Economic liberalization, ownership change and inward internationalization in Latin America

João Carlos Ferraz

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Economic liberalization, ownership change and inward internationalization in Latin America[1]

João Carlos Ferraz[2]

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Introduction

This paper covers three related subjects, taking Latin America as the focus of analysis: the general and recent trend towards economic liberalization; the on-going process of ownership change and the policy challenges associated with a process of inward internationalization which is the outstandig structural feature of these economies.

The paper is divided in six sections; in the first, development ideas, regularities and trends will be depicted, in order to establish an analytical benchmark for the upcoming discussion. Secondly, a stylized account of recent LA history is made, focusing on changes in national regimes of incentives and regulations, in order to contextualize the framework conditions facing the region. In the third section an comparative account is made of the process of capital internationalization, taking developed countries, Latin America and Asia as the reference. Following from there the process of ownership change in Latin America is analysed and section 5 discusses the nature of investments carried out by foreign firms in developing countries. In the last section policy challenges and implications are derived.

This is an exploratory analysis of ownership change and the main argument is as follows. In the recent past, through privatizations and mergers and acquisitions, the ownership landscape of Latin American countries has been significantly internationalized, opening relevant questions in relation to the style of and possibilities for future development. It is argued that inward internationalization – an extensive process of one way ownership change- is a very important recent phenomenon in the region, with long lasting consequences. These new structural conditions pose important challenges. Whithin a context of liberalized economies, policy-makers face the task of producing a new regime of incentives and regulations aimed at minimizing negative effects and maximizing benefits of ownership internationalized developing economies.

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[2] Instituto de Economia, Universidade Federal do Rio de Janeiro, jcferraz@ie.ufrj.br

Development: ideas, regularities and trends

For the purposes of this paper, departing from (Schlegel 1977) development is defined as a process of growth, with structural change and wealth distribution, intensive in learning. Conditioning factors and determinants of development are region/period specific but, looking back in history, few regularities can be observed.

In terms of determinants of progress, innovation is the direct cause of structural change; the process of competition is an important innovation driver and entrepreneurs are the relevant agents of competition (Dosi, Pavitt & Soete, 1990). The State has had a pro-active role in every process of national transformation; the question is not whether the State has a role to play but how it is involved, with which degree of success (Evans 1995).

Where progress was observed, corporations linked-up with innovation networks composed by other firms, and research institutions were capable to increase competences in order to explore expanding markets (Dosi and Fabiani 1994, OCDE 1999). In fact, as proposed by Boulding (1992), learning competences of economic agents should be considered the basic source of development.

Looking back at history and the performance of nations, according to Maddison (1994), it is possible to observe a trend towards intra-leaders convergence and increasing distance between leaders and laggards. In this context, while productive catching-up is a difficult and complex phenomenon, scientific and technological catching-up can be rarely observed.

This brief introduction is useful for the purposes of posing the following analytical questions:

- If an acceleration of international flows of capital, goods, services and technologies is under way, and large, international firms are the benficiaries of this process, what is the intensity of this process in Latin America?;

- Given the increasing economic importance of innovation and the approximation between science, production and markets, are (dominant) economic agents in Latin America willing to develop local technological capabilities?

- If economic liberalization is becoming an important feature of national regimes of incentive and regulation, how to aim at, simultaneously, (1) regulations capable of ensuring a pro-innovative competitive environment and, (2) effective incentives to attract economic agents to invest in local technological capabilities?

Stylized Latin America History and recent Economic Liberalization

Between 1930/94 the region attained high growth but with a low contribution of technical progress (Abreu and Verner 1997). In the last 20 years macroeconomic instability and low rythm of structural change prevailed Ferraz, Kupfer & Serrano 1999, Katz 1999). During the 1990s the main features associated with the productive sector were trade deficit, product and services updating and assymetric modernization (CEPAL 1999).

The most well known and relevant structural and framework conditions of Latin America are:

- Rich natural resources and large potential markets, marked by strong regional and social inequalities;

- Insufficient and concentrated infrastructural conditions;

- Strong propensity towards generating low skilled jobs;

- Macroeconomic stabilization cum low investment rates as well as strong dependence on foreign resources;

- Economic liberalization as the main feature of national regimes of incentives and regulation, meaning an increasing importance of private decision-making in the process of allocation of resources.

Given the importance of private competences for development, their main features are:

- Willingness to do business. There is a deep-rooted culture of negotiating and implementing contracts, within a capitalist framework. The vitality (Attention! Not competences!!) of the private sector is very remarkable;

- National and transnational companies occupy different spaces. TNCs are found in all areas/sectors/segments where the technical base is marked by wide opportunities and products are sensitive to income elasticity.

- Relative to international benchmarks, fragile competitiveness prevail; advantages are particularly noted in resource intensive industries.

- Companies are good in routines but weak in search activities. That is, local technological efforts are very low and firms extensive rely on external technologies.

During the 80s Latin American economies were facing difficulties due to (1) the debt crisis, which limited the access of local economies to growing international liquidity; (2) the disorganisation of public finances, weakening the intervention capacity of the State and, (3) lack of economic dynamism, comprehending inflation, low growth and investment rates, increasing difficulties in accessing export markets and increasing obsolescence of productive system.

These difficulties made clear the fragility of the so-called “inward oriented” or “import substitution” model: exports concentrated in the primary sector; protectionism for local

economic activities, State presence in infrastructure and intermediate goods production and, expansion of public expenditures.

External constraints, macroeconomic instability and low policy response capabilities proved to be a fertile ground for policy alternatives aimed at reverting the vicissitudes of the prevailing regime. Reforms were facilitated by the emergence, in international forums, of a new reference model, best summarised by what became known as "Washington consensus" (Williamson 1993).

