



# Foreign investment

IN LATIN AMERICA  
AND THE CARIBBEAN





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*Foreign Investment in Latin America and the Caribbean, 1999 Report* is the latest in a series published annually by the Unit on Investment and Corporate Strategies. It was prepared by Alvaro Calderón, Michael Mortimore and Luisa Rangel, with assistance from external consultants: Enrique Dussel Peters for the chapter on Mexico, Gary Gereffi (assisted by Dana Ehrlich) for the chapter on apparel, and Georgina Nuñez with respect to other aspects of the document. Statistical information was prepared by José Elías Durán and Lorena Farias, assisted by María Luisa Granda, Alfonso Barberena and Javier Meneses.

The Unit's own Information Centre is the primary source of quantitative data. In developing that Information Centre, the Unit had timely access to statistical and other information from a number of international organizations, including the International Monetary Fund (IMF), the Statistical Office of the European Communities (EUROSTAT), the United Nations Conference on Trade and Development (UNCTAD) and the Institute for European-Latin American Relations (IRELA), as well as a host of national institutions, such as central banks and investment promotion agencies, in Latin America and the Caribbean.

Comments and suggestions concerning this document are welcomed and should be sent to Michael Mortimore (e-mail: [mmortimore@eclac.cl](mailto:mmortimore@eclac.cl))

#### Notes and explanations of symbols

The following symbols have been used 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.

**ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN**

**FOREIGN INVESTMENT IN  
LATIN AMERICA AND THE CARIBBEAN**

**1999 REPORT**



**UNITED NATIONS**



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## ABSTRACT

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This study attempts to contribute to a better understanding of foreign direct investment (FDI) in Latin America and the Caribbean by examining the plentiful but disparate statistical information available on the subject within the context of a conceptual framework based on an analysis of corporate strategies. The research programme of the Unit on Investment and Corporate Strategies is structured around the analysis of the specific situations of individual investor countries and of FDI recipient countries and destination industries in the region. This research, combined with the statistical information compiled by the Unit's Information Centre, provides a more complete picture of this subject matter.

In 1998, FDI inflows amounted to US\$ 76.7 billion and thus surpassed the record level recorded in 1997; by the same token, 1999 inflows will be larger than those of 1998. FDI is a major economic variable in the performance of the Latin America and Caribbean economies and therefore needs to be understood more fully. Over 40% of the region's total inflows go to Brazil, where the liberalization and deregulation of financial services and the privatization of State assets in the telecommunications and electricity generation and distribution industries have opened up enormous opportunities for foreign investors interested in

purchasing existing assets. In contrast, the creation of new assets has been a more prominent feature of investment activity in Mexico.

In addition to detailed, up-to-date statistical information, the report provides a comprehensive analysis of Mexico's position as a recipient country, of Spain's status as a major new investor and of the apparel industry, where FDI has generated substantial export flows to the North American market. Each of these analyses affords valuable insight into the nature and impact of FDI in the region and contributes to a fuller understanding of this phenomenon.





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## FOREWORD



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The 1999 edition of *Foreign Investment in Latin America and the Caribbean* maintains the analytical structure adopted last year, which incorporates five main elements: (i) the interpretation of a selected aspect of foreign direct investment (FDI) that needs to be improved to increase our understanding; (ii) a presentation of the latest statistical information; (iii) a case study of a major FDI recipient country; (iv) a case study of a major investor country; and (v) an analysis of an industry in the region in which FDI is a significant factor.

In addition to the latest statistical information presented in this edition, which includes estimates for 1999 for the larger countries in the region, and a discussion of the normative issues that challenge our understanding of the FDI phenomenon as such, the 1999 edition continues the analysis presented in last year's report on the principal corporate strategies being applied in the region. The efficiency-seeking strategy is analysed in depth in chapter II, which this year focuses on Mexico as one of the major FDI destination

countries, and in chapter IV, which deals with the apparel industry in Mexico and the Caribbean basin. The market access-seeking strategy is explored in chapter III, which provides an analysis of Spanish FDI in the region, particularly in the services sector.

*Foreign Investment in Latin America and the Caribbean* has become the basic sourcebook for persons and institutions interested in the subject of FDI in Latin America and the Caribbean. In order to continue contributing to a fuller understanding of FDI,

however, the coverage and quality of the statistical information contained in this report needs to be improved and its conceptual framework has to be evaluated on an ongoing basis. In carrying out this task,

ECLAC relies on contacts with and the continuing support of governmental organizations, business associations, foreign enterprises and academic institutions.

José Antonio Ocampo  
Executive Secretary  
ECLAC





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## SUMMARY AND CONCLUSIONS



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This year's report begins with a discussion of the significant obstacles that stand in the way of a clear understanding of foreign investment, not only because of the difficulties faced by the international and national institutions that produce statistics on foreign direct investment (FDI) —including the differences that exist in methodologies, accounting practices, definitions, country and sectoral coverage, etc., that were discussed in the 1998 edition— but also because of the considerable degree of confusion surrounding normative or legal issues. The explosive increase in bilateral investment treaties, coupled with the multilateral commitments made within the framework of the General Agreement on Trade in Services (GATs), Trade-Related Investment Measures (TRIMs), Trade-Related Intellectual Property Rights (TRIPs) and others, and the investment provisions of free trade agreements, whether already in force (NAFTA, Canada-Chile, Mexico-Chile, United States-Bolivia, etc.) or still under negotiation —as in the case of the Free Trade Area of the Americas (FTAA)— have undoubtedly been a contributing factor in the steep upswing seen in the participating countries' FDI inflows. However, these instruments have not been of a great deal of help in providing greater insight into the FDI phenomenon itself. In fact, it is quite possible that the plethora of new normative or legal obligations may not fit in with any unified multilateral undertaking on foreign

investment agreed to in the future under the aegis of the World Trade Organization (WTO), especially if it is one in which the specific needs of developing countries are better reflected. This suggests that it might be prudent for the Latin American countries to use more caution in assuming further obligations until such time as the multilateral situation is clearer and the FDI phenomenon as such is better understood. Perhaps it is a good time for national decision-makers to focus on defining those priority activities in which they feel FDI can make a substantial contribution to national development goals and then on designing and implementing policies to facilitate those specific types of FDI.

The statistical and normative challenges associated with FDI did not in any way inhibit FDI inflows to Latin America and the Caribbean, since, at over US\$ 76 billion, net receipts in 1998 (and the estimates available for 1999) outpaced those of 1997. More detailed information on FDI inflows and other

related statistical aspects of FDI in the region may be found in the chapter of this report entitled "Regional overview". Comprehensive analyses of the recipient country (Mexico), investor country (Spain) and industry (apparel) highlighted in this year's edition are presented in separate chapters.

## 1. The regional survey

Global FDI inflows surpassed US\$ 650 billion in 1998, which was an increase of almost 39% over the preceding year and more than double the average for 1991-1996. These figures indicate that the international expansion of transnational corporations in the context of the globalization process is still gathering momentum. FDI inflows in 1998 were much more concentrated than before in the same industrialized countries (over 70%, versus 60% for the 1990s as a whole) that are also the source of about 90% of total capital outflows. This has reversed the upward trend in inflows to the developing countries that had been observed previously, as their share declined to less than 29% from the level of about 40% registered during the mid-1990s.

In absolute terms, the level of FDI flows to developing countries declined slightly during 1998. However, in terms of the distribution among regions, Latin America and the Caribbean almost closed the gap with developing Asia (40.6% versus 44.3%) and pulled far ahead of other developing regions (15.1%). The Asian crisis that began in 1997 undoubtedly put a dent in FDI inflows to East Asia, South Asia and South-East Asia (which fell by about 14%, from US\$ 88.366 billion to US\$ 76.292 billion) and especially in intra-Asian flows. Meanwhile, inflows to Latin

America and the Caribbean were quite dynamic (rising by almost 11% from US\$ 69.404 billion to US\$ 76.727 billion). Thus, although developing countries as a group lost ground to the industrialized countries as destinations for FDI in 1998, the Latin American and Caribbean region proved to be the exception and exhibited continued dynamism.

In 1998, the larger countries of the region belonging to the Latin American Integration Association (LAIA) received 84% of the region's total inflows, while the shares of the financial centres (8.5%) and the rest of the countries (7.5%) of the Caribbean basin rose relative to their trend levels for the 1990s. Among the larger countries, Brazil received the lion's share of FDI inflows (41.6%), followed at a great distance by Mexico (13.3%), Argentina (8%), Chile (6%) and Venezuela (5.8%). FDI inflows to financial centres were concentrated in the Cayman Islands (4.6%) and Bermuda (3.1%). Flows to other Caribbean basin countries went primarily to Panama (1.6%), El Salvador (1.1%), Trinidad and Tobago (1%), the Dominican Republic (0.9%), Guatemala (0.9%) and Costa Rica (0.7%).

Preliminary figures for 1999 suggest that Brazil has continued to be the principal destination for FDI in the region. Thanks mainly to the sale of Yacimientos

## NET FDI INFLOWS TO LATIN AMERICA, BY SUBREGION, 1990-1999

(In millions of dollars and percentages)

Subregion/country	1990-1994	1995	1996	1997	1998	Share 1998 (%)	1999 <sup>a</sup>
1. Central America and the Caribbean	1 397	2 005	2 108	4 251	5 776	7.5	5 500
2. Caribbean financial centres	2 506	2 427	3 119	4 513	6 486	8.5	5 000
3. Latin American							
Integration Association	14 238	27 750	41 416	60 640	64 465	84.0	75 420
Argentina	2 971	5 279	6 513	8 094	6 150	8.0	21 000
Bolivia	85	393	474	731	872	1.1	800
Brazil	1 703	4 859	11 200	19 650	31 913	41.6	31 000
Chile	1 219	2 957	4 637	5 219	4 638	6.0	8 900
Colombia	818	969	3 123	5 703	3 038	4.0	350
Ecuador	293	470	491	695	831	1.1	470
Mexico	5 430	9 526	9 186	12 831	10 238	13.3	10 000
Paraguay	98	155	246	270	256	0.3	100
Peru	785	2 000	3 226	1 785	1 930	2.5	1 500
Uruguay	...	157	137	126	164	0.2	100
Venezuela	836	985	2 183	5 536	4 435	5.8	1 200
<b>Total (1+2+3)</b>	<b>18 220</b>	<b>32 182</b>	<b>46 643</b>	<b>69 404</b>	<b>76 727</b>	<b>100</b>	<b>85 920</b>

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, based on information provided by the International Monetary Fund, the United Nations Conference on Trade and Development, and the central banks of each country.

<sup>a</sup> Estimates of the Unit on Investment and Corporate Strategies based on the projections of the relevant countries' central banks or other sources as of 1 December 1999.

Petrolíferos Fiscales (YPF) to the Spanish petroleum company, Repsol, Argentina will pass Mexico to claim second place among the LAIA countries. Meanwhile, Chile will more or less double its FDI inflows in 1999, largely as a consequence of the purchase of Enersis and Endesa-Chile by the Spanish electricity corporation, Endesa-España. Mergers and acquisitions, particularly by Spanish companies, have thus continued to play a very dynamic role in FDI inflows to the larger countries of Latin America in 1999.

Having noted the fact that Brazil received such a large share of the region's net FDI inflows, it should be pointed out that about half of the FDI that went to that country was channelled into just a few service industries in which State assets were being sold as part of the liberalization and deregulation of those sectors (telecommunications and electricity) or in which sales of private local companies have been a significant factor (financial services and retail trade). In all, 37% of the revenues generated by the Brazilian privatization

process came from the telecommunications industry and 33% from the electricity generation and distribution sector. European companies, and especially Spanish firms, have been particularly active in Brazil in these areas.

In the region as a whole, transnational corporations (TNCs) have come to play a much more important role as a consequence of both the globalization process and national policies facilitating new TNC operations (trade and financial liberalization, and the deregulation of specific sectors). A comparison of the assets and sectoral activities of the 500 largest firms (measured by sales) in Latin America during the 1990s makes this quite clear. If this dominant group of companies is divided into three main categories —TNCs, private local firms and State enterprises— then a breakdown of the group's total sales shows that the TNCs' share jumped from 26.6% to 38.7%, that of private local firms held fairly steady at around 40%, and the share of sales corresponding to State enterprises plunged from

35% to 19.1%. An analysis of their sectoral activities shows that manufacturing remained steady at about 42% of total sales, services' share climbed from 30% to 41.2% and primary-sector activities slipped from 27.8% to 17.4%. These figures strongly support the view that seeking market access in services has been one of the dominant strategies used by TNCs in the region during the 1990s. The case study on Brazil presented in the 1998 edition also corroborates this conclusion.

Similar information for the 100 largest manufacturing companies (also measured by sales) demonstrates that the TNCs' share rose from 52.8% to 60.7%, private local companies' share remained steady at about 40% and that of State companies fell from 5.2% to 1.2% of total sales. It is noteworthy that TNCs in the automotive sector saw their share of sales rise from 25.1% to 30.4%, indicating that about one half of the TNCs' total share of manufacturing sales corresponds to this one industry.

Information on the value of the external sales of the 200 largest exporters in Latin America between 1995 and 1998 (earlier data are not available) supplements the available information on the manufacturing sector. These figures show that the manufacturing sector's share held steady at 50% of the value of these firms' exports, while primary activities' share declined from 44.8% to 40.1% and that of services rose from 5.3% to 9.2%. TNCs were by far the most dynamic component of this group of leading exporters, with their share of total exports soaring from 30.6% to 44.8% in 1995-1998, while the automotive TNCs' share surged from 15.2% to 20.3%, thus once again underscoring the importance of this industry in the region. Private local firms maintained their share at about 33% of exports, while State companies' share dropped from 37% to 21.9% of these leading companies' total exports. This provides persuasive evidence that the use of an efficiency-seeking strategy in Latin America for the export of manufactures has played a significant role in strengthening the TNCs' presence in the region. The analysis of the Mexican automotive industry presented in chapter IV of the 1998 edition of this report, the examination of the apparel industry in Mexico and the Caribbean basin in chapter IV of this year's edition and the case study on Mexico appearing in chapter II all support this thesis as well.

An analysis of the consolidated sales of the 100 largest non-financial TNCs operating in six Latin American countries in 1998 indicates that major changes are taking place. Subsidiaries of United States-based TNCs continue to be the single largest

group (43.1% of total consolidated sales), but several European TNCs —based in Germany (10.6%), Spain (10%), France (9.2%) and Italy (5%)— have also established an important presence in the region. The new strength of affiliates of Spanish corporations is discussed in detail in chapter III of this report. The automotive industry (23.6% of consolidated sales) continues to be the sector in which TNCs maintain the greatest presence, but commerce (11.8%), mining/petroleum (10%), telecommunications (9.9%), electronics (9.5%) and electricity (8.1%) are also noteworthy in this regard. Over 70% of the consolidated sales of the top 100 TNCs in the region was accounted for by *Fortune* 500 companies. Viewed from the perspective of external assets, however, only slightly more than 50% of the consolidated sales of these 100 TNCs come from the major TNCs included in the UNCTAD ranking, which suggests that newcomers are playing a significant role in FDI inflows to Latin America. The affiliates of European, and especially Spanish, corporations in the services sector represent a dynamic element of change in terms of the principal transnational economic agents operating in Latin America.

The position of foreign banks has also changed dramatically in Latin America. Although relatively few global banks have extensive networks in the region, the assets held by Banco Santander Central Hispano (BSCH) in six countries of the region add up to almost as much as those of the combined networks of the second- and third-largest foreign banks: Citibank and Banco Bilbao Vizcaya Argentaria (BBVA). Spanish banks account for 32.5% of the total assets of the 20 largest foreign banks in Latin America, thus surpassing their United States-based counterparts, which hold 29.7%. Here again, the affiliates of Spanish banks act as dynamic elements in the expansion of transnational banks in the region.

In terms of modalities, the FDI entering the region during 1998-1999 maintained the existing breakdown of roughly 60% for the creation of new assets and 40% for the purchase of existing assets, even though the volume of FDI increased dramatically. ECLAC data suggest that mergers and acquisitions rose significantly during 1998-1999 while the value of privatizations fell sharply over the same period. The modalities of FDI represent an important aspect of the analysis of this type of investment in the region.

The mergers and acquisitions of 1998-1999 in Latin America were heavily concentrated in three countries: Argentina (45.6%), Brazil (26.4%) and Chile (16.5%). Most foreign investment came from

Spain (53%) and a few other foreign investors: United States (15%), France (9%) and the Netherlands (7.7%). Fourteen large-scale operations of over US\$ 500 million each accounted for 63.9% of the total value of these mergers and acquisitions. In fact, the five largest operations represented almost one half (49%) of the total. The biggest operation by far was the acquisition of the Argentine petroleum company, YPF, by the Spanish petroleum company, Repsol, for more than US\$ 13 billion in 1999. Other major transactions included the purchase of Endesa-Chile and Enersis of Chile by Endesa-España, in two separate operations. Also in the top five were the acquisition of Banco Real (Brazil) by ABN Amro (Netherlands) and Banco Excel (Brazil) by BBVA of Spain.

Most of the privatizations which took place in Latin America during 1998-1999 were in just two countries: Brazil (62.4%) and Argentina (18%). The participation of investor countries was much more diversified than it was in the case of mergers and acquisitions. The three principal investing countries were the United States (14.8%), Spain (8.7%) and Portugal (8.4%). Nonetheless, 24 operations involving more than US\$ 500 million each accounted for over 80% of all such transactions. The top five privatizations corresponded to 39.5% of the total. The airport concessions in Argentina awarded to United States, Italian and Argentine investors were valued at US\$ 5.134 billion. The other four major privatizations took place in Brazil and had to do with operations in the telecommunications and electricity sectors: Telefónica of Spain and a number of other investors purchased Telesp; Portugal Telecom acquired Telesp Cellular; AES and Houston Energy of the United States combined with Electricité du France to purchase Electropaulo Metropolitana de Eletricidad; and EMBRATEL was obtained by MCI Worldcom.

By 1998, two countries —Costa Rica and Bolivia— had met with considerable success in developing and implementing *new* policies linking the attraction of significantly increased FDI inflows to priority activities defined in their development strategies. In the case of Costa Rica, where FDI inflows increased to US\$ 531 million in 1998 (the equivalent of 6% of GDP) and where 64% of the existing FDI stock has entered the country during the 1990s, the new strategy is based on direct contacts with TNCs that have been using efficiency-seeking corporate strategies in high-technology activities, especially electronics. Previously, Costa Rica had had notable success in attracting FDI to the apparel assembly by offering horizontal (fiscal) incentives in export processing

zones (EPZs); however, there was disappointment with the developmental impact of the success of the EPZs in view of the lack of sufficient progress in terms of wage rates, the training of human resources and the integration of those activities into the national economy, together with the fact that other Central American countries began to offer lower wages and more incentives which eventually sapped the buoyancy of the Costa Rican apparel assembly industry. In a master stroke, however, by taking direct action and utilizing selective incentives, Costa Rican authorities succeeded in attracting a US\$ 300 million-US\$ 500 million investment project of the microprocessor giant, Intel, which built an assembly plant and testing facility in Costa Rica. This investment alone amounted to the equivalent of nearly 40% of the value of total exports in 1999 and over 90% of the value of Costa Rica's electronics exports. While the sheer volume and economic impact of this one FDI project is overwhelming, Costa Rica's new policy should not be regarded as having been consolidated until a number of such investments are captured and the country's electronics cluster puts down deeper roots there.

Bolivia attracted US\$ 900 million of FDI in 1998, which was equivalent to 10% of its GDP. Over 70% of its stock of FDI has entered the country during the 1990s. As part of the "Plan for Everyone" (Plan para Todos) development strategy, the capitalization programme for the sale of State assets and the Corazón Act, which provides special benefits for energy exports from border zones, have laid the foundation for a new policy aimed at channeling increased FDI inflows to priority activities and converting Bolivia into a major exporter of energy. The new policy fits in well with the natural-resource-seeking corporate strategies being used by major TNCs, especially those interested in establishing a regional energy network. The privatization programme accounted for more than 50% of FDI inflows in 1995-1998. The most innovative aspect of the Bolivian policy is the idea of using FDI inflows to capitalize mixed firms (50% owned by Bolivian citizens). Some of the large State enterprises that were sold included the petroleum company (YPFB), which accounted for 55.2% of the Plan, the State metal refinery (Vinto), the electricity company (ENDE), the telecommunications company (ENTEL), the railway (ENFE) and the State airline, Líneas Aéreas Bolivianas (LAB). However, the most striking success of the new policy has been in the energy sector, where, in addition to new petroleum exploration and operation contracts, the Corazón Act now offers sizeable incentives that create conditions approximating a

free-trade zone for the energy sector (40-year concessions, duty-free imports of capital goods, no value added taxes, etc.) in order to promote energy exports to neighbouring countries, especially Brazil. In 1999, natural gas exports to Brazil accounted for 26% of the total value of Bolivian exports.

The success enjoyed by Costa Rica and Bolivia in channeling increased levels of FDI to priority activities suggests that there is much more to FDI policy than simply liberalization, deregulation and privatization coupled with increased protection for foreign investors under bilateral, subregional or multilateral investment agreements. The first step is to have a game plan, that is, a development strategy that defines priority activities.

## 2. Mexico: a source of efficiency for TNCs operating in the North American market

Mexican authorities have had a hot-and-cold relationship with foreign investors during the twentieth century. For most of the period following the Mexican Revolution, the authorities maintained a nationalistic and restrictive position on FDI, especially when the petroleum industry was nationalized in the 1930s and when the new Mexican Investment Promotion and Foreign Investment Regulatory Act was passed in 1973. This stance changed radically in the late 1980s, however, when new regulations were added to the above-mentioned Act in 1989 and, then, in 1993, when new legislation was passed. This more recent policy gave a strong boost to FDI inflows and was in keeping with the more prominent role of TNC operations as an engine of growth for the Mexican economy and the possibility of entering into a North American Free Trade Agreement (NAFTA).

Mexico's entry into the General Agreement on Tariffs and Trade in 1986 probably marked the beginning of the shift away from the existing import-substitution industrialization (ISI) framework and towards a more outward-looking growth strategy based on new exports and the liberalization and deregulation of the Mexican economy. FDI was to be a major factor in this new strategy. The impact on TNCs was manifested in three main ways. First, in-bond assembly (*maquila*) operations were given a strong boost by the revitalized policies that facilitated the more widespread use of inexpensive Mexican labour for the assembly of imported inputs into final products (mainly automotive parts, electronic equipment and apparel) destined for the United States market. Second, existing subsidiaries in the manufacturing sector that had been part of the previous ISI policy framework were obliged to react by moving out of the increasingly competitive domestic market, by rationalizing their

production operations in Mexico (usually through the adoption of a defensive strategy to downsize) or by restructuring their overall production system (often by making major new investments to redefine Mexico's role in their internationally integrated production systems). The restructuring of the automotive industry was a milestone event in this regard. Third, increased market access attracted a number of new-entrant TNCs to Mexico in the services sectors (retail trade, telecommunications, financial services, etc.) and in manufacturing (food, beverages, tobacco, etc.). The signing of NAFTA, whereby Canada, the United States and Mexico joined together in an increasingly continental economy, consolidated the changes already taking place in Mexico. In 1990-1995, Mexico was the principal FDI recipient in Latin America, and most of this FDI came from its NAFTA partners.

The main results of the burst of FDI inflows to Mexico can best be understood when considered in terms of the primary corporate strategies being used by foreign investors (i.e., efficiency-seeking and market access-seeking strategies). United States-based TNCs facing sharp competition in their home market from Asian imports of motor vehicles, computers and apparel have been the main ones to set up assembly or production facilities in Mexico in order to lower their production costs by utilizing cheaper Mexican labour and taking advantage of the United States production-sharing mechanism and NAFTA so that they could compete more successfully in the North American market. As a result, Mexico has become the third-largest supplier to that market and TNC exports account for more than one half of all Mexican exports to it. Mexico has specialized in fast-growth items in the North American market (manufactures), gaining sizeable market shares in the process. Two thirds of the

FDI it receives comes from the United States and Canada, a fact which attests to the continental nature of the internationally integrated production systems that are being established. The creation of new assets (plants and equipment) has been much more prevalent than the purchase of existing ones.

The market access-seeking strategy has been associated primarily with the liberalization and deregulation of some service sectors (retail trade, telecommunications, financial services, etc.), with FDI coming from European as well as United States and Canadian TNCs and being concentrated in the purchase of existing assets rather than the creation of new assets. While direct exports from services sectors have been quite limited, this FDI has brought about an improvement in the systemic aspect of the international competitiveness of the Mexican economy.

Some of the obvious benefits of the increased role of FDI in the Mexican economy are evident in its greater integration into the international economy. Exports have risen sharply as a proportion of GDP, and the share of gross fixed capital formation accounted for by FDI has increased as well. Several different manufacturing industries have been strengthened and have become internationally competitive. The systemic competitiveness of the Mexican economy has thus been improved by FDI in services.

These successes have been accompanied by disappointments in other areas, however. The dynamism of the FDI-dominated segment of the

Mexican economy has not been great enough to raise the economy's overall long-term growth rate significantly, and the economy has become increasingly polarized as a consequence of the modern and the more traditional sectors' limited degree of integration. Mexico's success in becoming internationally competitive has been confined to a single market: North America. The national industrialization process has been cut short in some instances because efficiency-seeking TNCs have relied primarily on imported physical inputs and because the United States production-sharing mechanism penalized Mexican inputs. In addition, some problems of a regulatory nature have been encountered in telecommunications and financial services.

This analysis suggests that Mexican policy-makers could build upon these accomplishments and work to remedy problems where they exist. Further efforts need to be made to diversify export markets (such as Europe and Latin America) and FDI sources (Europe and Japan). The integration of the modern and traditional areas of the Mexican economy is vital to overall success. In part, this can be accomplished by taking greater advantage of NAFTA rules of origin, which, unlike the United States production-sharing mechanism, permit the incorporation of competitive Mexican inputs into final products destined for export markets. Thus, a much stronger programme is called for to promote and backstop Mexican suppliers, together with increased efforts to upgrade human resources through training.

### **3. Spain: a handful of aggressive investors dominate some of the principal service industries in Latin America**

The Spanish economy has been rapidly getting up to speed in terms of its integration into the international system. Previously, it had served as a gateway to the European market by hosting the export platforms of foreign investors. Now it has turned into a foreign investor itself and is focusing its attention increasingly on Latin America and, more specifically, on Mercosur, Chile and the Andean countries. Latin America's share of Spain's total FDI soared from 29% to 72% between 1990 and 1998. A very large proportion of those FDI flows went to services such as telecommunications, energy generation and distribution (electricity, gas,

petroleum) and financial services. A handful of Spanish TNCs accounted for the bulk of it.

The globalization process —understood as a long-term shift towards a single universal market— seems to be what is driving the international expansion of these Spanish corporations. They are in a hurry to set up their international systems, and the fact that the sectors in which they operate are being liberalized and deregulated under the General Agreement on Trade in Services (telecommunications and financial services) or the Directives of the European Commission (electricity) or are undergoing global shakeouts as a result of mega-mergers and mega-acquisitions



(petroleum and banking) is viewed by these corporations as a strategic opportunity. Both the established and the aspiring global players in these service industries are currently using FDI and strategic alliances as a means of positioning themselves.

For the Spanish TNCs that are now moving onto the global stage, very significant changes in the competitive situations of the international, European, Spanish and Latin American markets have obliged firms aspiring to world-class player status to embark upon extremely aggressive international expansion strategies. Some of the biggest Spanish corporations in telecommunications (Telefónica), financial services (BSCH and BBVA), energy generation and distribution (Endesa-España, Iberdrola, Repsol) and other service industries (Aguas de Barcelona, Iberia), are taking advantage of cultural and linguistic links to launch their international expansion drives *mainly in Latin America*. The principal corporate strategy of these firms is to obtain market access in services undergoing liberalization, deregulation and privatization in the region.

Telefónica, Spain's privatized telecommunications company, has become the largest Spanish-language telecommunications company in the world, and it has accomplished this mainly by taking advantage of the privatization of State telecommunications companies in Latin America. For example, its ranking in the global *Fortune* 500 rose from No. 239 in 1997 to No. 193 in 1998. After investing over US\$ 10 billion in the region (mainly in the form of mergers and acquisitions), 31% of its total assets are now foreign ones and it has 49 million customers in Argentina, Brazil, Chile, Peru, Central America and Puerto Rico. Telefónica plans to invest another US\$ 20 billion in Latin America to consolidate its dominant position in the Spanish- and Portuguese-speaking world and has established strategic alliances with MCI Worldcom and Portugal Telecom as well as other Spanish TNCs (Iberdrola and BBVA).

The Spanish banks BSCH and BBVA, themselves products of mergers during the 1990s, have been at the forefront of the consolidation process taking place in Spain's financial sector. The top three banks in Spain account for 45% of the sector's total assets, and the top six account for 67%. In Europe, the establishment of a solid national network of banks has proved to be an effective way for national banks to avoid being taken over by foreign institutions. These two Spanish banks have done just that and have, in addition, expanded into Latin America, where BSCH, BBVA and Citicorp possess the most extensive networks. In the

international ranking of the leading 1,000 banks published by *The Banker*, these banks moved up from No. 40 to No. 37 and from No. 50 to No. 47, respectively, between 1997 and 1998. BSCH and BBVA have invested over US\$ 10 billion in the region and, in addition to their large regional networks, with assets exceeding US\$ 20 billion and more than 16 million customers, they already figure among the region's leading private pension fund managers. It should also be noted, however, that these Spanish banks were assigned two of the three highest risk ratings out of all 50 of the major European banks in February of 1999.

Endesa-España and Iberdrola have led the international expansion drive of Spanish electricity companies. Endesa is the principal electricity company in Spain and in Latin America and ranks third in the European Union. It invested over US\$ 8 billion in 12 countries during 1992-1998 and has acquired major operations in seven Latin American countries; in most cases it has accomplished this by participating in local privatization programmes, but it has also used strategic alliances, as was originally the case with Enersis of Chile. In all, 40% of its profits are generated in Latin America, where it has 25 million customers. Iberdrola, for its part, has invested over US\$ 2 billion in six countries of Latin America and has about 15 million customers there.

Repsol, the privatized Spanish petroleum company, has invested over US\$ 19 billion in Latin America, with its most recent acquisition being the previously privatized petroleum company of Argentina, YPF. It has engaged in mergers and acquisitions of petroleum companies or acquired concessions for petroleum exploration in eight other countries of the region. Thanks in large part to its Latin American assets, Repsol is becoming an increasingly important petroleum group in the international marketplace, rising from No. 257 in 1997 to No. 224 in 1998 in *Fortune's* global 500.

Thus, as a whole, Spanish FDI in Latin America and the Caribbean in the 1990s has been very significant and has produced notable effects. These six aspirants to global player status, many of which are themselves privatized companies, have taken advantage of privatization processes in a few service sectors in Latin America in order to expand internationally. They have concentrated their mergers and acquisitions in Mercosur, Chile and the Andean countries. Some have also used the fact that the Spanish Government remains an important shareholder to their advantage. While their rapid expansion has generated



some local concern about the “Spanish reconquest” of its former colonies, the most serious difficulties associated with this process have stemmed from the weak and underdeveloped regulatory frameworks of the host countries, the effects of this drive on

competition, and the financial challenge that such a large-scale campaign signifies for these Spanish firms, given the weak performance of the economies in which they are doing business.

#### **4. The implications for Latin America of the restructuring of the North American apparel industry**

Industrial-country imports as a whole have been quite buoyant, and wearing apparel is one of the more dynamic components of import flows to the North American market, rising from 2.5% to 4.7% of the value of that market's total imports between 1980 and 1996. Imports now account for more than one half of total apparel sales in the United States in spite of that country's long-standing use of unilateral quotas under the Multifibre Arrangement and the fact that the apparel industry has one of the highest levels of tariff protection in the United States market (15.5% in 1997).

Asian countries have led the surge of apparel exports worldwide. Several of Asia's newly industrializing economies (Hong Kong SAR, Taiwan Province of China, the Republic of Korea) have been able to develop strong textile industries while also serving as intermediaries for major international buyers that have come to rely on them to produce full-package apparel on the basis of the buyer's designs, especially in the more dynamic fashion segments of apparel production. Some have even developed their own original brands. Other Asian countries have served as assembly sites for these intermediary-based systems. China had impressive import market shares in all major markets in 1996, with a 17.7% share of the OECD market, 8.4% of Europe's, 15.3% of North America's and 58% of Japan's. This “Asian challenge” provoked a strong reaction from United States apparel producers and some buyers, however, and the most obvious consequence was that the Asian countries' share in United States apparel imports dropped from 80% in 1980 to 44% in 1996 while that of the Latin American countries jumped from 6% to 28% over the same period. In effect, what United States apparel producers and buyers did was to seek greater efficiency for their subsidiaries, affiliates, associates and suppliers in Latin America (chiefly Mexico and the Caribbean basin) by taking advantage

of lower wages in order to compete better in the North American market.

Initially, United States authorities facilitated the use of this corporate strategy by local apparel firms through a production-sharing mechanism (TSUS 807, later HTS 9802) that allowed the reimportation of United States-made apparel components assembled into final products in lower-wage countries, with duty being charged only on the value added outside of the United States. The Latin American supplier countries were given preferential access to the United States market and their Governments rounded out this new competitive situation by offering tax and duty incentives in the form of export processing zones, as well as other advantages. Between 1993 and 1997, the total amount of United States apparel imports that entered the country by way of the production-sharing mechanism rose from 10% to 21% of total United States apparel imports, with Mexico (36.6% in 1997) and the Caribbean basin countries (55.9%) together accounting for over 90% of the imports coming in via that mechanism. Less than 1% of the value of United States apparel imports entering the country through the production-sharing mechanism came from Asian countries. Over 80% of Mexico's and the Caribbean basin's total apparel exports to the United States were brought in via the production-sharing mechanism.

The NAFTA provisions concerning apparel produced a split in terms of the implications for the region of the restructuring of the North American apparel industry, since NAFTA gives Mexico advantages that the Caribbean basin countries do not share. First, Mexican apparel is assessed at significantly lower implicit tariff duties (0.9% compared to 8.5% for the Caribbean countries). Second, Mexico faces fewer quotas and is able to conduct value-adding finishing processes (bleaching, garment dyeing, stone washing, permapressing, etc.). Third, under the NAFTA rules of origin Mexican

inputs are classified as NAFTA inputs, which has allowed a more integrated textile/apparel industry to begin to emerge. As a result, Mexico's share in United States apparel imports jumped from 7.4% in 1995 to 15.3% as of June 1999, while that of the Caribbean basin countries has only risen from 15.7% to 17.9% (and only Honduras and El Salvador have made significant advances). Mexico has thus displaced China as the principal supplier of apparel to the United States market. New FDI in textiles and apparel has generated an incipient cluster formation process, and this trend is particularly noteworthy in products such as men's and women's cotton trousers, especially blue jeans (where Mexico has an import market share in the United States of over 50%). The new opportunities opened up by full-package production raise the possibility that Mexico could become the "Hong Kong of Latin America".

The Caribbean basin countries have been locked into a low-wage/production-sharing/export-processing zone mode of delivery to the United States market that offers none of the new advantages enjoyed by Mexico

under NAFTA. Because they have been losing import market shares to Mexico, they (unsuccessfully) requested that the United States Congress accord them NAFTA parity. Mexico's NAFTA advantages, unfortunately, are just one of the new challenges to be faced by the Caribbean basin apparel assemblers. The last tranche of the Agreement on Textiles and Clothing that was signed under the aegis of GATT in 1994 will be subject to a new trade discipline (instead of the MFA quotas) as of 2005. Most of the apparel exports of the Caribbean basin are found in the last tranche. Its liberalization will mean that the Caribbean basin apparel assemblers will have to compete (without EPZs or market preferences and with significantly higher wage rates) with Asian powerhouses such as China. While Mexico possesses an integrated textile/apparel industry in which full-package options are emerging (although a great deal remains to be done in order to take full advantage of the NAFTA rules of origin), the Caribbean basin apparel assemblers will quite probably face a "race to the bottom" in respect of wage rates and FDI incentives in that industry.



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## INTRODUCTION: A NORMATIVE CHALLENGE



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The 1998 edition of *Foreign Investment in Latin American and the Caribbean* began with a discussion of the very significant **statistical** challenge which faces anyone interested in making sense out of the large but heterogeneous pool of official information available on foreign direct investment (FDI). It was pointed out that the very significant differences that exist in terms of the methodology, definitions and coverage of the principal official sources of statistical information result in a less than full understanding of FDI as an economic phenomenon. Consequently, policy-making in this field becomes unnecessarily difficult. Efforts to promote methodological convergence have been applauded by ECLAC, yet a great deal more remains to be done.

Another challenge—of a **normative** nature—also complicates policy-making by national authorities in relation to foreign investment. Simply put, there has been a proliferation of bilateral, plurilateral and multilateral agreements and negotiations in this field aimed at establishing basic legal norms to accommodate FDI flows within the context of the globalization process. The result has been more confusion than clarity (see also UNCTAD, 1999a, chapter IV). The challenge is to harmonize international rules and norms on FDI with existing

national laws and regulations (see figure) in order to serve the interests of *both* capital-importing and capital-exporting countries. However, it seems highly probable that investment will not figure among the topics on the agenda for the upcoming Millenium Round of the World Trade Organization (WTO).

The reader may recall that the following figure was used in the 1998 report as an interpretive scheme to permit a better understanding of foreign investment and other aspects of the international expansion of transnational corporations in the course of the

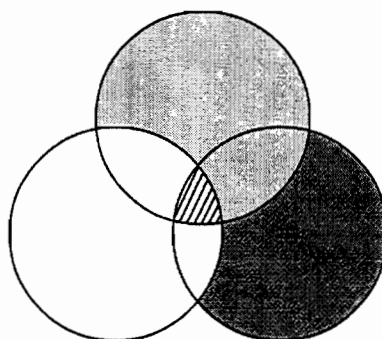
globalization process. This scheme provided a means of examining the intersection of three groups of factors: international market factors, national policies and corporate strategies. Clearly, the international and national legal contexts for FDI (highlighted in the

figure) need to be harmonized in order to facilitate the implementation of corporate strategies and the use of FDI to promote the achievement of national development goals.

### AN INTERPRETIVE SCHEME: THREE SETS OF FACTORS

#### 2. NATIONAL POLICIES

- general rules and norms
- sectoral regulations
- systemic competitiveness of host country
- policies related to FDI, technology, intellectual property, quality standards, etc.



#### 3. CORPORATE STRATEGIES

- strategies for taking advantage of international market trends and national policies
- seeking:
  - efficiency
  - market access
  - raw materials
  - strategic elements
- implementation of integrated international production system:
  - investment**, technology, human resources, supplier networks, etc.

#### 1. INTERNATIONAL MARKET FACTORS

- market structure
- nature of competitors
- technological aspects
- international rules and norms:
  - trade, **investment**, technology, intellectual property, quality, etc.

The reader may also recall that in 1948 the Havana Charter was drafted with a view to creating an International Trade Organization (ITO) within the framework of the United Nations. The goals envisioned for this organization were to promote not only world trade discipline but also new international rules on employment, commodity agreements, restrictive business practices, international investment and services (WTO, 1995, p. 8). While the General Agreement on Tariffs and Trade (GATT) worked towards world trade discipline, most of the other provisions never came into effect because the ITO initiative was not ratified by the United States Congress. During the ensuing 50 years, not a single multilateral initiative has succeeded in establishing common rules for FDI. The result is a confusing collage of partial measures that are generally of a limited scope in either sectoral or geographical terms. Examples of the former—all of which have been concluded within the context of the GATT/WTO—include the General Agreement on Trade in Services (GATS),<sup>1</sup> which deals with telecommunications, financial services, and air transport; the agreement on trade-related investment measures (TRIMs)<sup>2</sup> affecting mainly the automotive, chemical and petrochemical and computer and informatics industries (UNCTAD, 1991, p. 3); and the agreement reached concerning trade-related aspects of intellectual property rights (TRIPs),<sup>3</sup> which has chiefly had an impact on such industries as pharmaceuticals,

biotechnology and computer software. Examples of mechanisms of this type whose geographical scope is confined to the Americas include free trade agreements such as the North American Free Trade Agreement (NAFTA) and the Southern Common Market (Mercosur) and by the negotiations now under way concerning the Free Trade Area of the Americas (FTAA).

One of the principal reasons for this confusion is that international negotiations have focused almost entirely on trade issues, while the growing need for common FDI norms has only recently reached a critical level. This has produced a curious situation, inasmuch as the priority assigned to trade, which can be considered more of an effect than a cause of economic growth, has been equal to or higher than that of foreign investment, which can be considered more of a cause than an effect of economic growth. Trade liberalization has preceded financial liberalization and deregulation, but both have tended to be analysed and implemented in similar ways. From an analytical perspective, the cart was thus put before the horse. Trade logic and investment logic have been only partially aligned.

Another of the reasons is that the initial burst of activity in the establishment of investment agreements took place in the context of the search for more guarantees and protection on the part of capital-exporting countries and in that sense, it might be considered one-sided. This has resulted in the

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- 1 The GATS is the first multilaterally-agreed and legally-enforceable set of rules and disciplines governing international trade in services ever to be negotiated. The agreement contains three central elements: a framework of general rules and disciplines (presence of the service supplier and modes of delivery, national treatment, most-favoured-nation treatment, transparency, recognition of qualifications, payments, market access schedules and progressive liberalization); annexes addressing special conditions relating to the individual sectors covered (financial services, telecommunications and air transport services, plus one on the temporary movement of key personnel); and the national schedules of market access commitments. This can be considered a kind of framework for a multilateral investment promotion and protection agreement for services sector. It is primarily a "bottom-up" or "positive list" approach in which the national treatment obligation only applies to those sectors listed in the schedules of specific commitments undertaken by the Contracting Parties.
  - 2 The TRIMs agreement applies only to trade in goods. The agreement recognizes that certain investment measures (such as local-content, trade-balancing, and import-substitution requirements, investment incentives combined with export requirements, etc.) can restrict and distort trade, and it therefore prohibits any such measures that are inconsistent with articles III (national treatment) and/or XI (prohibition of quantitative restrictions) of the GATT (WTO, 1995, p. 31). Non-conforming TRIMs are to be notified and progressively eliminated. The agreement contains a clause which provides that, by 1 January 2000, consideration should be given to the question of whether or not it should be complemented by provisions on investment policy and competition policy.
  - 3 The TRIPs is not explicitly about investment, it deals with a central aspect of the legal environment in which foreign investors operate, national provisions on the protection of their intellectual property (Otten, 1996, p. 4). For the major transnational corporations that account for most of global FDI flows, the protection of intangibles can be just as important as the protection of physical assets. This agreement establishes rigorous national-treatment and most-favoured-nation obligations regarding copyrights, trademarks, geographic indications, industrial designs, patents, lay-out designs of integrated circuits and undisclosed information or trade secrets. The agreement also provides for effective enforcement measures to uphold those rights and for multilateral dispute settlement procedures.

progressive implementation of a quite tightly-knit network of bilateral investment treaties<sup>4</sup> (BITs)—over 1,720 by end-1998 (UNCTAD, 1999a, p. xviii)—which cover a high percentage of the total value of foreign investments (Häde, 1998, p. 68). Generally, these BITs have provided the guarantees and protection sought by capital-exporting countries but they have not made a significant contribution to the creation of the sorts of national policy instruments needed to channel FDI to priority activities and thus accelerate the national development process of capital importers. Hence, although BITs have created a tightly-knit network of investment agreements, no uniform multilateral standards have yet been achieved (Brittan, 1995, p. 7).

It might be mentioned in this context that capital-exporting countries attempted to establish more uniform standards in the Multilateral Agreement on Investment (MAI) drafted by the members of the Organisation for Economic Co-operation and Development (OECD), which account for 85% of global FDI outflows, and have thus, in principle, expressed the highest aspirations of capital-exporting countries. This initiative served to consolidate the trend that began in the 1980s whereby the emphasis was being shifted away from the investing firms' obligations in terms of the national priorities and government rights of the capital-importing country and towards the investing corporations' rights and the capital-importing country's government obligations (Brewer and Young, 1995, p. 70).

The features of the proposed MAI were described by the OECD Committee on International Investment and Multinational Enterprises (CIME) and the OECD Committee on Capital Movements and Invisible Transactions (CMIT) in the following fashion (OECD, 1995a, pp. 4-5):

The MAI would build on the achievements of the present OECD instruments, consolidating and strengthening existing commitments under the Codes of Liberalization and the 1976 Declaration and Decisions on International Investment and Multinational Enterprises. The aim of the negotiations is to conclude an agreement incorporating rollback, standstill, national treatment and non-discrimination/ most favoured nation (MFN) as well as new disciplines to improve market access and to strengthen the basis of mutual confidence between enterprises and states. The obligations under the agreement would need to be reinforced by effective dispute settlement procedures.

The agreement would be comprehensive in scope, covering all sectors under a broad definition of investment focusing mainly on FDI. The MAI would aim to raise the level of existing liberalisation based on a "top-down" approach under which the only exceptions permitted are those listed when adhering to the agreement and which are subject to progressive liberalisation. The multilateral character of the agreement would be reinforced by embodying the principles of national treatment and non-discrimination/MFN and by opening it to accession by non-Member countries.

In particular, the aim of the negotiations is to achieve an agreement, with a satisfactory scope and balance of commitments, that would:

- set high standards for the treatment and protection of investment;
- go beyond existing commitments to achieve a high standard of liberalisation covering both the establishment and post-establishment phase with broad obligations on national

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4 BITs impose certain obligations on the contracting parties with respect to the treatment of foreign investment as well as establishing dispute settlement mechanisms to enforce the fulfilment of those obligations (UNCTAD, 1998, p. 1). Although BITs have no single format, they tend to deal with some or all of the following aspects of each contracting party's foreign investment policy (UNCTAD, 1998; OAS, 1997; and IDB, 1998): (1) legal foundations for foreign investment (clarifying the security provided for such investments based on constitutional, legal and administrative provisions); (2) the scope of application of the BIT (basic definitions, entry into force, amendment); (3) investment admission procedures (identifying entry restrictions and conditions); (4) general standards of treatment (both absolute principles, such as fair and equitable treatment, full protection and security, prohibition of arbitrary or discriminatory measures, and relative ones, such as most-favoured-nation treatment and the national treatment standard); (5) nationalization, expropriation and compensation (definition of event, stipulation of acceptable conditions, norms regarding compensation); (6) war and civil disturbance (treatment and compensation, if any); (7) transfer of payments (specifies the status of investment-related capital flows and payments according to their purpose and coverage, and the protection provided); (8) other specific protection clauses, such as limits on performance requirements (local content, trade balancing, export levels, import-substitution practices, etc.), obstacles to entry of foreign nationals, obligations on use of local personnel, etc.; (9) transparency of local laws and administrative practices (publication of laws and regulations); and (10) dispute settlement mechanism and norms (State to State, International Centre for Settlement of Investment Disputes (ICSID) clause, judicial access).

treatment, standstill, roll-back, non-discrimination/MFN, and transparency, and apply disciplines to areas of liberalisation not satisfactorily covered by the present OECD instruments;

- be legally binding and contain provisions regarding its enforcement;
- apply these commitments to all parties to the MAI at all levels of government;
- deal with measures taken in the context of regional economic integration organisations;
- encourage conciliation and provide for effective resolution of disputes, taking account of existing mechanisms;
- take account of Member countries' international commitments with a view to avoiding conflicts with agreements in the WTO such as GATS, TRIMs, and TRIPs; and with tax agreements; and similarly seek to avoid conflicts with internationally accepted principles of taxation.

The agreement would make an important contribution to strengthening the multilateral system by providing better protection, further liberalisation and a basis for co-operation with non-Members.

Evidently, the promoters of the MAI initiative were trying to take advantage of the momentum of the recently concluded Uruguay Round, which had made very significant advances in trade liberalization and in the institutionalization of automatic dispute settlement processes in the newly-created WTO (OECD, 1995b). This is reflected quite clearly in the following passage (OECD, 1995a, p. 4):

A carefully constructed investment agreement would not only ensure that there is no conflict between the investment and trade regimes but that these complement one another until such time as they might perhaps be successfully integrated. A state-of-the-art agreement negotiated in OECD would be an important step on the road to a truly universal investment regime.

The aim of the MAI (which was originally to be concluded at the meeting of the OECD Ministerial Council in 1997) was to move swiftly to ensure that a trade-liberalization approach would be taken to investment matters so as to reflect the priorities of the

like-minded capital-exporting countries. OECD attempted to convince non-members that, since trade and FDI were major engines of growth in developed and developing countries alike, the case for opening markets to investment was as compelling as it was in the area of trade (OECD, 1998, p. 9). The clear implication was that developing countries that did not embark upon an MAI-style liberalization process would attract less FDI.

In early 1998, "the sinking of MAI" was proclaimed (*The Economist*, 1998a), and the Secretary-General of OECD responded by stating that he had always believed that the ultimate objective had been an investment agreement within WTO (i.e., not OECD) (*The Economist*, 1998b). Why had the obvious need for universal investment rules not produced positive results in the case of the MAI initiative?

There are at least four important elements involved in explaining the lack of success. First, the internal conflicts of the OECD members demonstrated that even the like-minded capital exporters were unwilling to apply the general rules fully. Their negotiations produced more than 300 pages of reservations and exceptions, which suggested that the initiative might not represent a substantial improvement over the existing bilateral investment treaties. Second, OECD was not the appropriate forum for this initiative. For one thing, it was voicing the opinion of capital exporters alone and, for another, while it often produces technically sound research, it has no competitive advantage in organizing legal negotiations. Furthermore, unlike WTO, it has no formal dispute settlement mechanism. Third, the process was quite secretive and exclusive, and this raised suspicions among non-government organizations (NGOs), especially those concerned with labour and environmental issues (Kobrin, 1998). A fourth aspect had to do with the possibility that the proposed rules regarding the liberalization of investment might be at odds with the policy needs of Governments of developing countries as they relate to financial stability (Agosin, 1999; Bhagwati, 1998) and to the requirements of industrial or development policy (Fitzgerald, 1998; Ganesan, 1998; South Center, 1997; and *Third World Economics*, October 1998).<sup>5</sup> It is this last point which we consider to be central to the normative challenge. Developmental considerations

5 UNCTAD has produced a very useful series of publications on the multilateral framework for investment issues that deals with several of the legal questions related to the negotiation of investment agreements (see bibliography).



must be given as much attention as investor guarantees and protection if functional multilateral rules for investment are to be negotiated.

As Dunning has pointed out, simply attracting FDI is no longer enough. Host countries must be able to evaluate (among other things) what competitive

advantages they derive from FDI and what it costs them (Dunning, 1994). It has become more than obvious that the developmental impact of FDI and the significant differences between investment and trade as economic phenomena must be explicitly taken into consideration in the process of establishing universal rules for FDI.

### **CHECKLIST OF ISSUES PROPOSED FOR ANALYSIS BY THE WTO WORKING GROUP ON THE RELATIONSHIP BETWEEN TRADE AND INVESTMENT**

It has been widely recognized that the working group's programme of activities should be open, non-prejudicial and capable of evolving as the work proceeds. It has also been emphasized that the development dimension of all the elements —not only those listed in category 1— should be a prime concern. Particular attention should be paid to the situation of least developed countries. In pursuing the items listed in its work programme, the Working Group should avoid unnecessary duplication of tasks performed by UNCTAD and other organizations.

#### **1. Implications of the relationship between trade and investment for development and economic growth, including:**

- Economic parameters relating to macroeconomic stability, such as domestic saving, fiscal position and the balance of payments;
- Industrialization, privatization, employment, income and wealth distribution, competitiveness, transfer of technology and managerial skills;
- Domestic conditions of competition and market structure.

The working group should seek to benefit from the experience of members at different stages of development, should take account of recent trends in foreign investment flows and should examine the relationship between different kinds of foreign investment.

#### **2. The economic relationship between trade and investment:**

- The degree of correlation between trade and investment flows;
- The determinants of the relationship between trade and investment; the impact of business strategies, practices and decision-making on trade and investment;
- The relationship between the mobility of capital and the mobility of labour; the impact of trade policies and measures on investment flows, including the effect of the growing number of bilateral and regional arrangements;
- The impact of investment policies and measures on trade; country experiences regarding national investment policies, including investment incentives and disincentives;
- The relationship between foreign investment and competition policy.

#### **3. Stocktaking and analysis of existing international instruments and activities regarding trade and investment:**

- Existing WTO provisions;
- Bilateral, regional, plurilateral and multilateral agreements and initiatives;
- Implications for trade and investment flows of existing international instruments.

#### **4. On the basis of the work detailed above:**

- Identification of common features and differences, including overlaps and possible conflicts, as well as possible gaps in existing international instruments;
- Advantages and disadvantages of entering into bilateral, regional and multilateral agreements establishing given investment rules as considered, *inter alia*, from a development perspective
- The rights and obligations of home and host countries and of investors and host countries;
- The relationship between existing and possible future international cooperation initiatives relating to investment policy and between existing and possible future international cooperation initiative with regard to competition policy.



WTO has already set up a working group to look into this matter in conjunction with UNCTAD (see box). Clearly, the development concerns of capital-importing countries must be reflected in any universally-accepted set of rules regarding FDI, as must the guarantees and protection sought by capital-exporting countries.

Within this context, and given the fact that several Latin American countries have entered into relatively more advanced FDI agreements —such as the investment chapters of the North American Free Trade Agreement (NAFTA), the Canada-Chile free trade agreement, the Mexico-Chile economic

complementarity agreement, bilateral investment treaties such as the agreement reached between the United States and Bolivia, and the negotiations concerning the Group on Investment that are being pursued within the framework of the Free Trade Area of the Americas— one of the specific normative challenges facing Latin America and the Caribbean is how to introduce new development-related considerations into FDI agreements, as well as to adapt those concluded under the aegis of WTO (GATS, TRIMs and TRIPs). It might be recommended that a clearer understanding of the FDI phenomenon and its relationship to trade precede the negotiation of multilateral rules on investment.





## **I. REGIONAL OVERVIEW**

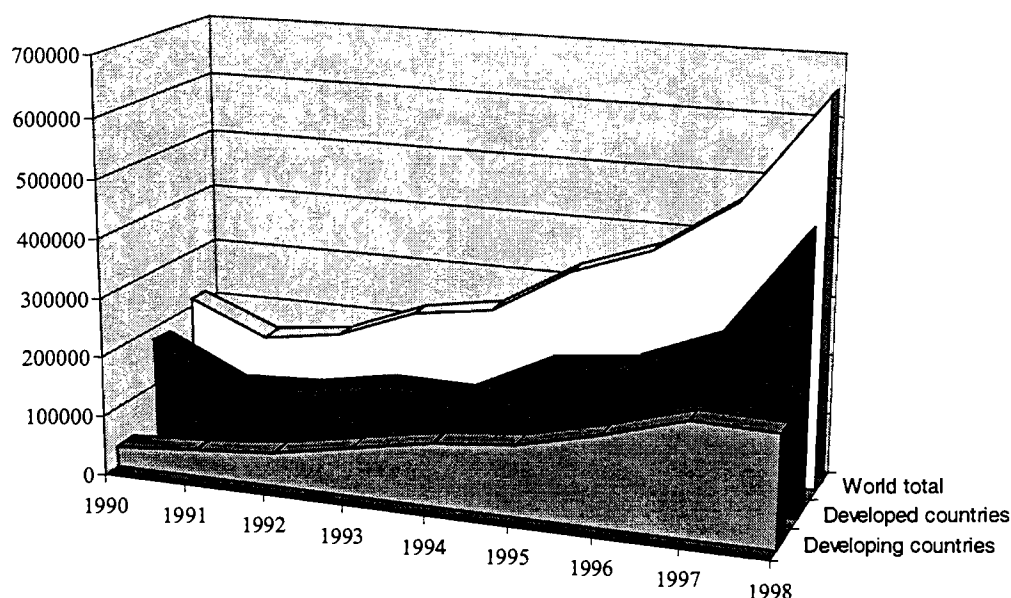


### **A. RECENT TRENDS IN NET FOREIGN DIRECT INVESTMENT (FDI) FLOWS TO LATIN AMERICA AND THE CARIBBEAN**

#### **1. The overall situation**

In 1998, worldwide foreign direct investment (FDI) flows set a new record, surpassing the previous year's figure by 38.5% to top US\$ 651.44 billion (see figure I.1). This result is even more significant than the figures themselves suggest, since it occurred under circumstances that have a negative influence on foreign capital movements. Among other factors in 1998, the crisis in the Asian countries deepened and spread to Russia and Brazil, credit became scarcer, and investors shied away from emerging markets (IMF, 1999; Institute of International Finance, 1999; UNCTAD, 1999a).

Figure I.1  
**NET INFLOWS<sup>a</sup> OF FOREIGN DIRECT INVESTMENT**  
*(Millions of dollars)*



**Source:** ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, based on information provided by the International Monetary Fund (IMF) and *World Investment Report 1999*, United Nations Conference on Trade and Development (UNCTAD).

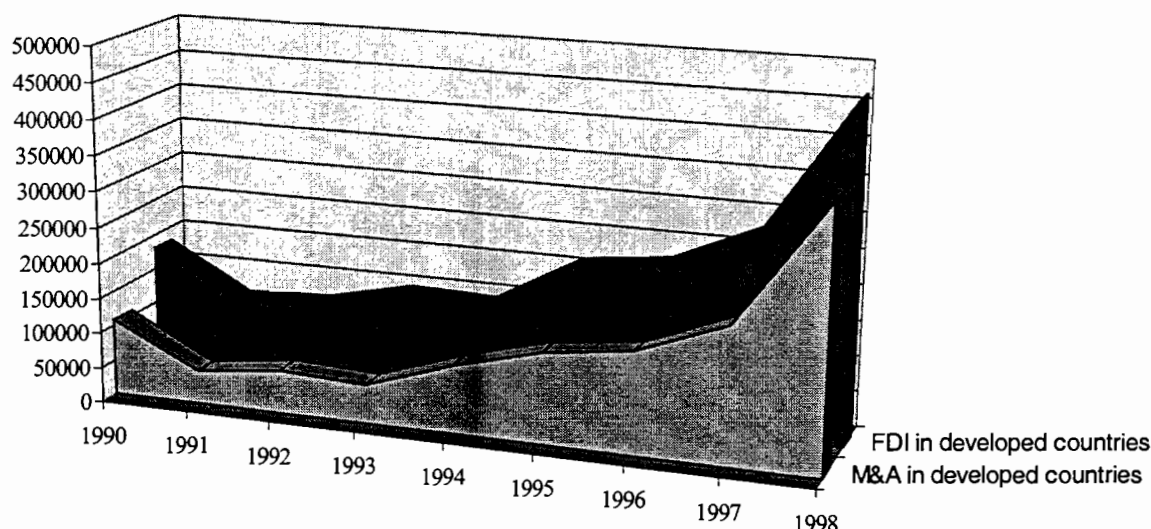
<sup>a</sup> Net FDI inflows cover all incoming capital whose purpose is to obtain a long-standing interest of at least 10% in a local company for foreign investors. The "net" concept means that capital inflows are expressed after deducting profit remittances and capital repatriation.

The main recipients of these larger global FDI flows have been developed countries, which saw their share of total net inflows rise from 59% to 71% between 1997 and 1998. As a consequence, the gap with respect to developing countries widened (see figure I.1), thereby reversing the trend seen during the last several years for FDI flows to be directed increasingly towards developing countries (ECLAC, 1998c).

Following the pattern of recent years, capital flows from developed countries in 1998 went largely to other developed countries - particularly those of the "triad" (North America, the European Union and Japan),

which accounted for nearly 93% of FDI inflows and 91% of all outflows (UNCTAD, 1999a, p. 33). This pattern was reinforced by the higher risks associated with investments in emerging markets, the strength of the United States economy and the advent of a single currency (the euro) in Europe. The onward march of the globalization process has also led to major changes in the strategies pursued by major transnational corporations, many of which have been involved in large-scale merger and acquisition (M&A) drives (see chapter III). A significant proportion of global FDI flows can be attributed to these mega-mergers (see figure I.2), and in 1999 this trend has strengthened

Figure I.2  
**DEVELOPED COUNTRIES: NET INFLOWS OF FOREIGN DIRECT INVESTMENT,  
 AND MERGERS AND ACQUISITIONS (M&A),<sup>a</sup> 1990-1998**  
*(Millions of dollars)*



Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, based on information provided by the International Monetary Fund (IMF); *World Investment Report 1999*, United Nations Conference on Trade and Development (UNCTAD); and KPMG Corporate Finance, *Dealwatch*, September 1999.

<sup>a</sup> In preparing its estimates, KPMG Corporate Finance uses a methodology based on the use of the specialist international press to monitor announcements of mergers and acquisitions involving both public- and private-sector firms. The figures used by ECLAC correspond to cross border operations in which a foreign investor acquires more than 50% of the voting stock in the resulting firm or institution.

further; it will therefore come as no surprise if FDI flows to developed countries turn out to have risen to new all-time highs.<sup>6</sup>

Developing countries, by comparison, suffered the most from the unfavourable international economic climate, with their share of world FDI falling back from 41% to 29% between 1997 and 1998. As a result, net FDI inflows to developing countries declined in absolute terms for the first time in the last 13 years (UNCTAD, 1999a, p. 45) (see figure I.1).

This reversal was mainly due to a steep drop in net FDI inflows to the developing countries of Asia, particularly Indonesia, Taiwan Province of China and

the Hong Kong Special Administrative Region of China. As a result, developing Asia's share of total FDI flows to developing countries slipped from 47.8% to 44.3% between 1997 and 1998 (see figure I.3). Nonetheless, developing Asia, headed by China, still absorbed more FDI inflows than any other developing region.

The Latin America and Caribbean region has continued to receive record levels of FDI, with inflows totalling US\$ 76.727 billion in 1998, or 41% of total FDI flows to developing countries, which was an increase of 10.6% over the previous year (see figure I.3). Of these inflows, however, 42% was concentrated

6 According to the KPMG consultancy, the number of M&A operations increased significantly in the first three quarters of 1999, and the size of the transactions involved has also grown over the past year. Companies from the European Union have been the most active, accounting for 70% of all cross border M&A operations. The United States remains the most important destination, with 30% of transactions, while Argentina and Chile are the leaders in Latin America. The telecommunications industry has been the most dynamic destination sector, followed by chemicals and then food, beverages and tobacco.

in a single economy, namely Brazil, which is remarkable given the instability displayed by the Brazilian economy since October 1997 (ECLAC, 1999b). Foreign investors seem to have optimistic expectations for the medium and long terms in this case, and are therefore making the most of ongoing

privatization processes to gain positions and expand their operations in the region's largest market. Other regions of the world, such as Africa and the developing countries of Europe, lag considerably behind in terms of their position as FDI recipients.

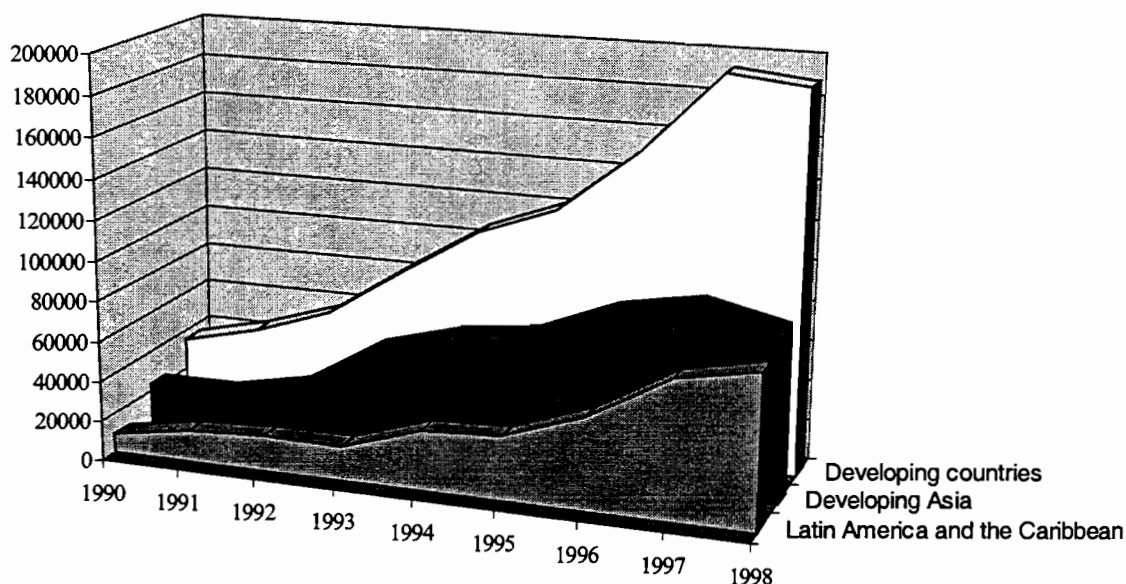
## 2. The situation in Latin America and the Caribbean

The new all-time record set for FDI in Latin America and the Caribbean in 1998 would appear to suggest that the region has managed to overcome most of the negative circumstances affecting investment flows to developing countries. It has been aided in this effort by

the simultaneous appearance of new and interesting alternatives for foreign investors, most of which involve the acquisition of existing assets.

During 1998-1999, the Asian crisis seems to have had less of an impact on net FDI inflows to the region

Figure 1.3  
NET FLOWS OF FOREIGN DIRECT INVESTMENT TO DEVELOPING  
REGIONS, 1990-1998  
(Millions of dollars)



Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, based on information provided by the International Monetary Fund (IMF); *World Investment Report 1999*, United Nations Conference on Trade and Development (UNCTAD); and the central banks of individual Latin American and Caribbean countries.

Table I.1  
**LATIN AMERICA AND THE CARIBBEAN: NET INFLOWS OF FOREIGN DIRECT INVESTMENT,  
 BY SUBREGION, 1990-1998**  
*(Millions of dollars and percentages)*

	1990- 1994 (annual average)	1995	1996	1997	1998	1998 share (percentages)	1999 <sup>a</sup>
LAIA	14 316	27 750	41 416	60 640	64 465	84	75 420
(Brazil)	(1 703)	(4 859)	(11 200)	(19 650)	(31 913)	(42)	(31 000)
Central America and the Caribbean	1 397	2 005	2 108	4 251	5 776	7.5	5 500
Financial centres	2 506	2 427	3 119	4 513	6 486	8.5	5 000
<b>Total</b>	<b>18 220</b>	<b>32 182</b>	<b>46 643</b>	<b>69 404</b>	<b>76 727</b>	<b>100.0</b>	<b>85 920</b>

**Source:** ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, based on information provided by the International Monetary Fund (IMF) and World Investment Report 1999, United Nations Conference on Trade and Development (UNCTAD).

<sup>a</sup> Estimates computed by the Unit on Investment and Corporate Strategies, ECLAC, December 1999.

than on other macroeconomic variables. In the countries of the Latin American Integration Association (LAIA)—the economies most directly affected by these international disturbances—capital inflows in 1998 rose by 6.3% from their 1997 level, to total US\$ 64.465 billion, and are expected to have risen again in 1999 (to an estimated US\$ 75.42 billion) (see table I.1).

As the LAIA countries' relative share of FDI has declined in the second half of the 1990s, other subregions that have traditionally been less favoured by foreign investors have gained in importance. The proportion of total FDI inflows at the regional level absorbed by the smaller Central American and Caribbean economies (excluding financial centres) rose from 6.1% to 7.5% between 1997 and 1998.<sup>7</sup> In the latter year—the last for which complete information is available—this subregion posted a new record of US\$ 5.776 billion and in all likelihood will receive a similar amount in 1999 (see table I.1).

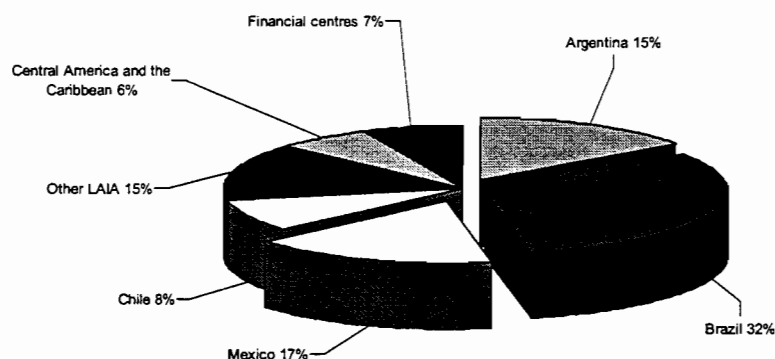
Nevertheless, despite the significant growth of net FDI inflows to Central America and the Caribbean and to some medium-sized countries (especially Chile), Latin America's three largest economies continue to be the main magnets for transnational enterprises. During the period 1995-1999, Brazil, Mexico and Argentina between them received nearly two thirds of the region's total net inflows (see figure I.4).

#### **(a) Foreign direct investment in the LAIA countries**

Although the 1998 figures were already high, foreign investment in the economies is expected to post a new record in 1999, with FDI inflows projected at US\$ 75.42 billion, up by 17% from the 1998 figure (see table I.2). The pattern of aggregate FDI flows in 1998 and 1999 is explained by their remarkable expansion in

<sup>7</sup> Panama has been included in this subregion in the current edition of *Foreign Investment in Latin America and the Caribbean* because its pattern of foreign investment in recent years has been more similar to that of other countries in the area than to financial centres.

Figure I.4  
**LATIN AMERICA AND THE CARIBBEAN: SHARE OF NET FOREIGN DIRECT  
 INVESTMENT INFLOWS, 1995-1999**  
 (Percentages)



**Source:** ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, based on information provided by the International Monetary Fund (IMF); *World Investment Report 1999*, United Nations Conference on Trade and Development (UNCTAD); and the central banks of the relevant countries.

Brazil, Argentina and Chile (FDI has levelled off in Mexico at around US\$ 11 billion). Brazil's performance as the main engine of FDI growth in Latin America in recent years is largely due to its wide-ranging programme for the privatization of State-owned assets and the progressive and rapid deregulation of certain key sectors of the economy. This has attracted a massive influx of new foreign investors to the services sector.

The huge increase in FDI in Argentina in 1999 was the result of the acquisition of Yacimientos Petrolíferos Fiscales (YPF)—the country's largest company—by Repsol, of Spain, in an operation that generated capital inflows of nearly US\$ 13 billion.<sup>8</sup> In a similar operation, the purchase by Endesa-España of the largest holding company in Chile's electricity subsector along with its main generating company (Enersis and Endesa-Chile) produced an FDI inflow of US\$ 3.55 billion to that country (see chapter III).

Foreign investment is expected to diminish in the other Latin American and Caribbean countries in 1999 as a result of several factors, including slower economic growth,<sup>9</sup> greater political instability in some cases, a slump in the prices of export commodities and a decline in privatization proceeds in several of the region's countries, with all these factors being seen against the backdrop of the increased risk associated with investment in emerging markets. At the global level, the recovery of the developing Asian economies during the second half of 1999 has heightened the competition for investment flows to emerging markets.

FDI has been a crucial factor in stabilizing external accounts during the 1990s, particularly in the larger economies, such as those of Brazil, Argentina and Mexico. It has also been an important engine of export growth in some economies (see the sections on Costa Rica and Bolivia in this chapter and the case of Mexico

<sup>8</sup> As an offset to this operation, portfolio investment declined by US\$ 10.838 billion, since the shares were mainly purchased from non-residents (Ministerio de Economía y Obras y Servicios Públicos de la República Argentina, 1999 p. 6).

<sup>9</sup> According to ECLAC projections, in 1999 output will fall slightly for the first time in the decade, and the upward trend will not be reinstated until some time in the year 2000 (ECLAC, 1999b, p. 13).



Table I.2  
**MEMBER COUNTRIES OF THE LATIN AMERICAN INTEGRATION ASSOCIATION (LAIA): NET INFLOWS OF  
 FOREIGN DIRECT INVESTMENT, 1990-1999**  
*(Millions of dollars and percentages)*

Country	1990- 1994 (Annual average)	1995	1996	1997	1998	1998 share (percentages)	1999 <sup>a</sup>
Argentina	2 971	5 279	6 513	8 094	6 150	9.5	21 000
Bolivia	85	393	474	731	872	1.4	800
Brazil	1 703	4 859	11 200	19 650	31 913	49.5	31 000
Chile	1 219	2 957	4 637	5 219	4 638	7.2	8 900
Colombia	818	969	3 123	5 703	3 038	4.7	350
Ecuador	293	470	491	695	831	1.3	470
Mexico	5 430	9 526	9 186	12 831	10 238	15.9	10 000
Paraguay	98	155	246	270	256	0.4	100
Peru	785	2 000	3 226	1 785	1 930	3.0	1 500
Uruguay	...	157	137	126	164	0.3	100
Venezuela	836	985	2 183	5 536	4 435	6.9	1 200
<b>Total</b>	<b>14 238</b>	<b>27 750</b>	<b>41 416</b>	<b>60 640</b>	<b>64 465</b>	<b>100.0</b>	<b>75 420</b>

**Source:** ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, based on information provided by the International Monetary Fund (IMF); World Investment Report 1999, United Nations Conference on Trade and Development (UNCTAD); and the central banks of the relevant countries.

