2001

Foreign investment

IN LATIN AMERICA
AND THE CARIBBEAN

UNITED NATIONS

ECLAC

ABSTRACT

Foreign direct investment (FDI) flows to Latin America and the Caribbean dwindled for the second year in a row in 2001, and preliminary data for 2002 show no signs of a recovery. This trend was observed in both greenfield investment and mergers, acquisitions and privatizations. The investments announced by transnational corporations (TNCs) for the coming years remain concentrated in the service and infrastructure sectors. This indicates that the region has continued to strengthen its links with the incipient networks being established in service provision at the global level. This development contrasts with the Latin American economies' gradual disengagement from international production systems led by TNCs in the manufacturing sector. This combination of trends has been most evident in the South American countries.

In addition to providing an overview of current FDI trends in Latin America and the Caribbean, this publication presents in-depth analyses of investment flows to Argentina both before and after the introduction of economic reforms, as a sample analysis of a recipient country; of the European Union as an international investor region; and of the hydrocarbons sector as a branch of activity that clearly illustrates the role of sectoral reform in attracting FDI.

SUMMARY AND CONCLUSIONS

Foreign investment in Latin America and the Caribbean, 2001 Report comprises four chapters. The first presents a region-wide analysis of recent trends in FDI flows, comparing them to FDI flows in the global economy, and looks at the investment strategies and approaches being used by the primary transnational corporations with interests in the region. The second chapter focuses on foreign investment in Argentina, which is now in the throes of a major economic and political crisis that has affected all economic agents in the country, including TNCs. This crisis has forced the latter to reorient their strategy after a decade in which Argentina was one of the chief recipients of FDI. The third chapter analyses FDI from the European Union, whose members, as part of their integration strategy, chose Latin America as the developing region of greatest significance for the expansion of their transnationals' activities, and accordingly have supplied a substantial inflow of investment. The fourth and final chapter contains an analysis of FDI in the hydrocarbons sector, in which the reforms of the 1990s have attracted new participants and encouraged investment flows to the region.

The regional outlook

FDI flows to Latin America and the Caribbean reflect the global forces that shape the world environment, and are further conditioned by processes within the region. As a result, after their unprecedented growth in the 1990s, FDI flows thus far in the current decade have registered a drop from US$ 105 billion in 1999 to US$ 80 billion in 2001, although net inflows of this type of investment are still higher than their average level over the past five years.

While the statistics on FDI in Latin America and the Caribbean are not unfavourable in comparison to those on global FDI trends, since the former fell by 10% and the latter, by 50%, they reflect some factors that could adversely affect the region in the medium term. Some of these factors are related to current international conditions, while others are of a more structural nature.

Uncertainty about the recovery of the United States economy in the first quarter of 2002[1] and expectations of slow growth in Europe and Japan imply that the chances of a recovery in global FDI flows are slim. A low global growth rate results in lower levels of investment overall, a decline in corporate profits and a slide in their stock prices, all of which affect FDI.

The structural factors include the fact that the countries have completed the implementation of economic reforms, which attracted much of the wave of FDI in the 1990s, especially through the privatization of large State enterprises in the energy and basic services sectors. By way of example, between January and April 2002 only two transactions were conducted, both in relation to electric power plants, for a total of US$ 36 million. While FDI flows tend to vary widely from one period to another, if this rate of investment continues for the rest of the year, the final figure will reach only US$ 432 million, which compares unfavourably to the US$ 1.35 billion invested in 2001 and, particularly, to the US$ 18 billion invested in 2000.[2]

Secondly, the takeover of large domestic firms by TNCs, which generated a large proportion of investment flows in the late 1990s, has been succeeded by a period of consolidation of the resulting industrial organization. Transactions of this type in the first quarter of 2002 amounted to US$ 4 billion. The annualized figure is lower than the one for 2001 (US$ 25 billion) and much lower than the annual average for the biennium 1999-2000 (US$ 43 billion).

Future investment is expected to comprise a larger proportion of greenfield investment, which is harder to obtain and depends on the projections of TNCs in Latin America and the Caribbean within their overall strategy. These projections hinge not only on the countries' political, economic and social stability, but also on the region's dynamic potential for economic and technological growth and development. The future investment plans which TNCs announced to the press between January 2001 and April 2002 focus mainly on infrastructure sectors, while investment in manufacturing, which accounted for 24% of the total in the 1990s, represents only 4% of the total projects announced.

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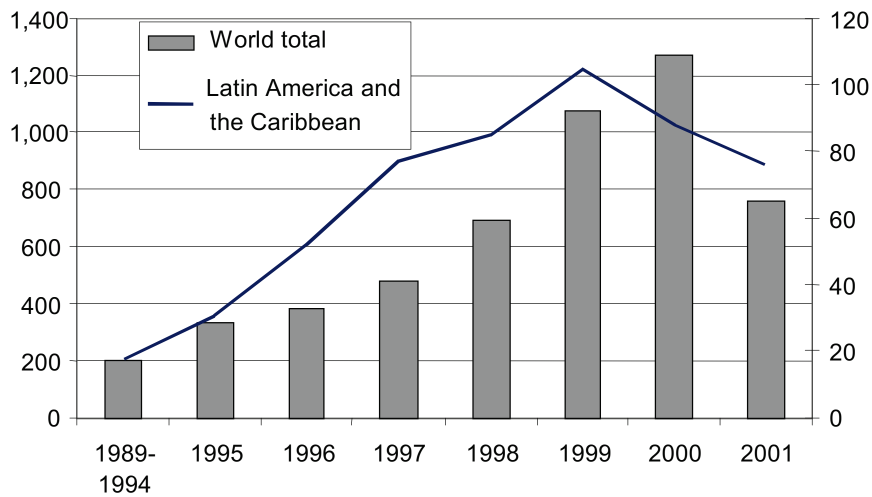
1 It should be borne in mind that the United States economy's annualized growth rate of 5.8% primarily reflects a slowdown in firms' inventory build-up and high government expenditure, especially on defence. Household consumption grew by 3.5%, but fixed investment declined; this will be extremely counterproductive for sustained economic growth. (More information on this subject can be found in "A hard act to follow", published in *The Economist*, 2 May 2002.)

2 See table I.10 of this publication, table I.13 of the 2000 edition and the *Economic Survey of Latin America and the Caribbean, 2000-2001*.

NET FDI INFLOWS IN LATIN AMERICA AND THE CARIBBEAN AND IN THE WORLD
(Billions of dollars)



Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of chapter I, table I.1, of this publication.

LATIN AMERICA AND THE CARIBBEAN: AMOUNTS OF FUTURE PROJECTS ANNOUNCED BY TRANSNATIONAL CORPORATIONS BETWEEN JANUARY 2001 AND APRIL 2002 [a]

Sector	Amount (Millions of dollars)	Percentage
Primary	**5,008**	**15.7**
Petroleum and natural gas	5,008	15.7
Manufacturing	**1,360**	**4.3**
Services	**25,528**	**80.0**
Financial	129	0.4
Electricity	14,030	44.0
Telecommunications	5,480	17.2
Commerce	726	2.3
Infrastructure and transport	4,331	13.6
Sanitation	832	2.6
Total	**31,896**	**100.0**

Source: Chapter I, annex table A.I.1.
[a] Announced projects scheduled to be carried out in the next five years.

Lastly, a phenomenon that is particularly influential in Asia and the Pacific, but nonetheless affects Latin America and the Caribbean as well, is China's strong attraction of global FDI (see the first section of chapter I). FDI flows to China approached US$ 40 billion in the past five years and continued to increase in 2001. Factors such as the country's entry into WTO and its relatively low wages, announced improvements in infrastructure and enormous domestic market, which is expected to register a strong increase in purchasing power, are likely to divert FDI flows targeting developing countries towards China.

The key problem, then, is to identify which of the factors that have emerged since the implementation of economic reforms can encourage capital inflows and, at the same time, strengthen regional development. The authorities of several countries have considered this question[3] and have concluded that, in an environment of keen competition for dwindling FDI flows, countries must have more policy options regarding this type of investment. In comparison to what has happened in Asia, the Latin American countries have tended to limit themselves in the area of productive development policies. This is evident both in the negotiation of bilateral or multilateral investment agreements and in the investment clauses of free trade agreements, which merely provide guarantees and protection to investors without defining their relationship to the national development strategy. The countries of the region have also been somewhat reluctant to use all the instruments at their disposal. For example, they use targeting[4] much less often than countries in Asia or Europe, where this strategy is commonly employed.

To compete more successfully for FDI, to make better use of the relevant resources and to ensure consistency between the objectives of corporate strategies and national policy goals, the countries must activate and clarify all aspects of their FDI policy. Accordingly, the "development dimension" must be spelled out in future multilateral negotiations on FDI. In other parts of the world, policies to establish and strengthen links between transnational and local firms are becoming increasingly widespread. Some important features of successful programmes are strong political commitment, consistency between ends and means, definition of responsibilities and effective cooperation between the public and private sectors.

At the microeconomic level, TNCs are playing an increasingly important role in the regional economy. There are many indicators of this trend, but the ones discussed in this publication are the shares of TNCs in the ownership of leading firms, in sales and in exports. While FDI has been credited with helping to open up new markets, speed up technological progress and increase capital formation, some factors that undermine its potential can be detected in the region.

These factors include, in particular, the enclaving of FDI and the lack of linkages between most TNCs and the rest of the region's production system. Moreover, except in Mexico, FDI has had little effect on competitiveness, measured in terms of the countries' share of world trade. The table below shows the decline in the South American countries' participation in world trade, in relation to both their share of total exports in the world market and their share of non-resource-based manufactured exports, especially high-technology products, which are the most dynamic exports in world trade. On the other hand, Mexico and the Caribbean Basin countries have gained competitiveness in the past five years, especially since Mexico joined NAFTA, but their performance cannot compare to China's achievements. This phenomenon is attributable in part to the concentration of FDI in new plants and in research and development. TNCs have not given priority to this strategy in the region.

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3 See the description of the case of Chile in chapter I; the cases of Costa Rica and the Dominican Republic in the 1999 and 2000 editions of *Foreign Investment in Latin America and the Caribbean*; and the report of the ECLAC/UNCTAD regional seminar on foreign direct investment in Latin America, held from 7 to 9 January 2002 in Santiago, Chile.

4 The term "targeting" refers to efforts to attract specific kinds of FDI by highlighting a few activities or sectors that reflect the country's comparative advantages.

LATIN AMERICA AND CHINA: INTERNATIONAL COMPETITIVENESS IN WORLD IMPORTS
(Percentages)

	1985	1990	1995	2000
Share of the world market				
Total exports				
China	1.60	2.81	4.80	6.12
South America	3.40	2.76	2.76	2.62
Mexico and Caribbean Basin	2.39	1.96	2.40	3.35
Non-resource-based manufactures [a]				
China	1.47	3.41	6.11	7.83
South America	1.24	1.14	1.12	1.03
Mexico and Caribbean Basin	1.34	1.55	2.33	3.57
High-technology manufactures [b]				
China	0.36	1.35	3.63	5.98
South America	0.47	0.36	0.29	0.45
Mexico and Caribbean Basin	1.66	1.40	1.91	3.19

Source: TradeCAN software, 2002 edition, ECLAC. Merchandise categories based on the Standard International Trade Classification (SITC, Rev. 2).

[a] Includes 120 groups representing the sum of activities in the textile and clothing, paper products, glass and steel and gems sectors and groups in the automotive, processing and engineering industries, namely the electronics group plus other pharmaceutical products, turbines, aeroplanes and instruments.

[b] Includes the engineering industry: the electronics group plus other pharmaceutical products, turbines, aeroplanes and instruments.

FDI in Argentina

Argentina was one of the leading FDI recipients in the 1990s. The privatization of State holdings, the introduction of a fixed exchange rate as a means of controlling inflation (Convertibility Act) and efforts to revitalize the regional integration process, especially with Brazil, in the framework of MERCOSUR facilitated the operations of foreign firms, enabling them to expand their activities into many areas that had previously been restricted. This occurred primarily in the areas of infrastructure and public services, in which the privatization programme had a decisive influence. First, foreign firms, together with local groups and international banks, acquired the vast majority of the State holdings offered for sale. Subsequently, international operators increased their shares in the ownership of privatized firms, displacing local groups and foreign banks. This gradual concentration of ownership took place through an intensive process of mergers and acquisitions, in which TNCs were once again the big winners.

TNCs were the most dynamic engine of Argentina's economic restructuring process in that period. They benefited, to greater advantage than most domestic firms, from the new conditions of competition and the incentives implicit in the structural reform programme. The FDI flows that Argentina received in the last decade radically changed the country's business landscape. Foreign firms increased their share of the sales of the country's 100 biggest firms from just over 24% in 1991 to nearly 50% in 2000. A sizable proportion of this increase was achieved through the purchase of existing assets, which did not result in the broadening of the country's productive capacity. Nonetheless, these investments undeniably helped to improve many of the services that were privatized, thereby enhancing Argentina's systemic competitiveness.

Until 1998, before the Asian crisis, Argentina offered foreign investors a highly favourable environment in which to carry out their activities, beyond the opportunities opened up by the economic reforms, particularly the price stability and exchange-rate security provided by the convertibility regime. Macroeconomic conditions then deteriorated, shaking the confidence of economic agents, as shown by the imposition of high risk premiums for external financing and a sharp contraction in private investment. In these circumstances, the presence of numerous foreign firms and their particular sectoral distribution became part of the problem.

First, the concentration of FDI inflows in the purchase of existing assets in non-marketable services sectors had the effect of limiting the authorities' flexibility in managing external imbalances. Initially, the purchase of firms by foreign investors helped to narrow the external gap, but as the investments matured the foreign firms located in Argentina began to demand a large volume of foreign exchange for the remittance of profits and capital abroad. This problem was rooted in the operating conditions negotiated in the process of privatizing public service and infrastructure enterprises. It is now clear that these agreements were unsustainable for purposes of maintaining the country's competitiveness, since the fact that rates were set in dollars prevented the firms that used these services as inputs from implementing a consistent cost policy.

Following the severe blow dealt to the Argentine economy by the Mexican peso crisis of late 1994, the authorities encouraged large-scale foreign investment in the banking sector with a view to preserving the system's stability and preventing additional capital flight and massive bank withdrawals. The theory was that this would result in a transnationalized, well capitalized banking system with an international lender of last resort: the home offices of the banking subsidiaries operating in Argentina. However, in late 2001, expectations of devaluation brought about a sudden drop in international reserves, the breakdown of the convertibility regime and a new and intractable financial crisis.

Meanwhile, foreign investment in marketable activities, particularly in manufacturing, suffered the rigours of the convertibility regime, with the result that the corresponding output lost much of its competitiveness in international markets. Many plants closed or confined themselves to supplying the domestic market, thereby increasing the difficulty of reducing the Argentine economy's external shortfall.

In brief, FDI flows have had ambiguous effects at both the macroeconomic and the microeconomic level. On the one hand, these inflows alleviated the country's external account imbalances in the short term, but led to tighter constraints in the long term as a result of increasing profit remittances. On the other hand, in the area of production, these inflows brought about rapid modernization, but with few linkages and little diffusion to the rest of the local economy; in the area of services, their effects reflected the inconsistency between rate-setting formulas and systemic competitiveness.

FDI in the European Union

The European Union has become one of the world's leading markets, with nearly 400 million high-income residents, some 300 million of whom share a common currency. Its population is slightly smaller, but has a per capita income over six times higher, than that of Latin America. The European Union is also a major source of global trade flows, surpassing both the United States and Japan. In the second half of the 1990s, it also became established as a primary source and destination of foreign investment. FDI inflows to the European Union increased nearly sixfold between 1995 and 2000, rising from US$ 117 billion to US$ 617 billion, while outflows amounted to US$ 790 billion in 2000.

The chief recipients of European capital were the United States and emerging economies, whose privatization processes were their primary attraction. Investment flows to Latin America rose from an annual average of US$ 1.6 billion in 1990-1995 to more than US$ 19.5 billion in 1996-1999. Latin America as a whole captured 13.5% of investments made outside the European Union and 6.5% of the latter's total investments. Within the region, the main recipient of this capital was MERCOSUR.

The political and economic relations between the European Union and Latin America developed in a framework that made it possible to take disparate regional and national circumstances into account. Accordingly, European firms have focused on three main areas of interest: access to the South American countries' markets for services and manufactures; the acquisition of an export platform in Mexico to facilitate access to the North American market; and access to natural resources, especially hydrocarbons, in the Andean countries.

Since manufacturing investments have a long tradition, manufacturing firms have followed a fairly long-standing pattern of internationalization, linked to the import substitution strategy in larger markets. Most investments in this sector come from Germany and the

United Kingdom, and, to a lesser extent, Italy and France, and are concentrated primarily in the automotive, food and beverage and chemical industries. Among the region's manufacturing industries, the automotive sector has attracted the most European capital.

Spain has been the largest investor in the service sector, but other Mediterranean countries, including Portugal, France and Italy, have also invested in services in the region. The chief poles of attraction have been the energy, telecommunications, banking and retail trade subsectors. The firms most deeply involved in this process have been Spain's Telefónica in telecommunications, ENDESA and IBERDROLA in energy and the Santander Central Hispano and Bilbao Vizcaya Argentaria banks in financial services.

The completion of the cycle of privatizations in Latin America and the culmination of the current stage of the mergers and acquisitions process raise questions as to the future of European Union investments in the region. In this regard, the promising outlook for more extensive economic and political agreements between Latin America and the European Union should foster trade and investment links between the two regions. The challenge for Latin America in this respect is to become a pole of attraction not only for investments in services, but also for investments in manufactures for export, which have a greater impact on employment and economic performance. Mexico is the country best placed to attract manufacturing investments. However, the region's political instability, which has recently been underscored by events in Argentina and Venezuela, could become an obstacle to the deepening of relations between the two regions.

FDI in the hydrocarbons sector

The reforms of the 1990s in the hydrocarbons sector, especially the privatization of State enterprises in Argentina, Bolivia and Peru, attracted new participants and stimulated investment in Latin America and the Caribbean. Nonetheless, in contrast to the pattern in other sectors of the economy, and owing to the high oil profits that represent a significant proportion of government revenue, State enterprises were not sold off in the countries with the largest oil deposits. Accordingly, those enterprises continue to make the bulk of investments in this sector and are by far the most profitable of the region's production firms.

Meanwhile, private oil firms have focused on exploration and production in new, deep-water and marginal oilfields and in costly extra-heavy crude oil extraction. A hallmark of foreign investment in hydrocarbons in the 1990s was that it departed from earlier trends by focusing on the exploitation of natural gas. That strategy was aimed at creating an energy chain that would branch out into electricity generation and distribution activities, thereby forming a service network that would enhance the sector's profitability. The worldwide liberalization of energy markets facilitated the strategy's implementation.

Transnational oil corporations carried out their expansion policies in four different ways. The first approach is exemplified by the Spanish firm Repsol, which took advantage of the sector's liberalization to become a global corporation under the name Repsol-YPF and to expand by taking over existing firms. The second approach is the one taken by TNCs that were already carrying out extraction activities in the region and capitalized on their resulting competitive advantage to diversify their activities geographically, as in the case of TotalFinaElf, BP Amoco and ChevronTexaco. Foreign firms that were not carrying out extraction activities prior to liberalization adopted a third strategy that focused primarily on consolidating their competitive advantages at later stages of the production process (Royal Dutch Shell, Exxon Mobil). Lastly, the fourth approach is represented by the region-wide expansion of Latin American oil firms in the wake of liberalization (Pérez Companc, Pluspetrol), initially through the purchase of privatized holdings.

Repsol-YPF and Pérez Companc, like other firms that opted for rapid expansion through the acquisition of existing firms, have quickly secured a prominent place among private firms operating in the region. However, both of these firms are marked by two factors that have become the Achilles heel of their expansion: a high concentration of activities in Argentina and a high level of indebtedness. They currently face two serious problems: insufficient financial capacity to develop the oilfields they have discovered and the projects they have announced, and a steep slide in their stock prices, which further hinders their access to financing and exposes them to a possible takeover.

The major transnational oil corporations, with the exception of Repsol-YPF, do not yet have a strong presence in the region. TotalFinaElf, BP Amoco and ChevronTexaco have increased their share of extraction activities since the reform. They have the financial capacity to undertake a major expansion in the region, which could be accomplished in two ways: through the acquisition of existing State or private firms or part of their assets, which would essentially target private firms with financing problems, or through the discovery of significant deposits in the areas they are exploring.

The oil reform of the 1990s changed the relationship between public and private firms by multiplying partnerships and joint ventures between them. As a result, the heads of transnational oil corporations pay close attention to the future investment plans of State enterprises, seeking new opportunities for partnership while pressing for better conditions for private investors and broader liberalization in the sector, including the privatization of some or all of the holdings of State oil enterprises.

I. REGIONAL PANORAMA

A. RECENT TRENDS IN FOREIGN DIRECT INVESTMENT IN LATIN AMERICA AND THE CARIBBEAN

The global upward trend recorded in foreign direct investment (FDI) throughout the last decade reached a turning point in 2001. The countries of Latin America and the Caribbean were also affected by the factors that caused world flows to practically halve in 2000, although specific adverse factors had already been in play in the region a year earlier. Capital inflows to the region decreased in absolute terms, with little likelihood of an upturn in 2002, in view of the political and economic crisis in Argentina and the uncertainty over whether it might spread to other countries, in combination with the maturity of the structural reforms –especially the sale of public-sector enterprises– which had boosted FDI in the past. Nevertheless, in comparison with international trends, the volumes of FDI flowing into Latin America and the Caribbean continue to be considerable and still fall within the average range of the second half of the 1990s.

1. World foreign direct investment

After growing strongly for a decade, in 2001 world FDI flows were less than US$ 760 billion, which was 40% less than the previous year's figure and represented the largest single drop in almost three decades.[1] Unlike financial investment and external credit, however, which performed in a manner that was especially harmful to developing countries, the contraction of FDI affected mainly developed countries (see table I.1).

This phenomenon was attributable to three interdependent but distinguishable factors:

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1 See UNCTAD (2001a) and UNCTAD, Press Release (2002). According to figures from UNCTAD (2002), FDI decreased previously in 1976 (22%), 1982 (17%), 1983 (13%), 1985 (5%) and 1991 (23%).

Table I.1
REGIONAL DISTRIBUTION OF NET FDI INFLOWS
(*Billions of dollars*)

	1989-1994[a]	1995	1996	1997	1998	1999	2000	2001[b]
World total	**200**	**331**	**385**	**478**	**693**	**1,075**	**1,271**	**760**
Developed countries	137	203	220	271	483	830	1,005	510
Western Europe	80	117	115	138	273	485	633	207
European Union	77	113	110	128	261	467	617	199
Other developed economies	3	4	5	10	12	18	16	168
Canada	6	9	10	12	23	25	63	20
United States	43	59	84	103	174	295	281	144
Japan	1	0	0	3	3	13	8	4
Developing countries and economies	60	113	152	187	188	222	240	225
Latin America and the Caribbean	16	31	52	77	85	105	88	80
Africa	4	5	6	7	8	9	9	11
Asia and the Pacific	38	76	95	103	95	100	143	125
China	14	35	40	44	43	40	41	47

Source: United Nations Conference on Trade and Development (UNCTAD, *World Investment Report 2001: Promoting Linkages* (UNCTAD/WIR/(2001)), New York, 2001, United Nations publication, Sales No. E.01.II.D.12, annex B, tables B.1 and B.2, pp. 291 and 296. The statistics for Latin America and the Caribbean were supplied by ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, on the basis of figures from balance-of-payments statistics supplied by the International Monetary Fund (IMF) and national agencies in the countries.

[a] Annual average.
[b] UNCTAD estimates, press release TAD/INF/PR21/Rev.1, 18 September 2001.

Table I.2
WORLD'S LARGEST MERGERS AND ACQUISITIONS IN 2001

Recipient country	Firm acquired	Buyer	Country of origin	Sector	Amount (billions of dollars)
United States	VoiceStream Wireless Corp.	Deutsche Telekom AG	Germany	Telecommunications	24.6
Germany	Viag Interkom GmbH & Co.	British Telecommunications Plc	United Kingdom	Telecommunications	13.8
Mexico	Banamex	Citigroup	United States	Financial	12.5
United States	Powertel	Deutsche Telekom AG	Germany	Telecommunications	12.3
United Kingdom	Billiton Plc	BHP Ltd	Australia	Mining	11.5
United States	Axa Financial Inc.	AXA Group (AXA-UAP)	France	Insurance	11.2
South Africa	De Beers Consolidated Mines	DB Investments	United Kingdom	Mining	11.1
United States	Ralston Purina Group	Nestlé	Switzerland	Foods	10.4
United States	CIT Group Inc.	Tyco International Ltd	Bermuda	Electronics	10.2
United States	AT&T Wireless Group	NTT DoCoMo Inc	Japan	Telecommunications	9.8
United Kingdom	Power Gen Pic.	E.On AG	Germany	Energy	7.3
Germany	Knoll AG (BASF AG)	Abbott Laboratories	United States		6.9
United Kingdom	GKN PLC-Support Services	Brambles Industries Ltd	Australia	Automotive and transport equipment	5.8
United States	Harcourt General Inc.	Reed Elsevier Plc	United Kingdom	Information services	5.6
Japan	Japan Telecom Co. Ltd and J-Phone Communications	Vodafone Group Inc	United Kingdom	Telecommunications	5.5
United Kingdom	Lasmo PLc	Eni SpA	Italy	Petroleum	4.1

Source: United Nations Conference on Trade and Development (UNCTAD), *World FDI Flows to Drop This Year* (TAD/INF/PR21/Rev.1), Geneva, 18 September 2001.

(a) The slowdown in the world economy (particularly in the United States). The adverse impact of this was transmitted through two channels: the decreased requirement for the expansion of productive capacity, which translated into a decline in investment in general and in the profits of large corporations, causing their stock prices to plunge. This had a strong impact on the price of shares, which constitute one of the main financing mechanisms for mergers and acquisitions –an important component of FDI in developed countries.
(b) The rate of expansion of the telecommunications sector decreased, which was both a cause and a consequence of more sluggish mergers and acquisitions activity and of the tendency to channel large investments to technological innovations. Nevertheless, the telecommunications sector continued to be one of the main players in FDI activity at the world level.
(c) Lastly, investment decisions were affected, albeit only in the short term, [2] by the lack of confidence and uncertainty generated by the events of 11 September 2001 in the United States. Surveys of executives of transnational corporations (TNCs) conducted by different sources have indicated a general intention of carrying forward existing investment plans, which suggests that the medium- and long-term impact of these occurrences will be limited.

The preliminary result of the combination of these phenomena was a 25% decrease in the total number of mergers and acquisitions in 2001, which accounted for a 50% drop in the amount of related FDI with respect to 2000.

This drop in the value of FDI was also a direct consequence of the plunge in corporate stock prices. Major transactions continued to be conducted, however, especially in telecommunications. The largest of these operations was the acquisition of Voice Stream Wireless Corp. by the German firm Deutsche Telekom AG, at a cost of US$ 24.6 billion. The second largest acquisition was also in the telecommunications sector: British Telecommunications of the United Kingdom acquired Viag Intercom GmbH & Co. of Germany. In the third-ranking operation, Citigroup of the United States bought the Mexican bank Banamex for US$ 12.5 billion (see table I.2). This purchase was particularly significant, as the rest of the year's mergers and acquisitions were conducted mainly outside the Latin American and Caribbean region.

The region where most mergers and acquisitions took place in 2001 was the European Union, thanks to the stimulus generated by progress in regional integration, currency unification, increased investor confidence that this would improve price transparency, lower transaction costs and the simplification of payments between member countries (see chapter 3). The United States was the world's largest developed-country recipient of FDI, however, accounting for over 25% of total flows, which alone was more than the sum of all flows to developing countries. Flows to Japan, meanwhile, failed to recover in that period.

Among the developing countries, the most favourable trends took place in Asia and the Pacific, where China –including Hong Kong– has seen an extraordinary increase in FDI (see box I.1). According to UNCTAD (2001a), there are three reasons for this performance: (a) the recovery of FDI flows following the Asian crisis; (b) larger volumes of investment funds flowing into China in anticipation of its entry into the World Trade Organization (WTO); and (c) cross-border mergers in the telecommunications sector, which alone accounted for nearly a third of FDI inflows.[3] By contrast, flows to Asia as a whole continued to decrease in 2001, suggesting that the rest of the region has not recovered the ability to attract funds in the volumes seen prior to the crisis of 1998.

According to UNCTAD (2002), FDI in Africa continued to be concentrated in a handful of countries –Morocco, Nigeria, Egypt and South Africa– as flows remained stable with respect to the previous year. Privatizations and mergers and acquisitions among large firms constituted the chief attraction.

As will be examined in the following section, the downward trend of FDI across the globe also spread to Latin America and the Caribbean, and is likely to signal a lower rate of investment in the future than in the past decade.

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2 In the short term this impact was transmitted through a deferment of consumption. Due to the Keynesian multiplier effect, this reduced aggregate demand and output, not only in the United States but also, through trade channels, in the rest of the world. It also caused investors to scale down their risk exposure, which prompted a "flight to quality" in terms of projects and sectors. This increased the gap between spreads on sovereign bonds and stock prices in developed and emerging countries, to the detriment of the latter.

3 These transactions resulted in the merger of China Mobile Ltd (Hong Kong) with a number of mobile telephony firms operating in continental China.

Box I.1

CHINA BECOMES LARGEST DEVELOPING-COUNTRY RECIPIENT OF FDI FOLLOWING ENTRY INTO WTO

In recent years China has become more attractive to foreign investors than any other developing country. Its accession to WTO has improved and consolidated its position in the eyes of not only Korean, Taiwanese and Japanese investors, but also the world's leading TNCs.

Owing to its FDI policy, China's investment portfolio shifted from labour-intensive sectors in the 1980s to technology- and capital-intensive industries in the 1990s. The main investors in China today include world leaders in computers, electronics, telecommunications equipment, pharmaceuticals, petrochemicals and electricity generation equipment. Recently investment has also flowed into research and development activities, with over 100 facilities created by TNCs that include Microsoft, Motorola, General Motors, General Electric, JVC, Lucent-Bell, Samsung, Ericsson, Siemens and Nokia (UNCTAD, 2001a). This has placed China securely within the integrated production systems of TNCs.

All this has enabled China to greatly improve its position in the world market and make great strides in the transformation of its production –and especially export– structure. Table B.1 below offers a clearer appreciation of this phenomenon, with a series of indices that measure China's market share and export composition. The most recent available information, from 2000, shows that products made or originating in China represented over 6% of world imports, compared with just 1.6% 15 years earlier. The composition of world imports from China is even more striking. The bulk of these consist of non-resource-based manufactures, which increased their market share from less than 1.5% in 1985 to almost 8% in 2000. Within this group, toys and footwear grew in significance (see table B.1), as did high-technology goods, which accounted for almost 6% of the world market. This was reflected in the structure of the country's main export products, as 87% of total exports corresponded to non-resource-based manufactures and 22% of the total were high-technology goods. In the five years leading up to 2000, China's high-technology exports increased in value from US$ 7.6 billion to US$ 37 billion. Table B.1 also shows that of the 10 main export products, which represent 41% of the total, nine are dynamic –those marked with a * in the first column of the table– meaning that they belong to the group of the 50 fastest-growing products in world trade.

The most interesting feature of this phenomenon is that in China –in contrast to what has happened in Latin America and the Caribbean– the new technology absorbed as a result of FDI has not remained within closed enclaves, but has spread to domestic firms in the coastal regions, which have now become competitors of TNCs themselves. The resulting synergy has shaped a very dynamic domestic and external market that is not always favourable to foreign firms. As discussed in A.T. Kearney (2001), a significant percentage of investments generate lower-than-expected returns because, among other reasons, investors have underestimated the local competition. Nevertheless, the results of a survey of the chief executives of the 1,000 largest TNCs with interests in China, which are also presented in the Kearney study, show that these firms are still attracted to China more than any other developing economy and intend to continue to invest there.

The development of infrastructure such as highways and inland roads will give a major new boost to market expansion in China by enabling firms to build plants in areas that are not accessible today and to enjoy the benefits of cheaper land and labour.

Although China still faces the challenge of spreading technological know-how and progress from the coast to the rest of the country (Dahlmon and Aubert, 2001), the economies of East and South-East Asia face a powerful threat from Chinese competition as the main destination for future TNC investment. Far from bringing up the rear of the "wild geese flying" pattern used to describe economic development in East Asia, today China is capable of producing a wide range of goods, from simple manufactures –such as toys and footwear– to semiconductors or computers, and even more sophisticated products across the whole of the value chain, on a scale that influences world prices.

China's entry into WTO, together with relatively low wages, the infrastructure improvements that have been announced and the huge domestic market –which is likely to gain significantly in purchasing power– represent a set of strong incentives for FDI and should help to consolidate the country's chosen development model.

Box I.1 (concluded)

CHINA: COMPETITIVENESS IN WORLD IMPORTS, 1985-2000
(*Percentages*)

			1985	1990	1995	2000
I. Market share			**1.6**	**2.8**	**4.8**	**6.1**
Natural resources[a]			2.3	2.4	2.5	2.4
Resource-based manufactures[b]			1.2	1.3	2.1	2.7
Non-resource-based manufactures[c]			1.5	3.4	6.1	7.8
– Low technology[d]			4.5	9.1	15.5	18.7
– Mid-level technology[e]			0.4	1.4	2.6	3.6
– High technology[f]			0.4	1.4	3.6	6.0
Others[g]			0.7	0.7	1.4	1.8
II. Export structure			**100.0**	**100.0**	**100.0**	**100.0**
Natural resources[a]			35.0	14.9	7.6	5.2
Resource-based manufactures[b]			13.5	7.8	6.6	6.3
Non-resource-based manufactures[c]			50.1	76.3	84.7	87.3
– Low technology[d]			39.7	53.6	53.5	47.6
– Mid-level technology[e]			7.8	15.4	16.8	17.3
– High technology[f]			2.6	7.3	14.2	22.4
Others[g]			1.4	0.9	1.0	1.1
III. 10 main exports by contribution	[h]	[i]	**14.2**	**30.1**	**38.5**	**41.3**
894 Baby carriages, toys, games and sporting goods	*	+	2.5	7.3	8.4	8.5
851 Footwear	*	+	1.2	4.6	7.2	5.5
764 Telecommunications equipment	*	+	0.4	1.9	3.5	4.9
752 Automatic data processing machines and units thereof	*	+	0.0	0.3	1.6	4.0
845 Articles of apparel, of textile fabrics, whether or not knitted or crocheted	*	+	3.6	4.4	4.0	3.9
759 Parts and accessories suitable for use solely or principally with office machines (751) and automatic data processing machines (752)	*	+	0.1	0.3	1.8	3.6
843 Women's, girls' or babies' outerwear, of textile fabrics	*	+	3.8	5.5	4.8	3.5
831 Travel goods, bags, cases, briefcases, etc.	*	+	1.8	3.6	3.6	2.8
893 Articles, n.e.s., of plastic or resin (chapter 58)		+	0.3	1.4	2.3	2.3
821 Furniture and parts thereof	*	+	0.5	0.8	1.3	2.3

Source: Based on the TradeCAN software, 2002 Edition, ECLAC.
Groups of goods based on the Standard International Trade Classification (SITC, Rev.2).
[a] Includes 45 simply processed commodities, including concentrates.
[b] Includes 65 components: 35 agricultural/forestry groups and 30 other groups (mostly metals other than steel, petroleum products, cement, glass, etc.).
[c] Includes 120 groups representing the sum of [d] + [e] + [f].
[d] Includes 44 components: 20 groups from the textile and clothing cluster, plus 24 others (paper products, glass and steel, jewels).
[e] Includes 58 components: 5 groups from the motor vehicle industry, 22 from the processing industry and 31 from the engineering industry.
[f] Includes 18 components: 11 groups from the electronics cluster plus 7 others (pharmaceuticals, turbines, aeroplanes and instruments).
[g] Includes 9 unclassified groups (mostly from section 9).
[h] Groups that correspond (*) to the 50 fastest-growing in world imports, 1985-2000.
[i] Groups that gained (+) or lost (-) market share in world imports, 1985-2000.

Source: ECLAC, Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, based on the United Nations Conference on Trade and Development (UNCTAD), *FDI Downturn in 2001 Touches Almost All Regions* (TAD/INF/2859 - TAD/INF/PR37), Geneva 2002, *World Investment Report, 2001: Promoting Linkages* (UNCTAD/WIR/(2001)), New York, 2001. United Nations publication, Sales No. E.01.II.D.12; A.T. Kearny, "Global Investment in China: A White Paper on the Quest for Profitability", 2002 (http://www.atkearny.com); *The Economist*, "China's economic challenge to East Asia", 23 August 2001.

2. FDI in Latin America and the Caribbean: recent flows and trends

In 2001, FDI flows to Latin America and the Caribbean were down by 10%, from US$ 88 to US$ 80 billion, although this figure was still higher than the average for the second half of the 1990s (see table I.3). Although the downward trend has continued into a second year, its magnitude has not been comparable to the decrease seen in developed countries. Investment flows to Latin America and the Caribbean, however, are uneven: some countries have found themselves much better off, while in others investors are awaiting an upturn in the domestic climate and international conditions.

(a) FDI in the countries of the Latin American Integration Association (LAIA)

In the last decade, LAIA has attracted FDI as a result of the favourable climate generated by economic and political stabilization and by a series of economic reforms which have provided different incentives for TNCs to set up operations in the subregion (see table I.4 and figure I.2). Trade liberalization offered TNCs a new mode of expansion in the manufacturing sector, through strategies focusing on improved efficiency and new markets. In addition, the mining and hydrocarbon sector was liberalized and opened to private capital, which attracted more new investment. As the financial sector and the capital markets were liberalized, international banking institutions moved into domestic financial systems. The privatization of public-sector enterprises, especially utilities, attracted international operators to the electrical energy and telecommunications sectors, thus involving the countries in the global trends in these sectors as the industry shifted the focus of its operations from the local to the world level. Lastly, the revitalization of regional integration processes opened up opportunities for new business, in addition to extraregional FDI, particularly in MERCOSUR.

As noted in the preceding section, the factors that affect FDI trends in the world economy have repercussions at the regional level, so a downswing was to be expected in 2001. Indeed, the harsh international economic environment and a longer-than-expected recession in the United States sharpened the downturn in economic activity in Latin America. This affected expansion programmes in activities that depend on the domestic market –commerce, electricity and telecommunications– in which a number of projects were postponed.

The global recession also affected the availability of financing. Capital flows to Latin America and the Caribbean slumped markedly (ECLAC 2001b), and resources for project finance in areas such as mining, which represent a significant percentage of investment in the region, became scarce or more costly to obtain.

Another reason for the downturn in subregional FDI is the fact that most of the countries have come to the end of a wave of privatizations. However, some sectors of economic activity, such as Brazil’s electricity sector and Mexico’s hydrocarbons and electrical energy sectors, still hold investment potential for the future in the eyes of TNCs. Lastly, worsening political and economic instability in the last few years has discouraged new investments in a number of countries, including, to differing degrees, Argentina, Venezuela, Bolivia, Ecuador, Colombia and Peru.

Figure I.2 shows how the destinations of flows to the region have changed, with Argentina’s share falling by 13 percentage points and Brazil’s by three, while Mexico doubled its share with respect to the period 1995-2000.

From a sectoral perspective, the latest official figures reported by government agencies (those available for 2000) indicate that the trend seen in the last few years has continued (see figure I.3), with the bulk of investment going to services. The large increase in flows to the primary sector in 1999 was attributable to the acquisition of YPF stock by REPSOL for US$ 15,168 million.[4]

(i) Mexico: the transnationalization of the reprivatized banking system

In 2001, FDI flows to Mexico doubled, and the country’s share of total flows to Latin America and the Caribbean increased from 17% in the period 1996-2000 (ECLAC, 2001a) to 35% in 2001, as shown in figure I.2. This increase was attributable to the largest operation ever conducted by a United States bank in Latin America – the acquisition of the Mexican financial group Banamex-

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[4] The Argentine Department of International Accounts recorded the entire transaction by which REPSOL purchased YPF S.A. as FDI, even though nearly 66% of the total amount represented purchases by REPSOL of minority stakes held in foreign stock markets (see chapter 4, box).

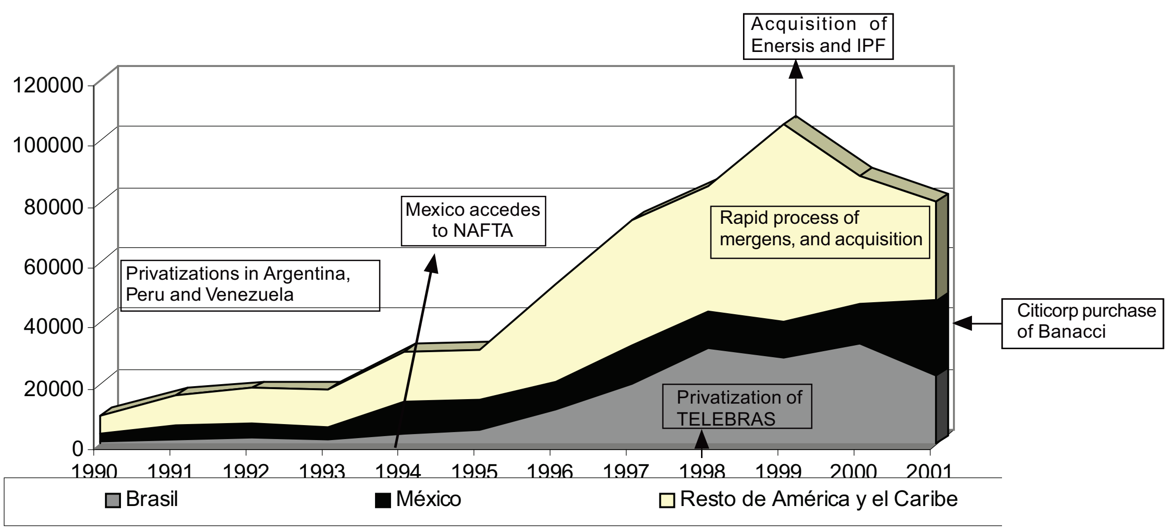
Table I.3
LATIN AMERICA AND THE CARIBBEAN: NET FDI INFLOWS, BY SUBREGION, 1995-2001[a]
(*Millions of dollars*)

	1995-1999[b]	1995	1996	1997	1998	1999	2000	2001
LAIA	56,150	28,084	41,741	61,535	66,764	82,627	70,643	63,705
(Brazil)	19,240	4,859	11,200	19,650	31,913	28,576	32,779	22,636
(Mexico)	10,954	9,526	9,186	12,831	11,312	11,915	13,286	24,730
Central America and the Caribbean	4,000	2,001	2,145	4,224	6,215	5,416	3,885	4,008
Financial centres	9,393	1,270	8,627	7,827	12,130	17,113	13,941	11,995
Total	**69,544**	**31,355**	**52,513**	**73,586**	**85,109**	**105,156**	**88,469**	**79,708**

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, on the basis of figures from balance-of-payments statistics supplied by the International Monetary Fund (IMF) and national agencies in the countries. The figures for 2001 are estimates based on information from the countries' central banks. The information on financial centres was provided by UNCTAD, on the basis of outflows to tax havens reported by OECD countries. The figures presented are updated on an annual basis according to government authorities' reviews of their statistics. The figures presented here differ from those shown in the *Preliminary Overview of the Economies of Latin America and the Caribbean, 2001*, published by ECLAC, as in the latter net FDI inflows are taken to be investment in the reporting economy, minus direct investment abroad by its residents.

[a] Corresponds to net inflows of direct investment in the reporting economy, minus capital taken out of the country by the same foreign firms.
[b] Annual average.

Figure I.1
LATIN AMERICA AND THE CARIBBEAN: LANDMARKS IN FDI ATTRACTION
(*Millions of dollars*)



Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, on the basis of table I.3.

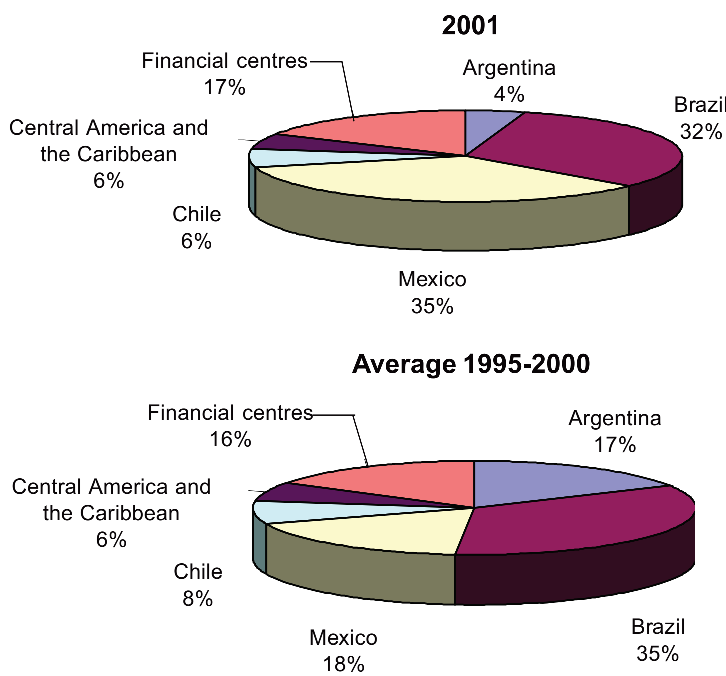
Table I.4
LAIA: NET FDI INFLOWS[a]
(*Millions of dollars*)

	1995-1999[b]	1995	1996	1997	1998	1999	2000	2001
Argentina	10,599	5,610	6,949	9,161	7,292	23,984	11,665	3,181
Bolivia	714	393	474	731	957	1,016	733	550
Brazil	19,240	4,859	11,200	19,650	31,913	28,576	32,779	22,636
Chile	5,334	2,957	4,634	5,219	4,638	9,221	3,675	4,602
Colombia	2,795	968	3112	5,639	2,932	1,326	2,615	2,018
Ecuador	618	470	491	625	814	690	720	1,331
Mexico	10,954	9,526	9,186	12,831	11,312	11,915	13,286	24,730
Paraguay	183	103	149	236	342	87	82	152
Peru	2,272	2,056	3,226	1,781	1,905	2,390	680	1,100
Uruguay	164	157	137	126	164	235	298	320
Venezuela	3,277	985	2,183	5,536	4,495	3,187	4,110	3,085
Total	**56,150**	**28,084**	**41,741**	**61,535**	**66,764**	**82,627**	**70,643**	**63,705**

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, on the basis of figures from balance-of-payments statistics supplied by the International Monetary Fund (IMF) and national agencies in the countries. The figures for 2001 are estimates based on information from the countries' central banks. The information on financial centres was provided by UNCTAD, on the basis of outflows to tax havens reported by OECD countries. The figures presented are updated on an annual basis according to government authorities' reviews of their statistics. The figures presented here differ from those shown in the *Preliminary Overview of the Economies of Latin America and the Caribbean, 2001*, published by ECLAC, as in the latter net FDI inflows are taken to be investment in the reporting economy, minus direct investment abroad by its residents.

[a] Corresponds to net inflows of direct investment in the reporting economy, minus capital taken out of the country by the same foreign firms.
[b] Annual average.

Figure I.2
FDI BY COUNTRY
(*Percentages*)



Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, on the basis of estimates calculated using information from the countries' central banks. The information on financial centres was provided by UNCTAD, on the basis of outflows to tax havens reported by OECD countries.

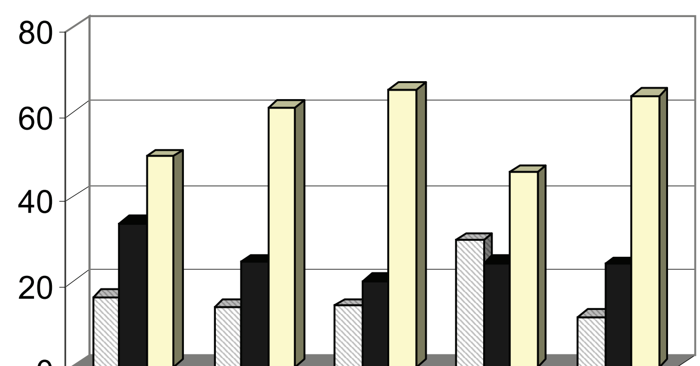
Accival, known as Banacci, by Citigroup (see box I.2 for more details). Mexico thus became the largest recipient of FDI flows to Latin America and the Caribbean, leaving Brazil –which occupied this position throughout the second half of the 1990s– in second place.

Citigroup's transaction was one of a number of acquisitions of financial assets on the part of international banks, as Mexico reformed its legislation on FDI in the financial sector, which was in need of capitalization after the tequila crisis. Before the Citigroup purchase, in 2000 the Spanish bank Banco Bilbao Vizcaya Argentaria (BBVA) acquired Banco del Comercio (Bancomer), and Banco Santander Central Hispano (BSCH), also of Spain, purchased Serfin, which led to the merger of these banks in processes that encompassed all the subsidiaries of the two groups. Also in 2000, Scotiabank and ING Baring increased their stakes in Inverlat and Comercial América, respectively.

As in previous years, the remainder of FDI in Mexico was attracted by the new breed of business opportunities that have emerged since 1994 in the framework of the North American Free Trade Agreement (NAFTA). In fact, NAFTA created an extraordinary incentive for United States FDI in Mexican export sectors (electronics, computers, automobiles and clothing), characterized primarily by the assembly of manufactures for export (*maquila*) (see ECLAC, 2000 and 2001b). Mexico also signed an agreement with the European Union in 2000, but this has failed to bring the expected investment in manufacturing sectors. In 2001, the European Union accounted for only 4% of FDI in *maquila* industries, and only 11% of investment reported to the National Registry of Foreign Investment (RNIE), according to the Mexico's National Foreign Investment Commission (see chapter 3).

Strikingly, in 2001 FDI inflows dropped in both *maquila*-dominated sectors and other branches of industry oriented towards the domestic and external markets. Figures from the National Foreign Investment Commission show that foreign investment in non-*maquila* industries decreased by almost 55% with respect to 2000. This reflected both the slowdown in the United States economy and the climate of uncertainty generated by the events of 11 September, as well as the stagnation

Figure I.3
LAIA: FDI BY SECTOR,[a] 1996-2000
(*Percentages*)



	1996	1997	1998	1999	2000
Primary	17	14	14	30	12
Manufactures	34	25	20	24	24
Services	50	61	65	46	64

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 national agencies. Argentina: Department of International Accounts; Bolivia: Central Bank; Brazil: Central Bank; Chile: Foreign Investment Committee; Colombia: Central Bank; Ecuador: Central Bank; Mexico: National Foreign Investment Commission; Peru: National Commission on Foreign Investment and Technology; Venezuela: Central Bank.

[a] The information provided by these agencies does not necessarily reflect total FDI as recorded in the respective country's balance of payments.

Box I.2

CITIGROUP ACQUIRES BANACCI TO BECOME MEXICO'S LEADING BANK

In the last three years the Mexican banking system has attracted large volumes of FDI in the form of mergers and acquisitions. In May 2001, Citigroup of the United States took the capital markets by surprise with the announcement of its purchase of the financial group Banamex-Accival, known as Banacci, at a cost of US$ 12.5 billion. This led to the merger of Banamex, Citibank Mexico and Banca Confía under the Banamex name. The respective pension fund administrators were also merged. California Commerce Bank, a Banacci subsidiary in the United States, was renamed Banamex-Citibank, with a view to attracting clientele among the increasingly significant Spanish-speaking population of the United States.

Citigroup had three reasons for acquiring the Banacci group. Banamex is a key brand name in Mexico, whose banking system is not yet highly developed and therefore offers great potential for growth. Bank loans in Mexico represent no more than 15% of GDP, compared to 72% in the United States. Credit cards are used to a very limited extent, accounting for only 3% of total spending, by contrast with 25% in the United States. Citibank is strong in both of these market segments and well placed to position itself in Mexico.

The purchase will help Citibank to consolidate its position in Latin America, where it had lagged behind the Spanish banks in terms of investments. Although the group already leads the corporate banking sector, which accounts for some three quarters of its business in the region today, the strength of Banamex in retail (personal) banking, with 1,340 branches in Mexico, has provided the opportunity to complement this position. Citigroup has thus moved further towards its objective of becoming established as a local bank in each segment of the financial market, a position which will enable it to challenge the leadership of the Spanish banks in these segments.

Lastly, in the United States market, Citibank aims to compete on a better footing for the custom of the rapidly growing Hispanic population by marketing the Banamex name in California. The 2000 census reported 35.3 million Hispanics in the United States, of whom two thirds are of Mexican origin and regularly send money to relatives in Mexico.

The Banacci purchase has a number of implications. Banamex emerges from the transaction as Mexico's leading bank –having overtaken BBVA-Bancomer, which formerly held the largest percentage of deposits (around 28%)– and as the market's largest stakeholder in commercial loans and in the growing pension funds market. From the perspective of Citigroup, the acquisition signifies a deeper engagement in emerging markets, particularly in Latin America, where its share of total profits increased from 21% to 25%.

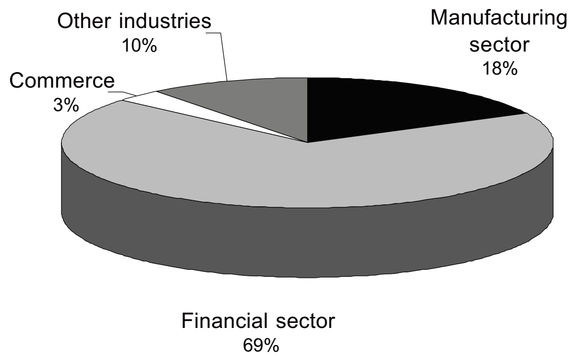
Although the authorities have promoted the entry of foreign capital into the banking sector (in which foreign stakes increased from 20% in 1995 to 78% in 2000), claiming that this would help to lift the financial system out of near-bankruptcy, increase capitalization, lower systemic risk and introduce new technology, the current situation of the Argentine banking system casts doubt on these arguments. Moreover, whether FDI effectively helps to bring financial intermediation closer to production sectors is still an open question.

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 taken from J. Barham, "Citigroup's Latin Platform", *Latin Finance*, June 2001; R. Ferro, "Citi vs los Españoles", *América economía*, 8 November 2001; G. Gatsiópoulos, "Negocios del año: volver al futuro", *América economía*, 20 December 2001; S. Lacy, "Merger: New Direction for Citigroup", *Silicon Valley/ San Jose Business Journal*, 18 June 2001; *The Economist Intelligence Unit,* "Country Commerce Mexico", 28 September 2001; *The Economist Intelligence Unit*, "Country report Mexico", 1 October 2001; Woodstock Institute, *Citigroup - Banacci Merger, Some Information from Mexico*, July 2001.

of economic activity in Mexico. The assembly industry reported a 27% decline in imports of machinery and equipment, probably because of lower demand from the clothing, automotive and electronics sectors as a result of the United States recession.

Nevertheless, the food, electronics, automotive and timber industries reported a number of investments in increasing productive capacity and productivity, in expectation of an upturn in the Mexican economy and in demand from its main trading partner in NAFTA. In addition, executives of TNCs are looking forward to the implementation of reforms that will allow FDI in the electrical and petrochemical sectors.

Figure I.4
FDI IN MEXICO, BY SECTOR, 2001



Source: National Foreign Investment Commission, *Informe estadístico sobre el comportamiento de la inversión extranjera directa en México*, Ministry of the Economy, (January-September 2001).

(ii) Brazil: the large domestic market continues to attract capital

Brazil continued to attract voluminous flows of investment capital in 2001, outstripped only by Mexico. FDI inflows amounted to US$ 22.6 billion, which was 30% less than the previous year, but still within the average range of the last five-year period. The downturn reflects not only harsh global conditions, but also uncertainty generated by the crisis in neighbouring Argentina, which is a major trading partner within MERCOSUR.

The reduction in flows with respect to the late 1990s was also attributable in large measure to the fact that the wave of privatizations, especially in utilities, has largely passed. The counterpart to this is an increase in concessions to the private sector, which represented US$1 billion according to figures recorded by Brazil's central bank. The bulk of these concessions were awarded in the telecommunications sector, to Telecom Italia, which acquired licences to operate cellular telephone services in São Paulo and in nine states of southern and western Brazil, including Rio Grande and Paraná. Together with other modalities of FDI income, such as mergers and acquisitions and expansion of capacity, operations in the service sector accounted for 60% of FDI inflows to Brazil.

Information recorded by the Information Centre of the ECLAC Unit on Investment and Corporate Strategies indicates that Brazil still has great potential for growth in the telecommunications and Internet markets. For example, Telecom Italia plans telecommunications investments of US$ 1.3 billion to continue developing mobile telephone services; Nextel plans investments of about US$ 2 billion over a four-year period; and Telecom Portugal has earmarked US$ 200 million for Brazil.

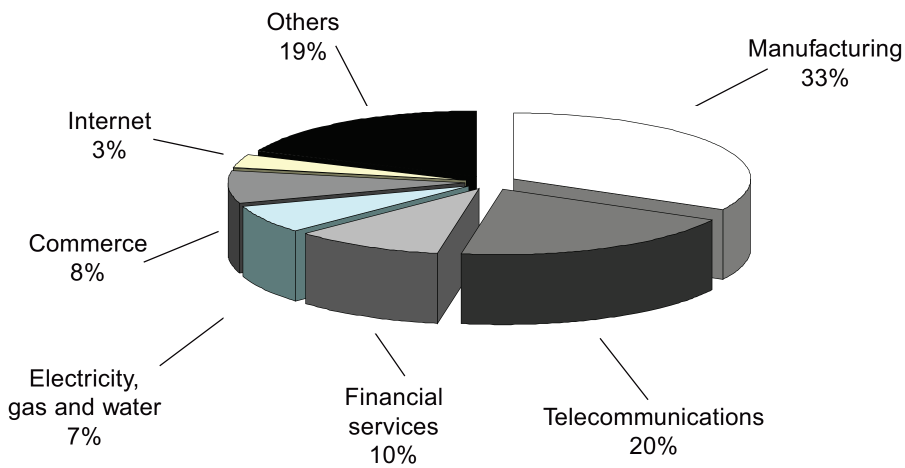
In the electrical energy sector, Iberdrola plans to install 1260 MW in gas combined cycle power plants in Brazil in the next few years. The Spanish firm Endesa took advantage of government subsidies offered to promote investments in electricity generation in the wake of the supply crisis, and in 2002 will build a natural gas combined cycle plant in the state of Ceará, at a cost of US$ 207 million.

Manufacturing accounted for the largest share of investment in production sectors, with 33% of total flows (see figure I.5). The most dynamic segments were automobile production (7% of inflows), chemicals (7%), electrical and telecommunications equipment (6%) and food and beverages (3%).

In the automotive industry, the operations of TNC subsidiaries located within MERCOSUR were restructured at a faster pace in 2001. This process entailed the closure of a number of plants in Brazil, such as the truck plants of General Motors and DaimlerChrysler (Germany), owing to the high cost of inputs and falling demand (*La Prensa*, 4 September 2001; *La Nación*, 5 September 2001; and *Clarín*, 15 April 2001).