Policy proposals were aimed at macroeconomic stabilisation and economic liberalisation and included: fiscal discipline, trade and financial liberalisation, increasing reliance on market mechanisms, privatisation and on the role of private sector. Table 1 shows, in detail, the evolution of structural reforms in different countries of the region.

Table 1- Evolution of structural reforms in Latin America - 1970/95

	1976-1979	**1980-1985**	**1986-1990**	**1991-1995**
ARGENTINA				
Import liberalisation	R	A	G	R
Export promotion		R	*	
Exchange liberalisation	R	A		R
Deregulation of capital account	R	A	*	R
Deregulation for FDI	R			
Deregulation of exchange rate	R			
Privatisation				R
BRAZIL				
Import liberalisation			G	R
Export promotion				*
Exchange liberalisation				R
Deregulation of capital account			G	
Deregulation for FDI				G
Deregulation of exchange rate				
Privatisation				G&P
CHILE				
Import liberalisation	R	*	*	R
Export promotion			P	
Exchange liberalisation				R
Deregulation of capital account	P			
Deregulation for FDI	R			
Deregulation of exchange rate	R			
Privatisation	R			P
MEXICO				
Import liberalisation			P	
Export promotion	R		*	
Exchange liberalisation		R		
Deregulation of capital account				R
Deregulation for FDI		R		
Deregulation of exchange rate		R		
Privatisation		G&P		R

Source: CEPAL (1996) **R**: Radical reform - **G**: Gradual reform - **A**: Reversion of process - **P**: Partial reform - * : Suspension

At least in terms of ownership regulations, the Latin American context is not different from international trends. Table 2 indicates that since 1991, a FDI-friendly trend has consistently increased. The number of countries that introduced changes in their investment regimes has increased from 35, in 1991 to 69 in 2000. This means that, in 2000, 147 countries, all ovre the world are explicitly concerned and have adopted measures towards facilitating the entry and the operations of foreign firms on local grounds.

Table 2 - National regulatory changes, 1991/2000

Item	1991	1995	2000
N. countries that introduced changes in their investment regimes	35	64	69
Number of regulatory changes, of which:	82	112	150
more favourable to FDI	80	106	147
less favourable to FDI	02	06	03

Source: UNCTAD, World Investment Report, 2001, Geneva, 2001, Box table I.1.1

CEPAL (1996b) suggests that differences in depth, breath, and rhythm of reforms are to be explained by countries' circumstances like: economic conceptions of government technical teams, characteristics of local political systems, size of markets and the existing productive and technological basis of countries. Argentina and Chile were already experimenting a first wave of liberal reforms during the 1970s, placing them as pioneers of a process that only later acquired a concerted format. Mexico inaugurated reforms along the first half of the 1980s while in Brazil policy actions was undertaken during the 1991-95 period. During this last period most countries either entered a second wave of reforms or reinforced existing policy directions, showing a definite commitment to a regime of incentives and regulations pro economic liberalisation. From the institutional perspective of globalisation, the above evidence indicates a close approximation of the region to recommendations found in international organisations like the IMF and the World Bank or liberal policy practices of most developed countries.

In these countries, with the exception of Chile, institutional changes were preceded or introduced simultaneously with macroeconomic policies aiming at inflation control, through a combination of monetary or exchange anchors and import liberalisation. Table 3 indicates that, in this area, all countries achieved significant success.

Table 3 - Latin America: evolution of consumer price index - (December to December % variation)

	1991	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999***
Latin America	199	414	877	333,1	25,8	18,2	10,4	10,3	8,6
Argentina	84,0	17,6	7,4	3,9	1,6	0,1	0,3	0,7	-1,3
Brazil	475,8	1149,1	2489,1	929,3	22,0	9,1	4,3	2,5	3,1
Chile	18,7	12,7	12,2	8,9	8,2	6,6	6,0	4,7	3,7
Mexico	18,9	11,9	8,0	7,1	52,1	27,7	15,7	18,6	17,4

*: Estimated Source: CEPAL (1999)

The internationalization of capital

The increasing internationalization of the world economy can be seen on Table 4. Since 1982 FDI inflows have increased twenty fold, reaching, in 2000, US$ 1.2 trillions. Along these years, M&A, not greenfield investment, became the prevalent mode of expansion of foreign firms; from 75% of total FDI inflows in 1990, to 90% in 2000. This is a recent phenomenon, most probably associated with the worldwide liberalization of national economies. The specialized literature has always placed emphasis on the contribution of FDI investments to host economies; the most important being the opening up of new and modern operations. The panorama of the new millenium is inherently different from the past: foreign firms are acquiring existing assets and market power in host countries. Although and acquisition process implies organizationla changes in acquired firms, and probably some degree of modernization, the net gains for local economies are smaller, relatively to greenfield investments. At the same time, as the market power of acquiring firms is expanded, conseuqnces for the competitive environment and consumer welfare are still unclear. Meanings and implications of this process are still to be correctly understood.

Table 4 - Selected indicators of FDI and international production, 1982-2000 (US$ billions)

Item	1982	1990	2000
World FDI inflows	57	202	1,271
Cross border M&A	na	151	1,144
Sales of foreign affiliates	2,465	5,467	15,680
Employment of foreign affiliates (thousand)	17,454	23,721	45,587
Exports of foreign affliates	637	1166	3,572
Exports of goods and non-factor services (world)	2,124	4,381	7,036
Gross product of foreign affiliates	565	1,420	3,167
GDP at factor cost (world)	10,612	21,475	31,895

Source: UNCTAD, World Investment Report, 2001, Geneva, 2001, table I.1

Correspondingly, worldwide sales of foreign affiliates have increased from US$ 2.4 trillions in 1982 to US$ 15.6 trillions in 2000. Total employment has also increased, but at a slower pace: from 17 millions to 45 millions since 1982. Export of foreign affiliates show a similar trend, expanding at a higher rate the world exports. This means an increasing share of foreign affiliates in world exports: from 30% in 1982 to 51% in 2000. The net of ownership internationalization is economically very relevant: the share of foreign affiliates of transnational corportaions in world GDP has increased from 5 to 10%, between 1982 and 2000.

