the structural adjustment and stabilization programme implemented by the Peruvian authorities, which has been one of the swiftest and most radical initiatives of its type in Latin America. The country's privatization programme has been of particular importance, since it has brought in about US\$ 8.4 billion through the sale of some 150 public-sector companies. Moreover, the new owners have committed themselves to making additional investments of about US\$ 7 billion for the expansion and modernization of the enterprises in question (*Latin Trade*, 1998a).

Peru has one of the region's most liberal foreign investment regimes. Foreign companies are guaranteed non-discriminatory treatment, access to all sectors of the economy, freedom to make capital and profit remittances as they see fit, and the opportunity to enter into a legal standstill agreement with the State that safeguards their investments in the country.

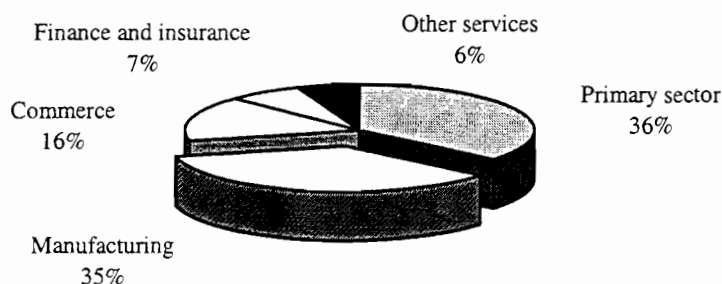
The statistics compiled by the National Commission on Foreign Investment and Technology (CONITE)⁵⁸ indicate that FDI flows have undergone major changes. During the 1980s these investment flows mostly went into manufacturing—in keeping with the import substitution model being applied at the time—and mining. In recent years, since the implementation of the above-mentioned reforms, foreign investors have focused on the services sector, particularly telecommunications, electric power generation and distribution, and the financial system (banking, pension fund management and insurance); as a result, these sectors have crowded out traditional activities such as mining (see figure I.17). Thus, the bulk of FDI flows have been generated by the investment commitments made as part of the various privatization agreements that have been signed.

⁵⁸ Under the current legislation (Decree 662), registration of foreign investments with CONITE is voluntary. Consequently these figures differ considerably from the estimates produced by the Central Reserve Bank of Peru when it prepares the balance of payments. Also, CONITE statistics classify investments from England, the British Virgin Islands, the Bahamas, Bermuda, the Cayman Islands and Scotland as coming from the United Kingdom. This can produce major distortions; in particular, investments from the United States and certain Latin American countries tend to be underestimated because they channel a significant proportion of their resources through those financial centres.

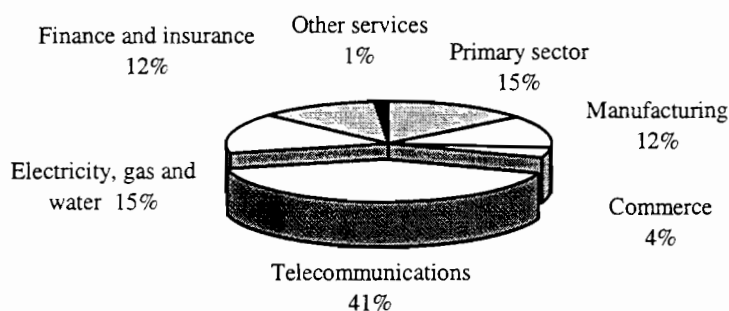
Figure I.17

PERU: SECTORAL DISTRIBUTION OF FOREIGN DIRECT INVESTMENT, 1980-1997
(Percentages based on annual averages)

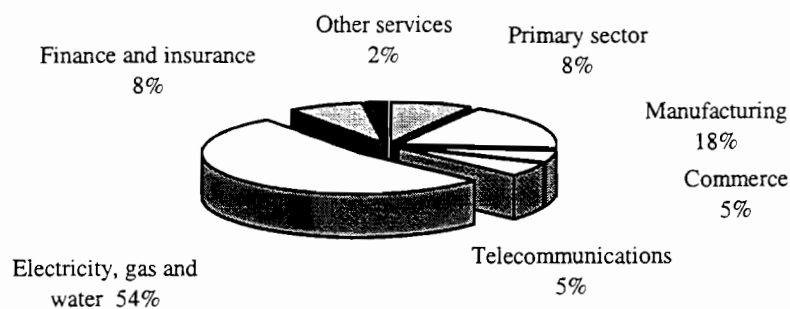
1980-1989 (US\$ 126 million)



1990-1996 (US\$ 703 million)



1997 (US\$ 1.003 billion)



Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the National Commission on Foreign Investment and Technology (CONITE).

Spain has overtaken the United States as the main source of inward FDI for Peru in recent years. During the period 1991-1997, Spanish investments represented more than 50% of total flows (see figure I.18). It should be borne in mind, however, that this figure is basically the result of a single transaction: the purchase by Telefónica de España of the Compañía Peruana de Teléfonos (CPT S.A.) and of the Empresa Nacional de Telecomunicaciones (ENTEL S.A.) (see box I.9). In recent years, the United Kingdom, the Netherlands, Chile and China have joined Spain as new and major sources of FDI in Peru.

Box I.9

PRIVATIZATION OF TELEPHONE SERVICES IN PERU

In February 1994 the country's largest telecommunications companies were privatized. Telefónica de España bought 35% of the Empresa Nacional de Telecomunicaciones (Entel) and of the Compañía Peruana de Teléfonos (CPT S.A.), which merged under the name of Telefónica del Perú.

This US\$ 2 billion transaction accounted for nearly 30% of the country's total FDI for 1997. Once in private hands, Telefónica del Perú invested more than US\$ 2.5 billion to expand its cellular phone, cable television, Internet connection and satellite communications services.^a As a result of this ambitious investment programme, the number of lines has tripled in just over three years.

The investments planned for 1995-1998 total US\$ 2.033 billion and are intended to prepare the company for the opening of the sector in June 1999, when Telefónica del Perú's exclusive control of the market for basic telephone service (local and long distance) was originally due to expire. By mutual agreement, the company's monopoly position was brought to an end one year before the date provided for in the original contract.

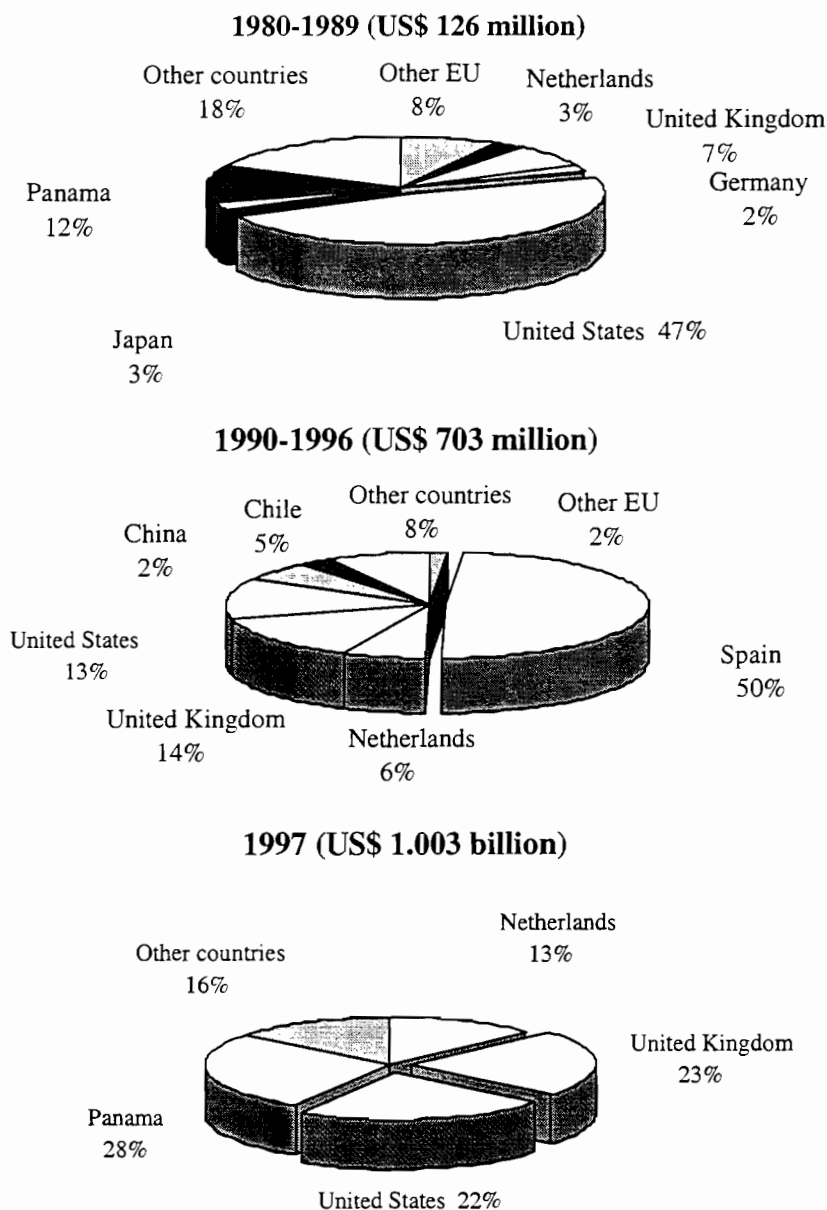
The establishment in March 1998 of an alliance among Telefónica de España, Worldcom and MCI bolstered the viability of the planned megaproject to set up a 7,000-kilometre pan-American fibre-optics telephone network which will span the entire Pacific and Caribbean coast, connecting up Chile, Peru, Ecuador, Colombia, Venezuela, Panama and the United States, and will also serve Argentina and Bolivia via land-based fibre-optic links. This is a vitally important project for Telefónica del Perú, since it will be in charge of operating and managing the Pan-American Cable System, for which it has pledged about US\$ 40 million of the US\$ 304 million required for the system's development.

^a *Latin Finance*, "Telecommunications and technology in Latin America 1995", No. 70, Coral Gables, Industry Supplement, September 1995.

In 1997, a sharp contraction was seen in FDI inflows owing to the slackening pace of the privatization process as the most attractive assets were sold off, the negative impacts of El Niño and the repercussions of the Asian crisis, which had a particularly harmful effect on the international prices of some of the country's export products. Given this situation, more than half of total inward FDI was generated by the privatization and modernization of the electric power sector. Almost two thirds of these investments came from just three countries: Panama,⁵⁹ the United Kingdom and the United States (see figure I.18).

⁵⁹ The investment registered as being from Panama is a capital contribution to the consortium Generandes S.A., the owner of 60% of the Empresa de Generación Eléctrica de Lima (EDEGEL), which is controlled by the companies Entergy Corp. (United States) and Endesa (Chile).

Figure I.18
**PERU: GEOGRAPHICAL DISTRIBUTION OF SOURCES OF NET FOREIGN
 DIRECT INVESTMENT, 1980-1997**



Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the National Commission on Foreign Investment and Technology (CONITE).

The main objectives of the strategies being used by foreign investors in the Peruvian economy can thus be summed up as follows:

- To gain access to natural resources, especially mineral resources for export and, more recently, hydrocarbons to meet the increasing domestic (and regional) demand for energy.
- To gain entry into domestic markets that offer high rates of return and growth potential, particularly telecommunications, electric power generation and distribution, and finance.

Peru is one of the world's seven richest countries in terms of its endowment of mineral resources; it is estimated to have between 10% and 20% of the world's copper and silver reserves (Roca, Avolio and Simabuko, 1998), and it is the world's eighth largest gold producer. Even though only about 12% of Peru's mineral potential is currently being tapped, mining generates half of the country's exports. Between 1995 and 2000, according to some estimates from sources in Peru's private sector, foreign enterprises will invest about US\$ 6.4 billion in the development of deposits of copper, gold and other metals, which should lead to an increase in exports of 70% by the year 2003⁶⁰ (*El Mercurio*, 1998a). To date, only US\$ 500 million (for the modernization of Southern Peru Copper Corp.) of these planned investments has actually been received, however.

In the early 1990s, Peru's mining industry was dominated by State-owned and foreign enterprises, with each of these categories accounting for about 35% of output. All the State-owned mining operations have now been transferred to the foreign private sector.⁶¹ Mining companies are prominent among the principal foreign corporations active in Peru (see table I.24) and include Southern Peru Copper Corp., Cerro Verde, Tintaya and Yanacocha; the latter is South America's leading gold exporter and has the largest reserves in the region (*The Economist Intelligence Unit*, various issues, 1998). Another important firm in this sector is the Chinese company Shougang-Hierro Perú, which was privatized in 1992 and is Peru's biggest iron producer.

These developments have resulted in a large increase in both investment inflows to the mining sector and applications for mineral exploration and operating concessions (Roca, Avolio and Simabuko, 1998). Of the 92 enterprises currently engaged in exploration programmes, 80 are foreign. It is estimated that investments for this purpose will remain at around US\$ 300 million per year as deposits are discovered, reserves determined and new mining operations begun, and will later fall to about US\$ 100 million.

⁶⁰ According to some estimates, the composition of Peru's future mineral exports will be as follows: copper, 36%; gold, 22%; zinc, 21%; lead, 9%; iron, 6%; and other metals, 8% (Roca, Avolio and Simabuko, 1998).

⁶¹ The largest transfers (all to foreign companies) include: Tintaya (US\$ 227 million), Cerro Verde (US\$ 35 million), and the refineries in Ilo (US\$ 67 million) and Cajamarquilla (US\$ 193 million). Other transactions which have generated less income for the State but which involve major investment commitments include: Quellaveco (US\$ 562 million), La Granja (US\$ 475 million) and Antamina (US\$ 2.52 billion). All these projects will be carried out by foreign enterprises. At this point, Centromin and some assets of Minero Perú still remain to be privatized.

Table I.24
PERU: MAIN PARTLY OR WHOLLY FOREIGN-OWNED COMPANIES, 1997
(Millions of dollars and percentages)

Company	Sector	Sales	Foreign investor	Foreign capital (%)	Home country	Exports
Telefónica del Perú	Telecom.	1 426	Telefónica de España S.A.	35	Spain	0
Southern Peru Copper Corp.	Mining	825	Southern Peru Copper Corp.	100	United States	768
Alicorp	Food	560	Birmingham Merchant S.A.	10	United Kingdom	...
Empresa de Distribución Eléctrica de Lima Norte S.A. (Edelnor)	Electric power	304	Enersis (33%), Endesa-España (18%)	60	Chile/Spain	0
Luz del Sur S.A.	Electric power	300	Chilquinta (36%), Hydro Ontario (24%)	60	Chile/Canada	0
Empresa de Generación Eléctrica de Lima S.A. (Edegel)	Electric power	...	Entergy Corp. / Endesa	60	United States/Chile	0
Empresa de Generación Eléctrica Nor Perú (Egenor)	Electric power	...	Dominion Energy	60	United States	0
Minera Yanacocha	Mining	249	Newmont Mining	51	United States	...
Nestlé Perú	Food	240	Nestlé AG	100	Switzerland	...
Minera Cerro Verde	Mining	220	Cyprus Minerals	100	United States	220
Occidental Petroleum Co. of Peru	Petroleum and natural gas	...	Occidental Corp.	100	United States	...
Minera Tintaya	Mining	210	BHP	100	Australia	220
Procter & Gamble de Perú	Hygiene and cleaning products	169	Procter & Gamble	100	United States	...
Cargill del Perú S.A.	Food	155	Cargill Incorporated	100	United States	...
Shougang-Hierro Perú	Mining	150	Shougang Corp.	100	China	150
IBM del Perú	Computers	...	IBM Corporation	100	United States	...
Cía. Oleaginosa del Perú (COPSA)	Food	107	Bunge & Born	...	Argentina	...
Toyota del Perú	Automotive	...	Toyota Motor Corp. / Mitsui	90	Japan	...
Tele 2000	Telecom.	75	BellSouth	59	United States	0
Goodyear del Perú	Tyres	75	Goodyear Tyre & Rubber Co.	100	United States	...

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from *The Peru Inc. Sourcebook 1995*; *Economática*, 1998; and *Major Companies of Latin America and the Caribbean*, 1998, London, Graham & Whiteside, 1998.

In 1997 expectations were running high that some of the major investment plans announced in previous years would get under way; most of these plans involved mining projects, such as: Antamina (Rio Algom-Canada), Quellaveco (Mantos Blancos-Chile/South Africa) and La Granja (Cambior-Canada). Nonetheless, projects such as Quellaveco and La Granja were postponed. In September 1998 the decision was made to start up the Antamira project, with investments exceeding US\$ 2.5 billion (see table I.25). Should the international situation improve, investments in the mining sector are likely to rise to about US\$ 1 billion per year.

Table I.25
PERU: PRINCIPAL FOREIGN INVESTMENTS, 1997
(Millions of current dollars)

Company	Foreign investor	Foreign capital (%)	Source country	Amount
Energy				335
Empresa de Generación Eléctrica de Lima S.A. (Edegel)	Entergy Corp./Endesa	60	United States/ Chile	235
Empresa Eléctrica Piura	Endesa-España	...	Spain	59
Manufacturing				227
Industrias Pacocha S.A.	Unilever	50	United Kingdom	72
D'Onofrio S.A.	Nestlé S.A.	99	Switzerland	71
Paramonga	Lehman Brothers Holding	...	United States	25
Alicorp	Bimbo	...	Mexico	16
Molino Italy	Empresas Carozzi S.A.	99	Chile	16
Pavco del Perú S.A.	Amindus Holding AG	...	Switzerland	11
Other investments under US\$ 10 million				16
Mining				156
La Oroya	Doe Run Co.	100	United States	121
Minera Cerro Corona	Arequipa Resources	100	Canada	30
Minera Quellaveco	Minera Mantos Blancos	100	South Africa	5
Telecommunications				110
Tele 2000	BellSouth	59	United States	110
Services				110
Santander Perú Holding	Banco Santander	100	Spain	25
Supermercados Scala	Santa Isabel	100	Chile	21
Banco Sudamericano	Bank of Nova Scotia	25	Canada	17
Mobil Oil del Perú S.A.	Mobil Oil Inc.	100	United States	15
Other investments under US\$ 10 million				32

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the National Commission on Foreign Investment and Technology (CONITE) and financial publications.

Although hydrocarbons production in Peru appears to have passed its prime and to be on the decline,⁶² the potential for exploration is still enormous. In fact, as noted in a recent study, Peru is the world's sixth most attractive country for international petroleum companies, surpassed only by Venezuela, the United Kingdom, Argentina, Indonesia and Australia (Roca, Avolio and Simabuko, 1998). The Peruvian authorities have granted concessions to 16 foreign consortia to drill 100 exploratory wells over the next six years, at a total investment of around

⁶² Having once been an oil-exporting country, Peru is now a net importer of petroleum.

US\$ 670 million. Crude oil production is currently controlled by the United States company Occidental Petroleum Corp. (43%) and the State-owned Peruvian company *Petróleos del Perú* (*Petroperú*).⁶³ However, the discovery of the Camisea natural gas deposits has radically altered the outlook for Peru's energy sector, and it is thought that this may attract some US\$ 4 billion in investment over the next five years (see box I.10).

Box I.10

CAMISEA: A MEGAPROJECT FOR THE FUTURE

The Camisea natural gas fields are the biggest hydrocarbon deposit ever to be discovered in Peru and one of the largest in all of South America. The deposit is estimated to contain 13.5 billion cubic feet of natural gas reserves and 725 million barrels of condensates. It was discovered in 1985 by Shell of the Netherlands in a heavily forested area 600 kilometres north of Lima.

On 17 May 1996, the Shell-Mobil consortium and the Government of Peru signed a contract licensing the consortium to develop the deposit in two stages. During the first stage, engineering studies were to be conducted to determine the characteristics of the deposit and the amount of recoverable liquid condensates it contains; the consortium was also to begin a feasibility study regarding the transport-related aspects of the project. The second phase is to include the construction of the necessary infrastructure for processing the natural gas and condensates and transporting them to the city of Lima. The first stage of the project was begun, and the consortium invested about US\$ 250 million in the venture. However, before the deadline set for confirmation that the scheduled activities would be carried forward, Shell and Mobil withdrew from the project, citing the considerable decrease in the undertaking's rate of return caused by an increase from US\$ 2.5 billion to US\$ 4 billion in the required investment.

The international consortium had sought to negotiate an arrangement under which the natural gas from Camisea could be exported to the Brazilian market via Bolivia while postponing fulfilment of its obligation to supply the city of Lima, as stipulated in its contract with the Government. From the consortium's point of view, rising costs and Peru's underdeveloped market for natural gas made the operation unviable, whereas selling the natural gas in Brazil's swiftly-growing market would be a profitable venture. The consortium also wanted the project to be vertically integrated, meaning that it would be involved in the extraction, transport and distribution of the fuel. Another bone of contention between it and the Government was their difference of opinion regarding how much to charge electricity companies for the natural gas. Since these difficulties were not overcome, Shell and Mobil pulled out of the project.

The withdrawal of the consortium created openings for other companies interested in the project, including YPF, Repsol, Exxon, Texaco, Chevron, Enron and Petrobras, to begin talks with the Government of Peru.

The privatization process has opened up new opportunities in areas of activity which had previously been off-limits to foreign private enterprise. One such case is telecommunications, a sector which has become the main destination for FDI in recent years (see figure I.17), primarily as a consequence of the purchase of the *Compañía Peruana de Teléfonos* by *Telefónica de España* for more than US\$ 2 billion (see box I.9).

The scarcity of fixed telephone lines has given a considerable boost to cellular phone services, with growth exceeding 100% in 1997. The Peruvian mobile telephone market is

⁶³ Plans for the privatization of *Petroperú* provided for it to be broken up into 26 operational units which were then to be sold off separately. The process began in May 1996 with the sale of 60% of the La Pampilla refinery for US\$ 181 million to a consortium consisting of Repsol (Spain), YPF (Argentina) and Mobil (United States), among others; and the granting of concessions on blocks 8 and 8X to a group which included Pluspetrol (Spain) and Daewoo (Republic of Korea), for US\$ 142 million.

controlled by two foreign companies: the Moviline division of Telefónica del Perú and Tele 2000, 59% of which is owned by the United States company BellSouth (see chapter III). Tele 2000 won a 20-year concession to provide cellular phone services in the country's provinces and plans to invest more than US\$ 200 million in the network⁶⁴ (*The Economist Intelligence Unit*, various issues, 1998). In 1998, after the monopoly held by the Spanish-owned Telefónica del Perú was terminated ahead of schedule, BellSouth decided to expand its investment plan substantially so that it could move into the market for fixed telephone services.⁶⁵

Between 1995 and 1997, the privatization of electric power generation and distribution provided more than US\$ 3.5 billion in revenues, and in 1997 the proceeds amounted to 53% of net FDI inflows (see figure I.17). The largest-scale transfers in the energy sector have taken place since 1994, as the various components of Electrolima are sold off.⁶⁶ In addition, the United States company Dominion Energy paid US\$ 228 million for 60% of the Empresa de Generación Eléctrica Nor Perú (Egenor). These transactions have added to Spanish, United States and Chilean investors' importance as sources of inward FDI for Peru (see figure I.18).

In the financial services sector, international investors —particularly Spanish institutions such as Banco Santander, Banco Bilbao Vizcaya (BBV), Banco Central Hispano (BCH) and Mapfre Seguros— have increased their share of the Peruvian market as part of their regional positioning strategy. The main formula they have used to do so is the purchase of local banking institutions. Such transactions include the acquisition of Banco Continental by BBV for US\$ 256 million, the sale of Banco Mercantil de Perú to Banco Santander for US\$ 42 million and the purchase of Banco del Sur de Perú by HSBC for US\$ 14 million.

Investments in manufacturing have been relatively limited; the most important operations of this type have included the privatization of iron and steel and petrochemicals companies (see figure I.17). In recent years, acquisitions have often been used as a strategy for gaining control of local companies, as in the case of the British firm Inchcape Overseas Ltd., which purchased Embotelladora Latinoamericana. In 1997, a number of notable transactions were conducted in the food industry by Nestlé and Unilever (see table I.25).

⁶⁴ Tele 2000 is installing 500 km of coaxial cable and another 100 km of fibre optics for cable television and data transmission; this infrastructure is essential if it is to take advantage of the steps being taken to open up the market for basic and long-distance telephone services.

⁶⁵ Telefónica de Perú and the Government brought forward to 1 August 1998 the expiration of the fixed-telephone monopoly which the firm had held since 1994; originally, this monopoly had been due to end in June 1999. These changes took telecommunications companies by surprise, forcing them to restructure their investment plans. BellSouth was one of the most severely affected firms. For its part, Telefónica del Perú has introduced a new product, the "popular telephone", with which it hopes to increase its market share rapidly.

⁶⁶ These operations include the transfer of 60% of the Empresa de Distribución Eléctrica de Lima Norte (Edelnor), which was sold for US\$ 176 million to the consortium formed by the Chilean firms Enersis (29%) and Chilectra (26%), the Spanish firm Endesa (30%) and other local investors; 60% of the Empresa de Distribución Eléctrica de Lima Sur (Edelsur, or Luz del Sur), sold for US\$ 212 million to the consortium consisting of the Chilean company Chilquinta (60%) and the Canadian firm Hydro Ontario (40%); and 60% of the Empresa de Generación Eléctrica de Lima (Edegel), bought for US\$ 524 million by the United States company Entergy Corp., together with the Chilean firm Endesa and other local investors.

According to projections made by the Peruvian authorities, the estimated total of medium- and long-term investment commitments is a little over US\$ 14.3 billion (CONITE, 1998a), with most of this being concentrated in mining (copper and gold) and natural gas (see table I.26).

Table I.26
PERU: PLANNED INVESTMENTS OVER THE NEXT 10 YEARS
(Millions of dollars)

Company	Project	Sector	Source country	Amount
... ^a	Camisea ^b	Petroleum and natural gas	...	4 000
Rio Algom, Noranda, Teck	Antamina	Mining	Canada	2 520
Cambior Inc.	La Granja	Mining	Canada	2 300
Shell Occidental, others		Petroleum and natural gas	United States	780
Cyprus Amax Minerals Co.		Mining	United States	683
Manufacturera de Papeles y Cartones		Paper and pulp	Chile	600
Mantos Blancos S.A.	Quellaveco	Mining	South Africa	560
Repsol	La Pampilla	Petroleum and natural gas	Spain	515
Southern Peru Copper Corp.	Ilo and others	Mining	United States	500
Three megaprojects (> US\$ 2 billion)				8 820
Six medium-sized projects (> US\$ 500 million)				3 638
83 projects (< US\$ 500 million)				5 682
Total future investments				18 040

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the National Commission on Foreign Investment and Technology (CONITE) and financial publications.

^a The Shell/Mobil consortium withdrew from the project.

^b To improve the viability of the project, the Government of Peru plans to divide it into four parts: extraction, transport, marketing and electric power.

The main foreign investment projects undertaken in recent years have included three projects that exceed the US\$ 2 billion mark:

- Development of the Camisea natural gas deposits, which, according to estimates prepared by Shell and Mobil Oil,⁶⁷ will require about US\$ 4 billion (see box I.10).

⁶⁷ This investment project is now being renegotiated following the withdrawal of the Shell-Mobil consortium.

- Mining of the Antamina mineral deposits by a consortium consisting of the Canadian firms Rio Algom Ltd., Noranda Inc. and Teck Corporation; this operation will require investments totalling about US\$ 2.52 billion.
- Development of the La Granja mineral deposits by the Canadian firm Cambior International, which is expected to invest some US\$ 2.3 billion.

Falling international prices for copper and other minerals, together with reduced purchases by the Asian countries, may slow the development of some of these projects, however. In point of fact, the Quellaveco and La Granja projects have already been postponed (*América economía*, No. 131, 1998, p.12). The outlook for gold production seems better, however, since despite the downturn in gold prices in international markets, the low production costs of the main companies operating in Peru make this activity profitable. The most interesting project starting up in this area is the Pierina mine, which is owned by the Canadian company Barrick Gold Corp. (*América economía*, No. 135, 1998, p. 20).

In 1998, the sale by the State of its stakes in partially privatized companies will be a major source of FDI inflows. Holdings to be sold during the second half of 1998 include 19% of Banco Continental, 30% of Edegel, the electric power generating company, and 30% of Edelnor, an electric power distribution company (*América economía*, No. 129, 1998, p. 79). According to estimates from the central bank, about US\$ 1.5 billion in FDI entered Peru during the first half of 1998, and by the end of the year the figure is expected to reach US\$ 3 billion. Thus, if work begins in the coming years on the ambitious projects that have been announced, Peru is likely to be the recipient of a plentiful and stable flow of inward FDI of a very different nature from the investments received in recent years, most of which have been generated by the country's privatization programme.

C. INTRAREGIONAL INVESTMENT: A NASCENT PROCESS IN LATIN AMERICA AND THE CARIBBEAN

Although it has increased considerably in recent years, intraregional investment is a process that is still in its early stages. Capital movements for investment purposes are very difficult to quantify, owing to a lack of adequate records. It is in fact in the area of intraregional investment that the shortcomings of the statistical information available on direct investment flows are most clearly apparent.

A rough approximation can be arrived at by analysing the data for direct investment outflows recorded in the balance of payments of Latin American countries and systematized by the International Monetary Fund (IMF). In this way certain representative facts can be ascertained:

- In aggregate terms, IMF reports around US\$ 12.745 billion in direct investment originating in the countries of Latin America between 1990 and 1996, a figure that represents around 8% of FDI flows in the region.

- In 1997, Latin American investment abroad totalled US\$ 4.358 billion, the most active countries being Chile (US\$ 1.95 billion dollars), Colombia (US\$ 791 million) and Venezuela (US\$ 476 million). The paucity of the contribution made by Argentina, Brazil and Mexico is striking, and reveals how difficult it is to obtain statistical information, since major companies from these countries do make large investments abroad, not only in Latin America but also in the United States and Europe.
- Intraregional investment has taken place on a much smaller scale in Latin America and the Caribbean than among the developing economies of Asia. Of particular importance in the latter region are the China factor and the investments of the Republic of Korea, Singapore, Malaysia and Hong Kong among each other and in other economies of the subregion such as Indonesia, Taiwan, Province of China and the Philippines.⁶⁸

Although the aggregate statistics do not reflect this, the expansion and diversification of trade within the region has been matched by substantial growth in investments between the countries of the region. This process has been facilitated by:

- The easing or lifting of restrictions on foreign capital;
- Privatization schemes;
- Progress in regional integration, especially in Mercosur;
- Strategic sectoral agreements between enterprises in different countries;
- Revised market penetration strategies that include establishing production activities or buying up local competitors.

Information published in the financial press can provide a better idea of the scale and dynamics of this process. In the period 1990-1996, according to some very preliminary estimates that do not include Mexican investment, intraregional investment flows were in excess of US\$ 7.5 billion (*América economía*, March 1997, p. 15). Within this total, Chile was the most active investor country with some US\$ 4.3 billion, followed by Brazil (US\$ 935 million) and Argentina (US\$ 900 million). The main destinations were Argentina and Peru—which received some US\$ 4 billion and US\$ 1 billion, respectively, from Chile— followed by Venezuela, which received some US\$ 600 million from Colombia.

It has thus been possible to identify three main focal points of investment within the region: the Southern Cone (Mercosur, Bolivia, Chile and Peru), especially the active internationalization of Chilean firms; Mexican investments, particularly in Central America and in some member countries of the Latin American Integration Association (LAIA) (Argentina, Chile, Colombia and Venezuela); and, albeit on a much smaller scale, the investments between Colombia and Venezuela.

Where Latin American investors are concerned, the most common method for entering new external markets has been to buy up existing assets in the sector industries in to which they have their core business. Investments to establish new companies abroad have been less frequent, and it would seem that most such investments are made in order to implement major projects for energy integration, exploration and development of oil and gas reserves and certain

⁶⁸ In East and South-East Asia, some data show that intraregional investment is more important than trade as a force for integration between the countries of the subregion (Stallings, 1995 and 1998).

manufacturing activities (especially in the case of Argentina). Thus, a good estimate of the funds committed by Latin American investors in pursuit of internationalization strategies within the region can be arrived at by measuring their involvement in privatization and acquisition of private assets (see table I.27).

Table I.27
**LATIN AMERICA AND THE CARIBBEAN: FOREIGN DIRECT INVESTMENT
 WITHIN THE REGION, BY MODALITY AND SOURCE COUNTRY, 1997**
 (Millions of dollars)

Home country	FDI in purchases of private assets		FDI in purchases of State assets		Total FDI for asset purchases	
	Amount	Percentage	Amount	Percentage	Amount	Percentage
Argentina	794	22.8	1 185	24.3	1 979	23.7
Bolivia	0	0.0	6	0.1	6	0.1
Brazil	380	10.9	115	2.4	495	5.9
Chile	621	17.8	2 535	51.9	3 156	37.7
Colombia	0	0.0	7	0.1	7	0.1
Costa Rica	2	0.1	0	0.0	2	0.0
Mexico	1 532	44.0	690	14.1	2 222	26.6
Peru	0	0.0	100	2.0	100	1.2
Venezuela	151	4.3	247	5.1	398	4.8
Latin America and the Caribbean	3 480	100.0	4 885	100.0	8 365	100.0

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from international financial publications, including *América economía*, *Expansión*, *The Wall Street Journal*, *Estrategia*, *Diario financiero* and *Latin Finance*.

In 1997, the amount spent by Latin American investors in acquiring shares in privatized companies and buying up local companies in different countries of the region totalled US\$ 8.365 billion (see table I.27). Of these funds, 58% came in by way of privatization programmes and the remaining 42% was used to buy up existing companies in private hands. The information provided shows that Chile (38%), Mexico (27%) and Argentina (24%) were the most active Latin American investors, accounting for around 88% of all funding for the transactions identified. Methodological problems notwithstanding, these provide a better idea of the intraregional investment process.

The main destinations for Latin American investment in 1997 were Venezuela (39%), Brazil (23%), Colombia (19%) and Argentina (11%), most of the activity being accounted for by the expansion of Chilean electricity companies in Brazil and Colombia, usually in association with Spanish firms, and of Argentine and Mexican iron and steel producers in Venezuela. The country where inward investment by Latin American companies was most diversified, in terms of both source and economic activity, was Argentina (see table I.28).

Table I.28

**LATIN AMERICA AND THE CARIBBEAN: FOREIGN DIRECT INVESTMENT
WITHIN THE REGION, BY SOURCE AND DESTINATION COUNTRIES, 1997**

(Millions of dollars)

Source/destination	Argentina	Bolivia	Brazil	Chile	Colombia	Peru	Venezuela	Total
Argentina	...	265	590	180	...	...	936	1 979
Bolivia	...	...	...	6	...	...	...	6
Brazil	380	...	...	...	...	...	115	495
Chile	221	...	1 337	...	1 315	139	154	3 156
Colombia	...	...	...	...	...	...	7	7
Costa Rica	...	...	...	...	...	...	...	2
Mexico	232	...	20	...	...	...	1 802	2 222
Peru	...	...	...	...	...	...	100	100
Venezuela	118	...	...	9	271	...	...	398
Latin America and the Caribbean	941	265	1 947	195	1 586	139	3 293	8 365

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from international financial publications, including *América economía*, *Expansión*, *The Wall Street Journal*, *Estrategia*, *Diario financiero* and *Latin Finance*.

Changes of ownership were highly concentrated among just a few subsectors (electricity in particular), among a small number of destination countries, among certain large transactions (particularly privatizations), among a handful of investor countries (especially Chile) and, consequently, among just a few firms. Thus, a particularly prominent role is played by Chilean companies in the electricity sector, which have been the biggest buyers of assets (in generation, transmission and distribution), particularly in Brazil and Colombia (see table I.29).

Table I.29

**LATIN AMERICA AND THE CARIBBEAN: ACQUISITIONS OF PUBLIC AND
PRIVATE ASSETS BY LATIN AMERICAN INVESTORS,
1997 AND FIRST HALF OF 1998**

(Millions of dollars)

Company	Country	Sector	%	Purchaser	Home country	Modality	Amount ^a
Siderúrgica del Orinoco (Sidor)	Venezuela	Iron and steel	70	Hylsamex, Tamsa, Siderar, Techint, Usiminas	Mexico Argentina Brazil	Privatization	2 300
Comercializadora y Distribuidora de Energía de Bogotá (Codensa)	Colombia	Electricity	49	Enersis, Endesa, Endesa-España	Chile Spain	Privatization	1 230
HIT de Venezuela	Venezuela	Beverages	50	Panamco	Mexico	Acquisition	1 112
Generadora de Energía Eléctrica de Bogotá (Emgesa)	Colombia	Electricity	60	Endesa, Endesa-España	Chile Spain	Privatization	951

Table I.29 (Cont.)

Company	Country	Sector	%	Purchaser	Home country	Modality	Amount ^a
Cía. Energética do Ceará (Coelce)	Brazil	Electricity	83	Enersis, Endesa-España	Chile Spain	Privatization	868
Centrais Elétricas Cachoeira Dourada (CDSA)	Brazil	Electricity	100	Endesa ^b	Chile	Concession	714
Central Hidroeléctrica de Chivor (Chivor)	Colombia	Electricity	99	Gener	Chile	Privatization	644
Cía. de Eletricidade do Estado do Rio de Janeiro (CERJ)	Brazil	Electricity	70	Enersis, Chilectra, Endesa-España, Eletricidades de Portugal	Chile Spain Portugal	Privatization	588
Energía del Pacífico	Colombia	Electricity	57	Electricidad de Caracas, Houston Energy Industries	Venezuela United States	Privatization	495
Central Hidroeléctrica de Betania (CHB)	Colombia	Electricity	99	Endesa, Corp. Financiera del Valle	Chile Colombia	Privatization	302
Empresa Petrolera Andina	Bolivia	Petroleum	50	YPF, Pérez Companc, Pluspetrol (Repsol)	Argentina Spain	Capitalization	265
Cía do Metropolitano do Rio de Janeiro - Metrô	Brazil	Transport	100	Cometrans, Sorocaba	Argentina Brazil	Privatization	262
Banco Consolidado	Venezuela	Finance	100	INFISA	Chile	Privatization	154
Companhia Navegação Aliança	Brazil	Transport	...	Cía. Sudamericana de Vapores	Chile	Acquisition	150
FICAP	Brazil	Electrical equipment	67	Madeco	Chile	Acquisition	121
Imagen Satelital	Argentina	Telecoms	100	Grupo Cisneros	Venezuela	Acquisition	118
Banco Tequendama	Venezuela	Finance	100	Banco de Crédito del Perú	Peru	Privatization	100
Coca-Cola Export	Argentina	Beverages	25	Femsa/Coca-Cola	Mexico	Acquisition	98
Incobrasa	Brazil	Food	100	Bunge & Born	Argentina	Acquisition	80

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from international financial publications, including *América economía*, *Expansión*, *The Wall Street Journal*, *Estrategia*, *Diario financiero* and *Latin Finance*.

^a Total value of the transaction. The share of Latin American companies may be less if the transaction concerned was carried out as part of a consortium with other investors from outside the region.

^b In addition to Endesa Chile, the Peruvian company Edegel, jointly owned by Endesa and the United States firm Energy Corp, also participated.

1. Chilean investments in other countries

At the beginning of the 1990s a group of leading Chilean companies began to invest vigorously abroad. These companies were extremely well managed and operated in an internal market which prolonged exposure to liberalization and deregulation policies had made orderly and competitive (Calderón and Griffith-Jones, 1995). Substantial competitive advantages had been secured in a number of industries, examples being telecommunications, electrical power generation and distribution, supermarkets and department stores, pension fund management (AFPs) and some branches of manufacturing. This meant that markets had matured rapidly, and signs of stagnation could be discerned.

At the same time that this process was taking place, the local capital market began to show signs of vigorous development, and this enabled companies to generate the funding needed to expand within the country and to initiate the first stage of the internationalization process.⁶⁹ Again, this improved performance in both the productive and financial sectors meant that it gradually became possible to obtain access to international capital markets and new financing mechanisms.⁷⁰

In addition to the changes that took place in Chile, many of the reforms implemented in neighbouring economies were favourable to this process. Renewed stability, market reforms, the consolidation of regional integration initiatives —Mercosur in particular— and privatization processes were all vital factors. This explains the strong Chilean presence in Argentine and Peruvian privatizations, and more recently in those of Colombia and Brazil, often as part of a consortium with transnational companies (see table I.29).

Chilean investment abroad has been the most dynamic in the region. During the 1990s, the total stock of Chilean investment grew from some US\$ 181 million in 1990 to almost US\$ 10 billion by the middle of 1998. In 1997 and the first seven months of 1998 alone, Chilean businesses invested US\$ 6.131 billion abroad (Banco Central de Chile, 1998b). This rapid growth reflects increasing integration with the country's neighbours, since more than 43% of these flows have gone to South America (28% to Argentina, 6% to Peru and 3% to Brazil). This figure could be even greater, as around 16% of all investment goes to financial centres, particularly Panama and the Cayman Islands, and these funds have subsequently been used to participate in privatization programmes in Brazil and Colombia. Again, a third of these outflows have gone into the financial system of the United States, whence they may have been redirected to other uses, such as participation in Latin American privatizations.

⁶⁹ The first step was to export to neighbouring countries (especially manufacturing firms); the next was to invest directly in order to consolidate or increase market share. The object of this strategy was to secure access to a major market (Mercosur).

⁷⁰ The increasing interest shown by institutional investors in the local stock market and the development of mechanisms such as foreign capital investment funds (FICES) and depositary receipts in the United States market (*American Depositary Receipts* (ADRs)), were among the factors that enabled large Chilean firms to participate effectively in the financial globalization process. Again, some Chilean companies began to use tax havens such as the Cayman Islands to obtain access to credit from the commercial banking sector.

As a result of these distortions in statistical information, it is not easy to determine the final destination of Chilean investments.⁷¹ There is other information available, however, which shows that the main destination sectors have been electric power (generation, transmission and distribution), the financial system (banks and pension fund managers) and manufacturing.

2. Investment by the member countries of Mercosur

The most significant investments within Mercosur have been the result of joint initiatives between large national companies to connect up the power supply systems of member countries (see the section on Argentina in this chapter). Examples are the initiatives of Yacimientos Petrolíferos Fiscales (YPF) of Argentina and Petróleo Brasileiro (Petrobras) in the areas of natural gas processing and transport and fuel distribution (investments of US\$ 700 million to build 1,500 petrol stations in Mercosur). The internationalization strategy of YPF centres upon Mercosur, as four of the five countries bordering Argentina —Brazil, Chile, Paraguay and Uruguay— are net energy importers. The exception is Bolivia, but YPF now controls 40% of the oil company Yacimientos Petrolíferos Fiscales de Bolivia (YPFB).⁷² This company now transports gas from Bolivia and exports it to Chile, and the possibility of supplying Brazil is also being studied.

Although investment by Argentine companies abroad is not a recent phenomenon (for example, investments by companies such as Bunge & Born and Alpargatas are of long standing), it has increased in volume over recent years. During the 1990s more than 50 Argentine firms made direct investments in other countries (Kulfas and Hecker, 1998). The external operations of these companies have been limited to the exploitation of natural resources (46%), particularly in the oil sector, in association with other international firms. This is the case with Pérez Companc, YPF, Bidas and Astra.⁷³ Around 75% of Argentine investment abroad has gone to South America, mainly Mercosur and Chile (35%). According to some forecasts, Brazil will be the destination of preference for Argentine businesses, and investments will become increasingly diversified as a result of the facilities provided by Mercosur.

As in the case of Chile, Argentine companies have gained experience through participation in consortiums that have taken control of privatized firms and through specialization in particular activities, for example, Pérez Companc in the extraction of oil and gas, Techint in iron and steel and Socma in road infrastructure, which has enabled them to build up substantial competitive advantages. According to estimates made by the Production Research

⁷¹ The official statistics of the Central Bank show that the economic activities of greatest interest to Chilean investors abroad have been financial services (69%), a finding that would appear to be distorted by the high degree of concentration in tax havens and the United States, followed by manufacturing industry (9%), transport, storage and communications (7%) and electricity, gas and water (5%).

⁷² As part of the process of capitalizing the main State companies, 50% of YPFB assets have been transferred to private ownership. The United States company Amoco is administering a number of areas grouped into a new company called Chaco S.A., and YPF, together with Pérez Companc and Pluspetrol —associated with Repsol— are operating Andina S.A.

⁷³ Bidas and the United States company Amoco have merged their operations to form a new company, Panamerican Energy. The Spanish firm Repsol has taken control of Astra.

Centre of the Ministry of Economic Affairs and Public Works and Services, opening new plants or production units has been the approach most favoured (37%) by Argentine investors abroad in this process of internationalization. Asset purchases have also accounted for a large share, accounting for around 30% of the funds used for operations abroad.

What is striking about Brazilian firms is how limited their degree of internationalization is, considering the size and level of development of the domestic economy. At the beginning of the 1990s, some Brazilian firms, chiefly the major exporters, began to invest abroad as a way of establishing better relations with and a greater presence in destination markets (Ventura, 1994). Nonetheless, a period of persistent macroeconomic imbalances, and the trade liberalization that followed, meant that large local corporate groups preferred to defend their share of the local market before commencing or proceeding with a strategy of internationalization.

Among the Brazilian firms with the greatest international reach, particular mention should be made of Odebrecht, which has extensive experience in infrastructure projects and a presence in Argentina, Colombia, Ecuador, Peru, Venezuela and the United States, and Petrobras, which engages in oil exploration and production in Argentina, Bolivia, Colombia and Ecuador, and also in the United Kingdom and the United States. Among the larger investments made by the State oil company should be mentioned the US\$ 500 million invested in natural gas production and processing in Argentina and the partnership with YPF to construct the Santa Cruz-São Paulo gas pipeline.

