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Any comments or suggestions regarding this publication should be addressed to Michael Mortimore (email: michael.mortimore@cepal.org).

CONTENTS

Tables, figures, boxes and maps

Acronyms and abbreviations

CAD	computer-aided design
CAFTA-DR	The Dominican Republic - Central America - United States Free Trade Agreement
CARICOM	Caribbean Community
CDMA	code division multiple access
CDP	colour display panel
CD-ROM	compact disk read-only memory
CD-RW	compact disc re-writable
CDT	colour display tube
CIS	Commonwealth of Independent States
CIS	CMOS image sensor
CMOS	complementary metal oxide semiconductor
CPT	colour picture tube
CPU	central processing unit
CRT	cathode ray tube
CRT-PJ	cathode ray tube projector
DDI	display driver integrated circuit
DLP	digital light processing
DRAM	dynamic random access memory
DVDP	digital versatile disc player
DVD-ROM	digital versatile disc read-only memory
DVD-W	digital versatile disc writer
GSM	global system for mobile communications
HDD	hard disk drive
HHP	hand-held product
HSDPA	high-speed downlink packet access
IC	integrated circuit
ICSID	International Centre for Settlement of Investment Disputes
ICT	information and communications technologies
IDB	Inter-American Development Bank
IMF	International Monetary Fund
ISDB	Integrated Services Digital Broadcasting
LCD	liquid crystal display
LNG	liquefied natural gas
LSI	large scale integration
MERCOSUR	Southern Common Market
MFP	multifunction printer
MIGA	Multilateral Investment Guarantee Agency
MP3	MPEG-1 Audio Layer 3
NAFTA	North American Free Trade Agreement
NAND	“not and” operation
ODD	optical disk drive
OECD	Organisation for Economic Co-operation and Development
OFDI	outward foreign direct investment
PC	personal computer
PDA	personal digital assistant
PDP	plasma display panel
PTO	public tender offer
SMEs	small and medium-sized enterprises
SoC	system-on-a-chip
SRAM	static random access memory
TD-SCDMA	time division-synchronous code division multiple access
TFT-LCD	thin film transistor liquid crystal display
U-health	ubiquitous healthcare
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

ABSTRACT

In 2006, foreign direct investment (FDI) inflows to Latin America and the Caribbean (excluding the main financial centres) continued their upward trend, reaching over US$ 72 billion, for an increase of 1.5% over 2005. At the same, however, the region's share of global FDI inflows declined, as flows increased more rapidly in other parts of the world.

The situation with respect to FDI outflows in 2006 was quite different, as outward FDI (OFDI) from Latin American and Caribbean countries jumped by 115% to about US$ 41 billion, expanding faster than in the rest of the world.

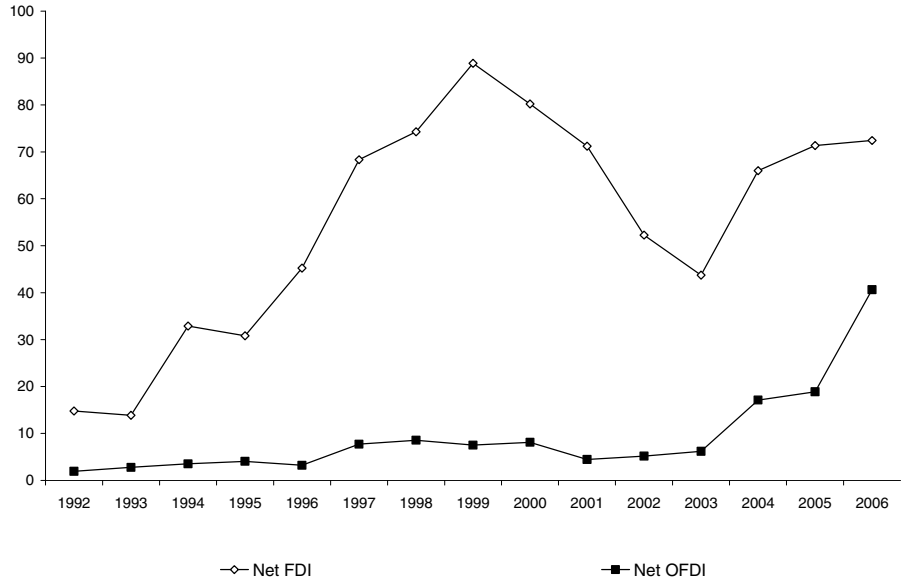
The main message of this year's report is that active and integrated FDI attraction policies linked to national development strategies are necessary to secure quality FDI. These are lessons drawn from policy practices in the more successful European and Asian countries, which contrast with the more passive and disconnected FDI attraction policies evident in Latin America and the Caribbean.

The 2006 report also contains chapters that analyse the experiences of two relatively small investor countries in Latin America and the Caribbean: the Republic of Korea and Portugal. In the first case, it was found that one of the reasons why the region plays a fairly minor role as a destination for OFDI from the Republic of Korea is that its FDI attraction policies have not been effective in attracting and upgrading dynamic FDI in the electronics, automotive and apparel sectors. In the second case, passive policies proved sufficient to attract significant FDI in services from Portugal to Brazil, but only for a limited period of time.

SUMMARY AND CONCLUSIONS

Inward foreign direct investment (FDI) to Latin America and the Caribbean (excluding the main financial centres) reached US$ 72.4 billion in 2006, up from US$ 71.4 billion in 2005 and US$ 66 billion in 2004. This appears to indicate that the region is on the road to regaining a stable position in terms of inward FDI flows, following a substantial fall at the beginning of this decade (see figure 1). Another positive aspect is the very significant rise of outward FDI (OFDI) from Latin America and the Caribbean (excluding the main financial centres), which demonstrates that companies from the region are internationalizing at a much faster rate than in the past. Trans-Latins, that is, emerging transnational corporations (TNCs) from the region, are the principal source of such outflows. These two indicators suggest that the region is adapting to the globalization process by becoming a more active participant in it.

Figure 1
LATIN AMERICA AND THE CARIBBEAN: FDI AND OFDI FLOWS (EXCLUDING FINANCIAL CENTRES), 1992-2006 [a b]
(*Billions of dollars*)



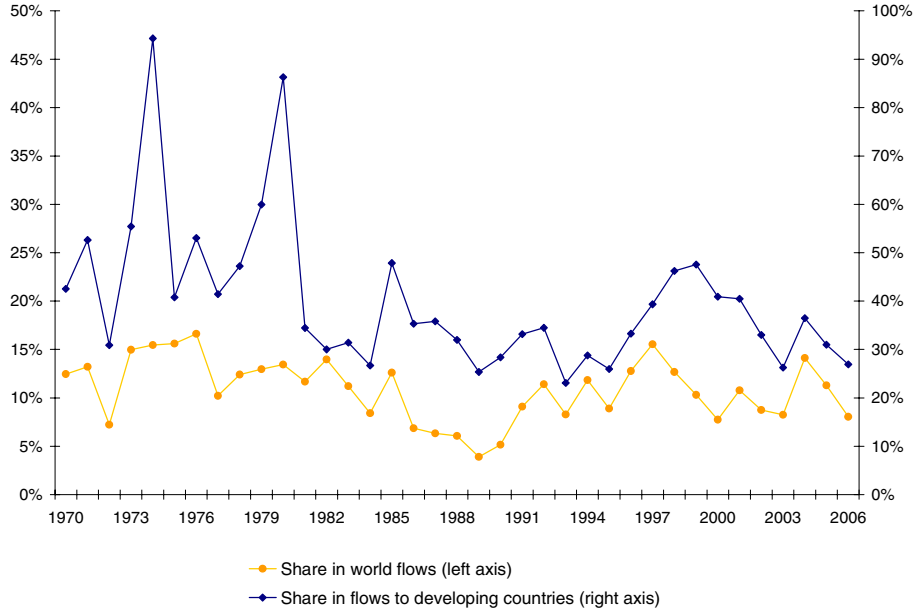
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures as at 24 April 2007.

[a] The FDI figures indicate inflows of foreign direct investment, discounting capital transfers made by foreign investors. The OFDI figures indicate outflows of investment by residents, discounting capital transfers made by those investors. The FDI figures do not include the flows received by the main financial centres. The OFDI figures do not include the flows originating in these financial centres.

[b] These figures are different from those contained in the editions of *Economic Survey of Latin America and the Caribbean* and the *Preliminary Overview of the Economies of Latin America and the Caribbean* published in July and December 2006, respectively, as they show the net balance of foreign investment, that is, direct investment in the reporting economy less outward foreign direct investment.

In spite of this achievement, the Latin American and Caribbean region's share of global inward FDI flows not only failed to increase but actually fell to 8% in 2006.[1] These figures reflect the fact that, while FDI to the region was stable, global FDI flows rose by an estimated 34%. Historically, the Latin American and Caribbean region has received a larger share of global FDI inflows than it is now. During the 1970s, when global inflows were much smaller, the region's share reached 17% before declining sharply in the aftermath of the debt crisis of the late 1980s (see figure 2). The region again became the recipient of a significant portion of global inflows during the FDI boom of the 1990s, with its share peaking at 16% in 1997 in the context of widespread privatization and deregulation programmes. During more recent years, the region's share averaged around 11%, before dropping to 8% in 2006. Its share of developing-country FDI inflows was also considerably larger in the 1970s (40%-50%), but by 2006 had fallen to approximately one-half its former level (see figure 2). Insofar as this decline reflects a cooling of transnational corporations' interest in the region or the region's inability to compete effectively for FDI, it poses a stark challenge to policymakers.

Figure 2
LATIN AMERICA AND THE CARIBBEAN: SHARE OF NET FDI INCOME, 1970-2006
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Conference on Trade and Development (UNCTAD), *World Investment Report, 2006. FDI from Developing and Transition Economies: Implications for Development* (UNCTAD/WIR/2006), Geneva, 2006, United Nations publication, Sales No. E.06.II.D.11; "Foreign direct investment rose by 34% in 2006" (UNCTAD/PRESS/PR/2007/001), press release, 9 January 2007; and International Monetary Fund, World Economic Outlook Database, April 2007.

[1] The figures presented in this paragraph include financial centres in order to ensure comparability with data for other regions. The trends identified in the text apply, however, to FDI received by Latin America and the Caribbean, excluding the main financial centres, which is the focus of this report.

These two possible explanations for the decline are also reflected in other indicators:

- The stagnant or shrinking share of FDI inflows from the principal traditional sources, such as the United States or Europe;

- The lack of dynamism exhibited by relatively new non-traditional sources of FDI, such as the Republic of Korea (see chapter 3) and Portugal (see chapter 4). In fact, the former has not yet reached its potential and the latter is on the decline;

- Transnational corporations' decreasing share in the sales of the region's top 500 companies;

- The increase in the number of TNCs that have decided to withdraw from the region or to significantly reduce their presence in major sectors such as telecoms (France Telecom, Verizon, BellSouth, AT&T, TIM), electricity (EDF, PPL), water (Suez), retail trade (Royal Ahold, Sonae), banking (Bank of America) and natural resources (Royal Dutch Shell, ENI, Total);

- Generally, the limited ability of Latin America and the Caribbean to attract and upgrade "quality" FDI projects. Examples of such projects include those that form part of integrated international production systems or involve research and development activities, introduce new production activities to their host economies and play a critical role in their industrial and technological upgrading.

One major concern is that the increasing level of conflict associated with the development of natural resources —be it a result of new petroleum and natural gas contracts that reduce foreign investors' control over their operations, increases in royalties or taxes applied to petroleum, gas and mining concessions, and/or environmental and social issues— could hurt FDI inflows. Another concern is the relative ineffectiveness of the formal international arbitration procedures provided for under bilateral investment treaties or free trade agreements in resolving existing investment disputes between foreign investors and some national governments.

Considering the important role that inward FDI can play in contributing to national development, these indicators suggest that now is an appropriate time to evaluate the nature of inward FDI in the region, to consider how to close the gap between the region's FDI policies and results and those of the more successful recipient countries, and to look for ways of promoting and consolidating FDI from non-traditional investors. This is the objective of this year's report.

A. OVERVIEW OF FDI IN LATIN AMERICA AND THE CARIBBEAN

The analysis conducted by ECLAC combines two data series to examine the nature of FDI and the presence of TNCs in the region. The first consists of balance-of-payments information on FDI inflows and outflows; the second series relies on information on the operations and transactions of individual companies. The combination of these two series permits a more comprehensive analysis of FDI in Latin America and the Caribbean.

Table 1 depicts the situation with regard to inward FDI during 1992-2006. The region was able to triple its average annual inflows from US$ 27.5 billion to US$ 76.9 billion between 1992-1996 and 1997-2001 before seeing them fall to US$ 60.0 billion during 2002-2006. As mentioned, during the last three years, the Latin American and Caribbean region has progressively increased the absolute value of inward FDI from US$ 65.5 billion to US$ 72.44 billion, although its share of global and developing-country FDI inflows has shrunk. FDI to the region, measured as a percentage of GDP, has also decreased, falling from 4% in 2004 to 3% in 2006, in contrast to increasing FDI/GDP ratios in other developing regions.

Mexico more than doubled its average annual FDI inflows, which jumped from US$ 8.7 billion in 1992-1996 to US$ 17.1 billion in 1997-2001, and has been able to improve its performance even further since then, with average annual inflows reaching over US$ 19 billion during 2002-2006. Central America and Panama more than tripled their average annual FDI inflows to US$ 2.5 billion over the same two periods and then succeeded in boosting them to US$ 3 billion in 2002-2006 and to over US$ 5 billion in 2006. Preliminary numbers for the Caribbean indicate sustained growth in FDI to the subregion. The South American countries received the lion's share of FDI inflows, tripling their inflows from an annual average of US$ 17 billion to US$ 54.3 billion between 1992-1996 and 1997-2001, although they declined to US$ 35.6 billion thereafter. This subregion saw a significant upswing for both 2005 and 2006 that brought inflows up to approximately US$ 44 billion. Brazil (US$ 18.8 billion), Chile (US$ 8.0 billion), Colombia (US$ 6.1 billion) and Argentina (US$ 4.5 billion) were the principal recipients in South America in 2006.

Table 1
LATIN AMERICA AND THE CARIBBEAN: NET FDI INFLOWS, 1992-2006 [a]
(*Millions of dollars*)

	1992-1996 [b]	**1997-2001** [b]	**2002-2006** [b c]	**2005**	**2006** [c]
1. Mexico	8 723.6	17 112.6	19 114.0	19 642.7	18 939.0
2. Central America and Panama	793.3	2 500.8	2 989.3	3 226.3	5 199.7
3. Caribbean (excl. financial centres)	1 031.0	2 928.2	3 248.9	3 714.0	3 621.2
4. South America: subtotal	16 989.2	54 361.6	35 811.0	44 777.8	44 679.7
Argentina	4 683.4	10 604.6	3 640.4	5 007.9	4 809.0
Bolivia	242.8	896.8	185.4	-241.6	237.1
Brazil	4 496.8	27 075.1	15 745.9	15 067.0	18 782.0
Chile	2 464.8	5 544.0	5 808.6	6 959.6	8 053.3
Colombia	1 442.9	2 963.7	4 706.2	10 255.0	6 295.2
Ecuador	436.0	858.4	1 544.8	1 646.1	2 087.4
Paraguay	116.4	172.1	50.8	74.6	116.6
Peru	1 999.8	1 535.4	2 227.0	2 578.7	3 466.5
Uruguay	109.9	219.2	632.9	847.4	1 374.4
Venezuela (Bolivarian Rep. of)	996.4	4 492.2	1 269.0	2 583.0	-543.0
Total: Latin America and the Caribbean	**27 537.1**	**76 903.3**	**61 163.1**	**71 360.8**	**72 439.4**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures and estimates.

[a] Excludes investment received by the main financial centres. Net FDI inflows are defined as FDI inflows to the reporting economy minus capital outflows generated by foreign companies. These FDI figures differ from those published by ECLAC in the *Preliminary Overview of the Economies of Latin America and the Caribbean* because, in that study, FDI is defined as net inflows to the reporting economy minus net outflows generated by residents.

[b] Annual averages.

[c] Data were not available, as of 6 March 2007, for FDI inflows to several Central American and Caribbean countries for 2006. The estimates presented here for these two groups of countries refer to extrapolations of quarterly data, official estimates and, when neither was available, annual averages for 2001-2005.

Viewed from the perspective of the corporate strategies driving this inward FDI, there are important differences among the subregions of Latin America and the Caribbean in respect of the kinds of inward FDI that they attracted. *Natural-resource-seeking inward FDI* goes where the resources are and where there is access to them, which historically has been Bolivarian Republic of Venezuela, Trinidad and Tobago, Argentina and the Andean countries in the case of petroleum and natural gas, and Chile, Argentina and Peru in the case of minerals. Other factors that favour inward FDI include the continued high international prices of many natural resources, the quality of the deposits and improved access to them (Colombia). Factors that work against it include the lack of clarity regarding contracts (Argentina), regulatory changes that increase the level of State ownership in the petroleum sector (Bolivarian Republic of Venezuela, Bolivia) and raise royalties in mining (Chile and, to a lesser extent, Peru), and environmental and social issues in the mining sector (Ecuador, Chile). The new and more forceful demands for increased national benefits from the extraction and export of non-renewable resources being expressed in the region are an additional consideration.

Market-seeking inward FDI has gone primarily to the larger markets in the region, such as Brazil and Mexico. Chile has also been a major recipient of this type of investment. In the goods sector, market-seeking FDI has been concentrated in the automotive, food products, beverages, tobacco and chemical industries, while in services the focus has been on financial services, telecommunications, retail trade, electricity and natural gas distribution. Both the continued macroeconomic stability in these markets and their growth potential have helped attract this sort of inward FDI, while other factors, such as the appreciation of national currencies, regulatory changes in basic services and higher growth rates in other markets outside the region (China, India, etc.) have done the opposite.

Efficiency-seeking inward FDI aimed at establishing export platforms (mainly for the North American market) has been directed primarily to Mexico in the electronics, automotive and apparel industries and to the Caribbean Basin for apparel and some light electronics. Factors conducive to higher levels of inward FDI include the continued restructuring of these industries in the United States and opportunities associated with free trade agreements with the United States, particularly NAFTA and CAFTA-DR. Factors that may dissuade investors from boosting inward FDI include increasing competition from China and other Asian countries and the upcoming discontinuation of fiscal incentives or subsidies for export processing zones under World Trade Organization rules.

The region's levels of *strategic asset-seeking inward FDI*, which is usually associated with research and development activities, are negligible.

Mexico and the Caribbean Basin are typically recipients of efficiency-seeking FDI, mainly from United States TNCs in the motor vehicle, electronics and apparel industries, while South America receives more market-seeking FDI, primarily from European TNCs in a few major manufacturing industries (motor vehicles, food products, beverages and tobacco), a number of services (finance, telecommunications, retail commerce, electricity and gas distribution), and natural-resource-seeking FDI, mostly from British TNCs in petroleum, natural gas and mining. A certain degree of specialization in terms of the corporate strategies underlying inward FDI is therefore evident within the region.

The principal changes that have taken place in recent years have to do with recipient countries, source countries and modalities. In terms of recipient countries or groups of countries, those that significantly surpassed their average annual FDI inflows for 2002-2006 in 2006 were Uruguay (141%), Ecuador (83%), Central America and Panama (71%), and Chile (40%). As for source countries, Europe has declined significantly, primarily due to a sharp downturn in Spanish FDI, and the United States has maintained its share. Most of the source countries that have increased their flows to the region are

relatively new investors, such as Canada, Mexico and other Latin American countries. Although OFDI from developing countries has risen globally, and investors from several developing countries (China, India, Republic of Korea) have expressed interest in investing in Latin America and the Caribbean, that interest has yet to be reflected in substantial new inward FDI for the region. Acquisitions continue to be an important FDI modality for inflows, but this category was less notable in 2006 than in previous years when huge acquisitions had taken place (i.e., Bavaria, Ambev, etc.).

Viewed from the perspective of the areas of activity involved, there has been no major change. Although the numbers for 2005 apparently pointed to a rise in FDI in natural resources, the situation for 2006 is unclear, with FDI increasing in some countries and stagnating or falling in others.

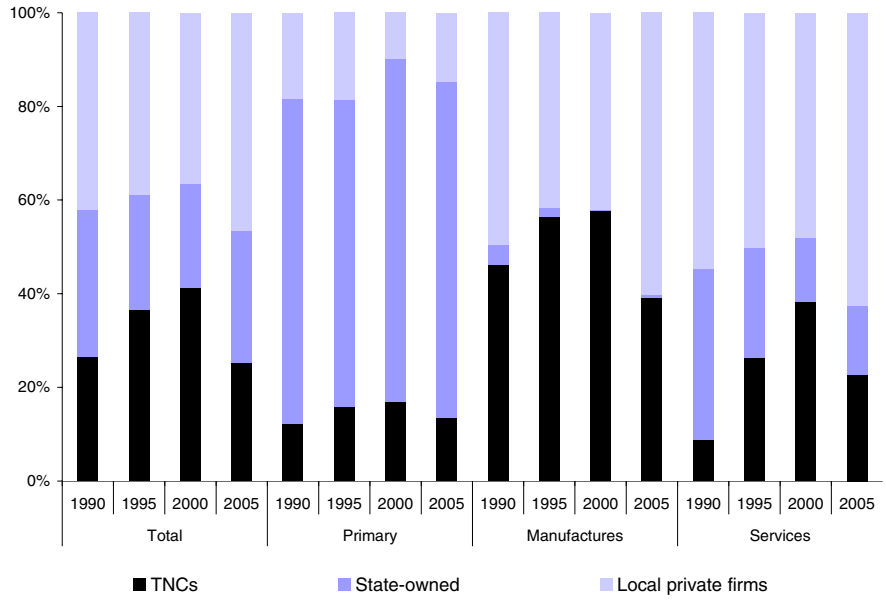
The information available on OFDI from Latin America and the Caribbean is relatively limited, but there is no doubt that a huge increase has taken place during the last three years, as official figures point to a rise from US$ 6 billion to US$ 38.6 billion during that period. The principal driver behind these OFDI flows is the internationalization of a relatively small group of Brazilian and Mexican trans-Latins. The Brazilian group includes Companhia Vale do Rio Doce (CVRD), which purchased INCO (Canada) for US$ 17 billion, and Petrobras, Gerdau and Itaú, which have purchased a diverse range of assets individually. The Mexican group includes América Móvil and Telmex, which made major acquisitions within Latin America and the Caribbean, and the Alfa Group, which expanded in the United States, Europe and China. Cementos Mexicanos (CEMEX) bought the Rinker Group (Australia) for over US$ 14 billion, but did not actually complete the deal until April 2007. Apart from these Brazilian and Mexican trans-Latins, major investments were undertaken by Tenaris (Argentina), which bought Maverick Tube Corp. (United States), and the State petroleum company of the Bolivarian Republic of Venezuela, Petróleos de Venezuela S.A. (PDVSA), which is investing in refineries (Argentina, Belize, Brazil, Uruguay) and gas pipelines (Colombia) in the region. These operations demonstrate that trans-Latins have recently become much more active participants in internationalization processes, especially outside the region.

The proportion of TNCs found within the top 500 companies, measured by sales, in the region grew sharply, rising from about 27% in 1990 to 41% in 2000, before falling back to 25% in 2005 (see figure 3). The share of both State and local private companies, by contrast, expanded significantly between 2000 and 2005. The presence of TNCs is most notable in manufactures, even though their share of the top 500 firms' sales of manufactures dropped from 58% in 2000 to 39% in 2005. The sector in which TNCs have the second-largest stake is services, where their share of the total sales made by service firms within the top 500 fell from 38% in 2000 to 23% in 2005. In the primary sector, where TNCs have a less pronounced presence, their share shrank from 17% in 2000 to 13% in 2005. Local private firms are the strongest in manufactures and services, while State companies clearly dominate the primary sector. Interestingly, there has been a notable turnaround in the composition of the 200 largest exporters in the region. Whereas in 2000 State-owned companies accounted for only 15% of exports and TNCs for 50%, by 2005 this situation had been reversed, with the former accounting for 46% of that group's exports and TNCs for only 27%. This reflects, among other things, the sharply rising prices of hydrocarbons, a natural-resource sector where State-owned firms are a dominant presence in the region.

In sum, the combination of these two data sets provides an analytical basis for insights into FDI and the operations of TNCs in Latin America and the Caribbean. On the one hand, while in recent years the region has succeeded in progressively increasing annual FDI inflows, which reached US$ 72.44 billion in 2006, its relative share of global and developing-country FDI inflows is shrinking. On the other, in terms of their position among the top companies in the region, TNCs are losing ground while local private and State-owned firms are gaining.

The current situation regarding FDI in the region represents a challenge for policymakers in Latin America and the Caribbean and calls for action on their part if they are to close the gap with more successful recipients of FDI in other regions.

Figure 3
LATIN AMERICA AND THE CARIBBEAN: SALES OF THE 500 LARGEST FIRMS, 1990-2005
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information provided by the Special Studies and Projects Department of the *América economía* magazine, Santiago, Chile, 2006.

B. FDI POLICIES IN LATIN AMERICA AND THE CARIBBEAN AND THE GAP BETWEEN THE REGION AND MORE SUCCESSFUL COUNTRY RECIPIENTS OF FDI

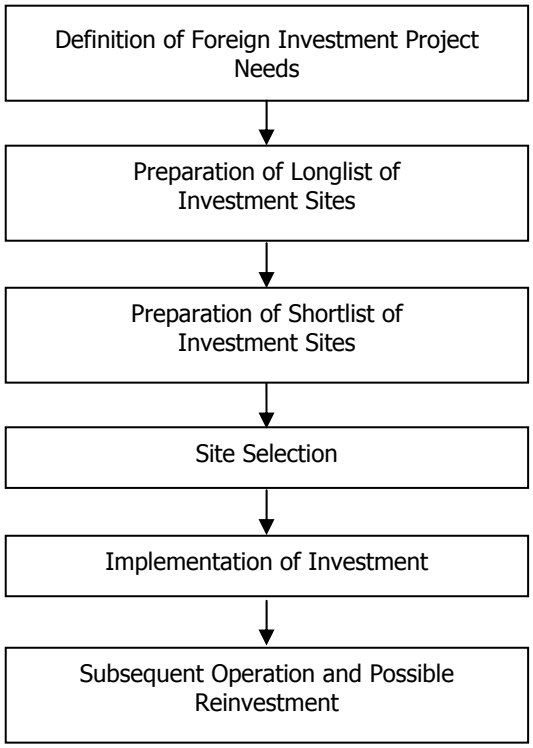
The 2005 edition of *Foreign Investment in Latin America and the Caribbean* analysed FDI-attraction policies and the corresponding institutional frameworks in Latin America and the Caribbean. That analysis showed that the region, in general, is in an infant stage of development in terms of FDI attraction policies, which are passive and rely fundamentally on natural advantages and horizontal incentives (opening up these economies, liberalization, deregulation, and privatization). The study also found indications that these countries are moving towards the design of more comprehensive policies that assign a more active role to national investment promotion agencies; nonetheless, these agencies tend to be small, understaffed and with limited budgets, which blunts their impact.

This year's report examines some of the best practices in the rest of the world in order to better define the gap between them and those of Latin America and the Caribbean (see chapter II). This examination highlights the principal differences between the passive policies common in Latin America and the Caribbean and the more active and integrated FDI policies found in the more successful FDI recipient countries and regions. This analysis indicates that the central difference between the two is that the role of FDI in the more successful recipients' development strategies is more clearly defined and is

progressively more important, such that greater and more focused efforts are made to attract "quality" FDI. In addition, the impacts of such investments are continually evaluated with a view to relating them directly to development policy objectives. The effective implementation of active and/or integrated FDI policies is one of the factors that has contributed to the "catching-up" process observed in several Asian countries during the last quarter century.

The starting point for this analysis is a more complete understanding of the TNC decision-making process involved in the selection of investment sites (see figure 4). This process consists of several stages. Once the investor has a definite idea of the firm's needs as they relate to the investment project, the first step is a preliminary analysis of possible investment sites and the preparation of a "long list" of the best potential sites that meet those needs. This is followed by a considered examination of those sites in order to rank them in terms of attractiveness and then pare down their number to a more manageable shortlist for more detailed evaluation. This examination often includes on-site visits by the investment team or by a team put together by a specialized company contracted to carry out this information-gathering activity. A more exhaustive evaluation is then undertaken to select the definitive investment site. Subsequent TNC decisions on further investment or reinvestment at that site are evaluated on the basis of the company's experience there and perceived opportunities in other locations.

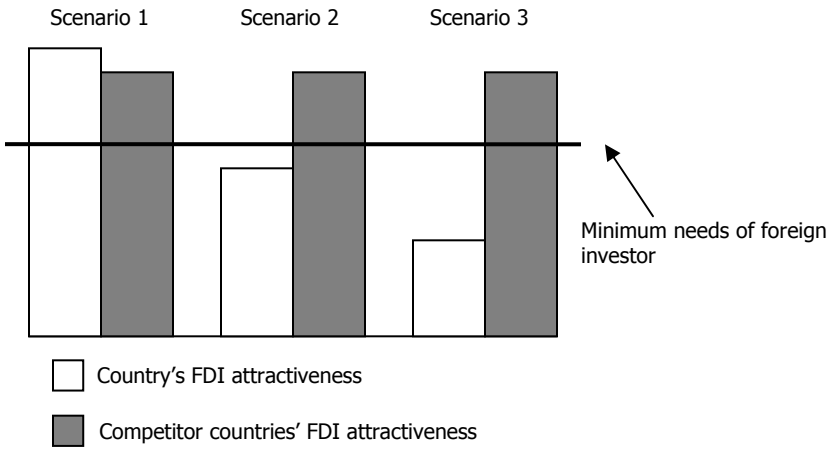
Figure 4
TNC INVESTMENT SITE DECISION-MAKING PROCESS



Source: Economic Commission for Latin America and the Caribbean (ECLAC).

Policymakers in potential host countries must decide whether they should attempt to influence the TNC investment site decision-making process at critical junctures and, if so, how. Simply put, an aspiring host country usually fits into one of three principal scenarios (see figure 5). In the first, the potential host country already possesses what the foreign investor needs. In the second scenario, the potential host country does not quite have what the foreign investor requires, whereas competitor host countries do. In the third scenario, the potential host country is far from possessing what the foreign investor requires, while, here again, other competitor host countries do.

Figure 5
TNC INVESTMENT SITE DECISIONS: THREE HOST-COUNTRY SCENARIOS



Source: Economic Commission for Latin America and the Caribbean (ECLAC).

The government of a potential host country in scenario 1 might decide that it need take no action and that *passive FDI policies* are sufficient to give it a good chance to capture the investment. The country's attractiveness, in the presence of passive FDI policies, revolves around its innate competitive conditions (such as the natural resources available, market size and growth, export potential and geographical proximity to major markets, as well as infrastructure, business environment, macroeconomic stability, foreign trade facilities, etc.), the existing legal framework for FDI (regulatory system, restrictions on property ownership, the FDI approval process and investment protection standards) and any specific initiatives, such as privatization programmes. This process is more typical of natural-resource-seeking and market-seeking FDI. Success on the part of the recipient country is usually measured in terms of the quantity of FDI received. This is quite characteristic of the historical situation not only in Latin America and the Caribbean as a whole, but even in the case of Mexico and the Caribbean Basin, which receive most of the efficiency-seeking FDI that reaches the region.

The government of a potential host country in scenario 2 might decide that more *active FDI policies* are needed to close the gap between what the country possesses and what the foreign investor needs. At this point, a major new element enters into the investment site selection calculus in the form of the country's investment promotion agency (IPA). The IPA may become proactive in several areas in an attempt to enhance the country's attractiveness to foreign investors. To this end, it may seek to promote the country, in general, by providing information, facilitating conversations with foreign investors or sometimes negotiating directly with them, and offering post-investment services. It may also

operationalize the national government's FDI priorities in terms of regions, functions, sectors, types of companies or types of projects by targeting individual TNCs. Beyond these measures, the potential host country may attempt to influence the investment site decision for specific high-priority projects by providing incentives (tax or financial measures) or selective policies (building infrastructure, undertaking human resource training, providing land, etc.) to improve its chances of selection. This decision-making process often concerns efficiency-seeking FDI in which a component of a transnational corporation's international system of integrated production is established in the host country. Success here is usually linked to improving the international competitiveness of the host country and specific achievements in priority regions, functions, sectors, types of companies and/or types of projects. This situation is more common in a number of developing Asian countries (e.g., Malaysia and the special economic zones of China and the Republic of Korea) and some European nations (e.g., the Czech Republic, Spain and France).

The government of a potential host country in either scenario 2 or 3 may decide that it requires *integrated FDI policies* to close the gap between what the country possesses and what foreign investors need in order to give the country a chance to attract FDI in the future. In this situation, the institutional framework and competitive conditions that a country needs in order to move on to scenario 2 or scenario 1 are created in a conscious and coordinated manner over the longer term. In the process, new policies to integrate FDI policy into development strategy will be implemented (such as a proactive identification and removal of FDI barriers, the improvement of the host economy's absorptive capacity, etc.), together with evaluations of the performance of FDI (measuring it against specific goals such as industrial and technological upgrading, technology transfer, the establishment of production linkages, human resources training, local enterprise development, etc.). In the celebrated cases of Singapore and Ireland, which have been the most successful with these policies, FDI has been transformed into the backbone of the national development strategy. Once it has matured, this kind of national policy is often associated with attracting strategic asset-seeking FDI, especially R&D activities and regional headquarters functions.

Globally, the shift from passive to active and/or integrated policies has generally been accompanied by greater harmony between the objectives and priorities of the host country's development strategy and the corporate strategies of the TNCs undertaking the investments. With regard to host-country FDI and national development policies, certain activities gain importance in the shift from passive to active or integrated policies, including policy interventions in factor markets (skill creation, institution-building, infrastructure development, supplier support), use of incentives and selective policies for high-priority projects, encouragement of R&D and technological institutions, proactivism in attracting, targeting and guiding investments, and efforts to improve the impacts of TNC activities in the context of national strategic priorities by directing new investments into defined higher-value areas and inducing existing affiliates to upgrade their technologies and functions. Thus, the focus shifts to attracting "higher-quality" FDI. In order to accomplish this, some of the more successful recipient countries have designed and implemented inward-FDI policies which are being increasingly integrated into the national development strategy and are continuously evaluated in terms of those priorities.

A central question is to what extent FDI can assist a recipient country to achieve basic development goals such as improving its existing production structure by shifting from simple, low-value-added and less internationally competitive activities to more technologically sophisticated, higher-value-added and more internationally competitive ones. In this regard, national policy definitely counts. The more successful FDI country recipients have had clearly defined priorities for their development strategies, and their FDI policies have focused on those TNCs that they feel can contribute to their achievement.

ECLAC has long espoused the thesis that quality FDI has a strategic role to play in Latin American and Caribbean development. On the basis of an analysis of recent trends in FDI inflows, the size of the gap between the region's FDI policy practices and those of the more successful FDI country recipients, the experiences of certain non-traditional FDI source countries and other factors, ECLAC is now advancing the proposition that the region's chances of attracting quality FDI will improve to the extent that it defines and implements more active and integrated FDI and development strategies.

The final two chapters of this year's report deal with the experiences of two non-traditional sources of FDI for Latin America and the Caribbean: the Republic of Korea and Portugal. The main purpose of this analysis is to examine the nature and impact of these non-traditional FDI sources, but it also provides some insight into the role of inward FDI in these countries' own development trajectories, particularly in the case of the Republic of Korea.

C. THE EXPERIENCE OF KOREAN TNCs IN LATIN AMERICA AND THE CARIBBEAN

The Korean development experience is impressive and provides important lessons for developing countries. The country was brought to a rude awakening during the twentieth century, first, by Japanese colonization (1910-1945), second, by its severe dependence on direct aid from the United States, which heavily influenced its development options after the Second World War, and, third, by the global clash between capitalism and communism that, in the wake of the Korean War (1950-1953), left the country divided into a communist north and a capitalist south. A poor country then based mainly on agriculture and mining (about 50% of GDP), with a per capita GDP similar to that of African countries such as Mozambique and Senegal, in the early 1960s the Republic of Korea started taking bold steps towards becoming an independent economy by way of "guided capitalism". Public policies were expressly focused on building up national industrial and technological capabilities in order to gain international competitiveness. The focus here was on strengthening the national conglomerates, or chaebols. Inward FDI did not play a significant role in this phase of the Korean development strategy, however.

The Republic of Korea's prolific GDP growth during this period was based on an outward-oriented industrialization process that transformed its economy into the world's tenth largest (measured by GDP), made it the world's twelfth-biggest trader and raised its per capita GDP to the equivalent of two thirds of the average of the OECD countries.[2] The Republic of Korea thus became one of the principal showcases of the "East Asian miracle".

In spite of this stellar growth, the country was overtaken by a debilitating financial crisis towards the end of the twentieth century that obliged it to rethink its existing development strategy. At the same time, the Republic of Korea found itself in an Asian "nutcracker" between a technology leader (Japan) and several Asian fast followers (especially China) that strained its international competitiveness. In short, the country was losing wage competitiveness without gaining ground in terms of advanced technology. In response, the government opted to promote the formation of a "knowledge economy" that would be better able to sustain GDP growth while making the transition from being a "technology follower" to being an "innovator". In order to do so, it began to focus on the continuous restructuring of the economy through

[2] To give but one comparison: the Republic of Korea's real per capita GDP jumped from US$ 1,110 to US$ 12,230 between 1960 and 2003, while that of Mexico only increased from US$ 2,560 to US$ 5,790 over the same period (Chen, 2006).

technological upgrading and innovation in higher-value-added and technologically sophisticated activities. In that context, the Korean economy mounted an R&D effort equivalent to more than half of the entire developing world's total private-sector R&D spending.[3] Starting from this stronger base, the country embraced the globalization process and became a world leader in information and communications technology, among other knowledge-based activities. Thus, the significance of the Korean experience lies in the country's ability to face up to severe challenges by taking tough decisions to reorient its development strategy under trying conditions. This ability can be considered particularly relevant for Latin America and the Caribbean.

In general, it would seem reasonable to conclude that when the Republic of Korea embarked on its fast-follower trajectory, it possessed a development strategy suited to that task. Now that it has evolved into a competitive stakeholder in the international economic system and aspires to become a technology leader, its national development strategy has been altered to reflect these changed circumstances and its policies have become more orthodox and focused on objectives associated with the knowledge economy. For example, specialized institutions now actively promote inward FDI and seek to direct it towards high-tech projects in competition with national companies.

Korean outward foreign direct investment (OFDI) played a role in both its initial and subsequent development strategies, although its effects have been conditioned by the country's balance-of-payments situation. The Republic of Korea has accumulated about US$ 70 billion in OFDI and generated a significant number of world-class TNCs. While the original industrial export model was in effect, OFDI was necessary to secure supplies of natural resources and gain access to the world's principal markets. As that model matured and the goal of creating a knowledge economy came to the fore, OFDI began to play a more important role in transferring certain export activities to export processing zones in lower-wage countries and in acquiring competitive technologies for use in the home economy. Globally, Korean OFDI has been concentrated in manufacturing (mainly in China, other Asian countries and lower-wage countries close to major markets such as those of North America and Europe). Large Korean TNCs have used OFDI to establish international and regional production systems in electronics (Samsung Electronics Company, LG Electronics) and motor vehicles (Hyundai Motor Company) and to strengthen their competitiveness in natural resources and resource-based manufactures (SK Corp, POSCO) while smaller Korean TNCs (Sae-A, Shinwon, Hansae, Hansoll) have used it to set up regional production systems in the apparel industry.

The principal focal points of Korean OFDI in Latin America and the Caribbean, to which about 8% of Korean OFDI has been directed, are found in the electronics industry in Mexico and Brazil, the apparel industry of Central America and natural resources in Peru, Brazil and Chile. This Korean OFDI has produced significant impacts, particularly with regard to increased local exports. In principle, these OFDI focal points should have become the "transmission belts" that would pass on the Korean economy's dynamism to host countries in the region, thereby helping them to learn from the Korean development strategy. In practice, however, these contact points have not done so and therefore have failed to realize their potential for inducing industrial and technological upgrading in the region. This is so for several reasons.

First of all, Korean OFDI in electronics has primarily been in large-scale plants devoted to the assembly of final goods, such as color television sets, mobile phones, monitors, DVDs, etc., in Mexico

[3] To give another example: the Republic of Korea undertook 35 times more industrial R&D, measured as a proportion of GDP, than Mexico, which produces roughly the same level of manufacturing value-added (UNCTAD, 2003).

and Brazil. Samsung Electronics Company, LG Electronics and their associates possess modern plants in Mexico, close to the border with the United States, and in Brazil, in the Manaus free zone and around São Paulo. These operations represent huge investments in capital equipment and have been very important for their headquarters companies, that is, Samsung Electronics Company and LG Electronics, but have been less successful ventures for their business associates (in terms of local supply networks) and the two host countries (in terms of the localization of components and the technological and industrial upgrading of these activities).

A good example is provided by the shift from conventional (cathode ray tube) color television sets to the modern liquid crystal display (LCD) or plasma display panel (PDP) models. Whereas the plants for conventional sets incorporated associate firms' locally assembled components (Samsung Electro-Mechanics, Samsung SDI in the case of Samsung Electronics, and LG Innotek and LG-Philips in the case of LG Electronics), the new LCD and PDP models incorporate modules imported directly from the Republic Korea which account for a large share of the final sales price. The most significant value-added operations in the host countries are essentially limited to the assembly of printed circuit boards, whereas, previously, the cathode ray tubes, deflection yokes, flyback transformers and other components and parts were locally produced. In other words, as this example suggests, the progress being made towards manufacturing modern, competitive final products by these Korean companies in Latin America seems to be coming at the expense of the local production of components.[4] The host countries have gained increased export earnings (Mexico) or more local R&D activities (Brazil), but their local industrialization process is being truncated in the process due to the lack of continuity in the transition from one model to the next. In addition, existing production linkages may be uprooted in the process.

Korean OFDI in the textile and apparel industry began to be directed towards Central America, especially Guatemala, primarily in the 1990s in the context of the United States import quotas facilitated by the Multifibre Arrangement, which limited direct exports from the Republic of Korea. Korean apparel firms took advantage of the quotas of host countries in Asia and Latin America to continue exporting to the United States market. Most assembled relatively simple knits (sweatshirts, shirts, blouses, trousers, etc.) in Latin America and the Caribbean. Some Korean apparel companies exported to the United States market using cheaper Asian cloth and paying duty at the United States border; others complied with the rules for "production sharing," which required the use of more expensive cloth cut and formed in the United States, as well as other inputs, in order to qualify for duty and quota benefits. Some of the headquarters firms of Korean subsidiaries operating in Central America became world-class competitors based on their textile industry and their capacity to serve as full-service apparel providers.

Rather than reflecting their global competitiveness, the operations of Korean firms working out of Central American export platforms have been severely impaired by several factors. The multilateral Agreement on Textiles and Clothing put an end to the era of quotas and progressively opened up the United States market to competitors, especially in lower-cost segments. As a result, fabrics cut and formed in the United States became less and less able to compete with the more efficient offshore vertically-integrated operations of firms from Asian countries such as China and India. Moreover, the appreciation of the Central American currencies and the worsening situation in terms of personal security in the subregion deterred Korean investors, especially established ones, and these investors therefore began to postpone reinvestments. Korean apparel companies started to re-examine their options for offshore apparel assembly sites and increasingly came to prefer Asian locations. Unfortunately, the host

[4] LG Electronics opened a new PDP plant in October 2006 at its complex in Reynosa, Mexico. It is the only one in the region and enjoys a clear technological edge in this regard. The new plant is an outcome of a corporate strategy aimed at increasing localization in core sites (China, Mexico, Poland and the Republic of Korea).

countries did not mount active or adequate policy responses to the problems faced by these Korean textile and apparel firms, nor did they build on these firms' competitive advantages as textile producers and full-service providers.

In the natural resources and resource-based manufacturing sectors, Korean TNCs maintain a rather passive presence in Latin America and generally work with partner firms in order to spread the financial risk. For example, SK Corp's participation in the huge Camisea natural gas project in Peru takes the form of a minority share in the project consortium, which is led by United States companies. LS Nikko sources more than half of its copper from Chile, Peru and Brazil by way of operations with Japanese partners. POSCO sources iron ore pellets from Brazil via its participation in a local firm, Kobrasco, whose operational management is in the hands of its Brazilian partner (CVRD). These companies tend to be much more active in other regions of the world, and the more strategic aspects of their internationalization processes are more visible outside Latin America.

Some changes are evident, however. SK Corp plays a role as partner in all three elements of the Camisea project: exploration/production, transportation (natural gas and liquids pipelines) and distribution (the liquefied natural gas plant). LS Nikko is beginning to purchase its own mines and is considering the possibility of building a copper smelter in Latin America or China. POSCO is setting up its own steel plant in Tampico, Mexico, to supply the local automotive industry with galvanized steel. Another active company is Eagon, which specializes in forestry products. This company's very existence has depended on its ability to adapt to the fallout from its headquarter firm's financial crisis by charting a more independent course. Nonetheless, the operations of these companies still typically take the form of passive participation in joint projects, in spite of the recent record highs reached by international prices for these commodities, which might be expected to make them more aggressive in investing in Latin America and the Caribbean.

The single biggest Korean TNC that is conspicuously absent in Latin America is Hyundai Motor Company (HMC). This world-class company is the most recent example of a new automotive TNC from a developing country that has broken into the top 10 global TNCs in this sector. HMC is usually considered to be one of the industry leaders, after Toyota and Honda. Thanks to its relatively more limited degree of internationalization, HMC was better prepared for the Korean financial crisis, which was a significant factor in the restructuring of that industry in the Republic of Korea. In fact, it was the only Korean automotive producer that was not sold to foreign investors, and it even acquired the number two Korean motor vehicle producer, Kia, around that time. Subsequently, HMC established an extremely competitive international production system that focused on major markets, and particularly those of the United States, China, India, Turkey and the Czech Republic (for the European market). This company's production capacity (together with Kia) is approaching 5 million units worldwide, and it exported 2 million units from its Korean base in 2005. Unfortunately, HMC still possesses no major operations in Latin America and the Caribbean, preferring to export to those markets where feasible. In Brazil, it has been mired in legal problems stemming from the operations of some of the affiliates of the firms that it acquired during the Asian financial crisis, namely Asian Motors and Kia. Eventually it decided against bringing Brazil into its international production system and is instead exporting knocked-down kits for light trucks and sport utility vehicles to a plant built by a local company. In Mexico, HMC is apparently close to a decision on investing in a new assembly plant. Under circumstances that appear to be similar to the case of LG Electronics' investment in the PDP module plant, the local FDI policy does not seem to have been a significant factor in this investment decision, which is instead primarily a reflection of the firm's own corporate strategy. In other words, with the exception of this new plant in Mexico, the automotive industry in the region does not enjoy the benefits that would be associated with the presence of one of the Republic of Korea's most competitive, world-class TNCs. Unfortunately, FDI policy in the region has not been a factor in changing this situation.

Thus, whether it is due to the existence of better investment options in other parts of the world, the comparative passivity of Latin America and Caribbean FDI policies, or other factors, the impact of the operations of Korean TNCs in the region would appear to fall far short of their potential. As a consequence, the host countries of Latin America and the Caribbean still have much to learn from one of the more successful and dynamic development strategies of the last half century, one that spans both export-based industrialization and the transition to the knowledge economy. This situation can be attributed to the fact that the existing transmission belts in textiles and apparel, electronics, motor vehicles and natural resources are not at present fulfilling their role.

D. THE EXPERIENCE OF PORTUGUESE TNCs IN LATIN AMERICA AND THE CARIBBEAN

In many ways, the case of Portugal represents the "flip side" of the Republic of Korea's experience. Whereas the latter set development benchmarks, Portuguese TNC operations have their origin in an empire that has long been in decline. The most competitive Korean TNCs are world-class ventures, whereas the principal Portuguese ones can be considered to be third- or fourth-tier enterprises. Whereas the largest Korean TNCs have a global presence, that of the biggest Portuguese TNCs is limited mainly to the Iberian Peninsula, neighbouring countries and former colonies (Angola, Mozambique, Cabo Verde, Macao, etc.). Similarly, in Latin America and the Caribbean, the presence of Korean TNCs is relatively widespread (Mexico, Brazil, Central America, Chile and Peru), whereas that of Portuguese TNCs is heavily concentrated in just one country: Brazil. Finally, whereas Korean FDI in the region holds out great potential, much of the Portuguese FDI in Brazil has lost its dynamism, and a substantial portion of it appears to be stagnating if not declining.

Portugal was the centre of an extensive empire in the sixteenth and seventeenth centuries, with overseas possessions in Asia, Africa and Latin America. Today, Portugal is one of the smaller members of the European Union. It has, however, enjoyed somewhat of an economic resurgence, in part based on European Union subsidies aimed at reducing regional disparities, national deregulation and privatization processes that have strengthened some of the principal Portuguese enterprises, and the national government's efforts to help emerging Portuguese TNCs to internationalize their operations. The pressure on Portuguese firms to engage in OFDI in recent years has come from the increased competition within the European Union associated with the liberalization process in services (such as telecommunications and electricity) and the impact of adopting the euro.

Annual flows of OFDI from Portugal were quite small during the early 1990s, averaging less than 500 million euros per year. However, they increased rapidly thereafter, rising to about 3.5 billion euros per year. As a result, the OFDI stock had surpassed 21 billion euros by the year 2000. Since then, outflows have, for the most part, remained strong, but with sharp fluctuations from year to year. The principal characteristics of Portuguese OFDI are that it is recent, encompasses few activities, is concentrated in a few recipient countries and is carried out by a small group of large but not highly internationalized companies.

The firms that dominate Portuguese OFDI come from two groups: large, recently privatized, public utility monopolies that needed to internationalize to avoid being acquired by larger European competitors in the context of the European Union's liberalization process; and existing private firms that had consolidated their base in Portugal and needed to expand internationally in order to sustain their growth. The first group includes companies such as Portugal Telecom (telecommunications),

Electricidade de Portugal (electricity) and CIMPOR (cement). The second is made up of firms such as Sonae (retail trade) and the Pestana Group (tourism), as well as a number of firms in the financial services, construction and other industries. Brazil became the epicentre of the Portuguese OFDI boom that began in the mid-1990s, accounting for 95% of Portugal's OFDI in Latin America and the Caribbean.

This concentration reflects the fact that these internationalizing Portuguese companies were interested essentially in Brazil, not the rest of Latin America and the Caribbean. Brazil was attractive for reasons of common history, language and culture, as well as its large market and growth potential, coupled with macroeconomic reforms (the Real Plan, the steps taken to open up the economy, liberalization, deregulation and, especially, privatization). Although Portugal accounted for only about 6% of Brazil's inflows of FDI in 1996-2000, Brazil was the destination for over 50% of Portugal's OFDI in roughly the same period (1995-2000). The macroeconomic crisis that hit Brazil in 2000 caused those inflows to nosedive, however, and several Portuguese companies subsequently decided to leave Brazil or sharply reduce their assets there. In other words, a small group of Portuguese investors engaged *briefly but intensively in* FDI activity in Brazil.

During the FDI boom, inflows were concentrated in just three principal activities: telecommunications (39.9%), retail trade (16.8%) and electricity, gas and water (15.4%). From this perspective, the history of recent Portuguese FDI in Brazil is mainly about the experiences of Portugal Telecom, Sonae, Electricidade de Portugal and a few others.

Portugal Telecom (PT) is the product of the amalgamation of three Portuguese telecommunications companies in 1994. It was privatized in the late 1990s, although the Portuguese government has retained its "golden share" in the company. By 2005, it had sales of 6.3 billion euros and 40 million clients and was the eighth-largest telecommunications company in the European Union. Although the firm has far-flung international investments, including assets in many former colonies (Cabo Verde, São Tome and Principe, Macao and Timor-Leste), its principal FDI destination is Brazil. These investments have, for the most part, been made in association with Telefónica of Spain, the European Union's fourth-largest telecommunications company.

Brazil accounted for 32% of the global sales of PT and 71% of its clients worldwide in 2005. PT was one of the principal participants in the privatization of Telebras, Brazil's dominant State telecommunications company, in partnership with Telefónica. Their joint venture, BrasilCel, which controls the Vivo brand, became the single largest national telecom in Latin America and the Caribbean, and its Brazilian market share peaked at 44% in 2003. The instability of the telecommunications market at the turn of the century has weakened PT, however, and it has begun to refocus its efforts on its home base and Spain, especially since another large Portuguese group (Sonae) tried to take it over in 2006. There is speculation that Telefónica will buy out Portugal Telecom's assets in Brazil.

Sonae started out producing wood panels for construction in the 1950s, but it then diversified into retail trade (originally in association with the French group, Promodes), the construction of shopping centres and other activities (telecommunications, tourism, etc.). By the 1980s, it was the largest private non-financial group in Portugal and it began its internationalization process in earnest. That process was focused on Brazil, where Sonae originally joined with a local firm, Josepar, to create Cia. Real de Distribuicão. It later bought out Josepar and created Sonae Distribuicão, which expanded rapidly in southern Brazil. It obtained significant market shares in several Brazilian states, such as Rio Grande do Sul (32.3%), Paraná (23.1%) and Santa Catarina (15.4%), as well as its share in the more populous São Paulo area (3.4%). In the course of its effort to establish its local footprint, Sonae faced increasing competition from other retail TNCs, such as Carrefour, Casino, Royal Ahold and, eventually, Wal-Mart.

The 2001 crisis and subsequent devaluation in Brazil also hit Sonae hard, causing its Brazilian sales to plummet from the equivalent of 4.4 billion euros in 2001 to only 2.3 billion euros in 2002. Its rationalization efforts caused Sonae to drop from third to fourth place in Brazilian retailing. By 2005, Sonae decided that it had higher priorities and better investment opportunities elsewhere. It proceeded to sell 10 São Paulo hypermarkets to Carrefour for 105 million euros and, towards the end of the year, it sold its remaining retail holdings in Brazil to Wal-Mart for US$ 750 million. These resources helped Sonae in its bid to take over Portugal Telecom in Portugal. Thus, this large private company eventually turned its back on Brazil as a major investment site.

Electricidade de Portugal was formed through the amalgamation of 13 electricity providers in 1976. In the 1990s, generation, transmission and distribution activities were separated to facilitate their privatization, although the Portuguese government still controls about 25%. In 2004, in recognition of its diversification into other activities, such as water, natural gas and telecommunications, its name was changed to Energias de Portugal (EdP). It is the tenth-largest electric company in the European Union, with sales of 9.7 billion euros in 2005. EdP has concentrated primarily on the generation and distribution of electricity, but it also holds 30% of the largest transmission company in the country, REN. The firm's strategy has been to preserve its lead in Portugal, to internationalize and to diversify. It has done so with the help of powerful local associates (GALP Energy, Aguas de Portugal, Brisa and BCP) and established TNCs (Iberdrola of Spain and Thames Water of the United Kingdom). Its internationalization efforts have focused primarily on the Iberian Peninsula (6,492 clients) and Brazil (2,972), where the vast majority of its 9,462 clients are found.

In a situation akin to the experience of Portugal Telecom in telecommunications, EdP was one of the principal participants in Brazil's privatization process in the electricity industry. The macroeconomic crisis in Brazil hit privatized services, and especially the electricity industry, particularly hard, and the firm's huge investments in that sector came under financial pressure. EdP then refocused its corporate strategy on the Iberian Peninsula and sold off many of its non-core activities while it attempted to reorganize its Brazilian holdings. In 2005, it launched Energias do Brasil on the local stock market. By 2006, it still had market shares of 1% of generation, 8% of distribution and 10% of supply activities (trading) in Brazil's electricity sector, and some of its new investments in generation were coming on stream. Thus, Brazil still plays an important, if reduced, role in EdP's internationalization process.

Another example is that of CIMPOR, one of Portugal's two principal cement producers. This company was also privatized in the 1990s. The new owners set out to expand beyond national borders by concentrating on three key markets: the Iberian Peninsula, the Mediterranean basin (Morocco, Tunisia and Egypt) and Brazil. This move is reflected in the firm's installed production capacity in 2006 in the Iberian Peninsula (9.6 million tons), Mediterranean basin (6.6 million tons) and Brazil (5.7 million tons). In terms of global sales, the Iberian Peninsula (where CIMPOR is second only to CEMEX) contributed about 60%, while Brazil (where CIMPOR is in third place after Votorantim Cimentos and João Santos) accounted for 18%. Thus, Brazil has become an important element in CIMPOR's internationalization process.

Finally, the Pestana Group seems to have decided to stay in Brazil for the long haul, as it is heavily investing in tourist facilities in the north-eastern region.

Portugal's experience serves to illustrate the case of a relatively minor source of OFDI. The interactions of several factors, such as the new competition coming from within the European Union, the liberalization of the national economy and the impact of the euro, have obliged many of the dominant Portuguese companies to accelerate their internationalization processes. In Portugal's case, this process is

quite recent, involves a small group of activities in a relatively few principal recipient countries and is driven by a fairly small number of dominant companies. In general, companies in the telecommunications, retail trade, electricity and cement industries have had similar internationalization strategies which revolve around neighbouring countries (especially Spain) and former colonies having a shared history, culture and language (particularly Brazil). The focus on Brazil as a hub for the internationalization processes of such companies as Portugal Telecom, Sonae, Energias de Portugal and CIMPOR was intense but, for many, it did not last long in the face of the macroeconomic crisis, regulatory problems, the entry of global competitors, and what these firms considered to be better opportunities elsewhere.

E. MESSAGES

The 2006 report contains three basic messages. First, the region has succeeded in stabilizing the absolute level of inward FDI over the last three years while outward FDI has skyrocketed, suggesting that the region is becoming a more active participant in the globalization process. Second, even so, the region's share of global and developing-country inward FDI has not increased. Numerous factors account for this outcome, and the causality involved is complex. The elements in this equation include the fact that some TNCs feel that they have better options elsewhere, that there are macroeconomic and structural limitations in the region, and that FDI policies in the region remain passive and relatively ineffective in comparison with more successful country recipients of FDI in other parts of the world. For example, the more successful host countries in Europe and Asia tend to employ active FDI policies, which are often integrated into their development strategies, to attract more and better-quality FDI. Third, in a context in which traditional sources of FDI, such as Europe or the United States, are not very dynamic, it makes sense to seek out non-traditional sources. Unlike the situation with traditional sources, OFDI from non-traditional investor countries is often concentrated in a relatively small number of companies. Thus, the effectiveness of active FDI policies to attract and upgrade FDI from non-traditional sources depends to a significant degree on the kind of FDI and the nature of the corporate strategies of the principal TNCs involved, as is amply demonstrated by the contrasts to be seen between the mainly manufacturing activities of Korean TNCs and the primarily service activities of the Portuguese ones.

These are a number of important lessons to be learned from these experiences by policymakers in Latin America and the Caribbean, who may wish to build upon them by adopting more active and integrated FDI policies that focus more on the quality rather than the quantity of FDI, that better define the role of FDI in the development process, and that evaluate its impact on an on-going basis within the context of national development priorities.

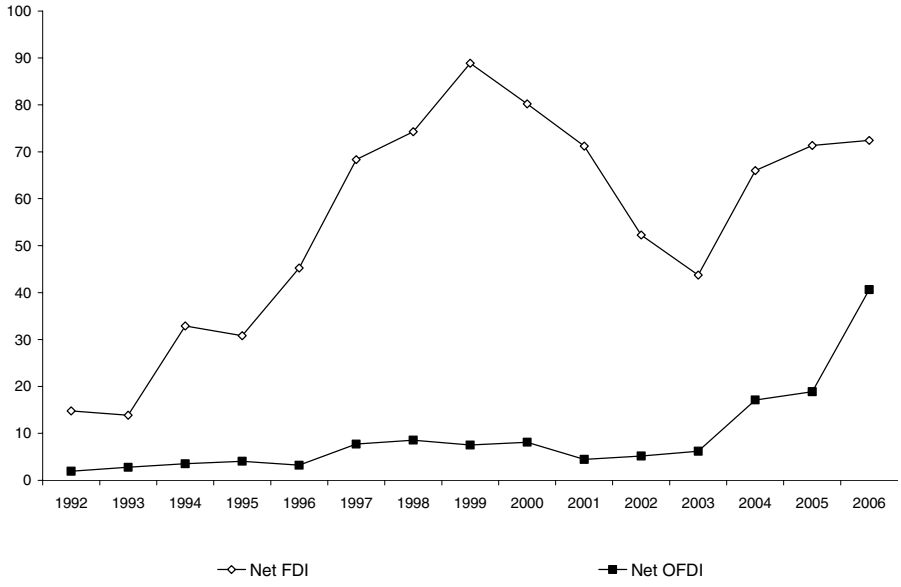
Chapter I

FOREIGN DIRECT INVESTMENT AND TRANSNATIONAL CORPORATIONS IN LATIN AMERICA AND THE CARIBBEAN

A. INTRODUCTION

In 2006 net FDI inflows in Latin America and the Caribbean, excluding the main financial centres, amounted to US$ 72.44 billion (see figure I.1 and box I.1). This is 1.5% higher than the 2005 figure and confirms that investment levels have stabilized after having declined early in the decade. This stability contrasts, however, with the estimated 34% growth in global FDI flows.

Figure I.1
LATIN AMERICA AND THE CARIBBEAN: FDI AND OFDI FLOWS (EXCLUDING THE MAIN FINANCIAL CENTRES), 1992-2006 [a] [b]
(Billions of dollars)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures as at 24 April 2007.

[a] The FDI figures indicate inflows of foreign direct investment, discounting capital transfers made by foreign investors. The OFDI figures indicate outflows of investment by residents, discounting capital transfers made by those investors. The FDI figures do not include the flows received by the main financial centres, and the OFDI figures do not include the flows originating in those centres.

[b] These figures are different from those contained in the editions of *Economic Survey of Latin America and the Caribbean* and the *Preliminary Overview of the Economies of Latin America and the Caribbean* published in July and December 2006, respectively, as they show the net balance of foreign investment, that is, direct investment in the reporting economy less outward foreign direct investment.

Box I.1

METHODOLOGICAL ASPECTS AND COVERAGE OF FDI DATA FOR LATIN AMERICA AND THE CARIBBEAN

The FDI figures contained in this report indicate inflows of such investment in the reporting economy, discounting capital transfers made by foreign investors. These figures are different from those contained in the editions of *Economic Survey of Latin America and the Caribbean* and *Preliminary Overview of the Economies of Latin America and the Caribbean* published in July and December 2006, respectively, as they show the net balance of foreign investment, that is, direct investment in the reporting economy less outward foreign direct investment.

The main financial centres of the region (Bermuda, British Virgin Islands and Cayman Islands) are not considered in this report, except in interregional comparisons in the international overview (section B). According to UNCTAD estimates, those jurisdictions received 99.2% of flows to the Caribbean financial centres between 1990 and 2005 (which in turn received approximately 10% of global flows between 2002 and 2006) (UNCTAD, 2006). Other jurisdictions in Latin America and the Caribbean that are considered tax havens or financial centres according to OECD and/or IMF criteria receive substantial amounts of foreign direct investment in non-financial sectors and are therefore included.

The data included are the most recent official figures available as at 16 April 2007. They are official figures for the year, official estimates or extrapolations on the basis of quarterly data for 2006 for those countries that had not yet published data for the complete year at that time. In the absence of annual or quarterly data or official estimates for 2006, and solely for the purpose of estimating an amount for the region and subregions, average flows received between 2002 and 2005 were considered. Owing to the response times of official surveys and investment records, the official data are usually revised retroactively by national authorities, which may result in differences appearing over time in FDI figures for one and the same period.

As for FDI data by destination sector and country of origin, the estimates are based on the best official data available for a representative universe of destination countries. Differences in data compilation methodologies and criteria between the various countries limit the quality of the estimates if they are considered as absolute values. In some cases they reflect net income and in others gross income or income actually received, while some countries exclude some investment sectors or categories of investment from their classification by country of origin. In the case of data by country of origin, there is the additional limitation that in many cases companies make investments from financial centres or subsidiaries located outside their country of origin. Nevertheless, these data can be used to identify general trends in the composition of investors and in FDI distribution at the aggregate level.

Source: Economic Commission for Latin America and the Caribbean (ECLAC).

Meanwhile, OFDI from the countries of the region has risen at an unprecedented rate, reaching US$ 40.62 billion, 115% more than in the previous year. It was this increase, which is part of a global rising trend in OFDI flows from developing countries, that led to the inclusion in this chapter of a section on OFDI and the strategies employed by Latin American and Caribbean firms (trans-Latins) in making such investments.[1]

This chapter analyses FDI trends and determinants from an analytical viewpoint based on the strategies adopted by firms that invest abroad (ECLAC 2004, 2005, 2006a). Two complementary data groups are used: (i) official figures on FDI flows and their distribution by sector and country of origin; and (ii) information on the operations of transnational corporations (TNCs) and trans-Latins, cross-border acquisitions and investment projects. The first group of data comes from official sources, while the second has been compiled from secondary information sources such as the specialized press, analysts' reports and information obtained directly from the companies involved.

Section B provides an overview of global foreign investment flows; section C analyses FDI inflows in Latin America and the Caribbean; and section D studies OFDI flows from the countries of the region.

[1] The characteristics of the internationalization process of this group of companies in recent years were described in detail in the previous edition of this report (ECLAC, 2006a).

B. INTERNATIONAL BACKGROUND

According to preliminary estimates, global FDI flows amounted to US$ 1.23 trillion in 2006, which is an increase of 34% in relation to the previous year (see table I.1).[2]

Table I.1
GLOBAL DISTRIBUTION OF NET FDI INFLOWS IN THE WORLD, BY GROUPS OF RECIPIENT COUNTRIES, 1991-2006
(Billions of dollars)

	1992-1996 [a]	1997-2001 [a]	2002-2006 [a b]	2005	2006 [b]	Percentage change 2005-2006 [b]
World total	276.3	908.7	700.7	916.3	1 230.4	34.3
Developed countries	170.9	674.9	434.6	542.3	800.7	47.6
Developing countries	101.7	223.0	237.0	334.3	367.7	10.0
Countries of South-Eastern Europe and CIS	3.7	10.8	29.1	39.7	62.0	56.3

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Conference on Trade and Development (UNCTAD), *World Investment Report, 2006. FDI from Developing and Transition Economies: Implications for Development* (UNCTAD/WIR/2006), Geneva, 2006. United Nations publication, Sales No. E.06.II.D.11; and "Foreign direct investment rose by 34% in 2006" (UNCTAD/PRESS/PR/2007/001), Press release, 9 January 2007.

[a] Annual averages.
[b] Preliminary figures.

The robust performance of the world economy —which posted average growth of 4% of GDP— was a decisive factor in the strength of global FDI flows. The United States economy posted higher-than-expected growth rates, although there may be a slowdown in 2007. In the euro zone and Japan, growth rates were higher than in previous years. Developing countries had average growth rates of 6.5%, with outstanding performances from India and China (ECLAC, 2006b).

China's 10.2% growth in 2006 (ECLAC, 2006b) has had an impact on global FDI flows in various ways. First, Chinese demand for natural resources has grown with the expansion in its production capacity, and this has put pressure on commodity prices and led to investments in other countries to secure the supply of minerals and other inputs. Second, China's growth has encouraged investments that capitalize on domestic market potential.[3] Third, the country's production competitiveness, based on low costs but also, to an increasing extent, on technological assets (human capital, science and technology infrastructure, innovation capacity and others) has created new parameters for competition among countries to attract efficiency-seeking investments to serve third markets.

There is growing competition among countries to attract FDI, especially of the kind that will bring greatest benefit to a country in terms of investment levels, job creation, higher-value-added activities and innovation (see chapter II). This is taking place at a time when larger companies are becoming increasingly active in their search for more competitive investment locations (OCO Consulting, 2005).

[2] UNCTAD estimates (2006, 2007).
[3] Real per capita GDP grew on average by 9.4% per year between 1990 and 2004 (ECLAC, 2006b).

The increase in global FDI in 2006 in relation to 2005 benefited developed countries and transition economies. This is a change from the trend of the past few years, when developing countries had posted more rapid growth. As in previous years, Western Europe and North America[4] were the main recipient regions. Investments in those regions have basically been intra-European or between the two regions. The global wave of acquisitions, which reached an all-time high in 2006, was a determining factor in this result. Assets in Europe and the United States accounted for approximately three quarters of the value of global acquisitions in 2006 (Columbia University and the Economist Intelligence Unit, 2006; UNCTAD, 2006; *Financial Times*, 2006a).

Of the developing regions, Asia and Oceania, followed by Latin America and the Caribbean, received the most FDI in 2006. Preliminary estimates indicate that China, the leading developing-country recipient of FDI in 2006, shows signs of experiencing a slowdown in the growth of these inflows (UNCTAD, 2007). The relative stability of flows to Latin America and the Caribbean contrasts with the growth in other regions, which reflects a fall in the region's share of FDI income received by developing countries and of global income (see figure I.2). If the main financial centres are included, the region's FDI/GDP ratio is higher than that of Asia and Oceania. Nevertheless, it has fallen in the past two years (see figure I.3).[5] If the main financial centres are excluded, the FDI/GDP ratio for Latin America and the Caribbean is 3% (see section C).

According to estimates for 2006, the United States and the European Union (especially the United Kingdom, France and Spain) were once again the main countries of origin of such investment (Columbia University/The Economist Intelligence Unit, 2006). Investments by developing countries, however, grew substantially between 2003 and 2005 (see figure I.4) and preliminary information on OFDI and on mergers and acquisitions indicates that this trend continued in 2006. In the last few years, many of these countries have improved their macroeconomic performance, increased their exports and accumulated financial assets. These countries' firms, with their increasingly developed management and financial capacities, have become more active as investors outside their respective borders. The Latin American and Caribbean region has not remained aloof from this trend, as the trans-Latins have expanded their international presence both in the region and outside it (see section D) (ECLAC, 2006a; Columbia University/The Economist Intelligence Unit, 2006; UNCTAD, 2006; *Euromoney*, 2006).

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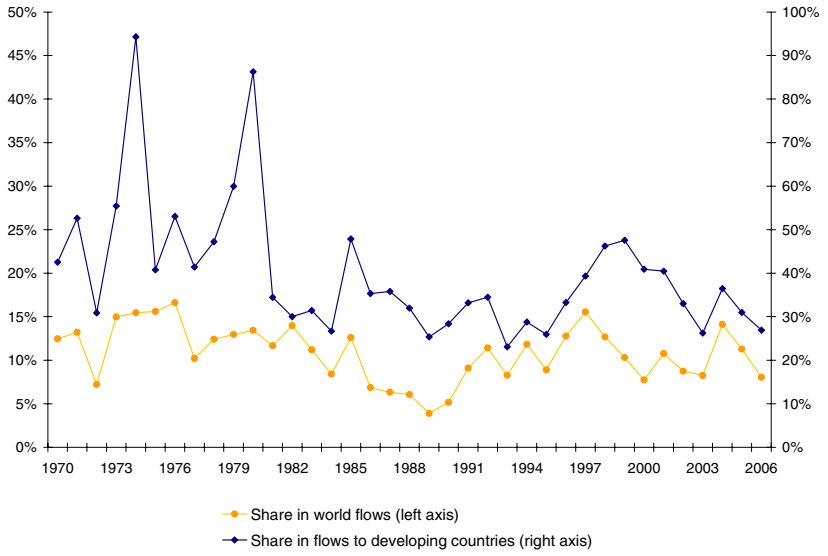
[4] Between 2004 and 2005, net United States OFDI fell from over US$ 220 billion (27% of global flows) to a negative figure of US$ 12 billion, owing at least in part to the entry into force of federal government fiscal incentives (the Homeland Investment Act). This law allowed the repatriation of profits at the lowest tax rates during a single tax year, 2004 or 2005. This has reduced reinvestment abroad, which is an important component of United States OFDI (UNCTAD, 2006).