At the same time, new investments are being made as plants are closed in Argentina and transferred to Brazil (MECON, 2001). A particular model of Renault, for

Figure I.5
FDI IN BRAZIL, BY SECTOR, 2001



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 from the Central Bank of Brazil.

example, is to be manufactured in Brazil with an investment of US$ 100 million in 2002.

In the primary sector, several foreign firms were involved in bidding at the third oil round, and purchased exploration licenses worth a total of US$ 203 million, which represented 85% of the funds collected by the National Petroleum Agency (ANP) at this round. This was in addition to investments made by foreign firms in areas acquired at the two previous rounds (1999 and 2000) and in the framework of partnership arrangements with Petrobras. A number of foreign oil firms are currently engaged in exploration activities in Brazil, mainly at deep-sea offshore sites. These include all the large TNCs (Exxon Mobil, Shell, TotalFinaElf, BP Amoco, Chevron Texaco, Repsol-YPF, Phillips, Conoco, ENI) and many other smaller firms, of which most are from United States, but a number are European (for further details, see chapter 4).

According to statistics compiled by A.T. Kearney (2001), Brazil figures among the countries, together with China, Mexico and India, that will top the list of future TNC investments in developing countries. This source indicates that 40% of investment projects in Latin America –excluding Mexico– will go to Brazil. This coincides with other rankings which have placed Brazil at the forefront of the region and among the 10 main destinations for world investments by TNCs in the period 2001-2005.

(iii) Rest of MERCOSUR and the Andean countries: diverging trends

The average level of FDI in South America, excluding Brazil, decreased significantly, basically as a result of declines in flows to two countries plagued by serious political instability and economic crisis, namely Argentina and Venezuela.

Political and institutional change in Venezuela has done little to improve the climate for attracting FDI; indeed, inflows shrank to just over US$ 3 billion –25% of the previous year's level– and were essentially linked to the oil sector (see chapter 4). In the case of Argentina, the government's desperate effort in 2001 to avert the collapse of the convertibility regime at a time of growing political instability, loss of confidence and strong expectations of devaluation forced foreign investors to defer potential projects pending a solution to a deepening crisis that still has not been resolved (for further details on FDI trends in Argentina, see chapter 2). However, in the service sector –electric power, commerce and telecommunications– capital flowed in as a result of corporate mergers and acquisitions, while investments proceeded in the oil and petrochemical sector: Pan American Energy completed construction of a gas plant, Polisur opened a new petrochemical complex and Proferil built new plants in Bahía Blanca.

In the remaining South American countries, FDI flows grew slightly in 2001. One notable case was Chile, where FDI inflows were similar to levels recorded in the mid-1990s.

A number of factors have continued to attract FDI to Chile both for the acquisition of private firms and for new investments: Chile's political and economic stability, the current government's shift towards greater openness in the capital account, moves to introduce greater protection for minority shareholders into the regulations on public tender offers (PTOs) and investors' perception of Chile as a stepping stone for investments elsewhere in South America. In 2001, mergers and acquisitions in Chile amounted to US$ 3.3 billion, with major transactions taking place in the energy sector (the sale of Gasandes to the French transnational TotalFinaElf), the electricity sector (the takeover of CGE by Pennsylvania Power and Light (PP&L-PPL)) and the manufacturing sector (the acquisition of a 30% share in Compañía Cervecería Unidas by the United States firm Anheuser-Busch). In addition, the programme of infrastructure concessions carried out by the Ministry of Public Works has continued to attract investments in highways. These operations, which have taken place in a turbulent regional and global environment, show that foreign investors have lost some of the short-sightedness displayed by TNCs in the past.

The completion of the market restructuring process, the shortage of important market niches dominated by Chilean-owned firms and the need to compete in new markets have prompted the government to attract investments into new production sectors through a policy to promote FDI in high-technology areas (see box I.3).

Oil firms continued to invest in Bolivia, Ecuador and Peru. In Ecuador, a consortium of TNCs in the petroleum sector started construction of a heavy crude oil pipeline, which will double the country's capacity to transport crude. This will act as an incentive for increasing production and investment in the hydrocarbon sector, where TNCs have been playing an increasingly important role in recent years. In Bolivia, additional extensive deposits of natural gas were found in the Tarija region in 2001. The size of the gas reserves discovered exceeds the absorption capacity of the Brazilian market –the main destination for Bolivian gas– supplied through the recently completed Bolivia-Brazil gas pipeline. Firms are studying various projects for developing these reserves, including a project involving the export of liquefied natural gas (LNG) from the Pacific coast to distant markets in northern Mexico and California, which will require major investments. In Peru, further investments were made in the development of the Camisea gas field, and construction is about to start on a gas pipeline for conveying it to the coast for distribution to the Lima market. The consortium carrying out this project –headed by the Argentine firm Pluspetrol– is also assessing a project for the export of Peruvian LNG to the same destination markets as those being considered for Bolivian gas (for further details in this regard, see chapter 4).

(a) FDI in the Caribbean Basin

In 2001, FDI inflows into Central America and the Caribbean amounted to US$ 4 billion, which was similar to their level in 2000. In relation to the size of the economies concerned, these flows are significant, representing on average almost 4% of subregional GDP. The Dominican Republic is the country with the highest proportion of total investment (32%), followed by Trinidad and Tobago (17%) and then by Guatemala, Costa Rica and Jamaica, each of which accounts for about 12% (see table I.5).

While FDI flows to the Caribbean have traditionally been concentrated in tourism, investments in the Dominican Republic and several of the Central American countries, including Costa Rica, Guatemala, Honduras and El Salvador, have targeted the manufacturing sector. This pattern of foreign investment has developed in response to: (i) the incentives offered by local governments for industrial free zones, in the context of the Caribbean Basin Initiative; (ii) the incentives offered by the United States government through production sharing mechanisms (TSUS 807 and HTSUS 9802), which provide preferential access to the United States market; and (iii) transnational corporations' efforts to boost efficiency and cut costs.

These factors have led to a strong expansion of FDI in manufacturing, primarily in relation to the low-technology assembly industry, such as the assembly of apparel for export to the United States market in the case of Honduras, El Salvador and the Dominican Republic. Recently, however, FDI flows have also been drawn to sectors involving more complex technology such as electronics and information technology, and Central American countries have been choice destinations for the installation by TNCs of call centres and cost centres. Indeed, strategies for promoting these new sectors are being implemented by several countries in the subregion. Costa Rica is a case in point (see Mortimore, Vergara and Katz (2001), section V). In 1997-2001, it successfully channelled most FDI into the industrial sector (see table I.6) and specifically the electronics subsector, including the manufacture of electronic, magnetic, telecommunications and microprocessor

Box I.3

CHILE AND THE PLAN TO ATTRACT HIGH-TECHNOLOGY INVESTMENTS

The first step towards a proactive policy on foreign direct investment?

The stagnation of economic growth, the emergence of problems such as unemployment and the decline in FDI flows have prompted the Chilean authorities to look at successful experiences in attracting FDI –such as those of Ireland and Singapore– and adapt them to the Chilean reality. President Lagos himself has personally launched some of these initiatives, including a programme to attract investments in high-technology sectors. [a] Though it does not amount to a comprehensive or consistent national policy of integrating the country into the international integrated production systems of transnational corporations, this new approach largely contrasts with the traditional *horizontal* character of Chilean economic policy and represents a first step towards a more *proactive* approach.

The goal of this programme is to strengthen the country's links to the global high-technology production and distribution network, to establish Chile as a platform for technological services for the region and, ultimately, to help create new sources of economic growth. The strategy is twofold. First, it focuses on investment promotion and on meeting and assisting investors in evaluating opportunities and conducting transactions, offering them the best possible facilities for their implementation. Promotional efforts are oriented towards activities identified as priorities –information technology, electronics, biotechnology and new materials– and focus on the main technological conglomerates, such as Silicon Valley in the United States. In addition, the Chilean government has set up a number of offices abroad to promote Chile as an investment destination through direct contact with foreign firms. [b] Investor services include information, assistance with project evaluation and investment facilitation in the legal, financial, tax, human resources and logistical spheres, among others.

Second, various incentives will be offered at each phase of the project: the preliminary study, the set-up of the firm and the operational phase.[c] They include:

- *Incentives for the preparation of pre-investment studies*. Provision of funds for the preparation and evaluation of pre-investment studies, which may include feasibility, environmental impact, architectural, engineering and other studies. Joint financing may be provided up to a maximum of 60% of the cost of such studies, with a ceiling of US$ 30,000 per firm.
- *Incentives for investment in fixed assets*. Provision of support and joint financing for the purchase of property, site development, infrastructure development and technological equipment. Joint financing may be provided up to a maximum of 40% of the investment, with a ceiling of US$ 550,000 per firm.
- *Guarantees for human resources development*. Subsidies for on-the-job human resources training. Subject to certain requirements, a subsidy of up to US$ 3,999 per worker hired may be granted for a maximum period of 12 months.
- *Guarantees for research and development activities*. Provision of funds for research and development activities with a potentially strong impact on trade.

Some projects under the high-technology programme have already started to take shape in the current year. For example, a technology project called *Gestión Integral de Clientes S.A.* ("Total Customer Management, Inc.") was set up in Valparaíso through a partnership between the companies General Supply S.A. and Tech-One Group S.A. In addition, Motorola has announced the establishment in Valparaíso of a technological centre for the development of mobile Internet solutions. In this regard, the authorities envision this city as a possible setting for a cluster of high-technology firms and, ultimately, as the country's future technology capital.[d]

In conclusion, Chile, in view of the need to diversify its sources of growth and position itself better in the digital economy, has established a programme for attracting high-technology investments at a time when questions are being raised with regard to its sources of development, economic growth rates are on the decline and unemployment is high. This programme is an incipient effort to channel incoming FDI into priority activities. The major objective is to move from the easy stage of attracting horizontal FDI –where more is better– to a more difficult one where the aim is to attract better-quality investments with more linkages to the rest of the economy. While the programme cannot be regarded as a new overall FDI policy direction, it may be understood as a new and important element of the national policy for attracting and channelling investments in line with priority objectives.

Source: Unit on Investment and Corporate Strategies, on the basis of interviews of executives of the Production Development Corporation (CORFO) of Chile.

[a] Another initiative to attract and channel investments is the *Programa Todo Chile*, aimed at attracting investments on the basis of comparative advantages at the regional level.

[b] Towards the end of 2000, a high-level delegation visited Silicon Valley to hold direct discussions with the world's major technology firms (Microsoft, Oracle, etc.), and he used the opportunity to inaugurate a Chilean investment promotion office.

[c] Incentives are available to both national and foreign firms.

[d] The authorities have already begun to take specific measures to this end. For example, national firms wishing to take advantage of the high-technology plan will be required to make their investments in Valparaíso.

Table I.5
CENTRAL AMERICA AND THE CARIBBEAN: NET FDI INFLOWS BY COUNTRY, 1995-2001[a]
(Millions of dollars)

	1995-2000[b]	1995	1996	1997	1998	1999	2000	2001[c]	2001 (%)
Anguilla	31	18	33	21	28	40	48	46	1.2
Antigua and Barbuda	26	31	19	23	27	27	31	30	0.8
Aruba	87	-6	84	196	84	392	-228	-237	-6.4
Barbados	15	12	13	15	16	17	14	13	0.4
Belize	22	21	17	12	18	47	18	17	0.5
Costa Rica	476	337	427	408	613	669	400	447	12.1
Cuba	10	5	19	1	15	9	13	12	0.3
Dominica	23	54	18	22	11	18	16	15	0.4
El Salvador	269	38	-5	59	1,104	231	185	198	5.4
Grenada	35	20	18	35	51	46	37	36	1.0
Guatemala	215	75	77	84	673	155	228	440	11.9
Guyana	64	74	93	53	47	48	67	64	1.7
Haiti	12	7	4	4	11	30	13	10	0.3
Honduras	147	50	91	122	99	237	282	186	5.0
Jamaica	314	147	184	203	369	524	456	438	11.8
Montserrat	3	3	0	3	3	8	2	2	0.1
Nicaragua	181	75	97	173	184	300	254	180	4.9
Panama	677	267	410	1,256	1,219	517	393	250	6.8
Dominican Republic	654	414	96	421	700	1,338	953	1,198	32.4
Saint Kitts and Nevis	31	20	35	20	32	42	38	36	1.0
Saint Vincent and the Grenadines	53	31	18	55	89	46	76	73	2.0
Saint Lucia	59	30	23	48	83	94	75	72	1.9
Suriname	-35	-21	19	-9	9	-62	-148	-154	-4.2
Trinidad and Tobago	615	299	355	999	730	643	662	636	17.2
Total	**3,984**	**2,001**	**2,145**	**4,224**	**6,215**	**5,416**	**3,885**	**4,008**	**100**

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies of the Division of Production, Productivity and Management, on the basis of figures from balance-of-payments statistics supplied by the International Monetary Fund (IMF) and national agencies in the countries. The figures presented are updated on an annual basis according to government authorities, reviews of their statistics. The figures presented here differ from those shown in the Preliminary Overview of the Economies of Latin America and the Caribbean, 2001, published by ECLAC, as in the latter net FDI inflows are considered to be investment in the reporting economy, minus direct investment abroad by its residents.

[a] Refers to inflows of direct investment in the reporting economy; direct investments abroad by its residents are not deducted.
[b] Annual average.
[c] Estimates based on information supplied by the countries' central banks.

components (see diagram I.1) and medical devices such as surgical equipment, software, medical preparations, mechanical monitoring equipment, surgical instruments and medical laser equipment.

Owing to the global recession and to an overestimation of the market's absorption capacity, several electronics and telecommunications firms saw their profits and market value plummet and were forced to conduct restructuring operations and plant closings in 2001, though this process did not affect plants in Costa Rica. Investments in that country have not declined, and it is expected that FDI in this sector will continue to expand.

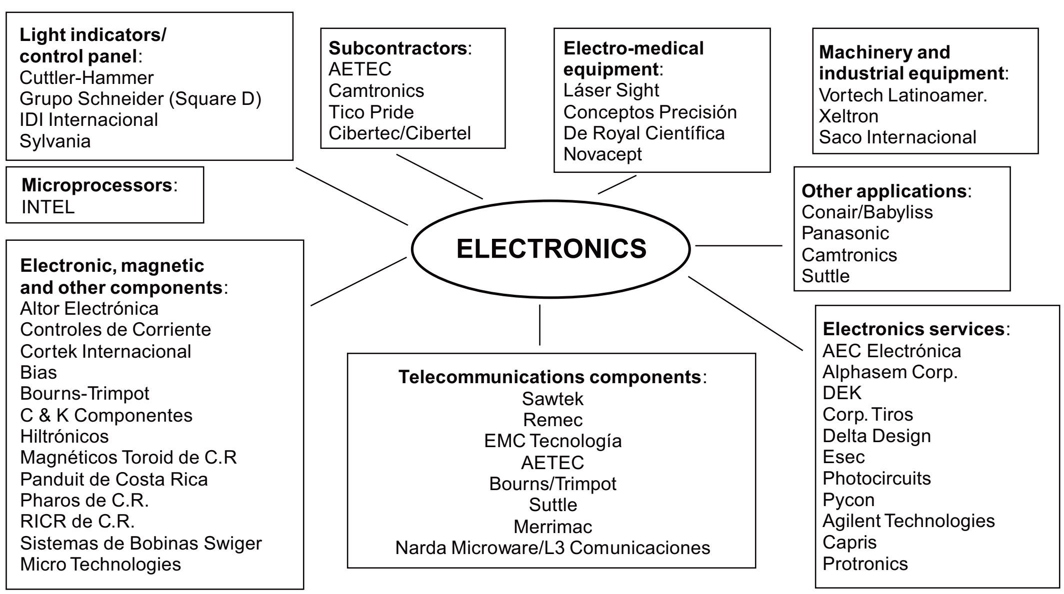
Although Central America and the Caribbean are still in the process of privatization and are seeking foreign capital for their infrastructure sectors, in 2001 there were few operations in this area. Towards the end of the year, negotiations on the management of the firm that owns Central America's electric power lines were completed, with Endesa España becoming the seventh financial partner and agreeing to invest US$ 70 million of the total

Table I.6
FDI DISTRIBUTION BY SECTOR IN COSTA RICA
(*Percentages*)

Sector	1997	1998	1999	2000	2001
Agriculture	9.4	6.9	8.1	-2.7	4.0
Agro-industry	1.6	2.4	1.7	2.8	1.4
Commerce	4.3	6.4	1.5	4.3	1.4
Industry	66.5	69.2	57.4	72.5	51.7
Services	-1.8	1.1	2.1	3.6	7.6
Financial system	0.0	3.6	15.1	6.6	6.7
Tourism	19.5	10.0	13.7	12.8	27.2
Other	0.6	0.3	0.5	0.2	0.1
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Central Bank of Costa Rica, Monetary Department, Balance of Payments Section, on the basis of figures provided by the Costa Rican Investment Board (CINDE), Agency for Foreign Trade Promotors of Costa Rica (PROCOMER) and the Costa Rican Tourism Institute (ICT).

Diagramme I.1
ELECTRONICS SECTOR IN COSTA RICA



Source: Anabel González, "Casos de países que han mejorado su competitividad internacional vía la IED en manufacturas: Costa Rica", document presented at the Regional Seminar on FDI politics in Latin America, Santiago, Chile, January 2002.

of US$ 320 million that the project will entail. In addition, foreign consortia were granted concessions for the construction of roads and airports in Costa Rica and the Dominican Republic. In the latter, the companies that operate in the different segments of the telecommunications market –Centennial Dominicana, Codetel Verizon, Tricom and Orange PLC– have planned investments to the tune of US$ 400 million to defend their market position. Unión Fenosa, for its part, will implement two energy projects: a US$ 18-million wind energy park and a US$ 500-million combined cycle power plant, which will significantly increase the country's energy capacity. Another investment in the energy sector is the planned investment by AES in the construction of a combined cycle power plant that will provide Honduras with 780 MW at a cost of US$ 650 million.

B. STRATEGIES, AGENTS AND MODALITIES OF FOREIGN DIRECT INVESTMENT

1. Strategies of transnational corporations in Latin America

As noted in the analyses published since 1998 in *Foreign Investment in Latin America and the Caribbean*, the TNCs that invested in the region over the past decade did so because they sought efficiency, raw materials and market access (see table I.7). These motives still existed in 2001, but the regional and international context described above caused investment flows to abate. Thus, slackening demand in the United States put a damper on the efficiency-seeking strategy of United States firms operating in Mexico and the Caribbean Basin, which had been attracted by advantages such as lower wages, geographical proximity and preferential access to the United States market.

Firms which have primarily sought new markets and which, in the case of the agro-industrial, chemical and automotive branches, have concentrated their investments in MERCOSUR reacted to the Argentine crisis and its potential contagion by slowing the pace of their business ventures. In the automotive sector, in particular, as pointed out in the preceding section, errors in forecasts of subregional demand, repeated crises in the subregion's economies and inconsistencies between the macroeconomic policies of the participating countries (especially Argentina and Brazil) have led to the withdrawal and transfer of some investments in these countries (see chapter 3).

The massive wave of investment in financial services and infrastructure was affected by factors which had a positive impact in the 1990s, but a negative one in 2001. In the case of the privatization of State assets and the concession of public services, investments declined once the process of selling off these assets had largely been completed. The mergers and acquisitions that took place in response to the competition generated by market liberalization will not recur with the same intensity while the new market structure is being consolidated. Lastly, changes in the rules of the game in some countries following the overhaul and reform of regulatory frameworks for infrastructure services have made investors uneasy, leading to the suspension of some projects, as in the case of the electricity sector in Brazil, Chile and Argentina.

Lastly, investments in natural resource development were hampered by falling commodity prices, the decreased profitability of projects and the difficulty of obtaining international financing under these conditions.

2. Impact of FDI on regional competitiveness

The FDI that has been channelled into natural resource-related activities and industry should improve the region's international competitiveness. One indicator for measuring this is the share of each country in total world imports. This information appears in tables I-A.2 and I-A.3 of the annex, which are similar to the table on China in box I.1, but relate to South America, on the one hand, and Mexico, Central America and the Caribbean, on the other. The two subregions may be distinguished by the different sectors targeted by FDI. South America's market share has shown a relative decline with respect to its 1995 level and an even sharper fall with respect to its level of a decade earlier. By contrast, Mexico, Central America and the Caribbean Basin have shown a relative increase of one percentage point in the last five-year period. This is important, considering that it was the region's economic reforms of the 1990s that were largely responsible for attracting the considerable volume of FDI inflows. Nevertheless, except in Mexico, this increase has not led to an overall improvement in competitiveness and international integration, since the region has retained its traditional vulnerability to external forces.

It is interesting to make a comparison with the way China's competitive position has developed. Although China opened up only partially to the market, its achievements were significant (see box I.1). This may be partly due to the fact that, in this case, FDI was channelled primarily into projects that expanded productive capacity through the installation of new plants rather than taking over existing facilities, as was the case in South America. In addition, FDI was oriented towards the entire value chain, strengthening production linkages and export development. With respect to this last point, FDI in Latin America and the Caribbean has

Table I.7
LATIN AMERICA AND THE CARIBBEAN: STRATEGIES OF TRANSNATIONAL CORPORATIONS IN THE 1990s

Corporate strategy	Efficiency	Raw materials	Market access (national or subregional
Sector			
Primary		**Oil/gas**: Argentina, Bolivia, Brazil, Colombia, Ecuador and Venezuela **Minerals**: Chile, Argentina and Peru	
Manufactures	**Motor vehicles**: Mexico **Electronics**: Mexico and Caribbean Basin **Apparel**: Caribbean Basin and Mexico		**Motor vehicles**: Argentina and Brazil **Agribusiness, foods and beverages**: Argentina, Brazil and Mexico **Chemicals**: Brazil **Cement**: Colombia, Dominican Republic and Venezuela
Services			**Financial**: Brazil, Mexico, Chile, Argentina, Venezuela, Colombia and Peru **Telecommunications**: Brazil, Argentina, Chile and Peru **Electricity**: Argentina, Brazil, Chile, Colombia and Central America **Natural gas distribution**: Argentina, Brazil, Chile and Colombia **Retail commerce**: Brazil, Argentina, Mexico and Chile

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

remained within closed enclaves, in both resource-based sectors and assembly industries, though with somewhat more positive results in the latter case. The enclave pattern characteristic of most FDI in the region and the absence of inter- and intra-industry linkages explain why results in terms of productivity and overall growth have been meagre even though exports have increased substantially.

South America's export structure continues to be dominated by natural resources and resource-based manufactures (see annex, table I-A.2), but the subregion as a whole has lost global market share in both resource-based and non-resource-based manufactures exports. On the other hand, in Mexico, Central America and the Caribbean Basin (see annex, table I-A.3), non-resource-based exports have been growing considerably since 1985, but especially since the tequila crisis and Mexico's accession to NAFTA. This enabled Mexico to become a preferred destination for investment in assembly plants for the United States electronics industry, but also to continue to gain ground in the apparel *maquila* and automotive industries. As mentioned earlier, the Central American countries have also been a destination for investments in the apparel sector and, recently, in electronics, under the Caribbean Basin Initiative.

The difference in the targeting of FDI by sector in the two subregions also explains why none of South America's 10 leading exports is on the list of the most dynamic products–the 50 most traded products on the world market – whereas practically all the exports from Mexico, Central America and the Caribbean Basin belong to this group. This fact should be taken into account in evaluating the potential for sustained regional growth in the future.

3. Importance of transnational corporations in Latin America and the Caribbean

In recent years, TNCs have continued to gain importance in Latin America and the Caribbean. A number of indicators point to this trend, but the ones deemed relevant for the purposes of this report are TNCs' percentage ownership of the leading firms and their share of sales and exports.

Table I-A.4 of the annex, which summarizes information for the period 1990-2000, shows that TNCs nearly doubled their share of the 500 largest Latin American firms between the beginning of the decade and the present, while almost tripling their share of sales. In terms of sectors, the biggest firms in Latin America and the Caribbean have been concentrated in manufacturing and services, but it is in services that the number of foreign firms has grown significantly in recent years; such firms have increased their share from less than 30% at the beginning of the 1990s to 38% in 2000 and have narrowed the sales gap between services and manufacturing.

A more limited analysis covering only the 200 largest export firms in the region (see table I.8) shows that in the second half of the 1990s, the share of foreign firms grew steadily to reach almost half (44%) of the group's total exports, while the remaining 56% was divided between private and public domestic firms. At the same

Table I.8

LATIN AMERICA AND THE CARIBBEAN: THE 200 LEADING EXPORT FIRMS, 1996-2000

	1996	1997	1998	1999	2000
By ownership					
Number of firms	200	200	200	200	200
Foreign	78	92	97	97	98
Domestic private	112	88	94	94	89
State-owned	10	10	9	9	13
Exports	115,317	139,833	133,841	131,041	191,813
Foreign	34,033	557,313	60,315	54,000	83,888
Domestic private	40,253	42,644	43,674	42,989	51,624
State-owned	41,031	39,926	29,582	34,052	56,301
Ownership (percentages)	100.0	100	100	100	100
Foreign	29.5	41.0	45.1	41.2	43.7
Domestiic private	34.9	30.5	32.6	32.8	26.9
State-owned	35.6	28.5	22.3	26.0	29.4
By sector					
Number of firms	200	200	200	200	200
Primary sector	45	36	32	39	46
Manufacturing	132	142	147	138	131
Services	23	22	21	23	23
Exports	115,317	139,833	133,841	131,041	191,813
Primary sector	52,643	50,923	38,896	44,992	68,197
Manufacturing	56,091	78,638	85,568	74,825	109,172
Services	6,582	10,322	9,376	11,224	14,444
Sector (percentages)	100.0	100.0	100.0	100.0	100.0
Primary sector	45.7	36.4	29.1	34.3	35.5
Manufacturing	48.6	56.2	63.9	57.1	56.9
Services	5.7	7.4	7.0	8.6	7.5

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 supplied by the research department of the *América economía* for 1995-1998 and the journal *Gazeta Mercantil,* October 2000, *América economía*, 30 August and *Gazeta Mercantil*, November 2001, for the year 2000.

time, the table shows that from 1996 to 2000, exports by TNCs increased 2.5 times, while those of domestic public enterprises (primarily in the mining and oil sectors) expanded by 38%, leaving domestic private firms lagging behind with an increase of 28%.

A per-sector analysis of the 200 biggest export firms shows that the manufacturing sector accounts for 57% of exports, followed by the primary sector, which has been losing ground in recent years.

A look at total sales by the 100 leading manufacturing firms to the foreign and domestic markets (see table I.9) reveals that there was a sustained increase throughout the 1990s; however, while TNCs increased their share of sales by 9 percentage points, domestic private firms lost 5 points. Market gains by TNCs in Latin America and the Caribbean reflect a combination of factors, including ownership of cutting-edge technology, higher productivity and access to lower-cost financing.

Argentina, Brazil and Mexico account for the bulk of sales by the 100 largest TNCs operating in the region (see annex, table I-A.5). According to the most recent consolidated sales statistics for 2000. Six out of the 10 top firms were in the automotive industry, with the majority being based in Mexico. Overall, the leading manufacturing activities were food and beverages and the automotive and electronic industries, while telecommunications headed up the list in the services sector.

4. FDI modalities in Latin America and the Caribbean

FDI modalities differ depending on whether the investment is geared towards fixed capital formation in a host economy, acquisition and/or administration of public goods (privatizations and concessions) or the purchase of private domestic assets, currently referred to as mergers and acquisitions. With respect to fixed capital formation, the investor contributes to the expansion of local productive capacity either by building new plants –known as greenfield projects– or by incorporating new machinery and equipment or introducing new technology. Such operations expand the country's productive capacity and usually result in increased labour productivity. The other two forms of FDI do not necessarily contribute to capital formation, though the negotiations for some privatizations and most concessions include plans for expanding the production or service concerned. This has occurred in the telecommunications and electricity sectors in some countries, and definitely in the case of contracts for the exploration and exploitation of hydrocarbons and road infrastructure projects (see Moguillansky and Bielschowsky, 2000).

The distinctive feature of the type of FDI effected in 2001 is that there were virtually no privatizations and substantially fewer mergers and acquisitions. Meanwhile, investments to expand regional productive capacity rose until they represented nearly two thirds of total FDI.

With respect to privatizations, the year 2001 marked a low point in a process that had first gained momentum in the early 1990s. The main privatization operations involving FDI in 2001 (see table I.10) were fewer in number and smaller in scale than those of previous years. This reflects the fact that many of the countries had already finished selling off public assets, leaving just a few major State-owned enterprises in the oil sector (in Colombia, Mexico and Venezuela), the electricity sector (in Mexico and Costa Rica) and the mining sector in Chile, where the privatization of the enterprise concerned is under discussion.

In terms of concessions, however, private-sector participation has soared in both the primary and service sectors (see annex, table 5). In the latter, new contracts were concluded in the area of telecommunications –in mobile telephony in Brazil and in the cordless telephone segment in Venezuela–, in the generation segment of the electricity sector (Mexico, Brazil and Peru) and in road transport (Chile and Costa Rica). Most of these concessions were granted to operators of European origin, but domestic investors have continued to participate, albeit to a lesser extent.

As pointed out earlier, mergers and acquisitions in the region mirror what has occurred at the global level. Thus, a significant drop can be observed in both the number of transactions and the amount involved –from over US$ 90 billion in 1999-2000 to just over US$ 25 billion in 2001 (see annex, table I-A.6). As in the past, operations were concentrated in services, where transactions totalled almost US$ 23 billion. Of this amount, 67% was in the financial sector, where the purchase by Citibank of the Mexican financial group Banamex-Accival was the largest operation. Some 23% was in telecommunications, while the electricity and transport sectors lagged behind. The United States was foremost among the countries of origin of investment in 2001, in terms of both the number of operations and the amount involved, and was followed by Spain, France, the United Kingdom and Portugal.

Table I.9
LATIN AMERICA AND THE CARIBBEAN: THE 100 LARGEST MANUFACTURING FIRMS 1990-1992, 1994-1996, 1998-2000
(*Number, millions of dollars and percentages*)

	1990-1992	1994-1996	1998-2000
Number of firms	100	100	100
Foreign	48	53	59
Domestic private	48	46	40
State-owned	4	1	1
Sales	102,094	176,923	198,137
Foreign	54,293	104,922	122,186
Domestic private	43,463	68,341	74,455
State-owned	4,338	3,661	1,497
Ownership	100.0	100.0	100.0
Foreign	53.2	59.3	61.67
Domestic private	42.6	38.6	37.58
State-owned	4.2	2.1	0.76

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 supplied by the research department of the journal, *América economía* for the trienniums 1990-1992 and 1994-1996 and information published in the journals, *La Nota*, April 2000; *Gestión*, June 2000; *Mercado*, July 2000; *América economía*, 27 July 2000; *Expansión*, 19 July 2000; *Gazeta Mercantil,* October 2000; *Expansión*, 25 July 2001, *Mercado*, July 2001; *América economía*, 30 August 2001; and *Gazeta Mercantil,* November 2001.

Table I.10
LATIN AMERICA AND THE CARIBBEAN: PRIVATIZATIONS INVOLVING FOREIGN INVESTMENTS, BY SECTOR AND AMOUNT, 2001
(*Millions of dollars*)

Date	Economic activity	Privatized firm		Buyer		%	Amount
Primary sector							
May-01	Extraction of metalliferous ores	Familiar	Mexico	Pan American Silver Corp.	Canada	100	3
Apr-01	Extraction of metalliferous ores	Cañariaco	Peru	Candente Resources	Canada	100	…
Service sector							
Jul-01	Electricity	Electroandes	Peru	Public Services Enterprise Group (PSEG)	United States	100	227
Jun-01	Hotels and restaurants	Casino de la Selva	Mexico	Costco	United States	100	10
Jan-01	Air transport	Compañía Dominicana de Aviación	Dominican Republic	Aeropostal	Venezuela	50	10
Sep-01	Telecommunications	Empresa Nicaragüense de Telecomunicaciones (ENITEL)	Nicaragua	Telia AB	Sweden	40	83
Dec-01	Financial intermediation	Banco Estatal Caja Obrera	Uruguay	Banco Montevideo	Uruguay	99.8	…
Apr-01	Financial intermediation	Banco do Estado de São Paulo (BANESPA)	Brazil	Banco Santander Central Hispano (BSCH)	Spain	64.1	1,068

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 from national agencies and the press.

II. ARGENTINA: FOREIGN DIRECT INVESTMENT AND CORPORATE STRATEGIES

INTRODUCTION

In the late 1980s Argentina embarked upon one of Latin America's most ambitious economic reform plans, based on two main pillars: the "Convertibility Plan", which used a fixed exchange rate to control inflation, and the downsizing of the public sector through massive privatization of State-owned assets.

- The Convertibility, or Cavallo, Plan was highly successful in bringing hyperinflation under control, but over the years it generated a number of distortions which played a decisive role in creating the current crisis. First, due to the exchange-rate lag, the Argentine economy's international competitiveness declined sharply and a substantial part of its production apparatus disappeared, as local output struggled to compete with imports. Second, as a result of this, the trade deficit worsened and the Administration began to use foreign borrowing to finance the external deficit, which inflated foreign debt to unprecedented levels (see table II.1).

- The privatization plan pared the State's role in production and service provision down to a minimum. In fact, Argentina scaled back the public sector more than any other country in Latin America. The manner in which these reforms were conducted, however, created a series of difficulties in some utilities sectors which are currently controlled by foreign private investors (energy, telecommunications and finances).

Table II.1
ARGENTINA: ECONOMIC INDICATORS
(Percentages and millions of dollars)

	1990	1995	1998	1999	2000	2001[a]
Growth rate of gross domestic product (GDP) (percentage)	-2.0	-2.9	3.8	-3.4	-0.5	-3.8
Consumer price index (CPI) variation (December to December)	1,343.9	1.6	0.7	-1.8	-0.7	-1.6
Unemployment	7.4	17.5	12.9	14.3	15.1	18.0
Imports	4,060	20,200	31,404	25,508	25,148	24,103
Exports	12,353	21,162	26,441	23,333	26,298	23,309
Current-account balance	4,552	-4,938	-14,708	-12,444	-9,361	-5,301
Capital and financial account	-5,169	2,920	18,800	14,471	8,143	-14,999
Foreign direct investment	1,836	5,610	7,292	23,984	11,665	3,181
International reserves	6,448	18,506	26,524	27,362	26,491	18,341 [b]
Public and publicly-guaranteed debt	46,905	55,970	77,285	84,568	128,018	132,143 [c]
Private non-guaranteed debt	1,800	11,265	27,866	27,320	...	...

Source: ECLAC, on the basis of *Statistical Yearbook for Latin America and the Caribbean, 2001* (LC/G.2151-P), Santiago, Chile, 2002. United Nations publication, Sales No. E.02.II.G.1; and *Preliminary Overview of the Economies of Latin America and the Caribbean, 2001* (LC/G.2153-P), Santiago, Chile, 2001. United Nations publication, Sales No. E.01.II.G.182.
[a] Preliminary figures.
[b] Reserves to July 2001.
[c] Public debt to 30 June 2001.

At the same time as these changes were occurring in the domestic economy, Argentina took steps to revitalize the process of regional integration, especially with Brazil. Its efforts in this connection were deployed within the framework of the Southern Common Market (MERCOSUR) and converted Brazil into Argentina's largest trading partner.

In this context, Argentina became one of the main recipients of foreign capital flows to Latin America and the Caribbean in the 1990s. Throughout the decade, foreign direct investment (FDI) flowed into the country in response to the elimination of restrictions on foreign capital, price stability, trade and financial liberalization, market deregulation, the privatization of public enterprises, relations with MERCOSUR and a number of explicit incentives which heightened the advantages of locating business enterprises in the country. According to a number of estimates, external investment in Argentina amounted to between US$ 65 billion and US$ 100 billion in 1990-2001 (CEP, 1999; MECON, 2001). As a result, the foreign stake in the sales of the country's leading firms increased from 24% in 1991 to 50% in 2000, making Argentina one of the most transnationalized economies in the world. Capital flows were mainly channelled into the purchase of existing assets —first within the framework of the privatization programme and later in the context of the boom in private merger and acquisition activity— and to capacity-building and expansion in line with increasing production complementarity within MERCOSUR (especially in the automotive industry). While they helped to finance the balance of payments, the corporate (production, trade and financial) strategies pursued by most of the subsidiaries of transnational corporations (TNCs) in this progressively more liberalized and deregulated economy have not necessarily translated into significant or widespread gains in competitiveness, but they have tended to exacerbate external constraints and disequilibria.

During this same period, TNCs have been heavily involved in the restructuring of the Argentine economy and have been in a better position than most local firms to capitalize on new competitive conditions and the incentives implicit in the structural reform programme.

Chapter II looks at this process, at the forms it has taken and at its effects. The first section deals with the main characteristics and historical trends of FDI, the sums involved and the main modalities, origins and destinations of flows. The second part examines the strategies deployed in Argentina by TNCs in industries in which they maintain a substantial presence. Lastly, a number of general conclusions are drawn about the implications of foreign capital in Argentina.

A. FOREIGN CAPITAL IN THE ARGENTINE ECONOMY

1. From British hegemony to nationalism, opening up the market and economic liberalization

Historically, foreign capital has played an important role in Argentina's economic structure. There have been three major waves of FDI. The first consisted of a series of investment cycles that occurred in the late nineteenth and early twentieth centuries, when Argentina was consolidating its position as an exporter of agricultural products. During this period capital flowed into the construction of railways, meat packing plants and utilities. The resulting economic structure was designed to capitalize upon the country's agricultural resources, as foreign investors provided capital to develop the infrastructure needed to produce and export agricultural goods. Most of the FDI received during these years came from the United Kingdom, although capital from other European countries was also invested in utilities and United States investors became involved in the meat packing industry. By the 1920s, however, the bulk of investment was coming from the United States, although a majority of the corresponding capital stock remained mostly in British hands (ECLAC, 1958).

This scheme came to an end with the global crisis of the 1930s and, like other countries of the region, Argentina embarked upon a process of industrialization based on import substitution. When the Second World War ended, many industrialized countries resumed their internationalization strategies, which included Latin America. In Argentina, however, there was very little foreign capital. In the late 1940s, President Juan Domingo Perón nationalized public utilities and implemented a series of protectionist policies which discouraged foreign investors.[1] In 1955, foreign capital represented 5% of total capital stock; this was a far cry from the high of 48% registered at the beginning of the century (ECLAC, 1958). Substantial changes took place after the overthrow of Perón, however. In particular, Arturo Frondizi, who became President in 1958, instituted policy changes to encourage foreign investment. The passage of Act 14780 eased restrictions on profit remittances and the repatriation of capital, and complementary legislation was passed regarding industrial and regional promotion.

1 In 1953 a less restrictive framework was established for foreign capital. However, a number of regulations were in place that discouraged foreign investors. These provisions included, in particular, strict rules on profit remittances and the repatriation of capital. This was in addition to the controversial Article 40 of the Constitution, which declared that public utilities and natural wealth (with the exception of agricultural activities) were the inalienable property of the Nation (Rapoport and Spiguel, 1994).

Capital now began to flow into manufacturing activities, especially the motor vehicle industry and the chemicals and petrochemicals sectors, which together accounted for two thirds of total investment. Petroleum activity was partially liberalized by means of tenders for exploration and operation contracts under the supervision of the State enterprise Yacimientos Petrolíferos Fiscales (YPF).[2]

The next influx of capital took place between 1966 and 1969. On this occasion, investment was primarily channelled into the purchase of local firms and the expansion of installed capacity. As a result, foreign investors' stake in the Argentine economy increased in the 1960s, with foreign firms' share in the sales of the top 100 industrial corporations growing from 63% in 1957 to 76% in 1962, and to 79% in 1969. The stake of TNCs in the country's industrial output expanded from 10% in 1957 to 18% in 1962 and 20% in 1969 (Khavisse and Piotrkowski, 1973).

The severe political and social instability of the 1970s caused FDI flows to dwindle. The Peronists' return to power in 1972 also brought with it new legislative restrictions on foreign capital. In the wake of the 1976 military coup and the associated turnabout in economic policy, FDI flows began to change significantly. In this period, several foreign flagship corporations withdrew from Argentina (such as General Motors and Citroën) or transferred their operations to local groups (Fiat and Renault).

In the 1980s, FDI was relatively slack owing to the conditions generated by the debt crisis. Generally speaking, the bulk of the investments made at this time were associated with industrial promotion programmes, which had a major impact on the location of production activities. Indeed, the main beneficiaries of these subsidization schemes were a number of local groups (Azpiazu and Basualdo, 1990). In consequence, for the first time TNCs began to show an interest in forming partnerships with local firms, as large local groups became increasingly powerful players in the Argentine economy (Azpiazu, 1995).

In the second half of the 1980s, most FDI flows were associated with debt-equity conversion mechanisms (see figure II.1). Between the end of 1984 and 1989, almost all capitalized debt corresponded to industrial projects sponsored by TNCs that were already operating in Argentina. Swap operations to convert external debt into equity investment were thus highly concentrated in a few export-oriented firms, activities and sectors (foods, motor vehicles and chemicals) (Basualdo and Fuchs, 1989). The possibility of partially privatizing some State-owned assets began to be discussed at this time, although no such step was actually taken.[3] During this period Argentina also lapsed into a deep economic crisis marked by high rates of inflation and external disequilibria.

Then, in the 1990s, changing international conditions, together with the economic policy adopted by the Administration of Carlos Menem (1989-1999), generated the third and largest wave of FDI to Argentina. These inflows occurred under very different conditions than previous ones. One of this wave's major differentiating features was the unrestricted access enjoyed by foreign capital to all economic activities, including public services and extractive industries.

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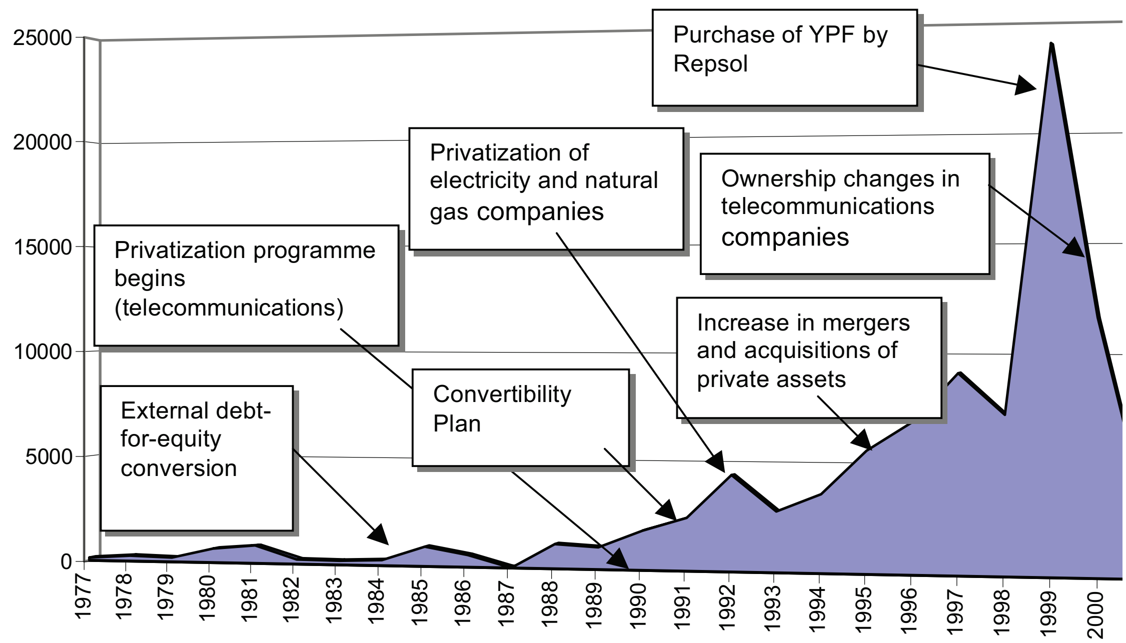
2 These contracts were cancelled under the government of Arturo Illia (1963-1966).

3 In 1987, the Government announced a scheme to partially privatize the Empresa Nacional de Telecomunicaciones (ENTEL) and Aerolíneas Argentinas (AA). This initiative failed to win sufficient support in parliament, however.

Figure II.1
ARGENTINA: FDI INFLOWS, 1977-2001
(Millions of dollars)



Source: ECLAC, Information Centre of the Unit of Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information provided by the International Accounts Office of the Ministry of Economic Affairs, Public Works and Services (MECON).

2. The expansion of FDI flows in the 1990s

FDI inflows to the Argentine economy began to recover in the late 1980s. It then rapidly gathered momentum in the 1990s, reaching a total of US$ 78,709 billion between 1992 and 2001 (see table II.2), according to official balance-of-payments estimates. Capital inflows increased throughout the decade, peaking at US$ 23,986 billion in 1999 before falling back in 2000 and 2001 (see table II.2). In consequence, according to the estimates of the International Accounts Office (DNCI) of the Ministry of Economic Affairs, Public Works and Services (MECON), the FDI stock rose from US$ 11,524 billion in 1990 to US$ 75,998 billion in 2001 (MECON, 2001).

Table II.2
ARGENTINA: FDI BY MODALITY, 1990-2001
(Millions of dollars)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	1992-2001[a]
Total FDI	**1,836**	**2,439**	**4,433**	**2,791**	**3,635**	**5,610**	**6,949**	**9,161**	**7,291**	**23,986**	**11,672**	**3,181**	**78,709**
Reinvestment of earnings	...	...	857	878	898	659	397	726	788	-144	1,548	-843	5,764
Capital contributions	...	...	474	628	1,287	1,685	2,011	2,580	3,179	4,116	3,178	2,750	21,888
Intra- company debts	...	...	371	251	387	700	1,525	1,159	802	1,627	688	500	8,010
Purchase of existing assets	1,174	460	2,717	1,036	1,063	2,566	3,014	4,694	2,522	18,386	6,258	774	43,030
- Privatizations	1,174	460	2,332	935	136	1,113	580	892	334	4,192	30	25	10,569
- Mergers and acquisitions	...	...	385	101	927	1,453	2,434	3,802	2,188	14,194	6,228	749	32,461

Source: ECLAC, Information Centre of the Unit of Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information provided by the International Accounts Office of the Ministry of Economic Affairs, Public Works and Services (MECON).
[a] Cumulative flows from 1992 to 2001.

The beginning of this new wave of foreign investment in Argentina came at a time of major political and economic changes, both in the national arena and in the regional and international environment. Throughout the 1990s the Argentine Government implemented far-reaching economic reforms based on the pillars of price stabilization, the privatization or tendering of public assets, the opening of large sectors of the local economy to trade, the liberalization of many goods and services activities and the renegotiation of external liabilities (Heymann, 2000) (see table II.3). Two reforms were particularly important:

- The introduce of a convertibility regime based on a fixed exchange rate, which was established in 1991 with the enactment of legislation that led to a rapid and long-lasting reduction in inflation (see box II.1). Price stability was thus crucial to the positive trend of economic activities in the years that followed.
- Public-sector reform, which was implemented through legislation that sanctioned the privatization or concession of a broad range of public-sector enterprises and activities (Aspiazu and Vispo, 1994). In 1990, the Empresa Nacional de Telecomunicaciones (ENTEL) and Aerolíneas Argentinas (AA) were transferred to the private sector. These operations were followed by the transfer of oil fields and other petroleum assets in 1991 and 1992; of electricity and gas utilities and the State-owned Sociedad Mixta Siderúrgica Argentina (SOMISA) in 1992; and, a year later, of Yacimientos Petrolíferos Fiscales (YPF), among others.

The consortia that purchased State enterprises were initially tripartite arrangements consisting of foreign investors, local economic groups and banks whose parent firms were based abroad. Although local economic groups were heavily involved in these consortia, in most cases the terms and conditions of calls for tenders required the successful bidders to include foreign operators. In addition, since in the early years the privatizations that were conducted entailed an external debt capitalization programme, the holders of this debt —foreign banks— naturally formed part of the consortia involved in these transactions. Later, these firms gradually restructured their capital base. First, the foreign banks and, later, many local economic groups sold their stake to their foreign partners (see box II.1). As a result, 67% of the total funds derived under privatization programmes were of foreign origin, and more than three quarters of this was FDI (MECON, 2000) (see table II.4).

Table II.3
ARGENTINA: MAIN ECONOMIC REFORMS AND POLICIES

Year	Monetary and financial policy	Fiscal policy	Trade policy	Privatizations	Deregulation
1989	- Restrictions on currency transactions lifted - Public debt reprogrammed	- Industrial promotion subsidies suspended; public utility charges raised - Intervention in state enterprises; mechanisms for privatization - Universal introduction of VAT[a] and/or reduction of rate (15% to 13.5%); income tax rates lowered	- Export duties raised and import tariffs lowered - Cash drawbacks suspended		
1990	- Bonex Plan	- "Unified window" for State-run enterprises - Reduction of areas under central administration - Corporate assets tax and VAT[a] increased to15.6%; VAT[a] base expanded; taxes on capital gains, net worth and other minor taxes abolished.	- Export duties raised and import tariffs lowered - MERCOSUR negotiations concessions	- Telephones - Airlines - Petroche-micals - Oil field and roads	
1991	- Convertibility Act	- Debt Consolidation Law - VAT[a] increased to 16%, then 18%; personal goods tax created - Public utilities transferred under central government/provinces agreement	- Most export duties eliminated - Import tariffs lowered (rates of 0%, 11% and 22%) - Temporary import regime - Treaty establishing MERCOSUR	- Telephone equity sold - Partnership and concession agreements for oil/gas extraction - Concession of railway stretches	- Dissolution of state entities - Freight transport
1992	- Charter of Central Bank (BCRA[b]) revised - Financial institutions act reformed - Dollar-denominated bank reserves authorized	- Agreement with IMF[c] on extended facilities - VAT[a] coverage increased; income tax rates raised - Central/provincial government agreement on minimum monthly income guaranteed from central government - Regularization of debts owed to pensioners	- Statistical rate on imports increased - Drawbacks increased - Progress in MERCOSUR system of preferences	- Transport and distribution of gas - Sanitary works - SEGBA[d] - Iron and steel firms	- Mining - Pharma-ceutical products - Motor transport - Ports Act
1993	- Brady Plan - Deposits of under 30 days prohibited - Mutual Funds Act - Securitization standards	- Pension system reform enacted - Agreement between national and provincial government on coordination of tax structures - Modification of income tax	- Agreement on common external tariff within MERCOSUR, regime of free zones	- YPF[e] - Hydroelectric and thermal power plants - Electricity transmission - Concession of stretches of overland and underground railways	

Table II.3 (concluded)

Year	Monetary and financial policy	Fiscal policy	Trade policy	Privatizations	Deregulation
1994	- Financial institutions act revised: same treatment for foreign- and locally-owned firms	- Employer contributions lowered - Pensions regime operational	- Mercosur CET (common external tariff) defined	- Electrical power plants - Electricity distribution - Sale of equity in gas transport and distribution	
1995	- Central Bank Charter revised - Trust funds - Deposit guarantee	- VAT[a] increased to 21%; threshold for tax on income and personal goods raised - Partial and temporary suspension of reduction in employer contributions	- CET effective - Import tariffs increased - Export drawback reduced	- Electrical power plants - Petroquímica Bahía Blanca	
1996	- Financial institutions act revised; legal framework applicable to assets and liabilities of liquidated financial agencies	- Employer contributions lowered - Fuel tax increased; income tax threshold raised - Family allowance scheme revised	- Extra- and intra-zone ceiling drawback rates altered - Drawbacks on capital goods production eliminated	- Provincial banks	
1997-1998	- Liquidity requirements increased - Mercosur: rule on operation of one country's banks in another's market	- Income tax rates increased - Tax reform: social security contributions reduced; VAT[a] reduced (21% to 10.5%) on staple food products; extension to exempt products: 10.5% on cable TV; 21% on private medical insurance and graphic advertising; domestic taxes increased - Labour reform	- External tariffs increased; statistical rate abolished	- Mail - Airports - Mechanisms to transfer nuclear power plants - Parliamentary approval - Sale of Banco Hipotecario Nacional	

Source: Daniel Heymann, "Políticas de reforma y comportamiento macroeconómico", *Desempeño económico en un contexto de reforma: la Argentina de los noventa*, Buenos Aires, Argentina, 2000.

[a] Value added tax.

[b] Banco Central de la República Argentina.

[c] International Monetary Fund.

[d] Servicios Eléctricos del Gran Buenos Aires.

[e] Yacimientos Petrolíferos Fiscales.

Box II.1

JOINT VENTURES, PORTFOLIO INVESTMENT AND OTHER FORMS OF FOREIGN INVESTMENT IN ARGENTINA

An unusual feature of the 1990s was the diversification of the sources of external capital and the appearance of new channels for FDI. Historically, most foreign investments had been made by the subsidiaries of TNCs. More recently, however, many new forms of investment have emerged, including the partnerships and joint ventures created to participate in the process of privatization, as well as partly foreign-owned investment funds.

In the mid-1990s, partnerships and joint ventures became a powerful force, as different TNCs teamed up among themselves and with local economic groups and foreign banks in order to make the most of the opportunities arising from privatization. These partnerships combined the business know-how of TNC subsidiaries with the market knowledge and local negotiating power of the domestic groups and the financial contribution —mainly through debt-equity conversions— of foreign banks. Such partnerships later tended to be phased out as local groups and foreign banks sold their stakes to their partners (especially to the TNCs).

Investment funds have emerged as a new modality of investment, not only in Argentina but in the whole of Latin America. Many of these funds have drawn wide comment because of the scale of their investments and the specificity of the phenomenon. They are akin to portfolio investment in terms of how the funds are raised, but they act as a form of direct investment in terms of the placement of those funds (ECLAC, 1998). Three of the largest such investment funds operating in Argentina are examined below in order to illustrate the way in which they operate.

Citicorp Equity Investments (CEI) was established in 1991. Originally created as a division of Citibank under the name Capital Investors, it began to seek partners in Argentina. The United States Federal Reserve had authorized the bank to acquire stakes in industrial firms in order to convert its Argentine external debt holdings into equity. This led to the creation of CEI, in which Citicorp retained a 40% stake, while Grupo República acquired 36% and Grupo Wertheim 10%. As a condition for authorizing the listing of CEI on Wall Street, the United States Government required that Citicorp gradually reduce its holding and, by 2002, sell its remaining stake altogether. This process began in 1998 with the sale of Citicorp shares to the United States fund Hicks, Muse, Tate & Furst (see table II-A.4). CEI eventually consolidated its position as a major group in the telecommunications and media sector.

Exxel Group was also formed in 1991. This investment fund is headed by Juan Navarro, a former executive of Citicorp. It currently controls over 50 firms in Argentina, Brazil, Chile and Uruguay. Financing for acquisitions has come from various institutional investors, of which 95% are based in the United States and the rest in Canada and a number of European countries (*Mercado*, 1998). One of the first investment funds to be associated with Exxel Group was Oppenheimer of the United States, and investors such as Aetna, Liberty Mutual, Calpers, Memorial Sloan-Kettering, PPM America, Putnam, The Ford Foundation, David Family Trust, General Motors Investment Company and others have also been involved in the group's expansion (*Apertura*, 1998). Exxel Group has invested over US$ 4 billion since it began its operations. Its strategy is based on acquiring firms with major assets and expanding them with the injection of new funds.

The main acquisitions of the Exxel Group include: Supermercados Norte and Tía (retail commerce); Fargo, Heladerías Freddo and Havanna (foods); Organización Coordinadora Argentina (OCA) and Villalonga Furlong (mail and logistics); Interbaires and Edcadassa (airport services); Argencard (credit cards); Blaisten (construction materials); Musimundo (sales of electronic goods and music); Vesuvio and Paula Cahen D'Anvers (clothing); and Sistemas de Protección Médica (SPM), Tim and Galeno/Life (private medical insurance). More recently, Exxel added its name to the spate of investments in Internet portals. The group's ambitious expansion strategy began to come up against serious problems in 2000, however, when the sharp drop in domestic demand and a number of bad decisions seriously jeopardized its future. In fact, it closed over a dozen Musimundo stores, Freddo sales slumped by over 30% and it transferred its stake in Supermercados Norte to the French company Carrefour, among other steps.

Lastly, George Soros' funds have concentrated on real estate investments and agriculture and, in this connection, on the privatization of Banco Hipotecario Nacional (BHN). They are grouped under the conglomerates Inversiones y Representaciones S.A. (IRSA), which has invested in real estate (especially retailing centres), and CRESUD, which invests in agricultural activities. Soros holds minority stakes in these groups (whose capital structure has changed in recent years), while the rest is accounted for by management and public offerings.

In the area of real estate investment, IRSA has acquired offices, hotels and retail centres, including: Alto Palermo, Alto Avellaneda, Buenos Aires Design, Patio Bullrich, Paseo Alcorta, Abasto Shopping Center (which it built) and Galerías Pacífico, all in the Federal Capital and Greater Buenos Aires, and has also invested in holdings in the country's interior (Nuevo Centro NOA in Salta and Mendoza Plaza Shopping in Mendoza). With respect to agricultural investments, the policy of CRESUD has been to acquire agricultural establishments for development, mostly located in the provinces of San Luis, Córdoba, Chaco and Santa Fe. Not all these assets are retained by the fund; many are improved and sold on, in line with its general policy (*Apertura*, 1998).

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

Table II.4
ARGENTINA: DOMESTIC AND EXTERNAL CAPITAL IN THE PRIVATIZATION PROCESS, 1990-2001
(Millions of dollars)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Total	**1,787**	**1,963**	**5,496**	**5,456**	**923**	**1,410**	**736**	**1,220**	**522**	**4,337**	**...**	**...**
Domestic capital	613	1,108	2,641	1,921	407	296	156	328	171	146	...	...
Foreign capital	1,174	854	2,855	3,534	515	1,114	580	892	351	4,191	...	...
- Foreign direct investment	1,174	460	2,332	935	136	1,113	580	892	334	4,192	30	25
- Portfolio investment	-	394	510	2,600	379	-	-	-	17	-	...	...

Source: ECLAC, Information Centre of the Unit of Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information provided by the International Accounts Office of the Ministry of Economic Affairs, Public Works and Services (MECON).

During the first phase of FDI expansion in the 1990s, privatizations and the award of private concessions were the main magnet for investment flows to Argentina. In fact, from 1990 to 1993, over 40% of total FDI inflows corresponded to one of these two types of operation. This percentage declined in the course of the decade, however. In the period 1990-2001, investment flows linked to acquisitions of State assets represented only 15% of total FDI (see table II.2).

From 1993 on, following the partial sale of the State petroleum company YPF, the privatization process ceased to be the main modality of FDI as its place was taken by mergers and acquisitions of privately-owned firms. Investment in greenfield projects and in the expansion of existing assets also became substantial, albeit on a smaller scale (Chudnovsky, López and Porta, 1994 and Kosacoff and Porta, 1998). Over 55% of Argentina's FDI inflows in 1992-2001 thus corresponded to transfers of existing assets (see table II.2). Since a considerable portion of FDI recorded under the heading of "capital contributions"[4] actually corresponded to corporate acquisitions, however, the share of total FDI inflows reflecting operations that involved a "change of hands" is almost certainly underestimated and is likely to be larger than the 55% figure given above.

