Foreign Direct Investment Policy and Promotion in Latin America

Centre for Co-operation with Non-Members in co-operation with the Commission of the European Union
OECD PROCEEDINGS

FOREIGN DIRECT INVESTMENT POLICY AND PROMOTION IN LATIN AMERICA

PUBLISHER'S NOTE
The views expressed are those of the authors, and do not necessarily reflect those of the Organisation or of its Member countries.

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FOREWORD

Under the auspices of the OECD Centre for Co-operation with Non-Members (CCNM), a workshop on “Foreign Direct Investment Policy and Promotion in Latin America” was held on 15-17 December 1998, in Lima, Peru. The meeting was jointly organised with the Commission of the European Union and in co-operation with the Government of Peru.

The meeting brought together 62 participants from twelve Latin American countries and ten OECD Member countries. It was opened by Mr. Alberto Pandolfi, Prime Minister of Peru, Mr. Rainer Geiger, Deputy Director for Financial, Fiscal and Enterprise Affairs at the OECD and Mr. Rafael Dochao Moreno, chargé d’affaires of the EU Delegation in Peru.

This workshop took place against the background of the new challenges posed by the financial crisis that hit emerging markets in Asia, and elsewhere, including in Latin America. This crisis made it imperative for emerging markets to consider and examine the sustainability of foreign direct investment inflows. The meeting identified appropriate policies and promotion methods to ensure this. It is hoped that the proceedings of the Foreign Direct Investment Policy and Promotion Workshop in Latin America will stimulate further debate and influence the formulation of policy priorities throughout the region.

This publication brings together selected papers by experts who attended the Lima meeting. It is intended to constitute a reference on foreign investment policy and promotion for policy makers and experts in the public sector, actors in the private sector and academic institutions, both in emerging market economies and in OECD countries.

This book contains the proceedings of the workshop conducted by the Private Sector Development Unit of the Directorate for Financial, Fiscal and Enterprise Affairs. Within the PSDU, this project was managed by Mr. Declan Murphy and the resulting publication prepared by Ms. Carmen Villegas Caballero, with the technical co-operation of Mr. Edward Smiley.
Part I introduces the topic with the summary report and main conclusions of the workshop. Part II focuses on the analysis of current trends in FDI in Latin America, and on the framework for international investment rules. Part III, which identifies the best practices in promoting FDI in Latin America, includes selected country and private sector case studies.

The views expressed here are the sole responsibility of the authors and do not necessarily reflect those of the OECD or its member governments. It is published on the responsibility of the Secretary-General of the OECD.

Eric Burgeat
Director
Centre for Co-operation with Non-Members
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Message from The Honorable Donald Johnston, Secretary-General of the OECD, to His Excellency President Alberto Fujimori of Peru

on the Occasion of the Workshop on Foreign Direct Investment Policy and Promotion in Latin America, held in Lima on 15-17 December 1998

Mr. President,

I would like to express the OECD’s gratitude to your Government for its generosity in jointly hosting this Workshop on Foreign Direct Investment Policy and Promotion in Latin America with the OECD and the European Commission. The invitation by your Government confirms that Latin America’s interest in the OECD’s work is spreading. OECD Members and Latin American countries have a mutual interest in a dialogue on foreign direct investment policies. Indeed, OECD Members can learn from the bold reforms implemented throughout Latin America over the past decade.

This meeting is held at the end of a challenging year for Latin America. The spin-off effects of the financial crisis in Asia and Russia have also been felt in this part of the world. However, it is very encouraging to observe that the countries affected by this crisis have not strayed from the path of economic reform. We have not seen a resurgence of protectionism, which has a proven record of ill-serving the countries that resort to it. I express my admiration for the reforms pursued throughout Latin America over the past decade and the results which these have produced.

Globalisation has been enormously enriching to the world through increased trade, investment and technology flows, but it raises also difficult challenges. Growing concerns among our populations in the present context of instability and uncertainty, underscore the fragility of the reform process and have given ammunition to those who would prefer to try to maintain the status quo.

A major role of the OECD is helping chart the path for countries -- OECD and non-OECD alike -- to take advantage of the opportunities and meet the challenges of globalisation. In this context, this meeting represents an
opportunity for a strengthening of ties between Peru and the OECD, and I will mention just a few other areas where co-operation with the OECD could be relevant to Peru’s current policy challenges.

Starting in 1999, the OECD’s Committee on International Investment and Multinational Enterprises will continue work on international investment policy issues and multilateral rules. These matters will be discussed in the context of important related issues, such as employment and labour relations, the environment, competition and good corporate conduct. The OECD would be pleased to have the contribution of non-Member countries to this work.

In the field of taxation, the OECD has well-known expertise in the area of international taxation and has developed common standards, in particular the Model Tax Convention and the Guidelines for Transfer Pricing. Preliminary contacts have been established with your government, with a view to it participating in the OECD co-operative activities in the area of taxation -- as well as in other areas such as trade, environment, labour markets, corporate governance and combating corruption.

Mr. President, it is my firm belief that, in this era of growing global interdependence, countries can only benefit from international co-operation in pursuing policies for both reform and sustainable growth. The OECD stands ready to pursue mutually beneficial dialogue on economic and social reform measures with your Government, along with other interested non-Member countries.

Donald Johnston
Secretary-General, OECD
15 December 1998
Part I

OVERVIEW
SUMMARY OF PROCEEDINGS

by

The OECD Secretariat

Introduction and background

This workshop was organised by the OECD, the Commission of the European Union and the Government of Peru as part of an ongoing dialogue on foreign direct investment. It was attended by representatives of OECD, EU, Latin America and Caribbean countries and international organisations.

The workshop took place against the background of the new challenges that are posed by the financial crisis that has hit emerging markets in Asia, but also elsewhere, including in Latin America. This crisis has made it imperative for emerging markets to ensure the sustainability of foreign direct investment inflows. The objective of this workshop was to identify the policies and promotion methods that are necessary to achieve this. Two broad themes were addressed at the workshop: a) Foreign Direct Investment: Trends, Assessment and Policies and b) Best Practice in promoting FDI in Latin America. The sessions on the first day were focused, respectively, on the analysis of current trends in FDI in Latin America, and on the framework for international investment rules.

Foreign direct investment: trends, assessment and policies

1. FDI in Latin America in the current financial environment

The discussion of FDI trends was introduced by representatives from Brazil and Chile, and by presentations of reports by ECLAC and by SELA, respectively.
Spurred by liberalisation and structural economic reforms, global FDI has expanded considerably over the past decade, to US$400 billion over 1997 (UNCTAD estimate). An increasing share of this FDI has gone to developing countries: one-fifth in 1990, one-third in 1997. Among the 25 principal recipients of FDI over 1990-1997, there were nine non-OECD Members: five Asian economies, and four Latin American ones: Brazil (13), Argentina (16), Chile (20), Colombia (25).

Asia still received more FDI than Latin America in 1997. However, Asian FDI was affected by the crisis which hit in that year, Latin America was not: FDI into Asia grew by 1.5 per cent, FDI into Latin America by 43.5 per cent. Brazil was the largest recipient, with 35 per cent of the total. In the preceding years (1990-1996), Mexico had been the largest recipient, with 32 per cent.

While the contrast between Asian and Latin American FDI growth may be striking, the most important thing was perhaps that FDI grew at all in Asia: loans and portfolio capital produced a sizeable outflow from Asia. This contrast underlines the role of FDI as a stable source of capital inflow which can cushion the impact of financial crises. The “tequila crisis” of 1994/95 did not stop the growth of FDI into Latin America. Brazil, a country severely affected by the current financial crisis, has continued to receive a net direct investment capital inflow. Latin America has remained a competitive venue for FDI because of the market access it offers, the cost level and the regional free-trade agreements. The relatively favourable development of FDI into Asia has also been spurred by new liberalisation measures; FDI into Korea, which took significant liberalisation measures, has picked up notably since April 1998.

It has also been encouraging that FDI growth has held up in spite of the completion of the privatisation projects that were the initial generators of FDI in Latin America. Since 1994, an increasing share of FDI has been in the form of greenfield investment; in 1997 this share dropped somewhat but was still one-third of all FDI.

Looking at the focus of FDI in Latin America, we can distinguish three categories: (i) investment focused on efficiency enhancement, e.g. in the manufacturing of cars which need to compete on the US market; (ii) investment seeking access to natural resources (oil, gas, minerals), and (iii) investment seeking access to local markets (e.g. the cement and agrofood industries).

This being said, the impact of the crisis that originated in Asia has had a marked impact in Latin America. A three-stage process has been observed. The first stage constitutes a diminished access of emerging markets to international capital markets: investors have become more risk-averse world-
wide and we have seen a “flight to quality.” More serious, however, has been
the second stage, the impact on trade. Demand on export markets has sagged,
commodity prices have gone down and Asian exporters have become more
competitive as a result of the currency depreciation. Chile is a case in point:
over 30 per cent of its exports have Asia as their destination and its economy
depends strongly on copper prices. Finally the third stage is that of economic
recession, which has indeed been spreading in this part of the world.

What should be the policy orientation in view of these adverse
circumstances? Part of the problem may be a matter of image: investors take a
homogeneous view of emerging markets and it is a challenge for Latin America
to show that it is different from Asia. To do so, it will have to continue building
a solid track record of open markets for FDI and trade: stick to the present
policy and avoid the impression of fair-weather liberalism. Another challenge
is to strengthen the financial systems, to avoid financial fragility and to promote
domestic savings. Industrialisation was a point of debate: there may have been
undue focus on investment in traditional, rather than cutting edge industries and
services. If FDI is to support industrialisation, it needs to support the transfer of
technology; the Caribbean Basin initiative of the 1980s failed in this respect,
because it made preferential access to the US market conditional upon the
import of production inputs from the US rather than their local production.
Finally, participants frequently pointed to the Free-Trade Agreement of the
Americas (FTAA) as the vehicle for furthering economic integration in the
coming years and for locking in the achievements in liberalisation and
economic reform that have been made.

2. The international framework for foreign direct investment

Latin America is not averse to international investment rules. FDI is
widely seen as an engine of economic development, of diversification of the
productive base and of job creation. The point was made that it would be easier
to come to an agreement on such rules in Latin America than it has proven to be
among OECD countries.

In this light, could the FTAA be a precursor of, or a testing ground for
a multilateral, or global, investment regime? It was observed that NAFTA has
been a source of inspiration by raising the standards of other investment treaties
in the Americas. Bilateral treaties concluded before NAFTA contain traditional
disciplines of investment protection. After NAFTA, we have seen higher-level
treaties, such as the investment protocols of Mercosur. The BITs concluded by
NAFTA partners go beyond the traditional protection provisions by also
offering market access on a National Treatment basis. As a result, higher-level
investment rules have progressively spread over the continent, thus laying a
possible basis for high-standard rules with a wider geographic application. At the same time, the proliferation of different and sometimes overlapping rules has been a source of confusion, which call for a degree of harmonisation.

While a certain optimism about the prospects of multilateral investment rules in Latin America may be justified, the question should also be asked what lessons can be learned from the MAI negotiations: what elements should be included in a new framework of investment rules, and what elements are bound to run into serious objections?

One speaker made a distinction between three types of investment disciplines: (i) fundamental guarantees, such as investor protection, national treatment and recourse to arbitration, (ii) “higher integration” disciplines, such as rules for tax, competition, R&D support, subsidies and incentives, and (iii) rules on politically generated issues, such as labour standards and culture. While rules guaranteeing fundamental rights enjoy wide support in the Western Hemisphere, it may be possible to incorporate some of these higher disciplines as well, while due account should be taken of the politically generated issues.

With reference to this typology, some speakers cautioned that the MAI process has shown that negotiators should not overplay their hands. Even the fundamental rights can be a bone of contention, as the “Ethyl case” in Canada demonstrated. Higher integration rules, such as those on tax, competition and incentives, were not part of the MAI negotiations, or the MAI only recognised existing arrangements. Difficulties emerged on other issues during the MAI negotiations, notably on performance requirements, culture, the relationship between MAI and existing regional investment rules, and the national sovereignty issues implied in investor-to-state dispute settlement.

However, the inclusion of a broad range of issues in a negotiation might also help achieve consensus, if it creates room for trade-offs. Multilateral investment rules are more than the sum of a number of BITs. At all stages, political support for multilateral investment rules is essential, and such support requires that the rules satisfy the needs of a broad gamut of interested parties. Hence, negotiations have to pay due attention to the politically generated issues, such as labour and environment. This can be particularly difficult. However, in spite of the difficulties down the road, the FTAA may well one of the very few broad fora where investment rules are negotiated over the coming years and will, as such, be watched with particular interest.
Best practice in promoting FDI in Latin America

3. Creating an attractive environment for investors

The discussion on “Best Practice in promoting FDI in Latin America” occupied the second half of the workshop programme. The first session, dealing with the overall theme of creating an attractive environment for investors and the role of government departments, regional authorities and international organisations in that regard, was introduced by speakers from Argentina, El Salvador and Panama.

The fundamental role of governments in creating an environment, which attracts investors and the benefits of investment to national objectives, was emphasised as the most vital part of promotion. Creating a stable political, economic and social environment with appropriate legal and institutional structures will make countries more competitive in attracting investment. Investment has been the driving force of high economic growth in some Latin American countries and has changed the basis of competitiveness by transfer of technology, mobilisation of natural resources and introduction of new ways of managing business. Speakers recommended more focus on factor productivity, reducing the cost of doing business, and investment in human resource development as underpinning an attractive environment.

Argentina has been one of the most successful countries in the reception of foreign investment in Latin America. The principal reasons for this, based on feedback from investors, are not just the global growth in FDI but the recognition by Argentina of what was described as the “new rules of the game” in competing for and attracting investment. Most notably this involves stability of the democratic political system, adoption of new macroeconomic policies (convertibility, fiscal balance, autonomy of the Central Bank), reform of the state, privatisation, deregulation of markets, creation of an open economy, introducing foreign investment laws which permit liberal movement of capital, and establishing an appropriate institutional framework with transparent regulations and procedures.

In the institutional arrangements to attract FDI it was suggested that the task was clearer if responsibility for this work was placed in the hands of an agency. New agencies have been established or existing agencies re-constituted in recent years by a number of Latin American countries. In an international environment of increasing competition it was seen as important to assign dedicated and clear institutional responsibilities to promote and attract FDI.
Primary responsibilities of such agencies are to disseminate information world-wide to improve national image and make investors more aware of investment opportunities. The importance of this task should not be underestimated -- historically many investors had a poor image of Latin America as an investment location and may not distinguish well between countries. Agencies need to continuously work to change this image. In addition agencies contribute to regional and provincial development; undertake extensive marketing and selling activity; act as “private sector facilitators”; and with their extensive practical experience can play a crucial role in policy development and international investment treaty discussions.

Varying promotion agency models were described by speakers, some based within Ministries and others established as separate more independent entities. There was no consensus on a single best promotion agency model for Latin America. Also agencies have very different mandates - in Argentina the main role of the agency is provision of information. Other agencies are more directly involved with specific projects. However four important features of agency structure and operations emerged from discussion - the joint involvement of the private sector where possible (e.g. on promotion missions, in meeting new investors and on agency boards where such exist, etc.) was seen as beneficial; the creation of the one-stop-shop agency insofar as possible; the need to have focused strategies in investment promotion aimed at relevant target sectors and companies with good prospects for high value added products, particularly where small countries are concerned and where they have no comparative advantage through natural resources, is seen as important; and ensuring that agency staff have the necessary business and sectoral skills to be competent discussion partners with potential investors.

To what extent do investment promotion agencies cause or contribute to growth in FDI? Some speakers raised this key issue and pointed to results achieved prior to the establishment of agencies. It raises the question of the real contribution of many IPAs to investment generation and new employment. With more new agencies and resources devoted by governments to FDI promotion and development it highlights the need for agencies to be given clear mandate/goals and performance properly measured.

Joint regional co-operation was advocated. However the distinction between countries in terms of type of investment sought and national needs was seen as a limiting factor here as well as the reality of international competition for FDI. Panama, for example, differs from some other Latin American countries. It is a service economy with 84% of GDP in the service area, 10% in manufacturing and 6% in the agricultural sector. Among its major objectives are to develop tourism and become a re-distribution center for other countries. Areas where there is scope for co-operation and action already happening
include sharing experience/training between agencies; selected regional promotion campaigns; participation in FTAA discussions and CBI negotiations; sharing experiences on, for example, EU/UNDP funded business center schemes.

The second part of this session addressed the role of regional and international organisations in creating the environment for investors and was introduced by the representatives from the Andean Community, the European Union funded Al-Invest Programmeme, UNIDO and the Foreign Investment Advisory Service of the World Bank.