<sup>a</sup> Estimates computed by the Unit on Investment and Corporate Strategies, ECLAC, based on projections made by the central banks of each country, 1 December 1999.

in chapter II) and has helped to improve the systemic competitiveness of most of the countries of the region.

**(b) Brazil: foreign direct investment in pursuit of access to the services market**

In recent years, in conjunction with the implementation of policies aimed at stabilizing (the *Real Plan*), liberalizing and opening up the Brazilian economy, net FDI inflows to this country have grown at an unprecedented rate. Capital inflows surged from about US\$ 1 billion in 1990 to US\$ 31 billion in 1999 (see table II.2), and since 1996 Brazil has been the leading Latin American FDI recipient and the second-largest destination among all the developing countries.

Traditionally, FDI in Brazil has targeted the manufacturing sector (ECLAC, 1998a, chapter 2) with the aim of capitalizing upon the advantages offered by its huge internal market, restrictive commercial policies and industrial development incentives for certain product lines. As a result, Brazil is one of the developing countries with the greatest presence of TNCs, with 384 of the world's 500 largest transnational corporations having operations in the country

(SOBEET, 1999). Since the early 1990s, the Brazilian economy has been undergoing a wide-ranging liberalization process which has opened up previously restricted activities to foreign investors. As a result, an increasing number of "new players" have entered services activities since 1993, and over 50% of total net FDI inflows were absorbed by this sector in 1998, which thus overtook manufacturing as the leading FDI recipient.

The extensive programme of public utility privatization and the urgent need to upgrade the country's infrastructure have been decisive in defining the pattern of net inflows. In 1998 this foreign investment trend was greatly reinforced when the doors were opened up to investors in infrastructure (telecommunications and electric power distribution) and the financial system. This has led several transnational service providers to include Brazil in their investment and international expansion strategies.

The most active foreign players in the services sector have been Telefónica de España, Portugal Telecom, Telecom Italia and MCI WorldCom (telecommunications); Carrefour Supermarché and Casino-Guichard (retailing); AES Corporation, Enron Corporation, Endesa-España, Iberdrola and Tractebel

Table I.3  
**BRAZIL: 50 LARGEST WHOLLY OR PARTLY FOREIGN-OWNED COMPANIES, BY SALES, 1998**  
*(Millions of dollars)*

	Foreign company	Sector	Sales	Foreign investor	Foreign capital <sup>a</sup> (%)	Source country	Exports
1	Fiat Automoveis S.A.	Automotive	7 420	Fiat SpA	100	Italy	1 116
2	Volkswagen do Brasil	Automotive	6 619	Volkswagen AG	100	Germany	675
3	General Motors do Brasil	Automotive	6 371	General Motor Corp.	100	United States	703
4	Carrefour Comercial e Industrial S.A.	Commerce	5 709	Carrefour Supermarché S.A.	100	France	-
5	Shell Brasil S.A.	Oil	4 470	Royal Dutch Shell	100	United Kingdom/ Netherlands	127
6	Light Servicos de Eletricidade S.A.	Electricity	3 949	AES Corp./ Houston Energy/Électricité de France	51	United States / France	-
7	Telecomunicações de São Paulo (TELESP)	Telecoms	3 720	Telefónica de España/BBVA/ Iberdrola/Portugal Telecom	52	Spain/Portugal	...
8	Pão de Açúcar	Commerce	3 627	Groupe Casino	25	France	-
9	Ford Brasil Ltda.	Automotive	3 475	Ford Motor Company	100	United States	947
10	Empresa Brasileira de Telecomunicações (Embratel)	Telecoms	3 309	MCI WorldCom	52	United States	...
11	Texaco Brasil S.A.	Oil	3 089	Texaco Inc.	100	United States	...
12	Esso Brasileira de Petróleo Ltda.	Oil	3 061	Exxon Corporation	100	United States	45
13	Eletropaulo Metropolitana de Eletricidade S.A.	Electricity	2 878	AES Corp./Houston Energy/ Électricité de France	75	United States/ France	-
14	CEVAL Food	Food	2 746	Bunge & Born	100	Argentina	1 149
15	Nestlé Industrial e Comercial Ltda.	Food	2 562	Nestlé AG	100	Switzerland	60
16	IBM do Brasil	Computers	2 482	IBM Corporation	100	United States	71
17	Industria Gessy Lever Ltda.	Hygiene/cleaning	2 368	Unilever Plc	100	United Kingdom / Netherlands	42
18	Daimler-Chrysler do Brasil	Automotive	2 293	Daimler - Chrysler AG	100	Germany	498
19	Multibrás S.A. Electrodoméstica	Electronics	2 027	Whirlpool	60	United States	...
20	Centrais Elétricas de Minas Gerais (Cemig)	Electricity	1 978	Southern Electric/AES Corp.	33	United States	...
21	Cargill Agrícola S.A.	Food	1 806	Cargill Incorporated	100	United States	304
22	Bompreço S.A.	Commerce	1 728	Royal Ahold N.V. -Disco	50	Netherlands/ Argentina	...
23	Companhia Siderúrgica Belgo- Mineira (CSBM)	Iron and steel	1 541	Belgo Group	...	Belgium	...
24	Companhia de Cigarros Souza Cruz S.A.	Tobacco	1 535	British American Tobacco (BAT)	75	United Kingdom	538
25	Ericsson Telecomunicações S.A.	Electronics	1 478	Ericsson AB	100	Sweden	120
26	Xerox do Brasil Ltda.	Electronics	1 407	Xerox Corporation	100	United States	141
27	Telesp Celular	Telecoms	1 392	Portugal Telecom	52	Portugal	...
28	Rhodia S.A.	Chemicals	1 340	Rhône-Poulenc S.A.	100	France	83
29	Lojas Americanas	Commerce	1 270	Carrefour Supermarché S.A.	100	France	...
30	Makro Atakadista S.A.	Commerce	1 204	SHV Makro NV	98	Netherlands	...
31	Siemens S.A.	Electronics	1 186	Siemens AG	82	Germany	63
32	Pirelli Cabos	Tyres	1 180	Pirelli SpA	100	Italy	160
33	NEC do Brasil	Electronics	1 112	Nippon Electric Co. (NEC)	100	Japan	...
34	Bunge Brasil	Food	1 105	Bunge & Born	100	Argentina	...
35	BASF Brasileira S.A. Indústrias Químicas	Chemicals	1 035	BASF AG	100	Germany	156
36	Parmalat Brasil	Food	1 016	Parmalat S.A.	100	Italy	...
37	Cia. Riograndense de Telecomunicações (CRT)	Telecoms	992	Portugal Telecom	32	Portugal	...
38	White Martins Gases Industriais S.A.	Chemicals	926	Praxair Inc.	70	United States	...
39	Dow Química S.A.	Chemicals	917	Dow Chemical	100	United States	72

Table I.3 (concluded)

	Foreign company	Sector	Sales	Foreign investor	Foreign capital <sup>a</sup> (%)	Source country	Exports
40	Companhia de Eletricidade do Estado da Bahia (Coelba)	Electricity	911	Iberdrola	24	Spain	...
41	Alcoa Alumino S.A.	Iron and steel	907	Aluminium Company of America (67%)/ Hanna Mining (33%)	100	United States	200
42	Santista Food	Food	902	Bunge & Born	100	Argentina	382
43	Saint Gobain Brasil	Glass	845	Saint Gobain	100	France	...
44	Novartis	Pharma-ceuticals	787	Novartis AG	100	Switzerland	40
45	Acesita S.A.	Iron and steel	786	Usinor S.A.	58	France	176
46	Tele Sudeste Celular	Telecoms	763	Telefónica de España/ Iberdrola/Nippon Telegraph and Telephone Corporation (NTT) Mobile/Itochu	52	Spain/Japan	...
47	Companhia de Eletricidade do Estado de Rio Janeiro (CERJ)	Electricity	743	Eletricidade de Portugal/ Energis / Chilectra/ Endesa España	100	Portugal/Spain	-
48	Comercio e Industrias Brasileiras Coinbra S.A.	Food	687	Louis Dreyfus & Cie.	48	France	327
49	Telepar (Telecomunicações do Paraná S.A.)	Telecoms	682	Italy Telecom	43	Italy	...
50	Telerj Celular	Telecoms	653	South Korea Telecom	20	Republic of Korea	...

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, based on information obtained from *Gazeta Mercantil Latino-América*, "1000 Maiores Empresas da América Latina", September 1999; Exame, "As 500 maiores empresas do Brasil", June 1999; *América Economía*, 1999, Special Edition, "Las mayores empresas de América Latina", 29 July 1999; and Foreign Companies in Brazil, 1999 Yearbook.

<sup>a</sup> Latest information available at the time of writing.

(electricity and natural gas); and ABN-Amro Bank, Banco Bilbao Vizcaya Argentaria (BBVA) and Banco Santander Central Hispano (BSCH) (banking and insurance). In 1998, services providers (telecoms, electric power and commerce) accounted for 24% of the total sales of the 100 largest foreign-owned companies in Brazil, just above the automotive and auto-parts industry (23%), which until then had been the country's main FDI destination. As a result, the number of wholly or partly foreign-owned firms among Brazil's 500 largest companies rose from 170 to 209 between 1997 and 1998 (*Exame*, 1999). In the following sections, FDI flows and corporate strategies in the telecommunications, electrical power, retail trade and financial services subsectors are examined in greater detail.

*(i) Access to the Brazilian telecoms market: opportunities for further specialization*

Privatization was the most important channel for foreign investment in Brazil's telecommunications

sector in 1998, accounting for 37% of the total proceeds from the sale of State-owned assets. The centrepiece of the privatization programme was the Telebras system, comprising 32 State-owned companies which provided telecommunications services in various market segments. In addition, at the time the bidding process began, there were also three independent operators—Companhia Telefônica de Ribeirão Preto (Ceterp), Companhia Riograndense de Telecomunicações (CRT) and Sercomtel Comunicações—belonging to different regional and local governments. At the start of the privatization process there was only one private-sector telecommunications operator, Companhia de Telecomunicações de Brasil Central (CTBC-Telecom), owned by the local Algar group. By 1998, 10 of the largest foreign companies in Brazil, as measured by sales, were in telecommunications, and two of them—Telefônica de São Paulo (Telesp) and Empresa Brasileira de Telecomunicações (Embratel)—were among the top 10 foreign companies in the country (see table I.3).

Table I.4  
**BRAZIL: PRIVATIZATIONS IN THE TELECOMS SUBSECTOR, 1997-1999**  
**MOBILE TELEPHONE OPERATORS**  
*(Millions of dollars and percentages)*

Enterprise sold	Reserve price	Sale price	Premium paid (percentages)	Successful bidder
<b>Band A</b>				
Telesp Celular	910	3 084	226.2	Portugal Telecom
Telemig Celular	190	650	228.7	Telesystem Wireless
Tele Sudeste Celular	472	1 169	138.6	Telefónica de España / Iberdrola / Itochu / Nippon Telegraph and Telephone Corporation (NTT)
Tele Celular Sul	190	602	204.8	Telecom Italia / Bradesco
Tele Centro Oeste Celular	190	378	91.3	Splice
Tele Nordeste Celular	186	567	193.8	Telecom Italia / Bradesco
Tele Norte Celular	75	162	108.9	Telesystem Wireless
Tele Leste Celular	104	368	242.4	Telefónica de España / Iberdrola
<b>Band B</b>				
Area 1 (São Paulo)	496	2 453	341.3	BellSouth
Area 2 (Estado de São Paulo)	496	1 223	121.2	Telia/Erlin / Lightel
Area 3 (Rio de Janeiro)	414	1 327	201.8	Lightel / South Korea Telecom
Area 4 (Minas Gerais)	331	457	30.0	Telecom Italia
Area 5 (Paraná, Santa Catarina)	273	729	134.5	Motorola / Global Telecom Nissho Iwai / DDI
Area 6 (Rio Grande do Sul)	273	315	1.36	Bell Canada / Telesystem Wireless
Area 7 (Goiás, Mato Grosso, Rondonia)	224	314	25.4	Bell Canada / Telesystem Wireless
Area 8 (Roraima, Pará, Amazonas)	...	50	...	Inepar / Splice
Area 9 (Bahia)	190	232	8.7	Telecom Italia
Area 10 (Ceara, Pernambuco, Alagoas)	190	512	141.6	BellSouth / Splice

**Source:** ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, based on information provided by the National Bank for Economic and Social Development (BNDES).

The sale of the Telebras system to the private sector not only generated massive revenues for the Brazilian treasury, but has also produced one of the region's most competitive markets. The firms belonging to this State conglomerate were split into three commercial segments: basic service, cellular telephony, and national and international long-distance communication. In a multi-stage process, new companies were created in each segment to compete with pre-existing ones (Band-B licences and mirror companies).

In the first phase, which was begun in late 1997, 10 new regional concessions for Band-B mobile telephony operations were auctioned off. These new operators were given 10 months to carry out their investments and market their products prior to the privatization of companies operating in Band A,

thereby giving them a head start so that they could compete with the existing cellular phone companies. As was to be expected, the highest premiums over reserve prices were paid in the most prosperous regions (São Paulo, Rio de Janeiro and Santa Catarina) (see table I.4). Although only four of the 10 operators began operating before the 10-month deadline, nearly all of them finished building their digital networks in 1999. The operating companies include Telecom Italia, BellSouth and a Bell Canada/Telesystem Wireless alliance, each of which holds two concessions. BellSouth's strategy in Latin America has been to position itself in the wireless telephony market to provide service to the higher-income groups. Telecom Italia has focused its Latin American investments on integrated telecommunications enterprises in Bolivia and Argentina, and, more recently, in the separate

Table I.5  
**BRAZIL: PRIVATIZATIONS IN THE TELECOMS SUBSECTOR, 1998-1999,**  
**BASIC TELEPHONY OPERATORS**  
*(Millions of dollars and percentages)*

Enterprise sold	Reserve price	Sale price	Premium paid	Successful bidder
Telecomunicações de São Paulo (Telesp)	2 912	4 970	64.3	Telefónica de España / Portugal Telecom / Iberdrola / BBVA
Telesp (mirror)	...	41	...	Bell Canada / Qualcomm / Libermann / WLL Holding
Tele Centro Sul (Telemato)	1 613	1 779	6.2	Telecom Italia
Tele Centro Sul (mirror)	...	0.05	...	GVT
Tele Norte Leste (Telemar)	2 812	2 951	1.0	Andrade Gutierrez
Tele Norte Leste (mirror)	...	30	...	Bell Canada / WLL Holding
Empresa Brasileira de Telecomunicações (Embratel)	1 488	2 278	47.2	MCI WorldCom
Embratel (mirror)	...	28	...	National Grid / France Telecom / Sprint

**Source:** ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, based on information provided by the National Bank for Economic and Social Development (BNDES).

management of its basic-service and wireless telephony businesses (see the section on Bolivia in this chapter). In July 1999, Band-B operators had a 24% market share.

The second phase began in late 1998 with the privatization of Band A (see table I.4), where, as in the case of Band B, the highest premiums were paid in the highest-income areas. Telefónica de España, Telecom Italia and Telesystem Wireless gained leading roles in this segment, with two concessions each. Before entering the Brazilian market, Telefónica had been known for investing in integrated telecoms businesses in Chile, Argentina and Peru (see chapter III). As a result of their acquisitions in Brazil, Telecom Italia and Telesystem each now have four cellular phone operating companies (see table I.4). By July 1999, Band-A operators had a market share of 76% (two percentage points lower than in 1998).

The third phase of the privatization programme entailed the sale of three regional basic-service and long-distance operators from the system and the auctioning of fixed-line and long-distance mirror companies (see table I.5). Although the proceeds were significant (especially in the case of Telesp, acquired by Telefónica de España), the premiums that were paid were no greater than those paid by the mobile phone companies. The auctioning of the mirror operators was

affected by the devaluation of the *real* in January 1999 and by a series of disputes with the regulatory body, Agência Nacional de Telecomunicações (Anatel), and the premiums paid for these companies were considerably lower. The operators that were awarded the basic-service concessions had already acquired other cellular phone companies in Brazil, while the new entrants were France Telecom in a consortium with Sprint and National Grid, and MCI WorldCom, both of which will be operating long-distance services. France Telecom also has investments in Mexico (Teléfonos de México, Telmex) and in Argentina (Telecom-Argentina), where it operates long-distance and wireless telephony services in conjunction with Telefónica de España.

Most of the independent telecommunications companies are operated by Brazilian business groups. One of these, CRT de Rio Grande do Sul, had been acquired by a consortium composed of Telefónica de España, Iberdrola and BBVA, but since Anatel regulations preclude an operator from holding more than one basic telephony company, Telefónica was ordered to sell its share by 31 January 2000.<sup>10</sup> Before the deadline expired, the Spanish company swapped shares with Portugal Telecom, its partner in Telesp (fixed-line telephony), so Telefónica ended up as the

operator of Telesp (fixed-line and mobile telephony) and Portugal Telecom as the operator of CRT.

The framework described above has allowed new operators to enter the telecoms sector in Latin America (Portugal Telecom, the Telesystem Wireless / Bell Canada alliance) and has led companies that have an extensive presence in the region (Telefónica de España, France Telecom, Telecom Italia and BellSouth) to reformulate their strategies. The size of the Brazilian market and its highly competitive nature have led operators such as Telefónica de España and Telecom Italia to reverse the vertical integration of their operations throughout the region by dividing up the management functions for their various business units in order to boost efficiency in each area so that they can compete more successfully in rapidly growing segments, such as Internet services.

This dynamic has been strengthened by the existence of free competition in both access and transmission technologies. Various infrastructure companies have applied to the Brazilian Government for licences and permits to set up transmission networks and joint ventures (with State and foreign capital) with a view to developing this business segment:

- Lightpar, a subsidiary of Centrais Elétricas Brasileiras (Eletrobras), is creating a 42,000 km data transmission network which is expected to generate US\$ 278 million in revenues over the next 10 years.
- The National Highway Department has signed an association contract with ImpSat to lay 1,940 km of fibre-optic cable across the country.
- Recently privatized railroad companies are laying a network of fibre-optic cables along their 10,000 km of track. The first stretch, which came on stream in January 1999 between the cities of Vitoria and Minas Gerais, required an investment of US\$ 11 million.
- Eletrobras and AES Corporation have set up a joint venture under the name of Eletronet to lay fibre-optic cables linking Brazil's main cities.

In the area of access technologies, Brazil is the first Latin American country to authorize cable television companies to provide Internet services to their subscribers, and in 1999 this has given rise to the formation of a series of partnerships and strategic alliances between local groups and computer and

Internet businesses that are wagering on the convergence of these technologies. The most important of these have been the alliances formed between Microsoft and the Brazilian television group O Globo and between the Venezuelan Cisneros group and America Online, and AT&T's acquisition of Netstream in 1999.

During the first half of 1999, the largest mergers and acquisitions have occurred in the telecoms subsector (KPMG, 1999), and further foreign investment resources were expected to flow into this area during the rest of the year as a result of award of concessions for over 60 cable television operators, along with other mergers and acquisitions among firms dealing with converging technologies. In addition, large-scale investment programmes are being carried out to modernize and improve the coverage and service of the telecoms companies that were transferred to the private sector in 1998. Thus a significant part of the US\$ 31 billion of FDI that entered Brazil in 1999 is likely to have gone to the telecoms subsector.

*(ii) Access to the Brazilian electric power market: a space for regional integration*

The sale of public electric power utilities has drawn a huge amount of financial resources to the country — nearly 33% of the total received — and has attracted companies that are operating on the basis of a strategy. The extension of this procedure to include other energy production activities, such as gas and oil, provides greater opportunities for horizontal integration for the largest transnational corporations in the energy sector. In 1998, five of the 50 largest foreign companies in Brazil, in terms of sales, were operating in the electric power industry, including three of the leading 25 — Light, Electropaulo and Cemig (see table I.3).

The process of privatizing the country's electric power utilities began in 1995, and its progress has been greatly influenced by the changes made in the corresponding regulatory framework. In the initial stage, the Brazilian State has retained control of nearly all electric power generation facilities and a substantial part of the transmission industry (92.7% and 64%, respectively, in 1999).

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10 Similarly, as a result of the merger between WorldCom and Sprint, Anatel had blocked the integration of the long-distance services of the two operators in Brazil.

Table I.6  
**BRAZIL: PRIVATIZATION OF ELECTRIC POWER COMPANIES, 1995-1998**  
*(Millions of dollars and percentages)*

Company acquired	Percentage acquired	Reserve price	Premium (%)	Buyer
Espírito Santo Centrais Elétricas S.A. (Escelsa)	97	522	12	Ivensa S.A. and GTD Participações S.A. <sup>a</sup>
Light Serviços de Eletricidade S.A.	50	3 093	0	AES Corporation / Électricité de France / Houston Energy
Companhia de Eletricidade do Estado do Rio de Janeiro (CERJ)	70	951	30	Endesa-España / Eletricidade de Portugal
Companhia de Eletricidade do Estado da Bahia (Coelba)	71	1 598	77	Iberdrola
Cachoeira Dourada	94	714	44	Endesa-Chile / Edegel
Distribuidora Gaúcha de Energia S.A. (AES Sul)	91	1 352	83	AES Corporation
Rio Grande Energia (RGE)	91	...	94	
Companhia Paulista de Força e Luz (CPFL)	58	...	70	Bradesco, Votorantin and Camargo Corrêa
Empresa Energética de Mato Grosso do Sul S.A. (Enersul)	84	...	84	
Centrais Elétricas Mato-grossenses S.A. (Cemat)	96		22	
Empresa Energética de Sergipe S.A. (Energipe)	92	...	96	
Cia. Energética do Rio Grande do Norte (Cosern)	80	607	74	Iberdrola
Companhia Energética do Ceará (Coelce)	85	868	27	Endesa-España / Enersis / Chilectra
Eletropaulo, Metropolitana Eletricidade de São Paulo S.A. (Eletropaulo)	75	3 018	0	AES Corporation / Électricité de France / Houston Energy
Centrais Elétricas Pará S.A. (Celpa)	55	372	0	
Elektro Eletricidade e Serviços S.A.	90	1 273	100	Enron Corporation
Centrais Geradoras do Sul do Brasil S.A. (GERASUL)	50	1 882	0	Tractebel
Empresa de Energia S.A. (EBE)- Bandeirante	75	839	0	
CESP-Paranapanema	39	692	...	Duke Energy
Electronet	51	155	...	AES Corporation
<b>Total</b>		<b>22 811</b>		

**Source:** ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, based on information provided by the National Bank for Economic and Social Development (BNDES) and the United States Energy Information Administration (EIA).

<sup>a</sup> The first is made up of financial institutions and the second by 11 pension funds.

The privatization of electric power distribution has generated over US\$ 22 billion in proceeds for Brazil's federal treasury, with large premiums being paid, especially in the case of companies privatized in 1997 and 1998. The highest premium was paid by Corporation to acquire Elektro, the distributor serving the State of São Paulo (see table I.6). Having also recently gained a share in the natural gas market, this operation turned Enron into an important player in the Brazilian energy market, (ECLAC, 1998a, box III.3).

To date, privatizations of power generation companies have included purchases, at high premiums, made by AES Corporation of the United States. AES already operates two electric power distribution companies in conjunction with Houston Energy and Électricité de France, plus another which it manages alone, as part of what appears to be a strategy of focusing on integrating energy services in Brazil (see table I.6).

Electricity consumption in Brazil is expected to grow by about 5% annually over the next 20 years (EIA, 1999d) and, although it already has a large generating capacity (59,025 MW), the country needs to add 3,650 MW per year to be able to keep up with this growing demand. To this end, the Government is implementing three policies for the period 1998-2007:

- Continue with the divestment of generating companies begun in late 1998;
- Press ahead with the integration of Brazil's transmission network and those of neighbouring countries; and
- Raise thermoelectric generating capacity from 8.6% to 17.5% of total capacity.

As many as 10 State-owned power generation companies —seven belonging to the federal government and three to individual states— are to have been sold by the end of 1999. The total generating capacity involved in these sales is 38,000 MW. In January 1999 the process of interconnecting all of Brazil's regions was completed, and this has made it possible to attract investors from neighbouring countries with a view to importing energy. Starting in 1999, Endesa-España is expected to sell Brazil 2,000 MW of power generated in Argentina, and United States companies operating in Bolivia were also

planning to sell energy to the Brazilian market by late 1999 (see the section on Bolivia in this chapter). In addition, the Venezuela's State-owned generator, Empresa de Electrificación del Caroní (Edelca), expects to complete interconnection with the border state of Roraima and should be selling power to northern Brazil by 2001.

As part of the plan to expand generating capacity, the construction of eight thermoelectric natural gas power plants between 1998 and 2002 has been given top priority.<sup>11</sup> One of the largest of these plants is being built by Enron Corporation in Cuiabá; this plant will have a generating capacity of 480 MW and will be supplied by an extension of the natural gas pipeline between Brazil and Bolivia, built by the same company. Other projected power plants in the south and north-east of Brazil are to be fuelled by natural gas from Argentina and Venezuela, respectively. In 1999, regional governments in Brazil also began to privatize gas distribution companies, so far with very encouraging results. In April, a consortium formed by British Gas and Royal Dutch Shell acquired a 62% stake in Companhia de Gás de São Paulo (Comgás), which serves the city of São Paulo, paying a premium of 100% over the auction reserve price and making Royal Dutch Shell one of the largest players in the Brazilian energy market. In 1997, Riogás and Companhia Distribuidora de Gás do Rio de Janeiro (CEG) had both been privatized, with Gas Natural de España (a management company controlled by Repsol) paying US\$ 146 million for Riogás, and CEG being bought by a consortium composed of Enron Corporation, Gas Natural, Iberdrola and Pluspetrol (an Argentine subsidiary of Repsol).

Brazil is adopting a system similar to the prevailing model in Argentina, which involves the creation of a wholesale energy market where prices are set by supply and demand. This scheme, together with the existing infrastructure, is bound to be highly attractive to foreign investors. The strategy pursued by power companies in Brazil entails gaining management control over distribution companies as a means of positioning themselves in the market, while the goal for the future is to integrate energy markets across South America —a project in which Brazil will play a key role, given the scale of its demand.

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11 In July 1999, completion of the gas pipeline connecting it with Bolivia has provided Brazil with a gas surplus (see box I.4).



*(iii) Access to the Brazilian retail market: consolidation of national networks through mergers and acquisitions*

There was no FDI flowing into Brazil's commercial networks during the import-substitution phase of its industrialization process because legal provisions were in force that prevented it. In recent years, however, these provisions have been amended, and the ban on profit remittances was lifted in 1994. In the last two years, some of the largest international operators have begun to position themselves in the Brazilian market by acquiring local retail chains. In 1998, five of 50 largest foreign companies in Brazil, measured by sales, were in this sector, and three—Carrefour, Pão de Açúcar and Bompreço—were among the top 25 (see table I.3).

Another contributing factor to this new wave of investment in retail trade has been the authorities' success in bringing hyperinflation under control, together with the size of Brazil's domestic market and its preferential access to Mercosur, which paves the way for the future integration of retail distribution networks as a means of achieving greater efficiency. In recent years, the largest foreign players in the Brazilian market have also invested heavily in the neighbouring markets of Argentina and Uruguay.

The retail market in Brazil differs from that of its other Mercosur neighbours, however, in that, because of the vast scale of operations that would be needed to cover the whole country, there is no nationwide retail chain. Instead there are regional chains and local ones that serve a city and its suburbs, many of which nonetheless have higher sales figures than many national chains in average-sized Latin American countries. This has led transnational companies in the sector to adopt a variety of strategies for breaking into the Brazilian market:

**Carrefour**, the leading retail chain in France, used a large-scale investment programme to introduce the concept of the hypermarket in Brazil. Over time, however, competitive pressures have forced the company to adapt its strategy to defend the significant market positions it has built up. Initially, this entailed taking over large regional chains (El Dorado and Lojas Americanas) in densely populated areas, where it has succeeded in achieving high sales figures. During a second phase, the company consolidated its presence in the regions, particularly through the purchase of medium-size chains (Planaltão and Minerão). A third phase has seen it buying up smaller chains that serve a single city and its suburbs. Carrefour

currently has 48 supermarkets and 67 hypermarkets in Brazil.

**Casino**, France's third-largest retail chain, opted for a strategic alliance with a local group (Pão de Açúcar) to develop supermarket networks in the regions. In the first stage, the alliance took over a series of local supermarkets (Barateiro, Peralta) so that it could stand up to the strong competition from Carrefour (its main rival). In a second phase, Pão de Açúcar has adopted a strategy involving lower risk (and cost), based on obtaining leases with a purchase option on existing supermarkets and department stores in a number of cities (Pães Mendonça and Mappin).

**Other groups**, such as Sonae of Portugal and the alliance between Disco of Argentina and Royal Ahold of the Netherlands, have burst into the Brazilian market in 1998 and 1999, acquiring supermarket chains in several regions. Sonae has a significant presence in retailing in the south of the country, and Disco/Royal Ahold, through Bompreço in the north-east.

**Wal-Mart**, one of the foreign investors with the most assets in the region, has only a minor presence in Brazil (see table I.14). In fact, this United States company had entered the local market in 1997 by acquiring Lojas Americanas, one of Brazil's largest retail chains, but poor results forced it to sell out and desist from further investments.

The huge wave of mergers and acquisitions among supermarkets in Brazil is also a reflection of the positions the relevant companies are achieving in world markets. In 1999, Carrefour completed a merger with another French company, Promodès, and has been negotiating an alliance with Sonae in Portugal. These mergers will have repercussions both in Argentina, where Promodès manages several chains in an alliance with the Exxel group, and in Brazil, where Carrefour and Sonae both have strong positions. Royal Ahold looks set to follow the example of Carrefour-Promodès and is said to be seeking a European partner.

Mergers and acquisitions on a global scale are creating a retail market in Brazil that is dominated by large firms, with smaller networks of stores serving specific market niches. Local groups that have formed alliances with foreigners have begun to worry about losing control of their businesses, owing to the need to expand their market. In other Latin American countries, and in different sectors, local groups that have been unable to keep up with their foreign partners have often ended up losing management control of their companies (see chapter II).

*(iv) Access to the Brazilian market for financial services: a strategy of specialization in market niches*

Thanks to the recent liberalization of the financial sector, banking activity in Brazil attracted foreign investment on a large scale in 1998 and 1999. Brazilian banks are by far and away the regional leaders, since they reflect the size of the national economy. In 1998, of the 100 largest banks in Latin America, ranked by assets, 45 were Brazilian, with combined assets amounting to US\$ 513 billion (*Gazeta Mercantil*, July 1999).

Even though the ranking of Brazilian banks continues to be led by local financial institutions, the presence of foreign banks has expanded significantly in recent years (see table I.7). Thus, by late 1998 foreign banks were accounting for nearly one-quarter (23%) of

total lending by the Brazilian banking system, compared to just 15.2% in 1997 (Salomon Smith Barney, 1999).

The largest investments have been made by European financial institutions and include acquisitions and mergers carried out by ABN-Amro Bank and BBVA. ABN-Amro has had a subsidiary engaged in specialized banking operations in Brazil since 1917, but its July 1998 purchase of 40% of Banco Real for US\$ 2.1 billion turned it into a universal bank in the local financial market. This was the Dutch group's largest acquisition to date and the largest ever in Brazil (see table I.17). The operation will allow ABN-Amro to consolidate its strategy of specializing in Latin American pension fund management and personal insurance, as these areas are precisely where the strengths of Banco Real lie.

Table 1.7  
**BRAZIL: FOREIGN PARTICIPATION IN THE BANKING SYSTEM, DECEMBER 1998**  
(Millions of dollars and percentages)

Local bank	Foreign investor	Home country	Percentage	Assets	Asset ranking	Share of deposits (percentages)
Banco Real	ABN-Amro	Netherlands	40	13 755	7	2.13
HSBC Bamerindus	Hong Kong Shanghai Bank Corp. (HSBC)	United Kingdom	100	11 450	10	2.29
Bank Boston	Bank Boston	United States	100	7 723	14	0.44
Santander Brasil	Banco Santander Central Hispano (BSCH)	Spain	100	7 533	15	1.29
Banco Sudameris Brasil	Banca Commerciale Italiana	Italy	78	6 955	16	0.73
Citibank	Citibank	United States	100	6 855	17	0.51
ABN-Amro	ABN-Amro	Netherlands	100	6 700	19	0.66
Banco Noroeste	Banco Santander Central Hispano (BSCH)	Spain	76	6 370	20	1.45
BBV-Brasil	Banco Bilbao Vizcaya Argentaria (BBVA)	Spain	100	5 201	25	1.04
Bandeirantes	Caixa Geral do Depositos	Portugal	90	4 609	27	0.89

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, based on information provided by Salomon Smith Barney, and Latin Finance.

BBVA, meanwhile, has consolidated its strategy of acquiring financial institutions specializing in Latin American pension funds by taking over Banco Excel Económico. BBVA already held a majority stake (54.5%) in this company and purchased the remaining capital through an operation, carried out between late 1998 and early 1999, that involved merging Excel with the BBVA-owned subsidiary of Banco Francés of Uruguay. BBVA currently operates in Brazil under the name of the Spanish group and has become one of the largest banks in the country (see chapter III and table I.7).

Although the acquisitions made by foreign banks in Brazil involve significant sums, the main banks are still controlled by local groups or by the State. Foreign banks have a small share of total deposits (see table I.7), but the still incipient development of pension fund management and insurance activities promises to open up opportunities for investors in the future. Because of the size of the Brazilian economy, the main banks will probably remain in the hands of local groups while foreign banks specialize in specific market segments.

The tendency observed in recent years for foreign investment in Brazil to be channelled primarily into the services sector intensified in 1998 and 1999, and this has been decisive in making the country the region's leading FDI recipient, especially since these types of investments are usually very sensitive to the size of the domestic market. FDI in services could become an important catalyst for the modernization of the services sector itself and could help strengthen the systemic competitiveness of industry. Everything depends on its performance and on the development of a suitable regulatory system for those service activities that can be regulated.

### (c) Foreign direct investment in the countries of the Caribbean basin

In 1998, the small economies of the Caribbean basin received US\$ 5.776 billion in FDI—a new record. The largest FDI recipients were Panama, followed by El Salvador, Trinidad and Tobago, Dominican Republic, Guatemala and Costa Rica, in that order; as a group, these countries absorbed 82% of the total inflow to the subregion (see table I.8). The data available for 1999, albeit incomplete, suggest this trend is likely to continue.

In Panama, the subregion's top FDI recipient in 1998, flows relating to service-sector privatizations and the creation of pension fund management companies have been growing increasingly important

since 1997. Two licenses for the operation of wireless telephony services were awarded (each for US\$ 73 million) in 1999: one to BellSouth of the United States and the other to Cable and Wireless of Great Britain. Cable and Wireless had already bought 49% of the country's basic-service telephone company in 1997 for US\$ 652 million.

In 1998, a 49% stake in two State-owned electric power generators—Chiriquí and Bayano—were sold to the AES Corporation of the United States for US\$ 92 million. In addition, reforms to the pension system have cleared the way for foreign investment in individual capitalization fund management firms, and several consortiums are participating in the Public Workers' Savings and Pension Capitalization System (SIACAP); these include foreign banks such as BBVA, Citibank and ING Barings, which were already operating in pension fund markets elsewhere in the region. For 1999 and 2000, FDI inflows are expected to drop to US\$ 500 million, partly because the privatization process is winding down and partly because of the overall performance of the economy (*Business Latin America*, 1999).

The figures for El Salvador and Guatemala, which occupied second and third place, respectively, in the ranking of Central American FDI recipients in 1998, are largely accounted for by the start-up of a programme for the privatization of electric power and telecommunications infrastructure, which has attracted major international investors. Latin American companies have been prominent in both areas. El Salvador's two electric power distribution companies were auctioned off to Corporación Electricidad de Caracas (SACA) of Venezuela and Empresa Eléctrica de Melipilla, Colchagua y el Maule (Emel) of Chile (recently acquired by Pennsylvania Power and Light, or PP&L, of the United States) for a total of US\$ 477 million. Another United States company, Duke Energy, paid US\$ 125 million for the electric power generator Acajutja. The main engine of FDI growth in El Salvador in 1998, however, was the privatization of telecommunications companies. Telefónica de España acquired the mobile telephony licence for US\$ 41 million,<sup>12</sup> and France Telecom obtained 51% of Administración Nacional de Telecomunicaciones (Antel), the basic-service operator, for US\$ 275 million.

The largest operations in Guatemala included the sale of 51% of the shares of Telgua, a basic telephony company, to the Luca consortium—formed by Teléfonos de México (Telmex) and a local Guatemalan and Honduran group—for US\$ 700 million and the

Table I.8  
**CENTRAL AMERICAN AND CARIBBEAN COUNTRIES (OTHER THAN FINANCIAL CENTRES):**  
**NET INFLOWS OF FOREIGN DIRECT INVESTMENT, 1990-1998**  
*(Millions of dollars)*

Country	1990-1994 (annual average)	1995	1996	1997	1998	1998 share (percentages)
Anguilla	10	18	33	21	21 <sup>a</sup>	0.4
Antigua and Barbuda	35	31	19	28	20	0.3
Aruba	38	-6	84	196	81	1.4
Barbados	11	12	13	15	16	0.3
Belize	14	21	17	12	18	0.3
Costa Rica	222	337	427	483	559 <sup>a</sup>	9.7
Cuba	7	9	12	13	30 <sup>a</sup>	0.5
Dominica	17	54	18	20	20	0.3
El Salvador	12	38	-5	0	872 <sup>a</sup>	15.1
Grenada	18	20	18	22	20	0.3
Guatemala	88	75	77	84	673 <sup>a</sup>	11.7
Guyana	69	74	92	52	44	0.8
Haiti	0	7	4	4	11	0.2
Honduras	41	50	91	122	84	1.5
Jamaica	124	147	184	203	369	6.4
Montserrat	6	3	0	3	3	0.1
Nicaragua	19	75	97	173	184	3.2
Panama	176	267	410	1 256	1 206	20.9
Dominican Republic	171	414	97	421	700 <sup>a</sup>	12.1
Saint Kitts and Nevis	22	20	17	25	25 <sup>a</sup>	0.4
Saint Vincent and the Grenadines	22	31	18	42	40 <sup>a</sup>	0.7
Saint Lucia	42	30	23	45	40 <sup>a</sup>	0.7
Suriname	-38	-21	7	12	10 <sup>a</sup>	0.2
Trinidad and Tobago	270	299	355	999	730	12.6
<b>Total</b>	<b>1 397</b>	<b>2 005</b>	<b>2 108</b>	<b>4 251</b>	<b>5 776</b>	<b>100.0</b>

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, based on information provided by the International Monetary Fund (IMF); World Investment Report 1999, United Nations Conference on Trade and Development (UNCTAD); and the central banks of each country.

<sup>a</sup> UNCTAD estimates.

sale of a concession to operate mobile telephone services to Telefónica de España for US\$ 33 million (see chapter III). Another three electric power companies were partially privatized, two of them passing into the hands of Unión Eléctrica Fenosa and the third to Iberdrola of Spain for a total of over US\$ 800 million.

In Honduras, FDI fell sharply (by 22.6%), basically because of the devastating effects of Hurricane Mitch. Capital flows into the country are expected to have climbed again in 1999 as the result of the implementation to a privatization programme similar to those carried out in El Salvador and

Guatemala, which will include the sale of a part of the national telecommunications enterprise. Nicaragua is also expected to attract FDI over the next few years through the privatization of its services infrastructure, but certain difficulties that have delayed privatization of the State-owned telecoms company in 1999 will need to be overcome first.

Although Costa Rica slipped to fifth place in the FDI ranking for Central American economies in 1998, it is still one of the most attractive countries for investors, thanks to its innovative policy on foreign investment, which focuses on sectors in which

12 AT&T, which was one of the strongest competitors in this bidding process, has filed suit against Telefónica alleging unfair competition and the use of insider information.

## Box I.1

**FOREIGN DIRECT INVESTMENT IN TRINIDAD AND TOBAGO:  
DIVERSIFICATION IN HYDROCARBONS**

In recent years, Trinidad and Tobago has been the largest recipient of foreign investment in the Caribbean basin. The strongest attraction has been the exploitation of the country's oil fields—one of its traditional economic activities—and an average of US\$ 351 million has been channelled to this sector over the last seven years. This pattern has recently been reinforced by the discovery of large natural gas deposits and by regulatory reforms. As a result, oil companies in Trinidad and Tobago have started to redirect their investments towards the extraction and processing of natural gas; transnational corporations invested nearly US\$ 400 million in the exploration and development of natural gas deposits in 1998. Exploration carried out over the past two years has raised the volume of proven gas reserves from 10 billion to 20 billion cubic feet, which at the current rate of extraction means that they will last approximately 60 years. Natural gas output has increased from 150 million cubic feet to a remarkable 800 million cubic feet in the space of just 10 years, and the figure is expected to double by 2005. In order to promote investments in downstream production activities related to natural gas extraction, the Government has set up an attractive tax scheme and highly

favourable contractual conditions for operations by private firms. The main foreign companies providing gas to the domestic market are Amoco and Enron Corporation of the United States and British Gas of the United Kingdom. The gas is sold exclusively to the local National Gas Company (NGC), which then markets it to industrial and residential customers. The Government has taken specific steps to expand the local market, such as the sale of pressurized gas in service stations and the installation of natural gas distribution networks in the country's principal cities. Nevertheless, the most promising foreign investments for the economy seem to be in refining and the production of natural gas derivatives for export. In 1999, Amoco, in association with British Gas, Repsol, NGC and Cabot, invested US\$ 1 billion to build a plant capable of exporting three million tons of liquefied natural gas (LNG), which, according to the United States Energy Information Administration (EIA), will make Trinidad and Tobago one of the continent's largest LNG producers. The main destination markets for these products are the United States, Spain and Puerto Rico, and exports are expected to generate average revenues of US\$ 4 billion per year. The consortium is currently engaged in negotiations aimed at expanding capacity by

an additional three million tons by 2003.

Trinidad and Tobago also has eight ammonia production units, together with five methanol facilities and one urea plant. The ammonia is mainly exported to Latin America and United States; methanol output has thus far been sold on the domestic market, but the country expected to begin exporting methanol in 1999, thanks to the construction of a new plant that will raise production to two million tons. York Research Corporation of the United States has invested US\$ 100 million to build a gas-fired electric power plant scheduled to come on stream in late 1999.

As happened in many other oil-producing countries, in 1998 FDI to Trinidad and Tobago was held back by the slump in hydrocarbon prices and the wave of mergers and acquisitions in the international oil market. Nevertheless, investments in natural gas have kept a significant amount of capital flowing into the country, which boasts the presence of 13 of the world's largest oil companies. For 1999 and 2000, analysts expect that rebounding oil prices and the creation of new government incentives for foreign companies will enable Trinidad and Tobago to continue receiving levels of foreign investment similar to those of recent years.

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

international trade is expanding rapidly (see the section on Costa Rica in this chapter).

Among the Caribbean countries, Trinidad and Tobago continued to receive large investments in the hydrocarbons and petrochemicals sector, although it did post a 27% reduction in 1998 because of the situation in the world oil market. According to the estimates of the Central Bank of Trinidad and Tobago, net FDI inflows in 1999 are unlikely to exceed those of 1998; nonetheless, the recent development of the country's natural gas industry should provide some degree of stability in future FDI flows (see box I.1).

FDI to the Dominican Republic soared by 66% between 1997 and 1998, and in the latter year, thanks to foreign investment in export processing zones and in the *maquila* sector, the country was able to replace 60% of its traditional exports with exports of textile products and inputs for the electronics industry. In 1999, as part of the Government's *maquila* promotion programme, the authorities decided to create incentives designed to attract foreign investment in information technologies (DROPIN, 1999; *Newsweek*, 3 August 1999), which is an area where the Caribbean basin countries have certain advantages. To make these investments viable, however, the country's electric power infrastructure needs to be modernized, as the country suffers from chronic shortages in this area. To address this problem, in 1999 the Government embarked upon joint ventures

in electric power generation and distribution, with foreign investors taking a 50% stake in these companies. Seaboard Corporation of the United States invested US\$ 145 million in Empresa Generadora de Electricidad Haina, and a consortium formed by Gener S.A. of Chile and Coastal Corporation of the United States invested US\$ 177 million in Empresa Generadora de Electricidad Itabo. Meanwhile, AES Corporation, which has become one of the region's largest companies in this sector, invested US\$ 109 million in Empresa de Distribución Eléctrica del Este, and Unión Eléctrica Fenosa of Spain invested US\$ 212 million in the Sur and Norte electric power distribution companies. The proceeds from these divestments enabled the State-owned Corporación Dominicana de Electricidad to spend US\$ 500 million on expanding its own generating capacity. In late 1999, companies in the sugar industry and a number of hotels were also privatized.

The figures on FDI flows to Central America and the Caribbean (excluding financial centres) probably underestimate the actual levels. Although it is well known that privatization has been the main conduit for recent FDI inflows, foreign companies also have a widespread and expanding presence in the duty-free zones and in the *maquila* sector. In the vast majority of cases the amounts invested by these companies, while not very large, are not registered with the local authorities, so they are not included in the balance-of-

Table I.9  
FINANCIAL CENTRES: NET INFLOWS OF FOREIGN DIRECT INVESTMENT, 1990-1998  
(Millions of dollars)

Country	1990-1994 (annual average)	1995	1996	1997	1998	1998 share (percentages)
Netherlands Antilles	23	10	11	103	a151 <sup>a</sup>	2.3
Bahamas	6	107	88	210	235	3.6
Bermuda	2 065	1 350	2 100	1700	2 400 <sup>a</sup>	37.0
Cayman Islands	255	490	410	2 000 <sup>a</sup>	3 500 <sup>a</sup>	54.0
British Virgin Islands	157	470	510	500	200 <sup>a</sup>	3.1
<b>Total</b>	<b>2 506</b>	<b>2 427</b>	<b>3 119</b>	<b>4 513</b>	<b>6 486</b>	<b>100.0</b>

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, based on information provided by the International Monetary Fund (IMF); World Investment Report 1999, United Nations Conference on Trade and Development (UNCTAD); and the central banks of each country.

<sup>a</sup> UNCTAD estimates.



payments figures. Some countries, such as Costa Rica, El Salvador, Guatemala and Honduras, are hosts to numerous international companies engaged in labour-intensive activities, particularly the production of wearing apparel (see chapter IV). In addition, high-technology companies have started to locate some of their less sophisticated operations in the subregion in order to take advantage of tax and tariff incentives, inexpensive labour and proximity to the United States market (see the section on Costa Rica in this chapter).

In 1998, net FDI inflows to financial centres grew by 44% (see table I.9). The Cayman Islands and Bermuda, the main recipients in recent years, do not disclose the origin or destination of the flows they receive because of their role as tax havens. Nevertheless, these countries are most probably no more than a way station for such investment flows, which are ultimately destined for other economies, probably within Latin America. FDI growth in recent years may well be associated with the boom in merger and acquisitions activity in the region, and it is quite possible that some of the funds used for these operations have been channelled through these financial centres.

To summarize, in most cases the increase in to Central America and the Caribbean in 1998 and 1999 is accounted for by the implementation of privatization programmes in services sectors and the deregulation of sectors that had previously been reserved for the State. In the coming years, as privatization programmes are brought to completion, FDI will tend to decline, as has already happened in the LAIA countries. Other Central American economies, such as Costa Rica's, may be able to attract stable investment flows in the early years of the coming decade, since in these countries export activities are the main focus of investor interest.

Because their domestic markets are quite small, the efforts of the economies of Central America and the Caribbean to attract significant amounts of foreign investment are hindered by structural obstacles. Their Governments are consequently faced with the tremendous challenge of designing a policy that takes into account the strategies of transnational corporations investing in Latin American and the Caribbean in order to make the most of their impact on small-scale economies (see section C of this chapter).

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## **B. STRATEGIES, AGENTS AND MODALITIES OF FOREIGN DIRECT INVESTMENT IN LATIN AMERICA AND THE CARIBBEAN**

### **1. Strategies of transnational corporations in Latin America and the Caribbean: an overview**

In the manufacturing sector, international markets trends and the new patterns of competition that have taken shape as a result of the liberalization of trade and finance have aroused the interest of new entrants and compelled transnational corporations already present

in the region to redefine their strategies. Some have *withdrawn* (at times choosing to supply local markets through exports); others, spurred by a desire to defend or increase their market share, have *streamlined* their operations (primarily by means of defensive strategies,

in terms of imports) or *restructured* their activities, which has involved making new investments that take into account the new national, subregional (in the case of and Mercosur) and international economic environment (ECLAC, 1998). Thus, within the manufacturing sector, two sets of basic strategies aimed at the following objectives are being applied:

- Increasing the efficiency of transnational corporations' internationally integrated production systems; and
- Seeking access to national and subregional markets for manufactures.

Notable results of the application of the first of these strategies include investments in Mexico and the Caribbean basin in the automotive and auto parts industries, computers, electronics and wearing apparel and the exports generated by these activities (see chapters II and IV, the section on Costa Rica in chapter I, and ECLAC, 1998a, chapter IV). Representative examples of how this strategy has been applied in the automotive industry are provided by the operations of General Motors, Ford, Daimler-Chrysler,

Volkswagen, Nissan and Lear Corporation in Mexico. In the computer industry, the investments made by IBM and Hewlett Packard in Mexico and by Intel in Costa Rica are considered the most significant cases. The operations of Sony, Philips, Samsung, Matsushita and General Electric in Mexico illustrate what is occurring in the electronics industry. In the garment industry, two of the best examples are Sara Lee and Fruit of the Loom in Mexico and the Caribbean basin (see table I.10).

As part of the second strategy, significant investments have been carried out in the automotive and food subsectors and in the chemical and machinery industries serving local markets. In particular, companies with a strong presence (Ford, General Motors, Volkswagen and Fiat) in the automotive industry within Mercosur have made major investments to defend their market share, above all in compact automobiles. New entrants (Chrysler, Renault, BMW, Toyota, Honda, among others) in search of market niches have also arrived on the scene (see ECLAC, 1998a, chapters II and IV).

Table I.10  
**LATIN AMERICA AND THE CARIBBEAN: STRATEGIES OF TRANSNATIONAL CORPORATIONS IN THE 1990s**

Corporate Strategy	Efficiency-seeking strategy	Raw materials-seeking strategy	Market (national or regional) access-seeking strategy
Sector			
<b>Primary</b>		<b>Petroleum/natural gas:</b> Argentina, Venezuela, Colombia, Bolivia and Brazil <b>Minerals:</b> Chile, Argentina and Peru	
<b>Manufacturing</b>	<b>Automotive:</b> Mexico <b>Electronics:</b> Mexico and Caribbean basin <b>Apparel:</b> Caribbean basin and Mexico		<b>Automotive industry:</b> Mercosur <b>Agro-industry:</b> Argentina, Brazil and Mexico <b>Chemicals:</b> Brazil <b>Cement:</b> Colombia, Dominican Republic and Venezuela
<b>Services</b>			<b>Finance:</b> Brazil, Mexico, Chile, Argentina, Venezuela, Colombia and Peru <b>Telecommunications:</b> Brazil, Argentina, Chile and Peru <b>Retail trade:</b> Brazil, Argentina, Mexico and Chile <b>Electric power:</b> Colombia, Brazil, Argentina and Central America <b>Gas distribution:</b> Argentina, Brazil, Chile and Colombia <b>Tourism:</b> Mexico, Central America and the Caribbean

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



As a result of the deregulation of Latin American economies —particularly through the privatization of State assets— new investment opportunities have opened up in sectors that were previously off limits to private activity, in general, and to foreign companies, in particular. This has prompted an influx of companies that had not established a significant position in Latin America before, especially in the areas of services, infrastructure and mining. Accordingly, another two strategies have been adopted by these investors in the region in an effort to:

- Gain access to national markets in the service and infrastructure sectors; and
- Gain access to raw materials.

In the services sector, the size of the local market, the regulatory framework and technological changes have been influential factors in foreign investment decisions. The extent of their influence can be measured on the basis of their contributions to the systemic competitiveness of the economy as a whole, the population's access to new products and services, and the dissemination of best international practices. This is of paramount importance in the case of Latin America and the Caribbean, since in recent years investments in the services sector have been increasing

significantly, particularly in the areas of telecommunications, financial services and electric power, in most of the countries of the region. In telecommunications, examples include the investments made by Telefónica de España, France Telecom, and MCI WorldCom. In financial services, noteworthy cases include those of Banco Santander Hispano (BSCH) and Banco Bilbao Vizcaya Argentaria (BBVA). Examples in the area of retail trade are Carrefour, Wal-Mart, Royal Ahold and Groupe Casino Guichard, and in the area of electric power, the operations of Endesa-España, AES Corporation and Duke Energy (see table I.10).

The entry of transnational corporations into mining activities has been coupled with the introduction a new organizational production model, the application of new technologies and the reform of regulatory schemes in countries with abundant natural resources. In general, the impact of these investments has been measured in terms of the increase in exports of natural resources and the construction of the necessary infrastructure (see the section on Bolivia in this chapter). Among the most noteworthy examples are Royal Dutch Shell, Repsol, Exxon and Broken Hill Proprietary (see table I.10).

## **2. The new presence of transnational corporations in Latin American business sectors**

The structural changes that have taken place in Latin American and Caribbean economies have substantially changed the business landscape of the region. The globalization process has strengthened the presence in the region of the international market's main economic agents: transnational corporations. The corporate strategies in use, which, in the case of manufacturing, seek efficiency and market access and, in other cases, raw materials and access to service markets, can be clearly identified by analysing trends in the sales and exports of the main Latin American companies during the 1990s.

Between the beginning of the decade and 1998, in the group of the 500 largest companies in terms of net sales (after taxes), subsidiaries of transnational corporations have been the big winners (their number increased from 142 to 202 and their share of total sales

rose from 26.6% to 38.7%) while State enterprises have been the losers (dropping from 93 to 40 companies and from 35.3% to 19.1% of total sales). Private local firms have tended, on the other hand, to maintain their share (approximately 260 enterprises, and between 38% and 42% of total sales). The bulk of these changes occurred in the period from 1995 to 1998, which coincided with the boom in FDI in Latin America and the Caribbean; this was especially true of foreign companies, whose share of the total sales of the 500 largest enterprises in the region rose from 29.5% to 38.7%. In other words, a clear result of the process of globalization and of the adjustment of economic policies in Latin America has been the reinforcement of the relative position of foreign enterprises and the weakening position of State enterprises, particularly in recent years (see table I.11).

Table I.11  
**LATIN AMERICA AND THE CARIBBEAN: TOP 500 COMPANIES,**  
**1990-1992, 1995 AND 1998**  
*(Millions of dollars and percentages)*

	1990- 1992 <sup>a</sup>	1995	1998
<b>1. Number of firms</b>	<b>500</b>	<b>500</b>	<b>500</b>
Foreign	142	154	202
Private local	265	279	258
State	93	67	40
<b>2. Sales (millions of dollars)</b>	<b>360 142</b>	<b>558 581</b>	<b>646 351</b>
Foreign	95 764	164 809	250 049
Private local	138 352	233 230	272 914
State	126 026	160 542	123 388
<b>Breakdown by ownership (percentages)</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Foreign	26.6	29.5	38.7
Private local	38.4	41.8	42.2
State	35.0	28.7	19.1
<b>3. Sectors (millions of dollars)</b>	<b>360 142</b>	<b>558 580</b>	<b>646 351</b>
Primary sector	100 058	140 190	112 413
Manufacturing	152 134	241 641	267 901
Services	107 950	176 749	266 037
<b>Breakdown by sector (percentages)</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Primary sector	27.8	25.1	17.4
Manufacturing	42.2	43.3	41.4
Services	30.0	31.6	41.2

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the ECLAC of Production, Productivity and Management, based on information provided by the Research Department of the journal *América economía*.

<sup>a</sup> The value for the period 1990-1992 was calculated as a three-year average.

An analysis of the 500 largest companies also reveals that manufacturing companies have maintained their dominance, generating nearly 42% of the group's total sales during the 1990s. The greatest changes were seen in the mining and services sectors. The primary sector's share of total sales declined from 27.8% to 17.4%, while services exhibited a dramatic increase, climbing from 30% to 41.2% and thereby matching the level of sales accounted for by the manufacturing sector (see table I.11). The steady, strong expansion of these activities has, to a great extent, been the result of the liberalization of the telecommunications and electric power subsectors, together with the privatization of the State enterprises providing these services.

The changes seen within the group formed by the 100 largest **manufacturing** companies have also been significant, particularly between 1995 and 1998 (see table I.12). Subsidiaries of transnational corporations succeeded in increasing their share of sales from 55.5%

to 60.7%, despite the fact that the number of such firms counted among the top 100 industrial enterprises in Latin America dropped from 48 to 47. While the number of private local firms remained constant, their share of total sales dropped from 42% to 38.1%. Meanwhile, State enterprises practically disappeared from the manufacturing sector. One notable fact is that in 1998 the subsector of motor vehicles and parts accounted for approximately half of foreign companies' total sales. This would appear to indicate that transnational corporations' impact on the industrialization process in Latin America has been concentrated in the automotive industry, particularly in Brazil, Mexico and Argentina (see ECLAC, 1998a, chapter IV).

Between 1995 and 1998, striking changes have also been observed in the **export** performance of Latin American firms. During this period, the increase in the number of foreign firms among the region's 200 largest

Table I.12  
**LATIN AMERICA AND THE CARIBBEAN: TOP 100 INDUSTRIAL ENTERPRISES,**  
**1990-1992, 1995 AND 1998**  
*(Millions of dollars and percentages)*

	1990- 1992 <sup>a</sup>	1995	1998
<b>1. Number of countries</b>	<b>100</b>	<b>100</b>	<b>100</b>
Foreign	46	48	47
Private local	50	51	52
State	4	1	1
<b>2. Sales (millions of dollars)</b>	<b>101 394</b>	<b>165 733</b>	<b>182 022</b>
Foreign	53 574	91 926	110 515
Private local	42 589	69 582	69 262
State	5 231	4 225	2 245
<b>3. Breakdown by sales (percentages)</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Foreign	52.8	55.5	60.7
(Automotive)	(25.1)	(29.0)	(30.4)
Private local	42.0	42.0	38.1
State	5.2	2.5	1.2

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, based on information provided by the Research Department of the journal *América económica*.

<sup>a</sup> The value for the period 1990-1992 was calculated as a three-year average.

Table I.13  
**LATIN AMERICA AND THE CARIBBEAN: 200 LARGEST EXPORTING FIRMS, 1995-1998**  
*(Millions of dollars and percentages)*

	1995	1996	1997	1998
<b>1. Number of companies</b>	<b>200</b>	<b>200</b>	<b>200</b>	<b>200</b>
Foreign	66	87	95	95
(Automotive)	(19)	(18)	(15)	(24)
Private local	120	102	97	97
State	14	11	8	8
<b>2. Exports (millions of dollars)</b>	<b>112 053</b>	<b>105 787</b>	<b>131 182</b>	<b>132 061</b>
Foreign	34 301	37 361	51 254	59 193
(Automotive)	(17 025)	(18 779)	(24 819)	(26 898)
Private local	36 272	28 827	41 284	43 961
State	41 480	39 599	38 644	28 907
<b>Breakdown by ownership (percentages)</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Foreign	30.6	35.3	39.0	44.8
(Automotive)	(15.2)	(17.8)	(18.8)	(20.3)
Private local	32.4	27.3	31.5	33.3
State	37.0	37.4	29.5	21.9
<b>3. Sectors (millions of dollars)</b>	<b>112 052</b>	<b>105 787</b>	<b>131 181</b>	<b>132 062</b>
Primary sector	50 209	41 040	62 172	52 971
Manufacturing	55 852	60 234	56 978	66 904
Services	5 991	4 513	12 031	12 187
<b>Breakdown by sector (percentages)</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Primary sector	44.7	38.8	47.4	40.1
Manufacturing	49.8	56.9	43.4	50.7
Services	5.3	4.3	9.2	9.2

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, based on information provided by the Research Department of the journal *América económica*.

exporters was significant: from 66 to 95 companies and from 30.6% to 44.8% of the total value of this group's foreign sales. Although the number of private local companies dropped from 120 to 97, these firms maintained their share of the value of exports (around 33%). The number of State enterprises fell from 14 to 8 and their share of exports slid from 37% to 21.9%. In general, the manufacturing sector maintained its dominance in exports (approximately 50% of the total), the share represented by natural resources shrank—due, in part, to weaker international commodity prices—and the role of services increased (from 5.3% to 9.2%). In terms of the impact of foreign companies on Latin American exports, a central factor has been the automotive industry, which has accounted for approximately half of the manufacturing sector's exports (see table I.13). The

notable growth of services among the top 500 companies was not clearly reflected in the performance of the 200 largest exporters.

During the 1990s, transnational corporations have clearly increased their presence in Latin America by consolidating their position in the manufacturing sector, above all in the automotive industry, and increasing their share of regional exports. In the services sector, they have taken advantage of opportunities opened up by the liberalization, deregulation and privatization processes to break into areas that were previously out of bounds to foreign investment. Within the group made up of the largest companies in the region, the increase in the number of transnational corporations coincided with the relative disappearance of State enterprises and the virtual stagnation of local private companies.

### 3. Major transnational corporations in the region

The large number of foreign direct investments received in recent years has strongly influenced the ranking of the largest corporations for 1998. This list, which is drawn up on the basis of consolidated sales in six countries in the region (see table I.14), reveals many new aspects and changes with regard to the main transnational corporations present in Latin America.

First, sales are highly concentrated in the top 20 companies, which account for 56.5% of the total value of the combined sales of the largest 100 firms. Five transnationals in the automotive industry (General Motors, Volkswagen, Ford, Fiat and Daimler-Chrysler) dominate the list, with a 21.3% share of the total sales of the top 100. These leading companies' sales are concentrated in the region's largest markets: Brazil, Mexico and Argentina.

Second, the importance of the parent companies of these foreign-based firms can be seen from their rankings in *Fortune* and in the *World Investment Report* issued by . In the case of the parent companies, *Fortune* ranks the 500 largest companies in the world according to their consolidated sales in 1998. The top 100 transnationals in Latin America are among those 500 companies and more than 70% of their consolidated sales are accounted for by firms included in the *Fortune* 500. The information provided in the

UNCTAD report, on the other hand, is based on the classification of parent companies according to their external assets as of 1997 and therefore provides a more accurate picture of the operation of integrated international production systems. This classification indicates that only slightly more than half of the combined sales of the 100 largest foreign companies in Latin America is accounted for by the world's most highly globalized transnationals. The asterisks appearing in the column corresponding to the *World Investment Report* indicate that 8 of the 20 top foreign corporations in the region are transnationals that do not have a broad-based international presence. These firms, which include Telefónica de España, Endesa-España, AES Corp., Carrefour, Repsol, Wal-Mart, France Telecom, Groupe Casino, Duke Energy and others, are found near the top of the ECLAC ranking as well (see table I.14). This would appear to indicate that many of the region's most important transnational corporations do not occupy leading positions among the transnational corporations of global stature in their area of activity, or are beginning their globalization process in Latin America.

Third, transnational corporations based in countries belonging to the European Union had higher sales figures (52.3% of consolidated sales) than United

Table I.14  
**THE 100 LARGEST TRANSNATIONAL CORPORATIONS OPERATING IN LATIN AMERICA,**  
**BY CONSOLIDATED SALES, 1998a**  
*(Millions of dollars)*

UNCTAD Report, 1999	Fortune 500	ECLAC 100	Company	Home country	Sector	Brazil	Mexico	Argen- tina	Chile	Colom- bia	Vene- zuela	Total
48	1	1	General Motors Corp.	United States	Automotive	6 371	9 265 <sup>b</sup>	1 066	521 <sup>f</sup>	530	740 <sup>f</sup>	18 493
8	17	2	Volkswagen AG.	Germany	Automotive	6 619	4 927	1 381	-	-	-	12 927
*	193	3	Telefónica de España	Spain	Telecom.	4 483 <sup>bc</sup>	...	4 209 <sup>bc</sup>	1 602	...	...	10 294
2	3	4	Ford Motor Company	United States	Automotive	3 475	4 452 <sup>b</sup>	1 765	...	...	580	10 272
*	*	5	Endesa-España	Spain	Electricity	1 165 <sup>bc</sup>	...	2 109 <sup>bc</sup>	5 582 <sup>b</sup>	843	...	9 699
*	*	6	AES Corp.	United States	Electricity	9 270 <sup>bc</sup>	...	...	...	...	...	9 270
*	95	7	Carrefour Supermarché	France	Retail trade	7 304 <sup>b</sup>	...	1 870	...	...	...	9 174
12	34	8	Fiat Spa	Italy	Automotive	7 420	...	1 268	...	...	183 <sup>e</sup>	8 871
10	2	9	Daimler-Chrysler	Germany	Automotive	1 293	6 605 <sup>b</sup>	950 <sup>b</sup>	-	-	...	8 848
3	11	10	Royal Dutch Shell	United Kingdom / Netherlands	Petroleum/ mining	4 470	...	1 934	889 <sup>f</sup>	251 <sup>e</sup>	208	7 752
*	257	11	Repsol	Spain	Petroleum	...	...	6 808 <sup>b</sup>	...	...	...	6 808
*	4	12	Wal-Mart Stores Inc.	United States	Retail trade	650 <sup>d</sup>	5 634	450	-	-	-	6 734
5	8	13	Exxon Corp.	United States	Petroleum/ mining	3 061	...	1 702	659	981	...	6 403
9	36	14	Nestlé AG	Switzerland	Food	2 562 <sup>b</sup>	1 648	435	580 <sup>f</sup>	303	97 <sup>e</sup>	5 625
77	164	15	British American Tobacco (BAT)	United Kingdom	Tobacco	2 050 <sup>b</sup>	1 021	866	140	...	599	4 676
7	14	16	IBM Co.	United States	Electronics	2 482	1 487 <sup>b</sup>	571	82 <sup>e</sup>	...	...	4 622
*	201	17	Coca-Cola Corp.	United States	Beverages	354	1 750 <sup>b</sup>	1 500	857	...	...	4 461
*	112	18	France Telecom	France	Telecom.	...	...	4 292 <sup>bc</sup>	-	-	-	4 292
18	43	19	Unilever	United Kingdom/ Netherlands	Food	2 369	545	944	220 <sup>e</sup>	194 <sup>e</sup>	...	4 272
91	101	20	Royal Ahold	Netherlands	Retail trade	1 728	...	1 601	845 <sup>c</sup>	...	...	4 174
*	255	21	Groupe Casino- Guichard	France	Retail trade	3 627	...	438	-	-	-	4 065
*	*	22	Cargill Incorporated	United States	Food	1 806	...	1 861	64 <sup>e</sup>	241 <sup>e</sup>	...	3 972
*	155	23	PepsiCo.	United States	Beverages	...	3 238 <sup>b</sup>	680	...	...	...	3 918
48	81	24	Texaco Inc.	United States	Petroleum	3 089	...	...	...	589	...	3 678
*	214	25	MCI WorldCom	United States	Telecom.	3 309	...	-	-	-	-	3 309
*	215	26	Duke Energy	United States	Electricity	3 239	...	...	...	...	...	3 239
29	27	27	Philip Morris Co.	United States	Tobacco	914 <sup>b</sup>	536	1 748	...	...	...	3 198
*	*	28	The Exxel Group	United States	Various	-	-	3 198	-	-	-	3 198
84	129	29	GTE Corporation	United States	Telecom.	...	...	608	...	...	2 180	2 788
19	22	30	Siemens AG	Germany	Electronics	1 186	674	554	...	146	130 <sup>e</sup>	2 690
*	*	31	Portugal Telecom	Portugal	Telecom.	2 609 <sup>b</sup>	-	-	-	-	-	2 609
1	9	32	General Electric	United States	Electronics	229	2 028	...	...	75	117	2 449
31	41	33	Hewlett Packard	United States	Electronics	478	1 634	261	...	...	...	2 373
38	93	34	Basf AG	Germany	Chemicals	1 035	901 <sup>b</sup>	240	59 <sup>e</sup>	83	...	2 318
*	60	35	NEC	Japan	Electronics	1 112	1 095	...	...	...	...	2 207
50	182	36	Xerox Corporation	United States	Electronics	1 407	515	163	...	...	...	2 085
*	428	37	Whirlpool	United States	Electronics	2 027	...	...	...	37	...	2 064
17	33	38	Nissan Motor Co.	Japan	Automotive	-	1 840	-	-	187	-	2 027
*	123	39	Telecom Italia	Italy	Telecom.	1 474 <sup>b</sup>	...	...	543 <sup>c</sup>	-	-	2 017
67	148	40	Ericsson LM	Sweden	Electronics	1 478	500	...	...	...	...	1 978
15	86	41	Bayer AG	Germany	Chemicals	604	602	527	...	...	98 <sup>e</sup>	1 831

Table I.14 (continued)

UNCTAD Report, 1999	Fortune 500	ECLAC 100	Company	Home country	Sector	Brazil	Mexico	Argen- tina	Chile	Colom- bia	Vene- zuela	Total
33	49	42	Renault	France	Automotive	264	...	1 389	...	136	...	1 789
*	367	43	Kimberly Clark	United States	Pulp / paper	206	1 345	221	...	...	...	1 772
13	134	44	Hoescht AG	Germany	Chemicals	325	1 119	139 <sup>e</sup>	82 <sup>e</sup>	...	29 <sup>e</sup>	1 694
*	*	45	Parmalat S.A.	Italy	Food	1 016	...	200	...	...	445	1 661
*	*	46	Glencore Holding	Switzerland	Retail trade	519	...	1 092	...	...	...	1 611
*	495	47	Colgate Palmolive	United States	Chemicals	280 <sup>d</sup>	700 <sup>e</sup>	122 <sup>e</sup>	...	309	162	1 573
*	*	48	Sidarfin S.A.	Belgium	Iron and steel	1 541	-	-	-	-	-	1 541
41	55	49	Du Pont de Nemours	United States	Chemicals	606	498	300	...	128	...	1 532
65	61	50	Procter & Gamble	United States	Chemicals	159	1 002	...	...	...	337	1 498
*	*	51	Avon Product Inc.	United States	Chemicals	742	355 <sup>e</sup>	329	...	...	70 <sup>e</sup>	1 496
20	*	52	Philips AG	Netherlands	Electronics	408	1 043	...	...	...	...	1 451
*	*	53	John Labatt Ltd.	Canada	Beverages	...	1 451	...	...	...	...	1 451
*	149	54	BellSouth	United States	Telecom.	...	...	720 <sup>c</sup>	...	...	724	1 444
36	279	55	Rhone-Poulenc S.A.	France	Chemicals	1 340	...	...	...	43	...	1 383
*	322	56	Eastman Kodak Co.	United States	Photography	396	985	...	...	...	...	1 381
*	*	57	SHV Makro NV	Netherlands	Retail trade	1 204	...	...	-	117	-	1 321
*	*	58	Asarco Inc.	United States	Mining	...	1 293 <sup>e</sup>	...	...	...	...	1 293
51	188	59	Saint Gobain	France	Glass	1 292 <sup>b</sup>	...	...	-	-	-	1 292
43	159	60	Novartis	Switzerland	Chemicals	787	...	238	...	181 <sup>e</sup>	...	1 405
*	489	61	Lear Corporation	United States	Automotive	...	1 205 <sup>b</sup>	...	-	-	-	1 205
*	175	62	McKesson Corp.	United States	Retail trade	...	1 182	...	-	-	-	1 182
*	*	63	Pirelli	Italy	Tyres	1 180	...	...	...	...	...	1 180
47	205	64	Dow Chemical Co.	United States	Chemicals	917	...	193	...	70	...	1 180
*	*	65	Dreyfus & Co.	France	Food	687	...	476	...	...	...	1 163
21	31	66	Sony Corporation	Japan	Electronics	...	1 144	...	...	...	...	1 144
66	361	67	McDonald's	United States	Retail trade	1 104 <sup>d</sup>	...	...	...	...	...	1 104
*	*	68	Saab-Scania AB	Sweden	Automotive	805 <sup>d</sup>	...	249	-	-	-	1 054
*	*	69	SCI Systems	United States	Electronics	...	1 054	-	-	-	-	1 054
89	*	70	Holderbank Fin. Glarus	Switzerland	Cement	348	685	...	...	...	...	1 033
59	226	71	Broken Hill (BHP)	Australia	Mining	...	...	...	1 027	-	-	1027
11	40	72	Mobil Oil Corp	United States	Petroleum	...	93	...	...	866	...	959
*	*	73	Iberia	Spain	Transportation	...	...	949 <sup>c</sup>	...	...	...	949
*	*	74	Citicorp Equity Investment (CEI)	United States	Telecom.	-	-	930 <sup>bc</sup>	-	-	-	930
*	*	75	Praxair Inc.	United States	Chemicals	926	...	...	...	...	...	926
*	*	76	Iberdrola	Spain	Electricity	911	...	...	...	...	...	911
*	261	77	Aluminium Co. of America	United States	Metals	907	...	...	...	...	...	907
88	288	78	Danone	France	Food	350	...	533	...	...	...	883
*	*	79	British Gas	United Kingdom	Gas distrib.	230 <sup>c</sup>	...	602 <sup>c</sup>	...	...	...	832
26	145	80	Alcatel Alsthom	France	Electronics	475	350	...	-	...	...	825
*	85	81	Enron International	United States	Energy	425	...	395	...	...	...	820
*	401	82	Anheuser-Busch	United States	Beverages	...	713	...	77 <sup>e</sup>	...	...	790
*	419	83	Usinor	France	Iron and steel	786	...	...	...	...	...	786
*	*	84	Ispat Group	India	Iron and steel	-	783	-	-	-	-	783
*	*	85	Rockwell	United States	Electronics	...	780	...	...	...	...	780
6	10	86	Toyota Motor Corp.	Japan	Automotive	...	...	409	...	136	230 <sup>e</sup>	775
69	144	87	Johnson & Johnson	United States	Chemicals	447	...	221	...	106	...	774
20	232	88	La Roche & Co.	Switzerland	Chemicals	415	180	175 <sup>e</sup>	...	...	...	770
*	*	89	André & Cie.	Switzerland	Chemicals	...	...	756	...	...	...	756
*	350	90	Goodyear Tire & Rubber	United States	Tyres	604	...	...	...	150 <sup>e</sup>	...	754

Table I.14 (concluded)

UNCTAD Report, 1999	Fortune 500	ECLAC 100	Company	Home country	Sector	Brazil	Mexico	Argen- tina	Chile	Colom- bia	Vene- zuela	Total
*	270	91	3M	United States	Chemicals	409	326	...	...	...	...	735
*	*	92	New Holland NV	Netherlands	Auto parts	706 <sup>d</sup>	...	...	...	...	...	706
*	277	93	Sanyo Corp.	Japan	Electronics	...	701 <sup>b</sup>	...	...	...	...	701
12	92	94	ABB Asea Brown Boveri	Switzerland	Machinery	550	...	...	...	74	69	693
*	87	95	Compaq	United States	Electronics	590	...	...	...	88	...	678
*	*	96	Agip	Italy	Petroleum	531	147	...	...	...	...	678
53	59	97	Peugeot	France	Automotive	...	...	609	62 <sup>e</sup>	...	...	671
*	*	98	South Korea Telecom	Rep. of Korea	Telecom.	653	-	-	-	-	-	653
*	*	99	Paulaner	Germany	Beverages	...	...	...	592	...	...	592
99	442	100	Gillette Company	United States	Hygiene/ Cleaning	361	...	226	...	...	...	587
<b>Total</b>						<b>123 151</b>	<b>70 031</b>	<b>57 472</b>	<b>14 483</b>	<b>6 864</b>	<b>6 998</b>	<b>278 999</b>

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, based on information provided in the following journals and other publications: *Gazeta mercantil, Latino-América*, "1000 maiores empresas da América Latina", September 1999; *América economía*, "Las 500 mayores empresas de América Latina", 29 July 1999 and several other issues in 1999; *Exame*, "As 500 maiores empresas do Brasil, 1999"; *Mercado*, 1999; *Semana*, 19-16 April 1999, No. 885; UNCTAD, *World Investment Report, 1999: Foreign Direct Investment and the Challenge of Development and Fortune*, 2 August 1999.