Another important consideration is that a great deal of this foreign investment was financed through external borrowing, and particularly the issuance of negotiable liabilities and other financial instruments on international capital markets. Seeking to benefit from the liquidity of these markets and from the growing interest on the part of investors in diversifying into emerging markets, a number of newly privatized firms run by foreign operators floated large issues of shares and bonds abroad. From 1992 to 1998, the non-financial private sector borrowed over US$ 35 billion externally, of which almost three quarters corresponded to foreign investors (MECON, 1999b). In some sectors (telecommunications, hydrocarbons and mining, and electricity, gas distribution and drinking water), many of the new investments were financed through these mechanisms.

According to the MECON Production Research Centre (CEP), one way of gauging the total amount of investments made by non-residents, regardless of their sources of financing, is by means of the Inversión de Firmas Extranjeras (foreign corporate investment), or IFE, indicator. From 1990 to 1999, this indicator registered total investments of US$ 126.638 billion.[5] An analysis of the IFE corroborates the fact that transfers of ownership accounted for a very significant percentage (51.2%) of the total investment in that period. Also, close to two thirds of external investments in capital formation corresponded to expansions, while only a third were greenfield projects. In turn, the most prevalent type of "change of hands" operations were mergers and acquisitions of private assets, which accounted for 75%.

[4] Between 1996 and 1998, 25% of capital contributions corresponded to purchases of firms. This estimate does not include the banking sector. Another 29% went to fortify the asset structure of companies, and 9% corresponded to increases of equity shares (MECON, 1999).

[5] Of the US$ 88.717 billion in IFE recorded between 1990 and 1998, it is estimated that US$ 72.317 billion (81.5% of the total) was financed by external capital in the form of FDI, portfolio investment in privatizations, equity acquisitions and borrowings by subsidiary companies. The remaining US$ 16.4 billion (18.5%) corresponded to locally raised funds and other unidentified sources (CEP, 2000).

Table II.5
ARGENTINA: FDI INFLOWS BY ECONOMIC SECTOR, 1992-2000
(Millions of dollars)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	1992-2000 (Percentages)
Total	**4,432**	**2,791**	**3,637**	**5,610**	**6,951**	**9,157**	**7,291**	**23,929**	**11,693**	**100.0**
Primary	1,226	273	519	576	1,728	177	1,324	17,845	2,496	34.7
Petroleum	1,222	277	502	436	1,046	105	1,313	17,830	2,487	33.4
Mining	4	-6	17	140	682	72	11	15	9	1.3
Manufacturing	634	858	1,798	2,186	2,776	3,308	1,147	1,950	2,404	22.6
Food, beverages and tobacco	384	338	1,014	793	405	360	256	1,192	600	7.1
Textiles and leather	..	39	-18	80	15	36	-5	-49	19	0.2
Paper	-102	27	31	119	375	335	89	15	580	1.9
Chemicals, rubber and plastics	217	350	325	792	937	770	231	762	537	6.5
Cement and ceramics	33	47	26	33	20	51	306	0	2	0.7
Machinery and equipment	-152	-32	60	8	165	106	111	361	-56	0.8
Common metals and metalworking	-120	26	244	-31	86	569	96	-18	130	1.3
Automobile industry	374	64	116	392	773	1,082	65	-313	591	4.2
Services	2,428	1,557	868	2,575	2,096	4,888	3,648	3,153	5,692	35.6
Electricity, gas and water	2,119	1,116	124	1,111	681	1,527	932	951	361	11.8
Commerce	82	42	339	318	523	150	699	742	147	4.0
Transport and telecommunications	36	-19	245	634	145	845	260	714	3,739	8.7
Banks	191	418	160	512	747	2,366	1,757	746	1,445	11.1
Others	143	104	452	271	350	784	1,172	983	1,102	7.1

Source: ECLAC, Information Centre of the Unit of Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information provided by the International Accounts Office (DNCI) of the Ministry of Economic Affairs, Public Works and Services (MECON).

From 1997 on, the pace of private-sector mergers and acquisitions began to pick up, accounting for 49% of FDI inflows between 1997 and 2001 (see table II.1). Of the total operations of this type conducted in Argentina, 88% of the funds involved were disbursed by partly or fully foreign-owned firms (CEP, 2000). Lastly, there is clearly a strong link between merger and acquisition activity and the privatization process. From 1990 to 1999, 46% of purchases of private assets are estimated to have corresponded to capital restructuring within the consortia that acquired the privatized enterprises and to the production strategies —in the new regulatory context— pursued by sectoral leaders of areas experiencing intensive concession and privatization activity (Kulfas, 2001).

With respect to the sectoral destination of FDI inflows to Argentina, a third of the stock accumulated in the period 1992-2000 went to the petroleum sector and 23% to manufacturing. Privatized utilities accounted for 21% of the total (of which 12% corresponded to electricity, gas and water and 9% to transport and communications)[6] and the banking sector absorbed 11% of FDI flows over the period. Within the manufacturing sector, the largest recipients of FDI were food, beverages and tobacco (7.1%), chemicals, rubber and plastics (6.5%) and motor vehicles and transport equipment (4.2%) (see table II.5).

Within the framework of the privatization process, public utilities proved to be the most attractive sector for foreign capital in the early 1990s. Midway through the decade, however, significant amounts of FDI began to be attracted to the manufacturing activities mentioned above, and towards the end of the 1990s the financial sector became the main investment destination. The petroleum sector received sizeable amounts of FDI throughout the period —thanks to deregulation and to the sale of a number of local firms— but it was not until the last two years of the decade, when Repsol of Spain bought YPF, that it consolidated its position as a leading

[6] The share of the transport and telecommunications sector would be slightly larger if it were measured for the period 1990-2000, because during the first two years the State-owned airline and telecommunications firms were sold to private agents.

investment recipient (see chapter IV). Considerable investments were also made in the telecommunications industry towards the end of this period, as the sector was opened up to admit more competition.

The most striking feature of FDI inflows in the 1990s in terms of their geographic origin was the rapid expansion of Spanish investments. In fact, Spanish FDI accounted for almost 40% of total inflows in 1992-2000 (about US$ 30 billion), while investment from the United States ranked second with 25%. France came in a distant third, with 7% of the total (see table II.6). From 1992 to 2000, Spain's share of the total FDI stock grew from 6% to around 28%. This increase largely accounts for the top ranking of the European Union, whose contribution increased from 41% of cumulative investments in 1992 to 53% in 2000. Although the United States continued to be the largest single investor in Argentina, its share of FDI stock decreased from 35% in 1992 to 31% in 2000. Another new feature of the decade was the involvement of Chilean investors, who were the source of 4.3% of total FDI inflows between 1992 and 2000. In 1998, Chile accounted for 8% of FDI stock; this figure later decreased, however, as a number of the most active Chilean firms in Argentina were bought by foreign —mainly Spanish— investors.

Table II.6

ARGENTINA: FDI INFLOWS BY COUNTRY OF ORIGIN, 1992-2000

(Millions of dollars)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	1992-2000 (Percentages)
Total	**4,432**	**2,791**	**3,637**	**5,610**	**6,951**	**9,157**	**7,291**	**23,929**	**11,693**	**100.0**
European Union	1,745	581	1,019	1,277	2,750	4,618	4,736	19,942	8,524	59.9
Germany	-18	101	224	15	250	547	466	70	161	2.4
Spain	277	102	-172	271	998	2,085	1,098	17,930	6,987	39.2
France	421	154	577	140	502	225	1,337	1,547	493	7.1
Italy	494	-211	70	576	264	436	499	501	506	4.2
Netherlands	172	91	277	166	155	955	986	-51	156	3.9
United Kingdom	257	272	84	24	236	227	251	-107	63	1.7
Other European countries	142	72	-41	85	346	143	99	52	158	1.4
North America	1,350	1,706	1,810	2,421	2,418	3,217	1,363	3,773	2,030	26.6
United States	1,105	1,555	1,714	2,303	2,190	3,074	1,352	3,763	2,078	25.3
Other North American countries	245	151	96	118	227	143	10	10	-48	1.3
South America	612	408	324	1,045	990	804	510	-514	212	5.8
Chile	501	317	190	784	913	578	327	-440	109	4.3
Other South American countries	111	91	134	261	77	226	184	-73	103	1.5
Central America and the Caribbean	9	21	41	140	-24	21	191	425	39	1.1
Others	716	75	444	728	817	497	491	302	887	6.6

Source: ECLAC, Information Centre of the Unit of Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information provided by the International Accounts Office (DNCI) of the Ministry of Economic Affairs, Public Works and Services (MECON).

3. Foreign capital in the transition to the twenty-first century

The privatization process and the active role played by foreign investors substantially altered the local business structure in the 1990s. This era of change may be divided into two periods. In the first, from 1991 to 1995, an economic reactivation fuelled a steep upturn in the sales of the country's largest firms; this, in turn, led to an increase in the concentration of economic activities around these larger corporations. The sales of the leading 100 firms jumped by 74% between 1991 and 1995, while GDP expanded by 21% and industrial output (measured by an index of physical volume) rose by 14% in the same period.

The main foreign-owned firms in Argentina arrived at their current capital structures by significantly different routes (see table II-A.1). Although most still conform to the classic pattern of TNC subsidiaries, there are also a number of partnerships between local and foreign firms (see table II.7). An analysis of the capital structures of the main Argentine firms shows that the changes that have taken place in those structures reflect are almost entirely attributable to the privatization process. The number of State-owned enterprises decreased (from 14 to 3), but there was almost no variation in the number of locally-owned firms, while the number of foreign-owned firms in partnerships with local groups grew (from 9 to 17).

From 1995 on, the divestiture of State-owned firms gradually came to a halt and private foreign-owned enterprises increased sharply in number (from 32 to 47). The development of foreign/local partnerships also slowed —as the stream of privatizations and utilities concessions (or both) abated— and the presence of private, locally-owned companies declined considerably (from 48 to 34).

Between 1991 and 1995, all three types of private firms (but especially foreign firms involved in partnerships with local groups) saw significant growth in their sales. Even so, between 1995 and 2000 foreign-owned firms were the ones whose earnings rose the most, as their revenues doubled and their share of sales increased to 50% of the top 100 firms' total sales (see table II.7).

In summary, the general trends among the country's large corporations in the 1990s were a steep decrease in the number of State-owned enterprises, a greatly increased presence of foreign-owned firms and a decline in the number of locally-owned firms. Partnerships multiplied rapidly in the early stages, then tailed off at the end of the decade, as foreign firms begin to acquire stakes in their local partners.[7]

Argentina's export performance has been quite strong, especially when considered from the perspective of international competitiveness (measured Argentina's exports as a proportion of total world imports). Between 1990 and 2000, the country's share of world trade climbed from 0.37% to 0.43%. This expansion was particularly strong in the first five years of the decade, after which it declined slightly [8] (see table II-A.2) due to macroeconomic problems, especially the lagging exchange rate. The largest increases were recorded in primary activities linked to the export of natural resources (mainly petroleum) and agricultural and livestock goods. Argentine exports have gained ground in most of these industries (which are not among the fastest-growing activities in world trade), especially in the case of petroleum from the second half of the 1990s on. In fact, 9 out of the 10 largest export items —accounting for 48.1% of the country's total exports in 2000— are in these categories (see table II-A.2). Argentina's pattern of international trade specialization remained substantially unaltered in the 1990s, and a sizeable share of its exports were primary products. In most cases TNCs accounted for a large proportion of exports.

Within manufacturing, mid-level technology activities —especially the automotive industrial complex— have gained the largest market shares, coming to represent around 3% of the industry's world trade in 2000 (see table II-A.2). This figure must be treated with

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7 The top-selling 1,000 firms also attest to the expansion of foreign capital in the Argentine economy. The stake of TNCs in the sales of the leading 1,000 firms increased from 35% in 1990 to 59% in 1998, while the number of foreign-owned firms grew from 199 to 472 in that period. In particular, the proportion of TNCs in manufacturing sales increased by around 20 percentage points in the course of the decade, rising to account for about 60% in 1998 (Chudnovsky and López, 2001).

8 Argentina's exports almost doubled between 1990 and 1995 and then hovered around the level recorded in midway through the decade (see table II.1).

Table II.7
ARGENTINA: SALES OF THE 100 LEADING FIRMS, BY OWNERSHIP, 1991-2000
(Millions of dollars, percentages and number of firms)

	1991			1995			2000			Variation	
	Amount	Percent-age	No. of firms	Amount	Percent-age	Nº of firms	Amount	Percent-age	No. of firms	1991/ 2000	1995/ 2000
Total sales	36,755	100.0	100	63,778	100.0	100	84,064	100.0	100	128.7	31.8
State-owned	12,312	33.5	14	2,402	3.8	3	2,362	2.8	3	-80.8	-1.7
Private locally-owned	11,306	30.8	49	22,906	35.9	48	22,341	26.6	34	97.6	-2.5
Private foreign-owned	8,794	23.9	28	17,991	28.2	32	41,722	49.6	47	374.4	131.9
Private foreign-owned firms in partnership with local firms	4,343	11.8		20,478	32.1	17	17,639	21.0	16	306.2	-13.9

Source: ECLAC, Information Centre of the Unit of Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information published in *Mercado,* several issues.

caution, however, as a significant percentage of Argentina's motor vehicle exports go to Brazil under MERCOSUR provisions and therefore cannot be regarded as a genuine signal of a significant increase in its capacity to compete in the world manufactures market. These activities, even more than primary activities, are dominated by foreign companies.

In consequence, foreign stakes in Argentina's export activities have not increased proportionally with the huge FDI inflows the country has received. Historically, TNCs have played a major role in Argentina's export trade. The major foreign food companies were active in Argentina throughout the twentieth century, and this activity was the main source of exports. New export activities sprang up in the 1990s and foreign investors were not idle in this respect. Foreign firms' share of the country's exports increased from 31.3% in 1992 to 49.1% in 1998. In 1998, Argentina recorded total exports of US$ 26.441 billion, of which US$ 12.911 billion corresponded to foreign-owned firms, mainly majority-owned subsidiaries (see table II.8). Of the exports of TNCs in this category, 46.5% corresponded to agri-food firms —both trading companies and producers of edible oils and other food products, including industrial ones. The automotive industrial complex accounted for 26.7% of TNC exports, while 17.5% corresponded to petroleum and mining, and the remaining 9.3% to other manufacturing firms (Chudnovsky and López, 2001).

Imports, too, exhibit market concentration, albeit to a lesser degree. From 1995 to 1998, foreign-owned firms accounted for around 45% of total imports. In 1998, Argentina imported a total of US$ 29.558 billion, of which US$ 13.408 billion corresponded to imports by foreign-owned companies, most of which, as in the case of exports, were mainly majority-owned subsidiaries (see table II.8). The automotive industrial complex was the leading importer, with 35% of the total, followed by chemical and petrochemical firms (23%), public utilities (17%), the electronics industry (13%), petroleum and mining (4%) and retail trade (2%) (Chudnovsky and López, 2001).

In summary, the distribution of trade among TNCs by sector of activity shows that almost two thirds of these firms' exports consist of edible oils, grains, and motor vehicles and autoparts. Together with the chemical and petrochemical segments, these items account for around 90% of exports by foreign firms. By contrast, imports are considerably less concentrated, with firms dealing in motor vehicles and autoparts and in chemicals and petrochemicals at the top of the list.

Table II.8
ARGENTINA: TNCs' SHARE IN THE SALES OF THE 1,000 LARGEST FIRMS, 1992-1998
(Millions of dollars, percentages and number of firms)

	1992			1995			1997			1998		
	Amount	Percentage	No. of firms	Amount	Percentage	No. of firms	Amount	Percentage	No. of firms	Amount	Percentage	No. of firms
1. Exports of TNC's	3,882	31.3	174	...	...	...	11,929	45.1	313	12,991	49.1	360
- Majority owned subsidiaries [a]	3,463	27.9	161	...	...	...	11,195	42.4	286	11,964	45.2	321
2. Total exports of 1,000 largest firms	10,772	86.9	1,000	...	...	...	23,314	88.2	1,000	23,911	90.4	1,000
3. Total exports	12,399	100.0	-	...	...	...	26,431	100.0	-	26,441	100.0	-
1. Imports of TNC's	...	...	...	8,438	44.9	417	12,750	44.7	509	13,408	45.4	524
- Majority-owned subsidiaries [a]	...	...	...	7,442	39.6	390	12,047	42.2	465	12,772	43.2	477
2. Total imports of 1,000 largest firms	...	...	...	13,641	72.5	1,000	18,049	63.2	1,000	18,704	63.3	1,000
3. Total imports	...	...	...	18,804	100.0	-	28,554	100.0	-	29,558	100.0	-

Source: ECLAC, Information Centre of the Unit of Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of Daniel Chudnovsky and Andrés López, *La transnacionalización de la economía argentina*, Buenos Aires, Research Centre for Industrial Transformation (CENIT), 2001.

[a] Firms whose parent company owns over 50% of equity shareholdings.

B. STRATEGIES OF TNCs IN ARGENTINA

An analysis of the strategies pursued by TNCs in Argentina in the 1990s shows that investments in raw materials and national or regional market-seeking investments were by far the most common. Investments in raw materials were primarily channelled into the petroleum, gas, mineral and agricultural sectors; market-seeking investments were undertaken both in the manufacturing sector —motor vehicles, foods, beverages and tobacco— and in services and infrastructure (telecommunications, energy, commerce and the financial sector).

Recent empirical evidence in Argentina bears out this largely qualitative analysis. Subsidiaries operating in resource-based sectors account for 12% of total TNC sales, while the remaining 88% corresponds to strategies directed mainly at the domestic market (Chudnovsky and López, 2001).[9] Firms that have concentrated on natural resource activities[10] tend to target the export market, with

[9] The authors distinguish among three subgroups of domestic-market strategies: (i) "pure domestic market" strategies, which account for 38.1% of sales and practically no exports; (ii) "domestic market with low export orientation" strategies, which represent 23.4% of the sales of the sample and have an average export ratio of 6.7%; and (iii) "domestic market with moderate export orientation" strategies, with 25.8% of sales and an export ratio of 15.9%.

[10] This group includes the firms that produce Argentina's traditional commodities exports and those that have moved into the petroleum industry since the privatization of YPF and the deregulation of the sector.

an average export/sales ratio of 72%. Their main markets are located outside MERCOSUR (and generally outside Latin America) and they engage in relatively little intra-firm trade, especially in respect of imports (Chudnovsky and López, 2001). By the same token, TNC subsidiaries export more, on average, than large locally-owned firms do.

Firms that have targeted the domestic market have tended to run trade deficits; this is especially true of manufacturing firms that export very little and use a large proportion of imported inputs. These firms all exhibit a similar patterns of internationalization: most of their exports go to MERCOSUR, while imports come from other sources and intrafirm trade tends to be very active.

The following section will build upon this general overview by looking at more specific aspects of TNC strategies. A review of domestic market-seeking strategies, with a distinction being drawn between services and infrastructure sectors and the manufacturing sector, will be followed by an examination of resource-seeking strategies.

1. Local market seeking-strategies in the services and infrastructure sectors

Foreign investors have been heavily involved in the services and infrastructure sectors; this was especially true during the first major influx of FDI in the 1990s. The privatization of public utilities attracted investment in a wide range of infrastructure segments, which suffered from a substantial technology lag and shortfalls in the provision of services. A second area to draw large foreign investments was private-sector services, especially retail commerce and the financial sector. The boom in large supermarket and hypermarket chains and their expansion into the country's interior gathered momentum with the arrival of new investors and the growth of those already established. A number of factors were involved in the expansion of FDI in the financial system, particularly the privatization of the pension system —the transition from a pay-as-you-go to a privately-funded system— and the concentration of the banking sector, which the authorities encouraged with a view to improving the solvency of the financial system in the wake of the Mexican crisis of 1994.

(a) Public infrastructure services: the pole of attraction for foreign capital in the first half of the 1990s

The rules applied in the privatization process have given most of these sectors strong locational advantages, since the privatized firms gain access to captive markets which have either been transferred under operationally monopolistic conditions, at least for an initial period of time, or have high entry barriers and regulations that guarantee a minimum level of profitability. These captive market conditions have enabled investors to realize large profits and to limit how much of the operational cost reductions and increased productivity achieved by means of streamlining are passed on to users via price mechanisms. The consortia gaining management control of privatized firms have usually consisted of foreign operators, local groups and banks. This capital structure has changed over time as foreign investors acquire larger stakes —and in most cases outright control— of these firms and the markets in which they operate.

The main determinants of competitiveness have depended on the technological changes taking place in the sector concerned. For example, in telecommunications —which has seen immense technical progress all over the world— the key to profitability has lain in the absolute and relative expansion of the service through the addition of new products, services and clients. In other public utilities, profit-enhancing measures have mainly been limited to streamlining, operational modernization and more efficient billing.

The terms of sale of privatized firms included quality-standards targets and, in some cases, objectives for the expansion of supply and obligatory investments (Moguillansky and Bielschowsky, 2000). These investment plans have generated strong growth in imports of equipment, inputs and technical services. Increased trade liberalization has facilitated this trend and substantially altered the supply structure. In turn, the objective of facilitating additional investments has been taken into account in the setting of rates. Most post-transfer investments have been financed by the reinvestment of earnings and by domestic or external borrowing. To an increasing degree over time, these consortia's financial strategies have consisted of paying out a greater proportion of dividends while also expanding their placement of debt issues in international markets.

The new owners have made drastic changes in corporate management, with the adoption of modern techniques of organization and the large-scale integration of computerized equipment and routines along with modern administrative systems. In general, employee productivity rates have risen, especially after initial staff cuts and the introduction of new management techniques. This has translated into a better quality of service in some cases. Suppliers of telecommunications services have substantially increased the number of lines per employee, surpassed the quality-of-service standards stipulated in the terms of calls to tender and offered new services. Indicators of productivity, density and quality still lag behind those of the operators' respective parent companies, however, and there are still marked differences in rates. Quality improvements in other utilities have tended to be more modest. In the gas and electricity sectors, for example, the regulatory bodies have fined suppliers on several occasions for failing to meet the standards established in the terms of sale.

(i) Telecommunications: the starting point for the transnationalization of the Argentine economy

A large share of recent FDI inflows has gone to the telecommunications industry (see table II.5), which was one of the fastest-growing activities in the Argentine economy in the 1990s. Fixed-line telephone services began to expand rapidly when the Empresa Nacional de Telecomunicaciones (ENTEL) was privatized, as did other activities such as cellular telephony, cable television, Internet and Internet content. In 1990, ENTEL was split into two areas and sold to foreign operators. This first step in a lengthy and far-ranging plan for privatizing State assets triggered an influx of new investors (see table II-A.3). The southern zone of the country's inland regions went to a consortium headed by Telefónica of Spain and Citicorp, and the northern zone to a group led by France Telecom and Telecom-Italia, in both cases in partnership with local groups and foreign banks. Later, the foreign firms conducted a series of equity transactions to acquire the privatized companies outright (see table II-A.4). The successful consortia obtained exclusive operating licences in their respective areas for a period of seven years, which can be extended subject to a number of objectives regarding the expansion of networks and quality of service.[11] The current structure is centred around four large operators that have stakes in almost all the segments of the market and have pursued vertical and horizontal integration strategies (ECLAC, 2001a, chapter IV; Moguillansky and Bielschowsky, 2000; and Celani, 1998).

The telecommunications sector has expanded rapidly in recent years. Between 1990 and 2001, the number of basic telephone lines increased from 3.6 to 8.1 million, and subscribers to mobile telephone services jumped from about 200,000 to almost 7 million (International Telecommunication Union, 2002). This easily bypassed the targets established in the terms of the calls to tender, and the quality of service improved substantially. One of the greatest difficulties encountered during the liberalization of the sector, however, has been high interconnection costs. The level of these costs has prevented greater competition in the short term and made it impossible to achieve a price reduction commensurate with the efficiency improvements made by operators.

(ii) Energy: European and United States investors dispute control of MERCOSUR energy

Argentina's energy sector moved into a new phase with the deregulation of hydrocarbon mining and drilling and the privatization of electricity and gas companies (see chapter IV). In addition to the exploitation of abundant natural gas reserves, new business opportunities were opened up by growing demand in neighbouring countries, such as Brazil, Chile and Uruguay. The electricity sector was privatized and split up into the business units of generation, transmission and distribution. Energy generation strategies were based on the construction of new thermoelectric plants, given the abundance of natural gas and the droughts experienced by the country in the 1980s.

The main players in the electricity sector were Spanish, United States, French and Chilean firms (see tables II-A.3 and II-A.4). The Chilean presence declined, however, when extraregional investors —particularly ENDESA-España S.A. and AES Corporation— acquired some of the leading Chilean electricity firms (ECLAC, 2001a). As a result, control of the sector was divided among Spanish, United States and French investors.

[11] After the first period of exclusivity, the regulator agreed to extend these conditions for another two years and embark upon a transition stage. The liberalization of the sector was begun in March 1998, which allowed new competitors to move into the market. Two new consortia entered the market seeking to take advantage of the installed infrastructure. These were Movicom —a partnership between the United States firms Bellsouth and Motorola— and CTI group —controlled by Verizon Communication of the United States and the local group Clarín—, which were already active in the cellular telephony and cable television markets.

Spanish firms have been increasing their stake in Argentine electricity markets since the early 1990s, mainly within the framework of the privatization programme (Calderón, 1999). ENDESA-España, for example, was originally a partner in the consortium that gained control of Empresa Distribuidora y Comercializadora Norte S.A. (EDENOR), one of the two companies resulting from the division of the State-run Servicios Eléctricos del Gran Buenos Aires (SEGBA) after privatization. The Spanish company then continued to expand its market presence and eventually —after buying the Chilean consortium ENERSIS— gained a virtual monopoly over electricity distribution in Buenos Aires and the surrounding area,[12] in addition to new assets in the country's interior. This brought ENDESA-España into serious conflict with the local regulator over the interpretation of the rules established upon the privatization of SEGBA. Regarding the dispute, the Competition Protection Department advised the electricity regulator (ENRE) to require ENDESA-España to sell its share in one of the two distributors. Ultimately, the Spanish firm decided to keep Empresa Distribuidora y Comercializadora Sur S.A. (EDESUR) and, in May 2001, sold its stake in EDENOR to the French firm Électricité de France (EDF).

Burgeoning demand for electricity in Brazil gave rise to new electricity transmission projects, in which ENDESA-España, at the head of the Compañía de Interconexión Energética (CIEN), was a leading player. This firm built a 1,000 MW high-tension network to supply the south of Brazil, with a total investment of US$ 350 million. It now sells some US$ 100 million annually in the country. Its electricity is generated at the Costanera plant (which also belongs to the ENDESA group) and is transmitted through the grid which connects the Salto Grande and Yacyretá dams.

In addition to the Spanish firms, French companies have also helped to expand the European presence in the Argentine electricity sector. Électricité de France (EDF), which currently controls EDENOR through the consortium Electricidad Argentina Sociedad Anónima (EASA), has been joined by TotalFinalElf, which owns a majority share in the Central Puerto, Piedra del Águila and Hidroneuquén generators. These investments are in addition to the TotalFinalElf's holdings in the hydrocarbons sector (see chapter IV).

Like the European firms, a group of United States corporations began to increase their stakes in the Argentine market, mainly by purchasing existing assets (see table II-A.4). The most active of these firms has been AES Corporation, which owns a broad network of generation and distribution assets throughout the country. The largest are Empresa Distribuidora de Energía Norte (EDEN), Empresa Distribuidora de Energía Sur (EDES), Empresa Distribuidora La Plata S.A. (EDELAP) and Hidroeléctrica Alicura S.A. The rivalry between the United States and European firms intensified during the privatization of the electricity and gas distribution systems in Brazil. Many United States firms have established a strong presence in Brazil too: ENRON Corporation, AES Corporation and Houston Power have bought electricity and gas companies, as have ENDESA-España, Électricité de France, IBERDROLA and Repsol.

The gas sector was also partitioned as part of the privatization process, giving rise to the establishment of transport and distribution companies. Here, too, investment opportunities have been associated with demand in neighbouring countries, and gas pipelines have been laid to Chile, Brazil and Uruguay. United States and Spanish investors have a large stake in this sector. United States investors include ENRON (Transportadora Gas del Sur (TGS)), CMS (Transportadora Gas del Norte), LG&E Energy Corp. (Distribuidora de Gas Cuyana) and CNG (with a share in Gas Pampina y Sur). Spanish investors have stakes in the two largest billing firms: Gas BAN (through Gas Natural) and Metrogas (through Repsol).

Foreign firms have thus moved rapidly and extensively into the utilities markets in Argentina. This was greatly facilitated by the overvaluation of the local currency and by advantageous operation contracts —established at the time of privatization or concession— which set rates in foreign currency and indexed them to United States inflation. The difficult political and economic situation which culminated in the resignation of President Fernando de la Rua rapidly eroded the favourable conditions hitherto enjoyed by foreign investors, however. The new Administration, under the leadership of Eduardo Duhalde, passed an Economic Emergency Act, which entailed the freezing and "pesification" of rates (that is, the mandated change from United States dollars to Argentine pesos). Coming at the same time as the devaluation of the local currency, this generated a sharp mismatch between firms' assets and liabilities and, in consequence, in their financial

[12] The Chilean group ENERSIS controlled Empresa Distribuidora y Comercializadora Sur S.A. (EDESUR), the other distribution company resulting from the division of SEGBA.

results. Faced with this situation and seeking to avoid mass bankruptcies, the government began to negotiate its contracts with the operators of the largest companies on an individual basis. The firms that have been hit the hardest by the crisis have been ENDESA and Telefónica of Spain, and this has been reflected in steep downturns in their stock values. In April 2002, as a result of the devaluation of the peso and the pesification of their rates, a number of companies, including Telecom-Argentina, announced that they were suspending payment on their loan principal.[13]

By means of these measures, the Argentine Government is attempting to maintain the normal supply of public services by getting firms to absorb the operational costs of devaluation while avoiding a sharp hike in rates. A number of alternative forms of compensation for affected firms are being examined in order to make these two objectives compatible. Possible courses of action include lowering quality standards, reducing investment and network expansion commitments, extending the term of concessions, and even lowering taxes. In addition, the government is attempting to make these negotiations transparent and to move towards the restructuring of the regulatory and legal institutions that oversee these activities.

(b) Commerce and finance: expansion in the second half of the 1990s

(i) Retail commerce: from the "corner shop" to supermarkets with French accents

The structure of retail commerce changed substantially in the 1990s as foreign capital moved into the market and established a major presence. The trend towards a concentration of activities around large supermarket chains has recently become even more marked. The absence of specific regulations governing the opening of new facilities has contributed to the expansion of these chains. Supermarkets currently own less than 1% of food-selling establishments, but account for over 57% of billing, in contrast to the mid-1980s when small shops and stores conducted over 70% of the billing recorded in the sector (*Mercado*, 2000).

International chains have been heavily involved in this process, and the concentration of activity in this sector has been heightened by a series of ownership transfers. The French chain Carrefour pioneered the establishment of hypermarkets, mainly in the suburbs of Buenos Aires. Then, in the 1990s, it opened new stores within the city itself and in other parts of the country. Three locally-owned chains —Disco S.A., Supermercados Norte and Tía— expanded rapidly after being bought by international operators.

The chain Disco S.A. owned a large number of stores in major cities and began to expand by opening new facilities and buying up smaller chains, including Supermercados Vea (Province of Mendoza) and Su Supermercado. In 1998 it formed a partnership with Royal Ahold of the Netherlands to create Disco Ahold. It then stepped up the process of expansion both in Argentina and abroad, acquiring the Chilean chain Santa Isabel, which also had outlets in Peru. In early 2000, Disco Ahold purchased the stores owned in Argentina by the Chilean chain Ekono in order to consolidate its position in an increasingly competitive sector (see table II-A.4).

Supermercados Norte was a small chain which then began to expand by opening new stores. In 1996 it was bought outright by Exxel Group, and its expansion continued apace as it went on to purchase other chains. In 1998, Exxel Group sold 49% of its shares in Supermercados Norte to Promodès of France, and in early 1999 the new partnership acquired the Tía chain, leading to the merger of the two. Also in 1999, Carrefour and Promodès merged in France; in the local market, this brought about a merger between Supermercados Norte-Tía and Carrefour Argentina. The operation was approved by the Competition Commission (CDC) in the early months of 2000, making the new merged corporation the leading operator in the sector. In 2001, Carrefour-Promodès bought a majority stake in Supermercados Norte from Exxel Group, consolidating all its operations and becoming the country's second largest foreign-owned company by volume of sales (see table II-A.1). In addition to Royal Ahold and Carrefour-Promodès, important roles have been played by such investors as the Chilean chain Jumbo-Cencosud, Wal-Mart of the United States and Auchan and Grupo Casino of France.

The rapid growth and concentration of international chains have heightened their predominance over small businesses and suppliers. This has led to frequent price wars which put pressure on suppliers, and as these chains' purchases rise in volume, they find themselves with greater negotiating

[13] In response to this situation, France Telecom announced that it would cease investing in Argentina and was considering the possibility of selling its stake in Telecom Argentina (14%). France Telecom lost US$ 318 million in 2001 as a result of the crisis.

power and the ability to establish larger mark-ups and more favourable purchasing conditions. The profit margins of other economic sectors have thus tended to narrow.[14]

(ii) The financial sector: the new Spanish conquest and epicentre of the current crisis

Foreign banks have traditionally maintained a presence in the local financial system. Due to the size of the State-owned banking sector —including those assets owned by national, provincial and municipal governments— and of local private entities, however, the subsidiaries of foreign banks used to be relegated to a minor role in the system.

In the wake of the Mexican crisis of late 1994, the Argentine banking system underwent a number of rapid and far-reaching changes. In particular, the measures implemented by the monetary authorities[15] in an effort to achieve and demonstrate greater solvency promoted the concentration of the system. In addition, the local economy's relatively low banking-service use rate —particularly in the interior of the country— offered major opportunities for market expansion. New branches opened up throughout the country, and the introduction of new and advanced technology led to the automization of many financial operations, as networks of automatic teller machines and self-service terminals were installed and extended. As a result, foreign-owned banks operating in Argentina increased their market shares at the same time as new agents moved into the system. In late 2001, foreign-owned banks effectively controlled 53% of the banking system's assets (Salomon Smith Barney, 2001). At the same time, as these markets have been deregulated, foreign investors' presence in pension funds and insurance markets has become much more marked.

The wholesale expansion of foreign banks has come about mainly through the purchase of existing assets. Beginning in 1995, foreign investors hastened to acquire local banks, with this move being led by Banco Bilbao Vizcaya Argentaria (BBVA) and Banco Santander Central Hispano (BSCH) of Spain (Calderón and Casilda, 2000) (see table II-A.4). These two Spanish institutions quickly became the main foreign operators in the Argentine banking system, relegating more traditional players, such as Citibank and BankBoston Corporation, to secondary roles (see table II.9). At the same time, a marked concentration began to develop in pension funds (known as AFJPs), which came under the control of the main foreign firms. AFJP Orígenes —controlled by BSCH— acquired Activa-Anticipa, Claridad and Previnter; Citibank gained outright control of Grupo Siembra; and BankBoston, which formed a partnership with BSCH to create a mega AFJP, obtained control of Orígenes-Previnter (see table II-A.4).

The current economic crisis has dealt a hard blow to financial institutions. In particular, the "pesification" of debts, the devaluation of the local currency, the protracted economic recession and the liquidity requirements imposed on private agents (known as the "corralito") have severely constrained the banks' performance.[16] The government has announced its intention to provide compensation by issuing bank capitalization bonds, backed by hydrocarbon export duties. Even so, the banks are in a particularly vulnerable situation, with no evident way out. On the one hand, the sharp decline in economic activity has hurt borrowers' ability to pay and, on the other, the *corralito* —needed to prevent a run on the banks— is limiting liquidity, which is essential in order to revive the production apparatus, imports and exports. Since the system is heavily concentrated around a few foreign —especially Spanish— agents, international investors have reacted adversely, and the prices of these firms on the world's main stock markets have suffered.

Despite these conditions, the foreign banks have offered no assurances against a possible run, nor have they guaranteed savers' funds. This has sparked a heated debate regarding these foreign institutions and their obligations, the conditions of their entry into the market, prudential supervision and the role that they ought to play in promoting savings and transferring them to the production apparatus.

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14 The Bunge & Born group, for example, sold its food company Molinos, citing among the reasons for the sale low profitability because of the conditions imposed by supermarket chains, to which they had been forced to resort in order to sell their products on a large scale.

15 The main measures included the raising of minimum liquidity requirements and of minimum levels of capital.

16 The banks have assets and liabilities denominated in United States dollars and in local currency. Devaluation and pesification, however, tip the balance sharply towards liabilities, which is why financial results are strongly affected.

Table II.9
ARGENTINA: LARGEST FOREIGN-OWNED BANKS, BY ASSETS, 2000
(Millions of dollars)

	Firm	Assets	Investors	Foreign capital (%)	Country of origin
1	Banco Galicia y Buenos Aires	15,323	Banco Santander Central Hispano (BSCH)	10.0	Spain
2	Banco Río de la Plata	14,087	Banco Santander Central Hispano (BSCH)	97.7	Spain
3	BBVA Banco Francés	11,995	Banco Bilbao Vizcaya Argentaria (BBVA)	67.0	Spain
4	BankBoston Argentina	11,131	BankBoston Corporation	100.0	United States
5	Citibank Argentina	10,344	Citibank	100.0	United States
6	HSBC Bank Argentina	6,675	Hongkong and Shanghai Banking Holdings PLC	99.9	United Kingdom
7	Banca Nazionale del Lavoro Argentina (BNL)	4,988	Banca Nazionale del Lavoro (BNL)	100.0	Italy
8	Scotia Bank Quilmes	3,937	Scotiabank	95.0	Canada
9	Banco Bisel	2,640	Caisse Nationale de Crédit Agricole	61.6	France
10	Banco Sudameris Argentina	2,620	Banco Sudameris	100.0	France

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

2. Market-seeking strategies in the domestic and subregional markets

Most FDI flows to local markets for manufactures have been channelled towards sectors which offer a cost advantage or readily available raw materials —the food industry, gas for the petrochemical industry— or in which specific promotion policies exist, such as the automotive sector.

In the context of economic liberalization and the undeniable exchange-rate lag, a bias developed against the local production of tradable manufactures. The creation of MERCOSUR, however, together with the growth of domestic and regional demand during most of the 1990s, encouraged TNCs to invest. The first stage consisted mainly of streamlining existing activities, which were then gradually combined with modern techniques of organization, production, marketing and distribution.

The new plants have usually incorporated world-class technology in production activities, management and, to a lesser extent, processes. The area of processes is, in fact, where most heterogeneities and asymmetries arise, not only in terms of modernization and greenfield projects, but also with regard to international best practices (Porta, 1999). In this respect, the scale of production of most of the projects undertaken in Argentina is below the optimal threshold, with the result that some phases of the production process exhibit relatively low rates of automation.[17]

In most cases, Argentine subsidiaries have concentrated on the core activities of their parent companies, and local operations have therefore tended to replicate the corresponding company's output profile. The similarity between the subsidiary and the parent company's overall structure is limited to a small part of the production mix, however, and does not encompass the corporation's overall scheme of strategic functions. In particular, subsidiaries have not internalized research,

17 From the perspective of operational efficiency, Argentine subsidiaries compare relatively well to their Brazilian counterparts and also —albeit to a lesser degree— to "state of the art" contemporaries at the international level. The main problems lie in the scale of production and the supply structure, which affects the range and quality of process technology.

development or the design of processes, products and applications and have only partially internalized such activities with regard to marketing and market development. Export companies have tended to develop production specialization schemes that generate growth in intra-industrial trade at the regional level. The main activity of this sort is the assembly of imported components (Kosacoff, 1994; Porta, 1999). As a result of such strategies, these firms were able to move early to capture the advantages of lower barriers to the movement of goods and factors of production within the integrated sphere of MERCOSUR.

For the most part, project investment decisions focusing on the domestic market were made in the context of a powerful upturn in domestic demand, which appeared likely to continue into the future. Although a slowdown in consumption might have been foreseen —as deferred demand became saturated— the decision makers' parameters did not include anything resembling the recessions generated by the "tequila effect" in 1995 or, still less, the economic crisis which has gripped Argentina since late 1998. The mere suggestion of such an eventuality would have stopped the firms in question from over-investing or, faced with the possibility of having to scale back production sharply, would have convinced them to postpone the launch of new plants. Early on, investors in greenfield projects or in plant expansion programmes found that their projects had more idle capacity than initially projected. This led investors to promote exports to MERCOSUR, in general, and to Brazil, in particular, especially during the upturn in domestic consumption in the neighbouring market that came in the wake of stabilization policies in late 1994. In any case, because TNC subsidiaries enjoyed greater financial backing than local firms, they were better able to weather the recessionary period and were thus in a more favourable position to benefit from the gains of the concentration process.

(a) The automotive sector: the end of an industry?

The Argentine automotive industry took shape in the late 1950s, when subsidiaries of the leading United States and European vehicle manufacturers set up facilities in the country. Ever since then, it has been an important part of the production structure, albeit constrained by the size of the market and by its increasingly limited competitiveness as its technology falls further and further behind international best standards. This industry began to contract sharply in the mid-1970s and especially in the 1980s, along with most of the rest of the manufacturing sector. In response to these conditions, a number of firms withdrew from Argentina (General Motors and Citroën), others licensed their subsidiaries to local groups (Fiat and Peugeot to the Macri group and Renault to the Antelo group) and others developed partnership strategies (Ford and Volkswagen, which established Autolatina).

The sectoral regime implemented in 1991, together with a strong upswing in domestic consumption, abruptly changed both the modalities of supply and the conditions of demand. From 1990 to 1994, output increased fourfold. In this new framework, TNCs renewed their investment strategies, taking back control of their subsidiaries and restructuring production processes. Renault and Peugeot recovered control of CIADEA S.A. and Sevel, respectively, while Fiat cancelled its arrangements with Sevel and set up a new plant in the province of Córdoba. Ford and Volkswagen dissolved their partnership in Autolatina and began to manufacture independently. General Motors returned to Argentina and set up a plant in the province of Santa Fe, while Toyota and Chrysler built new production plants.

TNCs in the motor vehicle sector tend to base their international strategies on the establishment of regional centres producing models for mass distribution, under a scheme by which both the vehicle and its parts and accessories are interchangeable between one centre and another. At least until 1998, MERCOSUR had become such a centre and was viewed as one of the areas likely to contribute most to the expansion of global sales of TNC vehicle manufacturers.[18]

The type of projects implemented in Argentina have reflected a strong locational advantage which is derived from the special regime that regulates the local automotive industry under the protection scheme developed for MERCOSUR as a whole[19] (Bastos and others, 1999). The Automotive Regime not only protects

[18] Around the middle of the decade MERCOSUR as a whole was expected to form a market for about 3 million vehicles per year.

[19] Until 2000, the sectoral regulation in MERCOSUR was based on the recognition and acceptance of the respective regimes of Argentina and Brazil, which —apart from a few major differences in design— shared a common structure. From 2000 on, a shared set of regulations were implemented. This set a common external tariff of 35%, but a number of important points are still being discussed. The negotiations on the harmonization of the sectoral regulations have been conflictive at times, especially with regard to the regime of incentives for investment and the time scale of intra-zone trade liberalization.

established plants from open competition in the domestic market, but also provides mechanisms for financing retooling at the microeconomic level. Two clearly differentiated stages can be identified in this process.

The first began with the implementation of the Automotive Regime in 1991. Uncertain about economic conditions and the sustainability of the reforms, the subsidiaries adopted similar strategies. Firms already active in the country drastically streamlined their operations and employed local production and subsidized imports to take advantage of domestic market expansion, using their installed capacity to the fullest. New entrants sought access to a foreign-currency allotment for subsidized imports —the top end of the market— to develop relatively small projects producing utility vehicles for export to the regional market.

Since then, retooling and production strategies have evolved at the regional level, while the installed capacity in the countries has tended to follow their respective patterns of specialization. Aside from certain preferences in demand —such as two-door cars in Brazil and four-door cars in Argentina— the pattern of specialization has tended to allocate more luxury models and some commercial vehicles to Argentine subsidiaries, while more compact cars have been produced in Brazil. Until 1994, domestic consumption expanded faster than expected, and although sectoral exports grew at rates that were historically very high, imports increased even faster.

Throughout this early stage, growing demand, together with the Automotive Regime, helped firms to adapt to the more open market conditions created by the reforms. Apart from the incipient process of specialization, however, domestic production continued to exhibit problems of scale, quality and price. In this context, Fiat and General Motors set up new plants, closely integrated with Brazil, to produce state-of-the-art vehicles.

The use of this strategy by new entrants prompted all the firms in the market to accelerate their timetables, thereby ushering in the second phase of the retooling effort. The go-ahead was given for a number of other new plants and for the extension and modernization of existing facilities, and plans for the production of utility vehicles were reformulated to produce more up-to-date models. The pattern of specialization persisted, but with less product diversification. Local supply was supplemented by imports from Brazil and, to a lesser extent, from other subsidiaries, and production plans were developed jointly with the respective Brazilian subsidiaries (see box II.2).

These projects entailed around 20% to 25% of excess installed capacity in relation to the most optimistic projections of local and regional demand, as it was never planned that subsidiaries would export significant volumes to the rest of the world. The reasons for the overinvestment were related to the scale threshold of each project within the new strategy and to the fact that each subsidiary's survival in the market depended precisely on the success of these undertakings. This generated cost-related problems and put pressure on the framework of protection even when demand was relatively strong, as it was in 1997 and 1998; the market plunge of the following years worsened the situation considerably.

The new projects had a profound impact on the local supply industry. They hastened and deepened the restructuring process in the vehicle parts segment, which was already adapting to the changes in the automotive segment. Motor vehicle subsidiaries selected local parts suppliers, including suppliers located in Brazil, on the basis of estimates which assumed long-term supply contracts.[20] Second, plants themselves "imported" suppliers by setting up new firms within the TNC structure itself or by encouraging independent international suppliers of the TNC to set up plants in the country. FDI was therefore attracted to this segment of the industry by the domestic component requirements established under the Automotive Regime, in combination with the MERCOSUR clearing arrangements.

The automotive industry has been mired in a deep recession since early 1999 due to the severe contraction of demand in Argentina. Firms that assemble and supply parts therefore began to scale back output, discontinue certain production lines, move some of their activities to Brazil and even close plants down altogether. As a result, the output of the industry as a whole has fallen sharply. Some of the individual firms that have been affected are the subsidiaries of Daimler Chrysler, Renault, Fiat and Volkswagen (see table II.10). Renault, Ford and Fiat have laid off large numbers of workers, and they even suspended production on several occasions in 2001 and early 2002. Fiat decided to move some of its activities from Argentina to its plants in Brazil. Renault has been the most drastic case, however, as the firm completely suspended production in Argentina from November 2001 to March 2002.

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20 The Automobile Regime, which requires 60% MERCOSUR parts, does not provide any specific requirement to develop local suppliers. If it had done so, better local capacities would probably have been developed in the early years of the transition.

Box II.2

FORD IN ARGENTINA: A MERCOSUR-BASED STRATEGY

Ford has traditionally been one of the leaders of the Argentine automobile industry. In the early 1990s it was still operating through Autolatina, a partnership established in the mid-1980s with Volkswagen of Germany. Autolatina enabled the two firms to ride out the crisis of the 1980s by creating economies of scale, cutting costs and producing and marketing their vehicles jointly. They used this strategy in Brazil too, and were able to maintain a lead position in both markets.

With the upturn seen in the sector in the 1990s and the establishment of MERCOSUR, the Autolatina partnership become less important because the firms were able to match the advantages of the joint enterprise by operating in a complementary manner with their own Brazilian subsidiaries, specializing in the production of certain models and importing others duty-free. The partnership was therefore dissolved in 1995. That year Autolatina invoiced US$ 1.76 billion. A year later, Ford Argentina —now split from Volkswagen— recorded sales of US$ 1.465 billion, while its erstwhile partner invoiced some US$ 1.23 billion. Ford thus maintained a market share of between 22% and 18% from 1997 to 2000. In the second half of the 1990s the firm invested US$ 1 billion in the technological retooling of plants and in restructuring its distribution networks.

The pattern of specialization —producing a small number of models and importing others— reflected a global strategy designed by the parent company in Detroit. The Argentine subsidiary has concentrated on producing the Escort and Ranger pickup models. In 1997, the Escort led the market in domestically produced models and reached a daily output of 600 vehicles. Later the Asian crisis hurt demand in Brazil —which accounted for 70% of export production— making it necessary to cut production. The situation became increasingly difficult, and in 2001 the plant was temporarily closed due to the fall in domestic sales as a result of the crisis in Argentina

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

Table II.10

ARGENTINA: VEHICLE PRODUCTION, BY FIRM, 1997-2002

(Complete units)

	1997	1998	1999	2000	2001	January-March 2001	January-March 2002
General Motors Argentina S.A.	20,258	45,364	36,099	41,217	27,097	6,062	5,767
Daimler Chrysler Argentina	19,585	24,812	11,105	15,904	6,665	1,364	550
Fiat Argentina	97,631	95,046	48,690	33,815	31,554	11,607	328
Ford Argentina	96,381	85,640	52,305	56,255	49,020	8,887	9,289
Peugeout-Citröen S.A.	29,010	30,270	26,549	69,117	45,418	7,709	2,221
Renault Argentina	79,552	87,351	60,181	58,710	26,180	4,314	0
Toyota Argentina	10,160	18,260	13,211	17,319	16,053	4,231	2,114
Volkswagen Argentina	89,772	66,888	53,205	44,439	31,767	7,505	2,808
Total	**446,306**	**457,957**	**304,809**	**339,246**	**235,577**	**52,463**	**23,389**

Source: ECLAC, Information Centre of the Unit of Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information provided by the Motor Vehicle Manufacturers' Association (ADEFA).

(b) Food and beverages: the transnationalization of activities afforded natural protection

The food sector has been one of the main attractions for external capital since the 1990s. Foreign enterprises in this sector have expanded largely through the acquisition of local firms (see table II-A.4) that are suffering from a certain degree of technological lag but whose brands are well positioned and have efficient distribution chains. Significant acquisitions were made by Nabisco of the United States (Terrabusi in 1995, Mayco-Capri in 1996 and Canale in 1999) and the French firm Danone (Bagley in 1994). The dairy sector also received a number of investments, including Nestlé of Switzerland and Parmalat of Italy, which rapidly boosted exports. In fact, exports rose almost fourfold between 1991 and 1998 (CEP, 1999).

The beer production complex has also aroused the interest of foreign firms. The Brazilian company Brahma, Warsteiner of Germany and the Luksic group of Chile —in partnership with Anheuser-Busch of the United States— built new plants in Argentina, while Heineken of the Netherlands forged an agreement with the local firm Quilmes.

In most of these activities, conditions prior to the market liberalization of the 1990s had resulted in the successful development of local producers and brands. TNCs installed additional capacity in the country as part of their independent strategy, but this was a strategy that featured low-grade product technology. The new competitive context redefined the domestic market conditions and heightened the ownership advantages of TNCs at the precise point in time when these sectors of the industry were undergoing a phase of internationalization marked by an aggressive policy of market capture and asset mergers.

Local firms thus found themselves with less manoeuvring room at a time when the surge in domestic consumption and the creation of MERCOSUR were strengthening the locational advantages for sectors which, like this one, enjoyed a certain degree of "natural protection" because of the relatively high ratio between transport costs and product prices. A large proportion of FDI inflows therefore went to existing assets. In this respect, although TNC investments were intended to derive benefit from the domestic market —sometimes extended to MERCOSUR— the strategy also included the acquisition of strategic assets and the rationalization of intra-firm activities, especially at the regional level.

Generally speaking, subsidiaries in Argentina have tended to reproduce and specialize in the core business of the parent company. This has led them to divest certain assets and become integrated into MERCOSUR within a scheme of complementarity. In the food industry, projects have been based not only on product differentiation but also on a strategy of increasing the sophistication of consumption.

In fact, subsidiaries in the food sector have increased their imports of final goods in order to supplement the range of products on offer or to develop new brands. They have also tended to focus on developing a market for new products using temporary imports, mainly from other MERCOSUR countries, which are then replaced by locally-produced products. TNCs that have subsidiaries in several countries of the region appear to be moving towards a strategy aimed at saturating their production capacity and taking advantage of the cycles of domestic demand in each market. Within this framework, intra-firm export and import flows have varied according to the prevailing conditions of demand. This has made it possible to make the fullest possible use of installed capacity without making larger investments. This strategy for boosting complementarity has been facilitated by duty-free trade and better harmonization of technical standards and marketing regulations within MERCOSUR.

(c) Chemicals and petrochemicals: the creation of natural gas clusters

Since the early 1990s, Argentina's chemical and petrochemical complex has attracted some of the world's largest firms, which have invested in three main areas: (i) pharmaceutical products and cleaning and beauty products; (ii) agrochemicals; and (iii) petrochemicals.

Investments in pharmaceuticals and in cleaning and beauty products have generally targeted mass consumption segments of the domestic market. The German firm Bayer made a number of investments, and several locally-owned laboratories were taken over, as Monsanto and Temis Lostaló bought Sintyal and Elvetium, respectively. In the cleaning and beauty products segment, the Anglo-Dutch firm Unilever expanded its investments significantly, and Procter & Gamble of the United States moved into the market by buying local firms and brands. The strategies of TNCs in this segment had features in common with those used in the food sector, especially in terms of product differentiation.

Investments in the agrochemicals sector were closely associated with the rapid expansion of the agricultural sector. In particular, Atanor was acquired by Albaugh of the United States as part of a major investment plan. Also, in late 2000, Profértil —a joint venture undertaken by

Agrium of Canada and Repsol-YPF— opened a fertilizer production plant.

The petrochemicals sector has also seen large investments. It has held a dual attraction for investors by virtue of the large increase in natural gas production (one of the sector's basic inputs) brought about by the expansion of the petroleum frontier, on the one hand, and the privatization of public enterprises, on the other. In the 1970s and 1980s the State had been heavily involved in investments in the early stages of the production chain, especially in Bahía Blanca. At that time three large corporations were established in the petrochemical sector: Petroquímica Bahía Blanca (PBB) (mixed ownership), Indupa and Polisur (both owned by local groups).

In the mid-1990s the capital structure of the petrochemical industry changed profoundly. PBB was privatized and was acquired by a consortium formed by Dow Chemical of the United States, Repsol-YPF and Itochu of Japan (10%) (see table II-A.3). Polisur was bought by Dow Chemical, and Indupa —after a series of transactions that included temporary nationalization— was acquired by the Belgian group Solvay. Later, the management of PBB and Polisur was merged under the control of Dow Chemical. The petrochemical industry thus underwent major structural changes based on the streamlining of production[21] and staff, vertical integration and an more flexible product mix (Leonardi and Dichiara, 1998). In addition, as the ownership of a number of different facilities was transferred, a specialization process gradually arose whereby the Solvay-Indupa group took over the production of chlorinated petrochemicals, while Dow Chemical-PBB-Polisur came to account for most non-chlorinated products.

Both groups set about the restructuring process with an ambitious programme of investments amounting to over US$ 1 billion. PBB-Polisur doubled its output capacity of ethylene and polyethylene by building two new plants and expanding two existing ones. Seeking to secure its supply of inputs, the group also embarked on an enterprise known as "Project Mega" involving an investment of US$ 430 million to finance the launch of a joint venture with PETROBRAS of Brazil. With this investment, the group plans to build a plant for separating out natural gas liquids in the Loma de la Lata field, a polyduct to Bahía Blanca and a gas cracking plant, also in the locality of Loma de la Lata. By joining forces, the two firms hope to derive the maximum benefit from their outputs: the ethylene will be used by PBB-Polisur while the other products (liquid petroleum gas, or LPG, and natural gasoline) will be exported to Brazil by PETROBRAS (Kulfas and Hecker, 1998).

3. Resource-seeking strategies: access to Argentina's natural resources

Resource-seeking strategies have been deployed by investors in agricultural (food) commodities —in particular, edible oils and cooked meats, both represented by long-established subsidiaries— and in the petroleum and mining sectors, in which this scale of FDI was an unprecedented phenomenon. Clearly, in all these cases the availability and cost of raw materials constituted the main locational advantage and were a major consideration in investment decisions. In the petroleum and mining industries, however, privatization and deregulation (in the first case) and a new promotional regime (in the second) were the main factors behind these new FDI flows.

The current production strategy in oils-producing and meat-processing sectors is based on increasing the scale of production and obtaining a secure supply of raw materials by developing long-term contracts and ties with suppliers. As in the past, the fact that TNCs continue to direct their investments at the world —rather than the regional— market is closely associated with their possession of international marketing channels. In this respect, the purpose of the local subsidiary has been to supply the TNC with products entailing a fairly low degree of processing. Since liberalization started, however, subsidiaries have diversified their trade strategies and begun to distribute inputs or manufactured food products on the domestic market or to other subsidiaries in the framework of the TNC integrated production system.

In the past, activities in the domestic market accounted for a comparatively small percentage of subsidiary business and tended to exhibit a number of common features: goods sold on the domestic market were either of lower quality than exported goods or

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21 This included the discontinuation of some production lines and the closure of seven plants that were largely obsolete.

corresponded to activities that were not a priority for the parent company but had instead been developed as one-off initiatives. Trade liberalization and changing domestic market perspectives made it necessary to rethink these strategies, however. In the first case, secondary lines of business were shut down and replaced by products imported by the TNC. In the second, low-priority production lines were closed and replaced by lines produced by export-oriented plants —which tended to raise the quality of the product— or by imports.

Mining and drilling investments and strategies adopted by TNCs in the sector are largely a reflection of institutional changes and have pushed back the production frontier substantially.

(a) Petroleum: TNC-driven expansion

Unlike other sectors of the economy, the main actors in the privatization of petroleum assets were locally-owned private firms which had hitherto operated as contractors with Yacimientos Petrolíferos Fiscales (YPF): Pérez Companc, Pluspetrol, Astra, Cadipsa, Bridas and Tecpetrol, among others.

When the privatization process —which provided the State with a total income of US$ 5.077 billion—[22] was completed in 1993, private locally-owned firms, led by YPF, were the unchallenged leaders in the business of supplying crude petroleum and natural gas. Of the 10 largest crude petroleum producers, seven were locally-owned and accounted for 74% of total output, while the three foreign-owned firms represented 18%. Of the 10 leading natural gas producers, the seven locally-owned firms accounted for 81%, while the three foreign-owned firms in that group produced 16%.

