For the third year running, foreign direct investment (FDI) flows into Latin America and the Caribbean have continued to fall, declining 33% from US$84 billion in 2001 to US$56.7 billion in 2002, according to ECLAC, in its Foreign Investment in Latin America and the Caribbean, 2002 Report.

In contrast to 2001, this decline in the region’s inflows is worse than general trends worldwide. Not only has the falling trend continued for the third year running, but also the pace of the decline has risen, following a 12.6% drop in 2000 and an 11% drop in 2001.

Moreover, “contrary to the pattern observed in 1998-2001, as of 2002 the net transfer of FDI resources would no longer compensate for the negative net transfer of financial resources.” This transfer rose by more than 4% of Latin America’s GDP in 2002, while the net transfer of FDI resources into the region fell to less than 2%.

Declining FDI worldwide reflects multiple factors, among which ECLAC points to “the sharp decline in the share prices of many transnational corporations (TNCs), mainly those associated with the new economy, the steep drop in privatizations and acquisitions of international assets and the downward spiral in the amount of financing generally available to TNCs.”

In Latin America and the Caribbean, this was further

(continued on page 3)
Latin America lived through a period of deep economic reforms during the 1990s, framed by what was called the Washington Consensus. Dramatic changes affected the relative importance of the State, which saw its sphere of action become more limited amidst deregulation, massive privatization, the reduction of public investment and expenditure, giving more space to private agents.

A decade of intense and profound reforms has left clearly positive results in several areas: the eradication of hyperinflation, more balanced public budgets, a rise in exports.

But performance has been poorest in precisely the most significant area, which is economic growth and equity. Annual Gross Domestic Product rose just 2.4% during the thirteen years between 1990 and 2002, and 1.2% in the past five years, which ECLAC has called the lost half decade. In terms of poverty, there are 20 million more poor people and income distribution remains very regressive.

Latin America needed reforms. We had economies that were over-intervened, with a restricted private sector and rules that were not transparent. The spirit of the Washington Consensus sought reforms that would generate right prices and be market-friendly, two principles we fully share.

Results, however, are contradictory. For example, key macroeconomic prices - the exchange rate and the interest rate - have tended to assume “wrong” values (one US dollar per one Argentine peso is one of many examples), suffering from enormous real instability after the reforms of the 1990s. Aggregate demand has fluctuated widely, led by the volatility of short-term capital. All this is not properly market-friendly, placing the productive sector under enormous tension.

Such “disappointing” growth, in the words of John Williamson, the English economist who coined the concept of the Washington Consensus, can be associated with many flaws. These include:

• Exports with low value added, non-dynamic and fluctuating markets. This is the result of not being concerned about the level of the exchange rate and the factors behind productive development.

• A fiscal balance that gives no priority to social and productive modernization. Rebalanced budgets have often been achieved by investing too little in human capital, technology, SMEs, and infrastructure. Tax revenues continue to suffer from enormous pitfalls and too much evasion.

• Real macroeconomic imbalance. Latin American firms and workers have been subject to enormous instability in domestic demand, exchange rates, and interest rates. It has become a roller coaster ride, discouraging productive investment, employment and equity.

Reforms to the economic reforms that preserve achievements at the same time as they correct the most severe failures, are crucial. Changes must build on what we have, and improve it. The changes required include:

• Macroeconomic reforms to achieve more sustainable equilibria, discourage excessive borrowing, control the external deficit, and avoid foreign exchange appreciation.

• Improvements to the prudent, countercyclical supervision of the financial system.

• Making systematic efforts to develop the long-term segment of the capital market, improving notoriously the access of small and medium-sized firms.

• Systematic programmes of labour and entrepreneurial training and technological spreading.

• Upgrading the quality of exports and their links to the domestic economy.

Latin America is capable of achieving all this.
affected by “increased instability, slower economic growth and the apparent end of the cycle of privatizations.” Crises in Argentina, Uruguay and Venezuela, “were also conducive to increased risk aversion and reduced foreign investment, all of which tended to heighten uncertainty on the part of foreign investors.”

However, the downward trend in FDI income was “quite uneven”, varying from one subregion to another, reflecting different factors and business strategies.