<sup>a</sup> In some cases, it was not possible to obtain sales figures for some subsidiaries.

<sup>b</sup> Includes more than one company.

<sup>c</sup> Equity shares are held by more than one foreign company.

<sup>d</sup> Gross sales.

<sup>e</sup> Sales for 1997.

<sup>f</sup> Sales estimated by *América economía*.

\* Not ranked.

States-based companies (44.4%) in 1998. Firms from European countries whose sales put them among the 100 largest companies are primarily based in Germany (11.1%), Spain (10.3%), France (9.4%), Italy (5.2%) and the United Kingdom/Netherlands (9%). Japanese transnational corporations account for barely 2.5% of the group's consolidated sales.

Fourth, transnational corporations in the region are highly concentrated in a relatively small number of economic activities. Some of these are the more traditional destinations for FDI in Latin America, such as the automotive industry (24.2%), mining and petroleum (10.3%) and chemicals (6.6%). Others could be considered new activities, such as retail trade (11%), telecommunications (10.2%), and the generation and distribution of electricity (8.3%). Electronics (9.7%) occupies an intermediate position between the two groups, since the portions of this industry located in Mexico and the Caribbean basin have been restructured in order to increase their international competitiveness and supply the North American market.

A number of important aspects and changes relating to the presence of transnational banks in Latin America should also be noted. The total assets of the 20 largest foreign banks in the region are highly concentrated in just three of those banks (BSCH, Citibank and BBVA), which account for 44.8% of this group of banks' total assets and are also the only banks with an extensive network in the six countries considered. The largest of these —Banco Santander Central Hispano (BSCH)—has more than one fifth of the total assets. Here again, it is notable that the main foreign banks in Latin America are not the most important international players. Twelve of these 20 banks are ranked below the top 50 by *The Banker*. Nearly two-thirds (65.3%) of the total value of the assets of these 20 banks is held by banks based in European Union countries, with North American banks having a smaller share (29.7%). The case of the Spanish banks stands out, since they hold nearly one third (32.5%) of the total assets and thus hold a larger share than the North American banks. The assets held by foreign banks tend to be more concentrated in the

Table I.15  
**THE 20 LARGEST FOREIGN BANKS OPERATING IN LATIN AMERICA,  
 BY COMBINED ASSETS, 1998**  
*(Millions of dollars)*

The Banker 1000	ECLAC	Bank	Home country	Argen- tina	Brazil	Chile	Colom- bia	Mexico	Vene- zuela	Total
53	1	Banco Santander Central Hispano (BSCH)	Spain	7 889 <sup>ab</sup>	13 903	14 107	1 816	4 464 <sup>ab</sup>	1 188 <sup>b</sup>	43 367
3	2	Citibank	United States	8 624	6 855	4 758 <sup>ab</sup>	1 437	2 797	591	25 062
61	3	Banco Bilbao Vizcaya Argentaria (BBVA)	Spain	5 192 <sup>b</sup>	5 201	1 800 <sup>b</sup>	1 936 <sup>b</sup>	6 817 <sup>b</sup>	2 059 <sup>b</sup>	23 005
106	4	BankBoston S.A.	United States	8 911	7 723	2 763	108	122	...	19 627
7	5	Hong Kong & Shanghai Bank (HSBC)	United Kingdom	3 338 <sup>b</sup>	11 450	793 <sup>b</sup>	...	3 335 <sup>b</sup>	...	18 916
6	6	ABN Amro	Netherlands	1 797	12 202 <sup>ab</sup>	2 021	81	78	88	16 267
*	7	Banca Commerciale Italiana	Italy	1 232	7 575 <sup>ab</sup>	215	476	...	...	9 498
22	8	Chase Manhattan Bank	United States	642	2 548 <sup>a</sup>	2 450 <sup>ab</sup>	...	137	...	5 777
4	9	Bank of America	United States	2 314	1 212	1 060	...	121	...	4 707
42	10	Lloyds Bank Ltd.	United Kingdom	1 446	2 937	...	181 <sup>b</sup>	...	...	4 564
64	11	Bank of Montreal	Canada	...	...	...	...	4 339 <sup>b</sup>	...	4 339
82	12	Banque Nazionale del Lavoro (BNL)	Italy	3 357	864	...	...	...	...	4 221
126	13	Caixa Geral do Depositos	Portugal	...	4 148 <sup>b</sup>	...	...	...	...	4 148
*	14	Interatlántico	Portugal / France	...	3 698 <sup>b</sup>	...	...	...	...	3 698
62	15	Bank of Nova Scotia	Canada	2 367	...	1 154 <sup>b</sup>	...	...	...	3 521
107	16	Crédit Commercial de France	France	...	3 359	...	...	...	...	3 359
36	17	JP Morgan	United States	1086	...	...	...	1 928 <sup>ab</sup>	...	3 014
*	18	Creditanstalt Bankverein	Austria	198 <sup>b</sup>	2 253 <sup>b</sup>	...	...	...	...	2 450
136	19	Rep. National Bank of New York	United States	1 922	...	348	...	142	...	2 412
20	20	Banque Nationale de Paris (BNP)	France	1 493 <sup>ab</sup>	802	...	...	...	...	2 295
				51 808	86 730	31 468	6 035	24 279	3 926	204 246

**Source:** ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, based on Salomon Smith Barney, "Update on Foreign Financial Institutions in Latin America", March 1999; *Latin Banking Guide & Directory 1999-2000*; Price Waterhouse Coopers, August 1999; and The Banker, "The top 1000 world banks", July 1999; in addition, for Chile, Chile's Superintendency of Banks and Financial Institutions, *Información financiera*, December 1998, Santiago; and, for Argentina, Central Bank of Argentina, 1998, *Información de entidades financieras*.

<sup>a</sup> Has a stake in more than one bank in that country.

<sup>b</sup> Does not hold 100% of the bank's assets, since it shares ownership with other national or foreign banks.

\* Not ranked.



Southern Cone and less so in Mexico. Spanish banks have followed the trend and have persevered with their strategy of acquisitions and mergers aimed at strengthening their position in the region (see chapter III).

The abundant inflow of FDI registered during the 1990s is leading to profound changes in the top

transnational banking institutions and other firms in Latin America. Many of these changes have been led by transnational corporations that are beginning to globalize their operations, as has been the case with a number of Spanish service companies, among others (see chapter III).

#### 4. Modalities of foreign direct investment in the region

Incoming FDI may be used either to create new assets or to purchase existing assets through mergers or acquisitions. There are two avenues in this respect: the purchase of assets from the State through a privatization process, and the purchase of local private-sector companies.

Mergers and acquisitions (particularly those undertaken as a means of obtaining a majority interest in existing companies) played a pivotal role in the boom in FDI seen throughout the world during 1998; this phenomenon was particularly marked in the industrialized countries, where total FDI rose from US\$ 234 billion in 1997 to US\$ 468 billion in 1998. Mega-mergers (above US\$ 500 million) totalled US\$ 210 billion, which was equivalent to 39% of the total value of mergers and acquisitions throughout the world (KPMG, 1999). Among these operations, those conducted by Amoco-British Petroleum and Total-Petrofina (petroleum) (see box I.2), Daimler-Chrysler (motor vehicles), Hoechst-Rhone Poulenc (pharmaceuticals) and DeutscheBank-Bankers Trust (finance) are of particular interest because of their implications for Latin America.

A new record for mega-mergers in the industrialized countries was set in 1999. The telecommunications industry has been one of the most dynamic in this regard (Air Touch-Vodafone, Spring-MCI WorldCom, Telecom Italia-Olivetti, and US West-Global Crossing), as well as retail trade (Carrefour-Promedès, Wal-Mart-ASDA Group Plc). In the former case, mergers and acquisitions are increasingly focused on convergence technologies that

link telecommunications firms, software companies and Internet portals (see box I.3).

In the countries, the proportion of revenues from FDI classified as the purchase of existing assets held steady at around 40% of the total between 1997 and 1999 (see figure I.5). It should be pointed out that the wave of mergers and acquisitions is accounted for by the sizeable sums involved in transactions carried out in the larger Southern Cone countries, such as the privatizations that took place in Brazil during 1997 and 1998, and the sale of private local companies in Argentina and Chile in 1999. Brazil —where the largest privatizations to date have been conducted in the telecommunications industry (the sale of the Telebras system) and the electric power sector (particularly in the area of distribution)— accounted for 70% of the majority-stake mergers and acquisitions in the region.

In the first half of 1999, with the purchase of YPF by Repsol for US\$ 13.158 billion, Argentina became one of the main centres of merger and acquisition activity in Latin America. Chile found itself in a similar position following the acquisition of Enersis and Endesa-Chile by Endesa-España.

In order to gain a clear understanding of the importance of mergers and acquisitions as the main FDI modality in Latin America and the Caribbean, it is necessary to distinguish between the purchase of State assets (through privatizations and the award of concessions) and the purchase of private local companies. It is also instructive to analyse the sectoral impact of the major transactions that have been conducted.<sup>13</sup>

13 The following analysis is based on the stated values of the largest operations, which do not necessarily represent the net amount of incoming FDI.

## Box 1.2

# INTEGRATION OF ENERGY MARKETS IN LATIN AMERICA AND THE CARIBBEAN: THE IMPACT OF OIL COMPANY MERGERS

In 1998, 14% of the total value of the mergers and acquisitions carried out during the year was accounted for by oil companies based in developed countries. In 1999 these companies continued to engage in these types of operations, and the value of these transactions was significant. Among the largest were:

- Amoco (United States) and British Petroleum (United Kingdom), a merger valued at US\$ 34 billion; later, the newly formed firm acquired the United States company Atlantic Richfield (ARCO), valued at US\$ 26.8 billion;
- Exxon and Mobil (United States), valued at US\$ 81 billion;
- Total (France) and Petrofina (Belgium), estimated at US\$ 11.26 billion; in 1999, this consortium merged with Elf Aquitaine (France), valued at US\$ 58.8 billion; and
- Repsol (Spain) and YPF (Argentina), a transaction valued at US\$ 13.158 billion.

These mergers were a response to changes seen in the global petroleum market since the beginning of the 1990s (oversupply, the discovery of new reserves, reduced profit margins in the production of crude oil) and to technological changes (lower-cost secondary deep-well recovery techniques, 3D drilling). Organizational changes involving the creation of business units to manage individual segments of a company's activities independently and the strengthening of marketing

capabilities have provided additional reasons for oil company mergers. As a result of this process, the new corporate strategies are aimed at marketing energy more efficiently on a global level. For these companies, the progressively stronger position of natural gas as the fuel of choice (for industrial and domestic use) and the relative abundance of crude oil lend increasing importance to market access-seeking strategies, as opposed to traditional raw materials-seeking strategies.

The presence in Latin America and the Caribbean of international petroleum companies is of long standing. In the 1990s, the changes that have gradually begun to be made in the regulatory system (governing both upstream and downstream activities, as well as the environment) and the characteristics of supply and demand in the energy market of the Americas have made it possible for these firms to use these new corporate strategies to gain a foothold in the region. In nearly all of the countries, sweeping changes have been made in the regulatory systems governing the hydrocarbons sector; these modifications have, general speaking, involved the following aspects:

- Greater openness in the distribution and marketing of hydrocarbon products.
- Setting of transfer prices on the basis of production costs.

- Incentives for substituting natural gas for petroleum as an energy source.

At the continental level, the energy market in the Americas can be described as being in equilibrium from a medium-term perspective thanks to the coexistence of energy exporting and importing countries. Furthermore, in Latin America and the Caribbean the growth rates of the demand for petroleum (4.5%) and natural gas (7%) are higher than in developed countries.

This set of factors explains the mounting investments being made in the region by transnational energy companies in recent years. In Argentina and Bolivia, where the most far-reaching changes have been in the regulatory system and where nearly all segments of the industry have been privatized, global corporations have found fertile ground for their new strategies (see the section on Bolivia in this chapter). In Argentina, the Spanish company Repsol paid more than US\$ 15 billion for YPF in 1998-1999 in order to pursue the following objectives:

- Development of export markets for petroleum products (butane and propane), in association with Petrobrás and Dow Chemical;
- Exportation of natural gas to Brazil and Chile;
- Integration of gas station chains to market under a single brand, YPF, in the markets of Argentina and Brazil, in partnership with its associated companies, EG3 and Astra.

## Box 1.2 (concluded)

The shifts that have been seen to date indicate that the strategies of the petroleum companies operating in the region in relation to natural gas development will increasingly be focused on the fractionation, distribution and marketing of this energy product. To this end, they are establishing alliances with electric power

companies, such as Enron Corp., AES Corp. and Endesa-España to construct gas pipelines that will link Latin American markets (Brazil, Chile, Argentina, Bolivia and Paraguay) or to operate fractionation plants and gas pipelines with a view to exporting natural gas to the United States

(Trinidad and Tobago, Mexico and Venezuela). Thus far, the most significant impact of these investments in the region has been the addition of enormous hydrocarbon reserves. The example of YPF, in Argentina, illustrates the business potential offered by the integration of Latin American and Caribbean energy markets.

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

### (a) Purchase of State assets

During the period 1998-1999, the purchase of State assets through and concessions was concentrated entirely in services (94% of total value) and in the petroleum subsector (6%). Within the services sector, the most dynamic activities in this regard were: telecommunications (45.1%), electric power (26%), transport (16.4%), sanitation (3.8%) and natural gas distribution (2.1%). Not a single manufacturing firm was included among the major privatizations—amounting to over US\$ 100 million—conducted during this period (see table I.16).

In the primary sector, the first step taken by the Spanish company Repsol to obtain control of the Argentine company Yacimientos Petrolíferos Fiscales (YPF) came in January 1999, when Repsol acquired a 14.9% stake in YPF from the Argentine Government for a little over US\$ 2 billion (see chapter III). Subsequently, it obtained a majority interest in the company by purchasing shares in the hands of domestic and foreign private investors (see tables I.16 and I.17 and chapter III). The Brazilian petroleum subsector has also been gradually opening up to private investment. During 1999, the State company Petróleo Brasileiro S.A. (Petrobras) concluded numerous agreements with international firms for joint petroleum reserve exploration and drilling. Some of the main companies that have begun operations in Brazil are British Petroleum (BP), Elf Aquitaine Group, Esso, YPF-Repsol, Royal Dutch Shell and Mobil.

The telecommunications industry accounted for the bulk of State assets privatized and awarded to foreign companies in Latin America and the Caribbean, with operations that totalled US\$ 21.092 billion during the period 1998-1999. The central event in this process was the privatization of the system, and particularly of the fixed-line telephone companies serving large urban centres—Telecomunicações de São Paulo (Telebras), Empresa Brasileira de Telecomunicações S.A. (Embratel) and Tele Centro Sul. In Brazil, the mobile telephone market was also important, particularly B-band concessions and the privatization of cellular (A-band) telephone companies belonging to the Telebras system (see the section on Brazil in this chapter). The remaining major transactions were centred in Argentina, where the market will arrive at its final stage of deregulation in the year 2000, and in Central America, especially Guatemala and El Salvador, which privatized their national basic-service telephone companies. Thus, through these transactions, some of the main European operators (Telefónica de España, Telecom Italia, Portugal Telecom and France Telecom) have consolidated a strong presence in Latin America, particularly in the Brazilian market. Some of the most actively involved United States companies are MCI WorldCom in Brazil and GTE Corp. and BellSouth in Argentina. One interesting case is that of Teléfonos de México which, with its entry into the Guatemalan market, has begun to

## Box I.3

### MICROSOFT AND AMERICA ON LINE: THE BATTLE BEGINS FOR THE CONVERGENCE MARKET IN LATIN AMERICA

The cable-modem industry is still in its infancy in Latin America, with a scant US\$ 23 million in net sales. However, according to recent projections of Strategis, a company specializing in telecommunications, this market could approach US\$ 740 million by the year 2003, with 84% accounted for by Argentina, Brazil and Mexico, where average revenue per subscriber is US\$ 70, US\$ 70 and US\$ 40, respectively.

The second phase of the deregulation of the telecommunications industry and the significant increase in teledensity are opening the way for the use of convergence technologies, such as cable-modems, and are attracting new foreign telecommunications companies to Latin America. Microsoft, the software giant, has recently set up joint ventures with Teléfonos de México (Telémex), the number one telecommunications firm in Latin American, and the Rede Globo de Televisão, a Brazilian

communications media and cable and satellite television operator. Microsoft has taken important positions in United States and German cable television companies in a bid to compete in providing broad-band Internet services. It has also acquired WEB TV technology, which makes it possible to access the Internet through television sets. Its alliance with Telmex is the most promising of these ventures owing to the infrastructure the company has for wide-band transmission.

In 1999, America Online formed a joint venture (America Online Latin America) with Cisneros, the Venezuelan media group as a means of positioning itself advantageously in the television and Internet services market. Cisneros is the owner of the regionwide operations of Direct TV (satellite television). The new firm started up in Brazil at the end of 1999 and plans to expand into other markets in the region in the future.

Another competitor will soon join the Brazilian Internet services market due to the acquisition of Netstream by AT&T in mid-1999. The United States-based company also has technology for TV-Internet connections. One of the most immediate effects of the introduction of this new technology into two of the region's most important markets has been the reorganization of the operational units of such firms as Telefónica de España (see the section on Brazil in this chapter). For its Internet segment, Telefónica has Terra Networks and has purchased ZAZ, an Internet directory in Brazil, as it readies itself to compete with new entrants. At the global level, the auspicious prospects for convergence technologies, combined with promising earnings in the Latin American market, are attracting investments from United States-based telecommunications and software companies in the region, where until now they have trailed behind European firms in a distant second place.

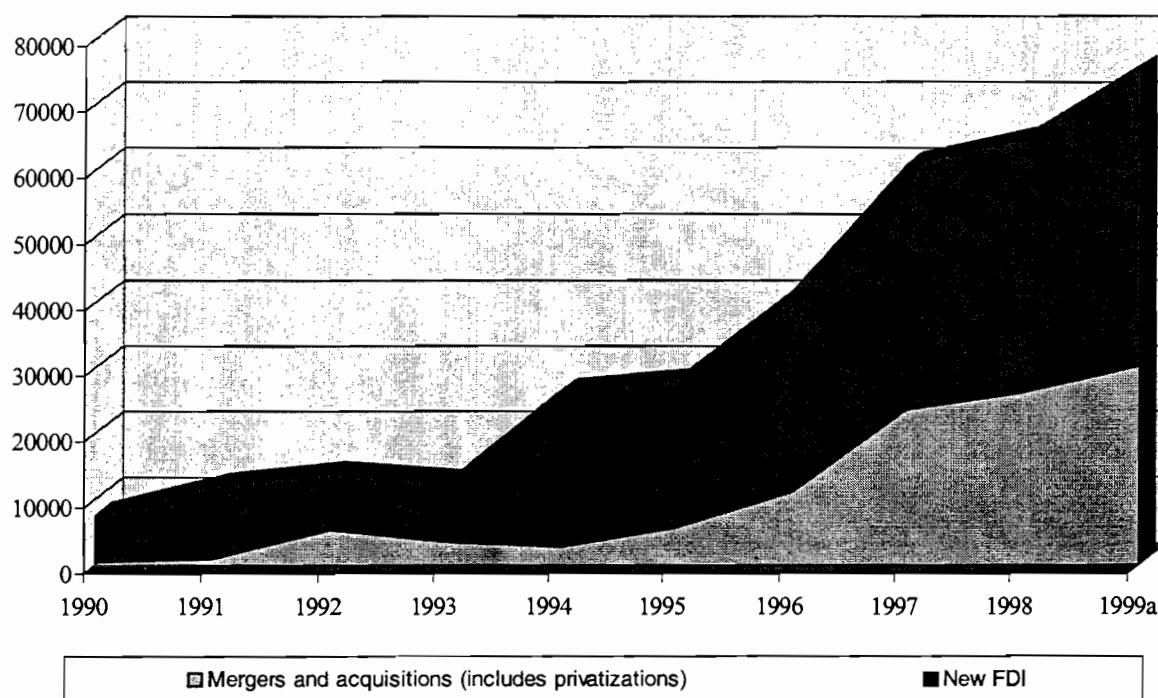
**Source:** Latin America Cable Modem Boom, TV International Daily, 29 October 1999; *Latin America Cable & Satellite Television and Telecommunications Markets: 1999*, P&D Net, 29 October 1999.

consolidate a globalization strategy that began in the United States and has recently been aimed at Central America.

The electric power subsector was in second place in terms of sales of State assets, with a total of US\$ 12.138 billion during this period. Despite the fact that 67% of these operations took place in Brazil, several other smaller-scale economies, such as Colombia, Guatemala, Ecuador, El Salvador, the Dominican Republic and Peru, also aroused the interest of some of the largest international operators. United States companies (AES Corporation, Houston Energy

Industries, Enron Corporation and Duke Energy Corporation) were the most active, displacing European and particularly Spanish firms (Endesa-España, Iberdrola and Unión Eléctrica Fenosa). One of the new entrants in this subsector is Electricidade de Portugal, a company which has not yet built up any significant international presence but which has recently embarked upon an active expansion drive in Latin America (primarily in Brazil, where it can take advantage of cultural, linguistic and economic links between the two countries). It is hoped that privatizations in the area of electric power will

Figure I.5  
**LAIA COUNTRIES: NET FOREIGN DIRECT INVESTMENT INFLOWS, BY MODALITY, 1990-1999**  
 (Millions of dollars)



Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, based on information provided by the International Monetary Fund (IMF); *KMPG Corporate Finance, 1999*; and the ECLAC Unit on Investment and Corporate Strategies, "Informe mensual de fusiones y adquisiciones", April to November 1999.

<sup>a</sup> Estimates computed by the Unit on Investment and Corporate Strategies.

proceed in the region, since there are still a number of major State assets to be transferred to the private sector, particularly in the area of electricity generation.

Some of the main transactions involving other services were the transfer of management responsibility for several major Latin American airports to private hands. The largest of these operations was the award of concessions for 33 Argentine airports to an Italian-United States consortium (see table I.16). Also of note is the entry of foreign investors into the area of sanitation services, where the Spanish-French alliance between de

Barcelona and Suez Lyonnaise des Eaux has proven to be the most active (see box III.5).

#### (b) Purchase of local private companies

During the 1998-1999 biennium, purchases of private local companies by foreign investors exceeded US\$ 40 billion, with a focus on services (52.7%) and the primary sector (33.3%) that crowded out manufacturing, which only accounted for 14.1% of the total sum involved in these transactions (see table I.17). Within the services sector, significant percentages of

Table I.16

**LATIN AMERICA AND THE CARIBBEAN: PRIVATIZATIONS AND CONCESSIONS VALUED AT MORE THAN  
US\$ 100 MILLION INVOLVING FOREIGN INVESTORS, BY SECTOR AND AMOUNT, 1998-1999**  
(Millions of dollars)

Company	Country	Buyer	Home country	Percentage of foreign capital	Amount	Year
<b>1. PRIMARY</b>					<b>2 813</b>	
PETROLEUM AND GAS					2 813	
Yacimientos Petrolíferos Fiscales (YPF)	Argentina	Repsol	Spain	15	2 010	1999
Petróleos de Venezuela (PDVSA) cargo and warehouse terminal	Venezuela	Enbridge (45%) / US Williams International (45%) / Northville Industries (10%)	Canada / United States	100	385	1999
Campo Petrolero Caracoles	Venezuela	China National Petroleum Corporation (CNPC).	China	100	241	1998
Petroleum exploration and drilling leases	Brazil	Several companies	Several countries	...	177	1999
<b>2. MANUFACTURING</b>					-	
<b>3. SERVICES</b>					<b>43 946</b>	
<b>TELECOMMUNICATIONS</b>					<b>21 092</b>	
Telecomunicações de São Paulo (Telesp)	Brazil	Telefónica de España (30%), Banco Bilbao Vizcaya Argentaria (4%), Iberdrola (4%) / Portugal Telecom (12%) / RBS Participações (3%)	Spain / Portugal / Brazil	52	4 970	1998
Telesp Celular Empresa Brasileira de Telecomunicações S.A. (Embratel)	Brazil	Portugal Telecom	Portugal	52	3 084	1998
Tele Centro Sul	Brazil	MCI WorldCom	United States	52	2 278	1998
	Brazil	Italia Telecom (9.8%) / Brazilian investors (41.9%)	Italy / Brazil	52	1 779	1998
Concession Area 3 (Rio de Janeiro and Espírito Santo)	Brazil	South Korea Telecom	Republic of Korea	...	1 327	1998
Tele Sudeste Celular	Brazil	Telefónica de España, Iberdrola / NTT Mobile Communications, Itochu	Spain / Japan	52	1 169	1998
Concession Area 5 (Paraná and Santa Catarina)	Brazil	Motorola / Nissio Iwai / DDI	United States / Japan	...	729	1998
Compañía de Telecomunicaciones de Guatemala (Telgua)	Guatemala	Teléfonos de México (Telmex) (49%) / Consorcio Luca S.A. (51%)	Mexico / Guatemala-Honduras	100	700	1998
Companhia Riograndense de Telecomunicações (CRT)	Brazil	Telefónica de España/ RBS Participações	Spain/Brazil	50 <sup>c</sup>	656	1998
Telecomunicações de Minas Gerais Celular (Telemig Celular)	Brazil	Telesystem Wireless	Canada	52	650	1998
Tele Celular Sul	Brazil	Telecom Italia / Globo y Bradesco	Italy / Brazil	52	602	1998
Tele Nordeste Celular	Brazil	Telecom Italia / Globo y Bradesco	Italy / Brazil	52	567	1998
Concession Area 4 (Minas Gerais)	Brazil	Telecom Italia	Italy	...	457	1998
Tele Leste Celular	Brazil	Telefónica de España (48%) / Iberdrola (4%)	Spain	52	368	1998

Table I.16 (continued 1)

Company	Country	Buyer	Home country	Percentage of foreign capital	Amount	Year
License to operate purchase in greater Buenos Aires	Argentina	France Telecom / Telecom Italia / Telefónica de España	France / Italy/ Spain	100	350 <sup>d</sup>	1999
Concession Area 6 (Rio Grande do Sul)	Brazil	Bell Canada / Telesystem	Canada	...	315	1998
License to operate purchase in Greater Buenos Aires	Argentina	GTE Corp.	United States	100	301d	1999
Compañía de Telecomunicaciones de El Salvador S.A. de C.V. (CTE-ANTEL)	El Salvador	France Telecom	France	51	275	1998
Licenses to operate purchase in the interior (four licenses)	Argentina	Telefónica de España / Telecom Italia / France Telecom / BellSouth	Spain / Italy / France / United States	100	198	1999
Tele Norte Celular	Brazil	Telesystem Wireless	Canada	52	162	1998
Eletronete	Brazil	AES Corporation	United States	51	155	1999
<b>ELECTRIC POWER</b>					<b>12 138</b>	
Electropaulo Metropolitana de Eletricidade S.A.	Brazil	AES Corp. / Houston Energy / Electricité de France (through Light Services Electricidade S.A.)	United States/ France	75	3 018	1998
Corporación Eléctrica de la Costa Atlántica (CORELCA) (Electrocosta and Electrocaribe)	Colombia	Houston Energy Industries / Corporación Electricidad de Caracas	United States / Venezuela	65	1 316 <sup>f</sup>	1998
Elektro Electricidade e Serviços (subsidiary of Companhia Energetica de São Paulo (CESP))	Brazil	Enron Corporation	United States	47	1 273	1998
Companhia Energética do Ceará (COELCE)	Brazil	Endesa-España (19%) / Enersis, Chilectra (13%) / Cerj (19%) <sup>g</sup>	Spain / Chile <sup>h</sup> / Portugal	51	868	1998
Empresa Bandeirante de Energia	Brazil	Electricidade de Portugal	Portugal	30	859	1998
Centrais Geradoras do Sul do Brasil (GERASUL)	Brazil	Tractebel	Belgium	42	802	1998
Companhia de Geração de Energia Elétrica Parapanema (filial de CESP)	Brazil	Duke Energy Corp	United States	39	692	1999
Empresa Eléctrica de Guatemala (EEGSA)	Guatemala	Iberdrola / Eletricidade do Portugal / Tampa Energy	Spain / Portugal / United States	80	520	1998
Companhia de Geração de Energia Elétrica Tietê	Brazil	AES Corporation	United States	61	486	1999
Concession to generate electricity	Ecuador	Wärtsilä Power	Finland	...	350	1999
Compañía. de Alumbrado Eléctrico de San Salvador (CAESS)	El Salvador	Corporación Electricidad de Caracas	Venezuela	75	297	1998
Empresas de Distribución de Energía Eléctrica Norte y Sur	Dominican Republic	Unión Eléctrica Fenosa	Spain	50	212	1999
Distribuidora de Electricidad del Sur	El Salvador	Empresa Eléctrica de Melipilla, Colchagua y Maule, EMEL (controlled By Pennsylvania Power & Light)	United States / Chile	75	180	1998

Table I.16 (continued 2)

Company	Country	Buyer	Home country	Percentage of foreign capital	Amount	Year
Compañía Generadora de Electricidad Itabo	Dominican Republic	Gener / Coastal Power	Chile / United States	50	177	1999
Empresa Generadora de Electricidad Haina	Dominican Republic	Enron Corporation	United States	50	145	1999
Companhia de Eletricidade do Estado da Bahia (COELBA)	Brazil	Iberdrola	Spain	30	140	1999
Generadora Acajutja S.A. de C.V. y Generadora Salvadoreña S.A. de C.V.	El Salvador	Duke Energy Corp	United States	80	125	1999
Construction of Cuchiquesera dam	Peru	Oderbrecht	Brazil	...	124	1999
Generadora Fortuna	Panama	Coastal Power / HydroQuebec	United States / Canada	49	118	1999
Construction of Yucatán hydroelectricity plant	Peru	Skanska	Sweden	60	117	1999
Compañía de Luz Eléctrica de Santa Ana (CLESA)	El Salvador	AES Corporation	United States	75	109	1998
Empresa Distribuidora Eléctrica del Este	Dominican Republic	AES Corporation	United States	50	109	1999
Instituto Nacional de Electrificación (INDE)	Guatemala	Unión Eléctrica Fenosa	Spain	80	101	1999
<b>TRANSPORTATION</b>					<b>7 670</b>	
Aeropuertos Argentina 2000	Argentina	Ogden (36%) / Societá Esecizi Aeroportuali (28%) / Grupo Eumekian (35%) / Constructora Riva (1%)	United States / Italy / Argentina	...	5 134	1998
Road concession for Santiago-Talca segment, Route 5	Chile	Cintra Concesiones	Spain	...	750	1999
Concession to operate four airports	Dominican Republic	Ogden	United States	...	400	1999
San José Airport Concession	Costa Rica	Airport Group International	United States	...	279	1999
Airports of the Southeast	Mexico	Copenhaguen Airports / Group GTM / Cintra Concesiones	Denmark / France / Spain	...	276	1999
Airports of the Pacific	Mexico	Unión Fenosa / Aena / Dragados y Construcciones	Spain	15	260	1999
Concession Empresa Fluminense de Trens Urbanos (Flumitrens)	Brazil	Renfe	Spain	...	241	1998
Concession for the Santa María Airport	Costa Rica	Lockheed Martin / George Soros	United States	...	180	1999
Manzanillo International Terminal	Panama	Stevedoring Services of America	United States		150	1998
<b>SANITATION</b>					<b>1 754</b>	
Empresa Metropolitana de Obras Sanitarias (EMOS)	Chile	Aguas de Barcelona / Suez Lyonnais des Eaux	Spain / France	42	960	1999
Concession for operation of sanitation services in Buenos Aires	Argentina	Azurix (subsidiary of Enron Corporation)	United States	100	439	1999
Companhia de Saneamento do Paraná (SANEPAR)	Brazil	Groupe Vivendi (Compagnie Générale des Eaux)	France	14	217	1998
Empresa de Obras Sanitarias de Valparaíso (ESVAL)	Chile	Endesa-España (through Enersis) / Anglian Waters	Spain / United Kingdom	40	138	1998



Table I.16 (concluded)

Company	Country	Buyer	Home country	Percentage of foreign capital	Amount	Year
<b>GAS DISTRIBUTION</b>					<b>988</b>	
Companhia de Gás de São Paulo (Comgás)	Brazil	Royal Dutch-Shell Group/ BritishGas	Netherlands / United Kingdom	53	988	1999
<b>FINANCIAL SERVICES</b>					<b>304</b>	
Banco do Estado de Pernambuco (BANDEPE)	Brazil	ABN Amro Bank	Netherlands	100	154	1998
Management of the civil service capitalization pension system (SIACAP)	Panama	Four companies and the Social Security Fund (CCS)	Several countries	...	150	1999
<b>4. TOTAL</b>					<b>46 759</b>	

**Source:** ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, based on information published in *Latin Trade*, *América económica*, *Wall Street Journal*, *Gazeta Mercantil*, *El Financiero*, *Estrategias* and other specialized publications.

<sup>a</sup> The main participating companies were British Petroleum, Elf Aquitaine Group, Mobil, Repsol, Exxon and Shell.

<sup>b</sup> The operator will be Teléfonos de México (Telmex).

<sup>c</sup> In December 1996, 35% of Companhia Riograndense de Telecomunicações (CRT) was sold; subsequently, in July 1998, another 50% of the equity in the hands of the Brazilian State was privatized; Telefónica de España ended up with a stake of almost 77% in CRT.

<sup>d</sup> In addition to this amount, both of the companies will have to pay US\$ 324 million in order to compete in this market.

<sup>e</sup> In 1998, Eletronet was created in order to build a national broad-band network that will be hooked up to the electric power transmission network in Brazil.

<sup>f</sup> Debt accounts for approximately US\$ 766 million.

<sup>g</sup> Companhia de Eletricidade do Estado do Rio de Janeiro (Cerj) is controlled by Endesa-España and Eletricidade de Portugal.

<sup>h</sup> Company/companies controlled by Endesa-España.

<sup>i</sup> In January 1998, 20-year management concessions for 33 Argentine airports were awarded to an international consortium. The winning consortium committed to investing US\$ 2.228 billion, of which 50% will be used for the Airport of Buenos Aires (Ezeiza).

<sup>j</sup> Consortium formed by the Banco Bilbao Vizcaya Argentaria and Wall Street Securities; Profuturo, made up of Citibank, Banco General, the Banco Continental and ASSA; Progreso de Inversiones, in which Banco Exterior, Aseguradora Mundial, Banvivienda, Pribanco; Bipan and Compañía Nacional de Seguros; and the DISA-ING consortium.

those operations were conducted by banking and financial services (22.9%), electric power (13.4%), retail trade (8.2%) and telecommunications (7.6%).

At the beginning of 1999, a single transaction in the petroleum subsector—the purchase of the outstanding equity in YPF by Repsol for US\$ 13.158 billion—represented 98% of the total value of acquisitions in this area and 32.7% of the aggregate amount of all those carried out during the period 1998-1999. With this acquisition, Repsol became the second-largest foreign company in the hydrocarbons sector in Latin America, second only to the United States company Exxon Corporation, which has also

expanded its activities into the mining subsector (see table I.14).

In the manufacturing sector, the food, beverages and tobacco industries accounted for more than 50% of all purchases of privately-held local assets. During the period under review, the United States corporation Coca-Cola Company moved forward with its effort to consolidate and increase its presence with its bottlers in Latin America, particularly in Chile and Peru (see table I.17 and ECLAC, 1998, box III.1). The strategy aimed at positioning the dairy and candy industries—areas in which leading roles are played by the European groups Parmalat, Danone and Nestlé—on a regionwide scale was also intensified. Almost all the

Table I.17  
**LATIN AMERICA AND THE CARIBBEAN: PURCHASES OF PRIVATE LOCAL  
 COMPANIES BY FOREIGN INVESTORS FOR OVER US\$ 100 MILLION,  
 BY SECTOR AND AMOUNT, 1998-1999**  
*(Millions of dollars)*

Company sold	Country	Buyer	Home country	Percentage acquired	Amount	Date
<b>1. PRIMARY</b>					<b>13 375</b>	
<b>PETROLEUM AND</b>						
<b>NATURAL GAS</b>					<b>13 375</b>	
Yacimientos Petrolíferos Fiscales (YPF)	Argentina	Repsol	Spain	83	13 158	1999
Companhia São Paulo de Petróleo	Brazil	Agip Petroli S.A.	Italy	100	217	1998
<b>2. MANUFACTURING</b>					<b>5 655</b>	
<b>FOOD, BEVERAGES AND TOBACCO</b>					<b>2 947</b>	
Grupo Modelo S.A. C.V.	Mexico	Anheuser-Busch	United States	13	556	1998
Tabacalera San Cristóbal	Honduras	La Tabacalera	Spain	100	367	1998
Productos Klim	Colombia	Nestlé	Switzerland	100	313	1998
United Trading (UTC)	Chile	Fresh del Monte Produce Inc.	United States	100	269	1998
FEMSA Cerveza	Mexico	Labatt Brewing Co.	Canada	8	222	1998
Inca Kola	Peru	The Coca-Cola Company	United States	50	200	1999
Industria Alimenticia Batavia <sup>a</sup>	Brazil	Parmalat SpA	Italy	51	200	1998
Embotelladoras Coca-Cola Perú	Peru	Embotelladora de Arica (Embonor) <sup>b</sup>	Chile / United States	...	186	1999
Embotelladora de Arica (EMBONOR) <sup>b</sup>	Chile	The Coca-Cola Company	United States	27	186	1999
Termas de Villavicencio	Argentina	Groupe Danone	France	100	135	1999
Perma Industrias de Bebidas S.A.	Brazil	Embotelladora Andina	Chile	100	108	1999
Embotelladoras Argos S.A. (ARSA)	Mexico	The Coca-Cola Company	United States	20	105	1998
La Serenísima <sup>c</sup>	Argentina	Groupe Danone	France	40	100	1999
<b>OTHER MANUFACTURERS</b>					<b>2 708</b>	
Igaras Papeis e Embalagens S.A.	Brazil	Jefferson Smurfit Group PLC	Ireland	...	511	1998
Elevadores Atlas S.A.	Brazil	Schindler Group	Switzerland	64	482	1999
Companhia Siderúrgica de Tubarão (CST)	Brazil	Usinor S.A.	France	19	389	1998
Grupo Diamante Samper	Colombia	Valenciana de Cementos (subsidiary of Cemex)	Spain / Mexico	90	262	1998
Companhia Aços Especiais Itabira (Acesita)	Brazil	Usinor S.A.	France	28	236	1998
Varig Motores S.A.	Brazil	General Electric Co.	United States	50	180	1998
Sabo Indústria e Comercio	Brazil	Federal Mogul Corporation	United States	...	180	1999
Companhia Materiais Sulfurosos	Brazil	Lafarge Group	France	...	159	1998
Elevadores Sur	Brazil	Thyssen Krupp A.G.	Germany	100	109	1999
Planta de DHC d	Brazil	Delphi Automotive Systems	United States	100	100	1999
Atica y Scipione	Brazil	Grupo Anaya	Spain	50e	100	1999
<b>3. SERVICES</b>					<b>21 169</b>	
<b>BANKING AND FINANCIAL SERVICES</b>					<b>9 220</b>	
Banco Real	Brazil	ABN-Amro Bank	Netherlands	40	2 100	1998

Table I.17 (continued 1)

Company sold	Country	Buyer	Home country	Percentage acquired	Amount	Date
Banco Excel Econômico	Brazil	Banco Bilbao Vizcaya Argentaria	Spain	100	878	1998
Banco de Investimentos Garantia	Brazil	Credit Suisse First Boston (CSFB)	Switzerland	100	675	1998
Sociedad O'Higgins Central Hispano (OHCH)	Chile	Banco Santander Central Hispano	Spain	50	600	1999
Banco Noroeste	Brazil	Banco Santander Central Hispano	Spain	76	564	1998
Banco Bandeirantes S.A.	Brazil	Caixa Geral de Depositos	Portugal	90	358	1998
Banco Hipotecario de Fomento (BHIF)	Chile	Banco Bilbao Vizcaya Argentaria	Spain	55	350	1998
Grupo Siembra (Siembra AFPJ, Sur Seguros de Retiro and Sur Seguros de Vida)	Argentina	Argentaria	Spain	50	280	1998
AFP Provida <sup>g</sup>	Chile	Banco Bilbao Vizcaya Argentaria	Spain	41	266	1999
Afore Banamex (now Afore Banamex-Aegon)	Mexico	Aegon N.V.	Netherlands	48	264	1998
Seguros Bital	Mexico	ING Barings	Netherlands	49	225	1999
Banco Geral do Comercio (now Banco Santander Brasil)	Brazil	Banco Santander Central Hispano	Spain	50h	219	1998
Banco del Buen Ayre S.A.	Argentina	Banco Itaú S.A.	Brazil	100	214	1999
AFJP Consolidar	Argentina	Banco Bilbao Vizcaya Argentaria	Spain	36	200	1999
Segurança ao Crédito e Informações (SCI)	Brazil	Equifax Inc.	United States	80	198	1998
Banco America do Sul	Brazil	Banca Commerciale Italiana	Italy	80	191	1998
Caja de Ahorro y Seguro S.A.	Argentina	Assicurazioni Generali SpA	Italy	33	190	1998
Banco Wiese	Peru	Banca Commerciale Italiana	Italy	65	180	1999
Banco Santa Cruz	Bolivia	Banco Santander Central Hispano	Spain	90	180	1998
Banco Río de la Plata <sup>i</sup>	Argentina	Banco Santander Central Hispano	Spain	16	180	1998
Banco Ganadero	Colombia	Banco Bilbao Vizcaya Argentaria	Spain	...	177	1998
Banco Caracas	Venezuela	IRSA (George Soros)	Argentina	60	150	1999
AFP Unión	Peru	Banco Santander Central Hispano	Spain	100	135	1999
Asistencia Médica Social Argentina S.A. (AMSA)	Argentina	Aetna	United States	100	120	1999
Banco Sudamericano	Chile	Bank of Nova Scotia	Canada	33j	116	1999
Banco Patrimonio de Inversión	Brazil	Chase Manhattan Bank	United States	100	110	1999
Banco de Galicia y Buenos Aires	Argentina	Banco Santander Central Hispano	Spain	...	100	1999
<b>ELECTRIC POWER</b>					<b>5 378</b>	
Endesa-Chile	Chile	Endesa-España <sup>k</sup>	Spain	30	2100	1999
Enerdis	Chile	Endesa-España	Spain	32	1450	1999
Enerquinta (subsidiary of Chilquinta)	Chile	Sembra Energy and Public Service Enterprise Group (PSEG)	United States	90	840	1999
Emdersa	Argentina	GPU Inc.	United States	100	435	1998

Table I.17 (continued 2)

Company sold	Country	Buyer	Home country	Percentage acquired	Amount	Date
Empresa Distribuidora de la Plata (EDELAP)	Argentina	AES Corp.	United States	90	350	1998
Empresa Eléctrica EMEC S.A.	Chile	CGE	France	76	203	1999
<b>RETAIL TRADE</b>					<b>3 308</b>	
Pão de Açúcar	Brazil	Casino Guichard Perrachon	France	26	865	1999
Supermercados Norte <sup>m</sup>	Argentina	Promodès	France	49	420	1998
Disco	Argentina	Royal Ahold N.V.	Netherlands	50	368	1998
San Cayetano	Argentina	Casino Guichard Perrachon	France	75	250	1999
Grupo Cinha	Brazil	Carrefour	France	40	250	1999
Mercadorama	Brazil	Sonae	Portugal	100	230	1998
Almacenes Éxito	Colombia	Casino Guichard Perrachon	France	25	205	1999
Musimundo	Argentina	The Exxel Group	United States	100	200	1998
Lojas Americanas	Brazil	Carrefour	France	...	199	1998
Grandes Superficies de México	Mexico	Carrefour	France	...	192	1998
Supermercados González e Hijos	Argentina	Royal Ahold (through Disco)	Netherlands	100	129	1999
<b>TELECOMMUNICATIONS</b>					<b>3 053</b>	
CEI Citicorp Holdings <sup>n</sup>	Argentina	Hicks, Muse, Tate & Furst	United States	43	842	1998
Telecom Argentina	Argentina	Telecom Italia / France Telecom	Italy / France	350	530	1999
Companhia Riograndense de Telecomunicações (CRT) <sup>p</sup>	Brazil	Portugal Telecom	Portugal	20	375	1998
Occidente y Caribe Celular (OCCEL)	Colombia	Bell Canada Inc.	Canada	68	302	1998
Netstream	Brazil	AT&T Corp.	United States	100	300	1999
VTR Hipercale	Chile	United International Holding (UIH)	United States	66	258	1999
Comtel Comunicaciones	Venezuela	BellSouth	United States	60	210	1998
Globo Cabo S.A.	Brazil	Microsoft	United States	12	126	1999
Cablevisión del Comahua	Argentina	Hicks, Muse, Tate & Furst	United States	100	110	1999
<b>OTHER SERVICES</b>					<b>210</b>	
Vendor	Mexico	Outdoor Systems Inc.	United States	44	210	1998
<b>4. TOTAL</b>					<b>40 199</b>	

**Source:** ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, based on information published in *Latin Trade*, *América económica*, *Wall Street Journal*, *Gazeta Mercantil*, *El Financiero*, *Estrategias* and other specialized publications.

<sup>a</sup> The Italian company Parmalat purchased the Brazilian firm Eti, which is one of the largest producers of tomato products and canned goods. It also entered into a partnership with the Cooperativa Central de Laticínios do Paraná (CCLPL) to create Batávia, a new company in which Parmalat has a 51% interest. This transaction has allowed the Italian firm to broaden its dairy product lines and to move into the meat and poultry products segment of the market.

<sup>b</sup> At the end of 1998, Embotelladora Arica (Embonor) began talks with the British company Inchcape Plc to acquire its shares in Embotelladora Williamson Balfour de Chile and in Embotelladora Latinoamericana (ELSA) of Peru. These two companies were acquired at the beginning of 1999 by Embonor for a total of close to US\$ 750 million; the latter, in order to finance the transaction, obtained an agreement from Coca-Cola Company to increase its ownership share in the company. Between November 1998 and the end of 1999, this United States company increased its stake in Embonor from 6% to 44.4%.

<sup>c</sup> In addition to acquiring part ownership in La Serénísima, the French group Danone increased its stake in Bagley, a company that produces crackers and cookies. In 1999, with a disbursement of US\$ 76 million, Danone's share in Bagley rose to 91%.

<sup>d</sup> Delphi held 49% of DHB. In 1999, DHB sold it one of its plants and assumed Delphi's stock share in the company.

Table I.17 (concluded)

<sup>e</sup> Grupo Anaya y Abril -the leading Brazilian publisher of newspapers and magazines in Latin America- acquired all of the shares of the Brazilian publishers Ática and Scipione. Each retained a 50% share, and the amount indicated represents a payment of 100% for the companies.

<sup>f</sup> For its Latin American expansion, the Banco Central Hispano (BCH) and the Chilean group Luksic set up the firm O'Higgins Central Hispano (OHCH) as an equal partnership. At the end of 1998, the firm held 43.5% of Banco Santiago (Chile), 88% of Banco del Sur (Peru), 100% of Banco Tornquist (Argentina) and 77% of Banco de Asunción (Paraguay). At the beginning of 1999, the firm was dissolved as a result of the merger of BCH with Banco Santander, and the Luksic group was paid US\$ 600 million for its share of OHCH.

<sup>g</sup> Ninety percent of Corp Group Pension is owned by the Chilean Corp Group International Limited, and the remaining 10% is owned by the National Bank of Canada. With the acquisition of Corp Group Pensions, Banco Bilbao Vizcaya indirectly acquires 40.74% of Provida (Chile), which has branches in Mexico, Peru, Colombia, Ecuador, El Salvador and Poland.

<sup>h</sup> With this acquisition, Banco Santander Central Hispano obtained 100% ownership of Banco Geral do Comercio, which, merged with other operations in Brazil, gave rise to the new firm Banco Santander Brasil.

<sup>i</sup> In August 1997, Santander acquired 35% of the capital stock of Banco Río de la Plata for US\$ 656 million. During 1998, it purchased an additional interest for US\$ 151 million. Following these acquisitions, and as a result of the merger of Banco Río and Banco Santander Argentina in the last quarter of 1998, Grupo Santander came to control 51.2% of Banco Río de la Plata. Banco Santander also signed a new purchase option agreement for an additional 21.42% of the capital stock of that Argentine firm for US\$ 174 million (US\$ 5.41 per share), to expire in June 2001 (Calderón y Casilda 1999).

<sup>j</sup> With this acquisition, the Bank of Nova Scotia obtained 60% ownership of Banco Sudamericano.

<sup>k</sup> Endesa-España, through its subsidiary Enersis, increased its stake in Endesa-Chile from 25.3% to 60%.

<sup>l</sup> Endesa-España increased its share in Enersis from 32% to 64%.

<sup>m</sup> The French chain Promodès and the United States-Argentine group The Exxel Group jointly acquired the Norte supermarket chain. Promodès holds a 49% interest.

<sup>n</sup> This transaction, which includes two purchases, allowed the purchasing group to obtain 66% of the shares of the group CEI-Citicorp (see box III.2). On 1 July 1999, France Telecom and Telecom Italia completed the joint purchase of 35% of Nortel Inversora S.A., which was controlled by the Argentine group Perez Companac and the United States bank JP Morgan. Thus, these two European companies own 100% of Nortel, giving them control of 60% of Telecom Argentina.

<sup>p</sup> On 25 June 1998 Portugal Telecom acquired 20% of Companhia Riograndense de Telecomunicações (CRT). This transaction was completed through the purchase of 23% of the consortium that holds 85.1% of the common shares of CRT, thus guaranteeing Portugal Telecom a role in the management of the Brazilian company. Other members of this consortium include Telefónica de España, Iberdrola and Banco Bilbao Vizcaya Argentaria.

mergers and acquisitions carried out in other manufacturing activities (iron and steel, metallurgy and motor vehicle parts) were in Brazil.

In the services sector, the largest transactions of this sort occurred in the area of financial services (banks, insurance companies and pension fund managers), where acquisitions amounted to a total of US\$ 9.22 billion (see table I.17). As a consequence of the implementation of broad-ranging deregulation and liberalization programmes for these activities, in combination with the difficulties experienced by local financial institutions in a more unstable economic environment, in most of the region's economies some of the major private local institutions were acquired by foreign banks. The largest of these transactions occurred in Brazil—the region's largest market—and included the purchase of 40% of Banco Real, the fourth-largest institution in the market, by the Netherlands' for US\$ 2.1 billion. European banks took greatest advantage of the opportunities in Latin America, with the two largest Spanish institutions,

BSCH and BBVA (see chapter III) standing out clearly from the pack. Once a broad network of banking institutions had been consolidated in the main Latin American economies, these banks began to diversify their regional operations by moving into pension fund management, insurance and health care. The purchase of leading local institutions in these market segments has been essential to this strategy, and the acquisition by BBVA of the Chilean pension fund manager Provida and its subsidiaries in other countries of the region has been a key event in this respect. A substantial number of private local firms in the electric power generation and distribution industry were also acquired. One of the most significant players in this respect has been Endesa-España, which purchased 32% of the Chilean firm Enersis for US\$ 1.45 billion, thus gaining a 66% interest in this regionally prominent energy group, and 30% (through Enersis) of the Chilean electricity generating company Endesa for US\$ 2.1 billion. These operations enabled Endesa-España to move into a leadership position in one of the

most important subsectors of the Latin American economy (see chapter III).

In retail trade, one of the main developments has been the strong expansion, through mergers and acquisitions, of some of the largest European operators in the countries, particularly in Brazil and Argentina. This has enabled the French companies Carrefour, Promodès and Casino, together with the Argentine-Dutch alliance Disco-Royal Ahold, to begin to consolidate new supermarket chains in a sector that has traditionally been dominated by local companies (see the section on Brazil in this chapter and in chapter II).

Another important development in the telecommunications sector is the search for convergence strategies to link up the different segments of this market. Thus, firms that already have a presence in fixed-line or cellular telephony have been seeking out business opportunities in other content and entertainment activities, such as cable television. For example, the United States conglomerate Hicks, Muse, Tate & Furst—in association with Telefónica de España—has played a central role in the creation of a multimedia group in Argentina (see box III.2).

Furthermore, despite the fact that the most important transactions in this subsector have been carried out through privatizations, in recent years there have been some interesting transfers of ownership, such as the increased share acquired by Telecom Italia and France Telecom in Telecom Argentina and the greater presence of Portugal Telecom in the Companhia Riograndense de Telecomunicações (CRT).

In summary, it is essential to take the different modalities of foreign investment in Latin America and the Caribbean into account, since transactions that create new assets have a significantly different impact on the recipient economy than those that transfer State or private property to foreign companies. The State has the highly important role of ensuring that the sale of national assets (especially in the case of those owned by the State) to transnational corporations is accompanied by an effective regulatory framework and by formal commitments on the part of the purchasers that result in clear benefits for the consumer, in terms of expanded and improved services, and for the economy as a whole, in terms of its modernization and the improvement of its systemic competitiveness.

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## **C. EXAMPLES OF NEW NATIONAL STRATEGIES IN LATIN AMERICA RELATING TO FOREIGN DIRECT INVESTMENT**

The successful cases of Costa Rica and Bolivia, which will be analysed below, are mainly a result of these countries' foreign investment policies, rather than simply being the outcome of deregulation, liberalization and privatization programmes. The first step in devising these policies was to design a strategy based on the full development of the country's

competitive advantages; this then served as a basis for identifying priority areas for investment. As will be seen below, there have been significant sectoral, macro- and microeconomic impacts from foreign investments made in the apparel and electronics industries in Costa Rica and in the energy sector of Bolivia.

## 1. Foreign direct investment policy in Costa Rica: targeting high-technology sectors and international competitiveness

FDI flows in Costa Rica grew rapidly during the 1990s to reach an all-time high of US\$ 559 million in 1998 (see table I.8). The macroeconomic impact of this has been significant: incoming investment in 1998 was equivalent to 6% of gross domestic product (GDP), and 64% of the stock of foreign investment has been accumulated during the 1990s.

Costa Rica's position with respect to foreign investment is exceptional in many ways. The range of sectors of economic activity to which investment flows have been channelled has changed radically in recent years as a result of a *proactive* and innovative policy for attracting foreign investment that has had a decisive impact in terms of the country's international competitiveness. The policy has turned Costa Rica into one of the main destinations for foreign investment in Central America and has made it the subregion's fastest growing exporter of products that are in great demand on international markets.

The predominant corporate strategy with regard to FDI in Costa Rica is an *efficiency-seeking* strategy focusing on exports to the United States market. As will be discussed below, the corporate strategies being applied are closely aligned with the foreign investment policy of the Costa Rican Government.

### (a) From apparel to electronics

In the 1960s and 1970s, like most Latin American countries, Costa Rica embarked upon a policy of industrialization based on import substitution, with the aim of diversifying its production apparatus and reducing its dependency on agricultural exports, which are prone to very pronounced cycles on international markets (Mortimore and Zamora, 1998). The results of the import substitution policy in Costa Rica were far less satisfactory than those obtained in other countries, and in the early 1980s its exports still depended on traditional agricultural goods such as bananas, sugar and coffee. By the middle of that decade, the country's macroeconomic imbalance had reached critical levels, and the authorities decided to revamp their economic policies.

In 1973, a temporary customs clearance regime and a system of tax credit certificates (CAT) and increased export certificates (CIEEX) were created under the Export Promotion Act in an effort to promote

exports and channel investments into internationally competitive sectors. Due partly to the high level of protection existing in the economy at that time, initially these instruments were not very successful, but in 1984 the authorities decided to give them a boost by combining them with a macroeconomic adjustment and trade liberalization programme.

The reorientation of the Costa Rican economy in support of export growth involved a gradual dismantling of tariff barriers with the aim of lowering the tariff ceiling to 20% on consumer goods and 5% on capital goods by 1992. This was accompanied by legislative amendments to promote exports and broaden the coverage of both export subsidies and tax and tariff exemptions on imported inputs. These export promotion schemes were originally intended to be temporary measures, as the Government was well aware of the constraints that an export bias generated in this way could impose on an economy that has good overall long-run performance, either by creating a deficit on the current account of the balance of payments or else as a result of weak linkages between the external sector and the rest of economy.

The central aim of these policies was to promote exports, and the results can be assessed in terms of the changes that have taken place within the manufacturing sector and their impact on international competitiveness. Table I.18 indicates that Costa Rica's international competitiveness improved in the North American (United States and Canadian) market in 1980-1995. Its overall share of total North American imports rose from 0.15% to 0.23%. The country's share was highest in agricultural products (in the 1.2%-1.36% range), but the most dramatic increase was in its share of the market for manufactures (from 0.03% to 0.16%), and especially manufactures not based on natural resources. During the period 1980-1995, the composition of Costa Rican exports to the North American market shifted from primarily natural resources (85.2% of the total) in 1980 to principally manufactures (56.6%) in 1995. An analysis of Costa Rica's 10 main exports to that market shows that the same 10 products accounted for three quarters of the value of those exports throughout the period considered, but that their relative contribution changed radically. Natural resources such as fruit and nuts

Table I.18  
**COSTA RICA: ASPECTS OF INTERNATIONAL COMPETITIVENESS IN THE  
 NORTH AMERICAN MARKET (UNITED STATES AND CANADA)**  
*(Percentages)*

	1980	1985	1990	1995	1996
<b>I. Share of North American imports</b>	<b>0.15</b>	<b>0.15</b>	<b>0.19</b>	<b>0.23</b>	<b>0.23</b>
Natural resources (1+2+3)	0.31	0.45	0.48	0.61	0.60
Agriculture (1)	1.20	1.17	1.25	1.36	1.39
Energy (2)	-	0.01	-	-	-
Textile fibres, minerals and metal ore (3)	0.03	0.05	0.02	0.04	0.05
Manufactures (4+5)	0.03	0.06	0.12	0.16	0.16
Based on natural resources (4)	0.03	0.04	0.07	0.06	0.06
Not based on natural resources (5)	0.03	0.06	0.13	0.16	0.16
Other (6)	0.07	0.04	0.08	0.11	0.15
 <b>II. Contribution (composition of Costa Rican exports to this market)</b>	 <b>100.0</b>	 <b>100.0</b>	 <b>100.0</b>	 <b>100.0</b>	 <b>100.0</b>
Natural resources (1+2+3)	85.2	71.0	49.6	41.8	42.3
Agriculture (1)	84.8	70.1	49.5	41.6	42.0
Energy (2)	-	0.5	-	-	-
Textile fibres, minerals and metal ore (3)	0.4	0.5	0.2	0.2	0.2
Manufactures (4+5)	13.5	28.1	49.1	56.6	55.3
Based on natural resources (4)	1.0	1.2	1.4	1.1	1.1
Not based on natural resources (5)	12.5	27.0	47.7	55.5	54.3
Other (6)	1.3	0.8	1.3	1.6	2.4
 <b>III. Ten main Costa Rican exports to this market</b>	 <sup>a</sup> <b>78.4</b>	 <b>74.0</b>	 <b>73.0</b>	 <b>72.3</b>	 <b>72.6</b>
057 Fruit and nuts (not including oilseeds), fresh or dried	+ 34.4	34.1	27.2	24.3	24.3
846 Undergarments, knitted or crocheted	* + 5.2	5.0	9.9	12.6	12.3
842 Wearing apparel, men's and boys, of textile fibres	* + 0.5	3.7	9.7	11.6	10.3
071 Coffee and coffee substitutes	+ 17.6	12.5	6.0	4.6	4.3
845 Wearing apparel and other articles, knitted or crocheted	* + 0.3	0.6	3.1	4.0	3.9
844 Undergarments, textile fabrics (other than knitted or crocheted goods)	* + 0.1	2.0	2.9	4.6	3.9
843 Outer garments, women's and girls, of textile fibres	* + 2.6	5.4	6.8	3.5	3.3
054 Vegetables, fresh, chilled, frozen or simply preserved	+ 0.8	1.0	1.6	2.5	2.6
897 Jewellery, goldsmiths' and silversmiths' wares, etc.	* + -	0.4	1.2	2.7	2.6
775 Electrical and non-electrical household appliances	-	...	0.9	2.4	2.5

**Source:** ECLAC, Information Centre of the Unit on Investment and Corporate Strategies based on the CANPLUS program.

Product groups based on the Standard International Trade Classification (SITC, Rev. 2).

(1) Sections 0, 1 and 4; divisions 21, 22, 23, 24, 25 and 29.

(2) Section 3.

(3) Divisions 26, 27 and 28.

(4) Divisions 61, 63 and 68; groups 661, 662, 663, 667 and 671.

(5) Sections 5, 6 (excluding the divisions and groups mentioned in (4), 7 and 8.

(6) Section 9.

<sup>a</sup> Among the 50 fastest-growing groups (\*) in the North American market in 1980-1996.

<sup>b</sup> Groups in which market share increased (+) or decreased (-) in 1980-1996.



(mainly bananas) and coffee fell off sharply, while exports of various articles of apparel climbed so steeply that by 1995 they had become very significant components of Costa Rica's export basket; these included undergarments (SITC 846), which accounted for 12.6%; men's and boy's wearing apparel (SITC 842), at 11.6%; undergarments (SITC 844), at 4.6%; other wearing apparel articles (SITC 845), at 4%; and women's and girl's outer garments (SITC 843), at 3.5%. In other words, the clothing industry made a highly important contribution to the dynamism of Costa Rican exports in 1980-1995. In 1996, these exports began to lose momentum, as their import market share leveled off at 0.16% and the relative importance of several of the items included among the country's principal export products (e.g., SITC 846, 842, 845, 844 and 843) began to decline. The only product category involving electronic items on the list of Costa Rica's 10 principal exports was also the only one to increase its weight in the export basket during 1996. Thus, by that year more than half of Costa Rica's exports were manufactures, and more than half of those manufactures were not based on natural resources. This structural change in the composition of exports signals an improvement in the quality of the country's export basket, which had shifted from natural-resource-based commodities at the beginning of the 1980s to manufactured and more labour-intensive products by 1996.

The major factors accounting for this trend in Costa Rican apparel products are as follows (see chapter IV of this report):

- A change in strategy by United States clothing manufacturers involving the transfer of certain assembly processes to neighbouring countries possessing privileged market access and offering low wages and trade incentives in order to defend themselves against Asian companies that have been penetrating the North American market.
- The establishment of production sharing mechanisms, such as headings 807 of the Tariff List of the United States and 9802 of the United States Harmonized Tariff Schedule, which facilitate the transfer of production processes and, in combination with the above, the establishment of duty-free export processing zones in the countries of the Caribbean basin.

The clothing manufacturers that set up operations in Costa Rica starting in the mid-1980s often established international networks of integrated production systems and enjoyed a highly favourable trading regime in the United States. By 1994 there were a total of 700 firms in the apparel sector, of which 138 were exporters, and 84% of Costa Rica's clothing exports entered the United States market under Harmonized Tariff Schedule Heading 9802. In this period Costa Rica, along with Mexico and other countries of the Caribbean basin, grew to be strong competitors of the Asian apparel industry.

Table I.19  
FOREIGN DIRECT INVESTMENT IN ELECTRONICS, BY COUNTRY OF ORIGIN  
AND AMOUNT, 1992-1998

Country	Number of firms	Amount invested (millions of dollars)	Percentage of total sum invested
United States	36	397 <sup>a</sup>	93
Japan	1	12	3
Sweden	1	8	2
France	1	6	1
Mexico	2	6	1
Switzerland	1	...	0
<b>Total</b>	<b>42</b>	<b>429</b>	<b>100</b>

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, based on information provided by the Ministry of Foreign Trade of Costa Rica.

<sup>a</sup> Includes US\$ 300 million invested by Intel.

The upward trend in the international competitiveness of the Costa Rican apparel industry began to stall in the mid-1990s, as the factors underpinning the activity's upswing were not enough to ensure the qualitative leap needed to maintain its advantages on a dynamic basis. Despite the notable expansion of Costa Rican apparel exports on the international market, other important aspects of the country's long-term development have been undermining the sector's comparative advantages. The apparel industry has continued to rely on low-cost factors instead of trying to develop a skilled workforce or industrial design and innovation technologies that would enable it to make a qualitative leap forward in the production chain. Nonetheless, during the period 1985-1994 the apparel industry did contribute to a constant inflow of investment which helped pay the country's external debt and create jobs.

The relative stagnation of the apparel sector as of 1995 was followed by an investment boom in the electronics and electronic components industries that set up operations in the duty-free export processing zone. In 1989, only 10% of industries were knowledge intensive while the remaining 90% were using low-cost labour, but by 1995 knowledge-based industries had grown to 25% of the total (Sibaja, 1998). According to data from the Module for the Analysis of Growth of International Commerce (MAGIC) computer program of ECLAC, just two electronics products —HTS 8473301000 (computer parts and accessories) and HTS 8517902400 (parts for telephones)— accounted for 16.5% of the value of Costa Rican exports to the United States market in 1998, with the individual market shares of these items coming to 2.19% and 31.67%, respectively. Foreign investments in the electronics sector accounted for 32% of total investment flows entering the manufacturing sector between 1992 and 1998 (see table I.19). The Ministry of Foreign Trade of Costa Rica reported foreign investments in electronics amounting to US\$ 245 million for the first six months of 1999, equivalent to 39% of the total.

Companies engaged in the production of electronic goods soon began to display a great deal of dynamism in generating exports. According to recent data provided by the Ministry of Foreign Trade, exports of electronic items (parts for modular circuits, electric microstructures and telephone switching apparatus) accounted for 19.3% of the country's total exports in 1998 and 36.6% of total exports in the first half of 1999. These were mainly destined for the United States market. This growth rate is similar to the rate recorded for the country's apparel industry a decade earlier.

The analysis of Costa Rica's international competitiveness up to 1996 does not include the impact of exports from the Intel microchip plant. In 1998, 10% of the country's total exports and 52.7% of electronics exports were produced by Intel, and in the first half of 1999 the corresponding figures were 36.6% and 97.3%, respectively.

The apparent relationship between foreign investment and electronics exports has, in the short run, offset the loss of international competitiveness suffered by Costa Rica's apparel industry since 1995. As is also true of the clothing industry, firms in the electronics industry form part of integrated international production systems, and the most important reason why these companies have set up operations in Costa Rica is the pursuit of efficiency in product lines that are dynamic performers within the arena of international trade.

#### **(b) A new foreign direct investment policy in Costa Rica**

The investment promotion policy in Costa Rica has played a crucial role in positioning the country as a major destination for foreign investment in the subregion. The development of this policy is interesting because it reveals the existence of a learning process from which lessons can be drawn by other countries in the region.

In the mid-1980s the country established a series of special duty-free regimes with the aim of directing investment towards the export sector. Under the scheme adopted in 1984, three types of arrangements were set up for exporting companies:

- Export contracts, which served as the basis for the issuance of tax credit certificates (CATs) or export subsidies. These contracts were drawn up for local firms eligible for the Generalized System of Preferences (GSP) of the Government of the United States (to be eligible under this system, products have to contain at least 35% of local value-added).
- A temporary customs clearance regime in which a zero tariff is applied to imported production inputs. This arrangement is intended for companies participating in the shared production programme under Heading 9802.00.80 of the Harmonized Tariff Schedule of the United States.
- Duty-free zones granting a variety of tax benefits and both export and import tariff exemptions for firms located within them. This scheme is also

designed for firms eligible for the production sharing programme.

These arrangements complement an investment and export programme set up in 1983 under the supervision of the Office of the President of the Republic and the private-sector Coalition for Development Incentives (Cinde), both of which work to promote foreign investment, and received financial and institutional support from the United States Agency for International Development (USAID). The horizontal policies discussed above are complemented by more active negotiations at the international level (bilateral agreements for the protection of investments and other international investment instruments), together with active participation in the World Trade Organization (WTO) and in the negotiating process concerning the Free Trade Area of the Americas (FTAA).

As mentioned above, these incentives were established for a limited time only (the CAT incentives were set to expire in 1999), and there were several reasons for this. Firstly, there are the financial limitations associated with subsidy policies, given the fiscal discipline that Governments must maintain. Secondly, tariff cuts become less and less effective in attracting investments as uniform tariff schemes progressively are adopted at the international level. Thirdly, and in relation to the previous point, the advantages of tariff incentives disappear for the country that has taken the lead in this respect as more and more other countries adopt them. Lastly, it should be noted that incentives and tariff reductions play a minor role in the learning process required for efficiently expanding sales on international markets (Piore and Ruiz Durán, 1998).

In the mid-1990s, the Costa Rican authorities and Cinde began to assess the need to adopt a more proactive policy for attracting foreign investment (Salazar, 1998), and this led to a strategy of seeking out companies that were interested in something more than the financial incentives offered by Costa Rica and that would enhance the country's competitiveness in the long run (Nehme, 1999). This new strategy proposed to:

- Move from activities that make intensive use of unskilled labour towards more skill-intensive activities;
- Develop competitive advantages based on human capital;

- Make the most of the country's competitive advantages, such as political and labour stability, human resource skills and protection for foreign investment.

This strategy also involved identifying firms in the electronics field and in knowledge-intensive industries in general, and discovering their needs and interests in the region. Cinde and the Government of Costa Rica played a proactive role in contacting firms that could play an important role within the framework of their new strategy.

The best-known example is the Intel microchip plant.<sup>14</sup> Intel had the investor profile that best fit Costa Rica's new investment promotion strategy and was an excellent starting point for attracting FDI and channelling it towards high-technology activities. The company wanted to set up a plant in Latin America to diversify its worldwide operations with a view to producing microchips exclusively for export and diversifying the production of given items among its plants. Costa Rica did everything it could to win this investment (Nelson, 1998; Spar 1998, p. 8), including building two electricity substations, one of which was for Intel's exclusive use; setting an electricity rate equivalent to half of that in force in 1996; carrying out a variety of highway projects to facilitate the construction of the plant and the transport of products; adopting an open-skies policy to increase the frequency of flights between Costa Rica and the United States; opening consulates in the Philippines and Malaysia; and creating an exclusive-use call centre. To make certain of fully meeting Intel's requirements in setting up the plant and putting it into operation, the authorities mounted an all-out effort to coordinate the various spheres of government (including the Administration *per se* and the National Assembly to pass the necessary legislative amendments) (González, 1997).