Once the local firms that had acquired significant amounts of the privatized assets had consolidated their position by integrating their petroleum businesses and expanding into other energy sectors and other countries of the region, foreign firms began to show an interest. From 1996 on, foreign companies poured into Argentina to invest in local petroleum firms. Also in 1996, Repsol acquired a 37.7% share of Astra; it later expanded this share by making a series of purchases worth a total of US$ 1.019 billion, and by 2000 owned 99.4% of that firm. In 1997, through Astra, Repsol acquired 45% of Pluspetrol Energy at a cost of US$ 340 million. Also in 1997, Amoco Argentina Oil (now a subsidiary of BP Amoco) merged its petroleum and gas assets in Argentina with the assets of Bridas, which was owned by the Bulgheroni family, to form Panamerican Energy, of which Amoco owns 60% and Bridas 40%. In 1998, Shell bought the rights to three potential natural gas deposits in the north-east of the country for US$ 470 million. Chevron acquired Petrolera San Jorge in 1999 at a cost of US$ 1.1 billion. This process culminated with Repsol of Spain's purchase of 98.2% of YPF S.A in 1999, in two successive operations, at a total cost of US$ 15.169 billion (see tables II-A.3 and II-A.4). Of this amount, the State received US$ 2.749 billion for its remaining shareholding of 20.3%, and the stakeholder provinces received US$ 1 billion for the 6.4% they still owned.[23]

A direct consequence of these acquisitions was that control of most of the country's gas and petroleum production facilities and reserves passed into the hands of foreign-owned firms. In 2000 foreign firms controlled around 75% of oil production, 67% of petroleum reserves and about 60% of natural gas production and reserves. Consequently, the structure of the sector, its level of activity and pattern of international integration changed radically, and Repsol of Spain became the country's largest operator (see chapter IV).

Investments made by privately-owned oil companies –local and foreign alike– in existing assets and blocks with proven reserves —and in the development and operation of these deposits— have generated a considerable expansion of output and exports. The annual production of crude petroleum and natural gas increased by 70% between 1989 and 2000. Petroleum exports expanded by 147% between 1994 and 2001, while gas exports —which began in 1997— reached an annual volume of 214 billion cubic feet in 2001.

By contrast, investment in exploration has been limited and has occurred mainly in very low-risk areas. This is reflected in the poor results of "Plan Argentina,"[24] which was established to govern the exploration of new areas, as well as in the marked decrease in the number of

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22 The State received US$ 464 million for the tender of the outlying YPF blocks; US$ 1.324 billion for the core blocks; US$ 248 million for the sale of other assets such as refineries, oil pipelines, marine terminals, transport equipment, and others; and, lastly, US$ 3.04 billion for the sale of 46.4% of the shares in YPF —the State retained 20.3%, the stakeholder provinces 11.3%, YPF staff 10% and the pension system 12%.

23 Over the years, the provinces, staff and pensioners sold most of their shares.

24 "Plan Argentina" was established in 1991 and set out rules for the exploration of new areas. This Plan covers most of the continental and marine sedimentary basins, which include less explored and higher risk areas, and also unexploited areas of working fields.

exploratory and outpost wells (which serve as an indicator of risk aversion)[25] and the sharp upturn in the percentage of successful explorations.[26] Clearly, for local and foreign private firms alike, buying existing assets has offered an opportunity to increase their reserves at much less cost than high-risk explorations in new areas.

The fact that these steep increases in production and in exports —a reflection of the profitability concerns of private firms keen to transform their new reserves into hard currency— have not triggered a parallel effort to explore new fields has raised concern over the country's production in the future.[27] This pattern of private investment diverges from the strategy of YPF in its State-run days, when it maintained a long reserve horizon by means of high-risk, long-term investments.

The current crisis in Argentina is having contradictory effects on the firms operating in the hydrocarbons sector. Given the small imported component of the industry (less than 10%), the sharp devaluation of the Argentine peso has considerably deflated their operating costs, calculated in dollars. The devaluation has also severely reduced the dollar purchasing power of residents, however, which, in combination with political pressures, has prevented companies from fully aligning domestic prices with international levels even though the country's legislation allows them to do so. In order to prevent supply to the domestic market —now less attractive than exports— from drying up, and given the State's enormous need for funds, the government passed Act 25561, article 6 of which imposes a tax of 20% on exports of all types of hydrocarbons. For the time being, this measure is being applied to petroleum only, while natural gas remains exempt. In addition, firms whose activities are concentrated in Argentina, such as Repsol-YPF and locally-owned firms, have been placed in a difficult financial situation by the devaluation, since this has generated a sharp mismatch between their assets, which are mainly denominated in pesos, and their liabilities, which have mostly in dollars (see chapter IV).

(b) Mining: the "final frontier"

Argentina is endowed with great geological wealth. In fact, a number of experts have referred to it as mining's "last frontier". Until the early 1990s, however, the sector was fairly undeveloped and was limited mainly to the mining of non-metallic minerals for the construction materials industry.

In the mid-1990s, however, this situation began to change, mainly as a result of new sector-specific laws.[28] This legislation encouraged the entry of some of the world's leading mining companies, many of which had already invested in neighbouring countries, particularly in Chile. This was further facilitated when Argentina and Chile signed a mining agreement. According to information supplied by the Department of Mining, between 1993 and 1999 a total of US$ 699 million was invested in exploration, while US$ 2.109 billion was invested in operations in 1994-1999. The main mining projects include:

- **Bajo de la Alumbrera**. Operated by M.I.M. Holdings Ltd. (50%) and North Ltd. (25%) of Australia, together with the Canadian firm Río Algom (25%). Based in the province of Catamarca, it produces copper and gold, and the total investment in the project is US$ 1.24 billion.
- **Salar del Hombre Muerto**. Operated by FMC Lithium Corp., of the United States. Based in the province of Catamarca, it produces lithium, with a total investment of US$ 137 million.
- **Cerro Vanguardia**. Jointly operated by Anglo American PLC of South Africa and the local group Pérez Companc. It is located in the province of Santa Cruz and produces gold, with a total investment amounting to US$ 198 million.
- **Piriquitas**. Operated by Sunshine of Canada in the province of Jujuy, this venture produces tin and silver. The total investment in the project amounts to US$ 100 million.

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25 From 1995 to 2000, the average number of exploratory and output wells drilled per year decreased by 25% with respect to the period 1983-1989 (Kozulj, 2002).

26 This percentage rose from 27% in 1983-1989 to 56% in 1995-2000 (Kozulj, 2002).

27 "The Secretariat of Energy does not measure real hydrocarbon reserves, which are reported by the firms themselves. According to corporate estimates, there are petroleum reserves for 10 years and gas for 17, but all the signs are that these estimates are inflated to avoid alarm over the high rates of export" (ECLAC translation) (*Page 12,* 24 February 2002).

28 In 1993, new legislation was passed to encourage mining investments. This provided a number of benefits, including: (i) tax stability for 30 years; (ii) accelerated amortization of capital goods; (iii) the possibility of importing capital goods and inputs tariff-free. It was also established —by means of an agreement with the provinces— that mining royalties may not exceed 3% of the minehead price, not counting production costs.

Other large projects have been postponed until market conditions improve. The fall in the prices of mineral products, the Asian crisis and the difficult economic situation in Argentina have prompted many investors to suspend planned projects. This is the case of Pachón (operated by Cambior of Canada, with a planned investment of US$ 700 million) and Agua Rica (operated by Broken Hill Proprietary (BHP) of Australia with an investment estimated at US$ 1.1 billion). More recently, Barrick Gold Corp. of Canada announced it would invest US$ 1 billion to develop the gold deposit of Pacua-Lama, located on the border between Argentina and Chile. This enterprise is expected to come on stream in 2003 and to produce US$ 500 million annually.

The underdevelopment of the sector clearly precluded the emergence of large local firms, and the new legislation was therefore of benefit almost exclusively to external operators. After virtually stagnating at around US$ 500 million during the 1980s and early 1990s, mining output almost doubled with the launch of Bajo de la Alumbrera alone. This mining complex also began to generate significant exports, and now, with exports amounting to US$ 385 million, the operator now ranks among the 20 leading exporters in Argentina (see table II-A.1).

C. CONCLUSIONS

During the 1990s the Argentine economy received large inflows of FDI. In fact, it was one of the most attractive destinations for TNCs embarking upon a new phase of their effort to position themselves and expand their operations in Latin America. The Administration implemented far-reaching reforms which, together with macroeconomic stability, facilitated the operation of foreign firms and enabled them to expand into many activities that had previously been closed to them. Many foreign firms moved into the areas of infrastructure and public utilities, mainly within the framework of the privatization process. During the initial phase, foreign firms joined forces with local groups and international banks to take control of the bulk of the State assets that were put up for sale. Later, international operators augmented their stakes in the privatized companies, displacing local groups and foreign banks. A gradual concentration of ownership therefore came about through an intensive process of mergers and acquisitions, in which TNCs were once again the big winners.

The market parameters affecting the presence and activities of manufacturing TNCs also changed substantially. First, trade liberalization altered the competitive configuration of the economy and obliged subsidiaries operating under the import substitution model —at least those that intended to maintain their production base in the country— to make large investments in order to compete with imported goods. Second, the establishment of MERCOSUR added a new, subregional perspective to investment in Argentina. Accordingly, the expansion and modernization of existing activities and the entry of new players into the market took place within the framework of an intensive integration between TNC subsidiaries in Argentina and their sister subsidiaries in Brazil with a view to their joint integration within MERCOSUR.

Lastly, the Argentine authorities implemented a development model that afforded foreign investors almost unlimited access to the country's generous endowment of natural resources. In this respect, some activities which had traditionally been State domains, such as hydrocarbons, became assets in the portfolios of foreign firms. The most significant example was the purchase of Yacimientos Petrolíferos Fiscales (YPF) —the country's largest firm— by the Spanish firm Repsol. Likewise, the new regulatory framework boosted some activities, including mining, which had been lagging far behind due to a lack of financing.

In short, FDI inflows to Argentina in the last 10 years have radically altered the country's business environment. Foreign firms' share in the sales of the leading 100 companies swelled from 24% in 1991 to almost 50% in 2000. A substantial part of this increase reflected the purchase of existing assets, which has not necessarily served to expand the country's production capacity. However, these investments have also upgraded many of the utilities which were passed into private hands, thus enhancing Argentina's systemic competitiveness.

In Argentina, foreign investors found a very favourable environment to do business. Over and above the opportunities arising from the economic reforms, they were particularly attracted by the price stability and exchange-rate security inherent in the convertibility regime.

III. THE EUROPEAN UNION: INVESTMENTS AND CORPORATE STRATEGIES IN LATIN AMERICA AND THE CARIBBEAN

Unlike previous editions of this publication, which have analysed the specific experiences of some of the countries that are major sources of foreign direct investment (FDI) flows to Latin America, this edition will review the experience of the European Union and its implications for the region.

The process of European integration began on 9 May 1950, when France formally proposed the establishment of a European federation. At first, this initiative involved six countries (Belgium, France, Germany, Italy, Luxembourg and the Netherlands). Today, after four rounds of enlargement (one in 1973, with the accession of Denmark, Ireland and the United Kingdom; another in 1981, with that of Greece; the third in 1986, with the incorporation of Spain and Portugal; and the fourth in 1995, when Austria, Finland and Sweden joined), the European Union has 15 member States and is preparing to take in an additional 13 countries in Central and Eastern Europe. From its clearly political origins, the European Union has gradually evolved into a global economic power. Despite the myriad difficulties that have attended this process, since the end of the cold war the European Union has acquired tremendous vigour and internal strength.

Greater political and economic integration has resulted in the freer movement of goods, capital and people among the member States. The establishment of the Economic and Monetary Union (EMU) and the creation of a common currency (the euro) have also helped to crystallize a European identity. Progress towards the formation of a single market has helped shape the strategies of the large European firms that first climbed to the top in their local markets, then expanded into other European countries and finally became global operators. Bearing in mind that these steps have not necessarily been sequential, some other leading European firms have begun to expand their international operations, especially in the United States. But many are also focusing their attention on Latin America and the Caribbean.

Latin America has thus quickly become the most important developing region for European firms. This has brought huge amounts of FDI into the region and enabled many of these firms to become leaders in several Latin American economies. In fact, the European Union as a whole is now the principal source of FDI in the region, greatly surpassing the United States (traditionally the major source of FDI). The European firms with a presence in Latin America have spearheaded three phenomena:

- FDI inflows in the manufacturing industry (automobiles, food and chemicals), primarily from firms in the major European economies (Germany, France, the Netherlands and the United Kingdom) that began internationalizing years ago. In the biggest countries (Argentina and Brazil), these firms have employed a strategy of seeking local and regional markets, with little emphasis on exports, whereas in Mexico they are seeking a platform for exporting their products to North America;
- The recent inflow of FDI in the services and infrastructure sectors (telecommunications, energy, trade and finance) from Mediterranean countries (Spain, France, Italy and Portugal). Several firms have made Latin America the linchpin of their strategy to become global operators. Their foremost objective has been to gain access to local (and regional) markets. The climate of increased competition within the European Union has been a decisive factor in this type of investment;
- Finally, FDI in recently liberalized primary activities in the Andean countries, especially hydrocarbons, by firms based in the United Kingdom, France and Spain.

This chapter will first analyse European FDI flows to the region from a general perspective and will then examine some specific experiences of European firms in Latin America.

A. THE EUROPEAN CONTEXT AS A DRIVING FORCE FOR THE INTERNATIONALIZATION OF EUROPEAN PRODUCERS

1. Creation of the European Union: from political to economic aims

The European Union is now one of the world's major political and economic blocs. Its origins date back to the middle of the twentieth century, when the division of Europe into two opposing blocs prompted the western countries of the continent to strengthen their collaboration in economic and defence matters. The aim was to increase the degree of supranationality until a level of integration was reached that would prevent the emergence of new endemic tensions between the European powers and, simultaneously, to transform Europe into an economic player able to compete with the new world economic leader: the United States. After the end of the Second World War, the Marshall Plan for the economic reconstruction of Europe was announced and the United Europe Movement, which advocated intergovernmental cooperation, emerged. In early 1948, Belgium, France, Luxembourg, the Netherlands and the United Kingdom signed the Western Union Treaty (Brussels Treaty) and the Organisation for European Economic Co-operation (OEEC)[1] was established to coordinate the Marshall Plan. The European Payments Union (EPU), created a few months later, was the first monetary initiative designed to mitigate the impact that the scarcity of dollars was having on the revival of economic activity and intra-European trade.

In the early 1950s, Belgium, France, Germany, Italy, Luxembourg and the Netherlands signed the Treaty of the European Defence Community and the Treaty of Paris, which created the European Coal and Steel Community (ECSC). The aims of the latter initiative were to coordinate French and German production of coal and steel –activities central to the war industry– and, especially, to lay the groundwork for a future European common market. In 1957, the six countries signed treaties –which later came to be known as the "Treaties of Rome"[2]– establishing the European Atomic Energy Community (Euratom) and the European Economic Community (EEC).

From that point on, the European integration process began to gather momentum. Integration efforts were underpinned by two fundamental pillars: the creation of a customs union and the gradual establishment of a

1 In 1960, OEEC became the Organisation for Economic Co-operation and Development (OECD).

2 The Treaties of Rome entered into force on 1 January 1958 after they had been approved by the parliaments of the six founding countries, and EEC and Euratom began operating in Brussels. In addition, the European Parliamentary Assembly and the Court of Justice of the European Communities were established.

common economic policy. In this context, the foundations for a common agricultural policy (CAP)[3] were laid and the Merger Treaty was signed, which created common institutions for the three communities (ECSC, EEC and Euratom). In mid-1967, the new institutional structure went into effect, with a single Commission and a single Council for the European Communities. The customs union became effective one year later.

In the 1970s and early 1980s, the Communities' institutional structure was strengthened through the creation of systems for the collection and management of its own financial resources, while citizen participation was increased through the institution of direct, universal voting in the election of representatives to the European Parliament. In addition, Denmark, Ireland and the United Kingdom joined the European Communities. Greece became the tenth member in 1981, and Spain and Portugal were admitted four years later. In the economic sphere, after the collapse of the Bretton Woods system, the European Communities –which came to be called the European Community (EC)– began to actively consider monetary coordination as a means of reducing exchange-rate fluctuations. In that spirit, in 1978 France endorsed a German proposal to create the European Monetary System (EMS), a mechanism that enabled the EC countries to establish currency parity based on a common accounting unit, the ECU (European currency unit).[4]

In the early phase of EMS, the economic picture was not very encouraging. Unemployment was high, labour productivity was low and some of the most important economic sectors were suffering a loss of competitiveness (IRELA, 1999). Faced with this situation, not all EC members were willing to participate in EMS. However, the EC unification process received a strong political boost from the Single European Act. This agreement gave greater powers to the European Commission –which became the de facto European government– and increased solidarity among the member States (through the European Social Fund and the Cohesion Fund). It also provided a powerful impetus for the creation of the single internal market and reinforced the aim of advancing towards the formation of a monetary and economic union.

With the end of the cold war, a vastly different world began to take shape, with Europe as one of its epicentres. The Soviet Union embarked upon a process of sweeping reforms (*perestroika* and *glasnost*), the socialist bloc collapsed and the Berlin Wall fell, leading to the unification of Germany. In this context, with a relatively stable EMS, support for full economic and monetary union grew. Efforts focused on achieving convergence between economic policies through the establishment of a European system of central banks, as well as on the introduction of the single market. To that end, substantial changes were made in the European institutions. These changes were ratified in the Treaty on European Union, better known as the Mäastricht Treaty, which put in place the legal and political framework for the Economic and Monetary Union (EMU), one of the most salient features of which was the creation of a single currency (see table III.1). The tremendous push for European integration has also been interpreted as an attempt to establish a new balance of power to challenge the hegemony of the United States in the post-cold-war era and as the only means of achieving true multilateral governance or of "multilateralizing" the foreign policy of the United States.

The process of ratifying the Mäastricht Treaty proved to be extremely complex, and plunged the European Union into the worst crisis since its foundation.[5] Nevertheless, the European integration movement received a fresh impetus. Three countries (Austria, Finland and Sweden) that had initially resisted the idea of the European Union formally applied for admission, bringing the membership to its current level of 15. In the economic sphere, the foundation was laid for a future European Central Bank (ECB), and members wishing to participate in EMS were required to meet rigorous macroeconomic convergence criteria (see table III.1). At the same time, the influence of the Union's institutions increased, a common foreign and security policy was established and restrictions on the free movement of persons among member countries were lifted.[6]

In the mid-1990s, international financial markets received a clear message that European integration was a solid and irreversible reality. When the European Council met in Madrid in December 1995, major strides were made towards fulfilling the provisions of the Mäastricht Treaty and establishing a timetable and procedure for introducing a single currency, the euro (see table III.2).

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3 In 1960, a series of measures were put in place to protect farmers' incomes and ensure the Community's self-sufficiency in the supply of commodities.

4 The value of the ECU was calculated using a basket of the currencies of member countries.

5 The Treaty was approved only after two referendums in Denmark, and it faced considerable opposition in the United Kingdom and France.

6 The Schengen Agreement, which entered into force in 1995, eliminated border controls between Belgium, France, Germany, Luxembourg, the Netherlands, Portugal and Spain.

Table III.1
STAGES IN THE CREATION OF THE ECONOMIC AND MONETARY UNION

Stage	Start date	Objectives	Institutions
First	1 July 1990	Finalize the formation of the single internal market, eliminating technical, physical and fiscal barriers Eliminate obstacles to the free movement of capital Move towards greater economic convergence [a]	
Second	1 January 1994	Guarantee the independence of central banks Prohibit privileged financing for the public sector Control public debt Coordinate economic policies Meet convergence criteria	European Monetary Institute (EMI) [b]
Third	1 January 1999	Introduce a single currency Formulate a monetary and exchange-rate policy. Fix exchange rates irrevocably Establish close convergence among economic policies (on deficits, public debt, inflation, interest rates and exchange-rate stability)	European Central Bank (ECB) European System of Central Banks (ESCB) [c] Disappearance of EMI

Source: ECLAC, based on information from the European Commission.
[a] This was to be accomplished by keeping the exchange rate within a 2.25% band of fluctuation around the central rate established under the exchange-rate mechanism (ERM) and by maintaining national inflation rates of not more than 1.5% above the average of the three lowest national rates, a national bond interest rate of not more than 2% above the three lowest national rates, a deficit of under 3% of GDP and a public debt of less than 60% of GDP. [b] This institution's functions were defined in the Mäastricht Treaty. It replaced the European Monetary Cooperation Fund (EMCF) and was primarily responsible for helping to establish EMU and paving the way for ESCB, which took over its functions; EMI ceased to exist thereafter. [c] The European System of Central Banks consists of the European Central Bank and the central banks of the countries that have adopted the euro.

Table III.2
TIMETABLE FOR THE INTRODUCTION OF THE EURO

Stage	Start date	Activities
First	3 May 1998	Confirmation of the effective date of the third stage of EMU Identification of the countries participating in the process Creation of ECB and formation of ESCB Approval of regulatory and organizational framework Implementation of single monetary policy Production of euro banknotes and coins
Second	1 January 1999	Setting of irrevocable exchange rates for the currencies of the participating member States vis-à-vis the euro Transfer of responsibility for monetary and exchange-rate policy to ECB Circulation of the euro, limited to monetary policy operations and interbank transactions and issuances Transition to the euro through the financial and banking sector
Third	1 January 2002 1 April 2002	Parallel circulation of national currencies and euro notes and coins Withdrawal of national currencies

Source: ECLAC, based on information from the European Commission.

In early 1998, ECB was created and it was announced that, of the 15 member countries, 11 had met the Mäastricht criteria. Greece had been unable to meet the criteria, while Denmark, Sweden and the United Kingdom opted to remain outside EMU. Thus, on 1 January 1999, with Germany holding the European Union presidency, the 10 currencies of these 11 countries were subsumed in the euro, at least in virtual terms, for banking transactions and corporate accounting.[7] Although the euro did not yet have a physical form, it transformed international financial markets. The single currency's issuance in notes and coins is expected to

[7] The exchange rate for member countries' currencies was fixed irrevocably as part of the process of implementing the new currency. The European Central Bank was asked to take over monetary policy operations using the euro.

expand the role it has been playing in commercial and financial transactions and in the composition of international reserves. Although the launching of the new currency has attracted a great deal of attention, it has taken place in an international context of profound upheaval that could threaten the foundations of EMU, since three of the principal countries in the euro area (Germany, France and Italy) may face sanctions from the European Commission in 2002. Given the worsening economic situation, they will find it difficult to fulfil all the budgetary commitments they have undertaken (*The Economist*, 3 January 2002).

At the dawn of the twenty-first century, as it completed the conversion to a single currency, the European Union faced one of its greatest challenges: its expansion towards Central and Eastern Europe.[8] This process has been fraught with intense conflicts regarding the balance of power among member States in the new Europe, especially among the large countries, and the maintenance of the Cohesion Fund, particularly for the Mediterranean countries. These disputes were partially settled in 2001 with the signing of the Treaty of Nice, which is awaiting ratification by the member countries' legislative bodies. Meanwhile, at the Göteborg Summit, held in June 2001, the countries affirmed their intention to finalize entry negotiations with the first six candidates that met the accession criteria,[9] though they did not commit to firm dates. This situation continues to create uncertainty about the ultimate success of the process, especially with regard to the institutions' ability to adapt and continue functioning effectively in the future. If the current enlargement negotiations conclude successfully, the number of members will nearly double, rising from 15 to 27 (*The Economist*, 19 May 2001).

The last European Union summit of heads of State and government for 2001 was held in December in Belgium. This was also the first summit since the terrorist attacks of 11 September 2001 in the United States and the subsequent crisis in Central Asia. On this occasion, several issues were raised which, though not completely new, had become more explicit and occupied a more prominent place in the debates, underscoring the complexity of the process of building Europe in the coming decade. First, the participants decided to convene a Convention on the Future of Europe. This advisory body will work for approximately one year, beginning in March 2002, to develop proposals for the next reform of the European Union. It will address issues such as the balance of power between the Union and individual member States and the possibility of drawing up a European Constitution to simplify the four treaties currently in force. The aim of these modifications, which were initiated at the summit held in Nice, is to prepare for the entry of new members. The more advanced candidates (at most, 10 of the 12 candidates) are expected to join the Union in 2004.[10]

The situation could become complicated, however, if the problem of Ireland is not resolved[11] and if conflicts arise with the Danish administration in the second half of 2002, since it is not clear what the new conservative government's position will be on matters such as defence and the euro (Denmark is not part of the euro zone).

In the future, one of the central issues with regard to European Union expansion will be the establishment of "economic governance," which would require stronger political institutions in order to implement common economic policies for the single-currency area. To date, the member States have agreed not to change interest rates or devaluate their currencies unilaterally, and, under the Stability and Growth Pact (adopted at Germany's request), they have worked to maintain responsible fiscal policies,[12] all of which has brought them closer to a common budget policy. Since setting budget policy is one of the most important acts of a nation, the countries appear to be advancing towards unified economic and political governance. For the moment, however, deepening and broadening the process will remain the priorities.

In summary, although the European Union originated as a political initiative, the economic dimension has become an increasingly important component of the European integration process, culminating in EMU and the euro. The strength of the process has been demonstrated by Europe's ability to revise and expand the original treaties and adapt to the changing features of global international relations. The

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[8] In 1998 the European Council opened negotiations for the admission of Cyprus, the Czech Republic, Estonia, Hungary, Poland and Slovenia. Eighteen months later it commenced negotiations with Bulgaria, Lithuania, Malta, Romania and Slovakia.

[9] The European Council set three general types of accession criteria for candidate countries: political (democracy and respect for human rights), economic (existence of a free market and competitiveness) and legal (ability to assimilate European Union legislation).

[10] Of the 12 candidates, Bulgaria and Romania are farthest from meeting the criteria for admission to the Union.

[11] Ireland's citizens rejected the Treaty of Nice in a 2001 referendum. However, another vote is to be taken in 2002, when it is hoped that a majority will favour enlargement.

[12] Deficits are allowed during recessions, but if a member State's budget deficit exceeds 3% of its GDP, the other members of the monetary union are entitled to impose sanctions or fines (*The Economist*, 19 May 2001).

European Union has now reached a high degree of maturity, though there are still many issues on which solid agreements have yet to be reached, including enlargement and the new balance of power among the most important economies on the continent. The changes in the international system during the 1990s and the dynamics of the integration process in Europe have transformed the Union into a political actor that speaks with a single, consistent voice on the world stage (IRELA, 1999). The Union also maintains a solid alliance with the United States, as was clearly demonstrated in the wake of the terrorist attacks of 11 September 2001.

However, it is also true that the enlargement process and the attempt to unify the continent could prove to be a stumbling block on the road to European integration. The Convention established at the Laeken Summit seeks to overcome these challenges and revamp the Union. In this framework, a set of "European values" has emerged and has begun to be manifested in concrete, strategic actions aimed at building and preserving alliances in the changing world order. Support for European Union involvement in international security operations seems genuine and solid.[13] As in the past, the recent major advances in the European integration process have occurred in a context of profound changes in the international sphere. The fact that Europe is evolving towards a federal State seems to follow the same pattern. For example, since the attacks of 11 September, the Union has dramatically stepped up cooperation in security and law enforcement, issues which until recently were matters of considerable controversy. Latin America forms part of this context and, indeed, occupies a place of "moderate prominence" that could lead to interesting opportunities.

2. The European Union: an economic bloc of increasing strength and size

Since the mid-1980s, as the European agenda took shape, the European Union began to emerge as one of the most significant and influential players in the world economy. First, it offers a market of some 400 million relatively affluent people, of whom nearly 300 million share a common currency. In comparison with Latin America, the Union's population is slightly smaller, but its per capita income is over six times higher. Second, in the year 2000, Europe accounted for close to 44% of world trade –including both exports and imports– surpassing the United States, Japan and the whole of Latin America.[14] Finally, last year the Union accounted for 67.2% of global FDI outflows and 48.6% of global FDI inflows (see table III.3). However, it must be borne in mind that a very significant percentage of these commercial and financial flows originate and remain within the Union itself (see table III.5). This is an indication of how strong European integration has become in terms of economic ties among the member countries.

Without doubt, one of the most notable aspects of the European Union's activity as an economic bloc in the world economy has been its involvement in foreign investment flows, including both inflows and outflows. Since the second half of the 1990s, Europe has become an epicentre of the global upsurge in investment flows. Whereas investment inflows and outflows were both on the order of US$ 100 billion at the start of the decade, as of 1999 they exceeded US$ 500 billion and US$ 700 billion, respectively (see figure III.1).

In the second half of the 1990s, the European Union thus became one of the world's largest sources and recipients of foreign investment. In 2000, investment activity within the Union intensified, with inflows totalling US$ 796 billion and outflows totalling US$ 960 billion (see table III.4 and figure III.1). At the country level, the United Kingdom was, for the second year in a row, the largest outward investor in the world (UNCTAD, 2001), but investment flows from Belgium-Luxembourg, France and, especially, Spain also rose sharply. As recipients of inward foreign investment, Belgium-Luxembourg, Germany and the United Kingdom topped the list in 2000 (see table III.4). Germany has received investment mainly from other European Union countries, while the extraordinary growth in inflows to and outflows from Belgium-Luxembourg has been largely the result of mergers and acquisitions involving groups of firms located in Belgium (EUROSTAT, 2001a). Capital inflows and outflows have thus been closely aligned, showing very similar trends, since the main investors in many cases are the European Union member countries themselves (see figure III.1).

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13 As a noteworthy example, the majority of European Union member States supported the intervention in Kosovo.

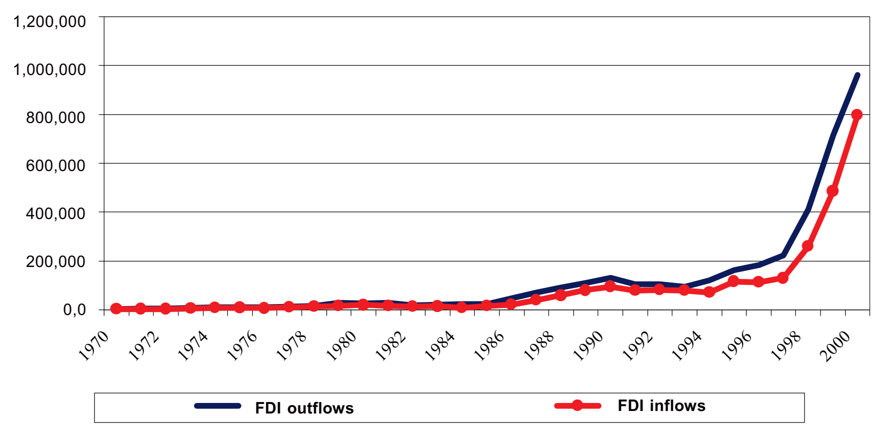
14 A more detailed analysis of the structure of trade reveals that Europe's share is larger in the case of exports of non-resource-based manufactures, especially those that utilize mid-level technology (motor vehicles, chemicals and pharmaceuticals). These products also make up the largest proportion of European exports to the rest of the world (see annex III.1).

Table III.3
BASIC INDICATORS FOR THE EUROPEAN UNION, UNITED STATES, JAPAN AND LATIN AMERICA

	European Union			United States			Japan			Latin America		
	1990	1995	2000	1990	1995	2000	1990	1995	2000	1990	1995	2000
Population (millions of people)	364	372	376	250	263	281	124	126	127	436	475	515
GDP at market prices (billions of dollars)	7,356	8,609	7,946	5,801	7,401	9,837	2,981	5,138	4,842	1,126	1,691	1,966
GDP per capita at market price (thousands of dollars)	20.2	23.1	21.1	23.2	28.1	35.0	24.0	40.7	38.1	2.6	3.6	3.8
Exports (FOB) at current prices (billions of dollars)	1,454	2,232	2,860	393	583	781	287	443	479	140	224	354
Imports (CIF) at current prices (billions of dollars)	1,556	2,124	2,804	517	771	1 258	235	336	380	125	250	390
Exports as a percentage of world exports (percentages)	42.3	43.6	45.3	11.5	11.4	12.4	8.4	8.7	7.6	4.1	4.4	5.6
Imports as a percentage of world imports (percentages)	44.1	40.9	43.1	14.6	14.9	19.3	6.7	6.5	5.8	3.5	4.8	6.0
Outward FDI (billions of dollars)	131	162	960	37	99	139	50	23	33	5	7	13
Inward FDI (billions of dollars)	96	117	796	48	58	295	2	1	8	9	32	86
FDI outflows as a percentage of the world total (percentages)	53.9	45.3	67.2	15.2	27.8	12.0	20.5	6.4	2.9	2.0	1.9	1.2
FDI inflows as a percentage of the world total (percentages)	45.4	34.7	48.6	22.7	17.5	23.2	0.0	0.0	0.6	4.2	9.6	6.8

Source: ECLAC, Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of: Statistical Office of the European Communities (EUROSTAT), European Union Foreign Direct Investment Yearbook, 2000, Luxembourg, 2000; United Nations Conference on Trade and Development (UNCTAD), World Investment Report, 2001: Promoting Linkages (UNCTAD/WIR/2001), New York, 2001, United Nations publication, Sales No. E.01.II.D.12; International Monetary Fund (IMF), International Financial Statistics Yearbook, 2001, Washington, D.C., 2001; Statistical Office of the European Communities (EUROSTAT), EUROSTAT Yearbook, 2001, Luxembourg, 2001.

Figure III.1
EUROPEAN UNION: INFLOWS AND OUTFLOWS OF FOREIGN DIRECT INVESTMENT
(Millions of dollars)



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

As noted earlier, the ongoing integration process has generated vigorous economic activity within the European Union. Numerous policies on regional, industrial, technological and competitive development have contributed to that end, strengthening the Union and the economies of its member countries. The less developed countries, such as Greece, Portugal, Ireland and Spain, have been among the greatest beneficiaries.[15] In addition, many of these policies have helped to internationalize the markets of countries that have traditionally been FDI recipients, such as Spain and Portugal, and to promote the attraction of capital, as in the case of Ireland.[16] In its efforts to achieve greater cohesion in the integration process, the Union has also

15 These four countries, because their per capita income is less than 90% of the European Union average, benefit from the Cohesion Fund.

Table III.4
EUROPEAN UNION: PRINCIPAL SOURCES AND RECIPIENTS OF FOREIGN DIRECT INVESTMENT
(Millions of dollars)

	Inward FDI			Outward FDI		
	1995	1998	2000	1995	1998	2000
United Kingdom	20,318	74,652	119,933	44,464	122,055	266,218
Belgium-Luxembourg	10,689	22,690	236,493	11,603	28,845	228,828
France	23,733	29,518	43,173	15,824	45,701	169,481
Germany	11,986	23,296	189,178	39,100	89,678	52,048
Netherlands	12,228	37,648	52,309	20,192	37,121	70,893
Spain	6,297	11,905	36,023	4,206	19,065	52,826
Total European Union	**116,705**	**259,308**	**796,226**	**161,747**	**412,056**	**960,422**

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

maintained high levels of protection in several areas of economic activity, especially agriculture and fisheries.

The new context has obliged businesses to tailor their strategies to an expanded market, and this has translated into a rise in investment –largely through mergers and acquisitions. This modality has enabled firms to quickly gain a foothold in markets where it would have been extremely expensive, difficult and time-consuming to do so by other means. Expansion beyond national borders, coupled with growing levels of local and regional competition, has forced businesses that aspire to become global operators to apply energetic expansion strategies. This has been particularly important in sectors in which increased competition has radically changed the structure of markets, especially those in which big companies once held a monopoly. Mergers and acquisitions have occurred primarily in sectors such as telecommunications, energy, banking and various research-and-development-intensive manufacturing industries with high value added, such as the chemical and automotive industries (see table III.6). Noteworthy in this regard is the acquisition of the German firm Mannesmann by the United Kingdom-based telecommunications firm Vodafone AirTouch –the largest cross-border merger carried out to date. As a result of this single operation, Germany became, for the first time, Europe's largest recipient of FDI (see tables III.4 and III.6).

The internationalization of business, especially in recent years, has occurred primarily within the European Union itself. Between 1992 and 1995, FDI of European origin flowing to other European Union members averaged US$ 60 billion; after 1996, these intraregional capital flows exhibited spectacular growth, reaching US$ 427.114 billion in 2000 (see tables III.5 and III.7). In aggregate terms, investment within the European Union in the period 1992-2000 accounted for more than 54% of total investment flows generated by the bloc (see figure III.2).

The other 46% of European investment went to countries outside the European Union. This extraregional FDI also increased markedly in the period 1992-2000, as the substantial amount of European capital in North America –chiefly in the United States– was complemented by huge investments in emerging markets, especially in Latin America. FDI flows from the European Union to the United States have grown tremendously in recent years. Between 1992 and 2000, nearly 60% of European investments outside the Union (and 30% of the total) were concentrated in the United States, mainly through large-scale mergers and acquisitions (EUROSTAT, 2000b). Japan –the third member of the Triad– received only a meagre share of European investment. Latin America, in contrast, became the primary recipient of European investment in the developing world, accounting for 6% of total flows from European Union member countries (see figure III.2). The importance of Latin America as a destination for European investment began to grow in 1996; between that year and the year 2000, the region accumulated 14% of European investments outside the Union (see table III.7).

[16] Of all the European economies, Ireland has registered one of the highest growth rates in FDI inflows in recent years, especially in high technology.

Table III.5

EUROPEAN UNION: PRINCIPAL ECONOMIC RELATIONS WITHIN THE BLOC

(Percentages)

	1990	1995	2000
Exports to EU member countries as a percentage of total EU exports	66.6	62.4	62.1
Imports from EU member countries as a percentage of total EU imports	64.0	61.0	57.8
Direct investment in EU member countries as a percentage of total inward FDI received by the EU countries	-	53.7	78.8
Percentage of total outward FDI of EU that goes to EU members	-	54.0	59.9

Source: ECLAC, Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of: Statistical Office of the European Communities (EUROSTAT), European Union Foreign Direct Investment Yearbook, 2000, Luxembourg, 2000; United Nations Conference on Trade and Development (UNCTAD), World Investment Report, 2001: Promoting Linkages (UNCTAD/WIR/2001), New York, 2001, United Nations publication, Sales No. E.01.II.D.12; International Monetary Fund (IMF), International Financial Statistics Yearbook, 2001, Washington, D.C., 2001; ECLAC, Statistical Yearbook for Latin America and the Caribbean, 2001 (LC/G.2151-P), Santiago, Chile, 2002, United Nations publication, Sales No. E.02.II.G.1; Statistical Office of the European Communities (EUROSTAT), EUROSTAT Yearbook, 2001, Luxembourg, 2001.

Table III.6

EUROPEAN UNION: PRINCIPAL CROSS-BORDER MERGERS AND ACQUISITIONS AMONG EUROPEAN FIRMS, 1999-2001

(Billions of dollars)

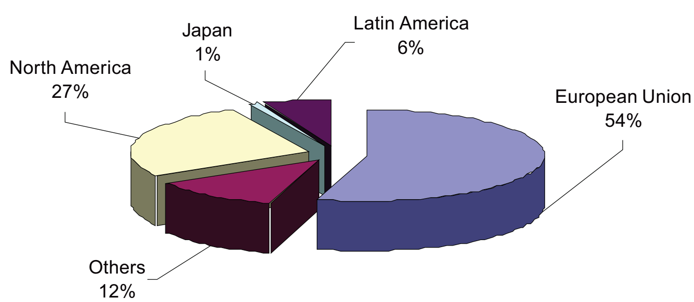
	Firm acquired	Country	Sector	Acquiring firm	Country	Amount
2000	Mannesmann AG	Germany	Telecom.	Vodafone AirTouch	United Kingdom	202.8
2000	Orange PLC	United Kingdom	Telecom.	France Telecom	France	46.0
1999	Astra AB	Sweden	Pharmaceuticals	Zeneca Group PLC	United Kingdom	34.6
1999	Orange PLC	United Kingdom	Telecom.	Mannesmann AG	Germany	32.6
1999	Hoechst AG	Germany	Chemicals	Rhône-Poulenc S.A.	France	21.9
2000	Airtel S.A.	Spain	Telecom.	Vodafone AirTouch	United Kingdom	14.4
2001	Viag InterkomGmbH	Germany	Telecom.	British Telecom	United Kingdom	13.8
1999	One 2 One	United Kingdom	Telecom.	Deutsche Telekom AG	Germany	13.6
2000	Crédit Commercial de France	France	Banking	HSBC Holding PLC	United Kingdom	11.1
1999	Olivetti-Telecom Italy	Italy	Telecom.	Mannesmann AG	Germany	8.4
1999	Tractebel S.A.	Belgium	Electricity	Suez Lyonnaise des Eaux SA	France	8.2

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

Figure III.2

EUROPEAN UNION: REGIONAL DISTRIBUTION OF FOREIGN INVESTMENT, 1992-2000

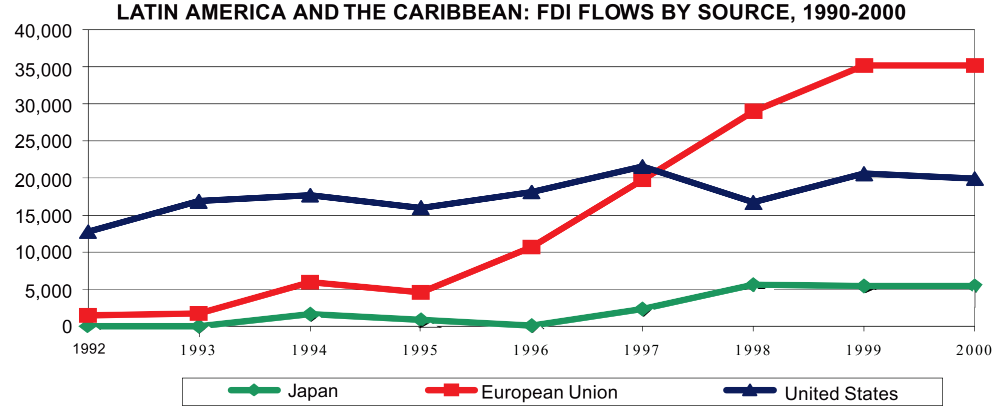
(Percentages)



Source: ECLAC, Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of Statistical Office of the European Communities (EUROSTAT), European Union Foreign Direct Investment Yearbook, 2000, Luxembourg, 2000.

Figure III.3

LATIN AMERICA AND THE CARIBBEAN: FDI FLOWS BY SOURCE, 1990-2000



Source: ECLAC, Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from the Statistical Office of the European Communities (EUROSTAT); Bureau of Economic Analysis, United States Department of Commerce (http://www.bea.doc.gov); and Inter-American Development Bank (IDB), Foreign Direct Investment in Latin America: The Role of European

Table III.7

EUROPEAN UNION: FOREIGN DIRECT INVESTMENT OUTFLOWS, BY REGION [a]

(Millions of dollars and percentages)

	1992	1993	1994	1995	1996	1997	1998	1999	2000 [b]
Within EU	63,792	47,105	59,571	69,267	78,202	85,397	143,134	316,716	427,114
Outside EU	23,076	28,303	28,565	58,942	59,272	95,859	222,511	276,578	280,770
–North America	9,368	15,968	11,091	32,714	21,435	40,027	141,000	192,078	166,375
–Japan	748	-1,686	383	1,445	3,428	572	425	8,826	4,215
–Latin America	1,477	1,799	6,026	4,652	10,675	19,799	29,045	35,128	35,220
Share of Latin America in European investment outside EU (percentages)	6.4	6.4	21.1	7.9	18.0	20.7	13.1	12.7	12.5

Source: ECLAC, Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of Statistical Office of the European Communities (EUROSTAT), European Union Foreign Direct Investment Yearbook, 2000, Luxembourg, 2000.

[a] The figures on FDI include capital investment but do not include reinvestment of profits. This is one of the reasons why the figures shown in this statistical breakdown by geographical area do not coincide with the total amounts published by the International Monetary Fund (IMF) and presented in table III.4. [b] Provisional figures.

3. European Union: investment flows to Latin America

In the second half of the 1990s, Latin America became the leading destination for European investment in emerging markets and the second leading non-European Union recipient after North America (see table III.7). In that same period, the European Union became the primary source of FDI flows to Latin America, far surpassing the United States (see figure III.3). Between 1996 and 2000, European investments in Latin America averaged close to US$ 26 billion a year, reaching a historic record of US$ 35.128 billion in 1999. Thus, some of the largest European TNCs quickly began to take their place among the business elite in Latin America.

European investment has largely been directed towards the economies of the Southern Cone, especially Chile and the members of MERCOSUR. Between 1992 and 2000, MERCOSUR received 68% of investment flows to Latin America from the European Union. Brazil was the final destination of 65% of this capital, while Argentina received around 35%, basically as a result of the opportunities created by the privatization of State-owned enterprises and subsequent acquisitions that served to consolidate the investor firms' subregional operations. Next in importance were Mexico (8.3%) and Chile (7.4%). In the case of Chile, by purchasing large local private groups with a strong presence in the region, European firms were able to rapidly increase their market share in South America. In fact, in this part of the continent, European firms –especially Spanish, French, Portuguese and Italian concerns– have gained large market shares in several services and infrastructure sectors (telecommunications, finance, energy and retail sales). In Mexico, European investment has followed a different pattern, focusing mainly on export manufacturing activities (automobiles and electronics) and financial services (see table III.8).

Table III.8
EUROPEAN UNION: DIRECT INVESTMENT IN LATIN AMERICA, BY COUNTRY AND SUBREGION, 1992-2000
(Millions of dollars)

	1992	1993	1994	1995	1996	1997	1998	1999	2000
South America	1,893	1,340	4,926	3,986	8,587	15,390	25,835	32,870	31,563
MERCOSUR	1,147	1,105	2,172	2,267	6,217	8,238	24,033	29,455	23,176
Argentina	531	598	974	1,129	1,803	2,541	3,757	17,801	4,611
Brazil	612	495	1,171	1,112	4,336	5,633	20,143	11,491	18,397
Andean Community	693	47	2,382	1,200	1,827	5,051	23	1,230	7,598
Colombia	85	-163	259	426	675	2,171	1,121	373	2,091
Venezuela	179	102	68	296	507	2,254	-1,509	518	4,095
Other Andean countries	429	108	2,055	475	645	626	411	339	1,412
Chile	53	188	372	522	543	2,102	1,778	4,337	790
Mexico	361	92	70	1,462	945	3,430	1,572	1,602	2,408
Central America	388	367	1,030	-796	1,143	979	1,638	656	1,249
Total Latin America	**1,477**	**1,799**	**6,026**	**4,652**	**10,675**	**19,799**	**29,045**	**35,128**	**35,220**

Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of information from EUROSTAT.

In the case of the Andean Community countries, economic and political instability has dampened the interest of European investors, especially those in the Mediterranean countries. In the first half of the 1990s, pioneering firms in the area of services –most of them Spanish– were heavily involved in the privatization programmes of Peru and Venezuela. In the second half of the decade, investor interest remained focused on privatization, but this time in Colombia and Bolivia. However, after these assets were acquired, new investment activity waned in comparison to what was happening in other Latin American economies. At the same time, the existence of large hydrocarbon reserves in Colombia, Ecuador, Peru and Venezuela has awakened the interest of some of Europe's largest oil companies (see chapter IV of this publication). In Central America, European firms have encountered stiff competition from United States firms for control of privatized State assets. These circumstances have limited the European presence in both subregions.

Most European investment in Latin America has come from Spain, the United Kingdom, the Netherlands, France, Italy, Portugal and Germany. Between 1992 and 2000, around 50% of European Union investments in the region were from Spain, making that country the biggest foreign investor in Latin America (ECLAC, 2000, chap. III). Spanish firms, faced with growing competition in their domestic and regional markets, took advantage of their country's cultural proximity to Latin America to launch an ambitious process of internationalization, mainly through the purchase of existing assets (Calderón, 1999). The Latin American privatizations of the early 1990s were the channel through which this process began. The initial success of Spanish firms attracted the interest of other European firms with similar characteristics. Thus, other firms from Mediterranean countries such as Italy, France and Portugal began to compete with the Spanish firms for control of the public services markets in the largest Latin American economies (see ECLAC, 2000, chap. III).

By the end of 2001, Spanish firms had invested between US$ 72 and US$ 83 billion in Latin America, depending on the source (*Cinco Días*, 24 December 2001) (see table III.9). Companies such as Telefónica de España, Repsol-YPF, Endesa España and the banks Banco Santander Central Hispano (BSCH) and Banco Bilbao Vizcaya Argentaria (BBVA) are among the largest investors in the region and have become leaders in many sectors and countries. For these firms as a group, the region is expected to account for close to 32% of projected net profits for 2001 (Sociedad de Valores del Santander, 2001). With inflows of around US$ 24 billion, Argentina has been the primary recipient of investment by Spanish firms in Latin America, followed closely by Brazil, with Chile a slightly more distant third (see table III.9). However, given the current situation in Argentina, the attitude of the Spanish firms in the region has shifted from euphoria to concern (see chapter II of this publication). One of the most noteworthy aspects of the Spanish experience is that most of the FDI flows from Spain to Latin America are concentrated in a very small group of companies (see table III.10).

In the early 1990s, the United Kingdom was the biggest European investor in the region (see figure III.4). Firms based in the United Kingdom have played an especially prominent role in the manufacturing sector

Table III.9
LATIN AMERICA: PRINCIPAL SOURCES AND DESTINATIONS OF INVESTMENT FROM THE EUROPEAN UNION, CUMULATIVE TOTALS, 1992-2000
(Millions of dollars)

	Argentina	Brazil	MERCOSUR	Colombia	Venezuela	Andean Community	Chile	Mexico	Latin America
EU-15	33,746	63,390	97,810	7,038	6,508	20,047	10,686	11,943	143,821
Spain	24,097	23,484	47,679	2,714	1,472	8,324	8,180	6,009	71,630
Portugal	33	8,810	8,846	0	2	4	5	31	9,040
United Kingdom	2,068	5,523	7,663	3,720	1,705	5,988	268	2,419	17,363
Italy	1,221	1,983	3,219	31	90	156	44	123	3,510
Other EU	6,327	23,590	30,402	573	3,239	5,576	2,189	3,361	42,277

Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of information from EUROSTAT.

Table III.10
LATIN AMERICA: FOREIGN DIRECT INVESTMENT BY THE LEADING SPANISH FIRMS
(Millions of dollars)

	1997	1998	1999	2000	2001
Telefónica de España	934	4,705	2,992	21,818	…
Banco Santander Central Hispano (BSCH)	1,249	1,156	1,565	8,969	…
Banco Bilbao Vizcaya Argentaria (BBVA)	613	2,905	549	2,781	…
Repsol-YPF	687	85	15,169	1,311	…
Endesa España	1,493	930	3,584	1,219	…
IBERDROLA	947	…	264	595	…
Unión Fenosa	212	101	165	362	…
Total	**6,135**	**9,882**	**24,225**	**37,055**	**6,175**

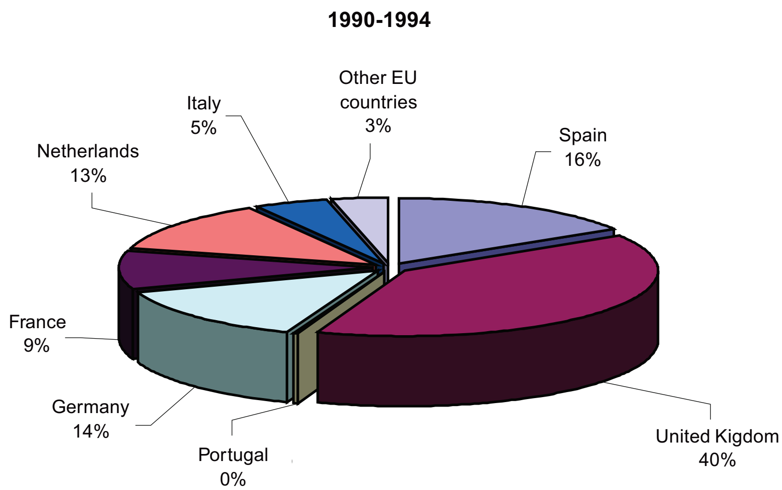
Source: ECLAC, Unit on Investment and Corporate Strategies.

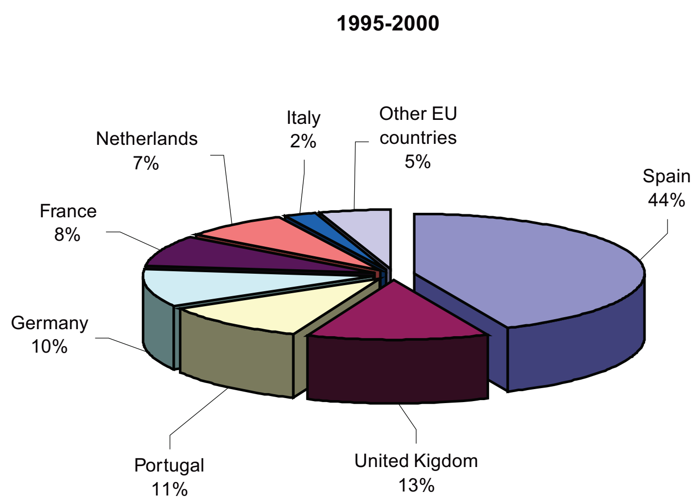
but, unlike firms based in France, Germany and the United States, they have concentrated their investment outside the automotive, electronics and engineering industries. In fact, the largest investments by these firms have been in the non-durable consumer goods and chemical industries (see figure III.5). Particularly noteworthy is the broad regional presence of United Kingdom-based firms such as Unilever, British American Tobaccos (BAT) and Diageo (see box III.4). A substantial portion of these firms' industrial base was established in Latin America during the import substitution period. In the 1990s, they applied a strategy of expansion based on the acquisition of local firms combined with new investment to equip their Latin American subsidiaries, especially those that supply large markets (Argentina, Brazil and Mexico), with modern production technology (see table III.9).

A more recent phenomenon is investment from the United Kingdom in the area of services. By the end of the 1990s, for reasons similar to those of other European investors, United Kingdom-based telecommunications firms (Vodafone AirTouch, British Telecom (BT) and National Grid PLC) and financial firms (HSBC Holding PLC) had acquired various assets in the region. However, one activity sets United Kingdom investors apart –their investment in petroleum and hydrocarbons. One of the most active firms is BP Amoco, which –with investments in petroleum and natural gas exploration and exploitation in Argentina, Bolivia, Brazil, Colombia and Venezuela– has become one of the foremost companies operating in this sector in the region. Together, the activities of BP Amoco and those of the Anglo-Dutch firm Royal Dutch/Shell represent an enormous investment in this sector (see chapter IV of this publication). The United Kingdom has thus become the European investor with the most diversified presence in Latin America.

The other European Union countries have focused their investments on MERCOSUR, particularly Brazil.

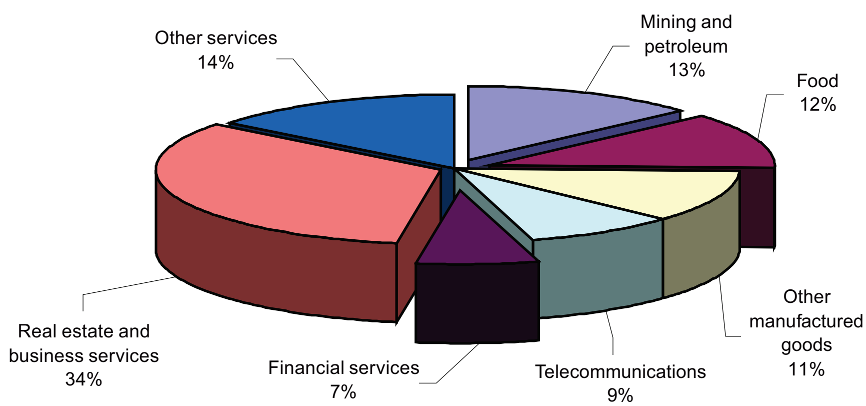
Figure III.4
EUROPEAN UNION: PRINCIPAL SOURCES OF FOREIGN DIRECT INVESTMENT IN LATIN AMERICA, 1990-2000
(Percentages)





Source: ECLAC, Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, based on information from Inter-American Development Bank (IDB), Foreign Direct Investment in Latin America: The Role of European Investors, Ziga Vodusek (comp.), Paris, 2001.

Figure III.5
UNITED KINGDOM: FDI STOCKS IN LATIN AMERICA, BY ECONOMIC ACTIVITY, 1999
(Percentages)



Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of information prepared by the United Kingdom Office for National Statistics, published in Edmund Amann, "United Kingdom", in Inter-American Development Bank, Foreign Direct Investment in Latin America: The Role of European Investors, Ziga Vodusek (ed.), Paris, 2001.

French firms have followed this pattern, achieving significant market shares in some recently developed areas of activity such as retail trade (Carrefour-Promodès) and sanitation services (Groupe Suez). Portugal, taking advantage of its cultural and linguistic ties with Brazil, has concentrated its internationalization efforts on this South American giant (see table III.9 and figure III.4).

Thanks to the enormous flows of FDI from the European Union, European companies are now among the most important firms in Latin America and among the largest TNCs with a presence in the region. Indeed, the expansion of the activities of firms with an established Latin American presence, coupled with the arrival of newcomers, has transformed European firms into key players. Of the 10 biggest TNCs in Latin America, 7 are from Europe and 3 from the United States; of the 25 biggest, 12 are based in the European Union, 11 in the United States, 1 in Switzerland and 1 in Japan.

Several distinct patterns are evident in the positioning of European investors in Latin America. The strategy adopted by Spanish and Portuguese firms stands out in this regard. For example, Telefónica de España, in a very brief period, has become the largest foreign firm in the region, as a result of which more than 50% of its sales revenues are now generated in Latin America. The Spanish firms Endesa España and Repsol-YPF and the Portuguese firms Eletricidade de Portugal, Portugal Telecom and Sonae Distribuição are in a similar situation. A second group consists of firms, especially in the manufacturing sector, with a long-standing regional presence. Noteworthy in this group are automotive firms (Volkswagen, Fiat SpA, DaimlerChrysler and Renault) and mass producers of consumer goods (Parmalat, Danone, Unilever and Rhône-Poulenc). In the case of the latter group, Latin America accounts for over 10% of their total earnings (see table III.11).

Although the European Union has had some difficulties in structuring a common foreign policy, its relations with Latin America have been favoured by the strong cultural affinity between the two regions, which derives from their historic ties, similarities in their political traditions and large volumes of migration from Europe to the Americas.

The European Union's policies towards Latin America have varied considerably over the years. Nevertheless, even within this diversity, there has been a consistent emphasis by Europe on independence and mutual benefit in its relations with the region. Each region or country has thus been able to develop its own potential in its interactions with the Union, in keeping with its particular level of development. Until the 1980s, relations between the European Union and Latin America were confined to cooperation agreements, financial and technical assistance and trade preferences in the framework of the Generalized System of Preferences (GSP). Some areas have benefited from European cooperation (especially in relation to democracy, peacemaking and drugs), while other areas with higher levels of development have become significant economic partners in activities of mutual interest. The end of the cold war brought an increase in such partnerships as commercial and economic factors gradually replaced ideological and military considerations as the basis for international relations.[17] Thus, Europe used two main instruments to reinforce interregional ties: on the one hand, the negotiation of gradual, reciprocal agreements on free trade with the Southern Common Market (MERCOSUR), Mexico and Chile, and, on the other, the maintenance of special treatment for less developed countries under a revised GSP for the Andean and Central American countries (see box III.1).