The internationalization of capital, by means of FDI can be further examined in terms of investment flows and their contribution to capital formation in national economies and regions. As shown in Table 5, among developed countries, between 1989 and 2000, FDI inflows and outflows have increased practically tenfold, from US$ 137 billions to US$ 1,046 billions. This means that, investments by foreign companies, in 2000, came to represent 17.0% of gross fixed capital formation of developed countries, up from 3.7% just ten years before. By all accounts,

this expansion is phenomenal, with long lasting consequences, even taking into consideration that, after 2001, the rate of expansion is apparently receding.

Table 5 - FDI outward/inward flows in millions of dollars and as a percentage of Gross Fixed Capital Formation, 1989-94, 1995, 2000

Region	1989-94		1995		2000 (% GFCF 1999 data)	
	Inflows	Outflows	Inflows	Outflows	Inflows	Outflows
DCs ($)	**137,124**	**203,231**	**203,462**	**305,847**	**1,005,178**	**1,046,335**
% GFCF	**3.7**	**5.5**	**4.4**	**6.7**	**17.0**	**19.4**
USA ($)	42,535	49,024	58,772	92,074	281,115	139,257
% GFCF	4.8	5.4	5.3	8.3	17.9	8.6
UK	19,236	24,249	24,435	43,562	130,428	249,794
% GFCF	10.7	14.0	10.9	23.7	32.5	80.6
Japan	969	29,576	39	22,508	8,187	32,886
% GFCF	-	2.9	-	1.5	1.1	1.9
Developing	**59,578**	**24,925**	**113,338**	**48,987**	**240,167**	**99,546**
% GFCF	**5.2**	**2.4**	**7.7**	**3.3**	**13.8**	**3.3**
Lamerica	**17,506**	**3,698**	**32,311**	**7,306**	**86,172**	**13,442**
% GFCF	**6.2**	**1.0**	**9.6**	**1.2**	**27.3**	**3.1**
Argentina	2,694	482	5,609	1,498	11,152	912
% GFCF	8.6	1.1	12.1	3.2	47.7	2.5
Brazil	1,498	595	5,475	1,163	33,547	2,984
% GFCF	1.7	0.7	3.8	0.8	31.3	1.4
Mexico	6,571	349	9,526	- 263	13,162	1,600
% GFCF	10.1	0.5	20.6	-0.6	11.7	1.2
Asia	**37,659**	**20,335**	**75,293**	**41,149**	**143,479**	**85,204**
% GFCF	**4.9**	**3.0**	**7.2**	**4.1**	**9.6**	**3.5**
China	13,951	2,154	35,849	2,000	40,772	2,324
% GFCF	7.9	1.3	14.7	0.8	11.3	-
H. Kong	4,164	9,236	6,213	25,000	64,448	63,036
% GFCF	14.8	30.2	14.6	58.7	60.2	47.4
Korea	869	1,350	1,776	3,552	10,186	3,697
% GFCF	0.8	1.2	1.0	2.0	9.3	2.2
Malaysia	3,964	681	5,816	2,488	5,542	2,919
% GFCF	19.4	2.8	15.0	6.4	20.1	9.3

Source: Compiled from UNCTAD, World Investment Report, 2001, Geneva, 2001, Annex tables B.1., B.2., B5

Among developed countries there are different patterns; besides being the world leader in FDI, with 20 to 25% of total share, the USA showed a balanced pattern between in and ouflows. In 2000, though the capacity to attract investments was higher than the willingnesss to invest abroad. This changing pattern is due to the recent investment boom occurring in that economy, particularly in information technology related activities. This is probably the reason why, in the UK, in 2000, the willingness to invest abroad was much higher than the capacity of that economy to attract FDI investment, reinforcing an established past trend of that economy. In fact, the role of the UK is similar to that of Hong Kong in Asia: as a financial center to other economies, it captures resources and channels them worldwide. The Japanese case is very peculiar and opposite of the UK's. There, not only the role of FDI in the economy is much lower than other developed countries but, most important, the willingness to invest abroad is

much higher than the capacity to attract foreign firms. However, from 1995 onwards there are important changes: outflows have stabilized while inflows have expanded.

For developing countries, as expected the volume of FDI inflows is higher than FDI ouflows; roughly a 2:1 ratio has persisted over the years. But, more recently, FDI inflows have expanded, coming to represent, in 2000, 13.8% of the region's capital formation. In that year US$ 240 billions were invested in developing regions while US$ 99 billions were invested abroad by residents of these regions. It is important to remark that out of these, US$ 63 billions are investments originated only from Hong Kong.

Latin America takes up a third of FDI inflows to developing regions, amounting, in 2000, to US$ 86 billions. This means that, in that year, 27.3% of the region's capital formation came from foreign companies while only 3.3% of the region's GFCF, or US$ 13 billions went abroad. Capital inflows to the region increased in particular because of the role of Brazil; while in 1989/94 the country attracted only US$ 1.5 billions, in average, in 2000, inflows amounted to US $ 33 billions. As it will be shown ahead, in further detail, this sharp increase is associated with the return of price stabilization, economic liberalization and, most important, to privatization. The interesting case in Latin America is that of Mexico; there FDI is relatively less important to capital formation (11.7% in 2000) despite the country's integration with the USA and Canada.