Two years after its opening, the main impacts of the Intel plant can be gauged by the following:

- An unprecedented increase in investment flows;
- A qualitative change in the type of investment received;
- Higher-quality exports; and
- Technical training for the labour force based on firms' specific requirements.

This strategy entails a series of future risks, and the main actors will therefore need to assess short-run results on an ongoing basis and make adjustments as

14 See ECLAC, 1998a, box I.1, p. 48.

necessary. Electronics companies operate in highly competitive segments of the international market because of the role they play in innovation. The integrated production systems of which they form a part involve global decision-making with respect to the advantages of location in any given country.<sup>15</sup> In such situations the location incentives offered by individual countries have less of an influence, and if existing advantages are not maintained on a dynamic basis, firms may decide to close down their operations. In the case of Costa Rica, the challenge is to attract more firms in this sector so as to form a cluster of electronics industries and obtain greater spillover effects in the rest of the economy, thereby minimizing the risks stemming from the closure of any one plant. Aware of these limitations, the Costa Rican authorities have identified the investment needs of several important transnational corporations in Latin America, including

Procter & Gamble and Abbot. In the year 2000, Procter & Gamble plans to set up a support services unit (administration, finance and human resources) to serve the whole of Latin America. Abbot, meanwhile, has invested over US\$ 100 million in 1999 to produce surgical catheters and its entire range of medical probes in Costa Rica as a means of integrating the operations of the plants it used to have in Puerto Rico, Dominican Republic and the United States for the manufacture of each of these products.

These companies will generate a demand for professionals and human resources with mid-range skills and will produce for the export market, in keeping with the central focus of Costa Rica's investment policy.

Lastly, the authorities and the private sector have recently taken steps to strengthen Cinde, and this institution will continue to coordinate proactive efforts to attract investment to Costa Rica.

## 2. Foreign direct investment in Bolivia: a policy to create an energy export complex

Since the mid-1990s, Bolivia has experienced Latin America's most rapidly growing FDI inflows. In 1998 nearly US\$ 900 million entered the country, equivalent to 10% of that year's GDP, and this upward trend apparently continued in 1999, with the country's investment inflows being estimated at US\$ 800 million (Ministry of Foreign Trade and Investment of Bolivia, 1999). A total of 74% of the current FDI stock has been accumulated during the 1990s.<sup>16</sup>

These figures are largely a result of the capitalization process that was launched in 1994, which has become a powerful tool for attracting foreign investment. The central feature of the capitalization process is the creation of firms backed by foreign capital to explore, exploit and market the country's abundant natural resources (hydrocarbons and water resources). Bolivia's strategic goal is to become a major energy exporter in South America.

This view of the country's development fits in quite well with the strategies of the region's

transnational power companies. In the 1990s renewed opportunities for access to regional markets with energy surpluses have enabled these firms to integrate markets and develop distribution and marketing infrastructure to supply deficit markets. The large-scale investments undertaken in Bolivia by companies like Shell, Enron, Total and Iberdrola, to mention just a few examples, show that Bolivia is a key piece in their Latin American strategies.

### (a) A new strategy

In the early 1990s, Bolivia had managed to maintain average economic growth rates around 4% and reduce inflation to single digits. The new government elected in 1993 decided to deepen the country's structural reforms by adopting a set of policies known as the *Plan de Todos* ("plan for all").

15 It is worth recalling what happened with the Motorola liquid crystal quartz plant in Costa Rica, which closed down recently as a result of restructuring in the parent company and replacement of the product by new technology.

16 ECLAC, Information Centre of the Unit on Investment and Corporate Strategies: Foreign Investment Directory, Bolivia, 1999.

Table I.20  
**FOREIGN DIRECT INVESTMENT: TOTAL AMOUNT AND AMOUNTS INVESTED  
 IN CAPITALIZED ENTERPRISES, 1995-1998 AND FIRST  
 TWO QUARTERS OF 1999**  
*(Millions of dollars and percentages)*

	1995	1996	1997	1998	1999
1. Total FDI	393	474	731	872	409
2. Total FDI for capitalization of firms	5	198	474	578	215
Percentages (2/1)	1.3	42.0	65.0	66.3	52.6
3. FDI for capitalization of oil companies	0	0	281	395	147
4. FDI for capitalization of electric power companies	0.1	23	27	53	42
Percentages (3+4/1)	0	5	42.0	51.4	46.2

**Source:** ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, based on data provided by the International Monetary Fund, the Ministry of Foreign Trade and Investment of Bolivia, the National Institute of Statistics of Bolivia, the Central Bank of Bolivia and the Confederation of Private Employers of Bolivia.

As part of these reforms, a vast and innovative privatization process was devised for the purpose of capitalizing large State-owned companies engaged in mining, hydrocarbons, telecommunications, electricity generation and distribution, railroads and air transport.<sup>17</sup> Bolivia's privatization plan differs from others in that public assets are handed over directly to the population and are destined for the capitalization of the privatized companies. State-owned enterprises are turned into mixed capital corporations (known as SAMs) owned 50% by Bolivian citizens and 50% by foreign capital.<sup>18</sup>

The capitalization process has had a considerable impact on FDI. Slightly over half of all inflows to the country in the period 1995-1998 were generated by firms privatized in this way (see table I.20), and in the first half of 1999 this relative level was maintained.

These investments have been used for the renovation of production facilities and for new

projects, which, in addition to their well-known macroeconomic influence, generally have considerable micro- and mesoeconomic effects as well.

Another significant change prompted by the capitalization programme has been the diversification of the origin of foreign investments. Although most investments still come from the United States (particularly in the areas of hydrocarbons and electric power), the proportion of investments from the European Union has grown in recent years to almost a third of the total. Notable among investments from the European Union are those from Spain (electric power and hydrocarbons) and Italy (telecommunications). Since 1995 Latin America has been the second-most important investor in the region, with Brazil, Argentina and Chile showing the greatest increases. The largest investments made by these countries have been in electric power, railways, financial services (Chile) and hydrocarbons (Brazil and Argentina).

17 The six companies included in the plan are Empresa Nacional de Telecomunicaciones (Entel), Empresa Nacional de Ferrocarriles (Enfe), Empresa Nacional de Electricidad (Ende), Lloyd Aéreo Boliviano (an airline), Yacimientos Petrolíferos Fiscales Bolivianos (YPFB) (exploration and exploitation of hydrocarbons, petrochemicals and the marketing of raw materials and derivative products), and Empresa Metalúrgica Vinto (mining).

18 Foreign investors pay the market value for the privatized firm, which is used in its entirety to capitalize the mixed corporation, in return for a 50% stake in the ownership and management of the company. The remaining 50% is distributed in the form of shares to all adult Bolivian citizens. These shares are held in personal accounts that are administered by pension fund managers established for this purpose.

Table I.21  
**BOLIVIA: TIMETABLE FOR DISBURSEMENTS AND FULFILMENT OF COMMITMENTS  
 TO INVEST IN CAPITALIZED ENTERPRISES IN THE HYDROCARBONS SECTOR  
 AS OF THE FIRST HALF OF 1999**  
*(Millions of dollars and percentages)*

Firm	1997	1998	1999	Total (percent- ages)	Dis- burse- ment	Balance	New invest- ment
Petrolera Andina	93.2	179.2	58.7	331.1	125.1	0	66.4
Petrolera Chaco	100	106.1	30.5	236.6	77.1	70.1	0
Transredes	87.4	109.5	57.5	254.4	96.6	9.1	0
<b>Total for the sector</b>	<b>280.6</b>	<b>394.8</b>	<b>146.7</b>	<b>822.1</b>	<b>98.5</b>	<b>79.2</b>	<b>66.4</b>
<b>Total for the Plan</b>				<b>1 470.0</b>	<b>82.0</b>	<b>302.8</b>	<b>101.7</b>

**Source:** ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, based on data provided by the Ministry of Foreign Trade and Investment of Bolivia, the National Institute of Statistics of Bolivia, the Central Bank of Bolivia and the Confederation of Private Employers of Bolivia.

Table I.22  
**YPFB: BIDDING FOR WELLS, BY FIRM AND COUNTRY OF ORIGIN, 1998**

Block	Winning bidder(s)	Country
Cambeiti	Maxus	Canada
Bereti	Total	France
Colibri	Pluspetrol	Argentina
Parapeti	Pluspetrol	Argentina
Canada	Petrobras	Brazil
Tatarenda	RTB Gamma Colanzi	Bolivia

**Source:** ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, based on data provided by the Energy Information Administration of the United States.

The capitalization of business enterprises led to major changes in the regulatory system governing the relevant economic sectors. The most significant reforms were undertaken in all the various stages of the hydrocarbons and electric power production chain, which together attracted 51.4% of the foreign investments received by the country during the period 1990-1998 (see table I.20) and 88.4% of the additional investments made within the framework of the capitalization process (see tables I.21 and I.23). The State-owned enterprise Yacimientos Petrolíferos Fiscales Bolivianos (YPFB), the oldest in the region,

has been the pivotal component of the country's capitalization programme.

#### **(b) A policy of channelling FDI into energy exports**

In the 1980s, prospecting activities were severely impaired by the financial crisis at YPFB. Incorporated reserves fell throughout the decade, and as a result production began to decline. This was the backdrop against which far-reaching reforms were undertaken in hydrocarbon extraction activities during the 1990s.

Table I.23  
**BOLIVIA: TIMETABLE FOR DISBURSEMENTS AND FULFILMENT OF COMMITMENTS  
 TO INVEST IN CAPITALIZED ENTERPRISES IN THE ELECTRIC POWER SECTOR  
 AS OF THE FIRST HALF OF 1999**  
*(Millions of dollars and percentages)*

Firm	1995	1996	1997	1998	1999	Total	Dis- burse- ment (per- cent- ages)	Bal- ance	New invest- ment
Empresa Eléctrica Guaracachi	0.1	0.7	4.9	30.1	29.7	65.5	139	0	18.4
Empresa Eléctrica Valle Hermoso		21.4	13.0	4.0	0.6	39.0	115	0	5.1
Empresa Eléctrica Corani		0.8	9.0	18.9	11.8	40.5	68.9	18.3	0
<b>Total for the sector</b>	<b>0.1</b>	<b>22.9</b>	<b>26.9</b>	<b>53.0</b>	<b>42.1</b>	<b>145.0</b>	<b>103.7</b>	<b>18.2</b>	<b>23.5</b>
<b>Total for the Plan</b>						<b>1 470.0</b>	<b>82.0</b>	<b>302.8</b>	<b>101.7</b>

**Source:** ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, based on data provided by the Ministry of Foreign Trade and Investment of Bolivia, the National Institute of Statistics of Bolivia, the Central Bank of Bolivia and the Confederation of Private Employers of Bolivia.

The deregulation of the hydrocarbons sector was carried out in three stages (Campodónico, 1998). During the third and most recent phase, the activity was completely liberalized and YPFB was entirely restructured within the framework of the Capitalization Plan. YPFB was reorganized into commercial units: two for exploration and drilling, one natural-gas transport company, two refineries and a marketing firm. YPFB can now prospect for and exploit resources only through the mechanism of association agreements, and the corresponding proceeds in the form of crude oil can be exported without hindrance by the partner company unless supplies are short on the domestic market. Refining and marketing have also been liberalized, and prices on the domestic market are now set by supply and demand.

The three YPFB companies that had been capitalized as of 1999 were the prospecting, drilling and gas transport units, and to date between 125% and 77% of the planned disbursements have been made (see table I.21). The hydrocarbons prospecting and drilling company, Petrolera Andina, was acquired in 1997 by the Argentine-Spanish consortium Yacimientos Petrolíferos Fiscales (YPF)-Pérez Companc-Pluspetrol. Between 1998 and 1999 it invested over US\$ 66 million more than the amount initially agreed upon, or just over two thirds of the total additional investments made as part of the capitalization process. Petrolera Chaco, the other prospecting and drilling company, was acquired in 1997 by Amoco<sup>19</sup> (United States). As of 1999, US\$ 70 million in investments remained to be carried out.

19 This company merged with British Petroleum (United Kingdom) in 1999.



## Box 1.4

**TRANSREDES: A NETWORK OF NATURAL GAS PIPELINES TO THE SOUTHERN CONE AND BRAZIL**

A significant portion of FDI in Bolivia has gone to building a natural gas pipeline from the Bolivian department of Santa Cruz de la Sierra to the Brazilian city of São Paulo and the state of Rio Grande do Sul. Service to São Paulo began in July 1999, and delivery to Rio Grande do Sul was expected to begin towards the end of the year. The current capacity of the pipeline is one billion cubic feet per day, a figure which is expected to double in five years.

The pipeline between the two countries runs over 3,000 kilometres, and was a joint project of the State enterprises YPFB and Petrobras. The rationale for Bolivia's undertaking a project of such magnitude is based on three objectives:

- To export to a market characterized by shortages and rising demand, as is the case of Brazil;
- To become a centrally located energy conduit for the countries in the southern part of the continent by building other pipelines, in particular to Peru and Chile;
- To capitalize on its position as the first Andean Pact country to begin serving Brazil's energy integration needs.

The construction of the pipeline was initially the responsibility of the United States firm Enron in association with YPFB and the United Kingdom-based firm British Gas and in partnership with Petrobras. Transredes is a

firm that was created in 1996 to handle the transport of natural gas based on the YPFB unit, which was purchased for US\$ 264 million by Enron and Shell.<sup>a</sup> The on-time delivery of the pipeline and the growth of proven natural gas reserves in Bolivia have generated a series of expectations regarding further pipeline construction in the future. The most important projects of this type are:

- Brazil's Villamontes-Sur pipeline, which is routed through Paraguay and is to provide natural gas to small cities in southern Brazil;
- The San Miguel-Cuiabá pipeline, which is designed to supply Enron's gas-fired power plant in this Brazilian city;
- A pipeline to the port of Ilo in Peru to export propane, butane and ethane to various international markets.

Of all these projects, the San Miguel-Cuiabá pipeline is the only one on which construction has begun. This is actually an extension of the pipeline to Brazil planned by the owners of Transredes at a cost of US\$ 560 million.

There are important economic and environmental reasons why these projects have not yet been undertaken. For one thing, there is growing concern about the actual level of demand for natural gas in the Brazilian economy, especially since the devaluation of the real in 1999. Indeed, while the original plan called for

Petrobras to buy 285 million cubic feet of natural gas per day when operations began, the company recently reduced its demand to 78 million cubic feet per day. This has led many analysts to fear that Petrobras is considering the possibility of resorting to other, cheaper sources for its fuel. Also, other competitors interested in building pipelines to bring products to the Southern Cone have appeared to contest this market with Bolivia. Argentina, which before 1992 was the main market for Bolivian natural gas, has recently begun building a number of pipelines to sell natural gas to northern Chile, Brazil and probably Peru. With the 1999 acquisition of Argentina's Yacimientos Petrolíferos Fiscales (YPF) by the Spanish company Repsol, it is likely that Petrolera Andina's reserves will become a strategic part of the Spanish company's plan to expand its energy operations throughout the region and will constitute competition for Transredes in the southern portion of the continent's energy market. In fact, Petrolera Andina is the capitalized enterprise that has so far made the largest investments in Bolivia.

The discovery of new natural gas reserves means that Bolivia faces the challenge of continuing to diversify its export markets among its energy-deficient neighbours.

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

<sup>a</sup> Shell has a strategic alliance with British Gas to operate various electrical power plants in Brazil.



The gas transport company, Transredes, is probably the one of greatest strategic interest to Bolivia (see box I.4). Transredes is constructing the gas pipeline to Brazil, which will enable Bolivia to export about 7 billion cubic feet of natural gas to Brazil in the coming 20 years (EIA, 1998b).

In September 1998 concessions were awarded for six new hydrocarbon prospecting and drilling blocks belonging to YPFB for US\$ 300 million. A number of foreign oil companies and one Bolivian company were the successful bidders (see table I.22). This tender was not entirely successful, since the Government received bids for only six blocks out of a total of 10. The auctioning of a further five blocks was planned for late 1999; these blocks will probably bring a lower price because the wells in question are difficult to exploit. In order to offset this disadvantage and obtain higher bids, the Government has extended the prospecting period from 7 to 10 years.

Following the sale of those blocks, the assets of YPFB will be reduced to three refineries, a liquid waste disposal plant and a number of petrol stations scattered around the country. Some analysts expected two of the refineries (Cochabamba and Santa Cruz) to be put up for sale in late 1999 at a floor price of US\$ 230 million (EIA, 1999b). With the sale of these last two assets, YPFB will take on the job of administering the exploration and drilling contracts, as provided for by the legal reform of 1996 (Campodónico, 1998).

The capitalization of YPFB has not been completed owing to a series of difficulties which made it necessary to postpone the established deadlines. Nonetheless, Bolivia has added 15.6 billion cubic feet of natural gas to its proven reserves during the 1990s (Ministry of Foreign Trade and Investment, 1999). The sector has been the destination of 55.2% of the total sum received through the capitalization process and has attracted the world's largest oil companies to the country. The impact on exports has been considerable. In 1998 natural gas exports represented 5% of total exports.<sup>20</sup> Up to now the results of the country's petroleum prospecting and drilling activity have been destined for the domestic market, but it is expected that

future discoveries will increase its export capacity as the capitalization of YPFB is completed.

The first State-owned enterprise to be capitalized was the Empresa Nacional de Electricidad (ENDE). This operation was coupled with a reform of the regulatory system which provided for competition in energy generation and distribution (six companies in the country as a whole) and a monopoly in transmission (Empresa Transportadora de Electricidad). Cross-ownership between the various segments was prohibited, it was provided that prices in each segment would be set by means of different methods and free access to the transmission sector was provided for generating and distributing companies.

In 1995 a number of power generation plants belonging to ENDE were sold to Dominion Energy (Empresa Eléctrica Corani), Energy Initiatives (Empresa Eléctrica Guaracachi) and Constellation Energy (Empresa Eléctrica Valle Hermoso) for a total of US\$ 140 million. The purchase contracts set a deadline of 1998 for full disbursement of the agreed investments (see table 1.23).

Corani is the only one of the capitalized enterprises which has not yet invested the full amount agreed upon. This company, located in Cochabamba, represents 18.7% of the national power grid (SIN) and has been affected by delays in the construction of its new projects at Palca and San José (Corani, 1999). Under the regulations governing the electric power sector, the company's non-compliance could lead to the revocation of its licence and the award of the licence to another firm. However, the company has announced its intention to complete its projects.

Together with the Compañía Boliviana de Energía Eléctrica (COBEE), a former electric power generation company which now belongs to USNRG,<sup>21</sup> these plants represent 88% of installed power generation capacity and supply 89% of the total electric power consumed in the country. Thanks to the investments made by these companies, a total generation capacity of 690 MW has been achieved, and if all the new investments are made as planned, this figure was to have risen to 880 MW by the end of 1999 (EIA, 1999b).

20 For 1999, the Energy Information Administration of the United States estimated that natural gas exports could amount to as much as a quarter of total output, with the gas pipeline to Brazil coming on stream. The fact that such a small economy as Bolivia's has managed to complete the construction of a project as large as the pipeline on schedule has a positive impact on investors and on the country's foreign trade (EIA, 1999, p. 4).

21 COBEE was sold to USNRG, a subsidiary of the United States firm Northern States Power Company, in 1996.

### Box I.5 ENERGY MAQUILAS IN THE HEART OF AMAZONIA

In early 1999, the Bolivian Congress approved the Corazón ("Heart") Act. The purpose of this law is to create a large duty-free zone which will attract energy exporters. The legislation is an acknowledgement of the need to increase incentives for energy companies to locate in the area as a means of ensuring continued foreign investment in this type of economic activity once the capitalization process has been completed.

Falling demand for natural gas in Brazil (Bolivia's main export market) and delays in plans to expand electric power generating capacity have led the Government to offer foreign investors a number of incentives which it has established under the duty-free zone provisions and to revitalize its strategy for turning

Bolivia into the energy conduit linking the Southern Cone with Brazil.

The proposed duty-free zone would be composed of 11 corridors situated within 50 kilometres of the border. The majority of these locations are on the country's border with Brazil. The hydrocarbons companies and electric power generation companies that locate there are to be given 40-year concessions. The companies currently operating in Bolivia in this sector of the economy have concessions of up to 10 years, many of which are about to expire. Other benefits for exporters include a total exemption from tariffs on imported capital goods and from the value added tax. Taxes on earnings and profit remittances remain in force.

As this report goes to press, an extension of the legislation is being debated which would offer the same tax and tariff incentives to companies that add value to raw materials produced in Bolivia. Traditionally, the Bolivian manufacturing sector has been much less developed than other types of economic activity and its products are sold on the domestic market.

The Corazón Act is intended to provide tax and tariff incentives for energy projects that have not yet been launched. However, aside from the rate of return on their investments, the reason that companies have suspended work on such projects may have to do with competition from other countries (such as Argentina) in Mercosur, which is the main market for Bolivian exports.

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

Bolivia's domestic market and potential export markets both appear promising for investors. Only 55% of the country has access to electric power, and demand has been growing at an annual rate of 10% (Business Latin America, 1999a). ENDE estimates the country's potential power generation capacity at 38,857 MW, which could generate annual earnings of about US\$ 800 million from exports to neighbouring countries such as Brazil, Peru and Chile. Of particular significance in this context are two projects being carried out by the Empresa Eléctrica Guaracachi, one at Santa Cruz de la Sierra, to construct a 123 MW gas plant, and a hydroelectric plant to produce energy for export to the Brazilian state of Matto Grosso.

These projects fell behind schedule because the Bolivian authorities delayed issuing the necessary authorizations owing to conflicting interpretations of regulations and the appearance of new competitors in

the region's potential markets. In order to make up for those delays, the Government has established a series of incentives under the recently-enacted Corazón ("Heart") Act (see box I.5).

#### (c) Capitalization in other sectors

Bolivia's chances of successfully implementing its strategy for turning itself into an important exporter of natural and water resources depend to a certain extent on the modernization of the country's infrastructure. Another important element in the capitalization process has been the sale of four telecommunications and transport firms.

In 1995 the capitalization of the Empresa Nacional de Telecomunicaciones (Entel) attracted offers from telecommunications companies in the United States and Europe, including the Spanish firm Telefónica.

Table I.24  
**BOLIVIA: TIMETABLE FOR DISBURSEMENTS AND FULFILMENT OF COMMITMENTS  
 TO INVEST IN CAPITALIZED ENTERPRISES IN THE TELECOMMUNICATIONS SECTOR  
 AS OF THE FIRST HALF OF 1999**  
*(Millions of dollars and percentages)*

Firm	1995	1996	1997	1998	1999	Total	Disbursement (percentages)	Balance	New investment
Entel	-	136.5	148.1	109.6	21	415.2	68.1	194.8	0
<b>Total for the Plan</b>						<b>1 470.0</b>	<b>82.0</b>	<b>302.8</b>	<b>101.7</b>

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, based on data provided by the Ministry of Foreign Trade and Investment of Bolivia, the National Institute of Statistics of Bolivia, the Central Bank of Bolivia and the Confederation of Private Employers of Bolivia.

Entel was sold for US\$ 610 million to Italia Telecom (now merged with Olivetti), which paid a premium of US \$132 million. Bolivia's potential market at the time of this privatization was promising enough to fully justify the premium paid by Italia Telecom. Telephone density was very low (3.8%), 40% of the telephone exchanges in operation were using analogue technology, there were long waiting lists for telephones and the international, cellular telephone and value-added segments had hardly been developed at all.

The structure of the telecommunications market, as established in 1994, was defined by a six-year monopoly on national and international long distance services granted to Entel and a number of small cooperatives, two mobile telephone operators (one of which is Entel) and open competition in value-added services. This structure was also based on the use of regulatory price caps for all services. In addition, as is usual in cases of service markets where competition is restricted, Entel is subject to a series of requirements regarding the expansion and technical upgrading of the network.

As of 1998, Entel had met the general goals for quality, expansion and modernization set during the

capitalization process (see table I.24). Some objectives remain to be achieved in the coming years, however. The density of basic telephone service is still very low (4.5%),<sup>22</sup> while the number of cellular phones has grown at a dizzying rate, reaching the equivalent of one third of the number of fixed-line telephone connections (Barja, 1998). This discrepancy is due to bottlenecks in the fixed-line basic services provided by cooperatives and to competition in the cellular market, which has brought prices there down. The market for international calls has grown very little in recent years because of high rates. Accordingly, in the last years before the expiration of its monopoly, Entel has been concentrating its investments in the installation of fibre optics in the country's major cities in order to increase its business in international calls and in its mobile network in order to continue increasing its market share in that segment. The company's strategy in the future will most likely be to scale back its own activities as a basic service operator, which have proven to be relatively unprofitable.

Three companies in the transport sector—two railroads and one airline—have been capitalized. These firms proved to be the most difficult cases to dispose of because of the financial condition of the

22 This is an average. There are significant differences between the principal cities and other population centres in terms of density of telephone lines.

Table I.25  
**BOLIVIA: TIMETABLE FOR DISBURSEMENTS AND FULFILMENT OF COMMITMENTS  
 TO INVEST IN CAPITALIZED ENTERPRISES IN THE TRANSPORT SECTOR  
 AS OF THE FIRST HALF OF 1999**  
*(Millions of dollars and percentages)*

Firm	1995	1996	1997	1998	1999	Total	Disbursement (percentages)	Balance	New investment
Ferrocarriles Andina		2.7	5.6	4.5	0.5	13.3	100	0	0.1
Ferrocarriles Oriental		3.9	12.5	16.0	5.1	37.5	145	0	11.7
LAB	5.0	31.9	not avail	not avail.	not avail.	36.9	78	10.6	0
<b>Total for the sector</b>	<b>5.0</b>	<b>38.5</b>	<b>18.1</b>	<b>20.5</b>	<b>5.6</b>	<b>87.7</b>	<b>100.1</b>	<b>10.6</b>	<b>11.8</b>
<b>Total for the Plan</b>						<b>1 470</b>	<b>82.0</b>	<b>302.8</b>	<b>101.7</b>

**Source:** ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, based on data provided by the Ministry of Foreign Trade and Investment of Bolivia, the National Institute of Statistics of Bolivia, the Central Bank of Bolivia and the Confederation of Private Employers of Bolivia.

companies and the obsolescence of their assets. The Brazilian airline VASP paid US\$ 47.5 million for Lloyd Aéreo Boliviano in 1996, and to date it has made approximately 78% of the scheduled disbursements<sup>23</sup> (see table I.25). Experts have concluded that this situation is probably a result of the fact that strong competition from other operators has made it necessary to invest more heavily than was originally planned (Latin Finance, 1999).<sup>24</sup>

The Andina and Oriental railroad companies were sold for US\$ 39 million in 1997 to two Chilean consortiums, Cruz Blanca and Antofagasta Holding (Luksic Group), respectively. In addition to modernizing the equipment, the companies are required to interconnect the two systems to provide a conduit for Andean products to reach Brazil and other eastern markets. As of 1999, however, the interconnections

were not yet in place.<sup>25</sup> Having made the disbursements called for in the contracts, the two companies have now begun making new investments to improve the tracks. Ferrocarriles Andina expects to invest US\$ 8 million to this end, while Ferrocarriles Oriental plans to invest US\$ 35 million over the next five years. Between them, the two systems carry 250,000 tons of minerals and 900,000 tons of soybeans to Chilean ports (American Chamber of Commerce of Bolivia, 1999).

The capitalization of Empresa Metalúrgica Vinto has been pending since 1995. Delays have occurred as a result of various institutional problems and market factors (namely, falling ore prices). Bolivia's mineral resources are at least as abundant as its energy resources, and unlike the latter, its mineral resources have been widely developed in the past (although it is estimated that barely 10% of reserves have been

<sup>23</sup> Because the company has not provided the necessary information, the amount invested by VASP so far cannot be accurately determined.

<sup>24</sup> Lloyd Aéreo Boliviano claims, however, to have spent close to US\$ 52 million more to purchase and rent aircraft, improve infrastructure and train personnel (American Chamber of Commerce of Bolivia, 1999).

<sup>25</sup> In mid-1999, the Federal Railroad Administration of the United States Government completed a technical study on the interconnection. It estimates that an investment of US\$ 1 billion will be required.

tapped.)<sup>26</sup> Another attempt to capitalize the company was under way as 1999 drew to a close. If the Government does not succeed this time, Vinto will be privatized in 2000.

The boom in FDI in Bolivia that began in 1994 involves a combination of factors designed to turn Bolivia into a major energy exporter to regional markets by taking advantage of corporate strategies being applied in the hydrocarbons industry and continuing the search for raw materials. In 1996 these efforts were given a boost by a successful strategy of trade and investment negotiations with

Brazil, which is one of the largest energy markets in South America, and the development of modern infrastructure.

There are some potentially weak points in this strategy that should be noted, however, including its dependence on a single export market and strong competition from other energy-surplus countries in the region (Argentina, Venezuela). Bearing these factors in mind, Bolivia has recently created a number of incentives for energy companies and is considering the possibility of building interconnections with other markets, such as Peru and Chile.

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26 Bolivia has reserves of gold, silver, platinum, antimony, copper, zinc, lead, tin, sulphur, potassium, lithium, borate and semiprecious stones. Large gold and copper mines along the Brazilian border were discovered in 1998.



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## II. MEXICO: INWARD FOREIGN DIRECT INVESTMENT AND CORPORATE STRATEGIES

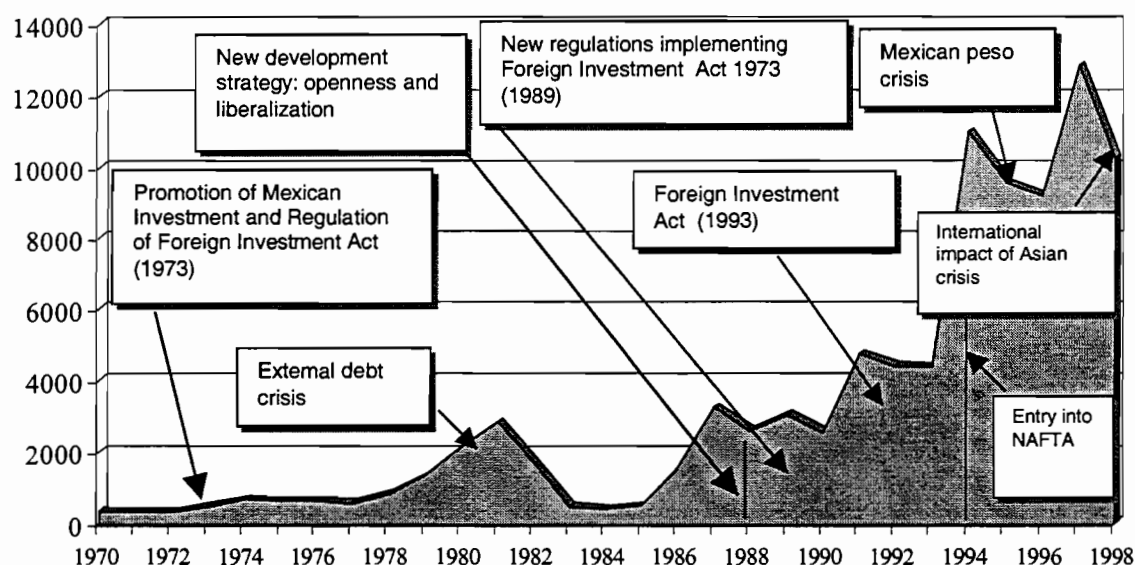
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There has been a great deal of growth in foreign direct investment (FDI) inflows to Mexico in the 1990s (see figure II.1). From 1990 to 1995, Mexico received more FDI than any other country in Latin America and the Caribbean and during 1996-1999 it was surpassed only by Brazil (ECLAC, 1998a). These inflows, which rose from under 1% of gross domestic product (GDP) in the 1980s to more than 3% in the 1990s, have had a considerable impact. Their influence has not been limited to the macroeconomic sphere, as they have also played a key role in the generation of the new productive and organizational structure that has developed concurrently with the remarkable modernization of part of the Mexican economy.

In this chapter, the characteristics of FDI inflows to Mexico are discussed against the background of the far-reaching reforms implemented by the national authorities from the mid-1980s onwards, the major changes that have occurred in the world economy in certain industries and their impact on Mexico, and the strong dynamism of the corporate strategies of the

main transnational corporations. In the second part, a more detailed analysis will be made of the main activities to which FDI inflows are channeled, in terms of the two main objectives of the corporate strategies, i.e., to improve efficiency and gain access to markets. The chapter ends with a number of conclusions.

Figure II.1  
**MEXICO: FOREIGN DIRECT INVESTMENT INFLOWS, 1970-1998**  
*(Millions of dollars)*



Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, based on information provided by the International Monetary Fund and Banco de México.

## A. FOREIGN CAPITAL IN THE MEXICAN ECONOMY

### 1. From nationalism to liberalization

Foreign direct investment has played a major role in some areas of the Mexican economy since the late nineteenth century. The largest capital inflows came from Europe and the United States and were especially oriented towards the mining, petroleum, textile and transport sectors, the exploitation of haciendas and plantations, the expansion of the railway system and a number of service sectors, such as electric power and banking. In 1910, cumulative

foreign investment was estimated at US\$ 2 billion, representing approximately 67%-73% of total investments in the country. These investments played a major part in lowering transport prices and improving communications across a large area of the country (Haber, 1992, p. 27). Furthermore, up to the late 1920s, the fiscal resources generated by foreign capital were instrumental in strengthening the Government (Sherwell, 1992).



A series of major transformations took place from the beginning of the Revolution of 1910 up to the late 1930s. The 1917 Constitution and subsequent legislation assigned the Mexican Government legitimate and inalienable ownership of natural resources, and established the right to strike (both all-out and sit-down strikes). These constitutional changes reflected not only a change in ideology as a result of the Mexican Revolution, but also a growing vigour in the domestic economy. Between 1910 and 1934, despite many disputes between the Government and foreign enterprises, there were no significant changes in levels of foreign capital (Meyer, 1992).

During the presidency of Lázaro Cárdenas (1934-1940), a social, economic and political restructuring took place that laid the foundations for the country's development, at least up to the late 1960s. Land reform and nationalizations, together with economic intervention measures taken by the State in an effort to modernize the country by strengthening domestic industries, were among the main pillars of development during this period. Railway nationalization in 1937 and, most of all, expropriation in the petroleum sector in 1938, had deep repercussions on foreign capital inflows and on the relationship between foreign corporations and the Government. The stock of FDI fell by 42% between 1935 and 1940 (Ornelas, 1989).

Following the Second World War, FDI inflows increased steadily; the average annual increase, which had stood at 2.3% in the 1950s, surged to 8.1% between 1961 and 1970. A number of factors strongly influenced the entry and establishment of FDI in Mexico, including a market that was relatively closed to imports and that limited competition from foreign goods and services by means of tariff barriers (import licences, permits and quotas), other non-tariff barriers and a fixed exchange rate.

Foreign investment showed increasing diversification, as it shifted from agricultural activities towards industry and the services sector. In the early 1970s, the share of foreign capital in manufacturing GDP was over 20%, and was concentrated in chemicals (71.2% of sectoral GDP), machinery and electrical appliances (62.6%), and transport equipment (35.5%) (Sepúlveda and Chamucero, 1973). Between 1940 and 1973, the United States was the main source of FDI inflows to Mexico, which came in steadily increasing amounts, rising from 63.7% to 78.1%. In 1970, it was followed by the Federal Republic of Germany, the United Kingdom, and Switzerland, with 3.4%, 3.3%

and 2.7% of total FDI, in that order (Chapoy, 1975; Sepúlveda and Chamucero, 1973).

The enactment, in March 1973, of the Mexican Investment Promotion and Foreign Investment Regulation Act was a major event in Mexico's economic evolution, as it established the first detailed regulatory framework for FDI. Under this legislation, national policies remained restrictive, and certain activities were reserved solely for the State and for Mexican investors. The State had exclusive control over activities relating to petroleum and other hydrocarbons, basic petrochemicals, the exploitation of radioactive minerals and nuclear power generation, mining, electric power, railways, telegraphic and radiotelegraphic communications, and others for which specific standards were established. There were also other areas that were reserved solely for Mexicans, including radio and television, urban automotive transport, domestic air and sea transport, forestry, gas distribution, and certain areas covered by specific legislation.

Foreign investment was restricted to a maximum 40%-49% share in the capital stock of enterprises and activities involved in the exploitation and development of minerals and secondary products of the petrochemicals industry, the manufacture of parts and components for motor vehicles, and other areas set out in specific legislation. In general terms, this law gave the State discretionary powers to determine in which sectors and activities foreign investment should not exceed 49% of a company's shareholdings. However, foreign investments were allowed to control majority interests in specific projects that were considered desirable for the country's economy.

In the late 1970s, the development model based on industrial import substitution was beginning to show considerable limitations. Stagnation in the private manufacturing sector was reflected in sustained increases in the trade deficit and the capital account, which could no longer be financed by the primary-sector surplus. At that time, oil exports and external borrowing enabled the country to cope with the structural crisis. Despite several decades of direct and indirect incentives, Mexican industry in general had not been integrated into the world economy (Fajnzylber, 1983). The only exceptions were a few branches of manufacturing in which foreign corporations held a substantial interest. In 1982, this situation became unsustainable, giving rise to the so-called external debt crisis.

The strong impact of this crisis led the Mexican authorities to redefine their development strategy and

reconsider the role of foreign investment (Peres, 1990). From 1985 onwards, they implemented a fast-paced trade liberalization programme. Between 1985 and 1987, weighted tariffs fell from 28.5% to 11.8%. In 1987, the maximum tariff was set at 20%. The tariff structure has since remained practically unchanged, except where significant modifications were made as a result of the implementation in 1994 of the North American Free Trade Agreement (NAFTA) (Bank of Mexico, 1999; Dussel Peters, 1997; Ten Kate and De Mateo, 1989). The changes took shape in final form with the signing, in December 1987, of the National Solidarity Pact (Pacto de Solidaridad Económica - PSE), which established that the country's new economic priorities were to develop a dynamic private manufacturing sector and to increase the share of Mexican exports in world markets.

These changes were consolidated during the six-year term of President Salinas (1988-1994). In addition to deregulation and economic liberalization, the authorities began to apply a broad programme of privatization of State assets, conversion of external debt into equity, and across-the-board elimination of direct and indirect subsidies, as well as programmes geared towards specific enterprises, sectors and geographical areas. However, the policy that had the

greatest impact on Mexico was the one aimed at increasing exports by promoting the *maquila* industry.

Initiatives designed to attract foreign investors became a very important element in the new strategy, and from the macroeconomic perspective, foreign investment became one of the largest sources of financing. Policies centred on microeconomics and industrial organization were abandoned, and foreign capital became one of the major factors in economic modernization and in export-oriented strategies in the manufacturing sector.

From that time onwards, the National Foreign Investment Commission (Comisión Nacional de Inversiones Extranjeras - CNIE) became the most important agency in the area of foreign investment policy. Since one of its duties was to set rules, it made a substantial contribution to the interpretation of the law and adapted the existing rules to the increasingly liberal approach of the Mexican Government in this area. In May 1989, in an effort to promote increased foreign investment through clear, self-enforcing rules, the authorities issued regulations to implement the Mexican Investment Promotion and Foreign Investment Regulation Act. Thus, a century that had been marked by a nationalistic approach to foreign investment closed with a policy of rapid liberalization.

## 2. Integration of Mexico into the world economy – or the North American economy?

The authorities implemented a strategy for improving the country's position in the international context. Mexico acceded to the General Agreement on Tariffs and Trade (GATT) in 1986; joined the Asia-Pacific Economic Cooperation Council (APEC) in 1993 and the Organisation for Economic Co-operation and Development (OECD) in 1994; signed free trade agreements with a number of Latin American countries, including Chile, Costa Rica, and the Group of Three (along with Colombia and Venezuela); implemented the North American Free Trade Agreement (NAFTA) with Canada and the United States in 1994; signed the Economic Partnership, Political Coordination and Cooperation Agreement with the European Union in 1997 and the Free Trade Agreement between Mexico and the European Union in November 1999 (see box II.1). All these measures

—both the internal ones and those resulting from its international economic policy— were aimed at adapting the Mexican economy to the needs and requirements of the “globalizing” transnational corporations, especially United States corporations (Calderón, Mortimore and Peres, 1994).

In practice, Mexico's growing linkages with the world market have entailed increased economic integration with the North American bloc and particularly with the United States economy (Calderón, Mortimore and Peres, 1996). Between 1990 and 1998, the share of North America in Mexico's trade increased from 69% to 82%, and more than two thirds of FDI stocks in Mexico were of United States and Canadian origin (see table II.1). The incorporation of the Mexican economy into the North American bloc is essentially a result, on the one hand, of the country's

## Box II.1

# THE FREE TRADE AGREEMENT BETWEEN MEXICO AND THE EUROPEAN UNION: AN OPPORTUNITY FOR MEXICO TO DIVERSIFY ITS EXPORT MARKETS?

Mexico's deepening economic relationship with the European Union is part of the country's broader integration into the world economy and of the correction of certain discriminatory trade practices - the European Union gives better tariff and non-tariff treatment to products from about 100 countries than to those from Mexico (De Mateo, 1999) - but above all it provides an opportunity to counteract Mexico's considerable trade dependence on the United States. During the 1990s, the European Union has lost part of its share in the Latin American market to Asia and the United States, falling from 21% to 16% of the region's total imports (ECLAC, 1999c). Mexico has played a particularly important part in this trend, mostly owing to its privileged economic and trade relations with the United States under the North American Free Trade Agreement (NAFTA). Between 1990 and 1998, the share of Mexico's total imports coming from the United States increased from 66% to almost 75% (see table II.1), while imports from the European Union fell from 17% to 9%. By the middle of the coming decade, according to many European analysts, this trend could be strengthened following the conclusion of negotiations to establish the Free Trade Area of the Americas (FTAA) (IRELA, 1999).

The European authorities have reacted by seeking mechanisms for strengthening and deepening economic and political relations between the two regions, such as the Interregional Framework Cooperation Agreement between the European Community and the Southern Common Market (Mercosur), signed in December

1995, the Economic Partnership, Political Dialogue and Cooperation Agreement between Chile and the European Union, signed in June 1996, and the Economic Partnership, Political Consensus-building and Cooperation Agreement between Mexico and the European Union, concluded in December 1997. All these initiatives provide for the subsequent negotiation of agreements on gradual and reciprocal trade liberalization. This process is progressing to differing extents and at different speeds in the various areas under negotiation.

In July 1998 negotiations began on a free trade agreement between Mexico and the European Union. This process moved forward swiftly, unlike similar initiatives between Europe and the Mercosur countries and Chile, perhaps as a result of Mexico's new status as a member of the Organisation for Economic Co-operation and Development (OECD) and of NAFTA. A year later, following nine rounds of negotiations between the Mexican and European delegations, the negotiations were concluded on 24 November 1999.

Disagreements had been overcome in the areas of market access, rules of origin, investment and industrial tariffs. Meat products, dairy products and grains were left out of the agreement and may be the object of future negotiations. Also, the agreement did not cover the area of government procurement, which is expected to be added at a later stage.

The objective of the agreement is a gradual liberalization of bilateral trade, taking into account economic disparities between Mexico and its future European

partners. Under the provisions of the agreement regarding market access, the European Union will liberalize 82% of its trade when the agreement comes into force, with the remaining 18% being postponed until 2003. The opening up of the Mexican market will take place in four stages. In mid-2000, Mexico will remove tariffs on 47.6% of imports from Europe.

Subsequently, tariffs on 5.1%, 5.6% and 41.7% will be eliminated in 2003, 2005 and 2007, respectively. For the textiles, apparel and footwear sectors, the automotive industry and agricultural products, special treatment will be given in respect of rules of origin and the timetable for liberalization. The final deadline for liberalization in the agricultural sector is 2010. The most complex parts of this agreement relate to the liberalization of financial services and the definition of rules of origin; in the latter area, agreement was reached on 80% of industrial products. These advances were made possible by the adoption of a more flexible position on the part of Mexico, which accepted an increase from 30% to 70% in the level of European or Mexican content required for products to be covered by the agreement. For some of Mexico's most important export sectors, such as the automotive industry, electronics and textiles, negotiations were more difficult. Agreement was reached concerning the automotive industry at the last possible moment. According to Mexican government officials, the agreement reached in relation to rules of origin should enable Mexican auto-parts producers to export to the European Union.

## Box II.1 (concluded)

Following ratification by the Mexican Senate and the European Council and Parliament, the agreement should come into force on 1 July 2000. Mexico will then be the only country in the world having free trade agreements with six Latin American countries -Bolivia, Chile, Costa Rica, Ecuador, Nicaragua and Venezuela- and with the world's two biggest markets: North America and the European Union. This process

has become the most ambitious trade liberalization programme ever undertaken by the European Union, since it extends to all areas of bilateral trade. Unlike its trade with the United States, Mexico's trade with the European Union shows a considerable deficit (US\$ 5.3 billion in 1998 and US\$ 4.7 billion from January to August 1999). This deficit is expected to trend downward, as it did in the case of the United States, with which

Mexico has had a trade surplus since 1995. Foreign direct investment flows from Europe are also expected to increase, partly because of Mexico's potential as a springboard for exports to the NAFTA area and Latin America. This would contribute to a more sound form of financing for the balance-of-payments current account deficit, which over the past 20 years has triggered a series of crises having to do with the external-sector deficit.

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

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efforts to improve competitiveness abroad as it is faced with the existence of a new international industrial order, and, on the other, of the fact that it is attractive to North American transnational corporations, as they strive to improve their competitiveness with respect to Japan and the European Union (Mortimore, 1998a).

In 1993, in anticipation of the implementation of NAFTA, the Mexican authorities amended the regulatory framework for FDI so as to adapt it to the new development strategy. They eliminated numerous restrictions on foreign investment that had existed since the enactment of the 1973 law.<sup>27</sup> New legislative changes were subsequently introduced for specific sectors (such as telecommunications, railways and finance), and in 1998, regulations were enacted implementing an amendment to the 1996 Foreign Investment Act, to bring the Mexican law in line with the provisions of NAFTA. Those provisions then

became the frame of reference and the "ceiling" applied by the Mexican authorities in all bilateral or multilateral negotiations on trade and investment. These criteria have been applied in negotiations on the OECD Multilateral Agreement on Investment (MAI), and in Mexico's participation in forums of the World Trade Organization (WTO) and the Free Trade Area of the Americas (FTAA).

All these changes were reflected in a considerable improvement in the performance of exports, mainly of manufactured goods, to the industrialized countries. Between 1989 and 1997, the average annual growth rate of exports of manufactured goods, in real terms, was 14%; this was four times higher than average output growth for the sector (Máttar and Peres, 1999). The share of these exports (not including those of the *maquila* sector) in the sectoral GDP rose from 34% to 58% between 1994 and 1996. Thanks to this

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27 The regulatory framework for FDI was approved on 27 December 1993, after NAFTA was signed and a few days before it was implemented. The 1973 law and the corresponding 1989 regulations had established restrictions on foreign investment in 142 items of the Mexican Classification of Activities and Products. Some were reserved exclusively for the State or for Mexican nationals, and for others, only a minority interest was allowed, or prior authorization from the National Foreign Investment Commission (CNIE) was required. The legislation currently in force permits FDI participation in most economic activities: of the 704 listed in the Mexican Classification, 606 are fully open to foreign capital, a share of up to 49% is permitted in 35 others, prior authorization from CNIE is required in 37, and FDI participation is not allowed in only 16 cases.

Table II.1  
**MEXICO: PRINCIPAL ECONOMIC RELATIONS WITH NORTH AMERICA**  
*(Millions of dollars and percentages)*

	1990 <sup>a</sup>		1994		1998	
	Amount	Percentage	Amount	Percentage	Amount	Percentage
Total exports	40 771	100.0	60 882	100.0	117 183	100.0
– United States	28 254	69.3	51 943	85.3	101 809	86.9
– Canada	326	0.8	1 470	2.4	1 716	1.5
Total imports	41 592	100.0	79 346	100.0	124 923	100.0
– United States	27 492	66.1	57 009	71.8	92 976	74.4
– Canada	541	1.3	1 600	2.0	2 255	1.8
Total trade	82 363	100.0	140 228	100.0	242 106	100.0
– United States	55 746	67.7	108 952	77.7	194 785	80.5
– Canada	867	1.1	3 070	2.2	3 971	1.6
FDI stocks	35 997	100.0	55 152	100.0	85 697	100.0
– United States	23 220	64.5	32 609	59.1	51 443	60.0
– Canada	506	1.4	1 410	2.6	2 330	2.7

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, based on data provided by the International Monetary Fund and the Ministry of Commerce and Industrial Development of Mexico (SECOFI).

<sup>a</sup> Estimated figures, owing to a change in the accounting method used in Mexico for external trade and FDI.

performance, Mexico was the country that achieved the greatest growth, after China, in terms of its share in goods imports of the OECD countries. Between 1980 and 1996, its competitive position on the North American market improved significantly (see table II.2). Mexico's share in that market's imports rose from 4.0% to 7.5%, with the greatest increase occurring between 1990 and 1996. While progress in the area of natural resources was erratic, the competitiveness of manufactures improved considerably. The structure of Mexican exports to the North American market underwent a fundamental change: in 1980, natural resources (especially crude oil) accounted for 63 of such exports, whereas in 1996, manufactures, especially those not based on natural resources, represented 79%. In 1996, eight of the ten main export products (SITC Rev. 2, 3 digits) represented imports that were showing growth on the North American scene, and Mexico made market gains in seven of them. Mexico managed to specialize in products that were strong on the North American market, especially in the automotive and electronics industries (see table II.2).

Between 1993 and 1998, the share of the largest foreign companies in Mexico's total exports, including *maquila* firms, increased from 56.5% to 64.2%. Some

of these branches of industry—including television sets (63.5%), metering equipment (55.4%), and electric power distribution equipment (53.8%)—have achieved a strong position in North American imports (Máttar and Peres, 1999). This reflects the strategy of the North American transnational corporations, which have seen their operations in Mexico as an opportunity to improve their overall efficiency—thanks to reduced costs and easy access to North American markets—, particularly in the automotive, electronics and clothing sectors. Mexico has risen to third place among the countries of origin of total imports into the United States. It also holds third place in motor vehicle imports, and first place in electronics and clothing (see table II.3).

Although considerable emphasis is placed on exports in the strategies of foreign enterprises in Mexico, the local market is also very attractive to them. Many transnational corporations have increased their market share in some manufacturing activities, irrespective of trade liberalization, usually by acquiring local companies, e.g., in the food, beverages and tobacco industries. In recent years, foreign investors have focused, in particular, on services sectors that have been deregulated, liberalized or privatized.

Table II.4  
**MEXICO: PRINCIPAL COMPANIES WITH FOREIGN PARTICIPATION, 1998**  
*(Millions of dollars and percentages)*

Company	Activity	Sales	Foreign investor	Foreign capital (%)	Country of origin	Exports
Teléfonos de México (TELMEX)	Tele-communications	8 564	Southwestern Bell Corp./ France Telecom	10 <sup>a</sup>	United States/ France	1 166
General Motors de México	Automotive	7 464	General Motors Corp.	100	United States	5 665
Daimler-Chrysler de México	Automotive	6 177	Daimler Benz	100	Germany	4 890
Cifra and subsidiaries	Commerce	5 634	WalMart Stores	53	United States	...
Volkswagen de México	Automotive	4 927	Volkswagen A. G.	100	Germany	3 682
Ford Motor Co.	Automotive	4 211	Ford Motor Company	100	United States	2 398
Sabritas S.A.	Foodstuffs	2 638	PepsiCo	100	United States	0
General Electric de México	Electronics	2 325	General Electric	100	United States	893
Nissan Mexicana S.A.	Automotive	1 840	Nissan Motor Co.	100	Japan	1 405
Nestlé México	Foodstuffs	1 648	Nestlé A.G.	100	Switzerland	91
Hewlett-Packard de México	Electronics	1 634	Hewlett Packard	100	United States	1 383
IBM de México	Computers	1 487	IBM Corporation	100	United States	...
Femsa-Cerveza	Beverages	1 451	John Labatt Limited	30	Canada	89
Coca Cola-Femsa	Beverages	1 392	The Coca-Cola Company	30	United States	...
Kimberly-Clark de México	Pulp and paper	1 345	Kimberly-Clark	47	United States	109
Nadco S.A. de C.V. <sup>b</sup>	Commerce	1 182	McKesson Corp.	23	United States	0
Delnosa S.A. de C.V.	Auto parts	1 166	General Motors Corp.	100	United States	1 166
Sony de Tijuana	Electronics	1 144	Sony Corporation	100	Japan	1 144
Grupo Celanese	Petrochemicals	1 119	Hoechst Group	100	Germany	385
NEC de México	Electronics	1 095	Nippon Electric Co.	100	Japan	...
SCI Systems <sup>b</sup>	Electronics	1 054	SCI Systems	100	United States	1 054
Philips Exportadora S.A.	Electronics	1 043	Philips A.G.	100	Netherlands	1 043
Cigarrera La Moderna	Tobacco	1 021	British American Tobacco (BAT)	100	United Kingdom	774
Mabe S.A.	Household appliances	1 007	General Electric	48	United States	427
Procter & Gamble de México	Chemicals	1 002	Procter & Gamble	100	United States	...
Grupo Kodak	Photography	985	Kodak	100	United States	629
Grupo Modelo	Beverages	793	Anheuser-Busch	50	United States	...
Ispat Mexicana <sup>b</sup>	Iron and steel	783	Ispat Group	100	India	619
Rockwell Automation de México	Electronics	780	Rockwell	100	United States	780
Colgate Palmolive S.A. de C.V.	Chemicals	...	Colgate Palmolive Co.	100	United States	...
Apasco S.A. de C.V.	Cement	685	Holderbank Group	100	Switzerland	...
Siemens S.A. de C.V.	Electrical machinery	674	Siemens A.G.	100	Germany	162
Deltrónicos de Matamoros	Electronics	635	General Motors Corp.	100	United States	635
Tubos de acero de México	Iron and steel	616	Grupo Techint	130	Argentina	...
Bayer de México	Chemicals	602	Bayer A.G.	100	Germany	...
Pepsi-Gemex S.A.	Beverages	600	PepsiCo	25	United States	...
Unilever de México	Cleaning agents/ Hygiene	545	Unilever	100	United Kingdom	...
Grupo BASF de México	Chemicals	542	BASF A.G.	100	Germany	82
Cigatam S.A. de C.V.	Tobacco	536	Philip Morris	21	United States	0
Samsunb <sup>b</sup>	Electronics	531	Samsung Corporation	100	Rep. of Korea	531
Matsushita S.A. de C.V.	Electronics	516	Matsushita Electric Co.	100	Japan	516
Kenworth Mexicana	Automotive	516	Kenworth Motor Truck Co.	100	United States	...
Xerox Mexicana S.A. de C.V.	Electronics	515	Xerox Corporation	100	United States	302
Motorola de México S.A.	Electronics	514	Motorola	100	United States	280
Kemet de México S.A. de C.V. <sup>b</sup>	Electronics	513	Kemet Electronics	100	United States	513
SIA Electrónica de Baja California <sup>b</sup>	Electronics	512	Sanyo Corp.	100	Japan	512
Favesa S.A. de C.V.	Auto parts	507	Lear Corporation	100	United States	507
Ericsson Telecom S.A. de C.V.	Electronics	500	Ericsson LM	100	Sweden	...
DuPont S.A. de C.V.	Chemicals	498	Du Pont de Nemours	100	United States	161
Sears Roebuck de México	Commerce	451	Sears Roebuck	100	United States	...
Lear Corporation México	Auto parts	445	Lear Siegler Systems	100	United States	277
Daimler Benz	Automotive	428	Daimler Benz	100	Germany	...
Industrias John Deere	Machinery	422	John Deere	100	United States	151
Daewoo de México						
S.A.b	Electronics	416	Daewoo Electronics Corp.	100	Rep. of Korea	416
LG Electronics Mexicob	Electronics	408	LG Electronics	100	Rep. of Korea	408
Compaq Computer SA	Electronics	392	Compaq Computer	100	United States	...
Embotelladoras Argos S.A.	Beverages	358	The Coca-Cola Company	20	United States	0



Table II.4 (concluded)

Company	Activity	Sales	Foreign investor	Foreign capital (%)	Country of origin	Exports
JVC <sup>b</sup>	Electronics	356	Matsushita Electronics	100	United States	356
Avon Cosmetics S.A. de C.V.	Pharmaceuticals	...	Avon Products Inc.	100	United States	...
Alcatel Indetel S.A. de C.V.	Electronics	...	Alcatel Alsthom	100	France	...
3M de México S.A. de C.V.	Chemicals	326	3M	100	United States	...
Mexinox S.A. de C.V.	Iron and steel	320	Krupp Thyssen GmbH	100	Germany	189
Grupo Iusacell	Tele-communications	309	Bell Atlantic	42	United States	0
Acer Computer Latino América	Electronics	303	Acer Inc.	50	Taiwan	218
Delphi <sup>b</sup>	Auto parts	290	Delphi Automobile Systems	100	United States	290
Hitachi de México S.A.	Electronics	280	Hitachi	100	Japan	280
Poliqles S.A. de C.V.	Petrochemicals	273	BASF AG	50	Germany	...
STB <sup>b</sup>	Electronics	267	STB Systems Inc.	100	United States	267
Grupo Smurfit Cartón y Papel de México	Pulp and paper	260	Jefferson Smurfit Group	100	Ireland	0
Pilgrim's Pride S.A. de C.V.	Foodstuffs	257	Pilgrim's Pride Corp.	100	United States	...
Hyundai de México S.A. de C.V.	Automotive	257	Hyundai Corporation	100	Rep. of Korea	257
Nemak <sup>b</sup>	Auto parts	241	Ford Motor Company	20	United States	120
Electrónica BRK	Electronics	239	First Alert Inc.	100	United States	239
Nokia Reynosab	Electronics	227	Nokia	100	Finland	227
Internacional de Cerámica	Non-metallic minerals	222	Interceramic	75	United States	118
Schneider Electric México	Electrical equipment	215	Schneider Electric	100	France	59
Caterpillar México S.A. de C.V.	Machinery	203	Caterpillar	100	United States	203
Ciba de México	Chemicals	199	Ciba Chemicals Corp.	100	Switzerland	64
Elamex S.A. de C.V.	Machinery	194		45	United States	194
Sanmex S.A. de C.V.	Electronics	189	Sanyo Corp.	100	Japan	189
Roche-Syntex	Chemicals	180	La Roche	100	Switzerland	...
Price Pfister de México S.A.	Metals	176	Price Pfister, Inc.	100	United States	176
Electrónica Clarion	Electronics	175	Clarion Co. Ltd.	100	Japan	153
SmithKline Beecham México	Pharmaceuticals	173	SmithKline Beecham plc	100	United Kingdom	...
EDS de México S.A. de C.V.	Electronics	168	Electronic Data Systems	100	United States	...
Albright & Wilson Troy de México	Chemicals	156	Albright & Wilson plc	100	United Kingdom	...
Dirona	Auto parts	155	Rockwell International	50	United States	...
Gillette de México S.A.	Chemicals	147	Gillette	100	United States	...
Honda de México S.A. de C.V.	Automotive	144	Honda Motors Co.	100	Japan	...
Olivetti Mexicana	Electronics	134	Olivetti Spa	100	Italy	52
Eli Lilly y Cía. de México	Pharmaceuticals	129	Eli Lilly & Company	100	United States	...
Alestra	Tele-communication	119	ATT	49	United States	...
Becton Dickinson de México	Pharmaceuticals	111	Becton Dickinson	100	United States	...
Singer Mexicana	Machinery	105	Singer Sewing Machine	100	United States	...
Dovaton de México S.A. de C.V.	Electronics	100	Dii Group Inc.	100	United States	73
Black & Decker S.A. de C.V.	Machinery	99	Black & Decker	100	United States	44
Dal-Tile México S.A. de C.V.	Non-ferrous minerals	97	Dal-Tile	100	United States	76
Mobil Oil de México S.A. C.V.	Petrochemicals	93	Mobil Corp.	100	United States	...
Cementos Portland Moctezuma	Non-ferrous minerals	90	Ciment Molins/Grupo Buzzi	66	Italy	...
BASF Pinturas	Chemicals	86	BASF AG	100	Germany	...
Merck México S.A.	Chemicals	83	Merck KGaA	100	Germany	...
Terza S.A. de C.V.	Textiles	79	Shaw Industries	50	United States	38
SKF de México S.A. de C.V.	Metals	74	SKF AB	100	Sweden	...
Grupo Echlin Automotriz	Auto parts	74	Diana	...	United States	...
NCR de México S.A. de C.V.	Electronics	69	NCR Corp.	100	United States	...
No Sabe Fallar S.A. de C.V.	Other manuf.	69	BIC	100	France	...

**Source:** ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, based on *Expansión*, "Las 500 empresas más importantes de México", 21 July 1999; *Expansión*, "Las 100 multinacionales más importantes de México", 15-29 September 1999; *América economía*, "Las mayores empresas de América Latina", special edition, 29 July 1999; and *América economía*, "Los 200 mayores exportadores ... y los 100 mayores importadores", 26 August 1999.

<sup>a</sup> Although they own only 10% of the capital, Southwestern Bell Corporation and France Telecom hold equal shares of a 49% block of AA-type voting shares.

<sup>b</sup> Export companies, mostly in the maquila industry, which sell close to 100% of their output in external markets.

## B. TRANSNATIONAL CORPORATION STRATEGIES IN MEXICO

### 1. The pursuit of efficiency to improve competitiveness on the North American market

In Mexico, efficiency criteria were applied mainly to the automotive, electronics and apparel industries, especially those operating under the *maquila* system. The automotive industry was the focus of a special chapter in the 1998 report, and a chapter on the apparel industry is included in this edition. Consequently, in this section, more emphasis will be placed on the electronics industry.

#### (a) United States corporations lay their stakes on the Mexican automotive industry<sup>28</sup>

Since the 1960s, the automobile industry has been one of the most dynamic sectors of the Mexican economy and the one that has received the most government support (Mortimore, 1995). Between 1962 and 1989, it was the subject of five official decrees aimed at its development and received direct subsidies, while commercial and local performance requirements were established and, in general, efforts were made to enhance its integration into the Mexican economy. From a normative standpoint, however, the North American Free Trade Agreement (NAFTA) accounts in no small measure for the recent dynamism of this subsector.<sup>29</sup>

The overwhelming advance of Japanese firms on world automobile markets and the challenge they pose to competing industries led the United States and European companies to change their global strategies

(ECLAC 1998a). Thus, integrated production systems, just-in-time production and the development of cheap factors of production were the main elements that determined the strategy of these companies. From the early 1990s on, as a result of the signing of NAFTA, Mexico became increasingly important in the global strategies of the main transnational corporations of the subsector, especially United States firms, as they sought to improve their competitive position on the United States market by selling vehicles assembled in Mexico. The Mexican authorities responded proactively to these international market trends by securing foreign investment and promoting export activities (Camacho Sandoval, 1999; Mortimore, 1998a).

In this context, the automotive industry established in Mexico underwent radical structural changes and exports became the engine of growth. In 1999, in fact, Mexico's motor vehicle production was higher than that of Brazil (*Gazeta Mercantil Latino Americana*, 13-19 September 1999). Automobile production almost tripled between 1980 and 1998, to stand at 1,475,000 units in 1998. During the same period, the share of exports in total output grew steadily, from 3.7% to 68.6%. This trend was interrupted only by the 1994-1995 crisis, which caused a sharp slump in domestic sales (see table II.5). Currently, with the domestic market staging a recovery of sorts, it is estimated that in the coming years, exports

28 For further details, see chapter IV of ECLAC (1998a), "The Automotive Industry: Investment and Corporate Strategies in Latin America".

29 The NAFTA text stipulates that between 1994 and 1998, *national value added* for the production of finished vehicles would be maintained at 34%, and that it would subsequently be reduced by 1% per year until 2003. As from 2004, only the *regional value added* of NAFTA countries, set at 62.5%, would apply. Similarly, performance requirements for the end-use industry would be eliminated in 2004. Domestic sales from the *maquila* industries—which are significant in the case of end-use sectors and parts and components—are expected to increase steadily, from 55% in 1994 to 100% from 2001 onwards. (BANCOMEXT, 1996; Ruiz Durán, Dussel Peters and Taniura, 1997).



Table II.5  
**MEXICO: PERFORMANCE OF THE AUTOMOTIVE INDUSTRY, 1990-1998**  
*(Billions of dollars and percentages)*

	1990	1994	1995	1996	1997	1998
Production (thousands of vehicles) <sup>a</sup>	821	1 097	931	1 211	1 338	1 475
– for the domestic market	544	522	152	240	354	464
– for export	277	575	779	971	984	1 011
Employees (thousands of persons)	57.6	49.7	41.8	44.3	44.8	...
Exports	4.5	10.4	15.3	19.6	20.8	...
– to North America (%) <sup>b</sup>	91.2	90.3	94.0	...	...	...
– as a percentage of imports into North America (%)	4.7	7.9	8.6	10.9	...	...
– as a percentage of total Mexican exports 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, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, on the basis of information provided by the Asociación Mexicana de la Industria Automotriz (AMIA) and the ECLAC Competitive Analysis of Nations (CAN) software.

<sup>a</sup> Passenger, commercial and other vehicles.

<sup>b</sup> Canada and the United States.

will represent approximately 60% of total output, and national sales will be concentrated on compact cars. Lastly, especially since the signing of NAFTA, new parts and components producers, as well as producers of finished vehicles, have entered the market (Honda, Mercedes Benz, BMW and Volvo). All these “newcomers” already have production and distribution centres in the United States and will have to assess their operations in Mexico—which amounted to less than 10,000 units in 1998—in the light of their global corporate strategies. The alliance between Chrysler—the fourth largest motor vehicle producer worldwide—and Daimler Benz will certainly have a major effect on Mexico, although it is still too early to make estimates in this regard.

Recently, vast sums have been invested in the automotive sector, and this trend is expected to be maintained over the next few years. Projected investments for the period 1998-1999 were expected to be in excess of US\$ 5.5 billion. This figure includes plans by Daimler-Chrysler to set up eight plants in the country at a cost of US\$ 1.5 billion, and the recent injection of US\$ 170 million in a new stamping plant in Saltillo. Ford plans to invest a further US\$ 1.5 billion in Chihuahua in plants for producing engines, around 90% of which will be geared to the export market. All

this attests to Mexico’s growing importance in the global strategies of these corporations.

The Mexican subsidiaries of General Motors, Daimler-Chrysler, Volkswagen and Ford have become the leading export companies in the country and in Latin America as a whole (see tables I.14 and II.4). To their high levels of investment, the Mexican subsidiaries have added a steadily increasing participation in total NAFTA production (Mortimore, 1998; Ruiz Durán, Dussel Peters and Taniura, 1997). Between 1990 and 1998, following the country’s incorporation into the integrated production systems of United States automotive firms, motor vehicle exports from Mexico to the United States soared from US\$ 2.883 billion to US\$ 17.645 billion. In the same period, the United States accounted for about 90% of the market. These structural changes apply not only to United States companies, but also to those of other origins, such as Volkswagen (see box II.2).

Nevertheless, some automotive firms, in particular some of Japanese origin, faced serious problems in 1998-1999. As a result of restrictions imposed by their parent companies and the difficulties experienced by the Latin American economies—sales in Mexico plummeted by 20% in 1998 (*Expansión*, 1998a; Rico Tavera, 1998)—companies such as Honda and Nissan

## Box II.2

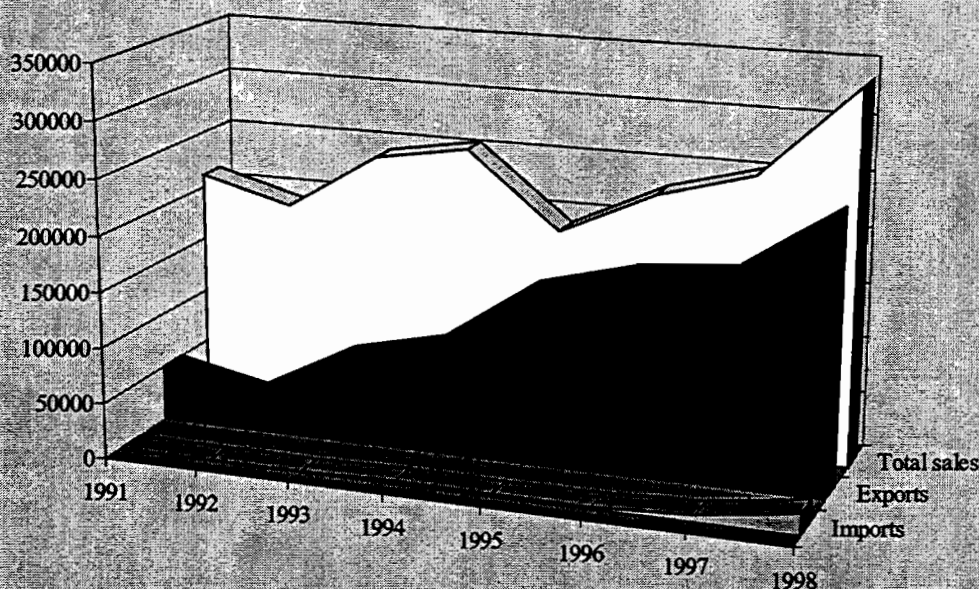
# VOLKSWAGEN CHOOSES MEXICO AS CENTRE FOR ITS OPERATIONS UNDER THE NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA)

In 1988, the German-based Volkswagen transferred its operations from the United States (Pennsylvania) to Mexico. Although its main focus had been the local market, it began to sell part of the output from its Puebla plant in North America. Even before the crisis of December 1994, it was exporting more than 30% of the units produced in Mexico, thus making Mexico its main base for exports to NAFTA member countries. Volkswagen is a good example of the structural change undergone by many of the

transnational corporations in Mexico, particularly those involved in the automotive industry. Under the NAFTA rules of origin, non-North American companies had to adjust their operations to include North American inputs in their production processes. From this standpoint, the NAFTA rules of origin and the Mexican currency devaluation deepened a trend that had begun several years earlier. Between 1990 and 1995, the rate of Volkswagen exports increased from under 20% to 82.9%. In 1998, the United

States market was the final destination for 73% of its output (Ramírez Tamayo, 1999b). The structure of the industry and NAFTA made it possible to maintain a relatively stable level of production in 1995 and 1996, despite the sudden fall in domestic sales in 1994 (from 158,052 to 32,244 units) (see figure). Thus, between 1994 and 1998, Volkswagen increased its production by 30.9% and its exports by 151.2%.

Figure  
VOLKSWAGEN: TOTAL SALES, IMPORTS AND EXPORTS  
OF PASSENGER VEHICLES, 1991-1998  
(Units)



Source: ECLAC, Information Centre, Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the Mexican Automotive Industry Association (AMIA).

In 1995, Volkswagen decided to produce its new Beetle model for worldwide distribution exclusively in Puebla. As a result of this decision, it invested over US\$ 1 billion and generated some 2,000 new jobs. The company expects to produce 160,000 units per year as from 1999, and more than 90% of the total will be for export, mainly to the United States and Europe. Thus, the Puebla plant has been consolidated as the

production base for the German consortium in North America, and three quarters of the vehicles sold by Volkswagen in the region are produced in this Mexican city (Ramírez Tamayo, 1999b). The Volkswagen case is important in many respects. On the one hand, around 75% of the vehicles sold in North America are produced in Puebla. The crisis of December 1994 did not affect planned investments, and

in fact, one of the largest investments of the last decade was made during this period. The structure of the industry and the quality standards and control methods adopted since then have made it possible to gear most production towards the external market within a relatively short space of time, since there was no longer any difference in quality between production for the domestic market and that designed for the export market.

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

reportedly slashed inventory and production costs. Nissan, which merged with Renault in March 1999, is making cuts of up to US\$ 1,000 on each vehicle produced in North America, and in 1999, it laid off 580 employees. In the medium term, this firm plans to take major decisions concerning its operations in the NAFTA area and to turn Nissan North America into a single company with headquarters in the United States. On the other hand, Honda has announced that in 1999, it will invest US\$ 50 million in the production of the Accord model.

Similar trends can be seen among producers of automobile parts, including Magna Internacional and Kasai Mexicana, which have Canadian and Japanese investment capital. Another is Delphi Automobile Systems, which recently split off from General Motors and which plans to concentrate its global operations in Mexico (Guzmán Reyes, 1999). Also of interest are the experiences of American Axle & Manufacturing Co., which has invested US\$ 120 million in the construction of an axle plant; Aventec S.A. will invest US\$ 70 million in the installation of a moulding plant to build parts for General Motors pick-up trucks and vans; Oxford Automotive Co. will bring on stream a new metal-cutting plant for General Motors automobile chassis, at a cost of US\$ 35 million. Other companies, such as United Technologies, Mannesmann, and Easton Control, will invest between US\$ 30 million and US\$ 40 million to expand their production capacity

and build new plants in the north of Mexico. Unik, a parts producer which belongs to the Mexican group Desc, has launched an aggressive growth strategy based on acquisitions. This is one of the few local firms that has survived and that has used an expansionary strategy within the context of NAFTA. It has bought 49% of the manual transmissions division of Robert Bosch, 100% of Borg Warner, and 51% of Dana transmissions. With sales totalling around US\$ 450 million in 1998, Unik plans to invest some US\$ 700 million to consolidate its operations and modernise its plants (*Expansión*, 1998a).