The Andean Community has a series of common provisions favouring investment. The community has undertaken concrete work in propagating free trade, integrated markets on goods and services, liberalisation of services, protection of patents, physical integration of the countries through regional transport policies, etc. which improves the wider environment for investors. This work is ongoing with a commitment to a full Free Trade Area by 2005. The region was described as an “open liberal territory for FDI” however it was proposed that individual national advancements need to be grouped together in a formal way in the region. Specific actions to reinforce inter-regional investment, examine the harmonisation of incentives as well as linking Andean Business Centers to the investment promotion agencies in the region are proposed.

The Al-Invest Programme, an initiative of the Commission of the European Union, has the goals of (a) strengthening of business co-operation between Latin America and Europe (b) promoting EU investment in Latin America. The main focus is on small and medium sized enterprises (SMEs) and the project has developed in two stages. In the period 1994-95 the Commission of the European Union committed US$10 million to this programme and from 1996 - 2000 a further contribution of US$45 million is envisaged. Using tools such as the TIPS network and a range of offices supported by the EU it can offer sub-contracting or outsourcing prospects and joint venture/business alliance leads. To date there have been 7575 participants and US$203 million in deals have been closed under this programme. New regional and technology transfer initiatives are being considered. This wide-ranging programme is an important facilitation in the environment to promote investment in Latin America.

A comprehensive presentation on UNIDO and the various UNIDO schemes and programmes relevant to Latin America was made. Sustainable industrial development with the main focus on SMEs is a central part of the work of UNIDO. A full range of service modules is available and a selection from these tools and methodologies can be made to address individual country
UNIDO works in cooperation with other international agencies and business associations in delivering services.

The FIAS representative pointed to the fact that in 1998, for the first time in 10 years, it appears that the total flow of FDI to Latin America has exceeded the flow to South East Asia. However Latin American FDI is restricted to too few countries and too few sectors. A challenge facing Latin American countries in the future is to achieve a wider geographic and sectoral spread.Key to this will be understanding industry sector restructuring taking place including the growth of service business and the different business strategies of international companies. This presents both challenges and opportunities to Latin American countries. The example of the US company, Intel investing in Costa Rica was widely discussed. Some speakers saw it as atypical. It was seen by most speakers as reflecting an excellent example of a country which had created the right environment for investors, partly through its significant investment in education and skills enhancement, and which undertook focused and imaginative marketing in attracting this project. There were clear lessons for investment promotion in this case study.

The various presentations illustrated divergent application and attitudes to the use of incentives in investment promotion. Some countries stated that no incentives were provided while other countries used a mixture of incentives to attract investors. One speaker referred to the use of non-transparent incentives. Participants suggested that this is an issue, which needs to be considered in the context of the FTAA negotiations.

The critical importance of education and skills availability was referred to as potential “deal breaker” in attracting FDI. Countries, which can offer a workforce with, for example, software, electronic, science and similar technology skills, have a decided competitive advantage. In their strategies to create the right environment for investors much stronger emphasis should be given to the importance of education and training. This was particularly the case in attracting the new high technology industry sectors but also an important factor in more traditional industries such as the automotive sector. For many sectors there is a lack of suitable personnel. It was suggested that countries should adopt a more realistic position on their statements that they have an excellent labour force.

4. **Expanding business in Latin America**

The afternoon session of the second day was devoted to a series of national case studies presented by Peru and Chile and industry case studies on the automotive, telecommunications and financial sectors.
Since 1990 Peru has created a new environment for investors. This has involved many of the reform steps taken by other countries: for example, deregulation of the economy, new laws providing for equal treatment for all investors, free access to sectors, stability of legal regime and tax systems, specific laws for the oil and mining sectors, substantial privatisation (over 190 companies), the signing of 25 bilateral investment protection treaties (including 15 OECD countries). Over US$7 billion in new investment has been attracted and it is estimated that a further US$14 billion investment will be undertaken in the coming years. The CONITE representative described the Peruvian network of agencies, which promote the new image and provide information and support to investors. This comprehensive presentation illustrated the progress achieved as a result of the new policies and creation of a new progressive environment for investors in Peru.

In the second country presentation the successful Chilean experience was related. Chile perceives FDI as an essential component of national development policy. Since the 1970s there has been drastic liberalisation and the country has been very successful in attracting FDI - US$22 billion has already been invested. Chile has created the institutional framework to build this investment. Sectoral opportunities are disseminated and there is an increasing focus on SMEs and added value product areas.

The private sector case studies presented the perspective of investors who have undertaken major investments in Latin America. Key points to emerge from the initial presentation on the telecommunications sector were:

- Telefonica Internacional, Spain has invested almost US$12 billion in Peru, Chile, Argentina and Brazil and consistent post take-over investment is taking place each year. Such investment is essentially long term and based on a belief in the future prospects of the region.

- Important factor for investors are: a regulatory framework which ensures security of their very substantial investment -- clear and stable rules and regulations for both initial and follow-on investors; a stable macroeconomic environment; capital transfer freedom.

- Apart from direct benefits of this investment it is estimated that 2.5 indirect jobs for each direct job have been created in Peru.

US$5.6 billion investment has been undertaken in the automotive industry in Argentina in the 1990s versus US$4 billion in the previous decade. This sector represents about 20% of all FDI and 50% of car supply in the Latin American Mercosur region. There have been substantial structural changes in
the industry - 40 models are being produced compared to 25 models in 1990; the time gap with Europe for introduction of new models has been reduced to approx. 3 years; exports (90% to Brazil which highlights the inter-regional dependency) are now $2.5 billion per year; human resource skills are a big factor for continued success. Two factors of concern to the industry are the high tax burden and the need for improvements in road infrastructure.

Completing the industry presentations, Banco Santander and Banco Bilbao y Vizcaya outlined their experiences as investors in the Latin American region. Both have made a strong investment commitment to Latin America and are seeking to provide the full spectrum of financial services through a strong presence in the main countries. Latin America offers the opportunity for impressive margins and expansion in an increasingly competitive world financial service market and this plus the historical and commercial connections between Spain and Latin America make the region an obvious target for investment. The presence of such banks in the region has brought benefits to the banking system as a whole - stronger marketing, better systems and access to better services.

The main conclusions derived from the country and private sector presentations were the importance of political and economic stability combined with transparent juridical systems and regulatory procedures to attracting investment. It was suggested that the Latin American region seems to be moving to a second stage of development where there was need for more focus on specific sectors including some of the newly emerging high growth sectors. Greater emphasis on using existing tools and programmes to integrate technology transfer into FDI promotional efforts is desirable.

5. Investment promotion techniques and the role of the investment promotion agencies

The third and final day of the workshop addressed promotion techniques and the role of IPAs.

The MIGA/World Bank speaker outlined that organisation’s role in capacity-building of investment intermediaries through training, workshops and their IPA network; dissemination of information on investment opportunities, business operating conditions and business partners; and investment facilitation by bringing different parties together. The central point that knowing clearly the product/service provided, the customer and the competition was emphasised. Successful investment promotion had pointed to important practices which facilitated effective promotion such as mixed government/private sector structures in agencies; governance by a board of
directors with strong private sector input; secure sources of funding; budgetary/administrative independence; exemption from civil service employment regulations; and separation of regulatory and promotional responsibility. The importance of getting the climate right for investors (referred to extensively by other speakers), and ‘providing solutions’ as well as good customer care to investors were seen as central to successful investment promotion.

The OECD presentation on this subject summarised critical issues for investment promotion and agencies in today’s competitive world environment:

− Clear distinction needs to be made in promotion between different categories of FDI: location-specific investment which is restricted to a particular location (for example to get access to natural resources or the acquisition of a specific company) and mobile investment (both ‘greenfield’ and expansion projects) which can locate in any one of numerous countries

− The essence of successful promotion is in establishing meaningful relationships with identified target sectors and companies and providing strategic solutions to such companies. All promotion techniques used should be measured against that objective.

− The most successful investment promotion agencies act like top class commercial service businesses. Their approach is highly professional and efficient. They act as development agencies where they seek not just to undertake promotion but to improve the wider environment for investors by instigating change through liaison with relevant authorities and are innovative in seeking investment in new and emerging sectors. They have the mandate and resources to undertake their work and are central to national industrial policy and development.

− There is a clear “best practice” agency model which should be recognised. Key elements of the “best practice” model included having a clear service management system within the agency which spells out the service they offer, target segment, and delivery method; uses customised marketing to target clients; pursues FDI in all elements of the value chain; roots FDI through linkage with local suppliers; achieves a high volume of repeat investment; and is focused also on opportunities in new sectors such as Ecommerce, software, biotechnology, multimedia, etc.
Commenting on the previous presentations the Dominican Republic speaker outlined action being taken in his country to develop the environment for FDI. A new agency to promote FDI has been established and action is being taken to improve the environment for investors. The main focus of action is to improve the regulatory environment, improve human resource skills and develop infrastructure such as ports and airports. A “roadmap” which charts present procedures for investors has been prepared and is the basis of reform proposals.
SUMMARY OF CONCLUSIONS

by
The OECD Secretariat

The principal objective of the workshop was to share the experience on foreign investment policy and promotion in Latin America and to assess the prospects for sustained investment in the region. For this purpose participants assessed current investment trends, reviewed policy developments and the need of multilateral rules and discussed specific aspects of investment promotion on the basis of country and case studies and presentations by international organisations.

Participants noted an unprecedented level of foreign investment flows to Latin America which grew at 43.5% over 1997. Since the beginning of the 1990s FDI inflows in Latin America and the Caribbean have risen more than five-fold. From 1990 until present, total FDI inflows into Latin America have amounted to over US$250 billion. Increasingly, Latin American countries find themselves in the position of capital exporters, in particular for outward direct investment within the region.

Privatisation has been one of the strongest driving forces for FDI. As the privatisation process is now coming to a close in many countries, there is a need for ensuring sustained investment flows through expansion of existing enterprises, greenfield investment and private financing of infrastructure and investment utilities through concession agreements. Participants felt that there is a strong potential for FDI growth in many sectors, in particular in infrastructure, energy and services.

The benefits of foreign investment were recognised. In a period of financial instability, it represents long-term commitments, increases the competitiveness of the private sector, both in domestic and export markets, and helps cushion countries from external shocks. While the impact of the financial crisis is felt in terms of reduced growth, Latin American countries have performed relatively well due to strong economic fundamentals and the implementation of structural reforms during the current decade.
The challenge is now to create longer-term competitive advantages for countries of the region through an appropriate policy mix. This implies: open markets and the pursuit of regional integration, continuation of legal and institutional reforms, in particular in the field of tax systems, strong emphasis on education and human resources development, sound environmental policies including waste management and clean technologies, and the modernisation of the services sector.

Investment promotion agencies have an important role to play in helping develop a suitable policy framework for investment and private sector development, providing reliable information on investment opportunities and providing a service function to foreign investors. They should cooperate closely with the private sector, including chambers of commerce and business associations. It was also suggested that greater efforts were needed to focus promotion activities on key sectors representing a comparative advantage and to undertake promotional activities on a regional basis. The need to give greater emphasis to integration of investment promotion, technology transfer and environmental performance was underlined.

Participants recognised the need for multilateral rules which would provide a stable and equitable framework for investment in a globalised economy. There are good prospects for the development of such rules within the FTAA. Countries within the region have achieved a high degree of convergence in national policies and structural reforms. The network of bilateral and regional trade and investment treaties is expanding and already includes elements, such as market access and national treatment, and the countries of the region have actively participated in discussions in international fora such as WTO and UNCTAD, as well as in the dialogue with the OECD in the context of the negotiations on a multilateral agreement on investment (MAI).

Participants felt that a high-standards agreement was feasible, building on the progress achieved at national, regional and international levels. Such an agreement would include fundamental principles of liberalisation and protection of investment and could address related subjects, such as competition, incentives, taxation, labour and environment. However the MAI negotiations have shown the complexity of some of these subjects and demonstrated the need for careful political management of the negotiation process and dialogue with interested parties from business, labour and other parts of civil society. While the MAI had not been concluded and negotiations are no longer taking place, core elements of a multilateral investment framework had been identified. Discussion in the OECD will continue on investment rules and related subjects, such as labour, environment, sustainable development and
standards of behavior for multinational enterprises. This work is open for participation of interested non-members countries.

Participants will welcome a continuing dialogue between OECD and Latin American countries on issues related to investment and private sector development including taxation, corporate governance, the role of institutional investors and action against bribery in international business transactions. They expressed their appreciation to the OECD, the EU Commission and the Government of Peru for their support for this workshop. They called for future periodical meetings where investment trends, policies, rules and promotion strategies could be reviewed and experience among promotion agencies and the private sector exchanged. Such meetings could also address specific issues of capacity building and create synergy among national and international institutions.
Part II

FOREIGN DIRECT INVESTMENT: TRENDS, ASSESSMENT AND POLICIES
FDI IN LATIN AMERICA IN THE CURRENT ENVIRONMENT

by
Antonio Martins *

Foreign direct investment (FDI) is defined as an investment involving a long term relationship and reflecting a permanent interest and control of a resident entity in an enterprise in another economy. FDI implies that the investor has a significant degree of influence on the management of the business in the other country.

During 1997, the flows of FDI world-wide continued their climb for the seventh consecutive year, increasing 19% over 1996, reaching a new record level of more than US$400 billion. The developed countries received almost two-thirds of this huge amount of investment. The developing countries accounted for a little more than a third of the global inflow of FDI in 1997, increasing from one-fifth in 1990. The developing countries made a lot of progress in attracting and receiving FDI. In 1990 these countries received US$34 billion, or 17% of the global inflows compared with 1997, where the same countries received US$149 billion, or 37% of the global inflows of FDI. In only seven years the total of FDI to developing countries was multiplied by four. It is significant that even with the Mexican and Asian crises, no one developing region experienced a decline in the level of FDI in 1997.

A new record level of US$45 billion of FDI was received by China, contributing to the US$87 billion received by the developing countries of Asian and Pacific Area. Even the South East Asia, the area most affected by the financial crisis during the second half of the year, experienced a small increase of 6% in the FDI inflows last year. Due to economic and financial difficulties this trend will not be repeated this year and in the years to came we could expect some drop in the level of FDI in the Asian emerging economies. The countries most affected by the Asian crisis - Indonesia, Malaysia, Philippines, Thailand and South Korea - are now trying to answer questions related to how

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the crisis and its economic consequences will affect the FDI inflows to that part of the world. Certainly, the cost of acquiring assets whose prices have fallen drastically, the abundance of firms seeking capital and the liberalising policies, especially in terms of merger and acquisitions, that are taking place in that region, are circumstances that make it easier to enter and expand operations in the region if the investor has a long-term view of the sound future of the market in that area of the world.

Thanks to economic stability, growth, liberalisation and privatisation, Latin America is the champion region in attracting FDI in 1997. The turnaround in FDI flows to Latin America that occurred in the beginning of the 90's was strengthened in 1997. With an increase of 28% over 1996, in 1997 Latin America and the Caribbean region attracted a total US$56 billion and invested abroad a record of US$9 billion. Apart from economic stability, liberalisation and privatisation, already mentioned, sustained economic growth and good macroeconomics performance, are key factors to explain the regional FDI boom. Other important factors are trade liberalisation, deregulation, and advances in the regional economic integration arrangement and macroeconomic fundamental improvements. The average annual rate of GDP growth rose from 1% in the 1980s to 3.5% in the 1990s. The per capita growth rates climbed from 1.0% to 1.8% in the current decade. The average rate of inflation dropped from 200 per cent in 1990 to 11 per cent in 1997.

Brazil with US$16 billion was the champion, exceeding Mexico with US$12 billion and Argentina with US$6 billion. Argentina, Brazil and Mexico together were responsible for 62% of total inflows to the region. Venezuela, Peru, Colombia and Chile accounted for a further 26%. Despite the increasing investment power of Western Europe and the growing role of the Asian countries, the United States remains as the largest investor in our region, with more than US$24 billion in 1997, mainly in automobiles, electronics, apparel and other manufacturing. MERCOSUR has given an upgrade to the attractiveness to intra-regional and extra-regional investments. Companies from Europe, United States and Asia are coming to invest in the growing MERCOSUR market. The increasing global competition and the market expansion seem to be the main driving forces to push the investment to MERCOSUR. Companies from Western Europe, United States and Asia, have invested strongly in the MERCOSUR area to defend and increase their shares in this market, which are expanding rapidly on account of economic growth and improvement in the regional integration process.

On the other hand, in Mexico, taking advantage of relatively low labour costs, geographic proximity to the United States, and the opportunities opened by NAFTA, the main attractive force has been the efficiency-seeking, and the United States is the final destination for the country export-oriented
industries. Privatisation has played a very important role in creating new opportunities for foreign investor, mainly in areas that a few years ago were closed to foreign capital. Latin American Governments have also played an important role in creating and maintaining a fair, friendly and liberal framework for receiving the FDI in the region. Statistical figures show that this FDI boon to Latin America is coming with good changes in the nature of the investment. Thanks to the structural reforms, macroeconomic stabilisation and adequate management, we can see some indicators that the FDI to Latin America is becoming more export-oriented and increasingly integrated into the global companies production strategies.