Table III.11
LATIN AMERICA: RELATIVE IMPORTANCE OF THE 30 LEADING EUROPEAN TNCs, 2000
(Percentages)

Ranking a	Ranking b	Firm	Country	Sector	Share of Latin America in total sales (%)
168	1	Telefónica España	Spain	Telecom.	56.7
5	3	DaimlerChrysler	Germany	Automotive	9.2
21	4	Volkswagen	Germany	Automotive	17.2
37	5	Groupe Carrefour-Promodès c	France	Commerce	20.3
80	6	Repsol-YPF	Spain	Petroleum	24.9
47	8	Fiat SpA	Italy	Automotive	13.9
6	10	Royal Dutch/Shell Group	Netherlands	Petroleum	4.3
365	13	Endesa España	Spain	Electricity	37.3
72	16	Unilever PLC	United Kingdom	Food	10.6
156	17	Olivetti SpA	Italy	Telecom.	15.8
58	23	Royal Ahold N.V.	Netherlands	Commerce	7.8
133	24	L.M. Ericsson	Sweden	Electronics	12.1
23	30	Siemens AG	Germany	Electronics	4.2
99	31	Renault S.A.	France	Automotive	8.4
...	32	Portugal Telecom	Portugal	Telecom.	63.5
...	34	Pirelli SpA	Italy	Tyres	30.0
...	36	Parmalat	Italy	Food	27.0
111	35	BASF AG	Germany	Chemicals	5.9
...	39	Casino Guichard-Perrachon	France	Commerce	8.2
124	46	Électricité de France	France	Electricity	5.5
107	47	Royal Philips Electronics	Netherlands	Electronics	4.8
393	49	Groupe Danone	France	Food	11.5
...	50	Sonae Distribuição	Portugal	Commerce	23.3
...	51	IBERDROLA S.A.	Spain	Electricity	23.3
150	54	Bayer AG	Germany	Chemicals	7.9
261	56	British American Tobacco PLC (BAT)	United Kingdom	Tobacco	7.7
127	60	France Telecom	France	Telecom.	4.0
94	63	Deutsche Telekom	Germany	Telecom.	3.2
...	64	Eletricidade de Portugal	Portugal	Electricity	33.3
...	65	Rhône-Poulenc	France	Chemicals	7.7
7	70	BP Amoco PLC	United Kingdom	Petroleum	0.7

Source: ECLAC, Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management.
[a] Ranking among the world's largest corporations (Fortune, 2001). [b] Ranking among the largest TNCs operating in Latin America. [c] The French firms Carrefour and Promodès merged in 2000.

[17] Mutual interest in bolstering interregional relations led to the convening of the first Summit of Heads of State and Government of the European Union and Latin America and the Caribbean, held in Rio de Janeiro in June 1999. The second Summit took place in Madrid in May 2002, and the third will be held in Mexico in 2004.

Box III.1
THE DYNAMICS OF THE RELATIONS BETWEEN LATIN AMERICA AND THE EUROPEAN UNION

In the second half of the 1990s, political and economic relations between the two regions intensified and evolved as Latin America asserted its own identity and established with Europe a bond different from the one it has with the United States. This relationship is reflected in the European Union's support for integration in Latin America, its formal and explicit acceptance of the concept of "shared responsibility" with regard to the global drug problem, its relative generosity as a supplier of official development assistance (ODA) and its support for the reintegration of Cuba into the Latin American community. Moreover, European policies have taken the region's heterogeneity into account in order to build ties that are better adapted to the characteristics and needs of each country and subregion. On the one hand, priorities framed within the concept of mutual benefit have been established with the most advanced economies: Chile, MERCOSUR and Mexico. On the other, special treatment has been accorded to the Andean Community and Central America, as preferences under the GSP have been maintained and ODA has been focused on actions to address issues such as drug trafficking, poverty, natural disasters, consolidation of democracy and support for integration processes.

MERCOSUR: At the 1999 Summit of Heads of State and Government, the European Union and MERCOSUR adopted a document affirming their intention to seek a gradual and reciprocal liberalization of bilateral trade, without excluding any area, in accordance with the rules of the World Trade Organization (WTO). That same year, the European Union-MERCOSUR Biregional Negotiations Committee was established and formal negotiations were opened. The first four rounds proceeded rather tentatively, with discussions revolving around general issues (political dialogue, cooperation and trade matters). The fifth round, held in Montevideo in July 2001, marked a crucial turning point in the negotiations, as the Union presented its tariff offer. That offer was considered too restrictive, especially in regard to market access for agricultural products, owing to the limitations imposed under the Union's common agricultural policy (CAP). At the next round, which was held in Brussels from 29 to 31 October 2001, MERCOSUR presented a counteroffer. The most recent round, which took place in Buenos Aires from 8 to 11 April 2002, was intended to serve as a forum for the exchange of views in preparation for the Summit of Heads of State and Government of the European Union and Latin America and the Caribbean, held in May 2002 in Madrid. Those discussions, together with the problems faced by the MERCOSUR countries –particularly Argentina– have slowed the pace of the negotiations.

Chile: In the mid-1990s, Chile and the European Union signed a framework cooperation agreement that entered into force in 1999. This agreement was intended to lay the groundwork for political and economic association between the European Union and Chile, in addition to creating a bilateral free trade area. To that end, the parties began to consider the feasibility of launching negotiations for a political and economic association agreement. As in the case of MERCOSUR, a mandate to begin the negotiations was issued, but the process with Chile was much faster and more expeditious. Although the trade issues involved were equally complex, especially with respect to agricultural products, Chile has utilized its open agenda for international negotiations to advantage. As a result, at the Second Summit of Heads of State and Government, held in Madrid in May 2002, Chile and the European Union signed an association agreement on political dialogue, cooperation and trade, which expands the areas of cooperation and includes a free trade agreement between the two parties that will liberalize more than 90% of bilateral exchanges in less than 10 years. This agreement will also open up the service sector and establish preferential conditions for investment.

Mexico: In this case, as with Chile, the European Union broke with its traditional strategy of negotiating with economic blocs in Latin America. Currently, bilateral relations between the European Union and Mexico are based on an agreement on economic partnership, political coordination and cooperation, which was signed in 1997 and took effect in 2000. This agreement is similar to the ones with MERCOSUR and Chile, but it has resulted in much faster progress, including the establishment of the first free trade area between the European Union and a country (or region) in Latin America (the Free Trade Agreement between Mexico and the European Union). The speed of the negotiations may be due in part to Mexico's new status as a member of the Organisation for Economic Co-operation and Development (OECD) and, especially, as a party to the North American Free Trade Agreement (NAFTA) (ECLAC, 2000). After nine rounds of negotiations between the Mexican and European delegations, a broad agreement was reached to achieve the progressive and reciprocal liberalization of bilateral trade while recognizing the economic asymmetries between the European Union and Mexico. In 2000, the Union eliminated 82% of its tariffs on industrial goods and agreed to do away with tariffs on all such goods as of 1 January 2003. On the Mexican side, the liberalization process will occur in four stages. In 2000, Mexico lifted duties on 48% of industrial imports coming from Europe. By 1 January 2003, 52% of its imports from the European Union will be duty-free, and an agreement has been reached to dismantle the tariff structure and to apply a maximum tariff of 5% as from 2003. After that date, although the liberalization of trade in European manufactured goods will not have been fully completed, exports from the Union will have access to the Mexican market under the same conditions as products from the United States and Canada. In the agricultural sector, liberalization will take place gradually

Box III.1 (concluded)

country outside its traditional sphere of interest and immediate geographical influence.

Andean Community: The two parties' relations in a wide spectrum of areas have been quite fruitful in recent years. A joint declaration on political dialogue was signed in 1996. Since November 1990, in the framework of the concerted effort to address the problem of drug trafficking, the European Union has granted exports from Andean Community countries preferential access to the European market under a special scheme of preferences (Andean GSP). Under this system, most industrial products and a specific list of agricultural and fisheries products imported by the Union are exempt from tariffs. The GSP preferences were recently extended through 31 December 2004. At the most recent meetings on political dialogue between the European Union and the Andean Community, the Andean countries put forward a proposal for a new partnership agreement that would take the two regions' levels of development into account and preserve the current system of preferential access to the European market. The authorities of the two blocs are currently studying the possibility of restructuring their relationship.

Central America: In 1984, at a time of severe political crisis in the subregion, the first meeting of ministers for foreign affairs of the European Union and Central America was held. This process has continued under the name "San José Dialogue." Its objective has been to seek solutions to the armed conflicts in the subregion by means of dialogue and negotiation. Political support from the European Union was backed up by a special cooperation programme aimed at addressing the socio-economic causes of the crisis. Over the last two decades, the European Union has made a significant contribution to the peace and democratization processes and also to the economic integration of the subregion. In recent years, in view of the new political, economic and social conditions in Central America, the tone of the relations between the two parties has begun to change somewhat, with the focus shifting more towards shoring up the peace process and bolstering democracy and economic and social development. A framework agreement on cooperation between the European Union and Central America entered into force in 1999. In the area of trade, the subregion, like the Andean countries, has benefited from the GSP, under which more than half of its exports to the European Union enter duty-free.

Source: ECLAC, Unit on Investment and Corporate Strategies, on the basis of information supplied by the European Commission.

B. BUSINESS STRATEGIES OF EUROPEAN TNCS IN LATIN AMERICA

When the characteristics of the European Union firms present in Latin America are analysed, two distinctive types stand out. In one group are those firms that have been in the region for several decades –the leaders in the import substitution phase–, which have concentrated basically on manufacturing activities. A second group comprises newer firms that arrived in Latin America in the 1990s, taking advantage of the opportunities offered by the privatization of State-owned assets. This process has been directly linked to the development of the European Union and to the economic reforms carried out on both sides of the Atlantic in the service and infrastructure sectors.

The strategic motivations of these two groups of firms also differ. While the manufacturing companies are seeking to increase their overall efficiency in Mexico and to gain access to markets in MERCOSUR, the service industries are pursuing access to domestic and/or regional markets (ECLAC, 2001; ECLAC, 2000; ECLAC, 1998). Meanwhile, the European firms involved in the exploration and exploitation of hydrocarbons are a special case (for further details, see chapter IV of this publication). Below is an analysis of the strategies, characteristics and behaviour patterns of the largest European TNCs present in Latin America, together with the factors that have influenced their activities in the region.

1. Manufacturing: a segment dominated by the traditional European firms that first came to Latin America

European manufacturers have a long-standing tradition of investment in Latin America. At first, such investments were part of a strategy for gaining access to local markets under the import-substitution model of industrialization. European firms created miniature replicas of their most important subsidiaries to supply Latin American markets with items produced locally. The principal investments in the manufacturing sector have come from Germany and the United Kingdom and, to a lesser extent, Italy and France, and are concentrated basically in the automotive, food and beverage and chemical industries.

(a) The automotive industry: the MERCOSUR wager

Subsidiaries of European firms in Latin America were first established in the 1950s. The main ones were Volkswagen, Fiat, Citroën, Peugeot, Renault and Scania. At the time, Latin American authorities were implementing policies aimed at stimulating the development of the automotive sector, which they saw as a linchpin of the industrialization process. The presence of European firms grew steadily, especially in the largest countries of the region.[18] In the 1980s, in response to the difficult situation of the Latin American economies, the European firms began to downsize their operations, rationalize costs and minimize investment, especially in the MERCOSUR countries. In this context, some firms decided to withdraw from the market, while others turned over control of their subsidiaries to local entrepreneurs (see chapter II of this publication). The European firms thus began the 1990s with a rather passive strategy in the region, as they shifted their focus to other parts of the world, such as Europe, Asia and North America.

With the introduction of structural reforms and the advent of better economic prospects in Latin America, industry patterns began to change. The European TNCs redirected their regional strategies markedly, expanding their operations and investing heavily in Brazil and Argentina, in the context of MERCOSUR, and to a lesser extent in Mexico, in order to take advantage of the opportunities afforded by the North American Free Trade Agreement (NAFTA). Several of these firms thus joined the ranks of the most powerful companies in the region (see table III.11 and annex I-A.4).

In the 1990s, European automotive firms showed renewed interest in MERCOSUR as the subregional grouping evidenced a strong increase in demand. Furthermore, in the policy sphere, various mechanisms were put in place to attract TNCs. In this climate, the foreign firms redesigned their operations and expanded their production activities. Accordingly, they implemented new investment projects, built new plants for the production of motor vehicles and parts and regained control of the subsidiaries that had previously been turned over to local industrialists.

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[18] Volkswagen opened its first plant in Brazil in the 1950s. It then moved into Mexico and, in the 1980s, Argentina. Renault built a production plant in Mexico and another in Argentina in the 1970s. Fiat carried out various services associated with the automotive industry in Argentina in the 1950s, and in 1960 built its first production plant. The company began making cars in Brazil in 1973.

The firms currently producing on the largest scale in Latin America are those with the longest history in the region, including Volkswagen, Renault, Fiat, Peugeot-Citroën, BMW, DaimlerChrysler and Volvo. In 1997, Renault regained control of the subsidiary it had transferred to the Argentine company CIADEA and, together with its Brazilian subsidiary, set out to make MERCOSUR the second biggest market worldwide for this French firm. Volkswagen, meanwhile, ended its partnership with Ford and began to produce on its own again. It also launched a series of projects designed to boost its regional production (see box III.2). In 1997, Fiat returned to Argentina, building a new plant in Córdoba, in which it invested some US$ 600 million. In Brazil, this Italian company has undertaken more diversified activities, branching out into related areas such as motor vehicle parts, lubricants and agricultural and road construction equipment (Basto and others, 1999). The French firm Peugeot also regained control of its subsidiary in Argentina and initiated production activities in Brazil. In general, the largest operations were established in Brazil to take advantage of the region's largest domestic market.

In recent years, as a consequence of macroeconomic turbulence and the fall-off in domestic demand, the chief strategy of the European automotive firms has been to coordinate their regional operations. The difficult situation in Argentina has forced companies to streamline their operations and has created a new environment, to which they are adapting quickly. Fiat, Renault and Volkswagen have modified production lines, reduced shifts and even closed plants in an attempt to adapt to regional conditions in the industry (see chapter II of this publication).

Revamping their strategies has led the European automotive firms to increase their presence in Mexico. In addition to global conditions in the industry, local factors such as sectoral policies and the signing of NAFTA have been decisive in attracting some European TNCs. The case of Volkswagen is particularly interesting in that, though the company had long been established in the Mexican market, it recently made large investments to expand its activities and adapt its productive processes so as to comply with the NAFTA rules of origin and thus gain access to the United States market (see box III.2).

At the same time, several European firms that had not previously been present in Mexico, including BMW and Daimler-Benz, decided to invest in new assembly plants. Initially, these firms sold only on the local market, but in recent years they have also begun to export. BMW, for example, has specialized successfully in luxury cars. Renault, meanwhile, through its partnership with Nissan, has re-established production operations in Mexico. In 2000, the company began producing the Scénic, the first model produced by the Renault-Nissan alliance anywhere in the world.

(b) The food and beverage industry: milking the potential of regional investment

European food and beverage companies also have an extensive and long-standing presence in Latin America. These firms arrived in the region decades ago with the aim of supplying domestic markets during the import substitution period. Today, four of the five largest European food and beverage firms have operations in Latin America: Nestlé (Swiss),[19] Unilever (Anglo-Dutch),[20] Groupe Danone (French) and Parmalat (Italian).[21]

In the 1990s, the European enterprises already in the region expanded their presence and many firms that were not established in Latin America decided to set up shop, especially in MERCOSUR and Mexico. The region's high market growth potential and unmet demand played a preponderant role in this process. Moreover, in the early years of the decade, consumption increased appreciably, spurred by the increase in urbanization and the growing importance of major supermarket chains (Nofal and Wilkinson, 1999). In addition, when MERCOSUR was formed, it aroused great expectations as a subregional market for manufactured goods, especially in certain areas, such as the dairy sector. Finally, in Europe, the consolidation of the European Union, with the consequent growth in competition, led to a decline in industry profits, creating an incentive for investment in other regions such as Eastern Europe and Latin America.

The European firms with a regional presence in the food and beverage industry can be grouped into three categories. First are the major TNCs that have had production operations in the region since the early part of the last century and were among the first to internationalize their activities. A second group comprises firms that arrived in the region later, have lower

19 While the Swiss firm Nestlé is not considered a European Union TNC, it is one of the oldest and most important European firms in Latin America.
20 Unilever is mainly involved in the chemical industry and will therefore be examined in greater detail below.
21 Another important firm is the United Kingdom-based company Diageo.

Box III.2

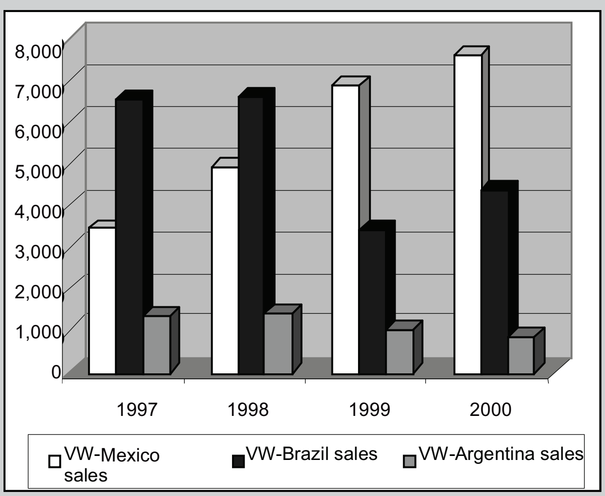
VOLKSWAGEN'S STRATEGY IN LATIN AMERICA

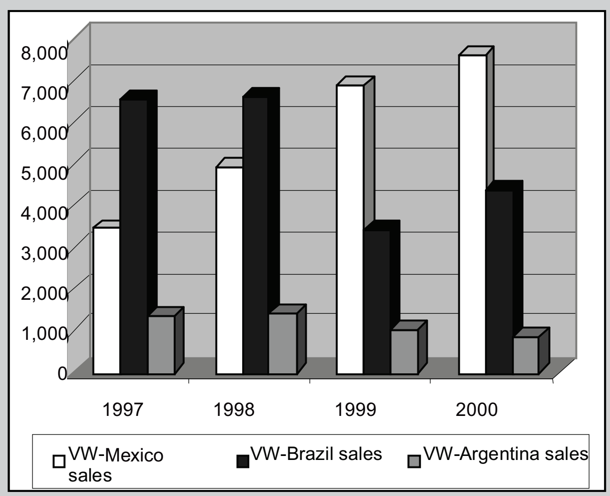
The German firm Volkswagen (VW) is one of the biggest automotive companies in the world and offers one of the most interesting examples of European investment in the manufacturing sector in Latin America. Volkswagen's activities in the region are concentrated in Mexico and the MERCOSUR countries. Its strategies are different in each case. In Mexico, VW established its principal production base for the NAFTA member countries. To do so, it had to develop new methods of quality assurance and control and, at the same time, adapt its production to the NAFTA rules of origin. This translated into huge FDI inflows and a substantial increase in sales. The latter, which totalled US$ 509 million in 1990, rose to US$ 1.2 billion in 1995 and exceeded US$ 7 billion in 2000. In addition, Mexican production was quickly directed towards external markets. Whereas in 1990, 130,000 units were sold in Mexico and only 50,000 were exported, in 2000, 60,000 units were sold domestically and nearly 350,000 were exported. In 1997, VW launched one of its most ambitious projects in Mexico: exclusive production of the new Beetle for the world market.

In Argentina and Brazil, Volkswagen's expansion of its production base was directly linked to the establishment of MERCOSUR. In Brazil, the firm's production has grown steadily and production patterns have been adapted to reflect new market trends, especially through progressive specialization in compact cars. The company currently produces a wide range of compacts. VW-Brazil accounts for close to 10% of the group's total sales worldwide. Although production is oriented mainly towards the domestic market, in recent years the volume of exports has grown. Brazil also boasts Volkswagen's only plant for the production of trucks, a market segment in which the company has experienced enormous growth and has even managed to outpace traditional truck producers such as Volvo and Scania. These operations are distinguished by their high degree of efficiency and perfect adaptation to the needs of the local market. VW is now reportedly assessing the feasibility of making Brazil a platform for exporting trucks to supply the world market. In contrast, in Argentina, the firm's strategy consists of exporting automobile production surpluses to Brazil and importing a similar number of cars from that country to increase the range of products on the domestic market. The level of sales is lower in Argentina than in Brazil, but exports account for a significantly higher proportion –around 40% of sales.

VOLKSWAGEN: SALES AND EXPORTS IN LATIN AMERICA

(Millions of dollars)





Source: Volkswagen (2001).

Volkswagen's experience is extremely interesting because the firm has been operating for many decades in Latin America and has adapted its strategies over the years in response to new prospects and conditions that have arisen in the region. The company's investments in Argentina and Brazil reflect its effort to gain access to regional markets for manufactured goods in the framework of MERCOSUR. Mexico, on the other hand, is part of Volkswagen's integrated international production system, and the company's strategy there is to increase its efficiency in order to expand its access to the global market, especially the North American market.

Source: ECLAC, Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, and Volkswagen (2001).

sales levels and target more specific market segments. These two groups of firms have the largest scale of operations and the widest regional presence. Their strategy seeks to take advantage of and gain access to local and subregional markets (such as MERCOSUR). A third group has followed a completely different pattern: it consists of small companies, operating in specific domestic markets, that are engaged primarily in extracting raw materials for processing and subsequent export.

The firms that arrived in the first decades of the twentieth century decided to establish production operations after supplying the region through exports. First they established themselves in the largest economies and then gradually moved into almost all the countries in the region (see table III.12). Today, their main objective is still to supply local markets. They practise a kind of horizontal investment, with a small export component and with similar functions, activities and products in the different countries. The most important of these firms are Nestlé and Unilever, global leaders with a long tradition that have a wide variety of product lines spanning different segments of the market.

In the 1990s, these firms strengthened their presence in the region through new investments and several strategic acquisitions. For example, Nestlé expanded its operations in Brazil by purchasing small manufacturers of chocolate and ice cream. Unilever employed an aggressive expansion strategy in the region that included the purchase of Brazil's largest ice cream producer, Kibon, for US$ 930 million. As a result of their expanded regional presence, these firms have strengthened coordination among their various subsidiaries, which makes it likely that intraregional exports will increase.

Table III.12
LATIN AMERICA: OPERATIONS OF THE LARGEST EUROPEAN FIRMS IN THE FOOD AND BEVERAGE SECTOR, 2000
(Year in which activities started and millions of dollars)

Firm	Home country	Brazil	Argentina	Mexico	Chile	Colombia	Consolidated sales 2000
Nestlé [a]	Switzerland	1921	1913	1935	1934	1944	5,283 [b]
Danone	France	1970	1994	1973	...	...	1,519
Parmalat [c]	Italy	1974	1992	1995	1994	1994	1,850 [d]
Unilever	United Kingdom	1929	1925	…	1954	....	5,160

Source: ECLAC, Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management.
[a] Nestlé also has operations in Peru, Ecuador and Paraguay.
[b] Includes operations in Mexico, Brazil, Argentina and Chile.
[c] Parmalat also has operations in Uruguay, Venezuela, Ecuador, Nicaragua, Dominican Republic and Cuba.
[d] Reflects only sales in South America.

Among the more recent arrivals in Latin America, Danone and Parmalat are particularly worthy of note.[22] Establishing themselves in the region –basically in Argentina and Brazil– was the first step in the process by which these firms internationalized their production. However, after European firms had rapidly expanded their presence in the region in the 1970s, investment levelled off. In the 1980s, European firms basically focused on maintaining their activities, without enlarging their operations. In the following decade, these TNCs began to exhibit renewed interest in Latin America, especially in the dairy sector, as a result of the Uruguay Round, which generated high expectations of a better international environment for exports to third markets. The fact that Brazil, at the time, was the world's leading importer of dairy products created a huge incentive for foreign firms to expand their operations within MERCOSUR. Thus, this was one of the sectors that benefited most from the formation of MERCOSUR, which spurred investment, consumption and exports.

In this context, Parmalat made sizeable investments in Uruguay and Argentina with the aim of supplying local and subregional markets (see box III.3). Danone, too, expanded and diversified its activities in the region, mainly through the acquisition of firms with well-positioned brands and through strategic partnerships with

22 Groupe Danone established itself in Brazil in 1970 by acquiring a local firm. In 1973, it expanded into Mexico through a partnership with local businesses. The Italian firm Parmalat arrived in Brazil in 1972.

Box III.3
PARMALAT: FROM BRAZIL TO THE REST OF THE REGION

In 1974, the Italian firm Parmalat chose Brazil as the site of its first production operations in Latin America. For Parmalat, the Brazilian market offered access to a large developing economy with great potential. Although initially it produced only yogurt, it soon diversified its operations and added other product lines. However, the firm did not really begin to extend its presence in the region until the 1990s.

Parmalat first expanded within Brazil by acquiring more than 15 processing plants. Then it gradually moved into the rest of the region: Argentina and Uruguay in 1992; Chile, Venezuela, Paraguay and Colombia in 1994; and Mexico and Ecuador in 1995. Parmalat-Brazil played a crucial role in this process as the coordinator of the firm's regional strategy. Latin America thus became a main focus of Parmalat's efforts to internationalize its production in the world. This expansion boosted its revenues substantially. Between 1994 and 2000, sales in South America grew at an average annual rate of 24%, amounting to US$ 1.85 billion in 2000 (27% of Parmalat's total sales). Today, Parmalat has production facilities in all the South American countries except Peru and Bolivia, and also in Mexico, Nicaragua, the Dominican Republic and Cuba. Its products are sold mostly on domestic markets, and its principal operations are located in the region's largest markets: Brazil, Argentina, Mexico and Venezuela.

In recent years, Parmalat's strategy has been characterized by the acquisition of smaller firms and the introduction of new products, especially in Brazil. In Argentina, though the current recession has sharply reduced both demand and prices, Parmalat has maintained its market position and has focused mainly on integrating the activities of several small firms acquired in 1999 (see chapter II of this publication). In Mexico, while Parmalat is still not earning high revenues, the firm is expected to improve its market share in the near future. In 2001,the firm announced the construction of a new distribution centre and a water treatment plant in the state of Jalisco.

Parmalat's experience in the region shows how the international and regional environment in the industry can induce companies to redefine their strategies in Latin America. The Italian firm's new approach has been characterized by greater emphasis on the region in its global strategy and by substantial investment through acquisitions and the opening of new production plants, especially in the region's largest markets, but also expansion into most of the countries in the region.

Source: ECLAC, Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, on the basis of information from Parmalat (2001).

local groups.[23] Danone currently has operations in Argentina, Brazil, Mexico and Colombia; it is the second largest producer of mineral water in Latin America and the leading producer of fresh products in Brazil, Mexico and Argentina.

(c) The chemical industry: progressive concentration in Brazil

Investment in the chemical industry in Latin America is another high-priority focus for European transnational manufacturers. European capital has been present in the industry for decades, and investment by European chemical firms in the region is a long-standing tradition. Their strategy has basically been to target local markets, focusing especially on Brazil. The pattern has thus been very similar to that of the food and beverage industry: traditional firms whose origins date back to the early years of the last century focused on the largest markets and came to prominence during the import substitution period. In addition, the activities of chemical firms have generally not been oriented towards export, and the scale of their operations has depended on market size, economic performance and trends in domestic demand.

Following the lead of the first TNCs in Latin America, other European firms began to expand into

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23 Danone expanded its presence in Brazil, gaining a share of the biscuit and sweets segment by purchasing the local firm Campineira. In Argentina, meanwhile, it set up operations in 1994 with the acquisition of a 51% interest in the firm Bagley for US$ 240 million (it acquired the remaining 49% in 1999). In the dairy sector, in 1996 Danone entered into a partnership with the local group Mastellone, one of the principal producers in Argentina. Initially, this alliance was limited to the production of cheeses and desserts, but gradually the two companies have expanded into dairy products. To that end, Danone acquired two dairy firms: Villa Alpina in 1997 and Cindor two years later. Recently, it purchased two mineral water companies, Villa del Sur and Villavicencio, for which it invested US$ 200 million.

other countries of the region.[24] Over time, these firms consolidated their activities in the various countries of the region, and today the European presence includes some of the oldest and most prestigious TNCs in the industry at the local, regional and global levels. Of the 10 most important chemical companies in the world, six are European and all have subsidiaries in Latin America. This is true of the French firm Aventis (the product of the merger between Hoechst and Rhône-Poulenc), the United Kingdom-based Unilever and GlaxoSmithKlein and the German firms Merck,[25] BASF and Bayer. Other important chemical manufacturers, though they are not based in the European Union, are the Swiss firms Novartis and Roche Holding AG, which also have affiliates in the region.

These firms have highly internationalized operations and an extensive presence in various geographical areas. Germany is currently the main source of European investment in the chemical industry; this reflects the high degree of internationalization of its manufacturing industry (Jungnickel and Shams, 2001). Although their main operations are in the largest markets, German chemical firms have a widely diversified presence throughout the region.

In general, TNCs have been the most important players in the chemical industry in Latin America, thanks to their know-how and experience with regard to processes, products and technologies. European TNCs have historically dominated the industry in the region, although some local suppliers and firms are also fairly active, especially in Brazil. As in other industries, the globalization process, new competitive conditions within the European Union and new strategic approaches by firms have prompted a number of mergers and acquisitions in the chemical industry. In addition to offering economies of scale, these mergers help to strengthen and expand the firms' presence in different regions, improve the efficiency of their global and regional operations –through economies of specialization at the geographical level– and provide a greater impetus for research and development activities, which are crucial in this industry.

The new corporate and strategic approaches have been reflected in the behaviour of European enterprises, with important implications for Latin America. The mergers among these firms have consolidated, expanded and concentrated their presence in the region, which, in turn, has boosted the growth of the subsidiaries of the resulting firms while increasing their market power in the Latin American economies. This was true of the merger between the German firm Hoechst and the French firm Rhône-Poulenc, which gave rise to Aventis. The new firm has a wide regional presence, with operations in Mexico, Argentina, Brazil, Uruguay, Venezuela and Colombia. Another example is the merger of Glaxo and SmithKline at the end of 2000, which resulted in a firm with activities in Mexico, Argentina, Chile and Brazil.

European firms are currently present in most Latin American countries, but their biggest operations are located in the biggest markets, especially Brazil and, to a lesser extent, Mexico and Argentina. Generally speaking, the region is not terribly important in terms of the global market for these firms, whose principal activities are in the European and North American markets and, increasingly, in the emerging markets of Asia (see table III.11). The most important firms in the region are Unilever, Bayer, BASF and Aventis (see table III.13).

In the first half of the 1990s, investment by European firms grew as a result of favourable economic conditions in the largest markets: Mexico, Brazil and Argentina. However, in recent years, investment has tapered off owing to macroeconomic instability and weak growth in regional consumption. The exception, again, is Brazil, whose local and inter-industry dynamism –especially in terms of links with petrochemicals– has made it an attractive target for investment by chemical firms.[26]

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24 The first chemical company to establish itself in the region was the German firm Bayer, which started production in Brazil in 1896. The German firm BASF came to Brazil in 1911, and Bayer expanded its activities to Argentina (1911) and Chile (1914). In 1919, the French firm Rhône-Poulenc entered the Brazilian market. Unilever also set up operations in the region in the early 1900s, concentrating on Argentina (1925) and Brazil (1929). Other firms arrived later, including Merck, which opened branches in Chile and Argentina in 1939 and in Mexico in 1955. BASF moved into Argentina in 1950 and into Mexico in 1964, and Unilever expanded into Chile in 1954. Glaxo commenced operations in Brazil in 1948 and expanded into Mexico in the 1960s.

25 The Merck group produces mainly drugs and laboratory products. However, it is also actively involved in the production of chemicals.

26 In the last year, for example, the German firm BASF announced a major investment project, worth more than US$ 450 million, in South America –mostly in Brazil– to modernize and open up new factories. Aventis, too, plans to invest US$ 170 million in the development of industrial projects in Brazil, Mexico and Venezuela.

Table III.13
MAIN EUROPEAN CHEMICAL FIRMS IN LATIN AMERICA: SALES IN MAJOR MARKETS, 2000
(Millions of dollars)

Firm	Home country	Argentina	Mexico	Brazil	Total for Latin America	Percentage of total
Unilever	United Kingdom	767	648	2,634	5,160	12.0
BASF	Germany	224	635	1,097	2,509	5.9
Bayer	Germany	343	616	580	2,264	7.9
Aventis	Germany/France	116	…	236	…	…

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

Box III.4
UNILEVER: THE CHEMICALS AND FOOD GIANT

Unilever is currently one of the largest producers of mass consumption goods in the world. Its activities are concentrated mainly in the food and chemical sectors, and it exemplifies one of the most traditional types of European investment in Latin America. For decades, Unilever gradually strengthened its presence and, at the same time, started operations in smaller markets. Today, the firm has production facilities in Brazil, Argentina, Chile, Mexico, Peru, Bolivia, Costa Rica, El Salvador, Guatemala, Honduras, Panama, the Dominican Republic, Trinidad and Tobago, Jamaica, Cuba and Haiti. The activities of this Anglo-Dutch firm in local markets have been linked to the size of those markets and to trends in consumption and demand. Very little of its production has been exported.

Close to 80% of Unilever's activity is concentrated in Brazil, Mexico and Argentina. Brazil, in particular, accounts for more than 50% of regional sales. Recently, Unilever devised a new corporate strategy, known as the "Path to Growth" strategy, under which two major divisions were created: (1) Foods and (2) Home and Personal Care. The firm also created a new product line: Unilever Bestfoods. The aim of these changes is to focus on the fastest-growing brands and to strengthen global brands without completely eliminating the presence of local or regional brands. The idea is to create a more focused, streamlined business while also achieving more growth.

At the same time, Unilever has begun to manage its activities in Latin America from a regional perspective. Its operations in various local markets are being complemented by the formation of sub-zones. For example, Unilever Río de la Plata comprises Unilever de Argentina, Sudy Lever de Uruguay and Unilever Capsa de Paraguay. The Andean region encompasses Colombia, Ecuador and Venezuela. The company's plants in Chile and Brazil are the regional centres for the production of toothpaste, which is exported to Peru, Colombia, Venezuela, Bolivia and the Caribbean.

Unilever has thus adapted quickly to the new conditions in global markets and, in particular, to those of Latin America by establishing subregional operations and strengthening the ties between its various subsidiaries throughout the region.

Source: ECLAC, Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management; Unilever (2001); interviews with Niall FitzGerald, Chairman of Unilever, in El Mercurio (13 October, 2001).

2. Service and infrastructure sectors: the new magnet for European investment

The vast majority of European investment in the service sector in Latin America has taken place since the second half of the 1990s. The central feature of these capital flows is that they have been directly linked to the new strategies that began to take shape among European firms as a result of changes in the European Union environment. At the same time, the countries of Latin America have implemented sweeping reform plans, characterized by the opening, liberalization and deregulation of markets; carried out large-scale privatizations; and established institutional and regulatory frameworks favourable to foreign investment. As a result of these factors, some of the classic corporate strategies employed by European firms began to be applied in the region: expansion and diversification of activities, mergers and acquisitions, partnerships between firms in large-scale projects and penetration of local and regional service markets with a view to becoming global operators.

Typically, this type of investment is concentrated among a limited number of large TNCs and consists primarily of FDI in the form of mergers, acquisitions and purchases of stock packages from local service companies. Thus, there have been relatively few investments in entirely new ventures (greenfield investment). Although the acquisitions have involved considerable flows of capital, they have been highly concentrated in relatively few operations (see annex I.6). Spain has clearly been the top investor, but other Mediterranean countries, including Portugal, France and Italy, have also made investments. The energy, telecommunications, banking and retail trade subsectors have been the main targets of this investment.

Clearly, the presence in the region of transnational services firms from the European Union is highly concentrated in terms of sectors and countries, from the standpoint of both source and destination. With regard to firms, a handful of TNCs have spearheaded this process: the Spanish firm Telefónica de España and the Italian firm Telecom Italia in telecommunications; the Spanish firms Endesa España and IBERDROLA in electricity; Repsol-YPF, also Spanish, and the United Kingdom's BP Amoco in hydrocarbons; the Spanish banks Banco Santander Central Hispano and Banco Bilbao Vizcaya Argentaria in financial services; and the French chain Carrefour-Promodès in retail trade.

(a) Telecommunications[27]

The first changes introduced in the regulations for the telecommunications sector in the European Union were set out in the Green Paper on the development of the common market for telecommunications services and equipment, published in 1987 as part of the process of undertaking the reforms needed to achieve the single market. The Green Paper put forth a strategy for overcoming national obstacles and differences and harmonizing national policies in order to replace the existing situation of monopoly with a model of limited competition, while maintaining special or exclusive rights to basic telephony and networks. After the single internal market became a reality in 1993, the Union embarked on the second phase of telecommunications liberalization, which gradually, in several stages, opened up the respective markets to unlimited competition.

The new regulations, coupled with technological advances that have made it possible to overcome old bottlenecks, have created a favourable context for the establishment of strategic alliances between telecommunications operators. Under such arrangements, firms can maintain their individual identity while cooperating in the utilization of products, the development of new marketing processes, research and other areas. Such alliances and, later, mergers in the telecommunications industry have led to the establishment of agreements and the creation of new companies through the combination of firms within the Union as well as mergers between European Union firms and overseas firms (see table III.6).

The dizzying pace of technological progress, together with the high cost of licences for the operation of third-generation mobile telephony in Europe, also encouraged the formation of new alliances, while introducing great instability in the sector, with increased systemic risk for the industry. This has translated into a sharp drop in the stock prices of the largest European firms in the sector, including British Telecom, Deutsche Telekom, France Telecom and Telecom Italia (ECLAC, 2001a).

At the same time, Latin American reforms and mass privatization of telecommunications firms have facilitated the expansion of some of the European firms that were affected most negatively by increased competition in the sector in Europe. Companies such as Telefónica de España saw in Latin America a tremendous opportunity to grow quickly and later to improve their prospects for competing successfully in the European market (Calderón, 1999). This Spanish company was followed by other European firms, especially when the Brazilian telecommunications market opened up in 1998. With more firms vying for regional assets, competition in the different segments of the telecommunications market has intensified (ECLAC, 2001a, chap. IV).

(b) Electric power: how a merger changed the regional energy situation

The energy sector has been a prime focus of investment flows from the European Union to Latin America in recent years. It also provides an example of the new corporate paradigms, which emphasize diversification of activities, mergers and acquisitions, alliances and integration with the hydrocarbons sector (especially the natural gas subsector). This phenomenon has resulted in the arrival en masse of major European firms: France's Électricité de France, Belgium's Tractebel, Spain's Endesa España and Portugal's Eletricidade de Portugal. These firms have established activities in Latin America with the aim of gaining access to local and subregional services markets. As a result of integration with other energy sectors –petroleum extraction and natural gas supply– the presence of other companies, such the Spanish firm IBERDROLA and the French firm TotalFinaElf, has also been important (see chapter IV).

[27] See ECLAC, 2001a, chap. IV, for more information on foreign investment in telecommunications in Latin America.

The factors that have influenced the recent influx of European firms are varied. The evolution of the European Union, on the one hand, and the liberalization process in the energy market,[28] on the other, brought about changes in the business environment, with the result that firms that had previously operated as monopolies in their markets found themselves competing in the European market, where they interacted with operators of different sizes. This created a need to scale up company size, which gave rise to an increasing number of conglomerates composed of European firms or both European and non-European firms, with the capacity to function effectively in more open and competitive markets. Thus, the development of the European Union prompted firms to increase their size in order to operate in the European market and, by extension, in the world market. This expansion, which became almost a necessity, was intended not only to take advantage of economies of scale, but also to form the core of a defensive strategy to guard against takeover by bigger firms (Calderón, 1999).

Although this is regarded as the element that triggered internationalization, the process was also motivated by specific conditions in the energy sector. For example, the maturity of the European market kept the industry's profitability low.[29] In addition, regulations underwent major changes, owing, for example, to the growing importance of environmental considerations. These elements combined to create a new sectoral climate in the European Union, prompting a change in the strategic behaviour of firms, which began to give priority to diversifying and internationalizing their activities, creating large conglomerates and forming alliances.

In this context, Latin America took on increasing importance, especially for Spanish firms, for which the region afforded an opportunity to increase their size and improve their competitiveness with respect to the leading European firms (Calderón, 1999; Rozas, 2001). This phenomenon was also favoured by the economic reforms being applied in Latin America. Moreover, the Latin American market offered tremendous potential for growth and for highly profitable investment.

These were the factors that induced European firms, led by Spanish companies, to launch a major expansion drive in the region through acquisitions, alliances with strategic partners and joint ventures (ECLAC, 2001; ECLAC, 2000). Various European firms formed consortia with firms in the region in order to take part in acquisitions and large-scale ventures. This translated into huge injections of foreign investment in the recipient countries, the expansion of service delivery and the launching of projects to meet growing demand in local and regional markets.

European energy firms, in particular Endesa España, Électricité de France, Eletricidade de Portugal and Tractebel, are now a significant presence in Latin America. Endesa España emerged rapidly as the market leader, with operations in countries throughout the region: Argentina, Brazil, Chile, Colombia, Mexico and Peru. The firm's position was consolidated when it took over control of the Chilean group Enersis, then one of the largest regional operators (ECLAC, 2001; ECLAC, 2000). Another company that has enlarged its regional presence considerably is the Belgian firm Tractebel, with activities in Argentina, Brazil, Chile, Mexico and Peru, among other countries. Électricité de France, on the other hand, has focused on the MERCOSUR countries. A very interesting case is that of Eletricidade de Portugal, which has confined its activities to Brazil.

The trailblazers in this process were the Spanish firms Endesa España and IBERDROLA,[30] which began doing business in Argentina and Peru in the early 1990s, taking advantage of the privatization processes under way at the time. Of all the European energy firms, Endesa España has achieved the greatest market penetration in Latin America. Its most decisive step in that direction was the formation of a strategic alliance with Grupo Enersis in 1997. The Chilean conglomerate had pursued an aggressive expansion policy and was, at that time, the leader in the electricity sector in the region, with a broad presence in Chile, Argentina, Brazil, Colombia and Peru (ECLAC, 2001). The association between the Chilean and Spanish firms began with a series of joint ventures.

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[28] Liberalization of the energy sector has been driven by economic and political pressures, combined with institutional action by the European Commission. In taking this action, the European Union governing bodies drew upon several pioneering liberalization experiments in the policy sphere and proceeded on the theory that liberalization of the sector would translate into lower prices for production inputs, which, in turn, would result in lower costs and final prices. The legal means used to liberalize both the electricity sector and the gas sector has been the adoption of a series of directives which must be incorporated into the legislation of each member State.

[29] For example, total consumption in the European Union grew by 0.7% in the period 1990-1995 but fell by 0.3% between 1996 and 1997. By contrast, in other, more dynamic markets such as that of Latin America, consumption increased by 3.4% in the first half of the decade and 2.8% in 1996-1997.

[30] In 1992, IBERDROLA, for example, acquired a 60% interest in Central Térmica Güemes, a power company that supplies north-western Argentina. In the second half of the 1990s, IBERDROLA concentrated on acquisitions in Brazil, and it currently holds large shares of Companhia Energética de Pernambuco, Companhia de Eletricidade do Estado de Bahia and Companhia Energética do Rio Grande do Norte. Recently, it also acquired the Mexican firm Enertek.

In 1997 Endesa acquired a 32% interest in Enersis. Finally, in a 1999 takeover bid, Endesa España acquired another 32% of Enersis stock, giving it a controlling interest in the Chilean group and making it the biggest foreign investor in the sector in Latin America. In the future, Endesa España intends to move towards the creation of a comprehensive energy services company by integrating its activities to take advantage of the synergies among its operations throughout Latin America (ECLAC, 2001).

Another company that has played a prominent role in the region is Eletricidade de Portugal, which has concentrated its operations in the Brazilian market. The firm participated, as a member of the consortia headed by Endesa España, in gaining control of Companhia de Eletricidade do Rio de Janeiro and Companhia Energética do Ceará; then, in 1999, it purchased 36% of the stock of ES Centrais Elétricas.[31] The French firm Électricité de France has positioned itself mainly in the Brazilian and Argentine markets (see box III.5), while Belgium's Tractebel has focused on the Chilean and Brazilian markets,[32] and recently initiated distribution activities in Mexico and power generation in Peru.

Meanwhile, several smaller companies have also taken an interest in the region, especially Mexico and the Caribbean Basin. These include Spain's Unión Fenosa, Switzerland's Sithe Energies and France's ABB Alstom Power.[33] Noteworthy among these firms is Unión Fenosa, which operates generating plants in Colombia, Costa Rica, Mexico and the Dominican Republic and has power distribution activities in Colombia, Nicaragua, Guatemala, Panama and the Dominican Republic. This firm's strategy for the future is to continue growing overseas, especially in the Latin American market.[34] In addition, several oil companies –such as TotalFinaElf– have become involved in the electricity sector, capitalizing on the integration of activities between subsectors (see chapter IV).

Box III.5

FRANCE THROWS LIGHT ON LATIN AMERICA

The energy group Électricité de France (EDF) is one of the world's largest electric power conglomerates, with sales of over US$ 31 billion and affiliates in Europe, America, Asia and Africa. Although its electricity activities are concentrated mainly in the European market, in the 1990s the firm embarked upon an aggressive internationalization plan. It now has investments in energy generation in the following regions: Europe (74%), Asia (12%), Latin America (8%), Middle East (4%) and Africa (2%). In the area of energy distribution, the composition of its investments is: Latin America (49%), Europe (44%), Africa (4%) and Middle East (3%). Latin America thus accounts for the largest proportion of its energy distribution activities, while most of its investment in generation is in Europe.

In 1996, EDF initiated its regional activities in Argentina, and two years later it acquired a large share of Empresa Distribuidora y Comercializadora Norte (EDENOR) and a controlling interest in Empresa Distribuidora de Electricidad de Mendoza S.A. (EDEMSA). In Brazil, meanwhile, Électricité de France headed a consortium that gained 50% ownership of Light Serviços de Eletricidade and 75% ownership of Eletricidade Metropolitana de São Paulo. EDF recently received several sizeable concessions in the region, primarily in Mexico. One is a 25-year concession for the construction of a generating plant in Tamaulipas, in which EDF has an investment of US$ 220 million, and the construction and operation of a US$ 129-million power plant in Saltillo.

In the 1990s, the French firm thus began internationalizing its activities, with Latin America as one of its primary focuses. EDF exemplifies how large European operators are seeking new investment opportunities in order to diversify their operations and position themselves in a more competitive energy market. Most such firms invest initially in Argentina and Brazil, then slowly begin to move into the Mexican market.

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

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31 The company also owns 56% of Empresa Bandeirante de Energia.

32 Its principal associates are the Brazilian firm Centrais Geradoras do Sul and the Chilean generating company Colbún Machicura.

33 Among the most important activities of these firms is a US$ 270 million joint venture between Sithe Energies and ABB Alstom Power for the construction of a thermoelectric generating plant in Mexico.

34 To that end, Unión Fenosa plans to group together all its Latin American investments in electricity production, transport and distribution. The firm was recently awarded a contract for the construction of an electric power plant in the Mexican region of Durango.

(c) Banking: Spanish regional banks at the forefront of the Latin American financial system

Like other European service enterprises, banks have faced growing competition in their domestic markets. Liberalization of the sector has led to the arrival of extraregional entities (mainly from the United States) and intense competition among the European banks vying for continental leadership. However, banking is an activity with high barriers to entry, and it has not been easy to create banking entities with a widespread presence in Europe.

In this context, the Spanish banks faced a highly uncertain future and the real possibility of being absorbed by the banks of some of the European powers with regional ambitions. As a result, in the mid-1990s, the two largest Spanish institutions (BSCH and BBVA) extended their fierce competition in the domestic market to Latin America. Through an aggressive strategy of acquiring local banks, these financial entities quickly achieved an extensive and diversified regional presence. BSCH and BBVA first targeted the commercial banking segment in the countries of the Southern Cone (see chapter II), later entering the Brazilian market and then, more recently, the Mexican market. They also began to incorporate investment banking and pension fund administration into their regional activities (Calderón and Casilda, 2000).

These two Spanish entities have thus been able to position themselves very advantageously as leaders in most of Latin America's markets and, in so doing, have also become two of the largest financial institutions in Europe.

The importance of the financial sector lies in the fact that it has been one of the most dynamic in terms of internationalization. In Latin America, this has been particularly true of Spanish banks and, to a lesser extent, some Italian financial institutions. Entities such as Banco Santander Central Hispano and Banco Bilbao Vizcaya Argentaria have become major players in the region. Though these firms have employed various strategies, they have had a common objective: to generate value for shareholders (Calderón and Casilda, 1999). Other European banking institutions, such as Caixa Geral de Depósitos (Portugal),[35] Assicurazioni Generali[36] and Banco Comerciale de Italia,[37] are also pursuing markets in Latin America.

(d) Commerce: a sector dominated by the French chains

European retailers, supermarkets and hypermarkets have become widespread in Latin America. Although these firms have a long tradition in their home countries, their presence in Latin America dates back only a few years. The first companies established themselves in the 1970s, but the region acquired strategic importance for the expansion of their activities only in the second half of the 1990s. This process has been led by French firms, notably Carrefour-Promodès and Casino Guichard-Perrachon, which already held a leadership position in Europe. They were recently joined by the Dutch firm Royal Ahold.

This phenomenon was influenced both by the favourable conditions prevailing in certain local markets in Latin America and by the new directives for the European market. In the region's main urban centres, there was considerable unmet demand and strong potential for increased consumption. In the European environment, meanwhile, the consolidation of the European Union modified the retail trade market. European retailers thus went from supplying only domestic markets to selling their products in one of the biggest markets in the world.

Latin America's importance has increased steadily in the context of these new European corporate strategies, particularly in the largest markets –Argentina, Brazil and Mexico. In strategic terms, some firms have preferred to operate independently, while others have opted to establish joint ventures or alliances with local groups. Several of the firms that formed partnerships with national groups have gradually taken over the ownership and control of these local chains and, simultaneously, have accelerated their acquisitions policy, which has strengthened their presence in the region.

The French firm Carrefour is one of the largest supermarket chains in the world, currently operating in 27 countries. In recent years, the firm has employed a strategy of expansion through investments in various countries –especially in South-East Asia– and it completed a merger with one of its biggest competitors in France: Promodès. In Latin America, Carrefour was the first major European supermarket chain to establish itself. It arrived in Brazil in 1975 and in Argentina in 1982, but did not expand into Mexico, Colombia and

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35 In 1998, Caixa Geral de Depósitos acquired 90% of Banco Bandeirantes de Brasil for US$ 358 million.

36 Purchased 33% of Caja de Ahorro y Seguro de Argentina in 1998 for US$ 190 million.

37 Gained a presence in Argentina (through the purchase of 85% of Banco Caja de Ahorro) in 2000; present in Brazil (through an 80% interest in Banco América do Sul) and Peru (65% interest in Banco Wiesen Sudameris Perú) since 1998.

Chile until the second half of the 1990s. At present, Carrefour's main activities are centred in Brazil, where it has also begun to implement an aggressive expansion policy.[38]

In Argentina, Carrefour is the top operator in the sector, with more than 20 hypermarkets and 120 supermarkets. In recent years, the company has solidified its leadership position through its merger in France with Promodès, which had controlled Supermercados Norte in Argentina (see chapter II). In Mexico, Carrefour opened its first store in 1994 through a joint venture with the local group Gigante. Then, in 1998, the company acquired Gigante and gained control of the Grandes Superficies supermarkets. In 1998, it opened its first supermarkets in Colombia and Chile. Carrefour currently has several expansion projects under way in the latter country.[39]

The Dutch firm Royal Ahold is also well known at the global level, being the second largest retailer in Europe, with operations in numerous countries around the world. In Latin America, the firm's strategy has been, first, to form alliances with local companies and, later, to purchase majority shares in those companies. It started out in Brazil in 1996, with the purchase of 50% of the local firm Bompreço. At present, Bompreço's revenues in Brazil exceed US$ 1.3 billion, and in recent years the firm has embarked upon a vigorous expansion campaign in which it has made several strategic acquisitions, notably Supermar in 1998. That same year it began to diversify in the rest of the region, acquiring a majority interest in the Argentine firm Disco and the Chilean supermarket chain Santa Isabel, with stores in Chile, Peru and Paraguay (see chapter II). In 1999, the firm launched activities in Guatemala through a joint venture with the local firm La Fragua.

In the past two years, Royal Ahold has pursued an intensive policy of strategic acquisitions and joint ventures with local firms. In 2000, the company acquired the remaining 50% of Bompreço, and through Disco Argentina it purchased the assets of the Chilean chain Ekono in Argentina for US$ 150 million. In July 2001, Bompreço bought five supermarkets from the French firm Carrefour and joined forces with Guatemala's La Fragua to create a new alliance aimed at expanding into the markets of Central America. Royal Ahold thus has a presence in Brazil, Argentina, Honduras, Guatemala and El Salvador, and its sales in the region account for 10% of its total sales worldwide. The firm's principal activities are in Argentina (43% of its regional sales) and Brazil (29%). For the future, Royal Ahold has announced several sizeable expansion projects and the opening of at least 15 new supermarkets in the region.

The French group Casino Guichard-Perrachon has relatively few activities in Latin America, and its sales in the region represent only 4.5% of its global sales. Its activities are concentrated in Brazil, Argentina, Colombia, Uruguay and Venezuela. The firm made its first foray into the region with the acquisition in 1998 of a controlling interest in the Argentine firm Libertad. In 1999, it acquired Éxito, Colombia's leading supermarket chain; that move elevated the group to a leadership position in the Colombian and Venezuelan markets. One of the most important steps for Casino was the conclusion of an agreement in 1999 with Companhia Brasileira de Distribuição (CBD), under which the French group gained control of 26% of the Brazilian firm, which has a market share of 13%. For the future, the firm envisages various expansion projects in the region, especially in Brazil. Another French firm, Auchan, initiated activities in Argentina and Mexico in the late 1990s (see chapter II).

C. CONCLUSIONS

In the second half of the 1990s, FDI inflows from the European Union grew markedly in Latin America and the Caribbean. This trend was the result of a combination of very specific factors on both sides of the Atlantic. On the one hand, the rapid consolidation of the single market in Europe provided new incentives to the large European firms. On the other, liberalization of the Latin American markets and expectations of growth opened up new business opportunities in the region. Thus, at the outset, firms that faced a difficult situation in the European environment –especially Spanish and Portuguese firms– saw in Latin America a tremendous opportunity to grow

[38] Since 1999, Carrefour Brazil has been applying a policy of strategic acquisitions of various regional chains, notably the supermarket chains Lojas Americanas, Planalto, Roncetti, Mineirão and Reina Dallas Continente. Carrefour operates more than 130 supermarkets in Brazil and also controls the Brepa company and its subsidiaries.

[39] To date, Carrefour's investments in Chile amount to US$ 80 million. Its recent projects include the opening of eight stores in the last five years, with an estimated investment of US$ 120 million.

IV. HYDROCARBONS: INVESTMENTS AND CORPORATE STRATEGIES IN LATIN AMERICA AND THE CARIBBEAN

INTRODUCTION

The petroleum industry was one of the first activities to become globalized in terms of both trade and foreign direct investment. Founded in the United States in the mid-nineteenth century, the industry expanded globally following the replacement of coal as a source of energy and the discovery of vast deposits in the countries of the Middle East. Transnational corporations, lured by the bright prospects for the fuel market created by the development of the automotive industry in the early part of the twentieth century, soon became involved, leading to further globalization of the sector.

The fact that oil was consumed in zones other than the producer zones, that it was a liquid and was therefore easy to transport and store and that technological advances reduced transport costs all contributed to the rapid growth of the international oil trade. The percentage of world oil production traded internationally has grown steadily in recent years and now stands at more than 57%. The main importers are the industrialized countries, with the United States heading the list.

Unsurpassed thus far by any of the alternatives, oil has maintained its position as the world's primary source of energy, and therefore continues to be a highly strategic raw material for countries' economic development and military potential. In 1999, 85% of total world primary energy consumption corresponded to fossil fuels, with oil accounting for 40%; natural gas, for 23%; and coal, for 22%. Next came renewable fuels (9%) and nuclear energy (6%) (EIA, 2002a).

Among the leading international energy agencies, there is consensus that this marked dependence on fossil fuels will continue for the next 20 to 30 years. The only change they foresee is an increase in the use of natural gas at the expense of coal. Hence, fossil fuels are expected to continue to account for approximately 85% of the primary energy supply in the coming decades, implying that the serious environmental harm caused by carbon dioxide emissions will continue. The 1999 Kyoto Protocol is designed to counter this problem by limiting such emissions, and was adopted by a substantial number of countries, each of which has established specific goals for the year 2010.

The investments of the capital-intensive oil industry are channelled mainly into soil and subsoil operations in the different oil-producing regions in the world to extract a product whose production costs vary significantly from one region to another. Prior to the nationalization of oil fields, prices were controlled by private cartels (the "seven sisters"); later, they were set by the cartel of State-owned enterprises: the Organization of the Petroleum Exporting Countries (OPEC).

The difference between average costs and oligopolistic prices has translated into enormous oil profits, which are reaped by the oil-producing States as well as by private corporations. The former seek to maximize revenue to add to the public coffers, while the latter are intent on maximizing profits for distribution as dividends among shareholders.

Since the late 1980s, the convergence of two forces –economic reforms geared to liberalizing markets and diminishing the State's role in the economy and the depressed state of oil prices– helped to challenge the strategic importance of oil, thereby promoting the elimination of State monopolies in producer countries and the deregulation of the oil industry.

While some producer countries introduced reforms geared to promoting private investment in the oil and gas sector in the 1990s, very few went so far as to privatize the industry completely, and most countries with a large oil industry, especially those of the Persian Gulf, maintained strong barriers to private investment. The main reason for this peculiarity of the sector is that States want to keep their substantial oil revenues.

Almost all producer countries in Latin America and the Caribbean except Mexico have introduced reforms to incorporate private investment into the sector. Brazil and Venezuela opened up opportunities for partnership with their respective State enterprises in some selected areas; Brazil granted licences for prospecting new areas without the participation of Petróleos Brasileiros S.A. (PETROBRAS). Colombia established better conditions for the formation of joint ventures between private firms and the Empresa Colombiana de Petróleos (ECOPETROL). Ecuador and Trinidad and Tobago invited bids in relation to a number of extensive areas, in which operations are now being conducted exclusively by private firms. Lastly, Argentina, Bolivia and Peru privatized their respective State-owned enterprises. These reforms have led to appreciable inflows of FDI into the region's oil sector.

This chapter looks at the strategies of transnational corporations (TNCs) in the oil sector which have invested in Latin America and the Caribbean from 1990 to the present. The strategies of these corporations are first analysed in the context of the world oil market and its main characteristics: (i) geographical distribution of reserves; (ii) pricing mechanisms; (iii) widely disparate production costs; and (iv) the main market players at the world level.