In Asia FDI has increased from an annual average of US$ 37 billions between 1989 and 1994 to US$ 143 billions in 2000. China and Hong Kong take up most of the resources: US$ 40 billions and US$ 64 billions respectively. FDI has increased substantially in Korea: from US$ 869 millions in average, between 1989 and 1994 to US$ 10 billions in 2000. The pattern in Malaysia has not changed significantly over the years; it attracts between US$ 4 and US$ 5 billions of FDI annually. As said above, the differing pattern is that of Hong Kong. In fact the region is the financial power house of China and, perhaps, other economies of the region.

As mentioned above, the new feature of the recent FDI upsurge is the increasing importance of M&A as the mode through which firms are investing abroad. Table 6 shows that the size of these operations are, in some cases, even greater than the amount of FDI inflows or outflows. In developed countries the ratio of asset acquisiton to FDI outflows has increased from 56.1% to 104.6%, between 1995 and 2000. In developing regions, where capital inflows are more important, the absolute size and relative importance of inward M&A is relatively lower than in developed regions but it has increased from 14.1% of total inflows to 29%. In Latin America this trend is even more pronounced; the ratio of M&A to FDI inflows increased from 26.7% to 52.5%. The exception is Brazil, because of the FDI upsurge in 2000. In Asia, however, although the trend is similar, the importance of M&A is lower, reaching, in 2000, 15.5% of total FDI inflows. As mentioned above, the consequences of this mode of capital internationalization are still to be adequately understood.

Table 6 - M&A and M&A to FDI ratio (US$ millions and percentage)

Region	1995		2000	
	% asset sales to inward FDI	% of asset acquisition to outward FDI	% asset sales to inward FDI	% of asset acquisition to outward FDI
DCs	80.9	56.1	105.2	104.6
Developing	14.1	26.1	29.0	42.3
LAmerica	26.7	54.1	52.5	138.5
Argentina	33.3	132.4	47.3	74.0
Brazil	31.4	170.6	15.7	22.6
Mexico	7.5	-	30.1	264.4
Asia	9.2	21.3	15.5	29.9

Source: Compiled from UNCTAD, World Investment Report, 2001, Geneva, 2001, Annex tables B.1., B.2., B5, B.7, B.8

The result of this recent expansion of internationalization is given in Table 7. When the FDI stock data is taken into account, differences among regions and countries come out more clearly. For developed countries internationalization is a dual carriageway, with prevalence of outward stocks over inward stocks, especially in the case of the UK. Presently the US shows a relatively balanced position, thanks to an increasing importance of inward investments. Japan is a case of relatively low levels of assset internationalization on both directions.

Table 7 - FDI outward/inward stock, 1980, 1990, 2000, selected countries and regions

Region	1980		1990		2000	
	Inward stock	Outward stock	Inward stock	Outward stock	Inward stock	Outward stock
DCs ($)	**374.968**	**507,366**	**1.397.983**	**1,637265**	**4.210.294**	**5,248,522**
% GDP	**4.7**	**6,4**	**8.4**	**9.8**	**14.5**	**19.0**
USA ($)	83,046	220,178	394,911	430,521	1,238,627	1,244,654
% GDP	3.1	8.1	7.1	7.8	11.1	13.1
UK ($)	63,014	80,434	203,894	229,294	482,798	901,769
% GDP	11.7	15.0	20.8	23.4	26.8	49.8
Japan ($)	3,270	19,610	9,850	201,440	54,303	281,664
% GDP	0.3	1.9	0.3	6.8	1.0	5.7
Develg ($)	**240,837**	**16,484**	**487,694**	**79,821**	**1,979,262**	**710,305**
% GDP	**10.2**	**0.9**	**13.4**	**2.6**	**28.0**	**10.1**
LAmerica $)	**49,960**	**9,119**	**116,678**	**19,476**	**606,907**	**111,051**
% GDP	**6.5**	**1.3**	**10.8**	**1.8**	**25.6**	**4.9**
Argent. ($)	5,344	6,128	9,085	6,105	73,441	20,189
% GDP	6.9	8.0	6.4	4.3	22.1	6.8
Brazil ($)	17,480	652	37,143	2,397	197,652	15,089
% GDP	7.4	0.3	8.0	0.5	21.6	1.6
Mexico ($)	8,105	136	22,424	575	91,222	8,639
% GDP	3.6	-	8.5	0.2	16.4	1.5
Asia ($)	**173,347**	**6,240**	**328,232**	**47,520**	**1,261,776**	**577,602**
% GDP	**14.2**	**0.7**	**15.4**	**2.7**	**30.2**	**13.6**
China ($)	6,251	39	24,762	2,489	346,694	27,212
% GDP	3.1	-	7.0	0.7	30.9	2.5
H. Kong ($)	138,767	148	162,665	11,920	469,776	384,732
% GDP	487.0	0.5	217.5	15.9	255.5	202.8
Korea ($)	1,140	127	5,186	2,301	42,329	25,842
% GDP	1.8	0.2	2.0	0.9	7.9	5.5
Malaysia ($)	5,169	197	10,318	2,671	54,315	19,799
% GDP	21.1	0.8	24.1	6.2	65.3	22.6

Source: Compiled from UNCTAD, World Investment Report, 2001, Geneva, 2001, Annex tables B.3., B.4., B6

For developing regions, the importance of inward FDI stocks is greater than outward stocks, representing 28% of 2000 GDP. But, even among developing regions, important differences exist: Latin America plays more of a host role than Asia. In the former, in 2000, inward stocks represented 25.6% of regional GDP while 4.9% of their assets were held elsewhere. Differences among the main countries in the region are not significant. In Asia, although the recipient position is higher than the investor one (30.2% and 13.6% respectively), since 1980, the trend has been towards an increasing willingness of local firms to own assets elsewhere. Again, the explanation of this Asian pattern is to be found in the role Hong Kong has played in channelling increasing investments funds to the region, especially to China.