Concerns about the sustainability of FDI flows into Latin America have proved unfounded. The principal concern was that privatisation-related acquisitions of state assets by foreign investors would have only a single positive impact on the flows of capital. Instead of this, new investments have been made in the modernisation of privatised companies and in already existing foreign affiliates. Indeed, as privatisation-related opportunities in some countries have declined, mergers and acquisitions have gained increasing importance. Another concern is about the negative impact of large and growing current-account deficits that are coming together with this recent FDI boon to Latin America. In the longer run, the export orientation of Latin America foreign affiliates could help solve the problem through improvements and gains in the trade balance of the region.

The case of Brazil is illustrative to explain the foreign investor confidence in Latin America. The strong FDI inflows to Brazil coincided with the determination of the Brazilian Government to implement a comprehensive macroeconomic stabilisation programme, that reduced our annual inflation rate from more than 2000% a year in 1995 to less than 2% that we are expecting in 1999. Another key element to attract FDI to Brazil was our privatisation programme that is still under way. During the period of 1997/8 the Brazilian privatisation programme will be responsible for more than one-third of total FDI that has been received by the country as whole. A good example was the privatisation of Telebras that was sold for the total of US$19 billion of which US$12 billion came from foreign investors. Experiences like that can be found in different Latin American countries. It is interesting to remember that Latin American companies are strongly investing abroad. In 1997 Latin American countries accounted for US$9 billion in FDI. Once again the opportunities offered by privatisation seem to be the main force behind this new trend. It can be illustrated by Chilean companies that are investing in electricity generation industry in Argentina, Brazil, Colombia and Peru. We can expect that this trend will continue in the future, once that the great opportunities offered by the region are also available to the region based companies.
The financial crisis that originated in Asia affected Latin America by reducing drastically the inflows of capital to the region. However, while large amounts of short-term capital left the region, the FDI inflows remained positive. There is no surprise once FDI flows involve a long-term relationship that includes not only financial capital but also technology, management and intellectual property rights that jointly will represent the assets and interest of the foreign investor. On the other hand, the investment is motivated by the strategic interest of the companies, that includes market access, resources, reduction of costs, increasing efficiency and so on. Taking into account all this, FDI is a typically a long-term association between the investor and their foreign affiliates and its mobility is limited and quite expensive as compared with portfolio investment that is motivated by immediate financial gain and is fully mobile at low cost.

In the case of Latin America, the financial crisis in Asia does not seem to have affected drastically the level of FDI flows into the region. It could be explained because access to local and regional markets remains the main attracting force for investing in the area. On the other hand, export-oriented FDI in manufacturing in the region is mostly directed to the United States market. Due to the relatively low transaction costs, geographic proximity and the NAFTA arrangement, the competitiveness of Latin America to United States market will not be affected by the currencies devaluation that occurred in Asia. Privatisation will remain an important factor although less important for the region as a whole. Investment in previously privatised firms should continue, in order to attend to the demand of the fast-growing local markets. Some manufacturing industries will continue to invest in order to consolidate their regional production systems. Mexico should continue to take advantage of being an export platform to the United States market. If the strong economic performance of the region continues, Latin America will remain the most fast growing area for FDI in the future.

Although the main driving forces and the prospects for FDI to the region remain positive, we should have in mind that continued effort should be made in order to maintain the attractiveness of the region. To preserve and enhance the regions’ FDI attractiveness, Latin America countries should continue to work on their macroeconomic stabilisation programmes, and also maintain their long-term agenda of structural reforms and liberalisation.
The exponential growth and increasing importance of foreign direct investment (FDI) as part of the process of globalisation has made it increasingly important to establish an international framework of rules to underpin these flows. FDI has become a major engine for economic growth and technological progress. It creates jobs. Under the right conditions, it can also generate positive environmental impacts. Due to its long-term character, it is an element of stability in international financial flows. Adherence to a multilateral set of investment rules could also contribute to increasing the attractiveness of developing countries as hosts to FDI, and help integrate them into the global economy.

The benefits of FDI are generally recognised, as are the claims of investors to legal security and non-discriminatory treatment. But there are also concerns. For example, foreign investors are sometimes perceived to be willing to use their mobility or negotiating power to avoid host countries’ requirements in areas such as environment and labour standards, or to pursue global strategies in contradiction to the host countries’ development objectives. Moreover there is concern that international rules, if not carefully drafted, might compromise the ability of host governments to pursue legitimate social and economic policy objectives and upset the balance of power between foreign investors and host countries.

Developing a multilateral framework for investment thus faces a twofold challenge:

− First, it needs to support the positive contributions that FDI can make for economic growth and -- as an agent of environmental

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improvement for sustainable development -- by setting up international rules which provide legal security and non-discriminatory treatment for foreign investors and investments. Such rules could help create confidence in markets, which is particularly important in a period of financial instability, and provide an effective means of avoiding or resolving investment disputes.

Second, it needs to deal with the concerns that have been expressed with regard to sovereignty, protection of labour rights and the environment, culture, the responsibilities of investors and other issues of interest to developing countries.

If conceived on this basis, a balanced framework of international rules would address key issues concerning globalisation and ensure respect of government policy prerogatives. Together with other instruments of international co-operation in areas like competition, taxation, corporate governance, labour and environmental standards and actions against corruption, it would offer a global partnership for developed and developing countries and complement bilateral, regional and sectoral agreements.

Elements of a multilateral framework

1. Scope

Views differ as to how broad should be the coverage of multilateral rules, and in particular whether they should cover short-term capital and certain forms of intellectual property rights. However, there is a broadly shared view on the value of long-term foreign direct investment, and the need to encourage it. Therefore, there is broad support that a multilateral framework would focus on foreign direct investment. To this purpose, one could build upon an enterprise-oriented definition as in NAFTA and the OECD Code of Liberalisation of Capital Movements, both of which deal with the establishment of enterprises. Under this approach, it would be possible to provide legal security with respect to all assets of a foreign-owned enterprise, without requiring all types of assets to be listed or identified.

There is broad support that all measures affecting FDI (laws, regulations, and administrative practices) by governments at all levels (federal, state, provincial, and local) would be covered.
As in bilateral and regional investment treaties, existing investments would be protected during a reasonable time after the withdrawal of a participant from the framework.

2. Participation

By all countries which share its goals and are willing and able to accept its rules and disciplines.

3. Substantive rules

National treatment/ Most-Favoured Nation (MFN) treatment

Countries would accord to investors of another participant with regard to their investment treatment no less favorable than the treatment they accord in comparable situation to their own investors (national treatment) or to investors of any other participant or of a third country (MFN treatment).

General exceptions

There is broad support for a rule that would explicitly allow a participant to take any action necessary for the protection of essential security interests. Such a rule could also include an exception clause concerning the maintenance of public order.

Taxation

There is broad support for recognizing the importance of bilateral treaties on the avoidance of double taxation in addressing discrimination issues.

Country-specific exceptions

There is broad support that existing non-conforming measures would be “grandfathered” (maintained) through a system of country-specific exceptions to the non-discrimination rule.
Investment protection

There is broad support for including rules on expropriation/compensation, and on the transfer of funds drawing on bilateral and regional investment treaty experience.

Expropriation

A rule would prohibit a participant from expropriating or nationalising an investment of a foreign investor in its territory except for a purpose which is in the public interest, on a non-discriminatory basis, in accordance with due process of law, and accompanied by payment of prompt, adequate and effective compensation.

Transfer of funds

All payments relating to an investment may be freely transferred without delay in a freely convertible currency at the market rate of exchange prevailing at the date of transfer.

4. Sovereignty and protecting regulatory authority

There is broad support for affirming the right of a participant to conduct its domestic policies, including social and environmental policies, fully and freely in a non-discriminatory fashion, and to ensure that the activities of foreign investors are in complete conformity with its laws and regulations.

5. Labour and environment

There is broad support for rules that would help ensure that the activities of foreign investors are beneficial to a good social climate and high environmental standards.

Labour issues

A multilateral set of investments rules could make a reference to the recent Declaration of principles adopted by the International Labour Organisation (ILO) Conference on June 1998 (Member countries’ commitments to respect, promote and realize in good faith, the principles concerning the
fundamental rights: freedom of association and the effective recognition of the right to collective bargaining, the elimination of all forms of forced or compulsory labour, the effective abolition of child labour, and the elimination of discrimination in respect of employment and occupation). It could also note that the ILO is the competent body to set and deal with core labour standards world-wide. Many governments support a provision that would commit them not to lower their domestic labour standards to attract or retain a particular investment.

**Environment**

A multilateral framework could recognize the need to implement the agreement in a manner consistent with sustainable development, with explicit reference to the Rio Declaration and Agenda 21. Many governments appear ready to commit themselves not to lower their domestic health, safety, and environmental standards to attract or retain a particular investment.

**6. Investors’ responsibilities**

A multilateral framework on investment could explicitly confirm the duty of foreign investors to respect the domestic laws of the host countries. It will also integrate non-binding standards of behaviour by enterprises, for instance the OECD Guidelines for Multinational Enterprises. It would take up the results of the recently launched review of those Guidelines.

**7. Developing countries**

It has been suggested to facilitate broad participation in the establishment of a multilateral framework on investment by allowing developing countries to negotiate their own pace of liberalisation in conformity with their economic capacities and strategies for development. For example, it has been proposed that one would take into account the specific situation of developing countries when they take individual exceptions, and that there could be transition periods for developing countries to bring their domestic laws into conformity with its rules.

**8. Dispute settlement**

The view is broadly shared that a multilateral framework on investment would provide for an effective dispute settlement mechanism. In
particular, there is broad support for a state-to-state dispute settlement mechanism.

**Further specific issues**

1. **Performance requirements**

   Performance requirements can be defined as obligations imposed upon investors as a condition for an authorisation or the granting of an advantage (e.g. a government subsidy). The WTO Agreement on trade-related investment measures (TRIMS) prohibits contracting parties, in principle, from imposing trade distorting requirements (e.g. import requirements, local content requirements, trade and foreign exchange balancing requirements). Under the TRIMS Agreement, special transitional arrangements apply to developing countries.

   There has been concern that extensive prohibitions of performance requirements --which apply to foreign and domestic investors alike -- might interfere with development strategies of host countries, especially developing countries. The question arises as to whether a multilateral framework on investment should include provisions on performance requirements.

2. **Further exceptions and specific arrangements**

   **Services**

   Many are of the view that investment rules should not require participants to enter into liberalisation commitments in services beyond those already agreed in the GATS.

   **Culture**

   Concerns have been expressed that a multilateral set of investment rules should not affect the right of participants to preserve their cultural and linguistic identity.
Regional economic integration organisations

Discussion is needed on how a multilateral framework on investment should treat regional economic integration organisations.

Intellectual property

It has been suggested that a multilateral framework on investment should allow deviations from the principles of national treatment and most-favoured nation treatment in respect of copyrights and other specifically mentioned rights consistent with the WTO-TRIPS Agreement and the Berne and Rome Conventions.

3. Extra-territoriality

It has been suggested that the question of conflicting jurisdictions should be addressed in a multilateral framework on investment.

4. Dispute Settlement

State-to-state dispute settlement

There is broad support for a state-to-state dispute settlement mechanism.

Investors-state dispute settlement

Concerns have been expressed that investor-state arbitration procedures could conflict with national sovereignty. However, investor-state dispute resolution has been a central feature of existing bilateral and regional investment agreements.
A few decades ago, countries in the region began adopting specific policies in relation to foreign investment. For over 30 years, these policies in Latin America had a protectionist bias and sought to favour national over regional capital.

In time, the failure of these policies and the advance of economic globalisation brought about economic reforms in the region that tended toward freer trade. Nations began to promote and protect foreign investment and began attracting the foreign investment resources and technology deemed necessary to make the development process possible, thus creating a progressive process of freer investment.

No longer primarily protectionist, regional foreign investment policies and regulations, in varying degrees, evolved toward promoting an attractive climate for investment.

In analysing the Comparative Study on Investment Policy, prepared by the IDB for the FTAA Working Group on Investment in 1997, and the 1998 World Investment Report, prepared by UNCTAD, it becomes apparent that at least 20 Latin American and Caribbean countries have specific policies concerning foreign investment. Of these 20, 15 have reformulated or modified their foreign investment policies in the 1990s.

National regulations are complemented by policies adopted via signed bilateral or regional accords that have greatly increased in number during the 1990s. According to information provided by the countries themselves during the negotiations of the FTAA Working Group on Investment, the majority of

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countries have signed more than one foreign investment agreement with one other country in the hemisphere. What is noteworthy is that the majority of these agreements have been signed during the present decade.

Efforts to promote investment are occurring in other regions as well. At the Bangkok Summit in 1995, the members of ASEAN, in a bid to stimulate investment flows agreed to, among other things, implement administrative simplification procedures for investment purposes and to promote transparency in investment policies.

The great number of national policies and the numerous regional and bilateral accords have generated a complex network of norms. The dynamic nature of the investment process, within the context of globalisation, would seem to suggest the need for an ample, uniform, multilateral policy for international investment. Such a policy would promote liberal national policies, offer adequate levels of protection and effective procedures for solving conflicts, as well as promote a stable and predictable investment climate.

The creation of this multilateral policy will be no easy task, as can be seen by the recent negotiations of the OECD countries.

For this reason it is necessary to prepare a multilateral policy based upon existing consensus, taking into account that investments must promote economic growth, sustained development, employment and must increase the standards of living for both developed nations, as well as developing nations.

Therefore, the process initiated in the hemisphere to prepare a fair and transparent investment policy, within the framework of FTAA, that will protect investors and related flows, without creating obstacles for other countries, will contribute to the creation of a multilateral investment agreement.

The Investment Negotiating Group has decided to develop a negotiation process around the 12 indispensable areas identified by the Work Group during their research over the past two years. These indispensable areas comprise an appropriate base for establishing multilateral investment agreements and, as will be indicated below, consensus is being built concerning the general concept of various points:

- the majority of countries define foreign investment under a broad concept linked to the definition of assets,

- the National Treatment and the Treatment of the Most Favoured Nation are principles that are applied by most of the countries in the region, in relation to the investments established in the country,
− in relation to aspects concerning the protection of foreign investments, the majority of countries include compensation mechanisms, in expressly defined clauses, in the event of expropriation,

− there is practically no country that restricts the transfer of earnings related to investment,

− the majority of Latin American countries adhere to the ICSID\(^1\) Convention’s Constitution or to some other international arbitration mechanism that deals with investment related conflicts.

One aspect that we believe should be included in the debate is the one concerning the definitions of investment and investor, since this will influence the way how the other aspects will be treated.

Furthermore, taking into account individual national legislation in the region, as well as the signed agreements concerning investments, we could try to outline, in brief, what aspects could generate the most difficulty in reaching a multilateral agreement:

The application of National Treatment and the Most Favoured Nation status in the initial phases is not a common practice among countries that sign bilateral agreements. If we analyse the existing investment policies, we can find that even today a significant number of countries apply some type of previous authorisation mechanism for foreign investment.

Application of the “performance prerequisites” is relevant if it is desired to go beyond the agreements reached in TRIMS.

The scope and magnitude of reserved areas -- the greater the magnitude of the reserved areas, the less effective the results via the agreement in terms of liberalisation. Therefore, according to the Comparative Study developed by the IDB, the majority of countries maintain sectors reserved for the state where foreign investment is restricted or prohibited

Additionally, it is important to note that the higher the standards concerning issues such as market accessibility (through National Treatment in an initial phase) and other issues, like the elimination of performance

\(^1\) International Convention on the Settlement of Investment Disputes between States and Nationals of other States
requirements and the search for high protection standards, the more difficult it will be to reach an agreement.

The main objective of a multilateral investment agreement should be growth and development. Investment flows may favour employment, technology transfer, and competitiveness, thus helping to promote the integration of developing countries into the world economy so that these may reap the benefits of globalisation.

The liberalisation process should be combined with healthy and coherent economic policies. Furthermore, it is necessary to pay attention to the measures that guarantee the proper functioning of the market and an effort should be made to generate research and development within our nations.

We must understand that the Multilateral Investment Framework is not in itself an end, but rather a means to obtain the objective of our nations’ development.

Finally, I would like to leave you with the following questions to think about:

- What exactly are we searching for in multilateral policy and regulations?

- Can we attain this based upon follow-up approaches?

Today we can learn from the experiences of the OECD, NAFTA and other regional agreements. Could we make the FTAA Investment Chapter a good precedent for multilateral policy?
INVESTMENT AGREEMENTS IN THE AMERICAS: CONVERGENCE OF RULES

by
Maryse Robert*

The mid-1980s and the early 1990s brought sweeping economic reforms and trade liberalisation to Latin America and the Caribbean. This also led to a substantial liberalisation in the investment regime of most of these countries, and a radical change in their regulatory framework regarding the treatment of foreign direct investment (FDI).