**Efficiency-seeking strategies**

In Mexico, Central America and the Caribbean, net FDI income fell 40% in 2002, but remained higher than the annual average for the second half of the 1990s. Most of this drop reflected a higher standard of comparison, as the huge inflow in 2001 was strongly influenced by Citigroup’s US$ 12.5 billion purchase of Mexico’s Banamex bank. It was the new FDI in financial services on top of manufacturing that kept FDI inflows at high historical levels in 2002.

“Efficiency-seeking strategies on the part of TNCs are most evident in Latin America, and it was therefore adversely impacted by the recession in the United States market, which reduced demand for the goods produced by the subregion’s export platforms,” ECLAC indicates. This cyclical downturn was particularly felt in Mexico, whose international competitiveness was also threatened by currency appreciation, with more than 200,000 jobs lost in the maquila industry as several plants moved from Mexico to Asia.

As quickly as it can be achieved, international competitiveness (defined as participation in the world import market) based on efficiency-seeking FDI can vanish. The key question is whether the receiving country is upgrading into higher value-added activities or simply pricing itself out of the market. In Mexico, jobs were lost in low-tech production (footwear, apparel, furniture and some electric and electronic goods). FDI flows into Central America and the Caribbean countries fell 13% in 2002, but remained similar to inflows from 1995 to 1999, with Costa Rica, where FDI income rose 41%, a case apart.

**Market and natural resource seeking strategies**

In South America, FDI inflows fell 31% in 2002, reaching just 60% of the annual average posted between 1995 and 1999. This is where TNCs market-seeking and natural resource-seeking strategies are most pronounced. Nonetheless, results for the Andean Community differed from those of Mercosur and Chile.

In the Andean Community, where natural resource-seeking strategies predominate, FDI income did not suffer as much from the global downturn. Although it dropped 18% in 2002, this was somewhat less severe than the downturn for the region as a whole, and reflected conditions in Venezuela. FDI in hydrocarbons rose the most while investment in minerals fell off considerably.

In Mercosur countries and Chile, FDI inflows fell 35% in 2002. These countries saw biggest rise in the previous decade and the sharpest fall in the new millennium. In 2002, FDI inflows were slightly higher than the annual average posted between 1995 and 1999. In this subregion, market-seeking strategies prevail among transnational corporations and FDI inflows were stymied by the completion of privatization processes, economic crises in Argentina and Uruguay, and lower growth in Brazil and Chile.

Faced with these crises, transnational corporations adapted as best they could, shutting down, rationalizing or restructuring their operations. Some companies in Argentina opted for leaving, while others took measures to deal with the crisis, including stopping payments. In Brazil, several car firms tried to shift sales away from the domestic or subregional markets and into the world market. In general, Mercosur became less attractive to market-seeking investors.

“The above considerations suggest that both cyclical and structural factors were involved in the decline in FDI flows to Latin America and the Caribbean,” ECLAC notes. Efficiency-seeking FDI, normally channelled through export platforms in Mexico, Central America and the Caribbean, was hard hit by cyclical factors such as the recession in the United States.

“The requisite policy response is not simply to wait for the United States market to recover, but rather to promote a continual upgrading of local assembly and manufacturing processes in order to improve their international competitiveness and thus set the stage for an upward trend in wages,” ECLAC states, and adds that this represents “the high road” in terms of country development strategies.

The report concludes that this “new and harsher environment in which more -and increasingly sophisticated- host countries compete for smaller global FDI flows suggests that the Latin American countries must upgrade their FDI policies and institutions in order to compete more successfully. This will entail graduating from a “beauty contest” approach designed to attract all potential FDI based on a country’s image and moving on to a developmental, targeted approach.” Specifically, countries must move away from quantity and toward quality in their efforts to attract FDI capable of contributing to their national development goals.

This study is available on our web site.
http://www.eclac.cl/search/shortcut.asp?id=12151
Getting their act together

Astute countries will take advantage of that fact to focus their efforts on the precise kind of FDI that they want in consideration of their national developmental priorities. In that context, they design tailor-made attraction policies to obtain it. This is most evident with regard to efficiency-seeking TNC strategies. As a result, TNC export platforms have come to account for 50 percent or more of the exports of manufactures of the more successful host countries (Ireland, Hungary, Philippines, China, Costa Rica, Mexico, Malaysia, Czech Republic).