In short, this paper illustrates a relatively well known economic fact. As shown in Table 8, developed countries do concentrate power over international transactions, being responsible for

the majority of FDI inflows and outflows, exports, imports and technology payments. Developing countries perfom better on exports and imports (27.5% and 26.2% of total) and as recipient of FDI (21.4% of inflows and 31.3% of FDI stock). Latin America's share is higher on these last two items while the Asian region performs better on exports and imports. Central and Eastern Europe are responsible for 4 % of trade transactions and around 2 % of FDI inflows. Africa is the region the less benefits from the internationalization of capital.

Table 8 - Geographical distribution of FDI flows, trade, domestic investment and technology payments, 1998-2000 (annual average, percentage)

Region	Inflows	Outflows	Exports	Imports	Investment	Tech.payment	FDI inward stock	FDI outward stock
Developed countries	76.3	92.9	68.4	69.7	74.5	85.6	66.7	87.8
Developing countries	21.4	6.8	27.5	26.2	23.3	13.1	31.3	11.9
Africa	0.8	0.1	1.6	1.5	1.4	0.8	1.5	0.3
Latin America	9.2	1.5	5.1	5.7	5.9	3.8	9.6	1.9
Asia & Pacific	11.2	5.2	20.4	18.5	15.8	0.1	20.0	9.7
Central & Eastern Europe	2.3	0.3	4.1	4.2	2.2	1.3	2.0	0.3
World	100	100	100	100	100	100	100	100

Source: UNCTAD, World Investment Report, 2001, Geneva, 2001, Table II.5

When the FDI inward stock data is disagregatted into major economic activities, some interesting general and regional trends come out. As shown in Table 9, the relative importance of major economic sectors does not change: tertiary sectors is where FDI mostly flows into, followed by secondary and primary activities. However, between between 1988 and 1999 these differences increase. By 1999 tertiary sectors had taken up 55.5% of total inward FDI stocks in developed countries, 52.2% in Latin America and 33.6% in Asia. Within tertiary activities, the financial sector is the outstanding internationalized economic activity.

Table 9 - FDI inward stock, by industry and region, 1988, 1999 (in billions of dollars and percentages)

Industry	Developed countries				Asia				Latin America			
	1988		1999		1988		1999		1988		1999	
	Value	Share	Value	Share	Value	Share	Value	Share	Value	Share	Value	Share
Total	890.5	100.0	2,520.0	100.0	65.1	100.0	796.6	100.0	50.0	100.0	193.4	100.0
Primary	91.7	10.3	144.4	5.7	8.5	13.1	28.1	3.5	4.5	9.6	23.2	12.0
Secondary	350.8	39.4	916.3	36.4	44.9	68.9	479.4	60.2	30.9	65.8	63.4	32.8
of which Chemicals	42.9	4.8	190.7	7.6	8.3	12.7	32.5	4.1	6.7	14.3	13.1	6.8
of which E.Eletr.	36.9	4.1	81.8	3.2	9.0	13.9	42.2	5.3	3.0	6.5	3.0	1.6
Tertiary	418.0	46.9	1399.3	55.5	11.1	17.1	267.5	33.6	11.5	24.6	101.0	52.2
of which Trade	128.3	14.4	322.8	12.8	1.0	1.6	32.7	4.1	2.1	4.4	12.0	6.2
of which Finance	160.0	18.0	518.8	20.6	1.7	2.6	14.0	1.8	3.1	6.7	23.8	12.3

Source: Compiled from UNCTAD, World Investment Report, 2001, Geneva, 2001, Annex table A.II.3/4

The importance of the primary sector decreases everywhere, with the exception of Latin America, where it increases from 9.6% in 1988 to 12.0% in 1999. The importance of FDI stock for manufacturing activities is greater in Asia than elsewhere; it represented 68.9% and 60.2% of total FDI stock, in 1988 and 1999 respectively. In Latin America and in developed regions, these activities took up approximately a third of total FDI stock and changes are not pronounced. Chemical and electronic related sectors are the most internationalized; investments there are expanding, although their relative share decreases, especially in Asia.

There is an interesting contrast between Asia and Latin America in terms of size and rate of growth of investments in these two sectors, between 1988 and 1999. In Asia, FDI stocks in Chemicals went up from US$ 8.3 to US$ 32.5 billions, a four fold increase; in Latin America they increase two fold, from US$ 6.7 to US$ 13.1 billions. In Electronics, as expected, relatively to Latin America, Asia is ahead, but differences are very significant. While in Asia FDI stocks increased from US$ 9 to US$ 42.2 billions, in Latin America they remained stagnant, at US$ 3 billions, between 1988 and 1999. However, when tertiary activites are taken into account, the situation is reverse: FDI stocks are larger in Latin America. As mentioned above, in the world, the financial sector is the leading internationalized economic activity. For this sector, in 1999, FDI stocks in developed countries amounted to US$ 518 billions, up from US$ 160 billions in 1988. In Latin America expansion is even greater; from US$ 3.1 to US$ 23.8 billions. In Asia there is also a sharp increase –from US$ 1.7 to US $ 14.0 billions, but the relative importance of FDI stocks is lower, around 2% of total stocks.

For Latin America, Table 10 provides further detail on the general picture given above. When the 500 largest firms of the region are taken into account, in terms of number, the relative share of firms belonging to the service sector increases from 34.4% in 1990-92 to 42.2% in 1998-2000, thanks, to a large extent, to a decrease in the number of firms belonging to manufacturing industry. But, in economic terms, the picture is slightly different; the relative importance of firms from the primary sector decreased along the years although they remained

responsible for 22% of sales in 1998-2000. The contribution of firms from manufacturing remained above 40% and those from the tertiary sector increased their relative importance from 30 to 37.5%. Along the years, firms from primary sector increased sales by 50%, those from manufacturing by 80% while those belonging to the service sector expanded sales from US$ 107 billions to US$ 258 billions.

