FOREIGN INVESTMENT IN LATIN AMERICA AND THE CARIBBEAN FALLS

After a decade of unprecedented growth, the flows of foreign direct investment (FDI) into Latin America and the Caribbean have fallen from US$105 billion in 1999 to US$80 billion in 2001. The decline has lasted two years running and preliminary data for 2002 shows no sign of a turnaround. On the contrary, the region’s marked instability, enhanced by recent events in Argentina and Venezuela, could become a significant negative factor.

Despite the decline, net inflows for this type of investment still remain above average for the past five-year period. And, as a region, the 10% decline during last year compares favourably to a 50% reduction in global flows. There is some uncertainty about the medium-term future of inflows. ECLAC notes in its report La inversión extranjera en América Latina y el Caribe, 2001 (Foreign Investment in Latin America and the Caribbean, 2001, soon to be published in English). This is partly due to adverse international economic conditions, with a longer than expected recession in the US and low growth expectations for Europe and Japan. This has reduced investment, as company profit rates have fallen, and stock values have also declined, all of which affects FDI. Another element that is also important is China’s enormous attraction to FDI worldwide. FDI into China reached US$40 billion per year during the past five years and continued to rise in 2001.

One of the structural factors in this decline within the region has been the completion of implementation of economic reforms, which attracted much of the wave of FDI during the 1990s, especially the privatization of large state-owned firms involved in energy and basic services. Thus, between January and April 2002, there were only two operations associated with electric power generating stations, worth US$36 million. If this pace continues for the rest of the year, figures will not reach the US$1.35 billion invested in 2001, let alone the US$18 billion invested in 2000.

COFFEE CRISIS HURTS THE REGION’S ECONOMIES

The collapse of coffee prices on international markets has plunged coffee sectors in Colombia, Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua into their worst crisis ever.

In response to governmental concern, ECLAC studied the impact of plunging prices on economic performance, the balance of payments, the financial sector, employment and income in Central America and Colombia.

The study, Centroamérica: El impacto de la caída de los precios del café (Central America: The Impact of Falling Coffee Prices), concluded that the crisis is caused by excess world production. In the past four years, stocks have risen significantly, pressuring prices.

In 2001, world coffee production outran consumption, which rose just 1%. The over-supply of around 10 million sacks and record export volumes (88.7 million sacks) have pushed importing countries’ inventories up to around 25.5 million sacks, almost three times the level compatible with good prices. The “C”
The mix of an active investment strategy, strong human capital accumulation and a broad macroeconomic stability framework could help to improve export competitiveness. Progress on these fronts will require major institutional and organizational efforts. In this context, an investment strategy is less an exercise in “picking winners”, than an effort to identify opportunities and to direct national and regional action needed to ensure that some of them bear fruit.

Opportunities for small economies are also highly dependent on regional integration efforts. Countries in Latin America and the Caribbean have advanced further in this field than those of any other area in the developing world. Nonetheless, regional integration processes will need to be deepened in the future if they are to remain relevant. Macroeconomic policy co-ordination can help to smooth out the effects of external shocks. Avoiding tax competition is also an essential objective that could be achieved by means of common tax provisions. Steps must also be taken to develop regional and subregional financial institutions and innovation systems that include the development of broader schemes for co-operation in education, research and technical development.

Divergent development levels associated with scale economies and the vulnerabilities specific to small economies, provide a strong argument for special and differential treatment for these economies. In multilateral trade agreements, this would include longer transition periods to meet new policy demands, more flexibility in setting thresholds or defining legal and institutional obligations, more manoeuvring room for active investment strategies, broader safeguards and the provision of technical assistance.

Greater international labour mobility should also be a clear priority for smaller economies, since it smoothes out the social costs of adjustment, guarantees access to the required pool of skilled workers and provides much-needed external resources via remittances to foreign exchange-constrained economies. The benefits of return migration are enormous when professionals who have studied and worked abroad return home. Thus, migration issues should be included in the hemispheric agenda, in multilateral negotiations between the region and the European Union, and in regional integration processes.