Second, TNC strategies in Latin America and the Caribbean are assessed in the context of their global strategy, the most noteworthy features of which are: (i) a market structure that maximizes profits; (ii) the drive to gain access to relatively low-cost reserves; (iii) a policy of mergers and acquisitions; and (iv) the creation of an integrated energy chain in the natural gas segment, with expansion into power generation and distribution activities, in response to the opportunities offered by the liberalization of energy markets at the global level.

This background is necessary for understanding the motivations and behaviour of foreign direct investors in the oil and gas sector in Latin America and the Caribbean since the introduction of the above-mentioned reforms.

Third, a concise overview is given of the different reforms introduced in the region's oil sector, followed by a brief assessment of the influence and scale of State-owned oil enterprises, which are dominant players in the oil industry.

Lastly, the importance of private oil firms in Latin America and the Caribbean is evaluated and their strategy for expansion in the region is examined, with emphasis on four specific corporations, each of which represents a different pattern of expansion.

A. CHARACTERISTICS OF THE CURRENT WORLD OIL MARKET

1. The geographical distribution of oil

At the end of 1999, proven world oil reserves[1] represented nearly a trillion barrels, or 41 times the total oil production for that year. Between 1980 and 1990, world reserves increased by 55.6%, while between 1990 and 2000 they remained practically unchanged, rising by just 2.2%.

The production outlook, calculated as the ratio of reserves to production, has deteriorated. Between 1990 and 2000 it declined from 42 to 38 (see table IV.1). This means that the discovery of new deposits and the increase in the recovery rate have not been sufficient to compensate for the quantities extracted from the reserves each year to meet global consumption needs.

The geographical distribution of the reserves is one of the decisive elements to be taken into account in analysing the political economy of petroleum. Some 78% of world oil reserves are concentrated in the underground deposits of OPEC member countries,[2] primarily the Arab countries of the Middle East.

Table IV.1
OIL: PROVEN RESERVES, PRODUCTION AND PRODUCTION OUTLOOK

Countries of	Reserves (R)			Production (P)		R/P	
	1980	1990	2000	1990	2000	1990	2000
	Millions of barrels					**Years**	
North America	44,200	41,900	36,100	3,971	3,816	10.6	9.5
Latin America	69,500	121,000	123,500	2,730	3,754	44.3	32.9
Europe	26,000	16,300	19,100	1,661	2,539	9.8	7.5
Former Soviet Union	63,000	57,000	65,300	4,221	2,933	13.5	22.3
Middle East	361,800	662,600	683,600	6,398	8,391	103.6	81.5
Africa	55,200	59,900	74,800	2,436	2,854	24.6	26.2
Asia-Pacific	40,200	50,300	44,000	2,456	2,909	20.5	15.1
Total world	659,900	1,009,000	1,046,400	23,875	27,196	42.3	38.5
of which:							
OECD [a]	113,700	110,400	84,800	6,877	7,864	16.1	10.8
OPEC [b]	432,800	771,700	814,400	8,963	11,251	86.1	72.4
Rest of world	113,400	126,900	147,200	8,035	8,081	15.8	18.2
	Percentages						
North America	7	4	3	17	14		
Latin America	11	12	12	11	14		
Europe	4	2	2	7	9		
Former Soviet Union	10	6	6	18	11		
Middle East	55	66	65	27	31		
Africa	8	6	7	10	10		
Asia-Pacific	6	5	4	10	11		
Total world	100	100	100	100	100		
of which:							
OECD [a]	17	11	8	29	29		
OPEC [b]	66	76	78	38	41		
Rest of world	17	13	14	34	30		

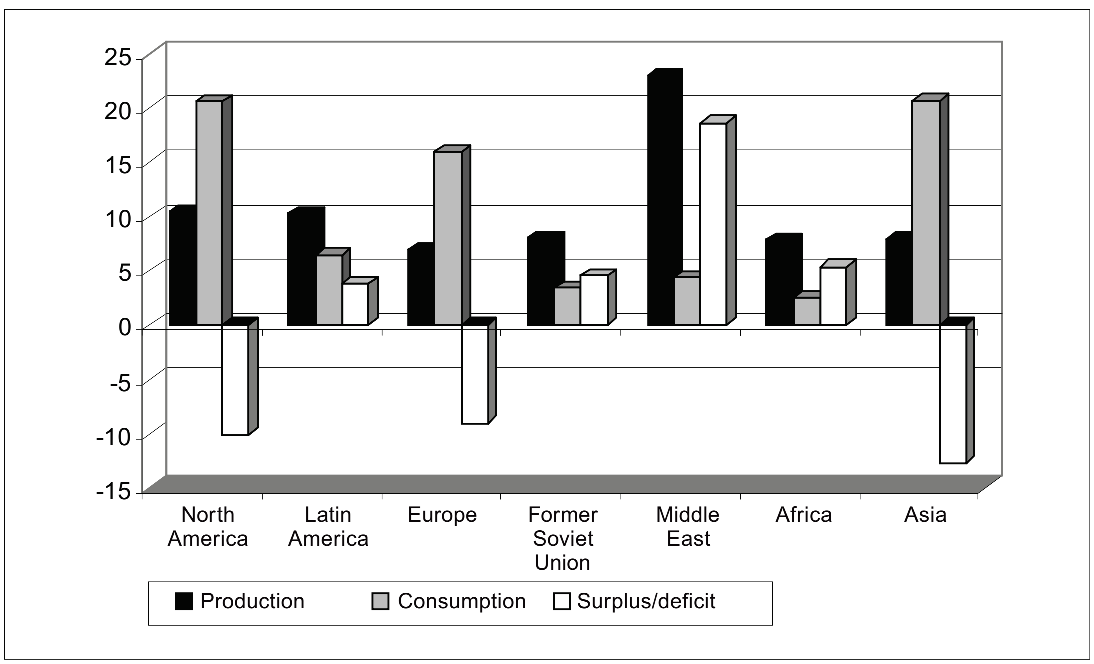
Source: British Petroleum (BP), *Statistical Review of World Energy*, June 2001.
[a] Organisation for Economic Co-operation and Development.
[b] Organization of the Petroleum Exporting Countries.

1 Proven reserves are those quantities considered to be recoverable in the future from known reservoirs under existing economic and operating conditions. The quantities may be adjusted in the light of new discoveries or of changes in the operating conditions of explored deposits, in production costs or in oil prices, which may result in the exclusion of deposits considered unprofitable when prices are low or the addition of marginal deposits when prices are high.

The other decisive element of the political economy of petroleum is the fact that the producer zones are not the same as the consumer zones (see figure IV.1). The countries of the Organisation for Economic Co-operation and Development (OECD) are the chief consumers of oil, but do not produce enough to meet their own demand, so that they must resort to imported oil, much of which comes from the OPEC countries. As oil is a fundamental input for production and transport, two constant concerns for the OECD countries are the level of international prices for those dependent on imports and supply security, especially in view of the geopolitical problems existing in the Middle East.

The OPEC countries' oil deposits are not only the most extensive, but also the highest in quality in terms of size and production costs, unlike the deposits in the OECD countries, where relative costs are among the highest. Barring any major discoveries that significantly alter the current composition of oil reserves, the OPEC countries –especially those of the Middle East– will have an increasingly influential role to play in the world supply of oil.

Figure IV.1
WORLD OIL PRODUCTION AND CONSUMPTION BY REGION, 2000
(Thousands of barrels per day)



Source: British Petroleum (BP), *Statistical Review of World Energy*, June 2001.

[2] These are: Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, the United Arab Emirates and Venezuela. Ecuador and Gabon withdrew from OPEC in 1992 and 1994, respectively.

2. The natural gas industry

Initially, natural gas production was closely linked to oil production, but in recent years it has started to function independently, although oil firms also produce gas.

There are two types of underground gas deposits: (i) deposits where the gas is associated with and considered a by-product of oil, in which case its technical cost of production is zero,[3] and (ii) deposits consisting solely or primarily of gas, in which case the exploration techniques are the same[4] and the technical costs of production differ little from those for oil.

The main obstacle to the development of gas as an energy source is the problem of transportation, which is more complicated than in the case of oil and coal, since the gas must be handled in a hermetically sealed unit. Gas is usually transported by pipeline, but when the geographical distance is very great it must be transported by sea, which is much more expensive. Natural gas has to be converted to a liquid state at low temperatures (liquefied natural gas or LNG) and then transported in refrigerated tankers. Once it reaches the port of destination, the LNG is regasified and distributed again through gas pipelines.[5] At present, close to 75% of the international trade in gas is transported through gas pipelines, and the rest, by tanker after conversion to LNG. Thus, unlike oil, natural gas is not traded in a truly global market, but rather in several regional markets.

Natural gas reserves are less concentrated than oil reserves in terms of geographical distribution. Most of the world's gas reserves are located in the countries of the former Soviet Union (38% in 2000), followed by the countries of the Middle East (35%). The latter have a longer production outlook, however (254 years in 2000), as a result of their relatively small share of world production (8.4%), which is attributable to the distance of the deposits from the main consumption centres (see table IV.2).

Table IV.2
NATURAL GAS: PROVEN RESERVES, PRODUCTION AND PRODUCTION OUTLOOK

Countries of	Reserves (R)			Production (P)		R/P	
	1980	1990	2000	1990	2000	1990	2000
	Billions of cubic feet					**Years**	
North America	278,200	263,700	228,400	21,316	25,185	12.4	9.1
Latin America	159,600	242,200	275,000	2,993	4,636	80.9	59.3
Europe	168,751	193,764	183,900	7,957	10,476	24.4	17.6
Former Soviet Union	920,066	1,600,314	2,002,600	28,397	25,039	56.4	80.0
Middle East	751,879	1,324,353	1,854,800	3,541	7,300	374.1	254.1
Africa	208,403	285,053	394,200	2,373	4,526	120.1	87.1
Asia-Pacific	151,271	299,007	365,100	5,329	9,344	56.1	39.1
Total world	2,638,404	4,208,520	5,304,000	71,905	86,505	58.5	61.3
of which:							
OECD [a]	537,870	532,572	474,300	30,113	37,668	17.7	12.6
Rest of world	2,100,534	3,675,948	4,829,700	41,793	48,837	88.0	98.9
	Percentages						
North America	11	6	4	30	29		
Latin America	6	6	5	4	5		
Europe	6	5	3	11	12		
Former Soviet Union	35	38	38	39	29		
Middle East	28	31	35	5	8		
Africa	8	7	7	3	5		
Asia-Pacific	6	7	7	7	1		
Total world	100	100	100	100	100		
of which:							
OECD [a]	20	13	9	42	44		
Rest of world	80	87	91	58	56		

Source: British Petroleum (BP), *Statistical Review of World Energy,* June 2001.
[a] Organisation for Economic Co-operation and Development.

3 Given the specific limitations affecting its transport, its economic value may also be zero, depending on the distance between the deposit and the place of consumption.
4 However, different parameters must be considered when the exploration is for gas only.
5 The costs of the conversion process, the vessels themselves, shipping and handling and special facilities add considerably to the cost of producing gas, thereby reducing its profitability.

3. Pricing

Between 1928 and 1973, the major oil firms, known as the "seven sisters" (Exxon, Gulf, Texaco, Mobil, Standard Oil Company of California, British Petroleum (BP) and Royal Dutch/Shell), formed a cartel through which they jointly set crude oil prices for the world market (Blair, 1978; Tugendhat, 1969; Martin, 1992; Percebois, 1989). Beginning in 1960, the cartel's power started to wane following the entry on the market of powerful European State-owned enterprises (Compagnie Française des Pétroles (CFP) of France, Ente Nazionale Idrocarburi (ENI) of Italy) and other, smaller firms known as "independents". In subsequent years, the OPEC countries carried out successive nationalizations, so that by 1973 they controlled most of their oil production.[6]

Oil and gas measurements

The abbreviations listed below are used in this chapter:

tbl = thousands (1×10^3) of barrels
mbl = millions (1×10^6) of barrels
bbl = billions (1×10^9) of barrels

tbl/d = thousands (1×10^3) of barrels per day
mbl/d = millions (1×10^6) of barrels per day
bbl/d = billions (1×10^9) of barrels per day

tft^3 = thousands (1×10^3) of cubic feet
mft^3 = millions (1×10^6) of cubic feet
bft^3 = billions (1×10^9) of cubic feet
$trft^3$ = trillions (1×10^{12}) of cubic feet
qft^3 = quadrillions (1×10^{15}) of cubic feet

tft^3/d = thousands (1×10^3) of cubic feet per day
mft^3/d = millions (1×10^6) of cubic feet per day
bft^3/d = billions (1×10^9) of cubic feet per day
$trft^3/d$ = trillions (1×10^{12}) of cubic feet per day
qft^3/d = quadrillions (1×10^{15}) of cubic feet per day

Nationalization of the oil industry shifted the decision-making power with respect to the pricing of crude oil. OPEC, whose operations accounted for over 50% of world production, emerged as the new cartel. It adopted a policy of controlling supply by setting production quotas for its member countries, thereby determining international oil prices. In 1973, OPEC decided to raise crude oil prices, within the space of one year, from US$ 2.41 to US$ 10.95 per barrel, an increase of over 400% (see figure IV.2).

As a result of the first and second oil crises (1973-1974 and 1979-1981, respectively), structural changes were introduced on both the supply and the demand side. On the one hand, demand declined owing to the economic slowdown in the industrialized countries and to the energy-saving and substitution measures they implemented. Demand did not pick up until 1984, and grew much more slowly than in the pre-1973 period (EIA) (http://www.eia.doe.gov/emeu/aer/txt/tab1109.htm). On the supply side, high crude prices were an incentive for oil exploration in non-OPEC countries, which resulted in the discovery of new reserves in Angola, Ecuador, Mexico, Norway, the Soviet Union and the United Kingdom. This led to a significant reduction in the OPEC share of world crude production: while the organization controlled 53% of world production in 1974, its share fell to 40% in 1981 and to 30% in 1985 (see figure IV.3).

The extraordinarily high price of oil led to irrational behaviour in the market, which made it advantageous to produce high-cost oil extracted from deposits in the United States and the North Sea and discouraged the exploitation of much lower-cost reserves in the Persian Gulf (Percebois, 1989).

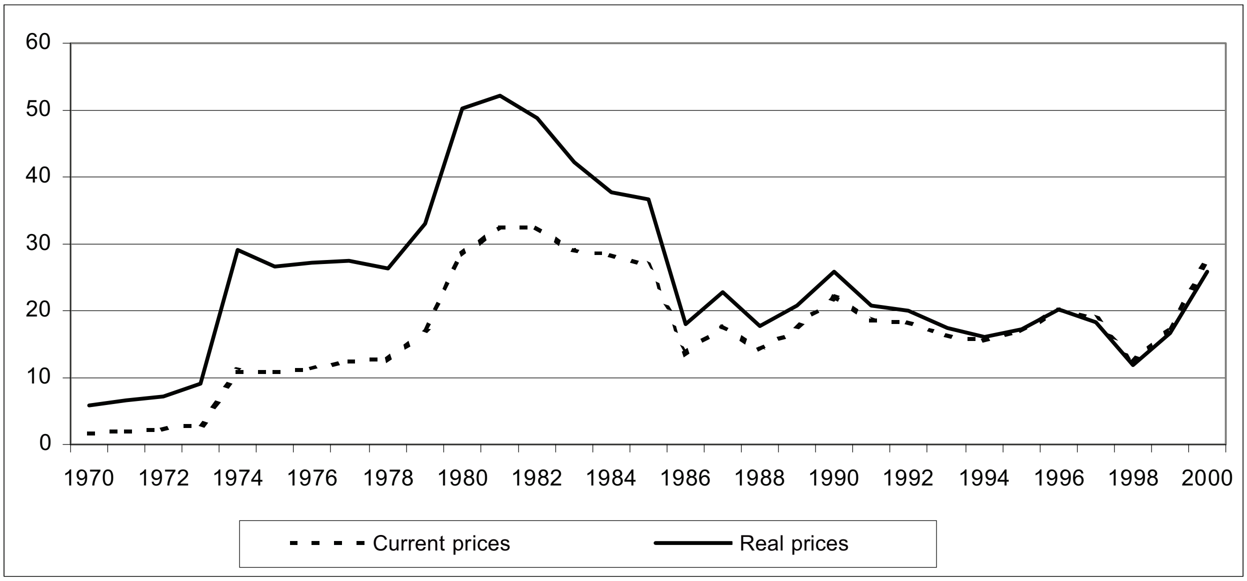
The OPEC countries, especially those situated in the Persian Gulf, headed by Saudi Arabia, reacted by replacing their price defence strategy with a market-share defence strategy, which was tantamount to declaring a price war. This strategy, introduced in December 1985, marked the start of a long period of low prices and, at the same time, caused divisions within OPEC, underscoring the heterogeneity of its members and their conflicts of interest.

Between 1986 and 1999, oil prices stabilized at low levels for a long period (see figure IV.2), somewhat discouraging upstream[7] production in the high-cost regions, especially the United States and then the North Sea, as will be discussed below. It should be noted that between 1986 and 1999, real oil prices were lower than they had been between 1974 and 1979 (during the oil crises), which slashed OPEC profits. It was not until 1991 –and then only for a few months, following the Persian Gulf War– that the price of oil rose again, reaching levels close to US$ 35 a barrel.

[6] In 1981, the OPEC countries controlled 88% of the oil production in their territories, compared to 6% in 1970. Conversely, the "seven sisters" saw their control over these deposits gradually diminish from 98.2% in 1950 to only 30% in 1980 (Percebois, 1989).

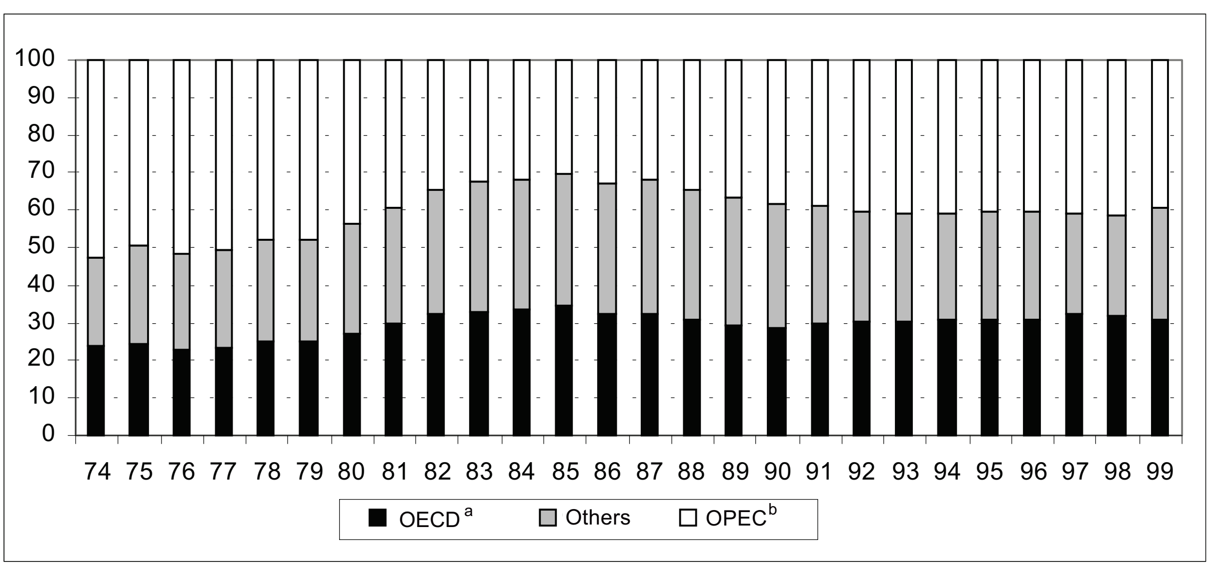
[7] Upstream activities are those relating to exploration, development and production. Downstream activities are those relating to transport, refining, distributing and marketing.

Figure IV.2
NOMINAL AND REAL OIL PRICES (RAS TANOURA),[a] 1970-2000
(Dollars/barrel)



Source: Organisation of the Petroleum Exporting Countries (OPEC), *Annual Statistical Bulletin 2000*, table 73, p. 119 (www.opec.org).
[a] For real prices, the implicit GDP deflator for the United States has been used, with 1996 as the base year.

Figure IV.3
SHARE OF WORLD OIL PRODUCTION, BY GROUPS OF COUNTRIES, 1974-2001
(Percentages)



Source: International Energy Agency (IEA), *Annual Oil Market Report*, various issues; *Annual Statistical Supplement for 1999, 2000*; Organisation for Economic Co-operation and Development (OECD), Paris.
[a] OECD figures include Mexico.
[b] Organization of the Petroleum Exporting Countries.

After hitting an average floor price of US$ 10 a barrel in 1998 –which was lower in real terms than pre-1973 prices– international oil prices started to recover in the first quarter of 1999 and reached an average of close to US$ 30 a barrel in 2000. This rally was the result of an agreement signed between the OPEC countries and non-OPEC producers (Mexico, Norway, Oman and Russia) to reduce production by 2.1 million barrels a day (mbl/d) as from 1 April 1999. These production cuts, in addition to those agreed upon by the OPEC members in 1998, reduced the total world oil supply by 6%. They also coincided with the higher demand generated by the economic recovery of the countries of South-East Asia and by the sustained strong growth of the United States economy during that period.

Although the price increase in current dollars was very steep, in real terms prices were lower than they had been in 1985. Therefore, the rise did not have as strong an impact on the economies of the industrialized countries as had the increases of the previous two crises. This was due mainly to the structural change in the United States economy, characterized by the rapid expansion of the services sector throughout the past decade. Another important factor was the development of the information and knowledge economy, which is much less energy-intensive (i.e., oil-intensive) than traditional industrial sectors. At present, only 800 barrels a day are required in order to produce US$ 1 million in goods and services, down from 1,400 barrels a day in 1976 (Stratfor, 2000, http://www.stratfor.com). The United States economy's lower dependence on oil meant that the price of US$ 30 a barrel in 2000 had a significantly lower economic impact than similar hikes in previous years. Nevertheless, this does not detract from the strategic importance of oil as the main source of energy for the industrialized countries. Canada, the United States, Western Europe and Japan import 22 mbl/d of crude oil –30% of world production– to meet their energy needs (Campodónico, 2000).

Furthermore, the buoyancy of oil prices was short-lived; in December 2000, owing largely to the slowdown in the world economy, oil prices began to decline, moving from an average of US$ 27.40 a barrel to US$ 15.20 a barrel a year later. Recently, in March 2002, the price picked up again following the intensification of the conflict in the Middle East. A number of factors suggest that international oil prices will be highly volatile in the future, namely: (i) the importance of the marginal barrel, due to the limited scope for the expansion of available supply in the short term because of insufficient investment in development; (ii) the petroleum industry's decision to reduce costs by drawing down inventories; and (iii) the decline in the number of tankers and refineries that can be brought on stream at short notice.

All of this has put more pressure on prices. At one time, the market usually was not affected unless there was a sharp contraction in supply or demand. Now, however, owing to market fragmentation, the lack of additional production capacity and the reduction in stocks, the market imbalance required to trigger a sharp increase in prices is much smaller than it would have been 10 years ago (Lynh, 2001).

4. Wide disparities in costs

The cost of production is defined as the cost of operating and maintaining oil wells and related machinery and equipment after an oil deposit has been discovered, acquired and developed for production. These costs vary widely between operations located in different parts of the world, owing to variations in the geological structure and characteristics (size, depth, pressure, ratio of oil to natural gas) of each oilfield.[8]

The lowest production costs in the oil industry are recorded in the OPEC countries, mainly those of the Persian Gulf and Venezuela. These countries have deposits categorized as giant (over 500 mbl) and supergiant (over 5,000 mbl). Thus, production costs in Iraq, Kuwait and Saudi Arabia are around US$ 1.50 to US$ 2 a barrel, as are the production costs of Petróleos de Venezuela, S.A. (PDVSA), while in the United States these costs amount to US$ 3.05 and, in China, close to US$ 6.90 a barrel. The costs of the leading oil TNCs[9] fall within a range of US$ 2.80 to US$ 6 a barrel (see figure IV.4).

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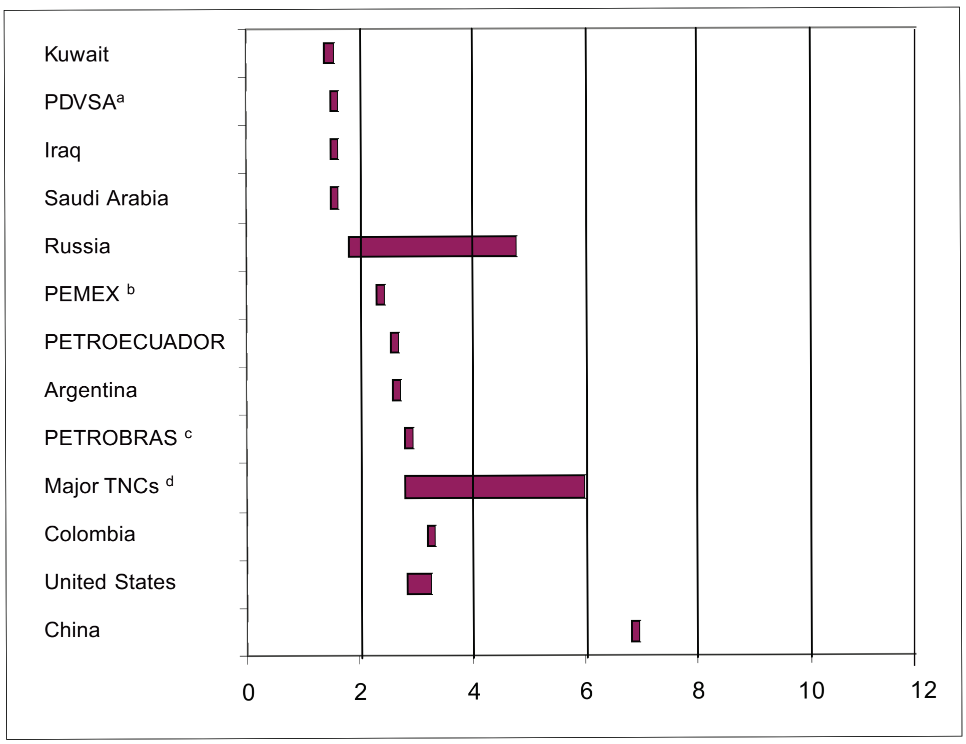
8 Production costs also vary depending on whether the operations are onshore or offshore. With respect to size, around 300 (1%) of the 30,000 known oilfields in the world account for 75% of all the oil discovered, and only 33 deposits (less than 0.1%) contain 50% of known reserves (Percebois, 1989; Martin, 1992).

9 These firms conduct their operations largely in developed countries, but are showing an increasing tendency towards greater diversification to developing countries.

In almost all cases, production costs –of countries as well as of TNCs– have been lower than international prices except at times when the latter have fallen to around US$ 10 a barrel in current prices, as they did, for example, for a few months in 1998.

Oil revenues are determined by the difference between the cost of production and the international price. State-owned enterprises of the OPEC countries reaped huge profits between the 1970s and the first half of the 1980s.[10] But the OPEC countries were not the only ones to accumulate such profits. Clearly, these revenues are also earned by firms whose production costs are below the international oil price. In the case of many developing countries, particularly a number in Latin America (Brazil, Colombia, Ecuador, Mexico and Venezuela), it was precisely because they wished to retain these revenues that governments decided not to privatize their State-owned oil enterprises.

Figure IV.4
PRODUCTION COSTS OF STATE-OWNED ENTERPRISES, PRIVATE CORPORATIONS AND SELECTED COUNTRIES, 2000-2001
(Current dollars per barrel)



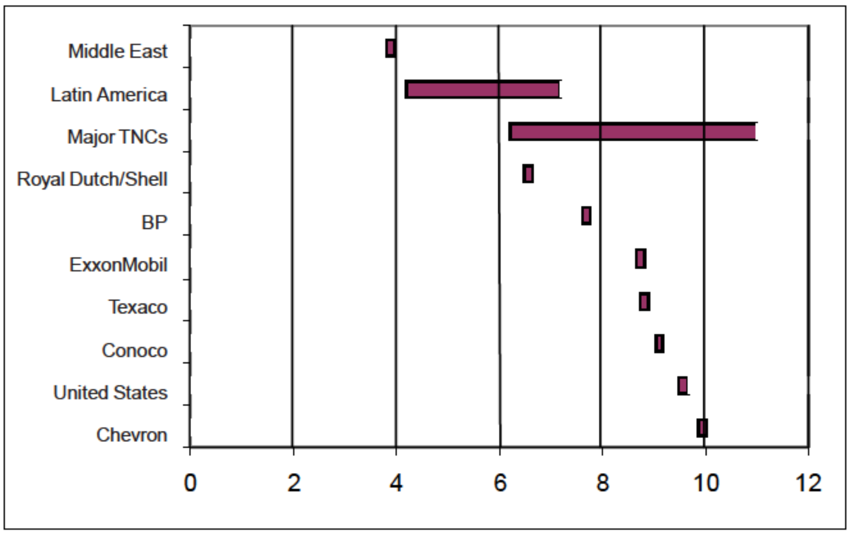
Source: Prepared by ECLAC, on the basis of official information from corporations and countries.
[a] Petróleos de Venezuela, S.A.
[b] Petróleos Mexicanos.
[c] Petróleo Brasileiro.
[d] Major transnational corporations.

Other indicators used in the oil industry, apart from production costs, are exploration and development costs. These are defined as the cost of finding new oil reserves –which includes all prospecting activities, whether successful or unsuccessful (dry wells)– as well as investments in field development for oil production. These costs have traditionally been higher than production costs.

[10] In 1980, for example, OPEC revenues amounted to US$ 280 billion in nominal terms (Ruiz Caro, 2001).

Total crude oil supply costs include exploration, development and production costs. The Middle East is still the region with the lowest total supply costs: approximately US$ 4 a barrel. In Latin America, these costs fall within a range of US$ 4 to US$ 7 a barrel (the higher figure relates to Brazil's offshore operations). The major TNCs have higher costs, ranging from US$ 6 to US$ 11 a barrel, while the average cost in the United States is US$ 9.70 a barrel (see figure IV.5).

Figure IV.5
TOTAL SUPPLY COSTS, 2000-2001
(Current dollars per barrel)



Source: International Energy Agency (IEA), 2001, *World Energy Outlook, 2001*, Organisation for Economic Co-operation and Development (OECD), Paris; Energy Information Administration (EIA), 2002, *Performance Profile of Major Energy Producers 2000*, Office of Energy Markets and End Use, United States Department of Energy, 11 January, Washington, D.C.; and Canales Treviño, "PEMEX: Retos y oportunidades", paper presented at the International Commemorative Seminar on the Fiftieth Anniversary of ECOPETROL, "Petróleo: Presente y Futuro", Bogotá, 24 August 2001.

Since 1986, when oil prices fell dramatically, oil TNCs have applied a series of cost-cutting policies, which have included: (i) technological improvements, in particular 3-D seismic technology, horizontal and oblique drilling, handling of multi-phase liquids, improvements in offshore drilling, use of new materials and use of computerized information technologies, particularly in geological and geophysical interpretation, among others (EIA, 1995, 2001a and 2002b); (ii) enhancement of administrative efficiency (corporate re-engineering) and institutional efficiency (mergers and acquisitions); and (iii) closure of wells with very high production costs.

According to the Energy Information Administration (EIA), the production costs of the largest oil firms in the United States have declined in recent years from US$ 7 a barrel in the mid-1980s to US$ 3.05 a barrel in 2000 (in constant 2000 prices), and were almost the same as the production costs incurred by the same firms in their operations outside the United States, which, in the same period, declined from US$ 5.10 to US$ 3.14 a barrel. In any event, wells were closed in the United States and in the North Sea, especially in the second half of the 1980s, when prices fell sharply.

Lastly, whereas technological advances and corporate structure are important and have a significant impact on cost reduction, the determining factor is the natural resource endowment; in this case, the oil-bearing capacity of the deposit. Thus, for example, cost reductions in the United States have not been accompanied by any increase in production, but –on the contrary– were made possible largely by the closure of high-cost operations, which brought output down from 10.1 mbl/d in 1980 to 7.7 mbl/d in 2000 (British Petroleum, 2001). Hence, in the production of a good which is a natural resource, maximizing productivity does not necessarily mean increasing output.

5. Key players in the world oil and gas market: public and private agents

The key players in the world oil and gas market can be divided into two groups:

(i) State-owned enterprises of producer countries in the developing world, which are leading actors on the global stage, since they own more than 80% of the world's oil and gas reserves (British Petroleum, 2001) and since 13 of them are listed among the 20 largest oil companies in the world (see table IV.3). Generally, their capacity in upstream operations exceeds the absorption capacity of their downstream operations, so that they are net suppliers of crude oil to the market;

(ii) Major transnational corporations based in the industrialized consumer countries, which are in the opposite situation, since they are net purchasers of crude oil on the market.

Figure IV.6 shows the leading producers of crude oil (vertical axis) and refined oil (horizontal axis). All the State-owned enterprises except PETROBRAS are on the left-hand side of the diagonal line, which means that their refining capacity is lower than their production capacity. However, PDVSA and Petrochina, two State-owned enterprises, have a refining capacity that covers nearly all of their output. All the private firms, which are in the opposite situation, are on the right-hand side of the diagonal line.

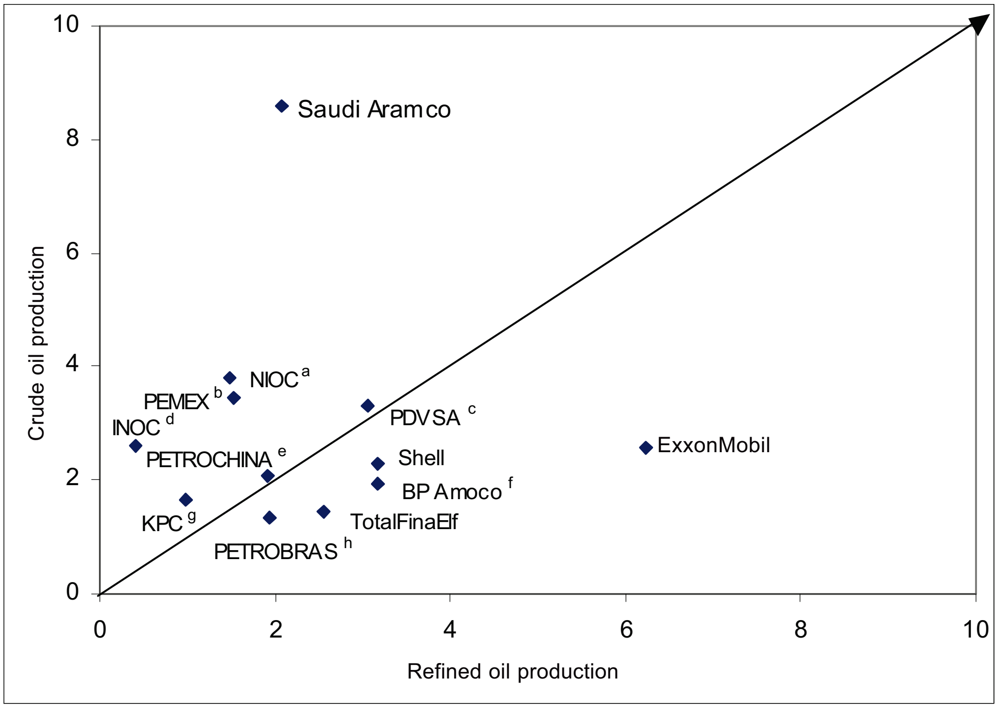
Some firms have sought to reduce the imbalance between their upstream and downstream activities. To this end, State-owned enterprises such as PDVSA, Saudi Aramco and Kuwait Petroleum Corporation (KPC) have invested in downstream operations in consumer countries. Private TNCs are primarily concerned with increasing their capacity in upstream operations, as will be discussed below, but they face stiff barriers to their entry into producer countries in the developing world, where the largest and most profitable deposits are found.

Table IV.3
OIL PRODUCTION OF THE WORLD'S 20 LEADING FIRMS, 2000

	Ownership		Production
	State-owned	Private	Thousands of barrels/day
Saudi Aramco	Saudi Arabia		7,915
NIOC [a]	Iran		3,660
PEMEX [b]	Mexico		3,460
PDVSA [c]	Venezuela		3,252
INOC [d]	Iraq		2,573
ExxonMobil		United States	2,501
Royal Dutch/Shell		Netherlands/United Kingdom	2,279
Petrochina (China)	China		2,096
NNPC [e]	Nigeria		2,038
ChevronTexaco		United States	1,962
Abu Dhabi NOC [f]	United Arab Emirates		1,904
BP Amoco [g]		United Kingdom	1,890
KPC [h]	Kuwait		1,633
OAO Lukoil		Russia	1,553
TotalFinaElf		France	1,433
Libya NOC [i]	Libya		1,416
PETROBRAS [j]	Brazil		1,274
Pertamina	Indonesia		1,268
OAO Yukos		Russia	992
Petroleum Development Oman	Oman		841

Source: *Oil & Gas Journal*, "OGJ 200, shrinks as financial results rocket", Special report, 1° October 2001.
[a] National Iranian Oil Company. [b] Petróleos Mexicanos. [c] Petróleos de Venezuela, S.A. [d] Iraq National Oil Company. [e] Nigerian National Petroleum Corporation. [f] Abu Dhabi National Oil Company. [g] British Petroleum Amoco. [h] Kuwait Petroleum Corporation. [i] Libyan National Oil Corporation. [j] The ownership structure (public versus private), of Petróleo Brasileiro (PETROBRAS) is unique. The Federal State is the principal shareholder (32.5%) and holds 55% of the voting share; it therefore has political control of the enterprise and can impose its own objectives. However, PETROBRAS is a joint-stock company listed on the stock exchange. Accordingly, its strategy must also be sensitive to private shareholders' objectives in terms of profitability.

Figure IV.6
CRUDE OIL AND REFINED OIL PRODUCTION OF THE WORLD'S LEADING OIL COMPANIES, 2000
(Millions of barrels/day)



Source: *Petroleum Intelligence Weekly*, Special Supplement, December 2001.
[a] National Iranian Oil Co. [b] Petróleos Mexicanos. [c] Petróleos de Venezuela, S.A. [d] Iraq National Oil Co. [e] Subsidiary of the China National Petroleum Corporation. [f] British Petroleum Amoco. [g] Kuwait Petroleum Corp. [h] Petróleo Brasileiro.

The opening of the oil sector to private investors in some developing producer countries in the 1990s enabled TNCs to achieve wider geographical diversification of their operations in upstream activities. In most of these countries, however, especially in Latin America, the State has retained ownership of government petroleum enterprises. In the new climate of reform, which to some extent has exposed State-owned enterprises to competition from the major TNCs but has also enabled them to maintain their dominant position in the domestic market, there has generally been an innovative process of restructuring and reorganization of such firms to enhance their efficiency, with the launching of joint ventures between these firms and new private actors.

Thus, the greater openness introduced in some oil-producing countries has not meant that State enterprises have withdrawn from the oil industry, except in a few countries, such as Argentina, Bolivia and Peru. Rather, these enterprises have tended to reorganize and to multiply their alliances with private firms in response to low real oil prices –which have prevailed since the mid-1980s– and to competition from private TNCs in their own markets.

B. INDUSTRIAL ORGANIZATION AND BUSINESS STRATEGY

The nationalization process caused a sudden and deep cut in the production chain of transnational oil corporations, reducing their upstream capacities to well below the absorption potential of their refineries downstream. In the light of this new situation, their first priority was to rebuild their reserves, in order to recover part of the oil rent and improve their vertical integration; this has remained a constant feature of their strategy to the present day. The measures used to achieve this aim have varied with the behaviour of prices, however. High prices encouraged TNCs to invest heavily in exploration and development in places with easy access to reserves –such as OECD countries– while low prices forced them to cut costs and redirect their upstream activities to developing countries that were, to some degree, reopening access to their reserves.

TNC strategies also reflected other goals and requirements, including those arising from the new situation of the industry and the need to rebuild their oil reserves. Between 1974 and 1985, the state of the industry forced TNCs to adjust and restructure their downstream activities in line with their upstream businesses and the behaviour of demand, both of which were affected by the high level of oil prices and the world economic slowdown (EIA, 1995). The behaviour of prices, together with access barriers to abundant reserves, encouraged diversification towards other forms of energy, such as nuclear power, coal and alternative energy sources (solar and biomass, among others). Oil TNCs also diversified into non-energy activities[11] in order to spread risk and exploit their know-how, especially in state-of-the-art technologies.[12] Low oil prices, by contrast, encouraged firms to engage in mergers and acquisitions to gain access to new reserves at lower cost, while also fostering the development of the natural gas industry and the new gas-electricity chain.

Given the lack of standardized data on oil TNCs worldwide, the figures presented here (and only the figures) are based partly on statistics published in the annual study carried out by the Energy Information Administration (EIA).[13] This study contains information on the leading oil companies in the United States[14] that file information with the Financial Reporting System (FRS).

1. Vertical integration and cartels – the optimal arrangement for maximizing profits

Vertical integration is the form of organizing production that has traditionally yielded the highest returns in the oil industry, and this is still the case today. The price-setting power wielded by the "seven sisters" cartel was based on its participation in all phases of the oil business chain (exploration, production, refining, transportation and wholesale and retail trade in petroleum products), which began with the ownership of 75% of world upstream production –especially in the Middle East and Venezuela– and was prolonged by the development of a complex and sophisticated network that controlled the petroleum chain downstream throughout the world.

This cartel made huge profits for its member firms, turning them into the world's most important and powerful companies. The source of these rents was the difference between the cost of production of crude oil and its resale price on the world market. Between the 1950s and the 1970s, production costs remained broadly constant, averaging between US$ 0.15 and US$ 0.20 a barrel, while the market price averaged US$ 1.40 a barrel (Mullen, 1978).

2. Nationalization, vertical disintegration and rebuilding of assets in upstream activities

The change in ownership of the world's largest oil deposits led to the vertical break-up of oil TNCs and forced them to make contracts with third parties to supply crude oil to their refineries. The need to regain their own oil reserves and production has been a key strategy objective ever since.

In the wake of the two oil shocks, and particularly after the second one, TNCs dramatically increased their exploration and development expenditure, redirecting their upstream activities towards OECD countries, which offered the advantage of greater political security but also the disadvantage of deposits with relatively high

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11 Such activities have included informatics, biotechnology, the pharmaceutical industry, mining and real estate.

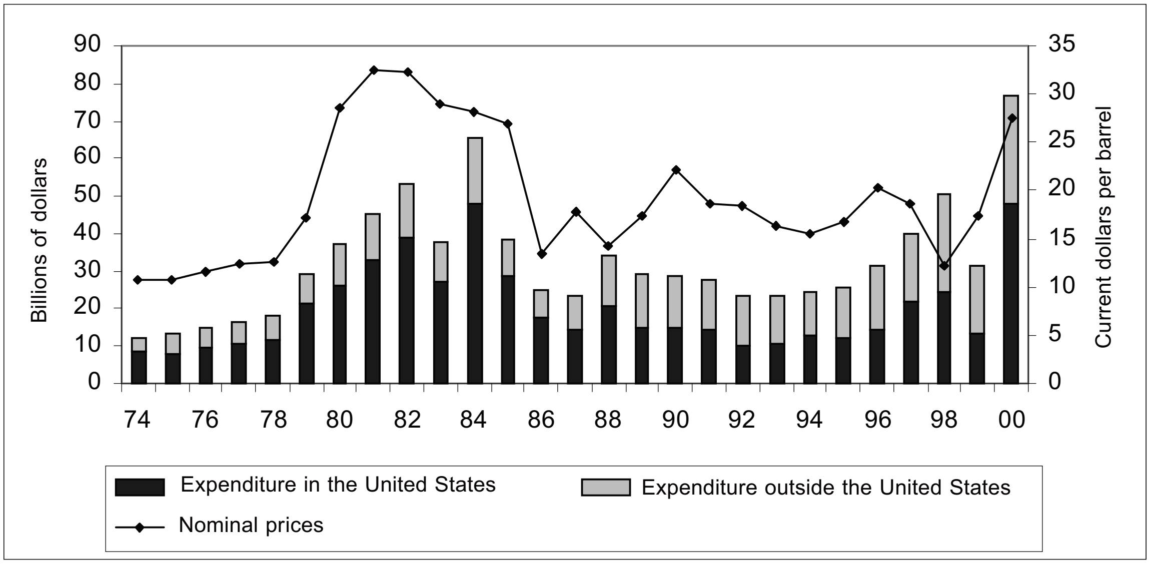
12 The results of the diversification drive were generally disappointing, and in the 1980s the trend was for firms to pull out of many of their non-traditional activities and focus more strongly on natural gas and oil. For an analysis of this topic, see Percebois (1989), Mikdashi (1986) and EIA (1995).

13 The study is entitled "Performance Profiles of Major Energy Producers".

14 The selection criterion relates to firms that have at least a 1% share in production, in oil or natural gas reserves, in refining capacity or in sales of petroleum products in the United States. This includes subsidiaries of foreign firms that meet this requirement. The number of these firms in 2000 was 33.

production costs. In the case of the leading United States oil firms, annual exploration and development expenditure virtually tripled between 1978 and 1980 and remained at high levels until 1985 (see figure IV.7). Between 1977 and 1985 nearly 90% of such expenditure was made in Canada, the United States and the North Sea, with the United States accounting for 72% (EIA) (http://www.eia.doc.gov/emeu/finance/frsdata.html).[15]

Figure IV.7
TOTAL EXPLORATION AND DEVELOPMENT EXPENDITURE BY THED LEADING UNITED STATES OIL FIRMS AND NOMINAL PRICES FOR RAS TANOURA OIL



Source: Organisation of the Petroleum Exporting Countries (OPEC), *Annual Statistical Bulletin 2000*, table 73, p. 119 (www.opec.org), Energy Information Administration (EIA), *Financial Reporting System Public Data*, 2001 (http://www.eia.doe.gov/emeu/finance/frsdata.html).

The abrupt fall in oil prices in the mid-1980s was accompanied by a sharp reduction in exploration and development activities, which was particularly pronounced in the United States. Given the persistence of low prices, TNCs decided to increase their investments in developing countries that offered some degree of access to their reserves. This is reflected in figure IV.8 by the relative increase in exploration and development expenditure in developing countries since 1989; this trend was confirmed and considerably intensified from 1996 onward. Initially, the focus was on Asia-Pacific and Africa, but, starting in the second half of the 1990s, investment increased substantially in all regions except the Middle East, and also began to target the countries of the former Soviet Union and Eastern Europe (see figure IV.9).

In the second half of the 1990s Latin America was the region receiving the largest increase in FDI for exploration and development (see figure IV.9), in response to policies that opened the door to private-sector investment in nearly all the region's oil countries except Mexico.

In 2000, exploration and development expenditure increased substantially (146%) and its geographical distribution broke sharply with the previous pattern. Although the increase affected all regions, it was most intense in the OECD countries (203%), especially the United States (256%) (EIA, 2002b).

This major increase largely reflected the acquisition of new areas for exploration and development[16] as a result of a powerful wave of mergers and acquisitions in the oil sector that year. It is also explained by higher prevailing oil prices, which significantly boosted corporate profits and encouraged investment in relatively high-cost regions.

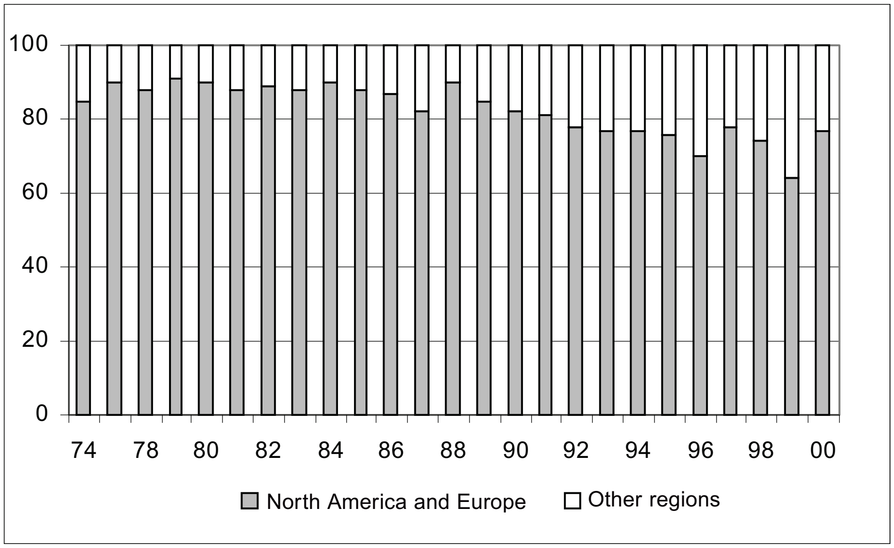
[15] If these figures had included the large European oil companies, the United States would certainly have been relatively less important as a target for exploration expenditure, and the North Sea would have been more important.

[16] These acquisitions accounted for 67% of exploration and development expenditure among the leading oil firms in the United States (EIA, 2001c).

Figure IV.8

DESTINATION OF EXPLORATION AND DEVELOPMENT EXPENDITURE BY THE LEADING UNITED STATES OIL FIRMS

(Percentages)

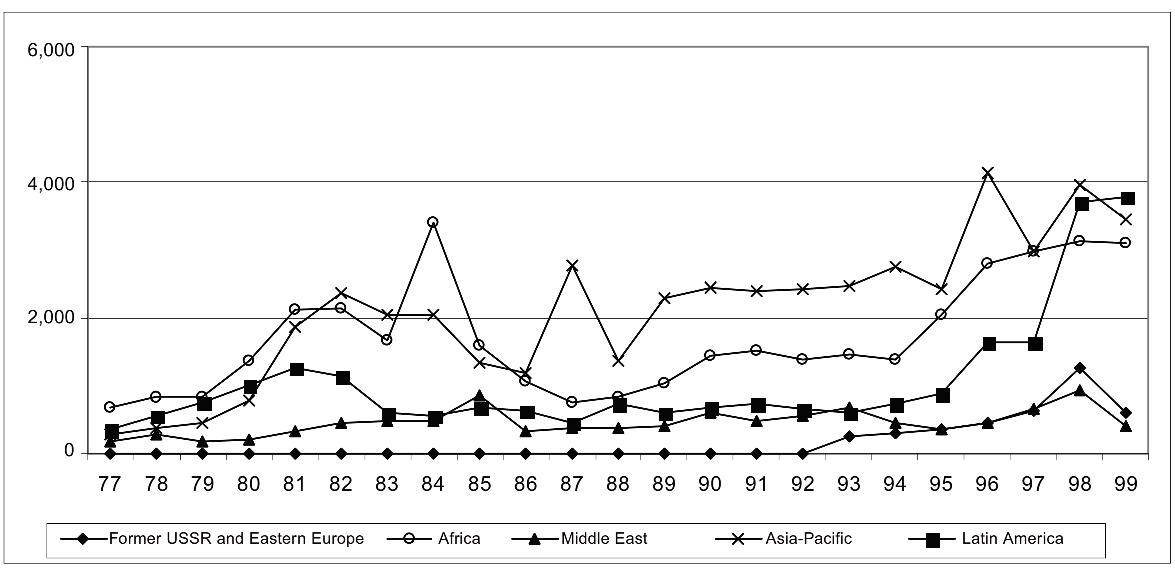


Source: Energy Information Administration (EIA), *Financial Reporting System Public Data*, 2001 (http://www.eia.doe.gov/emeu/finance/frsdata.html).

Figure IV.9

EXPLORATION AND DEVELOPMENT EXPENDITURE MADE IN DEVELOPING COUNTRIES BY THE LEADING UNITED STATES OIL FIRMS

(Millions of dollars)



Source: Energy Information Administration (EIA), *Financial Reporting System Public Data*, 2001 (http://www.eia.doe.gov/emeu/finance/frsdata.html).

3. Development of natural gas production and the gas-electricity chain

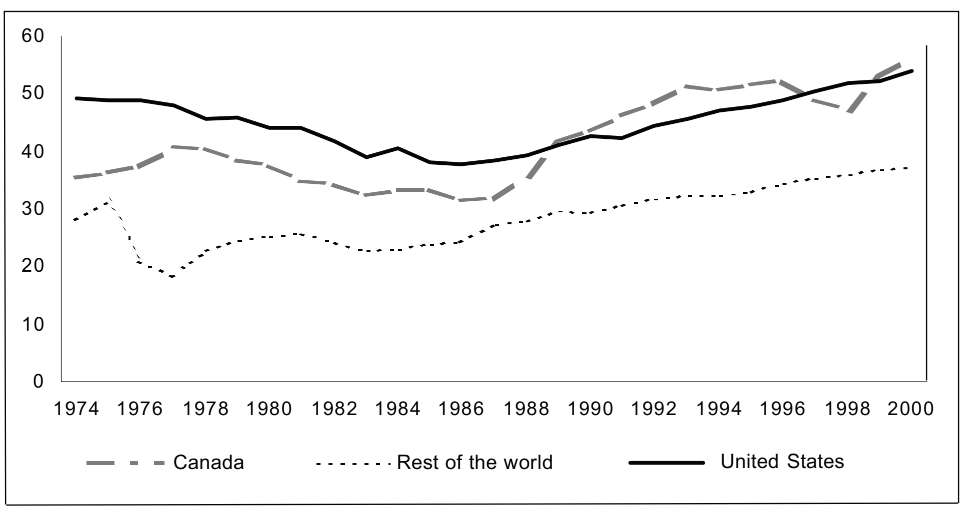
The steep fall in crude oil prices that occurred in 1986, followed by the progressive liberalization of the energy sector in several countries, together with increasing environmental concerns, combined to enhance the importance of natural gas in hydrocarbon production (see figure IV.10).[17] This was particularly evident in Canada, where TNCs purchased major gas assets starting in the second half of the 1980s, with a view to exporting to the United States (EIA, 2001a).

Natural gas thus became more important in worldwide primary energy consumption (see figure IV.11). According to EIA estimates, its share grew from about 18% in 1970 to 23% in 1999 (overtaking coal for the first time), and is expected to reach 28% by 2020. Its use in electric power generation is also expected to increase because of its economic and environmental advantages. In addition, natural gas is projected to account for 43% of the total increase in the energy consumed for electric power generation between 1999 and 2020 (EIA, 2002a).

The growth in natural gas output has been accompanied by greater investment in downstream activities. This has resulted in the proliferation of pipeline networks for transporting the gas, together with distribution networks connecting industries and households, as well as liquefied natural gas (LNG) projects made profitable by the significant progress made in liquefaction techniques and maritime transport. In addition, there have been multiple strategic alliances between oil companies and electric power and gas distribution firms, aimed at creating a gas-electricity chain in response to the liberalization and privatization of the electric power and natural gas markets in many OECD and developing countries. From the 1990s onward, the oil companies' integration strategy has been to branch out into the natural gas segment in a gas-electricity chain extending from raw material reserves to the final consumers of natural gas and the electric power generated from it. By means of such integration, the oil companies plan to secure a market for their reserves and diversify their activities in the energy sector, thus reducing their vulnerability to gas price volatility, whose effects on profitability are offset in the course of the progression through the various stages of the chain.

The growing importance of natural gas in the oil companies' strategy, which has led them to expand their activities to cover the whole energy chain, is clearly reflected in the creation of special gas and energy departments in the organizational structure of all oil TNCs in the 1990s.

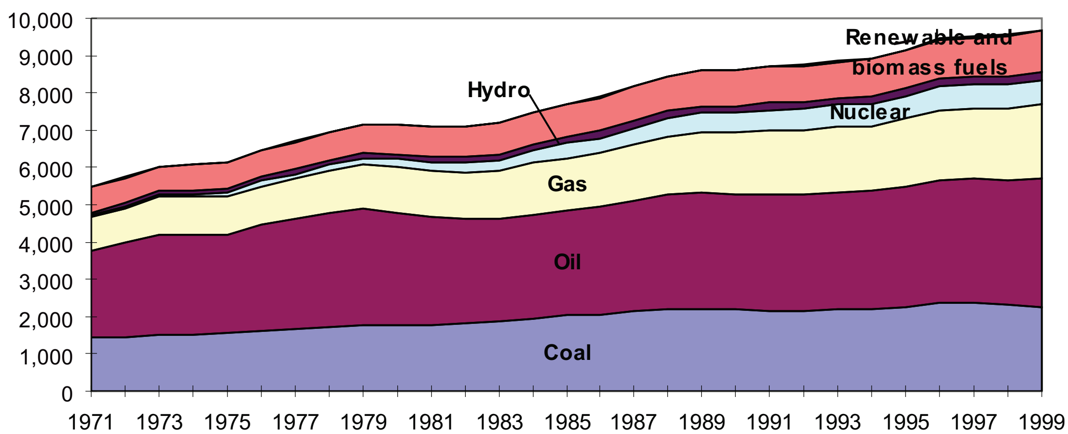
Figure IV.10
SHARE OF NATURAL GAS IN TOTAL HYDROCARBON PRODUCTION BY LEADING UNITED STATES OIL FIRMS, 1974-1999
(Percentages based on barrels of oil equivalent)



Source: Energy Information Administration (EIA), *The Majors' Shift to Natural Gas*, Office of Energy Markets and End Use, United States. Department of Energy, Washington, D.C., September 2001.

[17] This development was supported, among other factors, by a rise in the price of gasoline in the United States and by tax credits for the production of non-conventional fuels, introduced in 1990 (section 29 of the Windfall Profit Tax Act) (EIA, 2001a).

Figure IV.11
TREND OF TOTAL WORLD PRIMARY ENERGY SUPPLY, BY FUEL TYPE
(Millions of tons of oil equivalent)



Source: International Energy Agency (IEA), *World Energy Outlook 2001*, Organisation for Economic Co-operation and Development (OECD), Paris, 2001.

4. Mergers and acquisitions – greater industrial concentration

Over the past 20 years, TNCs have generated greater concentration in the oil market by taking over other firms. This trend emerged in the early 1980s, driven by a fall in their stock market values.[18] In this way, TNCs gained access to reserves and increased their vertical integration more cheaply than they could have done by discovering oil and gas for themselves (finding cost), thus also eliminating exploration risk and cutting costs through the exploitation of synergies and downsizing.

Between 1981 and 1984, merger and acquisition (M&A) operations totalled over US$ 58 billion, of which US$ 32 billion corresponded to a single year (1984) when the major oil TNCs joined the M&A wave.[19] Mergers and acquisitions in the sector remained at high levels every year until the end of the 1980s, but then faded during the first half of the 1990s before reviving again in 1996 in a context of low oil prices. From 1998 to 2000, record figures were achieved again, amounting to about US$ 140 billion in 2000 (see figure IV.12). The largest acquisitions include the purchase of Mobil by Exxon; Amoco and Arco by British Petroleum (BP); Fina and Elf Aquitaine by Total; Yacimientos Petrolíferos Fiscales (YPF S.A.) by Repsol S.A.; and Texaco's merger with Chevron. A possible merger between Phillips and Conoco is currently awaiting the authorities' approval and the shareholders' verdict (see table IV.4).