Table I.30
LEADING TRANSNATIONAL COMPANIES IN LATIN AMERICA,
1997
(Millions of dollars)

Position	Company	Country	Subsector	Sales ^a	Percentage abroad	Countries where it has operations
1	PDVSA	Venezuela	Petroleum	34 698	...	United States, Germany
2	Pemex	Mexico	Petroleum	32 909	37.9	United States
3	Petrobras	Brazil	Petroleum	17 425	...	United States, Argentina, Colombia, Ecuador, Bolivia, United Kingdom, Trinidad and Tobago, Angola
4	Bunge & Born	Argentina	Food	8 000	85.0	United States, Brazil, Australia, Paraguay, Venezuela
5	Teléfonos de Mexico	Mexico	Telecom.	7 530	13.3	United States
6	Yacimientos Petrolíferos Fiscales (YPF)	Argentina	Petroleum	6 136	28.0	Bolivia, Brazil, Ecuador, Venezuela, Indonesia, United States
7	Vale do Rio Doce	Brazil	Mining	4 707	40.9	

Position	Company	Country	Subsector	Sales ^a	Percentage abroad	Countries where it has operations
8	Cemex	Mexico	Cement	3 811	63.6	Spain, United States, Colombia, Venezuela, Panama, Trinidad and Tobago, Philippines, Dominican Rep., Thailand, Indonesia
9	Alpargatas	Argentina	Footwear	...	...	Chile, Switzerland, Brazil, Uruguay
10	Enersis	Chile	Electricity	3 040	28.5	Peru, Argentina, Brazil, Colombia
11	Usiminas	Brazil	Metals	3 018	9.2	Venezuela, United States
12	Cisneros	Venezuela	Telecom.	2 600	...	United States, Chile, Bolivia, Peru, Ecuador, Colombia, Brazil, Paraguay, Uruguay, Argentina, Mexico
13	Sadia	Brazil	Food	2 568	8.1	Argentina, Japan, Italy
14	Vitro	Mexico	Glass	2 526	29.4	United States, Peru, Bolivia, Colombia, Brazil, Guatemala, Ecuador, Costa Rica
15	Panamco	Mexico/ Panama	Beverages	2 510	78.2	Panama, Brazil, Venezuela, Nicaragua
16	Brahma	Brazil	Beverages	2 490	...	Argentina, Uruguay
17	Cía. Siderúrgica Nacional (CSN)	Brazil	Metals	2 310	19.6	United States
18	Grupo Ind. Bimbo	Mexico	Food	2 302	17.6	United States, Argentina, Colombia, Chile, Peru, Uruguay, Venezuela, Brazil, Guatemala, Honduras, Nicaragua, Costa Rica
19	Grupo Modelo	Mexico	Beverages	1 925	21.5	United States, Latin America
20	Gerdau Met	Brazil	Metals	1 775	...	
21	Grupo Televisa	Mexico	Media	1 757	21.1	United States, Chile, Peru
22	Pérez Companc	Argentina	Petroleum, banking, engineering	1 619	41.3	Venezuela, Brazil, Bolivia, Ecuador, Chile, Dominican Rep., France, Panama, Virgin Islands, United Kingdom, United States, Uruguay, Liechtenstein
23	Grupo IMSA	Mexico	Metals	1 461	28.0	Brazil, Argentina, Chile, Venezuela, Colombia, Guatemala, United States
24	Endesa	Chile	Energy	1 461	...	Peru, Argentina, Brazil, Colombia
25	Hylsamex	Mexico	Metals	1 456	17.8	Venezuela, United States
26	Gpo. Maseca, Gruma	Mexico	Food	1 346	54.8	United States, El Salvador, Nicaragua, United Kingdom
27	Gpo. México (GMéxico)	Mexico	Mining	1 293	50.9	South America

Position	Company	Country	Subsector	Sales ^a	Percentage abroad	Countries where it has operations
28	CMPC	Chile	Pulp and Paper	1 205	22.8	Argentina, Peru, Brazil
29	Coca-Cola FEMSA	Mexico	Beverages	1 152	34.3	Argentina
30	Disco	Argentina	Merchandising	1 146	...	Chile, Peru
31	ICA	Mexico	Construction	1 065	25.6	Argentina, Spain, Portugal, Chile, Colombia, Venezuela, Puerto Rico, Panama
32	Falabella	Chile	Merchandising	1 062	...	Argentina
33	Arcor SA	Argentina	Food	1 046	...	Brazil, Chile, Uruguay

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from "Las 50 empresas de competitividad global", *América economía*, 19 November 1998.

^a The sales figures are those published in the home country.

3. Mexican investment abroad

The rapid economic deregulation and trade liberalization measures taken in Mexico since the end of the 1980s and the country's strong trading links with the United States, which have been reinforced by the North American Free Trade Agreement (NAFTA), have been key factors in causing a very high percentage of Mexican investment abroad to be directed towards the neighbour to the north. As regards Latin America, the most substantial investments have gone to Central America and more recently to some countries in South America, in particular Argentina, Colombia and Venezuela (see table I.30).

The high degree to which Mexican investment is concentrated in a small number of sectors is very largely due to the existence of strong business groups, such as Cementos de México (Cemex), Teléfonos de México (Telmex), Grupo Alfa and Vitro. As a result, Mexican investment abroad is concentrated in non-metallic minerals (cement and glass), telecommunications, to a lesser extent construction (Tribasa and ICA) and more recently iron and steel (IMSA and Hysamex).

Of the big Mexican companies with investments abroad, the most outstanding example is Vitro,⁷⁴ which has major investments in Central America, Bolivia, Colombia and Peru, and is in alliance with a Brazilian company (Nadir Figuereido) to penetrate the Mercosur market (Garay and Vera, 1998). Another interesting case is that of Cemex,⁷⁵ which has bought a number of cement-making companies in Central America, Colombia and Venezuela, in addition to the assets it owns in the United States and Spain. In food, the most important company is Bimbo, which has investments in Argentina, Chile, Colombia, Peru, Uruguay, Venezuela, Central America and the United States. In the area of telecommunications, mention should be made of the purchase of television channels in the region by Grupo Televisa and TV Azteca.

⁷⁴ Vitro, the world's third largest glass maker, has major investments in the United States, owning Anchor Glass and Latchford Glass.

⁷⁵ Cemex is the world's third largest cement producer.

To sum up, during 1997 there has been strong growth in flows of direct investment between the countries of Latin America. This can be accounted for by the increasing internationalization of certain large business groups in the region, particularly in Chile, Mexico and Argentina. However, the lack of complete, consistent and comparable statistical data restricts the scope for further study of this process.

II. BRAZIL FOREIGN DIRECT INVESTMENT AND CORPORATE STRATEGIES

Over the last 50 years, foreign direct investment (FDI) and transnational corporations have played an important role in Brazil's economy. Currently, Brazil's gross domestic product (GDP) is the eighth highest in the world, and its production capacity is complex and relatively sophisticated compared with the patterns of other developing countries. The development of this industrial base is, to some extent, the result of the deep and wide-ranging penetration of foreign capital in the Brazilian economy, principally in manufacturing.

Since the mid-1990s, government authorities have relied on FDI inflows to assist them in achieving three major objectives, relating to external adjustment, adjustment of public accounts and modernization of the production base and services, namely:

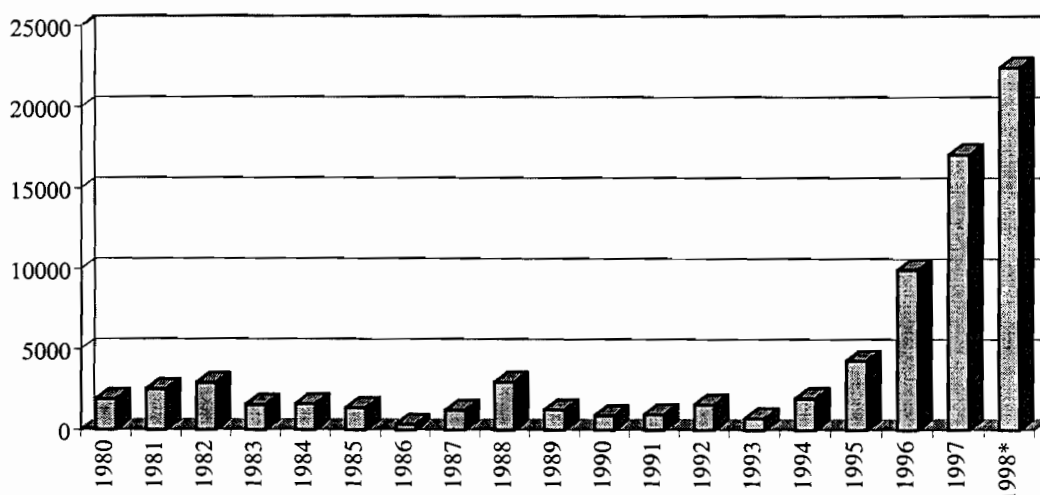
- FDI inflows should be used to finance the balance-of-payments deficit, which, in 1998, is expected to exceed 4% of GDP.
- FDI should be used to help finance public accounts—which are expected to show a nominal deficit of the order of 7% of GDP for 1998—through foreign investor involvement in the privatization of State enterprises.
- Foreign investors and transnational corporations should channel new investments into modernizing the Brazilian production facilities and services to enhance their productivity and competitiveness.

In 1995, FDI flows into Brazil increased sharply, interrupting the trend observed over the previous 15 years (see figure II.1). The stock of foreign direct investment amounted to US\$ 42.530 billion in 1995 (Banco Central do Brasil, 1998a), while net FDI inflows in 1996 and 1997 amounted to approximately US\$ 10 billion and US\$ 17 billion, respectively. According to preliminary data from the central bank, FDI flows for the first nine months of 1998 should have reached US\$ 18 billion (Banco Central do Brasil, 1998b). Total inflows for 1998 are expected to exceed US\$ 25 billion. For the period 1996-1998, total accumulated FDI inflows should be far in excess of US\$ 50 billion. Since 1995, FDI inflows have been higher than the stock accumulated throughout the history of the Brazilian economy.

The aim of this chapter is to analyse the recent pattern of foreign direct investment in Brazil, its characteristics, relative importance, principal determinants and impact. The first section contains a brief historical review of the presence of foreign capital in the Brazilian economy through FDI flows and, basically, the initiatives of transnational corporations—the principal agents responsible for FDI movements throughout the world. The second section provides an interpretation of the extraordinary levels of FDI growth in the Brazilian economy in the last few years. The final section considers the impact of FDI flows on the country, in

particular with respect to capital accumulation, foreign trade and the balance of payments. The chapter ends with a summary of the main conclusions.

Figure II.1
BRAZIL: FOREIGN DIRECT INVESTMENT FLOWS, 1980-1998^a
(Millions of dollars)



Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the Central Bank of Brazil.

^a Estimate.

A. THE PRESENCE OF FOREIGN CAPITAL IN THE BRAZILIAN ECONOMY

Historically, the productive sector of the Brazilian economy has included a broad-based, well-entrenched international component. In the early twentieth century (British hegemony), Brazil was already one of the major destinations for foreign capital. In 1913, it accounted for 3.9% of Great Britain's global stock of direct investments (Gonçalves and others, 1998, p. 165). This placed Brazil in seventh position, preceded only by Argentina (a major exporter of wheat, beef and wool) and five other countries that were still, or had been, British colonies.

After the Second World War, Brazil retained its position as one of the foremost FDI destinations in the world. According to United Nations statistics on cumulative FDI, Brazil was, in the early 1980s, the seventh most important FDI destination in the world, exceeded only by developed countries. In 1980, Brazil's share of world FDI stock was 3.6% (UNCTAD, 1997, pp. 313-317).

Although, in the 1980s, Brazil lost ground in relative terms, in 1990, it was still one of the ten leading destinations for FDI flows from Germany, Japan and the United States (Gonçalves and others, 1998, p. 166), a situation matched only by the Netherlands and the United Kingdom.

Foreign participation in Brazilian production is particularly high in the case of manufacturing. In the late 1970s, transnationals accounted for 32% of industrial production in Brazil. Only five other countries, namely, Singapore, Canada, Belgium, Malaysia and Venezuela, recorded higher levels of transnational involvement in the production of manufactures (UNCTC, 1988).

The manufacturing industry was the principal magnet for FDI in Brazil. According to data for 1995 obtained from the recent foreign capital census (see box II.1), the manufacturing industry accounted for 55% of the stock of FDI (Banco Central do Brasil, 1998a). There is no doubt that the import substitution policy —throughout its various stages— was instrumental in channelling FDI into manufacturing. The vast growth potential of the Brazilian domestic market was stimulated by a policy that offered opportunities for foreign investors, affording them, on the one hand, protection in the form of high tariff and non-tariff barriers and, on the other, a variety of incentives and subsidies.

Box II.1

A CENSUS OF FOREIGN CAPITAL IN BRAZIL, 1995

Brazilian legislation on foreign capital in 1962 (Law No. 4,131, Article 55) provides for periodic censuses of the activities of foreign companies in the country. The first such census was conducted by the central bank only in 1996, and the preliminary results were published in May 1998. This census covered a sample of 6,322 companies, in which non-residents controlled at least 10% of the common or voting stock, or 20% or more of total capital. The national system of classification of economic activities used by the Brazilian Geographical and Statistical Institute (IBGE), the official statistical body in Brazil, classifies companies by industry and identifies 57 branches of activity.

In addition to statistics for the 6,322 companies with non-resident shareholders, the census revealed findings for 4,902 companies with majority foreign ownership. The monetary values are expressed in *reais* and converted into United States dollars using the average selling rate for the dollar in 1995 (0.918 reais). First-line indirect ownership is assessed on the basis of the percentage of shares held by non-residents. In this way, the holding companies of foreign groups in Brazil and their networks of affiliates and subsidiaries are identified. The census does not take into account second-line or more indirect foreign investment. The industry under which a company is categorized is based on the product that contributes the most to the company's sales.

The statistics on cumulative foreign capital stock relate to 31 December 1995. These figures are broken down by industry and by FDI source country. As regards these source countries, financial centres (tax havens) which conceal the true origin of the investment continue to pose a problem. The form sent to companies called for a significant degree of detail on the company's assets and liabilities, earnings, other accounting information, data on foreign trade and number of employees.

The central bank is expected to publish additional and further disaggregations of the results of the census, including data on the number of companies operating in each industry. Moreover, it is hoped that some mechanism will be set up for updating information on the basis of a representative sample of companies —as has been done by the United States Department of Commerce— in order to improve annual information in the years to come.

Source: Banco Central do Brasil, *Censo de Capitais Estrangeiros no Brasil. Ano-Base 1995*, Brasília, 1998.

Between the second half of the 1950s, when the automobile industry was launched, and the second half of the 1970s, which saw the debut of the petrochemical industry, the policy of import substitution created a significant locational advantage for the Brazilian economy. If this policy had such a strong appeal for international investors, it was obviously because of the size of the Brazilian domestic market. This was, undoubtedly, the most significant advantage in locating industry in this country. It should be noted that annual GDP growth in Brazil averaged 5.7% between 1900 and 1980, while average annual growth in industrial output was 7.1% in the same period (Bonelli and Gonçalves, 1983, p. 3). This reflects Brazil's position as the foremost FDI destination in Latin America over the past 50 years.

1. The debt crisis: Brazil's gradual decline as an FDI destination

As already mentioned, Brazil started to lose ground as a destination for FDI flows in the 1980s. It slipped from seventh place in 1980, to eleventh in 1990, and twentieth in 1995. From 1980 to 1995, other developing countries, such as China, Mexico, Singapore and Indonesia attracted substantial inflows, thus becoming the leading FDI destinations (UNCTAD, 1996, pp. 239-243). Brazil's percentage share of the global stock of FDI fell from 3.6% in 1980 to 2.2% in 1990, with a further slide to 1.9% in 1995.

This relative loss of interest among international investors was due basically to the slowdown in the Brazilian economy starting in 1980. Annual GDP growth fell from the historic average of 5.7% in 1980 to 1.6% in 1990. The manufacturing industry suffered an even sharper decline and recorded negative growth (-0.2% during the period 1980-1990).

To a large extent, the "lost decade" was marked by the external debt crisis which broke out in 1982. The external adjustment process dragged on for years, and foreign exchange crises, real or potential, had serious repercussion on the country's economic performance. Since the availability of foreign currency is a key variable for international investors, macroeconomic instability —as reflected in the fragility of external accounts— became a specific local disadvantage for Brazil. The complex, and often critical, external accounts position prompted the implementation of policies for balance-of-payments adjustment based on contraction of aggregate demand and, on many occasions, expenditure switching.

In the 1980s, debt-equity swaps had a significant effect on patterns of FDI flows. During the period 1980-1992, gross FDI inflows amounted to US\$ 16.8 billion, including US\$ 6.1 billion (36% of the total) under the debt conversion programme. Approximately 60% of investments made through this mechanism were in manufacturing (Barros, 1993, p. 147; Mortimore, 1991; Calderón, 1993). On several occasions during this period, debt-equity swaps exceeded "normal" FDI inflows (see table II.1). In 1988, the Government promoted debt-equity swap mechanisms and, consequently, gross FDI inflows rose to US\$ 3.244 billion, of which US\$ 2.087 billion, or 64% of the total, were debt-equity swaps. A large proportion of inflows were in the form of retained earnings as part of a reinvestment policy imposed on Brazilian subsidiaries by foreign parent companies. Notwithstanding these mechanisms, FDI flows into

Brazil continued to decline, in terms of volume, throughout the 1980s. Indeed, these flows were not to recover until 1995 (see table II.1 and figure II.1).

Table II.1
FORMS OF FOREIGN DIRECT INVESTMENT, 1980-1998^a
(Millions of dollars)

	Capital	Debt/equity swaps	Privatization	Reinvested earnings	Total inflows	Capital outflows	Net flows
	A	B	C	D	E=A+B+C+D	F	G=E-F
1980	1 590	39	-	411	2 040	130	1 910
1981	1 881	2	-	714	2 624	102	2 522
1982	1 336	143	-	1 556	3 035	125	2 910
1983	565	452	-	695	1 712	152	1 560
1984	487	746	-	472	1 705	107	1 598
1985	480	581	-	543	1 604	246	1 358
1986	426	206	-	449	1 081	737	344
1987	561	344	-	617	1 522	297	1 225
1988	443	2 087	-	714	3 244	274	2 970
1989	314	946	-	521	1 791	524	1 267
1990	575	283	-	273	1 131	230	901
1991	663	68	-	365	1 096	123	973
1992	1 354	220	-	175	1 749	169	1 580
1993	967	220	-	100	1 294	580	714
1994	2 368	138	-	83	2 589	618	1 971
1995	4 784	307	-	384	5 475	1 163	4 312
1996	7 026	292	2 645	447	10 496	520	9 976
1997	...	...	5 249	151	18 745	1 660	17 085
1998 ^a	...	...	5 798	...	19 540	1 571	17 969

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the Central Bank of Brazil.

^a January-September 1998.

In terms of macroeconomic aggregates,¹ the share of foreign direct investment has been relatively insignificant; nevertheless, the importance of FDI and transnationals should be recognized, given their contribution to the accumulated stock of capital throughout the process of internationalization of production in the Brazilian economy. Between 1977 and 1995, transnationals owned 11% of total accumulated capital in Brazil. Their share was particularly high in manufacturing, where close to 25% of capital was held by foreign investors (see table II.2).

¹ Generally, FDI has accounted for an insignificant percentage of gross fixed capital formation in Brazil. In the second half of the 1980s, FDI accounted for 3.1% of total investment, or less than the world average (5.4%) or the Latin American average (11.3%). In the 1990s, it was not until 1995 that FDI started to account for a higher percentage of capital accumulation. In that year, FDI represented 4.7% of gross fixed capital formation and approximately 0.9% of GDP.

Table II.2
**RELATIVE IMPORTANCE OF FOREIGN INVESTMENT IN
 ACCUMULATED CAPITAL, BY SECTOR, 1977-1995**
(Percentages)

Sector	1977	1995
Primary sectors	...	...
Agriculture	5.0	1.7
Mining	8.6	8.2
Manufacturing	23.6	25.6
Food	11.9	11.5
Beverages	6.3	4.6
Tobacco	30.5	52.6
Textiles	17.3	16.2
Paper and paper products	21.5	15.4
Chemicals	16.0	15.4
Pharmaceuticals	70.2	67.7
Perfumes	48.3	34.7
Rubber products	56.4	62.2
Non-metallic mineral products	11.8	11.4
Metal products	15.1	13.7
Non-electrical mechanical equipment	36.9	36.2
Electrical equipment	53.9	40.2
Transport equipment	51.8	50.6
Other manufactures	24.4	50.7
Services	4.7	6.9
Wholesale trade	23.7	22.2
Retail trade	2.1	3.7
Public utilities	2.8	...
Financial services	2.4	6.2
Real estate services	5.4	9.2
Hotel and restaurant services	7.0	1.6
Repair and maintenance services	13.5	8.6
Personal services	0.7	6.8
Business services	16.1	12.7
Unspecified activities	44.0	15.8
Total	11.1	11.0

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, including data drawn from R. Gonçalves, "The military, foreign debt and the transnationals in Brazil", *Research Report*, No. 13, Uppsala, Sweden, Liefke Peace Institute, 1993, p. 28.

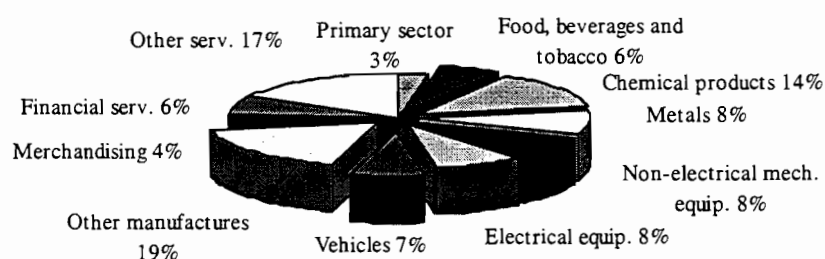
In 1995, 55% of the stock of FDI was channelled into manufacturing, followed by 43.4% to the services sector. Only 1.6% of the total went to the primary sector. Apart from business services, which included companies with activities in various sectors of the Brazilian economy (holding companies),² the share of the manufacturing industry increased to 75.2% and that of the primary sector to 2.2%, while that of services fell to 22.6% (see figure II.2 and table II.3). Under manufacturing, the most important subsectors, relatively speaking, were chemicals, basic metals, food, beverages and tobacco, automobiles, electrical equipment and non-electrical mechanical equipment. These activities accounted for 78% of FDI in manufacturing and 42.8% of the country's total stock of FDI. Apart from investments in holding companies, the share of the above-mentioned industries increased to 58.4% of total investment. In the services sector, FDI is concentrated in merchandising, finance and insurance. These two subsectors accounted for 62.6% of total FDI in the services sector and 24.1% of total FDI (after deducting the share of holding companies).

With respect to the distribution of the stock of FDI based on geographic origin, 25% of FDI in Brazil was from the United States, followed by 14% from Germany, 7% from Switzerland, 6% from Japan and 5% from France. These five countries accounted for 56.9% of the total stock of FDI in 1995. In the case of Brazil, Japanese investors, who are virtually absent from other countries of the region, hold a significant share. Flows channelled through financial centres in the Caribbean (17%), could mean that the actual share of the countries mentioned above is even higher (see table II.4 and figure II.3).

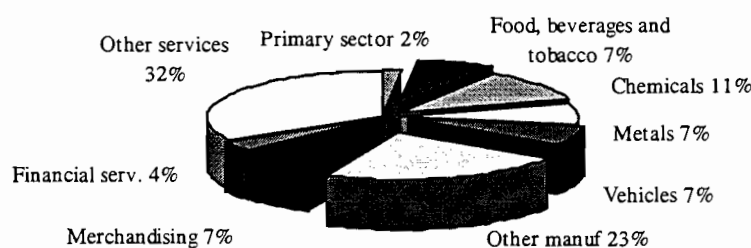
² The central bank records under the heading "business services" the operations of companies which, by virtue of their activity and ownership structure (holding companies), distribute the funds received among companies in various sectors. This is the case, for example, with the subsidiaries of the main transnational auto makers.

Figure II.2
BRAZIL: DISTRIBUTION OF FOREIGN DIRECT INVESTMENT BY SECTOR
(Percentages)

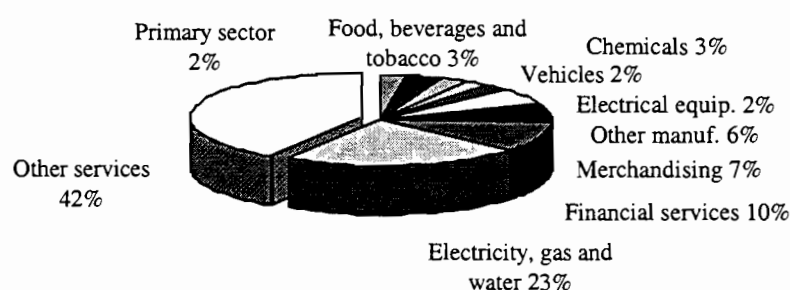
Stock 1990^a



Stock 1995^b



Flows 1996-1997^c



Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the Central Bank of Brazil.

^a The 1990 stock is based on the foreign capital registration conducted in the Department of Foreign Capital (FIRCE) of the Central Bank of Brazil, and includes, among other things, cash investments, foreign debt-equity swaps and reinvested earnings.

^b The 1995 stock is based on the foreign capital census conducted by the Central Bank of Brazil and reflects information provided by the companies on the basis of capital shown on the balance sheet.

^c The flows for the period 1996-1997 come from foreign exchange transactions involving direct investments in cash and do not include information relating to debt-equity swaps and reinvested earnings.

Table II.3
BRAZIL: FOREIGN DIRECT INVESTMENT BY ECONOMIC ACTIVITY
(Millions of dollars and percentages)

Sector	Stock		Flows ^a				Stock ^b	
	1995		1996		1997		1997	
	Amount	%	Amount	%	Amount	%	Amount	%
Primary	688.6	1.6	110.5	1.4	456.1	3.0	1 255.3	1.9
Agriculture	245.6	0.6	37.9	0.5	108.5	0.7	392.0	0.6
Mining and quarries	371.0	0.9	25.8	0.3	337.6	2.2	734.4	1.1
Crude oil and natural gas	72.0	0.2	46.8	0.6	10.0	0.1	128.8	0.2
Manufactures	23 402.4	55.0	1 740.0	22.7	2 036.4	13.3	27 178.8	41.5
Food, beverages and tobacco	3 047.8	7.2	435.9	5.7	322.9	2.1	3 806.6	5.8
Textiles, leather goods and clothing	1 032.8	2.4	72.8	0.9	60.2	0.4	1 165.8	1.8
Wood and furniture	29.0	0.1	0.0	0.0	88.1	0.6	117.1	0.2
Paper and paper products	1 518.1	3.6	21.9	0.3	11.8	0.1	1 551.8	2.4
Chemicals and chemical products	4 747.7	11.2	221.6	2.9	368.2	2.4	5 337.5	8.1
Coal and petroleum products	0.0	0.0	0.0	0.0	11.0	0.1	11.0	0.0
Rubber and plastic products	1 317.9	3.1	30.2	0.4	139.1	0.9	1 487.2	2.3
Non-metallic mineral products	816.0	1.9	194.9	2.5	207.7	1.4	1 218.6	1.9
Metals	3 139.0	7.4	93.9	1.2	0.0	0.0	3 232.9	4.9
Non-electrical mech. equipment	2 072.3	4.9	179.2	2.3	206.6	1.3	2 458.1	3.8
Electrical equipment	2 299.8	5.4	160.1	2.1	354.7	2.3	2 814.6	4.3
Motor vehicles	2 851.3	6.7	286.1	3.7	222.7	1.5	3 360.1	5.1
Other transport equipment	223.0	0.5	0.0	0.0	0.0	0.0	223.0	0.4
Other manufactures	307.7	0.7	43.4	0.6	43.4	0.3	394.5	0.6
Services	18 439.0	43.4	5 814.9	75.9	12 818.6	83.7	37 072.5	56.6
Construction	202.7	0.5	0.0	0.0	53.1	0.3	255.8	0.4
Merchandising	2 855.8	6.7	629.3	8.2	952.4	6.2	4 437.5	6.8
Transport and storage	193.0	0.5	208.2	2.7	0.0	0.0	401.2	0.6
Communications	195.1	0.5	611.2	8.0	831.3	5.4	1 637.6	2.5
Electricity, gas and water	2.0	0.0	1 626.4	21.2	3 554.4	23.2	5 182.8	7.9
Financial services and insurance	1 517.6	3.6	563.9	7.4	1 847.2	12.1	3 928.7	6.0
Real estate	1 057.4	2.5	82.9	1.1	40.4	0.3	1 180.7	1.8
Other services ^c	12 415.4	29.2	2 093.0	27.3	5 539.8	36.6	20 048.2	30.6
Total	42 530.0	100.0	7 665.4	100.0	15 311.1	100.0	65 506.5	100.0

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the Banco Central do Brasil, *Censo de Capitais Estrangeiros no Brasil. Ano-Base 1995*, Brasilia, 1998.

^a Includes direct investment inflows of over US\$ 10 million per target company. The sample data account for 73.6% and 81.6% respectively of total FDI inflows in 1996 and 1997.

^b The stock estimate for 1997 was obtained by adding the flows for 1996 and 1997 to the stock figure for 1995.

^c This entry corresponds mainly to business services, provided to companies, i.e., investments made by holding companies.

Table II.4
BRAZIL: FOREIGN DIRECT INVESTMENT BY SOURCE COUNTRY
(Millions of dollars and percentages)

	Stock		Flows ^a				Stock ^b	
	1995		1996		1997		1997	
	Amount	%	Amount	%	Amount	%	Amount	%
Developed world	32 480.9	76.4	5 525.0	72.1	9 719.4	63.5	47 725.3	72.9
Western Europe:	17 151.2	40.3	3 238.9	42.3	4 928.8	32.2	25 318.9	38.7
European Union	14 336.2	33.7	3 130.1	40.8	4 847.6	31.7	22 313.9	34.1
Germany	5 828.0	13.7	212.0	2.8	195.9	1.3	6 235.9	9.5
Belgium and Luxembourg	966.2	2.3	402.2	5.2	193.3	1.3	1 561.7	2.4
Spain	251.0	0.6	586.6	7.7	545.8	3.6	1 383.4	2.1
France	2 031.5	4.8	970.0	12.7	1 235.2	8.1	4 236.7	6.5
Netherlands	1 534.5	3.6	526.8	6.9	1 487.9	9.7	3 549.2	5.4
Italy	1 258.6	3.0	12.3	0.2	57.4	0.4	1 328.3	2.0
Portugal	106.6	0.3	202.7	2.6	681.0	4.4	989.7	1.5
United Kingdom	1 792.6	4.2	91.5	1.2	182.5	1.2	2 066.6	3.2
Sweden	567.2	1.3	126.0	1.6	268.6	1.8	961.8	1.5
Other Western Europe	2 815.0	6.6	108.8	1.4	81.2	0.5	3 005.0	4.6
Switzerland	2 815.0	6.6	108.8	1.4	81.2	0.5	3 005.0	4.6
North America	12 671.2	29.8	2 093.9	27.3	4 448.5	29.1	19 213.6	29.3
Canada	1 819.0	4.3	118.5	1.5	66.2	0.4	2 003.7	3.1
United States	10 852.2	25.5	1 975.4	25.8	4 382.3	28.6	17 209.9	26.3
Other developed countries	2 658.5	6.3	192.2	2.5	342.1	2.2	3 192.8	4.9
Japan	2 658.5	6.3	192.2	2.5	342.1	2.2	3 192.8	4.9
Developing world	5 939.0	14.0	1 974.6	25.8	5 324.8	34.8	13 238.4	20.2
Latin America	1 267.7	3.0	111.3	1.5	243.0	1.6	1 622.0	2.5
Argentina	393.6	0.9	30.1	0.4	186.9	1.2	610.6	0.9
Uruguay	874.1	2.1	81.2	1.1	56.1	0.4	1 011.4	1.5
Financial centres in the Caribbean ^c	4 667.5	11.0	1 800.0	23.5	4 990.5	32.6	11 458.0	17.5
Bahamas	509.7	1.2	74.3	1.0	300.1	2.0	884.1	1.3
Bermudas	853.1	2.0	33.8	0.4	241.1	1.6	1 128.0	1.7
Cayman Islands	891.7	2.1	655.7	8.6	3 382.9	22.1	4 930.5	7.5
British Virgin Islands	1 735.6	4.1	361.4	4.7	162.4	1.1	2 259.4	3.4
Panama	677.4	1.6	674.8	8.8	904.0	5.9	2 256.2	3.4
Asia	3.8	0.0	63.3	0.8	91.3	0.6	158.4	0.2
Rep. of Korea	3.8	0.0	63.3	0.8	91.3	0.6	158.4	0.2
Unspecified	4 110.1	9.7	165.8	2.2	266.9	1.7	4 542.8	6.9
Total	42 530.0	100.0	7 665.4	100.0	15 311.1	100.0	65 506.5	100.0

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the Banco Central do Brasil, *Censo de Capitais Estrangeiros no Brasil, Ano-Base 1995*, Brasilia, 1998.

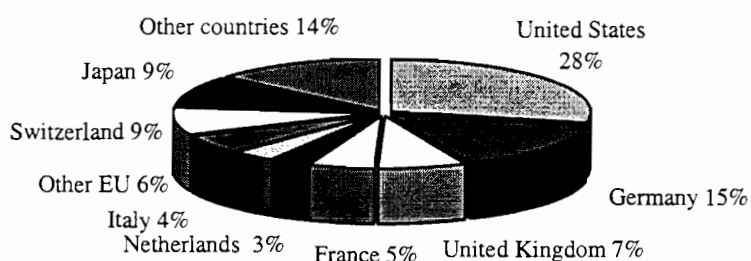
^a Includes direct investment inflows of over US\$ 10 million per target company. The sample data account for 73.6% and 81.6% of total FDI inflows in 1996 and 1997 respectively.

^b The stock estimate for 1997 was obtained by adding the flows for 1996 and 1997 to the stock figure for 1995.

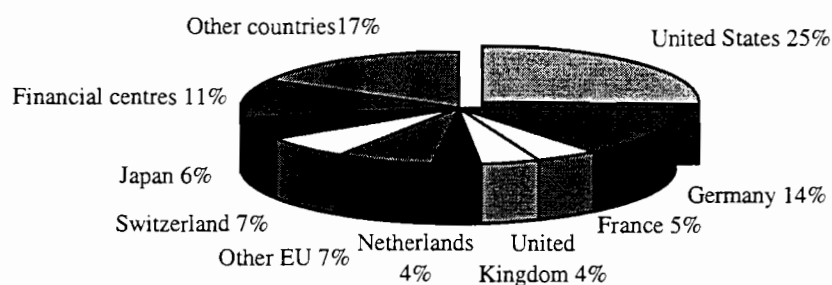
^c The increasing proportion of operations via financial centres or tax havens is attributable to the fact that the central bank takes note of the country of origin of the funds and not the nationality of the investment company. Financial centres are also widely used by holding companies.

Figure II.3
BRAZIL: GEOGRAPHICAL DISTRIBUTION OF FOREIGN DIRECT INVESTMENT
(Percentages)

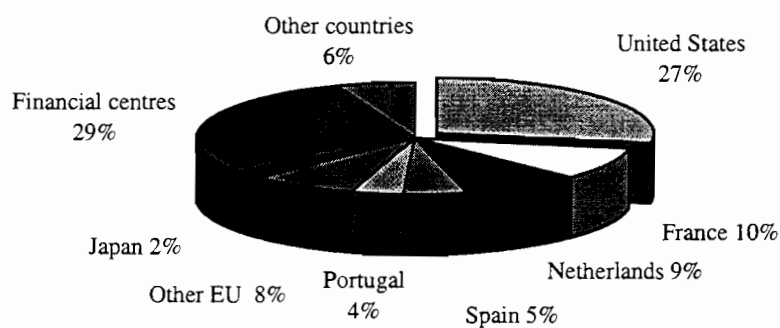
Stock 1990^a



Stock 1995^b



Flows 1996-1997^c



Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management on the basis of information from the Central Bank of Brazil.

Figure II.3 (concl.)

- ^a The 1990 stock is based on the foreign capital registration conducted in the Department of Foreign Capital (FIRCE) of the Central Bank of Brazil, and includes, among other things, cash investments, foreign debt-equity swaps and reinvested earnings.
- ^b The 1995 stock is based on the foreign capital census conducted by the Central Bank of Brazil and reflects information provided by the companies on the basis of capital shown on the balance sheet.
- ^c The flows for the period 1996-1997 come from foreign exchange transactions involving direct investments in cash and do not include information relating to debt-equity swaps and reinvested earnings.

2. Brazil recovers its position as the preferred destination for international investors

In recent years, with the stabilization policy (*Real Plan*) and liberalization of the Brazilian economy, FDI inflows into the Brazilian economy have strengthened considerably, moving from approximately US\$ 2.6 billion in 1994 to over US\$ 18.7 billion in 1997 (see table II.1). For 1998, inflows are even expected to exceed US\$ 24 billion, suggesting that Brazil has recovered its position as the preferred foreign investment destination in Latin America and the Caribbean.

In addition to opening up new business opportunities, the new economic context has also reduced protection levels, allowing imports to make deep inroads into the domestic market and improving profit margins for transnationals with operations in Brazil. Three concurrent trends of similar scope, which are largely responsible for the new FDI inflows, have begun to emerge:

- Widespread mergers and acquisitions designed to gain a position on, or improve control of, the Brazilian domestic market;
- The extension and deepening of the privatization programme; and
- New investments geared to streamlining, reorganizing and restructuring the operations of transnationals already present in Brazil, and investments by newcomers.

Trade liberalization has caught Brazilian entrepreneurs unaware either because of technologically obsolescent capital equipment; insufficient economies of scale to compete on international markets, in particular for commodities such as paper and steel; limited access to international capital markets and products; or increasing demands by clients, for example, on manufacturers of auto parts.

Faced with this situation, many Brazilian firms have sold out or sought partnerships with foreign companies. Transnationals have taken advantage of acquisitions requiring a low initial investment³ to gain rapid access to an expanding domestic market with high profit margins (FIPE, 1998).

In the past three years, privatizations have accounted for close to 28% of FDI flows (Banco Central do Brasil, 1998b). The first phase of the privatization programme concluded with the transfer of industrial companies in subsectors in which the share of foreign investors was

³ Generally, initial investment has been low, since bought-out companies were heavily indebted; after acquiring control of the company, transnationals would then avail themselves of low-interest loans on the international capital market, to which they had access, to replace the original costly debt.

insignificant, for example, aeronautics, mining, iron and steel, chemicals, petrochemicals and fertilizers. The privatization programme has moved on to the area of public utilities, including electricity generation and distribution, railways, water, gas and basic sanitation, telecommunications and financial institutions. By July 1998, more than 41% of transferred assets had been acquired by foreign investors (BNDES, 1998a). In the case of sales by states, basically in electricity and telecommunications (band B cellular telephones and federal telecommunications companies of the Telebras system), the share of foreign companies was even higher: 43% and 60%, respectively.

In the period 1990-1993, FDI flows to the manufacturing industry were relatively low and for the most part geared to streamlining existing companies (Bielschowsky and Stumpo, 1995). Since 1994, with the upturn in the economy, this trend has been reversing, suggesting that the domestic market continues to hold a strong appeal for foreign companies, one that is further enhanced by the consolidation and deepening of the Southern Common Market (Mercosur).

Producers of consumer goods did have some idle capacity, but this was insufficient to meet the new requirements for competitiveness on the domestic market in the phase of trade liberalization. Hence the need to increase efficiency and expand domestic production accounts, to a large extent, for the new investments in the manufacturing sector. Although the greater part of this investment boom came from companies that already had operations in Brazil, newcomers also emerged, especially in the automotive and electronics industries.

According to recent research (Laplane and Sarti, 1997a, p. 160), in the 1994-1998 period, new investments were concentrated in vehicle production (50.6%), followed by electronics (19%), chemicals and pharmaceuticals (9%) and food and beverages (6%). In aggregate terms, investments were geared mainly to setting-up new plants (57.7%), followed by expansion and modernization of existing facilities (23.3%). During this period, takeovers of existing assets represented 18.9% of total investments.

The automotive industry, which recorded sales of more than 2 million vehicles in 1997, attracts the interest of the leading world auto makers (see box II.2). General Motors announced a new investment plan for some US\$ 3.6 billion in Brazil (*Latin American Weekly Report*, 1998). Daimler-Benz transferred its 2,000-unit truck and bus assembly operations from Argentina to Brazil. The company now has two assembly plants in Brazil with an output of 40,000 vehicles per year and plans to invest approximately US\$ 1.1 billion by the year 2000. Ford Motor Co. will sink US\$ 1.5 billion by the year 2000 in the production of two new models, bringing its overall investment in Brazil to US\$ 3.5 billion (Bustos, 1998b). Fiat announced plans to invest US\$ 1.4 billion, also by the year 2000, for the production of a new model (Palio) at its Betim plant for export to other developing countries. By the end of 1998, Volkswagen will have invested US\$ 2 billion in the construction of a new plant in Paraná and will start exporting vehicles to its Mexican subsidiary (for further details, see chapter IV).

Box II.2

BRAZIL: A CENTRE OF INTEREST FOR MAJOR TRANSNATIONAL CORPORATIONS IN THE AUTOMOBILE SECTOR?

Six transnational corporations currently assemble passenger vehicles for the Brazilian market: Fiat, Ford, General Motors, Volkswagen, Toyota and a recent arrival, Honda. In addition, the following have announced investment plans: Kia Motors, BMW, Hyundai, PSA (Peugeot and Citroën), Renault, Audi (Volkswagen), Daimler-Benz, Chrysler, Mitsubishi, Suzuki and Subaru. Among the new entrants, the planned investments by Renault (US\$ 1 billion), Audi (US\$ 3.5 billion^a) and Daimler-Benz (US\$ 1.1 billion) are of particular significance.

If all these companies go ahead with their planned investments there will be 14 automobile producers in Brazil by the year 2000, producing about 20 different makes of vehicles including passenger cars, pick-up trucks, jeeps and sport-utility vehicles. This would be the largest number of producers in any one market in the entire world, more even than in the United States.^b This does not include the investments in the production of heavy commercial vehicles^c (basically, trucks and buses) by Skoda (Volkswagen) and Iveco (Fiat) which have also announced new projects. It is estimated that in the coming three or four years, investments in passenger vehicle production will total between US\$ 16 billion and US\$ 20 billion, even bearing in mind the effects of the current worldwide crisis. This would bring vehicle production up to 3 million units.

Although these estimates suggest that Brazil will become one of the world's biggest vehicle producers, it is also true that many of the companies which have expressed an interest in investing in Brazil will do so on a small scale, taking advantage of certain "market niches" in Brazil—or in Mercosur. The most likely outcome is that output will remain dominated by the "big four" companies (General Motors, Ford, Fiat and Volkswagen), which will pace their investments to changes in the international market, national policy and especially the domestic market (see chapter IV). The impact of the current worldwide crisis has, in fact, been felt heavily in Brazil, and particularly in its automotive industry. The Brazilian automobile market contracted by 20% during the first half of 1998, causing Fiat, for example, to temporarily shut down four of its Mercosur plants. General Motors, Ford and Volkswagen have also announced mandatory vacations at several of their plants, as a way of coping with falling demand.^d

^a Investments planned by Volkswagen for the period 1998-2000 for the production of Audi cars, the modernization of the São Bernardo plant, and the introduction of new models.

^b M.F. Laplane and F. Sarti, "Novo ciclo de investimentos e especialização productiva no Brasil", Rio de Janeiro, X Forum Nacional, 1998.

^c Trucks and buses are produced in Brazil by Ford, General Motors, Daimler-Benz, Scania, Volkswagen and Volvo, and Caterpillar. Fiat, New Holland and SLC-John Deere are involved in producing agricultural and earth-moving machinery.

^d Andreas Adriano and Lilian Satome, "Marcha atrás", *América economía*, Santiago, Chile, 22 October 1998.

3. The new FDI patterns in the second half of the 1990s

New FDI flows have produced significant changes in the pattern of foreign capital investments in different sectors of the Brazilian economy (see figures II.2 and II.3). The most notable feature is the increasing proportion of non-tradables, basically as a result of privatizations. This, together with the fact that the subsidiaries of transnational companies tend to export little, has generated an intense debate on the contribution of foreign investment to the Brazilian economy.

The services sector, which accounted for 43.4% of FDI stock in 1995, saw its share of FDI inflows into Brazil increase to 80%. There appears to be a strong trend towards tertiarization of FDI in Brazil (see table II.3).

The services sector has thus been the principal target for FDI, attracting gross inflows between 1996 and 1997 of approximately US\$ 18.63 billion, equal to the total stock of FDI in this sector in 1995. In terms of relative growth and excluding holding company investments, the bulk of these inflows went to electricity, gas and water, financial services and insurance, telecommunications and merchandising (see table II.3). These subsectors (not including holding companies) represented 65% of the stock of FDI in services in 1995 and 94% of gross cumulative FDI inflows in the period 1996-1997.

Although, in absolute terms, FDI in the primary sector (agriculture and mining) is less appreciable, in terms of relative growth, there was a significant increase in 1996-1997, due chiefly to FDI inflows in metal ore production (see table II.3).

The sharp fall in the relative importance of the manufacturing sector as a target for FDI was accompanied by a decline in concentration. The six industries with the highest relative importance (food, beverages and tobacco, chemicals, basic metal production, electrical equipment, non-electrical mechanical equipment and automobiles), which had 78% of the stock of FDI in the Brazilian manufacturing industry in 1995, absorbed 75% of inflows in the period 1996-1997.

Notwithstanding this sectoral shift in industrial investment, there appears to have been no significant increase in FDI in manufacturing compared with the primary sector and especially services. The total accumulated stock of FDI in Brazil (FDI flows for the period 1996-1997 plus the stock in 1995) reflects a 54% increase over the two-year period 1996-1997. The growth rate in the services sector was 101%, in the primary sector 82% and in manufacturing 16% (see table II.3).

The source countries responsible for the highest relative increases in FDI flows in recent years have also changed substantially compared with 1995 (see table II.4). Apart from financial centres (tax havens), FDI source countries accounting for the highest relative flow increases are France, the Netherlands, Spain and Portugal. In the period 1996-1997, FDI from Spain amounted to US\$ 1.132 billion, an increase of 451% over the stock of US\$ 251 million in 1995. The stock of FDI from Portugal soared to US\$ 884 million in 1996-1997, marking an increase of 828% over the FDI stock in 1995. The figure will be even higher when its share in the privatized Telebras system is taken into account. French firms have invested US\$ 2.205 billion over the past two years, corresponding to an increase of 109% above the stock in 1995.

The United States, the foremost source country for FDI in Brazil, accounted for a cumulative flow of US\$ 6.358 billion reflecting a 59% increase over the stock of US\$ 10.852 billion in 1995. Since the overall increase in FDI in Brazil for the period 1996-1997 (compared with 1995) was 54%, if we compare cumulative flows with stock, the United States does not seem to have lost its relative position notwithstanding the extraordinary growth of FDI in the Brazilian economy during the period (see figure II.3 and table II.4).