In general, Latin American and Caribbean countries have not been very successful in this regard. On the one hand, South American countries attract very little FDI of this nature. Considering that this kind of FDI has held up relatively well during the recession, the lack of focused national policies for efficiency-seeking investors limits their ability to attract FDI in the future.

On the other hand, in Mexico, Central America and the Caribbean, where these kinds of FDI attraction policies are more common, their policies generally have been deficient because they focus on attraction without linking it to the developmental impact. While the efficiency-seeking FDI that has arrived has created impressive export platforms, these platforms are not well integrated into the national economy, such that the export dynamism does not produce the expected multiplier effect. Complementary national policies are required to improve upon production linkages, the skill level of human resources, enterprise development and technology transfer in order to bring the FDI attraction and national development policies into line. This has been achieved in the well-known experiences of countries such as Ireland and Singapore. Costa Rica has been the principal success story of the region, although new policies are presently being designed in Mexico as well.

In other words, the world has changed dramatically and FDI policies must evolve to take advantage of new opportunities available in the more difficult international environment. A first step is to better understand why TNCs invest in particular geographical settings and that
means attaining a better knowledge of individual business strategies. A second step is to define a host country’s national priorities in the context of its advantages, especially the dynamic ones. A third step is to design a FDI attraction policy based on identifying and engaging the TNCs whose strategies coincide with national priorities. A final element is to evaluate the results to confirm that the expected impacts are produced in practice. In essence, FDI policies in the region must focus more on quality and less on quantity to contribute effectively to developmental goals.

Another theme which now requires reconsideration is to what extent a country’s international commitments under existing and future trade and investment agreements facilitate or complicate the design and implementation of more focused FDI policies.

The author is Chief of ECLAC Unit on Investment and Corporate Strategies.

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### Principal TNC Strategies in Latin America and the Caribbean:

<table>
<thead>
<tr>
<th>Business Strategy / Sector</th>
<th>Natural resource seeking</th>
<th>Market access seeking (national subregional)</th>
<th>Efficiency seeking</th>
<th>Strategic element seeking</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary</td>
<td>Petroleum/gas: Venezuela, Colombia, Argentina</td>
<td>Minerals: Chile, Argentina, Peru</td>
<td>Automotive: (Mercosur)</td>
<td></td>
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<tr>
<td></td>
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<td>Food products: Argentina, Brazil, Mexico</td>
<td>Chemicals: Brazil</td>
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<td></td>
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<td>Beverages: Argentina, Brazil, Mexico</td>
<td>Electronics: Mexico &amp; Caribbean Basin</td>
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<tr>
<td></td>
<td></td>
<td>Tobacco products: Argentina, Brazil, Mexico</td>
<td>Apparel: Caribbean Basin &amp; Mexico</td>
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<tr>
<td>Manufactures</td>
<td></td>
<td>Automotive: Mexico</td>
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<td>Electronics: Mexico</td>
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<td>Food products: Mexico</td>
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<td></td>
<td></td>
<td>Apparel: Caribbean Basin &amp; Mexico</td>
<td></td>
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<tr>
<td>Services</td>
<td>Finance: Brazil, Mexico, Chile, Argentina, Venezuela, Colombia, Peru</td>
<td>Telecommunications: Brazil, Argentina, Chile &amp; Peru</td>
<td>Retail trade: Brazil, Argentina, Mexico y Chile</td>
<td>Electrical energy: Colombia, Brazil, Chile, Argentina &amp; Central America</td>
</tr>
</tbody>
</table>

Source: ECLAC Unit on Investment and Corporate Strategies.

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### Latin America and the Caribbean: GDP Growth, 1998-2002 and Projections for 2003

(Annual growth rates)

![Image of GDP growth chart]

Source: Statistics and Economic Projections Division, ECLAC.

### Latin America: Foreign Trade in Goods and Current Account Balance, 1995-2003

(U$ billion at current prices)

![Image of foreign trade chart]

Source: Statistics and Economic Projections Division, ECLAC.

### Latin America and the Caribbean: Inflation 1995-2003

(Annual change, percentage)

![Image of inflation chart]

Source: ECLAC, projection based on official figures.
In their introduction, ECLAC’s enviromental specialists, Alicia Bárcena and Carlos de Miguel, note that in Latin America and the Caribbean, unsustainable levels of foreign debt remain a major obstacle to development. In this sense, initiatives to reduce debt must continue.