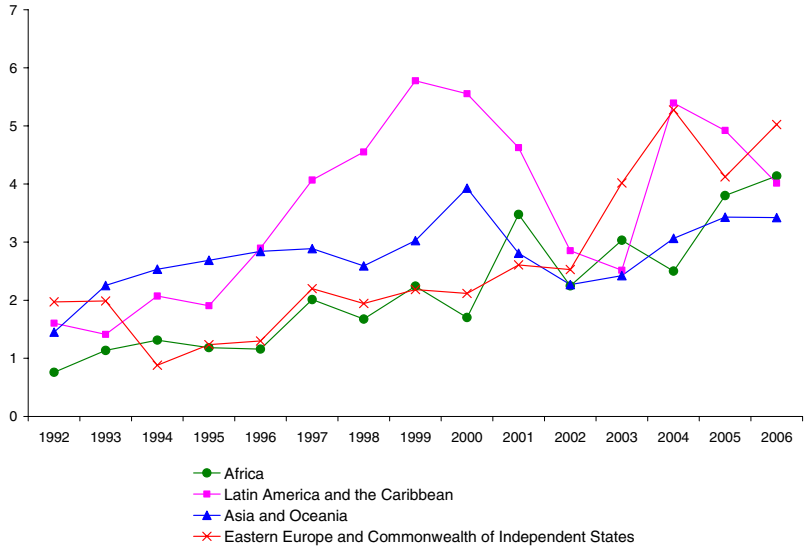
[5] In order to ensure comparability with data on other regions, all conclusions and data referring to Latin America and the Caribbean contained in this paragraph and in figures I.2 and I.3 include the main financial centres. The trends identified, however, also apply to data that exclude those centres.

Figure I.2
LATIN AMERICA AND THE CARIBBEAN: SHARE OF NET FDI INFLOWS, 1970-2006
(Percentages)



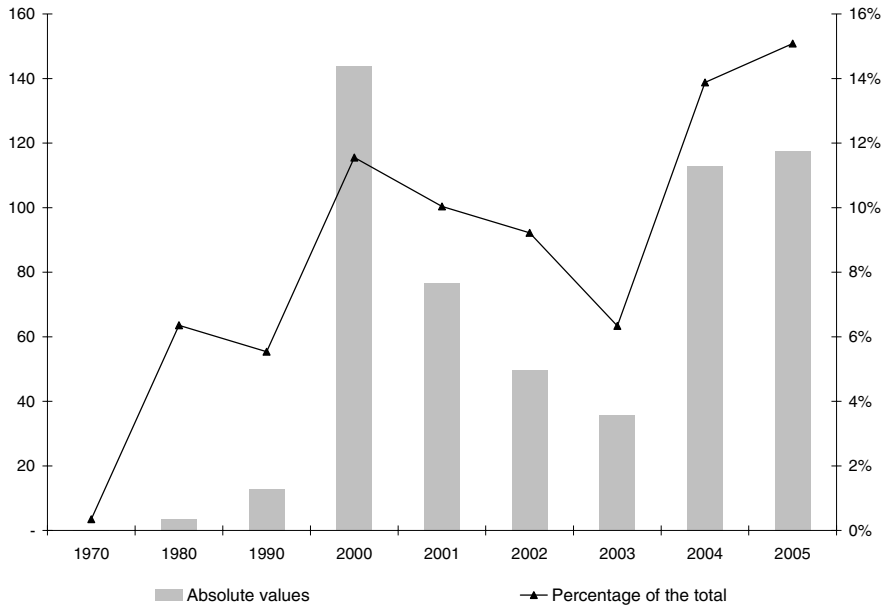
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Conference on Trade and Development (UNCTAD), *World Investment Report, 2006. FDI from Developing and Transition Economies: Implications for Development* (UNCTAD/WIR/2006), Geneva, 2006, United Nations publication, Sales No. E.06.II.D.11; "Foreign direct investment rose by 34% in 2006" (UNCTAD/PRESS/PR/2007/001), press release, 9 January 2007; and International Monetary Fund, World Economic Outlook Database, April 2007.

Figure I.3
FDI INFLOWS AS A PROPORTION OF GDP, DEVELOPING REGIONS, 1992-2006
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Conference on Trade and Development (UNCTAD), *World Investment Report, 2006. FDI from Developing and Transition Economies: Implications for Development* (UNCTAD/WIR/2006), Geneva, 2006, United Nations publication, Sales No. E.06.II.D.11; "Foreign direct investment rose by 34% in 2006" (UNCTAD/PRESS/PR/2007/001), Press release, 9 January 2007; and International Monetary Fund, World Economic Outlook Database, April 2007 for 2006 GDP figures.

Figure I.4
OFDI FROM DEVELOPING COUNTRIES, 1970-2005
(Billions of dollars and percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Conference on Trade and Development (UNCTAD), *World Investment Report, 2006. FDI from Developing and Transition Economies: Implications for Development* (UNCTAD/WIR/2006), Geneva, 2006. United Nations publication, Sales No. E.06.II.D.11.

These new trends are reflected in the dynamics of large-scale acquisitions. Although most of the large global cross-border acquisitions announced or concluded in 2006 involved purchases by firms in developed countries (see table I.2), some large transactions were carried out by developing-country firms (Brazil, India and Mexico), mainly in sectors using natural resources or manufactures based on those resources. The largest acquisition of this type made during the year was the purchase of Arcelor, the steel giant that resulted from the merger of Arbed and Aceralia, by Mittal Steel, a firm with Indian capital.[6] Latin American and Caribbean firms have become key agents. The Brazilian Companhia Vale do Rio Doce (CVRD) paid out approximately US$ 16.7 billion to buy control of the Canadian mining company Inco, after competing against Phelps Dodge (United States) and Teck Cominco (Canada).[7] CEMEX (Mexico) acquired Rinker (Australia) for approximately US$ 14.6 billion.[8] In addition, in January 2007, after several months of competition with the Brazilian Companhia Siderúrgica Nacional (CSN), Tata Steel (India) won control of the Corus Group (United Kingdom) (*Financial Times*, 2007). These operations involving trans-Latins —CVRD with the purchase of Inco and CEMEX with the purchase of Rinker— are larger than any acquisition made by TNCs in Latin America in the course of 2006.

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[6] Mittal Steel is controlled by the Mittal family of India and is listed on the Amsterdam (Netherlands) stock exchange.

[7] In this transaction, CVRD was competing with the United States company Phelps Dodge, which was subsequently purchased by another United States company, Freeport. This transaction, still pending, is not included in table I.2 as it is not a cross-border acquisition, despite involving assets outside of the United States.

[8] An offer of US$ 12.062 billion was made in October 2006 and the purchase was carried out in 2007 for US$ 14.627 billion.

Table I.2
CROSS-BORDER ACQUISITIONS FOR AMOUNTS IN EXCESS OF US$ 10 BILLION, 2006 [a]
(Millions of dollars)

Firm bought	Country of the firm bought	Buyer firm	Country of buyer firm	Stated value (millions)	Sector
(a) Operations concluded [b]					
Arcelor	Luxembourg	Mittal Steel Co. NV	India/Netherlands	35 929	Iron and steel
O2 Plc	United Kingdom	Telefónica	Spain	31 126	Telecommunications
BAA Plc	United Kingdom	Grupo Ferrovial and others	Spain	27 373	Engineering and construction
Scottish Power Plc	United Kingdom	Iberdrola SA	Spain	27 209	Electricity
Gallaher Group	United Kingdom	Japan Tobacco Inc.	Japan	19 020	Tobacco
Falconbridge Ltd.	Canada	Xstrata Plc	United Kingdom	18 049	Mining
Vodafone assets	United Kingdom	Softbank Corp.	Japan	17 528	Telecommunications
Inco Ltd.	Canada	Companhia Vale do Rio Doce	Brazil	16 727	Mining
Boc Group Plc	United Kingdom	Linde AG	Germany	15 599	Chemicals
Thames Water Plc	United Kingdom	Macquarie Bank Ltd.	Australia	14 883	Water and sanitary services
Lucent Technologies	United States	Alcatel SA	France	14 444	Telecommunications
Corus Group Plc	United Kingdom	Tata Steel Limited	India	12 780	Iron/Steel
Societé des Autoroutes Paris	France	Macquarie/Eiffage	Australia/France	12 138	Roads
Winterthur Schweiz	Switzerland	AXA	France	10 915	Insurance
Banca Nazionale del Lavoro	Italy	BNP Paribas	France	10 848	Banks
AWG Plc	United Kingdom	Osprey Acquisitions Ltd.	United Kingdom, Australia, Canada	10 388	Water and sanitary services
(b) Operations pending [b]					
Endesa	Spain	E.ON AG	Germany	72 495	Electricity
Rinker Group Ltd.	Australia	Cemex SAB	Mexico	14 627	Construction materials
KeySpan Corp.	United States	National Grid Plc	United Kingdom	11 283	Gas
Euronext NV	Netherlands	NYSE Group Inc.	United States	10 670	Diversified financial services

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures provided by Bloomberg.

[a] Transactions involving internal restructuring of enterprises were excluded. Purchases made by trans-Latins are shaded.
[b] As at 24 April 2007.
[c] Mittal Steel is controlled by the Mittal family of India. The company is listed on the Amsterdam stock exchange.

Another global trend has been the rise in cross-border investments made by private equity funds. These investments have a shorter timeline than those of TNCs and are considered direct when they involve a share of over 10% of a company's capital. This trend may cause concern in receiving countries about the long-term operations of the companies being purchased. At the same time, some of these sources of capital also represent solutions for enterprises in difficult periods or when large amounts of investment funds are needed (UNCTAD, 2006).

In general, the regulatory environment has been favourable to FDI. In this context, however, there are signs of a trend toward increasing social demands with regard to local participation in the benefits of FDI. Some measures have been taken in Latin America and the Caribbean to increase State participation in the ownership of natural resources and in the benefits from their extraction. This reflects a certain degree of dissatisfaction concerning the distribution of benefits from the exploitation of natural resources (see section C). Some Asian countries, in the context of more active and integrated investment attraction policies, have imposed conditions to ensure greater linkages between FDI and local companies. In Europe and the United States, obstacles to some of the main cross-border acquisitions have been associated with political sensitivity in relation to the purchase of "national champions", questions of national security, fear of job losses, or concerns about standards of corporate social responsibility and social protection (UNCTAD, 2006; Columbia University/The Economist Intelligence Unit, 2006; OECD, 2006; *Financial Times*, 2006b).

To sum up, global FDI reached an all-time peak in 2006, under generally favourable circumstances. The growth in FDI flows has mainly benefited developed countries. As for the composition of investors, companies from emerging economies are rapidly-growing sources of FDI. The Latin American and Caribbean region also showed growth, but at less than the global rate. The biggest news in terms of the region's share in global FDI flows is its growth as the origin of investments.

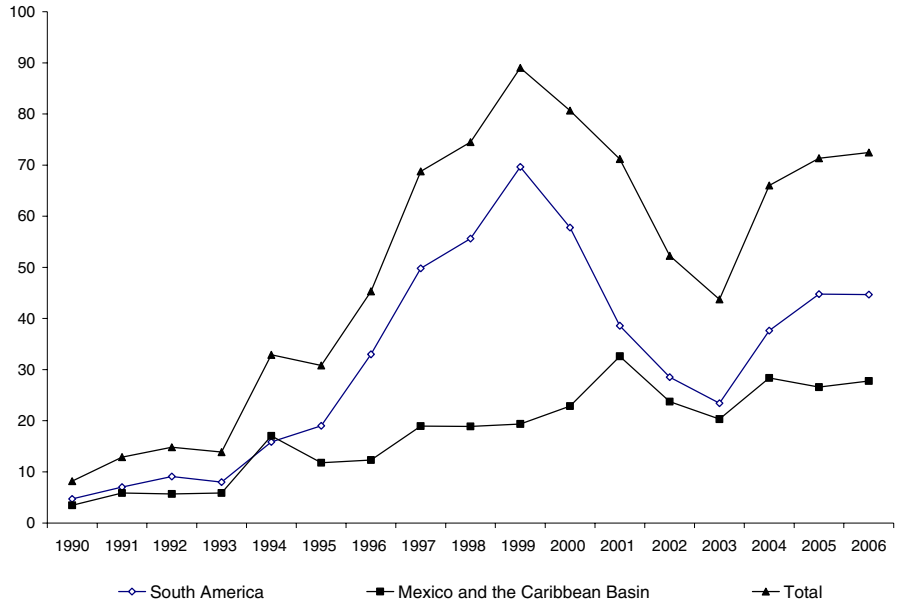
C. FDI INFLOWS AND TNCs IN LATIN AMERICA AND THE CARIBBEAN

1. Characteristics and trends

(a) FDI inflows

In 2006, FDI flows into Latin America and the Caribbean, (excluding the main financial centres) amounted to US$ 72.44 billion, which is 1.5% higher than in the previous year. This result confirms the somewhat stable nature of FDI over the past three years, a trend which reflects a slight fall in South America (0.2%) and an increase of 4.4% in net FDI inflows for Mexico and the Caribbean Basin (see figure I.5).

Figure I.5
LATIN AMERICA AND THE CARIBBEAN: NET FDI BY SUBREGION, 1992-2006 [a b]
(Billions of dollars)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), estimates on the basis of official figures as at 24 April 2007.

[a] The main financial centres are not included. The FDI figures indicate FDI inflows, discounting capital transfers made by foreign investors.

[b] These figures are different from those contained in the editions of *Economic Survey of Latin America and the Caribbean* and the *Preliminary Overview of the Economies of Latin America and the Caribbean* published in July and December 2006, respectively, as they show the net balance of direct foreign investment, that is, inward direct foreign investment in the reporting economy less outward foreign direct investment.

In 2006, the leading FDI recipient countries in Latin America and the Caribbean were Mexico and Brazil (which together accounted for 52% of total inflows); followed by Chile and Colombia (see table I.3 and table I of the annex). The largest variations recorded in relation to 2005 were due to specific transactions or accounting issues. The increase in investment in Panama was attributable to the purchase of Banistmo by the British Hong-Kong Shanghai Bank Corporation (HSBC), and the fall in investment in Colombia was due to the exceptionally high FDI figure for 2005 owing to the purchase of Bavaria by SABMiller.[9] The decline in FDI recorded in the Bolivarian Republic of Venezuela was mostly the result of accounting issues which are described in detail in subsection 2. The annex contains a brief description of the information available on these flows for each country.

[9] The effect of these transactions is also reflected in the large variation in the FDI/GDP ratio for these countries between 2005 and 2006 (see figure I.6).

Table I.3
FDI IN LATIN AMERICA AND THE CARIBBEAN, BY RECEIVING COUNTRY, 1992-2006
(Millions of dollars)

	1992-1996 [a]	1997-2001 [a]	2002-2006 [a]	2005	2006
South America	**16 989**	**53 362**	**35 811**	**44 778**	**44 679**
Argentina	4 683	10 605	3 640	5 008	4 809
Bolivia	243	897	185	-242	237
Brazil	4 497	27 075	15 746	15 067	18 782
Chile	2 465	5 544	5 809	6 960	8 053
Colombia	1 443	2 964	4 706	10 255	6 295
Ecuador	436	858	1 545	1 646	2 087
Paraguay	116	172	51	75	117 [b]
Peru	2 000	1 535	2 227	2 579	3 467
Uruguay	110	219	633	847	1 374
Venezuela (Bol. Rep. of)	996	4 492	1 269	2 583	-543
Mexico and Caribbean Basin	**10 548**	**22 542**	**25 352**	**26 583**	**27 760**
Mexico	8 724	17 113	19 114	19 643	18 939
Costa Rica	307	502	830	861	1 436
El Salvador	13	366	342	517	204
Guatemala	91	319	186	208	325
Honduras	50	187	301	372	385
Nicaragua	62	235	237	241	290
Panama	271	892	1 094	1 027	2 560
Dominican Republic	217	898	929	1 023	1 183
Suriname	-27	-47	-74	-37	-144 [b]
Trinidad and Tobago	346	777	884	940	883
Jamaica	136	436	621	682	621 [c]
Other Caribbean countries	342	609	888	1 106	1 078 [c]
Total	**27 537**	**76 903**	**61 163**	**71 361**	**72 439**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), estimates on the basis of official figures as at 24 April 2007. The figures exclude the main financial centres.

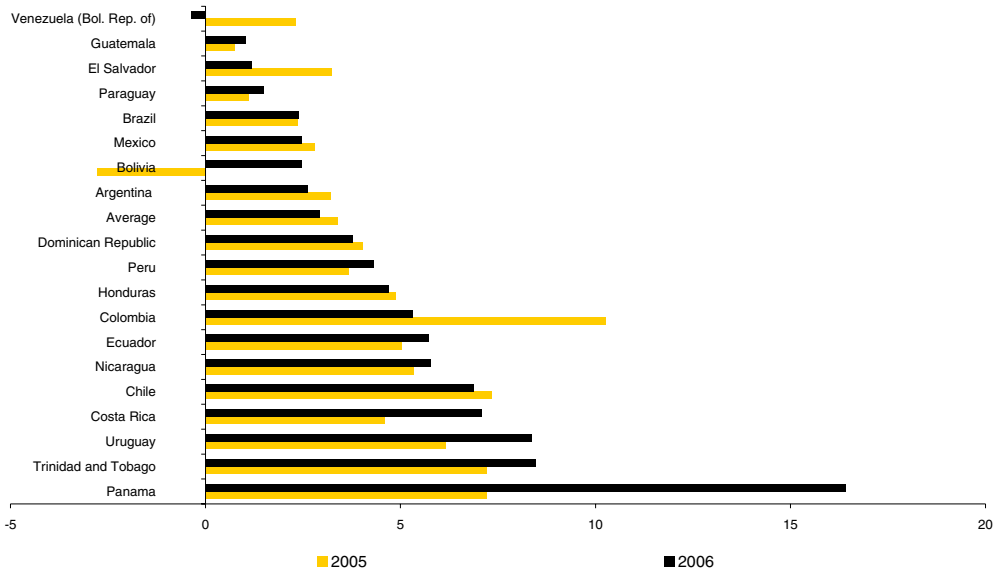
[a] Annual averages.
[b] Extrapolations based on the quarterly data available.
[c] Estimates based on the average for 2002-2005.

In terms of GDP, excluding the small Caribbean economies, Panama received the most FDI in 2006, followed by Trinidad and Tobago, Uruguay and Costa Rica. The regional average FDI/GDP ratio remains at 3% (see figure I.6).

In 2006, the United States, Netherlands, Canada and Spain were the main countries of origin of FDI received by Latin America and the Caribbean (see figure I.7). In relation to previous years, Spain's share has fallen while that of Canada[10] has increased. Intraregional flows fell in relation to 2005, but remained close to the average level for the period 2002-2005. This stability contrasts with the sharp increase in OFDI from the countries of Latin America and the Caribbean, which was mostly due to a small number of transactions outside the region (see section D).

[10] The strong presence of Canada is partly due to a transaction in Chile that involved the purchase of assets by Canadian companies from other Canadian companies. Chile records investments made, but not the withdrawal of investment, so Canada is overrepresented. Nevertheless, even without taking into account Canadian investments in Chile (which amount to much more than this transaction), Canada is still the third-largest investor in 2006 in the group of countries considered.

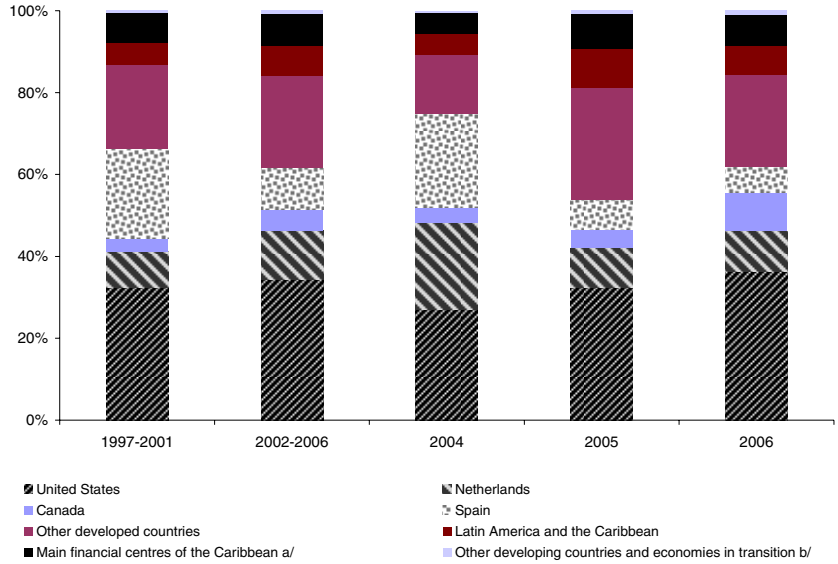
Figure I.6
LATIN AMERICA AND THE CARIBBEAN (SELECTED COUNTRIES): RATIO OF NET FDI INFLOWS TO GDP, 2005-2006 [a]
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures and projections for 2006.

[a] The ratio shown in the figure is obtained on the basis of each year's FDI and the three-year moving average of GDP.

Figure I.7
LATIN AMERICA AND THE CARIBBEAN: MAIN INVESTOR COUNTRIES AND GROUPS OF COUNTRIES
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), estimates on the basis of official figures as at 16 April 2007.

[a] Includes Bermuda, British Virgin Islands, Cayman Islands and Netherlands Antilles.
[b] Includes the economies of South-Eastern Europe and the Commonwealth of Independent States.

Latin America and the Caribbean has begun to attract investments from other developing regions, although this is not yet reflected to a significant extent in the official figures.[11] A clearer indication of this phenomenon can be found in the information on acquisitions and investment projects by investors from China, India and other countries which have launched new undertakings in the region, mainly in natural resources (see subsection 2). The Indian conglomerate Tata is an interesting exception as it has also started making investments in other sectors (see box I.2).

Box I.2
THE TATA GROUP: INVESTOR AND COMPETITOR

The Indian group Tata is a conglomerate of 96 companies distributed over seven sectors: information and communications systems; engineering; materials; services; energy; mass consumer products and chemicals. The group has operations in 54 countries, revenues of US$ 22 billion for the fiscal year 2005-2006 and over 200,000 employees. Three of the group's companies have a global presence and have had various roles in Latin America and the Caribbean or have interacted with companies in the region: Tata Motors, which takes advantage of synergies with Latin American companies to supply markets in the region and in India; Tata Consultancy, which seeks markets in high-technology services in Latin America; and Tata Steel, which competes with the region's companies for assets and global markets.

Tata Motors was created in 1945 and is the main Indian motor vehicle producer, with income of US$ 5.5 billion for the fiscal year 2005-2006. The company exports to Europe, Africa, the Middle East, other Asian countries and Australia, and has assembly operations in Bangladesh, Kenya, Malaysia, the Russian Federation, Senegal and Ukraine. In recent years, its international expansion has been driven by two acquisitions: Daewoo Commercial Vehicle Company, the second-largest Korean truck manufacturer, in 2004; and a share in Hispano Carrocera, a Spanish bus manufacturer, in 2005 (with an option to acquire the remaining shares). Tata Motors' first vehicles were produced under a collaboration agreement with Daimler-Benz (Germany) in the 1950s and the company continues to benefit from collaboration with other companies, including Cummins (United States) and Hitachi Machinery Company (Japan). Two collaborative projects with Latin American companies were announced in 2006. The first is a joint venture with Marcopolo (Brazil) for bus manufacture and assembly in India. Marcopolo's international operations, as in the case of Tata Motors, have grown substantially in the last few years as it has capitalized on its experience in markets with typical developing-country characteristics. The second is a collaboration project with Fiat (Italy), which is still under consideration, to manufacture Tata vehicles in Latin America. The Fiat plants in Córdoba, Argentina, or Minas Gerais, Brazil, would be used to manufacture vehicles of both makes for sale within and outside the region.

Tata Consultancy Services (TCS) is a leading consultancy firm for information technology, business process outsourcing (BPO) and technological solutions for companies around the world. It has offices in 33 countries and clients in 55, covering sectors that include banking and financial services, insurance, manufactures, telecommunications, retail trade and transport. Its main service centres in Latin America are in Brazil, Chile and Uruguay. The company was established in Uruguay in 2002 and has a global development centre for services to Spain and the Spanish-speaking countries of Latin America. At the end of 2006, it established a new centre in Uruguay. Its operations in Brazil were established in 2002 and focus on specific projects, operating in partnership with a local group. In 2005 these operations were expanded by the signing of an outsourcing contract with the bank ABN Amro. TCS also began to operate in Chile in 2002, and in 2005 it bought Comicrom, a BPO company. The purchase was made in the context of efforts to diversify the company's sources of income by increasing the BPO component, among other measures. In January 2007, the company announced a new investment in Ecuador, after signing an outsourcing contract with Banco Pichincha, the largest private bank in Ecuador. One of the company's main challenges in Latin America is finding qualified personnel.

[11] One of the reasons why official flows do not reflect this trend, apart from the fact that this is a recent phenomenon, is the use of financial centres or investments from subsidiaries situated in other countries (as in the case of SABMiller mentioned above), which are particularly significant for investors from countries such as China, where foreign investment is subject to numerous registration and approval procedures (OECD, 2006).

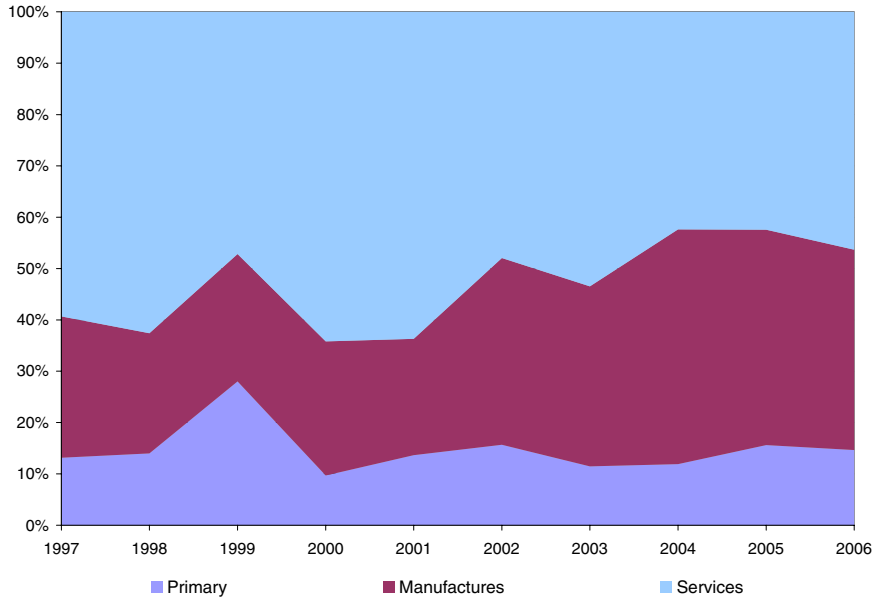
Box I.2 (concluded)

Tata Steel is India's largest integrated private-sector steel company. Outside India, it has operations in Singapore and Sri Lanka and projects in Australia, Bangladesh, the Islamic Republic of Iran, South Africa and Thailand. In contrast to its compatriot and competitor, Mittal Steel, it has not made significant investments in Latin America. At present, it is better known as a competitor rather than an investor. This became apparent in the battle with CSN (Brazil) for the purchase of Corus Steel (United Kingdom), which the Indian company won in January 2007. Tata Steel shares many of the competitive advantages of Latin American steel companies, such as backward linkages (iron, energy) and low production costs.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information obtained from the Official website [online] www.tata.com; *Isto é dinheiro*, "Tata de carro no Brasil", 28 June 2006; *Valor econômico*, "Múltis no país "importam" talentos de subsidiárias", 8 January 2007; Thomas Friedman, "Latin America's choice", *The New York Times*, 21 June 2006; *América economía*, "Tata cierra contrato por US$ 140 millones con banco ecuatoriano", 22 January 2007; *Financial Times*, "Tata Steel wins Corus with £6.2bn offer", 31 January 2007.

In terms of sectoral distribution, services have attracted the most FDI in the region over the past 10 years, followed by manufactures. This pattern has continued in recent years as well (see figure I.8). Excluding the Bolivarian Republic of Venezuela, which posted substantial levels of OFDI in 2006 in the primary sector (the reasons are explained in subsection 2), the proportion of FDI allocated to this sector has increased.

Figure I.8
LATIN AMERICA AND THE CARIBBEAN: SECTORAL DISTRIBUTION OF FDI INFLOWS, 1997-2006
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), estimates on the basis of official figures as at 16 April 2007.

Lastly, data on cross-border acquisitions in the region show that they accounted for a smaller share of FDI inflows in 2006 than in the previous year and that the growth in net FDI therefore appears to be due to increased investment in new capacity or extensions and modernizations (see the following subsection). Reinvestment has increased in Argentina, Chile, Colombia and Mexico, according to the data available for the main recipients.[12]

(b) Cross-border acquisitions in 2006[13]

In 2006, in line with the global trend, the total value of cross-border acquisitions increased substantially in Latin America and the Caribbean, although not all of them reflected actual FDI inflows.

Cross-border acquisitions may be classified as: (i) inflows (the purchase of assets or local companies by a foreign company); (ii) "change-of-hands" operations (the purchase, by a foreign company, of assets or companies controlled by another foreign company); or (iii) outflows (the sale of assets of foreign companies to local business groups). There are three important points to be made in relation to the 35 largest cross-border transactions concluded each year between 2004 and 2006 in Latin America and the Caribbean.[14]

First, inflows continued to predominate but were proportionally less in 2006 than in the two previous years (see figure I.9).[15]

TNCs from developed countries –traditionally the largest investors in the region– are also becoming less significant in relation to trans-Latins and firms from other developing countries. This trend, which is a reflection of the global trends mentioned previously (UNCTAD, 2006), can be seen both in inflows (see figure I.10) [16] and in change-of-hands operations (see figure I.11).

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[12] Brazil's published data do not distinguish between reinvestments, new investments and acquisitions.

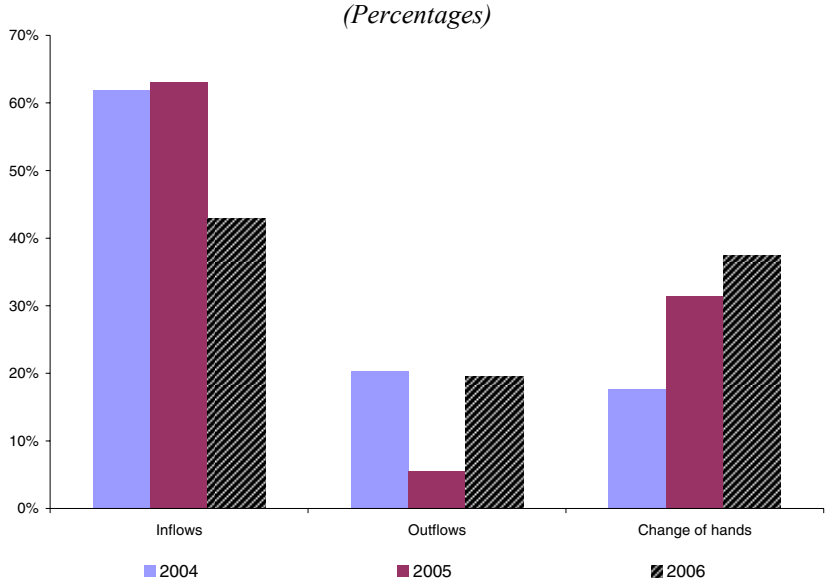
[13] This section is based on data provided by Bloomberg on transactions for which the amounts were made public. It therefore does not include the complete universe of cross-border acquisitions made. Nor does it include transactions involving companies from Latin America and the Caribbean which have their headquarters outside the region, as in the case of Quinsa, the holding company that controls Quilmes, which was purchased in one of the largest acquisitions in 2006 (see table I.4). Nevertheless, it does allow the identification of trends over time for a significant proportion of these transactions. Caution is required when interpreting the impact of known transactions on FDI flows, as in many cases the purchases are financed with shares of the same company. When a local company buys assets from a foreign company (in operations referred to in this section as OFDI), and the acquisition is financed with shares equivalent to more than 10% of the purchasing company, FDI inflows are recorded for the equivalent sum, which offsets the impact of the OFDI operation on FDI flows. Meanwhile, an inward FDI transaction, financed with shares amounting to more than 10% of the capital of the purchasing company, may be recorded in the balance of payments as OFDI of the purchased company's country. As will be seen in section D, this factor had a strong influence on the OFDI flows of some Latin American and Caribbean countries in 2004 and 2005.

[14] In 2006, the 35 largest transactions accounted for 83% of the total amount of cross-border transactions involving assets in Latin America recorded by Bloomberg for which the amount is known. In 2004 and 2005 this percentage was 86% and 92%, respectively.

[15] In 2006, the two largest outflows involving assets in the services sector in Brazil were: the sale by Bank of America of BankBoston operations in Brazil to the Itaú group (part of a transaction that also involves assets in Chile and Uruguay), and the sale by Électricité de France (EDF) of the electric power company Light to a group of local investors (see table I.4).

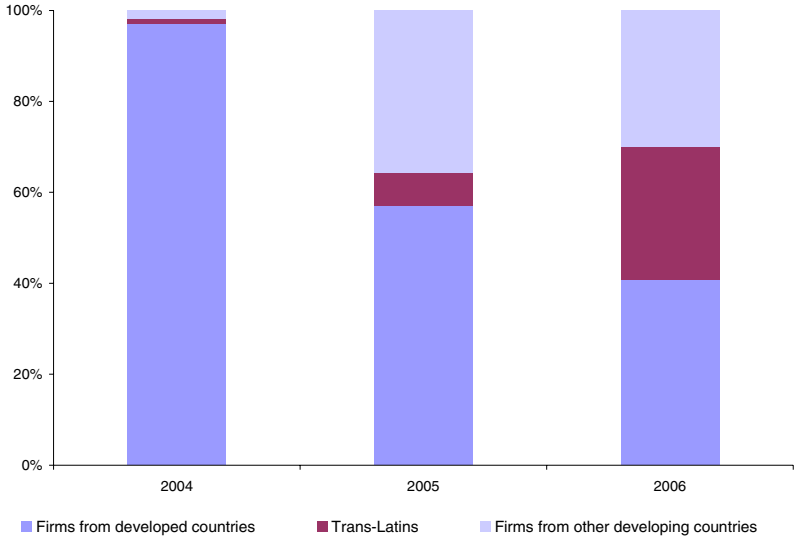
[16] The largest inflows in 2006 were: the acquisition of Kerzner International, a tourist development company in the Bahamas, by Istithmar (Dubai); and the purchase of Hylsamex by Ternium of the Techint group. The largest acquisition by a European company was Banistmo, purchased by HSBC. Of the inflow transactions worth over

Figure I.9
LATIN AMERICA AND THE CARIBBEAN: COMPOSITION OF CROSS-BORDER ACQUISITION BY INVESTMENT AMOUNT, 2004-2006 [a]
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures provided by Bloomberg.

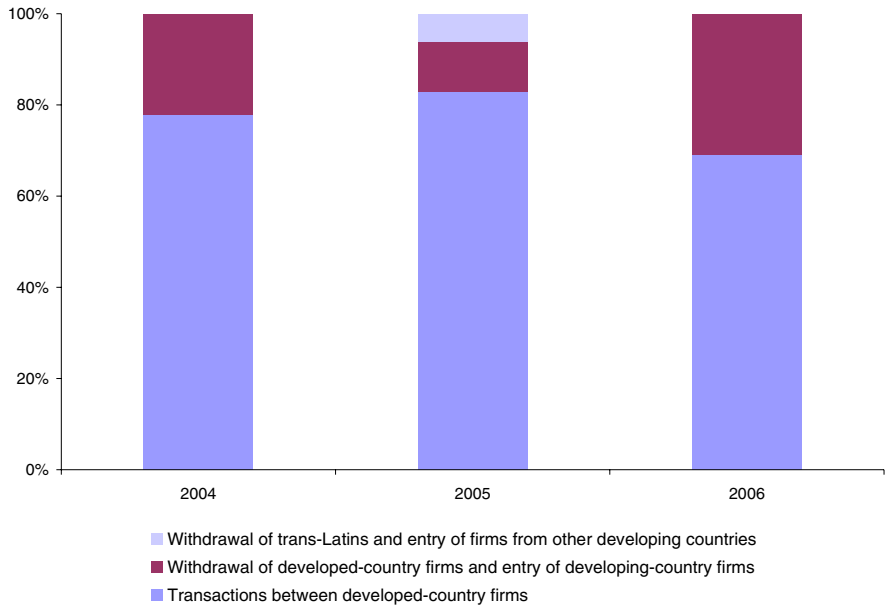
Figure I.10
LATIN AMERICA AND THE CARIBBEAN: COMPOSITION OF ACQUISITIONS INVOLVING FDI INFLOWS, 2004-2006 [a]
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures provided by Bloomberg.

US$ 500 million, none had a purchaser from the United States (see table I.4). Some firms from developing countries were also involved in changes of hands, as shown by the purchase of the Ecuadorian assets of Encana (Canada) by Andes Petroleum Company (China) and the purchase of 50% of Omimex Colombia (United States) by Sinopec and ONGC (China and India) (see table I.4). In addition to these operations there is the acquisition by América Móvil of Verizon´s assets in the Dominican Republic and Puerto Rico, which took place in 2007.

Figure I.11
LATIN AMERICA AND THE CARIBBEAN: COMPOSITION OF CHANGE-OF-HANDS OPERATIONS BETWEEN FOREIGN INVESTORS, 2004-2006
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures provided by Bloomberg.

Lastly, and also in line with the global trend (UNCTAD, 2006), 2006 brought an increase in relation to 2004 and 2005 in the share of foreign institutional investors (private equity funds, pension funds and others) in the largest cross-border transactions in the region (for example Istithmar's purchase of a controlling stake in Kerzner, and the acquisition of a controlling interest in Transelec by Brookfield Asset Management and others) (see table I.4). Local institutional investors also played a significant role, purchasing a larger share of TNC assets in 2006 than in the two previous years.[17]

The greater incidence of outflows in relation to inflows is a continuation of the trend observed in previous years of a decline in the share of TNCs among the largest enterprises in the region (see the following subsection). Added to the change in the structure of the largest investors, this trend means that public policymakers need to adapt their focusing strategies (see chapter II).

[17] Another large purchaser has been the Advent fund, which purchased the Milano retail chain in Mexico, the Brazif duty-free store chain in Brazil, Nuevo Banco Comercial in Uruguay, and, at the beginning of 2007, announced the establishment of a US$ 1 billion acquisitions fund for the region (*Business Latin America*, 2007a). The Matlin Patterson fund has also had a stake in the Brazilian airline Varig since the beginning of the company's financial restructuring process.

Table I.4
CROSS-BORDER ACQUISITIONS OF ASSETS IN LATIN AMERICA AND THE CARIBBEAN FOR OVER US$ 500 MILLION, CONCLUDED IN 2006 [a]

Firm or assets acquired	Country of the firm or assets acquired	Purchasing firm	Country of the purchasing firm	Seller	Country of seller	Value announced	Sector
Kerzner International	Bahamas	Istithmar	Dubai	--	--	3 630	Tourism
Hylsamex [b]	Mexico	Techint Argentina SA	Argentina	Local investors	Mexico	2 581	Steel
Transelec	Chile	Brookfield Asset Management	Canada	Hydro-Quebec	Canada	2 367	Electricity
BankBoston Brazil	Brazil	Banco Itaú Holding Financeiro	Brazil	Bank of America Corp.	United States	2 172	Banks/financial services
Grupo Banistmo SA	Panama	HSBC Holdings	United Kingdom	Local investors	Panama	1 770	Banks/financial services
Coal operations – Cerrejón	Colombia	Xstrata Plc	United Kingdom	Glencore	Switzerland	1 712	Mining
Light SA	Brazil	Rio Minas Energia e Part.	Brazil	Electricité de France	France	1 627	Electricity
Petroleum/pipeline businesses [b]	Ecuador	Andes Petroleum Company	China	Encana	Canada	1 420	Hydrocarbons
Quilmes Industrial SA	Argentina	Companhia de Bebidas das Américas	Brazil/Belgium	Bemberg Group	Argentina	1 250	Food/beverages
Banco Pactual SA	Brazil	UBS AG	Switzerland	Local investors	Brazil	1 000	Banks/financial services
FirstCaribbean International	Barbados	Canadian Imperial Bank of Commerce	Canada	Barclays Plc	United Kingdom	989	Banks/financial services
Embratel Participações	Brazil	Teléfonos de México	Mexico			812	Telecommunications
Omimex de Colombia (50%)	Colombia	Sinopec and ONGC	China and India	Omimex Resources	United States	800	Hydrocarbons
Tintaya Mine	Peru	Xstrata Plc	United Kingdom	BHP Billiton	United Kingdom/ Australia	750	Mining
Oil and gas operations in Argentina	Argentina	Apache Corp.	United States	Pioneer Natural Resources	United States	675	Hydrocarbons
50%+1 of Cartagena refinery	Colombia	Glencore International	Switzerland	Ecopetrol (State-owned)	Colombia	656	Hydrocarbons
BankBoston Chile	Chile and Uruguay	Banco Itaú Holding Financeiro	Brazil	Bank of America Corp.	United States	650	Banks/financial services
Sky Latin American Platform [c]	Brazil, Mexico	DirecTV Group	United States	News Corp., Liberty Media, and others	United States and others	579	Telecommunications
Share in Megacable and MCM	Mexico	Teleholding SA de CV	Mexico	RCN Corp.	United States	550	Telecommunications
Companhia de Transmissão de Energia Elétrica Paulista	Brazil	Interconexión Eléctrica SA	Colombia	State of Sao Paulo	Brazil	535	Electricity

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures provided by Bloomberg and press reports.

[a] Includes transactions in which the assets are situated in Latin America and the Caribbean. Does not include internal restructuring of business groups.

[b] Transaction announced in 2005, carried out in 2006.

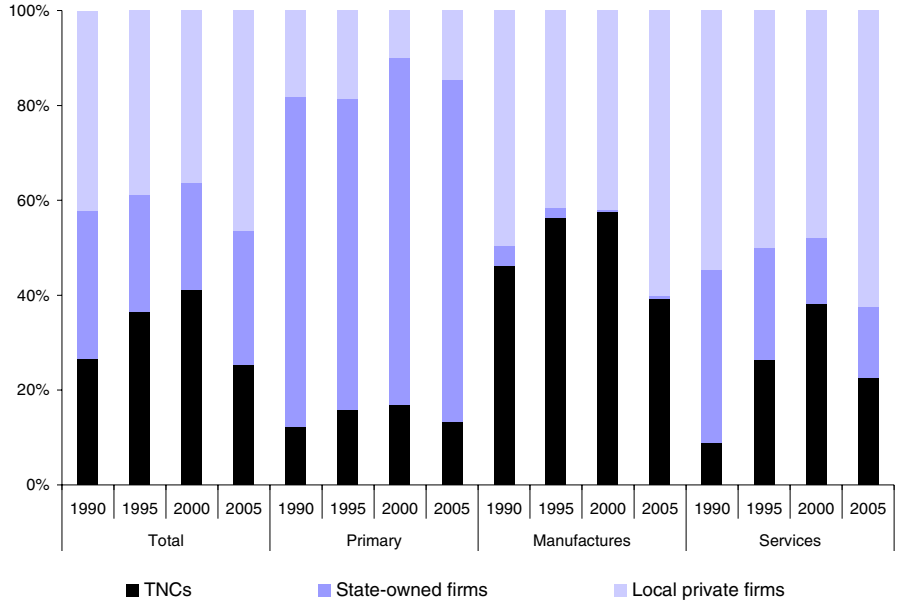
[c] Transaction announced in 2004, carried out in 2006.

(c) Presence of TNCs[18]

The largest TNCs in the region are found in the telecommunications, commerce and automotive sectors. In 2005, primary-sector companies had a larger share than in the previous year, this result being influenced by the rise in prices of the respective products (see table 4 of the annex).

The data for 2005 confirm the trend observed in previous years (ECLAC, 2006a) of a fall in the share of TNCs in the sales of the 500 largest companies of the region and an increase in the share of local companies, both State-owned (mainly in natural resources) and private firms (mainly in manufacturing and services (see figure I.12). The presence of TNCs in the region grew significantly between 1990 (27% of sales of the 500 largest enterprises in the region) and 2000 (41% of such sales). Nevertheless, by 2005 their share had diminished again to 25%, although in absolute terms the fall was less sudden. These changes are naturally influenced by many factors, including variations in the exchange rate and the effect of relative prices, in addition to the actual growth of some local companies and the withdrawal (or reduced activities) of some TNCs.

Figure I.12
LATIN AMERICA AND THE CARIBBEAN: SALES OF THE 500 LARGEST FIRMS, 1990-2005
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information provided by the Special Studies and Projects Department of *América economía* magazine, Santiago, Chile, 2006.

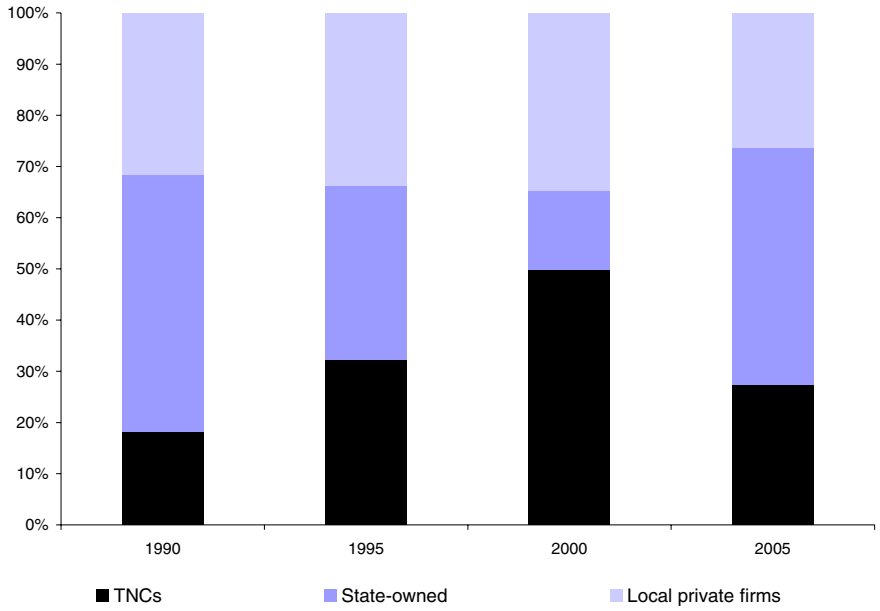
This relative fall in the presence of TNCs occurred in every sector. In the primary sector, sales of TNCs were down from 17% in 2000 to 13% in 2005, although in absolute terms sales actually increased.

[18] This section is based on data on the 500 largest companies in the region by sales, provided by the Special Studies and Projects Department of *América economía* magazine, Santiago, Chile. The most recent data available are for 2005.

For the manufacturing sector, the TNC share was down from 58% of the total of the 500 largest companies in 2000 to 39% in 2005. For the services sector, it declined from 38% to 23% over the same period. In contrast, local private enterprises were the ones that increased their share the most in each of the three sectors.

TNCs have also lost ground in terms of their position among the largest exporters in the region. This contrasts with the State-owned enterprises, which is mainly attributable to the upswing in the prices of natural resources.[19] Of the 200 largest exporters, TNCs accounted for 18% of exports in 1990, reaching a high point of 50% in 2000, and dropping to 27% in 2005. State-owned enterprises followed an inverse pattern. They accounted for 50% of the exports of the 200 largest exporters in 1990. This percentage dropped to 15% in 2000 and rose to 46% in 2005 (see figure I.13).

Figure I.13
EXPORTS OF THE 200 LARGEST EXPORTERS, BY OWNERSHIP
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information provided by the Special Studies and Projects Department of *América economía* magazine, Santiago, Chile, 2006.

Brazil and Mexico have the highest concentration of foreign-owned companies, accounting for 51% and 25%, respectively, of total sales in this group. They are followed by Argentina, Chile, Colombia and Peru.

In Brazil, TNCs are mainly involved in the telecommunications and automotive sectors. In telecommunications, Telefónica of Spain, Portugal Telecom and América Móvil (Mexico) are the main actors. In the automotive sector, the largest companies include General Motors (United States), Volkswagen (Germany) and Fiat (Italy) (see table 4 of the annex). Some companies which were included

[19] Of the 500 largest companies by sales, 293 are involved in exports, and data on exports in 2005 are available for 186 of these firms. For 15 companies, data on exports between 1995 and 2004 were used to estimate exports for 2005 based on the average ratio of exports to sales during that period. For the remaining 92 companies, the data available do not provide a sufficient basis for estimates.

in 2005 among the largest TNCs established in the country –such as AES Corp. (United States) and Électricité de France (France) in the electricity sector– sold a large proportion of their assets in 2006.

In Mexico, the automotive sector and retail trade are clearly the areas with the largest transnational presence. The first sector has General Motors, DaimlerChrysler (Germany), Volkswagen and Ford (United States). In the retail trade sector, the main participant is the Wal-Mart chain (United States), which has one of its largest operations outside its country of origin in Mexico (see table 4 of the annex).

The combination of data on FDI inflows, acquisitions and the presence of TNCs in the region indicates that FDI inflows have remained relatively stable, with a slight increase, which is a positive development; yet for a number of reasons, FDI in the region is slowing, declining in relation to global flows and to GDP. Acquisitions involve more and more departures and fewer entries of foreign companies; and TNCs account for a declining share of the region's large companies, not only in natural resources but also in manufacturing and services. The following subsection analyses these trends from the point of view of corporate strategies.

2. FDI in 2006 from the point of view of corporate strategy

Foreign investments can be categorized by the main motivation for the investment, which may be a search for markets, natural resources, efficiency for exporting to third markets or technological assets. A large proportion of FDI in Latin America and the Caribbean has been motivated by the search for markets. In addition, South America has attracted significant flows of FDI in search of natural resources, while Mexico and the Caribbean Basin have been the destination for efficiency-seeking investments, mainly for export to the United States market (see table I.5) (ECLAC, 2005, 2006a). Technological asset-seeking investments have not been significant in any of the subregions.

Table I.5
MAIN DESTINATION SECTORS FOR FDI IN LATIN AMERICA AND THE CARIBBEAN, BY CORPORATE STRATEGY

	Natural-resource seeking FDI	**Market-seeking FDI**	**Efficiency-seeking FDI**	**Technological asset-seeking FDI**
Goods	Petroleum and gas: Andean countries, Argentina, Trinidad and Tobago, Mining: Chile, Andean countries	Automotive: MERCOSUR Chemicals: Brazil Food: Argentina, Brazil, Mexico Beverages: Argentina, Brazil, Mexico Tobacco: Argentina, Brazil, Mexico	Automotive: Mexico Electronics: Mexico and the Caribbean Basin, Apparel: Caribbean Basin, Mexico	
Services	Tourism: Caribbean Basin, Mexico	Finance: Argentina, Bolivarian Republic of Venezuela, Brazil, Chile, Colombia, Mexico, Peru Telecommunications: Argentina, Bolivarian Republic of Venezuela, Brazil, Chile, Peru Retail trade: Argentina, Brazil, Chile, Mexico Electric power: Argentina, Brazil, Chile, Colombia, Central America Gas distribution: Argentina, Bolivia, Chile, Colombia	Back-office services: Costa Rica	

Source: Economic Commission for Latin America and the Caribbean (ECLAC), *Foreign Investment in Latin America and the Caribbean, 2004* (LC/G.2269-P), Santiago, Chile, 2005. United Nations publication, Sales No. E.05.II.G.32.

(a) Market-seeking FDI

Market-seeking investments in the region benefited from positive macroeconomic trends in 2006. GDP growth, inflation control, expansion of private credit, relatively low interest rates and lower unemployment have boosted domestic demand (ECLAC, 2006b). Nevertheless, these investments have suffered the effects of regulatory instability and of competition from imports, exacerbated by currency appreciation in some of the main markets. Some TNCs, mainly in the services sector, decided to sell all or part of their operations in the region in order to concentrate on more profitable markets. The trans-Latins have become more important as market-seeking investors within the region, especially for services and mass consumer goods.

(i) Services

In the services sector, the main destination sectors for FDI have been telecommunications, retail trade and the financial sector. In the electricity sector and in sanitation services, the year brought more FDI exits than entries. In any case, the trans-Latins have expanded their share in all of these segments.

In the telecommunications sector, the Mexican companies América Móvil and Telmex, and the Spanish Telefónica continued to dominate in the region, increasing their presence by acquisitions and new investments. This included the purchase by América Móvil of some of the assets of Verizon (United States) in Latin America.[20] These companies have invested in integrating telecommunications services and media, acquiring cable TV operators and broadband Internet services. In addition to these two groups, there is Millicom (Luxembourg), which acquired control of the State-owned Colombia Movil (Ola) for US$ 478 million (*Expansión*, 2006a). Telefónica, América Móvil and Millicom are also competing in the telecommunications market in Central America. The recent opening of the market in Honduras and Nicaragua has contributed to the growth of investments in this sector. CAFTA has played a positive role in this connection by guaranteeing the interconnection of networks (*Estrategia y Negocios*, 2006).

The main withdrawals of TNCs from the telecommunications market in Latin America included the sale by Telecom Italia of Digitel, in the Bolivarian Republic of Venezuela, to the local group Cisneros and the sale by Verizon of assets in the Bolivarian Republic of Venezuela, the Dominican Republic and Puerto Rico. Telecom Italia had already begun to reduce its Latin American activities with the sale of TIM Peru to América Móvil, followed by the sale of its share of ENTEL (Chile) in 2005. Telecom Italia began to focus its expansion on broadband services and media in Italy and other European countries, while in Latin America it continues its mobile telephone operations in Brazil.[21] Verizon has concentrated on markets with greater growth potential in wireless telephony and Internet, especially in the United States (Bloomberg, 2007).

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[20] América Móvil had made an offer for Verizon's assets in the Bolivarian Republic of Venezuela, Dominican Republic and Puerto Rico, estimated at US$ 3.7 billion. In December 2006, its assets in the Dominican Republic were included in the sale to América Móvil of Verizon Canada Holdings Corp., the owner of Verizon's assets in that country. In the Bolivarian Republic of Venezuela, in view of the announcement that companies in strategic sectors would be nationalized, América Móvil abandoned the planned purchase. These assets were then purchased by the Venezuelan Government in February 2007. As at March 2007, the purchase of the assets in Puerto Rico was still pending.

[21] In Brazil, after a long period of conflict with its partners, Telecom Italia announced that it would transfer its 38% share in the controlling company of Brasil Telecom to a trust fund, and authorized JP Morgan to sell this stake. During the year there was also speculation on the possible sale of the cellular telephony unit of Telecom Italia in Brazil, when the company released a statement confirming the receipt of an unsolicited offer and letting it be known that the administrative council had authorized negotiations for a possible sale (www.teleco.com.br). In

In retail trade, the large international operators have focused on the biggest markets —Brazil and Mexico— and on Central America, while the trans-Latins, especially the Chilean ones, are conquering other markets in South America. In 2006, Wal-Mart, the largest TNC in Mexico by sales, began a project worth over US$ 2 billion in that country. In Central America, it acquired control of Central American Retail Holding Co. (CARHCO), based in Costa Rica, with stores in Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua.[22] In addition, it began to enter financial services by establishing Walmex. In Brazil, Wal-Mart consolidated its position with the purchase of Sonae assets in 2005 (see chapter IV), and then announced an investment plan of US$ 800 million to open new stores and to alter existing ones (*Valor econômico*, 2006a).

The French companies Carrefour and Casino have focused their efforts on South America. After leaving the Mexican market in 2005, Carrefour bought minor assets of Sonae in Brazil and in 2006 began expansion programmes in Argentina, Brazil and Colombia. Casino also focused its growth on the latter two countries. In Colombia, it acquired additional shares in Almacenes Éxito (for which Cencosud, of Chile, had made an offer). In Brazil it maintains its share in Companhia Brasileira de Distribuição (*Dinero On Line*, 2007; *Valor econômico*, 2006b).

Chilean companies are entering the battle of the TNCs in Argentina, Colombia and Peru. While Argentina has been a traditional destination for Chilean investment in retail trade,[23] Colombia and Peru were the destinations with the strongest growth in 2006. Cencosud, Falabella and Ripley have expanded their regional operations, especially in the two countries mentioned. One of the competitive advantages that has resulted in this continuous expansion over the past few years is the integration of retail and credit facilities, while one of the factors leading these firms abroad is the small size of the domestic market (Calderón, 2006). These companies still have not entered significantly into larger markets such as Brazil and Mexico, where the competition of TNCs is stronger (*Capital*, 2006). In fact, FASA withdrew after a brief encounter with the Brazilian market and sold its main assets in the country, although it retains a strong presence in Mexico.

In the financial services sector, a number of foreign institutions made new investments, but there were also some significant withdrawals. In fact, the largest transaction in the sector was the sale, by Bank of America, of BankBoston's assets in Brazil, Chile and Uruguay to the Brazilian bank Itaú. This bank already had a significant presence in Argentina through the bank Itaú Buen Ayre, and thus consolidated its regional presence and its share of the domestic market. In Argentina, the assets of BankBoston went to Standard Bank Group, of South Africa.[24]

The main inflows of FDI in this sector were the purchases of Banistmo, in Panama, by HSBC, and of the Pactual bank in Brazil by UBS. The first is associated with the growth prospects of the Panamanian and Central American market, taking into account factors such as the expansion of the Panama Canal, CAFTA-DR, and growth in remittances from residents abroad, which has boosted the market for bank and financial services in the isthmus (see box I.3). The second reflects the expansion of UBS in a niche market —investment banking— in Brazil. The company also began to enter retail segments in Mexico. HSBC and Scotiabank have invested in that country´s credit and mortgage segments. As mentioned previously, Wal-Mart has begun to provide financial services in Mexico, targeting low-income consumers (*América economía*, 2007).

Bolivia, Telecom Italia has a majority share in ENTEL, which is being considered for nationalization (*Business Latin America*, 2007b).

22 Wal-Mart already owned 35% of the company and acquired an additional 51%.

23 The Chilean group Paulmann (Cencosud) leads the supermarket ranking in Argentina (Mercado, 2006).

24 Also in Brazil, American Express sold its operations to the local group Bradesco.

Box I.3
RECENT FDI IN THE BANKING SECTOR IN CENTRAL AMERICA

The Central American banking market is going through an intense restructuring. A number of large investments —acquisitions and expansions— marked this sector in 2006. One of the main factors to stimulate foreign investors' interest in the region's financial sector is the prospect of the entry into force of CAFTA-DR, which will increase trade, FDI in other sectors and the demand for banking services. A second factor is the prospect of bringing large segments of the population into the banking market. The region has low penetration rates by global standards: 26% in Costa Rica compared with 87% en Canada. In terms of demographic patterns, the young population of the subregion (as in the rest of Latin America and the Caribbean) is a contrast to that of the northern hemisphere and offers good prospects for growth and diversification of services and income sources. Lastly, family remittances create a growing demand for banking services.

In this context, a number of international banks have purchased regional banks that had expanded within Central America. The largest transaction in the sector (and in the subregion in general) in 2006 was the purchase of Banistmo (Panama) by HSBC (United Kingdom), for US$ 1.771 billion. When the negotiations for the purchase began, in 2005, Banistmo had significant positions in Colombia, Costa Rica, Honduras and Nicaragua, as well as Panama. In February 2006, it took control of Banco Salvadoreño, which, in addition to a strong position in El Salvador, has offices in California, Nevada and Texas (United States) to provide services to the immigrant community and facilitate remittances. The transaction gives HSBC a strong position, which its largest transnational rival, Scotiabank (Canada), had achieved through a gradual strategy that it has intensified in the last few years. Citigroup bought control of Grupo Financiero Uno (El Salvador) —which had assets in various Central American countries— and Grupo Cuscatlán (Panama). The latter had acquired the Central American operations of Lloyds TSB (United Kingdom) in 2004, which enabled it to enter Guatemala, Honduras, and Panama. It also has operations in Costa Rica and an office in Nicaragua.

There has also been a process of consolidation and internationalization among the Central American banks. In July 2006, Banco Continental (Panama) bought Banco Atlántico (Panama) from the Spanish bank Sabadell, counting on prospects of growth owing to the Panama Canal expansion. In Costa Rica, the national banking system has regulatory restrictions on expansion via acquisitions, but has plans to grow in the region through its partnership with Banco de Costa Rica. Banco de Reservas (Dominican Republic) has plans to establish itself in Haiti. Banco Industrial (Guatemala) is growing through acquisitions within the country, but also plans to expand to other countries in the region and to open offices in the United States and Mexico. At the beginning of 2007, there was a merger of Banco General and Banco Continental (Panama), and G&T Continental, of Guatemala, bought its rival Banex-Figsa. Lastly, Banagrícola (El Salvador) was purchased by Bancolombia in January 2007.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of "La defensa de Banistmo", *América economía*, 10 February 2006; "A kinder, gentler foreign bank", *LatinFinance*, August 2006; "May the best banks win", *Business Latin America*, 6 November 2006; "Upheavals whet big banks' appetites", *The Banker,* 1 September 2006; "Bancolombia anuncia compra salvadoreño Banagrícola", Reuters, 11 January 2007; "LatinFinance Banks of the Year 2006", *LatinFinance,* November 2006; "Deals", *LatinFinance*, February 2007.

As for the electricity sector, a series of domestic factors involving management problems led investors to exit from this sector in Brazil. The main such withdrawal was that of Electricité de France (EDF), which sold its share in Light, an energy distributor for the State of Rio de Janeiro, to a local consortium, after accumulated losses that were due, inter alia, to the effects of the currency devaluation in 1999 (which increased the value in reais of the company's debt) and the crisis in Brazil's energy sector.[25] In smaller transactions, Alliant Energy, El Paso, Public Service Enterprise Corporation Global (US) and AES sold electric power assets to local investors.[26] The total value of these transactions was almost US$ 3

[25] Light had been controlled by EDF since 2002 (the company had acquired its first share in Light at the time of its privatization in 1996). EDF also sold generating assets in Argentina in 2006.

[26] In the context of the announcement of nationalization of strategic sectors in the Bolivarian Republic of Venezuela, AES sold, in February 2007, its 82% share in CA Electricidad de Caracas (Radio Nacional, 2007).

billion (*Business Latin America*, 2006a). At the same time, in one of the largest cross-border transactions of the year, a new investment entered Brazil's electric power sector from Interconexión Eléctrica SA (ISA) of Colombia, which bought shares in CTEEP, an energy transmission company. ISA also purchased shares in Transmantaro, in Peru.[27]

In Argentina, in the period following the crisis which triggered the "pesification" of public utility rates, some companies renewed their investment projects in the country; others decided to leave, such as Aguas de Barcelona and Suez in the area of sanitation services. These companies withdrew from Aguas Argentinas, which returned to State control. Aguas de Barcelona also sold its share in Aguas de la Costa in Uruguay (which returned to State ownership) while Suez sold its share in Aguas Cordobesas and in January 2007 announced its withdrawal from drinking water supply services in Bolivia (*América economía*, 29 January 2007).

In summary, in the services markets there has been a great deal of interest in the telecommunications sector, some financial services segments and retail trade. In all of these sectors there have been winners and losers in the battles for national markets, both within and outside Latin America and the Caribbean. Some companies have therefore chosen specific countries on which to focus their expansion efforts. In the process, there were significant outflows of foreign investment from some countries, creating opportunities which have been taken up by trans-Latins and some local groups. Meanwhile, in basic services, outflows have been caused by regulatory changes and past sectoral and macroeconomic crises. Measures taken to nationalize some services in Venezuela since the beginning of 2007 may result in greater reticence on the part of foreign investors in the near future.

(ii) Manufactures

Market-seeking investments in manufactures included beverages in the segment of mass consumer goods and the automotive industry in the durable goods segment. Most of these investments went to South America.

Inflows to in the beverages sector were lower than in the two previous years as there were no large acquisitions such as those of AmBev (2004) and Bavaria (2005) (ECLAC, 2006a). Nevertheless, these same companies, now part of transnational groups, have made investments to expand their operations in the region. Bavaria invested in a new plant in Colombia and increased its share in Backus (Peru). AmBev purchased an additional share in Quilmes (Argentina) for US$ 1.2 billion and invested in new capacity in Argentina, Bolivia and Paraguay.[28]

The Mexican company FEMSA, which entered the Brazilian market in 2003 by purchasing Panamco (ECLAC, 2006b), expanded rapidly again in Brazil in 2006, purchasing 68% of the Kaiser brewery from Molson Coors (Canada) and integrating its beverage and beer operations. In Mexico, it increased its share of the carbonated beverages subsidiary that it operates in partnership with Coca-Cola and purchased, with this same partner, Jugos del Valle, a local company with a large share of the market in several countries of the region and substantial production capacity in Brazil.

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[27] ISA bought control of CTEEP for US$ 535 million. In January 2007, ISA made a takeover bid of US$ 352 million for additional shares in CTEEP (*América economía*, 2007).

[28] In 2007, AmBev made an offer of approximately US$ 313 million for the remaining share (*Business Latin America*, 2007c).

Also in Mexico —a key market for TNCs in beverages (see ECLAC 2006b)— the Peruvian Ajegroup, which in 2006 invested in a new plant in Tabasco, is competing with companies such as Coca-Cola and Pepsi and is gaining ground by establishing a low-cost niche. It also has operations in Venezuela, Ecuador, Costa Rica, Nicaragua, Guatemala and Colombia (*El Comercio*, 2007).

In contrast to the situation in Mexico (see subsection c), elsewhere in Latin America the automotive industry mainly supplies the local and regional market. There is a trend towards specialization in more compact vehicles: smaller and lower-cost models for the large manufacturers, motorcycles, and new corporate plans for low-cost cars that have been successful in other developing markets.

In 2006, FDI inflows to the automotive sector in Brazil dropped to their lowest level since 1997. Due to pressure from the exchange rate, idle capacity in some plants and labour conflicts, the closure of some plants was announced. Exports dropped in 2006 (Anfavea, 2007) and went mainly to other Latin American countries, especially Mexico.[29] As a result of currency appreciation, the former prospects for expanding Brazilian exports to other regions fell away (ECLAC, 2005). Volkswagen, for example, stopped exporting its Fox model to Europe (PriceWaterhouseCoopers Automotive Institute, 2006; Valor econômico, 2006c). Nevertheless, domestic sales of locally produced vehicles and vehicle production increased (Anfavea, 2006), indicating a decline in export prospects rather than in the domestic market. In this context, the main manufacturers began to modernize and expand. Fiat is implementing a modernization plan estimated at US$ 1.4 billion through 2008, Ford announced an investment plan of US$ 100 million until 2011, and Volkswagen US$ 1.2 billion until 2012 (*Business Latin America*, 2007d).

In Argentina, Toyota and PSA Peugeot Citroën expanded their operations to supply the rest of South America, and Honda established a motorcycle plant, a sector in which the government had established a series of investment promotion measures. As in other sectors, greater interest is gradually being shown by investors from India (see box I.2 on the investment plans of Tata motors) and China (a joint venture was established by Chery and the Argentine group Socma to produce Chery vehicles in Uruguay).

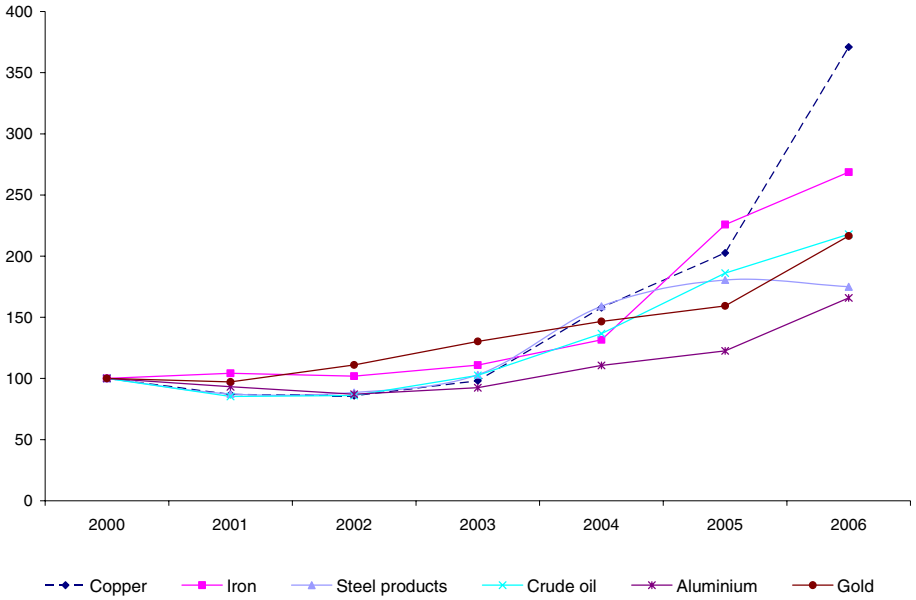
In general, the region has attracted substantial market-seeking investments in manufactures, although there are some factors which limit the volumes of this type of FDI. The main ones are: competition from low-cost Asian manufactures; GDP growth rates and per capita income at lower levels than in Asian developing countries; exchange-rate volatility (especially recently); and factors that constitute what is generally referred to as the business environment. At the same time, the shortage of qualified human capital and local supplier networks limits the nature of activities in the region. As chapter III shows, much of the investment in high-technology sectors such as electronics is in assembly activities, partly because of the difficulty of establishing linkages with local suppliers of components. The region continues to be generally off the map in activities that involve a higher R&D content and that could generate greater linkages with the local economies.

[29] An agreement implemented in 2003 provided for an import quota of motor vehicles at a zero tariff as a production complementarity initiative under which Brasil would export compact cars to Mexico, and Mexico would export to Brazil vehicles of higher unit values. Under this same agreement, there would be free trade as of 2007. Nevertheless, exports from Brazil to Mexico have been much higher than in the opposite direction. An agreement of November 2006 effectively established free trade in motor vehicles, but postponed it to 2011 for the commercial vehicles category (*Valor econômico*, 2006d).

(b) Natural-resource-seeking FDI

In 2006, natural-resource-seeking FDI in the region reflected the tension between two forces: the sustained rise in commodity prices (see figure I.14) and changes in the legal conditions for natural-resource exploration and exploitation in some countries. This occurred in the context of growing demands from governments and civil society groups for a greater share in the benefits of natural-resource exploitation and for greater control of the environmental and social impacts of these activities. In these circumstances, foreign investors have reacted in very different ways. While some have almost abandoned the region, have restructured their investments or are on stand-by in relation to new investments, others have announced new projects. Moreover, some trans-Latins and investors from other developing countries —especially China and India— have shown growing interest in the region.

Figure I.14
COMMODITY EXPORT PRICES
(Index: 2000=100)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund, *International Financial Statistics,* [online] ifs.apdi.net, 17 April 2007.

Note: The crude oil price is West Texas Intermediate.

(i) Hydrocarbons

In the hydrocarbons sector, two opposing trends are observed in relation to policies on the participation of foreign capital in exploration and production activities. Some countries have taken measures to attract companies to the sector as a way of ensuring investments in exploration and thereby restoring reserves and production levels. Others have made changes to their legislation, or have begun to actually implement measures they had previously adopted in order to obtain greater profits and increase the State role in petroleum activities (see box I.4).