Globalization poses new questions regarding size and development. In particular, it makes all countries smaller when compared to the relevant world market. The relative importance of large national markets has declined, and even larger economies are increasingly dependent on external conditions.

Nonetheless, small developing economies continue to be at a disadvantage in the global economy, regarding access to economies of scale, diversification and macroeconomic policy autonomy. They are not small enough to rely only on exports of a few commodities or services, nor are they large enough to reap the benefits of economies of scale or to successfully diversify into dynamic products. These countries, then, run the risk of being caught in a development trap.

Although the challenge of keeping up and getting ahead in a globalized world is substantial for small economies, the region has had its share of success stories. Service-based economies of the Caribbean have shown the most robust response to globalization, in activities such as tourism, informatics, e-commerce and finance. In countries where agriculture and mining are competitive, “clusters” associated with their key primary sectors are also an interesting option. Upgrading the “maquila” industry to include more value-added ladder products is yet another option, as Costa Rica has shown.

“An investment strategy is less an exercise in ‘picking winners’ than an effort to identify opportunities...”
In second place, transnational companies’ purchases of large national companies, which generated a significant percentage of investment flows, have given way to a period of consolidation in the resulting industrial organizations. Transactions for this purpose carried out during the first quarter of 2002 reached US$4 billion. The annualized figure is lower than in 2001, when it reached US$25 billion, and much less than the annual average for 1999-2000, which was US$43 billion.

FDI flows into Latin America and the Caribbean have performed differently in different parts of the region, with some countries receiving enormous amounts while others see investors waiting for conditions to improve domestically and internationally. In 2001, Mexico received 35% of FDI flows (compared to an average 18% between 1995-2000), Brazil 32% (down from 35% for the same period), Central America and the Caribbean 6% (it held steady), Chile 6% (down from 8%), Argentina 4% (down from an average 17% for the 1995-2000 period) and financial centres 17%.

In the future, investment should include a larger component of new (greenfield) investment, which is harder to obtain and intimately linked to the global strategies of transnational companies in the region. These in turn reflect the processes of political, economic and social stability in countries as well as the region’s potential for technological and economic development, and growth. Future investment plans, as transnational companies have announced to the press from January 2001 to April 2002, focus on infrastructure sectors. Manufacturing, which received 24% of foreign investment during the 1990s, accounts for just 4% of total projects announced.

The report reviews the elements that could encourage capital inflows and strengthen regional development as well. It indicates that compared to Asia, Latin American countries “tend to limit themselves in the field of productive development policies and, when negotiating bilateral or multilateral investment agreements as well as investment chapters included in free trade treaties, restrict themselves to providing guarantees and protection to investors, instead of defining their relationship with national development strategy.” They also tend to show some reluctance to make full use of all available instruments.

ECLAC states that it is necessary to activate FDI policy and make it more explicit. In future negotiations regarding this sort of investment, the “development dimension” should be defined. At the microeconomic level, the growing relevance of transnational firms in the region’s economy is increasingly apparent. But there are some disadvantages, such as the “enclave-like style and lack of articulation between most transnational firms and the region’s productive apparatus” and their weak impacts on competitiveness, except in Mexico and countries within the Caribbean basin.

A special chapter within the report focuses on Argentina, which was one of the countries that attracted the most FDI during the 1990s, but saw inflows of FDI fall from US$11,665 billion in 2000 to US$3,181 billion in 2001. Transnational firms were the most dynamic players in the restructuring of the Argentine economy in the 1990s and they radically transformed the business landscape. From 1991 to 2000, their share of sales of the country’s 100 largest firms went from 24% to almost 50%.

But since 1998, macroeconomic conditions have deteriorated, affecting economic agents’ confidence and leading to high-risk premiums for external financing and a strong contraction in private investment.