They also propose reformulating the debt-for-nature mechanism and turning it into a means of swapping debt for sustainable development. “In addition to relieving part of the debt burden of developing countries, it can serve as a powerful instrument for the conservation, restoration and expansion of natural capital,” they argue.

Flows of official development assistance (ODA) have “dwindled considerably”, falling from 0.33% of donor countries’ GDP in 1992 to 0.22% in 2001. In 1998-2001, no country in Latin America or the Caribbean figured among the ten main recipients.

A positive trend emerges

Since the Monterrey Conference (2002), the authors note a major trend has emerged whereby the provision of assistance is shifting away from country-based aid and towards a problem-focused international public goods approach. The public goods debate remains open.

The authors examine major trends affecting ODA since 1992, identifying three major challenges: increasing its effectiveness; ensuring that ODA and private investment funds complement each other, favouring technological innovations, especially the transfer of clean technologies; and achieving the provision of additional funds to deal with issues involving global public goods.

Private international flows into Latin America and the Caribbean began to decline in 1999 and this trend has continued now for three years. Bárcena and De Miguel suggest that to create positive synergy between foreign direct investment and sustainable development, “recipient countries should strengthen their environmental management systems in order to formulate clear and predictable rules.” The question of the environment must also be included among the quality criteria that countries use to determine what kind of investment they want to attract.

In the Plan of Implementation, participants agreed to explore innovative ways of generating public and private financial resources for sustainable development and the solution of global environmental problems. In the past ten years, concessionary funds have been strengthened, among them the Global Environmental Fund. However, the resources thus provided are not enough to resolve global problems of this magnitude and there has been little progress in designing global environmental market mechanisms.

Likewise, domestic policies for financing sustainable development have evolved very slowly, reflecting the ongoing weakness of the relevant institutions within state apparatuses. The authors argue that in general, “budget shortfalls and the need to generate resources to meet external obligations have resulted in budget cuts, particularly to the detriment of environmental initiatives.”

Environmental expenditure tends to be limited and it is necessary to examine its quality. “Efforts are therefore needed to strengthen public environmental spending in terms of both magnitude and composition.”

A major prerequisite for future success is “to achieve better coordination among the different ministries, particularly those responsible for finance and the environment, and closer cooperation between the public and private sectors in undertaking long-term investments that are conducive to sustainability,” Bárcena and De Miguel point out. The different levels -national, regional and local- at which the environmental budget is implemented underline the need for greater coordination among public institutions with environmental responsibilities.

This book is also available on our web site.
http://www.eclac.cl/search/shortcut.asp?id=12159
Today, all of the countries of Central America and the Caribbean are involved in free trade initiatives, including domestic, sub-regional and multilateral, the last ones under the aegis of the World Trade Organization (WTO). All these processes affect the agrifood sector, albeit partially, because of the enormous sensitivity of this issue for every country.

With this in mind, and in order to identify possible trade opportunities and challenges within the agrifoods sector in the countries of this subregion from the perspective of trade liberalization in the main import markets, ECLAC’s Agricultural Development Unit, with support from the Government of Holland, developed the study, The Competitiveness of Agrifoods in Central American and Caribbean Countries in the Context of Trade Liberalization, by Mónica Rodrigues and Miguel Torres.

This paper examines six Central American countries (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama) and eight Caribbean ones (Barbados, Belize, Cuba, Guyana, Haiti, Jamaica, the Dominican Republic and Trinidad and Tobago). The authors report that the main trade opportunities arise from the elimination of trade barriers for products that are strong performers in terms of international demand and, moreover, for which the countries studied enjoy competitive advantages.

The major challenges resulting from the reduction or elimination of unilateral preferential access currently covering key agrifood products from the countries studied.

These countries share common characteristics, among them their small size, geographic location, cultural aspects and a colonial past. In terms of international trade relations, to a greater or lesser degree they all enjoy preferential access to the two main import markets, the United States (US) and the European Union (EU). Furthermore, all are currently involved in regional integration initiatives, free trade agreements with third countries and/or the multilateral trade liberalizations process being led by the WTO.