Box I.4

CHANGES IN THE RELATIONSHIP WITH FOREIGN INVESTORS IN THE PETROLEUM AND GAS SECTOR IN THE ANDEAN COUNTRIES

In the last few years, significant changes have been made in the standards and rules that regulate the activities of private investors (in practice mostly foreign investors) in the petroleum and gas sector in the Andean countries. The direction of these changes has varied, however. While in the Bolivarian Republic of Venezuela, Bolivia and Ecuador the trend has been towards higher taxes and more restrictions on private investment as a way of ensuring that the countries receive a greater share of the profits from petroleum activities, in Colombia the changes have been towards greater openness, for reasons that include encouraging higher levels of investment in exploration and production and recovery of reserve levels.

In the Bolivarian Republic of Venezuela, at the end of 2005, the government required private investors to accept the conversion of their operating agreements into joint ventures, with a majority share for PDVSA. Soon afterwards, the government proposed an increase in royalty taxes (which had also been increased in 2004) on projects for extra-heavy crude extraction from the Orinoco Belt. At the beginning of 2007, there was an announcement that these operations would be nationalized as of 1 May. The consortiums were converted into joint ventures, with a controlling share for PDVSA.

In Bolivia, the Hydrocarbons Act of 2005 created a royalty of 32% in addition to the existing 18% tax. The law allowed foreign investors a period of 180 days to migrate to the new contracts. This period elapsed without changes being made in the contracts, although the investors were paying the additional royalties to the government. When the nationalization of hydrocarbons was declared on 1 May 2006, an additional period of six months was allowed, this time for the companies to sign new operating contracts (which included transfer of ownership to the State) with higher tax rates that varied according to the characteristics of each project, up to a legal maximum of 82%. In October the petroleum companies signed new contracts. In September, the nationalization of private refineries was announced. This would mainly have affected the interests of Petrobras, but the measure was in any case suspended a few days later.

In Ecuador, as in Bolivia and the Bolivarian Republic of Venezuela, the law on hydrocarbons was reformed in order to give the government a greater share in revenues from petroleum and gas extraction. It was established that when crude prices exceeded the levels agreed in the contract with each private company, the State would receive 50% of the export income. In contrast to what occurred in the other two countries, the reforms in Ecuador did not require a transfer of ownership to the State. Nevertheless, one episode did lead to the exit of a significant investor. On a date very close to the nationalization of hydrocarbons in Bolivia, the State procurator's office and Petroecuador accused the United States company Occidental of violating its exploration and exploitation contract, which led to the company's withdrawal from Ecuador. The Ecuadorian Ministry of Energy declared that Occidental had illegally transferred a piece of land from its exploration contract for Block 15 to the Canadian company EnCana in 2000. The concession was cancelled and the assets used in that operation were transferred to the State.

In Colombia, in contrast, foreign investment in the hydrocarbons sector has been encouraged as a way of increasing reserve levels. Since 1999 the government has reduced the obligatory share of Ecopetrol in joint ventures and has made regulatory and institutional changes which include the creation of the National Hydrocarbons Agency. In 2006, the Cartagena refinery was privatized. Glencore International AG (Switzerland) won the bidding, in which its competitors included Petrobras. The government announced that it would sell 20% of Ecopetrol, this measure being authorized by Congress in November 2006.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of "Ecuador: Tax before trade", *Business Latin America*, 1 May 2006; "What's new in your industry", *Business Latin America*, 15 May 2006; International Institute for Sustainable Development, *Investment Treaty News (ITN),* various issues; "Colombia charms oil and gas investors", *Financial Times*, 31 August 2006; "Bolivia acorralado", *Expansión*, 4-18 October 2006; "Estado asumirá operaciones en la Faja del Orinoco desde el 1 de mayo", press release, Ministry of People's Power for Energy and Petroleum, 2 February 2007; "Revisão de contratos no Equador pode afetar Petrobrás", *Valor econômico*, 29 November 2006; Genaro Arriagada, "Petróleo y gas en América Latina. Un análisis político de relaciones internacionales a partir de la política venezolana", Real Instituto Elcano, 20 September 2006; "Bolivia suspende nacionalização de refinarias", *Gazeta mercantil*, 25 September 2006.

As a result of this combination of factors, there has been a restructuring of the actors in the sector. Some companies, especially North American and European companies, have sold their assets in the

region. At the same time, there has been a rapid increase in interest shown by firms, especially State-owned companies, from China, India and other developing countries. Major acquisitions in 2006 included the purchase of EnCana's assets in Ecuador by Andes Petroleum Company (China)[30] and the purchase by Sinopec (China) and ONGC (India) of 50% of Omimex in Colombia. The latter also bought shares in an exploration block in Brazil operated by Royal Dutch Shell.[31] PDVSA signed a series of cooperation and investment agreements with China National Petroleum Corporation (CNPC) and with Petropars (Iran), and began joint exploration contracts with both companies. PDVSA was also one of the most dynamic investors in the hydrocarbons sector in the region, together with Petrobras (see section D).[32]

Other significant events included new investments by Repsol YPF in Argentina (where it also invested in the refining segment, after the introduction of new rules on fuel sulphur content) and the purchase by Glencore (Switzerland) of control of the Cartagena refinery in Colombia.

FDI flows to the hydrocarbons sector indicate that, in regional terms, the net effect of these opposing trends seems to have been positive in 2006, with flows increasing by 57% in Colombia and by 26% in Ecuador in relation to 2005. In Brazil, they diminished slightly in relation to 2005, but remained much higher than in 2004 and than the average level since 1997, when the sector was first liberalized. Although no data are available on flows to this sector in Peru in 2006, the granting of 16 new licences for exploration and production points to an increase in investment over the next few years (Ministry of Energy and Mines, 2007a).[33]

In Bolivia, the figures on FDI inflows do not show a substantial decline from 2005 to 2006, despite the regulatory changes mentioned above. The official data indicate that gross FDI inflows remained essentially stable at US$ 104.5 million, compared to US$ 105 million in the previous year.[34]

It is the Bolivarian Republic of Venezuela that shows the steepest drop in net FDI flows for hydrocarbons, reaching a negative value of US$ 1.958 billion in 2006. Nevertheless, this fall is not directly related to the regulatory changes made in 2005-2006. It is explained by the fact that between 2003 and 2004, PDVSA stopped publishing its financial accounts, thus preventing the distribution of profits among the foreign participants in strategic partnerships set up to operate in the Orinoco Belt. In 2005 and 2006 the financial accounts were published and the distributed profits were recorded as FDI outflows. Reinvestment in the Venezuelan petroleum sector remained relatively stable.

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30 The transaction was announced in 2005 and implemented in 2006.

31 Royal Dutch Shell bought ExxonMobil´s 30% stake in block BC-10 of the Campos basin, and sold 15% to ONGC (Shell Media Center, 2006).

32 PDVSA is also negotiating an agreement with ONGC. Moreover, the Government of India signed agreements with the Governments of Cuba and Ecuador for oil and gas exploration in these countries, and had talks with Brazil in relation to oil and gas exploration and production and cooperation initiatives to produce ethanol (ONGC 2006a, 2006b).

33 As in other countries of the region, environmental issues are one of the biggest challenges for the hydrocarbons sector in Peru. New gas leaks and a fire in 2006 raised doubts about the safety of the Camisea project. A new initiative in the context of the Camisea project, which involves the construction and operation of a natural gas liquefaction plant, a marine loading terminal and a connection to the gas pipeline of Transportadora de Gas del Perú (TGP), has been the subject of consultations between IDB and civil society. One of the requirements for the financing of the project is compliance with a strategy that takes social and environmental aspects into account.

34 As no data are available on disinvestment in the hydrocarbons sector, net flows cannot be evaluated, but according to the central bank, disinvestment in the first nine months of 2006 was due entirely to amortization of intra-firm loans (Central Bank of Bolivia, 2007).

The fact that the changes in the operating conditions of foreign companies, especially in Bolivia and the Bolivarian Republic of Venezuela, did not have a greater impact on FDI inflows between 2005 and 2006 may be explained by various factors, in addition to the appeal of high oil prices. First, the uncertainty in the years preceding these changes had already caused a contraction in the flows destined for the hydrocarbons sector, as of 2001 in the case of the Bolivarian Republic of Venezuela and 2002 in Bolivia. Second, no agreement was reached in 2006 on compensation for the assets nationalized in Bolivia or for the termination of PDVSA operating agreements with the companies that did not agree with the conversion to joint ventures in the Bolivarian Republic of Venezuela.[35] Accordingly, no disinvestments were reported, although some investors did leave the country.[36]

Last, as these activities have high sunk costs, exit costs are also high, which is a reason for investing in projects already underway. Nevertheless, some countries may have modified their investment plans in these markets in view of the changes mentioned. In Bolivia, for example, the moratorium on new investments declared by companies operating in Bolivia between the time of nationalization in May and the signing of the new contracts in October and the uncertainty that remains in relation to operating conditions have probably slowed any additional investment that had previously been planned, although the flows actually received have been maintained. The announcement by Petrobras that it would substantially increase its investments in gas exploration and production in Brazil in order to reduce its dependence on Bolivian gas is very significant in this connection.

(ii) Mining and metallurgy

Favourable international price trends have also stimulated new investments in the mining and metallurgy sector. In Chile, the increase in mining investments in 2006 has a strong reinvestment component. In Peru, investments in new mining projects reached US$ 700 million in 2006 (Ministry of Energy and Mines, 2007b). Xstrata (United Kingdom), Grupo México (Mexico), Newmont Mining (United States), Phelps Dodge (United States), Gold Fields (South Africa), Monterrico (United Kingdom), and Rio Tinto (Australia/United Kingdom) were among the main investors. Mining activity also shows signs of increasing in Bolivia. According to the Central Bank of Bolivia, FDI in mining in 2006 increased by 37% in relation to 2005 (Banco Central de Bolivia, 2007).[37] Despite a fall in relation to the previous year, mining was the main recipient sector for FDI flows in Colombia, with flows in the first semester of US$ 2.01 billion reflecting investments mainly in gold and coal operations. Drummond (United States) made significant investments in the La Loma coal mine.

In Brazil, where mining is strongly concentrated in the hands of local companies, the steel company Companhia Siderúrgica do Atlântico was established by ThyssenKrupp (Germany). The project, valued at US$ 3.6 billion, is the first investment in a new steel plant in Brazil since the 1980s. The objective is to take advantage of the availability of iron ore in Brazil to meet the expanding global demand for steel, and 100% of production will be exported. In addition to the plant, the investment, in which CVRD has a share, includes port facilities, a coking plant and a thermoelectric power plant (*Valor econômico*, 2006e).

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[35] In March 2007, the companies Total and BP ceded to PDVSA their operating rights to the Jusepín oil field. This transaction will bring them US$ 350 million (Americaeconomia.com, 2007).

[36] The compensation to Occidental for its Ecuadorian assets is also pending.

[37] At the end of 2005 the Indian firm Jindal Steel and Power won a tender for US$ 2.3 billion for an iron-ore exploration project associated with a steel plant, but this was suspended at the beginning of 2007 owing to lack of agreement with the government in relation to the terms of the energy supply.

Mexico also received large investments in the steel sector, in particular with Mittal Arcelor's purchase of the steel company Siderúrgica Lázaro Cárdenas-Las Truchas (Sicartsa) of the Villacero group and the purchase of Hylsamex by Techint, which was announced in 2005 and completed in 2006. The two companies —Techint and Mittal Arcelor— already own over half of Mexico's steel production capacity (*Expansión*, 2007a).

Nevertheless, some government, labour and civil society groups are making stronger demands for bringing the benefits of mining activities closer to the local population and limiting environmental impacts. With regard to fiscal issues, in 2005 Chile instituted a specific tax on mining activity.[38] In Peru, owing to speculation at the beginning of the year as to a possible tax hike in the mining sector, mining companies agreed to make a contribution of US$ 772 million over the next five years to reduce poverty, malnutrition and social exclusion. The Bolivian authorities announced increases in taxes on mining and the nationalization of the sector. There is still uncertainty in relation to the recent changes, especially in Bolivia and the Bolivarian Republic of Venezuela.

In relation to workers' interests, the employees of the Escondida mine in Chile, controlled by BHP Billiton and accounting for 8.5% of world copper production, went on strike for 25 days, with a significant impact on the company's production.[39]

Lastly, some mining projects have met with opposition from groups that protect the environment and the interests of indigenous peoples. The Pascua Lama (Argentina-Chile) and Junín (Ecuador) projects have been the focus of conflicts between companies, governments and civil society representatives on these issues.[40]

(iii) Paper and pulp

Environmental issues also had a strong impact on investment in the paper and pulp sector in 2006. This sector —and the associated forestry activities— contributed much of the increase in FDI to Uruguay. The projects of the paper companies Ence (Spain) and Metsae-Botnia (Finland) in the region of Fray Bentos are expected to bring approximately US$ 1.6 billion to the country over three or four years

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[38] The new law ensures that an invariable tax regime is maintained for defined periods for large companies operating under the regime of Decree Law 600. The invariable tax also applies to investors that sign new foreign investment contracts for mining projects with a value of no less than US$ 50 million (Foreign Investment Committee [online] www.foreigninvestment.cl). Moreover, through the law on the Innovation Fund for Competitiveness, the government agrees to assign part of the revenue collected to that fund.

[39] The mine's production fell to 40% of capacity, at an estimated cost to the company of US$ 17 million per day (EIU, 2006a).

[40] The Pascua Lama gold project of Barrick Gold, which includes activities in Argentina and Chile, has been criticized for alleged impacts relating to glaciers, water quality and quantity, tailings storage, and other aspects. The National Environment Commission (Conama) of Chile approved the project in February 2006, with conditions that seek to limit the impact of activities on the glaciers. Conama confirmed its approval after analysing the appeals filed by citizens' organizations on issues including impacts on water quality and noise levels (www.conama.cl; www.barrick.ca). In Argentina, the project was approved in December 2006 by the Interdisciplinary Mining Environmental Assessment Commission (CIEAM), after a period of 25 months. The Junín Project (copper, molybdenum, porphyrin) of Ascendant Copper (Canada) has encountered resistance from some local and Canadian organizations. In March 2007 the operations were still awaiting approval of the environmental impact study. In November 2006 the company signed cooperation agreements with local organizations on issues relating to health, education, infrastructure and local participation in the jobs to be generated by the project.

(*Business Latin America*, 2006b). Metsae-Botnia's investment, which is at a more advanced stage, has already generated investments by its local and foreign suppliers, including Stora Enso (Finland/Sweden), which is about to start investing in the central region of Uruguay. Nevertheless, the Fray Bentos projects have been the subject of disputes between the Argentine and Uruguayan governments and criticism and demonstrations by civil society groups in both countries for environmental reasons, which have generated uncertainty with regard to the actual timing and location of the investments.[41]

In summary, natural-resource-seeking investments in the region seem to be trapped between two opposing forces: on the one hand, the strong appeal of these activities in a context of high commodity prices and, on the other hand, stricter requirements from governments and civil society groups in relation to the benefits of these activities for the local population and the management of their environmental impacts. It is a huge challenge for industry and governments to reconcile these interests and ensure the sustainable production that brings concrete benefits to the local population, while not scaring off private investors that could bring value added to natural resources.

(c) Efficiency-seeking FDI

Mexico and the Caribbean Basin are long-standing recipients of FDI thanks to a combination of low costs and their proximity to the United States. A number of factors are threatening these comparative advantages, but the region seems to be adapting by creating new sources of competitive advantage.

Mexico has lost competitiveness in low-technology segments such as wearing apparel (see chapter III), and many companies have been closed down or transferred to Central America or Asia. Nevertheless, production costs in North America and the growing availability of skilled manpower have led some operators in more sophisticated sectors and activities to Mexico.[42]

In the face of the imminent restructuring of the United States automotive industry, Mexico seems well placed to receive new investments. After announcing the closure of plants in the United States, Ford representatives then announced an investment of US$ 560 million to expand the company's operations.[43] Volkswagen, General Motors and DaimlerChrysler announced investments in new capacity, new plants or supplier development. Nissan, Mazda, Honda and Toyota are investing in new capacity (*Expansión*, 2006b). One of the main reasons for the recent investments is the growth in demand in the United States for small, low-cost vehicles owing to high oil prices. The obstacles to be overcome in order to take advantage of proximity to the United States market include improvements in infrastructure, updating of the supply network and development of a more highly-skilled labour force that can help to attract more complex operations, in which competition is not only on a cost basis (*Business Latin America*, 2006c, 2006d; *The Economist*, 2006; *Expansión*, 2006c).

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[41] In Brasil, one of the most significant recipients of gross FDI inflows in 2006 was the paper and pulp sector. A large proportion of these investments are related to the restructuring of International Paper, which sold some of its assets to Stora Enso, Nippon Paper and the local company Votorantim.

[42] Whirlpool announced the transfer of part of its United States production to Mexico (www.whirlpoolcorp.com). General Electric, General Motors, Honeywell, and Delphi created R&D centres in the country. Bombardier also transferred some segments of its production from Canada to Mexico, and plans to increase the country's share of its aircraft assembly process (*Business Week,* 2006).

[43] The company did not deny or confirm the press speculations about a plan to significantly increase its Mexican operations with investments of US$ 9.2 million to 2012 (*Expansión*, 2006e).

In Central America and the Caribbean, competition from Asia, termination of free-zone incentives under WTO rules and the end of quotas in the United States market create a challenging situation for the wearing apparel sector, which accounts for a significant proportion of manufacturing in these countries. The entry into force of CAFTA-DR could generate significant opportunities if the countries manage to find niches where they can improve their competitiveness.

As the countries adapt to these new challenges, they are seeking new sources of competitiveness and diversification. Honduras has made changes in its textiles and wearing apparel industry in a move towards vertically integrated operations (Banco Central de Honduras, 2006). In El Salvador, there has been diversification into new sectors, such as motor vehicle parts, electronics and tourism (Proesa, 2006). In the Dominican Republic there are also efforts underway to increase the already substantial level of investment in tourism and to attract investments in call centres and other back-office services. Also contributing to this trend is the return of bilingual Dominicans with work experience in the United States (*Latin Finance*, 2006a). In Costa Rica, the country in the subregion with the longest experience in diversification and upgrading of its production, new investments have been made in electronics (mainly by Intel), medical equipment, call centres, outsourcing of business services, financial research, analysis and design of gas turbines, engineering and back-office services (CINDE, 2006). A process of diversification is also under way in the member countries of CARICOM (see box I.5).

Box I.5
RECENT FDI TRENDS IN THE CARIBBEAN

A recent CARICOM study shows increases in investment flows among the countries of the group and from abroad as a result of more flexible exchange controls, greater macroeconomic stability, double-taxation agreements and growing experience with internationalization processes.

The main investors are Canada, the United Kingdom and the United States. The intra-CARICOM flows (in which Trinidad and Tobago is the largest investor) account for approximately 10% of the total, a figure close to that of intra-regional investment in Latin America and the Caribbean as a whole. There is very little investment from the countries of South America, Central America and Mexico.

The main type of investment in terms of total amounts has been in natural-resource-seeking projects. In fact, the leading recipients of investment are Trinidad and Tobago (particularly in the hydrocarbons sector) and Jamaica (where bauxite and aluminium mining have attracted large volumes of FDI). In view of the relatively small size of the market, market-seeking investments are mainly in financial and telecommunications services and retail trade. In manufactures, there are good results from the beverages and foodstuffs and cement segments, where the logistical component justifies the local production option. As in Central America, the wearing apparel industry is suffering from competition with Asia. Nevertheless, several Caribbean countries have developed exportable services industries, such as call centres and other administrative support services, in which the English language is an advantage. In 2006, Verizon Communications announced an investment in call centres in Jamaica which would create 5,000 jobs.

There is a general shift of focus, even in the countries in which investments have traditionally concentrated on natural resources, towards services, and within this sector, there is greater diversification. In addition to the administrative services mentioned, FDI is growing in tourism and hotels and in transport. In the last few years, there has also been increased investment in land purchases, which is an indicator of future FDI, mainly in infrastructure and tourism-related services.

In relation to the OFDI of these countries, the main investor is Trinidad and Tobago, followed by Barbados and Jamaica. These investments involve a wide range of sectors. Some of the main investors are conglomerates with simultaneous operations in primary activities, manufacturing and services. Apart from the conglomerates, the largest companies are in the financial sector. An increase in FDI flows is expected among the CARICOM countries as a result of the common market that entered into force in January 2006.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Caribbean Community (CARICOM), *Caribbean Trade and Investment Report, 2005*, 2006; "What's new in your industry", *Business Latin America*, 24 July 2006; "Special report, Caribbean", *LatinFinance*, September 2006; OCO Consulting, *FDI Quarterly,* issue four, quarter 1, 2006.

In summary, changes are taking place in Mexico and the Caribbean Basin as a result of factors that include the challenges of growing competition from Asia. Some countries are making efforts to diversify their production base and create competitive advantages that go beyond low costs and can be sustained in the longer term.

3. Conclusions

This section has shown that, despite the exit of some investors and the significant challenges facing some countries and sectors in their efforts to enhance the region's appeal, FDI remains stable, and with a slight increase in absolute terms. Nevertheless, it has also shown that the region's share in global FDI flows is falling. The reasons for this are not entirely clear, but a number of factors are certainly involved. First, the region's growth rates have been relatively low compared to those of other developing countries, which has limited the region's appeal for market-seeking investments.

Second, the institutions that evaluate national business environments do not give very positive ratings to Latin America and the Caribbean relative to other regions, with the exception of a few countries.[44] Problems associated with the complexity of the tax structure, gaps in infrastructure, regulatory uncertainty and other factors not only reduce the region's appeal for FDI but also affect the competitiveness of the local operations of the region's companies. Latin America and the Caribbean continue to be one of the regions with the greatest number of disputes between investors and the State.[45]

Third, investments in Latin America and the Caribbean have been limited to those that seek static comparative advantages: natural resources, markets and efficiency derived from low labour costs and proximity to the United States market. The region has not managed to attract a significant amount of investment seeking dynamic comparative advantages such as technological assets. This type of investment usually has significant potential for generating benefits in terms of creating quality jobs and opportunities for local businesses, when there is local capacity available to absorb these benefits. It is also subject to strong competition among potential destinations because this type of investment does not depend on intrinsic national assets such as natural resources or geographical proximity to specific markets. It therefore depends on long-term policies that develop factors such as skilled labour, scientific, technological and innovation capacity, and local business capacity, and that promote these attractions in an active and integrated manner (see chapter II). The region's performance in developing these assets has been weak compared to the Asian developing countries, and this generates significant challenges for the expansion of manufacturing industries (Moreira, 2006).

These issues highlight the importance of consistent and stable public policies for developing assets to ensure the competitiveness of production in the respective countries, an issue for which the Korean experience is an important reference point (see chapter III). Moreover, rather than an objective, FDI is an instrument in the process of creating production capacities. As discussed in chapter II, FDI attraction policies can contribute to maximizing this potential if applied in an integrated manner in keeping with each country's development strategy.

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[44] In the World Bank's "Doing Business" classification of 175 countries, Chile is ranked 28th, Mexico 43rd, Trinidad and Tobago 59th and the other countries between 65th and 164th.

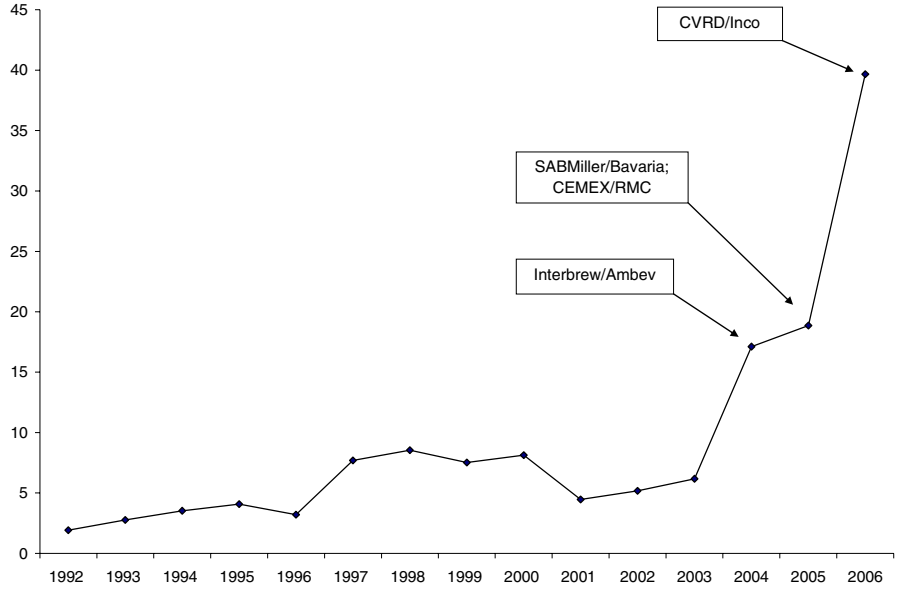
[45] Of the 109 cases pending in February 2006, 58 involved Latin American and Caribbean countries. Most of them date from the period from 2001 to 2004.

D. OFDI AND THE TRANS-LATINS

1. Outward foreign direct investment flows

In 2006 there was a significant increase in OFDI flows from the Latin American and Caribbean countries, which reached record levels (see figure I.15).[46] The total OFDI of the countries of the region amounted to US$ 40.62 billion, more than twice the level observed in 2005.

Figure I.15
LATIN AMERICA AND THE CARIBBEAN: NET FLOWS OF OFDI, 1992-2006 [a]
(Billions of dollars)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures as at 24 April 2007.

[a] The figures do not include investments from the main financial centres. OFDI figures indicate outward investment by residents minus capital inflows generated by those investors.

The increase in OFDI in recent years is largely attributable to a small number of large transactions originating in just a few countries, sectors and enterprises. In 2006, significant transactions included the acquisition of the Canadian company Inco by the Brazilian firm CVRD. In the two previous years, the amount of OFDI had been influenced by the purchase of RMC by CEMEX (2005) and two transactions associated with the purchase of trans-Latins by TNCs (the incorporation of AmBev into the

[46] Data on OFDI have serious limitations. Whereas national records and surveys provide reasonably full coverage for FDI, many countries keep little or no record of OFDI data and often estimate levels using samples. For FDI, countries usually record capital invested, inter-company loans and reinvestments, while data on OFDI are often limited to capital investment. Mexico, which is one of the main investor countries, only began to record its outward investment in 2001, which explains the apparent increase in OFDI for that country and the region as a whole from that year.

InBev group and the purchase of Bavaria by SABMiller).[47] As part of the financing of the last two operations, the owners of the acquired firms received shares in the acquiring enterprise (in the case of AmBev, from InBev, the entity resulting from the merger). Those acquisitions therefore involved significant amounts of OFDI, as well as FDI inflows.

The large scale of these operations has made for highly concentrated flows, which means that levels of OFDI and the growth rates observed in 2006 will not be maintained over the next few years.[48] Nonetheless, there is a clear upward trend in the outward investments of Latin American enterprises, and this should increasingly be reflected in official figures.

Figures from the 1990s show that Argentina and Chile were the main investor countries (taking into account the fact that Mexico began to publish OFDI data only as of 2001, and in that year reported higher investment than the other two countries). In the more recent period, Brazil and Mexico have taken the lead (ECLAC, 2006a).

Table I.6
LATIN AMERICA AND THE CARIBBEAN: NET OFDI FLOWS, MAIN INVESTOR COUNTRIES, 1992-2006
(Millions of dollars)

	1992-1996 [a]	1997-2001 [a]	2002-2006 [a]	2005	2006
Brazil	516	1 095	8 461	2 517	28 202
Mexico	...	881	3 389	6 474	3 897
Chile	726	2 220	1 697	2 209	2 797
Venezuela (Bol. Rep. of)	400	639	1 247	1 183	2 089
Argentina	1 196	1 754	749	1 151	2 008
Colombia	205	412	1 539	4 662	1 098

Source: Economic Commission for Latin America and the Caribbean (ECLAC), based on official figures as at 24 April 2007.

[a] Annual averages.

In 2006, Brazil was the top outward investor, followed by Mexico and Chile (see table I.6).[49] In terms of GDP, the top investor in 2006 was Brazil, partly owing to the acquisition of Inco (Canada) by CVRD (Brazil) and a series of other acquisitions and investments by companies such as Itaú, Petrobras, Votorantim, Gerdau, Odebrecht, Camargo Corrêa, Weg and Marcopolo.

The second largest investor (in absolute terms) was Mexico, with operations concentrated in telecommunications, food and beverages, and cement. Chile, the second investor in terms of GDP and the third in absolute terms, made investments in retail trade and mining. In the Bolivarian Republic of

[47] As part of the series of transactions that led to the creation of InBev, AmBev bought the Canadian Labatt and its controllers acquired shares in the merged company. The purchase of the Colombian Bavaria by SABMiller also involved the former controlling group buying shares in the purchaser's company.

[48] Having said that, transactions such as the purchase of Rinker by CEMEX could bring OFDI flows to similar levels in 2007.

[49] Many of the region's countries do not publish official OFDI figures. For these countries, data on FDI by Latin American and OECD country of origin suggest that Ecuador and Panama are the main investors. Similarly, official figures for Uruguay seem to significantly underestimate the FDI that other countries report as originating in Uruguay.

Venezuela, OFDI mirrored FDI inflows in the sense of being dominated by the hydrocarbons sector. PDVSA invested about US$ 1 billion abroad in the form of reinvested profits but the company also sold assets abroad (shares in a United States refinery, see box I.6) for a similar amount. In the case of the Bolivarian Republic of Venezuela, the main component of hydrocarbon investment abroad takes the form of PDVSA accounts receivable for petroleum sales to companies abroad (recorded as FDI).

Box I.6

TRANS-LATINS IN THE HYDROCARBON SECTOR: PETROBRAS AND PETRÓLEOS DE VENEZUELA SA (PDVSA) IN 2006

The hydrocarbons sector has played a significant part in OFDI from Brazil and the Bolivarian Republic of Venezuela. Initially, internationalization was prompted by the level of oil supplies within these countries. Petrobras concentrated on natural-resource-seeking investments at a time of uncertainty surrounding Brazil's domestic reserves, while PDVSA sought out petroleum refining and marketing channels in the main markets (United States and Europe). These strategies changed over time (ECLAC, 2006a).

Faced with new competitors in Brazil in the late 1990s, the management of Petrobras sought increasingly to diversify its markets and products; company's directors transformed Petrobras into an integrated energy company, developed the gas market and entered refinery and distribution markets in other Latin American and Caribbean countries without neglecting the international expansion of its exploration and production activities.

In 2006, Petrobras continued this strategy of investing in exploration and production within and beyond Latin America and the Caribbean. In terms of distribution activities, Petrobras purchased Gaseba (Uruguay's main natural gas distributor) from Gaz de France and also acquired Shell's distribution assets in Colombia, Paraguay and Uruguay. In Uruguay, Petrobas had already bought the gas distribution company Conecta from the Spanish group Unión Fenosa. These acquisitions are yet another example of the tendency for trans-Latins to fill the gaps left by European companies in the services sector.[a] Petrobas is now entering a third phase of international expansion: it has consolidated large crude-oil production flows in Brazil and other countries, and begun to invest in refining near some of its main markets. With a view to increasing its Brazilian heavy crude refining capacity and adding value to its export products, it paid out US$ 370 million to purchase 50% of a refinery in Pasadena, Texas (in association with the Belgian Astra Oil) and invested US$ 500 million in its modernization.[b] The company also made a bid for the Cartagena refinery in Colombia, but lost to the Swiss company Glencore. It then announced it was seeking opportunities in refining assets in Europe and Asia (probably Japan).

Meanwhile, PDVSA has made a radical change to its internationalization policy. It has moved away from the United States market and closer to other Latin American and Caribbean countries, China, India and other developing countries. In 2006, the company sold the share of its subsidiary Citgo in a refinery in Houston, Texas, signed an agreement with Petrobras for the construction of a refinery in Brazil (in the framework of broader cooperation agreements), and began studies for buying a refinery in India. The company has invested in exploration and production in several countries of Latin America and the Caribbean. It has also invested in the construction of a gas pipeline between Colombia and the Bolivarian Republic of Venezuela. In the fuel distribution segment, PDVSA also bought the ANCAP share in Petrolera del Cono Sur (PCSA), which has a large network in Argentina. As a result of intergovernmental agreements, several targets have been set in terms of energy integration and cooperation between the Bolivarian Republic of Venezuela and other countries in the region.

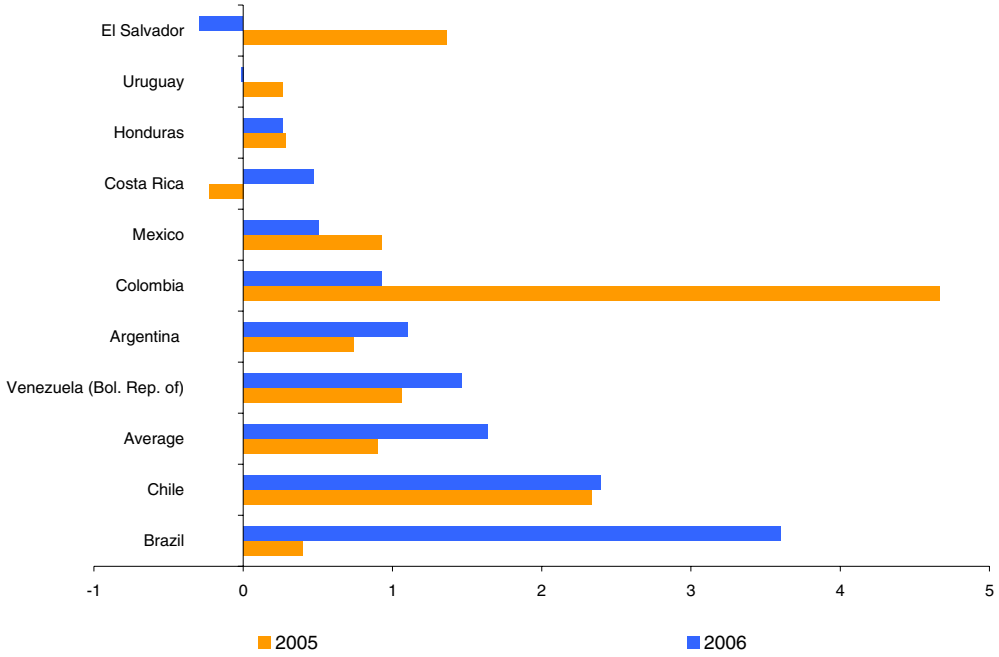
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of *Foreign Investment in Latin America and the Caribbean, 2005* (LC/G.2309-P/E), Santiago, Chile, 2006; official websites: www.petrobras.com.br and www.pdv.vn; "Petrobras vai às compras na Ásia e Portugal", *Gazeta mercantil*, 6 April 2006; "Petrobras investirá US$ 500 mi nos EUA", *Valor econômico*, 6 April 2006; "Petrobras compra e se torna a 5ª no Uruguai", *Gazeta mercantil,* 1 June 2006; "Petrobras conclui compra da uruguaia Gaseba", *Valor econômico*, 1 June 2006; "Petrobras compra refinaria no Japão", *Gazeta mercantil*, 14 September 2006.

[a] Using a similar strategy, ENAP of Chile bought Shell's distribution assets in Ecuador and Peru and invested in diversifying its sources of raw materials both within and outside the region.

[b] Brazil's refinery facilities were mainly built before large volumes of petroleum began to be produced there. Previously, it was processing lighter petroleum from the Middle East, but the national production of large volumes of heavy oil means there is a deficit in the country's refinery capacity in relation to its production of crude.

As with FDI, much of the variation in the OFDI/GDP ratio from one year to another can be attributed to the effect of a few very large operations (see figure I.16).

Figure I.16
LATIN AMERICA AND THE CARIBBEAN: RATIO OF NET OFDI TO GDP, 2005-2006
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), based on official figures as at 24 April 2007.

2. OFDI of Latin America and the Caribbean from the viewpoint of trans-Latins and their strategies

The previous edition of this report contained an in-depth analysis of the strategies of trans-Latins (ECLAC, 2006a). This section covers some of the trends observed during 2006 in the following sectors: (i) natural resources and natural-resource-based manufactures; (ii) mass consumer goods and services; and (iii) intermediate-technology manufactures. Each of these sectors has a different outward investment strategy in response to the competition patterns of each industry. All of the main acquisitions made during the year fit into one of these strategies (see table I.7).

Table I.7
MAIN ACQUISITIONS BY TRANS-LATINS OUTSIDE THEIR COUNTRIES OF ORIGIN, 2006 [a]
(Millions of dollars)

Acquired by	Country of acquiring company	Company or assets acquired	Country of company acquired	Announced value	Sector
Companhia Vale do Rio Doce	Brazil	Inco Ltd.	Canada	16 727	Mining
América Móvil	Mexico	Operations in Latin America and the Caribbean	Dominican Republic, Puerto Rico	3 700	Telecommunications
Techint (Ternium)	Argentina	Hylsamex	Mexico	2 581	Steel
Techint (Tenaris)	Argentina	Maverick	United States	2 390	Steel
Telmex	Mexico	Embratel	Brazil	812	Telecommunications
Companhia Vale do Rio Doce	Brazil	Canico Resource Corp.	Canada	678	Mining
Banco Itaú	Brazil	BankBoston	Chile and Uruguay	650	Financial
Alfa	Mexico	Hydro Castings	Germany, Austria, Hungary, Sweden	545	Motor vehicle parts
Interconexión Eléctrica SA	Colombia	Companhia Paulista de Transmissão de Energia Elétrica (CTEEP)	Brazil	535	Electricity

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures provided by Bloomberg and press reports.

[a] The table includes transactions over assets which are located in Latin America and the Caribbean. It does not include internal reorganizations of corporate groups. The purchase of Rinker (Australia) by CEMEX (Mexico) is not included because it did not take place until 2007.

(a) Natural resources and natural-resource-based manufactures: trans-Latins seek global leadership

The initial growth of many of the region's major companies was based on exports of natural resources or natural-resource-based manufactures from their countries of origin. In recent years, these enterprises have managed to broaden and diversify their markets, products and the location of their assets by investing in production capacity and reserves abroad, thereby ensuring their own competitiveness and financial robustness (ECLAC, 2006b). In this context, and in many cases owing to the high prices of their respective products, these companies have been involved in some of the main transactions and offers at the global level in 2006. Such operations are now part of a pattern of global competition based on scale, diversification and appropriate risk management for primary activities.

In the case of hydrocarbons, the peculiarities of the market and the fact that the region's main petroleum companies are State-owned has generated some unique experiences (see box I.6).

In the mining sector, the largest acquisition made by a trans-Latin (indeed one of the largest transnational acquisitions in the world) during 2006 was the purchase of the nickel mining company Inco (Canada) by CVRD (Brazil). This operation is part of the company's strategy to diversify the location of its assets and its supply of mining products, in contrast with the strategies of other major Brazilian groups towards a growing diversification of activities (ECLAC, 2006b). The acquisition of Inco brings down the percentage of CVRD mining reserves in Brazil from 98% to 60%, and the company is reducing its dependency on iron ore, which moved from 74% of sales in 2005 to 56% in 2006 (*Valor econômico*, 2006f). By purchasing Inco, CVRD is intensifying its concentration on its main business of mining (see box I.7). In November 2005, in keeping with the move towards focusing on mining while diversifying geographically and in terms of products, the company purchased Canico Resource Corp. (a gold mining company in the United States) and made new investments in Latin America and Africa. Those new investments included coal production in Mozambique, where the company is expected to invest some US$ 2 billion.

Box I.7
CONDITIONS PLACED ON THE ACQUISITION OF INCO BY CVRD

The Government of Canada approved the acquisition of the mining company Inco in Canada by Brazil's CVRD, subject to some major conditions regarding the future running of the company. The legal basis for these conditions is the Investment Canada Act, which makes approval of acquisitions conditional upon the existence of net advantages for Canada, in terms of a transaction's effects on the country's level of economic activity, the participation by Canadians in the project, the effect of the investment on industrial output and productivity, its compatibility with national economic, industrial and cultural policy and its contribution to Canadian competitiveness. In this case, the government-imposed conditions on the transaction were that the buyer's current and future nickel business management be transferred to Canada (under the new CVRD Inco); CVRD Inco's global activities be managed from Toronto; Canadian executives remain in key positions; no employees be made redundant for at least three years; and that the workforce should never fall below 85% of current levels.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information obtained from the Official website www.cvrd.com.br; Investment Canada Act, 1985.

In other news of trans-Latin mining companies, Antofagasta Minerals (controlled by the Chilean Luksic group) made headway in its expansion beyond Latin America by gaining control of the Australian companies Tethyan (whose main assets are copper and gold reserves in Pakistan) and Equatorial. The company also announced long-term plans to invest between US$ 600 million and US$ 700 million in Pakistan and bought exploration licenses for that country from BHP Billiton. Within Latin America, the company signed a joint venture with AngloGold to explore copper and gold reserves in Colombia.

As for iron and steel, CSN, Gerdau and Techint have all sought to take an active role in the new wave of steel-sector consolidations at the global level.

CSN, which owned 50% of Lusosider (Portugal), bought the remaining 50% from Corus. This transaction means that CSN can increase its exports of crude steel to Europe, using processing facilities in Portugal and selling products with higher value added while avoiding trade barriers to exports. This is along the same lines as previous CSN investments in the United States (ECLAC, 2006b). However, CSN was unsuccessful in its two main endeavours of the year. It failed in its bid for Wheeling-Pittsburgh in the United States and, following several months of offers and counter-offers in early 2007, lost out to Tata Steel in the battle for Corus Steel.

The Brazilian company Gerdau, which transferred most of its sales and capacity abroad in 2005, purchased Sheffield Steel in the United States and GSB Acero in Spain. The purchase of Sheffield Steel provides entry to the long steel market in the south-west of the United States (*Valor econômico*, 2006g). As these acquisitions were carried out by Gerdau-controlled companies in the United States and Spain, they do not necessarily affect Brazil's OFDI flows. In Latin America, Gerdau gained control of Siderperú. Following the lead of other companies, Gerdau is also beginning to explore opportunities in China (*Valor econômico*, 2006h).

The Techint group's production of flat and long steel is currently concentrated in Latin America and the Caribbean. In 2006, the group (through its subsidiary Ternium) finalized the purchase of Hylsamex in Mexico, which had been announced in 2005. In the steel tubes market, the group has expanded into other regions through its subsidiary Tenaris. In 2006, the largest acquisition abroad by an Argentine company was the purchase by Tenaris of the Maverick Tube Corporation in the United States, for US$ 2.39 billion (and taking on US$ 700 million of debt). This transaction will facilitate access to the hydrocarbon exploration, production and transport market in the United States. Spurred on by the buoyancy of the petroleum sector, Tenaris also announced investments in a tube-finishing centre in China and, in February 2007, the purchase of Hydril (a deep-water drilling valve and gauge manufacturer in the United States) for approximately US$ 2 billion.

In the cement market, CEMEX is one of the top three global operators, along with Lafarge and Holcim. After doubling in size by buying RMC in the United Kingdom during its last major expansion in 2005 (ECLAC, 2006a), the company geared up for further expansion in 2006. The new target of CEMEX was Rinker (Australia), for which it made an offer of US$ 12.062 billion in October 2006. The transaction was approved in April 2007 for an amount of US$ 14.627 billion. Rinker is in one of the world's 10 largest construction materials companies, with operations in Australia and the United States (*Expansión*, 2006d). While the offer was being finalized, CEMEX explored the possibility of entering the Chinese market (*Financial Times*, 2006c).[50]

Besides CEMEX, smaller companies in the region have been investing in cement and concrete manufacturers, especially in the United States. In 2006, the Colombian firm Argos purchased two major cement manufacturers in the United States (Ready Mixed Concrete and Southern Star) for a total of US$ 680 million, in addition to buying the smaller Concrete Express. Cementos de Chihuahua (GCC) of Mexico purchased Mid-Continent Concrete Co. and Alliance Transportation Inc. for US$ 271 million, and announced the construction of new production plants in the United States.

In summary then, these global players in natural resources and natural-resource-based manufactures have made good use of the financial opportunities offered by the international environment by successfully handling risk and borrowing to consolidate their global positions while deploying an aggressive acquisitions strategy. Thanks to the competitive advantages of the natural resources in their markets of origin, they have progressed from being exporters to global producers.

[50] CEMEX sold its 24.9% share of Semen Gresik in Indonesia following a dispute with that country's government over the purchase of additional shares in the company. The case was brought before the International Centre for Settlement of Investment Disputes (ICSID).

(b) Mass consumer goods and services: market-seeking within and beyond Latin America and the Caribbean

There is a second category of investment involving trans-Latins using competitive advantages acquired in their countries of origin to expand into markets where competition is focused on reaching the final consumer: mass consumer goods and services. The success of these companies in seeking markets is attributable to a combination of competitive advantages relating to knowledge of regional consumption patterns (in some cases the Hispanic community in the United States) and the fact that they operate in economic and regulatory environments that share some common features (ECLAC, 2006b). There are two characteristics that define the recent internationalization of Latin American companies in these sectors.

First, some trans-Latins have expanded in the region by competing with TNCs. The integration of AmBev and Bavaria into transnational groups in 2004 and 2005, respectively, raised the question of whether trans-Latins could survive in the face of competition from such major international groups, who were attracted by the penetration of these companies within the region, among other factors. In 2006 there was the acquisition of Banistmo by HSBC (see box I.3). Nevertheless, in contrast with that trend and as mentioned previously, the year was also marked by the expansion of trans-Latins, which in some cases took over market shares previously occupied by TNCs. In the services sector, América Móvil bought Verizon's assets in the Dominican Republic and Puerto Rico, while the Itaú bank purchased Bank of America assets in Brazil, Chile and Uruguay, and the petroleum companies Petrobras and ENAP acquired Shell fuel-distribution assets in a number of countries (see box I.5). The directors of Chilean retail chains have also taken measures to face up to competition from major global chains (Calderón, 2006). Having consolidated their position in Argentina and, increasingly, in Peru, during 2006 these companies began to invest strongly in the Colombian market. As mentioned previously, FEMSA has invested in capturing the Brazilian market, where it faces stiff competition from TNCs in sales of soft drinks and beer.

The second trend observed in these markets during 2006 is an expansion into new destinations outside the region. For a long time, Mexican companies have been using their regional competitive advantages in the Hispanic market within the United States. In 2006, Banorte (Mexico) purchased 70% of the bank INB (United States) for US$ 259 million and, in early 2007, bought the money transfer firm UniTeller (also of the United States). América Móvil also expressed possible interest in the North American market, where it is currently active only in the sector of prepaid telephone cards. The company also began to show interest in Europe, as suggested by the announcements of possible negotiations to acquire Telecom Italia (*The Wall Street Journal Americas*, 2007). In terms of manufactures, Mexican firms are expanding even further. In 2006, the food companies Bimbo and Gruma, which were already strong players in Latin America, the United States and Europe, began investing in Asia. Bimbo purchased the Chinese operations of the Spanish firm Pan Rico (*Valor econômico*, 2006i). Gruma bought Rositas Investments in Australia and invested in food production projects in China and Japan, costing an estimated US$ 200 million (*Latin Trade*, 2006b).[51]

Most of the manufacturing companies in this group are Mexican, except for the Peruvian from Ajegroup. In addition to its above-mentioned regional investments, the group has also launched operations in Thailand, helped along by the similarity between the two markets in terms of per capita production costs and consumption, plus advances in the opening up of bilateral trade between the two countries that facilitate the export of packaged and prepared goods from Peru (Agenda Empresarial, 2006).

[51] Televisa made an unsuccessful bid for control of Univision, the most watched Spanish-language television chain in the United States, and is seeking other ways of expanding into that market (*Expansión*, 2007b).

(c) Medium-technology manufactures: trans-Latins seeking efficiency

In sectors where the comparative advantage of trans-Latins has nothing to do with the availability of natural resources, such as medium-technology manufactures (motor vehicle parts, vehicles, white goods, white goods components, engines, etc.), there is a tendency to increase production close to main markets or in third countries with low costs and proximity or good access to those markets. Many of these investments have been directed outside of Latin America and the Caribbean.

In terms of motor vehicles and parts, the main investments were motivated by proximity to customers, the benefits for the development of products and solutions and the need to avoid trade barriers. In 2006, Nemak (part of the Alfa group) announced the construction of a new production plant in China and the expansion of its European operations. The company, which already had plants in North America and Mexico, made several investments in automotive parts abroad. It extended its aluminium-head and car-engine plant in the Czech Republic. The company also purchased operations of the high-technology aluminium-component manufacturer TK Aluminum in China, North America and South America, and then integrated those operations with the European plants of Hydro Castings (which it purchased from Norsk Hydro) in Austria, Germany, Hungary and Sweden. The Brazilian company Marcopolo launched a project with Tata Motors (see box I.2) to supply the Indian market (*Valor econômico*, 2006j). This operation means that the company can avoid high import tariffs and transport costs, while benefiting from the strength of a major local chassis producer and distributor in the promising Indian market.

Other motivations include more efficient production conditions to satisfy market needs traditionally met through exports. The main example is a group of Brazilian companies that began to invest abroad when currency appreciation damaged their export competitiveness.

The case of Marcopolo, referred to above, was examined in the previous edition of this report. It began its process of internationalization in the form of assembly operations for Brazilian-produced automotive parts. The company is slowly transforming and has begun to produce parts closer to destination markets to avoid the risks of exchange-rate volatility and trade barriers (ECLAC, 2006a). In 2006, other companies followed the same trend. Metalfrio set up a refrigerator factory in Turkey to supply the European market, abandoning its earlier plans to transform its headquarters in Brazil into an export platform. Weg, a producer of industrial engines and transformers, purchased shares in a transformer company in Mexico, with which it also carried out a joint venture to supply the North American market as part of its strategy to increase production in other countries. Lastly, the automotive part manufacturer Sabó began construction of a factory in the United States, with a view to increasing local production for the United States automobile industry while reducing the number of exports from Brazil (*Valor econômico*, 2006k, 2006l, 2006m).

These trends show the capacity of Latin American companies to make use of their competitive advantages in a market based on combining cost with technology. At the same time, in some cases the outward investment seems to be partly associated with shortcomings in the domestic business environment that lead firms to diversify the location of their assets and seek protection against instability factors such asexchange-rate volatility. In this context, it is important to develop attractive local production features that go beyond low labour costs or the local market, and improve the business climate.

3. Conclusions

In summary, recent investments by the trans-Latins have been motivated by forces that differ according to the competition patterns of their respective sectors: the need to maintain a leading position in the natural resources sector; opportunities to explore competitive advantages in new markets; and the need to ensure competitive production conditions to ward off threats to export competitiveness. Most of the increase in OFDI is concentrated in a small number of companies and sectors. It remains to be seen whether this investor base will expand, to what extent and with what consequences for the economies of origin.

For the Latin American and Caribbean countries in general, these companies are a potential new source of investment. In each individual country of origin, the increased international integration of local companies generates positive feedback, including direct effects on company growth, increased investment capacity for local operations, improved management skills and greater exposure to international levels of competition and best practices.

Nevertheless, the increasing capacity of local companies to internationalize their production also highlights the problems that prevent them from operating competitively in their countries of origin. These factors include the loss of advantages related to cheap labour, currency appreciation, risks created by macroeconomic, regulatory or political factors, and the effects these have on capital cost. In this sense, it is important for public policy to promote local production, not only in order to attract foreign investment but also to broaden the range of activities that can be conducted competitively in each country.

E. GENERAL CONCLUSIONS

In 2006 net FDI in Latin America and the Caribbean reflected a continuation of the period of stability that followed the sharp decline observed in the early part of the decade. Such growth is, to a great extent, the result of record macroeconomic performance and high commodity prices, which boosted inflows of FDI seeking markets and natural resources, respectively. Efficiency-seeking operations, mainly in Mexico and the Caribbean basin, face challenging times due to growing competition from other regions and changes in market access conditions for the products involved.

Although the figures are stable in absolute terms, the relative share of Latin America and the Caribbean in global FDI inflows has fallen. Data on the presence of transnational corporations among the largest companies in the region and the nature of the main transnational acquisitions suggest a loss of interest on the part of some traditional investors from the United States and Europe, although this has been partly offset by the entry of new investors. There has been no surge in strategic asset-seeking investments. Some contributing factors to this may be shortcomings in the business environment and slow advances in terms of skilled workforce and logistic, scientific and technological infrastructure. The region would have greater success with more active and integrated FDI policies (see chapter II).

There is growing demand for a greater share in the benefits generated by FDI, especially from investments in the extraction of natural resources. Improving the local distribution of these benefits is a major challenge for the region's policymakers and, in addition to regulatory changes, will require human resources and business capacity to be developed in order to take advantage of the potential profits from the operations of foreign companies.

As for OFDI from the region's countries, volumes continue to rise. This is attributable to a combination of the following factors: (i) large transactions in the natural resources sector and natural-resource-based manufactures by enterprises which export worldwide and are seeking asset bases so that they can continue competing with major operators, mainly outside the region; (ii) market-seeking investment in consumer services, food and beverages concentrated in the region but increasingly gaining ground in North America, Europe and Asia; and (iii) a move towards efficiency-seeking and market-seeking investment for medium-technology manufactures, also outside the region. This increased investment abroad reflects the capacity of local groups to react to pull factors on the world market. Nonetheless, higher investment is also a reflection of negative factors in local business environments and trade imbalances.

The public-policy implications of FDI and OFDI trends run along similar lines: the business environment, macroeconomic climate and local capacities (human capital, supplier base, science and technology infrastructure) must all be improved to attract foreign investment and to ensure that the internationalization of local companies' production is based on their competitive advantages, thereby complementing and contributing to industrial development in their countries of origin.

ANNEX

Annex

LATIN AMERICA AND THE CARIBBEAN: MAIN CHARACTERISTICS OF FOREIGN DIRECT INVESTMENT IN 2006, BY COUNTRY

Argentina

In Argentina, net inflows of FDI fell by 4% in 2006 compared with 2005, to stand at US$ 4.809 billion. The balance of payment figures show a strong increase in reinvestment (from 13% in 2005 to 47% in 2006) and in inter-company loans, while there was a reduction in the share of FDI in transnational acquisitions and equity investments (INDEC, 2007).

According to the investment database of the Production Research Centre (CEP), the value of investment projects announced by foreign firms in the first nine months of 2006 was 6% higher than for the whole of 2005. The same database shows the main investor countries to be Spain (27% of total investment), the United States (21%) and Brazil (17%). Capital-formation investment projects accounted for 61% of the total (compared with 72% the previous year), with acquisitions representing the remaining 39%. The main destination sectors of capital-formation investments were infrastructure and industry (ADI, 2006).

Flows of OFDI rose by 74% in 2006 (INDEC, 2007), to stand at US$ 2.008 billion.

In terms of investment-attraction policy, 2006 saw the investment promotion system strengthened thanks to budgetary and operational improvements at the Investment Development Agency, followed by the official establishment of the new National Investment Development Agency, with enhanced authority, instruments and budgetary independence.

Bolivarian Republic of Venezuela

The Bolivarian Republic of Venezuela recorded negative net FDI flows of US$ 543 million in 2006, in sharp contrast to the previous year's positive figure of over US$ 2.5 billion. These outflows were mainly attributable to transactions between foreign companies in the hydrocarbon sector and PDVSA. Between 2003 and 2004, PDVSA stopped publishing its financial accounts, thus preventing the distribution of profits among the foreign participants in strategic partnerships set up to operate in the Orinoco Belt. In 2005 and 2006 the financial accounts were published and the distributed profits were recorded as US$ 3.258 billion worth of disinvestment. Plans to nationalize the energy, mining and telecommunications sectors could have a negative effect on FDI inflows.

According to information from the Venezuelan Council for Investment Promotion (CONAPRI, 2007), non-petroleum and non-financial investment fell from US$ 629 million in the first three quarters of 2005 to US$ 76 million in the same period of 2006. The main investors were Colombia, Panama and the United States. The main recipient sectors were manufactures, commerce and construction (CONAPRI, 2007). Many of the groups investing in the country are from the tourism sector: Pestana (Portugal), Decameron (Colombia) Embassy Suites (United States) and Hesperia (Spain) (CONAPRI, 2006).

As far as OFDI is concerned, the US$ 2.089 billion recorded in 2006 was also the result of PDVSA transactions. That company invested around US$ 1 billion abroad in the form of reinvested profit, while also selling assets abroad (a stake in a United States refinery) for a similar amount. The main component of the country's OFDI in the hydrocarbons sector is PDVSA's accounts for petroleum sales to companies abroad and considered as FDI (information from the Central Bank of the Bolivarian Republic of Venezuela).

Bolivia

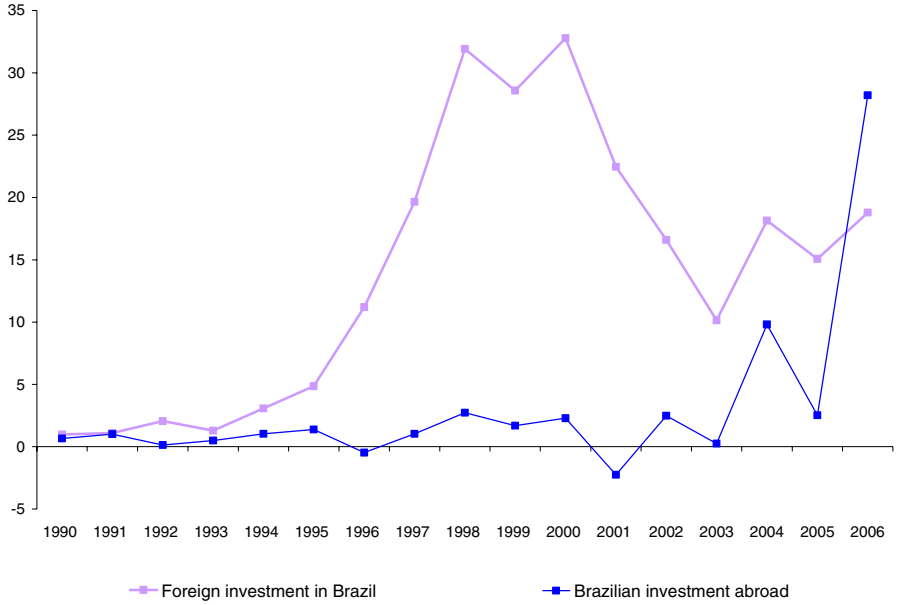
In Bolivia, net FDI inflows went from a negative balance of US$ 242 million in 2005 to a positive balance of US$ 237 million in 2006. Data on gross inward FDI show stable flows to the hydrocarbon sector and increased investment of around US$ 68 million (37%) in mining. The difference in liquid flows is mainly attributable to lower disinvestment in 2006 than in 2005. According to the Central Bank of Bolivia (2007), disinvestment in the first nine months of 2006 corresponds entirely to loan amortizations by resident companies to their parent companies abroad.

Brazil

In Brazil, net inflows of FDI stood at US$ 18.782 billion in 2006, which is 25% higher than the previous year. This is due to the combined effect of higher inflows and lower disinvestment. Some 55% of net inflows went to the services sector, especially to financial intermediation and electricity, gas and water. Industry received 39%, particularly the metallurgy (including iron and steel) and paper and pulp sectors, which were up considerably on 2005. In the primary sector, which accounted for 7% of inflows, the dominant segments were hydrocarbons and mining. The main countries investing in shareholdings in Brazil were the United States, the Netherlands and Switzerland (Central Bank of Brazil, 2007). Switzerland was particularly significant in the purchase of the Pactual bank by UBS.

The main new development in 2006 is that outward foreign direct investment (OFDI) overtook net FDI inflows for the first time, at US$ 28.202 billion (see figure I-A-1). The purchase of the Canadian mining company Inco by CVRD (for US$ 16.727 billion) was a major factor in that result. In fact, 62.9% of Brazil's external investments in shareholdings were in the mining sector.

Figure I-A-1
BRAZIL: INWARD FOREIGN DIRECT INVESTMENT (FDI) AND OUTWARD FOREIGN DIRECT INVESTMENT (OFDI), 1990-2006
(Billions of dollars)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures provided by the Central Bank of Brazil as at 24 April 2007.

Chile

In Chile, net FDI inflows amounted to US$ 8.053 billion in 2006, which is 16% higher than the previous year. Reinvestments have risen constantly since 1999, and represent a large proportion of the country's FDI inflows. Figures from the Foreign Investment Committee (2006) indicate that the main destination sectors for FDI during 2006 were electricity, gas and water, followed by mining and transport and communications. The main investors were Canada (54%), United States (11%) and Australia (6%). These data refer to gross inflows of FDI and are strongly influenced by the purchase of 92% of Transelec, with control of the company passing from one group of Canadian investors to another. That transaction reflects the large roles of the electricity sector and of Canada, but should not have a strong effect on net investment flows to Chile, in which mining is likely to be the dominant sector.

Chile's OFDI amounted to US$ 2.797 billion in 2006, 27% higher than in 2005. Retail commerce is one of the main sectors of Chilean OFDI. Data from the General Directorate for International Economic Affairs (DIRECON) of the Ministry of Foreign Affairs of Chile show that Argentina, Brazil, Colombia and Peru received 80% of Chilean OFDI realized between 1990 and 2006. The Santiago Chamber of Commerce predicts that US$ 3.0 billion will be invested in this sector outside Chile between 2006 and 2009 (Santiago Chamber of Commerce, 2006a, 2006b).

Colombia

Colombia posted net inflows of FDI totalling US$ 6.295 billion in 2006, a steep fall compared to the figure of US$ 10.255 billion in 2005. However, this drop reflects the exceptionally high figures recorded in 2005, mainly as a result of the purchase of the Bavaria brewery by SABMiller. Taking into account only the first three quarters of 2005 (Bavaria was purchased in the fourth quarter), FDI to Colombia in 2006 was up 25% on the previous year, thanks to a positive international environment for the exploitation of natural resources, national growth, macroeconomic stability, improved security conditions and a system favourable to foreign investment (Proexport, 2006a). In 2006, FDI was mainly channelled into mining and hydrocarbons, which accounted for 60% of net flows received (data from the Bank of the Republic).

As in the case of FDI inflows, the decline of Colombia's outward investment to US$ 1.098 in 2006 is due to the unusually high levels recorded in 2005 when SABMiller purchased Bavaria. Part of the compensation to the owners took the form of shares, which were recorded in the balance of payments as an outward investment from Colombia. Taking into account the first three quarters only and thereby excluding the sale of Bavaria, Colombia's OFDI increased considerably during 2006. According to data from the Bank of the Republic, the manufactures sector and electricity, gas and water were the main destinations for Colombia's outward foreign direct investment in 2006.

In terms of FDI attraction policies, the foreign investment promotion agency Coinvertir closed at the end of 2005 and its mandate passed to Proexport, whose infrastructure abroad has been fundamental for the adoption of a more proactive strategy. The entry into force of the free-trade agreement with the United States should attract investors seeking access to the Colombian market as an export platform for manufactures (*Valor econômico*, 2006n; Proexport, 2006b).

Costa Rica

Net inflows of FDI for 2006 stood at US$ 1.436 billion, which is 67% higher than the 2005 figure (Central Bank of Costa Rica, 2007). Preliminary estimates suggest that the main recipients of FDI in 2006 were industry, the property sector and the financial sector, which combine to account for 78% of total flows. The sectors that recorded the highest growth were the financial sector and tourism. Within the industrial sector, investments were recorded in medical equipment and electronics (including Intel's US$ 80 million expansion). Reports by the Costa Rican Coalition for Development Initiatives (CINDE) and the Inter-agency Group on Foreign Direct Investment emphasize the elevated level of FDI growth in high-technology sectors, both in terms of manufactures and services (electronics, medical equipment and information technology services) (CINDE, 2006, 2007; Inter-agency Group on Foreign Direct Investment, 2007). The main countries of origin of FDI (not including the property sector) were the United States and Canada, followed by Colombia and El Salvador.

As far as Costa Rica's outward investment is concerned, OFDI flows amounted to US$ 96 million, compared with the US$ 105 million recorded in 2005.

Dominican Republic

In the Dominican Republic, FDI flows reached US$ 1.183 billion in 2006, 16% higher than the previous year. Investment was boosted by a growth rate of around 10% (ECLAC, 2006b). The main sectors of attraction for FDI in 2006 were tourism and telecommunications. Spain and the United States were the main sources.

Ecuador

FDI inflows to Ecuador in 2006 amounted to US$ 2.087 billion, 21% higher than in 2005. Some 88% of FDI was channelled into the mining and quarrying sector, mostly hydrocarbons. Investment in this sector was 26% higher than the previous year. The main investor countries in 2006 were Canada and the United States (data from the Central Bank of Ecuador).

El Salvador

Net FDI inflows to El Salvador amounted to US$ 204 million in 2006. Although this represents a fall in comparison with earlier years, information on projects which have been announced promises good prospects for a recovery in FDI. In 2005, the country received US$ 517 million, with an average of US$ 357 million between 2001 and 2005. Although most foreign investment is channelled into the clothing sector, there has also been a diversification towards other sectors, such as vehicle parts and electronics, software development, telecommunications, business process outsourcing and distribution and call centres. The year 2006 saw the entry into force of the Tourism Act, which offers fiscal incentives for investment in tourism. The completed construction of the Puerto de la Unión and the expansion of the international airport's freight terminal are expected to encourage new investment. The United States was the largest source of investment in 2006, although flows from other countries in the region (Guatemala, Colombia, Peru, and Panama) were also significant (Proesa, 2006).

El Salvador generated OFDI of US$ 50 million. The country was one of the main investor countries of Central America, channelling resources into air transport, hotels and real estate, especially within the region.

Guatemala

Inflows of FDI to Guatemala are estimated at US$ 325 million in 2006. Data from the Central Bank show that investment was directed mainly at the communications, commerce and chemicals sectors. Information on acquisitions and investment projects suggests that the electricity, tourism and banking services sectors also received inflows.

Honduras

The Central Bank of Honduras reports net FDI inflows of US$ 385 million for 2006, plus about US$ 110 million for the maquila sector. Within maquila operations, investment is concentrated in the textiles sector and is mainly from the United States. In response to the challenge of Chinese competition and the prospect of CAFTA-DR, Honduras has begun to shift the industry towards more vertically integrated operations that encompass from thread production to the end product. Nonetheless, estimates for the first half of 2006 suggest a decline in investment in the maquila sector. Apart from maquila activities, the main destination sector for FDI in the first half of 2006 was telecommunications (44.5%), followed by manufacturing, in the milling, paper and cement sectors. The financial sector received 12.2% of non-maquila investment. The main investors outside the maquila sector in the first half of 2006 were the United States (with 73.8% of the total), followed by Central America (17.1%) and Europe with 12.1% (mainly from Switzerland and the United Kingdom). There was disinvestment from Bahamas-based companies, owing to repayments on business credit and loans.

Honduran OFDI amounted to US$ 22 million in 2006, and consisted of investments in commerce, industry and finance, mostly within Central America. El Salvador is the main destination of such investment (Central Bank of Honduras, 2006).

Mexico

In Mexico, inflows of FDI in 2006 stood at US$ 18.939 billion, approximately 4% below the 2005 figure. According to data from the Secretariat of Economic Affairs, the largest component of these flows was new investments, followed by inter-company accounts, profit reinvestment, maquila investment (maquila companies using foreign investment to import fixed assets) and mergers and acquisitions. There was a decline in the volume of new investments and acquisitions. Levels of investment and reinvestment in the maquila sector remained relatively stable (up by 5% and 7%, respectively) while inter-company account movement increased. Investment remained concentrated in manufactures (61.3% of net inflows), with the main segments being metal products, machinery and equipment. Commerce chalked up considerably lower flows in 2006 then in previous years, which is largely due to the purchase of Carrefour assets by the local Chedraui group (announced in 2005), resulting in negative FDI flows to this sector. In terms of the sources of investment, the United States was the main investor country, followed by the Netherlands, the United Kingdom and Spain (Secretariat of Economic Affairs, 2006, 2007a).

Mexico's OFDI amounted to US$ 3.897 billion, significantly below the 2004 and 2005 figures. The reduction is the result of a year that featured no major transactions, unlike 2005, when CEMEX acquired RMC. In addition, there were investment withdrawals, as when CEMEX pulled out of Indonesia.

Nicaragua

In Nicaragua, net FDI inflows are estimated at US$ 290 million in 2006, 20% higher than the previous year. Information on investment projects suggests that the United States was the top investor, with the main sectors being retail trade and clothing. The country also has new investment opportunities in hydrocarbons and biofuels.

In January 2006, the country announced the setting up of an inter-agency group to monitor foreign investment and private capital. The group includes the Central Bank of Nicaragua, the Ministry of Development, Industry and Commerce and the Supreme Council of Private Enterprise, and will carry out surveys to compile private-sector information used to produce the balance of payments (Central Bank of Nicaragua, 2006).

Panama

In Panama, FDI flows were US$ 2.56 billion, almost three times the 2005 figure. FDI has surged since 2003, following a decline between 1997 and 2002 which was partly due to the end of the cycle of privatizations and management concessions, the closure of some banks after 1999 and banking losses in 2002, and the transformation of the Canal Commission into a domestic enterprise in 2000. Much of the upturn in 2006 is linked to the acquisition of Banistmo and other Panama-based banks. Other significant sectors in 2006 were infrastructure, property and tourism. The widening of the Panama Canal, approved by referendum in October 2006, should have a significant impact on FDI in the coming years (data from the Comptroller-General of the Republic (2006), and the Ministry of Economic Affairs and Finance (2006a, 2006b)).

Information on the origin of FDI received in other countries shows that Panama is one of the region's main investors, which is partly a reflection of its position as a financial centre.

Paraguay

In Paraguay, net FDI stood at US$ 87 million as of the third quarter of 2006, close to the figure for the year-earlier period. There was a steep fall in shareholding investments and a rise in FDI in respect of reinvested profits and inter-company loans. The largest investors were the United States and Brazil.

In terms of investment promotion, in December 2006 the responsibilities of the trade and investment promotion agency Proparaguay were incorporated into the Investment and Export Network (REDIEX), which is part of the Ministry of Industry and Trade, with a view to rationalizing the use of available resources. New offices will soon be opening abroad (www.rediex.gov.py, 22 January 2007).

Peru

In Peru, net inflows of FDI represented US$ 3.467 billion, 34% more than the previous year, thanks to high growth rates and an international context favourable to the country's mining and hydrocarbon production (information from the Central Reserve Bank of Peru). The FDI stock in the petroleum sector has not changed since 2002. This does not include investment in gas development projects (such as Camisea), however. Another factor is that hydrocarbon investments can be classified according to specific activities (transport, services, construction).

Data from the Private Investment Promotion Agency (PROINVERSIÓN) show that the countries investing most in Peru in 2006 were the United Kingdom and the United States, and the main recipient sectors were mining and manufactures.

Uruguay

In Uruguay, 2006 saw inflows of US$ 1.374 billion in FDI, 62% higher than the 2005 figure. Much of the increase is due to investments in the paper and cellulose sector. According to the Central Bank, 17% of FDI received went to the banking sector and 22% to the property sector (Central Bank of Uruguay, 2007).

Net external disinvestments amounted to US$ 2.84 million.