FDI flows tend to have ambiguous effects, at both macroeconomic and microeconomic levels, the study reveals. “On one hand, it provided short-term relief for external accounts, but this led to greater restrictions due to the growing profit remittances in the long term. On the other, at the productive level, this led to strong modernization, but with little clustering and diffusion to the rest of the local economy, while in the service area inconsistency prevailed between fixed tariff formulae and systemic competitiveness,” it states.

The document also dedicates special chapters to the European Union, as an investing region, and to the hydrocarbon sector, as an example of a branch of activity that clearly reflects FDI’s attraction to sectoral reform.

This document is available at www.eclac.cl or www.eclac.org
small and medium-sized manufacturers (PYMEs) play a distinguished role in the debate about economic policy in Latin America and the Caribbean. In academic circles there are frequent proposals emphasizing their importance to development. The region’s governments consider them motors for growth and every country has some kind of instrument to support them. Nonetheless, in practice, the situation is very different. Support to PYMEs is more nominal than real and the official discussion is not supported by actions or backed up by sufficient funds and human resources to produce an impact on company performance.

PYME development to date has depended primarily on domestic macroeconomic conditions. Trade liberalization has had a negative impact on some countries due to an increase in imports, but this is far from a general trend indicating that PYMEs are the losers in the new economic model. Instead, liberalization has widened the gap between different branches of production involving PYMEs, rather than affecting the overall performance, and there is strong evidence of sectoral specialization processes among PYMEs. In this sense, it is more correct to say that “among PYMEs there are winning and losing sectors” rather than assuming deficient performance for all companies of this type.

In this framework, policies to support PYMEs designed by the region’s countries during the 1990s varied enormously. The context in which these were designed was dominated by structural reform processes that occurred in the region in recent decades. Policies to support PYMEs have been subordinate to goals for competitiveness and macroeconomic policies. Similarly, institutions designing support policies for PYMEs generally lack clout within government structures and lack powerful political instruments.

While these factors provide a somewhat negative outlook, demand for policies rose noticeably during the 1990s, producing some positive advances. Early in the decade, the prevailing view was that the best policy was no policy at all. By mid-decade, however, there was a clear resurgence of interest among governmental authorities and chambers of commerce in policies to actively support competitiveness, including providing assistance to PYMEs. However, this growing interest did not bring with it similar progress in terms of implementing this kind of measure.

In the late 1990s, conditions became much more encouraging and may have set the stage for the present decade. Several of the region’s countries, such as Chile, Mexico, Argentina and Colombia, developed innovative instruments for supporting PYMEs. Similarly, in terms of credit, large development banks, particularly in Brazil and Mexico, played a distinguished, innovative role.

The content of these policies has tended to grow more uniform and even to repeat itself. Thus, the three main competitive policy areas (support for exports, technological development and human resource training) are present in every country, along with the usual financing instruments in access, guarantees and cost. Possibly the most innovative aspect of the policies designed in the region has been the effort to increase links between PYMEs and/or between these and large firms.

In terms of potential impact on new job creation, evidence from national case studies shows that the human and financial resources assigned to policy implementation have been too limited to realize these expectations. Even in the region’s relatively developed countries, the resources directly assigned to this policy don’t add up to more than a couple of tenths of a percentage point of GDP. In the countries lagging further behind, actually implemented support for PYMEs tends to depend almost completely on international aid or cooperation. The lack of resources combines with institutional problems, particularly the excessive fragmentation of decision-making in this area.

Different levels of institutional maturity in terms of support for PYMEs are reflected in different capacities to articulate programs and initiatives. Thus, for example, compared to institutions with broad experience, extensive reach and regulatory capacity, such as the Brazilian service for supporting small and medium-sized firms (SEBRAE) or the corporation for stimulating production (Corporación de Fomento a la Producción, CORFO) in
Chile, the multiplicity of actions carried out by countries such as Argentina, Colombia and Mexico has not brought with it effective coordinating institutions, while other countries have generally carried out isolated actions only.