Despite these similarities, there are also some important differences in terms of levels and trends in economic development, political regimes, trade specialization and competitiveness, which influence their international participation and their approach to globalization.

The study takes a broad approach examining relative prices, market shares, trade specialization and the workings of import markets, identifying the main competing countries, destination markets and trade protection affecting the subregion.

Strengths and Weaknesses of Competitiveness

The report defined the agrifood sector as all primary farming, livestock and related manufacturing activities covered by the Standard International Trade Classification (SITC): food and live animals, beverages and tobacco, raw hides, skins and furskins, oil-seeds and oleaginous fruits, natural rubber, raw textile fibres, crude animal and vegetable materials, animal and vegetable oils, fats and waxes.

Among their conclusions, the authors indicate that the countries studied show a range of competitive situations, with some winning and some losing to their competitors. On one hand, the main strong points of these countries’ agrifood competitiveness occur in those markets where they enjoy preferential access. This is the case with melons and papayas in the US and the EU and crustaceans (mainly lobsters) in the EU. The same occurs with coffee in the US and EU and sugar in the US.

With regard to their weak points, the most worrisome cases are those where even with preferential access compared to their competitors, these countries have clearly been losing market share. In this sense, the situation of the Central American countries in the US beef market and the Caribbean countries in the case of imports of oranges into the US and rum into the EU is of particular concern.

Among their final conclusions, the authors indicate that a broad approach should be taken to the issue of competitiveness, which takes into account current strategies, potential and limitations inherent in the different segments of the agri-manufacturing chain, as well as the interactions among them. The study of competitiveness should examine interrelationships at four levels: the micro level (the company and its value-chain), the meso level (including the regulatory policies that affect the subsystem); the macro level (foreign exchange, budgetary, fiscal and trade policies); and the meta level (judicial, economic, and political patterns of organization).
Emergencia del Euro y sus Implicaciones para América Latina y el Caribe (The Emergence of the Euro and its Implications for Latin America and the Caribbean), coordinated by Hubert Escaith and Carlos Quenan. Macroeconomía del Desarrollo series No. 20, January 2003 (LC/L.1842-P, Spanish). This timely study analyses the euro’s potential for internationalization, suggesting it could affect Latin American economies more through financial rather than trade channels. 


La Dinámica Demográfica y el Sector Habitacional en América Latina (Demographic Trends and the Housing Sector in Latin America), by Camilo Arriagada Luco. Población y Desarrollo series No. 33, January 2003 (LC/L.1843-P, Spanish). Focusing on the 1990s, the author explores the seldom studied question of demographic trends’ impact on social housing, which has lagged behind education and health care, and its important implications for social service management.

Development Cycles, Political Regimes and International Migration: Argentina in the Twentieth Century, by Andrés Solimano. Macroeconomía del desarrollo series No. 22, January 2003 (LC/L.1847-P, English). In the early 1900s, almost 3 million Europeans and considerable foreign capital flowed into Argentina, fueling development until the 1950s. Then and to this day, the flow reversed, with drastic implications for the economy.

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JUNE | 2 - 6 Workshop - Course on “Sustainable Development Indicators for Latin America and the Caribbean.” | ECLAC
 | 9 - 10 “Fertility in Latin America and the Caribbean: Transition or Revolution.” ECLAC/ Government of France. | ECLAC
 | 9 - 20 Course on “Using Socio-Economic Indicators to Evaluate the Impact of Anti-Poverty Programmes.” ILPES | Antigua, Guatemala
 | 18 - 20 Second meeting, Statistical Conference of the Americas of the Economic Commission for Latin America and the Caribbean. | ECLAC
JULY | 23 “Challenges and New Models for Financing the Information Society in Latin America.” ECLAC/ Asociación Hispanoamericana de Centros de Investigación y Empresas de Telecomunicaciones (Spanish-American association of research centres and telecommunications firms, AHCIET)/ Regulatel/ World Bank. | ECLAC
 | 24 - 25 “VI Regulatel Summit - AHCIET”. AHCIET/ Regulatel | ECLAC
AUGUST | 18 - 29 Course on “Logical Framework and Evaluating the Impact of Projects and Programmes.” ILPES | Santa Cruz de la Sierra, Bolivia