Table I-A-1
LATIN AMERICA AND THE CARIBBEAN: NET INFLOWS OF FOREIGN DIRECT INVESTMENT, BY COUNTRY, 1997-2006 [a]
(Millions of dollars)

	1992-1996 (annual average)	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Anguilla	17	21	28	38	40	30	33	29	87	78	...
Antigua and Barbuda	22	23	23	32	43	98	66	166	77	114	...
Argentina	4 683	9 160	7 291	23 988	10 418	2 166	2 149	1 652	4 584	5 008	4 809
Bahamas	49	210	147	149	250	102	153	190	274	360	...
Barbados	12	15	16	17	19	19	17	58	-12	62	...
Belize	16	12	18	54	23	61	25	-11	112	126	153
Bolivia	243	731	949	1 011	734	703	674	195	63	-242	237
Brazil	4 497	19 650	31 913	28 576	32 779	22 457	16 590	10 144	18 146	15 067	18 782
Chile	2 465	5 271	4 628	8 761	4 860	4 200	2 550	4 307	7 173	6 960	8 053
Colombia	1 443	5 562	2 829	1 508	2 395	2 525	2 139	1 758	3 084	10 255	6 295
Costa Rica	307	408	613	619	409	460	659	575	617	861	1 436
Cuba	16	442	207	178	448		...	...	...	...	...
Dominica	26	21	7	18	18	15	18	29	24	26	...
Ecuador	436	724	870	648	720	1 330	1 275	1 555	1 160	1 646	2 087
El Salvador	13	59	1 104	216	173	279	470	142	376	517	204
Grenada	20	34	49	42	37	59	54	89	54	26	...
Guatemala	91	84	673	155	230	456	111	131	155	208	325
Guyana	91	52	44	46	67	56	44	26	30	77	
Haiti	1	4	11	30	13	4	6	14	6	26	160[a]
Honduras	50	122	99	237	282	193	176	247	325	372	385
Jamaica	136	203	369	524	468	614	481	721	602	682	...
Mexico	8 724	14 180	12 416	13 704	17 776	27 487	19 342	15 345	22 301	19 643	18 939
Monserrat	4	3	3	8	2	1	1	2	2	1	...
Nicaragua	62	203	218	337	267	150	204	201	250	241	290
Panama	271	1 299	1 203	864	624	467	99	771	1 012	1 027	2 560
Paraguay	116	236	342	95	104	84	10	25	28	75	117[a]
Peru	2 000	2 139	1 644	1 940	810	1 144	2 156	1 335	1 599	2 579	3 467
Dominican Rep.	217	421	700	1 338	953	1 079	917	613	909	1 023	1 183
Saint Kitts and Nevis	19	20	32	58	96	88	80	76	46	47	...
Saint Lucia	32	48	83	83	54	59	52	106	80	108	...
Saint Vincent and the Grenadines	33	92	89	57	38	21	34	55	66	56	...
Suriname	-27	-9	9	-62	-148	-27	-74	-76	-37	-37	-144[b]
Trinidad and Tobago	346	999	730	643	680	835	791	808	998	940	883
Uruguay	110	126	164	235	273	297	194	416	332	847	1 374
Venezuela (Bol. Rep. of)	996	6 202	4 985	2 890	4 701	3 683	782	2 040	1 483	2 583	-543

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures as at 24 April 2007.

[a] Extrapolated from third-quarter data.
[b] Extrapolated from data for the first half of the year.

Table I-A-2
LATIN AMERICA AND THE CARIBBEAN: NET INFLOWS OF FOREIGN DIRECT INVESTMENT BY DESTINATION SECTOR , 1997-2006
(Percentages)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Argentina	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	...	...
Natural resources	2	18	74	26	41	53	-17	53	...	...
Manufactures	36	16	8	14	2	46	69	29	...	...
Services	53	50	13	46	58	-21	33	3	...	...
Other	9	16	4	14	-2	23	15	16	...	...
Bolivia	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Natural resources	38	57	47	53	65	72	63	44	71	82
Manufactures	3	2	15	11	10	9	11	23	14	11
Services	59	42	38	36	26	19	26	33	14	7
Brazil	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Natural resources	3	1	2	2	7	3	12	5	10	7
Manufactures	13	12	25	17	33	40	35	53	30	39
Services	84	88	73	81	60	56	54	42	60	55
Chile	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Natural resources	34	42	15	12	23	59	31	8	39	37
Manufactures	12	9	9	8	16	6	18	9	10	3
Services	54	49	76	80	61	34	50	83	51	60
Colombia	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Natural resources	12	3	-3	5	42	42	53	57	32	60
Manufactures	9	28	34	21	10	15	18	8	54	11
Services	78	69	70	73	49	43	29	35	14	29
Costa Rica	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Natural resources	9	7	8	-3	0	-1	-6	6	4	3
Manufactures	68	72	59	75	51	74	69	57	43	31
Services	22	21	32	27	48	28	37	36	52	65
Other	1	0	1	0	1	0	1	0	0	1
Ecuador	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Natural resources	78	88	93	95	86	84	56	81	90	89
Manufactures	6	3	1	1	4	4	5	3	4	3
Services	16	8	5	4	10	11	39	15	6	8
El Salvador			**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Natural resources			-7	-6	11	4	-1	5	0	12
Manufactures			10	30	32	27	92	18	76	7
Services			98	77	57	69	9	77	24	82
Honduras	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Natural resources	6	3	47	11	5	13	9	11	6	2
Manufactures	41	24	20	63	43	40	51	53	48	45
Services	53	73	33	27	52	47	39	36	46	53
Mexico	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Natural resources	1	1	2	2	0	2	1	1	0	1
Manufactures	60	60	67	56	21	45	44	57	58	61
Services	39	39	32	43	79	54	56	42	42	38

Table I-A-2 (concluded)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Nicaragua	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	···
Natural resources	14	16	8	3	4	0	0	0	0	···
Manufactures	8	13	11	27	37	34	24	13	36	···
Services	78	71	81	70	59	66	76	86	64	···
Panama	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	···	···
Natural resources	0	0	0	0	0	0	0	0	···	···
Manufactures	3	-3	5	0	68	-77	0	4	···	···
Services	99	108	98	63	46	100	79	99	···	···
Other	-2	-5	-3	37	-14	77	20	-3	···	···
Peru	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Natural resources	9	20	21	1	8	11	3	87	88	56
Manufactures	20	16	9	3	21	38	73	-38	2	33
Services	72	63	70	96	71	51	24	51	10	11
Dominican Rep.	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Natural resources	0	0	0	0	0	2	11	7	3	2
Manufactures	51	25	17	21	22	29	21	40	36	25
Services	49	70	80	71	74	68	58	47	55	60
Other	0	4	4	9	3	3	9	-2	0	0
Trinidad and Tobago	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	···	···
Natural resources		80	70	90	94	98	88	89	···	···
Manufactures		2	1	-6	-2	2	1	2	···	···
Services	0	2	3	0	4	5	1	5	···	···
Other		16	26	15	4	5	7	4	···	···
Venezuela (Bol. Rep. of)	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Natural resources	54	36	68	26	59	67	0	-35	34	-356 [a]
Manufactures	21	48	17	22	14	-22	14	157	28	146
Services	25	16	15	51	31	55	36	27	38	110

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures as at 16 April 2007.

[a] Refers to negative net flows in the petroleum sector, totalling US$ 1.958 billion.

Table I-A-3
LATIN AMERICA AND THE CARIBBEAN: NET INFLOWS OF FOREIGN DIRECT INVESTMENT, BY COUNTRY OF ORIGIN, 1996-2006
(Percentages)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	1997-2006
Argentina	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	...	...	**100**
Netherlands	19	15	2	4	60	-20	-10	23	...	...	9
United States	22	13	5	9	25	16	-15	14	...	...	11
France	2	18	6	6	24	-29	-11	9	...	...	6
Italy	3	5	3	9	-3	-4	24	0	...	...	4
Spain	20	12	70	65	23	-15	2	1	...	...	43
Other	34	38	13	7	-29	152	110	52	...	...	27
Bolivia	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	...	...	**100**
Argentina	11	21	10	10	11	3	4	2	...	...	10
Brazil	8	3	14	5	8	18	11	2	...	...	9
Italy	17	11	6	6	7	3	5	0	...	...	8
Spain	10	5	1	6	7	27	11	11	...	...	9
United States	30	35	34	44	40	29	33	36	...	...	35
Other	24	25	35	29	26	20	36	48	...	...	29
Brazil	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
France	8	8	7	7	9	10	6	2	7	3	7
Netherlands	10	15	8	8	9	18	11	38	15	16	14
Portugal	5	8	9	9	8	5	2	3	2	1	5
Spain	4	23	21	33	13	3	6	5	6	7	14
United States	29	21	30	19	21	14	18	20	21	20	21
Other	45	26	25	25	40	50	57	32	50	53	38
Chile	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Australia	4	7	0	1	13	4	4	3	24	6	5
Canada	21	17	6	24	3	27	15	8	4	58	16
Spain	29	15	50	21	8	7	12	81	10	2	29
United Kingdom	10	12	4	5	9	45	11	2	13	3	10
United States	17	22	15	26	36	16	29	3	4	11	18
Other	20	27	26	22	31	1	29	4	45	20	22
Colombia	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**		**100**
Netherlands	2	6	18	5	10	2	6	0	4	1	5
Panama	33	4	8	7	7	3	14	4	3	8	10
Spain	26	15	7	15	10	6	13	7	7	16	13
United Kingdom	0	2	1	0	1	-1	3	1	46	1	12
United States	4	13	23	4	13	46	22	43	17	48	20
Other	35	61	43	70	59	43	42	45	23	28	41
Costa Rica	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	...	**100**
Canada	2	6	6	-1	8	-1	3	1	4	...	3
Mexico	5	3	15	7	7	4	7	5	5	...	6
Netherlands	1	0	0	0	1	35	5	3	1	...	6
Panama	0	0	11	6	14	5	0	3	2	...	4
United States	75	79	56	68	57	50	62	72	80	...	67
Other	17	11	12	19	15	7	23	17	8	...	14

Table I-A-3 (continued)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	1997-2006
Ecuador	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Canada	17	26	23	27	34	29	22	28	35	36	29
Italy	2	11	11	10	7	9	4	4	6	5	6
Panama	3	2	2	2	6	4	6	6	6	5	5
Spain	4	0	0	13	7	7	3	4	8	8	6
United States	46	46	40	37	25	33	14	28	22	16	27
Other	28	15	24	11	20	18	52	30	23	31	27
El Salvador	...	...	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Canada	...	...	1	0	10	1	1	2	17	12	7
Mexico	...	...	-6	0	1	2	8	131	8	2	27
Panama	...	...	3	4	2	7	0	1	10	32	8
Spain	...	...	18	0	19	19	2	8	0	0	8
United States	...	...	66	63	38	70	48	-1	-15	4	24
Other	...	...	18	33	30	1	41	-40	80	51	26
Honduras	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Canada	3	12	22	6	10	12	9	13	3	1	8
El Salvador	21	9	6	3	-1	9	3	5	7	3	6
Mexico	0	1	2	0	3	1	1	11	12	7	5
United Kingdom	10	7	1	6	6	0	-1	19	13	5	7
United States	41	36	47	18	31	83	60	21	35	65	44
Other	24	35	22	66	51	-5	28	31	30	18	30
Mexico	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Canada	2	3	5	4	4	1	2	2	2	3	3
Netherlands	3	13	8	15	9	8	4	15	11	8	10
Spain	3	4	8	12	3	4	12	33	7	4	10
United Kingdom	15	2	-1	2	0	6	7	1	5	5	4
United States	61	65	54	71	78	67	63	37	52	64	61
Other	16	13	27	-4	6	14	13	12	23	17	13
Panama	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**		**100**
Japan	16	5	4	5	-9	6	-29	14	7		5
Mexico	8	4	11	27	-11	-5	36	-1	-3		5
Spain	2	1	1	0	4	-6	27	6	28		6
United Kingdom	-1	63	14	12	2	18	19	3	-4		18
United States	16	8	36	37	30	19	174	11	8		22
Other	59	19	35	19	83	68	-128	66	65		44
Paraguay	...	...	...	...	...	**100**	**100**	**100**	**100**	**100**	**100**
Argentina	...	...	...	...	...	-33	49	-26	22	4	9
Brazil	...	...	...	...	...	-77	-71	-2	21	24	7
Japan	...	...	...	...	...	229	13	29	7	1	13
Portugal	...	...	...	...	...	-8	2	72	-1	-1	8
United States	...	...	...	...	...	355	112	6	68	84	80
Other	...	...	...	...	...	-366	-4	20	-18	-12	-17

Table I-A-3 (concluded)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	1997-2006
Peru	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Spain	-5	4	2	74	-3	13	1	277	2	0	25
United Kingdom	22	31	52	6	31	28	38	-317	-2	42	21
United States	23	21	18	4	-11	-43	18	161	56	28	16
Panama	26	3	1	0	1	36	102	11	-17	1	6
Netherlands	13	3	8	9	31	6	32	-8	-65	3	5
Other	21	38	19	7	53	60	-91	-24	126	26	26
Dominican Rep.	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**		**100**
United States	31	29	15	26	46	58	100	26	28	70	40
Spain	10	33	38	25	20	5	-3	18	24	19	21
Canada	39	21	8	17	1	3	-5	40	21	9	14
Netherlands	0	0	5	5	26	18	5	0	4	-3	6
France	0	0	3	13	6	17	7	12	9	0	6
Other	20	18	31	14	1	-1	-5	4	14	5	11
Venezuela (Bol. Rep. of) (hydrocarbons)	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	...	...	**100**
United States	39	39	5	31	3	36	6	17	...	...	13
Netherlands	1	0	2	0	22	4	0	53	...	...	8
Panama	3	0	5	3	0	0	0	0	...	...	2
United States	0	0	0	1	4	0	0	0	...	...	1
France	1	2	1	0	0	0	0	0	...	...	1
Other	57	59	87	66	71	59	94	29	...	...	74
Venezuela (Bol. Rep. of) (other)	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
United States	27	8	11	15	13	18	85	35	40	21	31
Netherlands	3	2	13	14	51	24	4	0	3	5	10
Spain	22	1	4	10	3	2	1	4	3	5	5
Switzerland	2	1	6	7	0	1	0	32	0	9	4
Colombia	2	4	11	9	5	3	2	4	0	10	4
Other	44	85	55	45	28	52	8	24	53	50	46

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures as at 16 April 2007.

Table I-A-4
LATIN AMERICA AND THE CARIBBEAN: TOP 50 NON-FINANCIAL TRANSNATIONAL CORPORATIONS, BY CONSOLIDATED SALES, 2005
(*Millions of dollars*)

Ranking 2005	Ranking 2004	Corporation	Country	Sector	Consolidated sales	Main subsidiaries in the region
1	3	Wal-Mart	United States	Commerce	21 124	Mexico, Brazil, Guatemala
2	1	General Motors Corp.	United States	Motor vehicle	19 965	Mexico, Brazil, Colombia
3	2	Telefónica de Spain S.A.	Spain	Telecommunications	19 425	Brazil, Argentina, Venezuela (Bol. Rep. of), Chile, Peru, Mexico, Colombia
4	4	DaimlerChrysler AG	Germany	Motor vehicle	15 971	Mexico, Brazil, Argentina
5	5	Volkswagen	Germany	Motor vehicle	15 680	Mexico, Brazil, Argentina
6	6	Bunge	United States	Agro-industry	10 407	Brazil, Argentina
7	7	Endesa	Spain	Electricity	10 252	Chile, Brazil, Argentina
8	9	Telecom Italia SpA	Italy	Telecommunications	9 904	Brazil, Argentina
9	12	Repsol YPF	Spain	Petroleum/Gas	9 661	Argentina, Peru
10	14	Royal Dutch-Shell Group	Netherlands/United Kingdom	Petroleum /Gas	8 033	Brazil, Argentina
11	24	Arcelor	Luxembourg	Steel	7 747	Brazil
12	13	Carrefour	France	Commerce	7 229	Brazil, Colombia, Argentina
13	17	Cargill, Inc.	United States	Agro-industry	6 489	Brazil
14	21	BHP Billiton Plc	Australia/United Kingdom	Mining	5 989	Chile, Brazil, Peru
15	25	ChevronTexaco	United States	Petroleum /Gas	5 874	Brazil, Colombia
16	16	ExxonMobil	United States	Petroleum /Gas	5 727	Brazil, Colombia
17	8	Ford Motor Co.	United States	Motor vehicle	5 665	Mexico, Argentina
18	11	AES Corp.	United States	Electricity	5 662	Brazil, Chile, Venezuela (Bol. Rep. of)
19	20	Nestlé	Switzerland	Food	5 183	Brazil, Mexico
20	30	Fiat Auto	Italy	Motor vehicle	4 708	Brazil, Argentina
21	35	The Coca-Cola Company	United States	Beverage/beer	4 327	Brazil
22	26	Siemens AG	Germany	Electronics	4 210	Brazil, Mexico
23	29	Iberdrola SA	Spain	Electricity	4 007	Brazil
24	22	General Electric	United States	Electronics	3 993	Mexico, Brazil
25	34	Portugal Telecom	Portugal	Telecommunications	3 611	Brazil
26	11	Dow Chemical	United States	Petrochemical/chemical	3 328	Brazil, Argentina
27	37	PepsiCo	United States	Beverage/beer	3 072	Mexico
28	28	Bayer	Germany	Petrochemical/chemical	2 762	Brazil, Mexico

Table I-A-4 (concluded)

Ranking 2005	Ranking 2004	Corporation	Country	Sector	Consolidated sales	Main subsidiaries in the region
29	50	BP Amoco Plc	United Kingdom	Petroleum/Gas	2 704	Argentina, Colombia
30	32	British American Tobacco Plc. (BAT)	United Kingdom	Tobacco	2 676	Brazil, Venezuela (Bol. Rep. of), Argentina
31	31	Anglo American Plc	United Kingdom	Mining	2 636	Chile
32	-	Caterpillar	United States	Machinery	2 594	Brazil
33	-	Renault	France	Motor vehicle	2 298	Brazil, Colombia, Argentina
34	48	Électricité de France	France	Electricity	2 087	Brazil
35	44	Kimberly-Clark Corporation	United States	Cellulose/paper	2 067	Mexico
36	47	Sonae SGPS	Portugal	Commerce	1 978	Brazil
37	-	Samsung Corporation	Republic of Korea	Electronics	1 877	Brazil, Mexico
38	15	Unilever	Netherlands/United Kingdom	Agro-industry	1 851	Mexico, Argentina
39	18	Hewlett-Packard (HP)	United States	Computing	1 763	Brazil
40	42	E.I. Du Pont de Nemours	United States	Petrochemical/chemical	1 753	Brazil, Mexico
41	-	Robert Bosch GmbH	Germany	Motor vehicle parts	1 715	Brazil
42	46	BASF AG	Germany	Petrochemical/chemical	1 651	Brazil
43	49	Procter & Gamble	United States	Hygiene/cleaning	1 556	Mexico
44	-	Mittal Steel Co.	Netherlands	Steel	1 551	Mexico
45	-	Volvo	Sweden	Motor vehicle	1 505	Brazil
46	-	Newmont Mining Corporation	United States	Mining	1 490	Peru
47	-	Avon	United States	Hygiene/cleaning	1 490	Brazil, Mexico
48	-	Rhodia	France	Petrochemical/chemical	1 482	Brazil
49	-	Intel	United States	Computing	1 444	Costa Rica
50	-	Makro	Netherlands	Commerce	1 441	Brazil
		Total			271 616	

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information provided by the Special Studies and Projects Department of *América economía* magazine, Santiago, Chile, 2006.

Note: This table was produced by aggregating the sales of the subsidiaries of each transnational corporation operating in the region, on the basis of primary information on the sales of the largest companies. In cases where the subsidiary is owned by two or more transnational corporations, its sales are distributed among them according to the percentage ownership of each parent company. This is the case with: Vivo (Brazil), which belongs to Telefónica of Spain and Portugal Telecom; Doña Inés de Collahuasi mining company (Chile), owned by AngloAmerican (United Kingdom) and Falconbridge (Canada/United Kingdom); and the mining company Antamina (Peru), owned by BHP Billiton (Australia/United Kingdom) and Falconbridge (this last example is not included in the list).
In terms of the subsidiaries in the region, the table mentions only those for which sales information was available, which means that the list does not necessarily include all subsidiaries of each transnational corporation.

Table I-A-5
LATIN AMERICA AND THE CARIBBEAN: NET FLOWS OF OUTWARD FOREIGN DIRECT INVESTMENT, BY COUNTRY, OFFICIAL FIGURES, 1997-2006
(Millions of dollars)

	1992-1996 (annual average)	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Argentina	1 196	3 653	2 325	1 730	901	161	-627	774	442	1 151	2 008
Barbados	2	1	1	1	1	1	0	1	4	9	...
Bolivia	2	2	3	3	3	0	0	0	0	0	0
Brazil	516	1 042	2 721	1 690	2 282	-2 258	2 482	249	9 807	2 517	28 202
Chile	726	1 463	1 483	2 558	3 987	1 610	343	1 606	1 527	2 209	2 797
Colombia	205	809	796	116	325	16	857	938	142	4 662	1 098
Costa Rica	5	4	5	5	8	10	34	27	61	-43	96
El Salvador	0	0	1	54	-5	-10	-26	19	-53	217	-50
Honduras	0	0	0	0	0	0	0	20	26	22	22
Jamaica	42	57	82	95	74	89	74	116	60	101	...
Mexico	0	0	0	0	0	4 404	891	1 253	4 432	6 474	3 897
Paraguay	2	6	6	6	6	6	-2	6	6	6	0[a]
Peru	-2	85	62	128	0	74	0	60	0	0	0
Trinidad and Tobago	0	0	0	264	25	150	106	-225	25	341	370
Uruguay	0	13	9	-3	-1	6	14	15	18	36	-2
Venezuela (Bol. Rep. of)	400	557	1 043	872	521	204	1 026	1 318	619	1 183	2 089

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures as at 24 April 2007.

[a] Based on third-quarter data.

Chapter II

ACTIVE POLICIES FOR ATTRACTING FOREIGN DIRECT INVESTMENT: INTERNATIONAL EXPERIENCES AND THE SITUATION IN LATIN AMERICA AND THE CARIBBEAN

A. INTRODUCTION

Transnational corporations (TNCs) are constantly seeking out and assessing possible new geographical locations for their investments, while countries compete globally to attract such investments and harness the benefits they provide. Beyond the theoretical, and, in some cases, ideological, considerations that may be brought to bear, governments face two fundamental policy options in their pursuit of foreign investment. The first is to do nothing, that is, to adopt a passive stance in terms of attracting investment; the second is to intervene actively to obtain the maximum benefit from the investment process.

The passive policies associated with the first option essentially rely on a country's comparative advantages or macroeconomic or structural conditions, which are taken as a given. In the extreme case, countries limit their role to defining the legal framework and administrative procedures that regulate foreign direct investment (FDI), and refrain from influencing firms' decision-making processes. This passive strategy may be sufficient to attract investments for which the key inducements are intrinsic to a particular country (domestic or neighbouring markets and natural resources). In such cases, the success of this policy is measured mainly by the size of the investment.

However, the global tendency has been to move towards increasingly sophisticated policy frameworks in which it is not just the volume of flows that is important but also the type of investment, that is, its quality in terms of its contribution to, and consistency with, the country's economic development objectives. While there are multiple strategies and emphases relating to FDI attraction, the countries that have been most successful in attracting these types of investments and in harnessing their benefits have been those that have adopted more active and targeted policies.

To the extent that a country's political objectives coincide with the interests of a particular TNC, a virtuous circle can be generated from which both parties stand to gain. Although the benefits of investment do not come automatically, taking into account the fact that FDI does not on its own —except in very rare cases— solve development and growth-related problems, it may play an important role if it is aligned with the strategic objectives of recipient countries.

As shown in the 2005 edition of this report, this trend is not unknown in the countries of Latin America and the Caribbean (ECLAC, 2006a, chapter II). Nevertheless, in comparison with the policies followed by some developed (mainly European) countries, certain transition nations (the Czech Republic and Hungary) and some emerging Asian economies (Malaysia, Republic of Korea, Singapore and Thailand), the efforts made in the Latin American countries have been weaker in terms of both the definition of explicit policies and their degree of integration with other national economic development policies.

The main purpose of this chapter is to discuss factors that may contribute to the design of more active policies that can help close the existing gap with countries that have been more successful in

attracting quality FDI. The first section develops a conceptual framework, based on corporate motivations and requirements, for the different components of an active and integrated policy. The second section examines various experiences in Asia and Europe which show how the concepts presented in the first section have been implemented. An effort is then made to determine how policies used by Latin American and Caribbean countries to attract FDI differ from those applied by countries that are more advanced in this respect, and a number of policy proposals are put forward with a view to narrowing this gap.

B. AN ANALYTICAL FRAMEWORK FOR ATTRACTING FDI: THE IMPORTANCE OF ACTIVE POLICIES

The elements of a theoretical framework which can serve as a basis for the design of policies for promoting and attracting quality FDI are set out in this section. Consideration will first be given to the motivations and other factors that have a bearing on a company's appraisal and selection of a given geographical location when it decides to invest abroad. The discussion will then move on to the approaches adopted by different countries —depending on the degree of proactivity and integration with development policies— for influencing those decisions and deriving the maximum benefit from existing FDI. Lastly, the promotion policies and incentives for attracting these capital flows are examined.

1. Motivations and factors that influence foreign investment decisions

A government that has prior knowledge of the motivations and requirements of TNCs is in a better position to design and implement policies and actions to improve conditions in its country and to convey these advantages appropriately to potential investors, thereby enhancing its competitiveness in attracting quality FDI. ECLAC has classified the motivations for foreign companies investing in Latin America and the Caribbean in four categories: natural-resource-seeking, local or regional market-seeking, efficiency-seeking and strategic asset-seeking investments (see chapter I).

The needs of investors will depend on the main purpose of the investment. Once a company has determined what these needs are, it prepares a plan of action for identifying the geographical locations where they can best be satisfied.

TNCs use a fairly structured approach for evaluating different investment options. This process usually includes the following stages (see figure II.1):

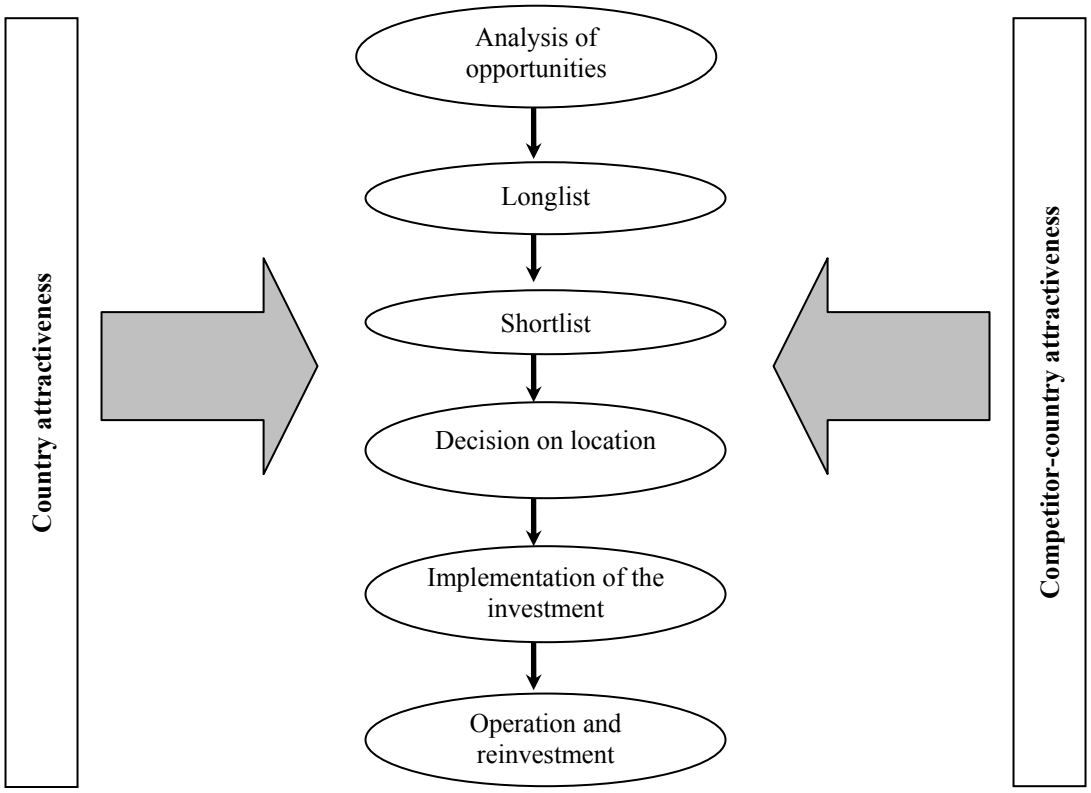
- Analysis of opportunities: companies are constantly seeking and analysing locations that are likely to satisfy their requirements.

- Longlist: once the formal appraisal has been started in accordance with the parameters and criteria that have been defined, firms collect general information and draw up an initial list of countries or locations that meet their requirements.

- Shortlist: based on this analytical process, a shortlist of the most attractive countries is prepared and more detailed information is then compiled. This stage usually includes visiting the countries on the shortlist to evaluate, check and compile information in the field and may include negotiations with local authorities.

- Appraisal: the final decision is taken on the basis of the information and data gathered in the previous stage. The process may involve several repetitions, since the conditions offered by countries may vary as negotiations concerning incentives or other facilities proceed. Once a location has been selected, the company keeps the possibility of making additional investments and reinvestments under constant review.

Figure II.1
CORPORATE DECISION-MAKING



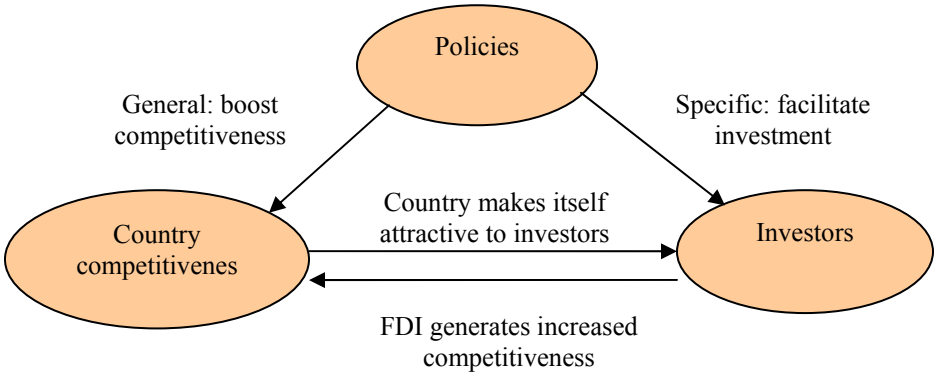
Source: Economic Commission for Latin America and the Caribbean (ECLAC).

During this process, companies explicitly set out the requirements they consider most relevant for their decisions. Crucial elements include access to resources or markets and a stable economic, political and social environment. Other conditions frequently mentioned are an enabling business climate, the existence of good, reliable infrastructure and basic services, the availability of professional, technical and managerial skills and a low level of corruption (MIGA, 2002). Interestingly, even though tax exemptions or rebates are some of the most commonly used policies for attracting investments, the tax system actually appears to be of secondary importance on this list of requirements.

Thus, the starting point for the design of policies for attracting FDI is to understand the motivations, factors and decision-making processes of TNCs. Whether a country will be included on the longlist depends on structural factors which determine how attractive a country is to would-be foreign

investors. Generally speaking, economically stable countries with good growth prospects and conditions, such as clear regulatory frameworks, efficient and transparent institutions, skilled human resources, a favourable business environment and openness to foreign trade, are in a better position to attract FDI. These variables may be influenced by general policies for improving competitiveness in the context of each country's development plan, priorities and resources. Similarly, policies designed to promote growth and economic stability generate a more inviting investment climate and make the country more appealing to foreign investors (see figure II.2). When a country determines that FDI or a certain type of FDI has the potential to contribute to these development objectives, it may then decide to design specific FDI policies to facilitate the inflow of such investments.

Figure II.2
LINKS BETWEEN COMPETITIVENESS, INVESTORS AND POLICIES



Source: Economic Commission for Latin America and the Caribbean (ECLAC).

In order to have a positive impact on corporate evaluation processes, countries can generate mechanisms or institutions that interact with foreign companies at different levels. Specific attributes of a country can be highlighted through promotional efforts and can be brought to the attention of corporate decision-makers. Investor support services help to generate knowledge and facilitate the evaluation of the country's attributes on the ground. Furthermore, many countries have decided to provide investment incentives which help to enhance their attractiveness vis-à-vis potential competitors.

Different models and policy options for attracting investments exhibit varying degrees of proactivity.

2. Models and policy options

There is increasingly intense competition for the resources and benefits to be derived from the international expansion of TNCs. The quality of FDI is also increasingly important, not just the quantity (Mortimore and Vergara, 2006). In terms of specific policies, national authorities have two basic options: either to adopt a passive stance, which does not imply a lack of interest in or rejection of FDI, or to intervene actively to tap into these capital flows.

Globally, the present trend is to establish increasingly sophisticated policy frameworks that are integrated into the country's other development policies. Countries that have been successful in attracting

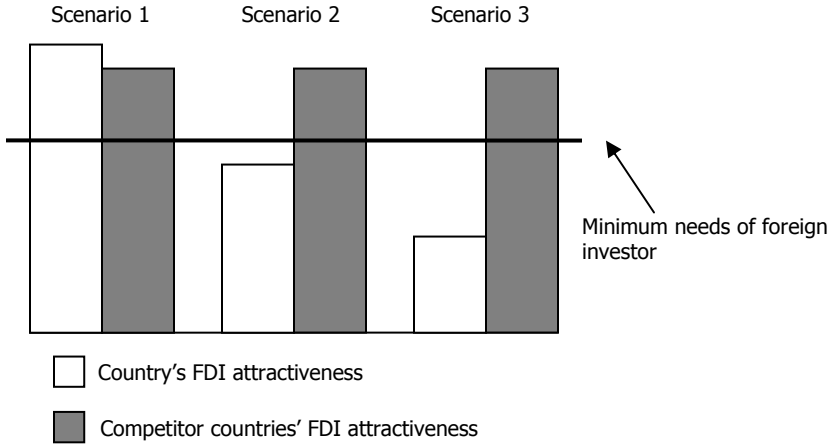
quality investments and in taking advantage of their benefits have been those that have adopted more active and more targeted policies (UNCTAD, 2004; UNCTAD, 2005a; and Mortimore, Vergara and Katz, 2001).

There are three basic models that can serve as a basis for a conceptual framework for the design of policies for attracting FDI: passive, active and integrated policies.

Passive policies rely on a country's comparative advantages and are confined to the establishment of policy frameworks geared to facilitating investment inflows. Active policies entail specific measures designed to attract types of investment that have a greater potential to translate into positive externalities for a given country (for example, production linkages or the generation of value added, know-how and employment). When a country chooses to attract a certain type of investment that it feels can contribute to its strategic objectives within the framework of its development policies, it is using what are known as integrated investment attraction policies. In this case, there is a feedback loop between the investment and general policies which gives rise to a virtuous circle that is of benefit to both parties.

These three basic FDI intervention models will be discussed below, starting with the simplest scheme and progressing to the most complex. Depending on the situation prevailing in a given country, an effort can be made to determine which type of policy would be the most appropriate. As shown in figure II.3, passive policies would be the most appropriate for a country whose attractions surpass those of its competitors, while active policies could be adopted by a country whose situation is slightly inferior to that of its competitors. The third case, that of a country which is far behind its competitors, would not benefit particularly from active policies and would call for long-term action to produce structural changes through the implementation of integrated policies (see figure II.3).

Figure II.3
POSSIBLE COUNTRY SCENARIOS

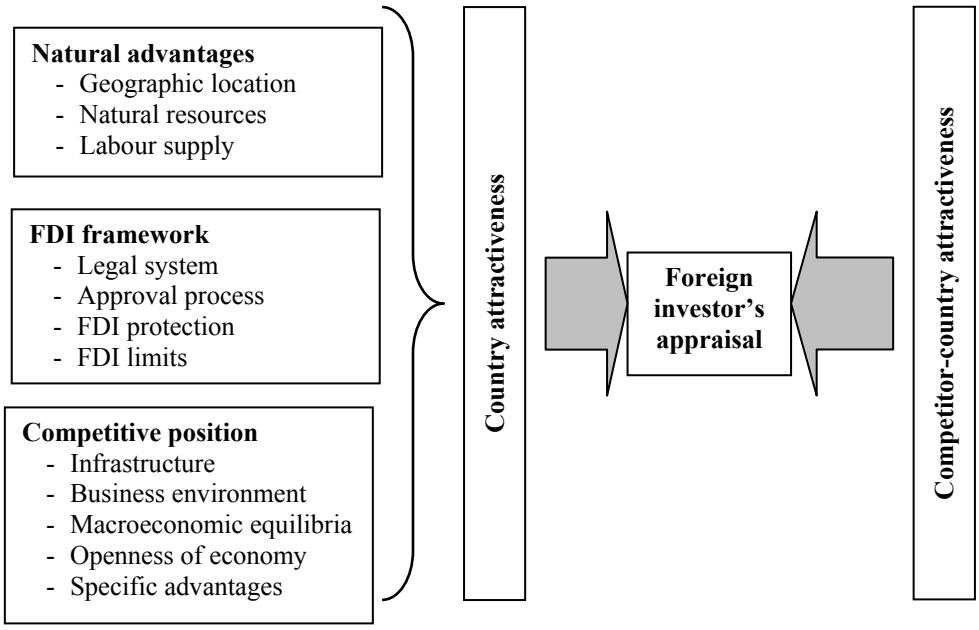


Source: Economic Commission for Latin America and the Caribbean (ECLAC).

(a) Passive policies: making the most of a country's comparative advantages

In this case, no specific policies are adopted to attract FDI, although this does not necessarily signify a lack of interest in such investments. Rather, the authorities feel that the country's comparative advantages or macroeconomic conditions are sufficient to result in FDI inflows and do not consider it necessary to intervene in the process. This type of scheme for attracting FDI is not necessarily integrated with any productive development policy, and its success is measured basically by the size of investment inflows. This approach may be sufficient to attract companies pursuing the advantages intrinsic to a particular country (domestic or neighbouring markets and natural resources). In this model, the host country's circumstances —for example, its macroeconomic situation, human resources, infrastructure and business environment— and the FDI regulatory framework are the basic components of what the country is offering to investors (see figure II.1). Investors then compare these elements with the profile of competing countries and evaluates the situation in the light of their own requirements (see figure II.4).

Figure II.4
PASSIVE POLICIES



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Nicolo Gligo S., "Políticas activas para atraer inversión extranjera directa en América Latina y el Caribe", *Desarrollo productivo series*, No. 175 (LC/L.2667-P), Santiago, Chile, January 2007. United Nations publication, Sales No. S.07.II.G.18.

A passive policy is successful when a country's advantages meet the investor's needs and surpass those offered by its closest competitor (scenario 1). The company's appraisal can result in other outcomes, however.

(b) Active policies: attempting to close the gap with competitors

These types of policies are used when national governments wish to take a more proactive approach to FDI attraction. The general idea here is to determine what kind of investment will produce the desired benefits and then to create —within the limits of the country's possibilities— the conditions needed to attract it. In many cases, these policies are geared towards attracting quality investments that will generate significant benefits for the host economy in terms of know-how, employment, production linkages, technology transfers, etc. In these cases, microeconomic variables —availability, quality and cost of factors of production— are highly important, and competition among countries to attract investors is much more intense.

In order to implement this type of policy, countries set up an institutional structure for promoting and attracting FDI and take explicit steps to achieve their stated objectives. The main components of this model are:

- Investment promotion agencies (IPAs): these bodies disseminate information about the country's attributes among potential investors and assist them with their appraisals.

- Incentives: many countries have opted to create investment incentives, which basically take two forms: tax incentives (exemptions or rebates) and financial inducements (direct subsidies for investment projects).

- Investment facilitation measures: improvements in the regulatory framework are part of a continuous process involving ongoing contact with investors.

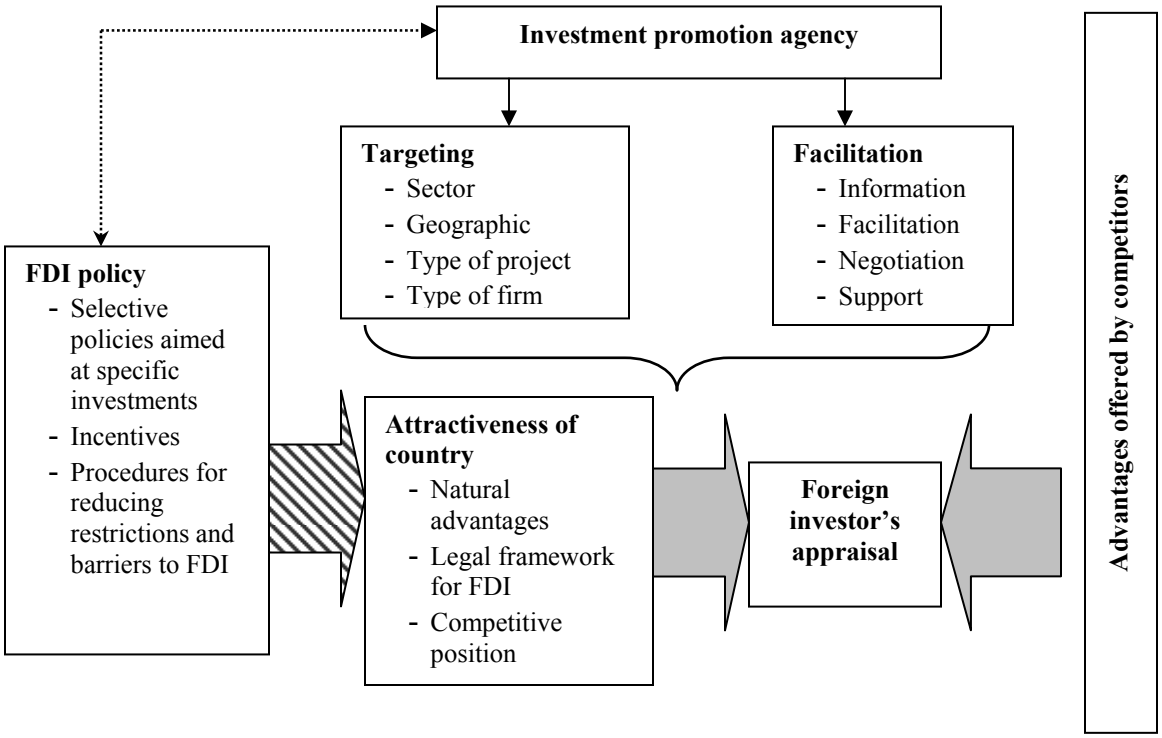
- Selective policies for boosting a country's competitiveness: a government may make a deliberate effort in the short run to improve factors that influence the country's attractiveness (by, for example, training scarce human resources).[1]

All these elements help to enhance what the country has to offer and to close the gap separating it from competitors, provided that it is not too wide (i.e., when the costs of doing so are clearly lower than the expected benefits and the government can afford to do so (scenario 2)). If this gap is not closed, the country runs the risk of losing the investment (see figure II.5).

A country may prioritize a particular type of investment or prefer it over other types and take certain steps to attract it. This type of policy is based on a targeting strategy and uses all the elements outlined above. There are at least two reasons for adopting this type of strategy: (i) when the country wishes to achieve a specific objective; and (ii) when funds are scarce and the authorities decide to concentrate the available resources on effective promotion activities.

[1] Costa Rica and El Salvador have set up specific training programmes to satisfy the growing demand for skilled bilingual technical personnel in international services sectors. Chile has created a national register of persons with a mastery of English to facilitate recruitment by firms that need bilingual personnel.

Figure II.5
ACTIVE POLICIES



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Nicolo Gligo S., "Políticas activas para atraer inversion extranjera directa en América Latina y el Caribe", *Desarrollo productivo series*, No. 175 (LC/L.2667-P), Santiago, Chile, January 2007. United Nations publication, Sales No.: S.07.II.G.18.

In these cases, the strategy's areas of emphasis are usually defined in terms of the advantages that the country has to offer, the requirements of potential investors and the country's interests as set forth in its FDI policy objectives. In the best-case scenario, these criteria match, and the country therefore has attributes that enable it to attract FDI in those areas that are of interest to it. If, however, the country's aspirations far exceed its actual assets, it may run the risk of setting aside resources for activities that do not produce the expected results (scenario 3) (see figure II.3). Targeting should be a natural outcome of a defined development strategy. Failing this, it will be a primarily operational tool for guiding the work of investment promotion agencies.

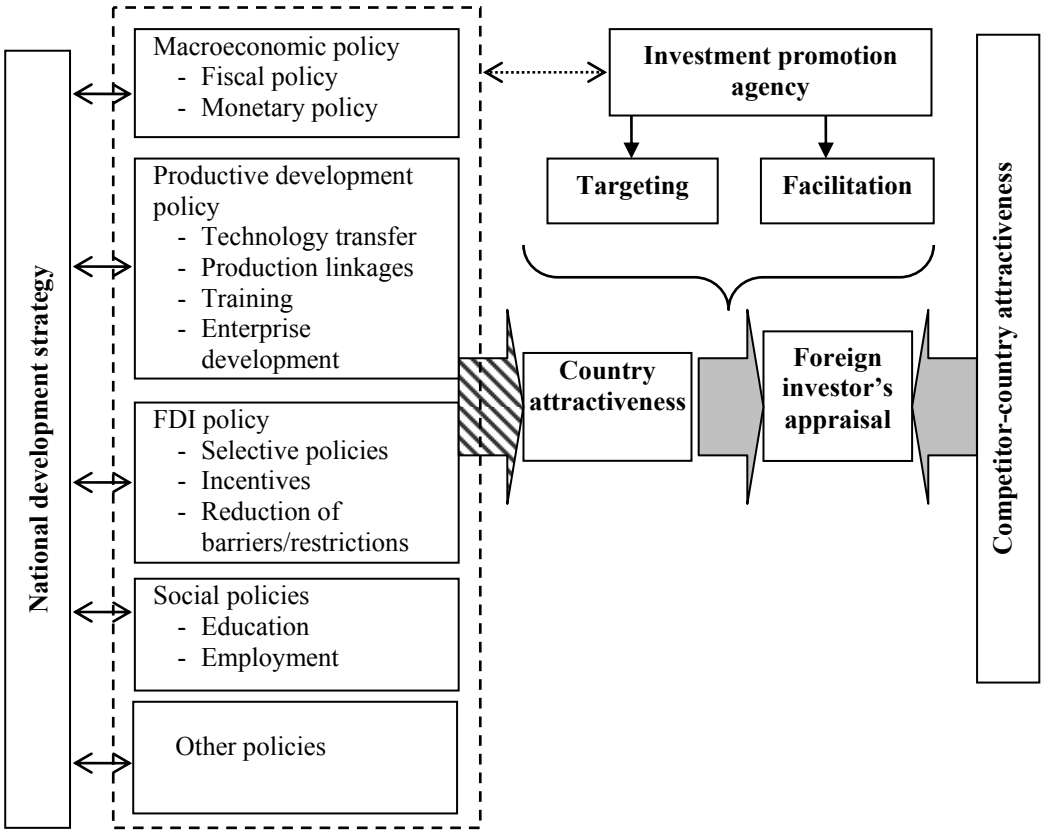
(c) Integrated policies: towards structural changes

When FDI attraction policies and development policies are coordinated and integrated, they can both leverage the conditions that make a country attractive to investors and make the most of the potential benefits that FDI has to offer. In such cases, the country defines its strategies, and FDI helps it to carry them out. This means that, within the context of international competition for investment, a country's profile may be structurally modified (Gligo, 2007, p.24).[2] In addition, countries can use a series of

[2] As will be discussed later on, in the cases of Ireland and Singapore, FDI has become a pivotal factor of development around which the definition of other policies revolves. In other cases, FDI has contributed to

indicators to monitor the impact of FDI, track progress in policy implementation and compare their performance with that of their main competitors. These policies do not seek only to attract FDI, but also to maximize absorption of the benefits it brings. To this end, it is crucial to raise the competitiveness of local firms so that they can be integrated into the production and marketing networks of the foreign corporations (see figure II.6).

Figure II.6
INTEGRATED POLICIES



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Nicolo Gligo S., "Políticas activas para atraer inversión extranjera directa en América Latina y el Caribe", *Desarrollo productivo series*, No. 175 (LC/L.2667-P), Santiago, Chile, January 2007. United Nations publication, Sales No. S.07.II.G.18.

With integrated policies, structural improvements may be implemented that enable countries to move out of scenario 3 over the medium or long term and eventually transition into a situation more in line with scenarios 2 or 1 in a wider range of activities and sectors. Such policies also allow countries to absorb greater benefits from FDI (see figure II.3).

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growth surges in sectors that are strategically important for a country's productive development plan (e.g., Malaysia's export-oriented electronics industry).

3. Active and integrated policy tools

There are two major promotion instruments that can be used to implement active and integrated policies: facilitation by investment promotion agencies, and incentives.

(a) Investment promotion agencies (IPAs)

One of the challenges faced by countries in seeking to attract FDI is potential investors' lack of familiarity with the features and advantages of a particular location or country. This is due to:

- Information asymmetries: Firms require information as decision-making inputs, but this information is not always available or readily accessible. Potential investors may therefore be unaware of a country's true situation or may develop a distorted perception of its situation in the course of the appraisal process.

- High learning and set-up costs: For companies investing in a country for the first time, unfamiliarity with legal procedures, factor markets, the business culture or even basic conditions of everyday life can become an obstacle to installation and may result in the loss of a potential investment.

The most common way in which countries and, in some cases, provinces or regions seek to solve these problems is by setting up an organization, unit or programme to promote investment (what is generically referred to as an "investment promotion agency", or IPA). The main purpose of such institutions is to make known the advantages of a location, provide relevant information to potential investors and facilitate decision-making and establishment in the country. Recently, as a result of growing competition for FDI, IPAs have been springing up in a large number of countries.[3]

Most IPAs are designed to provide support to investors in the different phases of the decision-making process (see figure II.7). At least five primary functions of such agencies and three others, which, while not necessarily crucial, complement their promotion activities, can be identified. The first group includes: (i) analysis of investment opportunities, bearing in mind potential investors and the conditions in the host country; (ii) definition and promotion of a favourable country image in terms of FDI; (iii) promotional efforts targeting potential investors; (iv) services for the investor during the appraisal process and project start-up; and (v) monitoring and post-investment service.[4] The complementary functions include (i) advising authorities on how to improve the local business climate; (ii) allocating and evaluating incentives,[5] and (iii) helping local companies to become more competitive so that they can become potential suppliers of products and services to foreign firms.

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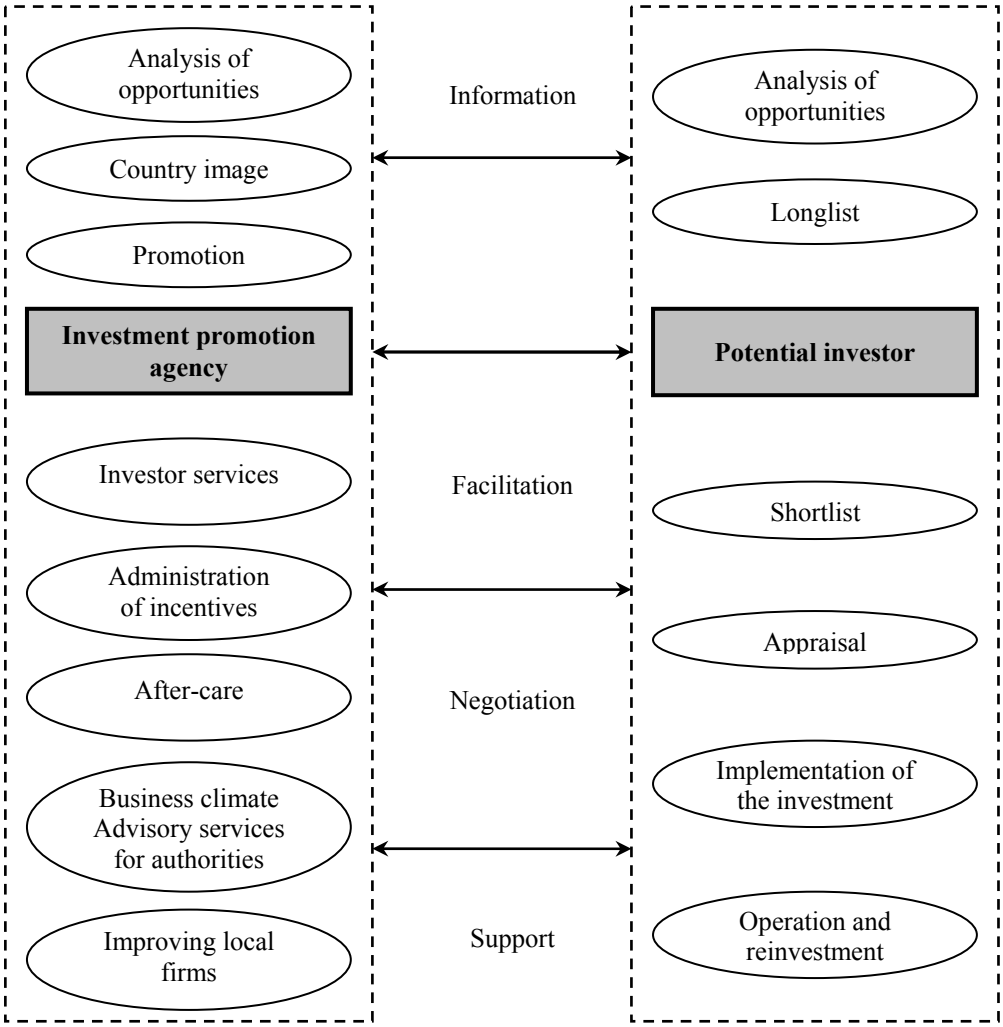
[3] More than 160 countries now have national IPAs. If regional and provincial agencies are included, the number rises to 250. Two thirds of them were created in the 1990s (UNCTAD, 2001).

[4] The best promotors for a country are "satisfied customers" (Gligo, 2007, p. 27).

[5] Since incentives are included in the negotiation process, IPAs should at least have access to information and be in constant touch with the agencies that administer them.

Figure II.7
IPA-INVESTOR RELATIONS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Nicolo Gligo S., "Políticas activas para atraer inversión extranjera directa en América Latina y el Caribe", *Desarrollo productivo series*, No. 175 (LC/L.2667-P), Santiago, Chile, January 2007. United Nations publication, Sales No. S.07.II.G.18.

Such an agency's scope for action is determined, among other factors, by the size of its budget and its human resource endowment. As pointed out by a recent study, a basic minimum of financial resources is necessary if promotion is to yield effective results (Morisett and Andrews, 2004). In addition, since attracting FDI depends on the establishment of relationships and networks, an ongoing presence and proximity to potential investors abroad —through offices abroad— can greatly facilitate this task (Gligo, 2007, p. 29). However, given the high cost of this type of operation, few countries maintain offices beyond their borders that are devoted exclusively to investment promotion.

(b) Incentive policies

The use of incentives as part of an active and integrated investment-promotion policy can heighten the attractiveness of a country or specific locality whose structural conditions assure it a place on a company's shortlist. Incentives are generally either fiscal (tax cuts or temporary or permanent exemptions) or financial (direct subsidies in the form of non-reimbursable contributions, reductions in the cost of production factors or provision of infrastructure) in nature.

FDI incentives would appear to be justified, in theory, insofar as they can correct market failures and create positive externalities for the country. The benefits of FDI, such as technology transfers or job creation, and the positive effects generated by early arrivals that are the first to set up operations in a country in a given industry are sound reasons for offering incentives so long as their cost does not outweigh the expected social benefits.[6]

In an ideal situation in which a country's assets give it an unquestionable edge over its competitors, incentives would not be necessary (scenario 1). However, countries that make it on to the shortlist often exhibit quite similar conditions. In such cases, incentives can influence the investor's final decision. Authorities should therefore weigh such factors as: (i) the conditions existing in their country; (ii) the incentives they are in a position to offer and their costs; and (c) the potential benefits of the FDI projects in question. This implies that the incentives to be granted are the outcome of negotiations with the potential investor (Gligo, 2007, p. 30). Thus, when a country is going to offer incentives, they should be the bare minimum required to meet the investor's expectations and outdo the conditions offered by competitor countries (scenario 2) (see figure II.3). The cost of the incentives should also be significantly less than the benefits to be obtained. Under no circumstances should incentives be used to close a very wide gap such as that existing in scenario 3.

This line of reasoning is similar to the rationale being used by competitor countries and the investing firm, however. Faced with the prospect of losing a desired investment, a country may improve its bid by increasing its incentives, which could prompt its competitors to match that offer. This dynamic may lead to a series of escalating bids and an "incentives war". Countries may even end up modifying their legal frameworks. One example of this is the competition that occurred among Brazilian states trying to attract automotive investments in the 1990s (ECLAC, 2004, p.119). Thus, the level of incentives to be offered should have a ceiling that is set on the basis of the potential benefits for the host country.

This dynamic could result in a fairly complex competitive situation in which investors press authorities for greater benefits. Countries, for their part, are facing a situation analogous to the "prisoner's dilemma", where they can cooperate with each other and reduce the amounts of incentives offered, or try to make a better offer than the competition and thus win the project, but at the risk of entering into an "incentives war" where the spiralling cost of inducements would eclipse the benefits that the country would stand to gain (Oman, 2000 and Charlton, 2003).

[6] While incentives may easily be quantified, measuring the social benefits of FDI may be a more complex task. Methodological and practical problems arise in assessing benefits of this type. For example, it may prove difficult to assign a value to the difference between an investment made by a prestigious company and one made by a company that is relatively unknown.

In practice, incentives are allocated in one of two ways:

- Automatic allocation: companies obtain incentives for investment projects that comply with previously established requirements.

- Allocation on a case-by-case basis: subsidies and their amounts are determined on the basis of pre-established criteria and the merits of the projects. This approach is more flexible, allowing resources to be targeted based on the impact of the investment, but the greater discretionality of this approach increases the associated administrative costs and may generate conflicts of interest.

Lastly, the empirical evidence would seem to indicate that in the initial selection phase, in which the company draws up its longlist, incentives are not particularly relevant, since it is the structural advantages of each country that are at stake. Incentives take on a more important role, however, in particular among efficiency-seeking companies, when the time comes to evaluate and compare countries that are already on the shortlist. In other words, incentives are not the most important determining factor, but it would appear that they can have an influence in the final stage of the selection process.

To sum up, incentives are not the most important factor for investors when assessing their investment site options, but they do seem to have more influence in certain investment categories (efficiency-seeking projects) and in the final phase of the selection process (the shortlist). Therefore, under similar conditions, the decision could shift towards the country that offers the best incentives. Even attractive incentives, however, are not enough on their own to compensate for a weak competitive position resulting from a poor business climate or insufficient resources.

The ideal situation from the standpoint of overall benefits is for countries to compete on the basis of their structural advantages rather than on the basis of incentives. However, when countries believe that the type of investment they want to attract warrants a special effort, it is important to have transparent mechanisms for evaluating the costs of the incentives and the potential social benefits of the investment in order to avoid competition that results in negative social effects.

C. INTERNATIONAL EXPERIENCES

Following this analysis of key elements in forging a strategy to promote and attract FDI, this section will turn to a number of specific cases in which these policies have been applied. The case descriptions serve a twofold purpose. On the one hand, they establish a point of comparison between practices in the region and the more successful active policies of more advanced countries. On the other hand, they provide information that the region's agencies can use in their policy design process.

1. Developing countries: active policies that have helped to close the gap with industrialized economies

The process of formulating and implementing active and integrated policies has usually proved complex and difficult. The experiences of different countries have varied widely. While some have agreed on ambitious, sophisticated policies that have lasted for a number of decades (Singapore), other countries have implemented more targeted measures (Malaysia). In the case of the Czech Republic and the

Republic of Korea, crises have prompted national authorities to make radical changes in their countries' linkages with the rest of the world and to assign a new role to FDI.

(a) Singapore: a knowledge-intensive economy

Singapore has implemented an integrated investment-attraction policy that is both ambitious and sophisticated (Lall, 2000). While focused on attracting TNCs in knowledge-intensive sectors, it has also improved physical and human infrastructure in order to increase the country's attractiveness.

Since the early 1960s, Singapore has managed to modernize its industrial structure through effective planning and the implementation of an industrial policy in which FDI has played a central role. Initially, the country focused its efforts on creating jobs, establishing a production structure and attracting FDI. In the 1970s, it strengthened its industrial base and then focused on developing the manufacturing and service sectors as a key element for economic growth and for research and development (R&D) activities.

One of the main institutions to stimulate national development has been the Economic Development Board (EDB). Founded in 1961 as part of the Ministry of Trade and Industry, EDB is responsible for general strategic guidance and coordination of all matters relating to FDI and industrial competitiveness. It has thus played a central role in implementing and executing economic policies for industrial and services development. It has also been the agency responsible for promoting and supporting FDI and has managed to attract investments for which skills training and development are crucial.

In this context, thanks to strong State support for industrial development in which TNCs have become key agents —together with the local private sector, universities and other educational and research institutions— Singapore has become one of the Asian region's main centres for innovation, incorporation of knowledge and R&D. Critical components of this process have included incentives for labour-intensive TNCs to switch to capital-, training- and technology-intensive activities. This has brought the country to a stage where it now acquires technology for subsequent adaptation, improvement and production.

The State's contribution to this process has been fundamental, particularly in relation to developing and improving the country's human capital. Proactive policies that match up with corporate needs have equipped the country with the kind of professional and technical workers that have the qualifications needed to meet production requirements (see box II.1). Thus, the combination of appropriate policies for human capital development, a good system of incentives, quality infrastructure and the guiding role of the State has enabled Singapore to out-compete other countries in attracting high-quality investments.

Meanwhile, rising labour and land costs have led the government to encourage companies to reorganize their operations on a regional basis. A number of mechanisms have been designed for this purpose, including the International Business Hub 2000 (IBH2000), which seeks to encourage TNCs to site many of their administrative, financial and logistical activities in Singapore in order to provide services to the entire region. Its highly qualified human resources and good road and port infrastructure are some of the factors that have encouraged large companies to move to Singapore.

Box II.1
TECHNOLOGICAL DEVELOPMENT BASED ON FDI AND EDUCATION

The Government of Singapore's most ambitious undertaking in recent times has been to transform the country into a high-level technological manufacturing centre. In order to make more rapid progress, the local authorities focused on FDI rather than on local businesses. Based on a long-term perspective, they created the conditions to attract certain kinds of investments from TNCs and established incentives for foreign enterprises to bring advanced technology into the country. This mechanism led to a "natural selection" in favour of enterprises with sophisticated technologies, while the producers of low-technological-content or labour-intensive manufactures opted to leave the country.

Singapore has introduced measures to create a stable and supportive business environment for high-technology investments. These measures include capital contributions, tax exemptions, progressive infrastructure and improvements in education. In all of these ways, Singapore has sought to maximize the benefits of FDI, which are understood to include a learning process, absorption of high technologies and technical capacity-building.

After several decades of applying this approach to industrial development, the country has seen FDI become a powerful engine of progress in high-technology sectors. Despite their focus on foreign companies, these policy measures have also been aimed at ensuring competitiveness by stimulating the creation of clusters, and in this area the performance of local businesses has been vital.

The government has also understood the importance of education for technological progress and has made substantive changes in university programmes, giving priority to courses relating to the exact and natural sciences rather than social sciences. In addition, it has encouraged the development of an industrial training system which is now considered to be one of the most advanced in the world.

In 1979 the Vocational and Industrial Training Board was established to provide and manage training programmes for young graduates and workers based on the needs of business enterprises. These programmes include practical classes at the plants themselves and theoretical classes at academic institutions. The programmes have had good results. They have mainly benefited large corporations, but efforts have been made to extend the benefits to small and medium-sized enterprises as well. To this end, the Skills Development Fund, also established in 1979, has provided financial assistance for the training activities of SMEs.

The most recent advance in relation to education and training is the founding of the Agency for Science, Technology and Research (A*STAR). Set up in 2002, this autonomous governmental organization's mission is to improve the competitiveness of the Singaporean economy by promoting R&D, especially in the public sector. It consists of a number of bodies responsible for different areas in the training of highly qualified human resources and support for technological progress. The substantive bodies of A*STAR are the Biomedical Research Council and the Science and Engineering Research Council, which promote, support and supervise the country's R&D activities; the A*STAR Graduate Academy, which offers scientific stipends to students and supports various initiatives and programmes to enhance human resources; and Exploit Technologies, which protects the intellectual property created by research centres and facilitates the transfer of new technologies to industry.

Source: Economic Commission for Latin America and the Caribbean (ECLAC).

Recently, efforts have been focused on creating and strengthening clusters for manufacturing activities. In 1991, the Manufacturing 2000 programme was created to promote not only FDI but also training in order to improve the competitiveness of major industrial clusters. In the same year, the National Technology Plan was launched, under which the National Science and Technology Board was created. The Board's goal was to allocate 2% of GDP to R&D in predefined sectors. In 1996 the second National Science and Technology Plan was launched to provide more explicit support for scientific knowledge. Expenditure on science and technology doubled between 1996 and 2000, and 30% of the total amount was assigned to strategic industries selected by the government.

As part of the country's investment attraction policy, incentives for TNCs are combined with measures to support local agents in order to move forward with the process of national industrial development. Thanks to these measures, about 7,000 TNCs, half of which have regional operations, are

now based in Singapore. The country's production structure is focused on manufactures and services, especially in areas of high value added. This is due not only to the government's proactive attitude towards investment attraction, but also to its capacity to anticipate the needs of firms and formulate appropriate solutions through a public/private partnership model.

(b) Malaysia: the development of an export manufacturing industry

Over the last few decades FDI attraction in Malaysia, as in a number of other South-East Asian countries, has been integrated with development strategies and policies. Malaysia's experience illustrates two components of the active and integrated policy discussed above: the restrictions and barriers of the FDI regulatory framework, and a system of incentives with clearly defined objectives based mainly on fiscal measures. Both of these elements are included and integrated into the country's industrial policy.

Malaysia is actively and selectively promoting FDI, seeing it as an engine of growth and of changes in its production structure, especially in relation to exports of manufactures. The authorities deploy a broad system of incentives that are aligned with their strategic priorities for national development. There is also a series of restrictions on factors such as ownership which limit the activity of foreign enterprises.

The beginnings of the Malaysian policy to attract FDI date back to 1958, when a law was passed granting a two-year tax exemption for "pioneering" manufacturing projects. This benefit was subsequently extended to other types of projects. In 1971, a new economic policy was promulgated under which foreign ownership of business enterprises was limited to a 30% stake. In 1975, in order to secure compliance with these provisions, the Industrial Coordination Act established a system in which manufacturing enterprises of a certain size had to request an operating licence, which led to a drop in foreign participation.

In the 1980s, Malaysia significantly changed the direction of its industrial and investment-attraction policy by placing greater emphasis on export manufacturing activities. In 1986 the Industrial Master Plan was launched, which defined strategic guidelines for the next 10 years. Under this initiative, some of the conditions established for granting licences were relaxed in order to give a new boost to private investment. Permission was thus given for up to 100% foreign participation in projects where 80% of production was destined for foreign markets. FDI was also accepted in other sectors in which local capacity was limited. In the same year, the Promotion Investment Act was promulgated. This law introduced new incentives to promote exports, tourism and agriculture, training, R&D and other activities. Since then, the country's exports of manufactures have grown robustly. This is especially true in the case of electronics, a sector dominated by foreign companies. From 1985 to 2005, the share of total exports accounted for by electrical products and electronics jumped from 9% to 50%.

In 1996 the second 10-year industrial development plan was introduced. This plan came in response to the new challenges facing the country, which included the much more competitive international environment engendered by the use of growth strategies based on export development and FDI attraction by other countries able to offer lower production costs. The new plan called for the further development of the manufacturing sector, expansion of higher-value activities in the production chain, productivity gains and the development of related services. As part of this scheme, the regulatory framework for FDI was made more flexible, with up to 100% foreign ownership being allowed regardless of the level of exports involved or the sector concerned.

In August 2006, the Third Industrial Master Plan was launched. The ultimate goal of this 15-year plan (2006-2020) is to transform Malaysia into a developed country. FDI continues to play a vital role, but there is even more emphasis on the need to attract investments for high-value-added activities. The three pillars of this plan are the manufacturing, services and agricultural sectors, and the aim is to achieve increases in value added, technology use and R&D. It is expected that by around the year 2020 Malaysia will have a mature manufacturing sector, thanks to the development of 12 clearly identified subsectors. The plan also includes measures to ensure the best possible use of natural resources and to generate high-value products, while also promoting the growth of the services sector in line with international trends.

These policy guidelines have been backstopped by the create of a suitable institutional structure. In 1967 the Malaysian Industrial Development Authority (MIDA) was created to coordinate and promote the country's industrial development. This organization's supervisory role has gradually evolved into a more proactive approach to FDI promotion. It now has a network of 16 offices abroad and 10 offices in different parts of the country. The main functions of this body are as follows:

- To promote local and foreign investment in manufactures and related services;
- To plan and develop policy and strategy proposals for industrial development which are then submitted to the Ministry of Foreign Trade and Industry;
- To evaluate investors' applications in terms of licences, tax incentives and customs exemptions;
- To support business enterprises in the implementation and operation of projects;
- To facilitate and coordinate the exchange of information among agencies involved in industrial development.

The Malaysian incentive system has three main features: (i) it is based on tax benefits; (ii) these incentives are aligned with the development strategy defined by the government; and (iii) the institutional framework is dynamic, with constant adjustments and improvements being introduced. The main incentives are a 70%-100% tax exemption for a period of up to 10 years ("Pioneer Status") and a provision allowing between 60% and 100% of a firm's capital expenditure to be offset against 70%-100% of its taxable income (Investment Tax Allowance) (Gligo, 2007, p. 77).

One of the incentive system's requirements is that the investor must demonstrate that the operation will support, directly or indirectly, income distribution, employment growth, exports, production quality, production diversification, the use of local raw materials, training and R&D (Thomsen, 1999). As of the mid-1990s, the incentives have been linked to the Industrial Master Plan, focusing on support for priority sectors, and they have subsequently been modified to support the government's new strategies. In fact, in the 1990s, the incentives were reduced and the selection of activities became stricter (Gligo, 2007, p.78). The system has also been expanding to incorporate new activities and products, especially the information and communications technologies (ICT) sector, which receives special treatment (Thomsen, 2004).[7]

[7] The Government of Malaysia created the Multimedia Super Corridor (MSC) long-term plan for the development of the ICT sector. This initiative is intended to attract foreign investment by means of a package of 10 incentives and government commitments, which include the provision of high-level physical and telecommunications infrastructure and special fiscal incentives.

Thus, Malaysia has displayed a very strong capacity for planning its industrial development over a 10-20 year timeline. FDI attraction policies have greater significance when their objectives are clear. In this Asian country, attracting FDI has been a key factor in the production changes that have been made, particularly in the area of exports of manufactures and electronics.

(c) Czech Republic: overcoming a lack of confidence in FDI

At the beginning of the 1990s, Czechoslovakia underwent profound social, political and economic upheavals as a result of the dissolution of the Soviet Union. The country abandoned the centralized planning model and split up into two new States: Slovakia and the Czech Republic.

In 1992, the new Czech government created CzechInvest with a mandate to promote the country abroad and attract FDI to support restructuring and industrial development. Over time, new programmes and services were included to respond to investors' needs, and this improved the quality of the products offered by the country. As a consequence of these changes, CzechInvest, initially intended to act as a promotion agency, became a development organization.8 It is precisely this capacity to adapt and evolve according to business needs and the country's development strategies that has made CzechInvest so successful.