The 1990s have also seen the convergence of rules governing foreign direct investment in the Americas. On issues that were contentious not long ago, common approaches have been adopted in investment agreements in areas such as scope of application, treatment, transfers, expropriation, and dispute settlement mechanisms. In fact, as a result of the debt crisis in the 1980s, countries in Latin America and the Caribbean, which had relied mainly on volatile portfolio investment and import-substitution policies, undertook economic reforms liberalising trade and adopted policy frameworks promoting, protecting, and liberalising FDI.

Including the United States and Canada, more than sixty bilateral investment treaties (BITs) have been signed by countries of the Americas with one another. Of these treaties, more than two-thirds were concluded between Latin American countries. Fourteen BITs were signed by Argentina, thirteen by Chile, ten by the United States, and nine respectively by Ecuador and Venezuela. The most recent BITs include treaties negotiated by Argentina with Guatemala (April 1998) and Nicaragua (August 1998), by the United States with Bolivia (April 1998), by Costa Rica with Paraguay (January 1998) and Canada (March 1998), by Ecuador with the Dominican Republic (June 1998), and by Panama with Uruguay (September 1998). All these new treaties have yet to be ratified.

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In the Caribbean, most countries have only negotiated bilateral investment treaties with countries from outside the Western Hemisphere, essentially with the United Kingdom, Germany, Switzerland, and France. The exceptions are Barbados, Jamaica, and Trinidad and Tobago. For example, Barbados has a BIT both with Canada and Venezuela, whereas Jamaica has signed bilateral investment treaties with Argentina and the United States, and Trinidad and Tobago with Canada and the United States.

Numerous free trade agreements (FTAs) containing specific investment commitments have been concluded during this past decade in the Americas. The Group of Three Agreement (Colombia, Mexico, and Venezuela) as well as bilateral free trade agreements negotiated by Bolivia, Chile, Costa Rica, Mexico, and Nicaragua provide for extensive investment coverage. The most recent free trade agreements include the FTA signed by Central American countries and the Dominican Republic on April 16, 1998, and the Chile-Mexico FTA signed on April 17, 1998. Both agreements are not yet in force. As it is in the case with the North American Free Trade Agreement (NAFTA) between the United States, Canada, and Mexico, and the Canada-Chile Free Trade Agreement, they incorporate comprehensive investment disciplines, which go beyond the traditional concepts usually included in bilateral investment treaties. The provisions of the two Mercosur Protocols (the Colonia Protocol for member countries and the Buenos Aires Protocol for non-members) also cover a broader range of issues. Other integration arrangements with investment provisions include the Andean Community (Decision 291) and Caricom (Protocol 2).

**Commonalities**

Investment instruments in the Americas share important commonalities. In fact, as mentioned above, a remarkable consensus has emerged on issues such as scope of application, treatment, transfers, expropriation and dispute settlement mechanisms. For example, most investment agreements have adopted a broad, open-ended, asset-based definition of the term investment, which is more encompassing than the traditional enterprise-based definition of foreign direct investment. This definition is usually accompanied by an illustrative -- but non-exhaustive -- list.

In other cases, the asset-based definition covers a very broad list of assets that are expressly linked to the activities of an enterprise. Moreover, recently concluded FTAs often indicate what is not included in the definition of investment, for example: real estate or other property, tangible or intangible, not acquired in the expectation or used for the purpose of economic benefit of other business purposes. Both natural and juridical investors are covered under these agreements.
The place of incorporation of a company generally determines the nationality of investors in free trade agreements. Control is not required in such cases. However, a “denial of benefits” clause is often included to address situations when an enterprise is controlled by investors of a non-Party, and when such enterprise has no substantial business activities in the territory of the Party under whose laws it is constituted.

Most investment instruments in the Americas also provide for fair and equitable treatment, some form of protection, non-discrimination, national treatment, and most favoured nation treatment. They guarantee the free transfer of funds related to investment and include a non-exhaustive list of the types of payments for which the transfer of funds is to be guaranteed. They also indicate that transfers shall be made in a freely convertible currency (US BITs and NAFTA use the phrase freely usable currency) at the applicable exchange rate on the date of transfer. Most treaties also note that transfers have to be made without delay.

With respect to expropriation, investment agreements in the Americas prohibit expropriation unless it is done for a public purpose and in accordance with due process of law and with compensation. The “Hull formula” is usually required for compensation purposes. It stipulates that compensation has to be “prompt, adequate, and effective.” Finally, dispute settlement provisions are also included. State-to-state investment disputes are covered by the general dispute settlement mechanism in free trade agreements, while there are specific provisions to that effect in bilateral investment treaties.

There are also provisions on investor-state disputes allowing parties to submit their claim either to an ad-hoc tribunal or a more institutionalized mechanism such as the International Convention on the Settlement of Investment Disputes between States and Nationals of other States (ICSID).

With respect to admission, two different approaches have been adopted with regard to this issue. Newer instruments such as the Colonia Protocol in Mercosur, most free trade agreements negotiated in the region, as well as US and post-NAFTA Canadian BITs (with the exception of Canada-Venezuela), call for national treatment and Most Favoured Nation (MFN) treatment as a condition for both the pre-establishment phase (admission) and the post-establishment phase. Hence, this new approach creates a right of establishment for investors and investments of the other Contracting Party.

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1. The five currencies recognised by the International Monetary Fund as freely usable are the US dollar, German mark, Japanese yen, pound sterling, and French franc.
In fact, these instruments have been designed with the purpose of assuring the free entry of such investments -- albeit with *country-specific reservations* -- into the territory of the host country. They require national treatment and MFN treatment, and prohibit specific performance requirements as a condition for establishment. With the exception of the Colonia Protocol, they mention that such treatment shall be for investments made in “like circumstances” (or in “like situations” in the case of US BITs). This phrase is not, however, defined.

Other bilateral investment treaties require that the national treatment and MFN standards be applied to investments of investors after admission of these investments, i.e., they are only applied at the post-establishment phase. The Buenos Aires Protocol and the Central America-Dominican Republic FTA, like most bilateral investment treaties signed between countries of the region, follow this more traditional approach. The most representative clause reads as follows: “Each Contracting Party shall promote, in its territory, investments of investors of the other Contracting Party and shall admit such investments in accordance with its laws and regulations”. There is no explicit reference to domestic laws or requirements.

**Challenges ahead**

Although a lot of progress has been achieved with respect to the rules and disciplines covering investment agreements in the Americas, a number of issues need to be addressed as countries of the Americas are beginning the negotiation of an investment agreement within the Free Trade Area of the Americas (FTAA) process. A key issue is to determine what role an investment agreement should have. Should it aim at only providing for non-discrimination and investment protection with an effective dispute settlement mechanism, or should it also aim at ensuring a progressive liberalisation of non-conforming measures?

A first challenge is therefore to determine whether a hemispheric investment agreement would maintain or go beyond the status quo. There are obviously arguments in favour of ensuring that the liberalisation that has already been achieved by countries of the Americas at the bilateral and regional levels is multilateralised. For example, most countries of the region have accepted the notion of a right of establishment accompanied by a list of reservations or country-specific exceptions.

To date more than twenty countries in the Americas have signed at least one investment agreement containing an obligation to accord national treatment and MFN treatment during *all* phases of an investment, including the
pre-establishment phase. With such a framework the host country will not be pressed by foreign investors to open a particular sensitive sector listed as an exception to the rules in the agreement, and the foreign investor can rest assured that the host government will not alter the admission requirements. However, the broader the scope of the reservations, the less significant will be the results of an open framework. But again, the main issue here is whether an investment agreement would go beyond a standstill commitment and aim at a progressive liberalisation of non-conforming measures with, for instance, a built-in agenda.

In conclusion, in negotiating an investment agreement within an FTAA context, countries of the region will strive for a balanced framework that will ensure mutual advantage and increased benefits for all participants. In so doing they may wish to review their recent experience with their own investment instruments and draw lessons from the negotiations to create a Multilateral Agreement on Investment. They will have to ensure consistency with an eventual WTO agreement should such an agreement be negotiated and completed before the end of the FTAA negotiations. They will also need to provide for compatibility between the service and investment frameworks in the FTAA. But more important, as mentioned earlier, countries need to reflect on the role that an investment agreement should play.

What is it that they want to achieve with such an agreement?
Part III

BEST PRACTICE IN PROMOTING FDI
COMPETITION IN THE ATTRACTION OF FOREIGN INVESTMENTS: THE ARGENTINE CASE

by
Lisandro Barry*

Argentina has been one of the most successful countries in the reception of foreign investments. The investment by foreign firms in our country grew about 15 times between the annual average for 1981/89 and for 1997. This privileged position for Argentina cannot be explained solely by the global growth in the flow of direct foreign investment in the world market and, in particular, in developing countries.

The main reasons for this success have to be sought, as pointed out by foreign business people who have started up operations in Argentina, in the stability of the democratic political system and the new economic rules of the game which were put into operation at the beginning of the decade.

Among the above-mentioned rules the most notable were: the adoption of new macroeconomic policies (convertibility, fiscal balance, autonomy of the Central Bank), reform of the State, privatisation, deregulation of the markets, the creation of an open economy, elimination of fiscal subsidies and inadequate special regulations, and, particularly, the Foreign Investment Law which set up a very liberal regulatory system for the movement of capital.

The result was not only successful from a quantitative point of view, achieving one of the world’s highest GDP growths, but the basis itself of growth was changed. It is now investment and exports rather than consumption that set the standards for the new market dynamics.

To maintain this economic transformation, combat poverty and eliminate unemployment, Argentina will continue to require foreign investment. Apart from acting as a complement to domestic saving, foreign investment is needed in order to continue to increase competitiveness by means of the transfer

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of technology, the mobilisation of available natural resources and the incorporation of new ways of doing and managing business.

On the other hand, it cannot be doubted that if competition in the attraction of foreign investment exists, this is because investors consider that there is more than one possible and/or convenient location for their investment. Furthermore, international organisations have carried out studies, which show that there are virtually no exceptions in the use of incentives by the different countries in their attempt to attract investment.

In this context, what can and should be done by a State Agency in consonance with rules that eliminate fiscal incentives and/or preferences? That is to say, when a country formulates a plan of foreign investment promotion with incentives and places it in the hands of an institution, the task appears clearer, including the aspect of measurement of results.

To answer the question, we can consider our vision of the dynamics of investment as forming part of a complex process which, from the economic point of view, is involved with long term decisions and therefore with increase in productivity. This is, in the last resort, the essential incentive for the investor. Therefore, as founders, organisers and managers of the Investment Development Agency (ADI)\(^1\), we set up as our objective that the required support and reinforcement of the process should be provided from an institutional level.

Essentially, our mission consists of promoting the attraction of foreign investment, and helping markets to operate effectively and with transparency. In order to do so, we have recourse to: the publication, abroad and internally the country, of the information which can improve the access to the available knowledge of business opportunities and also of potential investors or sources of funding; the training of provincial and municipal representatives, encouraging them to develop organisations for the attraction of investments and thus establishing a fully integrated institutional network; and also the analysis and discussion of subjects and aspects related to the best possible forms of localising and attracting investment.

To meet these commitments, we took into account first that the ADI had come into being at a time when the “global promotion” of Argentina had already completed a first stage of intense development, world-wide. Thus, without giving up the “global promotion” idea, we designed a strategy of “focused promotion” which has three intersecting dimensions: sectoral, regional

\(^{1}\) ADI: Agencia de Desarrollo de Inversión
and business. We can define our task as: a) the detection of “needs” (demands) as also that of the “offer” of investment or financing and b) the bringing together of “offers” and “demands” by means of missions, seminars, encounters, etc.

As a consequence, missions abroad take these matters into account, incorporating experts and/or business people from the selected sectors and regions, and choosing destinations related to the investment being sought. For this purpose, a centre of information has been developed, which also provides an advisory service to business people, delegations and missions visiting our country. Furthermore, training programmes were implemented for provinces and municipalities and also for outside the country, as well as forums for debate, in the country, with the attendance of local authorities and international experts. Finally, all communication materials (publications, Internet, newsletters, etc.) have also sought to fulfil precise objectives in respect of sectorial, regional and business information.

The Investment Development Agency (ADI) has been organised into three major areas: Institutional Promotion; Support of the Investor; and Administration, Logistics and Special Studies. The area of institutional promotion is in charge of organising missions abroad as well as seminars within the country. The area of support of the investor is engaged in four main lines of activity: assistance and provision of information to potential investors; reception of delegations from abroad; relations with provinces and municipalities, preparation and publication of informative material; and handling of relations with institutions collaborating with the ADI (outsourcing). Finally, the area of administration, logistics and special studies offers services to the two other areas.

In its first year of existence, the ADI has set up numerous missions abroad, of general and sectoral nature; received leading foreign delegations; organised forums or seminars in the country and represented Argentina in international forums on investment negotiations. The ADI has also attended and resolved a variety of requests for information and advice; provided training in provincial and municipal entities, and published a large quantity of informative material.

The ADI made a study of the importance of Technological Parks as a factor of attraction and localisation of investments, and as a factor also of the creation of new innovative enterprises. A seminar on the subject was organised with the attendance of experts from the country and from the International Association of Technological Parks, the Spanish Association of Technological Parks, the Technological Park of Galicia (Spain) and the University of Santa Catarina (Brazil). As a result of this initiative, various co-operation accords
were made and a mission to Galicia was organised to promote investments in technology, tourism and mining.

Taking into account the new manner of operation of investment and financing through private funds, the ADI organised a seminar and business encounter at the Buenos Aires Stock Exchange, with the presence of 32 Private Investment Funds from the USA, Europe and Canada and around 90 Argentinian medium size companies.

During two day-long working sessions, different national experts and business people made presentations on business opportunities offered by the sector, whilst representatives of the Funds and specially invited consultants discussed the diversity of financing forms offered by the Funds, the legal aspects applied by them, and also the process of due diligence required.

At the same time 170 encounters, arranged by previous appointment, were held between Funds and companies; many of these initial contacts continued after the event.

The success of this initiative allowed the ADI to organise a second seminar, of similar characteristics, but larger, for the coming year and to participate in an encounter of representatives of Argentinian business and private investment funds in the United States.

Finally, the ADI decided to start a debate on international competition for foreign investment as a form of evaluation of its activity and also to orient it and confront it with international experience in the field. For the purpose, two seminars were organised in the country, with the presence of leading authorities from multilateral organisations (the Vice President of the World Bank, the Secretary General of the UNCTAD, IDB, etc.), of governments from Mercosur and associates (Chile, Brazil and Uruguay), of multinational companies and private experts.

The following were the main conclusions:

− If it is true that in view of regional and social disparities not all incentives are to be condemned, any strategy which centres on incentives will not be assured of lasting success;
− Companies deciding on the placing of investment value the existence of promotion agencies, which can help them with their plans;
− The task of facilitating the operation of markets and providing them with transparency forms an essential part of the “best practice” of investment agencies.
By the end of the 1980s, the Peruvian economy, marked by hyperinflation, a deteriorating national infrastructure, isolation from the international financial community, the non-existence of reserves and terrorism, was chaos itself. Accumulated inflation between July 1985 and July 1990 reached 2,200,000 percent, while in the same period, Gross Domestic Product fell 7% and foreign debt grew by $7 billion. In the latter half of the 1980s, after initially promoting foreign investment, policies changed and the attitude became negative. This treatment went beyond establishing excessive controls and included limitations with relation to participation in the economy. It went as far as to adopt expropriatory measures by suspending the remittance of profits and royalties for a period of four years.

During the 1980s, average annual foreign direct investment barely reached US$28.9 million, while in the previous decade this figure had reached US$72.5 million. By contrast, this decade has seen dynamic growth in foreign investment, with an average annual growth of US$1,436.5 million. This dramatic increase is the result of policies implemented by the Government during this decade that have generated a qualitative change in the investment climate in Peru. This paper outlines and discusses the most outstanding aspects of Peru’s attempts to capture foreign investment during this decade.

Investment reform

In 1991 Peru launched a series of structural reforms, complemented by a stabilisation programme which commenced in August 1990. This programme aimed at liberalising and deregulating the economy, and looked to restore the relationship between the private and public sectors. Additionally, its

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objectives included the re-assessing of the market and competition to include them as essential players in the efficient allocation of resources. Similarly, an International Economic-Financial Reintegration Programme aimed at restoring our relations with other countries, after Peru’s policy not to honour its foreign debt had effectively closed the door to credit and foreign investment.