The same does not apply to the other major investors, Germany, Switzerland and Japan. Cumulative FDI flows by German investors amounted to US\$ 408 million in the period 1996-1997, marking a 7% increase over the 1995 stock of US\$ 5.828 billion. Cumulative FDI flows from Swiss investors in Brazil totalled US\$ 190 million, a 6.7% increase over the US\$ 2.815 billion stock of FDI in 1995. Japanese investors also suffered a relative setback recording a cumulative flow of US\$ 534 million, which, compared with FDI stock of US\$ 2.659 billion, represented 20% growth, i.e., less than half of the rate of increase in total FDI inflows during the period.

The earlier analysis of the volume, breakdown by sector and source of FDI flows pointed to significant changes between the 1980s and the 1990s, especially since 1995. Following erratic movements of low volumes of funds in the period 1980-1993, FDI flows into Brazil expanded exponentially, reaching extraordinarily high levels in 1994-1998.

Leading transnationals from the major FDI source countries have operations in Brazil, and, in some cases, these date back over half a century. Of the top ten foreign-owned companies in terms of net sales,⁴ five are automobile producers (see table II.5). In 1997, the leading transnational company operating in Brazil was the German-based Volkswagen, which boasted annual sales of US\$ 6.531 billion and a staff of 30,775. In fact, Volkswagen was the private-sector company with the highest sales figures in Brazil, in value terms, in 1997. Those in second, fourth and sixth place also belong to the automotive industry (Fiat, General Motors and Ford). Shell, Texaco and Esso are the leading distributors of petroleum products. Carrefour, with its chain of supermarkets, is the leader in retail trade. The Swiss firm, Nestlé, is the most important company in the food products industry. Among the newcomers are companies that have recently taken part in privatizations and are emerging as major foreign-based enterprises in Brazil. They include the electricity companies, Light (14) and Cerj (38) (see table II.5).

Table II.5
BRAZIL: MAIN FOREIGN-OWNED COMPANIES, IN TERMS OF SALES, 1997
(Millions of dollars)

Company	Branch of activity	Sales	Foreign investor	% Foreign	Source country
Volkswagen do Brasil	Automotive	6 531	Volkswagen A. G.	100	Germany
Fiat Automóveis S.A.	Automotive	5 824	Fiat S.A.	100	Italy
Shell Brasil S.A.	Oil	5 763	Royal Dutch Shell	100	UK/Netherlands
General Motors do Brasil Ltda.	Automotive	5 730	General Motor Corp.	100	United States
Carrefour Com. e Industrial S.A.	Commerce	5 098	Carrefour Supermarché S.A.	100	France
Ford Motors	Automotive	3 759	Ford Motor Company	100	United States
Texaco Brasil S.A.	Oil	3 144	Texaco Inc.	100	United States
Nestlé Industrial e Comercial Ltda.	Food	3 080	Nestlé AG	100	Switzerland
Esso Brasileira de Petróleo Ltda.	Oil	3 009	Exxon Corporation	100	United States
Mercedes Benz do Brasil S.A.	Automotive	2 852	Daimler-Benz AG	100	Germany
Industria Gessy Lever Ltda.	Cleaning products	2 429	Unilever	100	UK/Netherlands
CEVAL Centro-Oeste	Food	2 344	Bunge & Born	100	Argentina
IBM do Brasil	Computers	2321	IBM Corporation	100	United States
Light Serviços de Eletricidade SA	Electricity	1 803	AES/Houston Ind/Elec de France	51	USA/France
Cargill Agrícola S.A.	Food	1 791	Cargill Incorporated	100	United States

⁴ This refers to sales revenues excluding tax.

Company	Branch of activity	Sales	Foreign investor	% Foreign	Source country
Xerox do Brasil Ltda.	Electronics	1 760	Xerox Corporation	100	United States
Companhia de Cigarros Souza Cruz	Tobacco	1 693	British American Tobacco (BAT)	75	United Kingdom
Multibrás	Electronics	1 545	Whirlpool	60	United States
Santista Alimentos	Food	1 534	Bunge & Born	100	Argentina
Ericsson Telecomunicações S.A.	Electronics	1 233	Telefonaktiebolaget LM Ericsson	100	Sweden
Kibon S.A. Industrias Alimenticias	Food	1 192	Unilever	100	United Kingdom/ Netherlands
Makro Atakadista S.A.	Commerce	1 182	SHV Makro NV	98	Netherlands
Robert Bosch do Brasil Ltda.	Auto parts	1 140	Robert Bosch Bmbh	100	Germany
Alcoa Alumino S.A.	Metal production	1 073	Aluminum of America (67%) a/	100	United States
Basf Brasileira S.A.	Chemicals	1 059	Basf AG.	100	Germany
White Martins Gases Industriais SA	Chemicals	979	Praxair Inc.	52	United States
Saab-Scania do Brasil S.A.	Automotive	962	Saab-Scania AB	100	Sweden
Dixer Distrib. Bebidas S.A.	Beverages	930	Panamerican Beverage	...	Mexico/Panama
Parmalat Brasil	Food	867	Parmalat S.A.	100	Italy
Goodyear do Brasil Ltda.	Tyres	852	Goodyear Tire & Rubber Co.	100	United States
Bombriil S.A.	Toiletries	828	Cragnitti & Partners	100	Italy
Avon Cosméticos Ltda.	Toiletries	822	Avon Product Inc.	100	United States
Equip e Sist de Telecom EQUITEL	Electronics	809	Siemens AG	82	Germany
Novartis Biociências	Chemicals	774	Novartis.	100	Switzerland
Electrolux do Brasil S.A.	Electronics	743	Electrolux AB	100	Sweden
Coinbra S.A.	Food	739	Dreyfus & C.	48	France
McDonalds	Commerce	719	Mc Donalds	100	United States
Companhia de Eletricidade do Estado de Rio Janeiro, CERJ	Electricity	701	Endesa España; Chilectra, Enersis; Eletricidade de Portugal	70	Spain / Chile / Portugal
Pirelli Pneus S.A.	Tyres	680	Pirelli SpA	80	Italy
Dana do Brasil	Auto parts	665	Dana Equip. Ltd.	80	United States
Fleischman Royal Prods. Ltda.	Food	654	Nabisco Inc.	100	United States
Dow Chemical	Chemicals	651	Dow Chemical	100	United States
Industria de Pneumaticos Firestone	Tyres	639	Bridgestone/Firestone ^b	100	Japan
Philips da Amazônia	Electronics	630	Philips AG	100	Netherlands
New Holland Latino Americana	Automotive	615	New Holland NV	100	Netherlands
Siemens S.A.	Electronics	590	Siemens AG	82	Germany
Unisys Brasil Ltda.	Computers	583	Unisys Corporation	100	United States
Du Pont do Brasil S.A.	Chemicals	576	Du Pont de Nemours and Co.	100	United States
Bayer do Brasil S.A.	Chemicals	574	Bayer AG	100	Germany
Spal Ind Brasileira de Bebidas S.A.	Beverages	565	PanAmerican Beverages	...	Mexico/Panama
Pirelli Cabos S.A.	Electronics	557	Pirelli SpA.	86	Italy
Rhodia	Chemicals	539	Rhodia	100	France
Kodak Brasileira Ltda.	Photography	538	Eastman Kodak Co.	100	United States
Asea Brown Boveri Ltda., ABB	Machinery	534	Asea Brown Boveri Ltda, ABB	100	Switzerland
Volvo do Brasil	Automotive	534	Volvo AAB	82	Sweden
Caterpillar Brasil S.A.	Machinery	530	Caterpillar Tractor Co.	100	United States
Glencore Imp. e Exportadora	Commerce	504	Glencore Holding	100	Switzerland
BS Continental S.A.	Electronics	500	Bosch-Siemens Hauecceräte Gm	100	Germany
Philip Morris Marketing S.A.	Tobacco	499	Philip Morris Companies Inc.	100	United States

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information published in *Exame*, 1998; *Gazeta mercantil*, "Balanço anual, 1998"; No. 22, São Paulo, June 1998; *América economía*, 1995, 1996, 1997 and 1998; and *Major Companies of Latin America and the Caribbean*, 1998, London, Graham & Whiteside, 1998.

^a The United States company, Hanna Mining, holds the remaining 33% interest.

^b In 1988, the Japanese firm, Bridgestone, bought out Firestone Tire and Rubber Company—the second-largest United States tyre manufacturer—for US\$ 2.6 billion.

In 1997, 85 of the leading 100 foreign-owned companies with operations in Brazil were involved in manufacturing and generated 77% of total manufacturing sales. The automotive industry accounted for approximately one third of the income of the leading 100 transnationals, followed by the food, beverage and tobacco (17%), chemicals (13%) and electronics (12%) industries. European companies accounted for more than half of the sales of the top 100, while United States firms contributed 37%. Notwithstanding the massive rush of transnational companies into the Brazilian economic arena, the top 5 account for 27% and the top 20 for close to 60% of overall sales of the group of 100 leading companies.

B. INTERPRETING THE EXCEPTIONAL GROWTH IN RECENT FDI INFLOWS TO BRAZIL

The exceptional growth in FDI inflows to Brazil in recent years is mainly due to two different but related factors.

The first of these is the reaction to the new economic context by transnational corporations which have been present in the country for a long time. In 1995, as mentioned above, much of the stock of FDI has concentrated in the manufacturing sector (55%), with transnational corporations dominating the high-technology industries. Until the mid-1990s there was great macroeconomic instability in Brazil, and these corporations defended their market share mostly by *streamlining* their local operations without making major investments, causing them to fall further behind the leading edge of technology. With the successful implementation of the stabilization programme and increasing openness and liberalization of the economy, the transnational corporations present in Brazil were forced to review their business strategies in the country and their relationships with their worldwide integrated production networks. So, while some of them *withdrew*, others had to *restructure* and make major investments to defend their market shares. These new investments were designed to support two very different strategies:

- Restructuring and modernization of existing installations or construction of new, modern plants, as was the case with automobile assembly plants. In a number of industries this restructuring and modernization strategy extended throughout the Mercosur area.
- An aggressive strategy of acquisition of the assets of local enterprises, intended to strengthen and extend the transnational corporations' presence in the Brazilian market, concentrating on their main areas of activity. In recent years foreign corporations have generally diversified less, using acquisitions to eliminate or discourage competition, and trusting in the potential of the Brazilian and Mercosur markets.

Also noteworthy is the reaction of foreign investors not already established in Brazil to the new opportunities provided by the deregulation of the economy. The massive influx of new arrivals is particularly great in the service sector, where previously there had often been considerable restrictions on FDI. As a result, services overtook manufacturing as the main destination of FDI, accounting for 57% of the stock of FDI at the end of 1997 (see table II.3). The new opportunities attracted not only major transnational corporations but also others which were

smaller, even in their home markets; for these, entry into the Brazilian market was the first step in internationalization. The basic strategy adopted by these new investors was to purchase existing assets, through two main mechanisms:

- Privatization of State assets; in this area, foreign investors have been predominant in acquisitions in the electrical and telecommunications sectors. The modernization of the installations acquired has also brought in considerable FDI in the form of new assets.
- Acquisition of local enterprises affected by the new competitive situation in the Brazilian economy, a process which has been particularly intense in the financial subsector.

This stylized view draws attention to two new factors in recent events in Brazil: a significant proportion of FDI flows are *transfers of ownership*, and there is strong concentration in *non-tradable activities*. The consequences for the Brazilian economy are uncertain and have given rise to much debate:

- On the one hand, the massive arrival of foreign investors —through the purchase of existing assets— could have positive effects in terms of modernization and improvement of services, with the consequent positive impact on the country's systemic competitiveness. Moreover, new patterns of competition could encourage transnational corporations in the manufacturing sector to integrate Brazil more actively into their international production networks. Lastly, the considerable size of the internal market (strengthened by Mercosur) and the improved economic outlook should continue to attract international investors to Brazil.
- On the other hand, the huge FDI inflows into the Brazilian economy have the earmarks of a short-term phenomenon, rather than a firm long-term trend, particularly since the privatization programme will dwindle in the coming years. Also, the preference for services is likely to accentuate the anti-export bias characteristic of Brazil's industrialization process, and this could lead to worsening balance-of-payments problems in future.

1. The new economic environment and the reaction of transnational corporations present in Brazil

Beginning in 1994, the subsidiaries of transnational corporations which had begun their activities within the framework of the industrialization model based on import substitution had to adapt very quickly to the new scenario resulting from the application of the stabilization programme (*Real Plan*) and the implementation of structural reforms (liberalization and openness).

Stabilizing the economy has been of great importance. In Brazil it has been seen as a necessary but not sufficient condition for the revival of FDI flows. In the case of the structural reforms, trade liberalization affected patterns of competition in the domestic market and, consequently, the strategies of transnational corporations in the country as well as FDI inflows. The impact of trade liberalization on the Brazilian manufacturing industry was particularly

significant, especially in respect of imports,⁵ contributing to the competitiveness of the local market. Taking into account the weak growth of internal demand, it is noteworthy that external markets have not become a significant alternative for Brazilian manufacturing industry as a whole. Thus, in terms of FDI, the impact of trade liberalization has been somewhat ambivalent.

- The lowering of trade barriers is not an incentive for FDI, since it means that transnational corporations no longer benefit from a protected local market. Furthermore, international competition may force subsidiaries of transnational corporations to concentrate on their core activities, combining greater specialization and more imported inputs with disinvestment and the closure of enterprises. The attractive profit margins previously available thanks to tariff protection are lost and, as a result, transnational corporations may have greater interest in exploring the Brazilian market through alternative forms of internationalization of production, such as exports and contractual relationships.
- On the other hand, liberalization promotes greater productivity and efficiency. Importing more technologically advanced capital goods at lower prices and obtaining inputs from external markets enable productivity and efficiency to be improved, as a result of which profit margins can be increased. Furthermore, liberalization reduces the high gross profit margins (with low efficiency) of the domestic market, encouraging subsidiaries of transnational corporations to improve their performance patterns in the light of international competition. These companies therefore have to invest in purchasing new plants or modernizing existing production units. Moreover, liberalization may encourage oligopolistic strategies, since it becomes essential for the transnational corporations to invest in Brazil to prevent market entry by new competitors. Liberalization may also encourage FDI as a means of internationalizing production at a later stage, once the external trade boom has passed. In any of these situations, there is a stimulus to inward FDI in order to finance the *restructuring* of production, the expansion of already-established foreign companies investing in the country, or the entry of new investors.

Liberalization has therefore had a major impact on the Brazilian economy, particularly on the manufacturing sector. At first glance, it is hard to judge exactly how this process has affected recent FDI inflows in the country. Greater international competition may cause either reductions in FDI (for example, *streamlining* and the *withdrawal* of enterprises) or increased FDI inflows (modernization, *restructuring* and new production units). A recent study has produced a somewhat clearer picture of the way in which FDI inflows have been affected by trade liberalization in Brazil. For the 28 enterprises surveyed, which allocated a score between 1 (unimportant) and 10 (very important), trade liberalization and the entry of new competitors scored 6.6 as factors of FDI (Laplane and Sarti, 1997b, tables II.10 and II.11).

The realities of the evolution of Brazilian industry throughout the 1990s have transcended the issue of liberalization, having to do with performance in terms of profits, investment, employment, productivity and business strategies. The process of adjustment of Brazilian

⁵ From 1993 onwards there was considerable growth in imports, resulting from three simultaneous phenomena: the reduction of tariff barriers, growth in output and exchange rate appreciation.

industry during the current decade has passed through three distinct phases, which have affected the strategies of the transnational corporations⁶ (see table II.6).

Table II.6
THE RESTRUCTURING OF BRAZILIAN INDUSTRY

	1990-1992	1993-1994	1995-1998
Production	Deep recession (-4.7%)	Demand-led revival in growth (7.8%)	Slowing trend in growth (2%)
Investment	Significant contraction: reduction of installed capacity	Recovery, although at moderate levels and rates	Low investment rates, no upward trend
Profitability	Negative rates of return	Recovery	Low rates of return
Employment	Sharp fall	Slower fall	Downward trend
Productivity	Modest growth (2.6%)	Exceptional growth (9.7%)	Growth remaining high (8.5%)
Exports	Relative increase (exports/output); stagnation of absolute value	Relative increase (exports/output) and absolute value increases (8.2%)	Relative upward trend (exports/output); and slowing of the increase in absolute value (6.3%)
Imports	Relative increase (imports/output); stagnation of absolute value	Exceptional growth in relative value (imports/output) and in absolute value	Fast growth in relative value (imports/output) and in absolute value
Trade balance	Signs of a reduction in the positive balance	The downward trend continues	Beginning of an increase in the negative balance
Foreign direct investment	Reduction in relative (FDI/GFCF ^a) and absolute terms	Low in relative (FDI/GFCF) and absolute terms	Significant increase in relative (FDI/GFCF) and absolute terms; increase in mergers and acquisitions; increased presence of FDI in privatizations of State assets
Business strategies	Defensive, survival strategy; streamlining of costs; some companies withdrew from the market	<i>Streamlining</i> and beginning of <i>restructuring</i> and modernization; equipment replacement; new production technologies; new management methods	<i>Restructuring</i> and modernization continue. New entrants in service sectors as a result of the deregulation of the economy
Economic power structure	Weakening of local private groups; privatization of the main State-owned industrial enterprises	Considerable restructuring of local private groups and subsidiaries of transnational corporations; economic concentration	Increases in economic concentration and in the presence of foreign investors

Source: ECLAC, based on official data.

^a Gross fixed capital formation.

⁶ In this section, unlike many recent studies, the restructuring of Brazilian industry is divided into three periods rather than two (1990-1993 and 1994-1997). Since no significant change in overall trends is expected in 1998, the characteristics described for the period 1995-1997 are likely to be extended to 1998, showing that the main indicators have settled into a pattern over the past two years.

The period from 1990 to 1992 was marked by deep recession, and growth in productivity was modest, in the context of defensive adjustment strategies (*rationalization*). While exports did not rise in absolute terms, there was an increase in the export coefficient (ratio of exports to output) owing to the contraction of domestic demand. On the import side, the recession was so deep that despite trade liberalization there was no increase in external purchasing. The opening up of Brazilian industry therefore began amidst a deep recession, which began to undercut the country's large trade surplus.

The recession discouraged international investors, whose main interest lay in the growth of the domestic market. Meanwhile, while transnational corporations were pursuing a strategy of gradual withdrawal, Brazilian private-sector corporate groups were showing signs of weakness, and the privatization of State enterprises in the industrial sector was beginning. This first phase of privatizations (1992-1994) had no major impact in terms of FDI flows. Adjustment during this period, both by transnational corporations present in Brazil and by local enterprises and corporate groups, was basically defensive in nature and focused on *rationalizing* costs.

The period from 1993 to 1994 was marked by extraordinary growth in output in response to growing demand, under the stabilization programme. There was a slight recovery in productive investment. However, the hyperinflationary context caused risks and uncertainty, which discouraged any more significant return by investors.

During this period, increases in the absolute value of exports and the export coefficient reflected more favourable conditions on the supply side and the expansion of foreign trade (particularly within Mercosur). As for imports, there was exceptional growth in absolute value and in the import coefficient in the industrial sector, taking into account simultaneous progress in the liberalization process, output growth and exchange rate appreciation. The downward trend in the balance of trade continued during this period. Transnational corporations continued to maintain limited investments in the country, which were almost insignificant in terms of both the balance of payments and gross fixed capital formation.

There was exceptional improvement in productivity, brought about by organizational and technological changes in industry (Salm, Sabóia and Carvalho, 1997). The adjustment strategies of private and foreign business groups were based on *restructuring* and modernization involving the replacement of equipment through increased capital goods imports, new production technology and modern management techniques.

During the period 1995-1997 (and also in 1998), in the context of modest growth and low levels of investment in fixed assets and technology, there was strong growth in productivity thanks to progress in the restructuring and modernization process. The value of manufacturing exports grew less quickly, and the upward trend in the industrial export coefficient continued. The lack of dynamism in domestic demand was the key variable in this process, while the external market functioned as a "safety valve". The progress of Mercosur brought about a new regional division of labour, leading to an increase in the industrial export coefficient. The latter

factor also explains the increases in the value of imports and the import coefficient.⁷ The combined result was a worsening trend in the country's balance-of-trade deficit.

There was a significant increase in the relative importance of FDI in terms of both gross fixed capital formation and flows on the balance-of-payments capital account. There was also a progressive increase in the presence of transnational corporations in Brazilian industry. Overall, the current *restructuring* and modernization process has continued, still associated with low aggregate levels of investment in fixed assets and technology.

In short, throughout the 1980s and the first half of the 1990s transnational corporations remained wary of the Brazilian market (Gonçalves, 1997). The predominant strategy during that long period was one of gradual retreat, except for investments based on conversion of the external debt (debt-equity swaps). Beginning in 1994, transnational corporations faced a new competitive environment which forced them to re-evaluate their corporate strategies in Brazil. Some withdrew, others streamlined their operations and the remainder restructured and modernized their installations, announcing ambitious investment plans.

Deepening economic reforms have led to increased supply of assets. Increasingly open markets forced many owners of local enterprises to sell, since they lacked the necessary technology and capital to compete (Calderón and Vodusek, 1998). This situation enabled many foreign companies to take the opportunity to defend and expand their share of the Brazilian market. A number of newcomers also used acquisitions of local enterprises to begin their activities in Brazil.

Since 1994 there has been a wave of mergers and acquisitions involving foreign companies. A total of 600 such transactions went through between 1992 and 1997, and transnational corporations had a significant role in more than half of them. In Brazil most of the mergers and acquisitions were in the manufacturing sector, where 179 were carried out by foreign companies, and 195 by domestic companies.

According to some estimates, about a third of recent FDI inflows involved mergers and acquisitions (FIPE, 1998). A recent study by KPMG⁸ shows that, in the 600 operations of this type in Brazil, 61% of the resources involved came from foreign purchasers, mostly from the United States. The greatest number of these asset transfers took place in the manufacturing sector (59%), including food and beverages (22%), auto parts (14%), chemicals and petrochemicals (14%), metal manufactures and machinery (13%), electronics (12%) and pharmaceuticals (8%) (see table II.7).

⁷ Thus, the fact that the liberalization process did not move forward during this period (there were even some signs of backward movement) indicates that the observed exchange-rate appreciation is probably the major factor explaining the evolution of Brazil's imports.

⁸ KPMG is the world's largest consulting and accounting firm. It was founded in 1987 as a result of the merger of the United States company Peat Marwick International with the Dutch firm KMG.

Table II.7
**BRAZILIAN MANUFACTURING COMPANIES ACQUIRED BY
 FOREIGN INVESTORS, 1994-1998**

Company/Sector	Purchaser	Home country	Amount	Year
Food				
Adria Prod. Alimentos	Quaker Oats	United States	...	1994
Laticínios Avaré	Nabisco	United States	...	1995
Lacta	Philip Morris	United States	170	1996
CEVAL-Alimentos (100%)	Bunge & Born	Argentina	1 200	1997
Kibon SA	Unilever	Netherlands	930	1997
Molinos de Soya - Sadia	Archer-Daniels-Mid.	United States	165	1997
Agroceres	Monsanto do Brasil	United States	...	1997
Ind. Alim. Carlos de Brito	Bombril-Cirio	Italy/Luxembourg	...	1998
Textiles				
Celbrás	Rhodia	France	...	1994
Petrochemicals, chemicals and pharmaceuticals				
Petroquímica União	Union Carbide	United States	...	1994
Petroquímica Bahia	Dow Chemical	United States	...	1995
Tintas Coral	Imperial Chemical Industries (ICI)	United Kingdom	390	1996
Kenko do Brasil	Kimberly-Clark	United States	...	1996
Lab. Carlo Erba	G.D. Searle & Co.	United States	...	1997
Kolynos	Colgate-Palmolive	United States	1 000	1997
Phytoervas	Bristol-Myers Squibb	United States	...	1998
Mining and metal production				
Caemi Mineração e Metal.	Mitsui & Co.	Japan	264	1997
Cimentos Serrana	Cimpo-Cimentos	Portugal	380	1997
CST/Acesita	Usinor	France	...	1998
Electronics				
Continental 2001	Bosch/Siemens	Germany	...	1994
Refrigeração Paraná	Electrolux	Sweden	...	1996
Cia. Eletrônica Celma	General Electric	United States	...	1996
Dako	General Electric	United States	...	1996
Brasmotor (33%)	Whirlpool	United States	217	1997
Arno (41%)	Groupe SEB	France	153	1997
Ficap (67%)	Madeco	Chile	121	1997
Machinery				
Iochpe Maxion	AGCO Corp	United States	260	1996
Auto parts				
Metal Leve	Mahle/Cofap ^a	Germany/Italy	80	1996
Cofap (70%) ^a	Magneti Marelli	Italy	130	1997
Freios Varga	Grupo Lucas	United Kingdom	...	1997

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the published in *América economía*, various issues, and *Carta Capital*, of 8 July 1998, p. 33.

^a The German firm Mahle holds a 30% interest in Cofap.

Certain preliminary data for the first six months of 1998 show that 217 mergers took place, 71% of which involved transnational corporations (*Gazeta Mercantil*, 21 July 1998). This confirms the steady expansion of mergers and acquisitions and the relatively large role of transnational corporations in the process. The evidence also shows that, in 80% of cases where transnational corporations were involved in acquisitions, they took a controlling interest in the enterprise being purchased.

Recent data on investment opportunities, intentions and decisions in Brazil from 1995 to 2003 show that the manufacturing industry accounts for less than 30% of the expected volume of investments (MICT, 1996). There are significant concentrations in chemicals; food, beverages and tobacco; automobiles; basic metals; electrical equipment; and non-electrical mechanical equipment. These six industries account for 79% of the total investments planned by transnational corporations present in Brazilian industry for the period 1997-2000 (Laplane and Sarti, 1998, table I.8). This result is not surprising, since these industries have 77% of the stock of FDI in Brazil according to the 1995 census of foreign capital (Banco Central do Brasil, 1998a).

There are also numerous new investments which may take place in the coming years; these include both opportunities identified and decisions already made. Investment opportunities at the identification stage make up 8.4% of the total of these projects, planned investment projects 38.6%, and projects at the implementation stage constitute 42.6% of the total of reported investments (Laplane and Sarti, 1998, p. 6). This means that many of the announced investments may never get past the two initial stages, those of identification of opportunities and planned investments.

For the 1996-1999 period, according to a recent study among a sample of 730 industrial enterprises, investments in Brazilian manufacturing industry total US\$ 22.8 billion (CNI/ECLAC, 1997, p. 17). Of this total, 36% are at the actual execution and implementation stage and/or the equipment purchase stage, and in 20% of cases, work is under way or due to begin between January 1997 and December 1999. The remaining 44% of the investments break down as follows: 19% are at the economic and financial analysis or finance-seeking stage; 9% are projects which have been approved, but lack definite starting date because of uncertainty about the national or international economy; and 16% are identified opportunities at the preliminary study stage. Almost half the expected investments are therefore at the early stages of planning and identification of opportunities, which means that many of them may not be realized, owing to changes in the national and/or international situation (see table II.2).

The case of the automotive industry clearly illustrates the influence of new patterns of competition on the exceptional revival of FDI flows to Brazil. Until 1990, there were hardly any automobile imports. Between 1991 and 1993 the volume of imports of vehicles for private or mixed use grew from 18,000 to 141,000 units, and in 1995 the figure reached 244,000 (Morandi, 1997, table A.5). Consequently, the automobile companies which already had assembly plants in Brazil (Fiat, Volkswagen, Ford and General Motors) had to invest in order to acquire new facilities and expand and modernize existing ones in response to increasing competition from imports. In addition, the companies which had begun exporting to Brazil in the 1990s, such as

Honda, Renault and Peugeot, were motivated to invest in order to obtain locational advantages from proximity to Brazilian consumers (see box II.2 and, for fuller details, chapter IV).

Faced with the explosion of investments (and announced investments) in the automotive industry, a major restructuring has taken place in the auto parts industry. The major transnational corporations in the industry began to move aggressively into the Brazilian market. This strategy was based on acquisition of local enterprises facing serious difficulties owing to the trade liberalization process (see box II.3).

Box II.3

THE AUTO PARTS INDUSTRY IN MERCOSUR: THE CASE OF DANA

Brazil has the potential to become one of the automotive industry's biggest markets. By the year 2000, it is estimated that there will be about 17 vehicle assembly plants (14 companies, 20 makes), and a larger number of transnational corporations will be present than anywhere else in the world (see box II.2). For the auto parts industry (most of it Brazilian-owned), trade liberalization, together with the adoption of global sourcing practices by assembly plants in Brazil, made it hard for firms to keep their products technologically up to date and maintain their quality, owing to an abrupt fall in profit margins.^a This situation provided great opportunities for international auto parts companies, which were able to gain access to this attractive market by acquiring local companies.

This was the case for the United States company DANA, the world's fourth largest producer of auto parts, after Delphi Automotive Systems and Visteon Automotive Systems, also United States firms, and the German company Robert Bosch. Through an aggressive acquisitions strategy, DANA has established a network of 27 subsidiaries in the Mercosur countries, 17 of them in Brazil, 8 in Argentina and 2 in Uruguay. Since 1994, DANA has bought eight auto parts companies in the Mercosur area, the two most recent being Nakata S.A. (a manufacturer of suspensions and shock-absorbers) and Echlin, Inc. (auto parts for the spare parts market).

This entire process has resulted from the major changes in the automobile industry in recent years (see chapter IV). Auto parts companies increasingly deliver complete systems to the vehicle assembly plants, so that they have to be more actively involved in the design and engineering stages of new cars. An example of this is DANA's agreement with Chrysler Corp. to supply the complete chassis for the Dakota utility vehicle made at the Chrysler plant in Paraná, Brazil.^b

Latin America has become a key region for DANA, thanks to its considerable investments in the region. Over the past eight years, DANA has tripled its sales from about US\$ 350 million in 1990 to US\$ 1 billion in 1997 (US\$ 665 million in Brazil). Following its active acquisitions strategy to achieve a strong position in Mercosur, DANA is trying to consolidate its operations, concentrating on the production of parts for engines and transmissions. It has even sold off some of its less important operations, such as companies producing gears, hydraulic cylinders and truck parts.

^a Ruy de Quadros y Roberto Bernardes, "Cambiano con la economía: la dinámica de empresas líderes en Brasil", *Grandes empresas y grupos industriales latinoamericanos. Expansión y desafíos en la era de la apertura y la globalización*, Wilson Peres (ed.), Mexico City, Siglo Veintiuno Editores, 1998.

^b Lilian Rumi Satomi, "Como un tractor", *América economía*, Santiago, Chile, 4 June 1998.

2. Deregulation and privatizations: new openings for foreign investors

In the course of the 1990s, the many restrictions on FDI in the Brazilian economy have been gradually eliminated. Changes in basic legislation between 1991 and 1993 were intended to ease the conditions on outflows of foreign capital, mostly regarding restrictions on profit remittances and royalty payments (Canuto, 1993; Barros, 1993). The repeal in 1994 of the information technology act, which had created considerable obstacles to the entry of foreign capital into that sector, was another major step towards greater openness. At the same time, many of the incentives granted by the Government to promote manufacturing were reduced or eliminated.

Constitutional reform mainly in 1995, removed sectoral restrictions on the entry of foreign capital into the Brazilian economy. There was also movement in the direction of loosening the State's monopoly on petroleum.⁹ Restrictions in the service sector and extractive activities have also been gradually eliminated, most notably in the financial sector (banking and insurance) as well as in deep-sea and coastal shipping. In the telecommunications sector, foreign companies have been allowed to acquire controlling interests in privatized enterprises. The system of reciprocity previously applicable in the banking sector has been abandoned, and the privatization of State-owned banks with majority shareholdings has been announced (*Gazeta Mercantil*, 17 July 1998). Consideration is also being given to raising from 20% to 49% the ceiling on participation by foreign investors in the capital of aviation companies (*Gazeta Mercantil*, 20 July 1998).

The process of opening up to foreign capital cannot be separated from the strong move towards financial liberalization. The financial deregulation implemented in Brazil in the 1990s has in all likelihood created more favourable conditions for the transnational corporations established in the country. The loosening of restrictions on use of resources from the international financial system as well as those of the parent company itself has made the operation of foreign companies in the Brazilian economy more attractive.

Changes in the regulatory framework, particularly deregulation, the opening up of certain sectors to foreign capital and financial liberalization have been key factors in the influx of FDI into the Brazilian economy in recent years. This is especially true for the service sector, since there had been few restrictions on FDI in the primary and manufacturing sectors. Out of the overall investment in services, 94% has been concentrated in gas and electric power, finance and insurance, telecommunications and merchandising (see table II.3).

Within the service sector, the major attraction for FDI in Brazil has certainly been in the area of infrastructure. In this area, the privatization of publicly-owned enterprises has been the main mechanism for FDI inflows into the Brazilian economy in recent years. Between 1991 and July 1998 there were privatizations of publicly-owned enterprises belonging to the federal and state governments, including cellular phone concessions and the federal telecommunications

⁹ Increased flexibility in these activities is expected, either through partnerships between the State-owned *Petróleo Brasileiro* (Petrobras) and transnational corporations, or through direct and independent action by the major international petroleum companies.

companies of the Telebras system (see table II.8). Foreign investors contributed approximately US\$ 27.164 billion, more than 41% of the total collected by the programme. The main source country for these investments was the United States (15%), followed by Spain (12%) and Portugal (7%). The involvement of these three countries accounted for 33.2% of total privatizations and 80% of total foreign investment in this process.

Table II.8
**PARTICIPATION OF FOREIGN CAPITAL IN THE PRIVATIZATION OF BRAZILIAN
 PUBLIC-SECTOR ENTERPRISES, BY SOURCE COUNTRY, 1991-1998^a**
(Millions of dollars and percentages)

Country	Federal level		State level		Telecommunications ^b		Total	
	Amount	%	Amount	%	Amount	%	Value	%
United States	1 630.2	8.9	4 311.0	20.7	3 638.9	13.7	9 580.1	14.6
Spain	1.2	0.0	2 806.7	13.5	5 047.0	19.0	7 854.9	11.9
Portugal	0.5	0.0	176.0	0.8	4 227.0	15.9	4 403.5	6.7
Italy	-	-	-	-	1 220.3	4.6	1 220.3	1.9
Chile	-	-	1 006.1	4.8	-	-	1 006.1	1.5
Canada	21.0	0.1	-	-	641.6	2.4	662.6	1.0
Sweden	-	-	-	-	599.3	2.3	599.3	0.9
France	479.1	2.6	90.0	0.4	-	-	569.1	0.9
Rep. of Korea	-	-	-	-	265.4	1.0	265.4	0.4
Japan	8.1	0.0	-	-	257.0	1.0	265.1	0.4
Argentina	-	-	148.2	0.7	-	-	148.2	0.2
Germany	75.4	0.4	-	-	-	-	75.4	0.1
Netherlands	5.1	0.0	-	-	-	-	5.1	0.0
United Kingdom	2.4	0.0	-	-	-	-	2.4	0.0
Uruguay	0.1	0.0	-	-	-	-	0.1	0.0
Other	156.6	0.9	350.0	1.7	-	-	506.6	0.8
Foreign participation	2 379.7	12.9	8 888.0	42.7	15 896.5	59.9	27 164.2	41.3
Total	18 411.0	100.0	20 833.0	100.0	26 520.0	100.0	65 764.0	100.0

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the Banco Nacional de Desenvolvimento Econômico e Social (BNDES), *Privatization in Brazil: 1991-1998*, Rio de Janeiro, Secretaria Geral de Apoio a Desestatização, 31 July 1998.

^a Data from 1991 to July 1998.

^b Cellular phones and Telebras system.

Foreign participation has been particularly great in the case of telecommunications. In this subsector, FDI accounted for 60% of the total privatizations. Foreign participation was also significant in the case of public-sector enterprises at the state level, with 43% of the total assets transferred. As for the privatization of public-sector enterprises at the federal level, the participation of foreign companies amounted to 13% of the total.

The total amount collected through the sale of public-sector enterprises at the state level was US\$ 20.833 billion. In this category of transactions, foreign investors were involved in more than half of the privatizations of public-sector enterprises, for which they paid some US\$ 8.888 billion. Although in some of these enterprises the foreign investors have become minority shareholders, they are likely to exercise a degree of control, since the shareholdings they acquired were seldom less than 20%. In the case of the concessions for telecommunications companies (cellular phone band B and the Telebras system), which brought in proceeds of US\$ 26.520 billion, foreign investors hold substantial shareholdings in all the resulting companies, apart from Tele Norte Leste and Tele Centro Oeste Celular (see tables II.9 and II.10).

Table II.9
INVESTMENTS OF FOREIGN CAPITAL IN THE PRIVATIZATION OF BRAZILIAN
PUBLIC-SECTOR ENTERPRISES, 1996-1998^a

(Millions of dollars)

Enterprise privatized (percentage sold)	Brand of activity	Date of sale	Amount of sale	Foreign investor, home country and percentage shareholding
Federal enterprises				
Light Serviços de Eleticidade SA (51%)	Electric power distribution and generation	05/96	2 508	AES Corporation (United States, 27%); Houston Industries Energy (United States, 22%) and Électricité de France (22%)
Cia. Vale do Rio Doce (42%)	Mining	05/97	3 132	Sweet River Investments (United States, 9%)
State enterprises				
Cia. de Eleticidade do Estado do Rio de Janeiro (CERJ) (70%)	Electric power distribution	11/96	588	Eleticidade de Portugal (30%); Enersis (Chile, 30.6%); Endesa-España (10%); Chilectra (Chile, 29.4%)
Cia. de Eleticidade do Estado da Bahia (COELBA) (66%)	Electric power distribution	07/97	1 598	Iberdrola (Spain, 39%)
Centrais Elétricas Cachoeira Dourada SA (CDSA) (93%)	Electric power generation	09/97	714	Endesa (Chile, 60%) Edegel (Peru, 20%)
Cia. Centro-Oeste de Distribuição de Energia Elétrica (91%)	Electric power distribution	10/97	1 372	AES Corporation (United States, 100%)
Cia. Norte Nordeste de Distribuição de Energia Elétrica (91%)	Electric power distribution	10/97	1 486	Community Energy Alternatives, CEA (United States, 33.3%)
Cia. Energética do Rio Grande do Norte (COSERN) (78%)	Electric power distribution	12/97	607	Iberdrola (Spain, 12.2%)
Cia. Energética do Ceará (COELCE) (83%)	Electric power distribution	04/98	868	Enersis (Chile, 41.4%) Endesa-España (41.4%)
Eletropaulo Metropolitana de Eleticidade S/A (75%)	Electric power distribution	04/98	1 777	AES Corporation (United States); Houston Industries Energy (United States) and Électricité de France
Cia Estadual de Gás do Rio de Janeiro (CEG) (56%)	Gas distribution	07/97	430	Enron International (United States, 45%); Gas Natural (Spain, 34%); Iberdrola (Spain, 17%), and Pluspetrol (Argentina, 4%)

Enterprise privatized (percentage sold)	Brand of activity	Date of sale	Amount of sale	Foreign investor, home country and percentage shareholding
Riogás S/A (75%)	Gas distribution	07/97	146	Gas Natural (Spain, 60%) Enron International (United States, 20%); Iberdrola (Spain, 20%)
Cia do Metropolitano do Rio de Janeiro - Metrô (100%)	Urban transport	12/97	262	Cometrans (Argentina, 50%)
Centrais Elétricas de Minas Gerais (CEMIG) (33%)	Electric power distribution and generation	05/97	1 053	Southern Electric (United States, 40%); AES Corporation (United States, 50%)
Elektro Eletricidade e Serviços SA (47%)	Electric power distribution	07/98	1 273	Enron International (United States, 100%)
Cia. Riograndense de Telecomunicações (CRT) (85%) ^b	Telephone service	12/96 07/98	1 018	Telefónica de España (77%)
Centrais Geradoras do Sul do Brasil (GERASUL)	Electric power generation	09/98	808	Tractebel (Belgium, 42%)
Telecommunications^c				
Concession for Area 1 (São Paulo)	Mobile phones	07/97	2 450	BellSouth (United States, 44%)
Concession for Area 2 (São Paulo interior)	Mobile phones	08/97	1 220	Telia (Sweden, 49%)
Concession for Area 3 (Rio de Janeiro and Espírito Santo)	Mobile phones	03/98	1 330	Korea Mobile (Republic of Korea, 20%)
Concession for Area 4 (Minas Gerais)	Mobile phones	04/98	457	Stet (Italy, 43%)
Concession for Area 5 (Paraná and Santa Catarina)	Mobile phones	04/98	680	Motorola (United States, 22%) Global Telecom Nissho Iwai (Japan, 10%); DDI (Japan, 29%)
Concession for Area 6 (Rio Grande do Sul)	Mobile phones	04/98	347	Bell Canada (20%); Telesystem (Canada, 20%)
Concession for Area 7 (North and Centre-west)	Mobile phones	06/97	314	Bell Canada (20%); Telesystem (Canada, 20%); Citibank (United States, 9%)
Concession for Area 9 (Bahia and Sergipe)	Mobile phones	07/97	232	Stet (Italy, 43%)
Concession for Area 10 (North-east)	Mobile phones	08/97	512	BellSouth (United States, 44%)

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the Banco Nacional de Desenvolvimento Econômico e Social (BNDES), *Privatization in Brazil: 1991-1998*, Rio de Janeiro, Secretaria Geral de Apoio a Desestatização, 31 July 1998.

^a From 1996 to July 1998.

^b In December 1996 35% of CRT was sold, then in July 1998 another 50% of the capital controlled by the Brazilian State was privatized. Ultimately Telefónica de España owned 77% of CRT.

^c Details of the privatization of the Telebras system are shown in table II.10.

Table II.10
BRAZIL: PRIVATIZATION OF THE TELEBRAS SYSTEM, JULY 1998^a

	Sector	Minimum price	Sale price	Premium (%)	Purchaser and shareholding
Group A					
Telesp	Fixed-line telephones	3 020	4 961	64.3	Telefónica de España (57%); Portugal Telecom (23%); Iberdrola (Spain, 7%); BBV (Spain, 7%); and RBS (Brazil, 6%).
Tele Centro Sul (Telemato)	Fixed-line telephones	1 673	1 776	6.2	Stet-Telecom Italia (19%); Banco Opportunity (Brazil, 19%); pension funds (Brazil, 62%)
Tele Norte Leste (Telemar)	Fixed-line telephones	2 917	2 946	1.0	Brazilian investors 100%
Embratel	Fixed-line telephones - long-distance and international	1 544	2 273	47.2	MCI Communications Corp (United States, 100%)
Group B					
Telesp Celular	Mobile phones	944	3 078	226.2	Portugal Telecom (100%)
Tele Sudeste Celular	Mobile phones	489	1 167	138.6	Telefónica de España (93%) and Iberdrola (Spain, 7%)
Telemig Celular	Mobile phones	197	648	228.7	Telesystem (Canada, 48%); Banco Opportunity (Brazil, 21%); other Brazilian investors (31%)
Tele Celular Sul	Mobile phones	197	600	204.3	Stet-Telecom Italia (50%); Globo and Bradesco (Brazil, 50%).
Group C					
Tele Nordeste Celular	Mobile phones	193	566	193.3	Stet-Telecom Italia (50%); Globo and Bradesco (Brasil)
Tele Leste Celular	Mobile phones	107	368	242.2	Telefónica de España (93%) and Iberdrola (Spain, 7%)
Tele Centro Oeste Celular	Mobile phones	197	377	91.4	Splice (Brazil, 100%)
Tele Norte Celular	Mobile phones	77	161	108.9	Telesystem (Canada, 48%); Banco Opportunity (Brazil, 21%); other Brazilian investors (31%)
Total		11 555	18 921	63.76	

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the Banco Nacional de Desenvolvimento Econômico e Social (BNDES), *Privatization in Brazil: 1991-1998*, Rio de Janeiro, Secretaria Geral de Apoio a Desestatização, 31 July 1998.

^a The Government of Brazil has disposed of 51.79 of its ownership in each of the 12 companies belonging to the Telebras system.

The presence of Chilean and Spanish firms, as well as a few United States firms (AES Corp. and Community Energy Alternatives (CEA)), has been noteworthy in the privatization of the electric power sector in recent years (see boxes II.4 and III.2). In gas distribution, the United States company Enron has a major role (see box III.3). Mobile phone concessions have been dominated by the United States firm Bell South, the Italian company Stet-Telecom, and Bell of Canada. In the recent privatization of Telebras, Spanish companies were the most active (see box II.5).

Box II.4

FOREIGN COMPANIES DIVIDE UP THE BRAZILIAN ENERGY MARKET

Three years after the beginning of the privatization of electric power distribution companies in Brazil, the great majority of them are in private hands and a significant number are controlled by foreign companies. Firms from the United States (AES Corp. and Community Energy Alternatives (CEA)), Spain (Endesa and Iberdrola) and Chile (Enersis, Chilectra and Endesa) have begun to dominate major parts of the national and regional energy markets in Brazil. There has also been a certain trend towards concentration and regionalization: Iberdrola (Spain) in northern and north-eastern areas; AES Corp. and CEA in the south-east (and that area's connection with Argentina); Enersis and Endesa-España in the south as part of its Mercosur strategy; and the local group Votorantim, Bradesco and Camargo Correa (VBC) in the south and south-west. The investors already present in the market probably intend to consolidate their positions by means of the pending privatizations.

- The Spanish company Iberdrola owns stakes in the Cia. de Eletricidade do Estado da Bahia (COELBA) and the Cia. Energética do Rio Grande do Norte (COSERN), providing electric power to 3 million customers.
- The United States company AES Corp. (see box III.2) controls 90% of the Cia. Centro-Oeste de Distribuição de Energia Elétrica (CCODEE), with 800,000 consumers, owns 14% of the Cia. Energética de Minas Gerais (CEMIG) and participates in the management of Light and Eletropaulo (São Paulo) —the country's biggest markets, with 7.2 million consumers. It has also allied itself with another United States firm, CEA, which controls Cia. Norte Nordeste de Distribuição de Energia Elétrica (CNNDEE). Together, AES and CEA own two energy distribution companies in Buenos Aires. AES is also building a power generation plant in Uruguaiana. It is expanding its strategy to the rest of Mercosur.
- Chilean investors (Endesa, Chilectra and Enersis) are also active in the Brazilian market. Enersis and Chilectra participated in the purchase of Cia. de Eletricidade do Estado do Rio de Janeiro (CERJ) and Cia. Energética do Ceará (COELCE). Endesa owns 60% of Centrais Elétricas Cachoeira Dourada (CDSA). In the case of COELCE, the Chilean companies joined forces with Endesa-España. Thus, the recent strategic alliance between Enersis and Endesa-España (see box I.8) will certainly lead to an increased presence in the Mercosur area for this new Chilean-Spanish group, particularly in electric power generation.