In view of the initial mistrust shown by the government and the population to the presence of FDI, CzechInvest understood the need to show positive and rapid results. According to the government, the success achieved by CzechInvest is mainly attributable to three of its three programmes:

- An incentive system, created in 1998 and subsequently improved, is designed to make the country more attractive to foreign investors. According to the authorities, a significant proportion of the increase in FDI is due to this programme.

- Development of industrial facilities to meet investors' needs for suitable facilities.

- Improved local procurement for investors, which place a high value on quality local suppliers capable of dealing with foreign companies. This initiative includes a supplier development programme, which also helps the country to absorb the benefits of FDI (see box II.2).

The current structure of CzechInvest is based on the merger of three bodies with complementary aims: CzechInvest, the institution responsible for FDI promotion (which gave its name to the institution now in operation); the Business Development Agency (oriented towards SME development) and CzechIndustry, the industrial development agency. This consolidation has given the institution a broad enough structure and array of functions to allow it to find solutions for meeting investors' needs. After the merger of the three organizations, the distribution of both financial and human resources has continued to reflect a strong focus on attracting FDI (Gligo, 2007, p. 67), a task carried out by the promotion division and the investment support division.

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[8] The approach adopted by the Czech Republic differs from that of Ireland in a number of ways, one of which is that it has followed the opposite organizational path: while the Irish Industrial Development Agency (IDA) went from being a development agency to a promotional entity, CzechInvest started out as a promotional body and became a development agency.

Box II.2
THE CZECHINVEST SUPPLIER DEVELOPMENT PROGRAMME

In 1999, the Supplier Development Programme was launched as a pilot project. Although intended to meet the needs of foreign enterprises in terms of finding local providers (lower cost and more flexibility), it also sought to ensure that the benefits of FDI would be absorbed by the local economy.

The programme took an eminently practical approach. A group of 45 companies that showed potential were selected for training and then given individual technical assistance to raise their technical standards to meet investors' requirements. In 2003, a second phase of the programme was initiated, based on the first phase's success.

In addition, CzechInvest facilitates contacts between foreign clients and local suppliers by managing a database of approximately 2,000 providers from different sectors having different production capacities. In 2004, 15 contracts were signed with 10 foreign companies for a total of US$ 36.8 million over a three-year period.

Source: Economic Commission for Latin America and the Caribbean (ECLAC

The main task of the promotion division is to identify and attract new clients. In the case of FDI, this involves securing the greatest possible number of high-value investment projects for the country. The emphasis has been on high-technology sectors, such as electronics and microelectronics, precision engineering, R&D in the motor vehicle industry, aviation, biotechnology, pharmaceuticals and medical equipment manufacturing, software development and business service centres. In order to attract investments in these sectors, the Czech Republic, with the support of the European Union, has a network of offices in a number of European and Asian countries, as well as in the United States.

The investment support division works with investors as they assess, implement and subsequently operate their investment projects. It provides assistance in decision-making regarding the siting of projects, acts as an intermediary between the agencies that administer subsidies and investors, supports relations with local suppliers and promotes the expansion of existing investments in the country, while also offering assistance with any problem that may arise in the course of their activities.

The experience of CzechInvest illustrates the multiple functions that an investment promotion agency may taken on and how important it is for it to have sufficient resources. Clearly, the attraction of investments is an area in which promotion policies, the agencies that implement them and resource allocations are important factors.

The specific techniques, activities and programmes used by the different agencies around the world depend on the type of project concerned (sector of activity), the characteristics of the country and the objectives being sought. For example, attracting investment from enterprises that exploit natural resources is very different from attracting it from enterprises that carry out R&D. Nevertheless, the structure and functions of CzechInvest are sufficiently broad to serve as a reference and to illustrate the complexity of the investment-attraction process.

One of the merits of CzechInvest has been its capacity to adapt and evolve so as to remain in step with companies' needs and the country's development strategies. Ongoing contact with investors has made it possible to design support programmes better adapted to their needs. Its priorities and objectives are also clear, and criteria have been established for follow-up and evaluation of the agency's performance.

An organization's implementation capacity is, of course, directly related to the human and financial resources on which it can draw, especially as promotion activities abroad are expensive.

CzechInvest has had the good fortune to receive support in the form of European Union funds and expert consultancy services.

(d) Republic of Korea: opportunities during a crisis

The Asian crisis of 1997 triggered the introduction of significant changes in FDI. For several decades, the Republic of Korea had based its growth on the creation and development of large export-oriented business conglomerates which received strong government support. In this context, the economy restricted the entry of foreign capital (see chapter III). In 1998, however, the country began to modify its strategy as it shifted towards a market orientation and started to assign a more important role to FDI.

The economic reforms of that time were intended to bring about a shift from control and regulation to promotion and facilitation. They were also designed to convert the Republic of Korea into a North-East Asian hub for FDI, trade and logistics, manufactures, and R&D. There were two main factors that the authorities took into account. The first was the country's location between China and Japan, which makes it a natural centre for trade and logistics. The second was its need to position itself in high-value-added sectors and knowledge-based services, since it could not compete in manufacturing costs with China or Taiwan Province of China. Within this framework, the local authorities gave priority to the establishment of R&D centres in order to take advantage of the country's advanced technological infrastructure and highly skilled manpower.

In order to define an investment-attraction policy which sought quality rather than quantity, the Republic of Korea implemented a series of measures, including the following;

- Development of investment infrastructure and facilities. The government offers foreign investment zones, free trade zones and economic zones for enterprises investing in selected sectors or possessing a certain level of technology.

- Tax and financial benefits. Firms that meet certain requirements may request income tax reductions. In the case of high-technology sectors, financing is available for up to 15% of plant construction and equipment acquisition costs. There are also subsidies for up to 50% of employees' wages, with ceilings and time and other limits.

- The establishment of Invest Korea. Created in 1998, this investment promotion agency has the typical structure for institutions engaged in promotion and facilitation. There is also an investment ombudsman that plays a significant role. This office, which is outside the hierarchical structure of Invest Korea, helps resolve difficulties being experienced by foreign enterprises already present in the country.

- Decentralization. Local governments have more autonomy to compete in developing support and incentive packages, as well as to approve FDI projects.

Despite its success in boosting FDI inflows, the Republic of Korea still faces the challenge of improving its image in business circles, as it is considered a difficult market in which to operate. Bureaucratic costs need to be reduced and the population's negative view of FDI will have to be changed. A comparison with other countries and cities in the region, such as Singapore, Hong Kong (Special Administrative Region of China) and Shanghai, makes it even clearer that the country needs a comprehensive array of infrastructure for FDI reception. This would include, for example, a more

widespread use of English, improved programmes for new arrivals and assistance for foreigners in handling day-to-day affairs.

As this is a fairly recent initiative, and there are still some problems to be resolved, more time is needed to see whether the Republic of Korea's efforts in this regard will be successful and will fulfill initial expectations.

2. Developed countries: from passive to active policies

Because of the competition for FDI, even some developed economies which have historically been the main recipients of capital inflows have begun to adopt more active policies.

(a) Spain: the first steps

In general, Spain's strategy for FDI has been rather passive. With few restrictions on foreign investment and with conditions that make this country an attractive destination for TNCs, the lack of active policies —especially compared to other European countries— has not been an impediment to receiving large inflows of FDI. This attitude contrasts with the impetus that the Spanish authorities have given to the internationalization of their enterprises, both in terms of direct investments abroad and in terms of exports.

Nevertheless, in view of the downward trend in world FDI flows and the greater competition among countries to attract it, Spain has since decided to create an agency to promote and attract FDI, as well as to ensure that it stays in the country. In 2005, the Council of Ministers authorized the creation of the State Society for the Promotion and Attraction of Foreign Investments, SA. This new legal entity was established with capital provided by the Foreign Trade Institute (ICEX) and reports to the State Secretariat for Trade and Tourism of the Ministry of Industry, Trade and Tourism.

At the beginning of 2006, the new institution began to operate under the name of "INTERES Invest in Spain". With its mission to promote, attract and retain FDI, it has become a focal point for investors and a meeting place for all institutions at the central, autonomous and local levels that are involved in investment promotion and attraction. The organization has the structure of a service enterprise, with specific units responsible for promotion and institutional relations, investor support, and information and dissemination. In addition, support is provided by the network of offices for economic and commercial affairs of Spanish embassies around the world, three of which (London, New York and Tokyo) have departments that specialize in generating foreign investment.

(b) France: a search for investment and talent

In recent years, France has adopted a more proactive attitude to attracting investments and has increasingly sought to integrate this area with its development policies. In 2001, the French authorities created a national agency for attracting investment ("Invest in France Agency" (IFA)), which brings together in a single institution the network of promotion offices abroad operated by the national regional development agency, *Délégation à l'aménagement du territoire et à l'action régionale* (DATAR),[9] the

[9] In December 2005, DATAR was renamed *Délégation interministérielle á l'aménagement et la compétitivité des territoires* (DIACT). Its broad mandate includes investment promotion, investor relations and administration of regional incentives.

Invest in France Network (IFN), which consists of a coalition of regional development organizations, major enterprises, financial and consulting institutions, and the Delegation of Foreign Investments of the Ministry of Economy, Finance and Industry, which carries out trend analyses and surveying tasks. At present, IFA has a staff of 140 persons, 60 of whom work at the Paris headquarters while the rest work in the institution's offices abroad.[10]

Despite the fact that France is one of the main recipients of FDI at the global level (see chapter I), the growing competition among countries to attract FDI has prompted the government to take a series of short- and medium-term measures to generate conditions favourable to investment. In 2003, the authorities agreed upon an agenda for increasing the country's attractiveness and decided that the country should make a continuing effort to attract both the best human resources and investments that will have a strategic impact on economic growth. Specific measures have been introduced for this purpose in three priority areas (IFA, 2003):

- Attracting talent and experience. Programmes have been formulated to attract foreign investors and repatriate French researchers, improve conditions for the entry and long-term retention of foreign executives, and offer incentives to postgraduate students in scientific, technological and business administration fields. This is a special feature of the French proposal, as in most countries the emphasis is on attracting enterprises, whereas in this case the intention is also to attract people.

- Attracting international investments. To boost competitiveness, targeted improvements to the French tax system have been carried out, especially in relation to R&D and innovation. In addition, there is now more effective business set-up support, and investors have more legal security.

- Initiatives in specific sectors. A search has been conducted for new enterprises, and incentives have been offered to assist with the installation of major TNC subsidiaries and R&D centres. Procedures for the establishment of international organizations and non-governmental organizations have been simplified, and the country has become more competitive as a financial centre and in areas such as cinema and art.

This new approach has been reinforced by four ongoing initiatives which provide institutional support: (i) regular ministerial meetings;[11] (ii) a strategic council with private-sector participation (the *Conseil strátegique pour l'attractivité de la France*);[12] (iii) the development of indicators to measure the country's attractiveness and compare it with its main competitors; and (iv) an international communication campaign to improve France's image in business circles.

In order to evaluate the results of the new strategy, a set of indicators serving a twofold purpose has been designed. On the one hand, these indicators can be used as an objective yardstick for measuring

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[10] The international network consists of 22 offices: 12 in Europe, 3 in North America and 7 in Asia. They support investors in the selection of locations, organize field tours and help to maximize the financial incentives offered by the country.

[11] The annual meetings are also referred to as "government seminars to increase France's attractiveness".

[12] Established in 2004, the Council is made up of 20 executives from major French and foreign companies. It is consultative in nature and its job is to identify and propose ways of making France an attractive country for foreign investment. The Council meets once a year, with the Prime Minister presiding and IFA acting as technical secretariat.

the country's strengths and weaknesses as an investment destination. On the other hand, they can be used to monitor progress in the application of policies intended to make the country more attractive. To the extent possible, the values of these indicators are compared with those of another nine countries (Belgium, Germany, Italy, Japan, Netherlands, Poland, Spain, United Kingdom and United States) and with the European average. Other relevant countries, such as China, are included when considered necessary. This experience is expected to serve as a basis for a unified measurement system for the entire European Union.[13]

In an increasingly competitive international environment, where advantages are rapidly eroded, France is a particularly interesting case study. Even though it is already a major FDI recipient, France has adopted proactive measures in order to make the country more attractive. These measures are based on a strategic approach for identifying priority activities (R&D and major subsidiaries) that attaches special importance to human capital (that is, attracting talent and skills), an aspect that few countries have made an integral part of their strategies (Gligo, 2007, p. 64). An institutional support framework has also been set up with backing from the country's highest authorities, together with a mechanism to measure and monitor the results.

(c) Ireland: the capacity to evolve towards dynamic sectors

FDI attraction has been a fundamental part of Ireland's development strategy. This policy has focused on export-oriented investments and has resulted in almost half of manufacturing employment being created by TNCs, which also sell over 80% of their output abroad (mainly to countries of the European Union).

In the last two decades, the Irish economy has undergone profound changes, including a fall in unemployment combined with GDP and export growth. The Industrial Development Agency (IDA) has played a crucial role in this process. Created in 1949, and then restructured in 1969 and 1994, it has been responsible for attracting new investments and for supporting the expansion of existing ones. As IDA has gained more experience, it has concentrated its efforts on major sectors and companies, especially in electronics and pharmaceuticals.

The main tool used by this agency has been Ireland's tax system. The country's 12.5% tax rate, which applies to all companies (with some restrictions), is currently the lowest in the European Union and among the countries of the Organisation for Economic Co-operation and Development (OECD). This has been particularly beneficial for United States enterprises, which have seen Ireland as a potential export platform for the rest of Europe.

In addition to tax incentives, IDA has other tools at its disposal, including direct financial support for recruitment, training, R&D and the purchase of fixed assets. At the beginning of the 1990s, about 80% of foreign companies in Ireland had made use of such tools (OECD, 1994). In 2004, IDA allocated over 65 million euros for their financing.

Changing conditions in the country and in the world are posing new challenges for Ireland as it strives to maintain its current levels of competitiveness. On the one hand, its success has led to price increases and higher domestic wages. On the other hand, more recently, the euro has appreciated against

[13] Recently, a comparison was made with the situation in Eastern European countries. A joint project with Invest in Germany has been presented with a view to applying the same set of indicators to the other countries of the European Union.

the dollar and new competitors have emerged (Eastern Europe, China and India, to name a few) which are imitating its export- and FDI-based growth strategy and offering tax exemptions, incentives, lower costs and skilled labour.

Ireland has responded by adjusting its strategy in order to establish competitive advantages that are difficult to replicate in specific activities and niches (Forfás, 2003). To date, Ireland's main strengths have been concentrated in operational aspects of manufacturing and services, rather than product or market development. This is particularly the case in relation to foreign enterprises, which produce goods designed elsewhere in the world to meet foreign market specifications. Ireland has thus managed to make progress in the segments of the chain that generate more value, such as marketing and R&D.

This new strategic direction does not mean that Ireland has decided to abandon manufacturing, which continues to be one of the country's principal engines of growth. On the contrary, the idea is to focus on high-value-added niches where competition is not based on labour costs, but rather on productivity and specialization. This new strategy requires a greater orientation towards innovation, and Ireland is making substantial investments to generate the necessary infrastructure and human resources (Forfás, 2004).

This change of strategy, which began to be implemented in 2000, is also reflected in the redefinition of the IDA mission. The agency has gradually come to focus more on securing new investments in higher-quality segments in the value chain, encouraging the development and growth of companies already present in the country in order to increase the value added by their operations and their strategic importance, and developing the physical and educational infrastructure required by knowledge-intensive businesses (IDA, 2004). In addition to modifications in the IDA strategies and mission, new tools suited to these new orientations have been created to measure performance.

There are a number of factors underlying Ireland's success story. The first is that policies were designed from the top down, thanks to the institutions that proposed the national strategies. Forfás, a council that reports to the Department of Enterprise, Trade and Employment, has the mission of leading public policymaking in relation to business support and technological development. It provides technical support to IDA and to Enterprise Ireland (the agency responsible for supporting local companies), Science Foundation Ireland and other advisory councils. An annual assessment is made of the country's situation in terms of competitiveness and of any threats to its position, and the findings of the evaluation are then used to develop policy proposals at the national level.

A second element that has contributed to the country's achievements is that its investment strategy is not only integrated into the country's overall competitiveness policy, but is also a pivotal element of that policy. As an example, the rationale for the creation of Science Foundation Ireland emerged as a result of a detailed analysis of the country's loss of competitiveness vis-à-vis Asian and European competitors. The possibility that companies operating in Ireland might move to these other locations had to be countered by encouraging them to invest in R&D in the country rather than leaving it. The corresponding incentives were then created, the quality of the stock of human capital was improved, and joint ventures or partnering arrangements were promoted. This analysis also indicated that a small country such as Ireland should focus on a few high-value-added activities such as biotechnology and ICTs.

Yet another element has the direct involvement of the Irish government in the management of FDI policy. Its role in this respect includes direct implementation of business activities, centralized planning and public investments designed to create favourable conditions for private investment.

D. PROPOSALS TO REDUCE THE GAP BETWEEN LATIN AMERICA AND THE CARIBBEAN AND COUNTRIES WITH BEST PRACTICES IN TERMS OF FDI ATTRACTION POLICIES

The various European and Asian experiences discussed above differ markedly from the situation in Latin America and the Caribbean in certain ways. In general, the region is at an earlier stage in its efforts to develop a proactive investment-attraction policy. The countries of the region are beginning to transition from a passive system, in which investment inflows depend on the country's comparative advantages and where policy success is measured mainly by the amounts received, towards a more active approach. This new approach calls for greater proactivity in investment-attraction policies, together with complementary horizontal efforts to attract investments by means of specific measures targeting desirable sectors and projects.

1. Characteristics of the gap

A comparison of promotional activity in Latin America and the Caribbean —analysed in last year's edition of this report (ECLAC, 2006a)— and in countries that have been successful in attracting FDI shows that the region is lagging behind in this respect. Some of the elements accounting for this gap are considered below.

(a) A lack of strategic direction and targeting

In general, the investment promotion agencies of Latin America and the Caribbean, although recognizing the importance of FDI, have not managed to mount policies in this area that are integrated and coordinated with other national development policies. Even in countries such as Costa Rica and Chile, which appear to be the exceptions, the efforts being made to attract quality investments seem to be attributable to operational factors rather than the pursuit of strategic objectives (Gligo, 2007, p. 100). From the point of view of active policies, Costa Rica demonstrated its highest degree of proactivity during the negotiations for the installation of INTEL. From that time on, the issue does not seem to have enjoyed the same priority on the government agenda, and most promotional activities have been placed in the hands of a private organization, the Costa Rican Coalition for Development Initiatives (CINDE). In Chile, the investment-attraction policy was developed "from the bottom up", and its main promoter has been the government's economic development agency, the Production Development Corporation (CORFO). Recent events appear to be leading in the direction of a rethinking of this policy and a more strategic, development-oriented stance.

In contrast, in the more advanced countries FDI has taken on a strategic role and is integrated into the countries' overall policies. France wishes to be the "New France" and is focusing its efforts on attracting enterprises to carry out R&D. A similar effort is being made by Ireland, which, when it saw its competitiveness in the manufacturing sector being eroded by developments in Asian and Eastern European countries, it defined a strategy to attract higher-value activities in the production chain. In Malaysia, where rapid export development has been driven mainly by FDI, especially in the electronics sector, efforts are also being made to attract these kinds of activities.

Other nations facing complex political and economic situations have used FDI to re-establish their position in relation to the rest of the world. In the Czech Republic, foreign capital has been fundamental to the transition process and has contributed to productive changes. Based on the realization

that the country's industries cannot compete on the basis of cheap labour, efforts have been made to maintain the quality of technical education and to compete on the basis of quality and productivity. The Republic of Korea, facing an acute financial crisis in the late 1990s, began to make a radical shift in its economic policy, opening itself up to FDI. This country created an investment-attraction agency and made significant resources available for infrastructure, as well as offering offer incentives for change in order to position itself as the North-East Asian business hub. Nevertheless, this effort is still at an early stage, and more time will have to pass before the success of this type of agency can be evaluated.

In short, whatever the form and style of action associated with investment-attraction policies in the more developed countries, they all share a number of features: the existence of commitment, political will, strategic definitions, coordination and availability of resources for effective implementation. The economies of Latin America and the Caribbean can learn from the experiences of these countries and from the way in which they have integrated FDI into their national development goals. In this connection, it is important to determine whether active FDI promotion policies are appropriate and, if so, to ensure that they are properly coordinated and integrated with productive and economic development measures. Equipping FDI-promotion agencies with the necessary human and financial resources is one of the steps that must be taken in order to accomplish this.

In operational terms, the absence of strategic definitions in the Latin America and Caribbean countries results in a failure to target promotion policies properly. Although the countries in the region are working to develop measures for targeting their policies, in most instances these efforts are still rather general in scope and lack a strategic approach. To date, it is only in exceptional cases that countries are reaping the benefits of this type of strategy. It may be noted that Colombia is beginning the process in a fairly structured way (see box II.3).

Box II.3
TARGETING METHODOLOGY: THE CASE OF COLOMBIA

Colombia is in the process of shifting from a passive to a more proactive approach for attracting FDI. To this end, it is working with international consultants to identify target companies, by sector of activity and by country, using the following methodology:

- Developing a shortlist with initial criteria for sectoral selection. These criteria are designed to identify sectors to which FDI is being directed at the global level, growth sectors in terms of foreign trade at the global level, sectors with high value added, and sectors generating positive economic and social impacts.
- Mapping of the assets offered by selected sectors in Colombia so that they can be matched up with investors' interests.
- Verifying the impact of each sector on the country. When this classification has been prepared, second-order selection criteria are applied (impact on GDP, employment and exports, and definition of sectors where promotional efforts are actually required) to assign priority to certain sectors. Efforts are then to be focused on these sectors in terms of policies and competitiveness as well as promotion.

Source: Economic Commission for Latin America and the Caribbean (ECLAC).

(b) Weak promotion agencies

One specific manifestation of an active policy is the existence of an investment promotion agency equipped with sufficient tools and resources to carry out its work properly. In fact, this is the mechanism most frequently used to promote the advantages of a country and to serve as an interface between the country and investors. In 2004, there were at least 160 organizations of this kind at the national level and over 250 at the subnational level (OECD, 2005).

The work of these organizations takes place in a context of increasingly intense international competition. At present, export development strategies based on attracting FDI are no longer the exclusive province of the South-East Asian countries. Favourable developments in the transitional economies of the former Soviet Union and other Eastern European States have brought new stakeholders into this competitive arena, which, together with the appearance of new and large competitors such as China and India, have whittled away at the advantages of countries that had previously seemed well-established. On the other hand, new ICTs and falling transport costs offer new possibilities to investors, who now have many location options. Under these new circumstances, competition among countries to attract FDI is growing and becoming more sophisticated. Although this is a relatively recent phenomenon, countries are making increasingly frequent, more proactive and ambitious efforts to attract the best investment projects of foreign companies.

Seen against this backdrop, it is clear that investment promotion agencies should make every effort not only to identify the investors that can make the greatest contribution to the country's objectives, but also to spread awareness of what the country has to offer so that it will be considered by investors and included on their longlists and shortlists. This challenge is even present for countries which supposedly enjoy international recognition as investment sites. In order to be effective, then, investment-promotion agencies must have the capacities and resources to compete at the global level.

In Latin America and the Caribbean, most countries have set up investment promotion agencies or equivalent institutions to centralize these functions. Nevertheless, investment promotion activity in the region is still at an incipient stage.[14] In addition, Latin American agencies suffer from major weaknesses when compared to the more developed countries of Asia and Europe. The main differences include:

- A less proactive approach and a low level of promotion activity abroad (such as promotional seminars, visits to companies and participation in fairs and other events).

- A low level of awareness of their role as participants in global competition for investment projects. In general, the Latin America and Caribbean countries believe that their main competitors are their own neighbours.

- Scant resources and small operational budgets. The agencies in the region, with some exceptions, operate with budgets and staffing tables that are smaller than the international average and, in some cases, are even below what can be considered to be basic minimum levels. Whereas a high-income country spends about US$ 9.4 million and has a staff of about 20 for promotional activities, low-income countries spend an average of US$ 550,000 and recruit an average of 11 people to perform these tasks (Morisett and Andrews, 2004).

Latin America and Caribbean countries that want to increase their inflows of FDI therefore need to ensure that the resources and staff assigned to FDI attraction are up to the task. In this connection, the experiences —whether successful or not— of their neighbours and other countries that have faced similar challenges can be very valuable.

[14] In all, 12 of the 15 institutions included in a recent ECLAC study had been created or had undergone major changes as of 2000 or were in the process of institutional reorganization (ECLAC, 2006a).

(c) Inefficient and poorly targeted incentives

Fiscal incentives (corporate tax exemptions), mainly for the installation of businesses in free zones and specific sectors, are the most commonly used promotional tool in Latin America and the Caribbean. These incentives are granted automatically and are general in scope, which indicates a lack of targeting and a lack of specificity in relation to the type of investment received by the country. In addition, in federal systems (such as those of Mexico, Brazil and Argentina), states and provinces can offer incentive packages on their own. This has resulted in poor coordination with the central level, however, and, in some cases, in competing incentives being offered by various regions or states.

Meanwhile, two categories of incentives predominate in regions with more advanced FDI policies:

- In the South-East Asian countries, the predominant model is a combination of restrictions —control processes, limits on foreign ownership, exclusion lists, among others— and fiscal incentives, mainly corporate income tax reductions or exemptions. This is the case of Malaysia, where systems of incentives and restrictions coexist, both functioning in a coordinated manner according to defined national development criteria. FDI is sought out in a selective and proactive manner with a view to maintaining consistency with industrial development plans having timelines of from 10 to 15 years. Companies receive incentives on the basis of a technical evaluation, and their projects must be in keeping with national objectives.

- In Europe, the preferred option has been direct subsidies, financed by the European Union, the country or local governments, for training, job creation, investment, R&D and other activities. In general, these entitlements vary according to the geographic area within the country and European Union rules. Unlike fiscal incentives, this type of benefit places significant pressure on the budgetary resources of a country, especially if they are widely used. In Ireland, financial incentives are managed directly by IDA. As part of its negotiation process with investors, this agency can offer a package of incentives for recruitment, training and R&D, as well as for the purchase or establishment of fixed assets. In 2004, the budget allocated to incentives in Ireland amounted to 65 million euros. The main criteria used for their allocation are the quality of the employment created and the geographic location, although recently promotional efforts have also been focused on R&D-intensive projects. The main advantage of these types of benefits lies in the ease of evaluating their impact, thanks to the fact that they target specific activities that are of interest to the country.

If Latin American and Caribbean countries wish to define their priorities and attract specific kinds of investments, they would do well to review their incentive frameworks and evaluate the advisability of applying some more targeted measures, especially as they will have soon have to adjust their free zone systems to conform to the requirements of the World Trade Organization (WTO). Better targeting of incentives would not only make them more competitive —and better suited to companies' requirements— but would also increase the probability of making the best use of the resources allocated for such incentives.

2. Proposals to close the gap

This comparison of the experiences of Latin America and the Caribbean with those of more developed countries is not intended to serve as the basis for the proposal of any particular model. As each country

has unique structural conditions and its own objectives, no single model could be appropriate in all cases. Moreover, the objective situation makes it difficult to exactly replicate those models that have yielded good results owing to the differing constraints that may exist in terms of institutional frameworks or the availability of resources. Nevertheless, these experiences provide important points of reference.

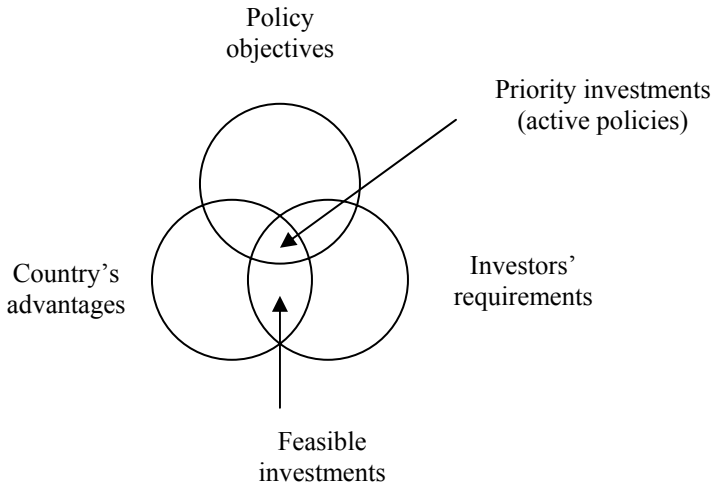
The intention here is rather to offer a series of recommendations that can be used to construct models for attracting FDI based on national circumstances. The first step is to define the elements that should be included in any model that is implemented.

The central element in any active or integrated policy model is the decision to seek to attract a certain type of investment on a selective basis. This determination should be based on three factors:

- Development policy objectives;
- The country's advantages; and
- Investors' needs.

Projects are viable when the country's advantages coincide with investors' needs. If they are not aligned with the country's policy objectives, however, there is no apparent reason to employ active attraction policies. Policy objectives, in turn, may not be in keeping with a company's requirements, especially if the country lacks the advantages that attract a certain type of investment project. When FDI is considered to be strategic for a nation's development, countries can build political and institutional capacities that result in a positive dynamic among these three factors (see figure II.8 and box II.4).

Figure II.8
RELATIONSHIP BETWEEN ADVANTAGES, NEEDS AND OBJECTIVES



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Nicolo Gligo S., "Políticas activas para atraer inversión extranjera directa en América Latina y el Caribe", *Desarrollo productivo series*, No. 175 (LC/L.2667-P), Santiago, Chile, January 2007. United Nations publication, Sales No. S.07.II.G.18.

Box II.4
CAPACITIES NEEDED TO CONVERGE DEVELOPMENT OBJECTIVES, COUNTRY ADVANTAGES AND BUSINESS REQUIREMENTS

In order to create a policy framework that can attract FDI, a country must have the capacity to harmonize its development policy objectives with the advantages it offers and the requirements of potential investors. Some of the elements to consider are the following:

Capacity to define policy objectives: Ideally, there should be a formal, explicit development policy that can serve as a basis to coordinate FDI promotion policy and to define specific objectives. This is not usually the case in Latin America and the Caribbean. The political will must exist, at least, for coordination with national development objectives and policies.

Capacity to define country advantages: This is an eminently technical task of strategic analysis. It is necessary to be able to evaluate both domestic factors and the country's position vis-à-vis its competitors, especially the closest ones. As has been noted, the Latin America and Caribbean countries have little awareness of the competition that exists beyond the region. The ideal solution would be to have in place a permanent team of experts in sectoral competitive analysis, with international connections and experience and the capacity to closely track international trends and even anticipate them. This would require an involvement in the networks of TNCs and, possibly, a presence in the countries of interest. Such capacities are usually the domain of international consulting firms, which significantly increases the cost of this type of activity. A more economical option would be to establish technical teams with local-market experience and capacity to research and monitor trends using public information sources. Permanent and fluid contact with foreign firms based in each country can help to secure relevant information.

Capacity to assess business requirements: A fluid relationship with both potential investors and those already established in the country is a core aspect of achieving convergence. Ideally, a country should have offices abroad or, at least, adequate mechanisms to ensure permanent interaction with investors. The capacity to conduct technical assessment of projects is also important, in order to make sound targeting decisions in relation to a project's expected benefits and to develop incentives whose benefits can reasonably be expected outweigh their costs.

Source: Economic Commission for Latin America and the Caribbean (ECLAC).

Nevertheless, beyond the specific mechanisms involved, if the gap is to be narrowed there must be the political will to do so. Where the political will exists, measures can be implemented that are highly effective and do not necessarily require huge disbursements of resources. More specifically:

- Investment promotion agencies should reflect the political will to attract investments; this will mean replacing their receptive approach with a more proactive one in order to ensure that decision-makers place the country on their "mental map". In a context of scarce resources, agencies should target their efforts more precisely and identify those measures that are likely to reap the greatest benefits. To this end, the agencies must build up their professional resources and accelerate their organizational development.

- The system of incentives should evolve from the provision of general support to a more selective and targeted model. Whatever the model of incentives used, the main point is that it should be consistent with policy decisions and the benefits expected from investments. An efficient system of incentives must be underpinned by the requisite technical expertise. First and foremost, ex ante evaluations must be carried out to determine the types of projects that the country wishes to attract (when allocation is automatic) or to establish and describe the appraisal criteria to be used (when the analysis is carried out on a case-by-case basis).

- When a given investment is deemed to be of strategic importance, specific measures are needed to close the gap between the conditions offered by the country and investors'

requirements. This type of action often calls for coordination between government agencies and the private sector. This can make it possible to identify factors that can generate positive impacts in the short run that will enhance the business and investment environment without requiring major financial disbursements. A country will be better able to implement this type of measure if the necessary political will exists, and, above all, if it has mature investment promotion agencies on which to rely.[15]

- Cooperation is a fairly effective way of acquiring financial resources and skills. At least two forms of cooperation are worth examining in this respect. The first is concerted action by the public and private sectors, whereby the presence of experienced professionals in the latter can compensate for the lack of expertise or lack of institutional maturity of the former (MIGA, 2005). An interesting case in this connection is that of Zonamerica in Uruguay (see box II.5). The second option is for Latin American and Caribbean countries to work together to promote the region (or given geographic areas within it). This would enable them to acquire critical mass, share resources and organize promotional events that would attract investors. The first step is to focus positive attention on the region. Once that is done, each country can put forward its best arguments for attracting investors to its own territory.

Box II.5
ZONAMERICA: AN EXAMPLE OF PRIVATE-SECTOR FDI PROMOTION

Funded with Uruguayan and Belgian capital, Zonamerica was originally conceived as a free zone for trade with the countries of the Southern Common Market (MERCOSUR). A number of problems soon arose, however. Under MERCOSUR regulations, goods from free zones in member countries (except the special customs areas of Manaus and Tierra del Fuego) were subject to tariffs as if they were entering from a third country, which defeated the purpose for which the venture had been created.

Meanwhile, reflecting global trends, the region started to attract the attention of companies in search of new locations from which to provide services (such as call centres and shared services). At the same time, Uruguayan software firms began to set up in Zonamerica in order to avail themselves of its free-zone advantages. These developments were quickly identified and it was decided to switch strategy and create a world-class business and technology park.

The location was appealing for a number of reasons: on the one hand were country factors, such as political stability, level of education and quality of life and, on the other, there was an attractive framework of tax and customs incentives linked to the free-zone regime. Zonamerica rounded off this proposition by creating architectural infrastructure and telecommunications services that met the standards required by TNCs. It also engaged in intensive efforts to proactively promote its services on the international market.

Zonamerica currently has 182 companies on board and actively promotes investments in seven business areas: shared-service centres, logistics and distribution, financial services, consultancy and auditing, call centres, information technologies and biotechnology.

From the viewpoint of the private sector, Zonamerica has supported the development of a new sector in Uruguay —export services— underpinned by new ICTs. The government provided the incentives and Zonamerica was able to use them to put together a deal of higher value. This initiative did not result from a concerted effort between the two parties, however. In fact, no information has been compiled on the size of investments or the employment generated in Zonamerica. It would be interesting to look at how a similar model might be implemented with the public and private sectors working in tandem from the outset.

Source: Economic Commission for Latin America and the Caribbean (ECLAC).

[15] Since they are in constant touch with investors, investment promotion agencies are in a very good position to detect what types of measures are needed and can, at the least, act as advisors to the competent authority in such matters. The resources that investment promotion agencies invest in fostering and disseminating investment policies seem to be those that bring in the highest returns in terms of attracting investment (Morisett and Andrews, 2004).

E. CONCLUSIONS

There is a degree of consensus as to the potential benefits of FDI. Harnessing those benefits is not an automatic process, however, and their transfer and absorption will depend both on the specific characteristics of the investment and on the particular features of the host country, in particular in terms of such factors as the existence of a trained workforce, the competitiveness of local manufacturers (and their capacity to serve as suppliers to foreign companies), and the existence of associated clusters. Host countries face the challenge of capturing these benefits, since if the necessary conditions are not present, a foreign company may end up as an enclave within the country, and no more than a fraction of the potential benefits will be transferred to the local economy.

More advanced countries' awareness of the need to boost technology transfer and absorption of FDI benefits has prompted them to employ a variety of measures which may be classified in the following categories:

- Boosting local businesses' efficiency and competitiveness. The aim is to ensure that these businesses can produce goods that meet foreign companies' quality standards and price requirements and can thus become suppliers for those firms.

- Establishing programmes to create links between local and foreign companies. Some support programmes are geared towards collecting information and contacts in order to facilitate sourcing from local firms (see box II.2).

- Specifying requirements for foreign investment. For example, in order to promote investments that are further up the value chain, Malaysia no longer provides incentives for low-skilled labour-intensive projects. For its part, Singapore encourages foreign companies to establish risk-sharing partnerships with local firms.

- Carrying out ex ante project evaluations. These appraisals are geared towards channelling promotional efforts, investment searches and support into those sectors, projects and companies that are expected to provide the greatest benefits for the country.

The competition for FDI is increasingly intense, and the countries that are competing successfully are those which, in addition to offering the necessary conditions, are developing active policies to attract and harness the benefits of FDI. The economies that stand the most to gain from these investments are the ones that have targeted them in the light of their national development objectives. Existing international experience is broad and sufficiently varied to offer valuable points of reference for each country.

In terms of their institutional profiles, most investment promotion agencies in Latin America and the Caribbean are relatively new and are still in the midst of an institutional learning and consolidation process. This is compounded, except in a few cases, by budgetary constraints, a shortage of human resources, and poor coordination and integration with other policies. This suggests that the capacity to execute FDI policies efficiently is yet to be fully developed.

Countries must assess their own competencies and advantages and, on this basis, draw up appropriate strategies for attracting investments. Among other things, they must develop the necessary technical capacity and the ability to conduct the kinds of evaluations that are needed in order to design effective promotion activities, gauge the level of incentives they offer to ensure that their costs will not

outweigh the benefits afforded by a given investment, and identify projects and companies that will make a positive contribution to the country's development strategies.

The countries of the region are making strides in this direction, and changes are being made with a view to consolidating the institutional structure for investment promotion. Countries are aware of the benefits of, and the need for, more precisely targeted promotion initiatives and are taking the necessary steps to achieve them. And, in fact, investment policies are becoming more active. It is to be hoped that the move in this direction will gather speed and become more focused so that the countries can narrow the still yawning gap that separates them from developed countries and the emerging economies of Asia.

Chapter III

REPUBLIC OF KOREA: INVESTMENT AND CORPORATE STRATEGIES IN LATIN AMERICA AND THE CARIBBEAN

A. INTRODUCTION

The development experience of the Republic of Korea is impressive and provides important lessons for developing countries. The country was brought to a rude awakening during the twentieth century, first, by Japanese colonization (1910-1945), second, by a severe dependence on direct aid from the United States that conditioned its development options after the Second World War and, third, by the global clash between capitalism and communism that, as a result of the Korean War (1950-1953), left the country divided into a communist north and a capitalist south. The Republic of Korea, then a poor country with an economy based mainly on agriculture and mining —the two sectors accounted for about 50% of GDP— and a per capita GDP similar to that of some African countries such as Mozambique and Senegal, began in the early 1960s to take drastic measures aimed at becoming an independent economy ("*Jarip Gyongjé*") through guided capitalism ("*Gyodo Jabon-Jui*"). As a consequence, public policies were deliberately aimed at building up national industrial and technological capabilities to gain international competitiveness.

The Republic of Korea's prolific GDP growth thereafter was based on an outward-oriented industrialization process that endowed the Korean economy with the world's tenth largest GDP, made it the twelfth largest trader (Invest Korea, 2005a) and raised its per capita GDP to the equivalent of two thirds of the average for the countries of the Organisation for Economic Co-operation and Development (OECD, 2003).[1] The Republic of Korea thus became one of the principal showcases of the rapid industrialization process known as the "East Asian Miracle".

In spite of this stellar growth, a debilitating financial crisis towards the end of the twentieth century obliged the country to rethink its existing development strategy. At the same time, it found itself in an Asian "nutcracker" between a technology leader (Japan) and several Asian fast followers (especially China), which challenged its international competitiveness. In short, the Republic of Korea was losing wage competitiveness without gaining advanced technology. Hence, the government opted to promote a knowledge economy in order to make the transition from "technology follower" to "innovator". The Republic of Korea thus opted to concentrate on continually restructuring its economy through technological upgrading and innovation in higher value, knowledge-based activities in order to advance towards a knowledge economy that would better sustain GDP growth. The Korean economy has made a very significant R&D effort, expending the equivalent of over half of the developing world's total private-sector R&D spending.[2] From this stronger base, the country has embraced globalization and become a world leader in information and communications technologies (ICTs), among other knowledge-based activities. The Korean experience is thus particularly relevant for Latin America and the Caribbean, since the country has been able to face up to severe challenges by taking tough decisions to reorient its development strategy under trying conditions.

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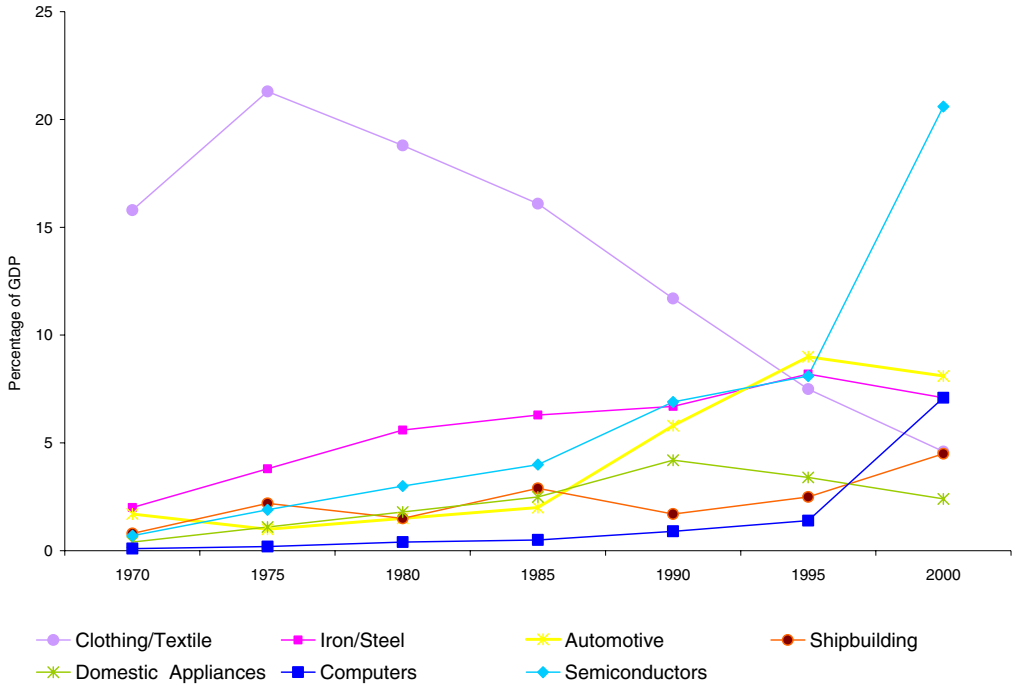
[1] By way of comparison: Korea's real per capita GDP grew from US$ 1,110 to US$ 12,230 between 1960 and 2003, while Mexico's increased from US$ 2,560 to US$ 5,790 over the same period (Chen, 2006).

[2] To give another example: the Republic of Korea undertook 35 times more R&D by industry as a proportion of GDP than did Mexico with roughly the same manufacturing value-added (UNCTAD, 2003).

1. The initial burst of growth, 1962-1997

The principal drivers of the first rapid growth phase were, initially, labour-intensive industries, such as apparel, footwear and domestic appliances and, later, capital-intensive activities such as textiles, automobiles, shipbuilding and semiconductors. In only three or four decades, the Republic of Korea made its presence felt in several global manufacturing industries by way of a focused investment programme that resulted in brisk growth. By the turn of the century, the Korean textile industry ranked seventh in the world by production capacity and fifth by exports and, measured by global market shares or production, the Republic of Korea ranked first in shipbuilding, third in petrochemicals and fifth in both the automotive and steel industries (Invest Korea, 2005a). Figure III.1 suggests that dynamic manufactures evolved mainly in a small number of industries that for the most part came on stream between 1970 and 2000. In general, manufacturing evolved from simple to complex activities and from lower to higher technology.

Figure III.1
REPUBLIC OF KOREA: DYNAMIC MANUFACTURES, 1970-2000



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of M-K. Pai, "How are Korea's core industries faring?", *KIET Industrial Economic Review*, vol. 8, No. 6, Seoul, November-December 2003.

The conventional interpretation of the Republic of Korea's success tends to focus on market reforms and export performance (World Bank, 1993), but this largely misses the central point.[3] The country achieved phenomenal success based on strategic industrial and technological policies designed

[3] This orthodox view has been strongly criticized for its neoliberal bias and for failing to recognize the developmental role of the State in East Asia's successes (Amsden, 1994; Kwon, 1994; Lall, 1994; Chang, 1993 and Stiglitz, 1996).

and implemented by a developmental State[4] for the purpose of strengthening national private conglomerates or *chaebol*.[5] That strategy combined selective import-substitution with forceful export promotion, protecting and subsidizing targeted industries that were chosen to provide the main exports. The government sought to keep control firmly in local hands and foreign direct investment (FDI) was allowed only where considered necessary (UNCTAD, 2003). The most significant aspect of this formative stage of the Korean experience —until the financial crisis of 1997— was the unorthodox development strategy employed by the Government of Korea to coordinate investment decisions during the first rapid growth phase.

The most unique aspect of the development strategy was the "government-business risk partnership",[6] under which domestic private firms engaged in government-monitored export bidding processes in order to secure government-guaranteed loans, thereby becoming agents of the State in carrying out its economic development plans (Lim, 2000). Or, viewed from another perspective (Rodrik, 2001, 1994), the country's coherent national strategy sought to raise the return on national private investment by awarding subsidies (loans at negative interest rates, government guarantees, export benefits), providing protective import tariffs, nationalizing the domestic banking sector, condoning the reverse engineering of foreign patented products and imposing performance requirements (trade balancing and domestic content requirements) on foreign companies operating in the economy.[7] While the initial vision of development did not formally exclude FDI, the government was unwilling to depend on it, clearly preferring foreign loans as the main form of external financing in order to build up national companies as the principal economic agents.

Another unique aspect of the Republic of Korea's development strategy was the way it went about promoting inward technology transfer and developing domestic absorptive capacity to digest, assimilate and improve upon transferred technologies. According to Chung, S. (2006), the government contracted foreign loans on a large scale and allocated them to major investments in selected industries, which led to massive importation of foreign capital goods and turn-key plants. This, in turn, helped Korean companies to reverse engineer imported capital goods in order to acquire the technologies necessary for the development strategy.

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4 Doner, Ritchie and Slater (2005) define a developmental State as an organizational complex in which expert and coherent bureaucratic agencies collaborate with an organized private sector to spur national economic transformation. They apply the term to the experiences of the Republic of Korea, Taiwan Province of China and Singapore.

5 *Chaebol* refers to the original core of Korean "big business", consisting of several dozen large, family-controlled corporate groups that became the privileged agents of government industrialization and export policy. This process began with the Park Chung Hee military government in 1961 and was deepened by the Heavy and Chemical Industries (HCI) policy in the 1970s. The *chaebol* were in many ways similar to the Japanese *keiretsu*, but there are important differences. For instance, the former are still largely controlled by the founding families while the latter tend to be controlled by professional managers. The former are more centralized in ownership, while the latter are more decentralized and, until recently, connected by cross-shareholdings. The former were prohibited from owning private banks (to facilitate government leverage via credit allocation), while the latter historically relied on an affiliated bank.

6 According to Lim (2003), the government-business risk partnership was the core of the Korean model and consisted initially of the public management of private risk. Investment risk was shared through government loan guarantees for international lenders providing credit for private Korean companies and by way of direct government credits and incentives for dynamic exporters based on export market performance.

7 Many of these policy instruments are no longer available to developing countries because they are either prohibited under multilateral and bilateral agreements or disapproved of by international financial institutions, or both (Chang, 2002).

The business-government risk partnership and the technology transfer policies were consolidated by the emblematic Heavy and Chemical Industries (HCI) policy of the 1970s, since the intermediate products —petrochemicals and steel— manufactured by State enterprises formed the principal inputs for the textile and apparel, automotive and shipbuilding industries which led the export boom. In the late 1970s, investment in these industries accounted for almost 80% of all fixed investment in the manufacturing sector, even though they accounted for only half that percentage of manufacturing output (Lim, 2000). And, indeed, the State picked winners. During the first three five-year economic development plans (1962-1976), the government focused on State-led planning by designing sectoral investment plans and mobilizing and allocating domestic and external resources to support their implementation. Thereafter, during the next three five-year economic development plans (1977-1991), the government shifted to more indicative planning by affording a larger role to private initiative (Woo, 2006).

Many of the dynamic manufacturing industries peaked as a percentage of manufacturing GDP during this period. Figure III.1 shows that textiles and wearing apparel peaked at 21.3% in 1975 and domestic appliances reached a high point of 4.1% in 1990. General machinery and automobiles reached their highest level, at 3.1% and 9.0%, respectively, in 1995 and industrial chemicals, iron and steel, and shipbuilding did so in 1998, at 7.0%, 8.2% and 5.8%, respectively. Only the more modern elements of the electronics industry (semiconductors and computers) continued to expand as a percentage of manufacturing GDP after that time. Thus, while the Republic of Korea's success was built on cumulative bursts of growth by a handful of dynamic industries, the rate of expansion began to decline, and these sectors' evident efficiency did not spread throughout the overall economy to the extent required, and especially not to services. Moreover, even in industries in which the country was among the global leaders, its labour productivity often fell significantly behind that of market leaders such as Japan and the United States (I-J. Lee, 2005) and domestic wage rises began to outpace productivity gains (Hussain, 2006), thus weakening the international competitiveness of many of the simpler exports.

The Korean economy was in need of a fresh set of dynamics. For Korean firms, this implied seeking out new growth opportunities —beyond exports— by establishing global production networks (Park, 2005). For the economy as a whole, it required the development of an effective globalization strategy to improve the competitiveness of non-export sectors (Cho and Kim, 2005; Kim and Choo 2002) and to deepen the incipient knowledge-intensive phase of development (Lee, 2000).

In this context, the Korean development strategy faced a very significant dilemma with regard to the principal economic agents driving the capital-intensive phase of accelerated growth. The huge scale of the investment effort absorbed by the outward-oriented industrialization process obliged the State to prefer the *chaebol* as its primary economic agents. For that reason, the government felt the need to guarantee the stability of the *chaebol*-based system, since the bankruptcy of any large national conglomerate would destabilize the entire national financial system. This implicit guarantee also encouraged competing *chaebol* to undertake excessive investments, however (Lim, 2001), which undermined the efficiency of the Korean economic system based on the government-business risk partnership, in spite of its evident dynamism as seen in the growth of the manufacturing sector. Finally, the financial crisis that erupted in 1997 —stemming from the over-indebtedness and consequent bankruptcy of many of the dominant Korean companies— forced policymakers to rethink the development strategy.

The move towards partial market liberalization and democracy during the 1980s had the unintended effect of actually strengthening the *chaebol* with respect to the government. By the 1990s, the top 30 family conglomerates in the Republic of Korea generated more than 46% of industry revenues, their combined assets accounted for 47% of the entire economy (Kim, Kandemir and Cavusgil, 2004) and

the indebtedness of the top *chaebol* was manifested in debt-equity ratios in excess of 500%. Thus, the financial crisis coincided with mounting pressure to break away from past practices and face up to new development challenges.

2. The 1997 financial crisis

Eventually, a series of bankruptcies among prominent *chaebol* drained the confidence of international lenders, who called in their short-term loans. In effect, although the Korean development strategy based on the government-business risk partnership proved an efficient choice during the 1960s, given the country's political economy and resource endowment at the time (Lim, 2001), the 1997 financial crisis revealed that model's limitations as regards corporate governance, especially in terms of "crony capitalism" (Lee and Hobday, 2003), and inefficient financial resource allocation.

The devastating effects of the financial crisis, in which nonperforming loans reached the equivalent of 28% of GDP, made clear the need for a new round of drastic policy changes. The sheer scale of the crisis forced the government to seek financial assistance from the International Monetary Fund (IMF)[8] in November 1997. The economic conditions imposed by the international financial institutions (IMF and the World Bank) encompassed five major market reforms (Tcha, 2006). The financial reform package was based on restructuring and prudential regulatory measures aimed at shifting the Korean financial system to a more market-based (less bank-based) and more arm's-length (rather than relationship-based) model. The corporate sector reform was directed at improving corporate governance, eliminating overcapacity, improving bankruptcy procedures and removing regulations that stifled competition. The labour market reform sought to introduce flexibility and stability while reducing economic and social disparities. The objective of the public sector reform was to achieve a more market-oriented economy by improving the institutional regime and privatizing public corporations. Lastly, the Republic of Korea was encouraged to open up more to the international economy and to globalization. Ultimately, the Korean Government took these measures much further of its own accord.

The recuperation was quite impressive. The country soon regained a growth trajectory, with GDP expanding by 6.7% in 1998 and 10.7% in 1999 (Woo, 2006). The government put its financial house in order, accumulating over US$ 200 billion in international reserves by 2004. The financial sector was reorganized: the number of banks fell from 33 in 1997 to 20 in 2001 (Woo, 2006), bad loans dropped from 66.7 trillion won to 31.8 trillion won between 1999 and 2002, the proportion of nonperforming to total loans fell from 11.3% to 3.9% (Tcha, 2006) and the debt-equity ratios of Korean companies decreased from 396% in 1997 to 111% in 2005 (M-S Chung, 2006).

Inward foreign investment became a significant new element of the evolving Korean development strategy. The reforms included vastly increased access for foreign direct investors to the Korean economy through firm measures to open the capital account and liberalize the capital market (Lim and Hahn, 2006). The results of government liberalization of FDI legislation were soon evident: over US$ 90 billion entered the country in 1998-2005, compared to only US$ 25 billion in 1962-1997, and the market share of foreign banks in the Korean banking sector rose from less than 9% to almost 22% over the same period (Invest Korea, 2005a). Numerous national companies, including State corporations, were sold to foreign investors. Moreover, the foreign-held share of the stock market jumped from 27% to over

[8] IMF extended resources to the Government of the Republic of Korea on the order of US$ 19.5 billion, consisting of a supplementary reserve facility of US$ 13.5 billion (which was repaid by September 1999), and a standby loan of US$ 6 billion (which was repaid in August 2001).

40% in 2000-2004. The traditionally restrictive treatment of foreign capital by Korean policymakers (Hill, 2004) underwent a dramatic transformation, for which there were also two other important reasons. One was that foreign capital gained new credibility in the Republic of Korea for its significant contribution to effective corporate restructuring and debt resolution (Sohn, 2002; Ha, 2004). Another was the need to design and implement a globalization policy, which pushed Korean policymakers to accommodate international standards, given that the country had become a member of the World Trade Organization (WTO) in 1995 and of OECD in 1996 (Kim and Choo, 2002; Lee, Kim and Choi, 2004).

One of the most impressive results was the change in the *chaebol* themselves (see table III.1). The corporate reform saw some of the main conglomerates decline (for example, Samsung and Hyundai) or disappear as independent entities (this happened to Daewoo, as well as Kia, Hanla, Jinro, Hanbo, Sammi, Haitai and some others) and many of their competitive core elements, such as Samsung Electronics Company, Hyundai Motor Company and LG Electronics, became more independent or were sold to competitors (as occurred with Kia Motor and Hynix). A number of relative newcomers entered the top 10 (Kookmin Bank, SK Networks and S-Oil).

Table III.1
TOP 10 KOREAN COMPANIES, 1995 AND 2005
(Trillions of Korean won)

Rank	1995		2005	
	Company	**Total Sales**	**Company**	**Total Sales**
1	Samsung Corporation	19.3	Samsung Electronics Company	57.4
2	Hyundai Corporation	16.7	Hyundai Motor Company	27.4
3	Samsung Electronics Company	16.2	Korea Electric Power[a]	25.1
4	Daewoo	15.0	LG Electronics	23.8
5	LG International Corp.	10.4	SK	21.9
6	Hyundai Motor Co.	10.3	Posco	21.7
7	Korea Electric Power	10.0	Kookmin Bank[b]	17.9
8	Posco	8.2	Kia Motor[c]	16.0
9	SK	6.6	SK Networks	14.9
10	LG Electronics	6.6	S-Oil	12.2

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Korea Listed Companies Association (KLCA), "A survey of Korean listed companies", 2006.

[a] Korea Electric Power Corp. was split into six generating companies in 2001. The Korean Power Exchange and the Korean Electricity Commission were established to oversee competition in the industry, especially the separation of the generation, distribution and sales sectors.

[b] Kookmin Bank emerged as the result of a series of large acquisitions.

[c] The Kia *chaebol* went bankrupt and Kia Motor was eventually acquired by Hyundai Motor Company after a number of government auctions.

But perhaps the most notable impact of the financial crisis was that Korean officials became increasingly convinced that it was again necessary to adopt drastic decisions to reorient the development strategy, above and beyond that entailed by the demands of the international financial institutions. For that reason, the financial crisis has been referred to as a blessing in disguise (M-S Chung, 2006).

3. Shifting the base of growth towards the knowledge economy

The Republic of Korea shifted its development strategy more forcefully towards higher value, knowledge-based activities in an attempt to extract itself from the sandwich between the rapidly advancing fast followers and R&D upstarts of developing Asia, especially China, on the one hand, and the dominant economic powers of Japan, North America and Europe, on the other (World Bank, 2000; Ernst, 2003). In short, the country was losing wage competitiveness without gaining advanced technology (An, 2005). Hence, the government opted to promote a knowledge economy[9] in order to make the transition from technology follower to innovator.

The differences between the central aspects of the new innovation-driven strategy (versus the old capital-driven one) were spelled out in the 2010 Industrial Vision (see table III.2).

Table III.2
REPUBLIC OF KOREA: COMPARISON OF CAPITAL- AND INNOVATION-DRIVEN STRATEGIES

Growth strategy	Capital-driven strategy	Innovation-driven strategy
Productivity	-low-cost labour management -automation -economies of scale -sales after production	-knowledge-information-driven human resources management -advanced production and management -knowledge-, technology- and information-intensive -flexible production on demand
Value added	-mass production -assembling and processing-centred -"Korea Discount" brand	-small quantity batch production -high-technology parts and materials -"Korea Premium" brand
Technology	-imitation and imported technology -no link between basic science and industrial technology -production technology development centered -insufficient combination of technologies	-developing source and core technology -strengthening the combination of sciences and industrial technology -concentrating on strategic development of next-generation technology -focusing on combining technologies

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Ministry of Commerce Industry and Energy (MOCIE), "Toward 2010" [online] http://english.mocie.go.kr.

[9] According to the World Bank (2006), a knowledge economy is one in which the sustained use and creation of knowledge are at the centre of the economic development process; one in which knowledge becomes the key engine of economic growth. The four pillars of the knowledge economy are: (i) an economic incentive and institutional regime that provides good economic policies and institutions, which promote efficient allocation of resources and stimulate creativity and incentives for the efficient creation, dissemination, and use of existing knowledge; (ii) an educated and skilled labour force that continuously upgrades and adapts skills to efficiently create and use knowledge; (iii) an effective innovation system of firms, research centres, universities, consultants and other organizations that keeps up with the knowledge revolution, taps into the growing stock of global knowledge, and assimilates and adapts new knowledge to local needs; and (iv) a modern and adequate information infrastructure that facilitates the effective communication, dissemination and processing of information and knowledge.

The Republic of Korea plans to become one of the world's top four industrial powers by shifting the capital- and external-growth-driven development strategy to one driven by innovation and qualitative growth. This means it will have to promote faster technology development than the industrialized countries do in future strategic industries (digital electronics, electronic medical equipment, bioindustry, environmental industry and aviation, for example) and promote upgrading, specialization and knowledge information in manufacturing-related services (such as business services and e-business), while also maintaining its position among global leaders in major basic industries (shipbuilding, semiconductors, automobiles, textiles, petrochemicals, steel, and machine parts and materials).

In the past, the Republic of Korea has experienced remarkable success as a technology importer. Its challenge now is to make the leap from technology importer to technology leader and, in a broader context, from an industrial to a knowledge society (Dahlman, 2005). The achievements in this field are already noteworthy (Invest Korea, 2005a). The country's R&D capability is ranked sixth in the world, it generates the eighth largest total R&D expenditure and holds third place in terms of patent productivity. The Republic of Korea's technological upgrading is now firmly based on competitive and financially stable large national corporations (Lee, 2005). Its world-class electronics companies have demonstrated high productivity (Woo, 2006) and gained impressive global market shares.[10] The ICT industry alone came to account for one third of GDP growth after the financial crisis (Hong, 2005) and its competitiveness is demonstrated by indicators of extensive diffusion throughout the economy, such as Internet use (61% of the population), broadband penetration (23%) and mobile phone subscribers (78%). According to Lee and Kim (2001), the Republic of Korea has demonstrated three different kinds of successes in technological catch-up: (i) path-following catch-up in consumer electronics, personal computers and machine tools, (ii) path-skipping catch-up in the case of DRAM semiconductors and automobiles; and (iii) path-creating catch-up in CDMA telephony and mobile handsets.

The Republic of Korea's growing international competitiveness is evident from the data reported in table III.3. During the period 1985-2004, Korean exports continuously gained international market share, rising from 1.46% to 2.80% of world trade. This market share demonstrated a positive evolution in that non-natural-resource-based manufactures, which are more dynamic within international trade, grew faster than commodities and natural-resource-based manufactures did and, within this category, the medium- and high-technology products gained market share while low-technology manufactures declined. This technological and industrial upgrading of the Korean export structure has been central to its improved international competitiveness. All of the top 10 exports, which represent over half of the country's total exports, gained international market shares and 8 of the 10 are among the 50 most dynamic products in international trade (out of 239). Moreover, most are items easily identifiable with the knowledge economy, such as semiconductors, telecommunications equipment, computers and their parts, even though some are still clearly based on consolidated industries, such as refined petroleum, polymerization and steel products.

The industrial vision of the Korean Institute for Industrial Economics and Trade (KIET) for 2020 contemplates an even more focused approach to 14 promising sectors, such as next-generation semiconductors, new biodrugs and bio-organs, ubiquitous networks, next-generation display, new-concept computers, next-generation vehicles, contents industry, health-care services, next-generation power production, robotics, high-tech chemical materials, advanced air and marine transport,

[10] For example, in 2005, Samsung Electronics Company held the second largest global market share in semiconductors (6.9%) after world leader Intel and was the world leader in DRAM (32.6%) and NAND Flash memory (55%). In the display industry, Samsung Electronics Company (TFT-LCD), LG Electronics (PDP), Samsung SDI (PDP and CRT) and LG Philips (TFT-LCD and CRT) were all world leaders.

hyperprecision equipment parts, and high-tech machinery and systems (Song and Lim, 2006). In other words, the Republic of Korea is making headway in evolving from imitation to innovation (Kim, 1997).

Table III.3

REPUBLIC OF KOREA: COMPETITIVENESS IN THE WORLD MARKET, 1985-2004

(Percentages)

			1985	1990	1995	2000	2004
I. Market shares			**1.46**	**1.87**	**2.19**	**2.52**	**2.80**
1. Natural resources [a]			0.30	0.38	0.32	0.31	0.16
2. Manufactures based on natural resources [b]			0.70	0.77	1.21	2.00	1.89
3. Manufactures not based on natural resources [c]			2.28	2.62	2.86	3.13	3.64
- Low-technology [d]			5.01	4.72	2.97	2.69	2.23
- Medium-technology [e]			1.11	1.54	2.21	2.50	3.07
- High-technology [f]			1.80	2.53	3.82	4.14	5.35
4. Other [g]			0.53	0.68	1.43	1.19	1.26
II. Export structure			**100**	**100**	**100**	**100**	**100**
1. Natural resources [a]			4.8	3.3	1.9	1.6	0.8
2. Manufactures based on natural resources [b]			9.3	7.4	9.2	12.3	10.6
3. Manufactures not based on natural resources [c]			84.6	88.0	86.7	84.3	87.0
- Low-technology [d]			48.9	41.8	22.5	16.7	11.9
- Medium-technology [e]			21.6	25.6	31.3	30.2	32.4
- High-technology [f]			14.4	20.7	33.0	37.5	42.7
4. Other [g]			1.1	1.2	2.2	1.8	1.7
III. 10 main exports			**17.7**	**24.0**	**42.3**	**52.2**	**57.5**
776-Thermionic valves and tubes, other semiconductors	*	+	4.8	7.4	16.7	15.1	13.6
764-Telecommunications equipment, n.e.s.	*	+	3.2	3.4	3.8	7.4	12.5
781-Passenger motor cars (excl. public service type)	*	+	1.4	3.2	5.1	7.4	9.1
759-Parts n.e.s. of and accessories for 751 and 752	*	+	0.7	1.1	3.4	3.4	4.3
871-Optical instruments and apparatus	*	+	0.1	0.2	0.2	0.6	3.4
752-Automatic data processing machines, units thereof	*	+	0.9	3.5	3.5	6.6	3.4
334-Petroleum products, refined		+	2.1	0.6	1.9	4.5	3.4
583-Polymerization and copolymerization products	*	+	0.7	1.2	2.9	3.1	3.0
778-Electrical machinery and apparatus, n.e.s.	*	+	1.2	1.3	2.5	1.7	2.5
674-Universals, plates and sheets, of iron or steel		+	2.7	2.3	2.3	2.4	2.2

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of "TradeCAN 2006" [CD-ROM Database], January 2006.

Note: Groups of products are based on the United Nations Standard International Trade Classification (SITC), Revision 2. The abbreviation "n.e.s." stands for "not elsewhere specified".

[a] Contains 45 simply processed commodities, including concentrates.

[b] Contains 65 items: 35 agricultural/forestry groups and 30 others (mostly metals other than steel, plus petroleum products, cement, glass, etc.).

[c] Contains 120 groups that represent the sum of d/ + e/ + f/.

[d] Contains 44 items: 20 groups in the textiles and wearing apparel cluster, plus 24 others (paper products, glass and steel, jewellery).

[e] Contains 58 items: 5 groups in the motor vehicle industry, 22 in the processing industry and 31 in the engineering industry.

[f] Contains 18 items: 11 groups in the electronics cluster plus 7 others (pharmaceuticals, turbines, aircraft, instruments).

[g] Contains 9 unclassified groups (mostly from section 9).

* Denotes groups that are among the 50 most dynamic in world imports, 1985-2004.

+ Denotes groups in which the Republic of Korea gained (+) market share in world imports, 1985-2004.

In general, with regard to the Korean development trajectory, it would seem reasonable to conclude that when the country embarked on a fast follower trajectory it possessed a development strategy adequate for the task. Now that it has evolved into a competitive stakeholder in the international economic system and aspires to become a technology leader, its development strategy has been altered

accordingly. Its economic policy has become more traditional or orthodox and focuses on objectives associated with the knowledge economy.[11]

The public policy focus on FDI evolved with the changes in the Korean development strategy. During the initial growth phase, inward FDI by transnational corporations tended to be viewed as a necessary evil in some situations but not to be relied upon: instead, the primary focus of the development strategy was on strengthening national conglomerates and accessing foreign technology. Outward foreign direct investment (OFDI) by Korean companies was for the most part dissuaded for balance-of-payments reasons, except as much as was strictly necessary to secure natural resources and move into export markets. As the focus of the Korean development strategy shifted towards innovation and R&D, particularly after the financial crisis, inward FDI was viewed much more positively and was actively promoted in order to access new technologies and improve the efficiency of the domestic economy and to facilitate its further integration into the international market. OFDI was promoted to the extent that the balance of payments improved and as it became increasingly apparent that such investment was needed to consolidate the international production networks of Korean companies and backstop their efforts to acquire world class R&D.

The rest of this chapter examines the nature of OFDI by the Republic of Korea in the context of its development trajectory. Section B contains an analysis of the evolution of and motivations for Korean OFDI. Section C focuses on the dominant corporate strategies in the main industries in which OFDI has been important (electronics, textile, apparel, automotive, and natural resources and natural-resource-based manufactures). Section D examines the principal operations of Korean transnational corporations (TNCs) in those industries in Latin America and the Caribbean. The final section draws together the different analyses and draws the pertinent conclusions.

B. THE DRIVERS OF KOREAN OFDI

OFDI from emerging economies is playing an increasingly important role in enhancing their integration into the global economy and improving the competitiveness of their companies. OFDI can help strengthen firms' competitiveness by securing natural resources and consolidating export markets, assisting them to improve their efficiency by establishing export platforms in lower-cost sites, and permitting their access to strategic assets (such as technology and skills). Thus, at a certain level of progress, OFDI becomes more relevant in a successful emerging economy's development trajectory.

The main purpose of this section is to survey the trends in Korean OFDI and the motivations for it, and thereby better understand its role in the country's development trajectory.

[11] In that context, free trade agreements (FTAs) could be an important instrument for accessing foreign markets and protecting Korean companies investing abroad and Korean owners of intellectual property. In 2004, Korea signed its first FTA with Chile. This was followed in 2005 by the signature of FTAs with Singapore and the European Free Trade Association (EFTA) and a Framework Agreement with the Association of South-East Asian Nations (ASEAN). During 2006, Korea was negotiating FTAs with ASEAN and the United States and an Economic Complementation Agreement with Mexico, and was engaged in continuing conversations with Canada, India, Japan, China and MERCOSUR.

1. The evolution and nature of Korean OFDI

Korean OFDI began to gain momentum in the late 1980s, prompted by changing legal and economic circumstances. The Export-Import Bank of Korea (Korea Eximbank) possesses a sophisticated system for tracking the evolution of Korean OFDI (see table III.4); however, official OFDI statistics suffer from certain shortcomings as regards reliability and interpretation which must be taken into consideration (see box III.1). Before the 1980s, Korean development was constrained by serious balance-of-payments problems, so that, except for OFDI needed to access natural resources, open export markets or support special activities (foreign-currency-generating construction projects in the Middle East, for example), such outward investment was generally prohibited by the Korean government. For that reason, up to 1980, only 400 cases, involving OFDI in the order of US$ 274 million, had been requested and only 352 cases, representing OFDI worth US$ 145 million, had been registered. However, by 2006, over 37,000 cases, representing about US$ 106 billion, had been requested and over 33,000 cases, totalling almost US$ 70 billion, had been registered.

Table III.4
REPUBLIC OF KOREA: OFDI FLOWS
(Number of cases and billions of current dollars)

Year	Authorizations requested		Actual investments	
	Number of cases	Amount authorized	Number of cases	Amount transferred
Until 1980	400	0.27	352	0.15
1981	64	0.29	49	0.03
1982	54	0.82	49	0.10
1983	67	0.83	56	0.11
1984	49	0.19	46	0.05
1985	42	0.22	38	0.11
1986	73	0.36	49	0.18
1987	109	0.37	91	0.41
1988	248	0.16	171	0.21
1989	369	0.97	269	0.57
1990	514	2.27	341	0.96
1991	526	1.80	444	1.11
1992	630	2.03	497	1.22
1993	1 052	2.00	689	1.26
1994	1 946	3.63	1 487	2.30
1995	1 572	5.22	1 332	3.10
1996	1 818	7.02	1 472	4.46
1997	1 608	6.10	1 330	3.71
1998	719	5.83	617	4.81
1999	1 268	5.10	1 095	3.33
2000	2 286	6.08	2 082	5.07
2001	2 327	6.36	2 153	5.16
2002	2 747	6.25	2 490	3.70
2003	3 079	5.58	2 809	4.06
2004	3 924	7.90	3 764	5.99
2005	4 555	9.03	4 389	6.56
2006	5 250	18.46	5 185	10.737
Total	**37 296**	**105.88**	**33 346**	**69.46**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the Export-Import Bank of Korea.