One fundamental aspect in the reform process was the change in attitude toward private investment, and in particular to foreign investment. The Law for the Promotion of Foreign Investment, passed by Legislative Decree 662 in August of 1991, was one of the first steps in the effort to create an appropriate climate for private investment in Peru, and thus marked a major deviation from previous conditions.

The Law for the Promotion of Foreign Investment was part of a working programme that took into account short- and medium-term measures in the areas of internal legislation, international legal framework, institutional development and investment promotion. Nonetheless, the proposal excluded an Investment Promotion Board such as the ones that exist in a number of Asian and Latin American countries.

The concept of promoting investment was defined instead as a combination of actions in the legal area. The end goal of promotion was to liberalise the investment process in the institutional area and coordinate the efforts of various government bodies specialising in different investment related areas. Abroad, the goal was to change the country’s image. The private sector was called upon to be the engine for Peru’s development. Therefore, securing international resources was to be an initiative by local businessmen propelled by their desire to make the most of investment opportunities in the new climate created by Government policies.

**The creation of an appropriate legal framework for investment**

The Law for the Promotion of Foreign Investment introduced a series of general guarantees, such as non-discrimination between local and foreign capital and unhindered access to all economic activities, eliminating prior authorisation procedures, as well as the right to freely expatriate profits on investment.

Secondly, investment was protected and guaranteed by law and various agreements to ensure legal stability for investors. Critical to planning and investment decisions, such agreements provide non-discriminatory treatment, a stable income tax regime, unhindered remittance of revenue and
profits, flexible labour regulations and stable export promotion regulations for a period of 10 years.

This law was complemented months later by the general Law to foster Private Investment in State-Owned Enterprises, the Law for the Promotion of Private Investment in Public Works and Infrastructure, and sector legislation, which comprises special regulations for the mining, energy, petroleum, telecommunications and agriculture industries.

With a view to consolidating the legal framework to protect and guarantee foreign investment, in 1991 Peru began a process of incorporating international legal mechanisms relating to foreign investment. Thus, Peru would guarantee, before the international community, its willingness to abide by internal laws and maintain them unchanged for a reasonable period of time. This was imperative since Peru had only recently given foreign investors a series of internationally-recognised guarantees and rights.

To this effect, in April 1991, the Peruvian Congress, approved the signing of the Multilateral Investment Guarantee Agency (MIGA). Later, in September of that year, Congress agreed to endorse the accord which establishes the International Convention on the Settlement of Investment-Disputes between States and Nationals of other States (ICSID). 

Concurrently, Peru developed a working programme for the negotiation and signing of bilateral agreements for the reciprocal promotion and protection of investments. As a consequence of this programme, in 1991, Peru signed agreements with Thailand and Switzerland. To date, Peru has already signed 25 such agreements including 15 with members of the OECD.

In the multilateral arena, Peru has followed with interest the efforts of OECD countries with the objective of establishing a multilateral agreement on investment. Similarly, it has actively participated in the negotiation process for the Free Trade Area of the Americas, which includes a section on investment. Additionally, Peru’s active involvement in the Asia Pacific Economic Cooperation forum (APEC), an integration mechanism which it joined at the beginning of 1998, will help publicise Peru’s investment policy and promote the country as an attractive location for new businesses and investment.

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1. The incorporation process was finalised in December of said year when all the administrative transactions were completed.
The institutional framework

The existing institutional framework for foreign investment policy-making and promotion essentially comprises the following government agencies:

- The National Commission for Foreign Investment and Technology - CONITE;
- The Commission for the Promotion of Peru --PROMPERU;
- The Commission for the Promotion of Private Investment -- COPRI;
- The Ministry of Foreign Affairs and its network of accredited missions abroad;
- The Ministry for Industry, Tourism, Integration and International Commercial Negotiations.

CONITE is responsible for proposing and executing Peru’s foreign investment policy. It provides information and advisory services to investors, administers the legal-stability agreements signed with foreign investors on behalf of the Government and maintains a close relationship with the Foreign Affairs Department. Additionally, CONITE also works closely with the Vice-Ministry of Integration and International Commercial Negotiations in the negotiation of international agreements on investment, and keeps records of investment in Peru.

Image building has played a significant role in restoring foreign investor confidence in Peru. Led by PROMPERU in coordination with other government bodies, this task has been fundamental in disseminating information concerning the investment climate in Peru.

COPRI handles the privatisation process, the main factor in attracting investment to Peru in recent years, including private concessions for public works and infrastructure. In each particular case, COPRI first establishes a Privatisation Committee responsible for the process. COPRI, as well as the corresponding Committees, are in permanent coordination with the various entities related to the activities designed to promote investment opportunities either through the transfer of assets and/or concession awards. Remarkably in each privatisation case, a carefully selected investment bank joins the process. Complementary diffusion and information dissemination is provided on the
occasion of the investment promotion meetings organised jointly with other involved agencies.

In recent years, Peru has developed a project with UNIDO to identify and promote investment opportunities beyond privatisation. Among its objectives, it aims at designing an Investment Project Portfolio and publicising it through UNIDO’s and other foreign networks open to Peruvian institutions. Based on this experience, the Ministry of Industry is establishing an investment promotion network that calls together public and private institutions such as CONITE, PROMPEX, the Ministry of Foreign Affairs, the Business Round Table (CONFIEP), the Foreign Trade Association (COMEXPERU), the Exporters’ Association (ADEX), the National Industrial Association (SIN), and the Lima Chamber of Commerce.

On the other hand, it is important to mention current developments in the private sector, especially Eurocentro, resulting from European cooperation, and CONFIEP’s Committee for the Promotion of Investment. In an effort to establish a database of investment opportunities also worth mentioning are COMEXPERU’s efforts to identify investment opportunities.

**Investment in the 1990s**

Central Bank statistics show that Peru, as a result of the economic liberalisation policy and the opening up of the economy to foreign investment, attracted a total of US$13.1 billion in foreign direct investment between 1993 and December 1998, generating an average growth of US$2.2 billion per year over this period.

Also according to the Central Bank, approximately 37% of foreign direct investment in this period stemmed from successful privatisations. Privatised enterprises not only became more efficient but also generated sufficient resources to fund the Government’s social investment plan. Among other results, it has ensured significant investment commitments, improved Peru’s sovereign risk as perceived by foreign investors and enhanced Peru’s image as an ideal investment location.

With more than 192 finalized privatisation operations that generated over US$8.6 billion in revenues --almost US$5 billion of which in foreign investment and another US$7 billion in investment commitments -- privatisation has lured important foreign companies which in conjunction with Peruvian capital have targeted the telecommunications, mining, electricity and manufacturing industries.
A sector-by-sector analysis of CONITE’s figures concerning investment sources and destinations reveals the high proportion of direct investment generated through privatisations.

The telecommunications, energy, industrial, mining and finance sectors comprise 90% of foreign investment recorded by CONITE, principally from investors based in Spain, the United States, the United Kingdom, Panama and the Netherlands. It can also be pointed out that 82% of investment originate from enterprises established in OECD member countries and some 15% from enterprises in Latin America and the Caribbean.

Up until now we have referred to privatisation as the principal factor in attracting foreign investment. Nevertheless, significant investments have also created new businesses and strengthened existing companies through capital stock increases.

Recent events

In 1997, The El Niño weather oscillation hampered Peru’s economic performance and the normal flow of production and exports, mainly in the fishing and agricultural sectors. Meanwhile, the international financial crisis placed some investment projects on hold, reduced international quotations for our main exports, and tightened external lines of credit.

Despite the difficulties experienced in 1998, the Central Bank recorded a rise in foreign direct investment to US$1,968 million, reflecting foreign investors’ confidence in Peru. An example of this confidence is the decision of Teck, Noranda and Rio Algom mining companies to undertake the Antamina Project. Other examples are investments by Standard Chartered, Motorola, Quebecor, Bristol Myers, Delta Airlines, Hydro Quebec, Madeco, Compañía Radiadores Roca, and Carozzi.

Foreign direct investment prospects and future initiatives

In the next five years Peru expects to receive foreign direct investment of no less than US$14 billion. This estimate reflects investment commitments related to privatisations, concession contracts signed with the Government and statements by top management officials of foreign companies operating in Peru.

In the short and medium-term, privatisation should continue to be the main magnet for foreign investment, not only due to the transfer of assets but especially as concessions for infrastructure projects are developed. Meeting the
infrastructure needs of the nation’s hinterland with private investment participation, will in the medium and long-term, allow for the development of various potential investment opportunities, especially in agriculture, agribusiness, manufacturing, tourism, aquaculture, forestry and mining.

Peru has unparalleled potential and its government will continue its efforts to facilitate investment and support the private sector in its crucial role as the driving force of economic development.
FOREIGN INVESTMENT POLICY AND PROMOTION IN CHILE

by

Eduardo Moyano *

I. Foreign direct investment in Chile given the current worldwide financial climate

1. The development of foreign direct investment in Chile

The growth-rate of foreign direct investment (FDI) in Chile, especially over the past few years, has been on the rise. Foreign Direct Investment as a percentage of Gross Domestic Product has reached significant levels of importance, such as in 1997 when it topped out at 7.7%, a figure that represents 31% of the country’s gross fixed capital formation.

In 1990, international financial institutions, as well as individual investors, began giving Chile favourable ratings because of the stability brought about by the new political and institutional order, thereby increasing the amount of foreign capital flowing into the Chilean economy. The 1974 Law concerning foreign investment (E.I.E) has been the main entranceway for foreign investment. In October 1998, 23 years later, total foreign investment reached US$32.8 billion, of which 82% materialised as of 1990.

Investments made through this modality, in the areas of exporting or processing natural resources and in financial and telecommunications services, have contributed to making the growth process dynamic and have had positive effects on production capacity, employment and exports. It is estimated that over 35% of all exported goods --that in 1997 reached approximately US$1.700 billion-- are generated by companies with foreign participation.

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From 1974 to the present, Chapter XIV, as an alternative access mechanism for direct investment, has accumulated close to US $3.1 billion, the majority of which has been channeled to the agriculture, industry and electric-power sectors.

From 1990 to 1997, foreign direct investment has had an accumulated annual growth rate of 27.6%. Capital contributions from the E.I.E. have made this figure reach 39.3%. Meanwhile, credits have been increasing at a more moderate rate, reaching an additional expansion of an average 8.4% annually.

During 1998, in the midst of the Asian crisis, direct investment for the January – October period significantly increased by 6.2% in relation to the same period of 1997. Although the average increase of this figure has been more moderate than that of previous years, it only serves to indicate that the effects of the Asian crisis have yet to be felt in the flow of direct investment in Chile.

Chile’s comparative advantage in sectors such as mining, forestry and wood industries, agriculture and related industries, has steered incoming capital toward these areas of the economy and has stimulated the development of services related to these. Since 1974 and through September 1998, over 42.7% of E.I.E. materialised investment has been channeled toward the national mining sector, a percentage mainly comprised of investments made during the 1990 – June 1998 period. This sector attracts 12% of the total amount spent in exploration worldwide and it is estimated that by the year 2000 Chile will supply 40% of the world’s copper and a significant percentage of other minerals such as lithium, iodine, silver, gold and others.

The next most important sectors are services, 24%, and industry, 15.5%. During the 1990 – June 1998 period, these two sectors appear to have redistributed their participation with services topping industry at a little less than double the historical average. Other sectors that stand out because of increased foreign investment, particularly over the last few years, are electricity, gas and water, entirely materialised throughout the 1990s. Likewise, in transportation and communications, 82% of the investment has occurred during this same period. Additionally both sectors have benefited from the planned port, road and highway privatisation and upcoming public works bids.

Over the last few years the major increase in foreign investment in Chile can be mainly attributed to political stability, a healthy economy and to the priority given by the monetary authority to maintaining the growth rate at a reasonable level. Undoubtedly, these factors are important to investors. Furthermore, clear, simple and fair foreign investment procedures play a fundamental role in giving both the system and the country credibility.
2. *Effects of the Asian crisis*

Within the context of an increasingly globalised world economy, Chile could not remain immune to an international crisis. Consequently, the Chilean government implemented a series of preventive measures aimed at absorbing the “external shock” and as a way to protect the advances already achieved. Some of these measures were put into practice as a way of reducing the trade deficit in the current account, minimizing the impact of exchange rate fluctuations, reducing public expenditure, fostering further opening of the domestic market by gradually reducing customs excises and guaranteeing the sufficient flow of foreign capital.

Chile’s economy is known for its close ties to many Asian nations and therefore a crisis in the said region necessarily affects the country’s exports. Fortunately, Chile’s foreign trade is balanced and the country has the capacity to redirect its shipments to diverse areas of the world thus limiting the repercussions on exports.

Nevertheless, the impact on Asian investment in Chile, particularly from countries affected by the present crisis, is not more than 3.4% of the total amount of Foreign Direct Investment (FDI). Therefore, any repercussion in this area is compensated for by the significant capital contributions from other countries (USA, Canada, Spain, England, etc).

Country-risk evaluations prepared by international classification agencies, maintain Chile’s position, showing the country’s strength in facing an external crisis. This is true because, among other reasons, Chile’s external debt, in absolute and relative terms, is extraordinarily low, with only a moderate and conservative increase and only where public sector obligations have decreased over time.

Chile’s short-term debt, today reaches only 1.7% of the Gross Domestic Product. Comparison shows that the level of indebtedness of countries involved in the crisis, for the same time period is 17% or 18% of Gross Domestic Product for their short-term debt.

Currently, with the sole exception of the year 2001 in which the amount reaches some US$4.3 billion, medium and long-term debt amortisation from 1998 on, indicates a trend similar to that of similar years, reaching levels of approximately US$2 billion. A significant portion of the US$6.4 billion that must be amortised as of the year 2006 has a long maturation period. Such is the case of Endesa, the electric company that issued 100-year bonds (Century Bonds) on the North American market, for a total of US$200 million.
Recent, healthy risk-index levels evidence the financial health of Chilean banks, even when taking into account non-performing loans. Overall, non-performing loans make-up 1.3% of total loan placement. The figures used in this indicator for the Asian Pacific countries top the 20% mark and, in some cases, have exceeded 50 and even 60% of total loan placements.

Many indicators attest to the soundness of Chile’s economy in the face of an international crisis, the most notable of which is the 8% average rate of economic growth recorded over the last ten years. Additionally, as reported by the Central Bank, gross fixed capital formation, as a function of gross domestic product, reached a level of 33% in 1997, which is indicative of strong growth and of an absolute value that can be compared favourably on an international level.

Foreign investment in the country has not suffered from the Asian crisis fallout. However, the same cannot be said of portfolio investment (primarily ADRs) that reacted adversely to stock market fluctuations, affecting practically the entire world, and especially emerging economies.

3. **Chilean investment abroad**

As of 1990, there has been a notable increase in Chilean investment abroad. This occurred due to the relaxing of the regulatory framework concerning investment, as well as to the insertion of Chile into the international economy, both of which boosted Chilean investment activity from that year. Over the past eight years exporting national capital has been concurrent with vigorous foreign trade and foreign investment.

As a result of the vigorous activity of many Chilean companies, the relative local market size has become increasingly limited. As a result, Chilean investors have expanded and developed into new geographic areas, investing in sectors they know best. Furthermore, one of the characteristics of exported Chilean capital is the continuation of business activity. Growth is horizontal, which means investors continue doing their same activity in the foreign country as they did at home, thereby ensuring good performance.

Secondly, the sizable privatisation process, especially the one taking place in Latin America, is favourable to Chilean investors for two reasons: it is based upon a model familiar to them and it opens sectors in which Chileans have already gained valuable experience, as is the case in the electricity and services sectors.
Thirdly, many Chileans making foreign investments did first arrive at these markets as exporters. Thus, they had the advantage of getting to know the market from the outside before operating and competing from the inside.

The internationalisation of Chile’s economy has given rise to both local businessmen forming companies abroad without third party participation and to others choosing to do so with foreign investors already operating in Chile. These foreign investors wish to expand to other Latin American markets and prefer to do so jointly with Chilean business people, thereby ensuring better cultural understanding in the region and developing more effective management.

Finally, it is important to mention that this entire process has been made possible thanks to the current financial soundness of a number of medium-sized and large Chilean companies.

According to a study of the process of Chilean capital investment abroad, conducted by the Committee on Foreign Investment and based upon press information, as of December 1997, there are a total of 878 Chilean projects being carried out abroad. Figures available for the period between 1990 and December 31, 1997 indicate that invested capital is around US$18.9 billion. This figure becomes even more significant if we take into consideration that another US$35 billion is committed to the development of international projects based upon the invested capital figure of US$18.9 billion.

Chilean capital is currently directed toward more than 50 countries in America, Europe, Asia and Africa. Nevertheless, only ten of these countries contain almost 89% of all materialised investment and equal participation in the total amounts considered for the universe of projects underway. These ten countries are: Argentina, Peru, Brazil, Colombia, Mexico, Panama, Channel Isl. Guernsey, Bolivia, Cayman Islands, Venezuela.