In brief, the United States automotive firms have invested heavily in Mexico in order to improve their competitive position in North America, particularly in view of the growing participation of Asian companies in international markets. In keeping with this strategy, the North American companies have taken full advantage of the facilities granted by the authorities of the United States (production sharing, HTS 9802 and NAFTA) and Mexico (*maquila*). With the entry into force of NAFTA, the increasing integration (within North America) of United States firms was replicated, to some extent, by companies from other countries, such as Volkswagen. This has meant that non-North American companies have had to increase the North American content of their products, in order to comply with rules of origin and be eligible to sell on this market; as a result, they have strengthened subregional

supply chains. Nevertheless, the automotive and auto parts industries are still seriously limited by the low level of Mexican value added and their excessive concentration in the North American market. These issues will undoubtedly pose major challenges to Mexican industry in the twenty-first century. It is of interest to note that Mexico's experience in this area has been quite different from that of the Republic of Korea. Both countries created large automotive industries that are competitive on the international market. The Republic of Korea, however, exports to the whole world. The dominant Korean companies work in association with foreign companies, and have strong national linkages. The Mexican automotive industry is focused essentially on the North American market, is dominated by foreign companies and has limited national linkages.

**(b) The Mexican electronics industry: a high-tech industrial complex?**

Recently, the electronics industry, like the automobile industry, has been one of the most dynamic branches of the Mexican economy. Between 1988 and 1996, this subsector, not including *maquila* activities, has grown at an average annual rate of 9.8%; in 1996, it generated 228,603 jobs. As with the rest of the manufacturing industry, it has recorded a remarkable expansion in exports, mainly to the United States. Thus, Mexico has become the leading supplier of electronic products to the United States market, edging out other countries, such as Japan and Canada (see table II.3). These achievements notwithstanding, imports of electronic inputs have also grown at a fast pace and generally reflect the difficulty this industry has experienced in trying to enter a field with a high value added.

From the 1980s onward, the Mexican electronics industry has been affected by a number of developments, both internal and external, which are fundamental to an understanding of its importance today. A series of trends may be noted at the international level. From the standpoint of the United States companies, Mexico has occupied a leading role in electronics, particularly in *maquila* activity, since the 1980s.

- Following the 1982 crisis, the electronics industry faced serious difficulties in its efforts to restructure its production and distribution channels. In view of the fall in domestic demand, exports, and especially the activities of *maquila* firms, have been essential to the subsector's recovery. Even

before the signing of NAFTA, a large number of *maquila* companies were already involved in electronics. The renewed buoyancy of this industry stems from the arrival of transnational corporations applying efficiency-seeking strategies in Mexico so that they can compete more successfully in the North American market.

- When NAFTA entered into force and it became possible to import raw materials and inputs on a tax-free basis for local sales, the *maquila* companies had the added incentive of being able to sell an increasing percentage of their production on the Mexican market.
- The broad process of trade liberalization and the signing of free trade agreements with many of the Latin American countries served as further incentives for the main companies operating in the sector to pursue their strategies.
- For Asian companies, the reduction of tariffs on Mexican exports to the United States and the security offered by NAFTA have been fundamental events; most of these firms gear their production to the United States market. The number of Asian companies with manufacturing activities in Mexico, particularly in electronics, rose from 19 in 1990 to 52 within the first three years of the entry into force of NAFTA.
- For United States corporations, the main thrust of their Mexican operations has become their usefulness in countering the growing competition from Asia, whereas in the past they had simply focused on assembling products in Mexico for sale on the domestic market.

Mexico has thus become a zone where the United States and Asian electronics industries are competing more and more for a share of the North American market. The proximity of the Mexican *maquila* companies to the electronics and computer industries in California has reinforced this trend (USITC, 1997a; USITC, 1998a). Mexico is now a major competitor of the Asian countries in assembly and sub-assembly and, to a lesser extent, original equipment manufacturing (OEM). Thus, in cities such as Tijuana and Ciudad Juárez, among others, there has been a vast proliferation of companies engaging in the assembly and sub-assembly of electronic products (*Expansión*, 1998d).

In view of the complexity of the whole field of electronics—consumer goods and components, high tech and highly differentiated products, such as computers—an analysis is made below of two specific branches—computers and television sets—in which

transnational companies have geared their operations towards improving efficiency.

*(i) The computer industry in Mexico: the predominance of United States corporations*

In the early 1990s, the United States computer and parts and components industry—with a few exceptions, such as INTEL and Microsoft—seemed to have succumbed to competition from Asia. Thus, while IBM was undertaking a radical restructuring in response to the crisis in regard to large servers and the growing importance of personal computers (PCs), companies in Japan (NEC, Hitachi, Fujitsu, Seiko Epson, Mitsubishi Electric, Toshiba, Sanyo and Matsushita), Taiwan Province of China (Acer), Republic of Korea (Samsung, LG Electronics and Hyundai), Singapore and Hong Kong SAR were on their way to becoming the new leaders in the global computer industry.

In the mid-1990s, Taiwan Province of China was the main producer of portable computers, monitors, scanners, keyboards, motherboards and mice. Singapore led the way with hard disks and sound cards and held fourth place worldwide in assembly of personal computers (PCs). The Republic of Korea was Japan's main competitor on the market for dynamic random access memory (DRAM). Lastly, Hong Kong had transferred much of its manufacturing base to China, but maintained its hegemony in the administration of these processes in Asia (Dedrick and Kraemer, 1998, p. 116). Since the 1980s, Asia had been the main supplier to the computer industry, including both Japanese and United States companies. Thus, companies such as Apple, Seagate and IBM itself were competing with Japanese firms for Asian suppliers (Ernst, 1997; Dedrick and Kraemer, 1998); for example, Singapore has no major hard disk manufacturers, and yet it accounts for about half the world output of these components.

In the last few years, although Japan has remained one of the main producers of parts and components—including DRAM, monitors for portable computers, peripheral equipment, hard disks, Compact Disk/Read Only Memory (CD-ROM), laser printers and monitor components—the United States companies have

staged a strong comeback. This may be attributed to their skill in imposing standards (for both software and hardware), as well as to their new corporate strategies.

Falling prices for chips, DRAM and a number of parts and components, combined with the strong impact of the recent financial crisis, have seriously affected Asian companies (Warnke, 1996). Given the reduction in the size of PCs, the success of the portable computer, and the crucial importance of global production and distribution networks designed to reduce inventories and respond in "real time" to the increasingly demand-based requirements of consumers and industrial organizations (build to forecast, configure to order, build to order), manufacturers have found it necessary not only to provide just-in-time delivery and reduce costs and stocks, but also to respond rapidly to constant fluctuations in demand (Pringle, 1998). Thus, the main PC brands have moved—gradually but steadily—towards selling their products directly by electronic mail, leaving distributors out in the cold.<sup>30</sup> This is reflected in some of the changes in industrial engineering and corporate strategy that have been implemented by certain key companies in this sector, including Compaq, IBM, Hewlett Packard and Dell Computer.

The adjustment in corporate strategies to meet demand in "real time"—which, in some instances, can mean reducing stocks from weeks to minutes, as in the case of Dell Computer (Stein and Sweat, 1998)—calls not only for new information flows to be developed between the components of the production, distribution and services network, but also for consideration to be given to distances between suppliers and customers and to response time. In the electronics industry, a new form of industrial organization has been generated whereby the United States companies have been able to respond rapidly to international competition through outsourcing. The big brand companies control the entire process of production, distribution and services, outsource most manufacturing activities and concentrate exclusively on intensive research and development, as well as on a few strategic parts and components (Sturgeon, 1997).

In this context, and thanks to the regulatory changes introduced in Mexico, the existence of the

30 Compaq, one of the leading companies worldwide in terms of PC sales, has implemented a system of enterprise resource planning that is designed to synchronize its outsourced operations with real-time demand (Tipton, 1999). Similarly, firms such as Hewlett Packard and IBM have implemented multiple organization systems for synchronizing their outsourced operations with demand (Bruton and Samiee, 1998; Electronic Buyers News, 1998).



*maquila* industry, and the supply of factors of production that are relatively cheap and comparable with those in Asia, the northern border region of Mexico, especially the state of Jalisco (see box II.3), has become a strategic zone for assembly and sub-assembly operations for the United States computer industry. At the same time, the entry and participation of Asian companies have diminished.

The above-mentioned trends are reflected in the fact that the United States market has become increasingly important to the Mexican computer trade, since over 95% of its production was sold in this country in the 1990s. Between 1990 and 1998, computer exports to the United States rose from US\$ 578 million to US\$ 5.248 billion. Mexico has the highest growth rates for these exports to the United States and has become its fifth largest supplier, having overtaken countries such as China, Canada and the Republic of Korea. In 1997, Mexico was the leading exporter of portable computers to the United States as its sales totalled US\$ 1,649 billion, and it accounted for 40.1% of that country's imports (Dussel Peters and Ruiz Durán, 1999).

The case of the Taiwanese firm, Acer, was quite interesting. Its new strategy entails improving integration between its activities in the United States and in Mexico, emphasizing exports to Latin America in its Mexican operations, and intensifying the assembly of PCs and portable computers—as well as the supply of parts and components—in Mexico. This strategy represents a response to the constraints of the Mexican domestic market and to the difficulties the company faces in its effort to recover its share in PC sales.<sup>31</sup> Thus, the aim of the new plants in El Paso—original equipment manufacture (OEM) *maquila* operations geared to the export market—and Ciudad Juárez,<sup>32</sup> is to reduce deadlines as required by the industry. On average, the El Paso plant supplies the United States operations with a lag of only three days, while the same process can take several weeks from

Taiwan Province of China or even Mexico City. From this standpoint, Acer—the main assembler of portable computers for companies such as IBM, Hitachi and Fujitsu (*Business Week*, 1999b)—has become one of the largest assembly companies in the industry. In addition, Acer has sought to reduce the weight of government purchases. Its recent contract with Teléfonos de México (TELMEX), which in 1999 launched a programme to offer computers for sale on credit, in an effort to expand its Internet access business, seems to be heading in that direction (*América economía*, 1999c).

In 1999, IBM planned to invest some US\$ 100 million in the expansion of its export-oriented plants in Jalisco; Seagate, for its part, was to invest US\$ 70 million in the construction of an electronics plant in Tamaulipas. Both initiatives reflect the complex network being developed in the computer industry in Mexico.

The US\$ 10 million invested by Softek in a software production company probably marks the start of a deepening of processes designed to increase the value added of this industry in Mexico. In May 1999, with an investment of US\$ 1.6 million, Softek and Microsoft agreed to initiate operations for the development of distance computer programs; it is estimated that Microsoft's demand will be between US\$ 5 million and US\$ 10 million. Other investments attest to the changes in industrial patterns and corporate strategies, including the investment by IBM of US\$ 25 million in the construction of a new corporate centre (*Expansión*, 1998c); the decision by Acer to expand its operations beyond Mexico to other Latin American countries and invest US\$ 30 million in ACBr, Brazil, in May 1999, and the transfer by Sanyo of its entire portable computer manufacturing operations from Japan to Mexico at the end of 1997.

In general, the growing presence in Mexico of plants belonging to the major computer companies has two distinctive characteristics:

31 In 1998, PC sales from Mexico (977,475 shipped) came from four major companies, namely, Compaq Digital (21.5%), IBM (12.8%), Acer (11.6%), and Hewlett Packard (10.2%). With a share of over 40% of the domestic market, the Taiwanese firm, Acer, held a predominant position during the first half of the decade. In addition to being one of the main PC manufacturers in Mexico, it also owns several computer parts and components plants in Ciudad Juárez and El Paso. In 1994, Acer—the third largest PC producer worldwide—merged with Computec, which had been the Acer equipment distributor since 1989, to form Acer Computec Latino América (ACLA). Since then, Acer's share has dropped sharply, and it has had to undertake a major restructuring process (Pérez Moreno, 1998b).

32 The Ciudad Juárez plant, with initial investments of US\$ 20 million, will be the ninth plant installed by Acer outside of Taiwan. Its objective is to produce up to 100,000 computers per month, as well as motherboards and other electronic consumer goods. According to the firm itself, this plant will be important to the build-to-order system in the United States (Computergram International, 1998). This plant assembles more than 400,000 portable computers for IBM every year.

### Box II.3 THE COMPUTER INDUSTRY IN JALISCO: MEXICO'S SILICON VALLEY?

Currently, a significant number of leading international firms are operating in Jalisco, including IBM, Hewlett Packard, Siemens, NEC, Kodak, Motorola, Lucent Technologies -bought in 1998 by Philips Electronics, whose plant will be sold now that the alliance between Philips and Lucent has been dissolved-, as well as suppliers such as SCI Systems, Natsteel, Keytronics, Flextronics, Avex Electronics, ALPS, Dovatron and USCO.

During the 1990s, Jalisco has received most of the foreign investment inflows from computer firms. In 1998, according to data prepared by the Jalisco state government, the electronics industry brought in US\$ 624 million in foreign investment, 88.5% of which was of United States origin, and generated 8 442 jobs. In 1995, it accounted for 12.4% of national GDP corresponding to electronic equipment and appliances, including the computer sector. In 1997, the electronic industrial complex in Jalisco had more than 70 firms and provided some 28,000 direct, and more than 100,000 indirect jobs. Since then, moreover, an estimated average of one electronics firm per month has been set up there.

In Jalisco, this industry has specialized in PC-related computer products, portable computers, printers, telephones, floppy disks, semiconductors, hard disks, harnesses, beepers and other parts, components and end products.

Between 1994 and 1998, exports from the subsector increased at an impressive rate, from under US\$ 1.5 million to an estimated

US\$ 6.5 billion in 1998. IBM, Motorola and Kodak, the three top exporting companies in Jalisco, are involved in electronics. In 1996, IBM, SCI Systems, Motorola and Lucent Technology together generated 94.9% of all exports of electronic products. Generally speaking, the companies based in Jalisco belong to two distinct generations, as follows:

- Those established since the 1980s, particularly IBM, which sought in Jalisco a source of cheap labour, proximity to the United States, and the benefits to be obtained from various government programmes designed to attract FDI.
- Those set up in the 1990s, which, in addition to being attracted by the aforementioned incentives, wished to take advantage of NAFTA, Mexico's macroeconomic and foreign-investment policies, and the "cumulative causation" process resulting from the pre-existing demand in the industrial complex. In Jalisco, the proximity of suppliers is crucial, given the increasing number of companies operating in the zone. This trend is all the more important because brand-name companies need to control the operations of contract electronics manufacturers and other inter-firm arrangements. Nevertheless, the success of the computer industry in Jalisco has not been matched by an equally strong process of national industrialization. The value-added structure of the computer industry is funnel-shaped. A large number

of upper-tier foreign companies have been set up, predominantly with United States capital. There are few subcontractors and even fewer companies that provide supplies for subcontractors. Most of the value added is imported, and very few Mexican companies have become involved in these processes. According to results of the input-output matrix, in 1996, electronics was the least integrated industry, both nationally and regionally. Despite the efforts of the Jalisco state government, an analysis of a significant number of companies in the area revealed an inadequate industrial structure (Dussel Peters, 1998).

- The first-generation companies have fostered -by providing engineers, technology and, in some cases, financing- the establishment of subcontracting firms that supply them with "necessary products" that are difficult to import because of their volume, weight or both (for example, plastic injection or packaging). However, this has not been a constant process.
- In addition, in many cases, second-generation companies have been established in Jalisco with a network of outsourcing of processes, parts, and components, all of which are imported. This situation, added to the technological, financial, quality and time lags, makes it very difficult to generate linkages.

- Major United States corporations, such as IBM and Hewlett Packard —both of which have operations in the state of Jalisco— have substantially expanded their assembly and subassembly capacity. In 1998, IBM assembled 800,000 portable computers and 500,000 PCs at its El Salto plants in Jalisco, of which 95% were exported (see box II.4). Nevertheless, the value added is declining steadily; although IBM has managed to develop some supply companies in the region, Hewlett Packard imports practically all the parts and components required for its PC assembly operations in Jalisco.<sup>33</sup> The production of printers —mostly ink-jet— has been one of the most impressive operations in the electronics industry in general, and in Hewlett-Packard in particular.<sup>34</sup> The Jalisco area was chosen for these operations mainly because of the availability of expeditious transport for inputs and distribution of the final product, the availability of highly skilled personnel, and the presence of suppliers of inputs, parts and components. For example, the establishment in Jalisco of Soletron, one of the main suppliers of inputs for printers, cut the cost of the product by 25%.
- Operations of parts and component producers are growing, albeit at a slow pace.<sup>35</sup> Steps are being taken in the state of Jalisco to attract suppliers and increase their level of integration into the regional and national economy (see box II.3). The organization Cadena Productiva de la Electrónica (CADELEC) has undertaken numerous studies to report on the demand generated by the electronics industry in Jalisco —plastic injection, power sources, cables and packing harnesses, print circuit and anti-static cards— with the aim of promoting the establishment of new companies in this region of Mexico. In the medium term, this strategy may generate its own dynamic, and the electronics industry may advance along different lines, focusing on assembly and on activities that

provide limited scope for national value added or local training.

In brief, as in the case of the automotive industry, the United States computer companies, faced with competition from Asian products, have transferred part of their productive processes —mainly assembly— to Mexico. This has helped them improve efficiency and become more competitive on the United States market. The Asian firms have also expanded their productive base in Mexico in order to comply with rules of origin for the North American market. In fact, some of them assemble computers for United States companies, for sale on the NAFTA market. From the standpoint of national economic development, these activities are still hampered by the fact that the level of Mexican value added is still very limited, linkages with the rest of the local economy are weak, and they are geared mainly towards exporting to the North American market.

#### *(ii) Television manufacture in Mexico: Asian dominance*

The television and computer industries in Mexico share a number of features, including an oligopolistic structure with few participating firms, the dynamic of technological innovation in parts and components and also in production and distribution processes, and strong competition on international markets. Apart from this, the NAFTA rules of origin and the *maquila* industry have also had a significant effect on the production of television sets.

There are also several significant differences between the two industries in Mexico, especially as regards the size and origin of the firms involved. In 1998, computer industry exports to the United States amounted to US\$ 5.248 billion, while exports of television sets amounted to US\$ 4.698 billion. Most of the players in the computer industry are of United States origin, whereas in the television market, United States producers have been displaced by Asian

33 In the case of Hewlett Packard, the parts and components of the three main models assembled in Jalisco (Brio, Vectra and Kayac), which overall represent between 20,000 and 30,000 units per month, are purchased internationally by the corporation, which does not permit local outsourcing.

34 Hewlett Packard produces approximately 330,000 printers per month, mostly for export, especially to the United States. The company has made Jalisco state in Mexico its main location for assembly of ink-jet printers worldwide.

35 IEC Electronics Corp. has concentrated its operations in Ireland (high tech activities and processes) and Mexico (labour-intensive processes) (Dunn, 1998). In 1998, Ge Plastics set up operations in Mexico to provide training services to companies and *maquila* activities in the management and use of plastic injection equipment. The Taiwanese company Delta Products has built a computer battery assembly plant in Nogales, in the state of Sonora, to replace its existing plants in China and Thailand.



## Box II.4

**IBM: A COMPUTER INDUSTRY GIANT IN MEXICO**

After 20 years of activity in the country, IBM moved its manufacturing facility from Mexico City to Jalisco. In 1985, in the wake of economic liberalization, it substantially expanded its activities at that plant. The case of IBM has historical importance, because it was the first foreign company in Mexico to have 100% ownership of a new plant, under the terms of an agreement with the Government. It was also allowed to import its production inputs on a duty-free basis. IBM invested US\$ 92 million to produce a line of personal computers at its Jalisco facility. The treatment given to IBM was innovative compared to earlier policies, but it also gave rise to contradictory situations, as the State overlooked existing trade rules and national-content requirements.

Today, the IBM plants in Jalisco have become an essential component of the company's corporate strategy, both in regard to members of the North American Free Trade Agreement (NAFTA) and worldwide. The facility provides employment to 11,000 workers, 800 of whom are hired directly by IBM, while the remainder work in the plant for a number of subcontractors. IBM has become one of Mexico's main exporters and the largest in the State of Jalisco. In 1998, IBM

brought in around US\$ 2.7 billion (Expansión, 13 October 1999). In 1998-1999, the company planned to invest over US\$ 400 million to build warehouses for chemicals, materials and equipment, and it is currently negotiating arrangements to set up a factory for the production of liquid crystal for computer monitors. This project, which would require an investment of about US\$ 2 billion, would be the largest in Latin America, and would have far-reaching consequences for the electronics industry in general and for the production of television sets and computers in particular. IBM operations in the El Salto industrial belt in Jalisco specialize in the assembly of personal and laptop computers. In both of these product lines, but especially in the latter, the Jalisco plants have become strategically important for the firm at the world level. In 1998, as many as 800,000 laptop computers were assembled there - in addition to the 400,000 assembled for IBM by Acer in Ciudad Juárez - representing 55% of the company's total laptop production worldwide. Ninety-five per cent of its production of this type of computer is sent to four destinations: 70% to the United States, 15% to Canada, 10% to Asia and 5% to Latin America. In 1998, IBM assembled 500,000 PCs, which was less than the

production of laptop computers not only in volume terms but also in value.

In the 1990s, the global scale of IBM operations has increased, and some of its plants and activities that were formerly located in Asia have been transferred to Mexico. Operations in Mexico are fundamental to understanding the far-reaching worldwide restructuring the company has undergone. In 1993, practically all laptop computer components came from Asia, whereas today 80% of them are made in North America. These changes have been less significant in other divisions of the company, as in the case of PC production. For the present, IBM activities in Mexico centre on the assembly of imported parts and components. However, the firm has also created a software development centre (Guadalajara Supporting Laboratory) staffed by 160 engineers and other skilled workers, and it has made significant efforts to set up suppliers in the electronics industry complex in Jalisco. The projected liquid crystal production facility is likely to be fundamental in raising local value added, which so far has been low in these activities.

**Source:** Enrique Dussel Peters, *La subcontratación como proceso de aprendizaje: el caso de la electrónica en Jalisco (México) en la década de los noventa*, LC/R.1808, Santiago, Chile, ECLAC, 1998; Enrique Dussel Peters and Clemente Ruiz Durán, "North American Integration and Development: the Computer Industry", unpublished manuscript, 1999.

companies, both internationally and in Mexico. The widespread establishment of television assembly plants in Mexico was motivated by the proximity of the United States market and the opportunity to avoid paying that country's high tariffs.

As a result, large amounts of television-related foreign investment have flowed into Mexico, especially to the northern border region. The country has become the main exporter of colour television sets to countries of the Organization for Economic Cooperation and Development (OECD); it accounts for 18.5% of total OECD imports and 60% of North American imports of this product (Mortimore, 1997, p. 13). The percentage of United States imports of colour television sets produced in the northern border region of Mexico could even be as high as 70% (Carrillo, Mortimore and Alonso Estrada, 1998, p. 47). From this standpoint, television-set *maquila* operations in Mexico have become very important owing to their virtually exclusive focus on the United States market and their ability to respond quickly to market demands.

Television set assembly operations are concentrated in just three locations. In Tijuana, there are at least six large assembly plants (Hitachi, S.I.A. Electrónica de Baja California, Sony de Tijuana Este, Sony Centro, Sanyo and JVC), as well as 20 parts and components producers. In Ciudad Juárez, there are seven large assembly operations (Philips, Zenco de Chihuahua, Thomson, LG Electronics, Goldstar, Funai and Orion). Finally, Mexicali is also growing as a television set production centre, as companies such as Samsung, LG Electronics, Osung Electronics and over 20 component makers have set up plants in that city (CNIME, 1998).

With practically no United States companies making television sets,<sup>36</sup> Asian companies have invested some US\$ 1 billion in this industry since 1994. The northern region of Mexico currently has the capacity to assemble 25 million sets—in 1996 it produced about 18 million. In March 1999, there were 501 electrical and electronic materials and accessories plants in the north of the country, and

they generated 279,988 jobs and US\$ 304 million in value added.

Since the signing of the NAFTA accords, these firms have expanded their activities in Tijuana—where Sony, the world's leading television set manufacturer, produced 17 million units in 1998 (Martínez Staines, 1998)—and in Ciudad Juárez. Mitsubishi has increased its production of printed circuits in Mexicali, after transferring the manufacture of circuit boards for large television sets to Mexico from Asia; Samsung and Daewoo<sup>37</sup> have begun to produce cathode ray tubes in Tijuana and Mexicali; and Samsung has entered a joint venture with Asahi Glass and Corning Glass to produce glass for computer monitors and television screens—an input that previously had been wholly imported. These cases, apart from reflecting international trends,<sup>38</sup> are evidence of the steady convergence that is taking place between the computer and television industries, particularly in the increasingly sophisticated technologies applicable to monitors. These trends are significant from several standpoints:

- Mexico's northern border zone has consolidated its position as the world leader in colour television set assembly, based on components imported from Asia and the United States. This leadership is likely to become even stronger. This industrial complex in the north of Mexico is more a result of international trends in the television industry and the adoption of consumer legislation and standards in the United States than of national or regional policies adopted by the Mexican authorities. With very few exceptions, all production is sent to the United States—a trend that has been given renewed impetus by the fact that benefits go beyond the production sharing provisions (TSNS 807/HTS US 9802).
- Despite the volume and total value of television set assembly operations, the value added they generate is very low, and linkages with the rest of the regional and national economy are negligible. However, under the NAFTA rules of origin,

36 The French firm Thomson Consumer Electronics bought the television manufacturing operations of General Electric and RCA; the Dutch company Philips bought the Sylvania and Magnavox brands, and Matsushita of Japan bought Quasar. In 1995, the Korean firm LG Electronics acquired the Zenith facility in Mexico.

37 In November 1995, Daewoo set up a US\$ 264 million facility in Mexicali to produce cathode ray tubes for computer monitors and television sets (Peñalosa, 1997).

38 Alliances and partnerships between firms are increasingly common, such as the one set up between Fujitsu and Philips Consumer Electronics to develop technology to produce laptop computer monitors and flat panel displays.

manufacturers have to increase the regional content of their products. As a result, new FDI has been channeled into the production of inputs and components. Since the 1980s when these activities started to take advantage of the country's cheap labour force, they have been exclusively export-oriented, and there has been no reference to the domestic market as a benchmark.

In accordance with NAFTA provisions, Asian and European firms have been obliged to increase their North American value added. Several of them, especially the Japanese companies in Tijuana and Mexicali, have found a variety of ways to integrate their operations in the region, as in the case of glass production and the manufacture of other components, mentioned above. Nonetheless, the chances of significant research and development activities being carried out in the region are still remote, and it is difficult to envisage Mexican-owned companies overcoming the high financial and technological entry barriers involved in joining this industrial complex.

Finally, in an industry from which United States companies have been virtually displaced, the NAFTA rules of origin have forced Asian companies to set up a production base in North America in order to supply this market. Thus, northern Mexico has become very attractive, and has been responsible for Mexico's becoming the main exporter of colour television sets to North America. Contrary to other industries, in this one there has been an incipient but on-going phenomenon of incorporation of local content, along with the creation of a technological industrial complex in Mexico.

### (c) The apparel industry<sup>39</sup>

The apparel industry was a dynamic element of foreign trade between 1980 and 1996, when its share of OECD imports rose from 2.6% to 4.1%. At the same time, the Asian economies, especially China, played a major role in the main world markets, and the situation in the United States garment industry had become extremely difficult. To meet the "Asian challenge", these firms—backed by national trade policy—began to implement a wide-ranging process of restructuring

that had significant implications for the Mexican economy.

The United States policy was aimed at weakening the competition (through tariffs and import quotas) and strengthening the main local firms in the garment subsector. The production sharing mechanism was important in this context (HTS US 9802), and, as a result, regional supply chains began to be set up to enable these firms to improve competitiveness in their own market. The industry took advantage of lower wages in Mexico and the Caribbean basin; however, the production sharing mechanism virtually prohibited the use of local physical inputs.

In general, the firms kept in the United States those activities that related to product design and development, together with capital-intensive manufacturing processes and tasks linked to domestic marketing. Labour-intensive assembly processes were moved abroad, mainly to Mexico and the countries of the Caribbean basin. Mexican legislation, especially on *maquila* activities, also facilitated the duty- and tax-free operations of clothing manufacturers.

When NAFTA came fully into force, Mexico's situation improved radically compared to other Caribbean basin countries, and it was further strengthened as a result of the devaluation of the local currency in late 1994. NAFTA in general, and its rules of origin in particular, created opportunities for United States firms to increase their production and sales, taking full advantage of economies of scale and inputs from the three member countries. Today, Mexico has overtaken China to become the leading supplier to the United States clothing market (see table II.3). The Mexican garment industry also contrasts sharply with some of the Asian experiences. In Hong Kong SAR, Chinese Republic of Taiwan and Republic of Korea, national companies grew internationally, largely because of their ability to offer a complete package, especially in the women's apparel industry. In Mexico, it seems that the emerging companies that produce complete packages are foreign, mostly North American, and their activities are not necessarily related to the fashion industry. The differences between the Asian and Mexican experiences are evidenced in the levels of national integration that have been achieved.

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39 For further details, see chapter IV of this document.

## 2. Domestic markets: difficult, but promising

Despite globalization, flexible production and consequent specialization, there are some activities that require production facilities to be set up in the destination market (Dussel Peters, 1999). In the case of Mexico, given the specific characteristics of the products and the existence of non-tariff trade barriers (sanitary and phytosanitary regulations), some product lines, such as foodstuffs, beverages and tobacco, pharmaceutical products and non-ferrous metals, have aroused great interest among foreign investors. This phenomenon is seen even more strongly in recently liberalized subsectors (or those currently in the process of deregulation), such as the retail trade, telecommunications, finance and electricity.

### (a) Retail trade: the Wal Mart experience

In the mid-1980s, the future seemed promising for retail trade activities (De Icaza, 1999). Anticipating the signing of the NAFTA accords, the subsector underwent significant reorganization; cutting-edge technologies were introduced, ownership of the main firms was thrown open to the capital market, and it seemed to be strongly positioned for future growth. In the early 1990s, the outlook for retailers was substantially altered by a series of alliances and mergers between Mexican firms with retail experience and major foreign players. In general, these alliances and mergers failed to last, owing to cultural differences relating to company management and the foreign partners' desire to rapidly expand the network of branches and increase sales. Retail trade was also hit hard by the crisis that broke out in late 1994, and Mexican-owned firms were especially weakened. In 1995, as a result of the crisis, inflation soared to 50% and the purchasing power of the Mexican population plunged by 20%; this led to a 22% drop in retail sales (De Icaza, 1999).

The most important partnerships between Mexican and foreign firms include those between Cifra and Wal Mart, Gigante and the French supermarket chain Carrefour (which only lasted four years), and Comercial Mexicana and Auchan, the large French distribution group. This latter alliance was dissolved after one year, owing to a dispute over control of the firm (Conger, 1999b). After this, Comercial Mexicana bought the Kmart stores left over from a failed union with Liverpool, which had also been unable to fulfil the

expansion plans envisaged in the alliance (De Icaza, 1999). At the present time, Comercial Mexicana has an association with the United States company Costco Wholesale Corporation (Conger, 1999b).

Despite the failure of most of these associations and the definitive exit of some foreign players, such as Kmart, as a result of the Mexican peso crisis, local firms seem to have drawn positive lessons from their experience. Firstly, alliances are more successful if each of the participating firms operates in different market segments; and secondly, the Mexican firms have benefited from their exposure to the management, standards and products imposed by their foreign partners. The Gigante chain, whose agreements with Flemings and Carrefour ended in failure, is an interesting case study. The company has maintained strategic alliances with Radio Shack and Office Depot since 1992 and 1994, which suggests that associations are successful when they are between companies that deal in different product lines (Conger, 1999b).

The only one of these major alliances still in existence is that between Cifra and Wal Mart, an association that has been characterized by prudence from the outset. In July 1991, an equal-shares joint venture was set up to manage the supermarket company, and this joint operation, valued at over US\$ 2 billion, became the market leader in Latin America. Unlike the case with other partnerships and mergers in the retail sector, Cifra's diversification—including the Vip restaurants, and the Suburbia department stores—allowed it to finance the projected expansion. In 1997, Wal Mart bought an additional US\$ 1.2 billion stake in Cifra, thereby taking its share to 51% and completing the definitive merger. In fact, this is a case where an apparently successful partnership has ended in take-over. Since then, the firm has continued to expand the number of stores it operates and increase its productivity. In 1998, Wal Mart was the largest retail chain in the United States, with over 2,800 stores and total sales of US\$ 139.208 billion (*Fortune*, 26 April, 1999).

Mexico offers promising opportunities for retail activity, as it is the Latin American economy where supermarket chains, which account for only 31% of retail sales, have penetrated the least (Conger, 1999b). Accordingly, Wal Mart envisages making substantial investments in the next few years, with a view to expanding to 47 Mexican cities (De Icaza, 1999).

**(b) Telecommunications in Mexico: a very attractive market for the main international operators**

In recent years, the telecommunications sector has been one of the most attractive fields for foreign investment in the region (ECLAC, 1998a). In the case of Mexico, current legislation sets a 49% upper limit on foreign ownership of firms in this sector (except for cellular telephony), and leaves access to the local market in the hands of *Teléfonos de México* (TELMEX). Since the start of the 1990s, the Mexican authorities have introduced a series of measures to provide security to private—and particularly foreign—investment in telecom activities. The TELMEX concession contract was amended in 1990, the Federal Telecommunications Act came into force in 1995, and a regulatory body—the Federal Telecommunications Commission (COFETEL)—was created a year later. Between June 1996 and August 1997, new regulatory frameworks were established in long-distance, international long distance, local service, public telephony and satellite communication.

TELMEX was privatized in December 1990. The aims of the Mexican authorities were to preserve national sovereignty in the subsector, keep most of the capital in the hands of Mexican entrepreneurs, guarantee the continuous expansion of the network, enable workers to participate in the equity of the company, raise service quality to international levels, and strengthen research and development (TELMEX, 1999). In order to keep majority control of the company in Mexican hands, a new equity structure was designed—without infringing the rights of existing shareholders—which at the same time facilitated widespread participation by foreign investors. The Mexican State transferred a majority of the voting shares (series AA), representing 20.4% of the company's stock, to the winner in the bidding process. As a result, management control of TELMEX

remained in the hands of a consortium comprising the local Carso group, the United States company Southwestern Bell Corporation (a subsidiary of SBC Communications Inc.) and the French State company France Cables et Radio (a subsidiary of France Telecom).<sup>40</sup>

As part of the privatization arrangement, TELMEX undertook to increase the number of telephone lines, provide phone service to every town of over 500 inhabitants and significantly reduce waiting times for the installation of new phone lines. In return, it was granted the exclusive right to provide telephone services until 31 December 1996. Since then, firstly long-distance telephony and then local calls have been opened up to participation by private investors (local or foreign) through concessions and tenders.

Despite the significant improvements made to the services provided by TELMEX,<sup>41</sup> telephone density in Mexico is much lower than in other developing countries, including Republic of Korea, Hong Kong SAR and Singapore, which have a telephone density of over 40 units per 100 inhabitants. This makes the country highly attractive to foreign investors, given the subsector's growth potential. The large United States firms (AT&T and MCI WorldCom),<sup>42</sup> in particular, have shown interest in the long-distance market, as they can provide these services at a relatively low cost by taking advantage of their wide-ranging network of global agreements.

Nevertheless, there are some restrictions that complicate access by foreign investors to this market. Since 1972, TELMEX has been the only firm with the infrastructure needed to make all types of calls, both local and international, having invested some US\$ 14 billion to achieve this (COFETEL, 1999). By 1998, TELMEX had managed to connect practically every town of over 500 inhabitants and was providing services to some 21,000 localities. As a result, new entrants were confronted by a monopoly structure, with over 55,000 km of optic fibre and a network that is

40 Accordingly, TELMEX was controlled, on the one hand, by group of Mexican investors who between them owned 51% of the voting stock, and on the other, by SBC Communications and France Telecom, which held equal parts of the remaining 49% (i.e., 5% of the total capital of the company was held by each foreign investor). The Mexican controlling interest consisted of the Carso group, with 44.9% (12.1% of the total capital of the company), and another 50 investors, none of whom held more than 0.76% of the voting shares (TELMEX, 1998).

41 Between 1990 and 1998, telephone density increased from 6.4 to 10.3 units per 100 inhabitants. In the same period, the average waiting time for the installation of a new line was shortened from two years to 27 days. In June 1999, telephone density was 10.6 per 100 inhabitants (COFETEL, 1999). Currently, the Mexican market has around 10.2 million lines, and over 2 million international long-distance calls are made, with this service growing at twice the rate of local calls.

42 In early October 1999, MCI WorldCom and Sprint announced an agreement to set up one of the largest telecom companies in the world. This merger, valued at US\$ 115 billion, is the largest of its type in the world.



almost 100% digital (29% in 1998). Moreover, any new firm, in either long-distance or local telephony, had to make use of the TELMEX network to be able to deliver its own services.

The fact that new firms had to use the TELMEX infrastructure for all phone services, thereby making them customers of their largest competitor (some firms even built their own infrastructure), gave rise to the so-called "telephone war". There were fierce debates on interconnection and payment rates, both for local and for long-distance and cellular telephony (see box II.5). Since 1997, these disputes have raged on two main fronts:

- The interconnection fees charged by TELMEX to users of its lines. The interconnection tolls that new long-distance firms had to pay to TELMEX had a 58% surcharge,<sup>43</sup> the highest among the world's 17 largest telephone companies (Olguín, 1998). User firms lobbied for the rates to be reduced, as otherwise they would not be able to compete in the Mexican market. The most visible new entrants, Alestra and Avantel, even threatened to postpone or halt their investment plans—worth about US\$ 1.5 billion—unless the contracts and interconnection charges were reviewed. The conclusion of negotiations between late 1998 and early 1999 produced a significant reduction in interconnection costs and a minimum fee charged to consumers in order to prevent firms from offering services at below cost (see figure II.4). For TELMEX, the cut in rates meant a decrease of around US\$ 650 million in revenues for the biennium 1999-2000.
- The "caller pays" system for cellular telephony. All companies lobbied for this system to be implemented, except for TELMEX, which considered the change unnecessary in a market that in 1998 had grown by as much as 90%. On 1 May 1999, following several months of negotiations and judicial rulings, the "caller pays" system came into force.

As a result of increased competition in long-distance telephony—a market of some US\$ 5 billion—, rates have fallen steadily and significantly, dropping by 15% and 30% in 1997 and

1998 respectively. In 1998, TELMEX had about 75% of the market, with the other 25% being contested by only two firms (Ferro, 1999) (see table II.6). Despite failing to achieve the 40% to 50% market share originally estimated, Alestra, Avantel, Marcatel and other companies still aim to expand their operations in Mexico, in particular by laying their respective fibre optics networks throughout the country and connecting the main urban centres.<sup>44</sup> This is a reflection of the massive local market penetration achieved by these firms and gives grounds for expecting these trends to be maintained in the medium-term future.

Following these investments in the long-distance market, several firms (both local and foreign) have begun to move into the local-phone segment, valued at between US\$ 5 and US\$ 7 billion. Between 1997 and 1998, over a million phone lines were withdrawn because of the high prices charged by TELMEX; this represents an additional challenge for new entrants (Guadarrama, 1999). According to some estimates, about US\$ 9 billion will be invested in local telephony over the next five years, with most of the new players being Mexican-foreign joint ventures, as in the long-distance segment.

New entrants in the local telephony market will face even greater difficulties than those experienced by long-distance companies.

- As a way of defending its leadership of this market, TELMEX has destined a significant proportion of its income and investments (about US\$ 1.2 billion) towards the extension and strengthening of its local telephony networks and services.
- The new firms will have to use the TELMEX network, so hard bargaining on interconnection charges is expected. The costs to a company of constructing its own local network are much higher than in the case of long-distance service.
- Local phone companies—unlike long-distance operators—have implemented a strategy that involves a high degree of regional specialization.
- Lastly, it is unlikely that local phone companies will compete to provide service in rural areas. The relatively high costs—low phone density, lower purchasing power and higher infrastructure

<sup>43</sup> The rates were published before the new firms began operations; they are expected to fall gradually between 1998 and 2000.

<sup>44</sup> Examples are United States companies such as Presto—which invested US\$ 150 million in 1998-1999 to install a fibre optic network for its long-distance service—and Alestra, Avantel, and Marcatel, which plan to invest more than US\$ 5.8 billion over a ten-year period starting in 1995-1997. Nextel, meanwhile, has budgeted US\$ 200 million in 1998 and a further US\$ 50 million in 1999 for radio communication services.

## Box II.5

**MOBILE TELEPHONY: BELL ATLANTIC CHALLENGES TELMEX FOR LEADERSHIP**

In the early 1990s, the Mexican authorities issued invitations to tender for cellular telephony bands A and B. As a result, TELMEX operates band B nationwide through its subsidiary, Telcel, while band A was awarded to nine companies. In recent years, four of these firms have become part of Grupo Iusacell, which controls nearly 40% of the market. There are currently 1.5 million cellular phone users in Mexico, and this number is expected to triple by 2000 (Alestra, 1999).

In October 1993, Iusacell formed a strategic alliance with Bell Atlantic, one of the largest players in the United States telecommunications market. Under this arrangement, Bell Atlantic acquired a 23% stake in Iusacell, via a US\$ 520 million purchase of shares corresponding to a previously agreed capital increase. In June 1994, the American firm completed the second part of the purchase,

thereby raising its total investment to US\$ 1.040 billion and its share in Iusacell equity to 42.1% [<http://www.bell-atl.com>]. In February 1997, Bell Atlantic took over administrative control of the company, appointed a new management team to take charge of Iusacell operations—including marketing, distribution, and customer service—and began to implement a new strategic plan. In October 1999, Bell Atlantic began talks with Motorola Inc. and the Spanish company Telefónica, with a view to strengthening its position on the mobile telephony market. If these negotiations are successful, Grupo Iusacell will become the strongest competitor of TELMEX, currently the leader in this market. According to some analysts, Telefónica is trying to buy four cellular phone companies in northern Mexico that are partly or wholly owned by Motorola, in order to bring them into the Mexican group managed by Bell

Atlantic. Iusacell would then cover a much larger portion of the national market than it does now; it would gain 800,000 new customers and become a partner of a company that is very strong throughout the rest of Latin America (see chapter III). Iusacell is also involved in separate negotiations for the acquisition of Portatel S.A., a cellular telephony supplier in southern Mexico. Bell Atlantic would then be able to start making substantial profits and speed up amortization of the large investment it has made in Mexico, thus offsetting the advantages enjoyed by TELMEX. In this regard, the subsidiary Telcel offers its customers a rate plan whereby they are able to call anywhere in the country without paying long-distance rates.

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

costs—do not make these operations profitable, at least initially.

Notwithstanding these difficulties, some of the new companies have a good chance of competing with TELMEX. In late 1998, five concessions had been granted, including the following (Olguín, 1999):

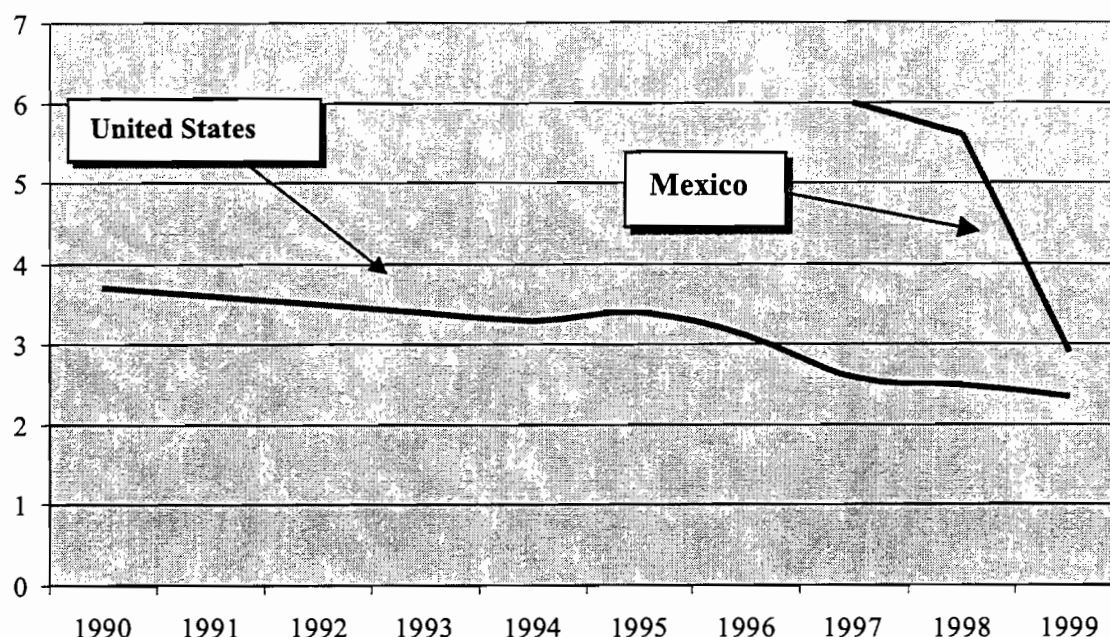
- Telinor (now known as Axtel).<sup>45</sup> Partially owned by Bell Canada (27%) and WorldTel Limited (22%), it plans to invest US\$ 1 billion. Axtel will

specialize in local residential telephony in cities of over 50,000 inhabitants in the north of Mexico.

- Servicios Profesionales de Comunicación (SPC). This company's main partner is the Elektra Group (Televisión Azteca); it plans to invest US\$ 1 billion over a three-year period. SPC is betting heavily on local telephony, to take advantage of its access to television and to customers of the Elektra store chain.

45 As from January 1998, Telinor changed its name to Axtel, in order to avoid being confused with Telcel, the TELMEX subsidiary in Baja California.

Figure II.4  
**UNITED STATES AND MEXICO: INTERCONNECTION FEES**  
*(In United States cents per minute)*



**Source:** ECLAC, Information Centre of the Unit of Investment and Corporate Strategies, Division of Production, Productivity and Management, based on information provided by the United States Federal Communications Commission, and the Mexican Federal Telecommunications Commission (COFETEL).

- Amaritel (main partners: Grupo Radio Centro and US Global Telecomm). The company plans to invest US\$ 940 million over the next ten years, concentrating its activities in Mexico City and in the southeastern part of the country, in a search for new users.
- Megacable (formed by Grupo Bours and C-Tec). It will invest US\$ 90 million to provide transmission services.

Some of these new entrants claim that they are not going to compete with TELMEX, but rather that they will create alternative markets, including services with greater value added, Internet connection, voice and data transmission, video on demand, and direct access to long-distance telephone companies. Meanwhile, the recent signing of an interconnection contract between

Axtel and TELMEX, guaranteeing traffic between the two networks for three years without charge, is unprecedented in Mexico and could be an indicator of future trends in this market.

After two years' experience in long-distance telephony, it is possible to draw some conclusions (Lozano and Alarcón, 1999). Firstly, the number of investment projects is likely to decrease substantially as a result of technological development and inter-firm alliances. In addition, corporate strategies in this market have constantly been faced with problems arising from a lack of decisiveness on the part of the regulatory institutions, which have often taken decisions after local and foreign capital has already been committed, thereby creating uncertainty, bewilderment and even threats to cancel foreign



Table II.6  
**MEXICAN FIRMS WITH FOREIGN OWNERSHIP OPERATING IN THE  
 LONG-DISTANCE MARKET, 1999**

	Foreign partner	Foreign Ownership (percentage)	Cumulative investment	Fibre- optic network	Digitization (percentage)	Year of entry
TELMEX	SBC Com and France Telecom	10	14 000	55 000	100	1990 <sup>a</sup>
Alestra	AT&Tb	49	1 000	4 500	100	1997
Avantel	MCI-WorldComc	49	1 000	5 700	100	1995 <sup>d</sup>
Marcatele	IXC Com and Westel Inc.	...	75	2 000	100	1995

**Source:** ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, based on information provided by TELMEX, Alestra, Avantel and Marcatel.

<sup>a</sup> Year of foreign investor participation in TELMEX equity.

<sup>b</sup> The other owners of Alestra, apart from AT&T, are the local business groups Alfa (25.6%) and Bancomer (25.4%).

<sup>c</sup> Avantel is the product of an alliance between Banco Nacional de México (BANAMEX) and MCI WorldCom.

<sup>d</sup> In September 1995, Avantel began to construct its fibre-optic network.

<sup>e</sup> In order to obtain competitive costs on long-distance calls to the United States, Canada and the rest of the world, a connection to the IXC Communications network was set up on the border at Reynosa, Tamaulipas and McAllen, Texas.

investments. Apart from this, there is still a need for new alliances. Alestra, for example, is looking for partners to invest in local telephony (Ferro, 1999), while Miditel, which failed to find an international partner following the withdrawal of Korea Telecom, lost its concession because it was unable to make the relevant payments (Cárdenas, 1999).

In brief, the gradual opening up of the telecommunications sector has allowed for a growing presence on the Mexican market of the main world operators. The largest company in the sector, TELMEX, was privatized, and its management was turned over to a consortium that included the foreign companies France Telecom and SBC Communications. After that, despite the fact that TELMEX dominated all market segments during most of the 1990s, competition gradually increased, especially for long-distance and mobile telephony. As things stand now, to the deregulation of the Mexican market and the entry into force of NAFTA have been added pressures and alliances of international corporations and a rapid process of technological change. All this has been reflected in a scenario of tremendous dynamism and substantial investments, as new entrants seek to consolidate and expand their

market positions, and the main local operator (TELMEX) puts underway a strategy of rationalization, modernization and hemisphere-wide expansion towards the United States and Central America.

By the end of 1998, 15 concessions had been granted for the installation, operation and use of public telecommunications networks, 5 for local telephony, and another 5 for services in a variety of frequencies in the radioelectric spectrum (Lozano Alarcón, 1998). Other activities, including paging services, specialized radio communication, and restricted transmission microwave television, are expected to grow vigorously. Thus, the rapid and strong growth of telecommunications during the last generation has made a positive contribution to system-wide competition in the Mexican economy, especially in view of its strong dependency on foreign trade.

#### (c) **The financial system: in search of capitalization**

In the early 1990s, 18 banks were being privatized, there were strict limits on foreign participation in the Mexican financial system. In the wake of the economic

crisis of 1994, these restrictions were eased substantially and today they have all but disappeared. In early 1999, legislative amendments were introduced making it even easier for FDI to gain access to the financial system. As a result, foreign investors are now pursuing a general strategy to establish themselves in Mexico for the first time and participate in that market on a large scale.

The Mexican financial system has undergone far-reaching changes, especially since the peso crisis, and there have been multiple mergers and acquisitions, mostly led by foreign banks. Despite the difficulties the Mexican economy, especially the banking sector, was experiencing, foreign banks saw a great opportunity to enter the market, particularly as they were encouraged by the potential arising from Mexico's recent admission to NAFTA (*Expansión*, 22 May 1996).

Foreign banks injected capital into local financial institutions that were ailing as a result of the crisis and the poor management practices followed in the years leading up to it. In 1995, the banks were generally applying high interest rates (sometimes over 100%) and had massive non-performing loan portfolios. This meant that there was virtually no connection between the financial subsector and productive activities.<sup>46</sup> To avoid a second general bank failure in less than 15 years (the previous one had occurred in 1982), the authorities had to undertake a bailout operation costing US\$ 92 billion, financed out of public funds. This was carried out by the Bank Savings Protection Fund (FOBAPROA) —now replaced by the Bank Savings Protection Institute (IPAB)— and represented nearly 19.3% of Mexico's GDP.

Thanks to the legislative amendments, since 1996, and especially as from January 1999, foreign investment seems to be seeking to establish itself in Mexico for the first time and on a major scale. Up to the mid-1990s, Citibank was the only foreign bank in Mexico. As in other countries and activities in Latin America, it appears that the purchase of financial institutions gives added security to foreign investment in the subsector (ECLAC, 1998a; De Quesada, 1999). Between 1994 and 1998, total deposits in foreign banks in Mexico, measured in current pesos, grew by 53 times, and the loan portfolio increased by 59 times. The

number of accounts grew from 30,616 to 2.2 million (*Mundo Ejecutivo*, 1999).

Despite the progress made by NAFTA, financial institutions in the United States (other than Citibank) have not shown much interest in entering the Mexican market. Other, bolder and globally smaller investors, such as Canadian and Spanish banks, have been more active. Since 1995, the Bank of Montreal and the Bank of Nova Scotia have acquired minority interests in Bancomer and GF Inverlat, while Banco Bilbao Vizcaya and Banco Santander have gained control of GF Probusa and Banco Mexicano (see table II.7). In late 1996, Canadian and Spanish investors were the main players in the subsector, and between them they owned 12% of Mexican bank capital (Conger, 1999a). In 1997, some of the world's largest financial institutions started to come to Mexico. The Hong Kong and Shanghai Banking Corporation (HSBC) and J.P. Morgan bought stakes in Serfin —Mexico's third largest bank— and a year later Citibank took over 100% of Banca Confía (see table II.7).

Nevertheless, these resources proved insufficient, and the system remained technically bankrupt, with debts amounting to 10.9 times its capacity to pay. In this situation, it became apparent that local banks would have to obtain new capital by entering into associations with or sell controlling interests to foreign firms. In January 1999, the banking legislation was amended to allow a greater presence of foreign capital (particularly in the large banks) and thereby help capitalize local banks (Solomon Smith Barney, 1999a). The Chamber of Deputies approved the presidential initiative eliminating restrictions on foreign capital. Consequently, international banks will be able to own 100% of Mexican banks that have over 6% of the market. Until this measure was passed, foreign institutions had only had a presence in small and medium-sized banks.

There is no consensus on the amount of resources that is needed to put the banking system back on a sound footing. According to an initial government estimate, US\$ 5 billion would be needed; the Mexican Bankers Association, however, puts the optimal level of funds required to capitalize the system at about US\$ 8 billion (García, 1999). These calculations have been far surpassed by financial analysts, who estimate

46 In real terms, lending by Mexican banks to the private sector was lower in 1998 than in 1994. According to data provided by the Bank of Mexico, bank financing for the private sector fell by 39.9% in real terms in 1996, by more than 16% in 1997, and by 4.3% in 1998. In fact, small and medium-sized enterprises have practically had no access to bank credit because of its high cost (Taylor, 1999).

Table II.7  
**MEXICO: MAIN ACQUISITIONS OF LOCAL BANKS BY FOREIGN INVESTORS, 1995-1999**  
*(Millions of dollars and percentages)*

Mexican bank	Percent- age	Foreign bank	Nationality	Amount	Year of entry
GF Probursaa	70	Banco Bilbao Vizcaya (BBV)	Spain	365	1995
Banco Mexicanob	75	Banco Santander	Spain	500	1996
GF Bitalc	8	Banco Central Hispano (BCH)	Spain	37	1995
	9	Banco Comercial Portugués	Portugal	...	1995
Grupo Serfin	20	Hong Kong & Shanghai Banking Corporation (HSBC)	United Kingdom	174	1997
	9	J.P. Morgan	United States	68	1997
Banca Confía	100 <sup>d</sup>	Citibank	United States	195	1998
GF Inverlat	55	Bank of Nova Scotia	Canada	75	1996
Bancomer	20	Bank of Montreal	Canada	456	1995

<sup>a</sup>Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management.

In September 1996, BBV acquired the branch network and business of the Mexican banks Cremi and Oriente, for US\$ 21 million, and these were integrated into BBV-Probursa operations (Álvaro Calderón and Ramón Casilda, "Grupos financieros españoles en América Latina: una estrategia audaz en un difícil y cambiante entorno europeo", Desarrollo Productivo series, No. 59 (LC/L.1244-P), Santiago, Chile).

<sup>b</sup>October 1996, Banco Santander bought 75% of Banco Mexicano for US\$ 378 million, and in April 1997, it completed the acquisition of 51% of Grupo Financiero InverMéxico, for US\$ 122 million. By the end of 1997, as a result of a subsequent capital increase and a merger with Grupo Financiero Santander México, the equity share of the Santander group had grown to 68.5%. The purchase of Banco Mexicano by Santander marked the first time that a foreign company that was not already a shareholder had gained control of one of the 18 privatized Mexican banks by bringing in fresh capital once the bank had been put on a financially sound footing (*ibid*).

<sup>c</sup>BCH retains a direct 8.26% holding in Grupo Financiero Bital. This group operates in Mexico with a universal banking approach covering traditional banking services and operations with securities, warrants, insurance and pensions. Banco Internacional is the leading member of the group and holds fourth place in the Mexican banking system, with more than 1,530 branches (*ibid*).

<sup>d</sup>Includes an option that can be exercised in the year 2000.

financing needs at between US\$ 10 billion and US\$ 25 billion.<sup>47</sup> The capitalization requirements of the main banks are enormous: Serfin and GF Bital need about US\$ 4 billion; Bancomer, about US\$ 2 billion, and Banamex, about US\$ 500 million (Conger, 1999a). Accordingly, in the case of banks that were intervened, the authorities are trying to capitalize and sell them as quickly as possible. In fact, Banco Serfin was intervened and put up for sale in July 1999. Other banks that have been intervened by IPAB, such as Banca Promex, Banco Atlántico and Bancrecer, are certain to be bought by one of the large Mexican or foreign players.

Despite the fact that the three largest banks in the system —GF Bancomer, GF Banamex-Accival and Serfin— already account for over half of Mexico's financial subsector, this high concentration can be

expected to accentuate further, especially as a result of new mergers and acquisitions. In view of the imminent increase in foreign participation in the Mexican banking subsector, several analysts have speculated on the possibility of a merger between the system's largest two players —Bancomer and Banamex (Taylor, 1999). In early 1999, foreign banks held 22% of the capital stock and 40% of the assets of the Mexican banking system (Conger, 1999c).

There is a similar dynamic among the pension fund management institutions (Administradoras de Fondos para el Retiro - Afores). Of the original 17 Afores, 13 remained after 18 months of operation, and only 11 are expected to survive to the end of 1999. Following a series of mergers, Principal, which belongs to US Principal Financing Group, is currently the only Afore that is entirely foreign owned. The Spanish banks BBV

47 This figure could rise substantially if small and medium-sized banks are included, such as Banca Promex, Banco Atlántico and Bancrecer, which could require up to an additional US\$ 12 billion.

and BSCH have stakes in some of the country's largest pension fund managers. Overall, Spanish and United States banks and financial institutions control over 45% of the pension fund management business in Mexico, which was handling nearly US\$ 9 billion in mid-1999.

In brief, the rapid opening up of the financial sector to international firms has coincided with an aggravation of difficulties faced by the major Mexican banks. This has led to opportunities for new entrants, but it has also given rise to some misgivings about the security of future investment in the Mexican financial sector. Although confidence in the Mexican economy has increased with the entry into force of NAFTA, the major United States banks —except Citicorp— have hardly participated at all, and they have left leadership in this field to the Canadian banks. Likewise, in keeping with their strategy throughout Latin America, European firms, particularly Spanish banks, have begun to play a strong role in several of the largest segments of the Mexican financial market, including commercial banking and pension fund management.

One of the greatest challenges for the solidity of the Mexican economy is to maintain a vigorous, healthy and adequately functioning financial system. Mexico's banks need to regain their capacity as lending institutions and enhance their links with the productive sector. Given the recent protagonism of foreign capital, there are major challenges for the future. Attracting the main international banks will not be an easy task.

#### **(d) The infrastructure and energy subsectors: new opportunities for foreign capital**

The nationalization of the electric power industry in the early 1970s had a number of goals: to integrate the existing systems, to standardize frequency of service, and to expand coverage, all under the exclusive competency of the Federal Electricity Commission (CFE) (Secretaría de Energía, 1999a). Currently, 95% of the population has access to electricity, and the

service needs to be expanded in order to ensure that adequate provision is made for future consumption, as demand is growing faster than the rest of the economy. The Federal Electricity Commission anticipates that national demand for electric power will grow at an average rate of 6% per year during the period 1998-2007. Growth will be even greater in the industrialized regions (Secretaría de Energía, 1999b).

The Mexican authorities estimate that over the next six years, an additional 13,000 megawatts (MW) of capacity will be needed; this is equivalent to over one third of currently installed capacity. Large investments in transmission and distribution systems will also be required. The total outlay, likely to be on the order of US\$ 25.3 billion, is beyond the reach of the Mexican State (Secretaría de Energía, 1999a). In view of this situation, the Government proposed a wide-ranging reform of the energy subsector that was aimed at admitting private capital in the different phases of generation and distribution,<sup>48</sup> and even envisaged the gradual privatization of State-owned firms in the subsector. This stage will begin in the year 2000.

These reforms have encountered strong opposition in Congress, however, which could delay them even beyond the end of President Ernesto Zedillo's term of office. Meanwhile, other obstacles to private participation have been removed, particularly the 4% tariff on natural gas imports from the United States. Authorization has also been given to use the gas pipelines belonging to *Petróleos Mexicanos* (PEMEX).

At present, private investors are allowed to participate in electric power generation projects, both in selling electricity to the Federal Electricity Commission and in meeting the energy needs of Mexican industry by setting up self-generation companies. Between 1994 and 1998, 128 permits were granted for a total of 5,445 MW, which represents 15.6% of installed generating capacity<sup>49</sup> (Secretaría de Energía, 1999b). In these projects, participation by foreign investors, particularly from Japan, the United States, France, Spain and Switzerland, has been very significant (see table II.8).

48 In 1992, the Public Service Electric Power Act was amended to allow limited private participation, both local and foreign, in electric power generation. Despite the changes, many restrictions still remain, which has caused the level of interest among private companies to remain low. At the present time, attempts are being made to amend Articles 27 and 28 of the Mexican Constitution, along with secondary legislation, to broaden the Electric Power Industry Act and introduce some new regulatory provisions. To ensure a smooth transition to a renovated electricity sector, the Government intends to carry out the process in three stages. The first two will be concluded by the end of President Ernesto Zedillo's term of office. Then, early in the new millennium, a new privatization programme will be initiated to divest State assets in the electricity subsector (Secretaría de Energía, 1999a).

49 Of these permits, 36 —for a total of 1,718 MW— were granted to PEMEX plants.

Table II.8  
**MEXICO: FOREIGN FIRMS IN ELECTRIC POWER GENERATION PROJECTS**  
*(In millions of dollars and megawatts)*

Project	Consortium (nationality)	Date of tender	Capacity (MW)	Investment	State of project
Samalayuca II	General Electric (United States), Bechtel Corporation (United States), El Paso Energy Corporation (United States) and ICA-Flour Daniel (United States)	1992	521.7	514	Commercial Operations
Mérida III	AES Corporation (United States), Nichimen Corporation (Japan) and Grupo Hermes (Brazil)	1996	531.5	293	Under construction
Cerro Prieto IV	Mitsubishi (Japan)	1996	100.0	132	Under construction
Rosarito III	ABB Group (Switzerland) and Nissho Iwai (Japan)	1996	550.0	400	Under construction
Chihuahua	Mitsubishi (Japan)	1996	417.8	326	Under construction
Monterrey I	ABB Group (Switzerland) and Nissho Iwai (Japan)	1996	489.9	396	Under construction
Rio Bravo I	Marubeni (Japan)	1998	568.6	274	In operation
Rosarito 7	Marubeni (Japan)	1998	...	...	In operation
Hermosillo	Westinghouse (United States)	1997	...	...	In operation
El Sauz (Bajío)	Westinghouse (United States)	1998	475.0	304	In operation
Huinalá	Westinghouse (United States)	1997	450.0	193	In operation
Hermosillo	Unión Fenosa (Spain)	1998	252.7	116	Under construction
Altamira II	Electricité de France (EDF)	1998	450.0	193	Under construction
Saltillo	Electricité de France (EDF)	1998	245.0	112	Under construction

**Source:** ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, based on information provided by the Secretariat of Energy [<http://www.energia.gob.mx>].

Most of these new electric power projects are fuelled by natural gas, so a surge in new gas pipeline construction can be expected (Secretaría de Energía, 1999b). A case in point is that of KN Energy—the sixth largest integrated natural gas company in the United States—and Sempra, which have announced a project to build new gas pipelines between the United States and Mexico (*Wall Street Journal Americas*, 29 June 1999).

The Government will soon invite bids to build a new electric power plant in Monterrey. For the first time, the successful bidder will be able to choose its natural gas supplier and will also be able to sell power

directly to industrial customers—a situation that has aroused interest among several of the largest United States players. Thus, the efforts by the Mexican authorities to increase the presence of foreign investors in the electric power subsector and thereby contribute to the integration of the Mexican and United States power systems are beginning to bear fruit.

In brief, it appears that the NAFTA countries have a hemisphere-wide strategy in regard to energy infrastructure. As long as regulatory constraints are eased, substantial investments can be expected over the next few years, and this could have a positive impact on the competitiveness of the system in Mexico.

## C. CONCLUSIONS: THE CONTRIBUTION OF FOREIGN DIRECT INVESTMENT TO THE MEXICAN ECONOMY

Since the late 1980s, FDI has been a key factor in the new Mexican development strategy aimed at integration with the North American economy. The general easing of rules governing the establishment of FDI, the search for greater operational efficiency and transparency, and the elimination of most sectoral requirements are evidence of the significant changes made in Mexican policy since the 1970s. Today, FDI is allowed to participate in virtually every economic activity, and in the next few years, it is likely that the Mexican authorities will do away with the remaining restrictions.

In this way, FDI has contributed in an increasing and sustained way to gross fixed capital formation and has become an important source of income and macroeconomic financing. Given its weight in the balance of payments, it has played a fundamental role in the development of export capacity and the improvement of the overall competitiveness of the Mexican economy. Since 1998, exports—mainly manufactures—have been the engine of economic growth, with the relative importance of external sales rising from 11.1% to 28.3% of GDP between 1988 and 1998.

In recent years, FDI inflows have grown in spectacular fashion, mainly as a result of the entry into force of NAFTA. The average annual inflow of US\$ 2.4 billion during the 1980s increased to over US\$ 10.5 billion in 1994-1999. During this latter period, over 60% of FDI was destined for manufacturing activities, mainly export-oriented ones. More than 60% of FDI inflows came from the United States. To summarize, the main strategic orientations of foreign investors in Mexico are as follows:

- To improve the efficiency of the transnational corporations' integrated production systems in the North American market, mainly in the automotive, electronics and apparel subsectors. In this regard, foreign firms—especially United States companies—have benefited from Mexico's export-promotion policy, essentially through the

*maquila* industries programme, and also from the production sharing policy adopted by the United States (HTS rule 9802), all of which has been given added force by NAFTA.

- To gain access to markets with high growth potential. Despite having obtained a significant market share in certain manufacturing activities (especially in the food, beverages and tobacco sector), foreign investor interest has focused increasingly on services, especially telecommunications, retailing, banking, pension fund management, electric power, and gas distribution. Although the opening of these markets has not been problem-free, transnational corporations are counting on Mexico's integration into the United States' production and distribution network. As this trend goes far beyond short-term changes, the country's investment plans are now being defined on the basis of long-term horizons.

From the standpoint of the local authorities, the increased participation of international companies in the areas of services and infrastructure is expected to have a positive impact on Mexico's overall competitiveness.

In recent years, the entry into force of the NAFTA accords has represented a watershed for FDI, and NAFTA provisions have come to represent a "ceiling" in the negotiation of bilateral agreements. The extent of the agreement's impact has been reflected in the changes made by the Mexican authorities to regulatory frameworks relating to FDI and in the strategies of transnational companies. The advantage given to firms from NAFTA countries—including rules of origin, tariff benefits and a regulatory framework providing security to investments—together with the production sharing scheme, have led to a massive inflow of investment, mainly from the United States, and, to a lesser extent, from Canada.

In the case of Mexico, the recent inflow of FDI—especially since the December 1994 crisis—has been aimed primarily at creating new assets and

purchasing fixed assets in the private sector. Efforts by foreign investors to create and expand productive capacity have been concentrated in the most dynamic export areas, and this has had a positive effect on manufacturing export capacity.

Mexican-based operations have become a crucial element in the United States' strategy in the face of competition from Asia those sectors where FDI participation is highest, i.e., the automotive, computer and apparel industries. In general, these industries are trying to raise the efficiency of their global production systems; apart from being the main investors in absolute terms, they have also given rise to a significant increase in intra-industry trade. Mexico has become an integral part of the global production and distribution network of some of the largest transnational companies in the international arena. In most cases, however, Mexico is part of the "United States" or "North American" network, and not necessarily part of the "global" network. This is confirmed by the fact that the concentration of Mexican exports in the United States has continued to intensify and the growth rates in total external sales have been high. The negotiations with the European Union could attenuate this trend, as the markets of destination for Mexican exports become more diversified.

The results reported by the export-oriented segment of the economy have been highly positive. The rest of the economy, however, continues to suffer from significant shortcomings, including the weakness of linkages between export activities and the national economy. This is in sharp contrast with the experience of certain Asian countries. Although the NAFTA rules of origin strongly encourage the creation of national linkages, this has not been facilitated by the operation of the North American production sharing mechanism, via TSUS 807 and HTS US 9802. However, the potentially positive impact is only beginning to be seen, and it will be quite some time before it becomes significant. In this regard, the performance of the television set and computer industries in Mexico's northern border zone is noteworthy. International integrated production systems, global trading links and

both intra-industry and intra-firm foreign trade have predominated in these activities from the outset, whereas links with the rest of the economy, in terms of value added, jobs for skilled workers and learning processes, have been negligible. Despite attempts to enhance the linkages of the *maquila* industry with the rest of the economy, it has not managed to create more than 2% in value added. Because of their neutrality and their horizontal nature, national policies have not encouraged integration between the local economy and these export-oriented activities.

These characteristics explain the dynamics of the Mexican economy over the past decade. From a macroeconomic standpoint, there have been some successes, especially in terms of exports and attraction of FDI, and, to a lesser extent, GDP growth. From a sectoral perspective, however, the structure of the Mexican economy is becoming increasingly polarized. Through FDI, a fairly small group of firms—many of them foreign—have driven GDP and export growth, and they have made a significant contribution to the modernization of one segment of the economy. Nevertheless, these firms, which make intensive use of capital and intra-industry trade, generally create few jobs for skilled workers, and their linkages with the rest of the economy are still minimal.

To summarize, Mexico has been fortunate in that its main export market and the greatest source of FDI inflows enjoyed a protracted and strongly positive economic cycle during the 1990s. However, national development policy should not be based on lucky circumstances. At any rate, much remains to be done as far as national economic policy is concerned. Some of the main challenges facing the authorities will be to find ways to diversify export markets and sources of FDI, in order to ensure the stability of the model; to help national companies become major suppliers of subsidiaries of transnational corporations that play a major role in export activities; and to consolidate the industrialization process by taking advantage of NAFTA rules of origin and reviewing the regulations governing a number of services that are required by the transnational corporations, in order to improve the overall competitiveness of the national economy.







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### **III. SPAIN: FOREIGN INVESTMENT AND CORPORATE STRATEGIES IN LATIN AMERICA AND THE CARIBBEAN**



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Since the late 1970s Spain has made rapid progress in establishing itself as an active player in the international economy, and its entry into the European Union (EU) in 1986 was one of the major milestones in this process. The country's economy has thus undergone thorough-going structural changes that have turned it into one of Europe's preferred locations for transnational corporations—which use it as a platform for their exports of manufactures to other members of the Union—and that have greatly reduced the presence of the State in the production of goods and services.

In the course of the 1990s and as the twenty-first century draws near, this process of structural change has intensified, and Spain's economy has become a net capital exporter. Whereas previously Spanish companies had played no more than a marginal role in international investment, with what little investment activity there was being focused primarily on fairly unsophisticated manufacturing industries (food, metals and metal manufactures), they are now taking on increasing importance, particularly in the services

sector. Thus, while some of the world's largest transnational corporations have been attempting to boost their efficiency by investing in Spain, Spanish companies have been expanding into Latin American markets so that they can compete more successfully with the leading companies in today's increasingly globalized international markets.

Since 1994 Latin America has been the prime investment destination in the globalization strategies of major Spanish service firms. This phenomenon is of

particular interest because, in the space of just a few years, Spanish investors have carved out leadership positions for themselves in some of Latin America's main markets, such as telecommunications, energy and

finance. What is more, this shift is being led by a small group of large firms (no more than 10), most of which, interestingly enough, have recently been privatized in Spain.

## A. DIRECT INVESTMENT BY SPANISH FIRMS IN LATIN AMERICA AND THE CARIBBEAN

In 1974, foreign investment by Spanish firms—chiefly in Latin America, the European Economic Community (EEC) and the United States (Durán and Sánchez, 1981)—began to gather momentum. In industrialized countries, the aim of these investments was to develop commercial networks that would enable investors to broaden their markets and expand their exports; in the case of financial institutions, the object was to establish a position in major international markets (Arahuetes, 1998). In Latin America, where many Spanish firms made their first move towards globalization, investment activity was designed to benefit from highly protected markets with promising growth prospects, advantageous relative costs and generous endowments of natural resources. These investments in the region were mainly channelled into the manufacture of industrial products (metal processing and precision engineering), followed by the financial sector, fisheries and construction (Durán, 1999).