A new model of integrated concentration seems to be appearing in Brazil, whereby the same company controls both distribution and generation —where privatization process has only recently begun. There is a tendency for energy distribution companies to enter the generation segment, up to a certain limit set by the National Agency for Electric Power (ANEEL). Having a stake in generation would give distributors a competitive advantage, since they do not have to expend resources in order to acquire others. The reverse is also taking place, as companies specialize in generation have taken their first steps into the area of distribution in the Brazilian market (AES Corp.).

Box II.5

THE WORLD'S BIGGEST AUCTION: THE PRIVATIZATION OF TELECOMMUNICATIONS IN BRAZIL

On 29 July 1998 a historic event took place in the privatization of State-owned enterprises in Brazil, when the Telebras system, which comprised Brazil's telecommunications companies, was auctioned off. Telebras was one of the world's 20 largest companies, and the biggest in the emerging economies. There are currently 17 million fixed lines in service, 4 million cellular phones and more than 400,000 public telephones. Nonetheless, prospects for growth are highly encouraging; in 1997 alone more than 13 million people were on waiting lists for conventional telephones. Moreover, from 2005 onwards, the successful bidders will be able to compete in the entire Brazilian market, whereas for the moment they are only allowed to supply the regions corresponding to their concessions.

The Government of Brazil collected about US\$ 19 billion from the sale of its majority interest (51.79%) in the 12 companies that made up the entire State-controlled system of fixed-line and mobile telephony, and that amount was used to pay off part of the massive public-sector debt. The estimated reserve price for the auction was US\$ 11.555 billion, meaning that the premium on average was 63.7%.

Foreign capital played a large role in the auction, acquiring shareholdings in 10 enterprises in which it will have controlling interests (see table II.10). The 10 enterprises which came under foreign control represent 82% of the proceeds of the auction. Considering the percentage share of each group, foreign capital contributed US\$ 12.62 billion, equivalent to 66.7% of the total value of the sale. European companies were the big winners, particularly Telefónica de España (Telesp, Telesudeste Celular and Tele Leste Celular), Portugal Telecom (Telesp and Telesp Celular) and Stet Telecom Italia (Tele Centro Sul and Tele Nordeste Celular). The United States company MCI Communications Corp. purchased Embratel for US\$ 2.273 billion.

The group led by Telefónica de España made the largest bid the Brazilian market has ever seen, offering US\$ 4.961 billion for control of the fixed-line telephone company of the state of São Paulo (Telesp), exceeding the reserve price by 64% and topping the second-placed bid by US\$ 1.56 billion. Telefónica has expanded aggressively in Latin America, and the high price paid for Telesp reflects the high strategic value the Spanish company places on the Brazilian market. Telefónica can now become a global operator in the region and, thanks to its recent strategic alliance with MCI, will gain access to a portion of the long-distance network controlled by the United States company, as part of its plan to create a pan-American network uniting the entire continent with Europe and the United States (see box I.9).

In mining, the share acquired by foreign investors in the Vale do Rio Doce company (CVRD) is a minority one (9%). However, most of the resources used by Brazilian groups to purchase CVRD came from a United States bank (Nations Bank), which has a modest presence on the international scene. Control of CVRD was acquired for US\$ 3.132 billion, and Nations Bank provided a bridge loan of US\$ 1.2 billion for the purchase of CVRD by Companhia Siderúrgica Nacional (CSN). According to Dow Jones, the new owners will have to try to lower their debt by selling a shareholding in CVRD, probably to the South African mining company Gencor (*América economía*, June 1997, p. 28).

The great majority of foreign companies which have taken control of privatized assets have been newcomers to the Brazilian economy. Their situation is similar to that of other firms which have recently entered the Brazilian market following the liberalization of many sectors where foreign investors had been subject to considerable restrictions. Generally, their market entry strategy has been to acquire local enterprises. In the services sector, foreign investors were involved in 110 of the 203 transactions that took place between 1992 and 1997. According to the

aforementioned KPMG study, 33% of acquisitions took place in the services sector, concentrated in finance and insurance, telecommunications and information technology.

This phenomenon has been very strong in the financial sector, where increased concentration in banking has been associated with entry by foreign banks (see table II.11). This has included the acquisition in 1998 of Banco Excel-Económico by Banco Bilbao Vizcaya (BBV) of Spain for some US\$ 500 million, and of Banco Real by the Dutch bank ABN Amro for a sum estimated at about US\$ 2 billion. Bamerindus was acquired by the Hong Kong Shanghai Bank Corporation (HSBC), Multiplic by Lloyds Bank, Noroeste by the Spanish bank Santander, and Garantía by Crédit Suisse.

Table II.11
BRAZILIAN SERVICE COMPANIES ACQUIRED BY
FOREIGN INVESTORS, 1994-1998

Company/ Sector	Purchaser	Home country	Amount	Year
Merchandising and supermarkets				
Bompreço	Royal Ahold	Netherlands	...	1996
Cia. Real de Distrib. (50%)	Sonae Distribuição	Portugal	...	1997
Eldorado	Carrefour	France	...	1997
Postos Hudson Brasileira	Texaco	United States	...	1998
Transport and communications				
Gevisa S.A. Locomotivas	General Electric	United States	...	1997
Com. Navegação Aliança	Cía. Sud. De Vapores	Chile	150	1997
Wireles Ventures of Brazil	Nextel Commun.	United States	186	1997
Finance				
Banco Com. de São Paulo	Banque Nationale de Paris (BNP)	France	...	1996
Bamerindus (100%)	HSBC Holdings	United Kingdom	1 000	1997
Banco Noroeste (50%)	Banco Santander	Spain	500	1997
Unibanco (50%)	American Intl. Group	United States	500	1997
Banco Geral do Comércio (51%)	Banco Santander	Spain	150	1997
Banco de Fénicia (51%)	American Intl. Group	United States	100	1997
Banco Noroeste (50%)	Banco Santander	Spain	500	1997
Paulista Seguros	Liberty Mutual Group	United States	105	1997
Multiplic	Lloyds Bank	United Kingdom	...	1997
Banco Real	ABN Amro	Netherlands	2 000	1998
Seg. ao Crédito e Inf.(80%)	Equifax	United States	198	1998
Banco Excel-Económico (55%)	Banco Bilbao Vizcaya (BBV)	Spain	500	1998
Banco Garantía	Crédit Suisse	Switzerland	675	1998
Banco América do Sul	Sudameris	France	...	1998
Other services				
Veja Engenharia Ambiental	Sita	France	...	1997

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information published in *América economía*, various issues, and *Carta Capital*, of 8 July 1998, p. 33.

In merchandising, particularly in fuel distribution, transnational corporations such as Texaco, Esso and Shell hold strong positions and have been present in Brazil for decades. They have expanded their investments by means which include acquisitions, as in the case of Texaco, which purchased the Hudson network of filling stations in the west-central area of the country.

Regarding investments in infrastructure during the period 1996-1999, the most representative projects concern the telecommunications system, both fixed-line and mobile telephone networks. To a great extent, planned investments are related to the federal Government's privatization process and the active presence of foreign companies (CNI/ECLAC, 1977).

3. Market size: the most long-standing advantage of the Brazilian market

In the literature on internationalization of production, and in empirical studies on the determinants of direct investment, market size appears as one of the most important variables influencing FDI. Brazil has an unusual specific local advantage in this respect.

- In terms of its absolute population and national income, Brazil is the world's eighth largest economy, with a GDP of more than US\$ 800 billion and per capita income in excess of US\$ 4,000 per year.
- The Brazilian economy has a history of rapid growth throughout the twentieth century. As stated above, during the period from 1900 to 1980 the average annual rate of GDP growth was 5.7%, while industry grew by about 7.1% per year.
- With low income and consumption levels in a significant part of its population and considerable income concentration, Brazil's internal market has extraordinary growth potential.
- The creation of Mercosur in 1991 led to expanded external trade opportunities at the subregional level and increased exports to Argentina, Uruguay and Paraguay. The regional system of preferential treatment in the context of an imperfect customs union can produce market gains as well as economies of scale.

Recent studies on determinants of investment in Brazil emphasize the importance of the internal market. One study has shown that 76% of Brazil's industrial firms consider prospects for sales on the domestic market to be the main determinant of investment (CNI/ECLAC, 1997, p. 31). It is also noteworthy that 43% of firms see Mercosur as a determining factor in industrial investment; for 41%, exports outside the Mercosur area are very important in their investment decisions. The majority say that the external market has been a factor of little importance in such decisions. Moreover, 57% of the firms in the sample considered the Mercosur market to be of little importance, and 59% of them believed that other external markets carried little weight in their investment decisions.

Another study, even more recent, shows that internal market growth is the most important determinant of FDI in Brazil, both for transnational corporations already present in the country and for new entrants (Laplane and Sarti, 1997b). Greater customer proximity is shown to be the

second most important local variable. These results demonstrate the importance of Brazil's internal market as a determinant of investment in general and FDI in particular.

As for Mercosur, it is frequently and correctly argued that this Latin American subregional market (Argentina, Paraguay and Uruguay) ceased to be a marginal variable in the decisions of Brazilian enterprises with the signing in 1991 of the regional integration agreement (Bouzas, 1997). In 1997, Brazil's exports to Mercosur totalled US\$ 9 billion, equivalent to 17% of total exports and 1.1% of GDP. Thus, although it does not have a significant impact on the Brazilian economy as a whole, Mercosur provides opportunities for the division of labour in the region and economies of scale, which can affect decisions regarding investment in specific sectors or enterprises. This seems to be the case, for example, in the automotive industry (see chapter IV).

For the period 1995-1999, exports to Mercosur appear to be a major factor in investment decisions only in a limited number of industries (CNI/ECLAC, 1997, p. 31). There are five industries in which at least 50% of firms attach great importance to Mercosur: paper and cardboard; metals; wood and furniture; transport equipment; and plastics. The presence of transnational corporations is particularly significant in the last two.

In 1996, in the transport equipment industry, Mercosur represented at least 20% of exports for 37% of the firms in the sample. With the anticipated new investment, this figure would increase to 44%.¹⁰ In 1996, 76% of Brazil's exports of automobiles and auto parts were to Argentina, compared with only 29% in 1989 (see chapter IV).

Regarding the role of Mercosur as a determinant of FDI, recent studies show that transnational corporations' main objective is to increase exports (Laplane and Sarti, 1997b, table II.15, p. 61). For all the firms in the sample, the other goals mentioned are relatively unimportant. These goals and the scores they received (from 1, unimportant, to 10, very important) are as follows: specialization and complementarity of production (4.4); increased imports of inputs (3.2); increased imports of final goods (3.1); and technology exchange (1.7).

There has been significant growth in intra-industry trade, mainly in the following sectors: food, beverages and tobacco; plastics and rubber; wood and leather; footwear; non-electrical mechanical equipment; electrical machinery and equipment; and transport equipment. Except for wood, leather and footwear, transnational corporations have strong positions in both Argentina and Brazil in the above industries (Bielschowsky and Stumpo, 1995). It is to be hoped that this intra-industry trade will also be intra-firm trade, involving affiliates and subsidiaries of transnational corporations in both countries. In this way, Mercosur will provide an opportunity for productive restructuring of networks of affiliates and subsidiaries of transnational

¹⁰ In other industries where transnational corporations are predominant, the relative growth of the Mercosur market does not seem to be a universal trend. For example, applying again the yardstick whereby Mercosur is the destination of at least 20% of a company's exports, this was true of 30.3% of firms in the electrical and communications equipment industry in 1996, and the figure should rise to 36.6% by 1999. For metal machinery and manufactures, the figure was 20.4% in 1996 and is expected to rise to 20.9% in 1999. For the rubber industry, the figure is expected to remain unchanged at 18.2%; and for the pharmaceutical industry, it is expected to fall from 5.3% to 5.0% between 1996 and 1999.

corporations in the southern part of Latin America, so that they can benefit from growth in the regional market and economies of scale brought about by regional integration.

C. CONTRIBUTION OF FOREIGN DIRECT INVESTMENT TO THE BRAZILIAN ECONOMY

As mentioned above, although in the 1970s and 1980s transnational corporations had a relatively small stake in the Brazilian economy as a whole —about 10% of the stocks of capital— they have a significant presence in a number of key sectors, mainly those which are highly technology-intensive.

This is confirmed by data recently published by the central bank in its 1995 census of foreign capital. Transnational corporations accounted for 10% of output in Brazilian industry in 1995 (see table II.12). Their share was much higher in industries such as plastics, rubber, electrical, electronic and communications equipment, transport equipment, and food, beverages and tobacco. The share of international investors in financial institutions was also significantly higher than the average.

Table II.12
CONTRIBUTION OF FOREIGN CORPORATIONS TO OUTPUT
IN BRAZIL, 1995

Sector	Foreign-owned corporations ^a (A)	Brazil (B)	(A/B) %
Primary sector	1 386 992	93 481 117	1.5
Agriculture, forestry and fisheries	377 661	83 299 692	0.5
Mining and extraction	1 009 331	10 181 425	9.9
Manufacturing	77 185 668	395 685 039	19.5
Food products, beverages and tobacco	13 580 473	86 528 146	15.7
Textiles	571 871	16 754 572	3.4
Wearing apparel and footwear	454 859	14 292 255	3.2
Wood products and furniture	1 303 291	18 487 232	7.0
Paper, paper pulp and printing	2 437 598	19 129 181	12.7
Chemical products	14 128 793	74 930 062	18.9
Rubber and plastics products	2 873 209	14 232 810	20.2
Non-metallic mineral products	2 042 415	14 802 380	13.8
Basic metals	4 833 442	50 696 407	9.5
Machinery and equipment	5 931 838	21 866 284	27.1
Electrical, electronic and communications equipment	7 084 758	26 969 733	26.3
Transport equipment	21 943 121	36 995 977	59.3
Services	18 691 916	483 846 284	3.9
Construction	551 909	91 348 289	0.6
Wholesale and retail trade	3 678 114	82 121 621	4.5
Utilities	17	27 771 930	0.0

Table II.12 (concl.)

Sector	Foreign-owned corporations ^a (A)	Brazil (B)	(A/B) %
Transport	491 560	40 071 847	1.2
Communications	27 138	10 631 222	0.3
Financial institutions	10 462 970	62 255 77	16.8
Other services	3 480 208	169 645 598	2.1
Total	97 264 576	973 012 440	10.0

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the Banco Central do Brasil, *Censo de Capitais Estrangeiros no Brasil. Ano-Base 1995*, Brasília, 1998; and H. Zockun, "Capital estrangeiro", São Paulo, Federação de Indústrias do Estado de São Paulo (FIESP)/Centro de Indústrias do Estado de São Paulo (CIESP), 1998, unpublished.

^a Net operating income less imports.

The share of transnational corporations in the total of the 500 largest private firms and the 50 largest public-sector enterprises increased from 31% to 33% between 1990 and 1994, reaching 36% in 1997 (see table II.13). In the early 1990s, about a third of Brazil's industrial output was controlled by transnational corporations; it is therefore probable that, given the strong advances made by those corporations during the current decade through mergers and acquisitions, their role is even greater now in manufacturing. Thus, among the top 500 companies, transnational corporations have acquired a major presence in several industries: food, automobiles, wholesale trade, retail trade, information technology, electronics, pharmaceuticals, mining, plastics, rubber and utilities (see table II.14). In addition, the relative share of transnational corporations in the Brazilian economy seems to be increasing.

Table II.13
**SHARE OWNED BY TRANSNATIONAL CORPORATIONS IN
 BRAZIL'S 500 LARGEST ENTERPRISES, 1990-1997^a**

(Percentages)

	1990	1991	1992	1993	1994	1995	1996	1997
Foreign enterprises	31.0	31.0	31.3	35.0	32.0	33.3	34.1	36.3
Brazilian enterprises	42.7	42.4	41.7	40.2	44.0	43.6	42.1	40.4
State-owned enterprises	26.2	26.6	27.0	24.8	24.0	23.1	23.8	23.3

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from "As 500 Maiores Empresas do Brasil", published by the periodical *Exame*, various issues.

^a Data refer to the 500 largest private enterprises and the 50 largest public-sector enterprises.

Table II.14
**SHARE OWNED BY TRANSNATIONAL CORPORATIONS IN
 BRAZIL'S 500 LARGEST ENTERPRISES, BY SECTOR, 1990-1997 ^a**
(Percentage of total sales)

Sector	1990	1994	1995	1996	1997
Mining	8	6	7	7	12
Food	35	41	50	42	57
Beverages	53	55	49	15	15
Clothing and textiles	na	na	na	9	13
Clothing	10	8	8	8	na
Textiles	14	7	12	15	na
Pulp and paper	21	16	16	18	18
Chemicals and petrochemicals	26	24	22	20	22
Pharmaceuticals	80	73	63	72	79
Personal hygiene and cleaning products	88	91	89	89	87
Plastics and rubber	60	58	49	49	62
Building materials	na	32	31	29	29
Iron and steel, metallurgy	na	na	21	25	24
Machinery	na	44	44	46	45
Data processing	62	69	78	79	81
Electronics	34	34	45	43	48
Automotive	92	91	93	93	95
Construction	0	0	0	0	3
Wholesale trade	20	23	25	35	34
Retail trade	0	18	23	17	25
Transport services	2	2	2	4	2
Telecommunications	na	0	0	0	0
Utilities	0	0	0	3	7

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from "As 500 Maiores Empresas do Brasil", published by the periodical *Exame*, various issues.

^a Data refer to the 500 largest private enterprises and the 50 largest public-sector enterprises.

In recent years there seems to be an increase in the presence of transnational corporations in the Brazilian industrial sector, associated with considerable economic concentration and a slowing in industrial output, accompanied by a pronounced modernization of the industrial structure. Business strategies of streamlining and restructuring may be supported by FDI flows or by investments in national currency by transnational corporations already present in the country.

Historically, FDI flows have not contributed greatly to GDP or to overall investment in the Brazilian economy.¹¹ In recent years (1996-1998) there has been a significant change. It is estimated that in 1998 the ratio of FDI to GDP will reach 2.5% and that of FDI to gross fixed capital formation (GFCF) will be about 13%. These ratios are at record levels for the Brazilian economy in the recent past. They are largely due to privatizations, which accounted for 28% of Brazil's total FDI inflows in 1996 and 1998 (see table II.1). Owing to the recent sale of the Telebras system, the relative share of privatizations in total FDI flows should be even higher by the end of 1998. Although the privatizations process will continue in 1999-2000 with banks

¹¹ During the 1980-1995 period, the ratio of FDI to GDP never exceeded 1%, and that of FDI to gross fixed capital formation (GFCF) was less than 3%.

owned by the states, new telecommunications concessions, oil companies (Petrobras) and others (including the privatization of the Banco do Brasil, Latin America's biggest bank), this exceptional upward trend in the FDI/GDP and FDI/GFCF ratios is likely to end at some point in the near future.

During the period 1996-1998 (or 1996-1999) Brazil may be repeating the Argentine experience of the early 1990s, when privatizations accounted for more than half of that country's FDI inflows.¹² The unusual growth of FDI in the Brazilian economy during the 1996-1998 period is therefore more likely to be of a short-term nature rather than a sustainable trend. While it is true that these transferred assets will require large amounts of resources for modernization and expansion, the bulk of the inflows will be payments in connection with the privatization process, which will dwindle with time.

1. Transnational corporations and the balance of payments

The issue of the possible unsustainability of the current extraordinary upward trend in FDI flows in the Brazilian economy has given rise to analysis of the impact of transnational corporations on the balance of payments, a subject which has been intensely debated in Brazil. Using the data published by the central bank in its 1995 census of foreign capital, it is possible to construct a balance of payments for the transnational corporations present in the country.

Although this is not a complete balance, it is useful to analyse the available information, covering 6,322 firms in which foreign investors hold at least 10% of the voting capital (see table II.15).

- In 1995, the trade balance for those firms was positive, amounting to US\$ 2.374 billion. Goods exports (f.o.b.) totalled US\$ 21.745 billion or 40.9% of total exports, and goods imports (f.o.b.) totalled US\$ 19.371 billion, 38.8% of the country's total imports.
- For the Brazilian economy as a whole, the negative contribution of transnational corporations to the transactions deficit was 22%; however, discounting unilateral transfers, their contribution to the deficit was 28%.¹³

¹² FDI inflows resulting from privatizations in the Argentine economy totalled US\$ 3.1 billion in 1993 (50% of total FDI) and fell to US\$ 547 million in 1994 (ECLAC, 1997b, p. 63).

¹³ In the balance on services, transnational corporations showed negative balances under the heading of interest (US\$ 1.249 billion) and profits and dividends (US\$ 2.571 billion). In addition, the value of reinvested earnings—which appear as a negative contribution in the services account and a positive amount in the capital account—totalled US\$ 384 million. Royalty payments amounted to US\$ 255 million. Bearing in mind the average c.i.f./f.o.b. ratio of 10% for Brazil's imports, expenditure on freight and insurance can be estimated at US\$ 1.937 billion. The sum of these figures yields a negative balance for the current transactions of the transnational corporations as high as US\$ 3.963 billion for 1995.

Table II.15
**BRAZIL: TRANSNATIONAL CORPORATIONS AND
 THE BALANCE OF PAYMENTS, 1995**

	Transnational corporations	Brazil
1. Trade balance (f.o.b.) (2+3)	2 374	-3 352
2. Total exports	21 745	46 506
Intra-firm exports	9 078	na
Other exports	12 667	na
3. Total imports	-19 371	-49 858
Intra-firm imports	-8 529	na
Other imports	-10 842	na
4. Balance on services (5+8+9)	-6 337	-18 594
5. Factor services (6+7)	-3 761	-10 748
6. Interest	-1 249	-8 158
Intra-firm interest payments	-515	na
Other interest payments	-1 100	na
Total interest payments	-1 615	-10 643
Intra-firm interest receipts	136	na
Other interest receipts	230	na
Total interest receipts	366	2 485
7. Profits and dividends (net)	-2 512	-2 590
Remitted	-3 183	-3 501
Received ^a	671	911
8. Reinvested ^b	-384	-384
9. Non-factor services	-2 192	-7 462
Freight and insurance, expenditure ^c	-1 937	-5 035
Freight and insurance, income	na	1 902
Royalties	-255	na
Other services	na	-4 329
10. Unrequited transfer payments (net)	na	3 974
11. Current transactions (1+4+10)	-3 963	-17 972
12. Balance on capital account	4 312	29 359
Foreign direct investment (net) ^b	3 928	3 928
Inward ^b	5 091	5 091
Outward ^b	-1 163	-1 163
Investment abroad by residents	na	-1 559
Portfolio investment (net)	na	2 294
Reinvested earnings ^a	384	384
Financing	na	2 834
Amortization payments	na	-11 023
Medium- and long-term loans	na	14 736
Short-term capital	na	18 834
Other capital	na	-1 069
13. Errors and omissions	na	2 093
Balance (11+12+13)	349	13 480

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the Banco Central do Brasil, *Censo de Capitais Estrangeiros no Brasil, Ano-Base 1995*, Brasilia, 1998, table I.

^a Refers to sums received as calculated using the equity equivalency method (US\$ 652 million) and the adjusted costs method (US\$ 19 million).

^b The value given for transnational corporations is equal to the total shown on the country's balance of payments.

^c Estimated on the basis of the average c.i.f./f.o.b. ratio for the country's imports, which is 10%.

- The balance-of-payments capital account shows a positive balance of US\$ 4.312 billion. The data released by the central bank does not provide information on external resources mobilized by subsidiaries and affiliates of transnational corporations present in Brazil. The capital account therefore underestimates the role of transnational corporations in external resource mobilization.

Despite the deficiencies of the data, and taking the figures as an order of magnitude, the outcome is that the contribution of transnational corporations to Brazil's balance of payments was practically zero, since the negative current account balance of US\$ 3.963 billion was financed by the positive capital account balance of US\$ 4.312 billion. In this regard, some activities, like those of the Manaus Free Zone, have proved very costly in terms of their impact on the balance of payments (see box II.6).

Regarding the balance of payments, while FDI inflows are growing at an extraordinary rate, there is at the same time a significant increase in outward flows in the form of profit and dividend remittances. Gross profit and dividend remittances rose from US\$ 3.841 billion to US\$ 6.508 billion between 1996 and 1997, an increase of 69.4% (see table II.16).

FDI inflows into the service sector, mainly through concessions and privatizations, should lead to even greater outflows of profit and dividend remittances in future, which will not be made up for by generation of income in foreign currency through exports. In other words, concerning the impact of FDI on Brazil's balance of payments in the near future, there are three points to be made: the extraordinary growth in the ownership of real assets by non-residents, the gradual dwindling of the privatization process, and the fact that the great majority of FDI flows have been into non-tradables sectors. It is therefore likely that in the near future there will be a significant deterioration in the balance of payments of transnational corporations in the Brazilian economy.

Box II.6

THE MANAOS FREE TRADE ZONE: ONE OF THE REGION'S BIGGEST INDUSTRIAL PARKS

Thirty years ago, the Brazilian Government created the Manaus Free Zone, granting land subsidies as well as tax exemptions and low tariffs for imported inputs. About 500 companies, mostly electronics manufacturers such as Toshiba Corp., Samsung Electronics Co., Sony, Philips Electronics NV and Xerox Corp., have set up assembly plants in this Amazonian city. With the advantages of a protected market, television sets and audio equipment produced in Manaus have dominated the Brazilian market despite their moderate quality. In the early 1990s, with the beginning of trade liberalization, these assembly plants encountered great difficulty in competing with imports, and many had to close down.

Faced with this situation, the authorities made it easier for the companies to fulfil local-content requirements, enabling them to use imported components. New rules for imports were established in 1993; in the context of the expanding Brazilian economy, these contributed to strong growth of the zone's industrial activities, and earnings totalling more than US\$ 11 billion were recorded in 1997. However, the increasing proportion of imported components in the finished products began to have a significant impact on Brazil's growing balance-of-trade deficit, causing great difficulties for the authorities responsible for economic policy.

Brazil's balance-of-trade deficit in 1997 amounted to some US\$ 8 billion, of which US\$ 3 billion was due to imports of electronic components through Manaus. Also, companies began to automate production, cutting back considerably on employment. In 1997 some 45,000 people worked in the free zone, which was half the number recorded at the beginning of the 1990s. Furthermore, the US\$ 2.4 billion provided each year by the Government in subsidies to the free zone were equivalent to about US\$ 50,000 for each industrial job, which was about ten times the average salary of the workers involved.^a

Box II.6 (concl.)

In mid-1997 the Government cut the incentives drastically, seeking to stimulate sales to external markets and encourage the industrial firms in the zone to export. Despite this, taking refuge in the Constitution of 1988, the state of Amazonas, which receives 40% of its fiscal revenue from the industrial park, obtained a temporary reversal of the suspension of subsidies.

Prospects for conversion to exports are uncertain for the great majority of the companies in the Manaus Free Trade Zone. In the case of the television assembly plant of the Japanese firm Sony, the main components produced in Brazil are the casings of the television sets and the boards bearing the semiconductor chips. The chips, like the other higher-value components, are imported. The finished product is sold for about US\$ 300, a price that is not competitive on the international market. There are, however, successful examples of export, such as Honda Motors, which exports motorcycles almost entirely manufactured in Manaus; Coca-Cola, which exports concentrate; and Gillette, whose razor-blades made in Manaus are sold in external markets.

In the light of the current international situation and its strong impact on Brazil, the Manaus experiment has been seriously called into question. Given the enormous costs in terms of subsidies and foreign currency for imports, its survival is in some doubt.

^a *The Wall Street Journal Americas*, "Zona Franca de Manaus: especie en vías de extinción?", *El Mercurio*, Santiago, Chile, 13 July 1998.

Table II.16
REMITTANCES OF PROFITS AND DIVIDENDS, 1996-1997
(Millions of dollars and percentages)

	1996		1997		Percentage variation 97/96
	Amount	%	Amount	%	
Dividends and bonuses	1 154	30.1	1 819	28.0	57.6
Shares of non-subsidiaries	376	9.8	365	5.6	-2.9
Shares of Brazilian companies	340	8.9	355	5.5	4.4
Shares of foreign companies	36	0.9	9	0.2	-75.0
Annexes 1-4 (Res.1289)	778	20.3	1 454	22.4	86.9
Dividends	655	17.1	1 065	16.4	62.6
Cash bonus payments	0	-	0	-	-
Capital gains	123	3.2	389	6.0	216.3
from equity investments	7	0.2	78	1.2	1014.3
from other investments	78	2.0	280	4.3	259.0
Profits, dividends and bonuses	33	0.9	30	0.5	-9.1
Profits of subsidiaries and affiliates	2 687	70.0	4 688	72.0	74.5
Profits of non-financial institutions	95	2.5	88	1.4	-7.4
Profits of financial institutions	51	1.3	52	0.8	2.0
Profits of subsidiaries and affiliates	1 866	48.6	3 016	46.3	61.6
Interest on equity capital	675	17.6	1 533	23.6	127.1
Total	3 841	100.0	6 508	100.0	69.4

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the Central Bank of Brazil and the Brazilian Society for the Study of Transnational Corporations and Economic Globalization (SOBEET).

2. Transnational corporations and exports

As mentioned above, transnational corporations account for about 40% of Brazil's exports. Nonetheless, these firms have a relatively low propensity to export (exports/total sales), since the internal market is their main focus. In the case of manufacturing, the average export propensity of the transnational corporations fell from 11.3% to 10% between 1995 and 1996 (see table II.17). There is, however, a considerable discrepancy among the various industries; exports seem to be stronger in the sectors characterized by more intensive use of natural resources, which are relatively speaking the most abundant factors of production in the Brazilian economy. The main examples are the iron and steel industry, metal-ore mining, and the pulp and paper industry. Transport equipment firms (passenger vehicles, tractors, auto parts) also have a propensity to export that is well above average as a result of the intraregional division of labour brought about by the restructuring of transnational corporations in the Mercosur area.

Table II.17
**BRAZIL: TRANSNATIONAL CORPORATIONS AND
 EXPORTS OF MANUFACTURES, 1995-1996**
(Millions of dollars and percentages)

	No. of firms	Exports				Exports/Sales (%)	
		1995		1996		1995	1996
		Amount	%	Amount	%		
Food products	33	1 310	7.7	1 317	7.8	7.1	5.2
Beverages and tobacco	17	1 079	6.3	1 190	7.1	8.5	9.7
Textiles	18	226	1.3	214	1.3	10.8	12.5
Paper and pulp	6	1 264	7.4	883	5.3	32.7	29.2
Chemicals	42	710	4.1	738	4.4	6.7	6.3
Pharmaceuticals	21	167	1.0	180	1.1	3.1	2.9
Petrochemicals	17	442	2.6	377	2.2	9.0	8.0
Tyres	4	482	6.0	511	3.0	8.6	20.1
Metals	22	1 803	10.5	1 559	9.3	23.3	22.0
Processed ores	4	266	1.6	273	1.6	51.4	60.6
Iron and steel	12	1 788	10.5	1 689	10.1	21.5	20.9
Machinery	35	923	5.4	867	5.2	18.0	16.9
Electrical equipment	7	93	0.6	72	0.4	4.7	3.3
Electronics	19	348	2.0	441	2.5	8.5	8.3
Information sciences - computers	9	220	1.3	313	1.9	5.6	7.8
Photographic equipment	10	264	1.5	212	1.3	32.2	21.7
Transport equipment (tractor- trailers)	4	348	2.0	390	2.3	26.9	36.7
Motor vehicles	14	2 456	14.4	2 782	16.6	8.6	8.7
Automobile parts	35	1 266	7.4	1 222	7.3	18.7	19.3
Total	412	17 099	100.0	16 794	100.0	11.3	10.0

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the Ministry of Industry, Commerce and Tourism (MICT), *Oportunidades, Intenções e Desisões de Investimento no Brasil, 1995-2003*, Brasília, 1996; Foreign Trade Department (SECEX), *Balança Comercial Brasileira*, Brasília, Ministry of Industry, Commerce and Tourism (MICT) (various issues) and Brazilian Society for the Study of Transnational Corporations and Economic Globalization (SOBEET), *Carta da SOBEET*, São Paulo (various issues).

This phenomenon is particularly strong in the automotive industry, especially between Brazil and Argentina, owing to a trade equalization mechanism between these two countries (see chapter IV). Trade flows (exports plus imports) increased from US\$ 478 million to more than US\$ 4.55 billion between 1991 and 1997. In the past year, trade flows between Argentina and Brazil made up 92% of the total amount for the Mercosur area (see table II.18).

Table II.18
BRAZIL: THE 30 LEADING TRANSNATIONALS IN THE EXPORT SECTOR, 1994-1997
(Millions of dollars)

Company	Subsector	Main destination market	1994	1995	1996	1997
Ford Indústria e Comércio	Automobiles	Argentina	382	406	849	1 000
Fiat Automóveis S.A.	Automobiles	Argentina, Eur. Union	625	444	330	928
General Motors do Brasil	Automobiles	Argentina, United States	271	266	612	725
Volkswagen do Brasil S.A.	Automobiles	Argentina	593	714	556	563
Coinbra S.A.	Merchandising	...	188	162	150	549
Souza Cruz Trading S.A.	Tobacco	...	215	287	425	410
Glencore	Merchandising	...	...	...	195	504
Cargill Agrícola	Food	...	...	...	195	386
Santistas Alimentos	Food	...	...	...	277	382
Caterpillar Brasil S.A.	Machinery	Argentina	239	239	224	338
Philip Morris Marketing S.A.	Tobacco	...	215	228	314	324
Universal Leaf	Tobacco	...	...	...	224	317
Mercedes Benz do Brasil	Automobiles	Argentina	481	401	249	315
Robert Bosch	Auto parts	Germany, United States	217	258	266	289
Alcoa Alumínio S.A.	Aluminium	...	293	324	253	266
Billiton Metais (Shell Brasil)	Aluminium	...	...	...	271	265
Goodyear do Brasil Ltda.	Tyres	United States	195	207	212	249
Starexport Trading SA	Auto parts	...	...	...	185	236
Bayer SA	Chemicals	European Union	...	...	193	200
Shell Brasil SA	Petroleum	United States	...	...	162	196
Velrome/Ishibras	Auto parts	...	...	...	...	182
Kodak Brasileira Com. e Ind.	Photographic material	...	108	89	161	...
Copaf	Auto parts	...	109	136	143	...
IBM Brasil	Computers	...	81	87	136	...
Pirelli Pneus S.A.	Tyres	...	109	122	132	...
Nestlé Ind. e Com. Ltda.	Food	...	77	143	123	...
Compaq Computer Brasil	Computers	...	...	59	117	175
Scania do Brasil	Automobiles	Argentina	115	127	112	161
Champion Papel e Celulose	Paper and pulp	...	93	173	110	...
Basf Brasileira SA	Chemicals	...	33	65	107	...
Philips do Brasil Ltda.	Electronics	...	99	90	103	...

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information provided by M.F. Laplane and F. Sarti, "O investimento direto estrangeiro no Brasil nos anos 90: determinantes e estratégias", Campinas, Universidad Estadual de Campinas (UNICAMP), July 1997; and *América economía*, 16 July 1998.

In recent years the regional integration process has led to increases in intra-firm trade and in the export/import coefficient within the Mercosur area (Laplane and Sarti, 1998, table 2.12). There are some segments in which Brazil has comparative advantages, and which have experienced higher export coefficients and ever-increasing trade surpluses. At the same time, however, trade liberalization during the 1990s has aggravated the deficit in most sectors, increasing the trade deficit of the transnational corporations present in the Brazilian economy (Laplane and Sarti, 1998, table 2.9).

D. CONCLUSIONS

Historically, there has been a high level of internationalization of production in the Brazilian economy. The size of the internal market, both actual and potential, is certainly the most important determinant of FDI in Brazil. Foreign companies have a strong presence in many technologically dynamic sectors, where they account for about 10% of the stock of capital and production. However, FDI flows have seldom had a major impact on gross fixed capital formation and GDP. Capital accumulation by transnational corporations in Brazil depends to a great extent on retained earnings reinvested in the country, in other words, on the self-financing capacity of subsidiaries and affiliates.

Beginning in 1995, together with increased worldwide FDI flows, there was an unusual upsurge in FDI inflows into the Brazilian economy. These investments have mostly been linked to the granting of public service concessions and privatizations of State-owned enterprises. An intense period of mergers and acquisitions of local private companies has also led to an upward trend in the presence of transnational corporations in the country's economy.

The changes which have taken place in Brazil during the 1990s, particularly those related to financial, exchange-rate and trade liberalization, have been major factors in processes of productive restructuring involving subsidiaries and affiliates of transnational corporations present in the country. Significant shifts in patterns of competition brought about changes in business strategies, in some cases in response to the creation of Mercosur. Transnational corporations, particularly in the automotive industry, benefit from this regional integration system with Argentina, since it allows economies of scale (see chapter IV).

Despite the success of the stabilization programme, the Brazilian economy continues to show serious macroeconomic imbalances including sizeable public-sector and balance-of-payments deficits. In addition, inflation control has been founded upon recessionary policies. It would therefore be difficult to argue that the changes which have occurred in the macroeconomic sphere have been decisive factors in attracting FDI to Brazil since 1995.

The most important determinants of FDI in Brazil in recent years include the changes made in the regulatory framework and, above all, concessions of public services and privatization of public-sector enterprises at the federal and state levels. An increasing proportion of FDI inflows since 1995 have been due to privatizations. These investments in non-tradable sectors have generated greater interest in analysis of the impact of transnational corporations on Brazil's

balance of payments, since the current account deficit has worsened in recent years. There are still doubts as to whether FDI flows in connection with privatizations will require increasing mobilization of external resources to service productive foreign capital (in the form of profit remittances). This issue is particularly serious given that resources derived from privatizations tend to diminish with time, that is, as there are fewer concessions to be granted and fewer public-sector enterprises to be sold in all the various service sectors.

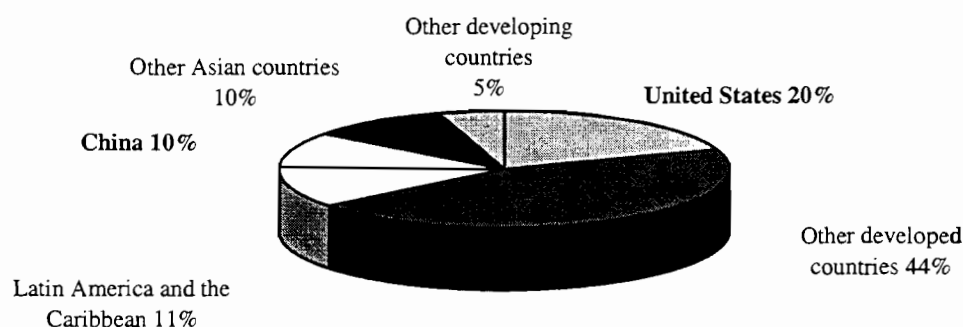
Analysis of capital inflows in 1997, especially the last few months, shows that the impact of the Asian crisis on FDI flows has been less obvious than on other forms of foreign investment, since FDI represents longer-term decisions and, as we have seen, is mainly associated with the privatization process. Preliminary data suggest that FDI flows for the first nine months of 1998 equalled US\$ 18 billion, and for the year as a whole should total US\$ 24 billion (Banco Central do Brasil, 1998b). It is difficult at present to assess the impact of the crisis, particularly for investments in manufacturing industry; decisions to postpone or downsize current investment plans will depend to a great extent on forecasts of domestic demand for the next few years.

III. UNITED STATES: INVESTMENT AND CORPORATE STRATEGIES IN LATIN AMERICA AND THE CARIBBEAN

A. UNITED STATES: THE WORLD'S LARGEST SOURCE AND DESTINATION OF INVESTMENT

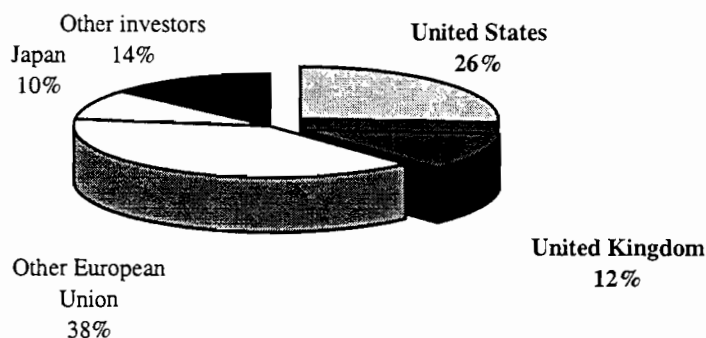
Although many economies have posted record levels of investment during the present boom in foreign direct investment (FDI) flows, a very substantial portion of the increase in FDI has been attributable to just two countries: the United States and China. Between 1990 and 1997, these two economies received nearly a third of total inflows of FDI (see figure III.1). By the same token, the United States and the United Kingdom have led the increase in FDI outflows, with almost 40% of total outward FDI for this same period coming from one or the other of these two sources (see figure III.2). Hence, the United States is, at one and the same time, both the world's largest investor and its largest FDI recipient.

Figure III.1
UNITED STATES: SHARE OF TOTAL INWARD FOREIGN DIRECT
INVESTMENT, 1990-1997
(Percentages)



Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the International Monetary Fund (IMF).

Figure III.2
**UNITED STATES: SHARE OF TOTAL OUTWARD FOREIGN DIRECT
 INVESTMENT, 1990-1997**
(Percentages)



Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the International Monetary Fund (IMF).

During the 1990s, the share of total FDI flows made up of equity investment has been increasing, primarily as a result of acquisitions and merger activity. In the last six years, such operations have become much more prevalent, and in 1997 these types of transactions amounted to a record figure of US\$ 341.653 billion, although this includes some minority equity investments that are classified as portfolio investment. If only those operations involving the acquisition of a majority interest are counted, then the figure falls to US\$ 236.216 billion, or 60% of total FDI flows (UNCTAD, 1998, p. 19). Most of these transactions are conducted between firms in developed countries, with transnational corporations based in the United States and the United Kingdom playing the most active role in this sphere. In fact, in 1997 they accounted for 33% of the acquisitions of majority holdings and 46% of such sales, measured in value terms.

In the mid-1980s, mergers and acquisitions began to become more frequent and to displace greenfield investment as the mechanism of choice for moving into external markets. In the case of the United States, greenfield investments represented 55% of all foreign direct investment between 1990 and 1994, versus 62% for the period 1951-1960 (Mataloni and Fahim-Nader, 1996; Gurham, Davidson and Suri, 1977). The percentage of FDI inflows to the United States economy corresponding to acquisitions has also been on the rise, especially since 1991.

United States firms play an extremely important role in the international economy, and this has been accentuated by the fact that, in addition to traditional FDI flows, a growing number of transborder agreements¹ are being concluded between companies in different countries. During the period 1990-1995, companies in countries belonging to what has come to be known as the "Triad" accounted for the bulk of these new international agreements, with firms in the countries of the European Union participating in 40% of them, Japanese firms in 38% and United States firms in 80% (UNCTAD, 1997).

In the course of the 1980s, the environment for technological innovation changed radically, and activity in this area, which had been fairly predictable and stable until that time, became more dynamic and more variable. There were a number of reasons why this occurred. In many industries, individual firms found it necessary to undertake large capital investments and R&D campaigns in order to remain competitive. More than ever before, firms were faced with the need to select and launch competitive capital-intensive projects. Intangibles such as know-how and innovativeness came to be recognized as crucial factors in a firm's ability to develop new products more efficiently. In addition, inter-firm competition became increasingly more globalized as markets and production systems became more fully integrated at the regional or international levels.

Initially, firms responded to these factors by resorting to mergers and acquisitions as a way of attaining the critical mass of resources they needed to stay competitive. This course of action did not, however, allow them the flexibility they needed to react to changes in patterns of demand and to the shortening of product cycles resulting from the more rapid pace of technological innovation, the reduction of lead times and the use of flexible production techniques.

Firms therefore began to form strategic alliances that allowed them to gain access to complementary technologies, to cut costs and reduce risk, and to generate synergies and spillovers. In high-technology industries, the formation of such alliances usually results in significant technological synergies, rapid innovation, access to tangible and intangible resources, and lower R&D costs and risks (UNCTAD, 1997). For firms in developing countries, these kinds of strategic alliances provide them with an opportunity to strengthen their technological capabilities and to shift over to products involving a higher value added more quickly.

Most transborder strategic alliances that do not involve equity investments are formed between developed-country firms. In 1995, 86% of the known agreements of this type involved at least one United States firm, 42% included one or more firms in countries belonging to the European Union, and 31% involved a Japanese firm or firms (UNCTAD, 1997).

Thus, internationalized production —the siting of value-added activities in a foreign country under the supervision of a transnational corporation— entails an integrated package of capital, technologies, skills, administrative practices, commercial ties and other elements that a transnational corporation must have when it engages in production activities overseas. It is very difficult, using the resources at hand, to gauge the real proportions of this phenomenon

¹ These agreements cover licensing, subcontracting and outsourcing, franchising arrangements, marketing, research and development (R&D), exploration and joint ventures (UNCTAD, 1997).

accurately, since the figures on FDI flows commonly used to measure foreign direct investment by transnational corporations are flawed in both statistical and valualational terms.² Unfortunately, however, this is the best information currently available.

According to the data compiled by the Bureau of Economic Analysis of the United States Department of Commerce, foreign investment by the United States has grown considerably in recent years, keeping pace with the boom in FDI at the world level. Outward FDI flows from the United States leaped from an annual average of almost US\$ 15 billion during the 1980s to over US\$ 67 billion in 1990-1997, and in the last three years has topped US\$ 93 billion. Over 60% of direct investments by United States firms are in Western Europe (mainly the United Kingdom, Germany and the Netherlands) and Canada. Among the developing regions, Latin America and the Caribbean have been the destination for over 20% of total outward investment by the United States, which is twice as much as the Asian economies (chiefly China, Singapore and the Chinese Province of Hong Kong) have received.³

A number of interesting changes have been observed in the stock of outward United States investment. In 1982, 66% of these funds were in Western Europe (primarily the United Kingdom), Canada and Japan. In terms of sectors, the largest share was being channeled into manufacturing (40%) —chemicals, industrial machinery and equipment, and transport equipment— and the oil industry. In 1990, most (69%) of the stock of United States direct investment was in countries belonging to the Organization for Economic Co-operation and Development (OECD) (see figure III.3); 48% of this stock of investment was in services, particularly in finance (insurance companies, banks and real estate) and commerce. Manufactures maintained their percentage share, with investments concentrated in industrial equipment and machinery in Europe, chemicals in Canada and Europe, and transport equipment in Europe and Latin America.