Table 10 - The largest 500 Latin American companies, 1990-2000, by sector of origin (number, sales in million dollars and percentages)

	1990-1992		1994-96		1998-2000	
	Value	%	Value	%	Value	%
Number	500	100.0	500	100.0	500	100.0
Primary	50	10.0	46	9.2	51	10.0
Manufacturing	278	55.6	264	52.8	239	47.8
Service	172	34.4	190	38.0	211	42.2
Sales	361.0	100.0	601.8	100.0	686.8	100.0
Primary	100.1	27.7	143.5	23.9	150.8	22.0
Manufacturing	153.0	42.4	259.9	43.2	277.9	40.5
Service	107.9	29.9	198.3	33.0	258.1	37.5

Source: CEPAL, La inversión estranjera en América Latina y el Caribe, Santiago, 2001, Cuadro I-A.4

Ownership change in Latin America

The 1990s was a period when Argentina, Brazil, Chile and Mexico liberalized their national regimes of incentives and regulation. Over the course of the decade, as microeconomic liberalization – including privatization- accompanied macroeconomic stabilization, confidence levels increased and, following international trends, there was a marked acceleration of capital inflows into the region, leading to significant ownership reestructuring and changes in corporate control. Inward internationalization – a historical feature of the region- has been made even more pronounced.

Table 11 informs the size of the privatization process in the largest Latin American countries, between 1990 and 1999. To a great extent privatization programs are associated with the size of these economies; in Brazil, the largest country, privatizations in the 1990s amounted to US$ 61 billions while in Argentina and Mexico it reached US$ 23 billions. The smaller amount in Chile is probably due to the fact that privatizations there occurred earlier on.

Table 11 - Privatizations in Latin America 1990-1999 in numbers and millions of dollars

Country	Number of Transactions	Number of transactions with declared values	Total value of transactions (US$ million)
Argentina	98	95	23,385
Brazil	113	113	61,568
Chile	17	15	2,070
Mexico	101	96	22,837
Total	329	319	109,860

Source: IE-UFRJ Latin America M&A and Privatization Database

M&A operations were economically more significant, amounting to US$ 217 billions, during the 1990s. In fact the economic importance of M&A transactions is much higher as not all transactions recorded in Table 12 registered information on values.

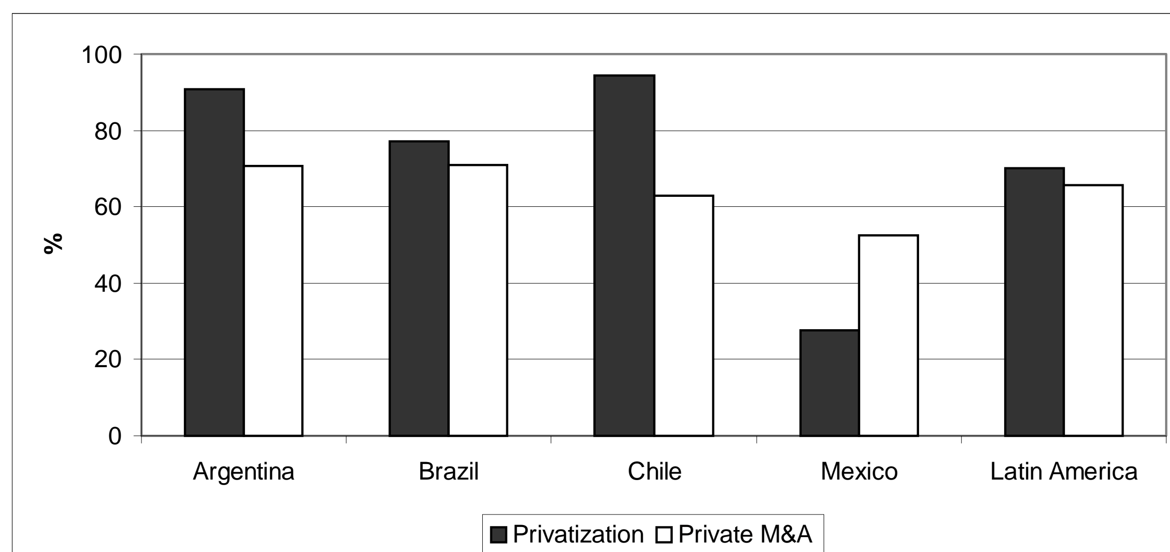
Table 12 - M&A in LA - 1990-1999 in numbers and millions of dollars

Country	Number of Transactions	Value of Transactions
Argentina	939	72.224
Brazil	1055	67.892
Chile	366	25.832
Mexico	725	52.037
Total	3085	217.987

Source: IE-UFRJ Latin America M&A and Privatization Database

Graph 1 below confirms and gives and idea of the internationalization of ownership in Latin America. During the 1990s, in Argentina, Brazil and Chile foreign capital had a dominant presence in privatizations and M&A transactions. The exception is Mexico, where the role of local capital was dominant.