Box III.1

KOREAN OFDI STATISTICS AND THEIR LIMITATIONS

The Export-Import Bank of Korea (Korea Eximbank) is the only authoritative source of statistics for Korean OFDI. However, as it is based on company reporting, some of the qualitative as well as quantitative aspects of this investment are very difficult to trace.

First, only the initial destination of the investment is registered and no subsequent follow-up is conducted with regard to the final destination. Therefore, this reporting system does not adequately capture projects which are financed offshore. This means that no adjustment is made to the official statistics when a company relocates overseas assets from one host country to another. There are numerous examples of such situations. One is LG Electronics' investment in the Netherlands in 2001 using capital withdrawn from China and Indonesia. Another is Korean investment flows to the Latin American and Caribbean region in 2004. These were 87% up on the previous year, mainly as a result of large investments of capital —US$ 85 million and US$ 82 million, respectively— by Hyundai Motor Company (HMC) and NHN, the country's largest Internet portal company, in the Cayman Islands tax haven. HMC subsequently transferred these resources to China to acquire a local subsidiary. NHN established a holding company for further investment in the Internet games industry (Suh, 2005a). Some investments by Samsung Electronics Company and LG Electronics in Mexico are financed from these firms' United States subsidiaries and are thus not counted as Korean OFDI in Latin America in the Korea Eximbank's statistics. Most of the big Korean TNCs treat their activities in Mexico as part of their North American operations.

Second, another challenge for Korean OFDI statistics is the lack of reliable sources for the sectoral distribution of such investment. Although numerous associations cover the major industries, such as textiles, electronics, automotive and construction, few of them maintain data on overseas investment. Above all, the country lacks a nationwide industrial standard for investment data collection. In contrast to foreign investment statistics, Korean trade statistics provide sectoral and other information because there is a specialized institution, the Korea International Trade Association (KITA), for that purpose.

Third, one new characteristic of the late 1990s and the first few years of the new decade was the sharp increase in OFDI withdrawals. The total amount of OFDI withdrawn during 1998-2002 was US$ 8 billion, which was no less than 64.5% of all OFDI withdrawn between 1968 and the end of 2005. In a country whose OFDI is relatively small, the amount withdrawn warrants special attention. If it is reinvested, it counts as a new investment in the official statistics. This means that the magnitude of Korean OFDI might really be smaller than the total amount indicated, hence the usefulness of the net investment figure. For instance, the fact that LG Electronics launched a massive investment in Netherlands with the resources withdrawn from Asia partly explains the huge gap between total investment and net investment in 2001. The official information is shown in the table below.

KOREAN OFDI: INVESTMENT AND WITHDRAWALS, UP TO 2004

(Billions of dollars)

Year up to	Amount invested	Amount withdrawn	Net amount
1992	5.2	0.8	4.4
1993	1.2	0.2	1
1994	2.3	0.3	2
1995	3.1	0.3	2.8
1996	4.5	0.7	3.8
1997	3.7	0.3	3.4
1998	4.8	1.1	3.7
1999	3.3	1.1	2.3
2000	5.1	1.5	3.6
2001	5.1	3.3	1.8
2002	3.7	1.1	2.6
2003	4.0	0.7	3.3
2004	5.9	0.8	5.2

To compensate for the limitations of the official statistics, it is necessary to complement that information with company case studies based on direct interviews with headquarters firms as well as offshore subsidiaries.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Hee-Jung Suh, "Trend of Korean OFDI in 2004", *Exim Overseas Economic Reviews,* Seoul, The Export-Import Bank of Korea, 2005 and B. Ha, "Korea's foreign direct investment policies: evaluation and implications", *Industrial Economic Review*, vol. 9, No. 4, Seoul, July-August 2004.

The second phase of Korean OFDI was triggered by the changing domestic and international environment in the late 1980s. An important turning point came in 1986 when the country recorded remarkable export growth and enjoyed a sizeable current-account surplus. The success of Korean exports provoked a response in the form of new trade barriers and restrictions in several major export markets; hence, there was a growing need to establish plants in those markets. At the same time, rapid domestic wage increases eroded the cost-competitive advantages of domestic production in foreign markets. These examples suggest that global pull and domestic push factors made it increasingly necessary for Korean firms to internationalize. During the late 1980s, various initiatives were taken to strengthen Korean competitiveness, from relocating production to low-wage countries to relaxing somewhat the existing regulations and restrictions on inward FDI in order to increase competition for Korean companies in their own market.

The globalization strategy of Korean firms in the 1990s drove an increase in OFDI flows. In line with the government's globalization policy, the top *chaebol* embarked on ambitious globalization strategies aimed at increasing their overseas share of production and sales in order to catch up with global leaders.[12] However, in some cases, premature and excessively bold internationalization strategies proved unsustainable, as exemplified by Daewoo's bankruptcy and the problems experienced by Kia. These firms embarked on internationalization without building up strong enough competitive advantages first.

The 1997 financial crisis caused Korean OFDI to decline dramatically. Korean firms went through extensive post-crisis restructuring, which included such measures as closing down foreign subsidiaries and cancelling or delaying investment plans amid liquidity problems. Failure of foreign-asset management on the part of financial institutions has been widely condemned for provoking the crisis and had a strong psychological effect. In 2003, when the economy emerged from that crisis, Korean OFDI began to recover. Notably, 54% of overseas affiliates have been established since 2000, which means that the profile of Korean OFDI is recent and changing rapidly. In effect, Korean OFDI started over in a much more considered and cautious manner.

The Korean OFDI/GDP indicator is relatively small given the size of the economy, at only 1.8% in 2005. This is far lower than that of neighbouring economies such as Japan (5.7%) and Singapore (21.8%). In this regard, the Korean institutional framework has recently taken some noteworthy OFDI-promoting initiatives. First, the Korea Investment Corporation (KIC) was officially launched on 1 July 2005. The role of KIC is to manage foreign-exchange reserves, initially US$ 20 billion, to achieve a sustainable return on foreign-currency assets and help the country's financial industry to attain global standards. Second, the government and public enterprises are in the process of selecting a financial company to manage funds for overseas oil development. Investment in an oilfield has long been an unattainable prospect for individuals or smaller companies. It has only been viable as a pan-national project or for large energy conglomerates. However, oil field development is now open to individual investors, which will naturally lead to more OFDI in this area (*Maekyung Business Newspaper*, 2006; *Seoul Economy*, 2006). In other words, the Korean government is now actively promoting OFDI by way of various institutional mechanisms.

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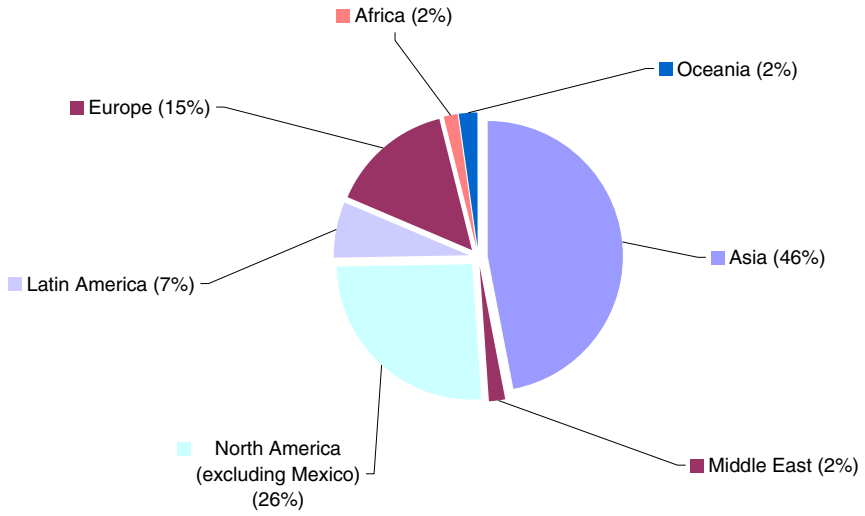
[12] This approach was manifested in a best-selling book entitled *It's a Big World and There's Lots to be Done*, written by Chairman Kim of Daewoo group. Around the same time, UNCTAD listed Daewoo Corporation as the second largest developing-country TNC ranked by foreign assets in 1998 (UNCTAD, 2000). Another powerful example was Samsung Electronics Company's semiconductor investment in California. The company established a laboratory in Silicon Valley as part of its catching-up strategy, in order to develop a series of DRAMs: 64K (1983-1984), 256K (1984-1986) and 1M (1985-1987). Thanks to the investment of the 1980s, Samsung Electronics Company emerged as the global market leader in DRAMs with a 32% market share, thereby demonstrating that it had become a technology pioneer.

(a) Geographical distribution of Korean OFDI

The Republic of Korea's OFDI stock is heavily concentrated in Asia (46%), North America (26%) and Europe (15%), according to official statistics for 1968-2006 (see figure III.2). Latin America is in an intermediate position as a recipient region with about 7%. The Middle East (2%), Africa (2%) and Oceania (2%) are barely on the map. Figures for 2000-2006 indicate that Asia's share has risen to 50% and Latin America's to 8%, while all the other regions have lost ground (see table III.5).

Figure III.2
REPUBLIC OF KOREA: OFDI STOCK, BY DESTINATION REGION, 1968-2006
(*Percentages of OFDI*)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Export-Import Bank of Korea, *Overseas Direct Investment Statistics Yearbook*, Seoul, 2006.

Table III.5
REPUBLIC OF KOREA: OFDI, BY REGION, 2000-2006
(Millions of dollars)

Region	2000	2001	2002	2003	2004	2005	2006	Total
Asia	1 575.6	1 386.2	1 748.1	2 422.7	3 390.9	3 931.9	6 059.3	20 514.8
Middle East	30.2	23.1	37.2	17.1	28.7	130.2	391.2	657.7
North America	1 420.4	1 486.5	574.5	1 066.5	1 385.0	1 277.1	2 141.8	9 351.7
Latin America	1 505.3	102.1	275.3	213.4	344.6	307.2	527.3	3 275.2
Europe	291.0	2 128.8	965.4	220.9	712.0	644.6	1 195.1	6 157.8
Africa	156.2	16.5	18.1	28.9	51.3	113.4	214.1	598.6
Oceania	89.6	20.5	78.6	91.9	76.2	152.8	202.3	711.9
Total	**5 068.5**	**5 163.7**	**3 697.1**	**4 061.5**	**5 988.6**	**6 557.2**	**10 731.0**	**41 267.7**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Export-Import Bank of Korea, *Overseas Direct Investment Statistics Yearbook*, Seoul, 2006.

In terms of individual recipient countries, Korean OFDI is very concentrated. The top 10 recipient countries accounted for 72.2% of total OFDI, and the top 25 received 88.8%. China (24.4%) and the United States (24.1%) alone represented close to half of Korean OFDI in 1968-2006. Apart from two financial centres (the Netherlands (3.5%) and Bermuda (2.3%)) and the United Kingdom (2.8%), all the rest of the top 10 recipient countries are Asian economies: Hong Kong, SAR (4.3%), Indonesia (3.4%), Viet Nam (3.1%), Singapore (2.1%) and Japan (2.1%). Three Latin American countries —Brazil, Peru and Mexico— are found towards the end of the top-25 list with shares of around 0.7%-0.8%.

From 2001 onward, 75% of total new OFDI in the *manufacturing* sector has been invested in China. Textile and apparel industries comprise the largest proportion of investments in China, accounting for 20.8% of the total number of projects. In terms of investment volume, metal components, at 31.3%, represent the largest category. In recent years, Korean firms' investments in China have mainly been in the information technology (IT), petroleum, chemical, steel and automotive industries. The focus of Korean investment is currently being shifted from manufacturing to service sectors and from the coastal areas to inland areas (Zhang, 2004). The average amount per investment project is only US$ 1.5 million. The level of investment per project is highest in Latin America (US$ 11 million), while per-project investment amounts in Asian countries average US$ 1.2 million. This suggests that Korean OFDI in Latin America and the Caribbean is concentrated in major natural-resource projects and large-scale export platforms, while in Asian countries it is primarily undertaken by smaller-scale investors and SMEs (Suh, 2005b).

(b) Sectoral distribution of Korean OFDI

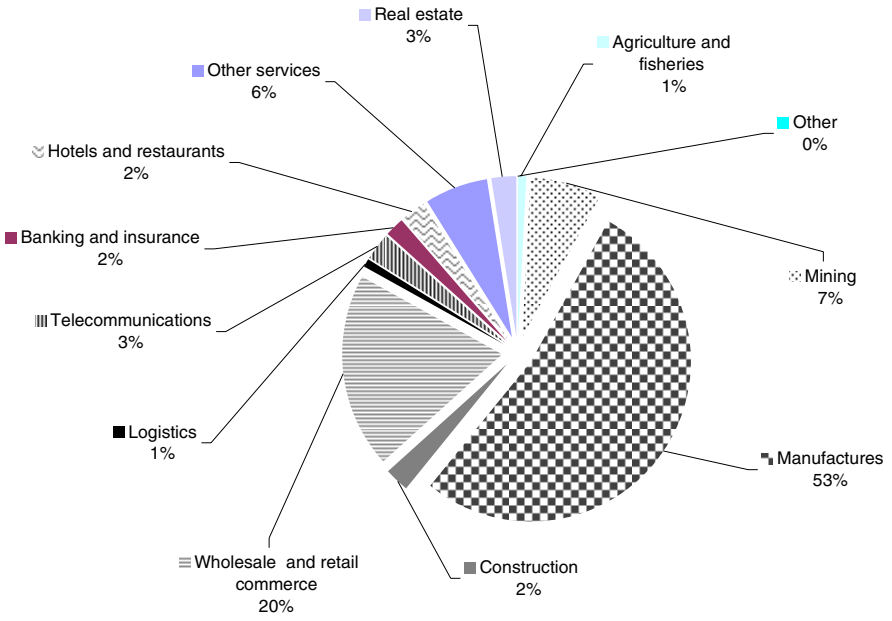
As mentioned above, early OFDI was export-facilitating and resource-seeking in such areas as mining and forestry. In the late 1980s, the primary sector accounted for 50.6% of the total amount invested while the manufacturing and trading industries represented 14.4% and 14.7%, respectively. During the 2000-2006 period (see table III.6 and figure III.3), the manufacturing sector represented the largest portion of Korean OFDI, with US$ 21.4 billion (51.8%), followed by services (40.7%) and mining (7%). Within services, the most significant branches were wholesale and retail trade (17.7%), real estate (2.9%), construction (2.8%), hotels and restaurants (2.2%), and telecoms (1.8%). The concentration of OFDI in the manufacturing sector confirms that the country's international competitiveness lies there, rather than in services. A breakdown of Korean investment in manufacturing in 2006 shows the electronics and telecoms equipment sectors with US$ 1.5 billion (29.1% of total investment in manufacturing). Second place was taken by motors and equipment with US$ 1 billion (20.6%). Another important sector was the petrochemical industry, which had a 13.6% share.

Table III.6
REPUBLIC OF KOREA: OFDI BY SECTOR, 2000-2006
(Millions of dollars)

	2000	2001	2002	2003	2004	2005	2006	Total
1. Agriculture and fisheries	18.1	8.5	19.3	27.1	34.4	30.0	42.9	180.0
2. Mining	92.6	66.0	200.0	321.0	308.2	470.5	1,426.9	2,885.2
3. Manufacturing	1,542.3	3,833.7	1,744.2	2,160.3	3,379.9	3,659.5	5,067.2	21,387.3
4. Services	3,414.0	1,255.6	1,733.5	1,553.0	2,265.3	2,397.2	4,194.1	16,812.7
-Construction	97.4	43.6	60.6	49.2	78.2	156.5	675.7	1,161.2
-Retail and wholesale	833.3	880.2	1,211.0	942.8	1,161.2	997.9	1,286.7	7,313.2
-Logistics	35.5	9.6	15.2	15.3	20.5	122.5	197.1	415.8
-Telecoms	158.4	45.9	37.9	62.5	80.9	135.3	207.4	728.3
-Banking and insurance	1,384.6	1.6	2.7	1.8	0.4	2.8	1.4	1,395.3
-Hotels and restaurants	248.0	27.2	39.0	78.7	110.4	205.2	208.5	917.0
-Real estate	97.6	38.2	81.4	99.3	187.6	158.8	521.3	1,184.2
-Other services	559.0	209.3	285.7	303.4	626.1	618.1	1,096.1	3,697.7
5. Others	1.6	0.2	0.1	0.1	0.7	0.0	0.0	2.6
Total	**5,068.5**	**5,163.7**	**3,697.1**	**4,061.5**	**5,988.6**	**6,557.2**	**10,731.0**	**41,267.7**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Export-Import Bank of Korea, *Overseas Direct Investment Statistics Yearbook*, Seoul, 2006.

Figure III.3
REPUBLIC OF KOREA: OFDI STOCK, BY SECTOR, 1968-2006
(Percentages)

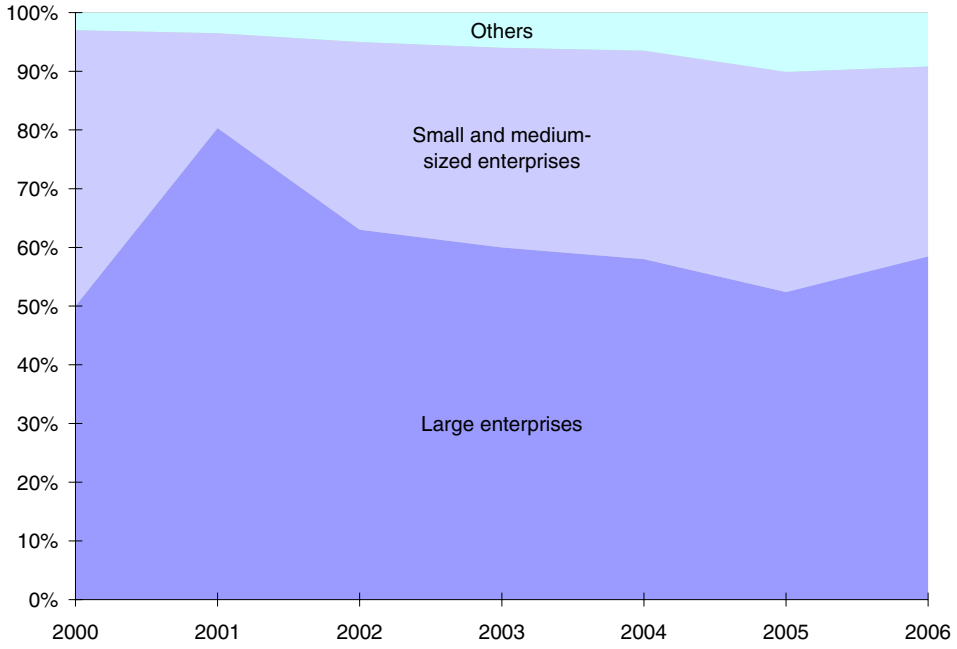


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Export-Import Bank of Korea, *Overseas Direct Investment Statistics Yearbook*, Seoul, 2006.

(c) Distribution of Korean OFDI by company size

One novel feature of the current increase in OFDI is that not only are large companies engaging in OFDI, but SMEs are doing so as well (see figure III.4). Currently there are more than 20,000 Korean firms operating in overseas territories. Although this number is relatively small given the size of the Korean economy, every year around 3,000 Korean FDI firms are setting up overseas, suggesting that many investments are undertaken by SMEs.

Figure III.4
REPUBLIC OF KOREA: OFDI BY COMPANY SIZE, 2000-2004
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Export-Import Bank of Korea, *Overseas Direct Investment Statistics Yearbook*, Seoul, 2006.

In 2006, OFDI by large enterprises reached US$ 6.3 billion, while SMEs accounted for US$ 3.4 billion. The proportion of OFDI conducted by SMEs increased constantly up to 2005, then dropped off in 2006. The investment pattern of SMEs is different from that of large conglomerates. Whereas big companies like Samsung Electronics Company, LG Electronics and Hyundai Motor Company have traditionally invested overseas primarily to secure local markets and establish export platforms, SMEs tend to go abroad to reduce production costs by using cheap and abundant labour (Lee, 2006). Although not classified as SME investments, OFDI by individual emigrants has also risen sharply. Over 1,440 cases of individual investment were reported during the first half of 2006, which is a 23.5% increase on the same period of 2005. Total OFDI by individuals reached US$ 480 million between January and June of 2006.

With regard to the target industry, large corporations and SMEs follow a similar pattern, since 558 out of a total of 1,443 individual investments (38.7%) went to manufacturing. Wholesale and retail trade occupied second place (22.1%). Hence, these two areas were the preferred activities (60.8%) for Korean investors (*Naeil Daily*, 7 September 2006). Although China is the preferred destination, with 648 cases, followed by the United States, with 483 cases or 33.5%, investments in emerging markets such as India, Indonesia and Viet Nam are increasing. Another trend in individual investment is the growing popularity of the overseas real estate market. The United States is the largest provider of overseas real estate for Koreans, but China is catching up in that respect.

2. Motivations for Korean OFDI

According to the Korea Eximbank's research into the principal motivating factors behind OFDI (see table III.7), the primary reason was to acquire and develop export markets (39.7%), while avoiding trade barriers (3.7%), and the secondary factor was to secure (1.2%) or develop (9.8%) natural resources in the host country. Taking advantage of low labour costs (9%) came in third place. Fourth came the acquisition of advanced technology (3.1%). Until the mid-1990s, the development of natural resources was the main objective of OFDI. Thereafter, it began to lose ground dramatically to the new dominant motivation —market-seeking— and, shortly thereafter, to the next most important incentive, efficiency-seeking.

Table III.7
MOTIVATIONS FOR KOREAN OFDI, 2000-2004
(Millions of dollars and percentages)

	2000	2001	2002	2003	2004	2000-2004
Acquire export markets	1 423 (23.6)	4 223 (66.5)	3 197 (50.7)	1 687 (29.1)	2 351 (29.6)	12 881 (39.7)
Develop natural resources	451 (7.5)	296 (4.7)	504 (8.0)	1 149 (19.8)	784 (9.9)	3 184 (9.8)
Take advantage of low wages	297 (4.9)	452 (7.1)	563 (8.9)	739 (12.7)	871 (11.0)	2 922 (9.0)
Avoid trade barriers	238 (3.9)	82 (1.3)	160 (2.5)	299 (5.2)	418 (5.3)	1.197 (3.7)
Acquire advanced technology	362 (6.0)	146 (2.3)	141 (2.2)	77 (1.3)	265 (3.3)	991 (3.1)
Secure raw materials	59 (1.0)	46 (0.7)	62 (1.0)	125 (2.1)	108 (1.4)	400 (1.2)
Others	3 205 (53.1)	1 108 (17.4)	1 672 (26.5)	1 731 (29.8)	3 146 (39.6)	10 862 (33.5)
Total	**6 037 (100%)**	**6 353 (100%)**	**6 300 (100%)**	**5 806 (100%)**	**7 942 (100%)**	**32 438 (100%)**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of the Export-Import Bank of Korea, *Overseas Direct Investment Statistics Yearbook.* 2005 and *Overseas Direct Investment Statistics Yearbook*, 2006.

According to Ha's survey (see table III.8), which offers a different view of Korean OFDI determinants, offshore investments appear to be determined primarily by cost-reduction motives, since 40.2% of the surveyed companies cited labour and other cost reduction as their main investment motivation. This factor was followed by market-seeking (34.5%), the overseas relocation of partner

companies (9.9%), and opening up third markets (4.9%). With regard to China in particular, labour and other cost reduction was fundamentally important to Korean companies, representing 42.6% of the total respondents —more than the average for all respondents regardless of the target region. The second main incentive is to open up new markets (33%). As for company size, larger enterprises are driven more by market-seeking motivations, while SMEs appear to lean towards labour and other cost reduction (43.4%).

Table III.8
DETERMINANTS OF KOREAN OFDI, BY INDUSTRY

Category	Industry type	First motive	Second motive	Third motive
Heavy and chemical industries	Electronics and telecoms	Market-seeking (48%)	Cost reduction (36.4%)	Overseas relocation of partner companies (20.2%)
	Machinery and equipment	Market-seeking (48.0%)	Cost reduction (25.0%)	Overseas relocation of partner companies (12.0%)
	Petrochemicals	Market-seeking (55.6%)	Cost reduction (23.4%)	Overseas relocation of partner companies /Entrance to developing country market (6.5%)
	Transportation equipment	Market-seeking (48.6%)	Overseas relocation of partner companies (27.0%)	Cost reduction (13.5%)
	Fabricated metals	Cost reduction (47.2%)	Market-seeking (33.3%)	Entrance to market (11.1%)
	Basic metals	Market-seeking (45.4%)	Cost reduction (36.4%)	Overseas relocation of partner companies (12.1%)
Light industry	Textiles and apparel	Cost reduction (66.2%)	Market-seeking (15.7%)	Entrance to developing country market (5.2%)
	Food and beverages	Market-seeking (54.3%)	Local natural resources (13.0%)	Cost reduction (10.9%)
	Footwear and leather	Cost reduction (65.2%)	Market-seeking (16.2%)	Shortage of national labour force (6.1%)
	Non-metallic minerals	Cost reduction (36.1%)	Market-seeking (18.2%)	Local natural resources (13.9%)
	Paper and printing [a]	Cost reduction (50.0%)	Market-seeking (25.0%)	Overseas relocation of partner companies /Entrance to developing country market/Shortage of national labour force (8.3%)

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of B. Ha, "Korea's foreign direct investment policies: evaluation and implications", *Industrial Economic Review*, vol. 9, No. 4, Seoul, July-August 2004.

[a] The 8.3% for paper and printing reflects the response of one company only.

Classified by industry types, most of the labour-intensive industries (textile and apparel, footwear and leather, non-metallic minerals, etc.) chose cost-efficiency as their major OFDI motivation, unlike more technology-oriented industries, such as transportation equipment, petrochemicals, machinery and primary metals, whose main driver was market-seeking.

This analysis of Korean OFDI indicates that it has been reactivated since the resolution of the financial crisis. It began mainly as natural-resource-seeking OFDI in Asia and market-seeking OFDI in the major markets (North America, Europe and Asia); however, efficiency-seeking OFDI is growing fast, especially in China and other Asian countries. Korean OFDI is conducted primarily in manufacturing activities where the Korean economy possesses its main competitive advantages. While both TNCs and SMEs have participated in Korean OFDI, the global strategies of the former are the force shaping the evolution and nature of these capital outflows. Although the official statistics indicate that little Korean OFDI targets strategic assets, it will become evident that this reflects a failure of the information gathering system more than an absence of asset-seeking investment; indeed, the catching-up strategies of what are today Korean TNCs were partly based on this strategy.

As is the case for other emerging markets, the Korean experience suggests that overseas investment is determined by various factors, both domestic and global. Rising domestic wages, interest rates, exchanges rates, an appreciating national currency, a limited domestic market and considerable regulation are relevant domestic push factors. The need for natural resources, export markets, technology and improved efficiency are important global pull factors.

As regards the future, a number of trends can be perceived. First, while large conglomerates will continue to make massive investments, micro-investments (each under US$ 1 million) will increase as Korean suppliers and individual investors move offshore. Second, although China will continue to be the most favoured destination for Korean OFDI, wage rises and mounting competition there will push some companies to consider alternative destinations such as India or Viet Nam. Third, even as companies invest according to prime motivations, such as efficiency- or market-seeking, they will increasingly integrate their separate motivations into a global strategy to improve their international competitiveness. Thus, the continuous relocation of investments to benefit from more appropriate host country conditions will become a central aspect of their activities.

3. Korean OFDI policy

The growth of Korean OFDI might suggest that there is a coordinated OFDI policy to promote it; however, this is not necessarily the case, since there seems to be room for improvement in this regard. A number of policy changes have taken place since the first rather restrictive law of December 1968 and especially since liberalization began in July 1981. The changes dealt mainly with four basic aspects (Moon, 2005). With regard to finance, the main changes concerned access to loans from the Korea Eximbank and the Economic Development Co-operation Fund, the negotiation of investment protection agreements (now numbering 62) with host governments and the establishment of foreign-exchange management rules. In terms of taxation, the most important measures involved the negotiation of double taxation agreements (of which there are now 57) with host countries and specific measures for resource industries. A third aspect had to do with access to the overseas investment insurance offered by the Korean Export Insurance Company. Lastly, different kinds of administrative and information support were offered by the Korea Overseas Company Assistance Center, the FDI Information Network, the Korea Overseas Information System of the Ministry of Finance and Economy, the Korea Eximbank and the Korean Institute for Industrial Economics and Trade. Starting in February 1994, notable advances were made in liberalizing Korean OFDI policy, by setting up a one-stop service on the part of transaction banks, allowing OFDI from all sectors, raising the individual investor limit, and encouraging strategic alliances with foreign firms. As of December 2003, more active assistance was offered and the OFDI problems of Korean TNCs began to be studied in depth.

As has been suggested, all these changes in the existing rules and regulations and activities by different Korean institutions are welcome but do not necessarily add up to a coherent and coordinated OFDI policy. What is missing is an overarching policy framework which ties OFDI in with Korean national development goals. Such an outlook could be expected to involve coordinated and coherent actions on the part of the Ministry of Finance and Economy, the Ministry of Commerce, Industry and Energy, the Korean Trade-Investment Promotion Agency and the Korean Institute for Industrial Economics and Trade. This explains why —in the context of a strengthening Korean won, which is undermining the international competitiveness of Korean products— there is currently a flurry of activity to put together a comprehensive package of measures aimed at promoting overseas investment and further reduce the existing restrictions. Perhaps this will help develop the many instruments dealing with Korean OFDI into a coherent and coordinated OFDI policy.

C. THE DOMINANT CORPORATE STRATEGIES DRIVING KOREAN OFDI

This section will examine specific, representative company experiences that have driven the Republic of Korea's industrial and technological advances. The corporate strategies of leading companies will be analysed in order to better comprehend the nature of the shift from an export-based industrialization to a knowledge-based economy in the principal industries and the role played by OFDI in establishing global networks.

1. The international expansion of the electronics industry

The electronics industry has been one of the most dynamic catalysts of global economic change during the last half-century. Recently, advances in integrated circuits and digitalization have been driving the industry. By 2005, the structure of the global industry was based on telecoms and networks (25.6% of production), computers and data processing (24.1%), and audio-visual and home appliances (21%), followed by industrial and medical electronics (14.5%), automotive electronics (8.1%) and aerospace and defence (6.6%) (Decision, 2006). The ability to break global value chains into discrete segments, combined with the growing convergence of computers, telecoms and consumer electronics, permitted the outsourcing of mass-produced components and final products to achieve ever-lower production costs, such that the geographical centres of consumption became progressively separated from those of production (see table III.9). This opportunity was seized primarily by Asian countries, first Japan, then other Asian economies such as Malaysia, the Republic of Korea, Taiwan Province of China, Singapore and, most recently, China. The production of electronic goods is shifting from high-cost to low-cost production sites. Asian assemblers, then Asian manufacturers and, finally, Asian designers subsequently made their appearance on the global corporate map of electronics.

The Asian region's electronics industry became its principal growth engine and set it apart from all other regions, although there was considerable diversity within Asia. In general, the Asian new entrants followed in Japan's footsteps. However, they did so in distinct ways with regard to the principal agents involved and with different degrees of success. In semiconductors, for example, the Korean *chaebol*, the SMEs in Taiwan Province of China and TNCs in Singapore and Malaysia demonstrated that the principal economic agents could vary appreciably. Within the ICT industry in Asia, distinct specializations emerged: Japan specialized in product technology for core components and sophisticated materials, the Republic of Korea in process technology for large-scale components and China in assembly technology, initially for analogue electronics (Joo, 2005).

Table III.9
WORLD PRODUCTION AND CONSUMPTION OF ELECTRONICS, 2005 AND PROJECTION FOR 2010
(Percentages)

	Consumption		Production	
Region/country	**2005**	**Projection 2010**	**2005**	**Projection 2010**
North America	30.8	28.3	22.1	19.9
Europe	27.3	25.1	21.1	19.0
Japan	10.9	9.5	15.5	13.5
China	9.9	12.3	22.6	27.6
Other Asian countries	11.0	13.1	14.6	15.3
Rest of the world	10.2	11.7	4.0	4.6
Total	**100**	**100**	**100**	**100**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Decision, "World electronic industries, 2005 - 2010" [online] July 2006 http://www.decision-consult.com.

The electronics industry became a showcase for the Republic of Korea's industrial and technological progress. It currently ranks fourth in the world in terms of electronics production (KEA, 2006). Computers and their components, mobile phones, home appliances and, especially, semiconductors, have been among its more dynamic manufactures (see figure III.1). The proportion of GDP generated by the electronics industry shot from less than 1% in 1970 to 6.6% in 2004 and the industry's share in exports rose from less than 7% to 38.1% over the same period (Kim, 1998; Joo, 2005). Table III.10 indicates the most important segments of the electronics industry from the point of view of production and exports in 2005. Items with a larger share in exports than in production include semiconductors, mobile phones, computers and peripherals, LCD monitors and digital televisions. Appropriately enough, semiconductors and digital electronics figure prominently in the Republic of Korea's 2010 Industrial Vision (MOCIE, 2006) and "a modern and adequate information infrastructure" is one of the four pillars of the knowledge economy framework as defined by the World Bank (World Bank, 2006).

Table III.10
PRODUCTION AND EXPORTS OF THE KOREAN ELECTRONICS INDUSTRY, 2005
(Millions of dollars and percentages)

Segment	**Production**	**Percentage**	**Exports**	**Percentage**
1. Information and communications equipment	78 249	37.1	45 731	44.5
- mobile phones	33 719	16.0	18 883	18.3
- computers and peripherals	25 775	12.2	14 117	13.7
- LCD monitors	8 668	4.1	6 352	6.2
2. General parts and components	60 273	28.5	10 871	10.6
- LCDs	35 436	16.8	4 684	4.6
- printed circuit boards	8 250	3.9	1 346	1.3
3. Semiconductors	37 192	17.6	29 996	29.2
4. Digital home appliances	29 240	13.8	14 656	14.2
- white goods	7 194	3.4	2 966	2.9
- digital televisions	2 630	1.2	1 431	1.4
5. Industrial equipment	6 174	2.9	1 450	1.4
Total	**211 128**	**100**	**102 704**	**100**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the Korean Electronics Association.

The Korean electronics industry has evolved from the simple to the complex (Joo, 2005). In the 1960s, the industry was based on the mass assembly of simple products (radios, black and white television sets, electronic tubes and other parts). The 1970s brought the manufacture of a wider range of electronic goods. The 1980s witnessed the use of more sophisticated technologies for semiconductor design and production, which was manifested in a sharp improvement in the quality of Korean products. The 1990s saw world-class technologies in terms of digital circuit designs, semiconductor processes and miniaturization, encompassed in large colour television sets, VCRs, microwave ovens, CDPs, DVDPs, PCs, CD-ROMs and memory chips. By 2000, the Korean electronics industry held the lead in technology and development of VLSI semiconductors and had a competitive global product line-up that included mobile phones, digital televisions, MP3 players, TFT-LCDs and PDPs, flash memory and DRAM. The two largest Korean TNCs —Samsung Electronics Company and LG Electronics— became world-class competitors in the electronics industry. Their corporate experiences reflect the core aspects of the evolution of the Korean electronics industry.

(a) Samsung Electronics Company (SEC)[13]

The Samsung *chaebol* has its roots as the Samsung General Store started in 1938 in Daegu, Korea. It became Samsung Corporation in 1948 and evolved into one of the largest and most dominant Korean business conglomerates. The Samsung Electronics Company (SEC) subsidiary was founded in 1969 and is one of a host of electronics subsidiaries of Samsung Corporation (including joint ventures such as Samsung Electro-Mechanics, Samsung SDI, Samsung SDS, Samsung Networks, Samsung Corning and Samsung Corning Precision Glass). It has other joint endeavours with Intel and Microsoft. SEC stands out as the largest and most important single element of the Samsung Group and it has become the best-known South Korean TNC, ranking forty-sixth in the world by sales (US$ 78.7 billion) in 2005 (Fortune Global 500). In terms of developing country TNCs, SEC was ranked fourth by external assets (US$ 14.6 billion) in 2004 (UNCTAD, 2006).

In 2005, SEC possessed the largest global market shares in electronic items such as DRAM semiconductors (32%), SRAM semiconductors (24%), flash memories (34%), NAND memories (50.7%), TFT-LCD (18%), DDIs (18%), computer monitors (22.3%) and televisions (9.4%; 14.6% in the second quarter of 2006). It was also among the leaders in laser MFPs (18%), after Hewlett Packard, and in hand-held phones (12.6%) after Nokia and Motorola. SEC experienced strong growth after the 1997 financial crisis, reflected in the doubling of its sales between 2000 and 2005.[14] Its sales come mainly from Asia (42%), Europe (24%), the Republic of Korea (18%) and the Americas (15%). Its brand value swelled to US$ 16.2 billion in 2006 (up from US$ 8.3 billion in 2002), making it number 20 in the world (ahead of arch-rivals Sony, Motorola and Panasonic). In terms of R&D efforts, it was ranked ninth in the world by expenditure (US$ 5.9 billion), sixteenth by technological innovation and sixth by patent management.[15]

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[13] This section is based on interviews at Samsung headquarters in Seoul and Samsung Electronics Company's Suwon Digital Complex, as well as Samsung (2005), Samsung Electronics Company (2006a, 2006b, 2006c and 2006d), Samsung Electronics Company (2005a), *The Economist* (2005), Yun (2005), Lee, G. (2005), Lee, Y-W (2005), Lee, K-T (2005), Choi (2005), Hwang (2005), and Lee, S-W (2005).

[14] The financial crisis dealt the Samsung *chaebol* a harsh blow. It was obliged to sell about half of its defence equipment assets to Thomson CSF and took a severe hit on its new automobile assembly plant, of which 80% was sold to Renault. Altogether, it divested more than 100 non-essential businesses, cutting about 30% of its workforce. SEC gained greater independence as a result of the restructuring process.

[15] In 1995, SEC purchased a United States firm, AST Research, for US$ 438 million, in order to gain access to its technology. Unfortunately, United States and Korean business management styles clashed and the firm soon lost many of its valuable human resources. This experience taught Samsung an important lesson about the limitations of its catch-up strategy and the best approach to R&D (Eun, 2002).

About 32,000 of the corporation's 138,000 employees work on R&D-related activities and most of these possess advanced university degrees (12,600 hold Masters degrees and 2,900, PhDs). The strategy adopted by SEC since the financial crisis was to restructure from volume-based to quality-based growth in order to transform itself from a fast follower into an "industry shaper".

SEC is organized into five basic businesses: Digital Appliances, Digital Media, Liquid Crystal Display, Semiconductors and Telecommunications Networks. The Digital Appliances unit accounted for 7% of consolidated revenue[16] in 2005, down from 16% in 2000. The principal products of this business group include refrigerators, washing machines, air conditioners, microwave ovens and home networking, as well as dishwashers, oven ranges, vacuum cleaners, and so forth. SEC has been working to improve the performance of these relatively traditional products by consolidating overseas assembly operations in lower-wage countries and upgrading its products towards higher-margin markets.[17] SEC is focusing increasingly on fewer but higher-margin products, such as system air conditioners, drum washing machines and side-by-side refrigerators. Another aspect of this upgrading is a large R&D project for Silver Nano Health System technology and the Homevita total home network solution initiative.

The Digital Media business contributed 22% of consolidated revenue in 2005, down from 31% in 2000. The main products of this business group include televisions (35% of sales), monitors (26%), audio-visual and optical equipment (17%), personal computers (11%) and printers (11%). Sales were concentrated in large markets such as Europe (37%) and the Americas (28%), such that this business group's offshore revenue represented 85% of its total revenue in 2005. Because of the low margins associated with many analogue product categories, SEC made a strategic decision to exit these in order to focus solely on digital ones. As for the Digital Appliances business group, SEC established a new manufacturing base for Digital Media in Eastern Europe (Slovakia and Hungary) to supply the European market. SEC is ranked first globally in televisions, computer monitors and DVD-VCR combos, second in projection televisions, DVD players and monochrome laser printers, third in LCD television sets and fourth in plasma televisions and camcorders. Its strategy seems to focus on raising its global rank in higher-margin, more sophisticated products, such as LCD and plasma televisions, which are providing strong revenues for the company.

The Liquid Crystal Display (LCD) business group accounted for 11% of the consolidated revenue of SEC in 2005. It was separated from Digital Media in 2004, after sales soared following aggressive production cost reductions (from US$ 20 per inch in 2000 to US$ 7 per inch in 2005) achieved through large investments and technological advances in design, process and materials. This business unit produces LCD panels for mobile phones, notebooks, desktop PCs and television sets. In 2004, together with its rival, Sony, SEC entered into the S-LCD venture. This partnership invested in the world's first seventh-generation fabrication facility for television LCD panels in its Tangjeong complex.[18] The LCD business group has become a new growth engine for SEC.

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[16] The Korean stock market requires listed firms to disclose the performance of Republic of Korea-based operations only. This represents a severe information challenge as regards the analysis of the total operations of global players, such as SEC and LG Electronics. In this particular case, the figures used are the consolidated revenues for all SEC operations (including international operations, but not financial affiliates) rather than the parent's operations in the Republic of Korea, as SEC is one of the few Korean global players to report consolidated figures. For insight into this problem, see Ramstad (2006).

[17] For this reason, microwave production in the Republic of Korea was recently transferred to Malaysia and Thailand and from the United Kingdom to Slovakia.

[18] SEC expects the burgeoning digital television industry (60-70 million units by 2010) to be dominated by the LCD models, ahead of projection and plasma models, and has positioned itself accordingly with clear investment, manufacturing and technological advantages.

The Semiconductors business group accounted for 25% of SEC total consolidated revenues in 2005. Its product line-up includes DRAM, flash memory, multichip packages, DDIs, CMOS image sensors and mobile CPUs, among others. SEC ranks second in the world in this industry, after Intel, and enjoys dominant global market shares in DRAM (31%), SRAM (28%) and flash memory (27%). It possesses the world's leading 300-millimetre wafer production line and is the only company capable of conducting flexible operations for both DRAM and flash. While this business group is often viewed as the cash cow of SEC, it faces two challenges. On the one hand, a good part of the semiconductor business in which SEC operates is based on commodities, in which price swings are sharp and demand variable, which makes it very risky. On the other hand, the most dynamic segment requires huge R&D investment to maintain technological advantages and thus appropriate higher prices for leading-edge products. In that vein, SEC is investing in the world's largest semiconductor manufacturing facility at its Hwasung complex. This facility is expected to generate US$ 61 billion in revenue by 2012. The SEC semiconductor product repertoire includes memory, storage and its large scale integration system (system LSI), which encompasses five strategic products: DDI, mobile CPU, integrated circuits for chip cards (chip card IC), CIS and system-on-a-chip for multimedia (media player SoC). Within its main memory line-up, SEC has classified products as leading edge (GDDR3 and 8Gb NAND), mainstream (DDR2 and 2/4Gb NAND), trailing edge (128Mb Sync and 64Mb Sync) and specialty (XDR, mobile DRAM and graphic), which suggests that the company has a clear vision of the evolution and competitiveness of its semiconductor product repertoire. SEC prides itself on maintaining high R&D investment in this business in spite of cyclical prices, on becoming a total solution provider fully encompassing mobile memory, flash memory, DDI, application processors, image sensors and software and on generating a strategic portfolio of key patents to maintain its technological advantage.

The Telecommunications Networks business group contributed 26% of total consolidated revenue in 2005. Its product line-up is based on mobile phones, network systems, core systems, wireless systems, broadband equipment and home and office products. SEC claims the global lead in CDMA phones and is ranked number three overall in the global mobile phone market (12.7%) behind Nokia and Motorola. It considers itself leader in the mid- to high-tech segment of that market, where the quality and technological sophistication of its hand-held phones fetch premium prices. SEC hand-held phones have seen explosive growth: sales exceeded 100 million units worldwide in 2005. In this field, in which it is building on the convergence of broadcasting and communications and the integration of wired and wireless communications, SEC has advantages in terms of both technology —such as TD-SCDMA in China, as well as HSDPA and WiBro— and design, with its clamshell, sliding and landscape models.

Within the five-business-unit organization of SEC, two units (Digital Appliances and Digital Media) are currently showing quite slow growth, relatively mature technologies and small profit margins. Two others, LCD and Telecommunications Networks, are fast-growing and have dynamic technologies and significant profit margins. Lastly, the Semiconductors unit performs variably according to cyclical market demand and is very demanding in terms of R&D. Thus, the SEC global production network currently appears to be focused on improving the efficiency of the Digital Appliances and Digital Media business groups by offshoring assembly to lower-wage platforms to supply the main markets (Europe, North America and Asia). The numerous international expansion strategies employed by SEC —efficiency-seeking (reducing production costs), securing natural resources, accessing markets and obtaining strategic assets (technology, strategic locations and so forth)— have varied in importance as the company has evolved (Moon, 2005). As regards OFDI, however, the most important is the establishment of an international system of integrated production on the part of the Digital Appliance and Digital Media business groups.

Table III.11 sets out the SEC international system, which accounts for 43% of its total assets. The less dynamic business groups (Digital Appliances and Digital Media) are quite broadly internationalized, whereas the production of the other three, more dynamic business groups is still very much centred in the Republic of Korea. The major exceptions involve the activities of the Semiconductor, LCD and Telecommunications Networks business groups in China, which SEC is developing into a centre for high-tech production, and the semiconductor activities in the United States. Other, more minor exceptions include LCD hand-held phone activities in large emerging markets, such as India and Brazil. R&D and design centres seem to be located in major markets (Europe, North America and Asia). The large markets of Brazil, Russia, India and China (which are collectively termed "Brics") are a particular focus of the corporation's international expansion.

Table III.11
SAMSUNG ELECTRONICS COMPANY: GLOBAL NETWORK OF MANUFACTURING SUBSIDIARIES AND R&D/DESIGN CENTRES

Business group	Republic of Korea	China	South Asia	East Asia	Europe/CIS	Americas
Digital Appliances	Gangue-refrigerators, vacuum cleaners, washing machines, air conditioning, others	Suzhou-refrigerators, washing machines, air conditioning, Note PCs	India-refrigerators, air conditioning, washing machines	Thailand-refrigerators, air conditioning	Slovakia-microwave ovens	Mexico- washing machines
Digital Media	Suwon- colour televisions, digital video devices, camcorders, PCs, computer monitors	Tianjin- colour televisions, VCRs, digital video devices, computer monitors	India- colour televisions, computer monitors	Viet Nam- colour televisions, computer monitors	Slovakia-colour televisions, computer monitors, printers	Mexico- colour televisions
	Gumi- printers, hard disk drives	Huizhou- audio equipment		Thailand- colour televisions, computer monitors	Hungary-colour televisions, computer monitors	Brazil- computer monitors, HDDs
		Shandong- FAX printers		Malaysia-computer monitors Indonesia- digital video devices, VCRs, optical disk drives Philippines-optical disk drives		
Liquid Crystal Display- LCD	Giheung/Hwaseong- TFT-LCD Cheonan/Tangjeong-TFT-LCD Gumi- hand-held phones	Tianjin- hand-held phones Shenzhen- hand-held phones Suzhou- LCD	India- hand-held phones			Brazil- hand-held phones
Semiconductors	Giheung/Hwaseong, Onyang	Suzhou				United States - memory
Telecom Networks	Gumi- wireless communications	Hainan- fibre optics				
R&D centers	Suwon (3)	Suzhou	India	Japan	United Kingdom	United States (2)
	Giheung (3)	Nanjing Beijing			Russia Israel	Brazil
Design centres	Seoul	Shanghai		Japan	United Kingdom Italy	United States (2)

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from Samsung Electronics Company, official site [online] http://www.samsungelectronics.com.

SEC possesses a clearly defined view as to its current growth engines (memory, display, mobile communications and digital television), its upcoming growth engines (printers, system LSI, mass storage and air control systems) and emerging growth engines (personal multimedia devices, home networks, U-health and home care robots). The future growth of this TNC is evidently associated with the knowledge economy. That clarity of vision will help the company to face the challenges ahead and will determine the future trends in terms of the internationalization of production facilities. The organization and experience of SEC suggests that the company designed and implemented an appropriate corporate strategy to shift its core business from quantity to quality and to transform itself from a fast follower to an innovator.

(b) LG Electronics (LGE)[19]

Lucky Goldstar was founded in 1946 and its business was electronics (under the name of Lucky, until it was changed to LG Electronics in 1958) and household goods (under the name Goldstar, which was later changed to LG Chemicals). After the financial crisis, it was reorganized into three separate groups: LG Group, GS Group and LS Group. LG Corp. became a holding company with three principal business activities: electronics and telecoms; chemicals and energy; and services. LG Corp. owns 34.8% of LG Electronics, which is its principal electronics affiliate. In turn, LG Electronics has important holdings in associates, such as LG Philips Display (37.9% capital share holding),[20] LG Philips LCD, LG Innotek (69.8%), LG Micron (33%), LG Nortel Networks and LG Data Storage (with Hitachi).

LG Electronics was ranked number 115 in the world by consolidated sales (US$ 45 billion) in 2005 (Fortune Global 500). Its parent, LG Corp., was ranked number 72. Among developing country TNCs, LG Corp. was seventh in terms of external assets (US$ 10.4 billion) in 2004 (UNCTAD, 2006). Overall sales are made mainly in the Republic of Korea (25%), North America (23%), Europe (19%), and Asia (17%). LGE is similar to Samsung Electronics Company in its product line-up and business organization, except that it is not a world leader in semiconductors, it has a somewhat different international market focus and its brand value and R&D effort are considerably lower than those of its principal Korean rival. LGE considers itself the world leader in market shares for optical storage (29%), home theatre systems (16%), CDMA handsets (21%), residential air conditioners (7.4%) and DVD players (10%). It is ranked second in plasma panels (27%) and plasma television sets (15%). Its vision is to become one of the top three electronics and telecommunications TNCs by 2010. LGE has refocused on its core businesses, principal markets and higher value, premium priced products. It aims to innovate 30% faster than its rivals by raising the proportion of its R&D-related employees from 40% to 60% of its total workforce.

LGE is organized into four main business units: Digital Appliances, Digital Media, Digital Display and Mobile Communications. The Digital Appliances business accounted for 25% of sales in 2005. Its product line-up comprises air conditioners (34%), refrigerators (26%), washing machines (23%) and other household appliances (17%). Its strategy is to surpass its global competitors (Whirlpool and Electrolux) by taking advantage of opportunities to evolve from low-margin to higher-margin home appliances, on the one hand, and from home appliances to higher value-added mobile and automobile units, on the other. With this aim, LGE is deploying three initiatives. First, its production system is set up in such a way that the more expensive, high-end products are manufactured in the Republic of Korea

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[19] This section is based primarily on interviews at LG Electronics headquarters in Seoul and LG Corp. (2006), LG Electronics (2006a), (2006b), (2006c), (2005), LG Innotek (2006), LG Micron (2006), LG Philips LCD (2006a), (2006b).

[20] Another consequence of the financial crisis was that LG Electronics sold a major stake of its flat screen business to Philips in 1999.

(35% of production) and the rest are made in China (50%), other Asian countries (10%) and the rest of the world (5%). Second, it targets the high-end market for its three principal products in order to secure premium prices. Third, its R&D is focused on vertical integration of key components (for example compressors for air conditioners and refrigerators). In 2006, the second-quarter sales of the Digital Appliances business unit were distributed as follows: Republic of Korea (45%), North America (21%), Europe (13%), Asia and Middle East (15%) and the rest of the world (6%).

The Digital Media business accounted for 13% of sales in 2005. Its principal products are based on the integration of various digital audio-visual appliances into a single device, such as home theatre and car "infotainment" systems, as well as personal computers (desktop and notebook), mobile appliances (PDAs and MP3) and optical storage devices (CD-ROMs, CD-RWs, DVD-ROMs, CD-DVDs, DVD-Ws). Sales are grouped into three categories: optical storage (44%), media (33%), and personal computers (23%). The strategy in this group is to expand premium product sales, taking advantage of opportunities arising from the digitalization of information and audio-visual equipment, and to move out of the more price competitive segments (i.e., low-end personal computers).

The Digital Display business unit provided 22% of total sales in 2005. Principal products include plasma and LCD television sets (40%), LCD monitors (29%), plasma display panels (25%) and other applications (6%). This unit of LGE is well placed to compete in the rapidly evolving digital television industry. It has region-specific production, R&D and marketing facilities for its flat panel displays in the Republic of Korea, China, Poland (for the European market) and Mexico (for the Americas market). The strategy of the Digital Display business unit is to maintain its technological edge by combining proprietary resources for modules, chips and total software solutions.[21] This activity represents a significant engine of growth for LGE.

The Mobile Communications business unit accounted for 40% of LG Electronics' 2005 sales. This unit's main product groups are CDMA handsets (50%) and GSM handsets (40%), with networks and other appliances contributing 10%. In 2005 LGE ranked fourth in global mobile handset sales, in general, and it ranks itself first in CDMA handsets (as does SEC). In the second quarter of 2006, sales were concentrated in North America (28%), Asia and the Middle East (22%), Central and South America (21%), Europe (17%), the Republic of Korea (5%) and other countries (7%). Sales of CDMA handsets reached 30 million units and those of the GSM handset were in the order of 25 million units. The "Chocolate" model was a best seller with sales of over 5 million, mainly in North America (40%), Europe (28%), Asia (20%) and Central and South America (12%). The strategy of this business unit is to continue to win market share based on intensive R&D and innovative designs. It uses an operator-centric marketing strategy for its CDMA handsets and an open-market approach for GSM handsets and seeks to place the LG brand above competitors such as Nokia and Motorola. Mobile Communications is the principal engine of growth for LGE.

A significant role in LG Electronics' global network is played by its associates, including LG Philips LCD, LG Innotek and LG Micron. LG Philips LCD is one of the world's leading merchant suppliers of TFT-LCDs for notebook computers, desktop monitors and television sets, as well as hand-held consumer products such as PDAs, and mobile phones, and other applications (entertainment systems,

[21] LG Electronics became associated with the United States company Zenith in 1995 for the purpose of improving its brand and accessing advanced technologies. Similar to Samsung Electronics Company's experience with AST Research, differences in management styles led to the loss of important human resources and LGE took over as of 2000. Important lessons were learned from this experience about approaches to R&D and technological catch-up (Eun, 2002).

automobile navigation systems, aircraft instrumentation and medical diagnostic equipment). LG Philips LCD has manufacturing subsidiaries in China and Poland. LG Innotek manufactures components, such as analogue and digital tuners, motors for optical disk drives and modulators for mobile, display, network and automotive electronics. It has overseas manufacturing facilities in China, Indonesia, Japan, Mexico, Poland and the United States, as well as an R&D operation in Russia. LG Micron produces CPTs for colour television sets and computer monitors. It has one overseas subsidiary in China.

Together, LGE and its associates have built up an extensive global production, R&D and design network (see table III.12). This international system encompasses 56% of total LGE assets. LGE clearly bases the manufacture of many of its lower-range products in China and, to a lesser extent, in other Asian countries. In its main markets —North America and Europe— it maintains primarily R&D operations, with smaller regional manufacturing facilities located in nearby lower-wage countries, such as Poland, in the case of Europe, and Mexico, in the case of North America. Many of the higher-range products are still manufactured in the Republic of Korea and exported to final markets. About 44% of the 66,652-strong workforce of LGE is located in the Republic of Korea, the rest overseas. The establishment of LGE subsidiaries in the United States (1981), Germany (1986), Thailand (1989), China (1993), India (1997) and Mexico (2000) marked some of the main steps in the group's internationalization process. Other milestones were the association with Zenith in 1995 and the establishment of LG Philips LCD in 1999 and LG Philips Display in 2001. Like Samsung Electronics Company, LGE has deployed numerous strategies for creating its global network, including increasing efficiency (by reducing production costs), accessing markets and securing strategic assets (technology, strategic locations and so forth), which have varied in importance in the course of its evolution (Moon, 2005).

The direction of the group's R&D efforts suggest that its current growth engines revolve around mobile handsets, digital displays (including television sets), appliances and retail air conditioners. New hand-held phones, larger LCD/PDP displays and television sets and commercial packages of air conditioners are being developed. Further down the line, LGE is placing its stakes on organic light-emitting diode displays, flexible displays, its car 'infotainment' system and non-electrode plasma lighting systems. Its 14 research laboratories in the Republic of Korea and 16 overseas and its design centres in major markets (China, Europe, India, Japan and the United States) are coordinating efforts in that regard. LGE is another Korean global electronics TNC which is actively working to shift its operations towards the knowledge economy.

Table III.12
LG ELECTRONICS: GLOBAL NETWORK OF MANUFACTURING SUBSIDIARIES AND R&D/DESIGN CENTRES

Region	Main Divisions	Associates
1. China	Taizhou- refrigerators, refrigerator compressors	LG Micron: Fuzhou, China- Manufacturing
	Hangzou- digital recording media	LG Innotek: Huizhou, China- optical disk drives, tuners, LCD modules, ICs
	Huizhou- digital storage, digital audio and video	LG Innotek: Shanghai, China- all products
	Nanjing- monitors, washing machines, digital televisions, PDPs	LG Innotek: Shenzhen, China- all products
	Qinhuangdao- casting of parts for equipment	LG Innotek: Beijing China- all products
	Shanghai- digital audio and video	LG Philips: Nanjing, China- assembly of TFT-LCDs
	Shenyang- televisions	
	Tianjin- microwave ovens, residential air conditioning, motors, magnetron, PVC, rotary compressors, R&D	
	Yantai- hand-held phones (CDMA)	
	Kunshan- PCs	
	Qingdao- hand-held phones (GSM)	
	Sandongsheng, China- R&D	
	Beijing, China- R&D, design	
2. Other Asian economies	New Delhi, India- televisions, refrigerators, washing machines, air conditioning, microwave ovens, monitors, design	LG Innotek: Japan- all products
	Bangalore, India- R&D	LG Innotek: Taiwan- all products
	Jakarta, Indonesia- televisions, refrigerators, air conditioning, VCRs, monitors	LG Innotek: Jawa, Barat, Indonesia- tuners, VCR motors and heads
	Bangkok, Thailand- televisions, residential air conditioning, washing machines	
	Hanoi, Viet Nam- televisions, monitors, digital audio and video, digital storage, hand-held phones (GSM)	
	Tokyo, Japan- R&D, design	
3. Europe/CIS	Paris, France- R&D	
	Neuss, Germany- R&D	
	Aachen, Germany- R&D	
	Milan, Italy- Design	
	Wales, UK- monitors	
	Mlawa, Poland- PDP televisions	LG Philips: Kobierzyce, Poland- backend modules
		LG Innotek: Wroclaw, Poland- inverters, television tuners and power supply units
	Moscow, Russia- refrigerators, washing machines, televisions, audio equipment	LG Innotek: Nizhny Novgorad, Russia- R&D
	Moscow, Russia- R&D	
	St. Petersburg- R&D	
	Almaty, Kazakastan- colour televisions, washing machines, VCRs, audio equipment	
	Istanbul, Turkey- air conditioning	
4. Americas	United States- R&D (2), design	LG Innotek: United States- all products
	Mexicali, Mexico- monitors, LCD televisions, hand-held phones	LG Innotek: Mexicali, Mexico- tuners, radio frequency modules
	Reynosa, Mexico- colour televisions, PDP televisions	
	Monterrey, Mexico- refrigerators	
	Manaus, Brazil- colour televisions, VCRs, DVDs, air conditioning	
	Taubate, Brazil- monitors, hand-held phones, CDRs	
5. Rest of the world	Cairo, Egypt- deflection yokes, fly back transformers, tuners	
	Herzelia, Israel- R&D	

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from Lockwood Greene, official site [online] http://www.lg.com.

In summary, two world-class electronic TNCs with quite similar characteristics in terms of evolution, corporate strategies, organizational structure, and internationalization processes have emerged from the Korean development trajectory. According to the Japan Electronics and Information Technology Industries Association (JEITA, 2005), SEC and LGE compete head-to-head in specific product groups, such as digital television sets (SEC market share: 9.4%, LGE: 9.3%), computer monitors (SEC: 22.3%; LGE: 13.7%), TFT-LCDs (SEC: 18%; LGE: 17%) and hand-held phones (SEC: 12.6%; LGE: 6.7). It is expected that the digital revolution will be complete by 2010, insofar as the share of digital electronics products will have reached 96%, up from 57% in 2004, and analogue products will have slumped to only 4%, from 43% in 2004, in a global market that will have expanded from US$ 109 billion to US$ 178 billion. Within those two groups of electronics products, digital television sets (PDP, LCD and CRT-PJ with digital tuners) will rise from 22% to 54% of the total, while analogue television sets (CRT-PJ without digital tuners) will fall to zero from 34% in 2004. SEC believes it has a one-year lead over its competitors in 40-inch LCD television sets and 60-inch PDP sets (Choi, 2005). This suggests that R&D efforts, on the one hand, and the nature of the internationalization process for digital displays, on the other, will be crucial factors in the competition between these two electronics TNCs.[22]

Initially, SEC and LGE followed trajectories similar to such Japanese electronics giants as Sony and Masushita. The main differences between the two Korean TNCs lie in the higher brand value of SEC and the scale of its semiconductor activities, both of which far surpass those of LGE, although the latter is more internationalized in terms of overseas assets. Both engaged in technological upgrading with path-following activities (consumer electronics, personal computers) and path-creating ones (CDMA telephony and mobile phones), but only SEC achieved a significant path-skipping technological advance, in the form of DRAM.

The two companies' internationalization processes have followed a certain common logic. Initially, they undertook large market-seeking investments to gain access to the major markets, such as North America and Europe, followed by initiatives in Asia, especially China. Then they made very significant efficiency-seeking investments in export processing zones in lower-wage Asian countries, such as Indonesia, Malaysia, Thailand and Viet Nam, and lower-wage countries that were close to major markets: Mexico in the case of North America and CIS countries in the case of Europe. Strategic asset-seeking investments —to purchase companies with technological advantages or to set up R&D or design centres— are undertaken mainly in the major markets. Both of these electronics TNCs seem to be showing a fresh interest in the emerging market BRICs. OFDI has been an important mechanism for the implementation of their corporate strategies.

These two Korean electronics giants face challenges if they are to maintain their competitive advantages. The appreciation of the won makes exporting from the Republic of Korea increasingly difficult. They find themselves in an Asian nutcracker between lower-wage fast followers and technological upstarts, especially China, and competitive TNCs from developed countries. SEC and LGE are being obliged to extend and calibrate their international production systems in order to compete

[22] In the case of SEC, one of the key questions is how it can best calibrate its international competitiveness by way of the internationalization of digital displays. For example, its strategic partners, such as Samsung Corning Precision (glass), Samsung Corning (back light), Samsung Electro-Mechanics (LED, PCB, etc.), Cheil Industries and Samsung Fine Chemicals (sheet, film, chemicals), and its in-house production to supply components and materials (driver IC, LCD/PDP modules) will need to coordinate their internationalization processes in order to supply strategic-partner final product assemblers, such as Samsung Electronics Company-Sony (TVs), or in-house final product assembly processes TVs, monitors, Note PC, HHP and multimedia. A key question is when and if Samsung Electronics Company will internationalize its production of LCD/PDP modules, as its current plants have been constructed exclusively in the Republic of Korea (Giheung/Hwaseong and Cheonan/Tangjeong complexes).

effectively in both mature and emerging markets. At the same time, they must also undertake ever-increasing R&D efforts to push deeper into those activities associated with the knowledge economy. As a result, these two companies have become the Republic of Korea's principal agents in that area.

2. The international expansion of the automotive industry

In 2005, the world's 10 leading automobile assemblers accounted for almost three quarters of the world-wide production of 66.5 million vehicles (up from 58 million units in 2000). The principal changes in the industry recently have been the rise of Asian manufacturers Toyota Motor Company, Honda Motor Company and Hyundai Motor Company (HMC) and the relative decline of United States companies, such as General Motors (GM) and Ford Motor Company.

According to the International Organization of Motor Vehicle Manufacturers (OICA), HMC of the Republic of Korea reached ninth in the global ranking, measured by production. Measured by sales, HMC is ranked sixth by the website Automobile.com (see table III.13). In the J.D. Power Associates initial quality study conducted in June 2006, HMC surpassed Toyota and Honda, rising to third place in terms of number of problems (102) per 100 vehicles and overtaking Nissan to gain sixth place in terms of sales (J.D. Power and Associates, 2006). Thus, in the space of three decades, a Korean automobile assembler established a prominent position among the top 10 firms of the global automotive industry. The dimension of that success reflects the fact that the Republic of Korea is the only country that has been able to simulate the success of the Japanese automotive industry by transforming an export business based primarily on national champions into a global competitor (Lautier, 2001; Ravenhill, 2001). HMC is a major global TNC —the eightieth largest in the world by sales (US$ 57.4 billion) in 2005 (Fortune Global 500). Among developing country TNCs, HMC was ranked thirteenth by external assets (US$ 5.9 billion) in 2004 (UNCTAD, 2006).

Table III.13
TOP 10 AUTOMOBILE TNCs, BY PRODUCTION AND SALES, 2005
(Millions of vehicles)

According to OICA		**According to Automobile.com**	
Automotive TNC	**2005 Production**	**Automotive TNC**	**2005 Sales**
General Motors (includes Opel, Vauxhall, GM Daewoo)	9.1	General Motors	8.4
Toyota Motor Co.	7.3	Toyota Motor Co.	8.1
Ford (including Jaguar and Volvo)	6.5	Ford Motor Co.	6.2
Volkswagen group	5.2	Volkswagen AG	5.2
DaimlerChrysler (including Evobus)	4.8	DaimlerChrysler AG	4.9
Nissan Motor Co.	3.5	Hyundai Automotive Group	3.7
Honda Motor Co.	3.4	Nissan Motor Co.	3.6
PSA Peugeot Citroën	3.4	PSA Peugeot Citroën	3.4
Hyundai (including Kia)	3.1	Honda Motor Co.	3.4
Renault (including Dacia and Samsung)	2.6	Renault	2.5
Subtotal top 10	48.9	Subtotal top 10	49.4
World	66.5	World	n.d.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of the International Organization of Motor Vehicle Manufacturers official site [online] http://www.oica.net and Automobile, official site [online] http://www.automobile.com.

In the Republic of Korea, the automotive sector contributes 9.4% of the manufacturing industry's value-added and production, accounts for 8.3% of national exports and employs 7.4% of the gross national workforce (http://www.korea.net). Automotive production was expected to exceed 4 million units in 2006 (KAMA, 2006). In 2005, exports reached almost 2.6 million units and were worth about US$ 27 billion. Imports were rising too, but from a very small base (46,000 units). In the same year, domestic sales accounted for 31% of total sales while exports made up 69%, indicating that the Korean automotive industry has become highly export-oriented (KAMA, 2006).

The success of the Korean automotive industry was not easily achieved.[23] Its evolution may be visualized in five principal stages: the assembly of imported knocked down kits (1960s); the development of the first proprietary models, such as the Pony (1970s); mass production and export (1980s); the development of independent models (1990s); and, after the financial crisis, the globalization of the industry (post-2000). In the first two stages, State-led industrialization policies in the form of import protection for the domestic market, preferential credit allocations, domestic content regulations and export incentives, as well as a particular geopolitical context, were very influential in shaping the industry (Lautier, 2001; Ravenhill, 2001). Towards the later stages, however, indirect initiatives to support the development of high-tech and core technologies were more representative of Korean automotive industry policy (Invest Korea, 2003). Free trade agreements (FTAs) could play a more important role in the international expansion of this industry in the future.

Most of the original Korean automobile assemblers were initially associated with global auto TNCs by way of minor capital shareholdings, acquired for the purpose of accelerating their catch-up processes (for example, HMC with Ford, then with Mitsubishi; Daewoo with General Motors and Isuzu; Kia with Ford and Mazda). However, continuing difficulties in achieving significant technology transfer led Korean government officials to back more independent efforts by these national producers.

Between 1979 and 1997, the principal assemblers ramped up domestic production capacity sharply: HMC from 104,000 to 1,347,000 units; Daewoo from 39,000 to 845,000 units and Kia from 59,000 to 760,000 units. The three companies had also increased their overseas production capacity significantly by 1997: Daewoo to 831,000 units, Kia to 228,000 units and HMC to 170,000 units (Nam, 2005). Daewoo focused mainly on acquiring existing operations in Eastern European countries, such as Romania, Poland and the Czech Republic. Kia tended to establish licensing agreements with knocked down kit assemblers in Asian countries (such as Iran, Pakistan, Philippines and Taiwan Province of China). HMC built a major greenfield plant in Bromont, Canada in 1989; however, this proved to be a strategic error (Nam, 2005) and the plant was closed in 1993. Thus, very aggressive internationalization strategies were deployed by these Korean automobile assemblers.

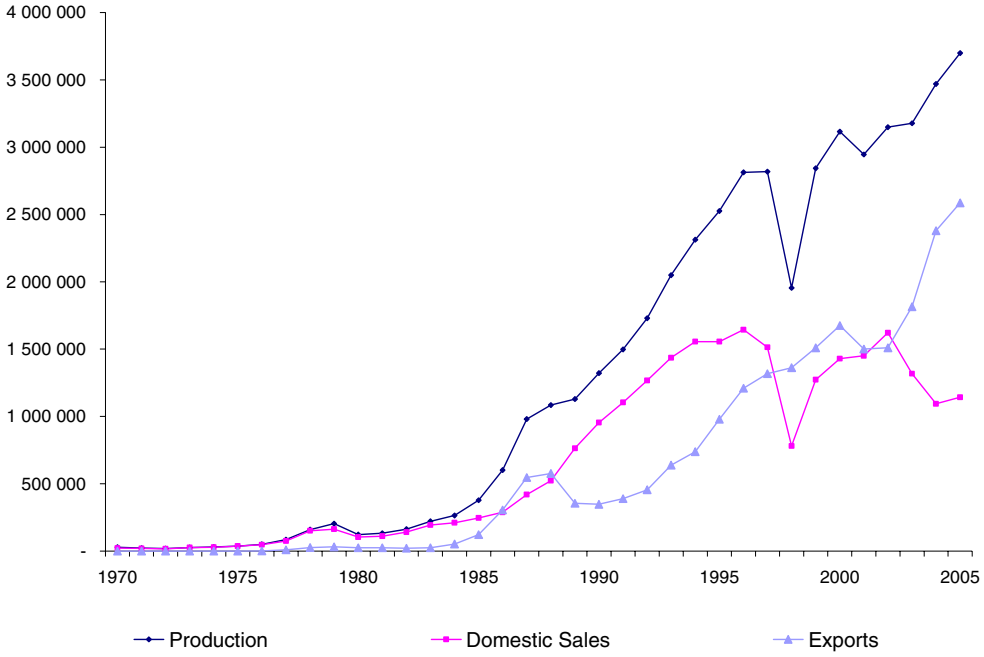
The rapid expansion of the industry's production capacity could not hide the fact that it suffered from a number of significant problems. Among its main shortcomings was its weak international competitiveness, which was due to continuing difficulties in accessing the best technology from foreign partners, coupled with Korean firms' limited technology generation capabilities of their own, as well as poor quality products, costly or poor quality locally-produced parts and components, rising local labour costs and premature internationalization (Lautier, 2001; Lee and Pai, 2004). In the 1990s, the combined

[23] In many ways, Korean automotive manufacturing reflected the systemic crisis that affected the country's development trajectory as a whole, insofar as the ongoing dispute between "techno-nationalists" (in favour of State-led industrial policy) and "techno-rationalists" (more comfortable with market-led initiatives) was played out in the evolution of the industry. The industry underwent a fundamental shift as a result of the 1997 financial crisis (Ravenhill, 2001), as did the Republic of Korea's development trajectory in general.

effects of these problems eventually led to huge and unsustainable debt-equity levels —in the order of 640%— among the principal Korean automobile assemblers. Kia Motors alone had debts in excess of US$ 6 billion.[24]

Some of the strongest impacts of the 1997 financial crisis in the Republic of Korea were felt precisely in the automotive industry. First, only those companies in a position to rapidly increase exports when domestic sales collapsed —such as HMC and Kia— had a chance of surviving intact. In the case of Kia, the firm's excessive foreign debt caused it to founder. Second, each of the other three producers, none of which had a proprietary model, were acquired by foreign automobile companies: General Motors (USA) purchased a major interest (44.6%, now 50.9%) in Daewoo Motor in 2002, Renault (France) acquired a controlling stake (70.1%) in the automotive wing of Samsung in 2000 and SAIC (China) bought 48.9% of Ssangyong in 2005. The industry leader in the Republic of Korea, HMC, acquired both Kia and Asia Motors in 1998.[25] Thus, the financial crisis devastated the Korean automotive industry by destabilizing producers and collapsing domestic sales (see figure III.5).