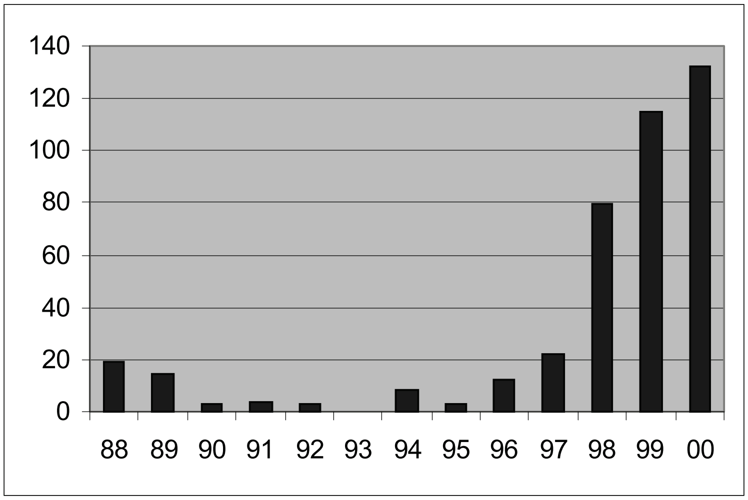
In addition to seeking advantages such as higher profitability, enhanced efficiency, geographical diversification and vertical integration, TNCs have also undertaken mergers and acquisitions with a view to becoming larger. This enabled the leading private-sector players to close the gap with respect to major public-sector firms that control the largest volumes of reserves and production, and also –once the M&A movement had started to gather momentum– helped them to avoid being taken over in the future.

[18] This fall is attributable to several factors: (i) the downward trend in oil prices, which fell gradually starting in 1982; (ii) the failure of the main TNCs to diversify into areas other than oil-related activities, which affected their profitability; and (iii) a more restrictive policy towards dividend distributions to shareholders in oil companies as compared to other industrial sectors (EIA, 1995).

[19] In 1984, Chevron bought Gulf Oil for US$ 13.3 billion, Texaco acquired Getty Oil for US$ 10.2 billion and Mobil paid US$ 5.72 billion for Superior Oil Corporation.

Figure IV.12

MERGERS AND ACQUISITONS IN THE HYDROCARBONS SECTOR
(TRANSACTIONS GREATER THAN US$ 1 BILLION)
(Billions of dollars)



Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, based on information from *Thomson Financial Securities Data, 2001*.

Table IV.4

MAIN MERGERS AND ACQUISITIONS IN THE WORLD OIL SECTOR BETWEEN 1989 AND 2001
(TRANSACTIONS GREATER THAN US$ 4.5 BILLION)
(Millions of dollars)

Year	Buyer	Country	Company acquired	Country	Percentage acquired	Amount
1999	Exxon Corp.	United States	Mobil Corp.	United States	100	78,946
2000	Total Fina S.A.	France	Elf Aquitaine	France	95	50,070
1998	British Petroleum	United Kingdom	Amoco Corp.	United States	100	48,174
2001	Texaco Inc.	United States	Chevron Corp.	United States	100	35,000
2000	BP Amoco	United Kingdom	Atlantic Richfield Co. (ARCO)	United States	100	27,224
2002	Phillips Petroleum Co. [a]	United States	Conoco Inc.	United States	100	15,170
1999	Repsol [b]	Spain	YPF	Argentina	98	15,169
1999	Total S.A. [c]	France	Petrofina S.A.	Belgium	99	12,769
2001	Transocean Sedco Forex Inc.	United States	R&B Falcon Corp.	United States	100	9,091
2000	Investor group	Netherlands	Dordtsche Petroleum	Netherlands	100	8,126
1997	Duke Power Co.	United States	PanEnergy Corp.	United States	100	7,667
2000	Andarko Petroleum Corp.	United States	Union Pacific Resources Group	United States	100	7,250
2000	Phllips Petroleum Co.	United States	ARCO-Activos petroleros, Alaska	United States	100	7,000
1998	Investors	Italy	Ente Nazionale Hidrocarburi (ENI)	Italy	13	6,643
2002	PanCanadian Petroleum Ltd.	Canada	Alberta Energy Company (AEC)	Canada	100	6,600
1989	Hanson	United Kingdom	Consolidated Gold Fields	United Kingdom	100	5,236
1999	Investor group	Norway	Saga Petroleum AS	Norway	100	4,933
2000	BP Petroleum Amoco	United Kingdom	Burmah Castrol	United Kingdom	100	4,705
2001	Minority shareholders [d]		PETROBRAS	Brazil	18	4,693
1998	Baker Hughes Inc.	United States	Western Atlas Inc.	United States	100	4,564

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management.
[a] This operation has not yet been completed but negotiations are at an advanced stage. [b] The operation was carried out in two stages: first the pruchase of 14.99% for US$ 2.011 billion, and then 83.24% for US$ 13.158 billion. [c] The operation was carried out in two stages: first the purchase of 41% for US$ 5.298 billion, and then 57.8% for US$ 7.470 billion. [d] The shares were sold in 2000 and 2001: first 14.3% for US$ 4 billion, and then 3.3% for US$ 693 million.

C. THE LEADING PRODUCERS IN THE HYDROCARBONS MARKET IN LATIN AMERICA AND THE CARIBBEAN

Prior to the oil-sector reforms of the early 1990s, TNCs had only a marginal presence in Latin America and the Caribbean. In upstream activities, they were confined to a few small and medium-sized producer countries such as Argentina, Bolivia, Colombia, Ecuador, Peru and Trinidad and Tobago, whose legislation permitted private investment in the petroleum sector. This was not the case in Brazil, Mexico or Venezuela, where investment in that segment of the market remained the preserve of State-owned firms. The presence of TNCs in downstream activities was even more limited, since nearly all countries also reserved these exclusively for State-owned oil companies –especially refining, pipeline transport and wholesale marketing of petroleum products.

1. Reform in the hydrocarbons sector

The reforms encompassed the following areas: (a) the rules governing contracts for exploration and production (upstream) activities; (b) transport, refining and marketing (downstream) activities; and (c) modernization of State firms and formulation of new business strategies to adapt to the new paradigm.

(a) Reform of the rules governing contracts for upstream activities

In this segment, the reform consisted essentially of measures to enhance the countries'competitiveness by offering stronger incentives to keep venture capital from migrating to other parts of the world, such as Russia, China or the Asian republics of the former Soviet Union. These countries have significant oil potential, but they barred access by foreign investors until just a few years ago. The countries of the region can be grouped as follows with regard to the changes made in the rules for contracting with foreign companies:

(i) Countries that already had FDI in upstream activities and improved incentives for foreign firms in the 1990s –privatization in Argentina, Bolivia and Peru; greater participation in oil production and better conditions for private firms in Colombia, Ecuador and Trinidad and Tobago;

(ii) Countries that opened their upstream activities to FDI while maintaining the preponderant role of State-owned firms (Brazil and Venezuela);

(iii) Countries that maintained the State monopoly: Mexico is the only country in the region that has not amended its legislation on upstream production, in which the monopoly held by Petróleos Mexicanos (PEMEX) in the exploration and production segments remains in force.

(b) Oil reforms in downstream activities and deregulation of retail markets

Most of the region's countries except Mexico have altered their legislation on the transport, refining and marketing of oil and petroleum products. The reforms open the door to private investment in these segments, which in most cases (except in Argentina and Brazil) had previously been the exclusive preserve of State-owned firms. Many countries have also deregulated their domestic markets, abolishing subsidies and price controls, and have allowed tariff-free importation of oil and petroleum products.

(i) Private-sector participation in oil pipelines

Nearly all the countries (excluding Mexico and Venezuela) allow pipelines for the transport of crude oil and petroleum products to be built and operated by both State-owned and private enterprises. In some countries, however, private firms must first sign operating contracts with the State firm.

(ii) Reform of the rules governing refineries

Practically all the countries analysed except Mexico have amended or strengthened their legislation to allow private investment in crude oil refining activities. The currently prevailing view is that there should be free competition in this segment.

(iii) Reform of the domestic fuel price regime

The general trend of the reforms in connection with the price of petroleum products on the domestic market is to allow them to be set in accordance with international prices. This policy has significantly improved the revenues of oil companies in general, but especially the earnings of State firms. The countries that have adopted this policy are Argentina, Bolivia, Brazil, Chile, Ecuador, Mexico and Peru. There are two price-setting methodologies:

– Prices left completely free. This is the case in Argentina, Brazil, Chile and Peru, where prices are monitored and supervised by government bodies;

– Prices set by a government body. This is the case in Bolivia, Ecuador and Mexico. In Bolivia the consumer price is subject to a ceiling set by the regulator. In

Ecuador, a law establishes a scheme for regulating fuel prices on the domestic market, based on a mechanism that considers import parity prices, together with other costs such as freight and taxes. In Mexico, the entire price structure is regulated by the Committee on the Prices of Oil, Natural Gas and Petrochemical Products (Campodónico, 1996 and 2000; OLADE, 2000; Sánchez-Albavera, 1997).

(c) Modernization of undivested State-owned firms and privatization in Argentina, Bolivia and Peru

State participation continues to dominate the Latin American hydrocarbons market. In view of the economic power of State oil companies, based on the oil rent (see box IV.1), and the strategic importance of the product for the economy's overall competitiveness, the countries approached privatization cautiously, often opting for strategic partnerships with transnational capital instead of privatization, or stimulating private participation in the different market segments. The exceptions were Argentina, Bolivia and Peru, where the State sold off its oil companies completely.

The participation of new players and the introduction of a degree of competition forced State-owned firms to modernize their management by creating decentralized administrative structures centred around business areas and holding companies. This enhanced the transparency of each segment of the oil business (exploration and production, refining, transport, marketing, natural gas), thereby improving administrative and managerial efficiency and ensuring higher levels of return and benefits for consumers.[20]

In countries where sectoral reform involved the full divestment of publicly-owned assets, the strategy adopted responded to a variety of forces (Booz-Allen and Hamilton, 1993; Kozulj and Bravo, 1993; Kozulj, 2002). In Argentina, the reform was heavily influenced by macroeconomic factors, and the main objective was to maximize the current value of hydrocarbon assets by expanding production. This, in turn, was aimed at: (i) improving the external account by increasing export revenues and attracting FDI; and (ii) strengthening the fiscal account via a capital injection resulting from the disposal of the State-owned firm and the lifting of the fiscal burden imposed by YPF, given its financial problems.[21]

In Peru, the main aim of privatization was to attract foreign capital by signalling the new direction of the country's economic policy; the price that could be obtained for the firm's assets was of secondary importance (Booz-Allen and Hamilton, 1993). Unlike Argentina, Peru did not see the expansion of fiscal revenues as a key objective, since its public accounts were in balance and its level of international reserves was high. The privatization strategy, based on the break-up of the State firm, also differed from the process in Argentina, where YPF was sold as a vertically integrated business.

Bolivia, meanwhile, developed a strategy aimed at capitalizing the State firm and increasing the country's saving. Capitalization of the oilfields belonging to Yacimientos Petrolíferos Fiscales Bolivianos (YPFB), together with the oil pipeline system, required the buyer to make new investments fully matching the market value of the assets acquired, thereby creating new equity equivalent to 50% of the total capital of the new firm. Ownership of the remaining 50% of the shares was transferred to Bolivian pension funds.

A case that contrasts with those of Argentina, Bolivia and Peru –all petroleum-rich countries that sold off their State-owned hydrocarbon firms– is that of Chile, which imports 95% of the oil it consumes and has used its State enterprise to obtain a secure supply of oil from outside its territory. In 1990 the National Petroleum Corporation (ENAP) created a subsidiary company (SIPETROL) devoted exclusively to oil exploration and production abroad. In 2000, ENAP produced 5,000 barrels a day in the Magallanes region, while SIPETROL produced 15,000 barrels a day from the various fields in which it participates outside Chile.

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[20] For a detailed analysis of reforms of State-owned oil and gas enterprises in Brazil, Colombia, Ecuador, Mexico and Venezuela, see Campodónico (1996).

[21] These problems resulted from institutional restrictions which for several years had prevented the firm from operating so as to maximize profits, using it instead as a tool to fight inflation and provide subsidies to local subcontractors. The most egregious example of this was the transfer to the latter of areas explored and developed by YPF –particularly during the last military dictatorship. Production from these areas, now exploited by private contractors, had to be purchased by YPF at prices above what it could obtain from sales to private-sector refineries. The firm's foreign currency debt grew from US$ 640 million in 1976 to US$ 4.646 billion in 1982 (Kosulj and Bravo, 1933; Gadano, 1998; Kosulj, 2002).

Box IV.1

THE MAGNITUDE OF THE OIL RENT IN LATIN AMERICA

To give an idea of the size of the oil rent in Latin America, calculations were made for five oil-producing countries (Argentina, Colombia, Ecuador, Mexico and Venezuela), defining the rent as the difference between the international oil price and the production cost, multiplied by output volume.

This exercise used the average international price of crude oil exports from each of these countries in 1998 (a year of low prices) and 2000 (a high-price year). Oil production costs, in dollars per barrel, were obtained from official data released by the companies.

The result represents an estimate of the maximum rent that could be received if all production were sold at the average international export price, both domestically and on the external market. The figures should be taken as reference values only, however, and two additional points should also be considered: (i) the amounts calculated do not include investments to explore new reserves and develop new deposits, which are essential to the industry's continuity. Firms would normally use part of the oil rent for such purposes; and (ii) the oil rent is shared between the business stakeholders in the petroleum industry (i.e., private firms and the State-owned company) and each country's Treasury. This analysis does not include a quantitative breakdown of the rent generated, as that would go beyond the scope of this chapter.

As can be seen, the rent generated by oil production reaches very high figures. For example, in Mexico and Venezuela in 2000, the total rent would have been US$ 22.5 billion and US$ 22.7 billion, respectively (see figure). In 1998, when oil prices were at their lowest levels of the decade, the rent in these countries was US$ 7.3 billion and US$ 10.1 billion respectively. In Argentina, Colombia and Ecuador, the figure would have been smaller, but still significant in relative terms for each of these countries.

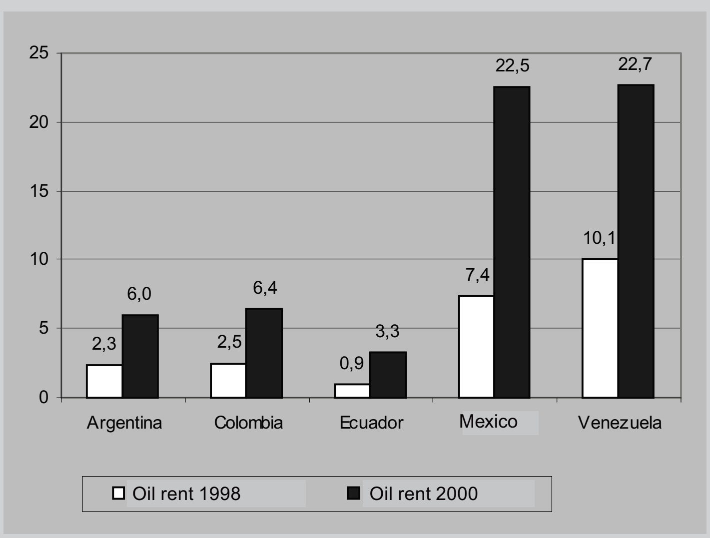
CALCULATION OF OIL RENT IN SELECTED COUNTRIES

	Cost of production	Average prices		Differential rent (1)		Production (2)		Oil rent = (1) * (2)	
		1998	2000	1998	2000	1998	2000	1998	2000
	Dollars per barrel					Millions of barrels		Millions of dollars	
Argentina	2.6	10.0	24.0	7.4	21.4	309	281	2,288	6,012
Colombia	3.2	12.5	28.6	9.3	25.4	270	251	2,521	6,365
Ecuador	2.5	9.2	24.9	6.6	22.4	137	146	906	3,276
Mexico	2.0	8.6	22.1	6.6	20.1	1,121	1,120	7,352	22,466
Venezuela	1.5	9.9	22.0	8.4	20.5	1,197	1,105	10,099	22,657

Source: OLADE, Economic and Energy Information System (SIEE), http://www.olade.org.ec/sieehome/home_siee.htm; and figure IV.4

OIL RENT IN SELECTED COUNTRIES

(Millions of dollars)



Source: Previous table.

The oil rent generated in these countries has two major positive effects on their economies: first, it produces an increase in fiscal revenues, through transfers made by the State firm; and second, it generates a large inflow of foreign exchange from crude oil exports. There can also be negative effects, however. One of these, known as "Dutch disease", occurs when the local currency appreciates as a result of the extraordinary increase in foreign currency inflows. It is crucial for countries to manage their use of these resources correctly.

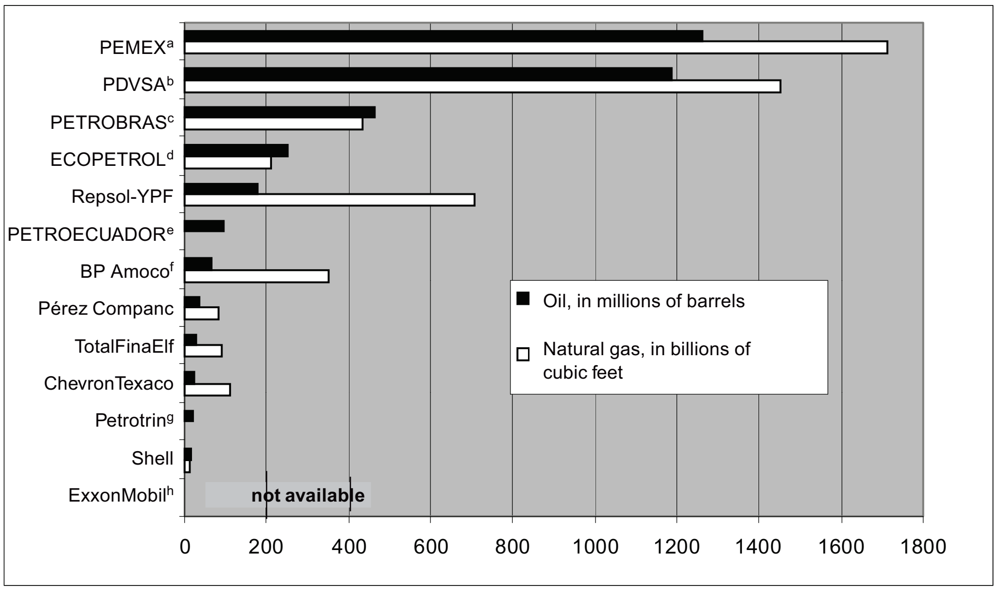
2. The size of State enterprises and their effect on the oil market

The dominant role retained by State-owned enterprises in the region's oil production (see figure IV.13), in terms of investments, sales, level of profits and regional exports, clearly illustrates the importance of their growth strategy and the amount of room they allow for TNCs in the petroleum sector.

Figure IV.13

PRODUCTION OF OIL AND NATURAL GAS BY LEADING PRODUCERS IN LATIN AMERICA AND THE CARIBBEAN, 2000

(Ranked by oil production)



Source: *Oil & Gas Journal*, "OGJ 200, shrinks as financial results rocket", Special report, 1 October 2001. Repsol-YPF, 2001, Annual Report on Form 20-F Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended: December 31, 2000, Commission file number 1-10220, United States Securities and Exchange Commission, Washington, D.C. BP P.L.C., 2002, Annual Report on Form 20-F Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, for the fiscal year ended: December 31, 2001, Commission file number 1-6262, United States Securities and Exchange Commission, Washington, D.C. PÉREZ COMPANC S.A., 2002, Annual Report and Accounts as at 31 December 2001 and 2000, together with Auditor's Report and Report of Regulatory Commission. TOTALFINAELF S.A., 2001, Annual Report on Form 20-F Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended: December 31, 2000, Commission file number 1-10888, United States Securities and Exchange Commission, Washington, D.C. CHEVRONTEXACO Corporation, 2002, fourth quarter 2001 earnings release investor relations supplement, January 29; ROYAL DUTCH PETROLEUM COMPANY, 2001, Annual Report on Form 20-F Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended: December 31, 2000, Commission file number 1-4039, United States Securities and Exchange Commission, Washington, D.C. EXXONMOBIL CORP, 2001, Annual Report on form 10-K Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended: December 31, 2000, Commission file number 1-2256, United States Securities and Exchange Commission, Washington, D.C.

[a] Petróleos Mexicanos. [b] Petróleos de Venezuela, S.A. [c] Petróleo Brasileiro. [d] Empresa Colombiana de Petróleos. [e] Petróleos del Ecuador. [f] British Petroleum Amoco. [g] Petroleum Company of Trinidad and Tobago Ltd. [h] In the case of ExxonMobil, production figures for oil and natural gas in Latin America appear under the heading "others outside United States", unlike other regions such as Asia-Pacific and Africa, which are specifically named when their importance so warrants (for example, Africa appears specifically in the case of oil production but not in the case of gas). This shows that Latin America is of minor importance in the firm's upstream operations.

In the 2000 ranking of the top 500 Latin American firms by sales volume (*América Economía*, 2001) (see table IV.5), the State-owned firms PDVSA and PEMEX surpassed all private companies in the region. PETROBRAS was ranked fourth, and several others were among the top 120. In 2000, State-owned oil companies also recorded the highest sales revenue in their respective countries –except in Brazil, where Telefónica S.A. was ahead of PETROBRAS, and in Chile, where the State-owned copper mining company, CODELCO, reported larger sales than ENAP. In that year, high international oil prices boosted the revenues earned by these firms, which totalled US$ 140 billion and accounted for 16% of consolidated total sales by the region's top 500 enterprises.

Table IV.5

***AMERICA ECONOMÍA* MAGAZINE'S RANKING OF STATE-OWNED OIL ENTERPRISES IN LATIN AMERICA, 2000**

(Millions of dollars)

	Sales	Net profit	Total assets	Exports
1) PDVSA [a]	53,234	7,326	55,856	26,584
2) PEMEX [b]	51,558	843	46,990	16,300
4) PETROBRAS [c]	25,459	5,085	34,253	1,456
27) ECOPETROL [d]	4,147	524	8,094	2,565
71) PETROECUADOR	2,541	1,430	2,468	1,321
106) ENAP [e]	1,709	51	1,260	141
120) PETROPERU [f]	1,611	24	669	150
Total	**140,259**	**15,283**	**149,590**	**48,517**

Source: *América economía,* No. 213, August 2001.
[a] Petróleos de Venezuela, S.A. [b] The official methodology used understates the profits of Petróleos Mexicanos (PEMEX). [c] Petróleo Brasileiro. [d] Empresa Colombiana de Petróleo. [e] Empresa Nacional de Petróleo (Chile). [f] Petróleos del Perú.

The profit trend of State-owned oil companies has also been positive in recent years, reflecting the modernization of their administration and operational management, together with the price liberalization that has eliminated the subsidies formerly financed by the State firms. In 2000, this enabled PDVSA and PETROBRAS to post the region's highest net profits –over US$ 5 billion in both cases.

In 2000, exports from State oil companies amounted to US$ 48 billion and accounted for 14% of the region's total merchandise exports (ECLAC, 2002b). The associated foreign-exchange inflow is economically important for all these countries, not only from the balance-of-payments standpoint but also in fiscal terms.[22] State-owned petroleum enterprises, led by PDVSA, PEMEX and PETROBRAS, have total assets worth an estimated US$ 150 billion, and this figure is likely to increase, as planned investment for the next few years has risen substantially.[23] Total annual investment by these firms trended upward over the past decade, despite the privatization of three of them during that time. Total annual investment[24] by the group grew from US$ 11 billion in 1991 to nearly US$ 16 billion in 2000, with PDVSA, PEMEX and PETROBRAS leading the field (see table IV.6).

State oil companies' investment levels dwarf those of private firms in the region's oil and gas sector. Calculations made in the course of this research reveal that capital expenditure by foreign firms in Latin America and the Caribbean in the second half of the 1990s approached US$ 5.5 billion a year (excluding the purchase of existing assets); this was equivalent to one third of the investments made by their State-owned counterparts.

22 It is also a powerful macroeconomic tool when used by governments to cushion the destabilizing effects (on public accounts, the money supply and inflation) of a devaluation forced upon them by external crisis.

23 In the case of Pemex, the congressionally approved budget for 2001 includes investments amounting to US$ 14.6 billion, double the amount invested in 2000. The 2000-2009 PDVSA business plan envisages investments of US$ 59 billion, while the PETROBRAS 2001-2005 strategic plan foresees investments totalling US$ 31 billion.

24 Total investments include those for exploration and production, refineries, lubricant plants and the transport, distribution and marketing of hydrocarbon products.

Table IV.6
TOTAL INVESTMENTS OF LATIN AMERICAN STATE-OWNED OIL ENTERPRISES, 1990-2000
(Millions of dollars)

Firm	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
PDVSA [a]	…	4,192	4,405	4,598	4,766	5,089	5,388	5,905	5,241	4,207	4,296
PEMEX [b]	…	2,995	2,927	2,718	2,966	2,468	3,395	4,625	5,820	5,627	6,806
PETROBRAS [c]	2,118	2,157	2,351	2,165	2,290	3,257	3,359	3,394	4,840	4,178	4,148
YPF [d]	…	902	811	1,333				PRIVATIZED			
ECOPETROL [e]	284	238	441	835	553	1,090	1,158	1,308	594	631	497
PETROECUADOR, 2001	100	187	131	133	154	147	171	103	45	17	48
ENAP [f]	65	98	109	119	116	127	148	274	230	153	128
YPFB [g]	100	105	108	70	72	35	40		CAPITALIZED		
PETROPERÚ [h]	51	44	39	54	68	90			PRIVATIZED		
PETROTRIN [i]	…	…	…	…	…	…	102	83	97	69	…
Total	**2,718**	**10,918**	**11,322**	**12,025**	**10,985**	**12,303**	**13,761**	**15,692**	**16,867**	**14,882**	**15,922**

Source: Petróleo Brasileiro (PETROBRAS), *Annual report, 1999, 2000* (http://www.petrobras.com.br); Petróleos Mexicanos (PEMEX), *Anuario estadístico*, 2000, 2001; Petróleos de Venezuela (PDVSA), *Annual report*, various years (http://www.pdvsa.com); Empresa Colombiana de Petróleos (ECOPETROL), *Annual report,* various years (http://www.ecopetrol.com); Ministry of Energy and Mining of Perú, *Anuario estadístico de hidrocarburos,* various years (http://www.mem.gob.pe)*;* Empresa Nacional de Petróleo (ENAP), *Annual report*, various years (http://www.enap.cl); Empresa Estatal Petrolera de Ecuador (PETROECUADOR)*,* Corporate Planning Unit (http://www.petroecuador.com.ec); (PETROTRIN), *Annual report,* various years (http://www.petrotrin.com). Unidad de Planificación Corporativa (www.petroecuador.com.ec).

[a] Petróleos de Venezuela, S.A. [b] Petróleos Mexicanos. [c] Petróleo Brasileiro. [d] Yacimientos Petrolíferos Fiscales. [e] Empresa Colombiana de Petróleo. [f] Empresa Nacional de Petróleo (Chile). [g] Yacimientos Petrolíferos Fiscales Bolivianos. [h] Petróleos del Perú. [i] Petroleum Company of Trinidad and Tobago Ltd.

3. Extent of TNCs presence in the hydrocarbons sector in Latin America and the Caribbean

The reforms of the 1990s opened up new investment opportunities in Latin America for transnational oil corporations, attracting additional players and generating new investment flows. This involved not only the major oil companies (BP Amoco, Royal Dutch/Shell, TotalFinaElf, ChevronTexaco, ExxonMobil), but also smaller firms from Europe and the United States (Repsol-YPF, Phillips Petroleum, Conoco and others). Latin American firms (mainly Argentine) have also emerged to take advantage of privatization processes, in order to consolidate their position in the local market before expanding into other oil-rich countries elsewhere in the region (Pérez Companc and Pluspetrol Resources Corporation, among others).

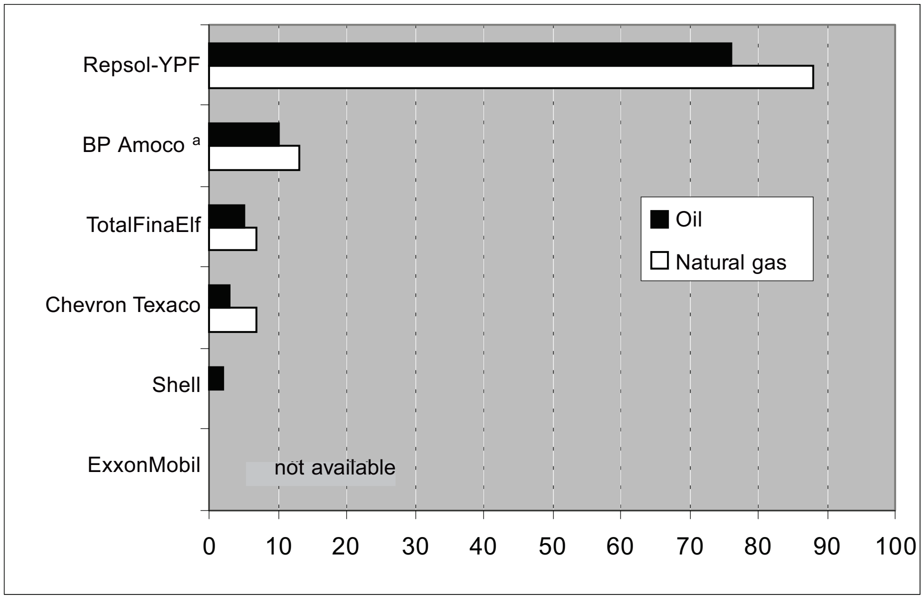
(a) Importance of TNCs in the hydrocarbons sector

As shown in figure IV.13, oil TNCs generally play a secondary role in the region's oil and gas production. The exception is Repsol-YPF, which substantially increased its production volumes by acquiring the assets of the former State-owned firm YPF S.A. in late 1999. Likewise, Latin America's share of TNCs' global oil and gas production (except that of Repsol-YPF) is also small, particularly in the case of ExxonMobil and Royal Dutch/Shell (see figure IV.14), which are ranked first and second among the world's private oil companies in terms of crude oil production volume. Private-sector firms play a supporting role in the supply of hydrocarbons in the region, not only because of the type of reforms introduced in the sector, but also because the process of opening up is recent and many private-sector investments are just entering the exploration stage. This is not true, however, in countries that opted for privatization, where a major component of FDI was used to purchase productive assets, or in Venezuela's Orinoco Belt, where production of extra-heavy crude has now begun.

Foreign investment has been more dynamic in the natural gas segment, and stronger growth in the role of TNCs can be anticipated here, given the privatization of rich gas fields in Argentina, Bolivia and Peru and significant exploration successes in Bolivia and Trinidad and Tobago, both of which introduced major incentives for private investment (see boxes IV.2 and IV.3).

The large hydrocarbons-producing countries have also established stronger incentives for private investment in the gas segment, the development of which requires huge investments to create new markets and build extensive infrastructure. The leading role being played by TNCs in the natural gas segment is particularly evident

Figure IV.14
IMPORTANCE OF LATIN AMERICA IN THE HYDROCARBONS PRODUCTION OF TRANSNATIONAL OIL CORPORATIONS
(Percentages based on figures expressed in barrels of oil equivalent)



Source: Repsol-YPF S.A., *Annual Report on Form 20-F Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended: December 31, 2000*, Commission File No. 1-10220, United States Securities and Exchange Commission, Washington, D.C., 2001 (www.repsol-ypf.com); BP PLC, *Annual Report on Form 20-F Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended: December 31, 2001*, Commission File No. 1-6262, United States Securities and Exchange Commission, Washington, D.C., 2002; Pérez Companc, S.A., *Annual Report,* informative review and financial statements as of 31 December 2000 and 2002; together with auditor's report and report of the Comisión Fiscalizadora, 2002; TotalFinaElf S.A., *Annual Report on Form 20-F Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended: December 31, 2000*, Commission File No. 1-10888, United States Securities and Exchange Commission, Washington, D.C., 2001; ChevronTexaco Corporation, *Fourth Quarter 2001. Earnings Release Investor Relations Supplement*, 29 January 2002; Royal Dutch Petroleum Company, *Annual Report on Form 20-F Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Fiscal Year Ended: December 31, 2000*, Commission File No. 1-4039, United States Securities and Exchange Commission, Washington, D.C., 2001; ExxonMobil Corp., *Annual Report on form 10-K Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended: December 31, 2000*, Commission File No. 1-2256, United States Securities and Exchange Commission, Washington, D.C., 2001.
[a] British Petroleum Amoco.

in the southern Andean region. At the initiative of private firms wishing to add value to their large gas reserves in Argentina and Bolivia,[25] the region is being traversed by a vast network of gas pipelines running from countries with rich natural gas deposits to those with deficits (Brazil, Chile and Uruguay). The region is also planning ambitious LNG projects to supply distant markets, following the example of Trinidad and Tobago.

(b) Oil TNCs investment modalities in Latin America and the Caribbean

The new investment opportunities that have emerged for TNCs in Latin America vary widely from one country to another, depending on the type of market liberalization and on the country's resource endowment and geological potential. One investment modality has been to acquire existing firms; this occurred in countries

[25] In the case of the main gas pipeline linking Bolivia to Brazil, the leadership of the State-owned firm PETROBRAS was decisive in bringing the project to fruition.

Box IV.2

BOLIVIA: HOW TO MARKET ITS ABUNDANT NEW NATURAL GAS RESERVES?

Since 1997, large private investments in natural gas exploration have been made in previously little-explored areas of Bolivia, such as the Tarija region. This has increased the country's proven and probable natural gas reserves almost tenfold in four years (1998-2001), from 5.6 to 52.8 trillion cubic feet (trft3).

Initially, the main objective of these exploration efforts was to fulfil export commitments to Brazil, for which purpose the Santa Cruz-São Paulo-Porto Alegre gas pipeline was built. Nonetheless, the magnitude of the new discoveries easily exceeds the absorption capacity of the Brazilian market and has opened up new prospects both for private firms and for the Bolivian government.

On the government side, while the use of natural gas is currently heavily focused on the Brazilian market, a natural gas-based diversification and internationalization strategy is now being considered. The strategy has two major prongs, the first of which is aimed at the Southern Cone, where Bolivia aspires to become the connections hub for natural gas energy integration projects, and aims to boost its exports by developing electric power generating plants and a petrochemical industry. The second prong targets North America and requires the construction of an access route to the Pacific Ocean. As this has given rise to competition between the ports of Mejillones in northern Chile and Ilo in southern Peru, the project has engaged government interests and aroused geopolitical sensitivities.

From the firms' point of view (see table), the large amount of natural gas discovered is forcing them to seek new ways to profit from their reserves. Apart from exports to Brazil through the gas pipeline, several other projects have prospered, the most ambitious of which involves exporting LNG to Mexico and California. This would require the construction of a gas pipeline to the Pacific coast, along with liquefaction plants and full complementary facilities at the port of export, as well as a regasification plant at the port of destination. The total project investment (destination markets included) is estimated at US$ 6 billion, one third of which is expected to be invested in the Southern Cone. In July 2001, the Pacific LNG consortium was formed to implement the project, comprising Repsol-YPF (37.5%), British Gas (37.5%) and PanAmerican Energy (25%) (controlled by BP Amoco). TotalFinaElf and ExxonMobil have recently begun talks with a view to joining the consortium.

The project has also attracted the interest of the consortium led by the Argentine firm Pluspetrol, which operates the Camisea project –the largest deposit in Peru, with reserves of 12 trft3 of gas and 650 mbl of petroleum condensates. The original Camisea project consists of capturing the natural gas in the deposits and conveying it to a liquid separation plant; from there it is prepared for pipeline conveyance to markets on the central Peruvian coast, while the excess gas is reinjected into productive reservoirs. The possibility of adding a new project for exporting LNG to the northern Pacific is currently under consideration. To this end, a pipeline is being designed that will make it possible to triple transport capacity in comparison to the amount originally envisaged under the project.

This consortium has an advantage over its competitors in Bolivia, in that construction of the pipeline from Camisea to Pisco on the central coast 200 kilometres south of Lima is about to start, meaning that it is likely to reach the Pacific coast first. The shorter distance from Camisea to the coast is an additional advantage in terms of transport costs. Nonetheless, its major disadvantage is that the quantity of proven reserves is limited for a project of this size, unless additional large reserves are discovered in the areas adjacent to Camisea. The upcoming tendering of these areas is generating interest among the Camisea operating consortium and the oil companies TotalFinaElf, Repsol-YPF and Occidental Petroleum.

BOLIVIA: NATURAL GAS RESERVES, SEPTEMBER 2001

	Share *(percentages)*	Reserves *(billions of cubic feet)*
Caipipendi		13.6
Repsol-YPF (operator)	37.5	5.1
British Gas	37.5	5.1
British Petroleum	25	3.4
Tarija oeste		9.27
TotalFinaElf (operator)	41	3.80
British Gas	25	2.32
ExxonMobil	34	3.15
San Antonio		5.26
PETROBRAS (operator)	35	1.84
Andina (Repsol-YPF)	50	2.63
TotalFinaElf	15	0.79
San Alberto		11.06
PETROBRAS (operator)	35	3.87
Andina (Repsol-YPF)	50	5.53
TotalFinaElf	15	1.66
Madrejones		
Pluspetrol	100	6.0
Total reserves Tarija		45.19
Total reserves Bolivia		52.85

Source: Office of the Deputy Minister of Energy and Hydrocarbons of Bolivia, *International Gas Report,* No. 433, 17 September 2001.

Source: Lykke E. Andersen and Mauricio Meza, The Natural Gas Sector in Bolivia: An Overview, La Paz, Instituto de Investigaciones SocioEconómicas, Universidad Católica Boliviana, 2001; Office of the Deputy Minister of Energy and Hydrocarbons of Bolivia, International Gas Report, Policy and Investment Unit, No 433, La Paz, 17 September 2001; Business News America, 19 December 2001 (http://www.bnamericas.com); Diario Gestión, 23 October 2001; El Diario, La Paz, 6 July 2001; La Prensa, La Paz, 6 July 2001; Infonegocio, Lima, 24 January 2002 (http://www.infonegocio.com.pe.).

Box IV.3

DEVELOPMENT OF THE NATURAL GAS INDUSTRY IN TRINIDAD AND TOBAGO

The exploration and production of natural gas by private firms in Trinidad and Tobago, located some 7 kilometres off the eastern coast of Venezuela, was aggressively promoted by the country's authorities in the 1990s and attracted the interest of several transnational oil firms, especially Amoco. Major investments were made starting in the second half of that decade, and led to the discovery of large reserves of natural gas. The substantial growth of natural gas production in Trinidad and Tobago –annual volumes doubled between 1995 and 2000 (see table)– has boosted exports of this product and resulted in the rapid development of the industrial uses of gas in petrochemical and thermoelectric projects. In addition to the main natural gas-producing firms shown in the following table, there are others with a presence in upstream activities, including TotalFinaElf, ExxonMobil and Shell, which acquired exploration permits, and Repsol-YPF, which in January 2000 acquired 10% of the reserves held by BP, with a three-year option to purchase an additional 20%.

ANNUAL OUTPUT OF NATURAL GAS PER FIRM

(Millions of cubic feet)

Company	1996	1997	1998	1999	2000
BP Trinidad and Tobago LLC	216,253	194,238	225,109	347,137	384,750
EOG Resources Limited	54,253	48,801	49,987	43,671	54,563
British Gas	22,377	56,625	64,217	53,184	85,821
Trinmar Limited [a]	13,277	13,921	16,370	16,937	15,352
Petrotrin [b]	7,373	6,922	6,806	5,427	5,672
Others	5,401	2,037	928	902	477
Total	**318,934**	**322,544**	**363,417**	**467,258**	**546,635**

Source: Ministry of Energy and Energy Industries of Trinidad and Tobago, 2002, http://www.energy.gov.tt.

[a] Trinmar Limited consists of two firms: Petrotrin (66 2/3%) and Texaco Trinidad Inc. (33 1/3%).

[b] Petrotrin is the State oil company of Trinidad and Tobago Ltd.

The main destination markets for Trinidad and Tobago's natural gas exports are the north-eastern United States and Spain. In 1996 construction began on the Atlantic LNG plant, which has the capacity to process 3 million tons a year and involves an investment of US$ 965 million, making it the only large-scale natural gas liquefaction plant in Latin America and the Caribbean. Production came on stream in 1999. The ownership consortium consists of Amoco Trinidad (LNG) B.V. (34%), British Gas Trinidad LNG Limited (26%), Repsol LNG Port of Spain B.V. (20%), National Gas Company of Trinidad and Tobago LNG Limited (10%, a State-owned firm) and Cabot Trinidad LNG Limited (10%). In 2000 construction began on two additional plants, scheduled for completion in 2003, with a view to tripling production capacity from 3 to 10 million tons a year and involving an investment of US$ 1.3 billion. The owners are Amoco Trinidad (LNG) B.V. (42.5%), British Gas Global Investments B.V. (32.5%) and Repsol Overzee Financien B.V. (25%).

The industrialization of gas has led to the rapid development of a petrochemical industry that has made Trinidad and Tobago the world's leading exporter of ammonia and methanol. An industrial park located in Point Lisas includes, among other things, five methanol plants and three ammonia complexes, involving eight production facilities and an electric power plant. The amounts already invested in Point Lisas are estimated at around US$ 7.5 billion, and in 2000 further investments totalling US$ 11 billion were projected for 2000-2004, with the aim of continuing to add value to gas.

Source: Ministry of Energy and Energy Industries of Trinidad and Tobago, "Fact Sheet", Energy Information Administration (EIA), May 2001 (http://www.eia.doe.gov); Revista Petroquímica, Petróleo, Gas & Química, No 162, Buenos Aires, June 2000.

that privatized their State oil enterprises, such as Argentina, Bolivia and Peru. Another modality has been to form a partnership (mixed ownership or joint venture) with the dominant State company to explore, develop or exploit certain areas, as happened in Brazil, Colombia, Ecuador and Venezuela. A third method has been to invest in risk exploration without any association with the State firm; this has happened in every country except Colombia, Mexico and Venezuela.[26] In the case of natural gas, investments in upstream activities have had to be accompanied by the construction of transport and marketing infrastructure (at the petroleum companies' expense) and the integration of a gas-electricity network for expansion of the market (see table IV.7).

Table IV.7
INVESTMENT MODALITIES OF TRANSNATIONAL OIL CORPORATIONS IN LATIN AMERICA AND THE CARIBBEAN

	Argentina	Brazil	Bolivia	Colombia	Ecuador	Peru	Trinidad and Tobago	Mexico	Venezuela
Privatization, capitalization or both	**Main participants Local private-sector firms:** - Pérez Companc - Pluspetrol - Bridas - Astra and others **Secondary participants Foreign firms:** - Amoco - Occidental Petroleum - Total - Repsol and others	Sale of 49% of PETROBRAS to minority shareholders	**Capitalization** **Andina S.A.:** - Pérez Companc - YPF - Pluspetrol **Chaco S.A.:** - BP Amoco - Bridas **Transredes:** - Enron - Shell			**Privatization:** - Repsol-YPF - PetroTech - Glenpoint Interp. - Pluspetrol Resources - Pérez Companc - Mobil			
Mergers/ acquisitions of local private enterprises by foreign firms	- Repsol-YPF - Chevron - PanAmerican Energy								
Partnerships with local State-owned companies		Areas put out to tender: - Amerada-Hess - Agip - Chevron - Coastal - Repsol-YPF - Shell - TotalFinaElf - Unocal		- British Petroleum - TotalFinaElf - Triton - Occidental Petroleum	- Pérez Companc - Repsol-YPF - Alberta-Energy - Occidental Petroleum - Agip - Kerr - McGee		- TotalFinaElf - Exxon Mobil - Chevron		- BP Amoco - TotalFinaElf - ExxonMobil - Conoco - Maxus (Repsol) - Agip - Enron Corp.
Venture investments in exploration, not in association with State firms	Plan Argentina	- Agip - Phillips Petroleum Co. - Shell - Texaco - El Paso Corp. and others				- Pluspetrol Resources - Pérez Companc - Shell - Chevron - BP Amoco - Esso - TotalFinaElf - ExxonMobil	- BP Amoco - British Gas - EOG Resources		
Vertical integration in oil	- Repsol-YPF - Pérez Companc - Pluspetrol	Repsol-YPF	- Pérez Companc - PETROBRAS		Repsol-YPF				
Natural gas: downstream investments	- Repsol-YPF - Total - Pérez Companc - Pluspetrol	- PETROBRAS (Gaspetro) - British Gas - El Paso Corp. - Shell - Enron - TotalFinaElf	- Enron-Shell - BP Amoco - PETROBRAS - TotalFinaElf	Enron		Tractebel Techint E&C	BP Amoco British Gas Repsol-YPF Cabot	- Repsol - Gaz de France - Tractebel	- Shell - ExxonMobil - TotalFinaElf - Repsol-YPF - Pluspetrol - Pérez Companc - Mitsubishi

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

26 Colombia and Venezuela allow private firms to undertake risk exploration, provided that they enter into a partnership with the State firm if their efforts are successful.

D. MAIN EXPANSION STRATEGIES OF OIL COMPANIES IN LATIN AMERICA AND THE CARIBBEAN

The continued importance of State-owned oil enterprises in terms of production, exports and investment in the hydrocarbons sector warrants an analysis of their global policies. These policies affect the strategies of their private transnational counterparts, not only because of the relationship between them but also because of the opportunities created for private firms and the areas they are allowed to use for exploration, development or production. Accordingly, this section contains an analysis of the strategies pursued by a group of State-owned firms and private-sector TNCs, chosen for their importance in the Latin American and world markets and for their rapid expansion following the reforms.

1. The strategies of State-owned firms

Among State-owned oil enterprises, PDVSA, PEMEX and PETROBRAS stand out because of the volume of their reserves, production, exports and investment.

(a) Petróleos de Venezuela S.A. (PDVSA)

In the early 1990s, Venezuela embarked on a policy to attract private capital which resulted in various partnerships between PDVSA and transnational firms (see box IV.4). In 1999, the government promulgated a new organic law on gaseous hydrocarbons that allows foreign investment in the exploration and exploitation of unassociated natural gas. This legislation has the twin objectives of expanding the domestic natural gas market through investments of up to US$ 10 billion over 10 years (with the active participation of private capital) and developing the infrastructure needed to export LNG, with an investment of US$ 2.2 billion. This project is currently being negotiated with Shell, ExxonMobil and Mitsubishi.

PDVSA has drawn up a business plan for 2000-2009, which involves investments totalling US$ 59 billion, distributed as follows: US$ 40.7 billion for exploration and production, US$ 5.4 billion for the natural gas segment, US$ 8.9 billion for chemicals, US$ 2.1 billion for refining and US$ 1.8 billion for other sectors.

For many years, PDVSA has had the most aggressive international strategy of the region's State-owned firms. The strategy consists essentially of developing external markets for its crude oil by purchasing refineries in the United States and Europe. In 1989 PDVSA took over CITGO, a United States enterprise with proven reserves, refineries and a network of service stations in that country. It also acquired refineries in Germany, Belgium, Scotland, England and Sweden, with a total refining capacity of 2.4 mbl/d (of which the PDVSA share is 1.1 mbl/d, in accordance with the percentage of equity acquired).

In 2000 PDVSA opened a subsidiary in Brazil (PDVSA do Brasil), and it is currently evaluating the potential for expanding the market for its crude oil and petroleum products in the region, especially in Argentina, Brazil, Chile, Paraguay and Uruguay. The enterprise is also investigating the possibility of acquiring firms with the infrastructure needed for retail distribution in South America. In Brazil, for example, there is special interest in the northern and north-eastern parts of the country, where, given its geographic location, Venezuela would be the preferred supplier of the volumes these markets demand. The PDVSA Brazilian subsidiary is also weighing alternatives for the direct supply of products from Venezuela or from local refineries.

(b) PEMEX

Mexico's State-owned oil company has suffered from chronic financing problems, given its total reliance on the federal budget. Unlike any private firm or other State enterprise in the region, PEMEX has neither economic nor financial autonomy. The PEMEX budget for operating and investment expenditure is submitted by the federal government for congressional approval, as part of the national expenditure budget. This explains why decisions on the amount, structure and objectives of PEMEX investments are dominated by macroeconomic considerations that give priority to other public expenditure areas, to the detriment of the investment priorities peculiar to an oil company.

Since 1996, however, PEMEX has been able to overcome these constraints by making use of a mechanism known as Projects with a Deferred Impact on Public Expenditure Recording (PIDIREGAS), which give it access to capital sources outside the firm for investments in productive development, expansion of refinery capacity and natural gas.[27] Their off-budget

[27] For further details on the PIDIREGAS mechanism, see Torres Flores (1999).

Box IV.4

PARTNERSHIPS WITH PDVSA IN VENEZUELAN OILFIELDS

The Venezuelan oil-sector reform allowed private firms to associate with PDVSA in upstream exploration and production activities, under three different arrangements: (i) operating agreements to exploit marginal fields; (ii) strategic partnerships in the Orinoco Belt; and (iii) risk exploration contracts with shared profits.

Over 50 firms from 14 countries have signed operating agreements with PDVSA to exploit marginal fields. Their investments totalled US$ 4.335 billion between 1991 and 1999, in addition to a US$ 2.192-billion participation bond relating to the third round of agreements. The production arising from operating agreements in 2000 amounted to 573 tbl/d, representing 16% of total PDVSA output (3.582 mbl/d). According to the firm, in the medium term (i.e., by 2009), production is expected to reach a figure of 1 mbl/d, with additional investments estimated at US$ 8 billion.

Strategic partnerships to exploit the huge deposits of extra-heavy crude oil in the Orinoco Belt involve total investments estimated at US$ 12.6 billion, of which foreign firms are expected to contribute US$ 7.721 billion. The investments undertaken by 31 December 2000 totalled US$ 7.886 billion, 58% of which came from private sources (see table). In 2000, the production of heavy crude under strategic partnerships amounted to 272 tbl/d and represented 8% of Venezuela's total production; the output of heavy crude under strategic partnerships is expected to reach 700 tbl/d by 2009.

STRATEGIC PARTNERSHIPS IN THE ORINOCO BELT

	Company	Share (percentages)	Investment (millions of dollars)	Realized as of 31/12/2000
Petrozuata	Conoco (U.S.A.) [a]	50	1,497	1,399
	PDVSA	**50**	**1,503**	**1,404**
			3,000	2,803
Hamaca	**PDVSA**	**30**	**1,020**	**108**
	PHILLIPS (U.S.A.)	30	1,020	108
	TEXACO (U.S.A.) [a]	40	1,360	144
			3,400	359
Sincor	TOTAL (FRA) [a]	47	1,974	1,501
	PDVSA	**38**	**1,596**	**1,214**
	STATOIL (NOR)	15	630	479
			4,200	3,194
Cerro Negro	MOBIL [a]	47	940	719
	PDVSA	**38**	**760**	**581**
	Veba Oel (SUE)	15	300	230
			2,000	1,530
		Total	**12,600**	**7,886**
			Millions of dollars	**Percentages**
	Total PDVSA investments		**4,879**	**39**
	Total investments by partners		**7,721**	**61**

Source: Petróleos de Venezuela (PDVSA), *Informe annual 2000*, 2001.

[a] Operator.

Under the third partnership arrangement to explore new light and medium crude oil deposits, eight contracts were signed with foreign investors, including BP Amoco, TotalFinaElf, ExxonMobil, Conoco, Maxus (now Repsol-YPF), Agip, Enron Corporation and other smaller firms. Cumulative investments up to 2000 amounted to US$ 777 million, and production from these areas could reach 500 tbl/d by 2003.

Source: Petróleos de Venezuela (PDVSA), Annual Report, various years, Caracas (http://www.pdvsa.com/).

nature makes these investments more flexible than those itemized in the PEMEX budget approved by Congress. In recent years the PIDIREGAS mechanism has financed over half of all PEMEX investment, and 80% of the company's investment will be financed this way under the 2002 budget.

Over the next five years, the PEMEX strategic plan envisages a total investment of US$ 33 billion. In January 2002, Congress approved the company's budget for that year, which included a US$ 14.6-billion investment allocation –double the amount invested in 2000. The main investment projects concern the expansion of natural gas production (Cantarell mega-project and Cuenca de Burgos), the redesign of the refinery system, the Grijalva Delta and the cryogenic plant.

(c) PETROBRAS

The key goal being pursued by PETROBRAS is to achieve petroleum self-sufficiency for Brazil by 2005 by expanding crude oil reserves and increasing production. Between 1998 and 2001 output grew by 60%, from 1 mbl/d to 1.6 mbl/d, and the target for 2005 is 1.9 mbl/d. In order to fund this growth and meet its targets, PETROBRAS has undertaken joint ventures with private firms, particularly in its exploration areas. In 2000 and 2001 the federal government also sold part of its equity on the stock market, retaining 32.5% of the firm's capital and 55.7% of the voting shares, thereby maintaining control. The shares sold represented 17.6% of the firm's capital and raised US$ 4.693 billion.

PETROBRAS is playing a leading role in the government's strategy to increase natural gas consumption in Brazil, and it plans to increase its share in the national energy network from 2% to 12% by 2012. For this purpose, it undertook a joint venture with the government of Bolivia and private firms (Royal Dutch/ Shell and Enron) to build the Santa Cruz-São Paulo gas pipeline, which came on stream in 1999. It now intends to increase natural gas production in Brazil by exploiting its recent major discoveries in that country.

PETROBRAS has the world's most advanced offshore exploration technology, which enabled it to win the prestigious Offshore Technology Conference award in 1992. Its excellence has opened the door to private financing through the project finance modality, with which it is developing the Baracuda/Caratinga, Espadarte/ Voador/Marimbas and Cabiunas fields, for a total investment in excess of US$ 4 billion.

In the international arena, PETROBRAS seeks to broaden its field of action through a variety of business strategies: (i) concentrating its exploration and production efforts mainly in South America, the Gulf of Mexico and Africa; (ii) entering the refining, marketing and distribution segments to integrate its activities in South America; (iii) guaranteeing refining capacity in the United States and the Caribbean; and (iv) positioning itself as one of the leading players in the natural gas market in South America.

The PETROBRAS strategic plan for 2001-2005 envisages investments of US$ 31 billion over the next five years for exploration, production, refining and marketing; as much as 30% of this investment is expected to be made outside Brazil.

2. TNCs business strategies in Latin America and the Caribbean

The opening of the region's hydrocarbons sector attracted the interest of a large group of private-sector oil companies. Their expansion strategies have differed, however, according to whether they were:

(i) Foreign firms taking advantage of liberalization to become global enterprises (Repsol-YPF), whose expansion mainly involved the acquisition of existing firms;

(ii) Foreign firms already engaged in extractive activities in the region, which seized the opportunity to exploit the competitive advantage this gave them to diversify geographically in upstream activities (TotalFinaElf, BP Amoco, ChevronTexaco);

(iii) Foreign firms not involved in extractive activities but with a presence in downstream activities prior to liberalization, which pursued a strategy aimed at consolidating that market (Royal Dutch/Shell, ExxonMobil); or

(iv) Domestic Latin American firms that regionalized their activities in response to liberalization (Pérez Companc, Pluspetrol), whose strategies initially centred on acquiring privatized assets. These firms have all developed a downstream expansion strategy in the areas of natural gas –a segment favoured by the liberalization of energy markets– and the construction of an integrated natural gas-electricity chain.

Below are case studies of the strategies of four private-sector oil companies in Latin America, each of which represents one of the four expansion strategies described above. The firms considered are Repsol-YPF, TotalFinaElf, Royal Dutch/Shell and Pérez Companc.

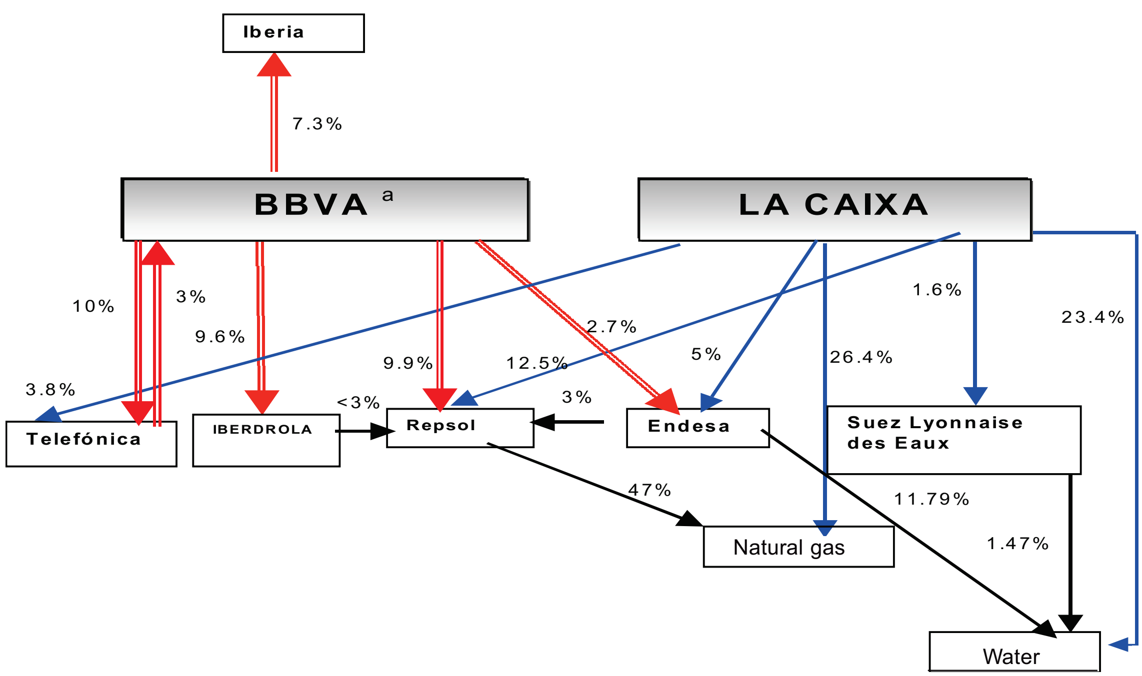
(a) Repsol-YPF

Like Spanish telecommunications and energy firms, Repsol S.A. sought to attain global-player status in order to compete, in the short and medium term, with longer-established and larger foreign firms operating in its own market. To this end, it focused its expansion on Latin American markets as they opened up to private investment (ECLAC, 2000; Rozas, 2001). Repsol entered those markets by purchasing privatized public enterprises, which offered the dual attraction of a dominant market position –thanks to the monopoly held by the former State-owned firms– and the initial absence of competitors. This enabled it to benefit from head-start advantages and impose its leadership before competition arrived. Spain's banks, which in many cases are the main shareholders of the Spanish firms present in Latin America (see figure IV.15), not only played an important role in financing this expansion, but also accompanied it by greatly strengthening their own presence in many of the region's countries.[28]

Traditionally, Repsol had been a small oil company with a low level of vertical integration, engaged mainly in refining and marketing to supply the Spanish market. Its upstream activities were located primarily in North Africa, the source of over 60% of its hydrocarbons. In the mid-1990s, Repsol adopted a strategy for substantially increasing its presence in that market segment, enhancing its vertical integration and reducing its vulnerability to the vagaries of oil pricing.