In the course of the 1990s the stock of United States FDI has practically doubled, reaching US\$ 860.723 billion in 1997. This demonstrates the forcefulness of the boom in FDI and the extent of the demands which the globalization and technological development processes place on transnational corporations. Although these funds are still concentrated in Western Europe (especially the United Kingdom and the Netherlands)⁴ and Canada, developing

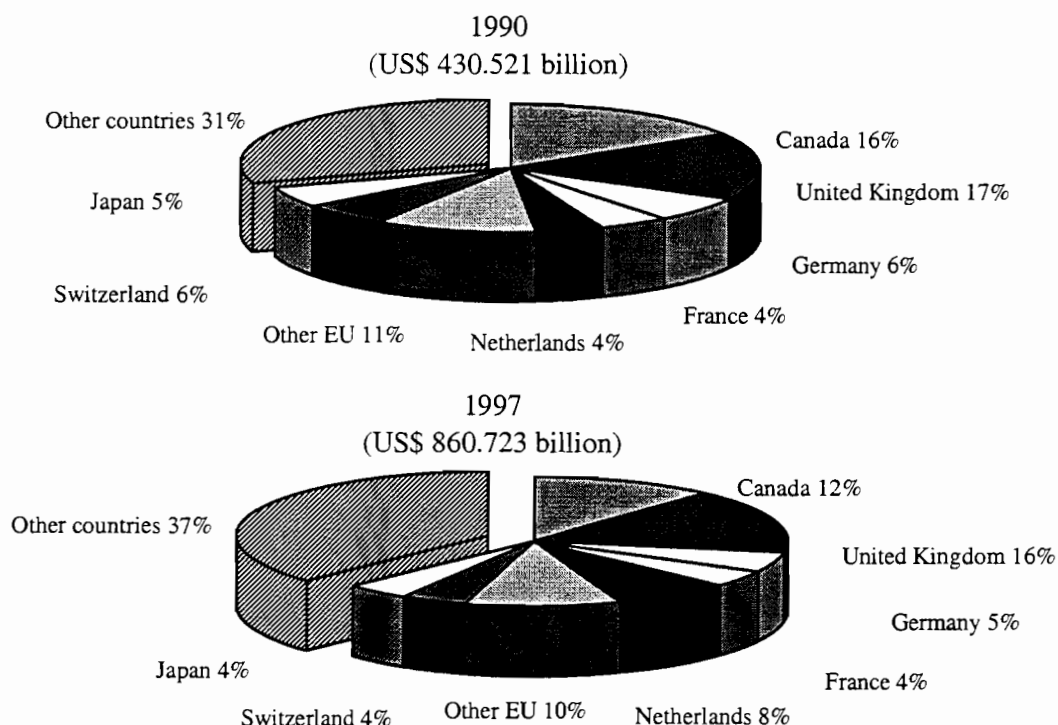
² These statistics do not reflect the actual amounts invested in foreign subsidiaries. Specifically, and by way of example, the available figures only cover the transnational corporation's (i.e., the parent company's and foreign subsidiaries') resources and do not take funding from outside sources into account. Since transnationals draw upon many different sources of financing, the total sum of external resources used in direct investment projects tends to be very considerable.

³ The most disaggregated statistics issued by the United States Department of Commerce cover only those subsidiaries in which United States corporations hold a majority interest. This means that the available figures underestimate the presence of United States transnationals in Asia, where United States investment modalities have included minority holdings and other types of non-equity associations; in contrast, United States investments in Latin America have generally taken the form of majority interests in subsidiaries or branches.

⁴ In recent years, a substantial portion of United States investments in the United Kingdom and the Netherlands have gone to holding companies, which are placed under the heading of finance (except depository institutions), insurance and real estate. This would appear to indicate that much of the profits of subsidiary firms that have been retained by their holding companies are being reinvested. New investments made by holding companies in

economies' importance as a destination for United States investment has increased considerably (see figure III.3). United States firms have stepped up their investment activity in a number of emerging markets, especially developing countries in Asia and Latin America. Between 1982 and 1997, the Latin American and Caribbean region's share of the total amount of FDI coming from the United States jumped from 13% to 20%, while developing Asian countries' share grew from 6% to 9%. This trend has allowed some developing countries to become more fully incorporated into the integrated production systems of the world's major transnational corporations.

Figure III.3
GEOGRAPHIC DISTRIBUTION OF THE STOCK OF UNITED STATES
FOREIGN INVESTMENT, 1990-1997
(Percentages)



Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the United States Department of Commerce, Bureau of Economic Analysis.

the Netherlands have gone primarily to Asia, but British holding companies' investments have been channeled to various regions of the world (Bargas, 1998). This is yet another factor that distorts the available information on direct investment.

B. UNITED STATES AND LATIN AMERICA: A NEW INVESTMENT RELATIONSHIP

Traditionally, the United States has been the largest foreign investor in Latin America and the Caribbean. Since the Second World War, its stock of direct investment has been concentrated in the manufacturing sector (particularly in food processing, chemicals, machinery and equipment) and in natural resource-based activities (mainly mining and the oil and gas industries).

In the 1950s and 1960s, the subsidiaries of United States companies in the region met the import-substitution needs of the local economies and, to a fairly limited extent, exported raw materials. Although it is true that United States-based transnationals have generated an increasing proportion of Latin America's exports of manufactures, in general their propensity to export has been quite low, due to their preference for the region's domestic markets, which are usually more profitable, and the relative inefficiency of local operations (Mortimore, 1993). After mining and oil companies were nationalized in the 1960s and 1970s, the attitude of the United States firms active in these sectors changed. Now, the ongoing globalization process and the challenge it poses in terms of manufacturing firms' orientation have caused United States firms located in the region to modify their behaviour substantially.

These firms have dominated a very large segment of Latin America's manufacturing sector, especially its more technologically complex industries (e.g., chemicals and machinery).⁵ They began by creating miniature replicas of the factories they had in the United States to assemble their products locally (using mostly imported components) and sell them on the region's protected markets. Trade restrictions made it necessary to set up a subsidiary in each market, and trade between these markets was therefore quite limited. Because these operations were inefficient, they failed to achieve threshold economies of scale—to say nothing of how far removed they were from the parent company's technological frontier—and were therefore unable to provide any significant stimulus for the competitiveness of the destination economies; this was particularly true in relation to exports (Jenkins, 1990; Blomström, 1990).

In the 1980s, when the region was in the throes of the external debt crisis, the transition being made by industrial enterprises from import substitution to export activity represented the greatest challenge facing United States transnationals operating in the region. Basically, these companies had three options: *withdraw*; *streamline* their operations by cutting costs and thus defend their market share; or *restructure* their operations (which called for large investments) and reorient their subsidiaries so that they could play a valuable role in the parent company's international system of integrated production.

These changes are reflected in the positions occupied by United States firms located in Latin America and the Caribbean in the 1990s. Since the official statistics do not provide a clear

⁵ In most cases, Latin American authorities have encouraged transnational corporations to set up operations in high-technology industries in the belief that these firms will supply the necessary technology; in many cases they have also required new entrants to undertake joint ventures with national companies in certain industries (auto parts, petrochemicals, computer hardware, etc.).

picture of the true extent of these changes, it is helpful to use them in combination with data from recent analytical studies. An examination of the new corporate strategies in use in the region helps us to arrive at a fuller understanding of this phenomenon. The two main basic investment strategies being used by United States transnational corporations in Latin America in the 1990s are outlined below:

- The achievement of greater efficiency so that the firm will be better able to compete against firms from other countries (especially Asian nations) in its own domestic market. This strategy is based on greenfield investments in manufacturing, and particularly in the automotive, electronics and garment industries.
- Entry into new markets in service industries in order to gain access to local markets with a strong growth potential and to consolidate the firm's position as a global agent in highly competitive and increasingly concentrated economic activities. The cornerstone for this type of strategy is the acquisition of existing companies, often as part of privatization programmes, with a view to supplying local markets.

Some of the more traditional strategies applied by United States firms in the region are still in use as well, however. Within Latin America's new economic policy environment, there has been renewed interest in developing mining projects and in obtaining concessions and leases for exploring and developing oil and natural gas fields. What is more, the production of goods for local markets, particularly in the larger economies (Argentina, Brazil and Mexico), has not been entirely abandoned either.

1. United States foreign direct investment in Latin America and the Caribbean in the 1990s

The statistics published by the United States Department of Commerce⁶ on direct investments made by the United States are very extensive, but nevertheless pose some problems when used for sectoral and geographic analyses (Stekler and Stevens, 1991 and 1995). One of the main problems is that the practice of channeling FDI through financial centres makes it difficult to pinpoint its final destination. In order to help get around these limitations, we will supplement this information with data on the operations of subsidiaries of United States transnational corporations.⁷

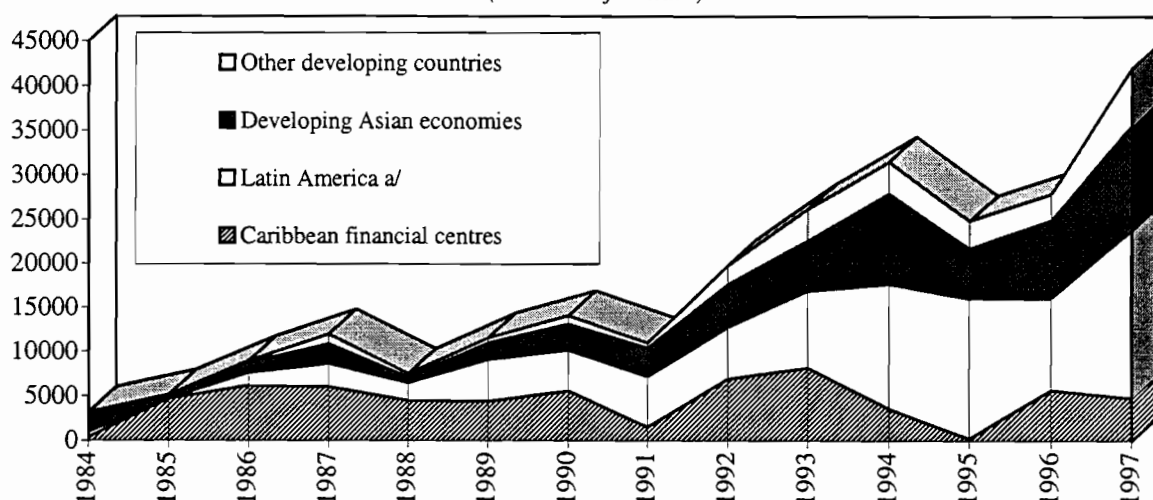
The problem posed by the routing of investment through financial centres is especially apparent in the statistics for Latin America and the Caribbean. In 1997, over 43% of the stock of United States investment in the region was located in financial centres, especially Bermuda, the Netherlands Antilles, a number of other Caribbean islands and Panama. Although their

⁶ The United States Department of Commerce publishes statistics on foreign direct investment in its *Survey of Current Business*, which is issued in June and October of each year.

⁷ These data can be found in the *Benchmark Survey: US Direct Investment Abroad*, which is published by the United States Department of Commerce. In this report we will examine the results of the surveys of United States transnational corporations conducted in 1977, 1982, 1989 and 1994 along with the preliminary results for the 1995 survey, whose coverage is more limited.

importance as a destination for investment flows has diminished in relative terms during the last few years, they will continue to generate severe distortions (see figure III.4).

Figure III.4
UNITED STATES: FOREIGN DIRECT INVESTMENT IN DEVELOPING COUNTRIES, 1984-1997
(Millions of dollars)



Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the United States Department of Commerce, Bureau of Economic Analysis.

^a Does not include investment in Caribbean financial centres.

Despite these limitations, the figures do attest to the growing importance of Latin America and the Caribbean for United States investors. Between 1990 and 1997, 43% of FDI flows from the United States that went to developing countries were routed to Latin America (not counting financial centres), which was far more than Asia's share of slightly over 27% (see figure III.4). During this same period, direct United States investment in the region (here again, excluding financial centres) climbed from US\$ 4.232 billion to an all-time record of US\$ 17.825 billion. This means that the average level of the region's annual inflows for 1990-1997 was over US\$ 8.5 billion higher than in the 1980s (see table III.1). Thus, the stock of FDI in Latin America that originated in the United States has almost doubled in the 1990s; this represents a radical change in the orientation and level of United States investments in the region.

Table III.1
**UNITED STATES: FOREIGN DIRECT INVESTMENT IN THE MAJOR LATIN AMERICAN
 ECONOMIES AND FINANCIAL CENTRES**
(Millions of dollars)

	1980- 1989 ^a	1990- 1997 ^a	1990	1991	1992	1993	1994	1995	1996	1997
Argentina	123	958	379	367	558	1 079	1 455	2 048	3 ^b	1 774
Brazil	663	3 467	876	890	2 054	3 263	3 338	6 954	3 812	6 545
Chile	106	759	520	174	106	198	1 875	1 291	1 066	842
Colombia	-116	180	77	33	406	4	336	164	131	292
Mexico	357	3 021	1 926	2 321	1 320	2 516	4 457	2 983	2 713	5 933
Peru	26	209	-83	-44	-3	-8	283	334	702	494
Venezuela	27	723	177	1 245	692	555	1 021	654	703	735
Latin America ^c	1 474	10 048	4 232	5 411	5 473	8 560	13 611	15 350	9 924	17 825
Financial centres ^d	1 329	5 026	5 909	1 783	7 278	8 335	4 099	690	6 157	5 959
Latin America and the Caribbean	2 803	15 074	10 141	7 194	12 751	16 895	17 710	16 040	16 081	23 784

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the United States Department of Commerce, Bureau of Economic Analysis.

^a Annual averages. ^b According to the Bureau of Economic Analysis of the United States Department of Commerce, the US\$ 3 million figure shown for Argentina is attributable to the fact that many subsidiaries of United States-based transnational corporations wrote off liabilities they had with their parent company, thereby generating a high level of intra-firm debt. In addition, there were some capital outflows as a result of the sale or stripping of subsidiaries' assets. ^c Does not include financial centres. ^d Includes the financial centres of Netherlands Antilles, Bahamas, Barbados, Bermuda, a number of other Caribbean islands and Panama.

The way in which the stock of FDI has changed can be seen more clearly by analysing the operations of subsidiaries of United States-based transnational corporations. While it is true that developing countries have played a secondary role in the global activities of these firms, historically Latin America and the Caribbean have occupied a more important position in this respect than any other developing region (see table III.2). In 1977, the value of their Latin American networks' sales was almost four times as much as the sales of developing Asian countries as a group and amounted to 11% of the total sales of United States subsidiaries worldwide. As for manufactures, the region accounted for 16% of local sales but just 4% of exports. Between 1982 and 1989, the position of Latin American subsidiaries weakened, and they slipped to 9% of total sales. The nature of their operations also began to change, however, and they became more export-oriented. In 1989, 22% of their total sales were on foreign markets (versus 12% in 1982), with the bulk of that going to the United States. In 1989, 10% of the exports of subsidiaries of transnational corporations based in the United States that were sold to buyers in that country came from Latin America. Despite the changes that are starting to take place, however, Latin American subsidiaries of United States-based transnational corporations have not yet formed a supply network nor managed to establish a position as a major export platform (Mortimore, 1993).

Table III.2
**TOTAL SALES OF SUBSIDIARIES OF UNITED STATES-BASED TRANSNATIONAL
 CORPORATIONS IN LATIN AMERICA AND THE CARIBBEAN,
 DEVELOPING ASIAN ECONOMIES AND THE WORLD, 1977-1995**
(Millions of dollars and percentages)

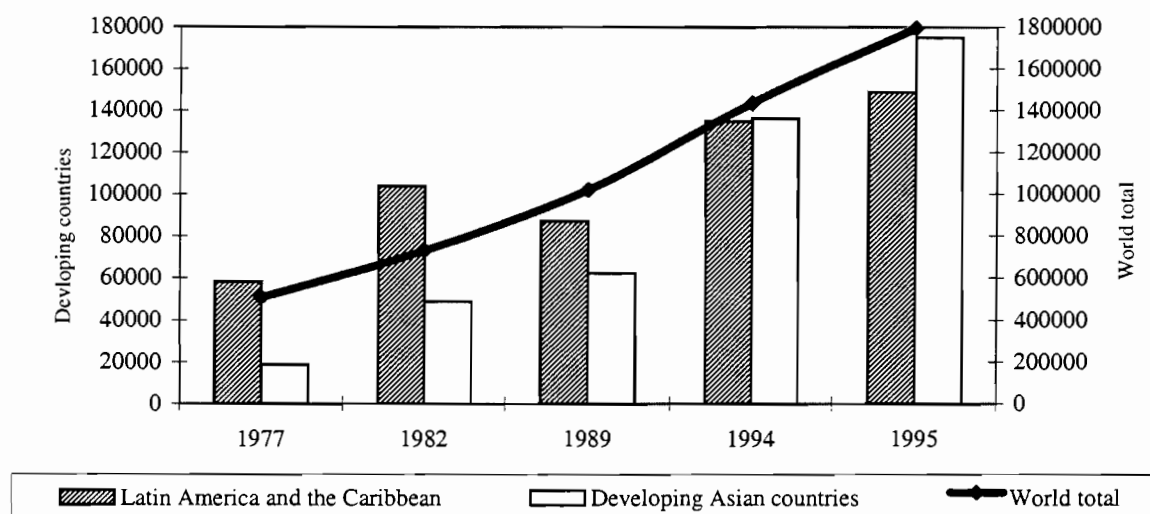
	1977		1982		1989		1994		1995	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Latin America and the Caribbean										
Manufactures	24 217	100	39 506	100	48 239	100	76 288	100	82 861	100
Local sales	21 876	90	34 814	88	37 626	78	57 595	75	61 116	74
Exports	2 341	10	4 692	12	10 613	22	18 692	25	21 745	26
- to United States	874	4	1 855	5	6 700	14	12 857	17	13 795	17
- to other countries	1 467	6	2 837	7	3 913	8	5 835	8	7 950	10
Total	58 208	100	103 857	100	87 014	100	134 808	100	149 193	100
Local sales	36 786	63	61 919	60	56 072	64	91 832	68	99 705	67
Exports	21 421	37	41 939	40	30 941	36	42 976	32	49 488	33
- to United States	11 091	19	16 432	16	18 460	21	24 905	18	27 059	18
- to other countries	10 330	18	25 507	25	12 481	14	18 071	13	22 429	15
Developing Asian economies										
Manufactures	5 125	100	9 933	100	25 008	100	54 782	100	72 893	100
Local sales	2 204	43	a	...	8 913	36	23 436	43	35 534	49
Exports	2 921	57	...	...	16 095	64	31 346	57	37 359	51
- to United States	a	...	a	...	9 698	39	16 527	30	a	...
- to other countries	a	...	1 894	19	6 397	25	14 819	27	a	...
Total	18 720	100	48 903	100	62 322	100	136 237	100	175 142	100
Local sales	7 312	39	20 198	41	30 548	49	75 393	55	99 167	57
Exports	11 409	61	28 705	59	31 774	51	60 845	45	75 976	43
- to United States	6 449	34	11 030	23	15 102	24	22 723	17	29 029	17
- to other countries	4 960	27	17 675	36	16 672	27	38 122	28	46 947	26
World total										
Manufactures	194 200	100	271 099	100	509 308	100	697 553	100	834 653	100
Local sales	134 427	69	179 267	66	316 632	62	413 873	59	485 881	58
Exports	59 773	31	91 834	34	192 676	38	283 681	41	348 772	42
- to United States	17 601	9	26 244	10	70 456	14	97 323	14	112 526	13
- to other countries	42 172	22	65 588	24	122 220	24	186 358	27	236 246	29
Total	507 019	100	730 235	100	1 019 966	100	1 435 901	100	1 794 089	100
Local sales	313 307	62	477 961	65	690 528	68	963 779	67	1 214 096	68
Exports	197 111	38	252 274	35	329 438	32	472 122	33	579 993	32
- to United States	93 573	18	76 780	11	114 719	11	147 345	10	167 689	9
- to other countries	100 138	20	175 494	24	214 719	21	324 777	23	412 304	23

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the United States Department of Commerce, *U.S. Direct Investment Abroad*, Washington, D.C., Bureau of Economic Analysis, 1981, 1985, 1992, 1997 and 1998.

^a Information not released by the United States Department of Commerce due to the fact that the figures correspond to a single firm.

While Latin America's importance in the operations of United States transnationals was declining, Asian subsidiaries' profile was improving. Between 1977 and 1989, their total sales increased nearly fivefold, and the rise was particularly notable in the case of exports of manufactures to the United States market (see figure III.5 and table III.2). This brought their share to almost half as much as that of Latin American operations in the manufacturing sector. Thus, although Latin American and Caribbean subsidiaries maintained their share of total sales, they lost ground in terms of their position in the global production structure of United States transnationals. Meanwhile, Asian subsidiaries began to become more prominent, especially as exporters to the United States market. As a result, the Asian countries gradually came to serve as supply centres for United States transnationals (Mortimore, 1993).

Figure III.5
TOTAL SALES OF SUBSIDIARIES OF UNITED STATES-BASED TRANSNATIONAL CORPORATIONS IN LATIN AMERICA AND IN DEVELOPING ASIAN COUNTRIES, 1977-1995
(Millions of dollars)



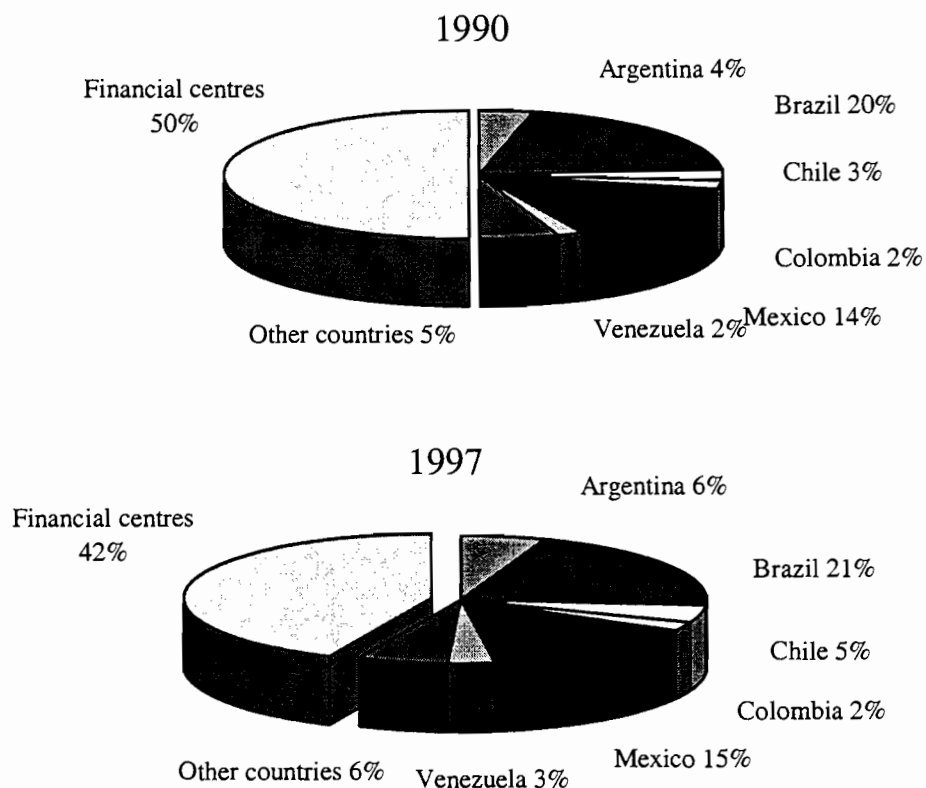
Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the United States Department of Commerce, *U.S. Direct Investment Abroad*, Washington, D.C., Bureau of Economic Analysis, 1981, 1985, 1992, 1997 and 1998.

As of the mid-1990s, the levels of total sales of subsidiaries controlled by United States-based transnationals in Latin America and the Caribbean and in developing Asian countries were comparable. Nonetheless, both of these regions have always played a peripheral role in the operations of such firms, inasmuch as they account for only about 10% of their worldwide sales (see figure III.5). Asian subsidiaries' exports are almost twice as high as those of Latin American subsidiaries in terms of volume, with over 50% of Asian subsidiaries' total sales being made up of exports, whereas only one third of Latin American subsidiaries' sales fall into this category. The importance of the United States market for Latin American exports has been increasing,

primarily because of the assembly industries sited in Mexico and the Caribbean Basin, whereas Asian subsidiaries' foreign trade flows are more diversified (see table III.2).

Despite an increasing geographic diversification of trade flows and a decline in the percentage of funds being channeled into financial centres, 90% of United States investment in Latin America during the 1990s (not including financial centres) has gone to just five countries, with Brazil and Mexico being the most prominent destinations (see table III.1 and figure III.6). Of the other three of those countries, Chile received the largest share, with investment inflows of over US\$ 1.265 billion per year between 1994 and 1997 originating in the United States.

Figure III.6
STOCK OF UNITED STATES FOREIGN INVESTMENT IN
LATIN AMERICA, 1990-1997
(Percentages)



Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the United States Department of Commerce, Bureau of Economic Analysis.

It appears to be the case that the manufacturing sector's supremacy as a destination for inflows of FDI originating from the United States is declining. In 1990, 57.6% of the stock of United States FDI in Latin America (not including financial centres) was in the manufacturing sector, but by 1997 the figure had fallen to 48.4%. These changes appear to be the result of shifts in the operations of subsidiaries of United States-based transnationals in Latin America and the Caribbean, which are concentrating their manufacturing activities in the region's larger

economies and striving to take advantage of the new opportunities opening up in recently liberalized sectors, especially services.

When the figures on FDI are examined in conjunction with the available information on the operations of subsidiaries of United States-based transnational corporations, the results are somewhat different (see table III.3). First of all, the relative importance of the manufacturing sector as a destination for investment does not appear to have diminished during the 1990s but has instead become concentrated in activities catering to local markets (foodstuffs and chemicals) and in high-technology industries (electrical and transport equipment), whose exports have been burgeoning. Second, the figures point to a sharp increase in the stock of FDI in less internationally competitive subsectors (foodstuffs and chemicals), whereas the increase seen in the electrical and transport equipment industries has not been commensurate with the prodigious effort made by firms in these industries to reorient their operations towards external markets.

Table III.3
LATIN AMERICA AND THE CARIBBEAN: OPERATIONS OF SUBSIDIARIES OF
UNITED STATES-BASED TRANSNATIONAL CORPORATIONS,
1989-1997 ^a
(Millions of dollars and percentages)

	Stock of FDI				Total sales				Exports			
	1990		1997		1989		1995		1989		1995	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Total	71 413	100	172 481	100	87 014	100	149 193	100	30 941	100	49 488	100
Petroleum	4 196	6	9 462	6	17 586	20	24 431	16	6 824	22	9 134	19
Manufactures	23 655	33	47 495	28	48 239	55	82 861	56	10 613	34	21 745	44
Food	2 985	4	10 892	6	7 100	8	14 950	10	969	3	1 903	4
Chemicals	4 954	7	11 161	7	9 661	11	17 026	11	^b		1 668	3
Equipment and machinery	3 101	4	1 995	1	5 848	7	4 320	3	1 650	5	1 655	3
Electrical equipment	1 551	2	3 157	2	3 568	4	5 893	4	1 542	5	3 487	7
Transport equipment	3 646	5	6 593	4	9 886	11	20 142	14	3 252	11	7 444	15
Commerce	2 816	4	8 358	5	6 459	7	16 670	11	2 692	9	6 397	13
Financial services	36 448	51	86 342	50	9 478	11	10 767	7	7 815	25	6 464	13
Other services	967	1	5 424	3	1 594	2	4 623	3	411	1	889	2
Other sectors ^c	3 331	5	15 400	8	3 658	4	9 841	7	2 586	8	4 859	9

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the United States Department of Commerce, *U.S. Direct Investment Abroad*, Washington, D.C., Bureau of Economic Analysis, 1992 and 1997; and *Survey of Current Business*, various issues.

^a Includes financial centres. ^b Information not released by the United States Department of Commerce due to the fact that the figures correspond to a single firm. ^c Includes agriculture, forestry and fisheries, mining, construction, transport, communications, electricity, gas and sanitary services.

These apparent contradictions can be cleared up if we look at some additional data, however. On the one hand, the steep rise in the stock of direct United States investment in the food and chemicals industries appears to be a reflection of the wave of mergers and acquisitions seen in Argentina, Brazil and Mexico during the past three years. On the other hand, the relatively low level of investment in the electrical and transport equipment industries may be attributable to the fact that investment flows to these industries are channeled through financial centres. Indeed, 50% of the stock of United States FDI in 1997 was in financial activities—as distinct from the deposit banking system— (see table III.3), and 83% of that amount was in financial centres. Although it is true that not all of these funds are subsequently routed to Latin America and, of those that are, only a fraction goes to these particular industries, the sums they eventually receive must nonetheless be quite sizeable.

These statistical inconsistencies therefore suggest that—far from having declined, as the official data would appear to indicate—the Latin American manufacturing sector's importance for United States transnational corporations has grown. The basis for this conclusion is that a substantial portion of the investments made in this sector appear to have been routed to it indirectly, via subsidiaries engaged in financial rather than manufacturing activities.

The above line of reasoning is backed up by a more detailed analysis of the operations of subsidiaries of United States-based transnational corporations in the region. Such an analysis shows that the industrial base deriving from United States firms in Latin America has shifted away from import substitution and is becoming increasingly export oriented. In the early 1980s, around 90% of total sales were made on domestic markets, but the figure had dropped to around 75% by 1995. This process has not spread to all manufacturing activities, however; instead, it has been led by just a few industries, chiefly those producing electrical and transport equipment (see table III.4). These two subsectors have redirected the focus of their activities and are now heavily oriented towards external markets, especially in the case of subsidiaries located in Mexico (Mortimore, 1995, 1998a and 1998b). As noted earlier, even though the food and chemicals industries receive large amounts of FDI, they have continued to cater primarily to local markets (see box III.1).

Carrying the analysis to a somewhat greater level of detail, we find that the behaviour of subsidiaries of United States-based transnationals varies substantially across markets within the region. In the region's three largest economies (Argentina, Brazil and Mexico), United States investments have been concentrated in the manufacturing sector, whereas in its medium-sized and smaller economies, FDI has mainly been channeled into extractive activities (mining in Chile and petroleum in Venezuela) and services, chiefly in the financial sector (see table III.5).

Table III.4
**LATIN AMERICA AND THE CARIBBEAN: TOTAL SALES OF SUBSIDIARIES
 OF UNITED STATES-BASED TRANSNATIONAL CORPORATIONS, 1977-1995**
(Millions of dollars and percentages)

	1977		1982		1989		1994		1995	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Manufactures - total	24 217	100	39 506	100	48 239	100	76 288	100	82 861	100
Local sales	21 876	90	34 814	88	37 626	78	57 595	75	61 116	74
Exports	2 341	10	4 692	12	10 613	22	18 692	25	21 745	26
- to United States	874	4	1 855	5	6 700	14	12 857	17	13 795	17
- to other countries	1 467	6	2 837	7	3 913	8	5 835	8	7 950	10
Food	3 870	100	6 717	100	7 100	100	14 311	100	14 950	100
Local sales	3 389	88	6 015	90	6 131	86	12 611	88	13 047	87
Exports	481	12	702	10	969	14	1 699	12	1 903	13
- to United States	103	3	80	1	424	6	677	5	679	5
- to other countries	378	10	622	9	545	8	1 022	7	1 224	8
Chemicals	5 278	100	9 096	100	9 661	100	15 904	100	17 026	100
Local sales	4 986	94	8 078	89	8 919	92	14 713	93	15 358	90
Exports	292	6	1 018	11	^a...	...	1 191	7	1 668	10
- to United States	55	1	400	4	^a...	...	375	2	631	4
- to other countries	237	4	618	7	^a...	...	816	5	1 037	6
Electrical machinery	1 991	100	2 674	100	3 568	100	4 815	100	5 893	100
Local sales	1 649	83	2 065	77	2 026	57	2 244	47	2 406	41
Exports	341	17	608	23	1 542	43	2 571	53	3 487	59
- to United States	260	13	507	19	1 373	38	2 336	49	2 666	45
- to other countries	81	4	101	4	169	5	235	5	821	14
Transport equipment	5 249	100	7 558	100	9 886	100	19 464	100	20 142	100
Local sales	4 867	93	6 887	91	6 634	67	12 028	62	12 697	63
Exports	^a...	...	671	9	3 252	33	7 436	38	7 444	37
- to United States	^a...	...	432	6	2 839	29	6 870	35	6 516	32
- to other countries	^a...	...	239	3	413	4	566	3	928	5
All sectors - total	58 208	100	103 857	100	87 014	100	134 808	100	149 193	100
Local sales	36 786	63	61 919	60	56 072	64	91 832	68	99 705	67
Exports	21 421	37	41 939	40	30 941	36	42 976	32	49 488	33
- to United States	11 091	19	16 432	16	18 460	21	24 905	18	27 059	18
- to other countries	10 330	18	25 507	25	12 481	14	18 071	13	22 429	15

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the United States Department of Commerce, *U.S. Direct Investment Abroad*, Washington, D.C., Bureau of Economic Analysis, 1981, 1985, 1992, 1997 and 1998.

^a Information not released by the United States Department of Commerce due to the fact that the figures correspond to a single firm.

Box III.1

LATIN AMERICA: BATTLEFIELD OF THE COLA DRINKS

With its strategy based on investments, product variety, technical assistance and coordination of bottling systems, the Coca-Cola Company plans to double its sales in Latin America by the year 2002.^a A key element in their strategy is the consolidation of production and distribution operations into a smaller number of larger bottling plants.

COCA COLA'S LATIN AMERICAN OPERATIONS

Country and number of bottling plants	Regional sales (%)	Growth of sales (%)	Local market share (%)	Investments (millions of US\$)	Period
Mexico (19)	39	11	67	1 000	1995-1997
Brazil (24)	24	2	52	2 000	1995-1999
Argentina (7)	8	13	62	1 000	1996-2000
Venezuela (1)	6	...	...	...	...
Colombia (1)	5	5	58	...	...
Chile (3)	5	13	72	...	...
Other	13	...	...	...	...

Source: ECLAC, based on information published in the *Gazeta mercantil latino-americana*, 24-30 August 1998.

The Atlanta-based transnational corporation has become a prime mover and participant in an active process of mergers and acquisitions involving a number of different bottling companies. Within this process of market concentration, which is taking place throughout Latin America, four companies are beginning to come to the fore:

- The region's biggest Coca-Cola bottling company is the Panamanian-Mexican firm Panamerican Beverages Inc. (PANAMCO), which accounts for 6% of the transnational's worldwide sales. In recent years, PANAMCO has purchased concessions in São Paulo, a number of Mexican states, Costa Rica, Colombia, Venezuela and Nicaragua.
- The Fomento Económico Mexicano company (FEMSA), of which Coca-Cola is the majority shareholder, has purchased a bottling plant in Argentina and is focusing its interest on Central America.
- The Chilean company Embotelladora Andina de Chile (of which Coca-Cola owns 11%) has operations in Rio de Janeiro and in various Argentine provinces, including Córdoba, Mendoza and Rosario.
- La Polar, another Chilean company, has activities in Argentina and is seeking to enter the Brazilian market.

This strategy of increased concentration and consolidation of Coca-Cola's activities in the region was devised in response to a loss of market share, as in the case of Brazil, where Coca-Cola's share fell from 57% to 51% between 1992 and 1997. This was due in part to a strong offensive by Coca-Cola's biggest international competitor, PepsiCo.

In Argentina, where there had been 15 bottling plants, the consolidation process produced a considerable improvement in performance, and the number of concession-holders was halved. Andina, FEMSA and Polar now cover most of the market. Coca-Cola's market share in Argentina has improved considerably in recent years, reaching 62% in 1997. In the case of Brazil, the consolidation process is only just beginning, and of the current 24 concession-holders, it is expected that only five or six will remain by the year 2002.^b

In Mexico, there are 19 concession holders but the consolidation process has not worked as Coca-Cola had hoped. Even so, the results have been good. The number of bottling plants has remained steady, but the company's market share has grown from 54% to 67% between 1993 and 1997. In other markets, the strategic goals of the Atlanta parent company are being met. There are three concession-holders in Chile, and only one each in Venezuela and Colombia.

Box III.1 (concl.)

Coca-Cola's major international competitor has been having serious difficulties in Latin America in recent years. In the mid-1990s, PepsiCo launched an ambitious expansion strategy in a bid to challenge the supremacy of Coca-Cola, which had a three-to-one advantage in sales in the region. This initiative ultimately led to a widespread financial crisis among PepsiCo's bottling plants in Latin America.

The Argentine firm Buenos Aires Embotelladora S.A. (BAESA) has been hit the hardest. In 1995, it was the biggest firm of its kind outside the United States. In early 1996, BAESA suspended payments to its creditors, its book value went into the red, and it found itself in imminent danger of bankruptcy; PepsiCo then took control of the company. A reorganization plan was implemented which involved the transfer of functional control over its operations in Chile to the Compañía Cervecerías Unidas (CCU) and of its Brazilian operations to the Companhia Cervejaria Brahma, along with the sale of its Cost Rican subsidiary. There were also serious difficulties in Mexico and Venezuela. Consequently, PepsiCo's new strategy is no longer to challenge Coca-Cola for leadership, but simply to make its operations in the region profitable once again. To this end, it has transferred its bottling operations to brewing companies with experience in the beverage industry and large distribution networks (Ferro, 1997).^c

^a *Gazeta mercantil latino-americana*, "Coca Cola quer dobrar suas vendas na região até ano 2002", year 3, No. 123, Rio de Janeiro, 24-30 August 1998.

^b Gisele Regatão, "Los chicos van a desaparecer del mapa", *América economía*, Santiago, Chile, November 1997.

^c Raúl Ferro, "El reto de la Pepsi", *América economía*, Santiago, Chile, December 1997.

In Argentina and Brazil, these companies have sought to capitalize upon the advantages offered by large, heavily protected domestic markets. In the past few years, they have reinforced their strategy in order to take advantage of the advances being made by regional integration initiatives, particularly the Southern Common Market (Mercosur). In both of these countries the manufacturing sector has generally displayed a very low propensity to export; the exception to this rule is the automotive industry, which has been stimulated by bilateral countertrade agreements between Argentina and Brazil (Mortimore, 1998a, 1998c and 1997a) (see table III.6).

In Mexico, most subsidiaries of United States transnational corporations have restructured their operations. Although they started out in much the same way as their Argentine and Brazilian counterparts, in the late 1980s United States-based transnationals converted their Mexican subsidiaries into export platforms in a bid to improve their competitive position on the international (and, in particular, their own) market (Calderón, Mortimore and Peres, 1996; Mortimore, 1998b). Thus, the signing of the North American Free Trade Agreement (NAFTA) signaled the political ratification of a process that United States firms had actually launched several years earlier. In fact, 40% of the sales of Mexican subsidiaries in the manufacturing sector correspond to exports, chiefly to the United States market (see table III.6). These changes have been the most evident in the electrical machinery and transport equipment industries. The sectoral distribution of the statistics issued by the United States Department of Commerce fails to shed light on the status of the subsidiaries of United States-based transnationals within the garment industry, which is quite similar to the two above-mentioned branches of activity.

Table III.5
**STOCK OF UNITED STATES INVESTMENT IN THE MAIN DESTINATION
 ECONOMIES OF LATIN AMERICA, 1990-1997**
(Millions of dollars)

	Argentina		Brazil		Chile		Mexico		Venezuela	
	1990	1997	1990	1997	1990	1997	1990	1997	1990	1997
Total	2 531	9 766	14 384	35 727	1 896	7 767	10 313	25 395	1 087	5 176
Petroleum	471	1 427	507	1 769	^a	^a	^a	109	113	1 232
Manufactures	1 336	4 017	11 494	22 584	226	743	7 784	15 119	674	1 833
Food	334	1 014	1 030	3 412	19	141	1 119	5 025	68	375
Chemicals	367	1 563	1 766	4 867	132	385	1 703	3 157	223	258
Equipment and machinery	^a	24	2 243	1 340	1	2	532	^a	^a	36
Electrical equipment	27	^a	731	1 936	^a	^a	676	803	42	89
Transport equipment	49	345	1 669	3 603	^a	^a	1 762	1 920	89	474
Commerce	150	506	157	656	163	437	551	862	179	294
Banking	337	1 181	513	1 489	360	639	^a	510	^a	^a
Other financial services	168	1 337	1 433	4 711	873	2 480	619	4 079	^a	59
Other services	43	711	118	1 602	^a	218	291	924	23	87
Other sectors ^b	26	588	163	2 915	125	^a	963	3 792	13	^a

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the United States Department of Commerce, Bureau of Economic Analysis.

^a Information not released by the United States Department of Commerce due to the fact that the figures correspond to a single firm. ^b Includes agriculture, forestry and fisheries, mining, construction, transport, communications, electricity, gas and sanitary services.

The available information on United States-based transnational corporations in Latin America indicates that they are heavily concentrated in a few countries and sectors. One of the main host sectors is the automotive industry, which accounts for over 25% of United States firms' total sales, and a single corporation—General Motors—generates just slightly less than half of that sum (see table III.7). About 90% of regional sales are concentrated in Argentina (18%), Brazil (33%) and Mexico (38%), mainly in manufacturing. The development and processing of natural resources and some types of services are other important areas of the economy in this respect.

Table III.6
**ARGENTINA, BRAZIL AND MEXICO: TOTAL SALES OF SUBSIDIARIES OF
 UNITED STATES-BASED TRANSNATIONAL CORPORATIONS,
 1977-1995**
(Millions of dollars and percentages)

	1977		1982		1989		1994		1995	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Argentina										
Manufactures - total	2 466	100	3 223	100	2 717	100	7 182	100	7 432	100
Local sales	2 276	92	^a...	...	1 960	72	6 084	85	6 048	81
Exports	^a...	...	...	...	757	28	1 098	15	1 383	19
- to United States	^a...	...	152	5	102	4	62	1	52	1
- to other countries	^a...	...	^a...	...	655	24	1 036	14	1 331	18
Electrical machinery	87	100	160	100	45	100	137	100	266	100
Local sales	82	94	157	98	42	93	134	98	255	96
Exports	5	6	3	2	3	7	3	2	11	4
- to United States	^b...	...	2	1	^b...	...	^b...	...	^a...	...
- to other countries	5	6	^b...	...	3	7	3	2	^a...	...
Transport equipment	762	100	^a ...	100	47	100	166	100	365	100
Local sales	721	95	^a...	...	^a...	...	129	78	147	40
Exports	41	5	...	...	...	...	37	22	218	60
- to United States	^a...	...	2	...	^a...	...	^a...	...	^a...	...
- to other countries	^a...	...	1	...	2	4	^a...	...	^a...	...
All sectors - total	3 615	100	5 104	100	4 057	100	11 545	100	12 244	100
Local sales	3 059	85	4 232	83	3 000	74	10 086	87	10 387	85
Exports	555	15	871	17	1 057	26	1 459	13	1 857	15
- to United States	24	1	172	3	149	4	157	2	88	1
- to other countries	531	14	699	14	907	22	1 302	11	1 769	14
Brazil										
Manufactures - total	11 218	100	17 038	100	24 330	100	25 445	100	30 065	100
Local sales	10 224	91	14 932	88	20 338	84	21 726	85	25 667	85
Exports	995	9	2 105	12	3 992	16	3 719	15	4 398	15
- to United States	261	2	473	3	2 132	9	1 812	7	1 910	6
- to other countries	734	7	1 632	9	1 860	7	1 907	8	2 488	9
Electrical machinery	1 091	100	1 168	100	2 022	100	1 107	100	1 269	100
Local sales	922	85	966	83	1 401	69	648	59	785	62
Exports	169	15	202	17	620	31	459	41	484	38
- to United States	^a...	...	160	14	572	28	^a...	...	^a...	...
- to other countries	^a...	...	42	3	48	3	^a...	...	^a...	...
Transport equipment	2 145	100	2 879	100	3 838	100	5 441	100	5 964	100
Local sales	1 947	91	^a...	...	3 377	88	4 976	91	5 399	91
Exports	199	9	...	...	461	12	465	9	565	9
- to United States	57	3	^a...	...	^a...	...	155	3	185	3
- to other countries	142	6	215	7	^a...	...	310	6	380	6
All sectors - total	16 630	100	26 045	100	30 588	100	33 232	100	40 005	100
Local sales	15 447	93	23 720	91	26 507	87	29 238	88	35 323	88
Exports	1 184	7	2 325	9	4 082	13	3 994	12	4 682	12
- to United States	299	2	518	2	2 181	7	1 929	6	2 014	5
- to other countries	885	5	1 807	7	1 901	6	2 065	6	2 668	7
Mexico										
Manufactures - total	4 679	100	9 438	100	14 246	100	30 873	100	29 001	100
Local sales	4 191	90	8 414	89	9 450	66	20 033	65	17 534	60
Exports	489	10	1 023	11	4 796	34	10 840	35	11 468	40
- to United States	305	7	716	8	4 115	29	9 966	32	10 387	36
- to other countries	184	3	307	3	681	5	874	3	1 081	4

Table III.6 (concl.)

	1977		1982		1989		1994		1995	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Electrical machinery	459	100	919	100	1 244	100	3 266	100	3 356	100
Local sales	358	78	615	67	371	30	^a...	...	1 162	35
Exports	101	22	304	33	873	70	...	...	2 195	65
- to United States	77	17	278	30	796	64	1 863	57	2 115	63
- to other countries	24	5	26	3	77	6	^a...	...	80	2
Transport equipment	1 002	100	2 323	100	5 570	100	11 962	100	11 498	100
Local sales	864	86	1 984	85	^a...	...	^a...	...	5 035	44
Exports	138	14	...	...	...	...	...	...	6 464	56
- to United States	126	13	^a...	...	2 548	46	^a...	...	6 316	55
- to other countries	12	1	^a...	...	^a...	...	^a...	...	148	1
All sectors - total	5 860	100	11 269	100	16 437	100	39 421	100	35 879	100
Local sales	5 276	90	10 110	90	11 189	68	27 022	69	22 846	64
Exports	584	10	1 158	10	5 247	32	12 398	31	13 034	36
- to United States	324	6	774	7	4 365	27	11 197	28	11 411	32
- to other countries	260	4	384	3	882	5	1 201	3	1 623	4

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the the United States Department of Commerce, *U.S. Direct Investment Abroad*, Washington, D.C., Bureau of Economic Analysis, 1981, 1985, 1992, 1997 and 1998.