In summary, there is significant room to develop public policies that support and encourage PYMEs. The most constructive step would be to concentrate efforts on developing institutions and assigning human and financial resources that would permit implementation of new instruments, with broad abilities to influence the universe of PYMEs. Nonetheless, maintaining stable macroeconomic conditions and generating a context favouring high, sustained economic growth remain crucial, and this is no small challenge to Latin America and the Caribbean at the beginning of this new decade.

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Coffee Crisis Hurts...  

The poor performance of the region’s economy in 2001 has not helped. Low international prices caused significant losses in foreign exchange earnings. In 2001 alone, countries lost US$713 million, equivalent to 1.2% of the region’s GDP.

Coffee accounts for 1.3% of GDP in Costa Rica, 2.5% in El Salvador, 4.2% in Guatemala, 7.2% in Nicaragua and 8.2% in Honduras, so the crisis has had a significant impact on their economies.

The finances of almost 300,000 coffee producers are in bad shape and their access to new loans limited. Many farms have been abandoned. In 2001 an estimated 170,000-jobs/year were lost, along with US$140 million in wages. Unemployment and lower wages in this sector affected some 1.6 million of the poorest people.

Although producers and governments have taken measures to relieve the crisis, ECLAC calculates that “overcoming the crisis will require a profound review of regional coffee farming’s participation in world markets, along with negotiations to rebuild dialogue between producers and consumers, in order to promote a new order within the market.”

The Colombian Case

In the study Colombia: Escenario social, económico e institucional de la actual crisis cafetera (Colombia: Social, Economic and Institutional Scenario of the Current Coffee Crisis), economist Luz Amparo Fonseca, indicates that coffee-related activities in Colombia are experiencing a structural crisis. Social conditions are extremely worrisome, since more than 500,000 families depend on coffee production for their livelihoods and have suffered continual impoverishment for the past decade.

Today, coffee-related activities in Colombia account for 2% of total domestic GDP (22% of agricultural GDP) and remain significant in terms of job creation. Ninety five percent of coffee producers are small-scale, while the remaining 5% are agribusiness-type producers, responsible for around 40% of total coffee production, by area.

Producers’ quality of life has declined, although relatively speaking, the country’s coffee-producing regions have less poverty and indigence. The percentage of people under the poverty line rose by 6.7% between 1997 and 2000, while the indigent households rose 2.8%. Unemployment in coffee areas rose by 7.8%, compared to a 5.7% increase in the rest of the country. Losses to the coffee industry in 2001 meant the general economy lost some 257,000 jobs/year.

Despite efforts in the 1990s to introduce new technologies, unit costs remain high. Colombian coffee is viable when the international price ranges from 87 to 92 cents per pound, but in 2001, it stood at 60 to 70 cents per pound, even with the quality premium assigned to Colombian beans.

During the 1990s, low international prices, bad weather, and growth in supply from Brazil affected the sector. In 2000-2001, Vietnam replaced Colombia as the world’s second largest coffee producer.

The author suggests that the most powerful policy instrument available to the Colombian coffee industry is the national coffee fund, FNC, created in 1940. Today the Fund’s role is the subject of national debate, given that private initiative requires greater flexibility.

Finally, Fonseca reviews proposals for emerging from the crisis and emphasizes the need to take short-term measures to deal with negative political and social impacts.
Although separated by the Pacific Ocean and different histories, like all developing countries, including the most successful, Latin America and Asia suffer from similar financial and macroeconomic vulnerabilities, as is apparent from the frequent crises of recent years.

To review the experience of Asian countries and identify lessons useful to Latin America, ECLAC, along with the Institute for Developing Economies/Japan External Trade Organization, (IDE-JETRO), the IDB Japan Program and the Federal University of Rio de Janeiro, organized the seminar Promoting Growth and Welfare: the Role of Institutions and Structural Changes in Asia, which took place in Santiago, Chile, and Rio de Janeiro, Brazil, in May. In both cities, 10 Asian economists presented their points of view, followed by commentary from Latin American experts.