Thus, a high level of concentration in the area where investments are materialised abroad characterizes Chilean capital investment. Currently, albeit lower than in previous periods, Argentina receives 36.2% of materialised investment, followed by Colombia with 20.5% participation, Peru with 10.3% and Brazil with 9.5%. Hence, as of the date of this study, four Latin American countries receive over US$14.4 billion, representing 76.5% of all national investment materialised abroad.

In a growing effort to diversify the different geographic regions of their capital investment, Chilean investors are making important efforts in developing new markets by either searching for similar conditions to those of neighboring countries, as well as on the basis of accumulated experience,
assuming a greater risk in lesser known markets that are further away. During the 1996-1997 period, a tenacious bid was made to gain access to the Brazilian market, resulting in a unique positioning in that country. Currently Brazil has 40 projects developed with Chilean capital.

Additionally, investment opportunities in Bolivia, Brazil, Colombia, Cuba, Ecuador and Mexico are under consideration and recently Bolivia, Brazil and Mexico are being developed as strategic niches. Furthermore, last year a growing interest was manifested concerning the process of economic transformation that the Central American and Caribbean Basin countries are undergoing. There is particular interest in Costa Rica, El Salvador, Guatemala and especially Venezuela. Although investment amounts in these countries are small, initial surveys are yielding opportunities in different areas.

Chilean capital abroad is invested in the principal sectors: electricity/energy (electricity and gas), making up 48.4% of materialised investment and 48.9% of total project investment; industry (in particular manufacturing) with 20.4% and 16.3% respectively, and the commercial sector with 5.3% and 7.8% participation respectively.

The agribusiness sector makes a novel appearance, ranking fourth on the list, mainly but not exclusively due to viticulture, fruit orchard cultivation and forestry projects with 4.3% and 2.7% participation respectively. Next, comes a banking sector in the process of consolidation with a presence in more than eight Latin American countries and with participation of 3.1 and 3.3% of materialised investment and of total project investment respectively.

One of the guidelines that is characteristic of Chilean investment behaviour abroad, given the sector context, is that Chilean companies generally tend to invest abroad in the same areas in which they participate in their internal market.

4. Prospects to continue attracting foreign direct investment

Even amidst the Asian crisis and the adjustment process that the Chilean economy underwent to sustain its economic growth base, current figures concerning FDI development indicate a certain level of optimism on which to base future investor capital flow estimates into the country. These estimates indicate that FDI will not decrease, rather, on the contrary it will continue to increase, as it has done up until now.

For investors FDI is more of a long-term option rather than an opportunity decision. Nevertheless, there are two contrary phenomena
operating in this field. One is the investors that shy away from Asia who have reason to opt for some Latin American countries or emerging countries as possible replacement destinations for their investments. This could be positive for investment in the region, including Chile. This phenomenon is strengthened by the fact that regional asset prices have in general been falling. On the other hand, we must admit, that given the current circumstances, some potential investors do not continue to invest in emerging markets. The net effect of both factors could be positive or negative, depending upon the attractiveness of each regional economy.

II. International agreements in relation to FDI

1. **Overall framework**

   In relation to commerce (trading goods) and to a lesser extent services, there has been a tendency to opt for international agreements that reduce protectionism and promote fair competition among nations and participating companies.

   The history of the creation of GATT is directly related to the preparatory work done to activate the World Trade Organisation in which the allied countries played a decisive role. It is important to note that the “Bretton Woods” conference, in which the IMF and BIRF were created, recommended that governments reach agreements to, reduce the obstacles to international commerce and to find ways to promote mutually beneficial international commercial relations.

   The most important objectives were and still are:

   - The substantial reduction of customs duties and other commercial barriers
   - The elimination of discriminatory practices concerning international commerce

   After 50 years of the creation of a system to promote freer trade, first through GATT and then later through its successor the WTO, international commerce has increased by a factor of 16, while gross world product has only done so by a factor of six.

   What is occurring in capital flow and particularly in FDI is that although over the past decade foreign investment has grown more than
commerce and world product, it is also certain that there are still many things that have yet to be resolved. The list of pending ills, among others, includes subsidies, tariffs and financial aspects, restricted access, obstacles impeding flow of capital investment, discrimination, lack of transparency when it comes to the rules of the game and the lack of legal security concerning ownership and property.

It is true that there have been certain notable changes, such as more open and clear policies, but the situation is confusing and still generates benefits to free riders that do not respect the basic rules.

It could be said that the lack of international regulations distorts the assigning of resources and the world thus descends to a sub-optimal level of development.

Chile’s situation

A principal tenet of Chilean foreign investment policy is that of non-discrimination. This principle is based on the Chilean Republic’s Constitution that guarantees that no person, regardless of nationality can be discriminated against by the State and its organisms in economic matters.

Non-discrimination is also found expressly authorised in the Foreign Investment Statute, Decree Law 600, and as such, foreign investment and the companies it participates in are subject to the same laws and regulations as is national investment and no form of discrimination, be it direct or indirect, is permitted against either. The principle of non-discrimination is applicable to the various economic sectors. Non-discrimination guarantees the existence of clear, transparent and recognised procedures that ensure fair and equal treatment to the foreign investor, eliminating any doubt arising from administrative procedures.

The Chilean Government guarantees access of all foreign companies to markets. Capital can be repatriated one year after it has entered the country. The applicable exchange rate for the transfer of capital and liquid assets abroad will be the most favourable rate that the foreign investors can obtain from any entity authorised to operate in the Formal Exchange Market. In fact, the required one year period does not constitute a restriction for foreign investment since the majority of the productive projects in the areas of mining, forestry, fisheries and others, require time periods that are considerably longer than one year to completely consolidate themselves. The repatriation of invested capital is exempt of all tax or contribution up to the amount of the materialised
investment. Only the amounts in excess of said amount are subject to the
general regulations of tax legislation.

In Chile, foreign capital can total 100% in a company and there are no
restrictions governing time periods for the property rights acquired by
foreigners.

Foreign investors have complete access to all the productive sectors of
goods and services, except for a number of limited restrictions in certain special
sectors such as coastal trading, air transport or communications. In the case of
fishing, restrictions function on the principle of international reciprocity.

The State’s role in the economy is limited and there are no economic
sectors that are solely reserved for the State, except for the following certain
strategic activities: the exploration and development of lithium and of liquid and
gas hydrocarbons as well as the exploration and development of existing fields
in marine areas under national jurisdiction or situated in areas determined by
law as important for national security; the production of nuclear energy for
peaceful purposes and the right to a first-buy-option on thorium and uranium.
Nevertheless, foreign capital participation in the above-mentioned areas is
permitted under certain circumstances.

Decree Law 600 and the signed contracts conforming to this law grant
the investor a legal framework of great security, stability and of permanent
game rules.

The Chilean government, with previous acknowledgement of the
agreement created by the International Convention on the Settlement of
Investment Disputes (ICSID), initiated negotiations leading to the signing of
Promotion and Reciprocal Investment Protection agreements. This was done to
maintain Chile’s comparative advantages, with respect to the legal framework
for foreign investment and for Chile to be able to participate in international
promotion and investment protection instruments.

The Agreements for the Promotion and Protection of Investments
(APPI) constitute, in general, an additional guarantee for foreign investors and
more specifically they allow them to have access to non-commercial, no-risk
insurance, offered by international or non-governmental agencies, at reasonable
rates.

The APPI fundamentally guarantees property rights, unrestricted
transfer and non-discrimination, thus establishing a mechanism for the solution
of controversies.
In these agreements each party agrees to treat the other party’s investments in a just and equal manner. Additionally, these agreements guarantee the principles of non-discrimination and also grant the status of most-favoured nation and offer substitutions in favour of entities, thus ensuring the investments for non-commercial risks are also guaranteed.

The protection afforded by these agreements is extended to all investments made after the date it becomes effective and to those investments already in existence.

Likewise, these agreements also guarantee that any expropriation or measure similar in effect to an expropriation can only be taken for public use, as per the law, in a non-discriminatory fashion and will require the corresponding compensation.

The contracting parties guarantee the unfettered transfer of capital profits or credits that these generate and in general the transfer of funds related to investment.

Finally, in the event of litigation, investors have the right to either chose the national legal system or international arbitration.

2. Toward international regulations concerning FDI

In analysing the current situation, it certainly seems necessary to establish some sort of international regulations relative to the following:

− FDI access to the nation’s markets
− National treatment of FDI
− Legal security of property
− Use of financial and tax incentives
− Conflict resolution

The important issue is whether or not these regulations should be established via an MAI (Multilateral Agreement on Investment) or in an arena where developing nations are not mere observers but also active negotiators.
III. FDI promotion

1. Overall framework of investment promotion

The following factors should be considered given the level of competition involved in investment promotion:

- The international arena contains a high degree of competition, especially in some sectors.
- The number of competitors (countries interested in attracting investment) is growing steadily.
- Competitors’ human and financial resources are abundant.
- There is an ever-present need for more specific promotional activities.
- Not only is it important to position a country as being attractive for investment, additionally, in order for a country to continue to receive foreign investment, promotional efforts must be active and innovative.

An investment promotion strategy requires a previous definition of the sectors and types of investment needed in the country, as well as the types of “potential partners” desired, in terms of countries and business groups since promotional resources are always limited.

For example, if a certain country wanted to attract investment for the agribusiness, tourism or wood industry sectors it would become necessary to research what countries in the world are the most important investors for each of these sectors.

Once sufficient definitions have been made, the promotional action plan can be designed. This would include a prioritised listing of the most appropriate contents and countries. Overall promotion would be left to countries leading in the area of foreign investment and specific promotion would either be for the leading nations or for countries that have a know-how in relation to certain sectors.

The design of the promotion strategy should not only consider the need to attract foreign investment and the most promising countries, but it should also attract the resources available for such activity.
The final and most important objective in the promotion of foreign investment is to make valid and important contact with potential investors interested in priority activities, providing them with information concerning the opportunities existing in the country and inducing them to invest in it. It is therefore essential that the country have a well-defined promotion strategy before initiating contacts with potential investors.

Following is a list of some of the promotional activities used by different countries:

- General press releases
- Participation in investment events
- Press releases in specialised media for specific sectors
- General investment missions from the receiving country to the potential investor country
- General investment missions from the investing country to the receiving country
- General information seminars concerning investment opportunities
- Research of specific companies followed up by “sales” presentations
- Establishment of investment consulting services
- Post-investment services.

Given that an investor has certain motives for investing in a certain country it is important to consider the following:

- In the case of manufacturing, the motivation for investing in a certain country has to do with taking advantage of the local market and with exporting to the region or to the international open market; international companies usually prefer to do both. Therefore, a country’s competitiveness plays an essential role.

- In the case of services (energy, commerce, financial services, construction, services to companies and others) foreign companies
tend to have an interest in almost any market as long as the pertinent regulations are favourable.

- In the case of public works concessions, legal and political security are essential aspects and, to a certain degree, so is project size.

- In the case of export projects, such as those that develop natural resources, the sector’s competitiveness is essential as is the availability of infrastructure. Of equal importance is having the possibility of being able to produce at comparatively lower costs than on an international level.

When an investor decides to develop a project, he chooses the worksite from a list of different countries and takes into account those countries that, through the release of information and other specialised methods, have achieved some degree of presence within this circuit.

Unfortunately, potential international investors, primarily medium-sized ones, do not become aware of budding investment opportunities in time, and, thus, are unable to invest with the speed they would hope for. Investors face two large problems related to this issue: the first has to do with accessing timely information and the second is related to the quality and depth of available information.

Therefore, the creation and eventual promotion of specialised information is a necessity for the country as well as for the investor who expects to be reasonably informed before deciding on the investment site. There are more than 100 agencies in the world vying for foreign investment.

A basic condition in promotional activities is that these should adhere strictly to promoting the country’s actual economic and legal reality. Otherwise, when conditions do present attractive opportunities, future effective promotional activities would be hampered.

The conditions that make countries investment destinations are not related to the promotional activities of any one specific country, rather, these are principally related to the conditions and internal economic expectations and or the growth strategies of the investing companies.

To exercise influence in investment decisions, the organisation in charge of promotion must, copying the worldwide trend, conduct active promotional programmes within countries that are classified as great investors.
A three-tiered structure would function well in an agency hired to promote and stimulate investment:

1. **Overall or “Country Image Creation” level.** This would be a very specialised activity with a global objective and therefore difficult to evaluate. There are promotional agencies that only work on this level.

2. **Sector level.** This involves promoting investment in specific sectors considered priority and requires a more focused effort than that of overall promotion. Additionally, this would involve gearing promotion toward countries, regions and companies. This promotional activity could either co-exist or not, along-side the overall promotion activity within the same agency. Agencies exist that promote investment in specific sectors with little emphasis on the overall promotional framework.

3. **Project level.** This activity comprises a more complex process that aims to stimulate investment in specific projects and can either focus on sector or overall promotion. This activity can co-exist with the above-mentioned ones or it could be the responsibility of an agency specialised in the promotion of projects.

The success of these agencies or programmes usually depends upon the use of well-trained business professionals, albeit in the private sector or with subsidies.

An important decision in this field has to do with whether or not investment promotion will be only for joint ventures, with national business people, or for pure foreign investment. If national business people participate in the programme they should also be involved in its operation. Nevertheless, sometimes the issue arises as to whether or not the agency is responsible for the local investor’s dependability.

Finally, it is important to mention that the target market will not include the large multinational companies who possess great resources in locating investment opportunities, but rather these will target medium-sized companies worldwide. As in any marketing process, and whatever be the specialty of the promoting agency, the best marketing to conduct will be direct marketing.
2. **Investment promotion in Chile**

Chile has been very efficient in attracting foreign investment. However, this is probably due more to having met the prerequisites of a country attractive to foreign capital, rather than to the promotional work it has done. Some of these prerequisites are:

**Suitable investment climate**

This is based upon political stability as well as stable and clearly established rules concerning economic matters. Experience indicates that investors prefer predictable, low-risk systems. This not only has to do with political and institutional topics but also with the quality of economic management. For example, high inflation rates are a disincentive to foreign investment. Chile offers an apt and attractive investment climate.

**Regulations that avoid discrimination and grant legal security**

Foreign companies are especially sensitive to regulations either that place them at a disadvantage in relation to host country companies or that damage their legal security. Chile’s constitution, legal framework and especially Decree Law number 600, that permits judicial security via the signing of a “legal contract” between the investor and the Chilean State, impart a high level of legal security.

**Ease of foreign capital entry and exit**

Foreign investors tend to be very sensitive to what is known as the “capital claustrophobia syndrome”. They are reticent to regulations blocking the exit of capital or profit and the greater the restrictions the greater their aversion to staying in the country. To this effect, current Chilean legislation grants sufficient guarantees to investors.

**Economic vigour**

One of the best reasons for foreign capital to flow abroad is to seek new dynamic markets. This is not necessarily about the average activity of an economy but also concerns the existence of growth niches.
Chile is an economy that has grown in a continuous manner over the past 14 years and has good possibilities of continuing to grow at a high rate.

*Proper country-risk*

This not only involves the formal classifications made by international agencies but also involves the course the country is taking and the trust it inspires. Chile has been classified as “investment grade” by such classifiers as Standard and Poor and Moody’s. The classification received is “A-“.

*A good image of the country*

It is not enough that a country have proper legislation and a well managed economy, it is also important that potential investors, especially the ones the country wants to attract, know of the advantages offered by the country.

In Latin America a study conducted by FIAS and the Venezuelan Government concerning the perception of multinational companies with respect to this country and the region, yielded interesting conclusions. The study consisted of interviewing a group of directors in their headquarters in Japan, Europe and America, concerning their attitudes toward business in Latin America.

According to companies interviewed only 4% of their sales were from the region. The Asia-Pacific region ranked first in investment priority, Europe second and The United States and Latin America third and fourth respectively. When asked to evaluate individual countries, Chile was placed high. Conversations held with business people at their home offices indicated a high level of knowledge concerning Chile. They had a clear and consistent perception that Chile is a country fit for business, where things got done and where foreign investment was welcomed. This alone is a great asset.

Up to the present, Chile has been characterised by its efforts to attract investment with a global focus, with less importance placed on the sectoral level (tourism, infrastructure, financial services, forestry-related industry, mining, agribusiness and other sectors). There are no consistent efforts to promote project investments and regional level promotion is still in its infancy.
The Dominican Republic has been relatively successful in attracting multinational companies and in increasing the investment flow in three sectors in particular: industrial free trade zones, tourism and telecommunications. These three sectors have been the main growth centres of the economy and the pillars of the economic transformation taking place in the Dominican Republic over the past 15 years. The country has now become an exporter of services and finished goods and is no longer on the track of being an exporter of primary agricultural products.