Graph 1 - FDI in privatizations and M&A, percentage over value of transactions, 1990-99, by target country



Source: IE-UFRJ Latin America M&A and Privatization Database

Table 13 allows for a further understanding of the internationalization process in Latin America. Among the elite of Latin American firms, along the years, it is possible to observe a decrease in the relative importance of state owned companies, stability of local companies and an important expansion of foreign owned firms. When sales and number of firms are contrasted the data is even richer: the economic importance of foreign firms is even more pronounced, as sales expanded from US% 99 bllions in 1990-1992 to US$ 285 billions in 1998-2000; locallly owned firms expanded sales by approximately 80% but their relative importance remained practically unchanged. State owned firms, however, while decreasing in relative importance in numbers (from 17.4 to 7.6%) remained economically more important. Their combined sales represented 33.2% of the group in 1990-1992 and 20.6% in 1998-2000. This figures indicate that the relative size of locally owned firms is not as high as the other two groups.

Table 13 - The ownership of the largest 500 Latin American companies, 1990-2000 (number, sales in million dollars and percentages)

	1990-1992		1994-96		1998-2000	
	Value	%	Value	%	Value	%
Number	500	100.0	500	100.0	500	100.0
Foreign	149	29.8	156	31.2	231	46.2
Local	264	52.8	280	56.0	231	46.2
State	87	17.4	64	12.8	38	7.6
Sales	361.009	100.0	601.794	100.0	686.776	100.0
Foreign	99.028	27.4	193.335	32.1	285.627	41.6
Local	142.250	39.4	246.700	41.0	259.784	37.8
State	119.731	33.2	161.759	26.9	141.365	20.6

Source: CEPAL, La inversión estranjera en América Latina y el Caribe, 2001., Cuadro I-A.4

In this sense, Latin American is substantially different from developing countries in other regions, especially Asia. Although large diversified local groups are prominent in Latin America, they have not been able to block inward internationalization. On the contrary, by and large, emerging opportunities were exploited by foreign companies.

Table 14 provides evidence on the process of ownership change in Chemical Industries. The most interesting feature is the changing pattern of establishing business alliances, from joint ventures in the years preceding economic liberalization to asset acquisition afterwards.

Table 14 – The role of M&A and Joint Ventures in Chemical industries in the Mercosul

	1985/90		1991/99	
	M&A	Joint Ventures	M&A	Joint Ventures
n. of operations	121	107	462	116
%	53	47	80	20

Source: Sá, Luís Guilherme, Fusões e Aquisições na Indústria Química do Mercosul: Impacto das Desregulamentações e Estratégia de Crescimento, PHD thesis, UFRJ, 2002

Most important though, when the origin of partners are taken into account in M&A operations in Chemical industries in Argentina and Brazil (Table 15), it is possible to observe that transactions among foreign companies prevail. Taking into account the context of regional economic liberalization on one hand and the active process of international M&A on the other, ownership changes in Latin America are, to a certain extent, a reflex process of that occurring elsewhere.

Table 15 - Participants in M&A in Chemical industries, by ownership (1985-1999)

Country	Local/Local	Foreign/foreign	Local/Foreign	Number of M&As
Brazil	30 %	57 %	13 %	346
Argentina	40%	60 %	0 %	107

Source: Sá, Luís Guilherme, Fusões e Aquisições na Indústria Química do Mercosul: Impacto das Desregulamentações e Estratégia de Crescimento, PHD thesis, UFRJ, 2002

The nature of investment by foreign firms

During the 1990s, direct investment aimed at privatization and mergers and acquisitions was instrumental to reorganize public finances and to finance national current accounts. From a macroeconomic perspective, their contribution was quite relevant. But most privatization and M&A were carried out in non-tradeable sectors, with new actors buying positions into local markets. Given the extension of internationalization, an open macroeconomic issue for the future is the extent to which financial remittances to home bases are likely to affect national current accounts. To a great extent this depends on the nature of investments carried out by firms. The higher the commitment, the more likely they will be to remain in the country, regardless conjuncture disturbances.

In the region, the wave of ownership change is receding, following the international trend, constituting the end of a phase and the beginning of a new one, of long duration and important implications for economic development and public policy. It signifies the implementation of productive and technological strategies by new actors in specific markets. It implies introducing and experimenting different management practices at all levels, which is a company specific phenomenon, not open for great generalization in terms of sectors and national origin, not to mention trends and outcomes.

What is certain, though, is the increasing co-existence, in the region, of firms from diverse origins. The process of inward internationalization was already a feature of the Latin American region; it was reinforced during the last decade and will remain relevant in the future to come.

Whether these new actors are willing to consolidate and further expand their presence in the region, through new investment and implementation of pro-competitive strategies, based on innovation and quality job creation remains to be seen. What are the likely consequences of inward internationalization and ownership change? Will the region observe a (positive) local reproduction of international patterns of competition? Are firms likely to concentrate operations in specific regions/clusters? Will firms reinvest or remit profits? Will foreign firms carry out technology related investment?

Although only time will reveal the nature of investments to be carried out, after this wide raging process of ownership change, it is possible to speculate on the difficulties the region will be facing on the basis of the prelimary data presented below.

In terms of the nature of economic activities, Table 16 indicates that Japanese firms have different strategies according to host countries. In the USA decision-making activities are balanced with other functional activities of corporations and there is a particular emphasis in operating R&D and design centres in that country. Mexico is clearly a production base from which to penetrate the North American market and the importance of R&D activities is lower. The Brazilian pattern is slightly different from the Mexican pattern: the ratio of decision making offices to final production sites is higher, as well as the number of R&D centres. Taking into account that in Argentina and Chile the emphasis is basically on sales activities, this evidence may suggests that Brazil plays a role as a decision making/design centre for the South American region.

Table 16 - Corporate networks of Japanese affiliates in selected American countries, 1999

Country	Regional headquarters and managerial offices	Sales offices	Final production sites	Parts an materials production	R&D and design centres
USA	897	877	887	446	580
Argentina	18	33	29	1	-
Brazil	53	94	77	10	40
Chile	1	8	1	-	-
Mexico	57	138	136	62	26

Source: UNCTAD, World Investment Report, 2001, Geneva, 2001, Table II.7

Table 17 provides further information upon which discussions on these subjects may be taken up.