During the 1980s, the wave of Spanish investment in Latin America began to ebb, first as a result of the external debt crisis and then as an outgrowth of Spain's entry into the European Union in 1986. Primarily as a consequence of the integration process under way in Europe, the countries of the European Union became

Spain's preferred investment destination during that period, with finance and commerce figuring as the main focus of Spanish firms' globalization efforts (Molero and Buesa, 1992). This trend reached its peak in 1991; thereafter, Spanish investment in the countries of the European Union began to subside as a result, among other factors, of a slowdown in these economies. At present, Spanish firms' efforts to expand within Europe are confined to neighbouring countries (Portugal and France) and the financial market in the Netherlands (see table III.1), and since 1994, Spanish investors have had their gaze firmly fixed on Latin America and the Caribbean (see figure III.1).

For indicative purposes and as a basis for an analysis of investment trends, the following discussion will draw upon the data on investment projects submitted to the Ministry for Economic Affairs and Finance of Spain for verification.<sup>50</sup> Although this is not the most accurate source of information on this type of investment activity, it does provide a picture of the main trends to be observed in Spanish foreign investment.

The growth of Spanish investment in recent years has been truly remarkable, with the total figure jumping

50 Although it provides a wealth of detail, this information covers investment projects authorized for implementation within the next six months, some of which may never actually be undertaken. Consequently, this information differs from the balance-of-payments figures prepared by the Banco de España, which include only those projects that are actually implemented. The latter data are not as fully disaggregated, however.

Table III.1  
**SPAIN: OUTWARD FOREIGN DIRECT INVESTMENT, 1990-1998**  
*(Millions of dollars)*

	1990	1991	1992	1993	1994	1995	1996	1997	1998
Developed countries	2 823	4 538	3 591	2 218	3 299	2 871	3 755	3 881	4 837
European Union	2 397	4 079	3 029	1 988	2 813	2 247	3 156	3 153	4 201
- France	242	462	473	180	150	862	350	219	404
- Netherlands	320	1 055	1 003	619	182	329	802	848	772
- Portugal	387	566	627	817	1 827	845	1 072	1 024	940
United States	191	276	465	184	400	358	549	630	456
Developing countries	1 625	1 964	1 765	1 264	4 314	4 871	5 763	9 395	13 622
Africa	287	108	958	163	38	32	43	69	264
Asia	48	4	25	3	18	65	68	152	24
Central and Eastern Europe	1	13	3	56	96	8	0	33	88
Latin America and the Caribbean	1 289	1 838	780	1 043	4 163	4 766	5 652	9 141	13 246
- Argentina	136	342	90	189	862	919	1 531	1 821	1 425
- Brazil	79	82	13	24	63	108	359	1 429	6 886
- Chile	22	42	27	173	47	57	806	1 894	1 483
- Colombia	3	10	30	5	20	24	357	872	1 896
- Mexico	82	27	13	117	225	242	81	325	312
- Peru	2	0	0	0	2 102	309	401	124	182
- Puerto Rico	111	71	133	90	69	458	303	1 471	387
- Venezuela	15	269	8	0	0	5	423	653	237
- Financial centres <sup>a</sup>	776	973	418	432	706	2 566	1 325	432	223
Latin America and the Caribbean (excluding financial centres) <sup>b</sup>	402	795	229	521	3 388	1 743	4 024	7 238	12 636
Other	0	0	0	11	0	15	87	66	54
<b>Total</b>	<b>4 458</b>	<b>6 501</b>	<b>5 356</b>	<b>3 492</b>	<b>7 613</b>	<b>7 757</b>	<b>9 605</b>	<b>13 342</b>	<b>18 512</b>

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of data from the Bureau of International Economic Affairs and External Transactions (DGEITE) of the Ministry of Economic Affairs and Finance of Spain.

<sup>a</sup> Includes Bahamas, Bermuda, British Virgin Islands, Cayman Islands, Netherlands Antilles and Panama.

<sup>b</sup> Does not include Caribbean financial centres, Panama or Puerto Rico.

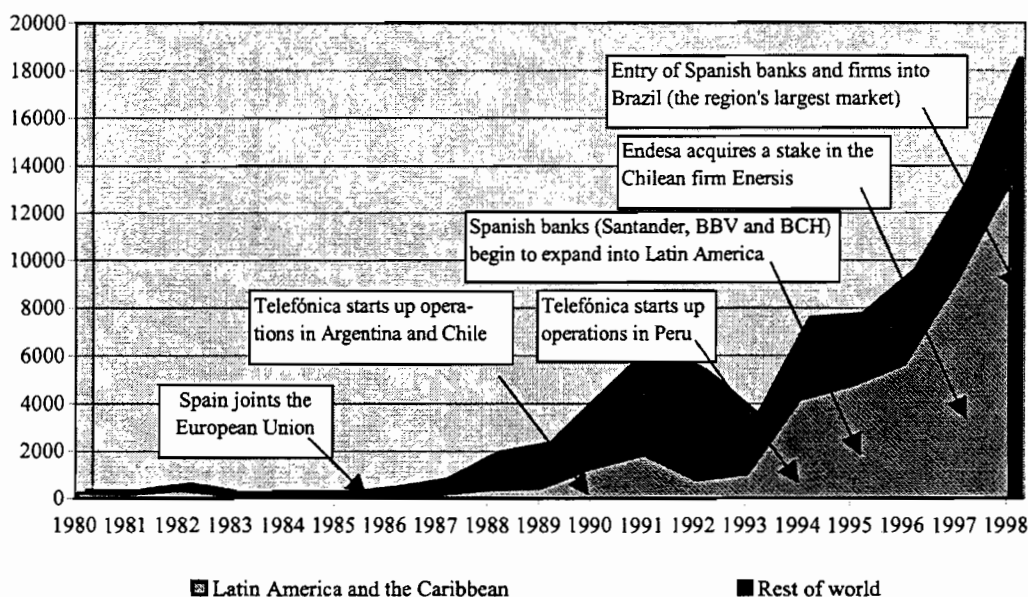
from US\$ 4.5 billion in 1990 to over US\$ 18.5 billion in 1998 (see figure III.1). Its forward momentum has increased even further since 1994, when Latin America became the preferred destination for Spanish investors. Between 1994 and 1998, the region's share of total Spanish foreign direct investment (FDI) has swelled from 55% to 72% (see table III.1).

Sectoral analyses are distorted by the fact that nearly 50% of the investments made by Spanish firms

in Latin America are channelled through investment trusts or holding companies<sup>51</sup> (see table III.2). The new demands made by the international market and the new opportunities it offers have enabled these firms to organize their foreign operations on the basis of these holding companies, with the main purpose of doing so being to obtain tax advantages. At a later stage, the resources originally channelled to these companies are

51 These holding companies are legal/economic instruments that serve as an intermediary between Spanish investors and the corporation which is the investment's ultimate destination. Many such holding companies are located in financial centres within the Caribbean subregion or in other countries offering financial and tax advantages (e.g., the Netherlands).

Figure III.1  
**SPAIN: OUTWARD FOREIGN DIRECT INVESTMENT**  
*(Millions of dollars)*



**Source:** ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of data from the Bureau of International Economic Affairs and External Transactions (DGEITE) of the Ministry of Economic Affairs and Finance of Spain.

re-directed to the investment projects in other sectors that constitute their ultimate destination.

The traditional pattern whereby Spanish firms have tended to invest in the sector corresponding to their main area of activity is still in evidence today, and any differences between source and destination sectors that may show up in the relevant figures are therefore attributable to the intermediary role played by such holding companies. In Latin America, the vast majority of Spanish investments in these companies are made by transport, telecommunications, energy (electricity, gas and water) and financial service firms. The second-most important category of investors is composed of oil drilling companies and various manufacturing activities (Arahuetes, 1998). The characteristics of Spanish investments in the region can thus be defined more accurately once the sectoral origin of the investments that are routed to holding companies

is determined. Thus, the great majority of Spanish investments can actually be traced to a small number of firms in just a few sectors: Telefónica de España S.A. and Iberia Líneas Aéreas de España (transport and telecommunications), Banco Bilbao Vizcaya Argentaria, Banco Santander and Banco Central Hispano (financial services) —both banks the product of mergers in 1999— and Endesa-España, Iberdrola, Unión Eléctrica Fenosa, Sociedad General de Agua de Barcelona S.A. and Repsol S.A. (electricity, gas and water) (see figure III.1).

During the 1990s, the two areas in Latin America that have been the main focus of attention for Spanish firms have been:

- The Southern Common Market (Mercosur) and Chile, in the Southern Cone. At the outset, Spanish firms invested heavily in Argentina and Chile in order to gain access to their markets and to

Table III.2  
**SPAIN: DIRECT INVESTMENT IN LATIN AMERICA,<sup>a</sup> 1993-1998**  
*(Millions of dollars and percentages)*

	1993	1994	1995	1996	1997	1998	1993-1998 (%)
<b>Primary sector</b>	<b>0</b>	<b>18</b>	<b>37</b>	<b>438</b>	<b>19</b>	<b>36</b>	<b>1.9</b>
Farming, livestock and fishing	0	18	37	9	19	19	0.3
Petroleum and fuel processing	0	0	0	429	0	17	1.5
<b>Manufactures</b>	<b>29</b>	<b>153</b>	<b>109</b>	<b>148</b>	<b>383</b>	<b>394</b>	<b>4.1</b>
Food, beverages and tobacco	12	10	0	6	48	57	0.5
Textiles and wearing apparel	0	0	0	0	2	2	0.0
Paper and publishing	15	4	43	35	73	47	0.7
Chemicals	2	5	31	5	14	21	0.3
Other	0	134	35	102	246	267	2.7
<b>Services</b>	<b>492</b>	<b>3 217</b>	<b>1 597</b>	<b>3 438</b>	<b>6 836</b>	<b>12 206</b>	<b>94.0</b>
Construction	5	52	64	45	200	170	1.8
Commerce	0	0	16	26	12	127	0.6
Transport and communications	106	2 211	179	176	497	103	11.1
Electricity, gas and water	9	51	116	217	810	2 352	12.0
Financial services (banking and insurance)	69	148	195	1 366	2 449	1 626	19.8
Hotels and restaurants	0	0	36	37	55	32	0.5
Holding companies <sup>b</sup>	303	755	991	1 571	2 813	7 796	48.1
<b>Total</b>	<b>521</b>	<b>3 388</b>	<b>1 743</b>	<b>4 024</b>	<b>7 238</b>	<b>12 636</b>	<b>100.0</b>

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of data from the Bureau of International Economic Affairs and External Transactions (DGEITE) of the Ministry of Economic Affairs and Finance of Spain.

<sup>a</sup> Does not include Caribbean financial centres, Panama or Puerto Rico.

<sup>b</sup> The holding companies are primarily transport, telecommunications, energy and financial service firms that use this mechanism to obtain tax benefits.

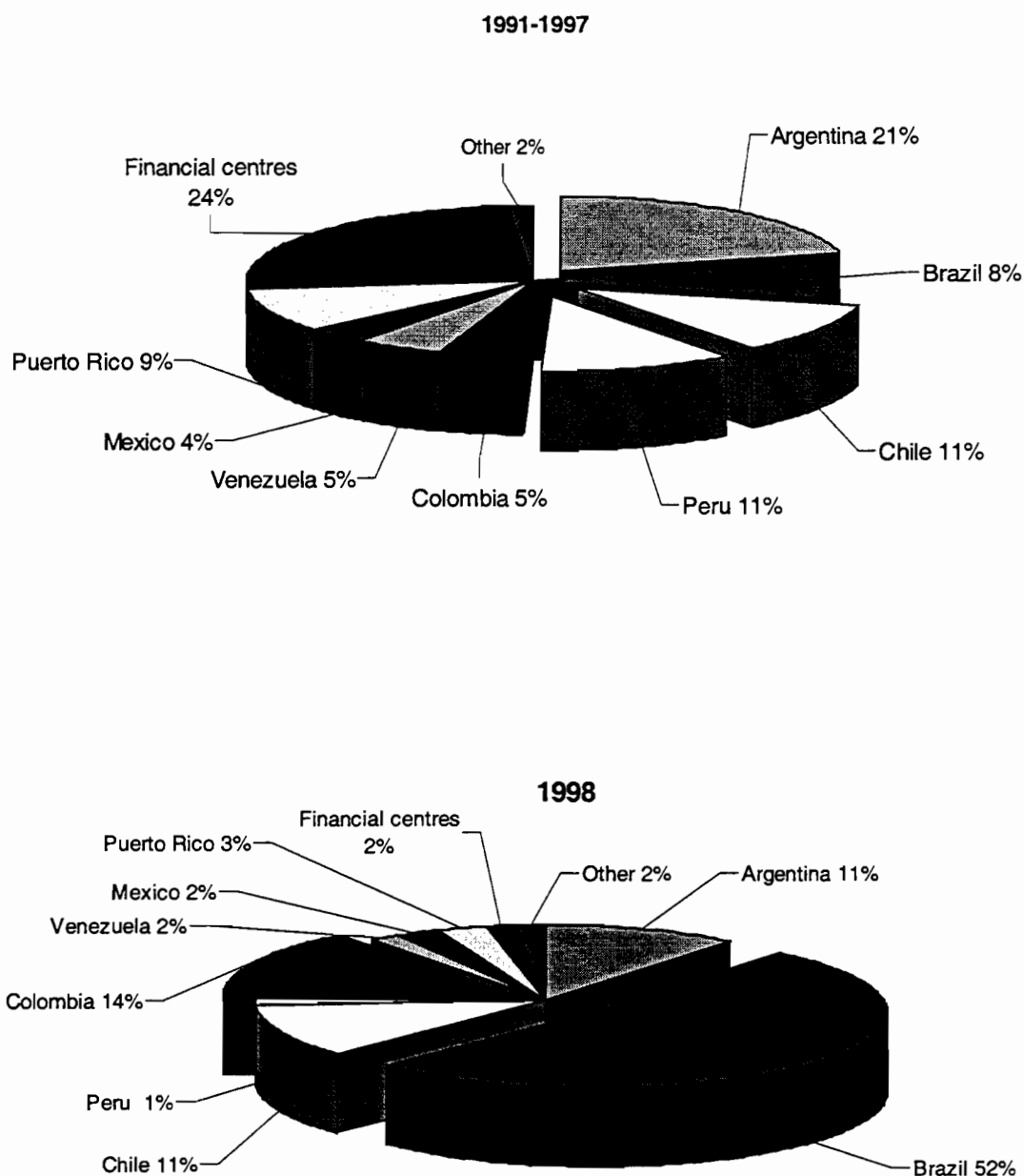
establish a position from which they could expand into the rest of Mercosur (especially Brazil) later on. In late 1997 and even more so during 1998, Spanish firms and banks began to increase their presence in Brazil, the region's largest market.

- The Andean Community, particularly Peru, Colombia and Venezuela. In this case, the focus has been somewhat different, since the main objective has been to maintain a presence in the various individual markets rather than to benefit from the advantages offered by subregional integration schemes.

During the period 1991-1997, Argentina was the main Latin American destination for Spanish

investment (see figure III.2). It was in this country that Spanish firms maintained the broadest-based and most diversified presence, as they rapidly expanded into transport and communications, financial intermediation, banking and insurance, and oil drilling and fuel processing, followed by the energy and water industries. Investments in Chile during this period were concentrated in telecommunications, banking and electrical power, while in the case of Peru, Telefónica's acquisition of the Compañía Peruana de Teléfonos (Copertel) and the Empresa Nacional de Telecomunicaciones del Perú (Entel) occasioned a major inflow of Spanish investment funds. Most of the investment activity in Venezuela has been in the banking sector.

Figure III.2  
**SPAIN: FOREIGN DIRECT INVESTMENT IN LATIN AMERICA, 1991-1998**  
*(Percentages)*



**Source:** ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of data from the Bureau of International Economic Affairs and External Transactions (DGEITE) of the Ministry of Economic Affairs and Finance.

Mexico is an interesting case chiefly because of the qualitative, rather than quantitative, aspects of Spanish investments in that country. In addition to the types of patterns seen in the rest of the region, especially with regard to financial activities, this economy has also been the recipient of investments made by a number of Spanish manufacturing concerns, notably in the food and beverages, graphics, metal processing and automotive parts industries (Arahetes, 1998). The share of Spanish FDI in Mexico that is accounted for by manufacturing firms exceeds the average both for Latin America and for the world as a whole, thanks primarily to the inducements associated with NAFTA (Durán, 1999).

The record level of Spanish FDI in Latin America recorded in 1998 is largely attributable to the rapid implementation by banking institutions of a broad-based strategy for expanding into the region through the acquisition of local banks and to the active participation of service firms in Brazil's and

Colombia's privatization programmes. Thus, in addition to moving aggressively into the region's largest market (Brazil), Spanish businesses have reinforced their traditional pattern of behaviour in the region as they focus their attention on finance, telecommunications and energy (electricity, petroleum and natural gas) (see figure III.2). In 1999, this trend has remained in evidence, with particularly notable levels of investment being made in Argentina and Chile—chiefly in the form of the purchase of existing firms—and in Brazil, where the focus has been on modernizing and expanding these companies' local operations.

In summary, during the past five years Spanish FDI in Latin America has grown at a remarkable pace in both absolute and relative terms. This investment activity is, however, confined to a small number of firms and economic sectors. The experiences of these firms and the strategies they have used to expand into Latin America and the Caribbean will be discussed in the following sections.

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## B. MAIN FOCAL POINTS OF SPANISH INVESTMENT IN LATIN AMERICA AND THE CARIBBEAN

The above analysis makes it clear that the basic aim of Spanish firms investing in the region is to gain access to service markets. Indeed, Spanish companies have been at the forefront of the wave of new entrants into recently deregulated service sectors (see chapter I).

In an economy that is as internationalized as Spain's, with large volumes of inward foreign investment and a strong transnational corporate presence, the control of the management of the mentioned companies (or conglomerate groups) remains in Spanish hands, despite the fact that their ownership is highly diluted. The firms that make up this select group are responsible for nearly all the Spanish investments reflected in the figures on aggregate

capital flows (see figure III.1 and table III.3). An interesting aspect of this phenomenon is that large Spanish companies—themselves recently privatized—have relied heavily on Latin American privatization programmes to gain entry to the region's services markets. This small group of Spanish firms, which are trailing quite far back in the pack in terms of the major corporations operating at a global scale (*Fortune*, 2 August 1999), have attained a significant and still growing presence in the Latin American business world (see chapter I). The strategies used by major Spanish corporate groups to deal with the new international situation and the factors underlying their decision to wager on expanding into Latin American markets will be explored in the following sections.

Table III.3  
**PRINCIPAL CORPORATIONS OPERATING IN THE SPANISH ECONOMY, 1998-1999**  
*(Millions of dollars)*

Firm	Activity	Sales	Assets	% in Latin America <sup>a</sup>	Investment in Latin America 1991-1999 <sup>a</sup>	Market capitalization	Fortune 500 rank
Repsol	Petroleum and Petroleum products	19 803	17 919	...	20 000	16 256	257
Telefónica de España	Telecommunications	18 214	51 653	31	10 000	51 151	193
Banco Santander Central Hispano (BSCH)	Banking	15 088 <sup>b</sup>	246 032	27	5 300	38 230	211
Banco Bilbao Vizcaya <sup>c</sup>	Banking	12 784 <sup>b</sup>	139 580	28	4 500	30 138	287
El Corte Inglés	Commerce	8 250 <sup>b</sup>	...	0	...	...	...
Endesa	Electric power	7 129	27 389	40	10 000	20 432	...
Cía. Española de Petróleos S.A. (CEPSA)	Fuel distribution	6 109	4 258	...	...	...	...
Argentaria <sup>c</sup>	Banking	6 043 <sup>b</sup>	72 849	...	...	11 225	...
Fasa Renault <sup>d</sup>	Automotive	5 132 <sup>b</sup>	...	0	0	...	...
Seat-Volkswagen <sup>d</sup>	Automotive	5 100 <sup>b</sup>	...	0	0	...	...
Iberdrola	Electric power	4 326	17 508	20	2440	13 257	...
Iberia Airlines of Spain	Transport	4 023 <sup>b</sup>	...	...	1 000	...	...
<b>Centros Comerciales</b>							
Pryca-Carrefour <sup>d</sup>	Commerce	3 500 <sup>b</sup>	3 321	0	0	...	...
Citroën Hispania <sup>d</sup>	Automotive	3 400 <sup>b</sup>	...	0	0	...	...
Gas Natural	Gas distribution	2 798	6 916	...	...	11 705	...
Banco Popular	Banking	2 235 <sup>b</sup>	25 191	0	0	7 988	...
Unión Eléctrica Fenosa	Electric power	2 210	7 223	...	...	4 036	...

**Source:** ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of figures from *Actualidad Económica*, *Dinero*, *Cinco Días*, *Expansión*, *Fortune*, "The Global 5 Hundred" (2 August 1999) and Hoover's Online [<http://www.hoovers.com>].

<sup>a</sup> Estimates made by the ECLAC Unit on Investment and Corporate Strategies.

<sup>b</sup> Information corresponding to 1997.

<sup>c</sup> On 19 October 1999, BBV and Argentaria merged to create a new bank named Banco Bilbao Vizcaya Argentaria (BBVA).

<sup>d</sup> Subsidiaries of foreign companies operating in the Spanish economy.



## 1. Telecommunications: the strategy used by Telefónica de España in response to international market liberalization, and its choice of Latin America

Telecommunications is currently one of the most competitive and dynamic industries in the international economy, and the world telecoms market is expected to have doubled between 1994 and 2000 (ITU, 1997). Radical changes have taken place in the field of telecommunications in recent years, including a rapid, far-reaching liberalization process and astounding advances in the technical environment. These two megatrends have prompted equally significant changes of strategy among the sector's major firms. Against this backdrop, Telefónica de España has completed its own privatization process, has dealt successfully with the changes taking place in the Spanish, European and world markets, and has embarked upon an aggressive international expansion drive aimed particularly at Latin America. Thus, the firm is seeking to become a global player in the telecoms industry of the twenty-first century, and it has used its strong presence in emerging markets (Latin America) to gain access to other more competitive markets or as a vehicle for negotiating the global alliances of the future.

### (a) Telecoms liberalization: towards a global market?

A small group of countries —United States, United Kingdom and Sweden in Europe; Australia and New Zealand in Asia; and Chile in Latin America— have several years' head start in the liberalization of the telecommunications industry. In these pioneering economies, the changes that have been made have resulted in significant growth in the sector, stronger demand, lower prices and rapid technological innovation. By the mid-1990s, the same principles had been adopted by most of the countries of the world.

- At the *multilateral level*, under the aegis of the World Trade Organization (WTO), following three years of negotiations the Governments of 69

countries (representing 95% of the world telecoms market) signed an agreement on 15 February 1997 to lower international barriers to trade in telecommunications services. Then, on 5 February 1998, schedules of commitments regarding basic telecommunications services were annexed to the protocols of the General Agreement on Trade in Services (GATS), in force since the conclusion of the Uruguay Round in 1994.

- In the *United States*, the liberalization of the telecommunications industry triggered a revolution that culminated in the authorization of cross-sectoral competition (Telecommunications Act of 1996). In late 1997, despite the difficulties associated with a period of transition and delays in opening up some segments of the market, this process gathered further momentum as regional phone companies in the United States ("baby Bells") gained access to the market for long-distance telephone service, and cable television companies were allowed to move into telecommunications services. The domestic market became the main target for the major local players (AT&T Corporation, GTE Corporation, SBC Communications Inc., MCI WorldCom Inc., Bell Atlantic Corporation,) as well as for some foreign firms (British Telecom, Deutsche Telekom AG and France Telecom).<sup>52</sup> United States companies have concentrated on their core business in their own territory, where the market has undergone profound changes in recent years, and are struggling to consolidate their positions.
- The telecoms market in *Japan* —the world's second largest and by far the largest in Asia— has been opened up to competition. The world's largest telecommunications services provider, Nippon Telegraph and Telephone Corporation (NTT), is Japanese-owned, and the country was one of the first to sign the WTO agreement

52 Most long-distance calls in the world either start, end or pass through the United States, so any firm that aspires to be a global operator must have a presence in that market. This explains British Telecom's frustrated attempt to acquire MCI and the decision of Deutsche Telekom and France Telecom to enter into a venture with US Sprint. Other European firms could enter the United States market if the alliance between UniSource and AT&T takes root. Another event reflecting this state of affairs is the recently announced merger of MCI WorldCom and US Sprint, which has irritated US Sprint's junior European partners.

following passage of the corresponding legislation in 1997.

- In the *European Union*, which accounts for one third of the world's telephone lines, the liberalization of the telecommunications market was completed on 1 January 1998, turning what had been one of the world's most heavily protected markets one of its most open ones. This process, which started in the early 1980s, led to the privatization of several European monopoly operators (including Telefónica de España, France Telecom and Telecom Italia) and the opening of their markets to global competition. New competitors have established themselves in the mobile telephony market; there has been an increase in other high-technology telecommunications services; initial steps have been taken to expand competition in basic telephony; and rates have begun to fall slightly, especially on for international calls. By agreement with the European Commission, full liberalization came to Spain on 1 December 1998<sup>53</sup> and was to be reached by Ireland and Portugal in 1999 and by Greece in 2001. So far, unlike what happened in the United States, European liberalization has not led to the entry of a significant number of non-EU operators (Clegg and Kamall, 1998). Technological factors have been decisive in this regard.
- In the early 1990s, many *Latin American* countries embarked upon ambitious programmes aimed at privatizing State-owned fixed-line telephone services and opening up new areas of the telecommunications industry (mobile telephony, data transmission, etc.) to private enterprise. Now, in addition to having signed the WTO agreements, several of the monopolies that have been transferred to international private-sector operators are themselves about to be opened up to greater competition (see table III.4).

Another factor —apart from the ongoing globalization of the world's economies and the deregulation and liberalization of national markets—that has been driving forward the rapid transformation of the telecommunications sector is technological innovation (digitization, the widespread use of fibre

optics, satellites, undersea cables and mobile telephony). Other factors have been the new needs and demands of telecom service users (better quality and lower prices); the explosive growth of the Internet; and the growing interrelation and convergence of the telecommunications, informatics and entertainment industries. This combination of liberalization and technological change has been the most important factor in the remarkable transformations seen in the telecoms sector at the international level, in Europe and, of course, in the Spanish and Latin American markets. These factors have helped spur forward a process of corporate concentration—through mergers, acquisitions and alliances—that is unprecedented in magnitude and nature (Martínez, 1998).

This intensive process of mergers and acquisitions aimed at achieving the size needed to compete in the world market has been accompanied by exponential growth in mobile telephony and data transmission, less dramatic growth in basic telephony—with a sharp increase in the number of international calls but more moderate increases in local calls—and the burgeoning growth of the Internet. The EU has been at the hub of these developments, and the major European firms have therefore had to form strategic alliances in order to meet the challenges of the new EU market.

- In 1992 *Unisource* was created by a number of firms, including KPN Telecom of the Netherlands and the Swedish company Telia, and these partners were joined a year later by Swiss Telecom. Unisource also has a stake in WorldPartners, together with AT&T, KDD of Japan, Sing Tel of Singapore and Testra. In 1997, this alliance underwent a significant shift due to the withdrawal of Telefónica de España and the entry of Telecom Italia.
- In 1993, British Telecom (BT) and the United States company, MCI, set up *Concert* with the intention of delivering telecommunications services worldwide. However, following a failed merger attempt between BT and MCI, the acquisition of MCI by WorldCom and the merger of BT and the United States corporation of AT&T, Concert came under the control of BT/AT&T and its presence in the European market declined

53 With the liberalization of the telecommunications market in Spain, several new operators gained entry. Retevisión, a company formed by Endesa-España and Telecom Italia, among others, was awarded the second basic telephony license, and this could have a strong impact on Telefónica's profit and loss account and its monopoly culture (Martínez, 1998).

Table III.4  
**TELEFÓNICA DE ESPAÑA: PRESENCE AND EXPANSION IN LATIN AMERICA**

Country	Company	Stake (%)	Main partners	Main services provided	Competition in main activities	Year of market Entry
Chile	Compañía de Telecomunicaciones de Chile (CTC) (now Telefónica CTC Chile)	44	Pension funds	Basic, long-distance and cellular telephone service, cable television, data transmission	Liberalized sector, with the exception of basic telephone service	1990
Argentina	Telefónica Argentina (TASA) <sup>a</sup>	29	CEI-Citicorp	Basic, long-distance and mobile telephone service, cable television and media.	Monopoly until November 1999	1990
Venezuela	Compañía Anónima Nacional de Telecomunicaciones de Venezuela (CANTV)	6	GTE, AT&T	Basic, long-distance and mobile telephone service, data transmission	Monopoly up to December 2000. Duopoly in mobile telephony.	1991
Puerto Rico	Puerto Rico Telefónica Larga Distancia (TLD)	79	Local authority	Long-distance and mobile telephone service <sup>c</sup>	Liberalized sector	1992
Peru	Telefónica del Perú	35	Local authority	Basic, long-distance and mobile telephone service, cable television	Liberalized sector	1994
Brazil	Cia. Riograndense de Telecomunicações (CRT)	45	Portugal Telecom, Iberdrola and BBVA	Basic and mobile telephone service	Monopoly, with the exception of mobile telephony	1996
	Telesp	29	Portugal Telecom, Iberdrola and BBVA	Local and intraregional long-distance telephone service, data transmission	Duopoly with mirror firm	1998
	Telesp Celular	19	Portugal Telecom	Mobile telephone service	Duopoly until bidding held in January 2001 for PCS licences	1998
	Tele Sudeste Celular <sup>d</sup>	48	Iberdrola	Mobile telephone service	Duopoly until bidding held in January 2001 for PCS licences	1998
	Tele Leste Celular <sup>e</sup>	20	Iberdrola	Mobile telephone service	Duopoly until bidding held in January 2001 for PCS licences	1998
El Salvador	Telefónica de El Salvador	26	Local authority	Basic, long-distance and mobile telephone service, data transmission	Liberalized sector	1998
Guatemala	Telefónica Guatemala	100	-	Mobile telephone service	Liberalized sector	1999

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of data from Telefónica de España.

<sup>a</sup> The Telefónica group also owns 55% of Impresora y Comercial Publigrúas, a firm that produces and publishes telephone directories. In October 1998, through CTC, it acquired 100% of VTR Larga Distancia for US\$ 50 million.

<sup>b</sup> In the Argentine media, Telefónica owns 100% of Telecomunicaciones y Sistemas (TYSSA), 36% of Cablevisión, 30% of Atlántida Comunicaciones and 20% of Torneos y Competencias, a content provider and owner of football broadcasting rights (see box III.2).

<sup>c</sup> In March 1999, TLD and the United States company Clear Comm reached an agreement to undertake a joint venture to provide mobile telephone services.

<sup>d</sup> TeleSudeste Celular is made up of the cellular telephone companies of the states of Rio de Janeiro (Telerj) and Espirito Santo (Telest).

<sup>e</sup> Tele Leste Celular is made up of the cellular telephone companies of the states of Bahia (Telebahia celular) and Sergipe (Telergipe Celular). These two companies are controlled by a consortium consisting of Telefónica (38%) and Iberdrola (62%). In June 1999, Telefónica and Iberdrola made takeover bids for 100% of the shares of the two Brazilian companies, achieving a response level of 54%.

considerably. On 18 April 1997, Telefónica de España joined this alliance.

- The third strategic European alliance is *Global One*, comprising France Telecom, Deutsche Telekom, and U.S. Sprint. In this case, however, a protracted consolidation process and successive postponements of the exchange of shares have substantially weakened the position of Global One in the European market. Moreover, the October 1999 merger of MCI WorldCom and US Sprint has distanced these European firms from the latter.

As yet there is still no sign of consolidation among the companies, operators and alliances that are likely to dominate the EU market, and there is some unease about the choices that have been made in a variety of areas, including technology, market selection, the make-up of alliances, growth strategies and diversification across sectors. In recent months there has been an unprecedented surge in merger and acquisition activity as the major European firms seek to enlarge their operations and become more influential in EU and world markets. This burst of activity has included the mergers of Telia (Sweden) and Telenor (Norway); a public tender offer made by the British operator, Cable and Wireless, for the Japanese company International Digital Communications (IDC); an alliance between BT and the Japanese company Nippon Telegraph and Telephone Corp. (NTT); and the failure of Deutsche Telekom's public tender for Italia Telecom in April 1999 as a result of a hostile bid by Olivetti for the Italian company. This is the complex set of conditions that forms the backdrop for the operations of Telefónica de España, one of the sector's boldest players.

**(b) Telefónica de España: an attempt to consolidate its status as the key operator in the Spanish-speaking world so that it can attain a leading position on the world stage?**

By late 1998, Telefónica had become one of the world's 12 largest telecoms firms, the sixth-largest in Europe and the top provider to the world's Spanish- and, recently, Portuguese-speaking populations. In 1998, Telefónica reported sales of US\$ 18.214 billion, an amount exceeded in the EU by Deutsche Telekom, BT, France Telecom, Italian Telecom and Alcatel of France (Business Week, 12 July 1999; Fortune, 2 August 1999). In Latin America it has become one of the region's three leading transnational operators (see table I.14). Company sources state that Telefónica plans to continue its expansion and intends to become

one of the five largest players worldwide (Telefónica, 1999). In 1998, through its network of subsidiaries in Spain, the EU, Latin America and the United States, the company increased its customer base by 40% to 49 million, out of a potential market of 530 million people.

Having previously been a monopoly operator in its own country, Telefónica has now built up a presence and is competing at the international level. The company, which completed its own privatization process in 1997, has grown from a telephone company into a communications business, from providing a public service to delivering differentiated services to a wide range of clients. In late 1998, as one of the steps taken by the firm to change its corporate image, "Telefónica" was adopted as its overarching brand name with a view to integrating and consolidating the company's different activities in the international arena.

The first large-scale Spanish investments in Latin America were made by the State-owned enterprises Telefónica and Iberia (see figure III.1 and box III.3). In the case of Telefónica, this marked the start of an aggressive internationalization strategy which was adopted in response to the imminent liberalization of the telecommunications market in Spain and the EU and to worldwide trends in the telecommunications market. The main thrust of the strategy was to improve the firm's competitive position by achieving a critical mass at the international level, which would in turn enable it to build alliances and strengthen its capacity as a global telecommunications operator (Calderón, 1999b). From Telefónica's standpoint, the opportunities that were beginning to arise in the region were an ideal means of helping it to meet the challenges of globalization. On the one hand, the regional market had a high growth potential (unsatisfied demand and insufficient infrastructural investment) and, on the other hand, it opened up the possibility of exploiting operational synergies (implementing common systems and strengthening bargaining power) (Perea, 1998). Since then, the company's Latin American operations (Telefónica Internacional) have accounted for an increasing share (31% in 1998 as compared to 14% in 1994) of the Telefónica group's total revenues (Telefónica, 1999).

So far, Telefónica has invested over US\$ 10 billion in Argentina, Brazil, Chile, El Salvador, Guatemala, Peru, Puerto Rico, and Venezuela and has become the leading global operator in the Latin American telecommunications market (see table III.4). The firm managed to consolidate this market position with its successful participation in the privatization of

## Box III.1

## TELEFÓNICA'S INTERNATIONAL ALLIANCES

In April 1997, following a brief membership in the European group Unisource, Telefónica attempted to form an alliance with BT and the United States company MCI Communications Corp. This agreement was supposed to have included a non-aggression pact in those markets where the parties were already present, and Telefónica was to be responsible for the management of joint activities in Latin America and would have access to the Mexican market, where MCI was already operating. However, the alliance collapsed when WorldCom made a hostile takeover bid for MCI. These events put Telefónica in a very difficult spot in the international market and seriously weakened its negotiating position. In late 1997, in an attempt to revive its strategy of international alliances, the firm sought to establish closer relations with Unisource,<sup>a</sup> particularly through the United States company AT&T. Telefónica was thus in a relatively isolated position and remained in possession of some of the most attractive assets for major world operators: its shareholdings in Latin American telephone companies. Faced with this situation, Telefónica halted its

drive in the region and began to expand into the mass media in Spain (newspapers and television stations).<sup>b</sup>

In March 1998, Telefónica formed a partnership with the United States company MCI WorldCom to explore business opportunities in Europe, the United States and Latin America. The accord emphasized the areas which MCI and Telefónica had focused on when they had undertaken a joint venture in April 1997. It was also agreed that Telefónica could acquire a minority interest in current and future MCI WorldCom businesses in Europe, and that the United States firm could have an interest in Telefónica's Latin American ventures. This agreement enabled Telefónica to expand its activities in Latin America (particularly in Brazil and Mexico), to enter the Spanish-language market in the United States and to expand its European presence through MCI WorldCom companies in that continent.

This agreement also bolsters one of Telefónica's main projects, the Pan-American Network, which is aimed at setting up a fully digital network to link up the region's main business centres. The project is to be carried out in

stages so as to keep pace with market demand and the requirements of regulatory bodies. About 12 business centres in Latin America are expected to be connected to the network by 2001.

In April 1997, Telefónica and Portugal Telecom signed an agreement designed to reinforce their international strategies, especially in Brazil. The alliance was sealed with the purchase of 3.5% of Portugal Telecom by Telefónica, and of 1% of Telefónica by the Portuguese firm. The alliance was further consolidated in March 1998 with an agreement to enter into joint investments in countries of the Mediterranean basin and in Brazil. Under this new agreement, Portugal Telecom can acquire a stake of up to 5% in Telefónica Internacional (Telefónica, 1999).

These alliances with international corporations complement the good relations that Telefónica maintains with other Spanish firms such as Iberdrola and BBVA. Telefónica is expected to continue to seek new partners in each of its lines of business as a means of strengthening its position as a "global player".

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

<sup>a</sup> On 18 April 1997, Telefónica pulled out of the Unisource group, in which it had held a 25% stake, and paid compensation to its partners for its unilateral renunciation of the commitments it had entered into the year before. When its first attempt to form an alliance with BT and MCI failed, it tried to repair its relationship with Unisource, but was unsuccessful in doing so.

<sup>b</sup> At a time when major United States telecommunications firms had begun to abandon their strategy of diversifying into mass media, Telefónica stepped up its efforts to move in the opposite direction, shifting its main business focus away from telecommunications and towards other content-production activities (Martínez, 1998). Even though the major companies maintained some links and tie-ins with related activities, they turned back to telecommunications as their main area of activity. This shift came in response to the sweeping changes occurring in this industry.



Telecomunicações Brasileiras, in which it gained control of the fixed telephony company serving the State of São Paulo (Telebras) and two cellular phone operators (Tele Sudeste Celular and Tele Leste Celular). Indeed, Telefónica had earlier announced that the Brazilian market would be its main target for 1998. Telefónica's success in Brazil was bolstered by the positive results achieved by its international partners in the sale of Telebras (see box III.1). MCI WorldCom won the bidding for the long-distance operator Empresa Brasileira de Telecomunicações (Embratel), while Portugal Telecom was awarded the concession for the cellular telephone operator serving São Paulo (Telesp Celular), the largest mobile telephony company in Brazil. Subsequently, Telefónica acquired a 36% stake in the consortium that had acquired Telesp Celular.

These operations were financed by a capital increase of US\$ 3.8 billion that was carried out through offerings on European markets and by a US\$ 2.347 billion loan from the Brazilian Government. In January 1999, Telefónica decided to make prepayments on its obligations with the Brazilian authorities, which were slated to fall due on 4 August 1999 and 4 August 2000, thus taking advantage of the fact that it had the right to prepay all or part of the total debt outstanding at any time. As a result of a change in the exchange rate between the date when the debt was formalized and the date of its repayment, this generated a positive balance for Telefónica of US\$ 1.14 billion. Telefónica then used these funds to amortize the purchase of the Brazilian companies on an accelerated schedule and to finance measures to safeguard Telefónica's investments in Latin America and put them on a sound financial footing (*Notas de Prensa de Telefónica*, 28 January 1999).

The strategic value of Telefónica's presence for Latin America is reflected in the level of funds committed to the purchase of regional assets. First there was the case of Peru and then, more recently, that of Brazil, where the sum offered by Telefónica for Telesp exceeded the reserve price by 64% and bettered the

next highest bid by over US\$ 1.56 billion<sup>54</sup> (Calderón, 1999b). In attaining this advantageous position in Brazil, Telefónica has taken the most important and definitive step towards consolidating itself as the telecom services leader in Latin America and the Caribbean.

In late 1998, Telefónica entered the Central American market. First, in conjunction with the local group Mesotel, it bought 51% of Intel (now Telefónica de El Salvador) for US\$ 41 million; then it purchased a licence to operate cellular telephone services in Guatemala for US\$ 33 million. In order to lay the groundwork for its participation in the forthcoming privatizations of telecommunications companies in Costa Rica, Honduras and Guatemala, Telefónica has created Telefónica de Centroamérica, in which it holds a 51% stake. These initial moves are designed to further the Spanish corporation's bid to become the subregion's second-largest operator and to consolidate its leadership position in Latin America.

The firm's strategy has not been confined to the acquisition of more assets; it has also formed strategic alliances with major international operators, such as the United States company MCI WorldCom, Portugal Telecom and the Spanish firms Iberdrola and Banco Bilbao Vizcaya Argentaria (see box III.1). Increasing concentration and competition in the international telecommunications market could lead Telefónica to establish new alliances, with France Telecom and the British company Cable & Wireless being the most frequently mentioned potential partners.

By the end of 1998, Telefónica had 18.6 million fixed telephone lines, about six million cellular telephone customers and two million cable television customers in Latin America (Telefónica, 1999). The company plans to invest about US\$ 20 billion in the region over the next two years in order to continue expanding its operations and consolidate its leading position, particularly in international telephone service, cellular telephony, cable television and the Internet. In late 1999, Telefónica also attempted to acquire stakes in a number of cellular telephone

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54 In a press statement, company president Juan Villalonga stated that "the São Paulo market is the jewel in the crown of the Brazilian telecommunications system, and Telefónica, as a leading player, had to be part of it...Telesp opens the door to a market of great strategic interest, mainly because of its high growth potential in all sectors of activity and because it is located in the region that has the highest purchasing power in Brazil" (*Notas de Prensa de Telefónica*, 29 July 1998).

Table III.5  
**PERFORMANCE OF PRINCIPAL TELEFÓNICA SUBSIDIARIES IN  
 LATIN AMERICA**

	CTC	TASA	Telefónica del Perú	CRT
Lines in service (millions)				
- Before entry of Telefónica <sup>a</sup>	0.6	1.7	0.7	0.8
- December 1998	2.6	3.9	1.6	1.4
Digitization (percentage)				
- Before entry of Telefónica <sup>a</sup>	51	15	38	51
- December 1998	100	100	90	60
Average waiting-list period (months)				
- Before entry of Telefónica <sup>a</sup>	96	48	70	-
- December 1998	1.18	0.37	2.0	-
Lines served per employee				
- Before entry of Telefónica <sup>a</sup>	88	78	56	176
- December 1998	347	324	355	222
Cellular telephone customers (thousands)				
- December 1997	220	763	320	359
- December 1998	554	840	505	553
Cable TV customers (thousands)				
- December 1997	257	-	252	-
- December 1998	281	-	305	-

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of data from Telefónica de España.

<sup>a</sup> Latest data prior to acquisition by Telefónica: CTC (December 1989), TASA (November 1990), Telefónica del Perú (December 1993) and CRT (December 1996).

companies in Mexico and set up a subsidiary<sup>55</sup>—Terra Networks—in a bid to win the leadership of the Internet market in the region.

Telefónica has been implementing its Latin American expansion strategy for almost 10 years now, and to date the outcome has been quite successful. As of mid-1999, Telefónica controlled five of Latin America's 15 largest telephone companies (basic-service, mobile and long-distance), with 8.3% of the region's revenue for the sector (*Gazeta Mercantil Latino-Americana*, 6-12 September 1999). The group's position and relative importance in the international market have strengthened considerably, as has the company's market value. Telefónica has achieved the highest levels of profits, assets and market capitalization and the largest customer base of any

Spanish company (Notas de Prensa de Telefónica, 17 May 1999). In 1998 it had 49 million customers, US\$ 20.377 billion in consolidated income, US\$ 1.53 billion in profits (14% more than the previous year) and a 52% increase in the value of its stock (not including the May 1998 capital increase) (Telefónica, 1999). From the standpoint of the countries where these investments have been made, the coverage, quality and rates charged for telecommunications services have improved considerably (see table III.5). It should be noted, however, that in the case of Brazil the assumption of management responsibility for the enterprises acquired in 1998 has by no means been easy. Because there have been so many problems, there is some discontentment among Brazilian customers, who had expected rapid and substantial

55 In mid-November 1999, Terra Networks S.A., the subsidiary created by Telefónica de España to handle its Internet business, debuted on international markets. The price of its stock nearly trebled on the first day it was traded on the Madrid and New York stock exchanges. Through this new subsidiary, Telefónica hopes to increase the scale and efficiency of its operations in one of the fastest-growing markets in the region. Just how bright a future this industry has is attested to by the fact that between 1999 and 2002, the number of Internet users in the region is expected to climb from 7 million to 16 million.

## Box III.2

# TELEFÓNICA IN ARGENTINA: THE LARGEST REGIONAL CONVERGENCE PROJECT IN THE TELECOMMUNICATIONS MARKET?

Argentina is the country in which Telefónica has pursued its strategy of convergence in the telecommunications industry and the mass media most energetically. This is of particular interest in light of the fact that the Argentine economy has the third-highest cable television density in the world and has the highest per capita GDP in the region (ECLAC, 1999). In order to implement this project, in conjunction with CEI Citicorp -formed by Citibank (23.4%), Hicks, Muse, Tate & Furst Inc. (32.5%) and Argentine businessman Raúl Moneta's Banco de la República (36.7%)- Telefónica has launched an aggressive acquisitions strategy in the radio, television, publishing and communications industries. Progress with this initiative has proved difficult, however, and it has not yet been possible to implement the high-technology project, which calls for the combination of telephone service, pay TV and a large volume of content into a powerful multimedia centre (Hudson, 1999). Firstly, the lack of synergy among the various enterprises that have been acquired and the problems experienced by the Argentine economy in recent months have seriously shaken the expectations of the firms involved in this multimedia experiment. Telefónica and CEI Citicorp are currently seeking to cut costs, obtain new financing and reschedule their hefty debt.

The strategy has also been hindered by the fact that thus far there is no single technological pathway or any international consensus in terms of convergence between telecommunications and the media. Faced with this situation, Telefónica and its CEI partners (especially Hicks, Muse, Tate & Furst Inc.) have differing views regarding the way in which telephone, Internet and other services should be offered to customers in Argentina and the rest of the region. Hicks, Muse, Tate & Furst Inc. favours cable television, while Telefónica puts its faith in its experience with telephone service. The main point of disagreement has to do with Cablevisión, a company that has a modern fibre-optic cable network in Buenos Aires, since this makes it a potential competitor of Telefónica Argentina, whose operations are also controlled by Telefónica and CEI. This could lead to a "break-up" between Telefónica and Hicks, Muse, Tate & Furst Inc. In fact, the Spanish firm made an unsuccessful bid for the stock in Telefónica Argentina held by Hicks, Muse, Tate & Furst Inc. (The Wall Street Journal Americas, 12 June 1999). The other issue in dispute relates to the ownership structure of the multimedia group. Telefónica has no stake in CEI, but the two groups have made joint investments in a number of

communications and media enterprises. In addition to Cointel, Telefónica and CEI own equal interests in four independent companies: Cablevisión (cable television), Torneos y Competencias (sports channel and football broadcasting rights), AC Inversora (Telefé, Azul TV and 10 regional television channels) and ATCO (radio stations and various publications). The Telefónica Group has created a new subsidiary to integrate all its television, radio and publishing operations in Spain, the United Kingdom, Argentina, Chile and Peru, which will enable it to work more closely with CEI but will also heighten competition with Hicks, Muse, Tate & Furst Inc. In late 1999, it appeared that these companies were on the verge of finding a solution. Some experts were reporting that Hicks, Muse, Tate & Furst Inc. would sell its share of Telefónica de Argentina, the Telefé and Azul TV television channels, its Radio Continental radio station and other enterprises to Telefónica for US\$ 1.6 billion. It was also believed that, for its part, Telefónica-España would transfer its stake in Cablevisión to CEI. In sum, Argentina is the scene of a very interesting phenomenon of convergence among different businesses within the communications sector which has underscored the difficulties and fierce competition existing in this unpredictable market.

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

<sup>a</sup> Telefónica and the CEI group hold equal stakes (35.9% each) in Cablevisión, which is the largest cable television group in Argentina.

<sup>b</sup> Cointel (of which Telefónica and CEI each own 50%) controls 51% of Telefónica de Argentina.



improvements in service. The situation was only made worse by an attempt to raise charges during a recessionary period.<sup>56</sup>

In 1999, in addition to the difficulties it encountered following its entry into the Brazilian market, Telefónica has run up against other problems in Chile, Venezuela and Argentina. In the first two countries, it is involved in complex litigation in relation to its rate structure which may seriously endanger the high profit levels it obtains on its services, while in Argentina it has been having some difficulties in its dealings with its partners in a project for the creation of a major telecommunications conglomerate (see box III.3). During the next few years, Telefónica will be working on expanding its mobile telephony operations

and on winning a place among the leading firms in the Internet market through its subsidiary, Terra. In fact, the firms business plans for Argentina, Brazil and Chile call for between 36% and 50% of its investments to be devoted to strengthening its presence in mobile telephony markets. As of October 1999, Telefónica was trying to negotiate its entry into the Mexican mobile telephony market and was attempting to acquire four cellular telephone companies in the north of the country which were wholly or partially controlled by the United States company Motorola. If successful in this attempt, Telefónica will seek to integrate these assets into Iusacell (see box II.5) in order to galvanize Mexico's second-largest mobile telephone company (*The Wall Street Journal Americas*, 22 October 1999).

## 2. Energy: liberalization of the European market and expansion of Spanish companies into the Latin American market

### (a) Liberalization of the European Union's electric power market

Electric power generation capacity in the European Union currently exceeds actual demand by 50%. Furthermore, its electric power grids are fully interconnected, making seamless energy sales possible among EU member States. The European energy market is a mature one that is now undergoing a gradual liberalization process, and the main focus is on the quality of customer service rather than on supply issues.<sup>57</sup> Thus, the objectives of the European Union electric power market at the present time are to optimize its capacities—to sell its surplus output—and to expand at the international level.

The European countries' plan to open up their energy markets to international competition on a progressive basis, from a minimum of 25% in 1999 to 33% in 2003, and to divide up the electric power generation, transmission and distribution operations of

their vertically-integrated State enterprises. Each country may implement these guidelines at its own discretion in line with its own situation and needs. Although European Community Directive 96/92/CE does not require that any change be made in the legal status of existing enterprises, most States have begun to privatize firms and have embarked upon liberalization programmes that are even more ambitious than those provided for by the European Union. The markets of the Nordic countries, Germany and the United Kingdom are the most open to competition, while those of Spain and the Netherlands will attain comparable levels of openness by 2007. Others, such as those of France, Italy and Portugal, are at an intermediate stage.

Full consensus has not been achieved within the European Union regarding the liberalization of the electric power sector. At one extreme, proponents of liberal economic thought contend, on the basis of article 7A of the Treaty on European Union (the Maastricht Treaty), that the internal market of the

56 The Brazilian authorities have imposed fines on Telefónica on a number of occasions for failing to fulfil commitments made at the time of the privatization, particularly with regard to service quality. In addition, a decision by a São Paulo court has frozen a rate increase which had previously been authorized by the regulatory authority for telecommunications in Brazil (*Expansión*, 30 June 1999).

57 European Community Directive 96/92/CE on "the internal market in electricity" of 19 December 1996, which came into force on 19 February 1999, defines common rules for the 15 member States of the European Union. It also lays the foundation for the liberalization of the sector, which is currently run by national State monopolies.

Box III.3  
**IBERIA: TURBULENCE IN LATIN AMERICA**

In the early 1990s, Spain was the main point of departure and arrival for flights between Europe and Latin America, and Iberia offered more of those flights than any other European airline, with a 17% market share and 52% of all tickets issued in Europe for flights to the region. This privileged position, together with the sweeping changes that were beginning to take place in the world market, led Iberia executives to embark upon an ambitious expansion plan, particularly in Latin America. The State-owned Iberia thus became a pioneer among Spanish enterprises seeking opportunities for internationalization. Between 1991 and 1994 it invested close to US\$ 1 billion in Latin America; its largest-scale operations during that period included the acquisition of stakes in Aerolíneas Argentinas and in Venezolana Internacional de Aviación S.A. (VIASA). This foray into Latin America brought Iberia to the brink of bankruptcy. It ended up with a 49% interest in Aerolíneas Argentinas and took over its management and financial

administration. Between 1991 and 1994, Iberia's direct investment in the airline (capital, loans and current account transactions) jumped from US\$ 40 million to US\$ 860 million, without it ever turning a profit. In fact, Aerolíneas Argentinas absorbed almost all of the US\$ 1.1 billion which Iberia received from the Spanish Government in 1992, and this was one of the major sticking points in negotiations with the European Commission for increased State aid. In 1993, Iberia was forced by pressure from Brussels to cut back its stake in Aerolíneas Argentinas to 20%, but it continued to run the airline. It then began to seek alliances in order to reduce its interest in the Argentine airline. In 1997, the situation of Aerolíneas Argentinas led the Government of Spain to intervene again and restructure the ownership of the airline; Iberia and American Airlines each retained 8.33%, with the remaining 83.34% being placed in the hands of a company in which the Spanish Government is the largest shareholder.

The outcome was even worse in the case of VIASA. From 1991 on, Iberia invested some US\$ 230 million in the Venezuelan airline in an effort to save it from bankruptcy. In 1997, as a result of its economic difficulties and the unwillingness of Iberia to continue injecting further funds—it was already owed US\$ 150 million by VIASA—the Venezuelan airline was liquidated. In recent years, Iberia has faced serious difficulties—a series of disputes with its pilots and other staff, increased competition on the world market and the removal of price controls within the European Union—and this, together with its negative experience in Latin America, has led it to seek alliances with other airline companies (American Airlines and British Airways). In these negotiations, Iberia has used its Latin American routes as a bargaining tool since it is still a major actor in the region, although less so than when it began its attempt to expand in Latin America.

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

European Union should permit the free circulation of goods, persons, services and capital. At the other, based on article 90-2 of the Treaty, the defenders of the notion of public service argue that enterprises providing services of general economic interest should be exempted from the rules regarding competition and the operation of a free market. Because of this situation, the EU directive on the electric power market gives firms a

long period in which to adapt and does not demand totally free competition. This explains the fact that the EU member countries have implemented changes at differing paces; nonetheless, they are all clearly moving in the direction of liberalization, particularly in the area of electric power generation.<sup>58</sup> According to some analysts, this process may continue for another 10 years.

58 According to a study by the European Commission, the liberalization of this market has led to significant reductions in energy prices. For residential customers, rates have been reduced by 60% in Greece, 47% in Portugal, 40% in the United Kingdom, and 36% in Spain. In Spain, the State, consumers and enterprises are all expected to benefit from the liberalization process thanks to the Cost of Transition to Competition (CTC) system. This scheme guarantees that companies will continue to realize the greater part of their present profits during the transition period, but also provides for reduced consumer prices and, at the same time, lower State subsidies.

The largest operator both in Europe and the world is Electricité de France (EDF). Because the public service concept is more strongly defended in France than in any other EU country, the status of EDF as a State-owned company is unlikely to change to any significant extent. In terms of production capacity, EDF is followed by the Italian company Enel and the German RWE, with Endesa España in fourth place.

In Europe, it is not expected that there will be major changes in ownership or any proliferation of new enterprises, as in the case of telecommunications. The electric power market's entry costs are very high owing to the vast size of power distribution grids. In addition, liberalization and increased competition will considerably reduce the major operators' profit margins. This new scenario has prompted some of Europe's largest electric power groups to alter their strategies and undertake active international expansion drives in a bid to become global energy companies. The large investments made in Latin America by Endesa and EDF, particularly in the Mercosur countries and Chile, are part of this overall picture.

Progress in Spain's electric power market has been faster and more comprehensive than the process called for by the EU directives, making it one of the European Union's most competitive markets (Endesa, 1999; Iberdrola, 1999). The Spanish electric power market was liberalized as of 1 January 1998,<sup>59</sup> when the power generation and distribution businesses were opened up to competition. Endesa has retained the leading market position (close to 50%), followed by Iberdrola and Unión Eléctrica Fenosa. Faced with this new scenario, Spanish electric power companies have added three new core elements to their strategies: diversification, internationalization and efforts to form strategic alliances. Latin America has been the focal point for this new strategy. Spanish companies have competed with United States and Chilean firms for the control of energy generation, transmission and distribution in Latin America. Just as in the telecommunications sector, the great potential for growth in demand (4.5% per year over the coming 20 years (EIA, 1999)), the

deregulation and liberalization of local markets and the opportunities offered by privatization programmes have all encouraged energy companies to invest in the region (Calderón, 1999a).

#### **(b) Endesa-España: from Chile to regional leadership**

The new competitive conditions existing on the European and Spanish markets have forced Endesa-España to make a number of major changes, including the reorganization of the Endesa group, improvements in productivity achieved through staff cuts and the introduction of new technology and management methods, and an expansion strategy designed to maintain the growth rate in the value of the company's stock. In the early 1990s, Endesa anticipated these changes and began expanding at the international level, first with investments in Argentina and later in Portugal and Peru. By 1998 it was operating in 12 countries, seven of them in Latin America (Durán, 1999). In Europe, it has successfully entered peripheral markets, such as those of Morocco and the Principality of Andorra, where it has been awarded electric power supply contracts.<sup>60</sup> As a result, as of mid-1999, with assets valued at more than US\$ 32.6 billion, the Endesa Group has become the largest producer, marketer and distributor of electric power in Spain and Latin America, and the third-largest in the European Union in terms of its market capitalization (Endesa, 1999). The Endesa Group is involved in various areas of business in Spain and 12 other countries; in addition to its main line of business (electric power generation and distribution), it is also active in telecommunications, renewable energy sources, gas distribution, water treatment and distribution, and the provision of other services (Endesa, 1999).

In 1992, Endesa launched its international expansion process and entry into the Latin American market by acquiring (as part of a consortium) the Empresa de Electricidad de la Zona Norte (EDENOR),

59 This was made possible by a protocol signed by the Government and the electric power companies in December 1996 and by the Electricity Sector Act, which was passed on 27 November 1997. The regulations required for its implementation were published a few days later (Endesa, 1999; Iberdrola, 1999).

60 In Spain, Endesa has signed cooperation agreements and formed strategic alliances with Repsol, Gas Natural and Banco Central Hispano (now Banco Santander Central Hispano). At the European level, Endesa attempted to form an alliance with the German company RWE, but ultimately negotiations fell through, forcing Endesa to sell its 1% stake in RWE. In 1999, Endesa acquired 10% of the Netherlands firm Amsterdam Power Exchange (APX), and in 1998 it signed an agreement to manage the submarine cable connection between Morocco and Spain and a contract with the Principality of Andorra to supply 70% of its energy imports until 2004.

which distributes energy to northern Buenos Aires. It later purchased a 22% interest in Yacylec—a company which transmits electric power generated by the Yacyretá power station—and a 35% stake in the Dock Sud power plant. Also, through the Companhia de Interconexão Energética (CIEN),<sup>61</sup> it is making a bid to supply electric power to all the Mercosur countries, particularly Brazil. According to some estimates, electric power consumption in Brazil (which makes up almost half of the region's GDP and population) should rise at an annual rate of 5% over the next 20 years (EIA, 1999). The Brazilian market is the greatest attraction for Endesa and was the ultimate target of its investments in Argentina and later in Chile. In addition to its investments in Mercosur and in Chile, it has also invested in Colombia, Peru, Venezuela, the Dominican Republic and Central America (see table III.6).

In the mid-1990s, with a view to broadening its presence in Latin America, Endesa looked into the possibility of forming a strategic alliance with the Chilean holding company Enersis. The latter, thanks to an aggressive programme of expansion into other Latin American countries in recent years, had achieved a considerable share in the electric power markets of Argentina (Costanera, El Chocón, Edesur), Brazil (Cerj and Cachoeira), Colombia (Betania, Codesa, Emgesa) and Peru (Edegel, Edelnor). These acquisitions had made Enersis the largest electric power conglomerate in Latin America, valued at US\$ 5 billion. In late 1996, however, its rapid growth brought to light financial limitations which restricted its ability to continue taking part in international bidding for major electric power companies (Rainieri, 1999). As a result, the idea of bringing in a new shareholder with a controlling interest to provide the needed capital for future expansion became very attractive.

In mid-1997, Endesa described its takeover and strategic alliance with Enersis as a key element in its Latin American expansion process. On 2 August 1997, after participating with other firms in the privatizations of Edelnor in Peru and Cerj in Brazil, and following

Endesa's decision to purchase a significant stake in the companies controlled by Enersis, the two corporations established a strategic alliance whose main objective is to mount a joint response to new business opportunities in the region. The agreement gives greater management responsibilities to the Chilean firm (Rainieri, 1999).

In late 1997, Endesa paid US\$ 1.179 billion for a 29% stake in Enersis—not enough to gain control—and several weeks later a consortium led by these two firms was awarded the Brazilian electric power distributor Companhia Energética de Ceará (Coelce) for US\$ 868 million.<sup>62</sup> This operation was particularly important for Endesa because it outbid Iberdrola, which also maintains a significant presence in Brazil by virtue of its investment in the electric power company of the State of Bahia (Coelba) (see box III.4). At the same time, it also enabled it to consolidate its position as one of the region's principal operators.

Difficulties in its relationship with the management of Enersis prompted Endesa to rethink its strategy and take steps to gain managerial control of the Chilean company sooner than originally planned. After some minor increases in its stake, and following complex and lengthy negotiations, in March 1999 it finally made a public tender offer for 32% of Enersis (US\$ 1.45 billion), which gave it a 64% interest and the management of the Chilean company. This operation, together with its tender for Endesa-Chile,<sup>63</sup> was the defining element of Endesa's new Latin American strategy, which calls for the centralization of its regional operations in the electric power industry in Enersis. A significant part of the financing for this operation came from the Endesa privatization process, which was completed in 1998. This represented the largest equity placement in Spanish history (Endesa, 1999) and made Endesa the leading foreign investor in the electric power subsector (with an outlay of over US\$ 8.1 billion), delivering electricity to some 25 million customers in the region.

61 CIEN was set up in order to carry out projects for the importation of electric power from Argentina to Brazil. To date, the company has invested about US\$ 200 million (out of a total of US\$ 325 million) in the purchase of 1,000 MW from the Mercado Eléctrico Mayorista (MEM) in Argentina. This project should begin commercial operations early in 2000. Endesa-España currently owns 55% of CIEN; the remaining 45% is held by Endesa-Chile, which also belongs to Endesa-España.

62 By late 1997, Endesa and Enersis had already initiated their joint activities by forming the consortium that acquired 48.5% of Comercializadora y Distribuidora de Energía de Bogotá, (Codensa) for US\$ 1.23 billion (ECLAC, 1998a).

63 In late April 1999, following a bitter dispute with Duke Energy of the United States, Endesa gained a controlling 60% holding in the Chilean generator Endesa, through Enersis, by purchasing 35% of the company—it already held 25%—with an outlay of US\$ 2.1 billion. Despite some difficulties with the Chilean authorities, the operation was finalized in mid-May 1999.

Table III.6  
**ENDESA-ESPAÑA: PRESENCE AND EXPANSION IN LATIN AMERICA**

	Company	Stake (%)	Main partners	Activity	Market supplied and generating capacity	Year of entry
Argentina	Empresa de Electricidad de la Zona Norte (EDENOR)	38.0	Electricité de France	Distribution	2.2 million	1992
	Empresa de Electricidad de la Zona Sur (EDESUR)	41.7 <sup>a</sup>	Enersis	Distribution	2.1 million	1997
	Central Dock Sud <sup>b</sup>	39.9	Repsol	Generation	775 MW	1996
	Central Costanera	20.0 <sup>a</sup>	Enersis	Generation	1 460 MW	1997
	Central El Chocón	15.0 <sup>a</sup>	Endesa Chile	Generation	1 320 MW	1997
	Yacylec <sup>c</sup>	22.2	...	Transmission	282 Km.	1996
	Proyecto CIEN (Interconnection Brazil-Argentina)	72.2 <sup>a</sup>	Endesa Chile	Transmission	500 Km.	1997
Brazil	Cía. de Electricidad do Rio de Janeiro (CERJ)	41.3 <sup>a</sup>	Eletricidade de Portugal	Distribution	1.4 million 64 MW	1996
	Cía. Energética do Ceará (COELCE)	34.6 <sup>a</sup>	Enersis	Distribution	1.4 million	1998
	Cachoeira Dourada	23.0 <sup>a</sup>	Enersis	Generation	658 MW	
Chile	Enersis	63.9 <sup>a</sup>	Enersis	Holding		1997
	Chilectra	47.3 <sup>a</sup>	Enersis	Distribution	1.2 million	1997
	Cía. Río Maipo	53.7 <sup>a</sup>	Enersis	Distribution	0.25 million	1997
	Endesa Chile	38.3 <sup>a</sup>	Enersis	Generación	3 200 MW	1997
Colombia	Comercializadora y Distribuidora de Energía de Bogotá (CODENSA)	39.0 <sup>a</sup>	Enersis	Distribution	1.6 million	1997
	Empresa Generadora de Energía de Bogotá (EMGESA)	49.0 <sup>a</sup>	Enersis	Generation	2 458 MW	1997
	Central Hidroeléctrica de Betania (CHB)	29.0 <sup>a</sup>	Enersis Endesa Chile	Generation	510 MW	1997
Peru	Empresa de Generación Eléctrica de Lima Norte (EDELNOR)	36.5 <sup>a</sup>	Enersis	Distribution	0.84 million	1994
	Etevenza	43.5	...	Distribution	540 MW	
	Empresa Eléctrica de Piura	29.4	...	Generation	150 MW	
	Empresa de Generación Eléctrica de Lima (EDEGEL)	10.0 <sup>a</sup>	Enersis Endesa Chile	Generation	800 MW	1994
Dominican Republic	Consortio Punta Cana-Macao (CEPM)	40.0	...	Generation	35 MW	1995
Venezuela	Electricidad de Caracas (ELECAR)	7.9	...	Distribution	1.1 million	1993
				Generation	2 369 MW	
Central America	Sistema de Interconexión Eléctrica para América Central (SIEPAC)	...	...	Transmission	1 800 Km.	1997

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of figures from Endesa-España and Enersis.

<sup>a</sup> Through its stake in Enersis.

<sup>b</sup> The investment company Dock Sud, owned by Endesa (57.1%) and by the Repsol subsidiary Astra (42.9%), bought 69.8% of Compañía Argentina Central Dock Sud. It is currently building a 769 MW generating plant that is slated to come on stream in the year 2000.

<sup>c</sup> Yacylec operates and maintains the Yaciretá electric power transmission line (282 km) and the Residencia substation.



## Box III.4

**IBERDROLA: A STRATEGY AIMED AT RELATIVELY LESS ATTRACTIVE NICHES?**

Like Endesa, Iberdrola was also forced to overhaul its operations in response to far-reaching changes in European and Spanish market conditions. Accordingly, the second-largest Spanish electric power utility has embarked upon an active diversification and internationalization strategy designed to turn it into a global services operator (Iberdrola, 1999).

According to company estimates, foreign operations are expected to generate nearly 30% of the group's total business volume over the next four years, compared to 10% in 1997 (Duran, 1999). Like most other large Spanish companies, Iberdrola has focused its international expansion effort in Latin America, where it has been doing business since 1992, first in the electric power industry and more recently in gas distribution, water treatment, engineering services and telecommunications. To date it has invested nearly US\$ 2.44 billion and has operations in six Latin American countries (Argentina, Bolivia, Brazil, Chile, Colombia and Guatemala), where it participates actively in the management of 13 firms (Iberdrola, 1999). In 1998, these companies had combined billings of over US\$ 7.8 billion in a market made up of some 15 million customers.

- In the first stage of its Latin American expansion, Iberdrola concentrated on electric power, its core business in

Spain. In 1992, it entered the Argentine market by purchasing 60% of Central Térmica de Güemes,<sup>a</sup> and since 1995 it has handled 45% of Bolivia's electricity distribution through the companies Electropaz and Electricidad Fuerza de Oruro (ELFEO). In 1997 Iberdrola moved into the Brazilian market, buying a significant holding in the electricity distributors Companhia de Eletricidade de Bahia (COELBA) and Companhia Energética do Rio Grande do Norte (COSERN) and taking over their management. It also moved into power generation by winning the concession to build the Itapebí hydroelectric plant in the State of Bahia. In Chile, where it has mainly been interested in electricity generation, it has a stake in Electroandina and is involved in the construction of the Peuchén and Mampil hydroelectric facilities. In 1998, thanks to a strategic alliance with Electricidade de Portugal (EDP), it acquired the Empresa Eléctrica de Guatemala (EEGSA), which is expected to serve as a basis for future operations in Central America.

- In 1992, Iberdrola started to move into the gas distribution business by purchasing Litoral Gas in Argentina.<sup>a</sup> In 1997, together with Repsol and Gas Natural, it acquired 53.7% of Gas Natural de Bogotá, and a year later gained control of

Gasorient; it also created the Sociedad Transportadora de Gas (TRANSCOGAS S.A.) to operate the gas pipelines delivering natural gas to the Cundi-Boyacense area, with exclusive distribution rights. Also in 1997, but this time in Brazil, it formed part of the consortium that gained control of Companhia Estadual de Gas do Rio de Janeiro (CEG) and Riogas, natural gas distributors in Rio de Janeiro.

- In 1998, Iberdrola entered the water business in Chile with its successful bid in the privatization of Empresa de Servicios Sanitarios de Los Lagos (ESSAL), in Region X, which gave it a 51% interest in the ownership and management of the company.

The interesting thing about the strategy of this particular Spanish company is that, in its core activity, it has sought out market niches that have attracted relatively less interest (northern Brazil, Central America and Bolivia) for its expansion drive in Latin America. It has thus avoided depleting its reserves in a struggle over the most attractive assets with larger, more experienced and more powerful companies. In addition, in its regional diversification process it has sought alliances or agreements with other Spanish companies that are leaders in their respective businesses, such as Telefónica and Repsol. This has enabled it to gain access to new activities with minimal learning costs.

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

<sup>a</sup> Between the end of 1998 and the first few months of 1999, Iberdrola sold off most of the assets it had in Argentina (Gazeta Mercantil Latinoamericano, 2-8 August 1999). In the case of the Güemes thermal power plant, power generation prices fell sharply in the Argentine market and this investment therefore failed to live up to the Spanish company's expectations. Iberdrola also put its share in the gas distributor Litoral Gas up for sale, and this was bought by Tractebel of Belgium.

Despite the success of this expansion process, the new scenario is not problem-free. Upon taking control of Enersis, Endesa acquired a dominant position in the electric power industry in several countries (Argentina, Chile, and Peru), a situation which, although not prohibited by the regulations on competition in these markets, has given rise to a variety of interpretations and public controversy.<sup>64</sup> The most delicate situation of all arose in Chile, where —through Enersis— Endesa gained control of the country's leading generating company (Endesa-Chile).

Having gained control of Enersis and Endesa in Chile, Endesa-España intends to slow down its expansion in Latin America and embark upon an internal restructuring process —the "Genesis Project". As a result of Endesa's investments in Latin America, nearly 40% of the company's assets and earnings are generated in the region, but Rodolfo Martín Villa, president of the Spanish group, has explained that the company has had to rule out further large-scale investments in Latin America in the short and medium-term as a consequence of its acquisitions in Chile (*Expansión*, 13 May 1999). As part of its restructuring process, Endesa intends to concentrate all its regional assets in Enersis with a view to enhancing the competitiveness and synergies of its operations in Latin America<sup>65</sup> (*Expansión*, 23 July 1999). It also plans to stay on the course it has plotted out in its bid to become a global service provider and, as part of that plan, will try to achieve a greater balance between its involvement in the telecommunications industry and other energy sectors, particularly in Spain. This new strategy could lead the firm to shed some of its less important assets and to cut its payrolls in its Latin American subsidiaries.

The transfer of the electric power business to the private sector has not been free of difficulties. The local regulatory systems that have entered into operation following privatization have been unable to prevent a number of undesirable effects, including the

concentration of the market in the hands of just a few agents, the failure of services to live up to initial expectations, insufficient investment to renew and modernize infrastructure, and job losses in the privatized firms. Nonetheless, it is also true that some of the companies transferred to international operators have made substantial improvements, especially in terms of coverage and productive efficiency, and particularly in relation to energy losses (see table III.7).