Some of the characteristics of this relative success are a clear reflection of FDI. For example, there are over 500 companies on the island most of which are dedicated to assembling manufactured products, such as, textiles, footwear, jewelry, electronic products and pharmaceuticals. Additionally, there are also approximately 40,000 bedrooms to meet the demand of tourism as well as investments by world class companies such as GTE, Motorola and All America Cables in the telecommunications sector.

Economic growth rates of 7.3% in 1996, 8.2% in 1997 and close to 6.5% for 1998, have been generated by companies in the above-mentioned sectors who decided to establish themselves in the Dominican Republic and expand their operations and by the vigorous activity in the construction and commercial sectors.

The model used for attracting companies in the manufacturing sector for export was based on the following:

* Executive Director of the Office for Promoting Foreign Investment in the Dominican Republic (OPRI-RD)
− Preferential treatment to US markets under the Caribbean Basin Initiative;
− Political stability;
− Geographic location;
− Incentives and financing of industrial free trade zones.

The tax incentives for all sectors except free trade zones but including those of tourism and agribusiness were eliminated in 1992 as a result of a tax reform. For the telecommunications sector, it is important to point out that it has been in the private sector since the 1930s. In the early 1990s the Government of the Dominican Republic (GORD) began a process of opening competition in this sector, making the Dominican Republic one of the countries with the highest traffic rate in the world, on a per capita basis.

Additionally, tourism in the Dominican Republic has experienced skyrocketing growth and has become the main source of revenue for the economy, as well as a significant employer of human resources. Dominican tourism has specialised in providing “all inclusive” type services at a low cost and taking full advantage of our natural resources.

With the arrival of the new government in 1996 the Dominican Republic adopted a new country-strategy destined to help us reach our goal of economic development. To do this a number of first level macroeconomic reforms have been initiated. A partial list of these reforms follows:

− The passing of the 1995 Foreign Investment Law that frees up restrictions on capital and dividend repatriation, eliminates sector restrictions and offers the same treatment to both national and foreign investors;
− The reconstitution of the Supreme Court and a modernisation of the judicial system, reducing the cases of corruption to a minimum and restoring credibility to the system;
− The initiation of the privatisation process for State-owned enterprises;

1 The Dominican Republic also benefits from the IVth Convention at Lome, and from the Generalised Preference System (GPS) with fewer levels of relative use.
Negotiations of free trade agreements with Central American and Caribbean countries. This substantially increases the market size to 40 million persons and ends the nation’s relative isolation with respect to its neighbors.

Modernisation of sector laws, such as: telecommunications, energy, banking and finance and others.

The GORD bases its strategy on the following main pillars:

- Improvement of the legal and judicial framework that regulates economic activity via the establishing of clear and transparent rules;
- Improvement of human resources via a curriculum reform and an increase in the educational expenditure (16% of the budget);
- Improving the economic infrastructure via public sector investment and allowing the private sector to participate in the construction and operation of public interest and public use projects that were traditionally carried out by the government.

The GORD has made FDI a priority and has made it the centrepiece of its policy for economic development. To this end, in March of 1997 the President of the Republic, via a decree, ordered the creation of the Dominican Republic Investment Promotion Office (OPI-RD), charged with designing a strategy to attract companies that will generate jobs, revenue and transfer technology to the country.

The Dominican Republic institutional strategy is two-pronged. The first focuses on the efforts to improve the investment climate, in particular the legal, regulatory and procedural framework related to investments. The second has to do with the functions of international marketing. With respect to the legal framework, the OPI-RD has commissioned various national and international consulting firms to conduct studies. It also employs, on a permanent basis, a team of attorneys and economists in charge of monitoring the business environment and of making recommendations in the event that changes need to be made.

The second prong or route is based on an exercise called “Investors Road Map”. This exercise mainly attacks the weakness of the Dominican legal framework: the bureaucratic procedures related to investment. The project methodology refers to the so-called second-tier reforms and is directed to identifying all the steps that an investor must take to establish his firm in the
Dominican Republic. This is done essentially in the areas of employment, location, registration and operation so as to recommend modifications later, especially suggestions for making administrative changes arising from sector workshops with officials and private sector firms.

With sights set on the medium-term, the Dominican Republic, via the Sector Committees, has pledged to work with the different sectors such as textiles, footwear, electricity and electronics, telecommunications and tourism, which, because of their potential, are considered to be of major importance. Crucial to these is the participation of the private sector that informs us about its necessities, contacts in affiliated companies, competitors and other related persons or companies that could be used as a means of attracting investment.
THE ARGENTINE AUTOMOTIVE SECTOR

by
Mario Dasso*

After a decade of low level foreign investment in Argentina the 90s became a decade of marked transformation. Changes in the legal framework, privatisation and macroeconomic stabilisation plans were crucial in the short-term for creating the necessary conditions and making foreign direct investment grow substantially during the 1990s. From 1992 to 1996, foreign direct investment was greater than US$19 billion. Out of this invested amount, 20% of it was concentrated in the automotive industry, most in final goods factories and the rest in spare parts plants.

The new legal framework was a fundamental part of the investment process, and although equal treatment of foreign and national capital already existed, as of 1989 the prerequisites for previous approval and registry in the Registry of Foreign Investments was made optional.

Since 1993 and up to December 31, 1999, the automotive sector, along with other sectors, has been governed under special regulations. These allow the sector to pass from a completely isolated system to one of total openness, and this is fixed to happen by the year 2000. Automotive regulations, plus a series of other factors, are at the head of the accelerated process of growth experienced by the automotive industry in the 1990s, with more than US$5.5 billion being invested in this industry in the 1990s alone.

The Argentine automotive regulation fundamentally consists of one basic and central idea on which the entire system pivots. In other words, ideas and strategies were put into effect via a co-participatory effort of the private and public sector. Studies and examples from what had occurred in other countries in similar situations were used. The diagnostic centre assumed that the only reasons to have an automotive industry in Argentina were the existence of

* Director of the Association of Argentine Automobile Manufactures (ADEFA)
specialisation criteria or the need to complement the rest of the world. The new regulation was then characterised by:

- Production by each company limited to only one or two models to allow for a better economy of scale and the import of complementary vehicles;
- Approach to international levels of quality;
- Export to generate exchange revenue to be able to import;
- Updated models;
- Insertion of Argentina into the world automotive industry.

Regulations for temporary imports were also changed. This meant that companies located in the country had to export to be able to import goods with a preferential tariff. Companies not located in the country could import up to 10% of the production of local industry.

As of the 90s, US$5.5 billion will have been invested in the Argentine automotive industry. This significant investment enabled to an improvement in existing factories and meant the installation of new factories and technology.

Production levels went from less than 100,000 vehicles in 1990 to 426,000 in 1997. Exports also grew during these years from very small numbers to topping 210,000 units in 1997. The new models are launched very close to the dates when they debut in their country of origin. Quality has also improved notably, and now reaches international parameters.

This success of the Argentine automotive industry has many important elements: the first is the integration of companies located in the country into the strategy of their head offices on a worldwide scale. The Argentine automotive industry is no longer an isolated market. Companies located in other countries participate in the distribution of investment for the manufacturing of new models.

A second element is that automotive regulations generated a sufficient nationwide policy for the integration of the country’s industry to the reality of the industry in developed nations. This integration responds to the necessity of growing in competitiveness and of staying profitable within the globalisation process.
The third element is the success of the “Convertibility Plan”, the government’s economic policy that got the Argentine economy growing again and established a fundamental framework for the growth in demand of automobiles.

The fourth and final element was the creation of Mercosur. This was crucial, since it was necessary to increase the market size in order to adjust to an appropriate scale in the regional development of the industry. Additionally, it was important because it allowed for putting a specialisation and complementation plan into operation in the factories for only one or two models and thus, for reaching internationally competitive volumes and economies of scale.

From an analytical point of view, it is difficult to establish a priority relationship between these four elements, since they all gave rise to the overwhelming process of investment mentioned at the beginning of this article.

Mercosur has set the year 2000 as the year in which it will launch an automotive policy to promote investment in the region.
INVESTMENT PROMOTION TECHNIQUES AND THE ROLE
OF THE INVESTMENT PROMOTION AGENCIES

by

Declan Murphy*

Introduction

The first section of the workshop considered major trends and broad policy frameworks in FDI. The second session examines the theme of best practices in promoting FDI in Latin America and commenced with the fundamental issue of the creation of an attractive environment for investors. This paper continues and builds on that discussion and in particular the notion of best practice in promotion techniques and the operations of investment promotion agencies.

Is there a model of best practice in FDI policy development and promotion of FDI? Where are the features of such model?

Solutions to the challenge of attracting FDI are individual to countries and regions but there are many identifiable and common features and best practices, used by the most successful agencies, that point the path to success. These are outlined in the following paragraphs.

Policy and promotion

Policy and promotion of FDI should be seen as the two sides of a coin. They are inextricably linked and promotion is the implementation of a key part of policy. The systemic influence between policy and promotion can shape and develop each side. Achieving best practice in promoting FDI is often in the first instance founded on the degree to which this two-way process is understood and functions well. Articulation of policy is essential but due consideration and

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regular review of the implementation of that policy should be an integral part of policy. Contrary to common preconceptions articulation may often be easier than implementation. Some FDI promotion agencies have found that emulating the practices of other more successful agencies has not always yielded results. Successful implementation of policy requires a multifaceted and strategic approach to creating the appropriate environment for investors, to establishing the legal and institutional framework, to providing the appropriate mandate and resources to undertake the challenging task; and to professional and creative marketing by the responsible public and private sector organisations.

**Segmenting foreign direct investment categories**

FDI today comprises an unprecedented range of sectors and companies investing in an unprecedented number of locations. Driven by globalisation, increased competition and new technology there has been a continuous and growing surge of new FDI in recent years and the prognosis is for this to continue although there are regular shifts in investment destinations. Is there a clear view by countries and agencies seeking such investment as to what categories can be attracted to their specific locations? Many countries talk in their policy and promotion strategies about attracting investment in the areas of agriculture, manufacturing and services. This broad categorisation without very clearly defined target categories does not take enough account of the worldwide competition for FDI and the differing needs of investors today.

For the purposes of the discussion on best practice in this environment it is useful to consider the following different categories of FDI:

- Location-specific investment
- Acquisition, privatisation
- Joint Venture
- New “greenfield” mobile investment
- Expansion investment

The first three categories are typically linked to a specific location. A company, which wishes to access, for example, mineral resources, forestry or commodity raw materials, is usually restricted to where such resources are available. Although in some industries the production process (e.g. bauxite, alumina, aluminium) may be divided between different locations. However the general principle that such FDI is less mobile than other FDI remains valid. In
similar fashion the acquisition of a specific company or investment through privatisation tends to be location-specific i.e. the investment is again less mobile than other categories of FDI and is most likely to happen where the specific resources or company to be acquired are located. Clearly in some instances an acquisition can lead to a new company being formed and located in a completely different location. This can also apply to a joint venture investment where new investment may be in an existing plant or the establishment of a new plant.

These categories are not mutually exclusive but in general the first three categories can be said to be location-specific investments. The last two categories fall into the “greenfield” category and are therefore more mobile i.e. they could go to any one of a number of locations and investors will usually examine a range of locations in detail before selecting the investment location. Expansion projects could be seen as location-specific because they involve the expansion of existing plants but most companies today will review the option of a new location versus expansion at an existing location. For countries which do not have natural resources, major markets or similar attributes, the “greenfield” mobile category may be the only area where they can realistically compete for FDI. This is the hard reality for most countries seeking to attract FDI. Making the distinction between location-specific and mobile investment and applying the different marketing and promotion approaches demanded by different segments are important features of best practice.

Trends and patterns in FDI

The scale of FDI worldwide has been well documented by previous papers presenters at this workshop. Unprecedented levels of FDI in the 1990s are succinctly and aptly described in the OECD’s statement:

“Never before have so many firms from so many countries invested in so many countries”
OECD Observer, April 1996

The bulk of this investment is made and received by the larger developed countries. Approximately two thirds of FDI now goes to 10 countries and these are also the major investors. These facts highlight the challenge for many other countries in attracting FDI and the competitive environment for such investment. This in turn points to the critical need for best practice in all aspects of FDI policy and promotion.

Combined with the change in scale of FDI there are other important features of FDI patterns that need to be recognised by policymakers and promotion bodies:
More companies, both large and small are now investing outside their home country. Many smaller companies now view FDI as a strategic necessity rather than something for larger companies only.

More global spread -- companies are open to investing in a much wider range of destination countries in their quest for more competitive conditions and new markets and market share.

More new sectors are undertaking FDI. In the new technology sectors such as biotechnology, new materials, electronics, telecommunications sector and especially in information technology there is burgeoning investment taking place. Increased competition, technology change, shorter product life cycles and demand for quality drive this growth.

More separation of the value chain components through outsourcing and establishment of new commercial spin-offs is taking place. Activities such as design, purchasing, production, sales and marketing, customer service, technical support, R&D, MIS, finance and administration and back office work may now be separated and undertaken in different locations. For example, the Japanese company, Nissan has established its European logistics base in Barcelona but manufactures in other locations. Many transport companies have moved along the value chain to handle not just the transport/distribution but the purchasing/logistics operations for their customers.

The search for skills is influencing both the scale and direction of FDI. An example -- India is reported to be undertaking $2 billion of year 2000 conversion work for European banks. The availability of “knowledge assets” will be important determining factors in future FDI patterns.

The rise in service business and increased tradability of services -- in software, electronic commerce, media and multimedia, teleservices, financial services, logistics, entertainment services, to name a few, is set to continue and to influence the scale, pattern and destination of FDI. Over 60% of all FDI (UN World Investment Report 1996) is now in the services sector in contrast to the historic pattern of predominantly manufacturing investment.

Recognition of all these changes and the implications will be critical for devising best practice policies and promotion and for success in attracting FDI.
Types of FDI Promotion Agencies

In the increasingly competitive environment for FDI the mandate and role of agencies charged with attracting FDI will influence results. What distinguishes best practice in promoting FDI? Why are some agencies more successful than others are? Some relatively small countries (e.g. Singapore, Costa Rica, Ireland, Israel and Scotland) with no apparent market or natural resource advantage have shown substantial success in attracting FDI, sometimes in competition with major countries which are traditional destinations for FDI. The potential role of clearcut policies twinned with market-driven approaches by promotion agencies is an important factor here. At one level, agencies may operate as information providers. This role is important and responds to the investor demand for information. Other agencies may extend this role to more comprehensive services including incentive funding. These are valid and useful roles in attracting investment. However at another level agencies can act as development agencies -- they see their role as real and proactive business partners of investors by:

− Researching sectors and companies and understanding the investment ‘triggers’ and strategic/sectoral issues for companies.

− Being prepared to identify and respond to significant structural changes in sectors and the emergence of new sectors.

− Seeking to provide development solutions, which address investor needs (for example, the needs of the pharmaceutical industry differ in many aspects to the electronics industry) rather than just promoting investment locations to companies.

− Targeting specific sectors and specific companies with best prospects for their country.

− Knowing their competitors and competition for FDI and their market shares and monitoring how and why investment decisions are made.

− Having the scope, strategy, skills and culture to act like a commercial service business that responds quickly and professionally to customer needs and maintains close relationships with its customer base.

These features represent best practice in FDI policy and promotion.
Marketing an investment location – building the relationship with investors

Marketing an investment location is similar to industrial marketing. It requires time and ongoing commitment to clearly identify target investors who match the profile of the investment location and develop meaningful business relationships with these. This relationship can be depicted as moving through four stages (see chart 1) from no interest on the part of a potential investor to definite interest and contract signing stage. In other words moving from no interest or even awareness to real commitment to invest.

Chart 1

DEVELOPMENT OF THE TYPICAL RELATIONSHIP IN MARKETING FDI

<table>
<thead>
<tr>
<th>STAGE 1</th>
<th>STAGE 2</th>
<th>STAGE 3</th>
<th>STAGE 4</th>
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<tbody>
<tr>
<td>NO INTEREST</td>
<td>REAL INTEREST</td>
<td>INVESTIGATION</td>
<td>CONTRACT</td>
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• Wedge to represent increasing client interest
The challenge for promotion agencies --and this is at the heart of best practice-- is to establish, build and maintain this relationship. Marketing an investment location is essentially a relationship business. Many agencies today resort to extensive detached or impersonal promotion techniques. These can assist the promotion process but ultimately not replace meaningful relationships with potential investors if success is to be achieved.

In conjunction with this relationship approach the relevance of all promotion and sales activity needs to be measured against the different stages of relationship progression (see chart 2). It should be designed and conducted with clear objectives in each stage. The activities shown in chart 2 are not the full range of activity undertaken by investment promotion agencies but illustrate that the principle of setting a clear and linked purpose for each such activity, and at each stage, in progressing relationships is part of the best practice approach.
Establishing relationships with existing investors means ‘rooting’ investment by encouraging linkage with local suppliers, business partners and industry clusters. Such practice can position a country better for repeat investment i.e. expansion or new investment by associated companies. Again this type of approach is at the core of best practice FDI policy and promotion.