^a Information not released by the United States Department of Commerce due to the fact that the figures correspond to a single firm. ^b Sum is less than US\$ 500,000.

Table III.7
**MAJOR UNITED STATES-BASED TRANSNATIONAL CORPORATIONS IN SELECTED
 LATIN AMERICAN COUNTRIES, BY SALES, 1997**
(Millions of dollars)

Company	Argentina	Brazil	Colombia	Chile	Mexico	Total ^a
Automotive	2 811	10 803	833	525	19 074	35 143
General Motors Corp.	774	5 730	833	525	7 146	15 381
Ford Motors Co.	1 866	3 759	...	...	4 871	11 200
Chrysler	171	...	...	...	6 501	6 672
Food, beverages and tobacco	9 751	9 905	241	1 215	9 130	30 880
Coca Cola Corp.	1 989	1 495	...	936	4 191	8 659
PepsiCo.	1 059	2 601	...	...	3 106	6 766
Philip Morris Co.	3 446	1 478	...	...	...	4 924
Cargill Incorp.	1 687	1 791	241	64	...	3 947
Electronics	928	7 448	...	82	8 528	17 208
IBM Co.	580	2 321	...	82	2 798	5 899
Whirlpool	...	1 545	...	...	...	1 545
General Electric	...	...	...	...	3 048	3 141
Xerox Corp.	143	1 760	...	...	468	2 382
Hewlett Packard	205	423	...	...	1 553	2 181
Unisys Corp.	...	583	...	...	...	583
Motorola	...	...	...	...	361	361
Chemicals	1 566	4 289	390	68	3 069	9 751
Avon Products Inc.	311	822	...	...	355	1 558
Procter & Gamble	...	...	...	...	1 200	1 449
Du Pont Co.	339	576	...	...	510	1 425
Colgate Palmolive	122	...	390	...	700	1 212

Table III.7 (concl.)

Company	Argentina	Brazil	Colombia	Chile	Mexico	Total ^a
Other manufactures	358	3 692	314	215	3 610	8 264
Kodak	...	538	...	...	1 606	2 144
Goodyear Tire & Rubber Co.	151	852	138	215	...	1 431
Kimberly Clark	...	...	...	...	1 278	1 278
Aluminum Co. of America	...	1 073	...	...	...	1 073
Petroleum and mining	2 951	6 153	3 153	1 940	1 382	17 332
Exxon Corp.	1 818	3 009	946	1 103	...	6 876
Texaco Inc.	...	3 144	786	...	...	3 930
Asarco Inc.	...	...	...	...	1 293	1 293
Mobil Oil Corp.	...	...	1 165	...	89	1 273
Services	6 679	2 972	...	684	5 391	18 090
Wal Mart Stores	400	...	...	...	4 081	4 481
GTE Corp.	252	...	...	...	...	2 400
AES Corp.	...	1 803	...	...	...	1 803
TOTAL	25 043	45 262	4 931	4 729	50 184	136 667

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the *América economía, Expansión* (Mexico), *Exame* (Brazil), *Estrategia* (Chile), *Mercado* (Argentina), *Dinero* (Colombia) and other financial periodicals.

^a Includes figures for Peru and Venezuela.

The information reviewed thus far regarding the changes undergone by subsidiaries of United States-based transnational corporations in Latin America is quite comprehensive, but there are nonetheless a few aspects of this process that are not fully reflected in the statistics:

- The widespread changeover to assembly (*maquila*) operations seen in some branches of manufacturing, especially the electronics and garment industries. In recent years, these industries have been thriving in Mexico (Carillo and Mortimore, 1998) and some of the countries in the Caribbean Basin (Mortimore, Duthoo and Guerrero, 1995; Mortimore and Zamora, 1998; Vincens, Martínez and Mortimore, 1998) because they have succeeded in utilizing such advantages as low wages and tariff preferences, both in the host countries and in their main destination market, the United States (Mortimore and Peres, 1998a and 1998b).
- The recently heightened presence of United States firms in the services sector as a result of the privatization programmes implemented in a number of Latin American countries. Particularly large investments have been made in telecommunications (mainly cellular telephone systems) and electricity.

Accordingly, in order to arrive at a fuller understanding of the way the corporate strategies of United States-based transnational corporations have evolved over the past few years, a more detailed analysis of some of the sectors that have attracted the interest of these investors will be presented in the following section.

C. THE MAIN INDUSTRIES OF INTEREST TO UNITED STATES INVESTORS IN LATIN AMERICA AND THE CARIBBEAN

The interpretation of the statistics on United States FDI in the manufacturing sector which will be set forth in this section tallies much better with the findings of numerous research projects conducted in Latin America and the Caribbean. These studies suggest that the orientation of United States FDI in the region can be determined with greater accuracy if the analysis focuses on individual industrial activities rather than being limited to the aggregate statistics (Mortimore, 1998d). Examples of relevant activities include the production of motor vehicles in Mexico for the United States market and assembly (*maquila*) operations in Mexico and the Caribbean Basin. In the services sector, a review of the acquisitions made by United States firms in various countries of the region will yield a number of interesting observations. This line of inquiry also affords a clearer picture of how transnational corporations have adapted their strategies to allow for the effects of the globalization process, which in turn makes it possible to conduct a more discerning analysis of their operations in Latin America and the Caribbean.

1. The production of motor vehicles in Latin America: an improved competitive position within NAFTA and access to Mercosur⁸

As of 1993, three of the world's six largest motor vehicle producers —General Motors, Ford and Chrysler— were United States companies that possessed important offshore assembly operations accounting for a substantial percentage of their passenger vehicles (48%, 59% and 46% of their output, respectively) (Vickery, 1996). Of those portions, a significant share was produced in Latin America: 8% by General Motors, 9% by Ford and 17.5% by Chrysler.

In 1997, the General Motors, Ford and Chrysler production systems in Latin America were the region's first, third and fifth largest transnational corporations in terms of sales volumes (which, taken together, amounted to 20% of the total sales of the 50 largest foreign firms operating in Latin America and the Caribbean). The automotive industry is currently the principal sphere of activity for transnational corporations in the region, since it includes 11 of the 25 largest (as measured by sales) foreign enterprises in Latin America and the Caribbean (see table III.8).

These firms have been in the region for quite some time, but the Latin American automotive industry has undergone major changes in recent years, and United States FDI —undertaken by General Motors, Ford and Chrysler— has played a key role in this respect (see table III.9). In the early 1980s, the industry's output of motor vehicles in Brazil totalled 1,165,100 units; this was twice as much as Mexico's (490,000 units), which was, in its turn, roughly twice as much as Argentina's output (281,800 units). In addition, the percentage sold on external markets was quite small. The extent to which these firms concentrated on the domestic market is demonstrated by the figures for 1981, when Brazil exported 14% of its output, Mexico exported 4% and Argentina 1%.

⁸ For more detailed information on this subject, see chapter IV.

Table III.8
**MAJOR SUBSIDIARIES OF TRANSNATIONAL MOTOR VEHICLE PRODUCERS
 IN LATIN AMERICA, 1997**
(Millions of dollars and percentages)

Ranking All	TNC	Subsidiary (country)	Home country	Sales	Exports	Exports/ sales
7	1	General Motors (Mexico)	United States	7 126	5 548	78
9	2	Volkswagen (Brazil)	Germany	6 531	563	9
10	3	Chrysler (Mexico)	United States	6 501	4 862	75
12	4	Fiat (Brazil)	Italy	5 824	928	16
14	6	General Motors (Brazil)	United States	5 730	725	13
18	8	Ford (Mexico)	United States	4 871	3 014	62
25	9	Ford (Brazil)	United States	3 759	1 000	27
29	10	Volkswagen (Mexico)	Germany	3 423	2 600	76
41	15	Mercedes Benz (Brazil)	Germany	2 852	316	11
64	22	Nissan (Mexico)	Japan	2 153	1 257	58
75	25	Ford (Argentina)	United States	1 866	748	40

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from *América economía*, *Expansión* (Mexico), *Exame* (Brazil), *Estrategia* (Chile), *Mercado* (Argentina), *Dinero* (Colombia) and other financial periodicals.

Table III.9
**ARGENTINA, BRAZIL AND MEXICO: OUTPUT, EXPORTS AND IMPORTS
 OF MOTOR VEHICLES, 1980-1997**
(In thousands of units)

	Annual average		1980	1990	1995	1996	1997
	1980-1989	1990-1997					
Argentina							
Total output	171	287	282	100	285	313	446
Exports	2	58	4	1	53	109	208
Imports	-	299	-	-	101	167	331
Brazil							
Total output	959	1 429	1 165	914	1 629	1 814	2 067
Exports	222	302	157	187	263	306	412
Imports	-	161	-	3	369	224	303
Mexico							
Total output	445	1 069	490	821	931	1 211	1 338
Exports	77	599	18	277	779	971	984
Imports	-	40	-	-	28	89	137

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from national automotive producers' associations: ADEFA (Argentina), ANFAVEA (Brazil) and AMIA (Mexico).

(-) = Negligible sums.

Latin America's external debt crisis plunged the countries' automotive industries into serious difficulties, after which it took them an entire decade to regain their former production levels. During this period, Mexico's automotive industry was developing a strong export orientation, and in recent years Argentina and Brazil have also begun to sell a higher percentage of their output on external markets. This would seem to suggest that the automotive industries in these countries are internalizing some of the main traits of the new corporate strategies being employed by United States-based transnational corporations.

In the 1990s, changes in the national and international environments sparked a full-fledged revolution in Latin America's automotive industries. By 1997, production figures had far outdistanced 1980 levels (they were 2.7 times higher in Mexico, 1.8 times higher in Brazil and 1.6 times higher in Argentina). These changes were not confined to aggregate production levels, however. The value of exports was also far higher than in 1980, having multiplied by a factor of 55 in Mexico and by a factor of 52 in Argentina; in Brazil, which was the exception here, it nearly tripled. Imports also became an important component of these national markets, amounting to 58% of supply in Argentina, 38% in Mexico and 16% in Brazil, as a result of the increased competitiveness of these markets.

The large amount of money being invested to modernize and boost the productivity of firms in major markets is another manifestation of these new corporate strategies. The most striking aspect of these investments is that, rather than being directed almost entirely to national markets as in the past, their scope has been broadened to include specific regional markets as well. Accordingly, these industries have been modernized and overhauled on the basis of the standards set for the sector by NAFTA and Mercosur, all of which has paved the way for the implementation of new business strategies. Thus, integration processes have played a significant role in the restructuring of newly globalized business enterprises.

2. Assembly of manufactures in Mexico and the Caribbean Basin⁹

In recent years other United States manufacturing firms have been faced with challenges that are quite similar to those which Japanese companies posed for their compatriots in the United States market (see chapter IV). Between 1980 and 1995, producers in developing Asian countries managed to expand their share of the United States market from 15% to 25% (China, for its part, succeeded in boosting its share from 0.5% to 6%). Producers of electrical equipment and machinery, garments and footwear, toys and sports equipment, and various low-technology goods were the most heavily affected by Asia's penetration of the market. In response, United States firms began to place priority on setting up assembly plants in Mexico and the Caribbean Basin.

Export processing zones (EPZs), whose operations are based on low wages and preferential access to the United States market, have been one of the main mechanisms used by

⁹ This section is based on Calderón, Mortimore and Peres (1996); Mortimore and Peres (1998b); Mortimore, Duthoo and Guerrero (1995); Mortimore and Zamora (1998); Lall and Mortimore (1997); Mortimore (1997b); Gereffi and Bair (1998) (ILO), 1996; Van Liemt (1994); Vincens, Martínez and Mortimore (1998); and Carrillo and Mortimore (1998).

these enterprises. EPZs of differing extents and types have been set up in Mexico and a number of countries in the Caribbean Basin, including the Dominican Republic and Costa Rica. In Mexico, the main activities conducted in the EPZs are involved in the production of electrical machinery and electronics, power distribution and telecommunications equipment, and circuit boards and electrical machinery. In 1995, around 20% of Mexico's exports to the United States came from these industries, whereas clothing accounted for 4%.

In contrast, clothing constitutes nearly half of the Dominican Republic's exports to the United States, which is quite a sharp increase from this industry's 10% share in 1980. The remainder of the Dominican Republic's exports are made up of medical instruments, circuit boards and jewellery. In Costa Rica, too, the lion's share (36%) of the country's exports to the United States come from the clothing industry (versus about 9% in 1980). These figures reflect the steps taken by United States firms to outsource electrical equipment, basic electronics and wearing apparel for their domestic market from subsidiaries in Mexico and the Caribbean Basin. As part of these practices, such firms rely on a number of different instruments to secure ready access to the United States market:

- The provisions applying to item 9802 in the Harmonized Tariff Schedule (HTS) permit firms located in the United States to export components from that country for their assembly elsewhere and then to re-import them while paying duty only on the value added outside the country (basically the corresponding wages, in most cases).
- The Caribbean Basin Initiative (CBI) provides tariff preferences to the countries of this subregion and establishes larger quotas for their exports to the United States (USITC, 1995).
- Under the NAFTA rules of origin, inputs coming from Mexico are classified as being of North American origin, which gives Mexico an added competitive edge.

HTS 9802 is of enormous importance (see table III.10). Mexico has benefited more from this rule than other developing economies, since more than half of all its imports are covered by it. The countries of the Caribbean Basin, as a group, have been the second-largest beneficiaries and have seen their market quotas increased substantially between 1990 and 1996. A large part of the exports sold by Mexico (38% of its total exports to the United States) and by the Caribbean Basin countries (Dominican Republic: 59%, Costa Rica: 35%, Honduras: 55%, Guatemala: 34%, El Salvador: 62% and Jamaica: 54%) enter the United States under HTS 9802, whereas, for the Asian countries, the percentage is much smaller. This mechanism has therefore given United States-based transnational corporations a definite competitive advantage over their Asian rivals.

The advantages of this scheme are particularly apparent in the category of wearing apparel (USITC, 1998). The Asian countries had managed to carve out a dominant market position in exports of textiles and clothing to the United States. In 1990, the value of United States imports from Asia amounted to US\$ 20.2 billion, or 72% of the total. Between 1990 and 1996, however, the value of apparel imports from Mexico and the Caribbean climbed from US\$ 2.7 billion (10% of the total) to US\$ 10.3 billion (22%), while Asia's share slipped to 59% of the total. During this same period, clothing imports under HTS item 9802 jumped from US\$ 1.4 billion (6% of the total) to US\$ 8.9 billion (19%), and 95% of this sum corresponded to imports from Mexico and the Caribbean Basin.

Table III.10
**UNITED STATES: IMPORTS FROM DEVELOPING ECONOMIES CLASSIFIED
 UNDER HTS 9802, 1990 AND 1996**
(Billions of dollars and percentages)

Country	1990	1996	% of total exports to United States
Mexico	12.8	27.9	37.6
Malaysia	1.4	2.4	13.4
Dominican Republic	0.7	2.1	58.7
Republic of Korea	2.2	1.8	7.9
Philippines	0.6	1.8	22.1
Taiwan (Province of China)	1.0	1.0	3.5
Singapore	1.3	1.0	4.8
China	n.a	1.2	2.3
Thailand	0.5	0.8	7.0
Costa Rica	0.3	0.7	35.4
Honduras	n.a	1.0	54.6
Hong Kong	0.3	0.6	5.9
Guatemala	n.a	0.6	34.2
El Salvador	n.a	0.6	62.1
Jamaica	0.2	0.4	53.6
Subtotal	21.3	43.8	-
Rest of world	1.4	1.4	-
Total	22.7	45.3	12.5

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the United States International Trade Commission (USITC), "Production Sharing: Use of U.S. Components and Materials in Foreign Assembly Operations, 1993-96", *USITC Publication*, No. 3077, Washington, D.C., December 1997.

Thus, by investing in Latin America and the Caribbean, United States firms have been able to use HTS 9802 to their advantage in competing with Asian companies in their own market. Mexico and the countries of the Caribbean Basin have paved the way for this process by establishing special export processing zones or programmes to promote the *maquila* industry (ECLAC, 1998d). Under these programmes, exporters can make the most of the cost reductions afforded by low wage bills; in addition, they have the incentive of tariff exemptions on products that are imported for assembly and re-exportation and tax exemptions on their exports, income and repatriated profits and capital. Administrative costs have also diminished thanks to the steps taken by these countries to streamline their customs procedures.

NAFTA has also given Mexico some advantages which are not available to the countries of the Caribbean Basin. Firms located in Mexico receive the equivalent of a six-point reduction in the applicable tariffs, and import quotas on many of the goods they sell have been lifted (USITC, 1997a). In addition, they can count the Mexican-made inputs they use as part of the percentage of North American-made content (Canada, Mexico and the United States) required under NAFTA rules of origin. These advantages, in combination with the steep devaluation of the peso in 1994-1995, convinced many United States firms to undertake further investments in

maquila industries and to set up local plants in Mexico while dismantling some of their integrated operations in the United States (Gereffi and Bair, 1998). Between 1994 and 1997, about US\$ 4 billion in physical investment has been made in Mexico's *maquila* industries, and much of this has been in the form of United States FDI (see box I.4) (SECOFI, 1998a).

The advantages which Mexico enjoys under NAFTA have also, however, prodded other countries to devise different types of strategies that will allow them to compete in other segments of the market for this type of investment. For example, Costa Rica, which has been losing the comparative advantages afforded by low wage levels, is trying to shift its production activities towards industries that demand more sophisticated technology and higher skill levels. Thanks to this policy, INTEL, the world's largest producer of microchips, is investing between US\$ 300 million and US\$ 500 million in the country in 1997-1998 (Spair, 1998; Bustos, 1998a) (see box I.1).

The practice of investing under HTS 9802 in assembly plants in Latin America as a means of dealing with Asian competition in the United States market is, therefore, another sign of how United States FDI in the region is responding to the conditions deriving from the globalization of United States firms. In this instance, the response is based on the use of EPZs, preferential access to the United States market and the relatively low level of wages in Mexico and the Caribbean Basin in order to improve these firms' competitive position in their own market.

3. Services and natural resources: a new frontier for United States investors

In recent years, another notable aspect of United States FDI in Latin America and the Caribbean that constitutes an innovative response to changes in external markets and national conditions has been the increasing frequency of acquisitions, particularly within the framework of State privatization programmes. In the early 1980s, before the outbreak of the debt crisis, there were almost no foreign investors in the region in sectors other than manufacturing since, for all practical purposes, they had been barred from services industries and had been obliged to leave the mining and energy sectors during the wave of nationalizations and expropriations that had occurred in the preceding decades. The subsequent move to open up these economies and to privatize State-owned assets has changed the situation completely, however.

The number of United States firms engaged in the extraction and exportation of natural resources and in services that are catering to the local market has therefore risen sharply. United States FDI in the energy and communications industries, where some United States firms are maintaining a very active presence, is of particular interest. In most cases, United States investors' involvement in these sectors began with smaller-scale operations and subsequently led into much larger investment projects. A number of United States firms are now among the leading companies in the Latin American services and energy markets, which are increasingly competitive and have become yet another arena of global competition among transnational corporations. A number of examples of the recent activities of such firms in these sectors will be presented below.

(a) *Pioneers in emerging energy markets in Latin America and the Caribbean*

Keen competition in their home markets has prompted some firms based in the United States and Europe to look to Latin America as an attractive option for their expansion plans. Although their commitments are of a smaller scope than those of some Chilean (Enersis, Chilectra and Gener) and Spanish (Endesa-Spain and Iberdrola) investors, a number of these companies are investing quite heavily in energy-related activities, particularly electricity generation and distribution.

United States firms have found Argentina and Brazil to be the most attractive investment sites, as is demonstrated by their active participation in those countries' privatization programmes. The largest firms in the sector and a number of others that have begun to globalize their operations have formed consortia with European, Chilean and local investors in order to purchase assets that the State has put on offer. Although acquisitions have been the preferred strategy for breaking into Latin American markets, firms have been investing heavily in new generating plants as well (see table III.11).

Between 1993 and mid-1998, United States firms invested close to US\$ 9.5 billion in assets related to the generation and distribution of electrical power in Latin America; AES Corporation stands out among these investors due to its aggressive strategy for expanding its operations in the region (see table III.11 and box III.2).

The electricity sector is closely related to the hydrocarbons industry, since natural gas is the main power source for many of the new electricity generation projects being undertaken in the region. The strategy being employed by Enron—an integrated United States firm operating in the electricity industry which has invested heavily in the region,¹⁰ particularly in Brazil—is of particular interest.

It is interesting to note that many of the United States electricity companies that are setting up operations in the region have a quite small market share in the United States, and their presence in Latin America is their first foray outside of their home market. These new transnational firms have been pioneering Latin America's newly liberalized markets, and their activity has caused some of the United States' major corporations to become interested in the region. These corporations have generally been preoccupied with the need to defend their domestic market positions, but the success of these pioneering firms and the steps taken to open up the Brazilian market have spurred them to look more closely at possible investment opportunities in Latin America.

¹⁰ According to a study prepared by the British consulting firm Wood MacKenzie, Brazil is currently the only country in Latin America that does not have enough generating capacity to meet its population's demand for electrical power. The country's generating capacity will have doubled by the year 2000, but even with this increase, it will barely be able to cover demand.

Table III.11
INVESTMENT BY UNITED STATES FIRMS IN THE LATIN AMERICAN ELECTRICITY SECTOR
(Millions of dollars)

Country	Investment	Amount	Year
AES Corporation		6 378	
Argentina	Construction of the San Nicolás thermal power station (69% stake)	200	1993
Argentina	Construction of two generating plants in Río Juramento	40	1995
Argentina	Construction of AES Paraná (67% stake) ^a	440	1997
Argentina	Construction of two generating plants in Caracoles ^a	250	1997
Argentina	Acquisition of Empresa de Servicios Eléctricos de Buenos Aires (ESEBA)	565	1997
Argentina	Acquisition of 60% de la Empresa Distribuidora Eléctrica Norte (EDEN) and Empresa Distribuidora Eléctrica Sur (EDES)	377	1997
Argentina	Acquisition of 90% of Empresa Distribuidora Eléctrica La Plata (EDELAP)	350	1998
Brazil	Construction of Uruguiana generating plant	350	1997
Brazil	Acquisition of 14% of Light Serviços de Eletricidade ^b	600	1996
Brazil	Acquisition of 90% of Cía. Centro-Oeste de Distribuição de Energia Elétrica (CCODEE)	1 372	1997
Brazil	Acquisition of 14% of Cía. Energética de Minas Gerais (CEMIG)	650	1997
Brazil	Acquisition through Light, of Eletropaulo Metropolitana de Eletricidade	250	1998
El Salvador	Acquisition of 80% de la Compañía de Luz Eléctrica de Santa Ana (CLESA)	109	1998
Mexico	Construction of the Mérida III generating plant ^a	250	1997
Puerto Rico	Construction of the San Juan generating plant ^a	465	1997
Dominican Republic	Construction of Las Minas generating plant	110	1997
Houston Industries Energy Inc.		996	
Brazil	Acquisition of Light	461	1996
Colombia	Acquisition of 56.7% of Energía del Pacífico (EPSA)	535	1997
Southern Electric		735	
Argentina	Purchase of a 30-year contract for the operation of the Alicurá hydroelectric plant	314	1996
Brazil	Acquisition of 12 % of Cía. Energética de Minas Gerais (CEMIG)	421	1997
Community Energy Alternatives (CEA)		683	
Argentina	Acquisition of 30% of EDEN and EDES (a 60% stake is held by AES Corp.)	188	1997
Brazil	Acquisition of 33% of Cía. Norte Nordeste de Distribuição de Energia Elétrica (CNNDEE)	495	1997
Dominium Energy		287	
Peru	Acquisition of 60% of Empresa de Generación Eléctrica Nor Perú (EGENOR)	228	1996
Bolivia	Involvement in the capitalization of Empresa Eléctrica Corani	59	1996
CMS Energy		205	
Argentina	Acquisition of 90% Empresa Distribuidora de Electricidad de Entre Ríos	160	1996
Argentina	Purchase of Empresa de Energía Eléctrica y Vapor (EDEVA)	45	1996
Pennsylvania Power & Light		119	
Chile	Acquisition of 25% of EMEL	119	1997
Energy Initiatives		47	
Bolivia	Capitalization of Empresa Eléctrica Guarachi	47	1996
Kansas City Power & Light		23	
Argentina	Acquisition of 6% from Pérez Companc Costanera plant	23	1997

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from *América economía*, 1996 and 1997, various issues; Fundación Invertir Argentina, *American Investments in Argentina*, Buenos Aires, 1997; Banco Nacional de Desenvolvimento Econômico e Social (BNDES), *Privatization in Brazil: 1991-1998*, Rio de Janeiro, Federal Privatization Office, April 1998; Michael Tangeman, "The Power and the Glory", *Latin Finance*, No. 96, February 1998; Ian McCluskey, "Paz, amor... energía", *América economía*, Santiago, Chile, December 1997; AES Corp., *1997 Annual Report*, Arlington, 1998 [http://www.aesc.com].

^a Under construction. ^b AES coordinates Light's generating operations, while the French company Électricité de France (EDF) is in charge of distribution.

Box III.2

THE AES CORPORATION: A GROWING ENTERPRISE IN LATIN AMERICA

Seventeen years after its foundation, the AES Corporation is the world's biggest independent electric power company, with operations in 35 countries. In the space of just a few years this small, virtually unknown United States electric power company has grown to worldwide proportions. Since 1992 the company's assets have quadrupled to US\$ 8 billion and its profits have tripled to US\$ 170 million.^a In the mid-1990s, AES switched its global priorities from Europe and Asia to Latin America. Through corporate acquisitions and its successful participation in privatization processes, the firm has achieved a strong position at the regional level. By late 1997, 20% of the corporation's profits came from Latin America, and this share could increase to 30% once its Brazilian operations are consolidated. The AES Corporation currently supplies electric power to about 9 million users in the region; its generating capacity is now over 5,300 megawatts (MW) and will increase by a further 1,314 MW once the plants currently under construction are finished.

AES Corporation's first major undertaking in Latin America was to put together the consortium which acquired a 51% stake in the company Light Serviços de Eletricidade S.A., whose network serves almost 3 million consumers in Rio de Janeiro. This consortium, which also includes Houston Industries Energy Corp., the French corporation Electricité de France S.A. (EDF) and the Brazilian companhia Siderúrgica Nacional S.A. (CSN), US\$ 1.7 billion for Light Serviços de Eletricidade S.A. and has invested an additional US\$ 450 million to improve its performance.^b In early 1997, AES paid about US\$ 82 million to expand its share in Light Serviços de Eletricidade S.A. to 14%.

In 1997, in its main area of business activity, AES was chosen to build and operate a generating plant in the Brazilian city of Uruguaiana. This plant will sell electric power to the Companhia Estadual de Energia Elétrica (CEEE), with which it has signed a 20-year contract. The natural gas needed to run the plant will come from Argentina, thanks to an extension of the gas pipeline for Argentina's northern network (see box I.6). The plant will begin operating commercially in 1999. Not only is this Brazil's first independent energy project, it is also the first one to be undertaken in cooperation with Argentina. The company has also begun construction of a new thermoelectric plant (AES Paraná, with an 830 MW capacity) next to the San Nicolás plant, of which AES is the co-owner.

Also in 1997, AES significantly expanded its distribution operations by acquiring four companies through the privatization programmes being implemented by Argentina and Brazil. Together with the company Community Energy Alternatives (CEA), it has purchased two distribution companies (EDEN and EDES) which supply Buenos Aires province (see table III.11). Both have contracts with the San Nicolás generating plant, also owned by CEA and AES. AES, Houston Industries Energy Inc. —its partner in Light Serviços de Eletricidade S.A.— and the Argentine company Techint later acquired 90% of EDELAP, another distribution company in the same region. Also, in conjunction with the Southern Company, AES acquired 14.4% of CEMIG, which supplies the area adjoining the zone covered by Light.

In late 1997 AES acquired 90% of CCODEE, formerly owned by the State of Rio Grande do Sul, paying a record 93% premium over the minimum sale price.^c This has been the largest transaction carried out by the company so far and has enabled AES to consolidate its share in the region's energy distribution market. The firm's operations link up well with the Uruguaiana plant and, thanks to its strategic location, it can act as a bridge between Argentina and Brazil, thereby furthering AES Corporation's plans for additional increases in its investments in the two countries. Unlike other companies, AES tends to invest in a number of projects and then to make a strategic acquisition to tie them all in with each other. The subregional integration process (Mercosur) is central to its expansion strategy in the Southern Cone. The purchase of the CCODEE distribution company and the construction of the Uruguaiana generating plant in Brazil, in addition to their possible linkage with the firm's operations in Argentina, point in that direction.

AES followed the same strategy in 1998, continuing to expand in Latin America. After purchasing EDELAP, AES and its partners in the consortium that bought Light acquired 75% of Electropaulo Metropolitana, Brazil's largest electric power distribution company, for US\$ 1.785 billion. The consortium did not exceed the established minimum sale price, which reflects the difficulties faced by the privatization process in Brazil. In early 1998, AES also acquired 80% of CLESA, an electric power distribution company in El Salvador. This may signal the beginning of an expansion of the corporation's Central American operations.

^a Ian McCluskey, "Paz, amor ... energía", *América economía*, Santiago, Chile, December 1997.

^b *The Wall Street Journal Americas*, *El Mercurio*, Santiago, Chile, 27 April 1998.

^c Later exceeded in the acquisition of the distributing company Elektro by the United States firm Enron (see box III.3).

Box III.3

ENRON: A SECTORAL AND GEOGRAPHICALLY INTEGRATED STRATEGY

Enron's investments in the region amount to approximately US\$ 2.5 billion. In 1992, it started out rather cautiously with a share in the privatized operations of Transportadora de Gas del Sur (TGS) in Argentina, but then went on to consolidate its position significantly in 1996-1998 through acquisitions in Colombia, Bolivia and Brazil. Despite competition from other major investors from the United States (Mobil, CM Energy) and Europe (the Spanish company Repsol, Royal Dutch Shell and British Gas), the approach employed by Enron is a good example of the very active market penetration strategies being used by some United States companies in Latin American markets.

Enron's growth strategy is focused on Brazil, even though its most important assets are located in neighbouring countries (Bolivia and Argentina). It paid US\$ 1.286 billion^a for a 64% share in Elektro, the distribution arm of Companhia Energética de São Paulo, has an interest in the Bolivia-Brazil gas pipeline,^b controls the natural gas distribution company in Rio de Janeiro (Companhia Estadual de Gas (CEG)) and Riogás, holds stakes in seven other gas distribution companies in Brazil through Gaspart, and is constructing a 480 MW natural gas-fired generating plant in Cuiabá. Enron is also interested in purchasing the Companhia de Gás de São Paulo (Comgás). The acquisition of Elektro and the latter's proximity to the site of the Bolivia-Brazil gas pipeline will make it easier for Enron to sell the power it generates.

In July 1998 the Brazilian Government granted permission for Enron to import natural gas from Argentina. This will enable Enron, which was the first private company to receive such authorization, to purchase 2.8 million cubic metres of natural gas per day from Yacimientos Petrolíferos Fiscales (YPF),^c representing 35% of the 8 million cubic metres that Brazil will begin to import from Bolivia in early 1999. Enron is a shareholder (with a 25% stake) and the operator of the Bolivian oil delivery network (Transredes), a company that co-owns the pipeline that will transport natural gas from Bolivia to São Paulo. Almost all of this gas will be used to supply the Cuiabá plant in Mato Grosso.

The Enron case is very interesting, since, apart from the plant being constructed in Cuiabá, it does not have any generating capacity in the subregion but is the technical operator and the owner of 50% of TGS, the largest gas pipeline in South America.^d The Texan company plans to buy energy from Argentine generators at a price that will allow them to make only a very small profit but will enable them to consolidate their presence in the Argentine-Brazilian electricity market. In the event of its not being able to obtain energy from Argentine suppliers, it could construct its own plant, since it would have a market for the electricity. Nevertheless, this option is unlikely to materialize since it would add to the existing energy surplus in Argentina.

^a Enron made a bid that was 98.9% above the amount set as the minimum selling price, an unprecedented differential in the history of privatizations of electric companies in Brazil.

^b Enron, in partnership with Yacimientos Petrolíferos Fiscales Bolivianos (YPFB), is building a gas pipeline between Bolivia and Brazil which will come on stream in early 1999.

^c The contract between Enron and YPF is value at US\$ 35 million per year and is valid for 20 years.

^d TGS covers almost 60% of total gas consumption in Argentina through a gas pipeline system that is over 6,700 kilometres long.

In the petroleum industry, United States firms have begun to rebuild their presence in Latin America, although without even approaching the position of supremacy they enjoyed prior to the wave of nationalizations that occurred in the 1960s and 1970s. A number of United States companies acquired small stakes in Argentina's Yacimientos Petrolíferos Fiscales (YPF) —the largest firm of its type in this subsector— when it was privatized, but the most important oil companies in the region, Petróleos Mexicanos (PEMEX) and Petróleos de Venezuela (PDVSA), have not been privatized via direct sales. Amoco and Mobil have bought some formerly State-owned assets in Bolivia and Peru, but the biggest investments in this industry have been concentrated in the exploration and development of new oilfields in Venezuela, where various United States firms have taken part in over US\$ 2 billion in projects in association with local companies (see the section on Venezuela in Chapter I, part B).

(b) Telecommunications: United States domination of the cellular telephone industry

Competition in the telecommunications industry within the region has become much more intense as long-standing State monopolies are dismantled. Unlike their European counterparts, United States firms have not been very active in the region's telecommunications industry, however. Some experts feel that this is because the major United States telecommunications companies are more interested in investing in their own country, where the wave of recent mergers has cut costs and boosted profits, but this trend now seems to be changing (see box III.4).

Box III.4

MCI: WINNING LONG-DISTANCE CARRIER IN THE MOST ATTRACTIVE MARKETS IN LATIN AMERICA

The United States company MCI's first foray into Latin America was in the long-distance market in Mexico, where, in partnership with the financial group Banamex it has formed Avantel S.A. Avantel is one of the 13 long-distance carriers operating in the Mexican market, which is dominated by the company Teléfonos de México (Telmex), which boasts a 70% share.

The great wager of this company has been its recent entry into the Brazilian market. MCI was the only United States firm to invest in Telebras, as part of an acquisition bid in which the true winners were European companies such as Telefónica de España (Telesp, Telesudest Celular and Tele Leste Celular), Portugal Telecom (Telesp and Telesp Celular) and Telecom Italia (Tele Centro Sul and Tele Nordeste Celular) (see box II.5).

When virtually matching bids came in from the prospective purchasers of the long-distance company, Embratel, an open-outcry auction was held to break the tie and complete the sale. Following fierce competition between Sprint and MCI, the latter paid US\$ 2.946 billion, some 47% above the floor price and only US\$ 8 million more than its opponent's bid.

The purchase of this long-distance company is a fundamental tactic in MCI's global strategy. As a further step in that strategy's implementation, MCI has formed a strategic alliance with Telefónica de España (Telefónica Panamericana-MCI, TPAM) for the establishment of an integrated telecommunications system joining Latin America, Europe and the United States.

GTE Corporation was the first United States firm to become actively involved in the region's telecommunications industry. In November 1991, a GTE-led consortium that included AT&T, Telefónica de España and two Venezuelan firms —Electricidad de Caracas and Banco Mercantil— bought a 40% stake in that country's telephone company, Compañía Anónima Nacional de Teléfonos de Venezuela (CANTV). GTE now owns 20% of CANTV and provides local and long-distance stationary telephone service (2.5 million lines), along with cellular telephone service to another 210,000 subscribers. GTE also owns Compañía Dominicana de Teléfonos (CODETEL), which provides local, international and cellular telephone service in the Dominican Republic. Yet another GTE-led consortium owns Compañía de Teléfonos del Interior S.A. (CTI), a cellular telephone company serving a population of 22 million people residing in 23 provinces in northern and southern Argentina.

The United States-based transnational BellSouth has been applying one of the most aggressive strategies in this area. Since the beginning of the 1990s —while Telefónica de España, the Italian firm Stet Telecom, and France Telecom, among others, have been spending billions of dollars to buy up existing telephone companies offering traditional services— BellSouth has invested around US\$ 2.8 billion (more than half of that sum in Brazil) in setting up its cellular telephone business in nine countries of the region.

BellSouth is the fourth largest telecommunications company in the world.¹¹ It is especially active in mobile communications markets, operates in 19 countries and is the largest basic telephone service provider in the United States. It has become Latin America's leading cellular telephone company, serving Argentina, Brazil, Chile, Ecuador, Nicaragua, Panama, Peru, Uruguay and Venezuela. In most cases, it has been this company's policy to form alliances with other firms in these markets (see table III.12).

Table III.12
MAJOR BELL SOUTH OPERATIONS IN LATIN AMERICA

Country	Company	Start-up date
Argentina	Owens 65% of Compañía de Radiocomunicaciones Móviles S.A. (CRM) which operates a cellular telephone network in the Buenos Aires metropolitan area. The CRM system operates under the trade name of Movicom.	1989
Brazil	Owens (in conjunction with Brazilian partners) operating concessions for cellular telephone service in the city of São Paulo and in the north-eastern states of Brazil.	1997
Chile	Controls 50% of the cellular telephone market. Since 1995 operates a national and international long-distance service network.	1991
Ecuador	Owens 61% of OTECEL, one of the two companies offering nationwide cellular telephone service. Currently controls nearly 35% of the market, but hopes to increase its share via a US\$ 75 million investment to expand its infrastructure and improve service.	1997
Nicaragua	Owens 49% of Telefonía Celular de Nicaragua (NICATEL), which now operates under the BellSouth trade name and is the only cellular telephone company in the country. The firm has invested some US\$ 20 million to complete the transition from an analog to a digital system.	1997
Panama	Has been awarded a 20-year contract for the construction and operation of the country's first cellular telephone network.	1996
Peru	Owens 59% of Tele2000, a cellular telephone company offering nationwide service. In June 1998, Tele2000 paid US\$ 35 million for a 20-year contract for the operation of cellular telephone services in the country. It has also announced plans to invest over US\$ 200 million to build and run a cellular telephone network in the region covered by the new concession.	1997
Uruguay	Owens 46% of Movicom, a cellular telephone company serving a population of 1.7 million in Montevideo and the coastal region.	1996
Venezuela	Owens 57% of Telefonía Móvil Celular (TELECEL), which covers 90% of the country.	1991

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from BellSouth.

¹¹ At the international level, BellSouth offers cellular telephone, data transmission and long-distance telephone service, alternative networks and software.

In Latin America, BellSouth has focused on Brazil, which is one of the most attractive markets in the world.¹² In July 1997, this company headed up the group that won the contract for the cellular telephone network in São Paulo with an offer of US\$ 2.45 billion.¹³ At the helm of the same consortium, in August BellSouth won a licence covering the states of Alagoas, Ceará, Paraíba, Pernambuco, Piauí and Rio Grande do Norte for slightly over US\$ 510 million.

This expansionary strategy has been successful, as demonstrated by the fact that in 1996 the Latin American division of BellSouth reported 27% growth, US\$ 455 million in sales and US\$ 60 million in net profits (Zellner, 1997). Even without counting the Brazilian market, this company has nearly one million customers in Latin America. Indeed, aside from Brazil, Latin America offers a number of other attractive options for BellSouth. As just one example, it might focus its efforts on breaking into the cellular telephone markets in Mexico and Colombia. It also has the chance to expand its operations beyond its cellular telephony niche. Its first attempt to do so has been in Chile, where thus far it has not had a great deal of success operating as a long-distance service provider.

In the coming years, more and more opportunities will be arising in the telecommunications industry. For example, in October 1999, this market is going to be opened up in Argentina. At first, the two major firms already in place will start competing with each other in both the local and long-distance service markets. A year later, at least four more operators are supposed to enter the market, and new cellular telephone operators will be given more scope.

A study conducted by the consulting firm Deloitte & Touche indicates that by the end of 1997 there were 8.3 million cellular telephone users in Latin America and that by the year 2007 this number will have risen to an estimated 31 million, with two thirds of the total being located in Brazil, Mexico and Argentina. These figures help explain why competition is now so fierce among cellular telephone operators, as they rush to establish a solid market position in the region's major economies. Service providers are not the only actors in this market, however; equipment manufacturers are also vying for position: Motorola, a United States-based corporation, is striving to gain market share at the expense of its main competitors, including Ericsson, a Swedish firm, and the Finnish company, Nokia. In late 1997 Motorola signed a US\$ 350 million contract with Telefónica del Perú for the incorporation of new cellular technology.

¹² São Paulo, with over 18 million inhabitants and only 12 lines for every 100 persons, is one of the markets with the most growth potential in the entire world. In fact, when BCP—a consortium led by BellSouth and the local Safra Group—opened up subscriptions for the first 150,000 customers, it was flooded with over 1.6 million applications and in less than a month it signed up more than 160,000 customers.

¹³ The BCP consortium was formed by BellSouth (44%), the Safra financial group (44%), the media conglomerate O Estado de São Paulo (OESP) (6%) and Splice (6%), a maker of telecommunications equipment.

D. CONCLUSIONS

The Latin American and Caribbean region is playing an increasingly important role in the strategies being used by United States-based transnational corporations to cope with the new challenges posed by the globalization process. Because of the distortions that United States investment in the region's financial centres introduces into aggregate statistics, a much clearer picture of the region's role in such strategies (which can only be guessed at on the basis of the global figures) can be formed by analysing a limited number of operations that are representative of trends in FDI in the region from United States sources. A key source of information on this subject is the *Benchmark Survey: US Direct Investment Abroad* series published by the United States Department of Commerce. The findings of the research project conducted by the Unit on Investment and Corporate Strategies of the ECLAC Division of Production, Productivity and Management have also contributed to a fuller understanding of this phenomenon. These and other data indicate that investment behaviour has changed substantially in response to the demands and opportunities associated with the globalization and structural reform processes in the countries of the region.

In the 1990s, Latin America and the Caribbean have become the most attractive of all the developing regions for United States investors, as is reflected by the fact that 20% of the total stock of United States FDI is to be found in the region (if the region's financial centres are excluded from the reckoning, then the region's share drops to 11%). The region also accounts for 8.3% of total sales and 8.5% of the exports of the Latin America and Caribbean subsidiaries of United States-based transnational corporations. In the case of manufactures, the region's shares of total world sales and exports amount to 9.9% and 6.2%, respectively. Thus, the region is clearly an important factor in transnational corporations' business strategies.

An analysis of FDI flows based on case studies of new focal points of economic activity demonstrates that United States firms are concentrated in manufacturing and services (telecommunications and energy). In the manufacturing sector, these enterprises are capitalizing upon various advantages (low wages, geographic proximity and preferential access to the United States market) to enhance their ability to compete in their own market against Asian firms. Clear examples include the Mexican automotive industry's operations under NAFTA (see chapter IV) and *maquila* industries operating under HTS 9802 in the Caribbean Basin.

Ford, General Motors and Chrysler have been better able to compete against Japanese and Korean motor vehicle makers in the United States market thanks to their new plants in Mexico. These corporations have succeeded to some extent in coping with Japanese competitors in their own market by investing in modern technologies and organizational practices in these new plants, where they then produce vehicles for export that can compete on the United States market. About three fourths of the passenger vehicles they manufacture in Mexico are sold in North America. The NAFTA provisions concerning the automotive industry set out rules of origin under which 62.5% of inputs will have to come from the United States, Canada or Mexico by the year 2004. Thus, a cross analysis of these three sets of factors —the challenge posed by Japanese competitors in the international market, the new rules governing the industry under

NAFTA and the overhaul of the corporate strategies employed by major United States firms in the sector— provide a clearer picture of the significance of current FDI trends.

The situation is much the same in the Caribbean Basin's garment industry. Faced with strong competition in their own market from Chinese garment makers, major United States clothing manufacturers, distributors and wholesalers have found that the EPZs of the Caribbean Basin provide them with significant advantages that allow them to become more competitive in the international marketplace. Under HTS 9802, garments assembled from United States-made inputs are subject to duty only on the value added outside that country. Here again, a three-way cross analysis of the relevant factors (competition from Chinese producers in the international marketplace, the new rules applying in EPZs coupled with HTS 9802, and the new strategies being employed by United States firms in this industry) sheds light on the implications of trends in FDI flows.

Changes in the competitive position of United States-based service companies have been much more recent and are not yet reflected in the aggregate statistics. The situation in the energy sector (electricity and gas distribution) and in the telecommunications industry appear to have a number of elements in common. Given the intense competition existing in the United States market—which has led to a greater degree of market concentration via mergers and acquisitions of leading firms— medium-sized and small firms wishing to expand have had to look for opportunities outside the United States, thereby joining in the ongoing globalization process. The new policies being implemented in Latin America (deregulation and privatization) open up opportunities for pioneering United States firms in these industries. Many of these enterprises have now moved into a second phase in terms of their investment behaviour as the wave of acquisitions begins to subside and they turn their attention to broadening their generating base. In the telecommunications industry, the start-up investments that United States firms have made in cellular telephone systems have enabled them to stake out a position in Latin American markets—especially for stationary local and long-distance telephone service— and thus prepare themselves for the time when those markets will become more competitive. As in the cases discussed earlier, this investment behaviour can be better understood if it is viewed as the outcome of a combination of factors relating to the international market, national policies and the new corporate strategies being used by United States-based corporations.

In summary, during the 1990s United States firms' FDI in Latin America and the Caribbean has been concentrated in a few branches of economic activity. These companies' objectives have been to increase the efficiency of their manufacturing activities —particularly in the automotive industry in Mexico and the garment industry in the Caribbean Basin— and to gain access to the Latin American and Caribbean countries' power generation, gas distribution and telecommunications markets.