### (c) Oil and natural gas: a source and supplement of electric power

The Spanish power companies have not stood on the sidelines of the ongoing convergence process among the various energy subsectors within the international economy. In the next few years, apart from establishing important alliances and agreements to further their internationalization programmes, these firms are likely to promote the expansion and intensification of their links with these subsectors (see figure III.3). Within this context, the rapid headway made by Repsol in Latin America is another factor to be considered when assessing the extensive network of power generation, transmission, distribution and marketing facilities established in the region by Endesa, Iberdrola, Unión Eléctrica Fenosa and Gas Natural.<sup>66</sup>

The Latin American acquisitions strategy of the Spanish oil company, Repsol, is aimed at turning the firm into a global enterprise. So far Repsol has invested around US\$ 19 billion in the region, mainly in the exploration, extraction and transport of hydrocarbons in Argentina, which is seen as a possible port of access to Brazil. It has also begun to diversify into the electric power business, with all its moves in this direction being made with a view to attaining a significant presence in Mercosur. Repsol also has considerable interests in Peru, Venezuela, Colombia, Bolivia, Mexico and Ecuador (see table III.8).

64 In general, as part of the privatization process the large vertically-integrated State firms have been broken up into subsidiaries before being sold separately to different operators. In Argentina it was argued that Endesa should choose between Edenor and Edesur (controlled by Enersis). In Peru, where the regulations prohibit the same firm from engaging in generation and distribution, it was suggested in some quarters that the Spanish firm should either opt for generation, taking advantage of its Etevensa and Piura facilities, or else concentrate on distribution through its subsidiary Edelnor.

65 The main goal of the Genesis Project in relation to the company's Latin American subsidiaries is to reduce costs by US\$ 500 million per year as from 2003 and thus match the efficiency levels achieved in Spain.

66 In August 1999, Unión Eléctrica Fenosa gained control of the electric power distribution and marketing operations serving two thirds of the Dominican Republic. The Spanish firm will invest about US\$200 million to capitalize Corporación Dominicana de Electricidad (CDE) (*Wall Street Journal*, 16 August 1999).

Table III.7  
**ENDESA-ESPAÑA: PERFORMANCE OF MAIN SUBSIDIARIES  
 IN LATIN AMERICA**

	Chilectra (Chile)	EDENOR (Argentina)	EDELNOR (Peru)	CODENSA (Colombia)	CERJ (Brazil)
Energy sales (GWh)					
- Year of Endesa's entry <sup>a</sup>	7 256	...	2 650	7 929	5 733
- 1998	8 175	12 301	3 389	8 217	7 208
Energy losses (%)					
- Year of Endesa's entry <sup>a</sup>	8.6	...	18.8	23.8	29.3
- 1998	6.0	...	9.7	19.5	19.1
Customers (thousands)					
- Year of Endesa's entry <sup>a</sup>	1 133	...	580	1 536	1 217
- 1998	1 212	2 219	816	1 628	1 452
Employees					
- Year of Endesa's entry <sup>a</sup>	1 643	...	866	2 067	4 376
- 1998	1 674	2 938	765	1 904	1 897

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of figures from Endesa, Enersis and Edenor.

<sup>a</sup> Figures correspond to results for the first year of Endesa's ownership of an interest in the company concerned: Chilectra (1997), Edenor (1997), Edelnor (1994), Codensa (1997) and Cerj (1996).

By late 1998, Repsol had gained control of Astra and Pluspetrol Energy, which gave it access to large natural gas fields and made it Argentina's fourth-largest oil company. On 20 January 1999, it significantly increased its presence by acquiring 14.99% of Yacimientos Petrolíferos Fiscales (YPF) for US\$ 2.01 billion, an operation that made it the largest single shareholder in Argentina's biggest company. Then, on 29 April 1999, Repsol made a US\$ 13.439 billion cash bid for the remaining 85.01% to ensure its control of YPF and its full integration into Repsol's operations.<sup>67</sup> This successful bid made Repsol one of the largest private oil companies in Latin America (see table I.14). At the same time, as part of its strategy of diversification and expansion towards the Brazilian market, it has sought an association with Iberdrola, its partner in two electric power generating facilities in Argentina and in its initial steps to move into the gas

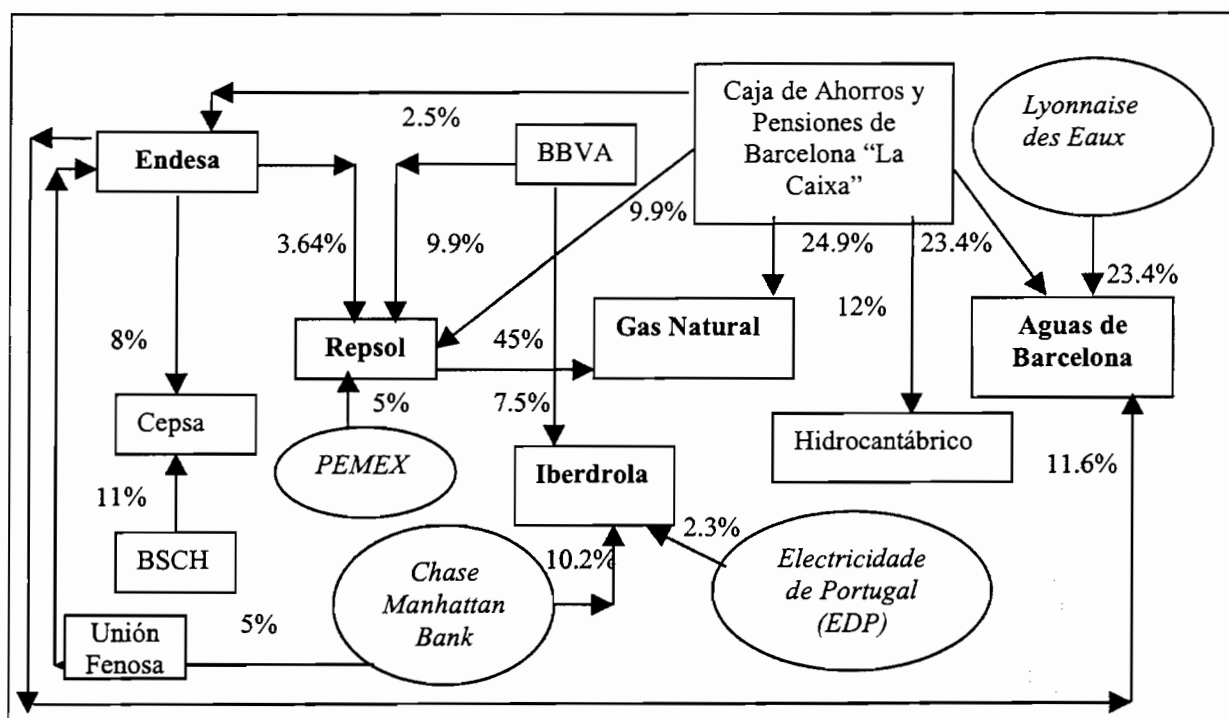
distribution business in Brazil (see box III.4 and table III.8). In early November 1999, there were rumours of a possible merger between Repsol and Iberdrola (*The Wall Street Journal Americas*, 12 November 1999).

Repsol's expansion strategy has not ended with its successful acquisition of YPF. As explained by Alfonso Cortina when he addressed the Repsol shareholders' meeting held on 5 July 1999 (*Gazeta Mercantil Latino-Americana*, 2-8 August 1999), the Spanish company intends to use its strong position in Argentina as a platform for the expansion of its operations into Brazil, Chile and Mexico. He also announced that Repsol would invest some US\$ 7 billion in Latin America before the year 2002 (*Gazeta Mercantil Latino-Americana*, 2-8 August 1999, *América Economía*, 26 August 1999) and that one of its first objectives would be to conclude a cooperation agreement or alliance with the Chilean fuel distributor

67 This operation was the only way Repsol could gain control of YPF, as according to the statutes of the Argentine oil company, any attempt to buy more than 15% of the shares had to be accompanied by an offer for 100% of the shares of the remaining stakeholders. Repsol offered to pay a premium of 25% over the market price of the shares, provided it would obtain ownership of more than 50% of the firm.



Figure III.3  
MAIN RELATIONSHIPS AMONG SPANISH ENERGY COMPANIES



Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of data from the Comisión Nacional de Mercado de Valores [<http://www.cmnv.es>], the Madrid Stock Exchange and *Cinco Días*, 21 October 1999.

Compañía de Petróleos de Chile (Copec). Repsol is keen to enter the Chilean market, where it has a modest 4% share, and the possibility of its making a hostile takeover bid for Copec can therefore not be ruled out. The company has also initiated talks with the Empresa Nacional del Petróleo (ENAP) with a view to exporting oil and fuels to Chile.

Another aim of this increased investment in Latin America is to achieve rapid entry into the Brazilian market. This goal may soon be achieved, thanks to a

series of anti-trust measures introduced by the Government of Argentina,<sup>68</sup> under which Repsol-YPF will have to divest itself of some of the service stations it owns in Argentina. Repsol plans to swap these stations for a share in one of the refineries belonging to Petrobras. The company will likely turn its attention to the Mexican market as soon as the sector (currently dominated by Pemex) is liberalized.

This new scenario, in which the two Spanish giants control the bulk of the energy industry in Latin

68 Apart from this, Repsol will have to reduce YPF's share of the natural gas segment from 60.7% to 43.6% and cut its refining capacity to 4% of total installed capacity in Argentina by 31 December 1999.

America, could lead to the formation of a new alliance. In fact, there has already been discussion of the possibility of a joint venture that would take advantage of Endesa's presence in the electricity sector and Repsol's in oil and natural gas. The first

step in this direction was taken when the companies participated in the bidding for 52% of Comgas, the gas distributor for the city of São Paulo (the bidding was ultimately won by a consortium led by British Gas and Shell).

Table III.8  
**REPSOL: PRESENCE AND EXPANSION IN LATIN AMERICA**

	Company	Stake (%)	Main partners	Activity	Year of entry
Argentina	Yacimientos Petrolíferos Fiscales (YPF) <sup>a</sup>	98.0	-	Oil, fuel distribution and petrochemicals	1999
	Astra	67.9	-	Oil, natural gas and electric power	1996
	Refinería San Lorenzo	28.8	-	Refining	1996
	Refinería del Norte (Refinor)	14.3	-	Refining	1996
	EG3 (800 estaciones)	100.0	-	Fuel distribution	1996
	Metrogas	31.7	British Gas	Natural gas distribution	1992
	Gas Natural Buenos Aires Norte (BAN)	31.5	Gas Natural	Natural gas distribution	1992
Bolivia	Drilling concessions	...	-	Oil	
Brazil	Cfa. Estadual de Gás do Rio de Janeiro (CEG)	4.0	Enron Iberdrola	Natural gas distribution	1997
	Riogás S.A.	...	Enron Iberdrola	Natural gas distribution	1997
Colombia	Gas Natural Bogotá	25.0	Iberdrola	Natural gas distribution	1997
	Sociedad Transportadora de Gas (TRANSCOGAS S.A.)	...	Iberdrola	Natural gas distribution	1998
Ecuador	Estaciones de Servicio Repsol (86 estaciones)	100	-	Fuel distribution	...
	Duragas	...	-	Liquid petroleum gas Distribution	...
Mexico	Distribuidora de Gas Natural Nuevo Laredo, Saltillo, Toluca y Monterrey	...	-	Natural gas distribution	1998
Peru	Refinería La Pampilla	100	-	Refining	1996
	Drilling concessions	...	-	Oil	1996
	Repsol Perú	91	-	Fuel distribution	
	Solgas	...	-	Natural gas distribution	1992
Trinidad and Tabago	Planta GNL	20	Iberdrola	Natural gas distribution	...
	Drilling concessions	...	Amoco	Oil	...
Venezuela	Crude oil reserves and production in Mene Grande, Quimare and Guarica	...	-	Oil	1997

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of figures provided by Repsol.

<sup>a</sup> Repsol-YPF controls about 50% of the Argentine energy market. YPF has 44% of the fuel distribution market, with a network of 2,350 service stations.

## Box III.5

**SOCIEDAD GENERAL DE AGUAS DE BARCELONA:  
A NEW REGIONAL PLAYER?**

The core activities of this Catalan firm include drinking water and sanitation, commercial water service, engineering and construction, solid waste and technical motor vehicle inspections. In 1993, Aguas de Barcelona (Agbar) started up operations in Latin America, chiefly in the water distribution and technical inspection areas. By late 1998 it had operations in seven countries (Argentina, Brazil, Chile, Columbia, Cuba, Mexico and Uruguay) and had invested over US\$ 900 million in the region (Durán, 1999). Up to late 1988, 18% of Agbar's activities in South America were concentrated in Argentina, where

it has stakes in Aguas Argentinas (25%), Aguas Cordobesas (15.4%) and Aguas Provinciales de Santa Fé (19%). Nevertheless, this Spanish group's largest business concern in the region, whereby it has more than doubled its past volume of operations, was launched in Chile on 11 June 1999. In conjunction with Suez Lyonnaise des Eaux, of France (owner of 23.4% of Agbar (see figure III.3)), it acquired 41.8% of the country's largest sanitation company, Empresa Metropolitana de Obras Sanitarias (EMOS), with a winning bid of US\$ 964 million. Like other Spanish companies in the region, Agbar

bid aggressively to enter the Chilean market, surpassing the second-highest bid by over US\$ 100 million and more than doubling the reference price of US\$ 420 million set by the Chilean authorities. EMOS distributes drinking water to nearly 1.15 million customers (5.3 million people) in the city of Santiago; in 1998, it reported US\$ 53 million in profits on sales of US\$ 159 million. The company's development plan envisages investments of some US\$ 1.68 billion over the next 20 years, and, as a first step, it will inject US\$ 448 million in capital—from privatization proceeds—to carry out the most urgent investments.

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

### **3. The financial sector: from mature markets in Europe and Spain to expansion in Latin America**

#### **(a) The Spanish banking system: from liberalization to internationalization**

The Spanish authorities began to liberalize and deregulate financial activity in the mid-1970s. Then, from 1985 on, the banking system started to undergo even more thorough-going changes as a result of the introduction of new technologies and products, changing consumer habits, increased disintermediation and Spain's admission into the European Union. Later still, more radical shifts began to be seen in the structure

and strategies of financial institutions with the advent of the single European market and of Economic and Monetary Union (EMU) in preparation for the introduction of the euro as the single currency for the European Union.

With the creation of the single market, barriers to the free movement of capital between EU member countries were removed and restrictions on the establishment and provision of banking services were lifted. As a result, the financial sector in Spain and the European Union as a whole<sup>69</sup> began to implement new

69 As from 1 January 1993, with the formation of the single European market and the implementation of a set of directives issued by the European Council relating to the free circulation of capital and the unrestricted establishment of EU financial institutions based on a single, comprehensive banking licence, EU regulations were formally introduced regarding the market for credit institutions. Subsequently, on 14 July 1995, a royal decree issued by the Government of Spain incorporated these EU provisions into the country's financial regulations.

growth and concentration strategies in order to adapt to this new competitive environment, and the market for banking services began to shift from an environment of competition based on geographic proximity and the provision of user-free services to a more homogenous one characterized by aggressive pricing policies and competition in the supply of products and services (Casilda, 1997). In this single-currency environment, banks either have to achieve the necessary economies of scale (size) or have to offer a competitive advantage to a specific market segment (specialization).

Since the end of the 1980s, the large banks have pursued growth strategies based on mergers and acquisitions; these are dual-purpose strategies aimed both at strengthening these institutions' market presence (nationally and, in some cases, internationally) and at increasing their competitiveness. In 1988, the Bilbao and Vizcaya banks merged to form Banco Bilbao Vizcaya (BBV); then, in 1991, Banco Central and Banco Hispano merged to form Banco Central Hispano (BCH) and the Corporación Bancaria de España (Argentaria) was created. In 1994, Banco Santander took over Banco Español de Crédito (Banesto) and, in 1998, Banco Exterior de España (BEX), Caja Postal and Banco Hipotecario all merged with Argentaria. In early 1999 Banco Santander and BCH merged to form Banco Santander Central Hispano (BSCH), one of Europe's largest banks, and in October of that year BBV and Argentaria merged to form Spain's second-largest bank, under the name of Banco Bilbao Vizcaya Argentaria (BBVA).

As a result of this process, Spain's banking sector has become one of the most highly concentrated banking markets in Europe. The market share held by the five largest players grew from 33% in 1987 to 50% by 1996, whereas in this latter year the corresponding figures elsewhere in Europe were 41% for France, 35% for Italy, 28% for the United Kingdom and 25% for Germany (Casilda, Lamothe and Monjas, 1997). In 1988, there were some 100 participating institutions in the Spanish banking system, with the three largest

accounting for 45% of total assets and the six largest for 67% (Calderón and Casilda, 1999a). As was to be expected, both efficiency and competition increased—basically as a result of a steady narrowing of intermediation spreads—and this contributed to modernization, innovation and other improvements in customer service. Within this new environment, the leading Spanish banks carved out solid positions for themselves in an increasingly competitive local market.

These mergers and acquisitions have also enabled the large banks to attain the size necessary in order for an internationalization strategy to work. In the case of Spain, this process has focused on Portugal, France, Morocco and especially Latin America. At the same time, they have also been signing cooperation agreements with many more banks in other EU countries as a means of defending themselves against competition from the major banks that are already consolidating their positions as genuinely trans-European institutions. Some of the larger Spanish banks have also sought to expand into other markets by forming alliances and by acquiring minority stakes in other EU financial institutions.<sup>70</sup>

In the increasingly competitive environment generated by widespread economic and financial globalization and the unification of the European market and its currency, pressures on the Spanish banking system are likely to intensify. Foreign investors' interests in the main Spanish banks has been increasing and, given these conditions, foreign banks may start to acquire increasingly large stakes in local banks and eventually may even merge with some of these institutions or acquire them outright.

Many analysts see this activity as leading to the emergence of large European banks with a wide-ranging presence in the main EU markets, although the process has not yet been as intensive as had been expected. Perhaps the only bank that has actually managed to establish a truly broad-based European presence is Deutsche Bank of Germany. In Spain, even though they do not face any major

70 BBV acquired 10% of Banca Nazionale del Lavoro (BNL), 3.8% of the French bank Credit Lyonnais, and a brokerage company in Portugal (Midas); the Banco Santander owns nearly 5% of the Italian bank San Paolo-IMI and 10% of the Royal Bank of Scotland; BCH has a small interest in Commerzbank (3%) and Société Générale (1.2%), and until its merger with Banco Santander, a strategic alliance with the Banco Comercial Português. Argentaria has a strategic alliance with the Belgian-French group Dexia. In addition, in mid-1999 BSCH and the Portuguese group Champalimaud began to negotiate a strategic alliance, and the new Spanish firm increased its share in Société Générale to 3.3% and in San Paolo-IMI to 6.9% (Calderón and Casilda, 1999a). In late 1999, there was some speculation about a strategic alliance between BBVA and Italy's third largest financial institution, Unicredito Italiano. This operation (an equity swap) could be concluded as early as January 2000 and thus become the first major European transborder alliance (*The Economist*, 27 November-2 December 1999).

restrictions, foreign banks have not managed to wrest market leadership away from local institutions. Spanish banks' extensive networks of branch offices constitute a formidable barrier for new entrants to overcome, since they have to make large-scale investments in order to reach potential clients. In fact, foreign banks have not won significant market shares in any EU country; nor does any EU bank have a leading position in any country other than its own. It therefore appears that, for the Spanish banking system<sup>71</sup> and, for that matter, most European banks in their home markets, physical proximity to customers continues to be a definite competitive advantage. Yet it is precisely this characteristic that raises concerns about a possible hostile bid for Spanish banks by European competitors, since such a strategy would give foreign competitors rapid access to a leadership position in Spain's banking sector.

The launching of the euro on 1 January 1999 has stepped up the pace of change and has shortened timetables, and the main European banks have adjusted their expansion strategies accordingly. As a first effect, mergers over the next five years are mostly likely to be between banks of the same nationality, since transboundary mergers tend to be more complicated owing to differences in language and culture and in the regulatory and tax systems involved. The leading European banks can therefore be expected to focus on strengthening their positions in their local markets—by striving to attain a size that constitutes a minimum critical mass—before taking up the continental challenge. In the early months of 1999 following the official inauguration of the single currency, five large-scale mergers and acquisitions were announced in three EU countries (Spain, France and Italy) for a total value of over US\$ 100 billion.<sup>72</sup> If these operations are successful, they will give rise to large-scale national banks that would be well placed to compete for leadership in Europe.

### **(b) Internationalization of Spanish banking: the Latin American option**

To maintain and reinforce their competitive position and to defend themselves from the threat of hostile bids by either local or foreign competitors, the large Spanish banks have had to look beyond their national borders in search of continental and global markets. An initial stage of this process saw a proliferation of alliances and cooperation agreements with other institutions, chiefly within the European Union, while the second phase has involved a fast-paced, aggressive expansion strategy aimed at the main Latin American markets. For the large Spanish banks, Latin America has offered a means of consolidating their active internationalization drive based on four main vectors:

- The pursuit of size and competitiveness;
- Entry into expanding markets and a shift away from mature ones (a stage that the Spanish market is starting to reach);
- The global utilization of resources and of organizational and technological capacities; and
- Appropriate risk diversification based on the corresponding rate of return.

Latin America has thus provided a unique opportunity, since less distant options—such as the markets of other European countries—are already mature and the potential acquisitions in those markets are few in number and high in price. What is more, the major Latin American financial systems are quite open and have been deregulated. Accordingly, the regional banking market's relative lack of depth, wide intermediation spreads, high potential rates of return and improved supervisory and regulatory systems have opened up promising new business opportunities. At the same time, the market has suffered from shortages of capital and of new products to meet the growing demand for financial services. In addition, the situation in the region has been all the

71 In 1998, Spanish banks had 17,569 branches throughout the country (Banco de España, 1999), with over 10,000 of these offices being located in the six largest cities. By the mid-1990s, banks and thrift institutions had 910 offices for every million inhabitants, or almost double the European Union figure (505) and three times as many as in the United States (nearly 300) (Casilda, 1997). This situation is basically attributable to the fact that the freedom to expand the number of branches predated the free determination of the price of money (initiated in the late 1970s). Thus, the best way to expand a business operation and increase its profitability was to open up new branches. In the 1990s, this trend lost momentum and there was actually a reduction in the number of branches as part of the cost-cutting programmes implemented by the Spanish banking system.

72 In Spain, Banco Santander merged with BCH and BBV merged with Argentaria; in France, the formation of a new entity was proposed by Banque Nationale de Paris (BNP) in conjunction with Société Générale and Paribas; and in Italy unsuccessful bids were made by UniCredito Italiano SpA for Banca Commerciale Italiana and by San Paolo-IMI for Banca di Roma SpA. In Germany, there are increasing rumours about a possible merger between Dresdner Bank AG and Bayerische Hypotheken und Vereinsbank AG.



## Box III.6

**BANCO BILBAO VIZCAYA: EXPANSION BASED ON A PHILOSOPHY OF LEADERSHIP**

In early 1995, BBV decided to overhaul its corporate strategy in order to give a decisive boost to its overseas expansion drive. Although 52% of its business activities are in Spain, the BBV group currently has operations in 35 countries, particularly in Latin America. The group's international expansion has been accomplished quite rapidly and it has taken on an increasingly important position in the region. In 1998 Latin America accounted for 25% of its total assets, 40% of its branch offices and 63% of the jobs created by the group, whereas just four years earlier its activities in the region had been negligible.

The BBV strategy has been to gain a progressively greater degree of management control over the companies in the group, without insisting on a majority shareholding. It has also tended to favour consensus and shared management with local partners. A key goal of its strategy has been to take over the lead position in each of the markets, segments and businesses in which it competes. This has involved action on two fronts: on the one hand, holistic growth and development of existing businesses; and, on the other hand, an acquisitions policy that has enabled it to speed up its growth in those markets where BBV has seen a need to mount a major effort.

Over the last four years, BBV has expanded rapidly in Latin America, moving into new markets by purchasing holdings in local banks, strengthening its position in markets where it was already present, and reinforcing its controlling interests in a number of local banks. It took over the management of banks in Mexico and Peru in 1995, in Colombia and Argentina a year later, next in Venezuela, and

then, in 1998, in Brazil and Chile (see table III.9). In managing its various enterprises, BBV has developed a unified model which it adapts to the particular features of each country and financial system.

During 1998, BBV virtually completed its positioning phase in Latin America, having achieved a significant and solid presence in the main regional markets. For the most part, BBV has invested in financially solid, leading banks that ensure it rates of return above 20% and have market shares of over 6% in their respective countries.

One of the most important objectives of the BBV strategy has been to increase its market capitalization and, despite difficult international conditions, the performance of BBV shares has been above average when measured against its main national and European competitors. In Latin America, despite deteriorating macroeconomic conditions, so far profits have not suffered. This is basically attributable to the fact that the institution has halted the growth of its loan portfolio and has geared its deposit-taking mechanisms to low-cost clients. As a result of these moves, by which the institution has adopted a more cautious approach in terms of credit risk and hedging, the BBV deposit structure in Latin America has changed markedly. The company has continued to expand rapidly into pension funds, as well.

In fact, BBV is a market leader in pension fund management in Spain, and it saw an attractive avenue for diversification and expansion in this area in Latin America, given the high growth potential of pension fund management in the different markets of the region. By late 1998, BBV had become the

second-largest pension fund manager in Latin America, with a weighted market share of 25% in the countries where it operates, and leading positions in Argentina, Bolivia, Colombia, Mexico, Peru and El Salvador. In these operations BBV manages about US\$ 4.57 billion through six pension fund management companies serving a total of 4.6 million members. On 13 May 1999, BBV strengthened and consolidated its dominant position in Latin America via the indirect purchase of 40.74% of AFP Provida, the largest pension fund manager in Chile. This enabled BBV to start up operations in this country and in Ecuador and to strengthen its positions in Mexico, Colombia, Peru, and El Salvador. Upon the completion of this operation, BBV trebled the amount of assets under its management in Latin America to over US\$ 14 billion, with a client base of more than seven million people. This acquisition made BBV the largest pension fund manager in the region, with a weighted market share of 26% in terms of assets under its management. In October 1999, the firm increased its share to 31% through its merger with Argentaria. According to its own estimates, the company has spent about US \$875 million to gain the number one position in the pension fund management business.

As in its home market, BBV has also looked for opportunities to invest in non-financial companies (in such cases it does not play a management role). It is believed that in the next few years it may invest around US\$ 3.5 billion in the region in emerging sectors such as telecommunications, energy and other services. Thus far it has acquired stakes in conjunction with firms in which it already has an interest, such as Iberdrola, Telefónica and Repsol (see table III.4).

## Box III-6 (concluded)

To summarize, in a very short span of time BBV has managed to consolidate itself in a strong leadership position in some of the main areas of the Latin American financial sector (commercial banking and pension fund management). Thus, whereas before BBV had virtually no business interests in Latin America, the region has now become a natural extension of this financial group's core activities, one in which it replicates not only its corporate strategy but also its rivalry with its

main competitor in the Spanish market, Banco Santander. According to some analysts, now that it has consolidated its position in Latin America, the firm may start to reorient its strategy with a view to strengthening its position in Europe. In late 1998, BBV gained control of Italy's fifth-largest banking group, Banca Nazionale del Lavoro (BNL) for US\$ 500 million, and in May 1999 it obtained 3.75% of the shares of Crédit Lyonnais when the French authorities chose it to be one of the core participants in the

privatization of this bank. It also appears to be negotiating an alliance with another of the largest Italian banks, Unicredito Italiano. This operation would involve the purchase of 10% of the Italian firm, with Unicredito taking a 5% stake in BBV and 10% of BNL (now owned by BBV). Thus, far from slowing the firm's expansion in southern Europe, the merger between BBV and Argentaria may even strengthen its growth in these countries.

Source: Alvaro Calderón and Ramón Casilda, "Grupos financieros españoles en América Latina: una estrategia audaz en un difícil y cambiante entorno europeo", ECLAC Desarrollo productivo series, No. 59 (LC/L.1244-P), Santiago, Chile, September 1999.

more appealing since both the banks and the economic authorities in Latin America have generally welcomed the arrival of foreign partners because they see them as providing a way of overcoming financing constraints and of modernizing their local financial systems.

Under these circumstances, Spanish banks have quickly built up an extensive presence in the region's major economies and have spearheaded foreign banks' increasing penetration into Latin America's financial systems. Between 1996 and 1998, foreign banks' share of total deposits jumped from 16% to 30% (Salomon Smith Barney, 1998b). Currently, nearly 60% of the loans and 50% of the equity in the banking systems of the region's seven largest economies are controlled by foreign firms (Salomon Smith Barney, 1999), although only three (BBV, Banco Santander and Citicorp) are operating in all seven of these countries (Durán, 1999). In recent months, despite the impact of the international financial crisis on Brazil and on other Latin American economies, foreign financial institutions have continued to channel funds into the region (Calderón and Casilda, 1999a), with the leading Spanish banks

(BBV, Santander and BCH) investing about US\$ 10 billion. In doing so, each bank has pursued its own strategy:

- *Banco Bilbao Vizcaya (BBV)*: The strategy of BBV has focused on the purchase of a majority equity package in leading banks and the conclusion of agreements with local partners. Although this approach has not always ensured ownership, management responsibility has invariably been assumed by BBV (see box III.6 and table III.9).
- *Banco Santander*: This bank's strategy has been based on the acquisition of majority equity holdings in local banks that guarantee it both ownership and management control. Santander has not chosen to enter into agreements with local partners (see box III.7).
- *Banco Central Hispano*: The strategy used by BCH has entailed the acquisition of majority stakes in association with a strategic partner. In most cases, BCH has left the management of these acquisitions in the hands of its local partner and has supervised operations from a distance.<sup>73</sup>

73 BCH and the Chilean Luksic group set up a holding company that controlled banking assets in four Latin American countries: Argentina, Chile, Paraguay and Peru. In early 1999, as a result of the merger between Banco Santander and BCH, this partnership was dissolved.



Table III.9  
**SPANISH BANKS: PRESENCE AND EXPANSION IN LATIN AMERICA, 1995-1999**  
*(Local bank, stake owned by Spanish banks, position in local banking system and year of entry)*

	Banco Santander Central Hispano (BSCH)		Banco Bilbao Vizcaya Argentaria (BBVA)
	Banco Santander	Banco Central Hispano	
Argentina	Banco Río de la Plata (51%, 2, 1997)	Banco Tornquist (100%, 16, 1996) Banco de Galicia y Buenos Aires (10%, 1, 1998)	BBV Banco Francés (60%, 3, 1996) Corp Banca Argentina (100% 20, 1999)
Bolivia		Banco Santa Cruz (90%, 1, 1998)	
Brazil	Banco Santander Brasil, formerly Banco Geral do Comercio (100%, 11, 1997) Banco Noroeste (76%, 9, 1998)		BBV Brasil, formerly Banco Excel-Económico (100%, 14, 1998)
Chile	Banco Santander Chile (86%, 2, 1960)	Banco Santiago (44%, 1, 1991) <sup>a</sup>	BBV Banco BHIF, formerly Banco Hipotecario de Fomento (55%, 6, 1998)
Colombia	Banco Santander Colombia (60%, 6, 1997)		Banco Ganadero (63%, 2, 1996)
Mexico	Banco Santander Mexicano (71%, 5, 1996)	Grupo Financiero Bital (8%, 4, 1996)	BBV México, formerly Probusa (67%, 6, 1995)
Paraguay		Banco de Asunción (85%, 5, 1996)	
Peru	Banco Santander Perú (100%, 6, 1995)	Banco del Sur (90%, 5, 1996)	Banco Continental (39%, 3, 1995)
Uruguay	Banco Santander Uruguay (100%, 3, 1990)		Banco Francés (58%, ..., 1995)
Venezuela	Banco de Venezuela (98%, 3, 1997)		Banco Provincial (51%, 1, 1997)
<b>Total investment</b>	<b>4 000</b>	<b>1 360</b>	<b>4 500</b>
<b>Total asset <sup>b</sup></b>	<b>50 302</b>	<b>38 942</b>	<b>39 551</b>

Source: Álvaro Calderón and Ramón Casilda, "Grupos financieros españoles en América Latina: una estrategia audaz en un difícil y cambiante entorno europeo", ECLAC, Desarrollo productivo series, No. 59 (LC/L.1244-P), Santiago, Chile, September 1999.

<sup>a</sup> In mid-May 1999, the Central Bank of Chile reached an agreement with BSCH, transferring to the latter its 35.4% stake in Banco Santiago. BSCH has a purchase option, to be exercised between 15 May 2000 and 15 May 2002, at a minimum price of 11 Chilean pesos per share, or a total payment of about US\$ 800 million.

<sup>b</sup> Total assets of the banks acquired by Spanish institutions.

## Box III.7

**BANCO SANTANDER: THE LONE RANGER OF SPANISH BANKING?**

The Santander group has a wide-ranging international presence, with close to 5,800 branch offices in 32 countries and about 17 million customers.

Banco Santander has shown the longest-term commitment to a strategy of international expansion of any major Spanish bank, while demonstrating a great capacity for innovation and flexibility and great skill in supervising its foreign operations. Given the vast international experience and strong leadership of the bank's President, Emilio Botín, Santander has for the most part chosen to act on its own—without local partners—in its Latin American operations.

The group's presence in Latin America dates back to the early 1950s; during this period its operation's growth was fairly modest and was concentrated in the Southern Cone, particularly in Chile. Then, in 1996, it launched an active expansion strategy, acquiring a number of different banking institutions throughout the region. Between early 1996 and the end of 1998, the contribution of the Santander group's Latin American operations to its overall profits soared from 8% to over 40%. In 1998, Latin America accounted for 27% of the group's assets, 30% of its branches and 53% of its employees.

Events in 1997 played a particularly significant role in the Santander group's strategy in the region, as banking institutions in Argentina, Brazil, Colombia, Mexico and Venezuela were added to its Latin American operations (see table III.9). In this first phase of its expansion drive, the group acquired half a dozen banks in five countries within the space of just over a year for a

total of more than US\$ 3.5 billion. Some experts believe that this aggressive acquisitions plan was to some extent a reaction to the rapid growth of BBV in Latin America. According to this line of thinking, the Santander group was concerned that the most attractive assets might be snapped up by its competitors (especially BBV), which would have limited its opportunities and pushed up prices, and it therefore decided to accelerate its acquisitions plan.

Two events in 1998 marked the culmination of the first phase in the group's expansion strategy in Latin America: the sale of its 8.8% stake in the United States Institution First Union Corp., and the purchase of the Banco do Noroeste in Brazil. The Spanish group used US\$ 1.5 billion of the proceeds from the first of these two transactions, plus US\$ 300 of its 1997 earnings, to amortize its investments in Latin America.

With these acquisitions, the Santander group is now involved in banking activities in nine of the region's economies: Argentina, Brazil, Colombia, Chile, Mexico, Peru, Puerto Rico, Uruguay and Venezuela (see table III.9).

According to its executives, the group's programme of acquisitions in Latin America is now practically complete, with no further large-scale purchases being planned for the near future. However, the company has not ruled out minor acquisitions in the financial services sector to increase the group's presence in the insurance and pension funds sector; or the addition of extra branches of existing institutions. The Santander group's strategy has also received some criticism. The jump in the number of subsidiaries in Latin America

from three to nine in just over a year has worried shareholders, since this not only increased Santander's exposure in a high-risk area but also increased the complexity of the task of managing the group. However, the bank's top executives have strongly defended its strategy in the region and have justified its acquisitions policy on the grounds that a large number of institutions in Latin America were analysed before the bank proceeded to purchase the very best of them.

Taking advantage of its experience in the Spanish market, Banco Santander has carried out a vigorous campaign to publicize its corporate image and increase its market share in the region. Indeed, the bank has received marketing awards for its "Super Depósito" product in Colombia and for the advertising of its pension fund company in Mexico. Like other banks which have expanded into Latin America (BBV and HSBC), the Santander group's high-profile promotional activities have forced other actors—both local and foreign—to redefine their strategies and commitments, and have raised the level of competitiveness in a sector of vital importance for the region's economic health and stability. Like BBV, Banco Santander has not concentrated solely on banking but has diversified into other financial activities such as investment banking and pension fund management. It has a leading position in Spain in the pension fund sector, with 15.6% of the market, and in Latin America it manages about US\$ 6 billion in pension funds in Argentina, Chile, Mexico, Peru and Uruguay, with a client base of more than 4.3 million people.

## Box III.7 (concluded)

In the mid-1990s, the Santander group opened an office in New York in a bid to become one of the three largest investment banks capable of attracting business relating to Latin America, which would complement the local banking network that it was establishing in the region. It rapidly earned the confidence of Latin American firms and Governments that were seeking to gain access to international capital markets. By June 1998, the Santander Investment research team for the region had already risen to fourth place (Moore, 1999). However, the Santander group was unable to take advantage of its strong position in Latin American markets to generate lucrative business in New York. It performed well in brokering securities on secondary markets, despite low profit margins, but achieved meagre results in more profitable operations such as bond issues, stock issues, or

mergers and acquisitions. Concluding that it had built up an overcapacity in Latin American investment banking, the Santander group decided to downsize its operations in New York and concentrate on local markets.

In addition to its failure to achieve its goals, the group's investment banking activities suffered the consequences of what proved to be a difficult period for Santander. Firstly, competitive pressure generated by the launching of the single European currency obliged it to reduce its exposure in emerging markets. Secondly, it had to deal with the worldwide financial crisis and its repercussions in the region, particularly in Brazil. These problems were compounded by the tension caused by the merger between Santander and BCH, since the latter insisted on restraining the high propensity to assume risk exhibited by Santander before the merger.

Lastly, like BBVA, the firm created by the merger of Santander and BCH —BSCH— has begun to step up its efforts to expand in Europe. Late in 1999 it was supporting a US\$ 40.689 billion by bid Royal Bank of Scotland (in which it has a 10% stake) for National Westminster Bank. If this operation succeeds, BSCH will own 6.5% of the newly merged company and thus improve its position in the United Kingdom's financial market. To finance this operation, BSCH plans to carry out a capital increase of 4.5% by selling these equities to some of its main shareholders, such as Société Générale, Commerzbank and Sao Paulo-IMI. This would allow it to establish closer ties with Société Générale, which would take up most of the new shares and gain a place on the BSCH board (*Expansión*, 30 November 1999).

Source: Alvaro Calderón and Ramón Casilda, "Grupos financieros españoles en América Latina: una estrategia audaz en un difícil y cambiante entorno europeo", ECLAC, Desarrollo productivo series No. 59 (LC/L.1244-P), Santiago, Chile, September 1999.

Rather than playing the traditional role of working alongside non-financial firms as they further their internationalization process (providing financing and financial services to such firms), in Latin America Spanish banks have aggressively expanded their core activity —commercial banking— with a view to building a presence in as many markets as possible (see table III.9). At the same time, major Spanish banks have actively pursued a plan to diversify and seek out new businesses in the region, including investment banking, insurance and especially pension fund management. BSCH and

BBVA (the result of the merger between BBV and Argentaria) between them control 45% of the private pension fund market in Latin America, with 16.1 million clients and US\$ 28.4 billion in assets. BBVA has the largest market share (31%), with BSCH (12%) coming in third place after Citibank, which has 14% (*Latin American Report*, 21 September 1999, p. 435; *Expansión*, 20 October 1999). As they have also done in Spain, they have acquired minority stakes in some non-financial firms, primarily in sectors where other Spanish investors are also very active (telecommunications and energy).

**(c) Heavy concentration in a key economic sector in Spain and Latin America**

The business environment for Spain's banking sector in 1998 was influenced by two different sets of circumstances. On the one hand, the domestic economy was performing well, with 4% growth and the lowest interest rates in decades. On the other hand, the international crisis triggered by economic problems in the Russian Federation and Asia was growing worse, and Latin American markets were hit hard. This situation lowered the stock market value of the major Spanish banks (BBV, Banco Santander and BCH), and this hurt their business in the region to some extent. However, despite these adverse conditions, the banks closed out the financial year with a positive balance sheet, although this was chiefly the result of a strong performance earlier in the year. As of early December 1998 the two major Spanish banks, BBV and Santander, had recovered and reported that their profits were up by 80% and 71%, respectively (Durán, 1999). Indeed, the highly profitable nature of these banks' operations in Latin America has enabled them to finance a considerable part of their investments in the region. The top decision-makers of the two Spanish financial groups have therefore remained committed to expansion in Latin America, and the groups appear to be embarking upon a second phase in their strategies, in which the emphasis is on improving the efficiency and competitiveness of their banks in the region.

Shares in BBV and Banco Santander lost almost 50% of their value between July and September 1998, and risk-assessment agencies lowered the two banks' credit ratings because of their overexposure in Latin America. Despite a strong market reaction, however, the two Spanish banks were apparently prepared for even worse scenarios (Calderón and Casilda, 1999a). Their Latin American subsidiaries have maintained loan-loss provisions of more than 100% even though the loan delinquency rate is fairly low. In late 1998, the percentage of non-performing loans in the region was 5.6% in the case of BBV and 3.7% for Banco Santander. In mid-1998 these institutions had also launched stringent restructuring and cost-cutting programmes.

Aside from market reactions, these transactions have also had their detractors within Spain. The increasing scale of the major Spanish banks' Latin American operations has become a cause of growing concern, mainly because of these economies' vulnerability to fluctuations on international financial markets. The Banco de España has concluded that

acquisitions in Latin America are much riskier than traditional banking operations and has gone so far as to urge Spanish banking institutions to give careful consideration to any purchase of new assets and to focus on selecting high-quality investments rather than seeking short-term profits.

At the same time that some instability was being seen in Latin American economies, the forthcoming introduction of the single European currency on 1 January 1999 was putting increased competitive pressure on Spain's banking institutions. As it became necessary for them to adjust their overall strategies, the likelihood of mergers among Spanish banks or between Spanish banks and partners in other European partners increased.

On 15 January 1999, Banco Santander merged with BCH to form Banco Santander Central Hispano (BSCH). This new bank, which has taken over the leadership of the Spanish market and become one of Europe's largest, is therefore in a considerably stronger position in terms of the establishment of future alliances within the euro area. With the conclusion of this agreement, BSCH also became Latin America's largest foreign financial group, leaving BBV in second place and displacing other institutions which have been operating in the region for many years, such as the United States corporations Citibank and BankBoston, and the Netherlands bank ABN-Amro.

The financial press saw BBV as being one of the major losers in this transaction, and many experts were watching to see how it would react. Then, on 19 October 1999, following nine months of incessant rumours, BBV and Argentaria merged to form a new institution, Banco Bilbao Vizcaya Argentaria (BBVA). As a result of this series of events, the Spanish banking system has consolidated around two major institutions, although BSCH remains the leader. BSCH controls about 20% of the lending market versus the 17% share of BBVA. In the case of deposits, each of the two firms controls about 15% of the market. Within Europe, BBVA has become a very important player and has a slightly higher market capitalization than BSCH.

BSCH is now operating on a European and worldwide scale and holds a leadership position in Spain. In the euro area, the new bank is in first place in terms of stock-market capitalization and in eighth place in terms of its total assets, has entered into important alliances with European banks and owns stock in some of them, and has become Latin America's largest financial group, managing US\$ 240 billion in customers' assets worldwide. In Spain, it has a market share of close to 20%, has 10 million customers and



holds large stakes in various industries, with a concentration of stock in strategic sectors (BCH, 1999 and Banco Santander, 1999). This merger has infused the market with optimism, and this has allowed the two leading Spanish firms (BSCH and BBV) to recoup part of the losses they suffered in the second half of 1998 (Calderón and Casilda, 1999a).

As mentioned above, since the strategies of these two financial groups were significantly different, the negotiating process was quite complex (see box III.7). The firms' top executives finally agreed that the new institution's main strategic priorities should be to strengthen retail, corporate and business banking in Spain, to boost its international activities' contribution to total profits—with emphasis on the European and Latin American markets—and to optimize its portfolio of industrial stock on an ongoing basis (BCH, 1999 and Banco Santander, 1999). In this respect, the policies advocated by the Banco Santander executives carried the greatest weight.

Although this merger has complemented and strengthened the new bank's presence in Latin America, the process has not been free of difficulties. It has exacerbated the problems associated with concentration and has brought to light certain shortcomings in the regulatory systems governing the markets in which these institutions are already operating or expect to enter in the future. In fact, in some of the countries of the region the authorities are currently looking closely at the position of dominance that has been assumed by Spanish banks, and this situation has been aggravated by the merger between Banco Santander and BCH (see table III.9). An adverse decision, in the event that the authorities were to find that the level of concentration impairs or hinders free competition, could force these institutions to shed some of their assets. In point of fact, BBV has larger market shares in such countries as Argentina, Chile and Venezuela than it has in Spain. BBV and BSCH are the only banks in the world to have achieved such positions outside their natural markets.

It is in Chile that the creation of BSCH has brought about the greatest problem. Banco Santiago and Banco Santander-Chile are the number one and number two banks in the country, with a combined market share of

almost one-third (28% of total bank lending). This situation, which would appear to contravene antitrust regulations, has also underlined the limitations of an individual country's regulatory framework in the face of the increasing globalization of the world market. In late April 1999, BCH dissolved its alliance with the Luksic group and paid it US\$ 600 million for its 50% share of the assets they had controlled jointly in Latin America.<sup>74</sup> This transaction gave BSCH control over 44% of Banco Santiago and 86% of Banco Santander-Chile. It also reached an agreement with Banco Central de Chile to purchase the latter's 35.4% stake in Banco Santiago within a period of three years (see table III.9). The Banco de España finds it inadvisable for a Spanish bank under its supervision to have (albeit indirectly) 30% of its exposure in Chile or any other country, however, since this means that any turbulence in the Chilean banking market could have serious repercussions on that bank and, hence, on Spain's entire banking system.

In view of this situation, BSCH has reached an agreement with Chilean authorities in the executive and legislative branches under which it has promised that the two banks it owns in Chile (Banco Santiago and Banco Santander) will be managed separately and will not be merged. BSCH has also agreed to reduce its stake in the Chilean market. Which of the two banks it will decide to sell off remains to be seen. This last question is the most complex one of all, since the two banks are worth enormous sums (Banco Santiago is valued at US\$ 1.8 billion and Banco Santander at US\$ 1.3 billion), but a sale is expected to take place soon. Analysts are wagering that BSCH will choose to build up Banco Santander and downscale Banco Santiago with a view to its subsequent sale. This transaction would include the transfer from Banco Santiago to Banco Santander of the whole of its fully-compatible portfolio, which should amount to about 8%, thereby increasing Banco Santander's market share by a like percentage. Potential buyers include Citibank and ABN Amro; it is highly unlikely that BSCH would sell Banco Santiago to BBV, its strongest competitor.

The situation has been somewhat different in the case of the merger of BBV and Argentaria. It is not believed that this operation will cause any great

74 On 12 February 1999, BCH announced that it wished to end its partnership with the Chilean Luksic group in the O'Higgins Central Hispano (OHCH) financial holding company, in which they held equal stakes. BCH put the value of the group at US\$ 1.2 billion and its own stake at US\$ 600 million. This valuation sparked a dispute because, at the time of the merger with Banco Santander, BCH had assessed its equity in OHCH at about US\$ 400 million. The Chilean group had two months in which to make a decision and it ultimately accepted the US\$ 600 million offered for its 50% share of OHCH.

difficulty, since these two Spanish financial groups' business activities in the region hardly overlap at all. BBV has concentrated on commercial banking and, more recently, on pension fund management, whereas, from the very start, Argentaria has been unwilling to pour huge amounts of funds into the acquisition of banking institutions and has instead opted for a low-risk line of business that it knows very well: the management of private pension plans. As of late 1998, Argentaria was managing some US\$ 3.6 billion in pension and insurance funds in Latin America and had over 3.4 million customers. It currently operates in Argentina, Bolivia, Colombia, El Salvador and Panama. Its most important business interest is its 50% stake in the Siembra group, Argentina's largest general insurance firm (Calderón and Casilda, 1999a).

Quite apart from the issue of concentration, from the standpoint of the Latin American countries it would be best if this influx of foreign —and particularly Spanish— banks could be accomplished in such a way as to fulfil the following objectives:

- To strengthen local financial systems by taking advantage of the greater capacity of foreign banks to obtain funds, at a lower cost, in international markets.
- To narrow interest rate spreads through increased competition, given the fact that foreign banks are accustomed to working with smaller profit margins (3% in the United States and the United Kingdom, compared with 6.3% in Brazil) (*Gazeta Mercantil Latino-Americana*, 28 June-4 July 1999). This would give borrowers the benefit of lower financing costs.

- To increase competition and lower operating costs, which would force local banks to boost their efficiency and reduce the vulnerability of their positions.
- To promote the growth of financial intermediation by fostering the development of a greater supply of new and more sophisticated products by institutions operating in local markets.

The most obvious result so far has been a strengthening of local markets, which, when faced with two major international financial crises (in late 1994 and mid-1997), have reacted more consistently than in the past (particularly when compared to their response to the external debt crisis). In terms of the benefits of greater competition and the extent to which such benefits have been passed on to customers, the results have been mixed. In general, the interest rate spreads used by foreign banks operating in Latin America have remained high —unlike what is has been happening in these banks' home markets— and the cost of borrowing has therefore not fallen significantly even though operating expenses have been reduced sharply.

In short, with the situation in the region having undergone numerous changes, the internationalization strategy pursued by the major Spanish banks has sparked a heated controversy. Not only in Latin America itself, but also in Spain and the European Union, political and economic authorities, entrepreneurs, shareholders, markets and clients have all voiced their differing points of view on the expansion of Spanish banks into the heart of Latin America's financial sector. This has been a phenomenon of unprecedented speed and scope, and its ultimate consequences will only become apparent in the years to come.

## C. CONCLUSIONS

Spanish investments in the region have attained magnitudes that have surprised most analysts. This phenomenon has not been orchestrated (although it does enjoy the support of the Spanish Government) nor does it have a common underlying strategy. Instead, it is a matter of Spanish firms simply finding investment

opportunities that have prompted them to place a "strategic wager" on Latin America. As a result of this process, which has been confined to just a few firms, Spain has become a net exporter of capital.

Although they come from a variety of economic sectors and are pursuing different strategies, the

Spanish companies investing in Latin America have various traits in common and are all facing a number of the same situations, including:

- Growing competition in Spain and the European Union;
- Concentration of their strategy of international expansion in a single region (Latin America);
- Choice of international expansion as a strategy for increasing their market capitalization;
- The Spanish companies that are the most active in Latin America are the product of recent, large-scale privatizations in their home country;
- Their international expansion strategies have been based on the purchase of existing assets, mainly through privatization schemes implemented by Latin American authorities;
- These Spanish companies started off their regional expansion strategy in the Southern Cone of Latin America (Argentina and Chile), and later spread out to include other Spanish-speaking countries (Peru, Colombia, Venezuela and Mexico). Most have now targeted Brazil as the most important destination market and, since 1998, have been investing heavily in that country;
- In order to expand on a regional scale, Spanish companies have exploited gaps in the local regulatory regime, and this tactic is now causing them a variety of problems.

As a result of this process, some of the largest Spanish firms have become key players, especially in recently liberalized service industries. By taking advantage of the revitalized Latin American economic environment, these firms have pursued a strategy of acquisitions in an effort to achieve the size needed to compete in the increasingly globalized European and world markets. As a result, a small number of Spanish companies have become leading players in three key sectors in Latin America's new economic scenario—telecommunications, energy and banking—and are making a positive contribution to the systemic competitiveness of their host economies.

The process has not been problem-free, however. In recent months, there has been growing criticism of the rapid, large-scale entry of Spanish companies into the main Latin American markets, in many cases as monopoly operators enjoying large profit margins. Based to some degree on nationalistic sentiments, but above all on a legitimate concern about how these markets will function in the future, the general public—in both Latin America and Spain—is beginning to express misgivings about this Spanish “reconquest”.

- From the standpoint of Latin America, the aggressive acquisition strategy pursued by Spanish firms and banks has revealed serious shortcomings in the regulatory systems governing the markets in which these companies now operate or plan to operate in the future. The economic authorities in several of the region's countries are currently looking carefully at the dominant positions attained by some of these companies. If they determine that the concentration of these firms is hindering free competition or prejudicing users' interests, they could be required to divest themselves of some of their assets.
- A number of concerns have also been raised on the Spanish side of the equation. First, the Spanish banks and firms that have wagered so heavily on Latin America have been punished by international stock markets. Since mid-1998 and as the situation in Brazil has worsened, the risk ratings and share values of the main Spanish firms have slipped, in some cases significantly. This has led the Spanish authorities to ask these firms to take a great deal of care in evaluating their future investments in the region. Apart from this, the growing concentration of certain Spanish firms in Latin American markets may contravene existing regulations applying to the Spanish market. This is clearly the case in the electricity sector, since Spanish legislation expressly requires the separation of power generation, transmission and distribution. Although at present there is no provision requiring Spanish companies to respect the same rules in their operations abroad, such a provision might be introduced in the future if difficulties arise in highly concentrated Latin American markets.

In addition to their possible effects on systemic competitiveness, the concentration of Spanish investments in the services sector could have a substantial balance-of-payments impact on some Latin American economies. Because these investments are aimed at serving domestic markets rather than improving these economies' export capacity or their ability to attract capital, tension between local economic authorities and the companies in question could arise due to such considerations.

Thus, as they step forward into a new century, it is highly likely that Spanish firms are coming to the most complex phase of their expansion strategy in Latin America: becoming assimilated into the region's markets and gaining full acceptance from each country's authorities and customers.





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## **IV. THE APPAREL INDUSTRY: FOREIGN INVESTMENT AND CORPORATE STRATEGIES IN LATIN AMERICA AND THE CARIBBEAN**



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Based on the same approach as was used in the examination of the automotive industry presented in chapter IV of the 1998 edition of *Foreign Investment in Latin America and the Caribbean*, this analysis of the restructuring of the North American apparel industry will seek to identify and explain the competitive position of this industry by looking at the interconnections among three groups of factors affecting that market: international and national market factors, national policy and corporate strategies. It should be mentioned at the outset that the apparel industry is increasingly becoming more of a buyer-driven than producer-driven one. Consequently, in addition to foreign direct investment (FDI), non-investment arrangements (such as buyers contracts) are important aspects of supplier relationships (see box IV.1).

Many countries' first experiences with manufacturing processes take place in the apparel industry, since it is based primarily on low wages, uses relatively simple technologies in the production of basic items and has low entry barriers. During the twentieth century the explosive growth of exports from

newly industrializing economies (NIEs) put strong pressure on the larger markets (Europe and North America) and obliged them to react. Asia thus began to pose a challenge, first in the form of Japanese apparel exports, followed by the rise of new exporters from newly industrializing Asian economies —Hong Kong

Special Administrative Region (SAR) of China, the Republic of Korea and the Chinese Province of Taiwan— and then by China and other Asian producers. During 1980-1996, clothing was a quite dynamic element of foreign trade, with its share of the total value of merchandise imports of the members of the Organisation for Economic Co-operation and Development (OECD) increasing from 2.6% to 4.1%. The information on the apparel industry's import market shares for OECD during the same period indicates that while China is still the leading edge of the Asian challenge (with an import market share of 17.7%), the Asian NIEs are now losing *direct* market share in the OECD economies (Hong Kong SAR is down from 13.72% to 6.72%, the Republic of Korea from 9.13% to 2.95%, and the Chinese Province of Taiwan from 6.62% to 2.18%), and Japan has nearly slipped off the list altogether (0.17% in 1996) see

table IV.1). The list itself contains a mixture of widely differing situations, including some OECD countries trying to defend falling market shares (France, Germany, Italy), up-and-coming market-gaining developing countries of Asia (India, Indonesia, Philippines, Thailand), Latin America (Costa Rica, Dominican Republic, El Salvador, Honduras, Mexico) and Africa (Egypt, Morocco, Tunisia), as well as transitional economies (Hungary, Poland, Rumania).

A closer examination shows that the apparel-producing countries occupy one of five different competitive positions in the international market:

- The OECD countries trying to defend declining market shares by moving upmarket into higher fashion articles (Italy, France) and/or by **establishing** regional apparel assembly systems

#### Box IV.1

#### PRODUCER-DRIVEN AND BUYER-DRIVEN SUPPLY CHAINS

Depending on the industry, the increased competition characteristic of the globalization process has resulted in two distinct types of international supply chains: "producer-driven" and "buyer-driven" ones (see figure). Producer-driven chains are those in which large, usually transnational, manufacturers play the central role in coordinating production (including backward and forward linkages). This is characteristic of capital- and technology-intensive industries such as automobiles, aircraft, computers, semiconductors and heavy machinery. The automotive industry offers a classic illustration of a producer-driven chain, with multi-layered production systems that involve thousands of firms

(including parent companies, subsidiaries and subcontractors). The average Japanese automaker's production system, for example, comprises 170 first-tier, 4,700 second-tier, and 31,600 third-tier subcontractors (Hill, 1989, p. 466). Japanese motor vehicle manufacturers have actually reconstituted many aspects of their home-country supplier chains in North America (Florida and Kenney, 1991). There are complex forces that drive Japanese automakers to create regional production schemes for the supply of automotive parts in a half dozen nations in East and South-East Asia (Doner, 1991). The internationalization of the United States and Japanese semiconductor industries has

also been characterized by producer-driven chains that have established an East Asian division of labour (Henderson, 1989; Borras, 1997). Buyer-driven chains are associated with industries in which large retailers, branded marketers and branded manufacturers play the pivotal roles in setting up decentralized production systems in a variety of exporting countries, typically located in developing countries. This pattern has become common in labour-intensive consumer goods industries such as garments, footwear, toys, housewares, consumer electronics and a variety of handicrafts. Production is generally carried out by tiered networks of local contractors that make finished goods to the specifications of foreign buyers.

## Box IV.1 (continued)

Profitability is greatest in the relatively concentrated segments of global chains that have high barriers to the entry of new firms. In producer-driven ones, manufacturers making advanced products such as aircraft, motor vehicles and computers are the key economic agents, primarily by virtue of their ability to exert control over backward linkages with raw-material and component suppliers and over forward linkages into distribution and retailing. The transnational corporations in producer-driven chains usually belong to global oligopolies. Buyer-driven chains, by contrast, are characterized by highly competitive, locally-owned, and globally dispersed production systems. In buyer-driven chains, competitive advantage has less to do with scale, volume, and technological advances than it does in producer-driven chains and has rather more to do with unique combinations of high-value research, design, sales, marketing and financial services that allow retailers, branded marketers and branded manufacturers to act as strategic brokers in linking overseas factories with evolving product niches in the main consumer markets. Thus, whereas producer-driven chains are controlled by industrial firms at the point of production, the main leverage in buyer-driven ones is exercised by retailers, marketers and manufacturers through their

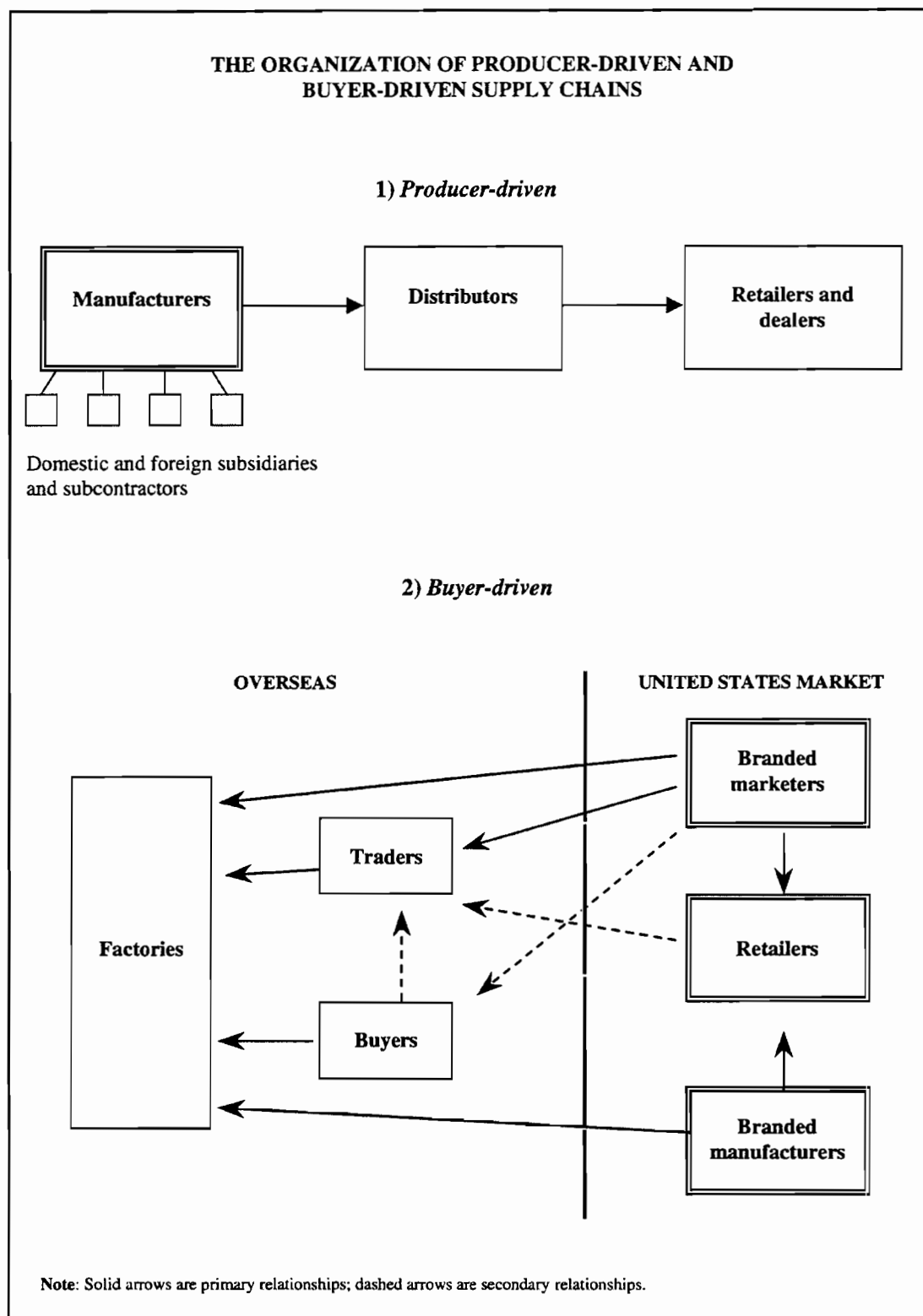
ability to shape mass consumption via strong brand names and their reliance on global sourcing strategies to meet this demand.

The leading firms in producer-driven and buyer-driven chains use entry barriers to generate different kinds of "rents" (broadly defined as returns from scarce assets) in global industries. These assets may be tangible (e.g., machinery), intangible (brands) or intermediate (marketing skills). Producer-driven chains rely primarily on technology rents, which arise from asymmetrical access to key product and process technologies (Kaplinsky, 1998), and organizational rents, which refer to a form of intra-organizational process know-how that originated in Japan and is particularly significant in the transition from mass production to mass customization (or flexible production). This shift involves an entire cluster of new organizational techniques such as just-in-time production, total quality control, modular production, defect prevention and continuous improvement. Buyer-driven chains are most closely tied to relational rents, which refer to several families of inter-firm relationships, including the techniques of supply-chain management that link large assemblers with small- and medium-sized enterprises, the

construction of strategic alliances, and small firms clustering together in a particular locality and manifesting elements of collective efficiency associated with original equipment manufacture (OEM) forms of production. They are also closely related to trade-policy rents, understood as the scarcity value created by protectionist trade policies such as apparel quotas, and brand name rents, which refer to the returns from the product differentiation techniques used to establish brand-name prominence in major world markets.

In the apparel chain, entry barriers are low for most garment factories but become progressively higher as one moves upstream to textiles and fibres; brand names and stores are attractive competitive assets which firms can use to generate significant economic rents. The lavish advertising budgets and promotional campaigns required to create and sustain global brands—and the sophisticated and costly information technologies employed by today's mega-retailers to develop "quick response programmes" that increase revenues and lower risks by getting suppliers to manage inventory—illustrate recent techniques that have allowed retailers and marketers to displace traditional manufacturers as leaders in many consumer goods industries.

Box IV.1 (concluded)



(North American market, European market, Japanese market) in neighbouring low-wage countries (UNCTAD, 1999j, chapter 2);

- The Asian NIEs that have developed their own systems of apparel production which offer “full-package” facilities<sup>75</sup> to buyers that include the use of assembly operations in low-wage countries;
- The special situation of China, which provides exports from its own integrated industry and also assembles apparel for Asian NIEs, full-package producers and others;
- The countries that **form part of** the regional assembly systems of the principal markets (Mexico and the Caribbean basin in the case of the North American market, and some North African and some transitional economies in the case of the European market); and
- The rest, mainly very low-wage countries.

An important distinction should be made between developing countries that supply only their corresponding regional supply chain<sup>76</sup> (North America

or Europe) and the case of China and certain Asian NIEs that are very active in ALL major markets. Also, these Asian countries tend to have vertically-integrated apparel industries while the developing and transitional economies linked to a single major market tend to perform the assembly function exclusively. With very few exceptions (Hong Kong SAR, India, Pakistan), the countries close to the southern border of the North American market (Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Jamaica) and those located on the European rim (Morocco, Romania, Turkey, Tunisia) are the ones that rely the most on apparel exports—one quarter or more of their total exports—within the context of their trade links to the international market (see table IV.1). The various challenges mounted by the Asian economies during the twentieth century have had very significant impacts on the global apparel industry and, during the 1990s, in terms of the restructuring of the North American apparel market. The establishment of regional supply chains has been part of that market's response.

## A. THE RESTRUCTURING OF THE UNITED STATES APPAREL MARKET

The United States apparel market had been undergoing a long-term structural decline. In 1970 the industry had 1.4 million employees, or the equivalent of 7% of the total workforce of that country's manufacturing sector. By 1997 those figures had

declined to 4.4% and only 0.8 million employees. The apparel sector accounted for 9% of all business failures in the United States economy in 1997 and had the highest attrition rate in the manufacturing sector for the period 1993-1997. In other words, the United

75 Full-package facilities go beyond the mere assembly of imported inputs to include many different local sourcing arrangements, such as textile production and fabric cutting, up to and including other phases of garment supply, such as design, input selection and the distribution of the final product. The Asian NIEs have been very successful providers of full-package facilities for major United States buyers. See Gereffi, (1999b).

76 A number of distinct concepts, such as commodity chains, values chains and supply networks, among others, have been employed to capture different organizational aspects of the apparel industry. The concept of supply chains captures the vertical integration of the apparel industry—from fibre companies and textile mills to contract assemblers, apparel firms, retailers and marketers—and the distinct roles of the various agents.

Table IV.1  
THE 50 LARGEST APPAREL EXPORTERS TO OECD COUNTRIES, 1980-1996

Economy	Import market share in OECD (%)			Export structure (apparel as % of total exports)		
	1980	1996	% variation	1980	1996	% variation
1 China	2.74	17.70	545.3	10.5	19.1	81.7
2 Italy	12.89	8.05	-37.6	8.2	7.2	-12.5
3 Hong Kong	13.72	6.72	-51.0	37.5	33.2	-11.5
4 Turkey	0.36	3.87	965.1	6.0	37.3	524.8
5 Germany	6.93	3.78	-45.4	1.8	1.4	-19.2
6 India	2.09	3.23	54.5	13.6	21.6	58.6
7 Republic of Korea	9.13	2.95	-67.7	25.8	7.0	-73.1
8 France	5.37	2.70	-49.7	2.5	1.8	-26.3
9 Portugal	1.72	2.51	46.0	16.3	17.6	8.9
<b>10 Mexico</b>	<b>0.77</b>	<b>2.42</b>	<b>213.3</b>	<b>1.6</b>	<b>4.4</b>	<b>178.2</b>
11 Indonesia	0.21	2.39	1 061.5	0.4	10.2	2 771.7
12 United Kingdom	4.12	2.34	-43.3	2.0	1.8	-8.7
13 Taiwan	6.62	2.18	-67.1	15.4	4.6	-70.1
14 Thailand	0.66	1.95	195.4	5.7	8.3	47.2
15 United States	2.04	1.78	-12.8	0.5	0.7	41.2
16 Tunisia	1.00	1.75	75.7	20.1	52.5	161.9
17 Malaysia	0.48	1.64	241.3	1.9	5.3	185.9
18 Philippines	1.41	1.62	14.6	9.2	14.5	57.6
19 Poland	0.80	1.60	99.1	5.8	13.4	133.8
20 Morocco	0.37	1.60	334.1	6.3	36.7	482.8
21 Netherlands	1.79	1.42	-20.5	1.1	1.4	35.9
<b>22 Dominican Republic</b>	<b>0.28</b>	<b>1.28</b>	<b>359.5</b>	<b>9.2</b>	<b>45.5</b>	<b>395.8</b>
23 Belgium/Lux.	2.30	1.18	-48.7	1.6	1.4	-12.1
24 Pakistan	0.24	1.16	389.0	7.4	33.1	346.3
25 Romania	1.01	1.06	4.9	10.5	28.1	167.9
26 Greece	2.73	0.99	-63.7	24.3	20.2	-16.7
<b>27 Honduras</b>	<b>0.04</b>	<b>0.79</b>	<b>1 861.8</b>	<b>1.7</b>	<b>49.1</b>	<b>2 860.0</b>
28 Hungary	0.98	0.79	-19.5	12.7	9.6	-24.2
29 Canada	0.45	0.77	71.4	0.3	0.6	130.8
30 Spain	0.77	0.69	-9.3	1.8	1.3	-27.1
31 Denmark	0.95	0.61	-35.7	2.4	2.5	4.0
32 Austria	1.60	0.60	-62.7	4.6	2.3	-50.6
<b>33 Guatemala</b>	<b>0.01</b>	<b>0.55</b>	<b>3 907.2</b>	<b>0.5</b>	<b>33.3</b>	<b>6 998.7</b>
<b>34 Costa Rica</b>	<b>0.12</b>	<b>0.54</b>	<b>355.6</b>	<b>4.7</b>	<b>23.2</b>	<b>399.2</b>
<b>35 El Salvador</b>	<b>0.06</b>	<b>0.47</b>	<b>685.3</b>	<b>2.3</b>	<b>49.3</b>	<b>2 017.5</b>
36 Israel	0.71	0.47	-33.8	6.2	4.5	-26.9
37 Singapore	1.01	0.41	-59.5	5.1	1.3	-73.8
<b>38 Jamaica</b>	<b>0.04</b>	<b>0.41</b>	<b>849.0</b>	<b>1.7</b>	<b>33.1</b>	<b>1 836.3</b>
39 Ireland	0.61	0.39	-35.8	2.8	1.5	-47.2
40 Switzerland	0.82	0.36	-56.0	1.1	0.8	-28.5
41 Egypt	0.04	0.33	688.0	0.3	10.6	3 052.0
42 Bulgaria	0.17	0.30	71.2	7.0	14.5	108.3
43 Colombia	0.10	0.27	167.0	1.1	4.9	367.5
44 Japan	1.11	0.17	-84.3	0.6	0.1	-80.7
45 South Africa	0.13	0.17	34.6	0.4	1.5	318.0
46 Peru	0.03	0.16	375.1	0.4	7.0	1 587.6
47 Sweden	0.61	0.16	-74.3	0.9	0.4	-58.3
48 Brazil	0.25	0.14	-44.3	0.6	0.7	8.4
49 Australia	0.04	0.10	147.1	0.1	0.5	456.6
50 Finland	1.63	0.10	-93.7	5.5	0.5	-90.3

Source: ECLAC, calculated using the CAN PLUS computer software on international competitiveness. Mexico and the Caribbean basin countries are shown in bold.

Table IV.2  
**UNITED STATES: ANNUAL SALES OF THE 10 PRINCIPAL APPAREL  
 COMPANIES, 1993-1997**  
*(Millions of dollars)*

Company	Category	1993	1997	Growth (%)
Sara Lee	Branded manufacturer	6 098	7 482	22.7
Levi Strauss	Branded manufacturer and retailer	5 893	6 900	17.1
VF Corporation	Branded manufacturer <sup>a</sup>	4 320	5 222	20.9
Liz Claiborne	Branded retailer <sup>b</sup>	2 204	2 413	9.5
Fruit of the Loom Inc.	Branded manufacturer and marketer	1 884	2 140	13.6
Kellwood Co.	Branded manufacturer and marketer	1 203	1 782	48.1
Warnaco Group Inc.	Branded manufacturer <sup>a</sup>	704	1 436	104.0
Jones Apparel Inc.		541	1 387	156.3
Phillips-Van Heusen Corp.	Branded marketer and retailer	1 152	1 350	17.1
Russell Corp.	Branded manufacturer and marketer	931	1 228	32.0
<b>Total - 10 companies</b>		<b>24 950</b>	<b>31 340</b>	<b>25.6</b>
<b>US market total</b>		<b>87 251</b>	<b>95 637</b>	<b>9.6</b>

Source: ECLAC, on the basis of Gary Gereffi, "The Transformation of the North American Apparel Industry: is NAFTA a Curse or a Blessing?", consultant report prepared for the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, May 1999; and United States International Trade Commission (USITC), "Industry and Trade Summary: Apparel", USITC Publication, No. 3169, Washington, D.C., March 1999, p. 10.

<sup>a</sup> Manufacturer of licensed brands.

<sup>b</sup> Retailer of licensed brands.

States apparel industry appeared to be in terrible shape.