The Information Age

“The key to national strength is no longer natural resources, nor geographic size, nor even military power. It is knowledge. Knowledge is at the heart of new technologies, new products, new processes, new services”
Professor Frank Rhodes, former President of Cornell University

To what extent do FDI policy makers and promotion agencies recognise technology and human skills as a critical factor of production today? And the implications of that for attracting FDI?

Shifting patterns of FDI are being influenced by the availability of knowledge and skills. Knowledge may now be described as the new basis of economic prosperity in many industry sectors. The attraction of new FDI in modern technology sectors will be strongly influenced by how countries develop their knowledge infrastructure and education/skills base. These are long term policy actions which combined with focussed promotion could position countries/agencies to achieve success in attracting FDI. A key part of best practice is preparing for the future changes, identifying trends and undertaking action that will ensure ability to compete for such investment in the short and long term.

Investment promotion agencies are service businesses

Research by various business practice commentators has identified the characteristics of outstanding service businesses. Investment promotion agencies -- similar to commercial service companies -- need to benchmark their approach against such characteristics (see chart 3) to assess whether they match the best practice profile.
− Service concept – is the agency clear on the service it is providing to investors?

− Is the agency professional and creative in the way in which it delivers the service to investors and potential investors?

− Is the agency clearly focussed on specific sectors/clusters and company segments?

− Has the country/agency established the right image to attract investors? And is there a continuing programme to build this image?

− Has the agency the internal organisation culture/philosophy to deliver a quality service?

Ensuring clarity and innovation in implementation on these issues is fundamental to the concept of best practice in promoting FDI.
Conclusions on Best Practice in Promoting FDI

The previous paragraphs outline the features of best practice as demonstrated by successful investment promotion agencies in today’s competitive world environment. In summary, these can be described as follows:

− Policy and promotion are inextricably linked and need to be seen as such.

− Clear distinction needs to be made in promotion between different categories of FDI --- location-specific investment which is restricted to a particular location (e.g. to get access to natural resources or the acquisition of a specific company) and mobile investment (both ‘greenfield’ and expansion projects) which can locate in any one of numerous countries.

− Segmenting potential investors not just between these broad categories but into clearly identified target sub-sectors is important.

− Alongside unprecedented growth in the volume of FDI there should also be greater recognition of the changing pattern of FDI driven by globalisation and the impact of technology, e.g. more and smaller companies are investing; new sectors and in particular technology and service businesses are fertile sources of FDI.

− The essence of successful promotion is in establishing meaningful relationships with identified target sectors and companies and providing strategic business solutions to such companies. All promotion techniques used should be regularly measured against that objective.

− The information age is shifting FDI volumes and patterns. Investment promotion agencies need a national strategy that recognises this influence and positions them to avail of opportunities.

− The most successful investment promotion agencies act like top class commercial service businesses. Their approach is highly professional and efficient. They act as development agencies where they seek not just to undertake promotion but to improve the wider environment for investors by liaising and instigating change with relevant authorities and are innovative in seeking investment in new and emerging sectors. They have the mandate and
resources to undertake their work and are central to national industrial policy.

- Key elements of the “best practice” policy and promotion strategy model include having a clear service management system within an agency which spells out the service they offer, target segments, and delivery method; uses customised marketing to target clients and build relationships; pursues FDI in all elements of the value chain; roots FDI through linkage with local suppliers; achieves a high volume of repeat investment; and is focused also on opportunities in new emerging sectors such as Ecommerce, software, biotechnology, multimedia, etc. and restructuring sectors such as telecommunications and financial services.

Best practice policy and promotion are identifiable and intertwined. The extensive experience of many countries and agencies in seeking to attract FDI has shown the major characteristics and features of this best practice.

NOTES

1. Estimates from the National Association of Software and Service Companies, India, Nov. 1998

2. “The University: National Powerhouse or Endangered Species”.
   The Third Annual Trinity College/Irish Times Lecture by Professor Frank H.T. Rhodes, former president of Cornell University, New York, delivered in Dublin 24 September 1996.

1. A regional survey from a new analytical perspective

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

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

The increase in FDI to Latin America and the Caribbean in recent years has been substantial, rising from US$33.1 billion to US$65.2 billion

This document is also available on www.eclac.org.
between 1995 and 1997. Moreover, despite the Asian crisis the trend appears to be stabilizing, since estimates for 1998 indicate that FDI inflows will roughly equal those for 1997. Because of this impressive growth, 45% of the stock of FDI in 1997 had accumulated over the previous seven years. In other words, the stock of FDI in Latin America has been renewed during the 1990s, hence the need to reconsider the nature of the phenomenon.

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

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

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

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

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

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

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

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

Foreign Direct Investment Flows to Countries of The Latin American Integration Association (LAIA), 1990-1998
(millions of dollars)

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<td>3 226</td>
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<td>2 183</td>
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<tr>
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<td>14 318</td>
<td>42 361</td>
<td>40 048</td>
<td>58 500</td>
<td>58 110</td>
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*Estimated.

Source: ECLAC, data base of the Unit on Investment and Corporate Strategies, from information provided by the International Monetary Fund (IMF) or taken from the balance-of-payments data of each country.
According to estimates by the ECLAC Unit on Investment and Corporate Strategies, FDI flows to LAIA countries in 1998 should be around US$58.1 billion, nearly identical to the figure for 1997. This suggests that, despite the Asian crisis, the extraordinary growth in FDI since 1994 is beginning to stabilize. As in the previous two years, FDI flows would seem to have been concentrated in Brazil, at levels well above the flows to Mexico, Chile, Colombia, Argentina and Venezuela. This reflects the great interest evidenced by international investors in 1998 in Brazil’s privatization program. In July 1998, for example, the sale of the Telebras system brought Brazil some US$12.620 billion in FDI.

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

- The advance of globalization has changed the structure of the world market, the nature of the competitors, the technological demands and the international rules and standards for trade, investment and intellectual property. Companies already operating in the region—as well as newcomers—have been confronted with a new competitive situation that has altered the structure, quality and scope of their investments in Latin America and the Caribbean.

- New national policies: macroeconomic stabilization, trade and financial liberalization, deregulation of the economy, wide-ranging privatization programs, loosening of the regulatory frameworks applicable to private investment, and regional integration movements have considerably modified the business environment in Latin America and the Caribbean, thereby providing an incentive for companies, both domestic and international, whether already established in the region or newcomers, to invest.

- Transnational corporations have adapted to this new environment and adopted new strategies to take advantage of trends in international markets and national policies. To a greater or lesser extent, these corporations have begun to establish integrated production systems on the international, regional and subregional
levels, systems in which some of the economies of Latin America and the Caribbean are gradually being incorporated.

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

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

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

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

The first of the four strategies identified above has been applied most intensively in Mexico, principally in the automotive, auto parts, information technology, electronics and garment industries. In response to the challenge posed by Asian competition in their home market, three major auto makers from the United States (General Motors, Ford and Chrysler—the latter before it was acquired by the German firm of Daimler-Benz) and several from other countries (Volkswagen and Nissan) tried to improve production efficiency by investing in new plants in Mexico with state-of-the-art technology and equipment. Moreover, other foreign firms (from the United States and to a lesser extent Asia), taking advantage of NAFTA and the *maquiladora* regime, decided to invest in plants Mexico to produce consumer electronics (televisions, computers, sound systems and telecommunications equipment) and wearing apparel for export to the North American market.
As in Mexico, many United States firms have invested or gone into partnership with local firms in the Caribbean Basin countries (notably Costa Rica, the Dominican Republic, El Salvador, Honduras and Guatemala) to reap the advantages of export processing zones (maquila), low wages and United States tariff preferences, in order to compete more successfully in the North American market. Their investments in the Central American and Caribbean countries in response to the Asian challenge have mainly been in the manufacture of wearing apparel and electrical and electronic appliances.

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

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

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

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

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

In finance, for example, the strategy adopted by Spanish banks, particularly Santander, Bilbao Vizcaya (BBV) and Central Hispano (BCH), is of great interest. Through an aggressive acquisition strategy, these three banks have established a strong presence in the region, especially in Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela. These three Spanish banks, and the same is true for the Hong Kong Shanghai Bank Corp. (HSBC) and a Canadian bank, the Bank of Nova Scotia, have apparently set out to achieve clear leadership in the Latin American financial sector through their regional positioning.

In recent years, as a result of the privatization of State-owned electricity generating and distribution enterprises, a new contingent of foreign investors has found a foothold in the Latin American energy sector, among them Chilean firms (Enersis, Endesa and Gener), Spanish firms (Endesa and Iberdrola) and a number of pioneering firms based in the United States (AES Corp., Houston Industries Energy Inc., Southern Electric, CEA, Dominium Energy and CMS Energy). The main target of this ambitious strategy of acquisition and investment is the Brazilian target, which suffers from an energy shortage. Given the large amount of money involved, the acquisition of the privatized assets has required the formation of consortiums composed of foreign firms of various origins in association with powerful local groups. Interest first focused on privatizations in Argentina, then shifted to Brazil. Huge projects for transporting and distributing natural gas began to be linked with electricity generation in Brazil. The United States firm of Enron has been especially active, participating on a large scale at all points of the energy delivery chain: in acquiring and developing natural gas deposits, transporting and distributing natural gas (locally and regionally) and generating electricity.
Telecommunications enterprises have been among the favorite targets of foreign investors. Since the end of the 1980s, the main State-owned telecommunications enterprises of Argentina, Bolivia, Chile, Mexico, Peru, Venezuela and more recently Brazil have passed into private hands, and cellular telephony concessions have been auctioned off. The liveliest actors on this new stage have been the Spanish company, Telefónica de España, in fixed-line telecommunications (local and long-distance calls) and the United States firm, BellSouth, in mobile telephony. The recent privatization of the Telebras system demonstrated the great interest of foreign corporations in such assets in the region: the Government of Brazil realized more than double its original expectations in proceeds. As in the markets of other industrialized countries, an increasing tendency is observable in the region towards the integration of telecommunications system with other communications media (network, cable and satellite television, Internet access and the press). This tendency is most clearly marked in Argentina, where an unusual strategic alliance is shaping up between Telefónica de España and the United States banking firm, Citicorp, for the control of a significant share of the market in fixed and cellular telephony, network and cable television, Internet access and other mass communication media.

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

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

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

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

- Restructuring and modernization of existing installations or construction of new, modern plants, as was the case with automobile assembly plants, for example. In a number of industries this restructuring and modernization strategy extended throughout the Mercosur area.

- An aggressive strategy of acquisition of the assets of local enterprises, intended to strengthen and extend the transnational corporations’ presence in the Brazilian market, concentrating on their core businesses. In recent years foreign corporations have generally diversified less, using acquisitions to eliminate or discourage competition, and betting on the potential of the Brazilian and Mercosur markets.

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

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

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

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

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

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

The globalization process can be seen much more clearly by analyzing certain operations which are representative of United States FDI in the region. The most important sources for improved understanding of the phenomenon are the data on transactions provided by the United States Government in the *Benchmark Surveys* produced by the Bureau of Economic Analysis of the Department of Commerce, and the results of the research program conducted by the Unit on Investment and Corporate Strategies of ECLAC. These have shown that the nature of the investments has changed substantially compared with traditional strategies, according to the needs and opportunities arising from globalization and structural reform in the countries of the region.

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

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

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

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

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

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

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

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

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

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

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

The Mexican experience has been seen as the most positive. At 33 vehicles per employee, productivity is almost double that recorded in Argentina and Brazil. International competitiveness is also far superior, not only in volume terms (US$20.8 billion in automobile exports in 1997), but also because the output is destined for a more demanding market — the world’s biggest, the United States market, where its share has more than doubled — and because of the large trade surplus that has resulted (US$7.8 billion in 1997). However, in order to achieve its competitive restructuring, Mexican industry has had to lower its national content standards (from 60% to 30% in the case of export models) and to some extent neglect the auto parts industry, formerly the preserve of domestic companies. In this way, it has succeeded in creating a flexible and competitive automotive industry, dedicated to exports and able to increase its external sales when domestic demand falls, as occurred after the peso crisis in December 1994. NAFTA has made it possible to consolidate the changes through the direct investments of the industry’s major transnational corporations, without major disputes among the member countries.
The experience of Ford (Mexico) is a very good example of the competitive restructuring of Mexico’s automotive industry. To protect its share of the United States market against the Asian challenge, Ford made considerable direct investments in Mexico, establishing plants to produce engines and vehicles for export which were capable of competing on the world market. Thanks to its partnership with Mazda, Ford applied international technology and organizational systems in these plants, with surprising results in terms of increased competitiveness on the North American market even against its Japanese competitors.

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

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

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

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

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

   FDI in Latin America in the Current Financial Environment
   Chair: Mr. Ricardo Harten, President National Commission on Foreign Investment and Technology, CONITE, Ministry of Economy, Peru

   − Mr. Antonio Martins, Deputy Manager, Registry of Foreign Capital, Central Bank, Brazil
   − Mr. Eduardo Moyano, Executive Vice-President, Foreign Investment Committee, Chile
   − Presentation on the ECLAC Annual Report on Foreign Investment in Latin America and the Caribbean by Mr. Michael Mortimore, Unit on Investment and Corporate Strategies, ECLAC
   − Presentation on the SELA report on External Financing and External Debt in Latin America and the Caribbean by Ms. Manuela Tórtora, Senior Consultant, SELA
The International Framework for Foreign Direct Investment

Chair: Ms. Anabel Gonzalez, Vice-Minister, Ministry of Foreign Trade, Costa Rica

Multilateral Framework for Investments

− Mr. Wolfgang Hantke, Head of Division for North and Latin America, Federal Ministry of Economics, Germany

Inter-American Investment Policies

− Mr. Roberto Echandi, Director General for International Trade and Investment Negotiation, Ministry of Foreign Trade, Costa Rica
− Mr. Carlos Herrera, Secretary General, National Commission on Foreign Investment and Technology, FTAA Chief Negotiator, Peru
− Ms. Maryse Robert, Principal Specialist, Trade Uni, OAS

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III. Best practices in promoting FDI in Latin America

Creating an attractive environment for investors

Chair: Mr. Werner Corrales, Venezuela Ambassador to WTO and UNCTAD

The role of government departments and regional authorities- How administrations help or impair the regulatory environment

− Mr. Lisandro Barry, Director, Investment Development Agency, Ministry of Economy, Argentina
− Mr. Werner Romero, Trade and Investment Promotion Counselor, Ministry of Foreign Affairs, El Salvador
− Mrs. Carmen Gisela Vergara, Director, Promotion and Production Department, Vice-Ministry of Foreign Trade, Panama
The role of regional and international organisations

- Mr. Juan Carlos Mathews, Al-invest Programme, Director, Eurocentre, Peru,
- Mr. Antonio Pinto-Rodrigues, Director, Investment and Technology Promotion, UNIDO
- Mrs. Mónica Rosell, Director, Investment Department, Andean Community
- Mr. Ben Rowland, Programme Manager, Latin America and the Caribbean, Foreign Investment Advisory Service - FIAS

Expanding business in Latin America

Chair: Mr. Werner Corrales, Venezuela Ambassador to WTO and UNCTAD

The Peruvian Experience: A case study

- Mr. Carlos Herrera, CONITE.on behalf of Ms. Rosario Almenara, Vice-Minister of Economy, Peru

The Chilean Experience: A case study

- Mr. Héctor Casanueva, Director, Pro-Chile, Ministry of Foreign Affairs, Chile

Private Sector Case Studies

Communications Sector

- Mr. Antonio Golderos, Director General de Planificación y Recursos, Telefónica Internacional, Spain

Automotive Sector

- Mr. Mario Dasso, Deputy Director, Asociacion de Fabricas de Automotores, Argentina

Financial Sector

- Mr. Alberto Ridaura, Directory Advisor, Banco Santander
Comments and Conclusions:

- Mr. Jose Ignacio Sanchez Asain, General Director, Latin America region, Banco Bilbao y Vizcaya

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Thursday, 17 December 1998

Investment Promotion Techniques and the role of the Investment Promotion Agencies

Chair: Mr. Rainer Geiger, Deputy Director, Financial, Fiscal, and Enterprise Affairs, OECD

- Mr. Mamadou Barry, Investment Promotion Officer, MIGA, World Bank
- Mr. Declan Murphy, Deputy Head, Private Sector Development Unit, OECD
- Mr. Eddy Martínez, Director, Dominican Republic Office for the Promotion of Investment

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Concluding Session

Chair: Mr. Rainer Geiger, Deputy Director, Financial, Fiscal, and Enterprise Affairs, OECD

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- Mr. Jorge Baca, Minister of Economy and Finance, Peru

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