IV. THE AUTOMOTIVE INDUSTRY: INVESTMENT AND CORPORATE STRATEGIES IN LATIN AMERICA

A. THE JAPANESE CHALLENGE TO THE WORLD AUTOMOTIVE INDUSTRY

In this century, the automotive industry has played a very prominent —sometimes crucial— role in the advance of industrialization in many countries. Its importance stems from the fact that the industry has been a pioneer in creating innovations that have radically transformed the way the manufacturing process is organized. These innovations have been adopted to varying degrees by other businesses and have gone on to transform the manufacturing industry as a whole, dramatically increasing labour productivity and industrial development.

1. Technological change in the automotive industry

Two episodes in the evolution of the automotive industry have had a strong influence on economic and industrial development. The first occurred at the start of the century, when the conveyor belt or assembly line was devised and began to be used in the United States for motor vehicles. Through that innovation, the Ford Motor Company revolutionized vehicle manufacturing, accentuating its nature as a process for mass production of standardized products and minimizing the craft elements that had persisted and were typical of previous methods of production. The externalities derived from economies of scale and their impact on reducing unit costs and increasing production volumes placed Ford in a leading position worldwide (Womack and others, 1990).

Ford's assembly line system was adopted and improved by other automobile manufacturers. General Motors in particular made extensive innovations in the organization of the work process, making it more functional for mass production and dividing it into repetitive, specialized tasks easily monitored by a few supervisors.

The conveyor assembly line and the changes in work organization went on to become the predominant way that automobile production and manufacturing in general was done. During the following 50 years, the development of the manufacturing industry was spurred by the need to increase cost savings by increasing the production volumes of virtually identical goods. Manufacturing became increasingly specialized and mechanized, and decisions as to design, organizational management and quality control became concentrated in a few individuals.

The second important episode in the development of the automotive industry —and of manufacturing— had a different origin. In Japan, after the Second World War, the Toyota company radically redesigned the way in which vehicles and vehicle parts were manufactured. E. Toyoda and T. Ohno proposed a different method of organizing vehicle manufacture, motivated to some extent by the differences between Japan and the United States in terms of market structure and resource base, a method that would subsequently be known as the “Toyota System” or “lean production”. Their contribution increased productivity dramatically in the Japanese automotive industry and made it a major player in the world market, taking market share away from companies that had been dominant up until that time and thus forcing them to redefine their global investment, production and trade strategies.

Committed to defect prevention, flexible multi-specialization of the labour force and product differentiation, the “Toyota System” was a vital part of the Japanese automotive industry’s strategy for penetrating world markets. With a great capacity to generate value added, reduce costs and raise quality, the Japanese challenge gained even greater strength as a result of the sudden increases in the international price of oil that occurred in the mid-1970s. Consumers in the member States of the Organization for Economic Co-operation and Development (OECD) began to appreciate the advantages of economy cars that used energy more efficiently, the typical product of the Japanese automotive industry.

The manufacturing process proposed under the “Toyota System” was based, among other things, on three basic elements:

- *Flexible organization*, which involves several aspects. With regard to the workforce, it means that workers must be given multiple training so that they will be able to do various jobs, and this applies both to manufacturing and to supervision and quality control. With regard to capital assets, it means that, at the plant, it is possible to manufacture production lots profitably in relatively low volumes and quickly modify the various characteristics of the final product to respond to sudden changes in demand. Under the “Toyota System” it is therefore possible to meet the requirements of differentiated market niches better by gearing the finishing features of the vehicle to the needs of different consumers. Production thus responds to consumer preferences, unlike the “Ford System”, which is based on mass consumption, imposed on the market by the need to increase economies of scale.
- *Emphasis on total prevention of defects*, as a result of the traditional effort to eliminate unnecessary costs. Unlike the concept of quality control based on detection of errors in the final phase of manufacturing, the “Toyota System” seeks to eliminate at the source any possibility of generating defects and periods of inactivity or interruptions in the use of the installed capacity. Thanks to this concept, the proportion of defective units produced has been drastically reduced and operating costs have been lowered even further.
- *An integrated concept of the manufacturing process*, viewed as a medium-term and long-term commitment between the auto maker and its employees, suppliers and distributors to generate value added throughout the entire production chain. The commitment emphasizes teamwork and a less hierarchical organizational structure.

Collective effort, together with better and more fluid communication between the participants, makes it possible to detect and eliminate quickly potential sources of inefficiencies in all phases of production. It also allows for long-term relationships between producers, suppliers and distributors and greatly lowers the transaction costs inherent in short-term commercial relationships. Such alliances involve, for example, purchasing schedules with time horizons extending over several years and joint responsibility for the design of parts, models and methods to improve quality or cut costs.¹

The “Toyota System” was soon adopted by other Japanese (and later Korean) companies and helped them to reduce costs and adapt their products more easily to the demands of different consumers. The Japanese production system was adapted in a variety of ways, both in Japan and in the so-called Japanese “transplants” and by other companies (Tetsu, 1994). Through its application and the experience acquired in producing for the local market, Japanese manufacturers gained a competitive advantage that made them major players in the international automotive industry and gave rise to what would be known as the Japanese challenge (Mortimore, 1998c). That development and the response from competitors redefined the global matrix of competition in the industry. The first observable effect was Japan’s increasing share in international motor vehicle trade, followed by a great wave of foreign direct investment (FDI) by Japanese companies in various regions of the world. Their investments changed the existing map of automotive production facilities, as the main companies formed international integrated production networks. That made it possible to include certain developing countries in the core group of producers of motor vehicles and automotive parts.

The significance of the Asian challenge is reflected in the increasing penetration of Japanese companies into the OECD automotive market in the last 30 years (see table IV.1). In the early 1960s, the Japanese auto industry was supplying fewer than 1% of the passenger cars and automotive parts imported into the OECD countries; a few years later, that figure had risen to almost 8%, and then reached nearly 20% in the early 1980s. In 1990, it accounted for 22%, although since then there has been some decline, having to do with the extension of Japanese international production networks into the main markets (North America and Western Europe).

¹ By fostering long-term relationships between suppliers and final assemblers, the system created more room and impetus for the development of suppliers and outsourcing in contrast to the vertical integration pattern that the big United States auto makers had developed. New inventory management methods were also introduced, based on an agreement with the suppliers to supply inputs and raw materials at the right times and in the exact proportions in which they would be needed in the various phases of vehicle production. This inventory management practice became known as just-in-time production.

Table IV.1
MARKET SHARE OF IMPORTS OF AUTOMOTIVE PRODUCTS,
1963-1996^a
(Percentages)

Origin: region/country	1963	1971	1980	1990	1996
1. Japan	0.6	7.8	19.3	21.8	16.3
2. North America	23.0	37.5	23.3	18.8	20.7
Canada	1.6	18.5	8.4	9.2	10.2
United States	21.4	19.0	14.9	9.6	10.5
3. Western Europe	74.6	53.1	51.5	52.6	53.2
Germany	32.3	22.1	22.9	21.0	19.3
Austria	0.2	0.2	0.8	1.0	1.5
Belgium/Luxembourg	3.9	6.1	5.7	5.8	5.4
Spain	0.1	0.4	1.5	4.0	5.7
France	9.6	8.9	10.3	8.7	8.3
Italy	6.1	5.0	4.4	4.1	3.5
United Kingdom	18.4	7.0	3.2	4.1	5.7
Sweden	3.0	2.6	1.8	2.5	2.5
The Netherlands	1.0	0.8	0.9	1.4	1.3
4. Other	1.8	1.6	5.9	6.8	9.8
Brazil	...	...	0.6	0.6	0.4
Mexico	0.0	0.2	0.4	2.2	4.0
Republic of Korea	0.0	0.0	...	0.9	1.4
All others ^b	1.8	1.4	4.9	3.1	4.0
Total	100.0	100.0	100.0	100.0	100.0

Source: ECLAC, based on the Competitive Analysis of Nations (CAN) computer software (versions 1.1 y CAN PLUS) developed by ECLAC.

^a Groups 713, 781 y 784, i.e., engines, passenger cars, and parts and accessories of motor vehicles (auto parts) in the Standard International Trade Classification (SITC), Rev. 2.

^b Countries with a market share of less than 1% in 1996.

Since the 1980s, trade figures have underestimated the importance of the Asian challenge in the automotive industry, since the OECD countries have reacted in very protectionist fashion to the entry of a large number of Japanese vehicles into their domestic markets. Foremost in this area are so-called "voluntary restrictions" on exports. In 1981 the United States decided that no more than 1.68 million vehicles manufactured in Japan could be imported, a limit that was raised to 2.3 million in 1985. France, Italy, the United Kingdom and other European countries also restricted imports of vehicles manufactured in Japan. However, due to the creation of the single market, the European Union and Japan agreed to eliminate barriers gradually on imports of Japanese vehicles starting in 1999. With the entry of the European Union into the World Trade Organization (WTO), the maximum quota of 1.23 million currently in effect is to be eliminated in 1999 (Mortimore, 1998c).

OECD trade barriers to the entry of vehicles produced in Japan spurred Asian companies to make heavy direct investments to open assembly plants in North America and western Europe (especially in the United Kingdom). As a consequence of that strategy, the OECD countries began to consume not only imported vehicles of Japanese makes, but also vehicles produced at

the Japanese assembly plants operating in the OECD member countries, Japan's so-called "transplants" in the OECD automotive sector.

In 1987, 90% of the automobiles produced in the United States were manufactured by its three biggest auto makers: General Motors, Ford and Chrysler. Six years later, that market share had dropped to 74%, as a result of the establishment of Asian vehicle assembly plants in the North American market (Mortimore, 1998c).²

The strategy of the Japanese companies in the European market was similar to the strategy they had used to penetrate the United States market: first through exports and then through local production. In 1993, automobile producers of Japanese origin were meeting 13.7% of the demand for automobiles in Germany, 4.4% in France, 4.2% in Italy, 12.7% in the United Kingdom and 20.3% in Sweden (Vickery, 1996, p. 189).

In addition to the protectionist response to the Japanese challenge, OECD auto makers were forced to rethink their long-term competition strategies. They embarked upon a total restructuring of vehicle production capacity. North American and European companies dismantled vehicle assembly plants—within and outside the OECD countries—and built new ones. The purpose of the investments was to relocate vehicle production in regions of cheap labour, high productivity and potential efficiency, while incorporating some elements of the "Toyota System" into their manufacturing processes.

On the threshold of the twenty-first century, the total restructuring of the automotive industry is not yet finished. Through previous investments and improvements in productivity, production capacity has increased to a level that exceeds demand by nearly 33% (Mortimore, 1998a). The potential oversupply augurs a phase of intense competition, primarily through price-cutting. The impact is already being felt; the smaller automotive firms will surely be the ones most affected. Some have begun to merge with each other or with larger firms to achieve economies of scale and scope that will enable them to survive, as in the case of BMW and Rover, Daimler-Benz and Chrysler, Rolls Royce and Volkswagen.³ Others have made major investments to strengthen and expand their presence in some subregional markets. In 1996, the difficulties of the automotive industry in Europe were plain, when the Governments of France and Italy had to support their domestic auto makers indirectly, through subsidies to consumers to induce them to replace their vehicles sooner (*The Economist*, 1997a, pp. 69 and 70).

² In 1993, Honda facilities in the United States produced 404,000 automobiles, which accounted for 6.8% of all vehicles manufactured in that country. Among other foreign companies, it was followed by Nissan with a market share of 4.9%, Toyota (3.9%), Mazda (3.7%), NUMMI (joint venture of Toyota and General Motors, 3.5%), Diamond Star (joint venture of Chrysler and Mitsubishi, 2.3%) and Subaru Isuzu (0.8%) (Dalton, 1991).

³ There have been persistent rumors as to Fiat's interest in acquiring BMW or another medium-sized automotive firm (*The Economist*, 1998, pp. 61 y 62).

2. Competition in the main markets

As stated above, the Asian challenge accentuated the globalization of the automotive industry and intensified competition in the main world markets, through increased imports and flows of FDI to produce locally. Thus, to evaluate the market shares of the various auto makers, one must consider the new competitive position in the largest markets.

At the start of the 1990s, foreign makes had a strong presence in the automobile markets of the western industrialized countries. In 1993, one third of all new automobiles registered in the United States were foreign makes —29.3% Japanese and another 4.3% primarily European. In France, foreign makes had a market share of 39.7%. In Germany and Italy, the proportion was more than half: 58% and 55.1%, respectively. The predominance of foreign makes in the Swedish market was even greater, at 73%; the extreme case was the United Kingdom, where domestic makes had disappeared from the local new-car market (see table IV.2). The United States auto makers were still the most important foreign competitors in these five European markets, and Japanese makes had a presence ranging from 4% to 20%. On the other hand, European automobile companies generally had a small market share in the United States and Japanese markets. In that sense, they remained rather regional companies.

Table IV.2
COMPETITION IN THREE MAIN AUTOMOBILE MARKETS, 1993^a
(Percentages)

Auto Manufacturer	United States	European Union					Japan
		Germany	France	Italy	United Kingdom	Sweden	
Domestic	66.4	42.0	60.3	44.9	-	26.6	96.0
Foreign	33.6	58.0	39.7	55.1	100	73.4	4.0
- United States	X	(25.6)	(14.5)	(16.8)	(39.4)	(27.5)	(1.1)
- Western Europe	(3.2)	(14.0)	(20.1)	(32.8)	(46.0)	(24.7)	(2.8)
- Japan	(29.3)	(13.7)	(4.4)	(4.2)	(12.7)	(20.3)	X
- Other	(1.1)	(4.7)	(0.7)	(1.3)	(1.9)	(0.9)	(0.1)

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from G. Vickery, "Globalisation in the automotive industry", *Globalisation of Industry: Overview and Sectoral Reports*, Paris, Organization for Economic Co-operation and Development (OECD), 1996, p. 189.

^a New passenger cars registered, by manufacturer's country of origin.

In contrast to the situation in the markets of the United States and western Europe, 96% of the new car sales in the Japanese market in 1993 were produced by its domestic auto makers (see table IV.2). That fact reflects the enormous difficulty foreign companies have had in penetrating the Japanese market through imports, as a result of the administrative obstacles and the lack of competitive products. Moreover, the companies of the United States and Europe have no large motor vehicle assembly plants in Japan (Mortimore, 1998c).

The automotive industry is one of the most concentrated in the world. Three firms account for 40% of all production of commercial vehicles and passenger cars and together with another 14 manufacturers account for nearly 90% (see table IV.3). The three largest auto makers are General Motors, Ford and Toyota, and they owe their predominance to the aforementioned innovations and to their ability to adapt to changes in the market.

Table IV.3
TOP AUTOMOTIVE FIRMS AND THEIR DEGREE OF INTERNATIONALIZATION,
1981 AND 1993-1994
(In millions of units and percentages)

Ranking according to production		Firms (country of origin)	1994 Production ^a	1993 Production ^b		
1994	1981			% in country of origin		% of prod. outside of country of origin
				Domestic sales	Exports	
		Division 1	19.7			
1	1	General Motors (United States)	8.0	52.4	...	47.6
2	2	Ford (United States)	6.5	41.2	...	58.9
3	3	Toyota (Japan)	5.2	85.2	(33.3)	14.8
		Division 2	20.8			
4	5	VW (Germany)	3.2	57.2	(21.8)	42.8
5	4	Nissan (Japan)	2.8	68.8	(30.8)	31.2
6	12	Chrysler (United States)	2.8	54.3	...	45.7
7	7	Fiat (Italy)	2.4	74.9	(36.4)	25.1
8	8	PSA (France)	2.0	81.1	(55.9)	18.9
9	6	Renault (France)	1.9	77.0	(44.6)	23.0
10	10	Mitsubishi (Japan)	1.8	83.3	(37.3)	16.7
11	11	Honda (Japan)	1.7	67.0	(34.3)	33.1
12	9	Mazda (Japan)	1.2	79.8	(53.7)	20.2
		Division 3	4.9			
13	-	Hyundai (Republic of Korea)	1.2	98.2	(42.7)	1.9
14	21	BMW/Rover (Germany)	1.1	100.0	(61.2)	-
15	15	Suzuki (Japan)	1.0	99.4	(43.3)	0.6
16	14	Daimler Benz (Germany)	0.9	100.0	(56.4)	-
17	-	Kia (Republic of Korea)	0.7	100.0	...	-
Total		17 top firms	44.4			
Total		All firms	49.7			

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from G. Vickery, "Globalisation in the automotive industry", *Globalisation of Industry: Overview and Sectoral Reports*, Paris, Organization for Economic Co-operation and Development (OECD), 1996, pp. 160 and 171.

^a Millions of passenger cars and commercial vehicles.

^b Passenger cars only.

In 1993, the production networks of General Motors and Ford had a more international structure than that of Toyota. In fact, half of their output was manufactured at plants located outside of the United States, their country of origin, in contrast to Toyota, whose percentage manufactured outside of Japan was 14.8%. The United States firms had automobile assembly plants in more countries than did Asian auto makers, reflecting a strategy of supplying regional markets through plants located within them or relatively close to them. At the start of the 1990s, General Motors and Ford had facilities in Canada and Mexico to support the United States plants in supplying the North American market. They also had operations in Germany, Spain and the United Kingdom to meet European demand, and in Australia and some South American countries to cover those subregional markets. On the other hand, Toyota's main plants abroad were located only in Australia, Canada, the United States and the United Kingdom.

In the second rank are nine auto makers with a combined market share of 39% of total vehicle production: Volkswagen of Germany; Nissan, Mitsubishi, Honda and Mazda of Japan; Chrysler⁴ of the United States; Fiat of Italy; and PSA-Peugeot-Citroën and Renault of France. In general, what these companies have in common is that they produce a significant percentage of vehicles outside their country of origin, are of medium size—in relative terms—and have long been world-class competitors, without managing to rise to the first rank. Some, like Chrysler and Renault, have undergone difficult periods, which have been overcome through government support or partnerships with other companies.

This second group of companies has a production structure less globalized than General Motors and Ford, but more so than Toyota. In 1993, Chrysler and Volkswagen were at one extreme, with approximately 44% of their vehicle production generated abroad. At the other extreme were Mitsubishi and PSA, with approximately 18% of their products manufactured outside of their countries of origin. The international dispersion of this second group is generally more restricted than it is for the first group, but much higher than for the third group. Volkswagen and Nissan are relative exceptions, because they have plants in four or five countries, including some in Latin America.

The last group is composed of auto makers that are smaller but have some prominence in world production; it includes Suzuki of Japan, BMW/Rover and Daimler-Benz of Germany, and Hyundai and Kia of the Republic of Korea. Unlike the other two groups, this last group has achieved its linkages with the global economy almost exclusively through foreign trade and not through productive investment abroad. All these firms produce more than 98% of their vehicles in their country of origin. Represented in this group is the other and most recent expression of the Asian challenge to the automotive industry: auto makers in the Republic of Korea, the only country—aside from Japan—that has managed in the post-war period to create an automotive industry with domestic capital that is able to compete internationally. Hyundai and Kia, together with Samsung and Daewoo, are Korean companies that have managed to enter the world vehicle market, by using the "Toyota System" and targeting the niche market of small, low-priced cars. Prior to the current financial crisis in southeast Asia, these companies had planned to go ahead with an intensive investment programme, in order to start the year 2000 with an annual

⁴ In this classification, the data for Chrysler and Daimler-Benz are considered separately, in spite of their recent merger.

production capacity of 6 million vehicles, practically three times what it was in 1996 (2,200 million), a development that would destabilize the industry even further.

3. Competitive advantages and repercussions of the "Toyota System"

The challenge of Japan (and the Republic of Korea) in the struggle for world markets continues and has grown stronger, supported by greater productivity and efficiency. At the end of the 1980s, according to available data, Japanese vehicle assembly plants located in Japan required on average 20% fewer man-hours per finished vehicle than did Japanese plants in the United States; 33% less than local plants of United States auto makers; and 50% less than plants of European companies. The Japanese plants in Japan had fewer assembly defects per thousand vehicles produced and nearly 10 times fewer days of warehousing per finished vehicle (J.D. Powers & Associates cited in *The Economist*, 10 August 1991, p. 63). Furthermore, information from the mid-1990s suggests that, although the United States companies have been reducing that difference, they still have not managed to dislodge the Japanese from their predominant position in terms of productivity and operating cost (UADE, 1996).

Recent studies at dozens of plants that manufacture auto parts, such as seats, brakes and exhaust systems, in Canada, France, Germany, Italy, Japan, Mexico, Spain, the United Kingdom and the United States have concluded that the performance of Japanese plants exceeds similar plants in other countries in terms of productivity, quality and inventory management (Andersen Consulting, 1992 and 1994). The evidence shows that that success can be attributed in large part to the advantages derived from the "Toyota System".

In recent years, and in spite of the problems of the Japanese market, some Asian automotive firms have started to undertake investment projects to renovate and expand their capital assets and gain positions in the international markets. Toyota, for example, plans to make a total investment of US\$ 13.5 billion from 1998 to the year 2000 to expand its production capacity beyond 6 million units per year and to better gear its vehicle offerings to regional demand (*Business Week*, 1997, p. 104). Its capital formation plans on the American continent primarily entail setting up or expanding vehicle and engine plants in Canada and the United States. That will bring its annual production capacity to 1.2 million vehicles in 1998, one and a half times what it was two years before. In Europe, with investments in France and the United Kingdom, Toyota will increase its vehicle production beyond 400,000 units. In Asia, with investments in China, Japan and Thailand, it will expand its distribution network, build up its system of suppliers and expand its production facilities in the region. By the year 2000, as a result of these investments, Toyota plans to increase its vehicle production capacity to a volume in excess of 4 million units in Japan and 600,000 in the rest of Asia.

It is important to note that, as in Asia, there are strong links between Toyota's plants in Canada and the United States and regional producers of auto parts. Toyota has established a regional network of more than 500 suppliers of parts and components. Its production facilities extend beyond assembly to include the production of four-cylinder and six-cylinder engines, axle manufacturing, stamping, casting and body manufacturing, as well as the production of certain plastic auto parts. Toyota also has a direct stake in metal-manufacturing companies (*Bodine*

Aluminium) and design firms (*Calty Design Research*). It is also directly involved in the production of piston heads and some aluminium parts. In other words, its North American facilities are significant components of its international integrated production network.

The consequences of Toyota's expansion in an industry with roughly stable total production are that the weakest companies will have to yield to its greater competitiveness. At the same time, Toyota's serious initiatives in Asia, Europe and especially North America stand in marked contrast to its virtual absence from Latin America. One can wonder what is happening with the automotive industry in Latin America such that world trends and the repercussions of the "Toyota System" are not reflected in the same way.

B. EVOLUTION AND CURRENT CONDITION OF THE AUTOMOTIVE INDUSTRY IN LATIN AMERICA

The global restructuring of the automotive industry caused by the advance of the Japanese companies—and to a lesser degree companies of the Republic of Korea—has allowed for economies of scale in the increasingly integrated international networks of the Japanese auto makers for production of vehicles and auto parts, particularly in Asia.

At the same time, non-Japanese auto makers have redefined their business strategies by reconsidering the role of some developing economies in their existing networks of vehicle production, in an attempt to lower operating costs and raise quality in response to the Asian challenge. They have gone from being consumption centres where investments were geared towards meeting local demand locally, to being perceived as possible production centres that are internationally competitive. Foreign direct investment in the automotive industries of some developing countries could cease to be an instrument for penetrating markets highly protected by trade barriers and become a useful tool for increasing the total productivity of the vehicle producing companies of the United States and Europe.

The automotive firms of the United States and Europe have invested massively in some developing economies to expand their international production networks, by building or modernizing existing plants in order to be able to compete through lower operating costs. The attraction has usually been low labour costs, which could mean—for production of more than 100,000 units a year—a 30% reduction in those costs compared to a similar plant located in an OECD country (O'Brien and Karmokolias, 1994). The competitive advantages might even increase as the local network for supply of auto parts and components becomes stronger, since labour costs represent only 15% of the direct cost of the finished vehicle.

In addition to labour cost advantages, developing countries have two additional features that are attractive for transnational corporations.

- In the 1990s, their markets have a potential for expansion that far exceeds that of the OECD economies.⁵
- Recent trends to strengthen so-called “open regionalism” through integration agreements between different countries are eliminating barriers to interregional trade in goods and services.⁶

In effect, the process of globalization of the automotive industry has come about through FDI by transnational corporations in some developing economies, especially those that offer expanded markets and special provisions for the sector. Early in the 1990s, Japanese companies focused on developing Asian economies, while North American and European companies focused on Latin America (see table IV.4).

At the start of the 1990s, 17 of the major automotive plants set up by Japanese companies in developing economies were in developing Asian economies, especially in the countries of the Association of South-East Asian Nations (ASEAN): five in Indonesia, two in Malaysia and five in Thailand. At that time, the Nissan plant in Mexico was the only major plant in Latin America owned by Japanese or Korean auto makers. However, Honda has recently made investments in Mexico for assembling vehicles intended basically to supply the domestic market. Similarly, Toyota is setting up new—relatively small—plants in Argentina and Brazil to take advantage of the benefits of Mercosur.

On the other hand, the companies of the United States and Europe have located 16 of their 26 plants in developing economies in Latin America: five in Argentina, four in Brazil, four in Mexico and three in Venezuela. It should be borne in mind that the rapid process of investment in the automotive industry in some countries in recent years may mean that the presence of transnational corporations in the region has been underestimated. Nevertheless, the general pattern of regional concentration of direct investments by auto makers has been maintained. It is interesting to note that Toyota, General Motors and Ford plants coexist only in Turkey (see table IV.4). That situation is reportedly about to occur in Argentina and Brazil with the investments that Toyota is now making.

⁵ In the OECD countries, the new-car market is driven basically by replacement, given high levels of saturation of vehicle demand per family and the sluggishness of demographic growth. On the other hand, in developing economies, both of these indicators point to high potential growth in vehicle demand. There, per capita domestic demand is far from the saturation point, and the population is expanding faster. Latin America and developing Asian economies offer great opportunities.

⁶ Similar arrangements are in place, for example, in the Association of South-East Asian Nations (ASEAN) between Brunei, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Viet Nam; in the North American Free Trade Agreement (NAFTA) between Canada, Mexico and the United States; and in the Southern Common Market (Mercosur) between Argentina, Brazil, Paraguay and Uruguay. Among their benefits, those agreements provide privileged access to the regional market for products that meet certain requirements as to regional content. The automotive industry benefits from special regulations under these three regional integration agreements (Mortimore, 1998c y 1998a; Sercovich, 1998).

Table IV.4
**MAJOR PLANTS IN DEVELOPING COUNTRIES OF THE LARGEST AUTOMOTIVE FIRMS,
 EARLY 1990s**

	Japan (17 plants)						United States (15)			Western Europe (11 plants)			
	Toyota	Nissan	Honda	Mazda	Mitsub	Suzuki	GM	Ford	Chrysler	VW	Fiat	Renault	PSA
Developing Asia													
China (4)							X		X	X			X
Indonesia (5)	X		X	X	X	X							
Malaysia (2)	X				X								
Taiwan													
province of													
China (2)		X						X					
Republic of				X	X		X	X					
Korea (4)													
Thailand (5)	X	X	X	X	X								
Latin America													
Argentina (5)								X		X	X	X	X
Brazil (4)							X	X		X	X		
Mexico (5)		X					X	X	X	X			
Venezuela (3)							X	X			X		
Other													
Turkey (4)	X						X	X				X	
Total (43)	4	3	2	3	4	1	6	7	2	4	3	2	2

Source: ECLAC, based on P. O'Brien and Yannis Karmokolias, "Radical Reform in the Automotive Industry. Policies in Emerging Markets", Discussion paper, N° 21, Washington, D.C., International Finance Corporation/World Bank, 1994, figure 2, p. 14.

In fact, in this decade, the global restructuring of the automotive industry together with the trend towards the formation of regional trading blocs—which have certain regional or subregional policies towards the sector—have given enormous vitality to the automotive activity of some Latin American countries. In some cases, modern plants have been set up with full production capacity that have already earned a reputation in the international market for vehicles and engines. Those investments have given the automotive industry—through subsidiaries of transnational corporations that manufacture vehicles and engines—a dominant role on the Latin American economic scene. Of the 20 largest subsidiaries of foreign companies in the region, 9 belong to the automotive sector. Of the 10 largest subsidiaries of foreign companies in Latin America, 5 are automotive companies: General Motors (Mexico, Brazil), Volkswagen (Brazil), Chrysler (Mexico) and Fiat (Brazil). In 1997, total sales of their subsidiaries in the region exceeded US\$ 63.4 billion (see table IV.5).⁷

⁷ In Latin America, the automotive sector is tremendously important, since it accounts for 10% of the region's total exports of goods and services. In fact, the largest automotive companies in the region—all of them foreign-owned—contributed 36% of the earnings generated by the 50 largest companies with foreign capital. The industries that followed in importance were petroleum (11.3%) and food products (10.3%).

Table IV.5
**LATIN AMERICA: LARGEST SUBSIDIARIES OF TRANSNATIONAL CORPORATIONS IN THE
 AUTOMOTIVE SECTOR, BY SALES, 1997**
(In millions of dollars)

Company	Argentina	Brazil	Colombia	Chile	Mexico	Venezuela	Total ^a
United States	2 811	9 489	833	525	18 498	1 097	33 253
General Motors	774	5 730	833	525	7 126	393	15 381
Ford	1 866	3 759	...	...	4 871	704	11 200
Chrysler	171	...	...	...	6 501	...	6 672
Western Europe	6 672	16 169	...	...	3 423	183	26 447
Volkswagen (Germany)	1 348	6 531	...	...	3 423	...	11 302
Fiat (Italy)	3 181	5 824	...	...	...	183	9 188
Mercedes Benz (Germany)	619	2 852	...	...	...	...	3 471
Renault (France)	1 264	...	...	...	...	...	1 264
Saab (Sweden)	260	962	...	...	...	...	1 222
Japan ^a	265	282	649	...	2 153	230	3 734
Nissan ^a	...	...	187	...	2 153	...	2 397
Toyota ^a	265	282	462	...	...	230	1 337
Total	9 748	25 940	1 482	525	24 074	1 510	63 434

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from *América economía, Expansión* (Mexico), *Exame* (Brazil), *Estrategia* (Chile), *Mercado* (Argentina), *Dinero* (Colombia), other financial publications and direct queries to the companies.

^a Includes operations of Nissan and Toyota in Peru.

Development of the automotive industry in Latin America has generally followed the same historical pattern that typified the region's industrialization. Thus, it is possible to distinguish three stages in the development of the automotive industry in the region. The first phase, the assembly phase, began shortly after the industry's initial boom in the United States at the start of the century and ended in the 1950s. It featured the establishment of companies that assembled motor vehicles under the CKD (*completely-knocked-down*) assembly system, using completely disassembled material imported from the industrialized countries. During this phase, the finished automobiles assembled in Latin America had few differences from those manufactured in the industrialized countries. However, the enterprises did differ enormously in terms of the complexity of their manufacturing processes and the degree of integration or linkage with other local industry. Because they engaged merely in assembly activities, they constituted enclaves with minimal impact on other local economic activity. In the industrialized countries, however, the automotive firms were centres of vitality for local production of supplies, components and automotive parts.

The second phase lasted until the late 1970s or early 1980s and marked the search for better results from the industrialization process through a more ambitious domestic policy for the automotive sector. It was characterized by a qualitative change in automotive activity, which ceased to be an assembly function and became one of true transformation, in keeping with the import-substitution strategy then followed in Latin America. A distinctive feature of this phase was the use of both industrial and trade policy measures and mechanisms to stimulate the establishment of plants for manufacturing vehicles with high local content (nearly 90% in

Argentina and Brazil and 60% in Mexico).⁸ The chief purpose of those operations was to meet the needs of the domestic market, and hence their equipment and productivity often fell far short of international standards and practices. The region thus began to have an automotive industry that was significant in terms of production and employment, but less and less competitive internationally, with severe limitations in terms of generating foreign currency.

Under those conditions, the investment necessary to modernize the automotive industrial base was not made, and production capacity remained stagnant and technologically antiquated; which was an obstacle to accessing foreign markets; even more importantly, production capacity sufficient to achieve efficient minimal economies of scale was not attained. The industry found itself on the horns of a dilemma: on the one hand, Governments were interested in limiting the negative impact of the sector's balance of payments and hence tried to restrict imports of parts and components and improve the export performance of automotive companies; on the other hand, foreign companies were satisfied with supplying the domestic market under those conditions, but were unable to export "by decree" using domestic components (Jenkins, 1977; Bennet and Sharpe, 1985; and Newfarmer, 1985).

In this way, the automotive industry in the region ceased to be a mere assembly process, and created jobs and business capacity in the manufacture of auto parts. However, there was a gradual increase in disparities in cost, design and quality, in other words, in the ability of vehicles produced in the region to compete with vehicles manufactured in industrialized countries. Some of the models that stood out in this phase of protection of the Latin American domestic market were the Volkswagen sedan (also known as the Beetle) in Mexico, the General Motors Chevette in Brazil and the Ford Falcon in Argentina (Mortimore, 1998c).

In the early 1980s—at the end of this second stage—the automotive industry had a major presence in the production systems of Argentina, Brazil and Mexico. Measured in terms of passenger cars, the Brazilian industry was the largest, twice the size of Mexico's and more than four times the size of Argentina's (see table IV.6). However, foreign trade in finished vehicles was relatively minor. The percentage of production exported was close to 20% in Brazil (in a context of a major drop in production volume) and in the other two countries it was nearly zero. On the other hand, the importation of finished vehicles was virtually prohibited. Throughout the rest of the decade, the negative impact of the debt crisis⁹ caused prolonged deterioration in the automotive industry in Latin America.

⁸ The economic authorities at the time were seeking to promote local development of the automotive industry—and of other manufacturing activities—by imposing high nominal tariffs on imports, quota limits and advance permit requirements. In various countries of the region, the importation of key parts—such as the engine and power train—was prohibited to force auto makers to set up local plants to manufacture them. That strategy was supported by industrial policies aimed at directly influencing the vehicle manufacturing process to strengthen its ties with the rest of the production system. In other words, the aim was to create a domestic auto parts industry. Thus, minimum levels of domestic content were defined; a policy of advance authorization of manufacturing and investment programmes was instituted; lists of products that had to be manufactured domestically were drawn up; and maximum limits were even placed on the number of lines and models, in addition to controls on retail prices.

⁹ The debt crisis weakened domestic demand due to macroeconomic instability and the high prices of imported inputs for assembling vehicles.

Table IV.6
ARGENTINA, BRAZIL AND MEXICO: PRODUCTION, EXPORTS AND IMPORTS OF PASSENGER CARS, 1980-1997
(In thousands of units)

Year	ARGENTINA			BRAZIL			MEXICO		
	Total production	Exports	Imports	Total production	Exports	Imports	Total production	Exports	Imports
1980	218.6	3.4	39.7	933.2	115.5	^a	303.1	13.3	^a
1981	139.4	^a	36.4	585.8	157.2	^a	355.5	9.3	^a
1982	106.9	2.2	4.1	672.6	120.3	^a	300.6	14.4	^a
1983	129.0	4.9	0.5	748.4	132.8	^a	207.1	20.8	^a
1984	137.2	3.0	^a	679.4	152.0	^a	244.7	30.4	^a
80-84 ^b	146.2	2.7	16.1	723.9	135.6	^a	282.2	14.0	^a
1985	113.8	^a	0.2	759.1	160.6	^a	297.1	49.9	^a
1986	137.9	0.1	0.7	815.2	138.2	^a	208.5	40.2	^a
1987	158.7	^a	1.1	683.4		^a	225.6	82.3	^a
1988	135.8	1.0	0.8	782.4	226.4	^a	353.8	145.0	^a
1989	107.6	1.1	0.4	731.0	164.9	^a	438.6	164.9	^a
1990	81.1	0.5	0.8	663.1	120.4	0.1	598.1	252.5	3.8
1991	114.1	4.3	22.6	705.3	127.2	11.1	720.4	341.8	5.2
1992	220.5	15.2	88.5	816.0	243.1	19.8	776.2	347.1	6.0
1993	287.0	22.1	86.9	1 100.3	249.6	52.9	835.3	445.6	3.5
1994	338.4	23.7	135.3	1 248.8	274.8	155.1	856.6	503.6	56.4
1995	226.7	22.8	77.1	1 296.6	189.7	305.6	699.3	596.7	17.0
1996	269.4	90.1	119.9	1 458.6	211.6	167.5	797.7	634.0	31.5
1997	366.1	161.6	117.0	1 680.0	305.1	205.2	854.8	593.1	45.4
95-97	287.4	91.5	104.5	1 478.4	235.5	226.1	783.9	607.9	31.3

Source: ECLAC, based on information from producer associations of Argentina (Asociación de Fábricas de Automotores, ADEFA), Brazil (Asociación Nacional de Fabricantes de Vehículos Automotores, ANFAVEA) and Mexico (Asociación Mexicana de la Industria Automotriz, AMIA).

^a Value almost zero.

^b Annual averages.

The third and current phase is connected with the adjustment caused in the international automotive complex as a result of the challenge the Asian manufacturing system posed to the companies of the United States and Europe. This period has been characterized by the selective restructuring of the vehicle production infrastructure in the region, which, although designed to satisfy domestic markets, has, increasingly, been able to compete successfully even in foreign markets, with minimal or no subsidy. Machinery and equipment have been modernized quickly, placing some engine and vehicle plants on a par with the most advanced in the world. In a few countries, the automotive industry has held its ground and grown (Argentina, Brazil y Mexico), while in others it has contracted or disappeared altogether (Chile, Colombia, Peru and Venezuela) (see box IV.1).

Box IV.1

**COMPANIES SURVIVING THE IMPORT-SUBSTITUTION PERIOD:
GENERAL MOTORS IN CHILE AND VENEZUELA**

General Motors has been one of the transnational auto makers that has utilized Latin American protectionist strategies most extensively. Currently, GM has assembly plants in Argentina, Brazil, Chile, Colombia, Ecuador, Mexico and Venezuela.

Some thirty years ago, many of the world's top auto makers had a presence in Chile. Today, only General Motors and some minor operations of Renault and Peugeot survive. At its plant in Arica, General Motors has been specializing in a single model (the Luv utility vehicle), and has continued to use basically the same manufacturing methods since it took over the company in 1974. It is a small operation, since key parts, such as the engine and chassis, are imported from the Japanese manufacturer Isuzu, completely disassembled and unwelded (under the CKD system). In Chile, labour and some components are added, such as windows and battery. The local content of the vehicle is about 40%. With nearly 500 workers, about 15,000 units are produced each year.

In Chile, the General Motors Luv model is the best-selling model —only in Thailand is a larger number sold — with which this United States company holds nearly 20% of the local market.^a Gradually, some units are being exported to other Latin American countries, primarily Argentina and Mexico. In 1997, General Motors sold more than 9,000 units in foreign markets (360% more than in 1993), for about US\$ 95 million. During 1998, General Motors expects to produce some 18,500 units, a record, 11,000 of which will be for export.

Nevertheless, the future is unclear for this subsidiary of General Motors. In spite of the fact that its operations turn a profit, it is supported through subsidies that it receives from the Government (without them, it would be better off importing the complete unit from Japan). In 1997, it reportedly received about US\$ 7 million in subsidies, that is, about US\$ 500 per unit sold in the domestic market. It also receives subsidies for vehicles exported. Under the liberal economic policy of the Chilean government, those subsidies should disappear as of 1 January 1999, when the "Automotive Statute" that has been in effect since 1985 expires. General Motors is trying to get the subsidy extended, but there is every indication that it will end on the scheduled date. With that outlook, General Motors has basically four options:

- Take advantage of Chile's associate membership in Mercosur, which would enable it to export to Argentina and Brazil on preferential terms. This alternative would be viable if the tariff advantages provided by the association agreement between Chile and Mercosur are extended to the automotive sector.
- If the Government of Chile decides to take advantage of the WTO provision that empowers its members to grant favourable tariff treatment to remote or strategic regions, General Motors could develop an automotive project geared to Mercosur. The city of Arica, situated in Region I, which is in a good geographical location due to its proximity to three countries (Argentina, Bolivia and Peru), meets the qualifications.
- Close the plant in Arica, and move the operations to Santiago, to cut costs, since 40% of the material inputs come from the country's central area. General Motors executives have stated that such a move would enable them to stay competitive, especially at a time when demand for vehicles in the domestic market is contracting.^b
- Shut down its production operations in Chile and import the models for which there is demand in the local market (one of the most competitive in the world). This type of alternative has already been adopted in Uruguay and Paraguay.

In Venezuela, General Motors has an annual production capacity of approximately 76,000 vehicles at its plant in the city of Valencia. At its facilities, 10 models of Chevrolet are manufactured that absorb 25,000 parts and components (10,000 more than a Brazilian plant). In Venezuela, vehicles are assembled using the CKD system, which includes nearly all the parts of the automobile. The local content thereby reaches 35%, nearly a third of which corresponds to labour.

In Venezuela, vehicle imports are subject to a 35% tariff, and that is the main reason why this General Motors plant is competitive. The managers are therefore requesting a reasonable time period in which to adapt to possible greater trade liberalization, whether unilateral or as part of integration schemes.

In the case of the Venezuelan plant, Mercosur and its negotiations with the Andean Community (which started in early July of 1998) are jeopardizing the continuity of its operations, basically due to the keen competition the plant would have to face from the Brazilian industry and the low local content of its products. Given that outlook, the

Box IV.1 (concl.)

General Motors plant in Valencia will most probably reduce the number of models. If so, the candidates for survival are the Blazer sports utility vehicle, which is popular in the Venezuelan market (currently approximately 25,000 units are produced each year); and the Cavalier mid-sized sedan, which is not manufactured in Brazil.

Unlike the case of Chile, General Motors is not thinking of closing down its operations in Venezuela and, in fact, is reportedly investing approximately US\$ 100 million.⁶ General Motors in Venezuela is wagering that, given the importance of the automotive industry, Brazil will most probably agree to a slow timetable for elimination of tariffs.

These two examples help to illustrate the direction of the automotive industry in Latin America, which is concentrated in the large markets (Argentina, Brazil and Mexico) or in countries enabling it to access even larger markets (Mexico for selling in the United States). In this context, the smaller operations have tended to focus on a model that is highly popular in the domestic market (Luv and Blazer) or has some possibility of export to other Latin American markets (Luv and Cavalier).

^a Pablo Bachelet, "GM Chile: colgando de un hilo", *América economía*, No. 120, Santiago, Chile, June 1997; and "Modelo para desarmar", *América economía*, Santiago, Chile, 2 July 1998.

^b "General Motors evalúa cerrar planta en Arica", *El Mercurio*, Santiago, Chile, 21 August 1998.

^c Pablo Bachelet, "Modelo para desarmar", *América economía*, Santiago, Chile, 2 July 1998.

Investments of foreign companies have been vital, since they have provided the financial resources necessary to expand and modernize the capital equipment and the distribution channels to link the automotive industries of certain countries with international integrated production networks. Competition between Japanese and United States companies has not occurred directly in the main markets of Latin America, since there are still major limits on the importation of finished vehicles and the presence of Japanese companies is weak in the region. Thus, the presence of United States and European auto makers in the main economies of Latin America has increased. In the mid-1990s, the four main automotive firms with operations in Latin America (Ford, General Motors, Volkswagen and Fiat) accounted for 25% of the total sales of foreign firms among the 500 largest companies in the region (Mortimore, 1998e).

Recent information shows clearly that the export orientation of the automotive industry has increased in the three large Latin American economies (see table IV.6). In them, the foreign market has come to absorb a sizeable portion of locally produced passenger vehicles. The most striking case is Mexico, where production for export in the 1995-1997 period exceeded production for the local market and was twice that of 1997. During the same period, export orientation increased in Argentina, which exports nearly one third of its output. In Brazil, the phenomenon has occurred less markedly: only 16% of vehicles produced are for export.

In this third phase, international auto makers have strengthened their hold on the Latin American automotive industry at a time when it has become common for national States to discontinue their direct intervention in the sphere of production and industrial policies. The automotive industry has fared differently in some respects from other industries, since some sectoral agreements and industrial protection policies have been maintained.¹⁰ However, this change of direction in national economic policy has coincided with a change in subregional policies oriented, to some extent, in the opposite direction.

¹⁰ In the cases of Indonesia and Malaysia, programmes of support for development of a national vehicle have even been maintained.

Thus, trade liberalization and the tendency to place the private sector at the centre of economic growth and accumulation have been accompanied by the formation of subregional trading blocs. Those trading blocs grant special concessions on trade in goods and services originating in their member countries and have the effect of both creating and diverting trade and investment. Thus, the creation of blocs has had an impact on the decision to carry out new direct investment projects to ensure preferential (selective) access to certain subregional markets.

Under the so-called "open regionalism" approach, two recent experiments are particularly important for the automotive industry: NAFTA and Mercosur. Their creation has influenced trade and investment in the region. Their regulatory frameworks contain special provisions for the automotive industry. They revive, at the subregional level, certain measures and objectives that were part of the strategies for development of the automotive industry while the import-substitution policy was in effect. For example, they establish incentives and requirements to promote subregional integration of the industry and boost production of auto parts. These measures have favoured companies with plants for production and assembly of vehicles in the subregion. To understand the impact of these trading blocs, it is necessary to analyse the development of the automotive industry in Mexico, Argentina and Brazil.

1. Mexico: consolidation of a continental automotive industry under NAFTA

In the last 15 years, as a result of the extensive programme of investments by transnational corporations, the automotive industry in Mexico has come to represent a very successful instance of globalization of a manufacturing activity in developing countries. The chronology and salient points of its profound restructuring have been extensively analysed (Ruiz Durán, Dussel and Taniura, 1997; Mortimore, 1995; Moreno-Brid, 1994; De María and Campos, 1992; and Bennett and Sharpe, 1985). Since the mid-1980s, the spectacular expansion and modernization of the production base of the automotive sector in Mexico has been due to a combination of three main factors:

- the competitive situation in the North American market;
- the new Mexican policy toward the industry; and
- the revised business strategies of General Motors, Ford and Chrysler.

In response to the challenge posed by the Asian presence in the North American market, these companies chose to relocate some production plants throughout the world, situating them in economies of low cost and high potential productivity. In order to compete internationally, the companies provided plants in Mexico with state-of-the-art machinery and equipment and Japanese organizational practices. The installation of brand-new plants in northern Mexico reflected a revised approach towards meeting the needs of the North American market and also made it possible to take advantage of the *maquiladoras* (in-bond assembly facilities), whose products enjoyed substantial tariff exemptions in the United States.