Figure III.5
THE KOREAN AUTOMOTIVE INDUSTRY, 1970-2005
(Numbers of units)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Korea Automobile Manufacturers Association (KAMA), *Annual Report 2006- Korean Automobile Industry*, Seoul, 2006.

[24] Government indecision about how to deal with Kia (first declining to intervene, then nationalizing the company, followed by two unsuccessful auctions of its assets) weakened market confidence in its ability to handle the debt crisis and negatively affected credit ratings. The bankruptcy of Daewoo compounded these problems (Ravenhill, 2001).

[25] HMC had recovered from the failure of the Bromont venture and had investment funds available, partly because the Korean government did not actively support its overseas investment projects in 1993-1997 after the President of HMC unsuccessfully entered the running for the presidency of the Republic of Korea. As a result, HMC was not as internationally exposed as its Korean competitors, such as Kia and Daewoo.

The structure of the Korean automotive industry changed dramatically after the financial crisis. Whereas domestic sales had driven growth during the 1980s and early 1990s, the heavy slump in these sales made exports the new engine of growth. By 2005, exports accounted for almost 70% of overall sales. Reflecting the tastes of foreign consumers, medium-sized passenger cars and SUVs increasingly replaced small vehicles as the dominant outputs of the Korean automotive industry. The principal export markets were North America and Europe; however, emerging markets gathered momentum after the year 2000, especially for knocked down kits. HMC and Kia were able to weather the dislocation of the financial crisis and continue to grow by specializing in higher-value-added medium-sized passenger cars and SUVs and by increasing exports. HMC raised its production from 770,558 units in 1998 to 1,683,760 units in 2005. Kia's production jumped from 362,947 units in 1997 to 1,105,170 in 2005. Daewoo rapidly recovered its 1997 level of production; however, its export performance was erratic until General Motors (GM) acquired control of the company. Thereafter, it did successfully export vehicles assembled in the Republic of Korea and knocked-down kits, exceeding the 500,000 unit milestone in 2005 with the assistance of the GM international system. Ssangyong floundered until its takeover by SAIC, and even then suffered a 22.8% drop in sales in 2005. Samsung recovered after it was purchased by Renault; however, its export performance was poor.

In spite of the sharp rise in foreign participation in the Korean automotive industry, HMC consolidated its presence with a market share of about 50%, in addition to the 23% corresponding to Kia (Hyundai Motor Company, 2006b). Its share of exports reached 43.7% in 2005, plus Kia's 32.4%. These two companies were able to utilize a far higher proportion of their production capacity than their competitors in the Republic of Korea. For that reason, the recent history of the Korean automotive industry is mainly about the evolution of HMC (see table III.14). The company's success has been described as "one of the most surprising turnabouts in automotive history" (*TimeAsia,* 25 April 2005).

Table III.14
KOREAN AUTOMOTIVE INDUSTRY PERFORMANCE, BY MANUFACTURER, 2005
(Number of units and percentages)

Producers/Aspect	Production capacity (KARI)		Production (KAMA)		Domestic sales (KAMA)		Exports (KAMA)	
HMC	1 850 000	41.1	1 683 760	45.5	570 814	50.0	1 131 211	43.7
Kia	1 250 000	27.7	1 105 170	29.9	266 508	23.3	838 513	32.4
Subtotal HMC Kia	3 100 000	68.8	2 788 930	75.4	837 322	73.3	1 969 724	76.2
GM Daewoo	1 060 000	23.5	648 788	17.5	107 583	9.4	544 809	21.1
Ssangyong	220 000	4.9	135 901	3.7	75 527	6.6	65 521	2.5
Renault-Samsung	125 000	2.8	118 438	3.2	115 425	10.1	3 610	0.1
Others	n.a.	n.a.	9 293	0.3	6 705	0.6	2 424	0.1
Total	4 505 000	100.0	3 699 350	100.0	1 142 562	100.0	2 586 088	100.0

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Korea Automotive Research Institute (KARI), *2006 Korean Automotive Industry*, Seom, Hyundai Motor Co., 2006 and Korea Automobile Manufacturers Association (KAMA), *Annual Report 2006- Korean Automobile Industry*, Seoul, 2006.

(a) Hyundai Motor Company (HMC)[26]

The Hyundai Motor Company (HMC) was established in 1967 as part of the Hyundai *chaebol*. It was actively involved in the Republic of Korea's Heavy and Chemical Industries (HCI) initiative. It evolved in three clear phases: (i) the development of an independent proprietary model; (ii) the establishment of large scale production; and (iii) the establishment of a global network (Nam, 2005). In the first phase, starting in the 1960s, HMC assembled knocked-down United States models (New Cortina and Ford 20M) in the Republic of Korea, with the technical assistance of Ford. But this was not a satisfactory experience for HMC and it adopted a self-reliant, export-oriented strategy, developing its own models. In 1974 HMC designed and manufactured the Republic of Korea's first independent car model, the Pony, which it exported to Latin America and the Middle East in the mid-1970s. In the case of the Middle East, HMC piggybacked on the presence of Hyundai Heavy Industries there. Production rose from 10,000 units in the early 1970s to 140,000 in 1984 and the company attained a 90% localization rate for the Pony model by 1976. Nevertheless, those exports peaked in 1980 and HMC developed its second proprietary model, the Stellar, in 1983.

The company's initial success with its own proprietary models allowed it to contemplate the second phase of expansion. This consisted of a huge increase in economic scale, the development of its own proprietary engine, increased exports and the beginnings of FDI-driven internationalization in the mid-1980s through to the 1990s. Much of the success of HMC in coming to dominate the Korean automotive industry derived, first, from its technical cooperation agreement with Mitsubishi, which was more satisfactory than the previous arrangement with Ford. Mitsubishi purchased 10% of the shares in HMC and the HMC plant built in 1980 was based on Japanese technology.[27] Second, rising demand by Canadian and United States customers for Korean vehicles was also a driver in the company's success.[28] HMC production capacity in the Republic of Korea rocketed from 240,000 units in 1985 to 1,347,000 in 1997. HMC also sought to increase its overseas production. Low quality products and rising labour costs caused a sharp fall in United States sales between 1989 and 1993, however, and the Canadian factory in Bromont was closed in 1993. HMC became much more cautious than its Korean competitors about further internationalization in the form of FDI, even though it did maintain small knocked down kit plants in Botswana, Egypt, the Philippines, Thailand, Malaysia and Zimbabwe. Given its difficulties with FDI as a channel of internationalization, HMC concentrated its production expansion in the Republic of Korea itself, where it possessed several world-class plants, such as Ulsan (which became one of the world's largest automobile factories), Asan (which became the world's most automated factory) and Chonju. Nevertheless, the 1997 financial crisis destabilized HMC, at the same time as it presented the company with the strategic opportunity to acquire the assets of Asian Motors and Kia. In view of the new situation that developed after the financial crisis, HMC set its sights on becoming a global automobile TNC.

Seeking to boost its sagging international sales, build trust in its products and demonstrate its seriousness about vehicle quality, HMC became the first carmaker to offer a 10-year warranty in the United States market. Its success in this gave it a basis from which to extend its technological independence to higher-value-added vehicles, which, in turn, increased profits. Nonetheless, although HMC is expected to be the fastest-growing assembler of light vehicles among all the major automotive

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[26] Based on interviews at HMC and Kia headquarters in Seoul, as well as Hyundai (2006a, 2006b, 2005 and 2004) and Nam (2005).

[27] In 1982 that technical cooperation evolved into a strategic alliance.

[28] HMC entered the Canadian market in 1984 and the United States market two years later. In 1986, HMC exported 300,000 cars to the United States.

TNCs in 2005-2010, it still has to catch up in terms of its R&D effort, which, at 1.5% of total revenues, is about one quarter of the resources allocated by other leading automotive TNCs (Autofacts, 2006). With renewed confidence, HMC embarked on a new and more coordinated strategy of internationalization through FDI, including the integration of the Asia Motors and Kia assets.[29]

The logic of HMC global business is evident in the structure of its assets. Its Korean manufacturing assets consist of the Ulsan, Asan and Jeonju plants. Ulsan, the principal manufacturing hub, consists of five independent manufacturing facilities with 34,000 employees and a production capacity of 1,530,000 units (the Accent and Getz models are made in plant one; the Santa Fe, Centennial, and Tucson models in plant two; the Elantra, Hyundai Coupe, and Matrix models in plant three; the H-1, Trajet, H-100 and H-1 trucks in plant four; and the Terracan and Tucson SUVs in plant five). The Asan plant makes mainly passenger cars for export and possesses a production capacity of 290,000 units. The Jeonju plant specializes in heavy duty commercial vehicles, including buses and trucks, and has a capacity of 60,000 units.

The company's main international manufacturing facilities are located in China, India, Turkey and the United States. In the first three, HMC was a first mover and achieved significant national market shares. The Hyundai plant in Turkey, Hyundai Assan Otomotiv Sanayi (HAOS), represents a transitional facility towards the new global business. Established in 1993, it was a joint venture with the Kibar Group, a small-scale undertaking aimed at making inroads into Turkey's domestic market and taking advantage of its bilateral treaties with Middle Eastern countries and in the belief that Turkey would soon become a member of the European Union. Seeing great potential, HMC eventually started producing the Accent small passenger vehicle (capacity 50,000 units) and the Grace van (20,000 units) at HAOS, but sales and exports were poor. HMC then set about revitalizing the facility, strengthening the product line-up with the launch of the Verna model, expanding the dealer network to 80 agents and aiming to increase capacity to 100,000 by 2007.

The Hyundai Motor India (HMI) plant near Chennai was a US$ 457-million greenfield investment with a production capacity of 120,000. It began making the Santro and Accent models in 1990 (80,000 and 40,000 units, respectively). Much of the machinery and equipment for Chennai came from the failed Bromont plant in Canada. HMC has reached a localization rate of 70% for parts by convincing 13 Korean parts suppliers to enter into joint ventures with local operators and 38 local suppliers to set up within 50 kilometres of the HMI plant. This plant has been very successful. The Santro was named "Car of the Year" in India in 1999 and the HMI plant began to turn a profit by 2000. It was later upgraded to regional headquarters for exports to developing countries and made a source of core components, such as engines and transmissions. HMI has a very significant share of the Indian market. Recently, HMC decided to strengthen the product line-up by adding the Verna and Getz models, increase the number of dealers to 220, add a third shift and build a second plant. In 2006, it sold 280,000 units, 189,000 in the domestic market and 91,000 as exports.

The Beijing Hyundai Motor Company (BHMC) joint venture with Beijing Automotive Holding Company was the first stage of a major commitment in China. The main objective was to secure a strong market share there. It began in 2002 as a relatively small US$ 200-million plant with a production

[29] Kia owned plants in the Republic of Korea at Sohari, Hwasung, Kwangju and Suhsan. Its main manufacturing facility abroad is in Slovakia, although it also has knocked down kit plants in the Bolivarian Republic of Venezuela, Indonesia, Iran, Namibia, Pakistan, the Philippines, Taiwan Province of China and Viet Nam. HMC and Kia share overseas R&D facilities in Germany, Japan and the United States. On 6 September 2005, Kia announced plans to build a new plant with capacity for 400,000 units, worth US$ 1.2 billion, in Georgia, United States.

capacity of 50,000 units for the Sonata model. It was later upgraded with a US$ 430-million investment to increase production to 200,000 units, half for the Sonata and half for the Elantra. Lastly, a fresh investment extended production capacity to 500,000 units and prepared for production of the Tucson and Verna models. This plant has been exceptionally successful. An engine-manufacturing plant with a capacity of 150,000 was added. The BHMC plant has the highest single market share in China, at 9% in 2006. Plans are under way for a second plant with a 300,000 production capacity.

The Hyundai Motor Manufacturing Alabama (HMMA) plant in the United States was the new HMC local production base for North America. Its was intended to increase the firm's market share in the United States and avoid trade disputes with the United States government. The US$ 1 billion investment was a fully-fledged plant complete with testing facilities and a production capacity of 235,000 units. It was to manufacture the Sonata model to compete with the most popular vehicles in the United States market: the Toyota Camry and the Honda Accord. The HMMA plant has a automation rate and ratio of modular production superior to the Asan plant in the Republic of Korea. It has won awards for quality and its 2006 sales reached 275,000, of which 242,000 were local sales and 34,000 were exports. Now the Santa Fe model is to be added to the line-up. Interestingly enough, HMC (and Kia) undertook major investments in the United States market at the same time that an FTA between the two countries was being considered by the two governments.

HMC intends to further expand its overseas capacity from 910,000 units to 1,820,000 units by increasing capacity in China to 600,000 units, in India to 250,000 units, in Turkey to 120,000 units and in Europe (Czech Republic) to 300,000 units. HMC consolidates its global business by way of R&D centres in the main markets: the United States (California and Michigan), Europe (Germany) and Asia (Japan). In other words, although HMC may initially have simulated the trajectories of Japanese automobile TNCs, today it is rapidly consolidating as an innovative global automobile manufacturer.

In sum, the automobile industry represents another prime example of successful industrial and technological upgrading to create a Korean-based global TNC. It began by following the Japanese trajectory but soon developed its own characteristics in terms of models, markets and global production networks. From the perspective of technological catch-up, the industry may be considered to have adopted a path-skipping trajectory (Lee and Kim, 2001). The success of HMC is all the more noteworthy because it was capable not only of recovering from a disastrous initial internationalization process, in which it lacked clear competitive advantages (Nam, 2005), but of learning from that experience in order to construct a truly competitive global business thereafter. As it evolved, HMC has demonstrated several internationalization objectives —accessing markets, reducing production costs, obtaining technology and strategic locations— and has pursued these with varying degrees of vigour at different stages (Moon, 2005).

The Korean automobile industry is now facing a number of challenges related to the globalization process. The rapid appreciation of the Korean won is placing limits on future automobile exports and increasing the attractiveness of models imported into the Korean market (especially from Japan and Germany). Manufacturers are being pressed to further raise the quality of their products in order to improve their brands and it is probable that Korean automobile manufacturers will expand further by way of OFDI.

3. The international expansion of the textile and apparel industry

The textile and apparel industry has played a significant role in the Republic of Korea's national industrialization process, even though its contribution to manufacturing GDP has declined sharply since it peaked at over 20% in the 1970s (see figure III.1). Apparel provided early export earnings and synthetic textiles were a key part of the HCI initiative, which laid down a solid petrochemical industry in the country. The industry's staying power as a driver of the Korean development trajectory is attributable to its ability to adapt to the changing rules and restructuring process of the international textile and apparel industry. However, in view of the current challenges, especially the heightened competition from China and India, the Republic of Korea will have to consider accelerated upgrading of the industry and its technology if textiles and apparel are to continue to play a significant role in the future.[30]

Following Japan's example, the Republic of Korea and other newly industrializing South-East Asian economies (such as Hong Kong SAR and Taiwan Province of China) experienced notable success by latching onto the textile and apparel industry to initiate exports and take the first steps towards forming a national industrial base. The spectacular success of Asian newly industrialized countries (NICs) in winning international market shares in the leading industrial economies elicited a harsh response from the respective governments in the form of restrictive trade practices and preferential trade agreements that blunted this export drive. Recently, however, new multilateral rules have brought fresh —and stiffer— competition into the international textile and apparel industry (see box III.2). Many Korean firms adapted to the changing rules by opting for new corporate strategies involving OFDI (see box III.3).

Historically, the textile and apparel industry was considered the mother of the Republic of Korea's modernization drive (KOFOTI, 2005). Although it now lags behind the more dynamic sectors of the Korean economy, it still represents a significant part of the manufacturing sector: 16.2% of firms, 12% of employment and 6.5% of value-added (see table III.15). The international competitiveness of the Korean textile industry is reflected in its world ranking as the largest exporter of synthetic fibres and the fourth largest exporter of both synthetic textiles and textiles overall. Notably, the Republic of Korea accounts for over 10% of global exports of polyester filaments. Nonetheless, the principal Korean textile companies are not global heavyweights as the Korean electronics and automotive industries are and the apparel companies are currently hard-pressed to remain internationally competitive against the rise of China, India and other major producers.

Figures III.6 and III.7 indicate that the competitiveness of both textiles and apparel slipped considerably during the 1990s. In the case of apparel, imports to the Republic of Korea grew significantly as well, thus lessening the favourable balance-of-payments impact that the sector had generally achieved. The Republic of Korea's international market share of textiles had grown from 4% to 8.2% in 1980-2000, but by 2004 this share had declined to 5.6%. The international market-share loss of the Korean apparel segment was even more dramatic: having stabilized around 7.3% in 1980-1990, it had fallen precipitously to just 1.3% by 2004 (Choi, 2006). In 2005 alone, the United States market share of Korean apparel fell by 26% and that of textiles by 4.5%. The market share of Korean textiles and apparel in the European Union declined by an astounding 58.2% in that same year (Park, 2006).

[30] Along with industrial and technological upgrading, in the case of textiles and apparel the FTA currently being negotiated with the United States could also boost the industry by lowering import tariffs and improving market access (KOFOTI, 2006a).

Box III.2

THE INTERNATIONAL TEXTILE AND APPAREL INDUSTRY: DEALING WITH THE EFFECTS OF DISTORTED TRADE

In response to the rapid success of developing country apparel exporters, many industrialized countries tried to recover lost market shares or slow the decline of their own textile and apparel industries by implementing restrictive trade practices. For example, the Multifibre Arrangement of 1974 authorized the major importing countries to impose quotas on the principal exporters of apparel. This led producers, from both importer and the major exporting countries, to establish assembly operations in third countries where they could use the local quotas to export to large markets, even if those countries lacked absolute comparative advantages. Such assembly operations were usually located in export processing zones in lower-wage countries. Thus, some developing countries that foreign investors would not otherwise have considered for apparel assembly suddenly became important FDI destinations.

Some of the principal importer countries followed up with bilateral trade agreements containing rules of origin, which provided incentives for the use of domestically-produced textile inputs and made those of the exporters' local industry relatively uncompetitive. For example, the Government of the United States designed and implemented such mechanisms as "production sharing" under section 807 of the Tariff Schedules of the United States (TSUS) and, later, heading 9802 of the Harmonized Tariff Schedule of the United States (HTSUS), as well as preferential trade agreements (such as the Caribbean Basin Economic Recovery Act of 1983, which evolved into the Caribbean Basin Trade Partnership Act of 2000, and, later, the Dominican Republic —Central America— United States Free Trade Agreement (CAFTA-DR) in 2005, and the North American Free Trade Agreement (NAFTA) in 1994). Such arrangements supported the United States' national textile industry by encouraging the duty-free incorporation of United States components, such as cloth, thread, buttons, and so on. Mexico and many Caribbean Basin countries thus became principal suppliers to the United States market, but in the process confined their activities to apparel assembly using the more expensive United States inputs, which complied with the respective rules of origin. Many of the Asian apparel exporters who were thus disadvantaged saw their direct United States market shares fall, although some adeptly used "triangular manufacturing" arrangements to establish apparel assembly facilities in developing countries with unfilled quotas or special access, including Mexico and Caribbean Basin countries.

A new Agreement on Clothing and Textiles negotiated in the context of the trade liberalizing agenda of the General Agreement on Trade and Tariffs (later, the World Trade Organization) and implemented in 1995 required the phasing out and elimination of quotas over the following 10 years. This made the textile and apparel industry even more intensely competitive and the main beneficiaries will undoubtedly be those countries that possess competitive integrated textile and apparel industries, most notably China and India and a small number of other countries, such as Pakistan, the Republic of Korea and Taiwan Province of China, which can offer buyers the "full service package" through their global networks. Thus, market economics are being re-established in the global textile and apparel industry and the existing distortions are being reduced.

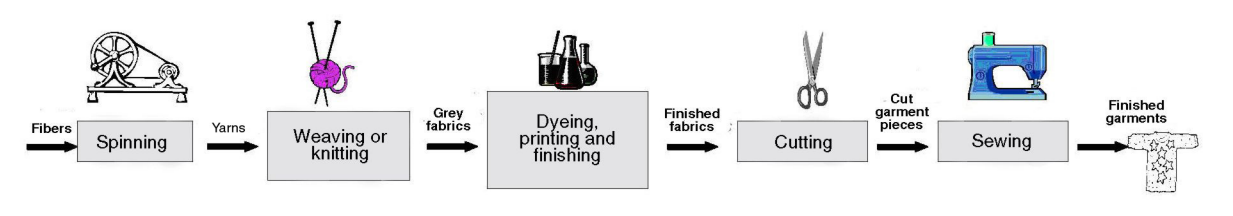
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Cotton USA, "Cotton USA sourcing program" [online] 2006 http://www.cottonusasourcing.com; G. Gereffi, "International trade and industrial upgrading in the apparel commodity chain", *Journal of International Economics*, vol. 48, 1999; Michael Mortimore, "Illusory competitiveness: the apparel assembly model of the Caribbean Basin", *INTECH Discussion Paper Series*, No. 2003-11, Maastrict, Institute for New Technologies, United Nations University, November 2003 and "When does apparel become a peril? On the nature of industrialization in the Caribbean Basin", *Free Trade and Uneven Development: The North American Apparel Industry after NAFTA*, G. Gereffi, D. Spener and J. Bair (eds.), Philadelphia, Temple University Press, 2002; United Nations Conference on Trade and Development (UNCTAD), "TNCs and the removal of textiles and clothing quotas", *UNCTAD Current Studies on FDI and Development*, No. 1, New York, 2005 and *The Competitiveness Challenge: Transnational Corporations and the Industrial Restructuring of Developing Countries*, New York, October 2000; International Trade Commission (ITC), "The impact of the Caribbean Basin economic recovery act- seventeenth report 2003-2004", Investigation 332-227, *ISITC Publication*, No. 3804, Washington, D.C., September 2005 and "Textiles and apparel: assessment of the competitiveness of certain foreign suppliers to the U.S. market", Investigation 332-448, *USITC Publication*, No. 3671, Washington, D.C., January 2004.

Box III.3

THE INTERNATIONALIZATION OF THE TEXTILE AND APPAREL INDUSTRY

The fact that the value chain of the textile and apparel industry could readily be broken into its principal components facilitated its early internationalization. The key elements of these (now global) value chains are the supply of textiles for yarn production (i.e., natural fibres like cotton, wool, silk, and so on, synthetic fibres such as polyester, nylon and acrylic, and artificial fibres like rayon or acetate), the provision of components (cut or uncut fabrics, thread, buttons, and so forth), the assembly of the apparel, the definition of the export channel, and the marketing carried out at the final point of sale. The first four components of the value chain could be located geographically to work around trade distortions in the form of quotas or preferential trade agreements with strict rules of origin.

THE TEXTILE AND APPAREL VALUE CHAIN



Taking the United States market as an example, United States manufacturers (such as Sara Lee, Levi Strauss, Warnaco or Fruit of the Loom) could thus move the assembly of apparel offshore in order to reduce costs and tackle import competition from Asia. New economic agents also emerged to take advantage of the evolving situation. "Lean" retailers and branded marketers were able to improve their negotiating relations with manufacturers to such an extent that previously producer-driven value chains became increasingly buyer-driven. Branded marketers, such as Liz Claiborne, Donna Karan, Nike and Reebok possessed very few production facilities because they outsourced to offshore assemblers. Such retailers as JC Penney, Sears and so forth emulated branded marketers by employing their own private labels or brand names which were assembled abroad.

This provided important opportunities for developing-country companies that were in a position to service the new needs of United States retailers and branded marketers. The most successful were those that went beyond final product assembly in low-wage sites using buyer-provided components and began to provide "full package" services. In the case of Asian companies, full package services typically included product development, fabric sourcing and cutting, garment sewing, packaging, quality control, trade financing and logistics arrangements. Successful examples include Li & Fung and Yue Yuen / Pou Chen Industrial Holdings (both Hong Kong SAR and China), Nien Hsing (Taiwan Province of China) and Sae-A (Republic of Korea), which often assembled final products in third countries from which they exported to end markets ("triangular manufacturing"). Coupled with the return of market economics to the global apparel industry, lean retail provided opportunities for Asian full package providers in China, Hong Kong SAR, the Republic of Korea and Taiwan Province of China.

In other words, the textile and apparel value chain's separability into its component parts allowed for new corporate strategies employing offshore sourcing in the form of efficiency-seeking FDI. United States apparel manufacturers typically established offshore assembly operations in Mexico and the Caribbean Basin in the context of trade restrictions established by the United States to help them —as well as United States textile manufacturers such as Burlington Industries, Cone Mills, Parkdale Mills and Guilford Mills— face up to competition from Asia. United States retailers and branded marketers typically outsourced to Asian assemblers with assembly sites both in Asia and Mexico and in the Caribbean Basin. In turn, the more successful Asian companies usually developed full package facilities to satisfy their United States customers and to upgrade their own business into original design and brand manufacturing. In this way, internationalization played a significant role in the evolution of the Asian textile and apparel industry.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Trade Commission (ITC), "Textiles and apparel: assessment of the competitiveness of certain foreign suppliers to the U.S. market", Investigation No. 332-448, USITC Publication 3671, Washington, D.C., January 2004.; R. Applebaum, "Assessing the impact of the phasing-out of the agreement on textiles and clothing on apparel exports on the least developed and developing countries", May 2004, unpublished; Cotton USA, "Cotton USA sourcing program" [online] 2006 http://www.cottonusasourcing.com; Economic Commission for Latin America and the Caribbean (ECLAC), *Foreign Investment in Latin America and the Caribbean, 2003* (LC/G.2226-P), Santiago, Chile, April 2004, United Nations publication, Sales No. E.04.II.G.54 and *Foreign Investment in Latin America and the Caribbean. 1999 Report* (LC/G.2061-P), Santiago Chile, January 2000, United Nations publication, Sales No. E.00.II.G.4; G. Gereffi, "International trade and industrial upgrading in the apparel commodity chain", *Journal of International Economics*, vol. 48, 1999; International Trade Commission (ITC), "The impact of the Caribbean Basin Economic Recovery Act- seventeenth report 2003-2004", Investigation 332-227, *ISITC Publication*, No. 3804, Washington, D.C., September 2005; United Nations Conference on Trade and Development (UNCTAD), "TNCs and the removal of textiles and clothing quotas", *UNCTAD Current Studies on FDI and Development*, No. 1, New York, 2005 and *World Investment Report 2002. Transnational Corporations and Export Competitiveness*, New York, August 2002.

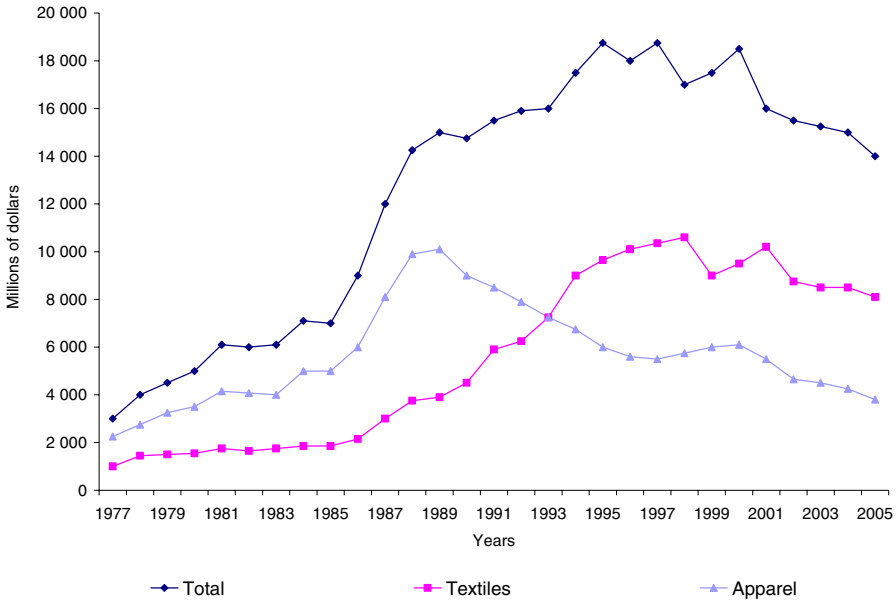
Table III.15
STRUCTURE OF THE KOREAN TEXTILE AND APPAREL INDUSTRY, 2003

Segment / Industry	Number of firms	Employees (Thousands)	Value-added (Billions of won)
1. Synthetic fibres	89	185	1.8
2. Textile processing[a]	9 397	12	9.3
3. Apparel	8 729	132	5.6
Textile and apparel industry	18 215	329	16.7
All manufacturing	112 662	2 735	255
Textiles and apparel as a percentage of manufacturing	16.2%	12.0%	6.5%

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of National Statistical Office, *2003 Statistical Survey Report on Mining and Manufacturing Industries*, Seoul.

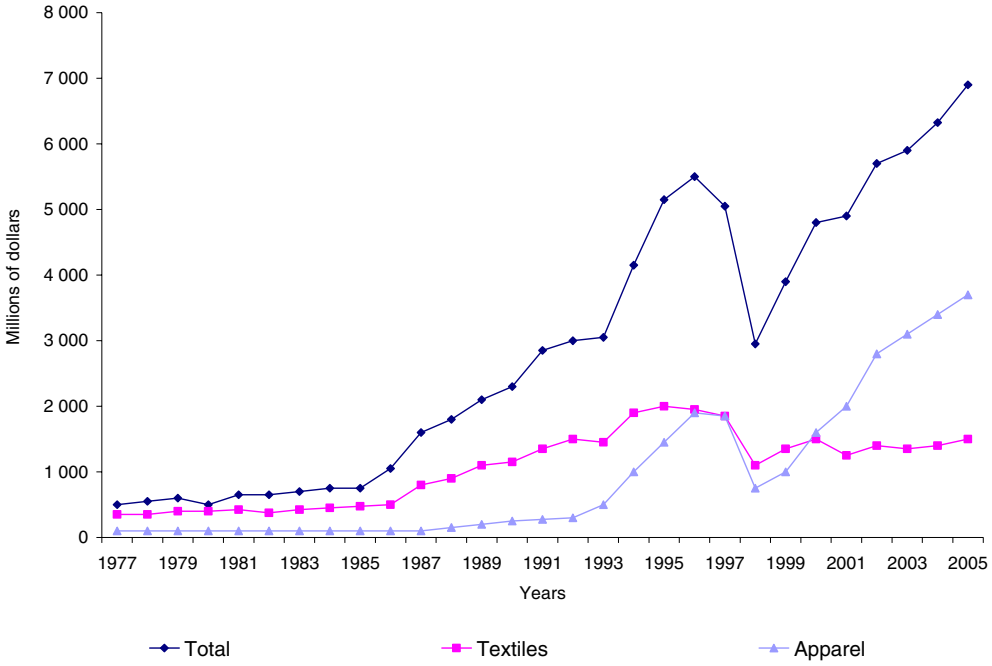
[a] Includes weaving, knitting, fabrics manufacturing, dyeing, and so forth.

Figure III.6
KOREAN EXPORTS OF TEXTILES AND APPAREL, 1977-2005



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Korea Federation of Textile Industries (KOFOTI), *Textile and Fashion. Annual Edition*, March 2006.

Figure III.7
KOREAN IMPORTS OF TEXTILES AND APPAREL, 1977-2005



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Korea Federation of Textile Industries (KOFOTI), *Textile and Fashion*. *Annual Edition*, March 2006.

A host of factors were involved in the loss of international competitiveness of Korean textiles and apparel. Among the most important were increasing wage rates in these industries in the Republic of Korea, the appreciation of the Korean won, rising international petroleum prices, labour shortages in these sectors, the emergence of China as a strong competitor with the abolition of export quotas in major markets, weak export marketing strategies and the lowering of design standards (Park, H., 2006). The apparel and spinning and weaving sectors were particularly badly hit by competition from lower-wage Asian countries (Choi, 2006).

To revert the decline in its international competitiveness in the textile and apparel sector, the Republic of Korea prepared a five-year technology innovation plan in the context of the shift towards the knowledge economy. The detailed roadmap associated with the five-year plan is summarized in table III.16.

Table III.16
REPUBLIC OF KOREA: ROADMAP FOR TECHNOLOGY DEVELOPMENT TASKS

Vision		**Production of world's first super-class, smart, intelligent and high-tech textile goods**
Future prospects		Textile products to be used in world's cutting-edge industries Grafting of IT, industrial textiles and dyeing and processing technologies Development of future-oriented, smart and intelligent apparel products
Core technologies		Super-high-tech industrial textiles, IT-ization of dyeing and processing and intelligent apparel products
Technologies to develop industrial textiles and new state-of-the-art materials	High-function textiles using phase changing materials (PCM)	Automatic temperature control textiles made by melt spinning of PCMs Textiles with applications of different kinds of functional materials, such as sensitizing dyes, thermochromic dyes, aromatics and vitamins
	Environmentally friendly biodegradable complex textiles	Dyeing and processing of polylactic acid (PLA) textiles, bean textiles and polyester-modified biodegradable textiles
	High-clean, environment-improving complex textiles	Super-efficient filters for air and water purification Filters for electron waves, acoustic and dust absorption and deodorization
	Biocompatible health care textiles and products	Medical textiles, blood filter textiles, textiles for moisturization of artificial skin, skin-care textiles with wound-treating properties
	New biotech-fusion environmentally friendly materials	Bio-textiles using animal-derived collagen (ADC), bio-polyester, spider silk, dyeing and processing for bio-textiles
	High-function textiles for use in tyre cord	Tyre cord yarns superior to existing polyethylene terephthlate (PET) materials, development and application of polyethylene naphthalate (PEN) textiles and modified cellulose for tyre cord
Digital, intelligent fashion apparel technologies	Digital-technology-enabled fashion apparel	Systems for 3D cyber space filling and 3D tailoring; technology for computer simulation, for artificial-intelligence control and management and for image processing and sensor applications; and technology for cyber fashion show materials and applications.
	Intelligent textile apparel	Intelligent textile apparel that can monitor the wearer's physical condition and actions, transmit data and report on monitored results for military and medical applications and for the elderly or infirm.
	Internet-based fashion apparel products	Application Service Provider (ASP) solutions for web-based and computer-aided design (CAD) and patterns for apparel, fashion-oriented web-enabled PDAs (for manufacturing of fashion materials and products and processing of logistics), bar-code systems for next-generation fashion products
	Design/manufacturing technologies for intelligent special protection clothes	Apparel that can sense changes in the external environment and react intelligently, for use in extreme sports (e.g., motorcycle racing, skydiving, hang gliding, paragliding, skin diving, wind surfing, rock climbing), airbags and military applications, among others.
	Smart apparel for daily life in the future	New kinds of apparel integrating various digital devices and functions, flexible digital devices that can be grafted onto apparel and applied products.
	New textiles incorporating biometrics technology	New textiles and fashion apparel products created through biometrics applications, unique synthesized super-bulky-feel fabrics

Table III.6 (concluded)

Vision		**Production of world's first super-class, smart, intelligent and high-tech textile goods**
State-of-the-art dyeing and processing technologies	High-value-added textile products made with next-generation clean digital textile printing systems	Digital textile printers, digital textile printing dyestuffs and textile products manufactured using these applications.
	Wear-comfort, easy-care, high-fashion products and high-tech dyeing and processing	Wrinkle-free natural textiles, wash-and-wear natural textile products with excellent stability for washing, dyeing and technological processing
	IT-grafted dyeing and processing technology and products	IT-grafted dyeing automation facility, creation of standardized facilities and an integrated system, automatic inspection systems and high-tech textile products applicable to these systems.
Policy suggestions		Textiles and fashion must be seen not as a declining industry but as a knowledge industry that is grafting the latest technology, culture and information. Awareness and active support is needed from the government to facilitate the development and production of the world's super-first-class, smart, intelligent and highly advanced textile products by inducing the industry to create unlimited value-added through utilization of its intangible knowledge assets —design, fashion, cutting-edge technology, marketing, informationization, and so forth.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Korea Federation of Textile Industries (KOFOTI), *Textile and Fashion*. *Annual Edition*, March 2006.

In essence, the new strategy is to move into higher-value-added segments by restructuring "losers", through fierce price competition played out in downsizing and offshoring, and promoting "winners", as a function of design and quality and through new product development and improved marketing strategies (Oh, 2002; KOFOTI, 2005; Park, H., 2006). In the textile industry, this involves moving into new materials, such as nano-fibres, industrial textiles and smart fabrics, and the use of modern techniques for digital dyeing and printing. The Korea Institute of Industrial Technology (KITECH) set up a research and development centre to help achieve these goals. In the apparel segment, it is necessary to enter the fashion industry by way of product and brand development and to continue to reduce manufacturing costs through improved supply chain management and marketing strategies (Park, S-H, 2006). The focus would thus move towards the manufacture of original designs. The success of the new strategy will depend on the textile and apparel companies investing in new technologies, restructuring their existing assets and establishing competitive internationally integrated production systems to service major markets.[31]

[31] Korean companies are investing in high-tech or smart fabrics and sophisticated dyeing techniques. Sojin TNA Co. developed breathable fabrics, notably its Brespo PCM smart fabric that automatically controls temperature for sports, casual and outwear clothes. Similarly, GNTX developed functional fabrics, such as Dupore-X Megafeel, which are used in garments designed to protect the wearer against cold and snow while permitting perspiration to evaporate (KOFOTI, 2005). YoungShin Textile Co. became a leading textile dye processor by acquiring patents as well as developing its own patented processes. It also began using its own brands (Single Player and Foo) and established a relatively large, state-of-the-art plant in Guatemala (Young Shin Textile, 2006 and company interview). Many Korean textile companies are investing in plants in China, some in order to export from a low-wage base, others to meet domestic demand in that market.

Apparel sector investments typically take the form of OFDI, as confirmed by the existence of over 2,500 overseas projects worth US$ 2.6 billion (*Newsweek*, 2006). Some examples are:

- Sae-A Trading Co. Ltd,[32] which considers itself the Republic of Korea's top apparel manufacturer and export company, lists its principal competitive advantages as global sourcing, with 19 plants in China, Guatemala, Indonesia, Nicaragua, Saipan (Northern Marianas Islands) and Viet Nam, as well as quality assurance enforced through rigorous controls and product development based on design and fabric R&D.

- ShinWon Corporation[33] defines itself as a leader among Korean apparel exporters. Its competitive advantages include a specialized and vertically integrated international production system with plants in China (handbags and leather jackets), Guatemala and Viet Nam (knits) and Indonesia (sweaters), as well as Gaeseong in the Democratic People's Republic of Korea[34] (whose output is marketed in the Republic of Korea); its own sweater designs and brand management (besti belli, SI, VIKI, SIEG and KOLHaaS), and its own commercial outlets in China.

- Hansoll [35] describes itself as one of the leading circular knits companies in the Republic of Korea. Its competitive advantages are a quick response time, based on a two-region international production system, its own designs and R&D in new yarn and fabric. Its global operations take place in an Eastern group of plants located in Cambodia, Indonesia, Saipan and Viet Nam, which produces more complicated products in vertically integrated operations, and a Western group in Guatemala and Honduras, which mainly assembles simpler articles.

- Hansae Co. Ltd [36] competes mainly through competitive pricing, based on its global sourcing and production systems. Hansae owns plants in Cambodia, China, Indonesia, Nicaragua and Viet Nam. It also has substantial subcontracting relationships in Guatemala.

- Youngwon Trade Co. built up its overseas production facilities with 20 plants in Bangladesh, three in China, and one each in El Salvador, Mexico, Turkey and Viet Nam, in order to achieve a more competitive cost structure, production flexibility and a high-speed response ability (KOFOTI, 2006a).

The Korean textile and apparel industry has been an important part of the country's development trajectory, since it initiated the export drive, impacted favourably on the balance of payments and helped to kick-start the Korean industrialization process (as had been the case for Japan previously). The industry's loss of international competitiveness has obliged the Republic of Korea to restructure the weaker elements and to undertake significant industrial and technological upgrading to reduce production costs, develop new products and establish its own brands. The success to date has been partial and differs from the Japanese experience, insofar as many Japanese producers essentially withdrew from the industry when international competitiveness flagged. The internationalization of the Korean textile and apparel industry through OFDI has been crucial in enabling the industry to adapt to increased international competition.

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[32] Based on interviews at Sae-A headquarters in Seoul.
[33] Based on interviews at Shin Won headquarters in Seoul.
[34] ShinWon plans to assemble 15%-20% of its total production in this plant.
[35] Based on interviews at Hansoll headquarters in Seoul.
[36] Based on interviews at Hansae headquarters in Seoul.

4. The internationalization of natural-resource-based manufacturing industries

From the beginning, securing natural resources was an important development goal for the Republic of Korea, since it was an extremely resource-poor country. Many of its principal natural-resource companies began as wholly or partly State-owned enterprises whose assigned purpose was to acquire natural-resource inputs for the industrialization drive. Indeed, this remains an important feature of the present development strategy. In 2001, the country initiated a new 10-year basic plan —which is revised every three years— for securing a steady supply of energy and mineral resources vital for economic development (Hwang, 2006). Nonetheless, for many of these companies now seeking to become major global players, international expansion has come to involve more than simply accessing natural resources. This section looks at examples of Korean companies that process petroleum (SK Corp.), refine copper (LS-Nikko), manufacture steel (Posco) and manufacture forestry products (Eagon).

SK Corp.[37] is the Republic of Korea's leading petroleum refiner and the fourth largest in Asia. It owns important assets in petroleum and gas exploration and production, petrochemicals, and lubricants. It was ranked number 111 in the world in 2005, with sales in the order of US$ 47.1 billion (Fortune Global 500). SK Corp. forms part of the SK Group, which is the fourth largest conglomerate in the Republic of Korea.[38] In 1982, Sunkyoung Ltd acquired the assets held by Gulf Oil Corp. in Korea Oil Corp., whose name was then changed to Yukong Ltd. In 1998, after the financial problems it experienced, Sunkyoung Group was renamed SK Corp. It currently possesses the world's second largest single complex oil refinery (Ulsan, with a capacity of 840,000 barrels per day) and a total refining capacity of 1,115,000 barrels per day (after the acquisition of Inchon Oil in 2005), which represents one third of total Korean refining capacity. SK Corp. exports about 40%-45% of its production (65% in the case of petrochemicals). Already heavily involved in acquiring natural resources around the world through natural-resource-seeking OFDI, SK Corp. intends to increase its foreign trade intermediation in natural resources beyond mere importation: the company aspires to become a leading energy player in the Asia-Pacific region.

SK Corp. possesses 19 petroleum or gas blocks in 12 natural-resource-rich countries, including Australia, Brazil (3), Cote d'Ivoire (2), Egypt, Equatorial Guinea, Eritrea, Indonesia (2), Libya, Peru (3), Russia, the United States and Viet Nam, plus LNG gas projects in Peru, Yemen and other Middle Eastern countries. It has also invested heavily in China, which absorbs 20% of its exports. SK Corp. intends to raise its refining capacity and increase its proven reserves from 420 million barrels of oil equivalent to 700 million by 2010. Thus far, one of the features of SK Corp.'s OFDI is its passivity: in order to minimize risks in new markets it has often formed partnerships with key local players rather than operating alone. Higher international petroleum prices may now provide it with the opportunity to become more aggressive.[39]

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[37] This section was based principally on interviews at the company's headquarters in Seoul, as well as Hwang (2006) and SK Corp. (2006a).

[38] SK Group was known as the Sunkyoung Group until the crisis of the late 1990s. It consists of 52 subsidiaries, of which SK Corp. is the largest, in a range of energy and telecommunications activities. Twelve of the subsidiaries are listed on the Korean Stock Exchange.

[39] SK Corp. implemented a share buyback plan in 2005, also suggesting that it might finance more aggressive international investments.

LS Nikko Copper Inc.[40] operates Korea's principal copper smelter and is Asia's fourth largest producer of copper after firms in China, Japan and India, with sales of US$ 2.7 billion in 2005. It produces mainly copper (76.7%), as well as chemicals and precious metals deriving from copper refining. The Onsam Smelter and Refining Co. was part of the LG *chaebol* until that group was divided into the LG, GS and LS groups in 2004. LS Nikko Copper was founded in 1999 as a joint venture between LG Metal (today LS Cable) and Japan-Korea Joint Smelting Co. Ltd. At present, it is one of the principal subsidiaries of the LS Group, along with LS Cable, LS Industrial Systems, Gaon Cable, E1, Yes'co and others and it secured a solid consumer base in the Republic of Korea through long term contracts with these other subsidiaries. LS Nikko Copper Inc. has sourced copper (through "materials transactions") from numerous countries, although about 55% of its copper ore comes from just three South American nations: Brazil, Chile and Peru. It has also acted as an intermediary for copper transactions with many other countries. The demand for copper in the relatively small Korean market constrained its expansion and made internationalization a necessity. The timing of the firm's establishment —during the Korean financial crisis— seriously constrained its initial internationalization possibilities and explained its interest in establishing a joint venture with a more internationalized Japanese partner. Its internationalization strategy to date has been very cautious, based on quite passive shares in large projects as a means to secure natural resources. LS Nikko Copper Inc. may now be in a position to internationalize more aggressively, however, thanks to the high international prices for the metal.

The Pohang Iron and Steel Co. (Posco)[41] was founded as a State company in 1968 and played a very important role in the HCI phase of Korean development. It was privatized between 1998 and 2000. In 2005, it ranked number 236 in the world, with sales of US$ 25.7 billion (Fortune Global 500), and eighth in the global steel industry. In the same year it possessed total assets of US$ 21.3 billion, of which 14.6% were located overseas. Posco has a production capacity of 32 million tons (about two thirds of the Republic of Korea's total), which is concentrated in hot rolled steel (35.7%), cold rolled steel (28.9%), plate steel (11.5%), wire rods (7%), stainless steel (6.7%) and electrical steel (2.4%), sold mainly to the automotive and shipbuilding industries. Posco also constructs steel plants. Its exports go mainly to Asia (60%, mostly to China and Japan) as well as North America and Europe (25%). Posco is the only Korean company listed on the Tokyo stock exchange (as of 2005).

Posco's main strategy was to focus on sales volume in order to produce price-competitive steel products. However, that strategy was weakened by mounting competition in the steel market, especially from China, a low-cost producer. For that reason, the company set out to become one of the world's most technically-advanced steelmakers, aiming to move upmarket by concentrating on higher-value-added products that would fetch premium prices and be distinguished by their quality. The new strategy relies on making 80% of its products "strategic" ones by 2008 (up from 45% in 2005), increasing its manufacturing capacity (including raising its overseas capacity to 10 million tons), extending its global network and diversifying its international investment portfolio, as well as securing natural resource supplies for its operations. That effort will be supported by an R&D effort equivalent to 1%-2% of sales and an investment fund in the order of US$ 16 billion dollars up to 2009.

Posco's international system was traditionally built on two primary elements. One was securing natural resources (iron ore, coal and energy), as is demonstrated by its joint ventures for that purpose in

[40] This analysis was based primarily on interviews at the company's headquarters in Seoul, as well as LS Nikko Copper Inc. (2006a and 2006b), LS Group (2006), LS Cable (2005), Bloomberg (2006), Stockhouse (2006), Chariot Resources (2006), United States Department of the Interior (2005) and Marcobre (2006).

[41] Based primarily on interviews at Posco headquarters in Seoul, as well as Posco (2006a, 2006b and 2006c), and KOSA.

Australia, Brazil, Canada and South Africa. The other was to gain access to competitive markets, which it did through its affiliates in Canada, Japan, Malaysia, Myanmar, Thailand, the United States and Viet Nam. Like several other Korean natural resource companies, Posco also formed strategic alliances with Japanese companies, in this case steelmakers Nippon Steel and JFE Steel. The new aspects of Posco's strategy are reflected in the huge investments it is undertaking in large markets, such as China and India. An investment of US$ 3.2 billion in China went into 14 strategic ventures, especially the steel complex at Zhangjiagong. The company's venture in India is a US$ 10-billion complex encompassing port infrastructure, mine development and a steel complex at Orissa. Posco also targets steel as part of its internationalization process, specifically for the automotive industry. It has plants for this purpose in China (6), South-East Asia (5), Japan (2), and India and is starting up new ones in China, Japan and Mexico in 2007. In other words, the company's internationalization strategy continues to be based on a mixture of natural-resource-seeking and market-seeking FDI, with the emphasis shifting towards the latter. It has been staking out an international market position between technology leaders from Japan and price competitors in China, by using a new strategy to move upmarket while operating in both those countries.

Eagon Industrial Co.[42] is a small company compared to the others discussed in this section. It was created in 1972 to produce forestry products, after which two shocks strongly influenced the way it evolved. First, in 1979, a shortage of natural resource inputs —trees— in the Republic of Korea led the company to work towards becoming an integrated operator in the industry, spanning plantations, manufacturing activities and trading. That decision had a direct effect on its internationalization process. Second, in 1997, the financial crisis in the Republic of Korea caused upheaval in the company, prompting a management decision to reorganize, modernize and globalize.

As part of its effort to secure natural resources through internationalization, Eagon Industrial Co. set up a trading operation (for plywood, veneer moulding, and so forth) in Indonesia in 1987, a manufacturing operation (pine plywood and veneer for shuttling) in Chile in 1993, a plantation and manufacturing plant (sawn logs) in Solomon Islands in 1995, and a manufacturing operation (veneer, plywood for flooring, specific plywood) in China in 1996. The financial crisis severely destabilized the company and it chose to meet the challenge head-on by focusing on higher-value-added products. Subsequently it reorganized into five more modern divisions: Eagon Living, Eagon Interiors, Eagon Industrial, Eagon Window and Door Systems and Eagon Overseas. The company's global activities became associated with knowledge-based activities such as R&D in improving wood species, designing environmentally-friendly products, and energy-saving windows.

At present, Eagon offers a wide array of forestry products and building systems. It has moved from simple, low-price manufactures based on natural resources to more sophisticated, higher-value-added manufactures. Its principal markets are in still in Asia (90%), but its sales are expanding in the United States and Chile, as well as other markets. This case demonstrates that even relatively small Korean companies have been obliged to internationalize in order to remain competitive.

Earlier in this chapter, the discussion focused on the competitive position of many of the leading Korean companies in some of the industries most closely involved in the country's development process. It is apparent that Korean corporate internationalization is highly concentrated in a relatively small number of manufacturing companies. In general, most of these firms are caught in a kind of sandwich between their original technological leader (Japan) and other Asian fast followers and technological imitators (especially China). Korean firms have been losing competitiveness in traditional low-cost

[42] Based on interviews with Eagon Industrial Co. in Seoul, as well as Eagon (2006).

commodity-related activities and are obliged to enter into more knowledge-intensive activities, moving from industries and technologies which rely on volume and low production costs to those characterized by quality, value-added and premium prices. The competitive situation is somewhat distinct in each major industry; nonetheless, the direction of change is similar. Some Korean firms, such as SEC, LGE and HMC, are world-class transnationals. They already possess sophisticated globalization strategies and are well advanced in the transition to more sophisticated products, many of which are associated with the shift towards the knowledge economy. Others are smaller (textile and apparel producers) or operate in very traditional activities (SK Corp., LS Nikko Copper, Posco), or both (Eagon) and have been obliged to globalize in order to remain competitive —even in their home market. This has entailed industrial upgrading, technological innovation and the establishment of a solid global network through OFDI. In different ways, all are defining and implementing more aggressive corporate strategies for this purpose.

The internationalization processes of these dominant Korean companies have spanned numerous objectives, including natural-resource-seeking, market-seeking, efficiency-seeking and strategic-asset-seeking. In the rush to internationalize, several Korean TNCs ran into serious problems, which caused them to be more cautious thereafter.[43] While the situation varies from industry to industry and firm to firm, it is evident that the last two FDI strategies are becoming more important than the first two in the context of the shift towards the knowledge economy and in relation to the evolution of each firm's global network.

D. KOREAN FDI IN LATIN AMERICA AND THE CARIBBEAN

As noted in Section B, official Korean statistics on OFDI suffer from certain failings that limit their analytical value. These statistics must therefore be complemented with additional data, particularly information on corporate strategies, which is best obtained by way of direct company interviews. The biggest statistical problems associated with the official OFDI data have to do with distortions of recipient country information arising from the use of financial centres or tax havens, the non-registration of investments undertaken by major overseas subsidiaries (for example, United States subsidiaries of Korean companies that invest in Mexico using capital raised offshore), and distortions resulting from the practice of not subtracting OFDI "withdrawals" from the database. Nevertheless, when complemented by company interviews and other additional information, official OFDI statistics can provide important insights for the analysis of Korean FDI in Latin America and the Caribbean.

As has been mentioned, Korean OFDI data suggest that, with a share of roughly 7%, Latin America and the Caribbean have played a rather small role in the internationalization process of Korean firms, although this figure has risen somewhat during 2000-2006. A major distortion in this statistical information is that financial centres (especially Bermuda, with 34%) account for 48% of the total OFDI flows. Brazil (12%), Peru (11%) and Mexico (10%) are the major non-financial-centre country recipients in the region in terms of their shares of Korean OFDI. Thus, just four countries account for two-thirds of the total in the region. When OFDI is measured by the number of firms, the situation changes somewhat: Mexico (17%), Panama (11%), Brazil (11%), Guatemala (11%), Honduras (7%) and Argentina (7%).

[43] Some, like Daewoo and Kia, were severely destabilized by the overindebtedness associated with their internationalization when the financial crisis set in. Others, such as SEC, LGE and HMC, experienced very specific problems (i.e., the purchase of AST by SEC and of Zenith by LGE, and the failure of the Bromont plant in the case of HMC). Those that survived exercised much greater caution in their subsequent internationalization plans.

In terms of activities, the Korean OFDI in the region is concentrated in a few major industries: manufacturing (59%), trade (24%) and natural resources (6%). The original focus on natural resources shifted to manufacturing activities, especially electronics (37.8% of the investing firms), textiles and apparel (34.2%), iron and steel (9.7), and petroleum and petrochemicals (7.3%). Most of the investments in electronics, iron and steel, and petroleum were carried out by large Korean firms, while Korean SMEs played a relatively larger part in textile and apparel investments. This information points to major focal points for Korean OFDI in manufacturing in Mexico, Central America and Brazil and in natural resources in Peru. In terms of OFDI strategies, there is evidence of natural-resource-seeking, market-seeking and efficiency-seeking strategies.

1. Korean activities in the Latin American and Caribbean electronics industry

The electronics industry is one of the main areas of international expansion for Korean companies and this is reflected in Korean OFDI in Latin America and the Caribbean as well. The two dominant Korean TNCs —Samsung Electronics Company (SEC) and LG Electronics (LGE)— have made very substantial investments to establish assembly plants in Mexico and Brazil.

(a) The Mexican electronics industry [44]

The electronics industry is an important part of the Mexican economy, representing about 5% of manufacturing, employing 342,000 technicians and engineers (Padilla and Iammarino, 2005; Secretariat for Economic Affairs, 2007) and generating an impressive volume of exports, which rocketed from US$ 21.1 billion in 1996 to over US$ 50 billion in 2006. However, the industry has recently swung from being a solid foreign-exchange earner (in the order of US$ 3 billion a year), to returning a trade deficit of about the same magnitude. The Mexican electronics industry has three primary segments: computers (31.2%), consumer electronics (30.3%) and telecoms (21.3%). It has two main hubs —the consumer electronics industry in the State of Baja California and the computer industry in the State of Jalisco— both of which are export platforms for the United States and Canadian and, to a lesser extent, the Latin American, markets. The first electronics hub functions with FDI by TNCs mainly from Japan (Sony, Matsushita, Hitachi, Mitsubishi, JVC, Sharp, Sanyo and Pioneer), the Republic of Korea (SEC, LGE, Daewoo Orion) and elsewhere (Thomson, Bosé, Fender). The second has been built up by FDI mainly from the United States (IBM,[45] Hewlett-Packard, Intel, Sanmina-SCL, Jabil) and other countries (Siemens, Flextronics). FDI inflows between 1994 and 2004 reached US$ 7.5 billion and went mainly to three segments: telecoms (39.5%), consumer electronics (33.9%) and computers (23.3%). These flows were concentrated in four Mexican states: Baja California (28.2%), Jalisco (18.1%), Chihuahua (13.5%) and Tamaulipas (12.9%).

The Mexican electronics industry is now facing a number of severe challenges (Ordoñez, 2006). The television-manufacturing industry reflects those challenges (Carillo and Hualde, 2006) in the form of falling market shares in the North American market and declining localization of Mexican-assembled televisions as a consequence of technological change (see box III.4).

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[44] Based on interviews with the SAMEX, Samsung SDI and SSD Plásticos plants in the Tijuana complex, the LGE plants in Mexicali (LGEMX) and Reynosa (LGERS), and the LG Innotek plant in Mexicali.

[45] In 2004, IBM sold its computer operations to the Chinese firm Lenovo.

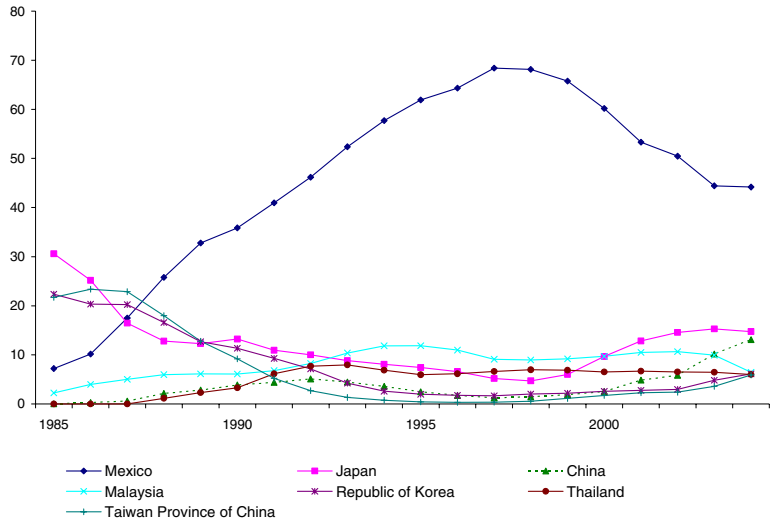
Box III.4

THE RISE AND FALL —AND RISE?— OF MEXICAN TELEVISION EXPORTS TO THE NORTH AMERICAN MARKET

The Mexican television set industry grew up in the 1970s and 1980s, simply assembling imported components to produce conventional cathode ray tube (CRT) colour televisions for the United States market. Many of the Asian television-manufacturing TNCs that dominated the industry began to assemble their products in Mexico for export to the United States rather than export from their home countries (Japan, Republic of Korea, Taiwan Province of China) in the face of increasing tariff and non-tariff restrictions and for logistical reasons. Mexico soon became the principal foreign supplier to the North American market (Canada and United States), with import market shares over 60% in 1995-2000. Moreover, for reasons relating to both United States trade rules and transport logistics, many of the components that went into those colour televisions began to be localized in Mexico. The rules of origin of the North American Free Trade Agreement (NAFTA) beginning in 1994 provided a strong boost for that process. Thus, towards the end of the twentieth century, Mexican television exports to the North American market were voluminous and contributed significant value-added through the local assembly of components (CRTs, deflection yokes, fly back transformers, tuners, cabinets, and so on), as well as final products.

UNITED STATES IMPORTS OF TELEVISION SETS

(Percentages)



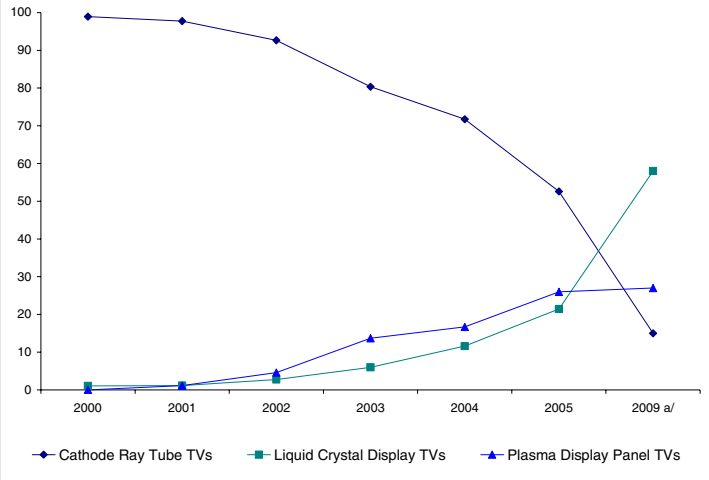
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of "TradeCAN 2006" [CD-ROM Database], January 2006.

Unfortunately for the Mexican television-manufacturing industry, with technological change in the form of digitalization, United States consumers increasingly preferred liquid crystal display (LCD) and plasma display panel (PDP) televisions, which offered significant advantages (especially larger, slimmer screens) over the conventional CRT models in which the Mexican industry had specialized. As a result, although Mexico still is the main source of North American television imports, its import market shares shrivelled considerably to 44% in 2004 and the annual production of colour television sets in Mexico crashed from about 30 million to some 19 million units. Projections for 2009 suggest that the LCD and PDP versions will considerably outsell CRT televisions in the United States market, further compounding that problem for the Mexican television industry. The main television-manufacturing TNCs are shipping more of these high-priced models directly from their plants in Asia and are investing in hugely expensive LCD and PDP plants in their home countries. Moreover, any future internationalization in this area seems to favour China as the primary investment site.

Box III.4 (concluded)

UNITED STATES FACTORY ORDERS FOR TELEVISION SETS, 2000-2005 AND PROJECTION FOR 2009

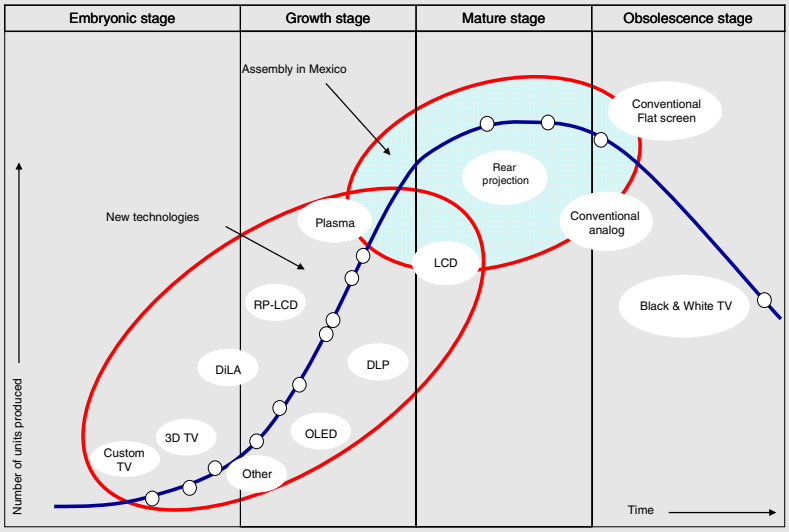
(Percentages of all orders)



[a] Projection.

The assembly of LCD and PDP television sets is now expanding in Mexico, which suggests that the Mexican television product cycle is moving back onto a growth phase and away from mature or obsolete conventional products. The question is whether this represents a "higher-quality" rebirth of the Mexican television industry. There is no doubt that the shift from conventional to digital televisions entails technological upgrading, but this will need to be accompanied by the localization in Mexico of digital components, especially the LCD and PDP panels, if it is to make a more tangible contribution to Mexican industrial development. Hence, the PDP plant opened by LGE in Reynosa, Tamaulipas in October 2006 is highly significant, especially if it represents the beginning of a new trend in Mexico.

THE TELEVISION PRODUCT CYCLE AND ASSEMBLY IN MEXICO



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of S. de los Santos and Elías, J. Gilberto, "Análisis de la industria del televisor en Baja California y su transición tecnológica", *La industria del televisor digital en México. Retos ante la transición tecnológica, el aprendizaje y el empleo*, A. Hualde and J. Carrillo (coords.), Tijuana, El Colegio de la Frontera Norte, 2007, forthcoming; J. Carrillo, "The evolution and reorganization of maquilas", document presented at the seminar of the Center on Globalization, Governance and Competitiveness, Duke University, 5 June 2006; Environmental Protection Agency; Consumer Electronics Association, "Table 1004-consumer electronics and electronic components, factory sales by product", *Electronic Market Data Book* 2006 [online] http://www.ce.org; Research and Markets, "Large-sized TFT-LCD industry report, 2006" 2006 [online] http://www.researchandmarkets.com; *Yahoo! News*, "Global flat TV makers brace for industry shakeout" [online] 10 January 2007 http://news.yahoo.com.

SEC and LGE are two of the principal producers of electronics goods, especially television sets, in Mexico. SEC began in Mexico with a market-seeking investment in a microwave oven plant in Mexico City in 1978. Ten years later, it made an efficiency-seeking investment in a television plant in Tijuana, State of Baja California. In 2002, a white goods plant in Queretaro was inaugurated. With the signing of NAFTA in 1994, the company shifted the focus of its Mexican operations to assembling electronics goods for export to the United States market. The Tijuana complex became the heart of those operations.

The SEC Tijuana complex was similar to the firm's other three global television production complexes in Suwon, Republic of Korea, and Tianjin and Suzhou in China. These were all SEC subsidiaries assembling television sets from inputs provided by subsidiaries of SEC joint ventures with other Korean firms, such as Samsung SDI (CRTs), Samsung Electro-Mechanics (components) and SSD (plastic cabinets). The SEC television assembler in Mexico —SAMEX— was established in 1988 and the cabinet-maker subsidiary, SSD, was set up in 1993. Then the subsidiary of parts supplier Samsung Electro-Mechanics was established and the operations of the CRT producer Samsung SDI were opened in 1995. The SEC Tijuana complex enjoyed spectacular growth: production shot from 1 million units in 1990 to 6 million units in 2005; sales went from US$ 125 million to US$ 2.1 billion and employee numbers rose from 1,000 to 4,500, according to company sources. Its products are exported primarily to the United States and Canada (80%) and Latin America (12%), with the remainder sold in Mexico (8%). In other words, the Tijuana complex is the principal export platform for several SEC digital media and visual display products in the Americas.

SEC has progressively increased the degree of localization of its television operations in Mexico in response to supply chain needs and the rules of origin of NAFTA. However, the rising demand for large-screen digital televisions (PDP and LCD) and the declining demand for conventional colour television sets in the United States market are creating tensions for the SEC partners in the Tijuana complex. The shift to the newer technology digital televisions would require them to make very significant investments and some appear unwilling to do so. The Samsung Electro-Mechanics subsidiary in Mexico shut down its plant, because it could not compete with the conventional colour television parts sourced from China. The SSD subsidiary declined a request from SAMEX to raise its production level because future demand was unclear. The Samsung SDI subsidiary continues to produce CRT modules for conventional colour televisions, aimed increasingly at the second television and children's television market, and apparently will not shift to flat models for another two years. It has cited the bad experience of the LG Philips Display factory in Gomez Palacio, Durango State, as an example of the high risk of new technology investments. The PDP and LCD televisions assembled by SEC in Mexico utilize imported panels and therefore have a much lower localization rate. These televisions have much higher unit prices but contribute relatively little to local cluster formation.

LGE also arrived in Mexico in 1988, when it invested in an efficiency-seeking assembly plant for conventional colour televisions in Mexicali (LGEMX), Baja California State, to export primarily to the United States market. LG Innotek established a neighbouring plant (LGITMX) to supply electronic components to LGEMX. In 1995, LGE formed a partnership with the Zenith television-manufacturing facilities in Reynosa, Tamualipas State. Later, in 2000, it took over the operations of that plant to create the LGERS operation. The Mexicali colour television operations were then transferred to LGERS.[46] In 2001, LGE set up a new refrigerator production plant in Monterrey (LGEMM), State of Nuevo Leon.

[46] One unintended consequence of the transfer of the conventional colour television operations to Reynosa was that the LG Innotek plant in Mexicali was severely dislocated. Because it had other clients as well as LG Electronics (Sanmina, TC Network, DirectTV, and so on), a move to Reynosa was considered uneconomical and it was forced to shift its production away from the original television components (tuners) to another line of activity

The LGERS complex in Reynosa represents one of the main LGE television-manufacturing operations, like its complexes in Poland (for the European market), China and the Republic of Korea. The Reynosa complex targets the North American, Latin American and Mexican markets (60%, 30% and 10%, respectively). It operates out of four plants: one makes conventional televisions (superslim, flat CTVs), one surface-mounts electronic components onto printed circuit boards, another manufactures plastic cabinets and the fourth, a new plant, makes PDP modules and PDP televisions. This complex produces approximately 2.5 million television sets (70% digital and 30% conventional), records sales of about US$ 850 million and employs some 2,500 people. Having recently convinced four Korean suppliers to establish operations in Mexico, LGE brought in new technology in order to test it in the United States market. In contrast, its plans to export to the European market from Mexico were shelved when the European Commission required that digital tuners be European-sourced.

The shift of the Mexicali CTV operations to Reynosa allowed the LGEMX plant to focus on the assembly of new technology LCD televisions and monitors (the LCD modules are imported from Asia), as well as hand-held phones (HHPs). By 2005, it was assembling 2.2 million LCD televisions and 1.7 million HHPs, with sales of US$ 862 million and 1,200 employees. It was still operating well below capacity, however, especially for HHPs. Most of its sales are made in the United States and Canadian, Mexican and Central American markets (70%, 20% and 10%, respectively). Thus, the LGE television-manufacturing operations in Mexico show two different tendencies, with the Mexicali plant assembling LCD television sets from imported LCD modules and the Reynosa plant producing its own plasma display panels for its PDP televisions.

Both SEC and LGE have made large efficiency-seeking investments in Mexico to supply the North American and Latin American markets with televisions, other visual display items and home appliances. Both of these large Korean electronics TNCs are shifting their visual display operations towards LCD and PDP televisions, away from conventional CRT-based colour televisions. However, there are two sharply diverging trends in the Mexican television industry. On the one hand, the SEC Tijuana complex and the LGE Mexicali plant (LGEMX) both import display panels from Asia and these plants' localization rate for television components has declined considerably. They are thus producing relatively less local value-added than they did with conventional colour televisions. On the other hand, in October 2006 the LGE complex in Reynosa (LGERS) opened a new plant to manufacture plasma panels, which significantly increased localization and raised the value-added of its PDP television assembly activities in Mexico.

While the unit price of both companies' products has risen substantially, the local content is being seriously eroded in the case of SEC. This suggests that there is a role for Mexican national policy in promoting the local production of LCD and plasma panels in order to further the industrial and technological upgrading of digital television operations in the country. Undoubtedly, it makes sense for Mexican policymakers to take action to turn the second trend —localization— into the stronger one, so that these goods' increasing United States and Canadian market shares will translate into more significant component localization in Mexico.

(radio frequency components for television sets, set-up boxes, satellite receivers). Between 2000 and 2005, its production fell from 1 million to 800,000 units (well below its capacity of 2 million), sales fell from US$ 1.8 million to US$ 1.2 million and the number of employees from 400 to 300.