The focal point chosen for Repsol's expansion in Latin America was Argentina, where, by purchasing existing enterprises –most notably YPF S.A. in 1999 for US$ 15.168 billion– it became a dominant and integrated player in that country's hydrocarbons sector, while also extending its activities to the energy sector as a whole.

Figure IV.15
MAIN OWNERSHIP RELATIONS BETWEEN PUBLIC UTILITY FIRMS AND SPANISH FINANCIAL INSTITUTIONS



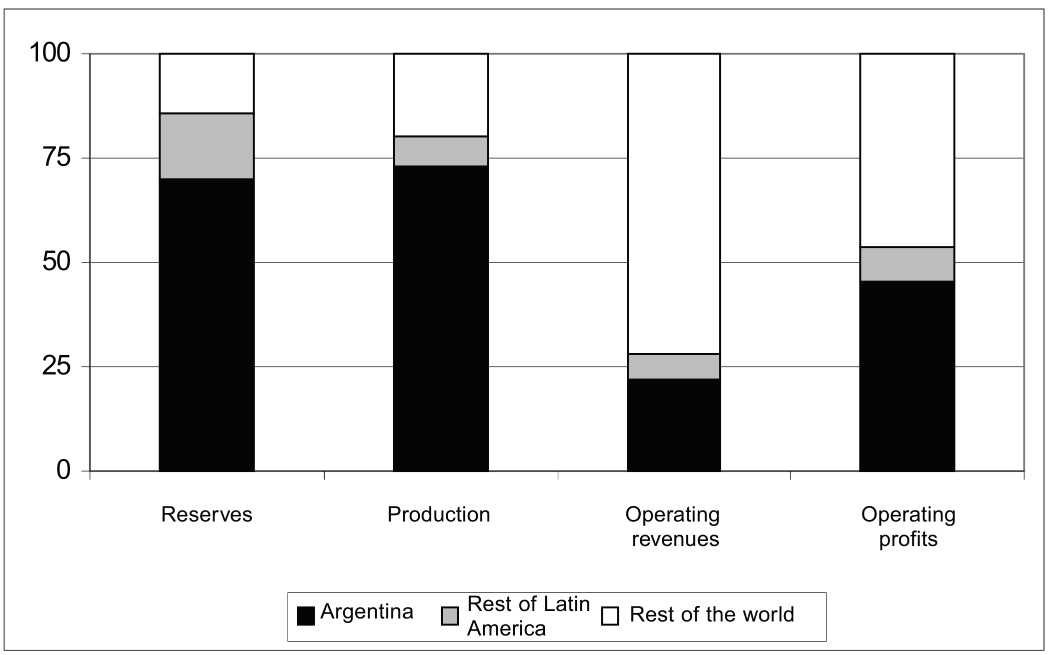
Source: ECLAC, Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management.
[a] Banco Bilbao Vizcaya Argentaria.

[28] Repsol-YPF is controlled by two main shareholders: the financial institutions La Caja de Ahorros y Pensiones de Barcelona, S.A. (La Caixa) (12.4%) and Banco Bilbao Vizcaya Argentaria S.A. (BBVA) (9.9%). PEMEX owns nearly 5%, and the electric companies Endesa and IBERDROLA, about 3%. The remaining shares are divided among United States institutional funds, Spanish investors and minority shareholders. BBVA and La Caixa are also major shareholders in Spain's leading energy suppliers –Endesa, IBERDROLA, Gas Natural SDG– and in other non-energy firms such as Telefónica S.A. and Iberia, among others (see figure IV.15). Alfonso Cortina, president of Repsol-YPF since 1996, came from the ranks of BBVA, while Emilio Ybarra, who was president of BBVA from 1991 to December 2001, has also been vice-president of Repsol since 1996, a post he has shared since July 1999 with La Caixa president Joseph Vilarasau.

The YPF takeover brought about a major quantitative leap for the firm: between 1998 and 1999, its reserves expanded by 364%; hydrocarbon production, by 169%; refinery capacity, by 38%; operating revenues, by 38%; operating profits, by 59%; and total assets, by 188%. In addition, Repsol ceased to be a marginal producer of gas, as its daily production volume of 267 mft^3 in 1998 grew to 1,298 mft^3 in 1999 and 2,215 mft^3 in 2000. This sudden increase in size made it a global enterprise and placed it among the top oil companies worldwide.

The acquisition of YPF, a vertically integrated firm with abundant reserves, also entailed a major qualitative leap for Repsol due to the complementary nature of the two firms' assets. The large reserves contributed by YPF enabled Repsol to improve the vertical integration of its petroleum activities, while its assets in Bolivia, Ecuador and Venezuela complemented those held by Repsol in Argentina, Colombia, Ecuador, Peru and Trinidad and Tobago, thereby boosting the firm's regional expansion strategy. In 2000, Latin America accounted for 86% of Repsol's reserves and 81% of its hydrocarbons output, together with 28% of its operating revenues and 53% of its operating profits. Argentina accounted for a large share of these percentages (see figure IV.16).

Figure IV.16
SHARE OF LATIN AMERICA IN REPSOL ACTIVITIES, 2000
(Percentages)



Source: Repsol-YPF S.A., Annual Report on Form 20-F Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended: December 31, 2000, Commission File No. 1-10220, United States Securities and Exchange Commission, Washington, D.C., 2001 (www.repsol-ypf.com).

Nonetheless, the purchase of YPF for a sum equivalent to more than twice the net worth of Repsol[29] also meant a substantial increase in the firm's debt. Between 1998 and 1999, the firm's short-term debt rose by 267% and its long-term debt, by 538%, resulting in a debt-equity ratio of 79%. Repsol's two main shareholders –BBVA and La Caixa– played a key role in bringing the transaction to fruition by successfully enlisting Citigroup, Merrill Lynch, Union Bank of Switzerland (UBS) and Goldman Sachs to join them in forming a club of banks to fund the acquisition.

Although centred on Argentina, Repsol's expansion also extended into other countries of the region, namely Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, Trinidad and Tobago and Venezuela. Its strategy has had two main thrusts: one relating to gas and the other to oil. In the gas segment –the faster-growing of the two– the firm has developed an integrated strategy in the gas-electricity chain. In the oil segment it has implemented integrated activities in Argentina, Brazil, Ecuador and, to a lesser extent, Peru (see table IV.8).

Table IV.8
EXPANSION OF REPSOL IN LATIN AMERICA UP TO 31 DECEMBER 2001

	Argentina	Bolivia	Brazil	Chile	Colombia	Ecuador	Guyana	Mexico	Peru	Trinidad and Tobago	Venezuela
1. Upstream activities											
Gas and oil											
Exploration lots (No.)	42	16	8		5	3	1		6	1	4
Production lots (No.)	104	18	1		1	1				…	4
Hydrocarbons reserves (thousands barrels of oil equivalent)	3,347	273	…		8	99				217	154
Oil production (million barrels)	158	3	11		2	5				2	9
Gas production (billion cubic feet)	661	16								33	
2. Downstream activities											
Oil											
Refineries (No.)	4		1						1		
Owned pipelines (No.)	2					1					
Non-owned pipelines (No.)	2										
Owned service stations (No.)	2,892		23	51		57			71		
Non-owned service stations (No.)	813		144	72		57			87		
LPG plants [a] (No.)	1			1		1			1		
Gas											
Gas pipelines (No.)	4			2							
Distribution	2 firms		1 firm		2 firms			7 permits			
Liquefaction plants (No.)		1 [b]								1+2 [c]	
3. Electric power generation											
Generating plants (No.)	7 + 1 [c]										

Source: Repsol-YPF S.A., www.repsol-ypf.com.
[a] Liquefied petroleum gas. [b] Project. [c] Project in execution.

(i) Integration strategy in the oil sector

In Argentina, Repsol-YPF has maintained its vertical integration from production to final consumer, and is the leading firm in each of the links of the oil chain running from extraction to final sale. In December 2000 it controlled about 37% of the country's oil reserves and accounted for about 48% of production (Ministry of Energy (http://energia.mecon.gov.ar/)). In downstream activities, it came to control 55% of the fuel market before it ceded its EG3 refinery, along with a network of approximately 700 service stations and a refinery in Bahía Blanca, to PETROBRAS in December 2001 as part of an asset swap. As a result, its share of the market fell to 45.6% (*La Nación*, 13 November 2001; Yahoo Finanzas, 28 December 2001). In addition, Repsol is sole owner of two oil pipelines, and it has stakes in the country's domestic oil pipeline network and in the trans-Andean pipeline (18%) that conveys crude oil from the Neuquina Basin to Talcahuano in Chile. Lastly, Repsol is the leader in the liquefied petroleum gas (LPG) business in Argentina, where it has a 38% market share, with sales of 385,000 tons a year (*La Nación*, 13 November 2001; Yahoo Finanzas, 28 December 2001; Repsol-YPF (http://www.repsol-ypf.com)).

[29] The YPF takeover cost Repsol US$ 15.168 billion, while the firm's net worth as of 31 December 1998 was 6.043 billion euros, or less than US$ 7 billion (Repsol-YPF S.A., 2001).

Repsol's extraction activity in Argentina is also integrated with the Chilean market through 123 service stations (of which it owns 51) and, since November 2000, a 45% holding in Lipigas (an LGP distributor), which controls 41% of the market (Repsol-YPF (http://www.repsol-ypf.com)).

In Brazil, it is participating in eight exploration blocks –five of them in deep water– and a production lot operated by the Santa Fe Energy company of the United States, which began to produce a minimum volume of 29 tbl/d in 2000. The asset swap with PETROBRAS brought Repsol assets in both upstream and downstream activities. In the former, it obtained a 10% stake in the offshore Albacora Leste deposit, a project that is in the development stage, with reserves estimated at around 1.3 mbl. It is expected that, by 2006, this deposit will be producing 175 tbl/d. In downstream activities, it received a 30% share of the Alberto Pascualini refinery (REFAP), Brazil's first, with a capacity of 180 tbl/d, equivalent to 22% of the country's total capacity, together with a service station network with annual sales of 480 million litres.

In Peru, Repsol has a controlling interest in the La Pampilla refinery,[30] whose 100-tbl/d capacity represents over 50% of the market. In upstream activities, it holds six exploration permits, but has not yet undertaken any extraction activity. Accordingly, the integration of its activities in this country starts with refining and ends with major interests in fuel distribution (including a network of 158 service stations, of which it owns 71) and distribution of LPG produced in La Pampilla (through its ownership of the distributors Solgas and Limagas, which control 49% of the market).

In Ecuador, Repsol-YPF is currently exploring in three blocks and operating in block 16. In 2000 it was the country's second-largest oil producer, with 45.3 tbl/d, behind the State-owned PETROECUADOR, which produced 260 tbl/d. It also has a 25.69% stake in the heavy crude pipeline currently being constructed; a network of 114 service stations, of which it owns 57; and 75% of Duragas, a leading LPG distributor with a 49% market share.

(ii) An integrated regional strategy in the gas-electricity chain

Currently, one of Repsol's main goals in Latin America is to profit from the large natural gas reserves it has accumulated in Argentina, Bolivia, Trinidad and Tobago and, more recently, Venezuela. To this end, it has become heavily involved in downstream activities in natural gas, participating in gas pipelines, liquefaction trains, distribution companies and electric power generation and distribution.

The importance of the natural gas-electric power subsector in the firm's strategy is clearly reflected by its share of the group's total investments (33% in 2000). For 2001-2005, out of projected investments totalling 23.1 billion euros, 28.7% are expected to be in gas and electric power. In addition, although 41.5% of investment in the period 2001-2005 will be channelled into exploration and production, these funds will mainly be used to develop reserves in Argentina, Bolivia, Trinidad and Tobago and Venezuela, where the firm has large natural gas reserves (Repsol-YPF S.A., 2001; *La Nación,* 11 July 2001).

In 1997, before it accumulated its current large reserves, Repsol undertook a joint venture in Latin America with IBERDROLA and Gas Natural S.D.G. (its own subsidiary). In this alliance, Repsol was responsible for hydrocarbons exploration and exploitation; Gas Natural S.D.G., for transporting and marketing natural gas; and IBERDROLA, for natural gas-fired electric power generation. As part of this venture, the three firms acquired assets in downstream natural gas activities in Brazil and Colombia.[31] Later, in early 2000, Repsol won a tender, along with BP Amoco, to build an electric power plant in the state of Ceara,[32] while Gas Natural S.D.G. gained a natural gas distribution concession in the state of São Paulo (Repsol-YPF S.A., 2001).

In 1998 Repsol entered the Mexican market through Gas Natural México, the Mexican subsidiary of Gas Natural S.D.G. Today it is the leading distributor in Mexico, holding seven natural gas distribution permits (out of a total of 21) with a total coverage target of 1,236,739 users. This represents over 50% of the coverage target for all 21 gas distribution permits nationwide (CRE, 2001; *InfoCRE*, various editions).

In Argentina, Repsol is the leading firm in terms of natural gas reserves and production (28% and 31% of the country's total, respectively).[33] Of its proven gas reserves, 65% are located in the Neuquina Basin, which is linked to Buenos Aires through a pipeline network. Repsol also has a major stake in two leading natural gas

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[30] Repsol-YPF owns 78.76% of the Refinadores del Perú consortium, which, in turn, has a 60% stake in La Pampilla.

[31] In Colombia the joint venture owns 53.71% of Gas Natural de Bogotá and controls Gasoriente (the distributor in the eastern region), and has an exclusive contract for gas distribution in the Cundi-Boyacense area, as well as interests in gas pipelines. In Brazil, Gas Natural S.D.G. headed a consortium including IBERDROLA and others, which in 1997 acquired the Companhia Estadual de Gas do Rio de Janeiro (CEG), together with Riogas, both of which are natural gas distributors in Rio de Janeiro (Rozas, 2001).

[32] The two firms are still evaluating the project's viability (Repsol YPF S.A., 2001).

[33] The figures are for 2000 (Ministry of Energy).

distributors in Argentina: Gas Natural BAN,[34] serving the northern sector of Buenos Aires, and Metrogas,[35] which operates throughout the federal capital and in 11 municipalities in the southern part of Greater Buenos Aires (Repsol-YPF S.A., 2001). In addition, it has interests in electric power generation and distribution, with shares in four electric power plants with a total installed capacity of 655 MW, as well as a 40% stake in a partnership with Endesa (40%) and PanAmerican Energy (20%) to build a new combined-cycle power plant in Central Dock Sud. The new plant, which will have a 780 MW capacity, is currently nearing completion. Lastly, the firm operates three gas-fired power plants, from which it self-supplies and which have a total installed capacity of 154 MW. Repsol-YPF was also a leader in electricity distribution until 2001, when it disposed of its assets in this sector, partly because of regulatory requirements and partly because of the need to lower its high debt ratio.

Repsol-YPF also sells Argentine gas to the Chilean market, conveyed by gas pipelines linking the two countries. It sends gas from its deposits in the Austral Basin to a methanol plant in southern Chile, and it supplies central Chile with gas from the Neuquina Basin conveyed by the GasAndes and Pacífico gas pipelines. Lastly, the deposits it exploits in the North-West Basin supply electric power plants in northern Chile through the GasAtacama and Norandino pipelines, and also a facility in southern Brazil through another pipeline running from northern Argentina to Uruguaiana. Repsol holds a 10% stake in the Pacífico pipeline and 15% stake in the pipeline to Brazil.

In Bolivia, Repsol-YPF has substantially increased its gas reserves over the past two years, partly because of major discoveries in the Tarija region and partly as a result of its increased holding in Andina S.A. (now 50%),[36] a firm with large gas reserves in that country. In addition, Repsol-YPF is field operator and has a 37.5% stake in the Margarita (Caipipendi) field, the deposit where the most reserves have been discovered in the Department of Tarija. Probable additional reserves owned by Repsol-YPF in Bolivia, estimated at 10.6 trft^3,[37] place it first among the firms operating in upstream gas activities in that country. In January 2001, the firm began gas production in Bolivia, supplying the Brazilian market through the Bolivia-Brazil gas pipeline. It is also studying a project to export LNG from the Margarita field to markets in Mexico –where Repsol is the leader in gas distribution– and the United States (see box IV.2).

In Trinidad and Tobago the company participates in the Atlantic LNG consortium, which operates an integrated natural gas chain exporting to the North American, Caribbean and Spanish markets. In January 2000 it acquired 10% of the reserves previously owned by BP Amoco in Trinidad and Tobago, and it holds a three-year option to purchase an additional 20%. It also has a 20% stake in the Atlantic LNG consortium, owner of the only liquefaction train that processes these reserves, and it is participating in the construction of two additional trains (see box IV.3).

Lastly, until 2001 the activities of Repsol-YPF in Venezuela centred on the production of crude oil in four oilfields operated by it[38] –whose total production amounted to 37 tbl/d– and on exploration of the Guapariche field operated by BP Amoco.[39] In 2001 the firm began upstream activities in the natural gas segment by signing an agreement with PDVSA to produce gas from the Quiriquire field. The final phase of the project was completed in December 2001, and production volumes are currently 250 mft^3/d. In June 2001 the firm took a 15% minority stake in a consortium led by TotalFinaElf, which won two gas permits for the Yucal Placer Norte and Yucal Placer Sur blocks in the state of Guárico, both of which have extensive proven gas reserves; it also won a gas permit for the Barrancas exploration block.

(iii) High level of debt

As can be seen from the above, Repsol-YPF has enjoyed vigorous and rapid growth in the region, especially in the last three years. However, this was made possible by the firm's extensive borrowing, which leaves it highly vulnerable to variations in cash flow and thus, also, to oil prices. The high prices that prevailed in 2000 and the first half of 2001, supported by the sale of a number of non-strategic assets, enabled the firm to pay its debts and dividends and to invest. Nonetheless, starting in the second half of 2001, two factors have been testing

34 Gas Natural S.D.G. (a Repsol subsidiary) has a 72% holding in the Invergas consortium, which controls 70% of Gas Natural BAN.

35 Astra (99.4 % owned by Repsol) has a 45.3% stake in GASA, which, in turn, owns 70% of Metrogas.

36 Andina S.A. was formed in 1996 from the capitalization and privatization of the oilfields owned by the former State-owned firm YPFB. Andina S.A. is 50% owned by Bolivia's pension funds, while the other 50% has belonged exclusively to Repsol-YPF since February 2001.

37 According to estimates made in September 2001 by the Policy and Investment Unit of the Office of the Deputy Minister of Energy and Hydrocarbons of Bolivia.

38 Under an operating agreement with PDVSA.

39 Under the arrangement for risk exploration and exploitation with shared profits.

the solidity of Repsol-YPF: lower oil prices and the worsening crisis in Argentina, where most of its assets are located and half of its 2000 earnings were generated. In mid-2001 the Argentine crisis forced the firm to review the targets contained in its strategic plan for 2001-2005,[40] and in April 2002 it announced a 20% cut in investments for that year (*Clarín*, 8 April 2002).

The company's future investments will depend heavily on asset sales and the maintenance of a high price per barrel of crude oil. Standard & Poor's lowered the firm's risk rating from A to BBB in November 2001, and Moody's has also downgraded its credit rating (*El País*, 17 November 2001). After having reached US$ 24 in January 2000, the company's share price had fallen to below US$ 12 by March 2002 (see figure IV.17), which makes the firm a takeover target.

Figure IV.17
TREND OF REPSOL SHARE PRICE ON THE NEW YORK STOCK EXCHANGE FROM 1997 TO 11 APRIL 2002
(Dollars)

Source: Bloomberg, 19 June 2002 (http://quote.bloomberg.com/).

As this chapter was going to press, on 18 May 2002 Repsol-YPF announced the sale of 23% of Gas Natural S.D.G., thereby reducing its stake in this firm to 24.042%. The buyers were pension funds, insurance companies, lending institutions, investment funds and stockbrokers. This move made La Caixa the leading shareholder of Gas Natural S.D.G., with 26.4% of the equity, pushing Repsol into second place (24%); nonetheless, the two shareholders together still have majority control of the firm (50.4%) and have maintained the "joint control" structure that has been in place between them since 11 January 2000.[41] The sale raised 2.008 billion euros for Repsol-YPF, which will be used to reduce its debt and see it through the Argentine crisis.

The main assets owned by Gas Natural S.D.G. consist of its network of gas pipelines and small distribution networks in the Spanish domestic market, where it has about four million customers; distribution companies in Latin America, where it has over three million customers; and supply contracts in Algeria with the Sonatrach Company (*El País*, 18 May 2002; Repsol-YPF, *Noticias,* 16 May 2002, www.repsol-ypf.com).

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40 Its production target for 2005 was revised downward (from 1.61 to 1.35 million barrels of oil equivalent) and its target debt-equity ratio was revised upward (from 24.5% to a range of 30%-35%) (*El País*, business supplement, year 14, N°822, 5 August 2001).

41 As mentioned above, La Caixa is the principal shareholder in Repsol-YPF.

(b) TotalFinaElf

The TotalFinaElf group is the product of the 1999 merger between the French oil company Total and its Belgian counterpart Petrofina, which were joined in 2000 by the French industrial group Elf Aquitaine[42] to form TotalFinaElf. This is the world's fourth-largest private-sector oil company, measured by volume of crude oil production.

In 1998, 14% of Total's oil production and 13% of its gas came from Latin America. Following the merger with Petrofina and Elf Aquitaine, neither of which had a significant presence in the region, these percentages dropped to 5% and 7%, respectively, in 2000. Nonetheless, the firm's strategy was aimed at expanding its projects in the region, and Latin America is currently the destination for 20% of TotalFinaElf capital investment (Alexander Oil & Gas, 2001b).

The presence of TotalFinaElf in Latin America stems mainly from the previous activities of the Total group, together with the exploration assets acquired by Elf Aquitaine in the second half of the 1990s, consisting basically of offshore assets in basins with high potential in Barbados, Brazil and Trinidad and Tobago. Prior to the reform of the 1990s, Total participated in upstream activities in Argentina and Colombia in both oil and gas. In Argentina, beginning in 1978, it operated a consortium of private firms that had signed a contract with the former State-owned firm YPF for exploration and production in the low-risk gas deposits of Tierra del Fuego (Hidra and Cañadón Alfa). These deposits came into production in 1989 and 1990, respectively. In Colombia, since 1987 it has participated as a member of a BP-led consortium that signed association contracts with Empresa Colombiana de Petróleo (ECOPETROL) to exploit the deposits at Santiago de Atalayas (1987) and Tauramena (1990). These contracts led to the discovery, in the early 1990s, of large high-quality oil reserves in the Cusiana and Cupiagua fields. In late 1998, cumulative production from these two deposits totalled about 460 tbl/d of crude oil (TotalFinaElf (http://www.totalfinaelf.com)).

(i) Expansion in upstream activities

In the oil segment, Total's upstream activities in Latin America grew as the sector progressively opened up to private investment. The firm's investments in the gas segment were concentrated in Argentina until the mid-1990s, after which they began to extend into Bolivia and Venezuela, and focused mainly on upstream activities until 2000, when the firm acquired interests in gas pipelines and thermoelectric power plants.

Oil

Total increased its investments in Colombia in the 1990s, acquiring a stake in Consorcio Oleoducto Nacional S.A. (OCENSA).[43] This consortium built the 800-kilometre oil pipeline linking the Cusiana and Cupiagua fields with the port of Covenas on the Caribbean coast,[44] for an investment of US$ 2 billion. The pipeline has a capacity of about 500 tbl/d, accounting for about 60% of the country's total crude oil production. The firm also acquired two exploration permits, one in Gaitanas (Alto Magdalena), where it is field operator with a 65% stake, and the other in neighbouring Guadalupe, where it is the sole participant. It also has a 9.53% stake in the Oleoducto Colombia pipeline, which runs from the middle Río Magdalena valley to the port of Covenas.

In Argentina Total won the 1991 tender for 70% of the El Huemul deposit in the province of Santa Cruz, in partnership with YPF (30%), as part of the YPF privatization. In July 1999 it sold this stake in order to devote its entire potential in this country to natural gas activities.

The opening-up of the Venezuelan hydrocarbons market drew an enthusiastic response from the firm, which entered into partnership with PDVSA under all the different arrangements allowed by the Venezuelan reform: operating agreements, risk exploration with shared profits and strategic partnerships in the Orinoco Belt (see box IV.4). It thus became one of the foreign firms with the biggest investments in that country.

The most important investment project in Venezuela is the joint venture with PDVSA in the SINCOR project, launched in 1997 to produce extra-heavy crude oil from the Orinoco Belt. SINCOR is the largest of the four projects being carried out in that area. In January 2002, TotalFinaElf announced the completion of the project, which had involved a total investment of US$ 4.2 billion and was now ready to produce 180 tbl/d of light crude (with a gravity of 32 degrees API, a measurement used by the American Petroleum Institute) (Petrolatin, 2002).

In 1993, in partnership with Amoco, Total signed a 20-year operating agreement with PDVSA to revive the marginal Jusepín field, where it is field operator with a

42 Two thirds of Elf Aquitaine's activity was in the hydrocarbons sector.

43 The partners in OCENSA were ECOPETROL (25%), British Petroleum (15.2%), Total S.A. (15.2%), Triton (9.6%), TransCanada Pipelines (17.5%) and Interprovincial (17.5%). In September 2000, TransCanada sold its stake to ECOPETROL (10.3%) and Enbridge Inc. (7.2%).

44 This pipeline came on stream in 1997.

55% stake. This field came into production in April 1997, and is currently producing 35 tbl/d of light crude. Encouraged by a new oil discovery in Jusepín in 1998, the consortium is planning major investments in this field –in particular, the construction of a gas injection system at a cost of US$ 300 million (Rozas, 2001; TotalFinaElf (http://www.totalfinaelf.com)). TotalFinaElf also has two risk exploration contracts with shared profits in Venezuela– one in the Guanare zone, in which it is field operator, and the other in Punta Pescador, which is operated by BP Amoco (Notitarde, 1997).

In addition, it has interests in the offshore deposits in Latin America and the Caribbean which Elf Aquitaine acquired in the 1990s. In Brazil, it signed two partnership contracts for deep-water exploration with PETROBRAS. One of these, operated by Elf Brasil with a 35% stake, is located in the strategic Campos Basin, which has great oil potential.[45] In the other, located in an unexplored zone in the Amazon delta and operated by BP Amoco (35%), Elf has a 15% stake. In June 2001, TotalFinaElf added operation (with a 30% stake) of another exploration block in the Campos Basin to its Brazilian offshore assets.

Natural gas

The favourable conditions for private enterprise generated by the sectoral reform in Argentina allowed the consortium led by Total Austral to convert the Tierra del Fuego contract into a concession at no cost. This conversion was accompanied by the transfer to the consortium in 1994, also at no cost,[46] of two gas-bearing areas in the Neuquina Basin with 1,634 mft^3 of proven gas reserves (8.6% of the country's total) and 28.6 mbl of oil (1.3% of the country's total) as of the date of the transfer. In 2000 these figures rose to 2,921 mft^3 of gas (10.9%) and 45 mbl of oil (1.5%) (Ministry of Energy (http://energia.mecon.gov.ar)).

In 1994 the consortium began a campaign of long-distance horizontal drilling in its Tierra del Fuego deposits,[47] which substantially increased both its reserves and its production. Total Austral, which in 1993 was the fourth-ranked producer of natural gas in Argentina, with a 10.8% market share, came to occupy second place behind Repsol-YPF in 2000, accounting for 18% of production and 23% of reserves (Ministry of Energy (http://energia.mecon.gov.ar)). In December 2001, Total Austral announced its decision to develop new gas deposits (Carina and Aries) in Tierra del Fuego, for a projected investment of US$ 400 million (http://www.totalfinaelf.com). Production is expected to come on stream in the second half of 2003, with volumes reaching 424 mft^3/d.

Starting in the second half of the 1990s, the firm made investments in natural gas exploration in the Tarija zone in Bolivia, where major gas reserves were discovered. In this zone, TotalFinaElf has interests in three of the five existing fields, and its proven and probable natural gas reserves in that country amount to 6.25 trft^3 (see box IV.2).

With its takeover of Elf Aquitaine in 2000, TotalFina gained three additional offshore exploration permits in Trinidad and Tobago, which had been acquired by Elf in 1996. In one of these it is field operator with a 40% stake; in another (block 2C) –operated by Broken Hill Proprietary (BHP) with a 45% stake– it is a minority partner with a 30% stake. Successive discoveries of oil and gas in block 2C between 1999 and 2001 encouraged Elf to take a 35% stake in another block, in Barbados, operated by Conoco (65%). Recently, in December 2001, TotalFinaElf acquired a 10% stake in a consortium operated by BHP (30%) to explore a block adjacent to 2C in Trinidad and Tobago (TotalFinaElf (http://www.totalfinaelf.com/); Alexander's Gas & Oil Connections, 2001).

In Venezuela, TotalFinaElf obtained two 35-year permits in 2001 to exploit the gas-bearing blocks of Yucal Placer Norte and Yucal Placer Sur, with proven unassociated gas reserves of 2 trft^3. In both blocks, the firm is field operator with a 69.5% share, partnered with Repsol-YPF (15%) and the Venezuelan groups Inelectra (10.2%) and Otepi (5.3%).

In Peru, TotalFinaElf currently has interests in the lots adjacent to the Camisea deposits (see box IV.2), which are about to be put out to tender (*Gestión*, 31 October 2001).

(ii) Vertical integration in the gas-electricity chain

The accumulation of major natural gas reserves in the region paved the way for strategic vertical integration in the gas-electricity chain, enabling the firm to actively add value to these reserves. TotalFinaElf inaugurated this strategy in 2000 by acquiring stakes in a number of gas pipelines and gas-fired electric power plants.

In June 2000, it purchased the 9.7% share formerly held by BHP in Transportadora Brasileira Gasoducto Bolivia-Brasil S.A. (TBG S.A.), the operator of the Brazilian stretch of the Bolivia-Brazil gas pipeline. It also

45 The Campos Basin has substantial proven reserves and accounts for nearly 80% of the country's oil production.

46 The purpose of this transfer was to "compensate" the firm for the expected difference between the sale price of natural gas as agreed by contract prior to the reform and the price the firm would be able to obtain under the new rules of the game (Kozulj, 2002).

47 The advantage of long-distance horizontal wells is that they reduce the number of platforms required in offshore production.

formed a consortium with PETROBRAS and Andina to build a new pipeline linking the Tarija gas fields to the Bolivia-Brazil pipeline. Lastly, in conjunction with ExxonMobil and British Gas, its partners in Tarija Oeste, it is considering the possibility of joining the Pacific LNG consortium to export Bolivian natural gas to the distant markets of Mexico and the United States (see box IV.2).

As regards its gas deposits in Argentina, in January 2001 TotalFinaElf announced the acquisition of the stakes held by TransCanada Pipelines Limited (TCPL) in three gas pipelines that form an interconnected system supplying gas to the markets of Argentina, Chile and part of Brazil. In February 2001 it also purchased TransCanada's stake in the Brazilian gas pipeline project Transportadora Sul Brasileira de Gas S.A., which will connect the cities of Porto Alegre and Uruguaiana with the Argentine border. The total value of these transactions amounted to US$ 440 million (*Estrategia*, 24 January 2001; *Gazeta Mercantil*, 24 September 2001).

In March 2001, it paid US$ 641 million for all the electric power generation and transmission assets owned by the Chilean firm Gener in Argentina. These assets have given it access not only to the electric power market in Argentina, but also to markets in northern Chile and Brazil. The assets include 63.9% of the Central Puerto power plant; 100% of the TermoAndes thermoelectric power plant in Salta and the associated InterAndes power transmission line running from Salta to Antofagasta in northern Chile; 70% of Sociedad Hidroneuquén, which owns 59% of the Piedra del Águila hydroelectric plant; and an electric power interconnection project between Argentina and Brazil. These assets represent total installed potential of about 4,200 MW (TotalFinaElf (http://www.totalfinaelf.com)).

The above has shown how TotalFinaElf's expansion in Latin America, which began in 1978 at the southern tip of the continent (Tierra del Fuego), accelerated sharply in the 1990s as the region's oil markets were progressively opened up. Reforms in Latin America's hydrocarbons sector allowed the firm to increase its investments in upstream activities in practically all the countries of the region. It has managed to accumulate large reserves through partnerships with private and State-owned firms, operating in both deep-water areas offshore and in continental zones, in both gas and oil and in both extra-heavy crude and light crude deposits. In the late 1990s, the firm struck out in a new direction by making a robust entry into downstream activities in the natural gas sector with a view to boosting regional demand for gas. To this end, it acquired stakes in several gas pipelines, participated in the planning of additional new ones and acquired electric power generation assets, thereby forging increasingly strong links between its activities and the region's economies (see table IV.9).

Table IV.9
EXPANSION OF TOTALFINAELF IN LATIN AMERICA

	Upstream activities				Downstream activities		
		Production		Oil	Natural gas		
	Exploration	Oil	Gas	Oil pipelines	Gas pipelines	LNG export project [a]	Generation
Pre-reform: presence in upstream activities							
Argentina	x	x	x				
Colombia	x						
1990s: accumulation of oil and gas reserves							
Argentina	x	x	x				
Barbados	x						
Brazil	x						
Bolivia	x						
Colombia	x	x		x			
Peru	x						
Trinidad and Tobago	x						
Venezuela	x	x					
2000 onward: expansion into natural gas downstream activities							
Argentina	x	x	x		x		x
Barbados	x				x		
Brazil	x				x		
Bolivia	x				x	x	
Chile					x		
Colombia	x	x		x			
Peru	x						
Trinidad and Tobago	x						
Venezuela	x	x					

Source: ECLAC, Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management.
[a] Liquefied natural gas.

(c) Royal Dutch/Shell

Currently the world's second-ranked private-sector oil company behind ExxonMobil in terms of hydrocarbons production volume, Royal Dutch/Shell is one of the firms that had not carried out hydrocarbons production activities in Latin America when the petroleum-sector reform began. Instead, it had a substantial presence in the fuel resale market in Argentina and Brazil, with a network of service stations that brought it a major share of the market in both countries.[48]

With the opening of the oil market, Shell's strategy in the region targeted downstream activities with a view to strengthening the firm's position in countries where it already had a presence, while also expanding into the gas-electric power segment and other neighbouring countries. In the late 1990s, its strategy veered towards strengthening its position in upstream activities, in order to correct the imbalance in its asset portfolio in the region (see table IV.10). Today, the firm's main objective is to become an integrated oil company and a leading player in the gas segment.

Table IV.10
EXPANSION OF SHELL IN LATIN AMERICA

	Upstream activities		Downstream activities in oil				Downstream activities in natural gas					
	Exploration	Production	Refining	Lubricant plant	Distribution	Tanker fleet	Gas pipelines	Distribution	LNG export project [a]	LNG import project [a]	GTL project [b]	Generation
Pre-reform: presence in oil downstream activities												
Argentina	x		x		x	x						
Brazil					x							
Peru	x			x								
First half of 1990s: expansion into oil downstream activities												
Argentina	x	x	x	x	x	x						
Brazil				x	x							
Paraguay					x							
Peru	x			x	x							
Second half of 1990s: expansion into natural gas downstream activities												
Argentina	x	x	x	x	x	x						
Bolivia							x					
Brazil				x	x		x	x				x
Chile					x							
Mexico							x					x
Paraguay					x							
Peru	x	project		x	x		project					
Venezuela	x				x							
Late 1990s: acquisition of upstream assets												
Argentina	x	x	x	x	x	x					x	
Bolivia							x					
Brazil	x			x	x		x	x		x		x
Chile					x							
Colombia	x											
Mexico							x			x		x
Paraguay					x							
Peru	x	withdrew		x	x		withdrew					
Trinidad and Tobago	x										x	
Venezuela	x				x				x			

Source: ECLAC, Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management.
[a] Liquefied natural gas.
[b] Gas-to-liquid.

48 It also owned a refinery in Argentina and a lubricant plant in Peru (http://www2.shell.com/home/Framework).

Prior to the sectoral reform in Latin America, Shell had engaged in exploration activities in Argentina (without great success) and Peru, where in 1984 it discovered extensive hydrocarbon reserves, mostly gas, in the Camisea region. Nonetheless, it did not develop these finds, and withdrew from the project 14 years later, having invested US$ 200 million in exploration during the 1980s and a further US$ 246 million between 1996 and 1998.[49] The latter expenditure was shared with Mobil, its partner since 1996.[50] The Shell/Mobil consortium abandoned the project in 1998 because the government rejected its requirements for proceeding with the investments. In February 2000, the project was awarded by tender to the Pluspetrol Hunt Oil/SK Corporation.

(i) Expansion of downstream activities

Shell's expansion of its downstream activities focused first on the liquid fuels segment, with investments to extend and modernize its assets in Argentina and Brazil. The firm concentrated on adapting its plants and tankers to meet environmental standards and obtain quality certification for its products. It also took advantage of market liberalization to expand into other countries (Paraguay, Peru, Venezuela and others).

Starting in the mid-1990s, Shell's strategy targeted the natural gas market. The firm secured an integrated position in downstream activities in the gas-electricity segment by acquiring stakes in gas pipelines, natural gas distribution companies and electric power generators fired by natural gas transported through those pipelines. It is also evaluating its participation in LNG projects, both for import (Brazil, Mexico) and for export (Venezuela), together with gas-to-liquid (GTL) projects to convert natural gas to liquid fuels.

Liquid fuels

In 1993, Shell inaugurated a lubricant factory in Barracas, Argentina; by 1995, it had gained a 32% share of the Argentine market. It also made investments to expand and modernize its Dock Sud refinery, its transport fleet and its network of service stations scattered throughout the country.

In 1997, it entered the LPG market in Brazil by purchasing the LPG producer-distributor Petrogas. The firm's plan is to become the leading player in Brazil, with a market share of 15% within five years. Shell currently owns 4,200 (20.8%) of the country's service stations, and its lubricant factory covers 19% of the Brazilian market. In the aviation sector, it has a domestic market share of 42%, with 54 aircraft refuelling facilities at various airports.

In Peru, the lubricant plant owned by Shell since 1963 currently meets over 27% of domestic demand. In addition, Shell was the first company to invest in the fuels market after the government decided to liberalize in 1993. The firm currently has a network of over 200 service stations and 25 lubricant distribution businesses, as well as deposits in Piura, Trujillo and Arequipa.

In Paraguay, Shell is the LPG market leader, having bought Incogas in 1990 and later inaugurated a modern plant on the outskirts of Asunción with enough capacity to supply nearly 50% of the Paraguayan market.

In Venezuela, Shell was one of the first international firms to enter the fuel distribution market after it was opened up in 1998. The new participants, which include Mobil and Texaco, are each trying to capture at least 15% of the local market, while PDVSA intends to retain around 40%. There are currently about 1,600 service stations in Venezuela, but it is estimated that a further 1,200 are needed. This opens up growth prospects for firms investing in distribution (Rozas, 2001; http://www2.shell.com/home/Framework).

Natural gas and electric power generation

Starting in the second half of the 1990s, Shell took a strategic gamble on the natural gas market in Brazil, where growth was being promoted by government policies to increase the share of gas in the country's energy mix, over 90% of which was based on hydroelectric power. The firm's investments in this sector began in 1997 with the start, after some delay, of construction on the Bolivia-Brazil gas pipeline, which provided the first concrete evidence that this government policy was being implemented. Shell participates directly in the two consortia responsible for building the pipeline: 4% in TBG (the Brazilian part) and 17% in Gasoducto Transboliviano (GTB) (the Bolivian part). In 1999, the privatization of natural gas distributors in Brazil enabled Shell to break into the natural gas segment in that country by joining a consortium controlled by British Gas,[51]

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49 *Anuario Estadístico de Hidrocarburos*, Ministry of Energy and Mining, Peru.

50 In 1996 the Shell (57.5%)/Mobil (42.5%) consortium signed a 40-year permit contract with Perupetro (the government body created by the 1993 Hydrocarbons Act to negotiate hydrocarbons contracts) for a total investment commitment of US$ 2.47 billion. The consortium had two years to decide whether or not to develop the deposit. Further details on Shell/Mobil's activities in Camisea can be found in Campodónico, 1998.

51 The consortium consists of British Gas (72.74%), Shell (23.22%) and CPFL (3.93%).

which in 1999 acquired 52.7% of Comgas, a distributor in the city of São Paulo, where the gas pipeline terminates.

In the same year that it acquired a holding in Comgas, Shell formed a consortium with Enron Corporation to acquire a 50% stake in the Bolivian pipeline transport network (TransRedes),[52] in the framework of the capitalization programme being carried out in Bolivia. TransRedes is the operator –with a 51% share– of the Bolivian stretch of the Bolivia-Brazil gas pipeline; it also has a 12% minority interest in the Brazilian part.

In conjunction with Enron, Shell recently implemented the Cuiabá integrated energy project in Brazil, which consists of expanding a 480-MW combined-cycle thermoelectric plant in that city and constructing a pipeline to supply it with gas. The pipeline will be about 630 kilometres long and will run from Río Grande, Bolivia, to Cuiabá, Brazil. The project's cost is estimated at US$ 600 million –US$ 200 million to build the pipeline and US$ 400 million to expand the power plant. Shell is also participating in the project to construct the 945-MW Carioba II thermoelectric power plant in the state of São Paulo, in partnership with InterGen and Companhia Paulista de Força e Luz (CPFL).

Lastly, in 2000, Shell teamed up with PETROBRAS to take equal shares in a project to build the first LNG reception and regasification terminal in South America, to be located in Porto de Suape in the state of Pernambuco. The regasification unit will have a capacity of up to 212 mft^3/d of natural gas –enough to generate about 1500 MW of electric power. The total investment is estimated at US$ 200 million. The basic engineering project has already been completed, and construction is scheduled to begin in 2002. The facility is to come on stream in 2005.

Shell also has projects in gas processing activities in other countries of the region, namely Argentina, Mexico, Trinidad and Tobago and Venezuela. In this last country it forms part of a consortium of private firms that are studying the possibility of developing the Cristóbal Colón LNG project in partnership with PDVSA, to exploit offshore reserves in the Gulf of Paria. The execution of this project is awaiting agreement between PDVSA and the private consortium on the conditions of their partnership. The consortium consists of Shell (45%), which will contribute liquefaction technology; ExxonMobil (43%), which will contribute its experience with deep-water oil rigs; and Mitsubishi (12%), which will provide oil tankers and financial capacity.

In Mexico, in June 2001, Shell Gas & Power and El Paso Global GNL announced their decision to jointly develop an LNG regasification terminal in Altamira in the state of Tamaulipas. The terminal is scheduled to start importing in the first half of 2004, and is expected to develop a final capacity of 1.3 trft^3/d. The two partners will each have a 50% stake in the project, which will involve an initial investment of US$ 300 million. The Shell-El Paso project will sell gas directly to PEMEX, as well as to independent electric power generators and other industrial customers. In Mexico, Shell also has stakes in three electric power plants and a transboundary gas pipeline (http://www2.shell.com/home/Framework).

Lastly, the firm is considering establishing four mega-plants somewhere in the world in the course of the current decade to convert natural gas into liquid fuels. These GTL plants will use the Shell Middle Distillate Synthesis (SMDS) proprietary technology, which the firm has been applying for the last 10 years in a pilot plant in Malaysia –currently the only GTL plant in the world. Seven natural-gas-rich countries, including Argentina and Trinidad and Tobago,[53] have been pre-selected as locations for these projects. The advantage of liquid fuels produced from gas is the absence of sulphur and aromatics. The process generates intense heat, however, which would be harnessed to produce 100 MW of electric power per day (*Clarín* and *La Nación* newspapers, 11 April 2001).

(ii) Expansion of upstream activities

As mentioned earlier, Shell's expansion in the region clearly targeted downstream activities, in both gas and oil. As it developed these activities, its reliance on external production to supply raw materials increased. To reduce this dependence and its vulnerability to price volatility, in the late 1990s the firm took steps to strengthen the vertical integration of its activities in the region.

In Brazil, between 1999 and 2000, Shell acquired stakes in six deep-water exploration blocks, three of which are operated by it. Two of the blocks are located in the prolific Campos Basin. In December 2001, the firm announced discoveries in block BS-4 in Bahia de Santos, which it operates with a 40% stake. So far, the existence of large oil reserves with low API gravity has been confirmed in this block, of which 300 to 500 mbl are thought to be recoverable (http://www2.shell.com/home/Framework).

In Colombia, Shell signed a 22-year association contract with ECOPETROL in 1998 to evaluate the potential of the Guajira gas field, located offshore in the Caribbean. That same year, it sold its 37.5% stake

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52 The other 50% was ceded to Bolivian pension funds.

53 The other countries are Australia, Egypt, Indonesia, Iran and Malaysia.

in the Samoré association contract as a result of serious conflicts with the U'wa indigenous population, which was threatening collective suicide if the project went ahead.

In Argentina, in 1998 Shell paid US$ 470 million for three areas with potential gas deposits located in the country's North-West Basin, and it sold its 40% stake in the La Ventana deposit in Mendoza province, which it had acquired in 1994. Lastly, in Trinidad and Tobago, the firm entered a partnership with Agip in 1998 for offshore exploration of block 25(a).

(d) Pérez Companc

Pérez Companc started out in 1946 as a small family shipping business and subsequently diversified into other activities,[54] including the energy sector in general and hydrocarbons in particular, which ended up dominating its business.

Like other private Argentine oil companies, Pérez Companc grew in the oil business as a subcontractor exploiting petroleum-bearing areas that had already been explored and developed by the former State-owned firm YPF. In 1968, the company began to produce oil and gas for the first time, signing a contract with YPF for production in the Entre Lomas area. This was followed by a further seven contracts.[55] In addition to receiving areas that did not require much initial investment, the subcontractors benefited in their sales to YPF from prices that were continually being renegotiated close to international levels, irrespective of domestic prices, which were set lower.

(i) Vertical integration in Argentina

The manner in which YPF was privatized gave Pérez Companc, along with all former subcontractors of the State-owned enterprise, the opportunity to accumulate its own reserves under very favourable conditions and to vertically integrate its petroleum activities. At the same time, liberalization and privatization in other energy sectors gave it the chance to integrate its activities throughout the energy chain.

With the petroleum-sector reform, the eight exploitation contracts that Pérez Companc had signed with YPF were turned into concessions at no cost, and in three areas YPF remained as a marginal minority partner.[56] Together, the eight areas accounted for nearly 10% of the country's total output at the time of the conversion. Pérez Companc also participated in tenders for both marginal zones and central areas of YPF, and teamed up with other former subcontractors of the State firm to purchase privatized assets in downstream activities. These included the San Lorenzo and Campo Durán refineries and the Allen-Puerto Rosales oil pipeline. Pérez Companc also took advantage of liberalization elsewhere in the Argentine economy to acquire holdings in privatized firms and take on new businesses in various sectors: natural gas transport and distribution (Transportadora Gas del Sur (TGS) and Metrogas); electric power generation, transport and distribution (Hidroeléctrica Pichi Picun Leufu and Empresa de Distribución Eléctrica del Sur (EDESUR)); and telecommunications, where it has a 25% stake in NORTEL, which, in turn, owns 51% of Telecom Argentina-France Telecom S.A.

By the end of the liberalization process in Argentina, Pérez Companc had emerged as the leader of a group of firms linked mainly to the energy sector, with hydrocarbons as their main business. In 1993 it was ranked second among oil and gas producers behind YPF, with shares of 16% and 12% respectively in national output volumes (Kosulj and Bravo, 1993; Gadano, 1998; Ministry of Energy (http://energia.mecon.gov.ar); CEP, 1998). It had also become a vertically integrated enterprise, in both oil and gas, and strove to deepen this integration in the 1990s.

(ii) Expansion in Latin America

Once it had consolidated its activity in Argentina, the firm took rapid steps to expand its hydrocarbon business at the regional level and to achieve greater geographical diversification of its hydrocarbon reserves (see table IV.11). In 1993, 97% of these reserves were located in Argentina, but by 1998 the proportion had dropped to 44% (Warn, 2000).

A highlight of the firm's Latin American expansion was its participation, in 1994, in the second round of operating agreements for marginal areas with Venezuela's PDVSA, when it was awarded one exploration area. Later, in 1997, it participated in a third round, gaining an additional exploration area and a further three exploration/production areas.

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54 These included forestry production, banking (with the acquisition of over 90% of Banco Río in 1960), construction, computer and information systems, industrial activities and miscellaneous manufactures, cement production, petrochemicals, agriculture, telecommunications, cable television and other activities.

55 Six of these contracts were signed under the last military dictatorship.

56 The YPF stake was 8% in one area, 2.5% in two others and 0% in the remaining five. In relation to the overall production volume from the eight areas at the time of conversion, YPF participation amounted to 2.3% (Kosulj and Bravo, 1993; Gadano, 1998).

Table IV.11
EXPANSION OF PÉREZ COMPANC IN LATIN AMERICA

	Upstream activities			Downstream activities						
		Production		Oil		Gas-electric power				
	Exploration	Oil	Gas	Oil pipelines	Refining	Gas pipelines	Electric power generation	Electric power transmission	Electric-power distribution	Petrochemicals
Pre-reform: subcontractor for State-owned firms										
Argentina	x	x								
Bolivia	x									
Peru	x									
First half of 1990s: vertical integration in Argentina										
Argentina	x	x	x	x	x	x	x	x	x	x
Bolivia	x									
Peru	x									
1994 onward: expansion in Latin America										
Argentina	x	x	x	x	x	x	x	x	x	x
Brazil										x
Bolivia	x	x			x					
Ecuador	x			x						
Peru	x	x								
Venezuela	x	x								

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

In 1996, Pérez Companc expanded its petroleum activities to three other countries in the region, namely Bolivia, Ecuador and Peru. In Bolivia[57] it participated in the YPFB capitalization, forming a consortium with YPF S.A. and Pluspetrol S.A. that was awarded 50% of Andina S.A. In 1999 it took a step towards integrating its activities in that country by acquiring two refineries with a joint capacity of 60 tbl/d, in partnership with PETROBRAS. In 2000, as part of an asset swap with Repsol-YPF, it gave up its share in Andina S.A., along with 50% of the gas fields in the Gulf of San Jorge in southern Argentina, receiving in return the Repsol-YPF share of the gas-bearing zones of Santa Cruz I (30%) and Santa Cruz II (62.2%), also in southern Argentina (Yahoo en Español Finanzas, 16 February 2001).

In Ecuador, Pérez Companc was awarded an exploration block in the eighth round of international tenders for exploration and exploitation in the Amazon region. The exploration activities resulted in the discovery of an estimated 300 mbl of oil reserves between July and September 2000. In 2001, the firm acquired 70% of exploration block 18, located in Ecuador's Oriente Basin. That same year, it took a 15% stake in a consortium that began construction of the heavy crude oil pipeline intended to convey an additional 450 tbl/d of heavy crude from the Amazon jungle to the coast starting in 2003.

In Peru, the firm acquired Lot X on the north coast as part of the privatization of the oilfields owned by PETROPERÚ. Later, it also took stakes in exploration blocks.

In 1997, in Brazil, it set up a firm called Innova that operates three plants located in the Triunfo petrochemical complex in Rio Grande do Sul. The plants have produced styrene, polystyrene and ethyl benzene since 2000, and have an annual production capacity of 250,000, 120,000 and 190,000 tons, respectively. Also in Brazil, in 1998 Pérez Companc signed an agreement with PETROBRAS for the exploration of the Tucano Central gas-bearing block; but this was declared economically unviable in 2001 (Pérez Companc, 2001). Lastly, it is currently studying with ENAP the possibility of jointly developing a new petrochemical plant in Magallanes in southern Chile.

[57] The firm had been in Bolivia since 1989, operating oil and gas deposits in Colpa Caranda.

In the next few years, the firm intends to consolidate its growth outside Argentina. As of March 2001, the investments planned for 2001-2005 amounted to US$ 3 billion, just 25% of which will be made in Argentina, while 43% is earmarked for Venezuela (*La Nación*, 15 March 2001).

(iii) Financing problems

The firm is facing problems in financing its expansion and development strategy in the region. Its net debt-equity ratio is higher than those of the large oil TNCs with which it competes for market share and access to reserves in Latin America.[58] At the same time, its access to credit is more limited and more expensive.[59] In recent years the family that controls the firm has struggled to solve the thorny problem of how to obtain investment funds to develop its new reserves without losing control of the firm or massively increasing its borrowing.

With this aim, since 1997 the firm has sold a number of assets not related to its core business, in banking, telecommunications, construction and elsewhere, which raised an estimated US$ 2 billion in funds (Manjul, 2001).

In 1999, it designed a financial architecture aimed at expanding the firm's capital by issuing new shares while maintaining family control of the firm. Initially, this consisted of a stock swap in which the family increased its control of voting shares from 58% to 80% without having to pay a cent.[60] Subsequently, this measure enabled it, in January 2000, to start trading on the New York Stock Exchange, using new share flotations to finance its expansion without diluting family control. Nonetheless, since their debut on the New York Stock Exchange, the shares have steadily fallen in price, and in March 2002 they were trading at less than half their January 2000 level (see figure IV.18). According to a Merrill Lynch analyst, this is largely because agents on international markets associate the firm with Argentina's country risk.[61]

Figure IV.18
TREND OF PÉREZ COMPANC SHARE PRICE ON THE NEW YORK STOCK EXCHANGE FROM JANUARY 2000 TO 11 APRIL 2002
(Dollars)

Source: Bloomberg, 19 June 2002 (http://quote.bloomberg.com/).

58 According to an article published in *LatinFinance,* its net debt-equity ratio was 39% in 1999, compared to an average of 23% for the "big oil" companies (Warn, 2000).

59 "Today, Argentine companies have to pay a high cost for capital... I can take money at 10%, but that's not very satisfactory," the firm's executive vice-president, Óscar Vicente, told *LatinFinance* in March 2000.

60 In the swap operation, minority shareholders received, in exchange for each Pérez Companc S.A. share they gave up, 2.7854 class B shares in PC Holdings S.A., which owns 98% of Pérez Companc as its sole asset. Class A shares remained exclusively in the hands of the Pérez Companc family. These are worth five votes each, whereas class B shares are worth a single vote but have the advantage of offering dividends that are 50% higher than those of class A shares. Executive Vice-President Óscar Vicente explained that the intention had been to maintain policy control of the company but not economic control, in order to avoid takeover (Revista *Petroquímica*, Petróleo, Gas & Química 157: October -November 1999).

61 Frank McGann, quoted by Manjul (2001).

In December 2001, the steep currency devaluation in Argentina, where Pérez Companc had made 75% of its net sales that year (Pérez Companc S.A., 2001), complicated the firm's financial situation still further. This prompted it to announce, in March 2002, its intention to renegotiate its US$ 2.656-billion foreign-currency debt with its creditors (ibid). The company's executive vice-president had recently stated in a seminar that the firm had half or fewer of the pesos it needed to make its dollar payments, and that a group like Pérez Companc was unviable in that situation (*Gestión*, Peru, 15 March 2002). Standard & Poor's recently downgraded the company's corporate credit rating in foreign currency from CCC+ to CCC, in view of the high risks of renegotiation and lower-than-expected profits for this year (Reuters, 19 April 2002).

E. CONCLUSIONS

Reforms in the hydrocarbons sector during the 1990s attracted new players and encouraged investment flows towards Latin America and the Caribbean. In contrast to the pattern in other sectors of the economy, and given the existence of a large oil rent, the reforms tended to preserve the position of State-owned firms, which continue to undertake the bulk of investment in the sector and comfortably head the ranking of productive firms at the regional level.

The oil deposits that had traditionally been the richest and most profitable remained in the hands of State-owned enterprises, while projects undertaken by private-sector firms focused on exploration and production in new regions or in deep waters, or else involved production from marginal or extra-heavy crude oilfields at high cost. The exceptions were Argentina, Bolivia and Peru, which privatized their oil firms.

In the natural gas segment, foreign investment was more dynamic and received greater incentives, since development of the sector required massive investments to create new markets, including the construction of extensive and costly infrastructure to reach the final consumer. TNCs possess large gas fields in Argentina, Bolivia, Peru and Trinidad and Tobago, where they operate alongside State-owned firms without association contracts, and they have also been participating in upstream natural gas activities in Colombia and, more recently, Venezuela –with the requirement, in both cases, that they work in partnership with the State firm. In addition, they have made major investments in downstream activities in the natural gas segment (gas pipelines, industrialization, distribution). This has happened in Argentina, Bolivia, Brazil, Chile, Colombia, Mexico, Peru, Trinidad and Tobago and Venezuela. TNCs are also moving into the electric power generation and distribution business, and are currently planning a number of other projects.

In this chapter, four different strategies for private oil firms' expansion in the region were identified, which were used by the following firms:

(i) The Spanish firm Repsol, which took advantage of liberalization to become a global enterprise trading as Repsol-YPF and based its expansion initially on the purchase of existing firms;

(ii) Foreign firms that were already engaged in extractive activities in the region and exploited the competitive advantage this gave them to diversify their presence geographically in upstream activities (TotalFinaElf, BP Amoco, ChevronTexaco);

(iii) Foreign firms that were not involved in extraction but were participating in downstream activities prior to liberalization, which pursued strategies aimed primarily at consolidating their competitive advantage in that segment (Royal Dutch/Shell, ExxonMobil); and

(iv) Local Latin American firms that regionalized their activities in response to liberalization (Pérez Companc, Pluspetrol), initially by acquiring privatized assets.

Firms such as Repsol-YPF and Pérez Companc, which followed the rapid expansion route by taking over existing firms, have quickly managed to secure a strong position among private firms operating in the region. Repsol-YPF is by far the leading private-sector hydrocarbons producer in Latin America and the Caribbean, and Pérez Companc is the third-ranked private oil producer, though it is far behind Repsol-YPF in terms of size. Nonetheless, the two firms have in common a heavy concentration of activities in Argentina and high levels of debt, which have become the Achilles heel of their expansion. Currently, they face the dual problem of (i) insufficient financial capacity to develop the fields they have discovered and the projects they have announced, and (ii) a sudden drop in the value of their shares, which has made access to financing even more difficult and rendered them vulnerable to takeover.

Among the large oil TNCs (excluding Repsol-YPF), the two leading global players, ExxonMobil and Shell, do not yet have a strong presence in the region. On the other hand, firms such as TotalFinaElf, BP Amoco and ChevronTexaco have increased their presence in upstream activities since the reform. All these firms have the financial capacity they need to undertake a major expansion in the region, which could be accomplished in two ways: (i) through the acquisition of existing firms, either State-owned or private, or some of their assets –the most vulnerable being private firms with financing difficulties; or (ii) through the discovery of significant deposits in the areas they are exploring.

TNCs may find that their future investment opportunities are enhanced by the fact that they are already positioned in the region and have established relations with governments and publicly owned firms, which are the primary investors in the sector. The oil reform of the 1990s gave rise to a new type of relationship between public and private firms, involving multiple partnerships and joint ventures. Accordingly, the directors of transnational oil corporations now pay close attention to the future investment plans of State-owned firms, looking out for new partnership opportunities while also pressing for better conditions for private investors and further liberalization in the sector, including the partial or full privatization of State-owned petroleum assets.