A decisive factor in the new business strategies of the transnational corporations was Mexican sectoral policy. Although the Government of Mexico had traditionally applied special measures or programmes to encourage increased local content in the automotive industry, under the Decree for Development of the Automotive Industry promulgated in 1977 it began an active search for strategies to increase international competitiveness. Since then, this “outward” orientation has characterized Mexico’s policy in the automotive sector, but the philosophy as to the form and sphere of State intervention in the production sector has changed. The regime embodied in the North American Free Trade Agreement (NAFTA), signed on 1 January 1994, was, in fact, the culmination of a long process involving heavy investments by United States transnational corporations in the automotive sector. Specific measures were applied so that the transition to an open economy would consolidate Mexico’s automotive industry as an international producer with a high subregional content. The process served to strengthen the competitive position of the three United States companies in the North American market.

In essence, the special NAFTA rules and transitional measures enabled the United States companies to adjust their strategies and reposition their Mexican automotive base for the better.¹¹ It exempted them gradually from the rigorous regulations that up until that time had governed production of motor vehicles in Mexico, with respect to the mandatory use of domestic inputs and generation of foreign currency. It gave them additional advantages by pressuring European and Japanese companies to increase the subregional content of their products—which was significantly lower than the stipulated minimum. However, the effects of NAFTA extended beyond the sphere of trade.

The greatest impact of the Agreement was to convince investors—both international and domestic—that the Government of the United States was willing to accept the Mexican economy as a manufacturing platform for entry into the North American market, provided that the products were manufactured in the region—in other words, that they met certain requirements as to regional content. In the automotive sector, that signal had tremendous impact on auto makers from outside the region that were already established in Mexico (Volkswagen and Nissan); they made major efforts and substantial investments to develop their network of local suppliers to increase the subregional content of the vehicles they produced and thus meet the stipulated requirements for maintaining their presence in Mexico and accessing the North American market. BMW, Honda and Daimler-Benz—companies that had no presence in

¹¹ NAFTA established rules of origin defining the goods entitled to automatic tariff exemption in subregional trade. It stipulated a regional content of at least 62.5% of value added, calculated on the basis of the net cost. It also eliminated a number of provisions contained in previous decrees on the automotive industry that influenced the production process of the vehicle assembler and limited its selection of inputs or production lines and use of foreign currency. The transitional provisions of NAFTA for the sector gradually liberalized imports of automotive vehicles, for automobile manufacturers with a positive trade balance. Requirements as to net generation of foreign exchange were eased and their eventual elimination was scheduled. The proportion of inputs with mandatory domestic content was also reduced, so that auto parts manufactured at export *maquiladoras* could be counted, and all requirements as to domestic content were to be eliminated as of the year 2004. Legal entities (companies) of the signatory countries were to be allowed to have absolute control of the capital stock of auto part factories set up in Mexico (previously prohibited). In turn, the Agreement gave greater access to the United States market by lowering tariffs on imports of automotive products from Mexico from 2.7% in 1993 to 0.6% in 1997 for finished vehicles and from 1.7% to 0.6% for auto parts.

Mexico— made the decision to open new assembly plants in the country, basically to supply the domestic market.

In 1997, Mexico's automotive industry manufactured 1.3 million vehicles of all types, triple the volume achieved in 1980 and more than four times the 1986 figure. From 1980 to 1997, the share of motor vehicle production in manufacturing gross domestic product (GDP) rose from 3.7% to 5.6% (INEGI, 1997). If automotive parts and engines were included, the figure would rise three points.

The accelerated expansion of production was export-driven. From 1980 to 1984, Mexico exported on average 14,000 passenger cars, in other words, only 5% of production for the domestic market. In contrast, from 1995 to 1997, it exported an average of 607,900 passenger cars, well exceeding production for the domestic market (see table IV.6). The shift toward exporting has intensified in recent years. The increase in exports has been just as spectacular in value terms, rising from US\$ 404 million to US\$ 20.8 billion from 1980 to 1997.

The Mexican automotive industry has won a significant share of the United States market, which is the recipient of nearly 90% of Mexico's exports. In 1996, according to the CAN PLUS software developed by ECLAC, Mexico was responsible for 10.4% of the passenger cars, 18.8% of the commercial vehicles, 12.6% of the engines and 8.0% of the auto parts imported by the United States.

The globalization of the Mexican automotive industry can also be seen in its imports, which, after increasing sharply since 1986, suddenly became stagnant in 1995. From 1980 to 1994, the value of imports in the automotive sector had risen from US\$ 2.3 billion to US\$ 11.5 billion, generating a trade deficit of more than one billion dollars in both those years. In 1995, as in the two following years, due to the export effort and some reduction in imports, the automotive industry recorded a trade surplus, something it had not achieved in many years (see table IV.7).

Table IV.7
MEXICO: PERFORMANCE OF THE AUTOMOTIVE INDUSTRY, 1990-1997
(In billions of dollars and percentages)

	1990	1994	1995	1996	1997
Production (thousands of vehicles ^a)	820.5	1 097.4	931.3	1 211.3	1 338.0
- for the domestic market	543.7	522.4	152.5	240.4	353.8
- for export	276.8	575.0	778.7	970.9	984.4
Employees (thousands of people)	57.6	49.7	41.8	44.3	44.8
Exports	4.5	10.4	15.3	19.6	20.8
- % to North America ^b	91.2	90.3	94.0	-	-
- % of imports from North America	4.72	7.91	8.62	10.85	-
- as % of exports from Mexico to North America	15.6	20.8	19.9	21.6	21.8
Imports	5.8	11.5	9.5	10.4	13.0
Trade balance	-1.3	-1.1	5.8	9.2	7.8

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from Asociación Mexicana de la Industria Automotriz (AMIA) and the Competitive Analysis of Nations (CAN) software developed by ECLAC.

^a Passenger cars, commercial vehicles and others.

^b Canada and United States.

In large part, the penetration of foreign markets can be attributed to the boost in Mexican exports of the three big United States firms. Moreover, the improvement in the international competitiveness of the Mexican automotive industry has been largely due to the modernization of the capital equipment of the vehicle assembly companies. This process started in the second half of the 1970s and has intensified in the 1990s. From 1989 to 1996, according to information from the Ministry of Commerce and Industrial Development (SECOFI), the five automotive firms with a traditional presence in the Mexican market —Ford, General Motors, Chrysler, Volkswagen and Nissan— invested approximately US\$ 8.4 billion; adding in the investments of the auto parts industry, the figure would exceed US\$ 15 billion (see table IV.8). This figure does not include the investment of other auto makers that have recently set up vehicle assembly plants in Mexico: BMW, Honda and Daimler-Benz. These latter three, at least until 1996, were exclusively concerned with producing for the domestic market (Ruiz Durán, Dussel and Taniura, 1997).

Table IV.8
MEXICO: INVESTMENTS BY MAJOR AUTO MAKERS, 1989-1996
(In millions of dollars)

	1989	1990	1991	1992	1993	1994	1995	1996	Total
Chrysler	49	45	52	230	332	392	490	409	1 999
Ford	142	69	167	441	297	124	229	114	1 583
General Motors	131	29	49	87	235	631	888	227	2 277
Nissan	-	76	302	317	242	154	164	89	1 344
Volkswagen	38	91	305	273	100	61	66	251	1 185
Total	360	310	875	1 348	1 217	1 363	1 837	1 090	8 400

Source: ECLAC, based on information from the Ministry of Commerce and Industrial Development (SECOFI) of Mexico.

The restructuring of the automotive sector in Mexico and the adoption of modern techniques —patterned after the “Toyota System”— in its manufacturing process brought about an increase in labour productivity.¹² From 1987 to 1996, real GDP per person employed in Mexico’s vehicle assembly industry grew by 150% (Ruiz Durán, Dussel and Taniura, 1997), and average annual output per employee in the industry rose from 12.2 to 18.8 vehicles from 1970 to 1993 (Pichini, 1995).

From this standpoint, the assessment of the last 20 years of development of the Mexican automotive industry and its current prospects are very favourable. This transformation can be attributed basically to the change in the sectoral policy followed by the Mexican authorities to facilitate the corporate strategies of the big United States auto makers. NAFTA reflects the fortunate synchrony of interests between these firms and the Mexican Government. The former are interested in creating a platform of production and export in Mexico and the latter are seeking to strengthen the country’s automotive industry, so as to help to link the Mexican economy with the global economy, set it on a path of rapid growth and integrate it into continental networks of production and export.

¹² Only some elements of the “Toyota System” have been adopted in Mexico. Little emphasis is placed on work safety or the networks of suppliers characteristic of this production system (Dussel, 1997).

In sum, the history of the Mexican automotive industry in the 1990s has been shaped by NAFTA, which the countries began negotiating long before it actually went into effect. Analysis of the agreement shows that the special rules established for the automotive industry merely ratified the thrust of the investments that had been made by the main transnational corporations in the sector, which reflected the confidence that foreign companies had in the course of development of the Mexican economy. Thus, NAFTA —by guaranteeing preferential access to the North American market— sent a clear signal to large firms in the United States, Europe and Asia that Mexico could serve as a platform for penetrating the markets of the subregion as a whole. The case of Ford illustrates the changes experienced by automobile manufacturing companies in Mexico (see box IV.2).

Box IV.2

FORD'S OFFENSIVE STRATEGY UNDER NAFTA

In the first half of the 1990s, of the auto makers that were operating in Mexico, Ford was the one most committed to globalization of its production base. It had opted heavily for FDI as a medium- and long-term tool to rectify its loss of market share in the United States, as a result of the Asian challenge. Its business strategy —currently known as “Ford-2000”— sought to strengthen its global character. In 1993, over 50% of Ford’s production capacity was located outside of the United States. This strategy was reinforced by Ford’s stake in the Japanese company Mazda. But Ford did not neglect its operations in North America; 41% of its vehicle production capacity was still located in the United States, in addition to 9.3% in Canada and 4.7% in Mexico.^a

To better understand the implications of the Ford-2000 strategy for Mexico, it is necessary to review some of its history in Mexico. Ford entered the Mexican automotive industry as a vehicle assembler in the 1920s and as a full manufacturer in the 1960s, when it set up its car and truck plant in Cuautitlán, in the State of Mexico. That investment was spurred by the 1962 Decree on the Automotive Industry, which prohibited imports of completely knocked-down (CKD) material for assembly and encouraged the installation of manufacturing plants with high domestic content. Although it had obsolete machinery and equipment, the plant in Cuautitlán gave Mexico the capacity to produce 60,000 compact cars in four different models.

In 1983 —somewhat later than Chrysler and General Motors— Ford initiated its “outward” orientation by setting up a new plant in Chihuahua, with a production capacity of 200,000 engines per year, for the Topaz and Tempo models, which are assembled in the United States. This large production and export capacity was achieved thanks to the world-class technology of the Ford plant in Chihuahua. Some analysts were of the view that the engines produced there could compete successfully with any engine manufactured outside of Mexico by Ford or its competitors.^b Ten years later, the plant was modernized and its capacity was expanded 150% to produce the “Z” engine —at that time, the engine with the best technology of all the engines manufactured by Ford worldwide. With that investment, Ford in Chihuahua enhanced its global export orientation, since the Z engine would be supplied to plants assembling the Mondeo model throughout the world and not just in the United States.

As it was advancing in engine production, Ford made sizeable investments in order to export finished vehicles from Mexico. In 1986, in Hermosillo (Sonora), it set up a plant for assembling the Mercury Tracer model, with Mazda technology and organization methods, to supply the North American market. In 1990, after additional expansion, its annual production capacity reached 160,000 —including an additional line for Escort models— and it achieved sufficient volumes to benefit from economies of scale.

From the start, the Hermosillo plant —like the plant in Chihuahua— was an integral part of the company’s global strategy to improve its competitiveness in the North American market. In fact, its machinery and design exemplified the advanced level of technology that Ford had achieved in automobile manufacturing. It was rated Ford’s best in North America in terms of quality and competed successfully with plants of other auto makers in the region. In a comparison of 46 assembly plants in North America, the Ford plant in Hermosillo was rated among the top five.^c The new Ford plants were the first factories of the Mexican automotive industry to try flexible schemes of work organization, including the so-called “quality circles” and handling of inventories pursuant to the “just-in-time” system of production. Since results varied considerably from plant to plant, it gave up on some of these attempts and went back to using conventional methods.^d

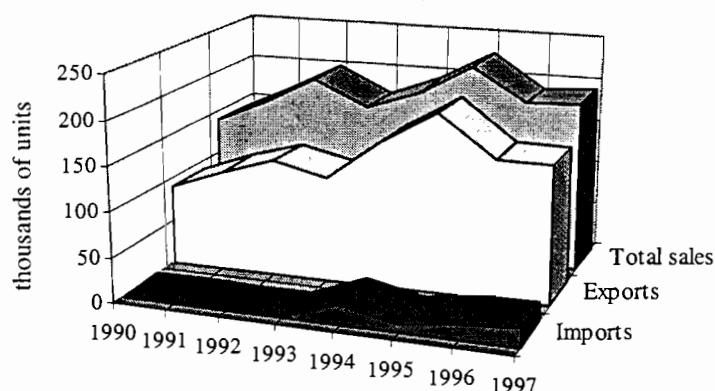
Box IV.2 (cont.)

Ford planned to invest approximately US\$ 1 billion from 1997 to 1999 to integrate its operations in Mexico more fully into its global system. The plant in Cuautitlán is in the process of remodelling to adapt it to the present stage of "outward oriented" growth and integrate it into the export network, from which it has always been excluded. Ford's other activities in Mexico involve either export *maquiladora* facilities or partnerships or joint ventures with companies that manufacture windshields, aluminium pistons and plastic auto parts.

The restructuring of Ford's production capacity in Mexico has resulted in changes in the quality and type of model that it supplies to the market. Prior to 1987, the models assembled in Mexico were sold solely in the domestic market. There was a great variety of lines and models, so that production volumes rarely exceeded 20,000 units per year, which undermined competitiveness. In 1987, Ford began to export the Tracer and later the Escort from the Hermosillo plant. From 1988 to 1992, these two models accounted for average annual exports in excess of 50,000 units. In 1995, the Contour model was introduced to replace the Tracer, also for the export market. In 1996, as a result of its outward orientation, Ford (Mexico) realized export earnings of US\$ 2.4 billion, out of a total of US\$ 3.9 billion in aggregate sales. Because of that performance, offsetting imports valued at US\$ 1.9 billion, it generated a surplus of nearly US\$ 500 million (see figure below).

In short, Ford's response to the loss of market share in the United States caused by the Asian challenge was to make Mexico an important component of its international production system, specializing in two compact-sized vehicles and one engine with state-of-the-art technology, both manufactured for export. The transformation of its production capacity was manifest in the highly competitive plants in Chihuahua and Hermosillo. In the Hermosillo plant, it took advantage of the Japanese design capacity obtained through its stake in Mazda. Those two plants revealed the course that Ford was pursuing in Mexico, as it abandoned its traditional dependence on the domestic market and proceeded to compete in the international market with the sophisticated "Z" engine and the Mercury Tracer and Ford Escort or Contour models.

FORD (MEXICO) TOTAL SALES, IMPORTS AND EXPORTS
OF PASSENGER CARS, 1990-1997



Source: ECLAC, based on information from the Asociación Mexicana de la Industria Automotriz (AMIA).

Ford's example shows that a combination of a changing competitive situation in the international market, a new subregional policy for the automotive industry and a revamped business strategy on the part of one of the companies most affected can produce very favourable results for the company, the host country and the regional integration scheme.

^a G. Vickery, "Globalisation in the automotive industry", *Globalisation of Industry: Overview and Sectoral Reports*, Paris, 1996, pp. 160 and 170.

^b H. Shaiken and S. Herzenberg, "Automation and Global Production: Automobile Engine Production in Mexico, the United States and Canada", Monograph series, No. 26, San Diego, Center for United States-Mexican Studies, University of California, 1987.

Box IV.2 (concl.)

^c H. Shaiken, Technology and work organization in Latin American motor vehicle industries (LC/R.1517), Santiago, Chile, 1995.

^d J. Carrillo, "Flexible production in the auto sector: the industrial reorganization at Ford-Mexico", *World Development*, vol. 23, No. 1, 1995.

2. Argentina and Brazil: differing views of the automotive industry under Mercosur

The second regional integration initiative of relevance for the Latin American automotive industry is the Southern Common Market (Mercosur), which has incorporated special provisions to promote this sector in the subregion. The aim is to rationalize the production capacity of the member countries, to link it more dynamically to the production networks of the world's major auto makers, especially European firms. Nevertheless, the results are meagre in comparison with those of the automotive industry in Mexico. NAFTA strengthened the latter's position as a platform for production and export of vehicles and engines. In contrast, the automotive industry in Mercosur is tied into subregional integrated production networks which may or may not make the transition to the world market. In July 1998, Argentina and Brazil were unable to resolve their differences, among other things, with respect to the common external tariff for the Mercosur automotive industry (The New York Times, 1998).¹³

Comparison of passenger vehicle production volume and relative weight of exports clearly shows the differences between the automotive industries at the two extremes of Latin America in terms of their linkages with the global economy (see table IV.5). From 1995 to 1997, the combined exports from Argentina and Brazil totalled just under half of Mexico's motor vehicle exports, which reached 676,900 units per year. Argentina and Brazil exported a smaller proportion of the automobiles produced—32% and 16%, respectively—, while in Mexico the percentage approached 80%. In other words, there are sharp differences in the level of international competitiveness of the Mexican automotive industry compared with that of Mercosur, and significant disparities between Argentina and Brazil.

(a) *Brazil: economies of scale to expand the domestic market*

After solid growth in the 1960s and 1970s—based on the domestic market—Brazil's motor vehicle producers were hit hard by the domestic recession in the 1980s. The situation of instability harmed the vehicle assemblers—even jeopardizing their survival—and the restructuring of their production capacity, which would have enabled them to compete in markets of industrialized countries, took several years to come about. For reasons of cost and quality, a

¹³ Other disputes between Brazil and Argentina have to do with the incentives that Brazilian producers would have and the method of calculating the level of domestic content of auto parts necessary for a vehicle to qualify for the "Mercosur" category. It has been debated whether it should be calculated binationally, or whether minimum portions of the percentage should be set for each country—to stipulate, for example, that, if the minimum regional content is 60%, at least 30% must be Argentine.

sustained increase in exports was highly unlikely. The situation gave rise to some fairly unconventional solutions, such as the merger of domestic operations of companies that previously had been competitors, to take advantage of economies of scale and reduce operating costs. The best-known such experiment was the formation of Autolatina, which merged the operations of Volkswagen and Ford and continued in operations to 1995.

In the 1990s, largely thanks to macroeconomic stability, Brazil's automotive industry started to rebound (*Gazeta mercantil*, 1998a; Quadros et al., 1997; Ferro, 1995; Posthuma, 1995 and 1997). From 1990 to 1997, vehicle production doubled, increasing from 914,500 to 2,067,000 units (see table IV.9). However, a possible reorientation toward foreign markets was hindered by currency appreciation¹⁴ and by the fact that it was much more profitable to sell vehicles in the Brazilian domestic market. The expansion occurred proportionally in both the foreign and domestic markets, with roughly 20% of total vehicle production going to exports. The improvement in productivity during the period —7.7 to 19.8 vehicles per employee per year— was insufficient to increase the proportion of vehicles exported. Despite the fact that a larger percentage of Brazilian exports were going to Mercosur countries (especially Argentina), Brazil's share in total imports of automobiles under the integration scheme deteriorated. Consequently, with that level of export sales, it was impossible to avoid a substantial trade deficit (see table IV.9).

Table IV.9
BRAZIL: PERFORMANCE OF THE AUTOMOTIVE INDUSTRY, 1990-1997
(In billions of dollars and percentages)

	1990	1994	1995	1996	1997
Production (thousands of units ^a)	914.5	1 581.4	1 629.0	1 813.9	2 067.0
- for the domestic market	712.6	1 203.8	1 366.0	1 506.8	1 655.0
- for export	187.3	377.6	263.0	305.7	412.0
Employees (thousands of people)	117.4	107.1	104.6	101.9	106.1
Exports	1.9	2.7	3.0	2.4	4.6
- % to Argentina	2.4	35.11	30.8	42.3	..
- % of Mercosur imports	17.5	15.6	14.0	..	..
- as % of Brazil's exports to Mercosur	14.3	21.5	20.7	..	..
Imports	0.7	2.6	4.8	4.9	5.4
Trade balance	1.2	0.1	-1.9	-2.3	-0.8

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from Associação Nacional dos Fabricantes de Veículos Automotores (ANFAVEA) of Brazil and calculations using the Competitive Analysis of Nations (CAN) and Industrial Performance Analysis Program (PADI) software developed by ECLAC.

^a Commercial vehicles, passenger cars and other.

Brazil's industrial policy for the automotive sector had two main aims: to stimulate the recovery of output and to promote modernization of the sector, in order to increase its outward orientation and thereby alleviate balance-of-payments problems. During the 1990s, the emphasis of automotive policy shifted from the former to the latter of those objectives. The first aim was to

¹⁴ With the institution of the stabilization programme (*Real Plan*), the Brazilian economic authorities used the nominal exchange rate as an anchor to control inflationary expectations.

encourage growth in the industry through domestic demand and found expression in the "Popular Car" plan. The second aim was to reduce the trade deficit that accompanied the rebound of automotive activity. The specific provisions for the automotive sector that were adopted under Mercosur were a central facet of this second element of Brazil's industrial policy.

The "Popular Car" programme consisted of a transfer of government revenues to subsidize the private purchase of new small cars. From 1990 to 1993, the tax on the purchase of new vehicles with a cylinder capacity of under 1,000 cc was cut in half (34.5% to 17%). That cut and the effects of a social agreement reached by the industry representative body immediately resulted in a reduction in consumer prices. From 1993 to 1997, domestic sales quadrupled, increasing from 200,000 to 882,000 units, despite an increase in the tax rose to 23% in 1995. The share of small cars in the domestic market for vehicles produced in Brazil rose from 28% to 64% from 1993 to 1997 (ANFAVEA, 1997). The "Popular Car" became the speciality of the Brazilian automotive industry. However, although the passenger car industry experienced substantial growth, it did not—significantly—change its orientation toward foreign markets.

During the 1990s, the companies that benefited from this specialization—Volkswagen, Fiat, Ford and General Motors—introduced new compact models for manufacture in Brazil. Volkswagen's sales in the local market came chiefly from its new Gol model, Fiat's from the Uno and later the Palio, Ford's from its Fiesta and Ka models, and General Motors's from the Corsa. In 1997, three of these models—Gol, Palio and Corsa—achieved annual sales in excess of 150,000 units.¹⁵

Along with the "inward-oriented" growth of the Brazilian automotive industry based on the "Popular Car", the second aim of sectoral policy was to link the industry more closely to international chains of production and trade (Ferro, 1995). Hence, the Brazilian authorities signed a number of protocols with Argentina that later served as a basis for the creation of Mercosur.

- In 1988, the Protocol on the Automotive Industry (Protocol 21) of the Programme of Integration and Cooperation between Argentina and Brazil specified a precise plan for eliminating tariffs in bilateral trade in motor vehicles, based on reciprocal quotas on total vehicles to offset imbalances in the flow of currencies.¹⁶
- In 1990, Protocol 21 was incorporated into Economic Complementarity Agreement No. 14 signed between the two countries. In 1994, it was replaced by Mercosur.

According to the special Mercosur provisions for the automotive sector, on 1 January 2000 a common market is to be established, in which imports in finished vehicles from the signatory countries will be exempt from tariffs, if they comply with the rules of origin requiring at least 60% subregional content. Otherwise, they will be subject to the common tariff applicable to all trade in automotive products originating outside of the subregion. Lastly, the importance of

¹⁵ The other models were sold in smaller quantities: Fiat Uno 93,000 units, Ford Fiesta 79,000 and Ford Ka 48,000.

¹⁶ From 1989 to 1994, provision was made for a gradual increase in the quotas initially established. The plan also included industrial and commercial policy measures whose effect and verification would have to occur at the company level. Accordingly, lists of common automotive parts were specified, and it was stipulated that the trade flows between the countries had to be balanced at the company level.

the special provisions for the automotive industry should be underscored, since they stipulate that an even trade balance —inside the subregion— should be maintained and that any government subsidy that might distort patterns of trade and investment should be eliminated.

Macroeconomic instability in Brazil disrupted the trade opening of its automotive sector. In 1995, in response to a balance-of-payments crisis, import tariffs on vehicles rose to 70%, despite the existence of special quotas on imports. This decision elicited strong reactions from Brazil's trading partners in Europe, Japan, the Republic of Korea and even Argentina. The Brazilian authorities put into effect a new system of regulation for the sector, "Regulations for the Automotive Industry." The new regulatory framework established a number of incentives and restrictions to encourage the establishment of new automotive plants in Brazil. It also facilitated imports for firms with production facilities in Brazil, provided they improved their export performance.

The Regulations for the Automotive Industry restored the previous schedule for tariff reduction, starting with 35% in 1995 and then dropping gradually to 20% in the year 2000. The tariff reduction was to be applied on a conditional basis, depending on whether or not importers had production facilities in Brazil. Those who did could benefit from the 35% tariff, while those who did not were subject to a tariff of 70%. A maximum quota of 50,000 units was established for imports of vehicles of companies that did not have local facilities in Brazil, and a minimum quota of 60% domestic content was required for vehicles produced in Brazil.

Foreign companies have responded positively to these measures, making substantial direct investments in the Brazilian automotive sector. In fact, the major transnational corporations have announced their intention of investing from US\$ 12 billion to US\$ 17 billion in the local automotive industry in the next few years, to increase the annual production capacity to nearly 3 million vehicles. Most of these investments are being made by the big companies that already have facilities in Brazil, notably General Motors (US\$ 3.25 billion), Volkswagen (US\$ 3 billion), Ford (US\$ 2.5 billion) and Fiat (US\$ 2.5 billion).¹⁷

(b) Argentina: economies of scale through subregional exports

The automotive industry of Argentina, perhaps more severely than that of Brazil, experienced the exhaustion of the growth model based on import substitution (see table IV.6). In addition to the collapse of the domestic market, in which sales dropped from 218,600 to 81,100 passenger cars from 1980 to 1990, and the industry's traditional difficulty in competing in world markets —before 1990 exports never exceeded 5,000 passenger cars— there were the effects of an acute macroeconomic crisis. In fact, the restructuring of the Argentine automotive industry would not have been possible without the country's success in combating hyperinflation.

¹⁷ Investments have also been announced by Daimler-Benz (US\$ 980 million), Scania (US\$ 300 million) and Volvo (US\$ 150 million), and by new companies that have recently entered the market: Renault (US\$ 1 billion), Asia Motors (US\$ 719 million), PSA (US\$ 600 million), Toyota (US\$ 600 million), Honda (US\$ 400 million), Chrysler (US\$ 565 million), Hyundai (US\$ 286 million), Audi (US\$ 250 million), BMW (US\$ 250 million) and others.

Concurrently with the improvement in the economic climate, the industry received a boost from a sectoral policy designed to promote greater integration with Brazil: the 1991 Regulations of the Automotive Industry (Bolsa de Comercio de Córdoba, 1996; FIEL, 1997; Maceira, 1995; and UADE, 1996).

Those two domestic factors —macroeconomic and microeconomic— plus the foreign factor, namely, the need to meet the Japanese challenge, spurred European and United States auto makers to increase their direct investment in the Argentine automotive sector. In fact, some of the companies —Fiat, Chrysler, General Motors, Renault and Peugeot¹⁸— that had withdrawn from the Argentine market during the protracted economic crisis returned.

In 1991, an agreement on transformation of the automotive industry was signed, providing a major stimulus for the sector. In essence, the new national policy instituted a number of trade incentives and industrial policy measures to promote more investment by vehicle manufacturers to modernize and expand capacity to produce and export vehicles.¹⁹ The new requirements forced most vehicle plants existing in Argentina at that time to modernize production equipment and thereby improve international competitiveness. Foreign trade then became an important factor in Argentina's automotive industry.

From 1990 to 1997, the industry's productivity improved markedly —from 5.7 to 17.8 automobiles per employee—, productivity of all types of vehicles quadrupled and the sector proved capable of surviving the effects of the Mexican financial crisis (the "tequila" effect). These results were possible thanks to the new export capacity of the Argentine automotive industry, which increased from 1,100 to 208,200 units in that period. In 1997, exports represented nearly half (46.7%) of total output, but export sales were directed almost exclusively to Mercosur countries and particularly to the Brazilian market (85.5% in 1996). Argentina's automotive industry was increasing its share in Mercosur automotive imports (8.9% to 12.9% from 1990 to 1995) and Argentina's exports to Mercosur were increasingly concentrated in vehicles (6% to 18.2% of total exports from 1990 to 1995).

¹⁸ The companies Fiat and Renault withdrew as majority shareholders of Sevel and Compañía Interamericana de Automóviles S.A. (CIADEA). In both cases, they kept a minority stake in locally-owned companies, which were producing Renault and Fiat vehicles under license.

¹⁹ The agreement established tax incentives for auto makers that had actually undertaken to carry out investment projects to restructure the country's automotive plant. Foremost among the provisions was the 2% tariff on vehicles imported by domestic producers —whereas it was ten times higher (20%) for the other producers. In fact, imports by other producers were subject to quantitative restrictions (10% of domestic sales) and limited permits, granted by auction. The minimum percentage of domestic content in vehicle production was lowered from 80% to 60%, and the obligation to maintain at least an even balance between imports and exports at the company level was established.

Table IV.10
ARGENTINA: PERFORMANCE OF THE AUTOMOTIVE INDUSTRY, 1990-1997
(In billions of dollars and percentages)

	1990	1994	1995	1996	1997
Production (thousands of vehicles ^{a)})	99.6	408.8	285.4	312.9	445.9
- for the domestic market	98.5	370.1	232.7	203.9	237.7
- for export	1.1	38.7	52.7	109.0	208.2
Employees (thousands of people)	17.4	25.7	21.4	22.7	25.0
Exports	0.3	1.0	1.4	1.8	2.8
- % to Brazil	35.0	75.4	90.0	85.5	..
- % of Mercosur imports	8.92	12.48	12.93	..	..
- as % of Argentina's exports to Mercosur	6.0	18.3	18.2	..	..
Imports	0.4	3.4	2.4	3.3	4.9
Trade balance	-0.1	-2.4	-1.0	-1.5	-2.1

Source: ECLAC database developed by the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from Asociación de Fábricas de Automotores (ADEFA) of Argentina, various industrial publications and calculations using the Competitive Analysis of Nations (CAN) and Industrial Performance Analysis Program (PADI) software developed by ECLAC.

^a Commercial vehicles, passenger cars and others.

In addition to the aforementioned agreement, the establishment of price controls on the sale of new vehicles in the domestic market provided an extra stimulus to the industry by increasing domestic demand. In 1991, when the Convertibility Plan was first being applied, price controls signified a 33% cut in vehicle prices, which spurred automobile manufacturers to make greater efforts to produce in Argentina.²⁰ Exporting began somewhat later, in response to incentives under the automotive regulations rather than to the drop in prices. Companies located in Argentina that exported were permitted to import an equivalent number of vehicles under a preferential tariff. Exporting thus became the prerequisite for producing and importing under preferential conditions in Argentina.

The mandatory balance of bilateral trade in automotive products as stipulated in Protocol 21 and later incorporated into Economic Complementarity Agreement No. 14 stimulated Argentine vehicle producers to export to Brazil. In 1996, thanks to those bilateral agreements, approximately 103,000 units were sold in Brazil, nearly 50% of that country's annual automobile imports. Considering the magnitude of Argentina's share in the Brazilian market between 1989 and 1994—from 5,000 to 35,000 units—the volume exported in 1996 is impressive.

The export success of the automotive industry was accompanied by even greater growth in imports in the domestic market. In 1997, imports reached US\$ 4.9 billion, and a growing trade deficit developed, expanding from US\$ 100 million in 1990 to US\$ 2.1 billion in 1997. That trend contrasts with the experience of Mexico, where the restructuring of the automotive industry has generated a trade surplus in the last two years.

²⁰ The reduction percentage was in large part the result of tax cuts, and to a lesser extent can be attributed to "sacrifice" on the part of the vehicle producers.

Behind the greater export orientation of Argentina's automotive industry is a strong wave of investment from the main foreign auto makers. From 1991 to 1995, investments were announced valued at approximately US\$ 2.2 billion to modernize the old Ford plant and to install and commission new General Motors, Volkswagen and Fiat facilities. All these investments were completed after 1995; General Motors started its operations in 1998 and Fiat in 1997. Thus, for the first time, as a result of that process of modernization and fixed capital accumulation, the automotive industry had a more competitive look.

According to some estimates, FDI in the automotive industry for the 1995-2000 period could reach approximately US\$ 4 billion or US\$ 5 billion, led by investments of companies with a long-standing presence in the country, such as General Motors (US\$ 1.1 billion), Ford (US\$ 1 billion), Fiat (US\$ 645 million) and Volkswagen (US\$ 280 million)²¹ (Mortimore, 1998a). With these flows of FDI and the process of fixed capital accumulation associated with them, it could be possible to raise annual vehicle production capacity to 800,000 units, or twice the estimated domestic demand.

The foregoing paragraphs describe the most prominent features of the automotive industry in the 1990s in Argentina and Brazil, the two members of Mercosur with large motor vehicle production capacity. In these cases, as in the case of Mexico, the path of growth of the automotive industry and its restructuring have been dictated by the FDI decisions of auto makers influenced by regulatory schemes—both domestic and subregional. The case of Fiat affords us a better understanding of this phenomenon and highlights certain differences in the strategies followed by transnational corporations with respect to the automotive industry in Argentina and Brazil (see box IV.3).

Box IV.3

FIAT'S DEFENSIVE STRATEGY IN ARGENTINA, BRAZIL AND MERCOSUR

For the Italian company Fiat, as for most medium-sized auto makers in the second rank of world competition, the Asian challenge is a serious threat. With a production system very centralized in its home country, and a specialization in the small car, it will be very vulnerable to competition from Japanese and Korean firms when the current European restrictions on imports and the national policy of promoting renewal of the country's fleet of vehicles expire. In 1997, Fiat (Italy) had total sales of US\$ 50.6 billion, heavily concentrated in Western Europe. The company is essentially a geographically limited global producer, in spite of its recent joint ventures in India and Russia.

Its Brazilian facilities are its main investment outside of Italy and account for a considerable proportion of the company's worldwide sales (20% in 1997). They are also very important to the Brazilian economy, since they currently constitute one of the largest foreign-owned enterprises in the country (see table II.6). Fiat's success in Brazil is due basically to its strategy for penetrating the compact car market—increasing market share from 14.6% in 1990 to 37% in 1997—, facilitated by Brazil's "Popular Car" policy. Its success was due to substantial direct investments to restructure and modernize its operations in Betim and its decision to specialize in just two models—Uno and Palio—to take advantage of economies of scale and thereby improve efficiency and productivity.^a In 1997, production at its plants in Brazil reached a total of 552,575 vehicles (32.9% of Brazil's

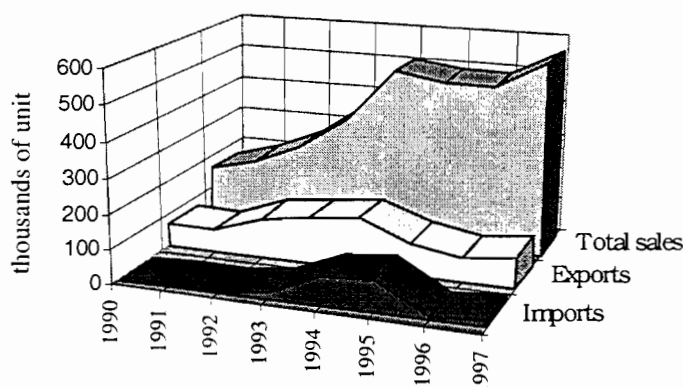
²¹ Substantial investments are also expected from some recently arrived (or returning) companies, such as Daewoo (US\$ 610 million), Renault (US\$ 500 million), Toyota (US\$ 150 million), Chrysler (US\$ 80 million), Mercedes Benz (US\$ 80 million), Scania (US\$ 15 million) and Iveco-Fiat (US\$ 8 million).

Box IV.3 (cont.)

production), 94% of which were passenger cars, and approximately two thirds compact models —115,000 units of Uno and 388,000 units of Palio. With those two models, it achieved an average production volume far above what it had obtained previously when it was bringing out six different models: Uno, Tempra, Premio, and Elba for domestic consumption and Duna and Spazio for export, under the CKD assembly regime. Fiat's repositioning in the Brazilian market entailed reassigning the export-import roles of its vehicles.

The specialization of its production in two models —with a modest price-tag and wide domestic demand— was accompanied by a decline in exports and imports of finished automobiles. The operations of Fiat (Brazil) are focused on selling modestly-priced cars in the Brazilian market, and international trade is of little importance. Imports declined from 150,000 units in 1994 to 70,000 units in 1996. Under its heavy investment programme, Fiat generated a large trade deficit of US\$ 2.34 billion (exports of US\$ 330 million and imports of US\$ 2.67 billion) (see graph below).

FIAT (BRAZIL) TOTAL SALES, IMPORTS AND EXPORTS OF PASSENGER CARS, 1990-1997



Source: ECLAC, based on information from the Associação Nacional dos Fabricantes de Veículos Automotores (ANFAVEA), Brazil.

After the success achieved with the compact car in Brazil, Fiat (Brazil) started to place more faith in the potential of Mercosur. In 1997, according to preliminary data, with monthly exports of 7,000 units of the new Palio model intended for developing economies and another version of the same Palio (Weekend) for the European market, Fiat's weak export effort was on its way to being corrected.^b Announced investments of US\$ 2.1 billion to be made over the 1998-2000 period are proof of Fiat's commitment to strengthening its leadership in the compact car segment and putting into practice a new strategy to export to Mercosur and other countries.

In 1995, the second phase of Fiat's strategy in the region began, when it resumed production in Argentina, after many years of absence. In the 1980s, it opted to withdraw and left its local facilities —merged with those of Peugeot— to the Argentine group Sevel, which assembled and sold Fiat vehicles under a licensing agreement. Given the favourable outlook for Mercosur and the bilateral arrangements concerning the automotive industry, Fiat resumed its operations in Argentina, this time specializing in mid-sized cars to complement its operations in Brazil. In 1997, two years later, its share of the Argentine motor vehicle market was 22%.^c For its part, the Sevel group has continued to assemble automobiles, but has a steadily decreasing presence in the market.

Fiat's largest single investment in Argentina was US\$ 600 million and went to set up a new plant in Córdoba with capacity to produce 200,000 units of a utility vehicle model of the Palio/Siena line intended primarily for Mercosur. In 1996, Fiat (Argentina) assembled nearly 100,000 vehicles, including its Siena (35,000), Uno (32,000), Duna (15,000) and Palio (13,000) models. Fiat also has a modern plant for producing engines.

Box IV.3 (concl.)

In sum, Fiat's strategy in Brazil and Argentina was a step toward selective globalization of its vehicle production matrix and had two central elements:

- defending its presence in a market (Brazil) very attractive in terms of annual sales (economy cars); and
- increasing its share of an expanded market with high potential sales (Mercosur).

Through investments in both countries, it has managed to modernize and expand its vehicle production base, even laying the foundation for a *subregional* system of integrated production. This has enabled it to specialize in producing just a few models, taking advantage of economies of scale and increasing efficiency and productivity.

The case of Fiat in Mercosur shows how a second-rank company is endeavouring to defend its share of the Brazilian market and improve its capacity to compete in an expanded market. Its business strategy has adapted to Brazil's changing policies and the various strategic views of Mercosur. Through renewed subregional specialization, it has sought to take advantage of the opportunities provided by the transitional provisions of the regulatory system designed to develop the automotive industry and promote automotive trade in the subregion. The last element of its business strategy is still in an initial phase, and it has not yet succeeded in producing positive trade balances.

^a "Interview with Roberto Vedovato-Grupo Fiat: US\$ 2,1 bilhões em novos investimentos", *SUMA Económica*, July 1998.

^b Ibid., p. 7.

^c Universidad Argentina de la Empresa (UADE), "La industria automotriz en Argentina. Informe sectorial", No. 7, Buenos Aires, July 1998.

C. CONCLUSIONS

Foreign investment has been —and continues to be— the driving force of the automotive industry in Latin America. The sudden entry of Japanese companies into the world automobile market and the challenge they posed for competitors brought about a change in the global strategies of companies in the United States and Europe, a change that enabled some countries of Latin America to be integrated into the fledgling systems of regional or subregional production of vehicles and engines. Thus, the current situation of Latin America's automotive industry results not from FDI flows from Japanese auto makers setting up shop in the region, but rather from the reaction of United States and European firms, which have invested in Latin America to improve their competitiveness in foreign markets or maintain their share in domestic markets with high growth potential and in an advanced process of trade liberalization.

As these changes have been occurring in the world automobile market, the Governments of the region have been adopting radical reforms in the conduct of national economic policies. They are allowing the market a central role in the allocation of resources, lowering traditional protectionist barriers to international trade, abandoning selective industrial policies, doing away with subsidies and eliminating restrictions on domestic or foreign private initiative. However, they have insisted on major exceptions for the automotive sector in the context of integration schemes.

In the last decade, integration agreements have been concluded that basically create common protectionist barriers in order to promote trade within the bloc. They provide for rules

of origin that favour subregional products in trade insofar as they are relatively competitive. The aim is to stimulate investment, production and exports within the subregion.

The most outstanding examples of this trend in Latin America and the Caribbean are NAFTA and Mercosur. Both incorporate special provisions for the automotive industry, applicable even in periods of transition to full enforcement of the agreements. In essence, these transitional measures grant preferential treatment to subregional automotive production. They also prolong the period of tariff protection and spread out or limit the elimination of incentives and requirements as to regional content, generation of foreign exchange and exports.

The three economies of the region in which the automotive industry has proven to be highly dynamic are parties to NAFTA or Mercosur. To differing degrees, FDI has transformed and restructured vehicle production capacity in those countries, putting them in a more competitive position, whether in foreign markets or in relation to vehicles imports into their own markets. However, in the 1990s, they have experienced very different degrees of progress in the transformation of their production capacity and hence in their position in regional and subregional networks for integrated production of vehicles and engines.

In the last 10 years, the automotive industries of Mexico, Argentina and Brazil have been effectively restructured. In addition to significantly increasing their levels of production, all three industries have modernized and improved their performance in terms of productivity and international competitiveness. However, there are differences between them.

The Mexican experience has been seen as the most positive. At 33 automobiles per employee, productivity is twice that in Argentina and Brazil. International competitiveness is far superior, not only in amount (US\$ 20.8 billion in exports in 1997) but also because the products are sold in a more demanding market—the world's largest, North America, where it has more than doubled its market share—and the industry runs a large trade surplus (US\$ 7.8 billion in 1997). However, for the Mexican auto industry to achieve its competitive restructuring, the country had to lower its domestic content requirements (from 60% to 30% in the case of models for export) and neglect, to some extent, the auto parts industry—formerly the preserve of domestic companies. By these means, it has created a flexible and competitive automotive industry, oriented to exports and able to increase its foreign sales when domestic demand falls—as occurred after the peso crisis in December 1994. With NAFTA, it was possible to consolidate the changes that had been made in the industry through direct investments by the big transnational corporations with no major conflicts between the member countries.

The experience of Ford (Mexico) captures very well the thrust of the competitive restructuring of the Mexican automotive industry. To defend its share of its original market against the Asian challenge, Ford made considerable direct investments in Mexico, establishing plants to produce engines and vehicles for export capable of competing in the world market. In these plants, thanks to its partnership with Mazda, Ford applied world-class technology and work organization methods, with surprising results in terms of increased competitiveness in the North American market, even against Japanese companies with operations there.

From that perspective, it is easier to see some of the things that are wrong with the Mercosur automotive industry. In Argentina and Brazil productivity (19.5 and 17.8 vehicles per

employee) is substantially lower than in Mexico, as is international competitiveness, in terms of both amount (exports of US\$ 4.6 billion and US\$ 2.8 billion in 1997) and the characteristics of the target market (Mercosur). In August of 1998, falling Brazilian demand caused the suspension of production at some Argentine plants, because they lacked the competitiveness to export to other, more demanding markets (*América economía*, 13 August 1998, p. 12). Both countries' automotive industries are also running significant trade deficits, as a result of slack exports of vehicles and strong imports of auto parts (and vehicles in the case of Argentina).

Moreover, there has been some friction between the main Mercosur partners —Argentina and Brazil— due to the automotive industry's heavy dependence on the Brazilian market. Such problems became apparent when Brazil restricted imports at times of balance-of-trade difficulties (1995), when it diverted FDI by offering incentives, or when there were disagreements on levels of external protection for the Mercosur automotive industry (1998). In fact, the two countries have different views regarding the place of the automotive industry within that integration scheme. Brazil has placed the emphasis of its automotive policy on the domestic market and compact cars, while Argentina has put its faith in strengthening the subregional market.

The experience of Fiat in Argentina and Brazil is an instructive example of the restructuring of the automotive industry in those countries. Fiat has a fairly limited international system of production; its largest investment outside of Western Europe has been in Brazil. Fiat's basic strategy in response to the Asian challenge was to defend its share of the Brazilian market; it therefore made investments in order to specialize in two models of "Popular Car". Once its position in the main segment of the Brazilian domestic market had been strengthened, Fiat considered the opportunities offered by Mercosur. In the early 1980s, Fiat had withdrawn from Argentina, operating thereafter through a local company, Sevel, under a licensing agreement. Its subsequent return to Argentina can basically be explained in terms of the specialization encouraged by trade equalization regulations. Thus, the experience of this Italian company encompasses the two visions of Mercosur embodied by Argentina and Brazil.

The influence of national policy has, on some occasions, been more important than subregional policy; it has, for example, had a strong impact on the direct investments made by Fiat. Uncertainty about access to markets, on the other hand, has a negative effect on direct investments in plants for export. In the last two years, Fiat's operations have produced a large trade deficit in Brazil. Thus, the example of Fiat in Mercosur shows some of the problems that can arise from a combination of the competitive situation in the international market, variability of national and subregional policies, and the business strategies of a second-rank competitor.

Analysis of examples from the automotive industries of Mexico under NAFTA and Argentina and Brazil under Mercosur, such as the specific experiences of Ford and Fiat, shows that a good understanding of the competitive situation in the international automotive market, combined with a knowledge of the corporate strategies of the most important players in the industry, allows for better definition of the national and subregional policy goals of the automotive industry and a higher probability of success.

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