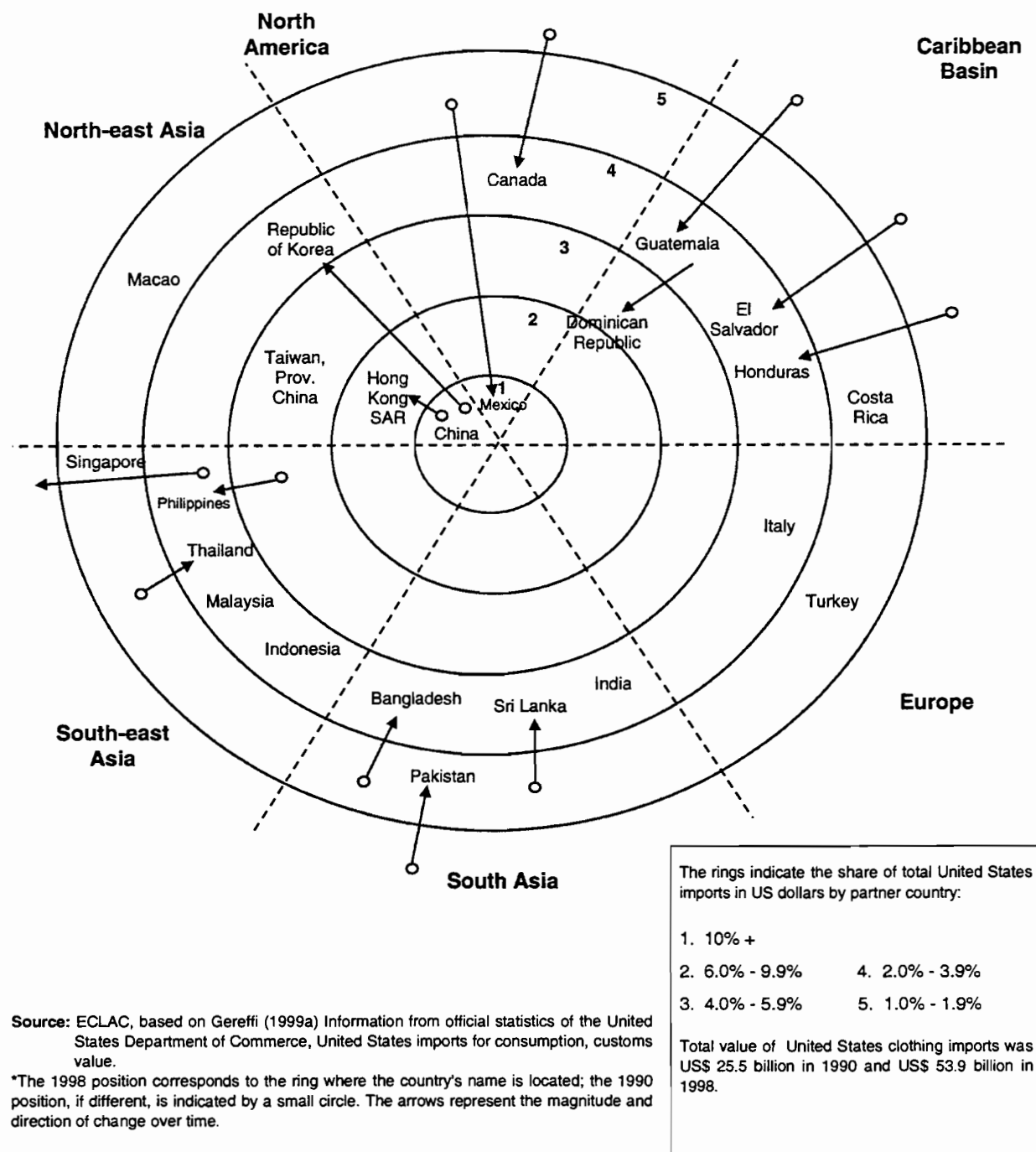
What is more, the situation appears to have deteriorated further during the period, judging by numerous indicators (USITC, 1999). The industry's percentage of manufacturing GDP fell from 2.4% to 2%. The number of business establishments in the sector declined from 18,281 to 17,600. The number of production workers dropped from 829,000 to 664,000. The value of shipments (in constant 1993 dollars) barely grew at all, edging up from US\$ 53.7 to US\$ 53.8 billion. Capacity utilization fell from 86% to 80%. Hourly wages rose from US\$ 7.09 to US\$ 8.25. As a result, the return on sales of apparel firms was considerably lower, and their ratio of long-term debt to net worth was considerably higher than the average for

the manufacturing sector as a whole. The apparel industry's trade gap widened from US\$ 11 to US\$ 40 billion. By 1998, over one half of the value of apparel sales in the United States market was accounted for by imported goods. Thus, it appeared that the United States apparel market was being overwhelmed by foreign producers.

Apparel imports to the United States market underwent a very significant shift in origin, in parallel with the restructuring process. In 1983, for example, about 80% of such exports came from Asian countries. By 1998, however, that share had fallen to 44% and the share coming from Mexico and the Caribbean basin had risen steeply (from only 2% to 13% and from just 4% to 15%, respectively) (see figure IV.1). In general it is evident that, with the exception of China, the



Figure IV.1  
**SHIFTS IN THE REGIONAL STRUCTURE OF UNITED STATES APPAREL  
 IMPORTS FROM 1990 TO 1998\***



## Box IV.2

## RETAILERS, MARKETERS AND BRANDED MANUFACTURERS IN BUYER-DRIVEN SUPPLY CHAINS

Because of the intensive use of low-skilled labour in apparel production, transnational corporations have limited potential for deriving firm-specific advantages from foreign direct investment in overseas locations. Instead, they have turned to other forms of transnational activity, such as the importing of finished garments, brand-name and trademark licensing, and the international subcontracting of assembly operations. These various activities have led to the emergence of multiple lead firms in buyer-driven supply chains. There are three types of "lead firms" in the apparel commodity chain: retailers, marketers and branded manufacturers (Gereffi, 1997). As apparel production has become globally dispersed and the competition among these types of firms has intensified, each has developed extensive global sourcing capabilities. While "de-verticalizing" out of production, they are fortifying their activities in the high value-added design and marketing segments of the apparel chain, leading to a blurring of the boundaries between these firms and a realignment of interests within the chain.

Here's a quick look at where each "lead firm" stands in apparel sourcing:

**Retailers.** In the past, retailers were apparel manufacturers' main customers, but they are now increasingly becoming their competitors. The share of apparel sales made through the top 10 purveyors (national chains, mass merchants and department stores) rose from 35% in 1990 to 47% in 1998 (Bobbitt Live, 1999a). As consumers demand

better value, retailers have increasingly turned to imports. In 1975, only 12% of the apparel sold by United States retailers was imported; by 1984, retail stores had doubled their use of imported garments (AAMA, 1984). United States apparel marketers, which perform the design and marketing functions but contract out the actual production of apparel to foreign or domestic sources, represented 22% of the value of apparel imports in 1993, and domestic producers made up an additional 20% of the total (Jones, 1995, pp. 25-26). The picture in Europe is strikingly similar. European retailers account for fully one half of all apparel imports, and marketers or designers add roughly another 20% (Scheffer, 1994, pp. 11-12). Private-label lines (or store brands), which involve merchandise made for specific retailers and sold exclusively in their stores, constituted about 25% of the total United States apparel market in 1993 (Dickerson, 1995, p. 460).

**Marketers.** These non-factory manufacturers include companies such as Liz Claiborne, Donna Karan, Ralph Lauren, Tommy Hilfiger, Nautica and Nike, which were literally "born global" because most of their sourcing has always been done overseas. In order to deal with the influx of new competition, marketers have adopted several strategic responses that are altering the content and scope of their global sourcing chains. These measures include: shrinking their supply chains by using fewer but more capable contractors; instructing contractors where to obtain needed components, thus

reducing their own purchase and redistribution activities; discontinuing certain support functions (such as pattern grading, marker making and sample making) and reassigning them to contractors; adopting more stringent vendor certification systems to improve performance; and shifting the geography of their sourcing networks from Asia to the western hemisphere.

**Branded apparel manufacturers.**

The decision facing many larger manufacturers in developed countries is no longer whether to engage in foreign production, but how to organize and manage it. These firms supply intermediate inputs (cut fabric, thread, buttons and other trim) to extensive networks of offshore suppliers, typically located in neighbouring countries with reciprocal trade agreements that allow goods assembled offshore to be re-imported with a tariff charged only on the value added by foreign labour. This kind of international subcontracting system exists in every region of the world. It is called the "HTS 9802 program" or "production sharing" in the United States, where the sourcing networks of United States manufacturers are predominantly located in Mexico and the Caribbean basin; in Europe, this is known as "outward processing trade" (OPT), and the principal suppliers are found in North Africa and Eastern Europe (OETH, 1995); and in Asia, manufacturers from relatively high-wage economies such as Hong Kong have "outward processing arrangements" (OPAs) with China and other low-wage nations (Bimbaum, 1993).

Source: ECLAC, on the basis of Gary Gereffi, "The Transformation of the North American Apparel Industry: is NAFTA a Curse or a Blessing?", consultant report prepared for the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, May 1999.

<sup>a</sup> These figures do not include the production-sharing activities of United States apparel firms in Mexico and in the Caribbean basin, which also have been expanding very rapidly (USITC, 1997c).

north-east Asian countries that had once dominated the United States apparel market via imports are losing *direct* market share<sup>77</sup> and, while newer export bases in Asia are playing a role, it is the upsurge of Mexico as it strives to become a tier 1 supplier (surpassing China) (see table II.3), plus the advance of certain countries in the Caribbean basin, that stands out. This new state of affairs, combined with the surprising strength of the principal United States apparel companies, requires further explanation.

While the restructuring of the United States apparel industry produced numerous casualties in the form of firms that went under, the larger United States firms that dominate the industry have been doing quite well. There has been a further consolidation in the industry, especially among the 10 firms with sales of more than US\$ 1 billion in 1997, whose share of total sales increased from 28.6% to 33.8% (see table IV.2). This helps to explain how it came to be that the apparel industry's return on assets, return on equity and return on invested capital were higher than those of the

manufacturing sector as a whole in 1993-1997 in spite of the fierce restructuring process that was taking place, as indicated by the foregoing statistics.

Moreover, the concentration of firms is extremely high in certain product lines. In 1998, VF Corporation (26.1%) and Levi Strauss & Co. (14.8%) accounted for over 40% of United States sales of jeans. Sara Lee and Fruit of the Loom were responsible for more than two thirds of the sales of men's and boys' underwear and for around one half of those for women and girls. During 1994-1998 it was precisely companies such as VF Corporation (which cut its staff from 68,000 to 62,800 employees), Levi Strauss (from 36,500 to 30,000) and Fruit of the Loom (from 37,400 to 28,500) that were reducing their workforce in the United States at the same time that they were increasing their offshore assembly operations by way of FDI and buyers contracts (see box IV.2). Thus, there was a clear link between the restructuring of the United States apparel market by the principal United States apparel companies and the increase in imports to that market.

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## B. THE IMPACT OF NATIONAL POLICY IN THE UNITED STATES

United States policy-makers have dealt with the various challenges posed by Asian economies in the apparel industry by means of two main policy packages: policies that focus on disarming the challengers, and policies designed to strengthen the major United States apparel companies. The first group of measures includes trade restrictions (import tariffs and quotas) and direct pressure applied on particular Governments. The second group of policies are centred on the formation of regional supply chains that allow

United States apparel firms to become more competitive.

The apparel industry is one of the most heavily protected sectors of the United States economy. In 1997 it still enjoyed a 15.5% ad valorem average trade-weighted rate of duty as compared to 3% for other products (USITC, 1998, pp. 1-12 and 3-3, note 5). The high tariff protection provided to this industry in the United States has been accompanied by very substantial import quotas. It may be recalled that the apparel industry was excepted from the 1947

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77 An interesting aspect of the supply chain analysis is that an examination of the case of these north-east Asian countries indicates that while they lost direct import market share for apparel in the United States apparel market, they increased their textile and fibre exports, primarily to Asian assembly sites (especially those whose output falls within established quotas for the United States market). This demonstrates one of the benefits of promoting the development of an integrated apparel industry rather than specializing in simple assembly functions.

provisions of the General Agreement on Tariffs and Trade (GATT) because importing and exporting countries were to negotiate bilateral agreements limiting textile and apparel shipments (USITC, 1999, p. B-3). The Arrangement Regarding International Trade in Textiles, usually referred to as the Multifibre Arrangement (MFA), came into effect in 1974. This agreement allowed importing countries to take *unilateral* action in the event of the absence or violation of an agreement. Quantitative limits were established on imported textiles and apparel in order to prevent or limit market disruption in importing countries. The United States applied apparel quotas to 41 countries that affected about 70% of their shipments (Schott, 1994, p. 58). In 1995, half of all apparel imports to the United States were subject to quotas (Shelton and Wallace, 1996). Thus, tariffs and quotas were two of the main national policy instruments used to limit import penetration in the United States apparel market.

This situation changed radically in 1994 when the new Agreement on Textiles and Clothing (ATC) made it necessary for GATT—later WTO—member countries to start phasing out restrictions on imports under the MFA so that regular GATT disciplines could be applied to the apparel industry over a 10-year period (US-OTEXA, 1999). At the start of each of the four integration phases (1 January of 1995, 1998, 2002 and 2005), importing countries are obliged to integrate a specified minimum proportion of their textile and apparel imports based on total trade volume as of 1990. In the case of the United States, 16% was integrated in 1995, 17% in 1998, and 18% and then the remainder are to be integrated in 2002 and 2005, respectively. Although products have to be selected in each phase from four different product groups—tops and yarns, fabrics, made-up textile products and apparel—the United States Government has left most of the apparel products for integration in the last tranche, thereby giving the maximum of adjustment time to the country's apparel firms. While the use of quotas is being eliminated, the United States still applies relatively high import tariffs to the apparel industry.

Another tool in the repertoire of the United States Government for limiting the import penetration of the apparel market has been direct pressure on specific exporters. The case of China is particularly relevant in this regard. The bilateral agreement with China for

1996-1997 applied tight quotas, with no growth foreseen for the first year and only 1% for the second. A new agreement in February 1997 reduced some quotas for products that United States officials identified as being linked to quota-beating transshipment practices, strengthened enforcement measures and authorized the United States Government to charge triple quotas for repeated violations. These measures came on top of changes in the United States rules of origin for textiles and apparel under which quotas are to be applied to the country in which the cutting took place rather than in the one in which assembly operations have been conducted.<sup>78</sup> China was obviously the principal target of these changes. Eventually, the United States pressured China into agreeing that, should it become a member of WTO, even though it would immediately receive the same benefits on the same schedule accorded other WTO textile-exporting countries under the ATC, its exports to the United States would be subject to the application of a selective safeguard clause for four years beyond the termination of all other quotas for WTO countries on 1 January 2005 (USITC, 1999, 30). Thus, where import tariffs and quotas have not provided sufficient import protection, direct pressure on the dominant apparel exporters has also been applied. Nonetheless, the battery of instruments available to the United States Government to disarm the challengers is being reduced by the progressive implementation of international agreements such as the ATC.

The second set of policy instruments employed by the United States Government has been aimed at strengthening United States apparel companies by helping them reduce their production costs so that they can compete more successfully with their Asian challengers. This has been done by facilitating the creation of regional supply chains close to the United States market. In essence, the aim has been to allow United States apparel firms to take advantage of lower wages in Mexico and the Caribbean basin by making use of two specific policy instruments: the first is what is known as production-sharing mechanisms, while the second takes the form of trade preferences for the participating countries. Wage rates have been an important consideration in this regard. While hourly rates in the apparel industry in the United States stood at US\$ 8.70 in February 1999, the average hourly wage

78 This resulted in a heated dispute with the European Union over silk scarves. The United States Government wanted to label the fabric as Chinese rather than European, while European producers wanted it to remain identified as a product of Europe.

(including social security and fringe benefits) in 1995 for a Mexican apparel worker was US\$ 1.61, and those of apparel workers in other Caribbean basin countries were as follows: Dominican Republic: US\$ 1.52, Costa Rica: US\$ 2.23, El Salvador: US\$ 1.43, Guatemala: US\$ 1.30 and Jamaica: US\$ 1.55. In an industry where labour costs usually account for about 25%-30% of production costs (Chacon, 1999, p. 10), this represents a significant opportunity to gain competitiveness in the United States market, even though the comparable hourly wage in the Chinese apparel industry amounts to the equivalent of only US\$ 0.25.

According to the United States International Trade Commission (USITC, 1999 p. i), the rationalization of production through the use of production-sharing operations has become an increasingly integral part of global efforts by United States companies to reduce manufacturing costs. These firms typically invest in production-sharing facilities to reduce labour costs and thus improve competitiveness in United States and developing-country markets. The firms usually retain product development and design, capital-intensive manufacturing, and marketing-related activities in the United States, while shifting labour-intensive assembly to countries with lower labour costs. Under Harmonized Tariff Schedule (HTS) provision 9802.00.80, the production-sharing mechanism provides a duty exemption for the value of United States-made components incorporated in imported articles that have been assembled abroad. The domestic content of United States imports entering under the production-sharing mechanism is also exempt from the merchandise processing fee (the customs "user fee" —a 0.21% ad valorem fee with a \$485 per entry cap). Apparel is the industry that is affected the most by the reductions afforded through the use of the production-sharing mechanism. Apparel imports accounted for 59% of the total duty savings from the use of this mechanism in 1997, even though they comprised only 15% of the total value of such imports.

In the second half of the 1980s, the United States Government granted preferential market access to items imported from Mexico and the Caribbean basin Initiative (CBI) countries, thereby giving a significant boost to United States production-sharing trade in the apparel sector (Bobbin Live, 1999a). The 807(A) programme, under which guaranteed access (no regular quota restrictions) is provided to the United States market for all apparel assembled in participating countries from "fabric wholly formed and cut in the United States", was applied to the CBI countries in 1986 and to Mexico in 1989. Most apparel imported

from Mexico and the Caribbean basin is sewn together from United States-made components in facilities located primarily in industrial parks in Mexico and export processing zones in the Caribbean basin (USITC, 1998b, p. 3-3). The relevant legislation in Mexico (mainly dealing with the *maquila* industry but also including the Programme for Temporary Imports for Export Production —known as the Pitex programme— and the export drawback mechanism) and the Caribbean basin countries (mainly legislation concerning export processing zones, but also temporary import programmes and an export drawback mechanism) have facilitated the duty- and tax-free operations of apparel assemblers.

The implementation of these policy instruments has resulted in a sharp rise in United States FDI outflows related to the apparel industry (from US\$ 971 million in 1993 to US\$ 1.3 billion in 1997), most of which has gone to Mexico and the Caribbean basin (USITC, 1999, pp. 11-12). Trade flows have been more impressive still. According to USITC (1999, p. 23), Asia's share of United States apparel imports dropped from 70.4% to 57.9% during the same period, while that of Mexico and the Caribbean basin rose from 16% to 26.8% (almost 30% in 1998), and the proportion of total apparel imports accounted for by production-sharing mechanism HTS 9802 advanced from 10% to 21%. Between 1993 and 1997, Mexico (36.6% in 1997) and the Caribbean basin and Central American countries (55.9% in 1997) together accounted for 87%-93% of the total value of the apparel that entered the United States market under the HTS 9802 production-sharing mechanism (see table IV.3). Asian countries accounted for less than 1% of such imports. Clearly, these policy instruments have been successful as measured against explicit policy goals.

United States apparel companies have sought to improve their efficiency through the implementation of new corporate strategies and have met with considerable success in this regard (Bobbin Live, 1999a). United States apparel firms have achieved a high level of efficiency in the offshore assembly of basic garments under production-sharing arrangements in Mexico and the Caribbean Basin. The HTS 9802.00.80 apparel trade focuses primarily on garments whose production involves standardized runs, simple tasks and few styling changes, and thus differs significantly from United States apparel imports from the Asian NIEs, which represent more of a cross-section of domestic demand. More recently, however, United States firms have expanded their apparel production-sharing arrangements to include

Table IV.3  
**UNITED STATES APPAREL IMPORTS UNDER PRODUCTION-SHARING MECHANISMS,  
 BY SOURCE, 1993-1997**  
*(Millions of dollars and percentages)*

Source	1993	1994	1995	1996	1997
<b>Total imports (millions of dollars)</b>	<b>4 853</b>	<b>5 836</b>	<b>7 758</b>	<b>8 845</b>	<b>11 491</b>
Mexico	1 067	1 523	2 331	3 033	4 204
Caribbean Basin Initiative countries	3 165	3 632	4 508	5 008	6 420
Dominican Republic	1 212	1 377	1 565	1 601	2 060
Costa Rica	543	587	670	646	793
Guatemala	424	450	520	579	651
Honduras	332	451	675	970	1 362
Jamaica	313	371	448	437	425
El Salvador	185	303	477	588	894
Other	463	493	727	683	711
<b>Total imports (percentages)</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>
Mexico	22.0	26.1	30.0	34.2	36.6
Caribbean Basin Initiative countries	65.2	62.2	58.1	56.6	55.9
Dominican Republic	25.0	23.6	20.2	18.1	17.9
Costa Rica	11.2	10.1	8.6	7.3	6.9
Guatemala	8.7	7.7	6.7	6.5	5.7
Honduras	6.8	7.7	8.7	11.0	11.9
Jamaica	6.4	6.4	5.8	4.9	3.7
El Salvador	3.8	5.2	6.1	7.7	7.8
Other	12.3	11.7	11.9	9.2	7.5

**Source:** ECLAC, on the basis of the United States International Trade Commission (USITC), "Production Sharing: Use of U.S. Components and Materials in Foreign Assembly Operations, 1994-1997", USITC Publication, No. 3146, Washington, D.C., December 1998 and "Production Sharing: Use of U.S. Components and Materials in Foreign Assembly Operations, 1992-1995", USITC Publication, No. 3032, Washington, D.C., April 1997.

garments requiring higher levels of production flexibility and sewing skills.

In the case of manufacturers, the implementation of these new corporate strategies has entailed maintaining a presence in several countries within the region that enjoy trade preferences and that compete among themselves to attract FDI or buyers contracts (FIAS, 1997, pp. 12-15). In many cases major United States apparel corporations have set up assembly plants in several Caribbean Basin countries and Mexico so that they can adapt more easily to the changing competitive positions of individual assembly sites. If exchange rates appreciate, wage and social security costs increase substantially, or transportation or

infrastructure problems arise at any particular site, then the parent company can adapt by reducing local production through the closure of one or more of its assembly lines and by increasing production elsewhere through the addition of another assembly line in a more convenient location where it already has a subsidiary. Unlike the case of the footloose operations of many smaller United States firms which, because of changing cost factors, are forced to jump from site to site in order to compete for buyers contracts, these subregional assembly operations have allowed the bigger United States apparel companies to maximize efficiency without generating bad public relations (see the case studies of Mortimore (1999b), Mortimore and Zamora

(1999), Mortimore, Duthoo and Guerrero (1995), and Vicens, Mortimore and Martinez (1998)).

A number of representative cases involving some of the bigger United States apparel companies in relevant product groups can be used to illustrate the specific nature of the changes that have been made in corporate strategies. These cases concern branded manufacturers of jeans (Levi Strauss and VF Corporation), branded manufacturers and/or marketers of women's intimate wear (Sara Lee, Fruit of the Loom and Warnaco), and the case of one branded retailer of women's apparel (Liz Claiborne). Each example illustrates specific aspects of the new strategies being applied in Mexico and the Caribbean Basin countries.

VF Corp., with brands such as Lee, Wrangler, Rider, Rustler and Britannia, and Levi Strauss, with brands such as Levi's, Dockers and Slates, are among the most prominent manufacturers and (in the case of Levi Strauss) retailers of jeans in the world. VF Corp. also produces intimate wear. Levi Strauss saw its United States market share collapse in the 1990s (plunging from 31% to 14%) because it did not keep abreast of changing consumer trends and the increased role of other retailers, nor did it act quickly enough to reduce its high production costs by moving its assembly operations offshore. In the all-important category of men's (16 or older) jeans, Levi's market share dropped from 48.2% to 25% in 1990-1998 while VF's share (Lee and Wrangler) jumped from 22.1% to 31.9% (Munk, 1999). As a result, it was forced to restructure in 1998, closing 12 of its 32 United States plants and 4 of its 12 European plants. In 1999 it announced the closure of another 11 plants in North America, reducing its workforce by 38%. Its operations are now primarily based at its own assembly plants in Mexico and the Caribbean Basin plus buyers contracts for Docker apparel. The latter takes advantage of suppliers that offer full-package facilities. VF Corp. restructured earlier on, in 1995, closing 14 United States plants and moving 35% of its production offshore to Mexico (eight plants) and Caribbean Basin countries (six plants in Costa Rica and one in Honduras). By 1998, 57% of its production was offshore and its stated aim was for this figure to rise to 80% of its total sewing operations. As well as its own brands, VF Corp. announced a US\$ 1.25 billion investment programme to license other brands, such as Tommy Hilfiger and Nike. Levi Strauss' delay in taking advantage of the production-sharing mechanism clearly was a contributing factor to its loss of United States market share.

The cases of the three principal branded manufacturers of intimate wear are also very instructive. Sara Lee (Hanes, Playtex, Bali and L'eggs), Fruit of the Loom (Fruit of the Loom, BVD, Gitano and Munsinger) and Warnaco (Warner's, Olga, Lejaby) all produce well-known brands. Sara Lee, with 32% of the United States market for brassieres and 38% of the market for men's and boys' underwear, was one of the first major United States apparel companies to move offshore in the mid-1980s. In 1992 it also purchased major Mexican firms (Rinbros and Mallorca) to further consolidate its offshore operations. By 1997, 42% of its apparel output was being produced at foreign plants. Even so, to further enhance its competitiveness it decided to de-verticalize its United States operations by exiting the knit textiles business. In 1999, it announced a US\$ 45 million investment to expand its 12 plants in Puerto Rico, where it is the largest employer. It maintains a widespread presence in assembly subsidiaries in Mexico and the Caribbean Basin, with contract operations in Mexico, Jamaica and El Salvador. Fruit of the Loom was slow to react to the opportunities opened up by production-sharing arrangements in Mexico and the Caribbean, and it was not until 1995 that it started moving offshore. However, by 1998, 95% of its sewing operations were located offshore, with about one half of that figure being accounted for by its own new plants in El Salvador and Honduras. Warnaco, a major player in brassiere sales, with 30% of the United States market, has coupled its offshore assembly activities for its own brands in Asia, North and South America and the Caribbean Basin with the licensing of other brands, such as Calvin Klein (Designer Holdings), White Stag, Speedo and Chaps (Ralph Lauren). Warnaco owns 20 Calvin Klein stores in Asia. In the case of intimate wear, in order to catch up with Sara Lee after it had used production-sharing mechanisms to boost itself into the lead, Fruit of the Loom and Warnaco had to follow suit, as well as following up on other competitive options such as the licensing of other brands from competitors.

The case of Liz Claiborne is quite different from the foregoing examples because it is solely a branded retailer, not a manufacturer. The company owns 113 exclusive sales outlets in the United States market, where its competitive advantages are found in design and marketing. It has awarded buyers contracts in 30 different countries, licensing producers to manufacture Liz Claiborne designs. In 1998, it broadened its brands portfolio by licensing other labels from Donna Karan (DKNY Jean and DKNY Active) and launching



JH Collectables. Given this situation, the firm is very interested in full-package suppliers in Asia and, more recently, Mexico.

These examples of new corporate strategies demonstrate the importance of production-sharing opportunities in enabling United States apparel companies to increase their competitiveness by reducing production costs by way of coming from Mexico and the Caribbean Basin and thus boosting

their efficiency. While each strategy has its own particular nuances, the common element is the need for increased efficiency and the role of Mexico and the Caribbean Basin in supplying parent firms either directly through manufacturing subsidiaries or via buyers contracts. In this regard, the North American Free Trade Agreement (NAFTA) provided benefits to Mexico that were not available to the Caribbean Basin countries.

### C. NAFTA: CREATING DIFFERENCES BETWEEN MEXICO AND THE CARIBBEAN BASIN COUNTRIES

Mexico and the Caribbean Basin countries have both played a part in strengthening United States apparel companies since, through the use of production-sharing mechanisms, these firms have been able to create regional supply chains to take advantage of the lower wages in those countries for the purpose of winning back United States import market share from Asian challengers. A very high proportion of the apparel exports of these countries to the United States market are linked to production-sharing mechanisms. In 1997 almost 82% of apparel exports from Mexico to the United States market entered under HTS 9802, and over 84% of those of the Caribbean Basin countries did so as well. However, the implementation of NAFTA as of 1 January 1994 put Mexico in a much better position than the Caribbean Basin countries to supply the United States apparel market.

An examination of the overall United States apparel import data series for which recent information is available (see table IV.4) shows that Mexico is rapidly closing the gap between it and the CBI countries and may soon overtake them as the principal apparel supplier of the United States market. Between 1992 and 1999, its share went from 3.4% to 15.3%, while that of the CBI countries only advanced from 12.1% to 17.9%. By June 1999, the value of Mexico's annualized apparel exports to the United States had risen by almost 9% compared to the previous year,

while that of the CBI countries was barely maintaining its 1998 level. In essence, it might be said that Mexico's special access has become "more special" than that of the Caribbean Basin countries.

In general, NAFTA has opened up opportunities for United States fibre, textile and clothing manufacturers to expand their sales and increase production, to make full use of economies of scale and to take advantage of complementary resources in the three member countries—Canada, United States and Mexico—to enhance their export potential (US-OTEXA, 1999). Benefits for Mexico come in the form of:

- The reduction or elimination of tariff duties;
- The reduction or elimination of quotas; and
- The enforcement of common rules of origin (USITC, 1999, p. 30).

NAFTA provides for the programmed elimination of duties on apparel trade among members in goods that "originate" in the member countries. In the case of Mexico, virtually all United States tariffs on originating apparel had been phased out by 1 January 1999. The United States eliminated quotas for apparel originating from Mexico upon the implementation of NAFTA and will have phased out the quotas for non-originating goods from Mexico by 1 January 2004. With respect to the rules of origin, most apparel articles are subject to a "yarn forward" origin rule, whereby all

Table IV.4  
**UNITED STATES APPAREL IMPORTS FOR SELECTED YEARS BETWEEN  
 1992 AND JUNE 1999**  
*(Millions of dollars and percentages)*

Source	1992	1995	1998	June 1999
<b>Total imports (millions of dollars)</b>	<b>26 713</b>	<b>34 649</b>	<b>48 175</b>	<b>23 025</b>
Mexico	901	2 566	6 494	3 529
Caribbean Basin Initiative countries	3 228	5 433	8 270	4 125
Dominican Republic	1 203	1 731	2 342	1 098
Costa Rica	589	757	821	396
Guatemala	451	682	1 134	555
Honduras	365	918	1 873	1 014
Jamaica	292	530	422	173
El Salvador	166	582	1 171	610
Other	22 584	26 650	33 411	15 371
<b>Total imports (percentages)</b>				
Mexico	3.4	7.4	13.5	15.3
Caribbean Basin Initiative countries	12.1	15.7	17.2	17.9
Dominican Republic	4.5	5.0	4.9	4.8
Costa Rica	2.2	2.2	1.7	1.7
Guatemala	1.7	2.0	2.4	2.4
Honduras	1.4	2.6	3.9	4.4
Jamaica	1.1	1.5	0.9	0.8
El Salvador	0.6	1.7	2.4	2.6
Other	84.5	76.9	69.4	66.8

Source: ECLAC, based on data for United States imports for consumption (customs values) supplied by the Office of Textiles and Apparel, International Trade Administration, Department of Commerce.

manufacturing steps including yarn formation must take place in one of the three member countries, thereby fortifying the North American supply chain.

The NAFTA benefits have translated into certain competitive advantages over the Caribbean Basin countries, such as duty-free entry of goods produced under production-sharing contracts, whereas the Caribbean countries still pay duty on value added outside of the United States (mainly wages) and are subject to certain quotas. Also, NAFTA benefits apply to Mexican apparel goods made under production-sharing contracts even if the goods do not meet the NAFTA "yarn forward" rule of origin or if they undergo certain finishing processes in Mexico after assembly (such as bleaching, garment dyeing, stone-washing, acid-washing or permapressing—processes which constitute further fabrication in any other country and thus disqualify the treated garments for a partial duty exemption, even though they contain United States-made parts— (Bobbin Live, 1999b, p. 2).

The effects of Mexico's NAFTA preferences soon became evident. The closure of 250 plants and the loss of 123,000 jobs in the Caribbean Basin countries have been attributed to Mexico's NAFTA advantages (Stinson, 1999). Between 1994 and 1998, total United States apparel imports and imports from Mexico of apparel made under production-sharing contracts increased by 307.4% and 247.1%, respectively, while those of the Caribbean Basin countries did so by only 84.2% and 91.6% (Gereffi, 1999a, table 2). In 1998, Mexico surpassed even China to become the principal apparel supplier to the United States market (see table II.3). This dramatic change was probably even greater in scope than the figures suggest, since considerable undercounting of United States imports of Mexican apparel is suspected (USITC, 1999, pp. 1-5). The implicit United States tariff applied to apparel imports from Mexico dropped from 6.4% to 0.9%, while that of the Caribbean Basin countries only declined from 9.1% to 8.5% (Buitelaar, 1999, p. 2). Other clear benefits

have had to do with the increasing specialization of the Mexican apparel industry in the *integrated* production of cotton trousers and especially blue jeans, which has entailed the development of a locally-based supply chain.

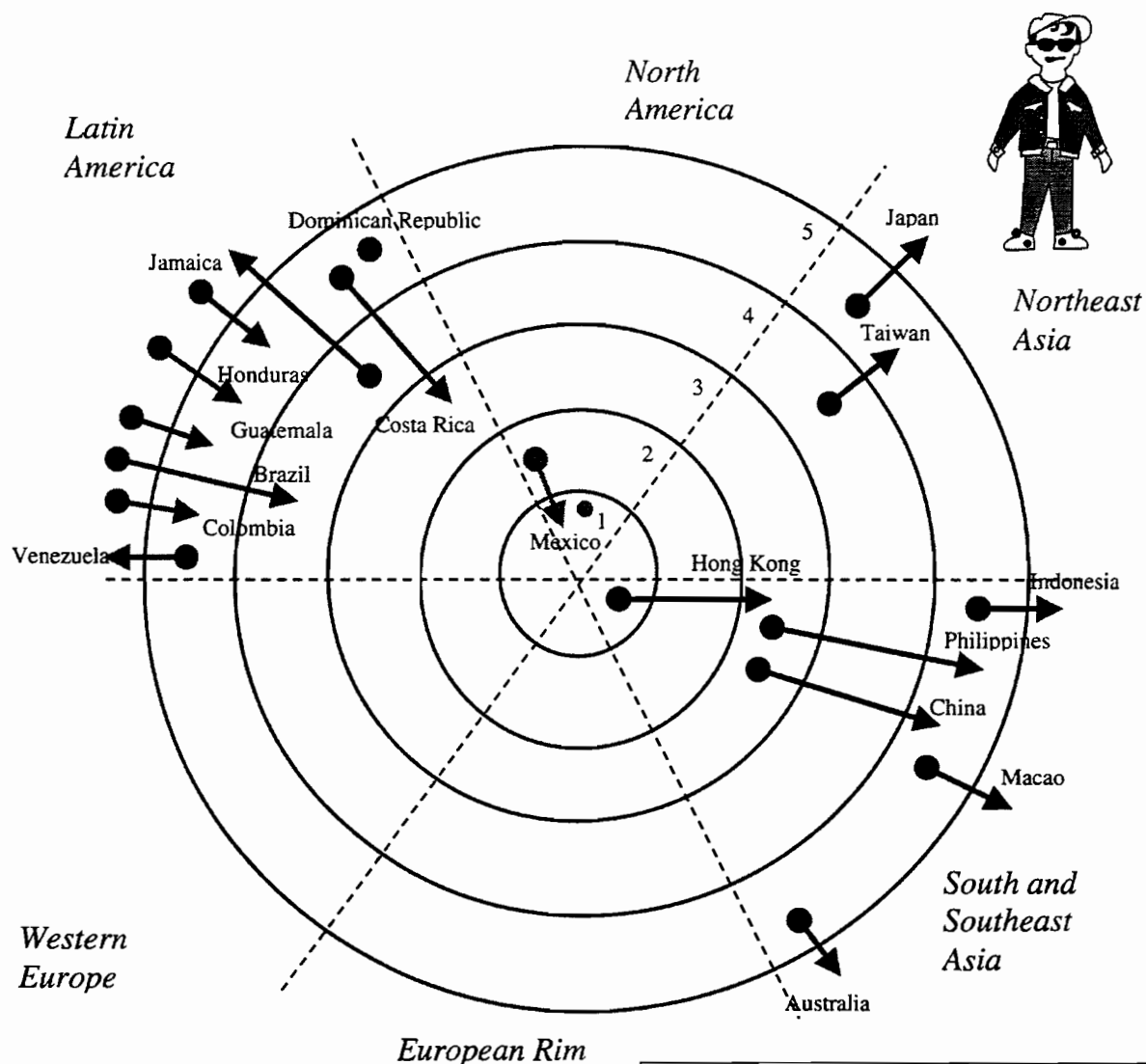
The manufacture of blue jeans is perhaps the example that best illustrates the types of changes that have been brought about by NAFTA. By 1998, Mexico had become the main supplier of this line of men's and women's apparel to the North American market, with a market share of about 60% of United States imports of these items (see figures IV.2 to IV.5). The two cases outlined below demonstrate how Mexico's competitive situation has improved in relation to major suppliers in the Caribbean basin as a result of the advantages and rules of origin established by NAFTA.

- United States imports of men's and boys' blue jeans (HTS 6203424010) have been burgeoning. Between 1990 and 1994, imports of these items rose from US\$ 198.7 million to US\$ 424.3 million, which also means that they increased from 0.04% of total United States imports to 0.064%. Before NAFTA entered into force, both Mexico and the countries of the Caribbean basin were expanding their shares in this market and Mexico had moved from the second to the first ring, as its market share had grown to over 25% by 1994. Costa Rica jumped from the fifth to the second ring as it increased its share to over 6.25%. Other Caribbean basin countries, such as Honduras, Guatemala and Belize, also succeeded in enlarging their market shares. These economies were thus taking over market share from such Asian economies as Hong Kong SAR, China, the Philippines and Taiwan Province of China (see figure IV.2). Events during the period between 1995 and 1998, on the other hand, reflect the impact of NAFTA on the competitive positions of suppliers of men's and boys' blue jeans to the United States market. During this period imports of these garments soared from US\$ 556.9 million to US\$ 882 million, or from 0.075% to 0.097% of total United States imports. Mexico thus consolidated its position as the market's number one supplier, but in so doing it cut into the market shares of Caribbean basin countries such as Costa Rica and the Dominican Republic (see figure IV.3).
- Something similar has happened in the case of women's and girls' blue jeans (HTS 6204624010). Between 1990 and 1994, United States imports of these garments were sluggish, slipping from

US\$ 318 million to US\$ 303.8 million and from 0.064% to 0.046% of total United States imports. Before NAFTA, both Mexico and the Caribbean basin countries were gaining ground in this market. During this period Mexico advanced from the third ring to the first, with its market share growing to over 25% by 1994; the Dominican Republic shifted from the fifth to the fourth ring with a market share of over 3.125%; and Honduras moved into the fifth ring. These economies were taking away market share from Asian economies such as those of Taiwan and Japan, but were faced with fierce competition from others, such as the Philippines (see figure IV.4). The impact of NAFTA on competition in the United States market for women's and girls' blue jeans can be seen in the period 1995-1998, when imports of these items soared from US\$ 345 million to US\$ 725.6 million and from 0.046% to 0.079% of total United States imports. In this case, too, Mexico consolidated its position as the largest supplier at the expense of the market shares of Caribbean basin countries such as the Dominican Republic and Honduras (see figure IV.5).

The example of jeans manufacturing activities also demonstrates one of the more significant aspects of the NAFTA benefits for Mexico. Several United States companies have initiated major investments in the production of denim in Mexico, now that Mexican inputs count as North American ones under the NAFTA rules of origin. Cone Mills has established a joint venture with Mexico's largest textile producer, Compañía Industrial de Parras, in Torreón. VF Corp., through Wrangler Comercializador de México, is investing US\$ 30 million to build three denim plants in Chihuahua. A new US\$ 3 million project to build a "textile city" in Morelos has also been undertaken by major United States textile companies, including Burlington Industries (see the discussion of its NAFTA strategy in box IV.3), Guilford Mills and DuPont. Part of that investment is in three new denim plants that were scheduled to open in 1999. This specialization and integrated production is one of the longer-term benefits of NAFTA and sets Mexico apart from the Caribbean Basin countries. Indeed, soon after the signing of NAFTA, Mexico began to be touted as the "new Hong Kong of Latin America" and as the new leader of all aspects of the industry, from fibres to fabrics to apparel (Poole, 1998). The NAFTA advantages have thus helped to foster the development of a denim supply chain in Mexico.

Figure IV.2  
**SHIFTS IN THE REGIONAL STRUCTURE OF MEN'S AND BOYS' BLUE JEANS (HTS 6203424010)  
 IMPORTS TO THE UNITED STATES MARKET DURING 1990-1994**



The rings indicate the share of total United States imports of this item, measured in United States dollars, by partner country:

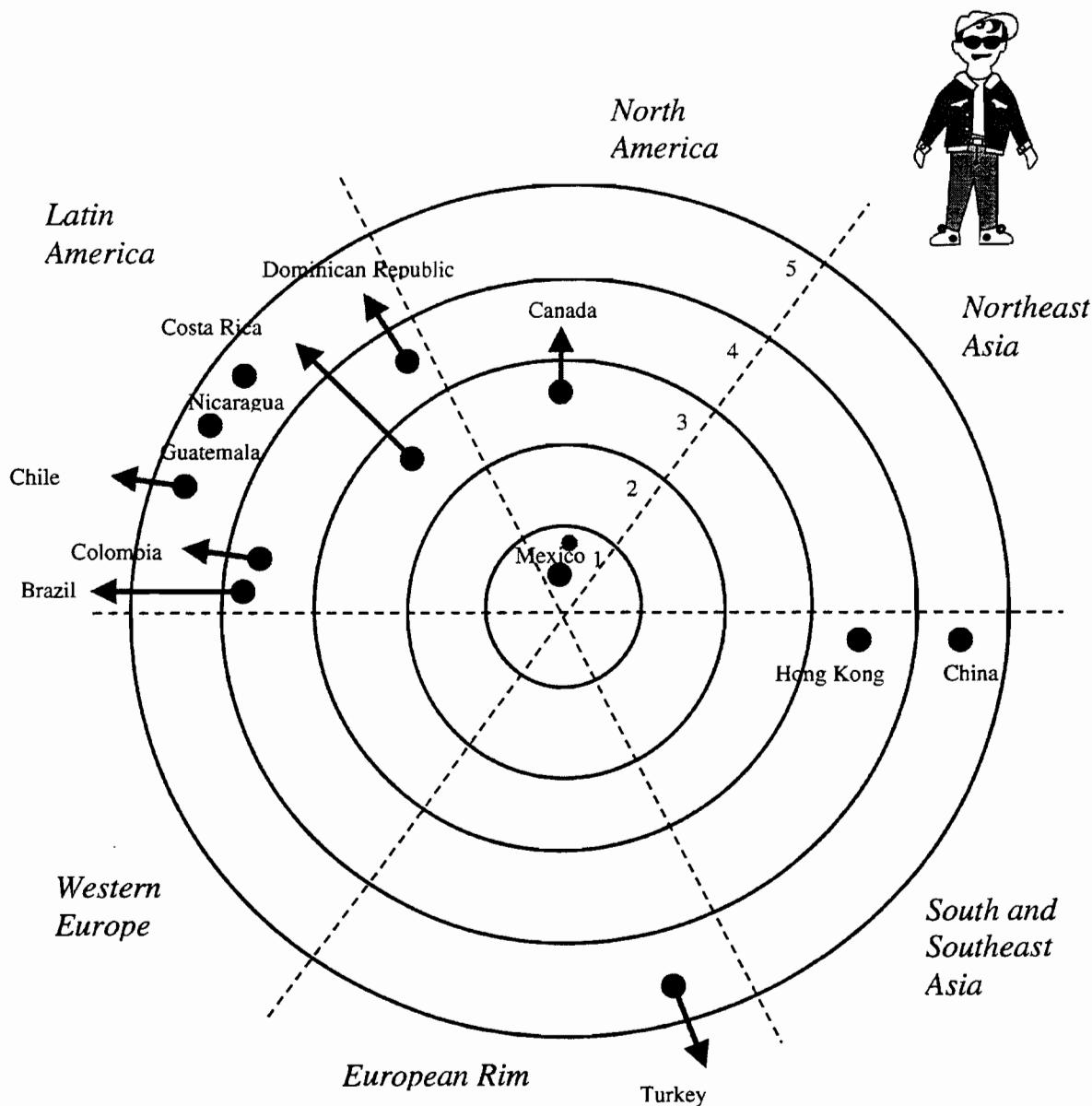
- |                 |                  |
|-----------------|------------------|
| 1. 25% +        | 4. 3.125 - 6.24% |
| 2. 12.5 - 24.9% | 5. 1.52 - 3.124% |
| 3. 6.25 - 12.4% |                  |

Total value of men's and boys' blue jeans imports was US\$ 198.7 million in 1990 (0.04 % of total United States imports) and US\$ 424.3 million in 1994 (0.064 %). The 1994 position corresponds to where the country's name is located; the 1990 position, if different, is indicated by a small circle. The arrows represent the magnitude and direction of change over time. Mexico's share increased from 13.2% to 36.1% during 1990-1994.

Source: Calculated using the MAGIC computer program developed by ECLAC.

Figure IV.3

**SHIFTS IN THE REGIONAL STRUCTURE OF MEN'S AND BOYS' BLUE JEANS (HTS 6203424010)  
IMPORTS TO THE UNITED STATES MARKET DURING 1995-1998**



The rings indicate the share of total United States imports of this item, measured in United States dollars, by partner country:

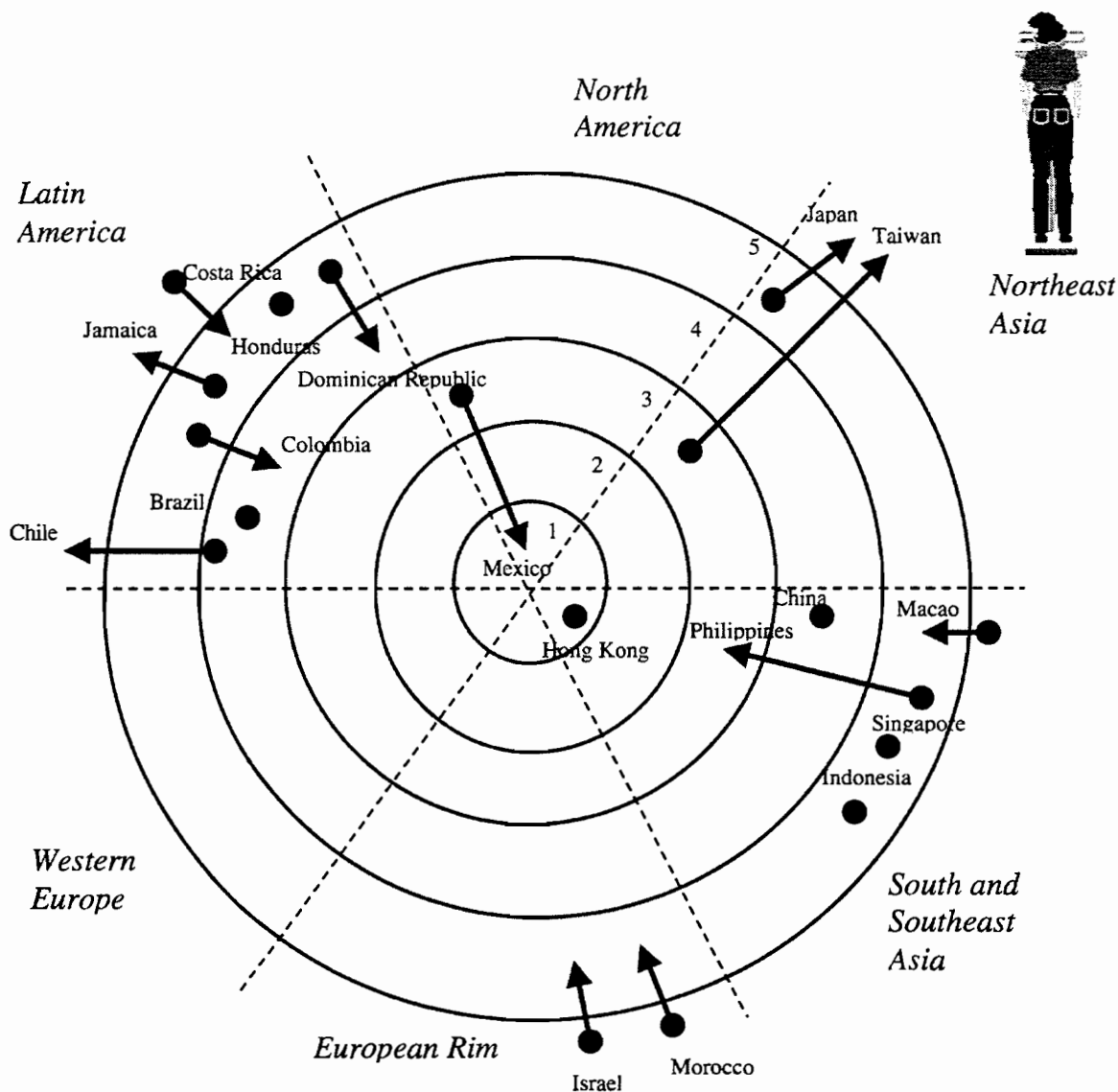
- 1. 25% +
- 2. 12.5 - 24.9%
- 3. 3.125 - 6.24%
- 4. 6.25 - 12.4%
- 5. 1.52 - 3.124%

Total value of men's and boys' blue jeans imports was US\$ 556.9 million in 1995 (0.075 % of total United States imports) and US\$ 882 million in 1998 (0.097 %). The 1998 position corresponds to where the country's name is located; the 1995 position, if different, is indicated by a small circle. The arrows represent the magnitude and direction of change over time. Mexico's share increased from 44.9% to 58.1% during 1995-1998.

**Source:** Calculated using the MAGIC computer program developed by ECLAC.

Figure IV.4

**SHIFTS IN THE REGIONAL STRUCTURE OF WOMEN'S AND GIRLS' BLUE JEANS (HTS 6204624010)  
IMPORTS TO THE UNITED STATES MARKET DURING 1990-1994**



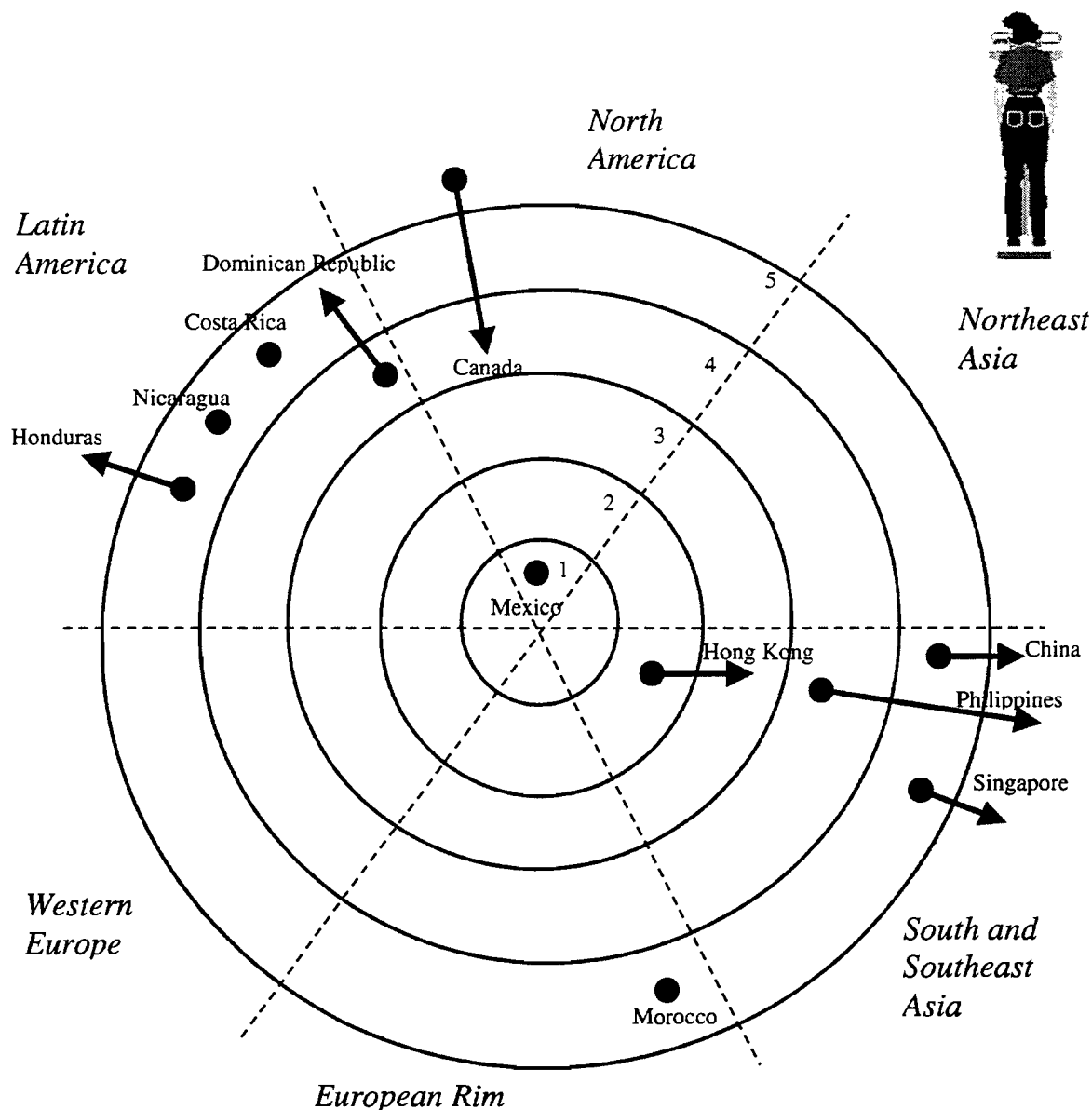
The rings indicate the share of total United States imports of this item, measured in United States dollars, by partner country:

- |                 |                  |
|-----------------|------------------|
| 1. 25% +        |                  |
| 2. 12.5 - 24.9% | 4. 3.125 - 6.24% |
| 3. 6.25 - 12.4% | 5. 1.52 - 3.124% |

Total value of women's and girls' blue jeans imports was US\$ 318 million in 1990 (0.064 % of total United States imports) and US\$ 303.8 million in 1994 (0.046 %). The 1994 position corresponds to where the country's name is located; the 1990 position, if different, is indicated by a small circle. The arrows represent the magnitude and direction of change over time. Mexico's share increased from 11.4% to 26.1% during 1990-1994.

Source: Calculated using the MAGIC computer program developed by ECLAC.

Figure IV.5  
**SHIFTS IN THE REGIONAL STRUCTURE OF WOMEN'S AND GIRLS' BLUE JEANS  
 (HTS 6204624010) IMPORTS TO THE UNITED STATES MARKET DURING 1995-1998**



**Source:** Calculated using the MAGIC computer program developed by ECLAC.

The rings indicate the share of total United States imports of this item, measured in United States dollars, by partner country:

1. 25% +
2. 12.5 - 24.9%
3. 6.25 - 12.4%
4. 3.125 - 6.24%
5. 1.52 - 3.124%

Total value of women's and girls' blue jeans imports was US\$ 345 million in 1995 (0.046% of total United States imports) and US\$ 725.6 million in 1998 (0.079%). The 1998 position corresponds to where the country's name is located; the 1995 position, if different, is indicated by a small circle. The arrows represent the magnitude and direction of change over time. Mexico's share increased from 43.2% to 62.8% during 1995-1998.



## Box IV.3

# THE NAFTA STRATEGY OF A UNITED STATES TEXTILE COMPANY: BURLINGTON INDUSTRIES

Burlington Industries recently celebrated its seventy-fifth anniversary as one of the world's largest textile manufacturers (US\$ 2 billion in sales in 1998). It has 29 plants in six states in the United States as well as mills in Mexico and India. Production of textiles for apparel accounts for 60% of Burlington Industries' revenue. The firm serves four major product categories: denim, synthetics, worsted wool and cotton sportswear. Based in Greensboro, North Carolina, the Burlington story is twofold. First, it is a prime example of the textile industry trend towards the use of offshore locations. Second, Burlington is diversifying into apparel. Having previously operated exclusively as a manufacturer of textiles, it is now integrating forward by venturing into sewing and garment assembly.

Mexico is a key growth area for Burlington, which hopes to use Mexican production to capture middle-tier market share from Asian companies. Though Burlington has been involved in Mexico for over 40 years, its interests had previously been limited to supplying home textiles for the domestic market. As of 1994, Burlington had only three plants in Mexico, two of which were for the production of cotton

and synthetic fabrics. Yet layoffs at United States plants were an early indicator that the United States textile industry was looking south. As late as 1996, Burlington was claiming that it would "keep core production based in the United States" (Krouse, 1996). However, soon thereafter this strategy began to change rapidly. In 1997, Burlington entered into a joint venture with Guilford Mills, DuPont and the Mexican company Grupo Alfa to build "Textile City", a US\$ 3 million industrial park south of Mexico City, to serve as a base for United States clothing producers. The goal of this project, entitled "NuStart", is to promote the vertical integration of fibre, fabric and manufacturing activities using the most advanced technology. Plans include a training centre for middle managers and workers to be built with Mexican state and federal support. In 1998 Burlington announced it would invest US\$ 80 million over the next three years in five garment-making facilities coordinated by its garment service centre in Mexico; these facilities are expected to employ 2,000 workers and to add US\$ 225 million to Burlington's annual sales. In 1999 three new

plants were scheduled to open in Yecapixtla, Morelos, to produce denim, worsted wool fabrics and cotton yarns.

Currently, Burlington is carrying out a comprehensive reorganization of its apparel fabrics business. Its United States plants' production capacity will decrease by 25%, with seven plants to be closed, while its Sportswear Division has been converted into a unit of the Global Denim Division. The sportswear unit has moved to Mexico and makes men's shirts and slacks; some of the fabrics come from Mexican weaving plants, and the sewing work is contracted out to apparel manufacturers around Mexico City. This full-package supply chain is being adopted in various stages by Burlington's other divisions as well. In 1994 Burlington began to assist its customers in the production of finished garments through an agreement with International Garment Processors of El Paso, Texas, to build a garment finishing plant in Chihuahua (Gereffi and Bair, 1998, p. 32). The newer plants in Mexico, unlike their predecessors, are being equipped with state-of-the-art technology, and substantial investments are being funneled into training programmes.

Source: ECLAC, on the basis of Gary Gereffi, "The Transformation of the North American Apparel Industry: is NAFTA a Curse or a Blessing?", consultant report prepared for the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, May 1999.

Mexico is beginning to establish itself as a supplier to the North American market while occupying a new middle-ground position between: (1) the East Asian model, in which national exporters in the East Asian NIEs supply full-package apparel to United States buyers and thus are able to dominate important segments of the higher-value, mainly women's fashion-apparel market; and (2) the Caribbean Basin model,<sup>79</sup> which is based on the traditional HTS 9802 form of production sharing and entails a mixture of lower wages, an export-processing zone format, preferential access to the United States market and quotas that offer none of the longer-term benefits associated with the NAFTA rules of origin (Mortimore, 1999b). Thus, the emerging Mexican model is one in which the NAFTA rules of origin create an incentive for more integrated apparel production in Mexico and in which it is mainly United States companies (rather than Mexican firms)

that are vying for the lead role in coordinating the full-package option.

Clearly, NAFTA has altered the nature of competition between Mexico and the Caribbean Basin countries. While it is true that the apparel specialization of the Caribbean Basin countries is more in the area of cotton shirts, brassieres and underwear, the fact remains that blue jeans were the main item in which Costa Rica, Dominican Republic, El Salvador and Honduras *lost* United States apparel import market shares to Mexico after the implementation of NAFTA (Buitelaar, 1999, p. 7). This type of spillover from NAFTA prompted calls for "NAFTA parity" for the Caribbean Basin countries. One benefit of this could be that they may establish a more specialized and integrated—and therefore competitive—apparel industry before the last tranche of the GATT Agreement on Textiles and Clothing opens up the United States apparel market to more competitive Asian exports in 2005.

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## D. CONCLUSIONS

It appears that a new import competition model is starting to emerge in the North American apparel sector: the Mexican model. The relative success and limitations of the existing East Asian and Caribbean Basin models of apparel production and of the emerging Mexican model are determined by a number of factors whose influence can be seen in the intersection of international and national market factors, national policy and new corporate strategies. Ultimately, success in the contemporary global economy requires an understanding of how to use supplier chains and organizational networks to penetrate major markets. And in fact, the three models

of competition we have identified do indeed use supplier chains and organizational networks quite differently.

The *East Asian model* is based on the highly successful operations of textile and apparel exporters from Hong Kong SAR, the Chinese Province of Taiwan and the Republic of Korea (preceded by Japan, and now followed by China) that have progressed through a sequence of export roles from assembly to full-package operations to, in some cases, original brand manufacture (OBM) (Gereffi, 1999). The East Asian NIEs developed and refined their full-package capabilities in the 1960s and 1970s by establishing

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79 It should be noted that some Central American countries, such as El Salvador and Honduras, export a very significant volume of items of apparel to the United States that originate in assembly plants located in their territories that are owned by Asian enterprises (particularly firms based in the Republic of Korea and the Chinese Province of Taiwan). The principal benefit for the Asian firms is that this allows them to make use of the host country's quotas in the United States market.

close ties with United States retailers and marketers, and then “learning by watching”; thus, they used these foreign partners as role models to build East Asia’s export competence. The trust built up through many successful business transactions with these United States buyers enabled suppliers in the East Asian NIEs to internationalize their full-package expertise via “triangle manufacturing” —i.e., the East Asian manufacturers became intermediaries between the United States buyers and hundreds of apparel factories in Asia and other developing regions in order to take advantage of lower labour costs and ample quotas all around the world. The creation of these global sourcing chains helped the East Asian NIEs to sustain their international competitiveness when domestic economic conditions and quota constraints threatened to undermine their original full-package bilateral relationships. Currently, the East Asian NIEs are moving beyond the intermediary role in multiple ways: shifting to higher value “upstream” products in the apparel industry (e.g., exports of textiles and fibres, rather than simply items of apparel); moving “downstream” from full-package to OBM operations; and switching to new lines of production where their export success with apparel can be replicated.

In their home-country operations, the East Asian NIEs did not employ the production-sharing provisions established under the HTS 9802 United States trade regime for apparel because their great distance from the United States made the use of United States textile inputs impractical. In addition, United States textile mills did not have the production capability or mentality to supply the diverse array of fabrics favoured by designers of women’s wear and fashion-oriented apparel, which had become the specialty of the East Asian exporters. The combination of these two factors has created a full-package niche for East Asian apparel companies that they have exploited adroitly.

The emerging (but by no means consolidated) *Mexican model* involves an ongoing transition from assembly to a more full-package type of production. The key factor in Mexico’s shift has been NAFTA. With the passage of NAFTA in 1994, the trade restrictions that had virtually locked Mexico into an assembly role began to be lifted. The *maquiladora* system effectively made Mexico’s access to the United States market conditional upon the use of United States

inputs.<sup>80</sup> The progressive 10-year phase-in period for NAFTA provides an opportunity to observe how, step by step, more and more components of the apparel supply chain (such as cutting, washing, and textile production) are relocating to Mexico as specific tariff restrictions on each of these stages are eliminated.

However, NAFTA does not guarantee Mexico’s success. While the massive peso devaluations of 1994–1995 made Mexico very attractive as a production site for United States apparel manufacturers with international subcontracting operations, the infrastructure of related and supporting industries needed in order to conduct full-package production has not yet evolved, at least not in an internationally competitive manner. As noted earlier, United States textile and apparel companies have been expanding their investments in Mexico at a rapid and accelerating pace. As a result, Mexico is now better positioned to provide the quantity and quality of inputs needed for full-package production of standardized apparel items such as jeans, knit shirts and trousers, and underwear, but it is still lagging in the fashion-oriented women’s wear categories. The solution to the problem of how to complete the transition to full-package supply and how to develop new production and marketing niches is to forge linkages with the kinds of lead firms that can supply the needed resources and tutelage. In other words, Mexico needs to develop new and better supply chains in order to compete with East Asian suppliers for the United States full-package market (Gereffi, 1997, pp. 16–31). Until this is done, the Mexican model will not become consolidated.

United States firms have already shown a strong interest in transferring missing pieces of the North American apparel supply chain to Mexico. A real problem to be confronted, however, is the question of who is to control critical nodes of the chain and how to manage the dependency relationships that this will entail. Thus far, United States firms are in clear control of the design and marketing segments of the apparel chain, while Mexican companies are in a good position to maintain and coordinate the production segment. However, textile manufacturers in the United States and, to a lesser degree, in Mexico, are making strong bids to integrate a broad package of apparel services that would increase their leverage vis-à-vis smaller garment contractors. For the foreseeable future, Mexico is likely to retain a mix of assembly plants

80 It should be noted that the *maquiladora* format was recently extended up to December 2001.

linked to United States branded manufacturers and a new set of full-package producers linked to private-label retailers and marketers. As more of the critical apparel inputs become available in Mexico, the use of United States inputs will decline and traditional Mexican assembly plants will be replaced by more vertically integrated manufacturers or by clusters of related firms that compete through localized chains, such as the jeans producers in Torreón (Gereffi and Bair, 1998, pp. 26-35).

The *Caribbean Basin model* is almost exclusively limited to assembly activities located within export processing zones that operate under the HTS 9802 trade regime. Because the Caribbean Basin economies do not have "NAFTA parity", they are faced with quota restrictions and are subject to higher tariffs and more limited possibilities for vertical integration than Mexico. For that reason, this model has been referred to as "threadbare" (Mortimore, 1999b). Nonetheless, these countries have enjoyed considerable success in their export assembly role. Some of them, such as El Salvador and Honduras, continue to expand their position in the United States apparel market primarily through large assembly plants linked to the production-sharing operations of major United States apparel companies. However, in several of the main lines of assembly they are losing ground to Mexican firms that can export similar goods to the United States more cheaply and quickly than their Caribbean Basin counterparts. The example of blue jeans, as discussed above, demonstrates this. If the Caribbean Basin economies do secure a trade enhancement package in the near future, this would help to level the playing field with Mexico in terms of the regulatory and economic environment. However, these countries still need to develop supply chains with United States retailers and marketers if they are to acquire the skills and resources needed to move into the more diversified activities associated with full-package production.

The United States Government and the principal United States apparel corporations continue to define the terms under which changes are made in the regional supply chain of the North American apparel market (for an example, see box IV.4). United States global brands dominate the industry, and the producers of these brands must be geographically close to the United States market, since demand is consumer driven and fluctuates rapidly. Mass customization and flexible, responsive production processes represent the next generation in manufacturing, and United States firms are taking a leadership role in trying to deliver highly personalized products at mass-production prices. This requires an appropriate integration of information technology, automation, and short-cycle, team-based management systems. Giant United States retailers have raised the bar for domestic as well as overseas suppliers with state-of-the-art "quick response" systems that place stricter inventory management demands and greater financial risks on producers, which must be able to supply consumer goods more quickly, more cheaply, and in greater variety than in the past.

Sustained competitiveness in the international apparel industry involves continual changes in economic roles and capabilities. New exporters are constantly entering the global and regional supply chains, and this is pushing the existing firms to cut costs, upgrade, or exit the market. In other words, they have to run faster just to stay in place. To facilitate adjustment and, indeed, survival in a volatile, export-oriented sector such as apparel, industrial upgrading typically requires organizational linkages with the buyers and suppliers in developed-country markets. Mexico is making use of supply chains with United States firms to try to occupy niches that have previously been the stronghold of East Asian suppliers, and the Caribbean Basin countries are trying to keep pace with Mexico. In the case of the CBI countries, however, the NAFTA advantages available to Mexico make the task that much harder, especially since the time for adjustment is running out.

## Box IV.4

## THE COSTA RICAN APPAREL INDUSTRY: AN INNOCENT BYSTANDER?

A significant challenge to the Costa Rican clothing industry has arisen in connection with the country's relationship with its principal trading partner: the United States. One of the prickliest areas in that relationship has had to do with the application by the United States Government of unilateral restrictions on access to the United States market in the form of quotas and "calls". In 1994, over one half of all Costa Rican apparel exports to the United States were subject to quotas, and that figure rose to almost two thirds in 1995 due to the calls applied to undergarments and pajamas in most of the Caribbean Basin countries. These import quotas—which were imposed for a period of two years by the United States Government in response to complaints by United States apparel companies operating in the United States that "market disruption" (that is, unduly rapid import expansion) was taking place—represented new limits on exports administered by the National Council for Textile and Apparel Quotas, which was established in Costa Rica in 1988. The 1995 calls were applied to many of Costa Rica's most important clothing export items (MFA 352-632: cotton and synthetic fibre undergarments, and MFA 351-651: cotton and synthetic pajamas). In the case of underwear, the limit imposed was 14.4 million dozen. This represented a direct challenge to the future expansion of this part of the clothing industry. These calls apparently were a result of strategic manoeuvres on the part of major United States underwear and pajama makers. Fruit of the Loom, which had not succeeded in taking advantage of

the United States' production-sharing mechanism to establish significant regional assembly operations in the Caribbean Basin, used the calls procedure available in the United States market to blunt the success achieved by arch competitor Sara Lee in this regard. This action put a limit on Sara Lee's rapidly growing imports from its extensive regional assembly facilities in the Caribbean Basin (Costa Rica, Dominican Republic, El Salvador, Haiti, Honduras, Jamaica, Colombia and Mexico). It also gave Fruit of the Loom time to extend its own assembly operations beyond Mexico and Jamaica, which it proceeded to do by establishing operations in El Salvador (1995) and Honduras (1996). The different competitive positions of these two major United States apparel makers help to explain why Sara Lee has been a firm supporter of NAFTA parity for the Caribbean Basin countries and why Fruit of the Loom has been a firm opponent of such a step.

The Costa Rican response to the calls lodged by the United States was a more combative one than that of most of the other countries of the Caribbean Basin that were affected by such measures. In the name of international trade discipline, it decided to take the dispute to the World Trade Organization (WTO), where it was the first case to be heard concerning textiles. In June 1995, the United States implemented the limits it had threatened to impose. In July, the WTO Textile Monitoring Board, which oversees disputes in this sector during the transition phase of the implementation of the Agreement on Textiles and Clothing (to 2005), decided by a 9-0 vote that the United States had not proven

that such Costa Rican imports did "serious damage" to the United States industry. However, this body could not reach consensus on whether it represented "a threat of" such damage. In a revealing vote, developing countries (Brazil, India, Indonesia, Pakistan, and the Republic of Korea) voted that it did not, while industrial economies (Canada, the European Union, Japan and Norway) voted that it did. The relevant parties were advised to continue bilateral negotiations. While Honduras came to a separate agreement with the United States in this area (and saw its limits lifted), Costa Rica notified WTO in December 1995 that its negotiations had failed and requested that a formal dispute settlement panel be formed. The Costa Rican goal, apparently, was for WTO to recommend duty-free and unconditional access to the United States market for its underwear exports. The panel's decision went in Costa Rica's favour.

Costa Rica won an important symbolic victory in the name of international trade discipline. However, an examination of the trend in United States import market shares for apparel suggests that this victory was won at a significant cost. Over the 1995-1998 period, Costa Rica's overall share of United States apparel imports plummeted from 2.2% to 1.7% and its share of production-sharing imports of apparel dropped from 10.1% to 6.9% during 1994-1997. Even more to the point, Costa Rica's fourth-largest export to the United States market—HTS 6108: women's or girls' underwear, pajamas, etc.—saw its United States import market share fall from 11.25% to 10.05% between 1995, when the calls were implemented, and 1998, when they were discontinued.

## Box IV.4 (concluded)

Something similar took place with regard to Costa Rica's ninth-largest export to the United States market (HTS 6212: brassieres, etc.), whose United States import market share dropped from 9.69% to 5.8% during 1995-1998.

Was the Costa Rican apparel industry an innocent bystander in a global dispute between two United States apparel giants? Did Costa Rica win the battle in WTO but, in the process, lose the war in the United States apparel market? What is the lesson? Had

the Costa Rican apparel industry priced itself out of the market, compared to Mexico and some of the lower-wage assembly sites in the Caribbean Basin? Further research is required in this area.

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**Source:** ECLAC, on the basis of Michael Mortimore and Ronney Zamora Leiva, "La competitividad internacional de la industria de prendas de vestir en Costa Rica", Desarrollo productivo series, No. 46 (LC/G.1979), Santiago, Chile, February 1998; F. Chacon, "Comercio internacional de los textiles y el vestido: reestructuración global de las fuentes en los EE.UU. durante la década de los noventa", IDB-INTAL Project on the Impact of NAFTA on Central America, March 1999, unpublished.





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