Table 17 - Sales, Investment and R&D: US MNCs and affiliates in 1999 (US$ billion)

	Sales	Investment	Inv/sales	R&D	R&D/sales
US parents	5,709.5	357.8	6.3	123.5	2.2
All Affiliates	2,195.3	113.4	5.2	18.4	0.8
Europe	1,201.5	53.9	4.5	12.4	1.0
UK	340.2	20.4	1.7	4.1	1.2
Japan	125.1	4.0	3.2	1.6	1.3
Latin America	245.6	18.6	7.6	0.6	0.2
Brazil	55.2	3.7	6.7	0.3	0.5
Asia	425.4	20.9	4.9	3.3	0.8

Source: Survey of Current Business, Operations of US MNCs companies – Preliminar results from the 1999 Benchmark survey, R. Mataloni Jr. & D. Yorgason

The evidence is quite straightfoward and expected. Firstly, US parents concentrate value at home: the sales ratio of afilliates to parents is 38.5%, the investment ratio is 31.7% and the R&D ratio is 14.9%. The higher the strategic value of operations, the more likely firms are to implement them from home grounds. Secondly, other developed regions are the favourite destination of operations but, even there, R&D efforts are comparatively lower: while US parents spend 2.2% of sales in technological activities at home, in Europe these expenditures reach only 1.0%, in the UK 21.2% and in Japan 1.3%. Thirdly, developing regions are considered as markets to be supplied from the home base, as far as strategic inputs are concerned. R&D to sales ratio in Latin America is 0.2% and, in Asia, 0.8%.

Policy challenges

In Latin American, after decades of inward-oriented industrialization, the 1982 debt crisis and a long process of uncontrolled inflation, most countries went through structural and institutional reforms, oriented towards inflation control, liberalization, deregulation and privatization. But, even after such radical turnaround, sustained growth has not been attained in most countries.

Structural and macroeconomic associated instability is a regularity in the region. Nature, direction and duration of economic and institutional instability define levels of uncertainty and confidence prevailing among economic agents, thus affecting their willlingness to invest in

exploring new business opportunities, in new plants, in innovation.

Structural change produces uncertainty and the need for adaptation; however, adaptive capabilities of agents and organizations differ; the recent evolution of Latin America has shown that this is a process generating winners and losers; more interestingly though, the recent process of change, since the Asian financial crisis, has not induced modifications in the relative position among different actors, organizations or countries; those that were relatively stronger in the period pre-crisis have shown better adaptive capacity and vice-versa.

Given that (1) these economies are now even more internationalized than before; (2) that this is a long term and permanent feature and, (3) that history tell us that local innovation capabilities are a necessary condition for sustained economic and social development, Latin American policy makers are facing challenges associated with how to attract investments that are likely to induce the creation of long lasting value to firms and their related environment. To a great extent, this will mean an important departure from established policies practices to new ways of regulating and inducing firms towards value creation. Especially for public agencies, periods of intense transformation contribute to the disorganization of the cognitive systems of individuals and institutions until the diffusion of a new set of heuristics – including methods of detecting, controlling and solving problems- take place.

Policy wise, the challenges Latin American countries are facing is how to promote a national regime of incentives and regulations inducive to activities that generate qualifying jobs, in a context of open economies and ownership internationalization. Qualifying jobs mean the continuous creation of work opportunities that have the capacity to enhance the skill base of the labour force, thus potentially expanding the welfare of the population.

Given the higher degree of freedom of private decision making in the process of resource allocation and the increasing power of international corporation in different markets, from the regulatory perspective, it is necessary to build up policy making capabilities, through regulatory agencies, that are oriented towards facilitating investment and restraining anti-competitive market structures and behaviour. From the incentive perspective, the challenge is to promote national <u>attractiveness for innovation</u>. The propostion for discussion is to develop agencies and instruments oriented towards a double movement of <u>pincers</u> and <u>focus</u>.

The <u>pincer strategy</u> involves long term commitment to increase investments, aiming at, on side, company efforts towards modernization and, on the other, expanding the local S&T infrastructure. The <u>focus strategy</u> is associated with identifying and actively supporting those few companies/research institutes that implement an innovation based competitive strategy.

Sustained increases in S&T financial resources, aimed at these goals will increase the chances that, in the future a specific region/country may attract economic agents (especially foreign firms/research institutes) to internalize technology related activities. Taking Brazil as an example, if the country is to reach 2.5% of S&T expenditures in 2010, Table 18 below provides an idea of the extent of the necessary efforts.

Table 18 - Necessary efforts to advance

Year	GDP in Real billion of 1999	S&T expenditure in Real billion of 1999	S&T expenditure as % of GDP	Projected rate of annual increase (%)
1999	961	11,5	1,20	13,3
2000	999	12,0	1,20	
2001	1.039	13,8	1,33	
2002	1.081	15,9	1,47	
2003	1.124	18,3	1,63	
2004	1.169	21,1	1,81	
2005	**1.216**	**24,3**	**2,00**	8,8
2006	1.264	26,4	2,09	
2007	1.315	28,8	2,19	
2008	1.368	31,3	2,29	
2009	1.422	34,0	2,39	
2010	**1.479**	**37,0**	**2,50**	

Source: own ellaboration

Regardless the extent of success in the above areas, a permanent challenge is to root innovation as one of the strategic and praised beliefs entrenched in any society. All economic, social and political actors must be convinced and have faith; must convince and convert others that S&T is beneficial to social and economic development. For that end, private and public policy makers must engage, with tenacity, in permanent mobilization aiming at objective and ambitious goals. But, beware: we all will be swimming against the current!

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