At the two seminars, ECLAC Executive Secretary José Antonio Ocampo noted that for some time the exchange of information between Asia and Latin America took place through Anglo-Saxon intermediates, and that more direct dialogue on developmental experiences was necessary.

When Latin America was barely emerging from its lost decade (the 1980s), news from the region concentrated on successful Asian experiences, he said. But then, a two-way dialogue began, associated with Latin America’s growing international integration and the grave financial crisis in Asia (1997-1998) and its contagion to practically the entire world. Ocampa underlined three major common issues: macroeconomic management, types of productive insertion in the global era, and regional cooperation.

Southeast Asia as a region is even more diverse than Latin America. With a total population of 1.9 billion (713 million without China), it includes Japan, South Korea, China, Hong Kong, Taiwan and another ten countries. These countries are all very different in terms of their state of economic development: per capita income in Japan is US$37,546, but just US$855 in China, US$728 in Indonesia and barely reaches US$136 in Myanmar.

For a decade starting in 1987, the economies of Southeast Asia lived an “economic miracle”, with high, sustained growth. As Ippei Yamazawa, of IDE/JETRO, explained, the mechanism used was to rapidly update manufacturing. New products were introduced into domestic markets through imports, production was developed to replace imports, and products were exported. Success was attributed to high savings levels, an appropriate work ethic, more education and cautious macroeconomic management. Government policy toward manufacturing and financial support for promising industries was also applauded.

Nonetheless, with the 1997-1998 crisis, the miracle vanished. Growth ceased, currencies depreciated and investment and trade both fell. The economies of that region fell into a trap, according to Yamazawa. When still growing quickly, they benefited from the virtuous circle of exports and investment: exports drove growth, while high growth prospects encouraged investment in expanding and improving competitiveness. During the crisis this became a vicious circle of depressed exports and discouraging prospects for investment.

These economies began to recover in 1999, when many achieved growth of 3% to 5% and some, such as Korea, reached 9%. In 2000, a bipolar trend emerged, with the economies of Northeast Asia, such as China, Taiwan, Hong Kong and Korea continuing to recover, while those of the Southeast, such as Indonesia, the Philippines and Thailand, remained weak, with emerging political unrest.

Ocampo pointed out that the financial crises of recent years reveal the financial and macroeconomic vulnerabilities of all developing countries, even those that have achieved significant success. This leads to a necessary review of how macroeconomic, fiscal and foreign currency policies are developed, including regulation of capital flows.
Impact of Social, Economic and Technological Trends on Public Transport: a Preliminary Study in Latin American Cities, by Ian Thomson. This study examines social and technological change as it affects the great car versus public transport dilemma, emphasizing the need to provide quality alternatives if Latin American cities really hope to control car use. www

¿Cuán Dinámicas Son las Exportaciones Intrarregionales Latinoamericanas? (How Dynamic are Latin America’s Intra-Regional Exports?), by José Miguel Benavente. Different patterns characterize trade flows throughout the region, with the United States playing a dominant role. www

Los Derechos de Propiedad Intelectual en el Mundo de la OMC (Intellectual Property Rights and the World Trade Organization), by Jacqueline Abarza and Jorge Katz. The authors recommend reopening the debate within the WTO, to re-establish “equality and confidence” among different parties. www

Panorama de la Inserción Internacional de América Latina y el Caribe, 2000-2001, by Jacqueline Abarza and Jorge Katz. This overview provides both analyses and figures, revealing a decline in the region’s participation in the world economy. www

ECLAC’s on-line Directorio en Red de Instituciones Sociales de América Latina y el Caribe is available in Spanish at: http://www.eclac.cl/dds/noticias/proyectos/6/7796/instruccion.htm, with over 827 institutions involved in education, health care, social security, work and housing. www