(b) The Brazilian electronics industry [47]

In 2006, the Brazilian electronics industry generated sales equivalent to US$ 49 billion (up 14% from 2005), exports of US$ 9.2 billon and imports of US$ 18.7 billion and employed a workforce of 143,000. ICT products form the industry's largest segment, with sales up by 22% in 2006 to US$ 30 billion. In Brazilian statistics, the electronics industrial cluster encompasses producers of equipment for both electronics and electric power, comprising IT equipment (29%), telecommunications equipment (17%), household appliances (16%), industrial equipment (13%), related components (9%), electricity generation, transmission and distribution equipment (8%), installation materials (6%) and industrial automation (2%).[48] Although the recent growth of the industry has been impressive, it had to overcome obstacles created by the Asian crisis in the 1990s and the Brazilian crisis at the start of the new decade.

The Brazilian electronics and electrical equipment industry generates a large trade deficit (US$ 9.5 billon), owing to the fact that it is largely based on the assembly of imported components (electronic components constitute 64% of imports). Unlike the Mexican electronics industry, in which imported inputs are transformed into exports for the United States and other foreign markets, in Brazil, imported inputs go mainly into products for the domestic market. Semiconductors and components for telecommunications equipment are the principal imports. The main source of imported products is now Asia (62.5%), which has displaced the European Union as the largest supplier of electronic products to Brazil.

Exports are limited. The single largest export item was telecommunications equipment (especially mobile phones), which accounted for 32% of the cluster's exports. Most exports go to the Latin American region, followed by the United States, which is the largest single country recipient (ABINEE, 2006).

Some of the largest electronics and electrical equipment companies in Brazil are world-class TNCs, such as Siemens (ICTs, automation and control, medical equipment, power, transportation and lighting products), General Electric (GE) (electric equipment and motors, household appliances and medical equipment), SEC and LGE (both electronics and telecommunications products), and Ericsson (telecoms products). The siting of such firms within Brazil depends on a number of factors. In the telecoms segment, for example, the main producers of mobile phones are located in the Manaus Free Trade Zone (MFZ) (Nokia, Siemens, Gradiente, Vitelcom and Evadin) or the São Paulo area (Motorola, Sony Ericsson, LGE, SEC, Telemática, Kyocera and Huawei) (http://www.teleco.com.br).

Much of the Brazilian electronics industry involves the assembly of imported components in a special free trade area. Electronic consumer goods are assembled mainly in MFZ, where operations benefit from tariff and tax discounts (see box III.5). As well as the legislation on MFZ, the Informatics Law of 2001 fosters the industry by providing tax rebates for companies that invest the equivalent of 4% of revenues in specified R&D activities and which localize components or other inputs (for example batteries and battery chargers for hand-held phones). More recently, Law 11.196 (passed in November 2005) exempted PCs and notebooks under a certain price level from different categories of taxes. Thus, the Brazilian government offers a number of tariff and tax benefits, requiring in exchange certain R&D activities and localization to promote the electronics industry.

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[47] Based on interviews with the SEC head office in São Paulo, the Samsung Electronics da Amazônia Ltda (SEDA) plants in Campinas and Manaus and the Samsung SDI plant in Manaus, and with the LGE head office in São Paulo and its LGESP plant in Taubaté.

[48] Accordingly, the Brazilian electronics and electricity equipment industry is not directly comparable to the Mexican electronics industry.

Box III.5

THE ADVANTAGES OF THE MANAUS FREE TRADE ZONE

The Manaus Free Trade Zone (MFZ) was established as a free port in 1957. In 1967, the government set about transforming it into an industrial pole by creating fiscal incentives for a period of 30 years, which was later extended to 2023. From 1967 to 1976, activity in MFZ was mostly commercial, based on the import of goods —especially electronics— that were prohibitively expensive to import outside the free trade zone. The second phase, from 1976 to 1990, was more industrial. Local content requirements were established for products assembled in MFZ for sale in the domestic market, and some limits were imposed on imports. A third phase began in 1991, when the Brazilian market opened further to imports and competition from foreign products increased. The companies operating in MFZ were obliged to improve both productivity and quality. Regulations were established for the main industries, governing the production process that companies had to implement in Manaus in order for qualify for incentives (this replaced the previous local content requirements). Currently, the incentives system includes the reduction of up to 88% of import tariffs on goods that are to be assembled in MFZ and sold in the local market; the waiver of the industrial products tax (IPI) and social security contributions, among other exemptions from federal, state and municipal taxes. Land can be obtained at nominal cost within the industrial district. There are 508 companies established in MFZ, with total sales of US$ 21 billion in 2006. These companies employ approximately 105,000 people and are thought to generate a further 400,000 jobs indirectly. The electronics industry is responsible for 55% of the State of Amazonas' industrial income. The main products assembled in MFZ are colour televisions, mobile phones and motorcycles. Exports have risen by 60% since 2002.

MFZ is dominated by its 10 largest firms. One of the main differences in the corporate strategies of these major players in the Brazilian electronics industry is their degree of localization and cluster formation. Honda and Nokia, for example, have established an elaborate network of local suppliers, while others, such as SEC and Samsung SDI, prefer to assemble imported inputs.

Company	Type	Sector	Registered investment (millions of dollars)	Number of employees
Moto Honda da Amazona Ltda	TNC	Automotive	870.6	7 130
Samsung Eletronica da Amazona Ltda	TNC	Electronics	618.7	2 302
Nokia do Brasil Tecnologia Ltda	TNC	Electronics	500.4	2 339
Samsung SDI Brasil Ltda	TNC	Electronics	479.6	1 709
CCE da Amazonia SA	National	Electronics	471.0	2 356
Ocrim SA Produtos Alimenticios	National	Food Products	407.6	111
Siemens Eletroeletronica SA Filial	TNC	Electronics	350.0	708
Philips da Amazonia Ind. Eletronica Ltda	TNC	Electronics	264.1	1 375
Sonopress-Rimo Amaz. Ind. Com. Fonog.	TNC	Electronics	195.8	213
Gradiente Eletronica SA	National	Electronics	192.8	1 759
Top 10 total			4 350.6	20 002

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the Superintendency of the Manaus Free Trade Zone

According to the Brazilian Central Bank, the principal destination of Korean FDI in Brazil between 2001 and 2006 was the electronics sector (electronics materials, communications equipment, office machines and IT equipment), which accounted for 37.3% of FDI from that country. SEC and LGE were two of the largest foreign investors. These electronics TNCs are attracted to Brazil more by its market size and growth prospects (market-seeking FDI) than by its possibilities as an export platform (efficiency-seeking FDI). In themselves, the assembly processes within the industry are not that different, but much depends on the scale of production and the technology supporting it.

Through Samsung SDI and Samsung Electro-Mechanics, SEC made its first investments in production facilities in Brazil in the mid-1990s; however, these operations were not integrated in the same manner as other SEC complexes in China, Mexico and the Republic of Korea. Samsung Electronics da Amazônia Ltda (SEDA), the principal SEC subsidiary in Brazil, had a rocky beginning owing to its inexperience in the country. Samsung Electro-Mechanics subsequently shut down its operation in Brazil, as it could not compete with imported components from Asia, and the Samsung SDI venture there has recently encountered difficulties. Thus, SEC and its associates have experienced problems with the running of their Brazilian operations.

SEDA overcame its initial difficulties and between 2000 and 2005 its sales grew from US$ 225 million to US$ 1.072 billion and its workforce increased from 800 to 1,500 (193 in the São Paulo office, 740 in the Manaus plant and 596 in the Campinas plant). The utilization of plant capacity was relatively low, however, and there was considerable product volatility. Its plant in Manaus was established in 1995 to assemble colour televisions. The assembly of VCRs and monitors was added in 1998; however, colour television assembly was terminated in 1999 owing to the Brazilian crisis. Also that year, SEDA started producing hand-held phones (HHPs) and in 2002 added hard disk drives (HDDs).[49] In 2004, the company resumed conventional television assembly in Manaus and established its Campinas plant, to which the Manaus HHP assembly operation was then transferred, to lock into the benefits available under the IT law and the relative development of the nearby science and technology infrastructure. In 2005, SEDA expanded its existing plants for television sets, DVD players and recorders, monitors, HHPs and HDDs and introduced new technologies for PDP, LCD and DLP digital televisions and CDT and LCD monitors. In 2005, the company had gained significant market shares for HDDs (50%), monitors (31%), television sets (12%) and mobile phones (11%). In the television market, SEC now mainly assembles digital models from imported components, especially LCD panels. SEC is also contemplating increased investments in digital television technology, with a view to beginning production in 2008 (*Folha de São Paulo*, 2006).

In 2006, SEC announced the expansion of its range of locally-assembled products to include air-conditioning equipment and printers. The firm is also considering the production of refrigerators, washing machines and notebooks. These products, which SEC currently imports, account for 3% of its sales in Brazil and the company hopes to increase this figure to 20% (*Valor online*, 2006a). SEC has also started producing digital cameras through Samsung Techwin.[50]

Currently, only some 10% of the corporation's Brazilian production is exported, including 20% of its HHPs and monitors. Ninety percent of these exports go to Argentina, with the rest destined for

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[49] SEC is the only producer of HDDs in Brazil and, in turn, its Brazilian operation is the only HDD production facility SEC has outside the Republic of Korea, which makes it very special. Apparently, the decision to site the plant in Brazil was part of the resolution of a tax dispute there. SEC has rendered an impressive performance in the HDD market in Brazil, with its market share rising from 5% to 25% between January and September 2006. Besides having been able to market a lower-cost product by assembling it in Brazil, the company benefited from a change made to the national legislation in July. Previously, computer manufacturers were entitled to tax benefits when they acquired Brazilian-produced batteries and PC boxes as inputs. In July, HDDs were included as a third option, so that producers could choose any two of these three components to qualify for the benefit. Brazilian-made PC boxes were price-competitive anyway, and many companies started buying Brazilian-made HDDs and importing batteries (which can be sourced more cheaply from Asia) (*Valor*, 2006a).

[50] This is the company's first investment in the production of digital cameras outside Asia. After an investment of US$ 5 million, the plant was inaugurated in the State of Minas Gerais in July, with a capacity of 70,000 units per month (production is currently between 15,000 and 20,000). Tax benefits were granted by the municipality of Varginha (*Valor online,* 2006b).

Colombia and Peru. SEC exports from Brazil were valued at approximately US$ 125 million in 2005 (Samsung Brazil website; *Gazeta mercantil*, 2006; *América economía*, 2007).

Samsung SDI set up its Manaus operation, Samsung SDI Brasil Ltda (SDIB), in 1996. SDIB experienced some start-up problems owing to the Asian and Brazilian crises and to the cessation of colour television assembly by the main SEC subsidiary in Brazil, SEDA, in 1999, but prospered between 2000 and 2005. In this period its sales went from US$ 169 million to US$ 353 million and its employees came to number almost 1,100. Nevertheless, SDIB does not have its own glass plant (as its competitor, Philips, does) and is now having difficulty in competing against CRT imports from China. It will not return a profit in 2007, which will make its investment programme in Brazil more difficult.[51]

From June 1998, Samsung SDI produced mid-sized CRTs for television sets, for the Latin American market. In 2000, it reconstructed the existing production line and added CDTs, so it currently has an annual CRT capacity of 6 million units. The company's main products are now CRTs, monitors and deflection yokes for television sets. In 2006, it dropped the production of LCD modules for HHPs.

As has been mentioned, similarly to the situation in Mexico, Samsung Electro-Mechanics closed its operations in Brazil, as it was unable to compete effectively with Asian imports and saw no clear role to play in the transition from analogue to digital television.

In contrast to its Mexican operations, SEC established two R&D centres in Brazil, to develop products and technology for the Latin American market. Samsung Instituto para Desenvolvimento de Informática (SIDI), located in Campinas, develops and tests mobile communications software technologies for Samsung HHP to be sold in Latin America. Samsung Instituto de Desenvolvimento para a Informática da Amazônia (SIDIA), in Manaus, focuses on high-resolution and digital image technologies (http://www.sidi.org.br). SEC announced in August 2006 that it would invest US$ 15 million to develop technology for the digital television standards recently adopted in Brazil. Investments are also to be made over a 30-month period in research centres in Brazil, China, Japan, Poland, the Republic of Korea and the United Kingdom, which will be supervised by the R&D operation in Brazil. These investments are intended to free SEC of the need to acquire technology for television sets and converters for the Brazilian digital television market, which is based on the Japanese system, ISDB (*Folha de São Paulo*, 2006).

Compared to its export platform operations in Mexico, in Brazil SEC operates in a much smaller market that is less demanding in terms of technological change. SEC assembles some products in Brazil, such as HHPs and HDDs, that it does not assemble in Mexico. It also has two R&D centres in Brazil, but none in Mexico. Some of these differences may be explained by Brazilian industrial and technological policy, others by corporate strategies.

LGE investments in Brazil were mainly channelled through its subsidiaries and the LG Philips joint venture. LG Electronics made Brazil one of its core countries as of 2005. It had moved into the country in 1995 with a head office in São Paulo and two subsidiaries: LG Electronics da Amazonia in

[51] In 2006, Samsung SDI announced a new investment of US$ 10 million in its Manaus plant, in order to start producing display tubes for computer monitors. The initial aim was to produce approximately 1 million units (in addition to current capacity), 80% of which would be sold in Brazil and 20% exported. This venture was related to a negotiation among MERCOSUR members in 2005, in which it was decided to postpone the elimination of the 8% import tariff on display tubes: otherwise these products would be unable to compete against Chinese-made ones (*Tribuna da Imprensa*, 2006; *Valor*, 2006b).

Manaus, State of Amazonas, and LG Electronics de São Paulo in Taubaté, São Paolo State. The plant at the Manaus subsidiary initially assembled television sets, VCRs and microwave ovens while the Taubaté plant assembled monitors. The line-up at the Manaus plant was later expanded to DVDs, projection televisions, air-conditioners and PDP televisions and the Taubaté plant added CDMA and GSM hand-held phones, CD-ROMs and CDR-Ws to its product repertoire. CD-ROM assembly was later terminated. LGE assembles most of the products it sells in Brazil locally (http://br.lge.com). The company's operations there were severely disrupted by the Asian and Brazilian crises, which raised the question of whether or not to continue in Brazil. LGE persisted and its sales rose from US$ 630 million in 2003 to US$ 1.3 billion in 2006.

In 2005, LG Electronics de São Paulo had invested a total of some US$ 90 million in the Taubaté plant, where it employed a workforce of 2,333. This plant assembles monitors and HHPs (with an annual capacity of 3 million and 9.6 million units, respectively), provides logistical support for distribution of the Manaus plant's production and carries out mobile telephony R&D. In 2005, approximately US$ 60 million was invested in a new HHP plant in Taubaté, for the production of both CDMA and GSM phones. While monitors still represent a higher share of production at the Taubaté plant, HHP sales are growing faster. Production from Taubaté is sold in Brazil and in other Latin American markets, including Argentina, Chile and Peru. LGE has a strategic partnership with Vivo, the largest CDMA operator in Brazil. It currently ranks first in the Brazilian CDMA segment, with 25% of the market, and third in the GSM sector, with a 10% market share (KOTRA, 2006).

LG Electronics da Amazonia (LGEAZ) has invested about US$ 100 million in its three Manaus plants, which employ 2,196 people. It possesses an annual production capacity of 2.5 million televisions, 1.5 million VCR/DVDs, 500,000 audio units and 300,000 air-conditioners. Planned investments will enable the company to expand television-manufacturing to 3 million units per year (equivalent to 30% of Brazilian demand), offering both conventional and LCD/PDP television sets, and to expand capacity in air-conditioners to 500,000 units by 2007 (*Valor online*, 2006b).

LGEAZ has a head office and an R&D centre in São Paulo and has forged partnerships with local research centers. One example is an agreement signed in 2006 with Centro de Pesquisa e Desenvolvimento em Telecomunicações (CPqD) in Campinas, to develop an environmentally-friendly technology to recycle the lithium batteries used in cell phones. This is partly a response to a government measure requiring HHP manufacturers to adopt environmentally-friendly recycling or disposal procedures.

LG Philips has plants in Brazil making CRTs, deflection yokes, glass, electron guns and other display components. Its plant in Capuava and glass-making facility in Suzano (both São Paulo State) employ workforces of 450 and 370, respectively. In 2006, LG Philips announced that its Capuava plant, which already produced glass for television screens, was to become the first manufacturer of glass for monitor screens in Latin America. The investment is being made mainly in response to changing demand in the Brazilian monitors market and will cost an estimated US$ 5 million, essentially for upgrading the furnace. LG Philips will sell to monitor manufacturers, including its LGE competitor, SEC (which has thus far imported these parts). The investment will also free capacity and enable the company to increase production of glass for television screens, which is produced in Manaus for the larger television sets that the Brazilian market is increasingly demanding (*Gazeta mercantil*, 2006). Most sales are made in the Brazilian market, with Central and South American sales accounting for less than 7% of all sales by LG Philips' Brazilian plants.

Conversely to the situation in Mexico, in Brazil LGE manufactures more white goods (home appliances) than brown goods (electronic equipment), although televisions, monitors and HHPs are among the principal products in both locations. The LGERS Reynosa plant has a larger annual capacity for television sets (3 million PDP and conventional televisions) than does LGEAZ in Manaus (2.5 million, mainly conventional, televisions). The latter is larger than the Mexicali (LGEMX) operation, however, which specializes in LCD televisions. The Taubaté plant assembles more monitors and HHPs than the Mexicali plant (3 million monitors compared to 2.2 million and 9.6 million HHPs compared to 1.7 million). The main differences between LGE operations in Mexico and Brazil have to do with the degree of localization in the plasma module plant in Reynosa and the R&D activities undertaken in Brazil.

These two Korean electronics corporations —SEC and LGE— have similar options as regards selling their goods in the Americas and they have, for the most part, made similar choices. Until now, market access through NAFTA has made Mexico the best choice for their electronic goods export platforms, even though this trade arrangement's rules of origin call for a significant degree of localization of principal inputs (CRTs, deflection yoke, fly back transformers, and so on, in the case of conventional televisions). Mexico is one of the main assembly sites of both corporations' international production systems, targeting the United States market in this case. Both TNCs have indicated that Mexico's advantages are based mainly on lower labour costs and good geographical location, coupled with acceptable logistics and preferential access to the United States and many other markets of the region via FTAs. Mexican industrial or technological policy has not played an important role in the evolution of the industry: even the notable advances made by the LGERS PDP module plant in Reynosa as regards localization of digital television components seem to reflect corporate strategy more than Mexican industrial or technological policy. At the same time, both the Korean corporations have experienced a host of problems in their Mexican operations, including very high labour rotation, scarcity of skilled workers, increased competition from Asia (especially China), a weak supplier base, a need to improve physical and IT infrastructure and, most of all, heightened personal insecurity.

In Brazil, the higher level of import protection on final products, the relatively large size of the domestic market and the tax and tariff advantages of MFZ led these companies to opt for local assembly. Consumer demand is clearly lower and less sophisticated in the Brazilian market than in the United States. Moreover, host country industrial and technological policies have a stronger influence on company activities by providing tax incentives for the local production of certain inputs or R&D activities. Curiously enough, although there is a nascent shift from cheaper, simpler CRT-based televisions to LCD and PDP models in Brazil, government policy does not seem to promote the localization of digital components, such as LCD and plasma panels, since the import tariffs on these goods are low in comparison to CRTs for conventional televisions. The main advantages of Brazil for these companies are its large and growing market, the MFZ tax benefits, the availability and quality of skilled human resources and the R&D infrastructure. The main problems have to do with the complicated and frequently changing tax system, "Brazil cost",[52] the weak legal system, the limited local supplier base, the "spaghetti bowl" of FTAs in the region that limits exports from Brazil, quotas set for Brazilian television sets in the Argentine market and, most of all, the frequent changes to local policies on required components, IT requirements and so forth.

[52] "Brazil cost" refers collectively to factors unrelated to internal productivity that dampen the efficiency of firms operating in Brazil. It encompasses a large number of variables, ranging from the tax burden to costs arising from shortcomings in infrastructure.

The SEC and LGE operations in Mexico and Brazil may well be the largest foreign direct investments by Korean TNCs in the region. Hence, they strongly symbolize the nature and impact of Korean FDI in Latin America and the Caribbean. Although industrial and technological upgrading may be presumed to be national priorities in both Mexico and Brazil, the internationalization of the two Korean electronics giants has not, apparently, resulted in any such upgrading in their host countries, to judge by recent developments in the digital television industry —for all that the evolution of the products they assemble in the region reflects the technological advances they have achieved. In that line of reasoning, a clearer definition of the role of FDI in the evolution of the electronics sector is called for and, consequently, so too is closer coordination of national FDI, industrial, technological and other policies. For example, it would be necessary to coordinate —including between the federal government and the state level— the promotion of specific industries, local content requirements, import protection, human resource training, R&D requirements, the targeting of TNC suppliers and after-service for foreign investors, among others, in order to produce improved results.

2. Korean activities in the Latin American and Caribbean automotive industry

Compared to the international expansion of Korean electronic TNCs and their operations in Latin America, the Republic of Korea's largest automotive corporation, Hyundai Motor Company (including Kia), surprisingly has virtually no significant presence in the region. Hyundai Motor Company (HMC) seems to be content to operate in Latin America with small volumes of knocked down kits assembled by local partners and it exports from the Republic of Korea where possible. Since the automobile industry in Latin America is dominated by TNCs and is concentrated in just two countries, Mexico and Brazil, the question is why HMC has limited interest in the auto industry there. The Mexican and Brazilian automobile industries are quite distinct (ECLAC, 2004), so it would appear that there is no single common explanation.

(a) The Mexican automotive industry

The Mexican automotive industry is usually considered one of the great efficiency-seeking FDI success stories, as its evolution represented the transformation of a "sitting duck" into a kind of "flying goose" (Mortimore, 1995). As of the 1990s and in the context of NAFTA, FDI (mainly from the United States) in new plants converted an uncompetitive industry focused on the national market, which assembled antiquated, overpriced and poor quality vehicles, into a highly-competitive export platform for the United States and Canadian markets. United States automotive TNCs (General Motors, Ford, Chrysler[53] and Volkswagen)[54] were the main movers, taking advantage of the geographical proximity of Mexico, its relatively lower wages and its preferential access to the United States market via NAFTA to establish modern export operations to supply that market with lower-cost vehicles and thus compete on better terms there with imported or locally assembled Japanese and Korean vehicles (Mortimore, 1998, 1997). Between 1985 and 2000, the production capacity of the Mexican automotive industry rose from 400,000 to almost 2 million units. Production and exports peaked at 1,889,500 and 1,434,100 units, respectively, in 2000. These Mexican plants came to account for about 14% of vehicle imports to the United States and Canada. However, dependence on a single —North American— market created instability when that market entered recession and production and exports declined to 1,607,400 and 1,186,300, respectively, by 2005. Even so, in 2005, the automotive industry represented 16% of

[53] Before its purchase by the German automotive TNC, DaimlerBenz.

[54] The German automotive TNC, Volkswagen, moved its United States plant to Mexico to supply the United States market from there.

manufacturing GDP, 21% of exports and 18% of employment in Mexico (Secretariat for Economic Affairs, 2007b).

At the same time, Mexico also depends excessively on auto parts imported from just one source —the United States— and lacks a broad enough supplier network to comply with the rules of origin set out in its various FTAs with other markets, especially the arrangements with the European Union and Japan and those being negotiated with the Republic of Korea. A key issue in the Mexican automotive industry, therefore, is the difficulty of establishing an auto parts supplier network that is sufficiently integrated, competitive and sophisticated to support efforts to position its output in the global market as well as in its NAFTA partner countries (Mortimore and Barron, 2005).

To successfully compete in major world markets, the Mexican automotive industry must design and implement appropriate strategies to make the shift from export platform —based on low wages and privileged access and geographical proximity to a single market— to integrated manufacturing centre able to compete on the basis of skilled human resources, technological capabilities and an integrated chain of world-class suppliers (Mortimore and Barron, 2005). Soon after 2000, the Mexican Automotive Manufacturers Association and the Secretariat for Economic Affairs proposed doubling Mexico's automotive production capacity by 2010. However, the industry stalled. The new FDI that has entered the country has continued to come mainly from United States auto TNCs that are closing less efficient plants in the United States and Canada and opening new more efficient ones in Mexico (Rozenberg, 2006; Carrillo, 2006). The Mexican automotive market is expected to grow by 35%, to a capacity of over 2 million units, by 2010 (PriceWaterhouseCoopers, 2006). Mexico is clearly taking advantage of the restructuring of the United States automotive industry (USITC, 2002), yet it is not attracting large investments by the most competitive global automotive industry leaders, such as Toyota, Honda and HMC (Mortimore and Vergara, 2006). Honda has a plant with a 25,000-unit capacity which assembles the Accord sedan model, mostly for export, and Toyota has a plant with a capacity of 35,000 units, which assembles the Tacoma model solely for export. But HMC has no plant in Mexico to date, although it has appears to have decided to invest in a small one.

Hyundai Motor Company's apparent lack of interest in investing in Mexico until now may be attributed to four main factors. First, any operation intending to sell on the domestic market faces quite severe competition from established assemblers, vehicles imported by established assemblers and the import of used cars from the United States. This relegates the domestic market to a relatively minor role in the decision to invest in a vehicle assembly plant or not.

Second, any export operation would have to meet the regional rules of content for the corresponding FTAs. HMC seems to be in a similar situation to the world automobile industry leader, Toyota. Toyota began to invest in Mexico (a light truck plant was set up close to Tijuana in 2005 to make the Tacoma model and truck beds) only once it had consolidated its vehicle assembly and supplier network in the United States and Canada by way of an FDI effort in the order of US$ 15 billion. Toyota's hyper-competitiveness in the North American market has been largely responsible for obliging the United States auto TNCs to ramp up their assembly in Mexico in order to lower the production costs of the vehicles they sell in their home market. This suggests that HMC might be in a position to consider investing in Mexico after the consolidation of its huge vehicle assembly plants in Georgia (Kia) and Alabama (Hyundai) and the corresponding auto part supplier network in the United States. The use of United States-based imports in Mexican assembly would place the company better to meet the regional content requirement of 62.5% for any vehicles assembled in Mexico and sold in Canada and the United States.

Third, the lack of Korean suppliers in Mexico has also inhibited investment. Until now there has been a total absence of Korean auto part and components suppliers in Mexico. What has changed recently —and represents a major advance in this regard— is that Pohang Iron and Steel Company (Posco) has begun to construct a US$ 200-million facility to produce specialized galvanized steel for the automotive industry in a 400,000-ton-per-year plant in Tampico, Tamaulipas State. Posco is one of the six or seven major world-class TNCs specialized in this product. This new plant in Mexico aims to service the Mexican market, the southern United States market (where the new Hyundai and Kia plants, as well as those of Toyota, Honda and Nissan, are located) and, possibly, the Brazilian market. The Mexican automobile industry requires approximately 600,000 tons of galvanized steel a year and currently produces only about one third of that amount. Hence, the new Posco plant provides the opportunity to increase Mexican value-added, which could play a role in a number of export options within the context of Mexico's numerous FTAs.

Fourth, up to this point in time, HMC has had more attractive opportunities for its investment funds in the major markets (the Alabama and Georgia plants for the United States market and the Czech Republic and Slovakian plants for Europe), as well as in the larger, more promising and less competitive emerging markets, such as China, India and Turkey. Having consolidated those investments in markets that are large, fast-growing or both, HMC is now showing greater interest in Mexico as an investment option.

This suggests that the time may be ripe for a more active Mexican FDI policy to target HMC and avoid replicating the case of Toyota: although explicitly interested in establishing a North American manufacturing centre, Toyota did not consider Mexico as a site because the Mexican authorities did not have an effective FDI policy for that purpose (Mortimore and Vergara, 2006). Hyundai Motor Company's major investments in the Georgia and Alabama plants in the United States suggest that the company is now in a position similar to Toyota's five or so years ago.

(b) The Brazilian automotive industry

The automotive industry in Brazil also began as an import-substituting initiative which produced antiquated, overpriced and poor quality vehicles. The principal differences with regard to Mexico's automotive industry is that it has not been transformed into an export platform; rather it attracts much more market-seeking than efficiency-seeking FDI. For that reason, it specializes in small, economical passenger vehicles —particularly those that run on both ethanol and gasoline— for the domestic market rather than cars designed to meet the tastes of higher-income consumers in export markets (ECLAC, 2004). For the same reason, the Brazilian automotive industry is less competitive than Mexico's in terms of export orientation and product sophistication.

The new macroeconomic stability achieved by the Real Plan in Brazil in the 1990s, coupled with aggressive incentives for new automotive industry investments by various Brazilian states, gave rise to the modernization of Brazil's automotive industry —including new technologically-sophisticated modular plants— by bringing new investments from existing producers (General Motors, Ford, Chrysler, Volkswagen and Fiat) and from new entrants (mainly Renault-Nissan and PSA Peugeot Citroën), which raised annual production capacity to over 3 million vehicles. With the macroeconomic crisis of 1999, capacity utilization plummeted from over 90% in 1996-1997 to just 50% in 2000, as local demand collapsed (ANFAVEA, 2006). Several of the automotive TNCs operating in Brazil then tried to shift their production to export markets.

One of the major economy-wide challenges faced by the Brazilian automotive industry, apart from macroeconomic stability, is the appreciation of the national currency. This could complicate the continued expansion of the automotive industry and its growing export orientation. Between 2000 and 2005, while the

Mexican automotive industry stagnated owing to slow growth of the United States market, Brazil's production rose from 1,691,200 to 2,528,300 units and its exports jumped from 371,300 to 897,100 units (equivalent to 35.5% of national production). The appreciation of the currency has not increased automobile imports, because the industry is strongly protected by import tariffs of some 35% on goods originating outside MERCOSUR. Accordingly, imports were equivalent to only 3.5% of national production.

The Brazilian authorities have also attempted to attract world automotive industry leaders and, like Mexico, have had only relatively minor success. Honda assembles its Civic model in a relatively small plant (45,000-unit capacity) in Sumaré, and Toyota assembles its Corolla model in a 60,000-unit plant in Indaiatuba, both in São Paulo State. Neither of these has earned the Japanese assemblers significant market shares in Brazil. HMC has not entered the competitive market for domestic demand in Brazil in any significant way, apparently because it has had better options for its investments, as well as doubts about Brazil's macroeconomic performance and unresolved legal problems stemming from the period of strong state incentives (see box III.6). Thus, Brazilian FDI policy did not succeed in convincing HMC, one of the leading global automobile TNCs, to finalize any new vehicle assembly plant in Brazil.

Box III.6

HYUNDAI MOTOR COMPANY, KIA AND ASIA MOTORS IN BRAZIL

Asia Motors, Kia and Hyundai Motor Company (HMC) started up in the Brazilian market by selling imported knocked-down kits in association with local business groups. Even after HMC acquired Asia Motors and Kia in the late 1990s, separate local partnerships were maintained. In the 1990s, projects for local assembly of Asia Motors, Hyundai and Kia brand vehicles were started up but subsequently suspended. The situation evolved as follows:

Asia Motors began an automobile assembly project in Brazil through its local partner in the 1990s. Federal and state incentives were obtained for the construction of a plant in the State of Bahia. However, the project stalled and the company withdrew, leaving a US$ 280-million debt in fines and losses. Subsequently, HMC acquired Asia Motors' brands and assets in the Republic of Korea.

The local partner of HMC, CAOA, started building a plant in Bahia State but, owing to environmental and other problems, transferred the project to the State of Goiás in 2004, after being included in an investment promotion scheme that included tax rebates and the provision of infrastructure. The project was to be an assembly operation financed and managed by CAOA under a licensing agreement from HMC. The company also received fiscal incentives from the federal government (equivalent to 32% of the industrial tax charged on vehicles, including imported ones, sold in the country, which could be used to pay other federal taxes). In May 2005, the federal government suspended the incentives, arguing that the company had fallen behind in the implementation schedule to which it had agreed. Production is estimated to begin by 2007; if it does not, the company will have to return the financial equivalent of the tax benefits already received.

Kia had a project for a commercial vehicle plant to be built, as in the case of the HMC project, by the local partner (in this case, the Gandini group, after a partnership initially planned with Usipart, a subsidiary of Usiminas, did not materialize). The project was subsequently suspended. According to the media, the reasons for the suspension were volatility in exchange rates and import tariffs for auto parts.

Unlike the tax dispute between the Brazilian government and Samsung Electronics Company (SEC), which had a positive outcome in the setting up of the firm's only HDD plant outside of the Republic of Korea, the controversy between the government and HMC has still not been brought to a positive resolution. On 20 February 2007, *ValorFuturo* reported that the CAOA group was to finance a new US$ 250-million plant in Anapolis, south of Brasilia, to assemble 50,000 small SUV and Porter model light trucks per year. This suggests that HMC has finally decided to relegate Brazil to a minor position within its international production system by operating through intermediaries assembling entirely knocked-down kits.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Ministry of Development, Industry and Trade; Agência Estado, "Projeto da Hyundai em Goiás pode ser suspenso", 5 June 2005; *ValorFuturo*, 20 February 2007.

In sum, neither the Mexican automotive industry based on efficiency-seeking FDI nor the Brazilian industry based on market-seeking FDI were effective in attracting major investments from world industry leaders. While Toyota and Honda have recently made relatively minor investments in new plants in both countries, HMC has not done so. In Brazil, it became embroiled in a tax dispute with local authorities, which led it to back off from its planned investment there, leaving the impression that industrial and FDI policies could have been better coordinated. In Mexico, the situation seems auspicious yet no official decision to invest in a new plant has been announced. It would seem that the long delay in achieving results is due in part to lack of focus in the national authorities' FDI attraction policies which, moreover, did not specifically target HMC, in spite of its position among the automotive industry leaders.

3. Korean activities in the Latin American and Caribbean textile and apparel industry

The textile and apparel industries in Latin America and the Caribbean have undergone a sharp transformation from relatively uncompetitive national industries surviving behind elevated import tariffs to export-oriented assembly activities focused on the United States market. That shift was first triggered by new United States import quotas imposed under the Multifibre Arrangement. Mexico and the Caribbean Basin gained special advantages under the Arrangement, in the form of United States trade preferences: first, both Mexico and the Caribbean Basin gained such preferences under the production-sharing mechanism; the Caribbean Basin was advantaged by the Caribbean Basin Economic Recovery Act of 1983, the Caribbean Basin Trade Partnership Act of 2000 and the Dominican Republic – Central America – United States Free Trade Agreement (CAFTA-DR) of 2005; and, lastly, Mexico benefited from the North American Free Trade Agreement (NAFTA) of 1994. The aim of the United States government was to help United States textile producers and apparel companies to compete better in their home market against Asian imports, by granting non-tariff access to goods assembled abroad using United States components (cloth, thread, buttons and so on). The advantages of Mexico and the Caribbean Basin in this respect stemmed from geographical proximity, relatively low wage rates and export processing zone facilities designed to complement the United States initiative.

Three main types of apparel companies took advantage of the opportunity to export to the United States market from Mexico and the Caribbean Basin (Mortimore and Zamora, 1999). First, larger United States own-brand apparel manufacturers often set up assembly operations in a number of different locations, typically Mexico, a Central American country (El Salvador, Guatemala or Honduras) and a Caribbean country (the Dominican Republic or Jamaica). This allowed them to add or drop assembly lines as the competitive advantages of each individual location evolved, without having to withdraw completely from any of them, except in extreme circumstances. Second, medium-sized intermediaries offering assembly services to United States buyers or manufacturers often set up a single assembly operation in the area to take advantage of the new framework. These firms sometimes had to move from place to place as local competitive advantages changed. Lastly, national apparel companies, normally with no international operations of their own, also attempted to operate as contract assemblers for United States buyers and manufacturers. If the national economy lost competitive advantage in apparel, these firms were obliged to internationalize or shift to another activity. For many of the Caribbean Basin countries, apparel sales to the United States market became the backbone of their export repertoire. For Mexico, clothing assembly was not nearly as important an activity as the electronics and automotive export platforms, but it did compete effectively with the export platforms of the Caribbean Basin.

The phased elimination of import quotas under the trade liberalizing agenda of the General Agreement on Tariffs and Trade (GATT) and, later, the World Trade Organization (WTO) evaporated most of the special advantages of Mexican- and Caribbean Basin-based assembly operations, particularly

after the last tranche of liberalization in 2005. That tranche included the basic goods in which Mexico and the Caribbean Basin specialized (knit shirts, pants, underwear and nightwear), made in large and standardized runs, with relatively simple sewing operations and few styling changes. With improved access to the United States apparel market, the import market shares of Asian producers, especially China and India, rose precipitously while those of Mexico and the Caribbean Basin countries began to decline.

(a) The Mexican textile and apparel industry

The textile and apparel industry is still important to the Mexican economy (Zaga, 2006; Ministry of Foreign Affairs, 2006; Molina, 2006). The textile industry accounted for 3.2% of manufacturing GDP, generated US$ 5 billion in exports and provided 122,000 jobs in 2005. The apparel industry contributed 2.8% of manufacturing GDP, generated US$ 5.2 billion in exports and provided 400,000 jobs. Together, these industries accounted for 15% of employment in manufacturing. The textile industry was located primarily in the States of Mexico (22.5%) and Puebla (21%). The apparel industry was more dispersed, with focal points in the States of Coahuila (11.6%), Mexico (9.1%) and Puebla (8.8%) and the Federal District (9.8%). The apparel industry was much more directly involved in assembly operations for export to the United States market, since the production-sharing mechanism precluded the incorporation of non-United States components. That changed under the NAFTA rules of origin, which allowed Mexican inputs within certain limits. Fully 77.7% of the US$ 1.8 billion in FDI that entered Mexico's apparel industry in 1999-2005 came from United States investors, most seeking to use Mexico as a production or assembly base to compete on better terms against Asian imports in their home market.

Mexico became the number one supplier of textiles and apparel (taken together) to the United States market in 1998-2001, in part as a result of its NAFTA advantages. However, as of 2000, Mexico's exports to the United States began to fall far behind those of China. Apparel is one of the segments most fiercely contested by Mexico and China in the United States market, even though China tends to specialize more in lightweight, labour-intensive items and Mexico in heavier items that require a quick turnaround and less complicated sewing (Watkins, 2006). In 2005, China placed US$ 19.9 billion of apparel exports in the United States market (26.1%) while Mexico's exports of such goods declined to US$ 6.3 billion (8.3%). At the same time, the Mexican textile and apparel sector shed 286,668 jobs (240,682 in apparel and 45,986 in textiles) between 2000 and 2005. Mexican competitiveness in apparel declined fundamentally because of wage rates (the average hourly rate in Mexico is US$ 2.30, compared to US$ 0.69 in coastal China and US$ 0.41 in inland China) and an appreciating national currency. Mexico had difficulty in competing with China as regards other factors too: assuming China to have an index of 100, Mexico was uncompetitive in energy cost (283), water cost (250), depreciation (120) and interest rates (225). In other words, Mexico's chief economic advantage in comparison to China was reduced solely to geographical proximity (including the associated rapid response capability).

The problem is not only that China's assembled apparel is out-competing Mexico's. Even some of the more integrated parts of the Mexican textile and apparel industry seem to be suffering a significant loss of United States import market share. The area of La Laguna, which is well known as the principal source of denim jeans for the United States market and whose ability to upgrade to full package provider using mostly locally-produced denim (Bair, 2002) has often presented it as a NAFTA success story (Gereffi, 2000), has seen its exports nosedive and economic activity slow significantly due to competition from Asia (Gereffi, citing Rosenberg, 2006). One United States textile producer, Cone Mills Corporation (which later went bankrupt and was acquired by International Textile Group), closed plants in the United States and set up a joint venture with a major Mexican textile producer, Parras, to form Parras Cone, in the framework of NAFTA. However, the Mexican partner came close to receivership as a result of declining denim exports, which were blamed on Chinese competition (Parras, 2006). The International

Textile Group is currently investing US$ 100 million in a new denim plant in Nicaragua (*Business Latin America*, 24 July 2006). This suggests that even the additional advantages available to the Mexican textile and apparel industry under NAFTA have been insufficient to lay the basis of sustainable international competitiveness. Moreover, national policies were not very supportive during this period.

Information from the Korean Trade-Investment Promotion Agency (KOTRA) indicates that there are about 40 Korean firms operating in Mexico's textile and apparel sector. These consist mostly of traders located in Mexico City (20), component manufacturers linked to the footwear industry in Guanajuato (11) or apparel firms located in Puebla (6). These figures suggest that Mexico's textile and apparel industry is no longer an important focal point for Korean FDI in Mexico. Korean FDI in this industry is very small compared to that in the electronics industry in Baja California, for example. Moreover, Korean firms represent a very small element of the Mexican apparel industry. Two Korean firms were interviewed in the town of Atlixco in Puebla State, in order to ascertain the position of Korean firms in this industry in Mexico (see box III.7).

Box III.7

A TALE OF TWO KOREAN APPAREL FIRMS IN ATLIXCO, PUEBLA STATE

Two Korean apparel firms were established in Atlixco at approximately the same time in 1998-1999. One was the subsidiary of a medium-sized Korean apparel TNC with international operations in Bangladesh and Indonesia. The other was a joint venture between a Korean firm resident in Mexico and a Korean trader located in Los Angeles, California, the latter with subcontracting relations with other assemblers in Guatemala and El Salvador. Both companies produced similar products (T-shirts, sweat-shirts and so forth) for export to the United States market, but they did so in radically different ways. The first had a flexible production process, since it possessed an integrated operation producing its own cloth from United States yarn, while also assembling goods using inputs imported from both Asia and the United States. Its products entered the United States market duty-free or paid duty on Asian inputs, as the case might be. The second firm assembled only United States-sourced inputs. The contrast between the experiences of the two Korean apparel companies reflects many of the central aspects of the changing situation of the Mexican apparel industry.

The first firm had a successful experience in that it more than doubled production and sales between 2000 and 2005, while increasing its workforce by only 82%. This company opted to complement its sewing operation with a US$ 35-million investment to produce and dye its own cloth in Mexico in order to possess in-house full package capability. This capability, in the context of the NAFTA rules and along with geographical proximity, gave it a special just-in-time competitive advantage within its own corporate framework, even as it progressively lost its low-cost advantage owing to rising wages in Mexico.

The second firm started out using full capacity for its sewing operations and experienced a significant boom in its operations until 2003, when its competitive edge in the United States market was blunted by rising wage levels, changes in the Temporary Import Programme for the Production of Export Items (PITEX) and an appreciating Mexican peso. Apparently, the partner in Los Angeles, California began to send more of its United States orders to firms in Guatemala and El Salvador. By 2006, this firm was forced to subcontract its services to the first firm in order to survive.

Both of these firms faced similar problems. They faced loss of international competitiveness due to rising wage rates, an appreciating peso and certain other local problems, including high labour turnover, excessive bureaucracy by Mexican administrative officials, the theft of containers and their contents and public safety issues. The interesting point is that the firm that opted to adapt its production to changing local circumstances was more successful, while the firm that simply continued with the strictly "sewing" option was less so.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of interviews and plant visits with the companies in Atlixco.

Thus, Korean firms did not play a front-line role in the evolution of the Mexican textile and apparel industry; however, they were very much affected by it. Many were attracted to Mexico by its geographical proximity to the United States market in the context of the quotas allowed under the Multifibre Arrangement. They opted to export to the United States market in the framework of the production-sharing mechanism, limiting their activities to assembling higher-priced United States inputs, which was a viable option immediately after the huge devaluation of the Mexican peso in 1994. Under the new NAFTA rules, some adapted by developing local production facilities in order to develop full package capabilities for just-in-time operations rather than continuing to compete on a strictly price basis in an increasingly uncompetitive local environment. Thus, the more integrated firm in box III.8 prospered while the other did not.

With regard to any impact in Mexico of the new, higher-technology activities currently being pursued by the principal Korean textile and apparel TNCs in their home economy, there seems to be none. The Korean textile and apparel operations in Mexico and the new activities in the Republic of Korea do not seem to be connected in any manner.

(b) The Guatemalan textile and apparel industry

Korean FDI in the Central American textile and apparel industry is heavily concentrated in Guatemala. The Guatemalan textile and apparel industry consists of 508 companies and employs a workforce of 121,916 (Vestex, 2006). The textile segment comprises 50 textile mills employing 18,500 workers, while the apparel segment consists of 198 companies providing 88,416 jobs, with the accessories and services sector making up the rest. The textile segment generated an annual output of 135 million pounds (69.3% knits and 30.7% woven). The apparel segment had an installed capacity of 76,875 sewing machines and its output was mainly cotton knit shirts and blouses for women and girls (category 339) (25.5%), cotton trousers and shorts for men and boys (category 347) (10.4%), man-made-fibre trousers and shorts for women and girls (category 648) (6.6%), and other manufactures of man-made fibres (category 669) (Hanson, 2005). In 1989-1994, the Guatemalan apparel industry concentrated on cotton yarns, cotton woven shirts and cotton trousers and over 60% of exports to the United States enjoyed preferential entry through the production-sharing mechanism. By 2000-2005, the industry had shifted its focus towards cotton knit shirts, cotton trousers and man-made-fibre items and the proportion of Guatemalan apparel products entering the United States market via Caribbean Basin Trade Partnership Act (CBTPA) preferences had dropped to about 30%. The Guatemala apparel industry stands out from the industry in the rest of Central America for three reasons. First, the industry has a large proportion of Korean companies, both subsidiaries of Korean textile and apparel TNCs and the small local firms owned by resident Koreans to whom they subcontract. Second, about two thirds of apparel exports, especially cotton trousers for women and girls and other manufactures of man-made fibre, enter the United States market without CBPTA preferences. That is, duty is charged at the United States border because non-United States yarn or cloth is used in the final product. Third, the share of production and exports associated with local artisans is considerably larger in Guatemala than in the rest of Central America. The first two aspects are relevant for this analysis.

The Guatemalan textile and apparel industry became more competitive in the United States market over the 1989-2005 period, raising its import market share for textiles and apparel from number 33 in the ranking (0.62%) to number 20 (1.18%). For apparel alone it moved up from number 22 (0.81%) to number 16 (2.52%) (Hanson, 2005).[55] The Caribbean Basin apparel suppliers to the United States

[55] Over the same period, the Republic of Korea saw its rank as apparel supplier to the United States fall from third place to below tenth, although it was able to conserve its place as a combined textile and apparel supplier

market were subjected to changing rules. Import quotas were eased in the United States market in 1989-1994, through the special access programme under the production-sharing mechanism, which guaranteed access levels for United States-formed and cut fabrics. However, NAFTA brought in a major competitor —Mexico— with more favourable benefits (in particular, duty-free entry and rules of origin) that were not available to the Caribbean Basin apparel suppliers. The Caribbean Basin Trade Partnership Act (CBTPA) of 2000 helped to reduce that disadvantage by providing duty-free benefits for United States yarn-based apparel and some regionally-formed fabrics and by permitting local cutting operations. The benefits of the rules of origin —which allowed more vertically-integrated production, similar to that of Mexico— were not extended to the Caribbean Basin until CAFTA-DR was negotiated in 2005. This has produced a curious situation in which Guatemalan apparel producers are progressively less inclined to utilize the preferences offered by the United States government for Caribbean Basin apparel producers, even though the apparent benefits from those preferences are increasing.

The end of import quotas in the United States market in 2005 enabled Asian —especially Chinese— firms to mount much stiffer competition for Caribbean Basin countries there (Hernandez, Romero and Cordero, 2006). Guatemala has lower wage rates in apparel than do competitors such as Mexico and Costa Rica; nonetheless, it is considerably more expensive than other Central American countries and far more expensive than China (Milian, 2005; Amenábar, 2006). Furthermore, some Central American countries (Nicaragua and Costa Rica) enjoy some special trade preferences under CBPTA. One possible competitive advantage of Guatemala is that its textile and apparel industry is relatively larger (111 of 200 principal TNCs operating in export processing zones in Central America are apparel companies in Guatemala) and the industry's main employers are Asian (mainly Korean) companies, many of which already offer full package services (Amenábar, 2006; Milian, 2005). In other words, the Korean-based apparel companies in Guatemala apparently had a competitive advantage in facing the Chinese challenge.

Six Korean textile and apparel companies were interviewed in Guatemala.[56] One was a textile firm which dyed cloth on commission for local Korean companies. Another operated exclusively by subcontracting local apparel firms owned by resident Koreans. The remaining four were large apparel companies from the list of the 200 largest in Central America (two were in the top five). Five of the six were founded in the 1997-2003 period and the sixth began in 1989. Their sales ranged from US$ 14 million to US$ 311 million in 2005. Excluding the apparel company that solely subcontracted and the textile firm, their employee numbers ranged from 1,200 to 6,000.

The principal differences in the performance of these companies had to do with their access to the United States market. Some accessed that market in the framework of the production-sharing mechanism or CBTPA, using United States-formed cloth and limiting local activity to cutting and sewing. Others did so without preferences, employing Asian-sourced yarn or cloth and paying duty upon entry to the United States. Two offered full package services while the others did not. Another difference had to do with subcontracting. One firm only subcontracted and another did no subcontracting. The other three apparel firms subcontracted to local Korean assemblers primarily to respond to variable demand which sometimes exceeded the capacity of their own plants. While these differences are important, it is the overall similarity of the firms' activities that stands out.

(slipping only from third to fifth place). In 2006, as a supplier to the United States market, the Republic of Korea was ranked fourth in yarn (US$ 61.8 million), third in fabric (US$ 597.4 million), and ninth in made-up goods (US$ 99.6 million) (IDS, 2006).

[56] These firms are Hansae Guatemala Office, Hansoll Guatemala SA, Young Shin Guatemala SA, Shin Won Guatemala SA, CimaTextiles SA, and Sae A International SA

These companies shared many key features. Leaving aside the textile firm, all of the apparel companies produced knits, mainly T-shirts, tops, and trousers. They all also sent at least 90% of their production to the United States market. They shared many principal clients, such as Target, Wal-Mart, K-Mart, Sears, JC Penney and Liz Claiborne. The subsidiaries formed part of international production systems that were strikingly similar in that they tended to include Guatemala, Honduras and Nicaragua in Central America and China, Indonesia, Saipan and Viet Nam in Asia. The more complex goods were assembled in Asia and the simpler ones in Central America. For most, the Guatemalan operations represented a significant part of their international production network. The apparel companies all saw the Guatemalan operation as a cost centre to supply the United States market, based on Guatemala's competitive advantages. Originally, these advantages consisted mainly of geographical proximity (rapid response), low cost (relatively low wages), preferential access to the United States market, the presence of other Korean textile and apparel companies, the availability of relatively skilled labour, the availability of local inputs and a climate that they considered conducive to higher productivity than the rest of Central America.

Perhaps the most important finding was that most shared the opinion that Guatemala was losing international competitiveness in apparel exports and, given that CAFTA-DR was apparently not going to resolve that problem before the United States safeguards against Chinese apparel imports expired in 2008, their parent firms' future FDI priorities were now turning towards Asian countries. The principal problems they mentioned with respect to their Guatemalan operations were rising wages, the appreciating national currency, insecurity, theft of goods during transportation, administrative bureaucracy and political instability. In combination, these negative factors reduced Guatemala's competitive advantage to rapid response for less price-sensitive products, as was the case for Korean apparel firms in Mexico.

Two main conclusions emerge from the analysis of the Korean textile and apparel industry in Guatemala. First is the paradox that Guatemala should be losing international competitiveness in this industry, since it appeared to be the Central American country best prepared for the opening up of the United States market to global competitors in the context of the multilateral Agreement on Clothing and Textiles. Indeed, proportionately more apparel producers in Guatemala already offered full package services utilizing fabrics both locally-produced from United States yarn and imported from Asian countries. The new rules of origin under CAFTA-DR should have represented a new opportunity for these companies. Second, as was the case for Korean apparel firms in Mexico, here again, none of the technological upgrading taking place in the Korean headquarters is being reflected in their subsidiaries' operations in Guatemala.

In conclusion, national policy action is needed to avoid the Korean plants in Latin America and the Caribbean becoming examples of what has been termed "illusory competitiveness" (Mortimore, 2003), whereby increased apparel exports are accompanied by high import content and the decline of the local textile industry, which in the end condemns the industry to falling market shares in a more competitive world. The objective of such policy action would be to build on the more integrated nature of the Korean textile and apparel industry in the region to take advantage of the new opportunities available under the CAFTA-DR rules of origin.

4. Korean activities in the Latin American and Caribbean natural resources industry

With few exceptions, Korean TNCs operating in natural resources and natural-resource-based manufacturing have historically maintained extremely passive strategies in Latin America and the Caribbean. Their natural-resource-seeking strategies originally sought to ensure natural resource supplies through long-term contracts or minority capital shares in natural resource projects, or both.

As noted earlier, SK Corp. is ranked number 111 among TNCs by sales and it is the Republic of Korea's principal petroleum refiner. Its initial OFDI was undertaken mainly to secure sources of petroleum and offshore exploration and production operations continue to be among its principal activities. It possesses 19 petroleum or gas blocks in 12 different countries around the world. Today, it engages in exploration and production both for its own use and for trading. In Latin America, SK Corp. is exploring for petroleum in three blocks each in Brazil and in Peru, in association with other TNCs.

The huge Camisea natural gas production and export project in Peru is a very important initiative for SK Corp. in Latin America (del Solar, 2006; SK Corp., 2006b). The project consists of three elements. Upstream, there is a US$ 550-million investment to explore and operate blocks 56 and 88 over a 40-year period under contract. This investment began in August 2004 and should come on stream in 2008. The project is run by a consortium led by Pluspetrol (27.2%), Hunt Oil (25.2%), SK Corp. (17.6%), Repsol (10%), Sonatrach (10%) and Tecpetrol (10%). The second component of the initiative is a US$ 820-million investment to construct two pipelines for transporting natural gas and associated liquids: a 729-kilometre natural gas duct to Lima and a 548-kilometre liquids pipeline to the port of Pisco. This is being undertaken by a consortium comprising Tecgas (23.6%), Hunt Oil (22.4%), Sonatrach (21.2%), Pluspetrol (12.4%), SK Corp. (11.2%), Suez-Tractebel (8.1%) and Graña y Montero (1.2%). Lastly, the third aspect is product distribution. This involves the construction of a US$ 2.8-billion LNG plant on the Peruvian coast in a venture run by Hunt Oil (50%), SK Corp. (30%) and Repsol (20%). The LNG plant possesses significant geographical advantages for the Chilean, Mexican and United States markets in comparison to its principal global competitors.

The only cloud on the horizon for this project is the increasingly active stance seen in the region with regard to public-sector intervention in large-scale, natural-resource export projects (Ruiz-Caro, 2006). This is evident in moves towards energy integration via interconnections in the petroleum, gas and electricity field, a growing role for revitalized State petroleum companies and changes in pricing policies. However, this trend is less evident in Peru than in other petroleum and gas producers in the region, such as Argentina, Bolivarian Republic of Venezuela, Bolivia and Ecuador (see chapter I).

In sum, the financial dimension of its Latin American project demonstrates that SK Corp. is willing to take on greater risks; nevertheless, it continues to operate with local partners to spread that risk. Thus, the magnitude of its investments has increased, even if its corporate policy in the region is still somewhat passive.

LS Nikko obtains over half of its copper from just three countries in Latin America: Brazil, Chile and Peru. Currently high international copper prices have allowed this company to undertake more active internationalization and it has set its sights primarily on Latin America. First, it has sought to integrate upstream by way of natural-resource-seeking FDI to purchase mines in Peru (Marcona)[57] and, possibly, Chile and Mexico. Second, LS Nikko Copper Inc. has considered further downstream integration by way of market-seeking FDI in cable activities in China, one of its biggest customers, and, possibly, a new copper smelter in either Chile or China. Another internationalization initiative is the company's association with Pan Pacific Copper Co. Ltd, an alliance established in 2000 by Japanese producers Nippon Mining and Metals (65%) and Mitsui Mining and Smelting Co. Ltd (35%), and which is now

[57] The Marcona copper mine was purchased in 2004 from Rio Tinto for US$ 33.5 million, as a joint enterprise between the Canadian firm Chariot Resources (70%) and two Korean partners, Kores and LS Nikko Copper Inc. (both 15%), and will take a further US$ 248 million to develop. LS Nikko Copper Inc. acquired the right to purchase the majority of output (70% of cathodes and 90% of concentrates) for 10 years on market terms. It is expected to come on stream in March 2009 (Chariot Resources, 2006, United States Department of the Interior, 2005).

ranked as the world's third largest copper refiner, after Codelco of Chile and Phelps Dodge Corp. In other words, LS Nikko seems to be internationalizing more aggressively; nevertheless, it still does so mainly with Japanese partners and in a relatively passive way. The smelter project represents an opportunity for the company to become more independent in that regard, in the favorable context of high copper prices.[58]

Posco ranks at number 236 in the world by size, and is the fourth largest steelmaker. Jolted by stiff competition from low-cost steel production in China, Posco has been obliged to move up-market and undertake huge projects in China and India, as discussed earlier. In Latin America, the effects of the firm's internationalization have been quite modest. For years, it has been a passive partner in a joint venture known as Companhia Coreano-Brasileira de Pelotização (Kobrasco), together with Companhia Vale do Rio Doce (CVRD), whose purpose is to produce iron ore pellets in Brazil and thus ensure its own supply for steelmaking. Only recently has Posco committed to a more active internationalization process in the region by investing in a US$ 200-million galvanized steel plant in Tampico, Mexico, to supply the automotive industry. Thus, although Posco initiatives in Latin America are quite small in comparison to those it has undertaken in other parts of the world, they do represent a shift from a strictly natural-resource project to a natural-resource-based manufacturing one. Box III.8 discusses the case of a small competitor of Posco, which began internationalizing by way of OFDI in Latin America in order to produce lower-cost steel plate for the Korean market.

Box III.8
DONGKUK STEEL IN BRAZIL: FROM TRADE TO OFDI IN ORDER TO REDUCE PRODUCTION COSTS

Dongkuk Steel, incorporated in 1954, has grown into a group of interrelated affiliates including Dongkuk Steel Mill Co. Ltd, Union Steel Mfg. Co. Ltd, Kukje Machinery Co. Ltd, Kukje Transportation Co. Ltd and Cheunyang Transportation Co. Ltd. Dongkuk Steel had total sales of US$ 3.5 billion in 2005, of which over 90% were domestic. Its core business is still the supply of steel plate for shipbuilding, LNG tanks, oil pipelines and other branches of construction. Its steel plate plants in Pohang have a capacity of 2.5 million tons.

Facing stiff competition in the steel plate industry, Dongkuk Steel contracted the Italian firm, Danieli SpA, to modernize its steel plate technology in Pohang but, even so, the rising won and cheaper steel imports severely challenged Dongkuk's competitiveness in the Korean market. In 2005, Dongkuk Steel decided to internationalize in order to produce steel plate offshore for export back to the Republic of Korea and thus compete on a better footing in its home market. For that purpose, it joined up with Danieli SpA and a Brazilian firm, CVRD, in order to establish a new steel plate factory, Usina Siderurgica do Ceara (USC), in Brazil. Dongkuk owns 50% of the voting capital, will invest US$ 100 million in the project and will directly purchase 50% of the venture's 1.5 million tons of steel plate produced for export to the Republic of Korea. Before joining this venture, Dongkuk Steel had long-term contracts to purchase 1 million tons of steel plate from another Brazilian producer, Companhia Siderúrgica de Tubarão (CST). By internationalizing, Dongkuk Steel has assured itself of a long term supply of lower-cost steel plate for its Korean customers from its own offshore facilities.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Dongkuk Steel, "Annual Report, 2005" [online] 2006 http://www.dongkuk.co.kr; Dongkuk Steel, "Dongkuk Steel Group" [online] 2006 http://www.dongkuk.co.kr; *Valor econômico*, "Brasil sera base de suprimento de usinas da Dongkuk na Coréia", 19 October 2005.

[58] One of the new policy issues to arise in Latin America as a result of vastly increased international prices for minerals is the definition of the tax take of host governments. For example, Chile and to a certain extent Peru have raised the royalties charged to mining companies, though without affecting project ownership (Sánchez-Albavera and Lardé, 2006).

Eagon Industrial Co. Ltd [59] is one of the few small companies analysed in this report. As has been mentioned, it initiated its outward FDI due to a shortage of raw materials and rising labour costs at home. It established natural-resource-seeking subsidiaries in Malaysia (1980), Solomon Islands (1983), Indonesia (1987), Chile (1993) and China (1996). The 1997 Asian crisis produced dramatic problems for Eagon in the Republic of Korea, as the huge devaluation of the Korean won forced it to refocus on its core competences. As a result, it began to source natural resources exclusively from Asia and to rethink its corporate strategy to attain global standards.

In the short term, its Chilean subsidiary, known as Eagon Lautaro SA, was left stranded by the situation of its parent firm in the Republic of Korea during the financial crisis. Originally established to provide pine veneers to that firm, Eagon Lautaro SA faced immediate bankruptcy when that role disappeared and it was obliged to rebuild itself. It began to specialize in higher-value pine plywood (such as sanded and knotless) for furniture, for export primarily to the United States and Mexico. This astute transformation proved a winning strategy for several reasons: (i) it exited the Asian market, where it could no longer compete due to the huge devaluations associated with the Asian financial crisis; (ii) it took advantage of the recent development of the United States market by major Chilean plywood producers, such as Arauco; (iii) it piggybacked on the existing import operations of the Eagon subsidiary in the United States market until it came to account for 70%-80% of that subsidiary's imports; (iv) it consolidated its competitive advantages in the United States and Mexican markets thanks to the FTAs Chile had signed with those countries; and (v) by specializing in the higher-value furniture plywood, rather than higher-volume, lower-quality plywood, it was able to coexist with the principal Chilean producer, Arauco, which accounted for about 80% of plywood exports and, more importantly, with the two Chilean companies —Arauco and Compañía Manufacturera de Papeles y Cartones (CMPC)— that controlled about 80% of the raw materials inputs for plywood in Chile. Eagon Lautaro SA was so successful with its new strategy that it became one of the most profitable units of Eagon Industrial Co. Ltd and is now in a position to consider expanding into the production and export of native plywood for furniture —and may even purchase the Eagon subsidiary in the United States in order to consolidate its position there.

In other words, Eagon Lautaro SA provides an example of subsidiary survival when the altered circumstances of the head office made it uncompetitive within the corporate organization. It did so to a large degree independently of its Korean corporate headquarters and not only survived, but became one of the more dynamic components in the corporation.

Korean TNCs were relative latecomers to the region. It would appear that their initial experience did not meet the original expectations and these firms consider they have better investment opportunities elsewhere. The top Korean electronics TNCs seem hesitant to transform their assembly plants into manufacturing centres (with the partial exception of the LG Electronics Reynosa complex) and prefer to channel their OFDI to China and other Asian countries. The top Korean automotive TNC —Hyundai Motor Company— has only recently demonstrated an interest in extending its international production system to the region, having done so in Asia, the United States and Europe first. The numerous textile and apparel TNCs already present in the region are reluctant to modernize their assets there and have refocused their OFDI on Asian countries, especially China. TNCs seeking natural resources or natural-resource-based manufactures continue to display passive investment strategies in the region, even in the recent era of high international prices for their commodities. All this suggests that Latin American

[59] Based on interviews at Eagon Industrial Co. headquarters in Seoul, Republic of Korea, and its subsidiary in Lautaro, Chile, plus information from the Eagon official site [online] http://www.eagon.com.

policymakers have a huge job ahead of them to enhance the region's attractiveness to foreign investors in a manner that can contribute materially to its industrial and technological upgrading.

The foregoing analysis suggests that the internationalization process of these Korean TNCs is still limited to relatively simple functions associated with the first phase of the Korean development trajectory —outward-looking industrialization— such as securing supplies of natural resources, gaining access to markets or establishing export platforms to service third markets. The analysis of the principal focal points of Korean FDI in Latin America and the Caribbean demonstrates that Korean TNCs, in general, do not consider the region to be of primary importance with regard to their international production systems. Therefore, there is no direct link between the current phase of the Korean development trajectory —advancing towards a knowledge-based economy— and the industrial and technological upgrading of their investments in the region.

E. CONCLUSIONS AND POLICY RECOMMENDATIONS

The development trajectory of the Republic of Korea has been one of the most impressive of all the developing countries and the country became a showcase for the East Asian Miracle. The Korean experience, which was mainly a policy-driven success, demonstrated the feasibility of shifting from outward-oriented industrialization towards a knowledge-based economy, from fast follower to technology leader, from imitator to innovator. In the process, the role of inward and outward FDI —FDI and OFDI— changed considerably. The former, which was restricted during the outward industrialization stage, came to be viewed as a source of technology and other strategic assets in the context of the transition to a knowledge economy. The latter, originally discouraged for balance-of-payments reasons, came to be promoted to facilitate the internationalization of the Republic of Korea's emerging TNCs in their quest to become world-class players.

The internationalization of Korean TNCs was concentrated in relatively few companies, in a handful of industries —especially electronics, automotive, textile and apparel, and natural resources and the manufactures based thereon— and focused primarily on the major markets: North America (especially the United States), Europe and Asia (especially China). As Korean firms began to lose competitiveness in traditional low-cost, commodity-related activities, they were obliged to shift their operations towards those identified with a knowledge-based economy, moving from industries and technologies that rely on volume and low production costs to those characterized by quality, value-added and premium prices. Essentially, many of the leading Korean companies found themselves caught, competitively speaking, in a kind of sandwich between their original technological leaders (Japanese TNCs) and other Asian fast followers and technological imitators (especially Chinese firms), and this was what drove their internationalization.

The competitive situation of each major industry varies somewhat; nonetheless, the direction of change is similar. Some Korean firms are world-class TNCs, such as Samsung Electronics Company, LG Electronics, and Hyundai Motor Company. They already possess intricate globalization strategies and are well advanced in the industrial and technological upgrading of their assets at home and abroad, specializing in progressively more sophisticated products. Others are smaller (textile and apparel producers) or operate in more traditional activities (SK Corp., LS Nikko Copper and Posco), or both (Eagon Industrial Co.). These firms were obliged to globalize in order to remain competitive —even in their home market. Their response was to establish a global network through OFDI in an effort to become global players.

The internationalization processes of these dominant Korean companies have spanned numerous objectives, including natural-resource-seeking, market-seeking, efficiency-seeking and strategic-asset-seeking, and their priorities have varied over time. In their initial rush to internationalize several Korean TNCs ran into serious problems, which caused them to be more cautious and selective thereafter. While the situation varies from industry to industry and firm to firm, it is evident that the last two FDI strategies (efficiency-seeking and strategic-asset-seeking) are becoming more important for internationalizing Korean TNCs than the first two (natural resource-seeking and market-seeking), in the context of the shift towards the knowledge economy and relative to the evolution of each firm's global network.

The detailed analysis of the principal focal points of Korean OFDI in Latin America and the Caribbean demonstrates unequivocally that Korean TNCs do not consider this region to be of primary importance and most feel that they possess better investment opportunities elsewhere. Many Korean TNCs have experienced problems in Latin America and the Caribbean and consider that host countries have not extended them adequate treatment. As a result, these Korean TNCs still limit their involvement in the region to relatively simple functions associated with the first phase of the Korean development trajectory —outward-looking industrialization— such as securing supplies of natural resources, gaining access to markets or establishing imported-component-driven export platforms to provide the United States market with final products.

Few of the leading Korean TNCs are currently contemplating major investment initiatives in the region. With the significant exception of the new plasma panel plant of LG Electronics in Reynosa, Mexico, the top Korean electronics TNCs seem hesitant to transform their Latin American assembly plants into manufacturing centres. Rather, they continue to focus their OFDI mainly on China and other Asian countries. The top automotive TNC, Hyundai Motor Company, is only recently considering new investments to extend its international production system to include Latin America, having preferred thus far to concentrate on Asia, North America and Europe. The company's decision not to include Brazil in its own international production system is not auspicious. The numerous textile and apparel TNCs already present in the region are reluctant to modernize their assets there and are reorienting their OFDI towards Asian countries, especially China. TNCs seeking natural resources or natural-resource-based manufactures, with few exceptions, continue to display rather passive investment strategies in the region, even in the recent era of high international prices for their commodities. As a consequence, there is little evidence of any surge in Korean FDI in the region and still less of a direct link between the current phase of the Korean development trajectory —advancing towards a knowledge-based economy— and the activities of Korean TNCs in Latin America and the Caribbean. The Korean OFDI in the region does not serve as a transmission belt to bring the industrial and technological successes of the Korean economy to Latin America and the Caribbean.

Can country policy make a difference? The Korean experience suggests that policymakers in Latin America and the Caribbean could obtain better policy results from "FDI-assisted economic development" (Lall and Narula, 2006; ECLAC, 2005), by way of improved policies to attract the TNCs that mesh best with their own national development priorities and to obtain better benefits from the investments they do attract (Mortimore, 2004; ECLAC, 2005). Better policies can help to realize the potential of FDI to assist with economic development in Latin America and the Caribbean, especially in the case of Korean investment.

In a world in which the competition for higher-quality FDI is increasing and the policies of potential host countries are becoming more and more sophisticated (see chapter II and Gligo, 2007), most Latin American countries still rely on the original horizontal incentives from the economic reform period of the 1990s, such as opening up the economy, liberalizing, deregulating, privatizing and the like. Few, if

any, of these countries currently employ the kind of strategies that have been most successful in other regions, especially in Asia and Europe. Many countries in these regions have successfully attracted the kind of FDI they considered most suitable to their purposes by employing more active or integrated FDI policies, often by using targeting strategies. That is, they prioritized the kind of investment they wanted, identified the main investors that fitted the profile, then actively concentrated their FDI promotion efforts to attract them (Lowendhal, 2001). Countries as different as the Czech Republic, France, Ireland, Malaysia and Singapore have demonstrated how focused and targeted FDI policies can produce better results in terms of FDI-assisted economic development.

There is no doubt that the economies of Latin America and the Caribbean have benefited from FDI, but they have not done so in the same proportion as other regions in which optimizing the impacts of FDI is a conscious policy concern. Passive policies in this matter in the region have either not produced the benefits expected from inward FDI or have not done so to the desired degree (Mortimore, 2006).

An example demonstrates this situation. It is well-known that efficiency-seeking FDI can potentially produce concrete benefits with regard to technology transfer, production linkages, human resource training and enterprise development (UNCTAD, 2002), although it is recognized that those benefits are far from automatic. In Latin America and the Caribbean, passive policies based on horizontal incentives (especially tax exemptions in export processing zones) have not effectively integrated investment activities into the local industry in any of the areas examined (Mortimore, 2004, 2006). The result is enclave-like operations that produce impressive export earnings but do not contribute in any fundamental way to the continual technological and industrial upgrading of the host economy (UNCTAD, 2002; Mortimore, Vergara and Katz, 2001; ECLAC, 2005, 2006a). The situation of the electronics industry —the principal focal point of Korean FDI in the region— would seem to confirm that observation, especially in the context of the digitalization process, as does the virtual absence of Hyundai Motor Company from the regional automotive industry, the declining international competitiveness of the Guatemalan operations of Korean textile and apparel firms, and the comparatively passive and risk-averse corporate strategies of Korean natural resource firms and natural-resource-based manufacturers in the region. More active and integral policy frameworks on the part of Latin American host countries could help heighten the presence and impacts of the principal Korean TNCs in the context of their national development priorities.

Home-country government policy can also play a role. The Government of the Republic of Korea can play a role by further improving relations with Latin America and the Caribbean. It was unfortunate that the honeymoon period of renewed Republic of Korea-Latin American relations in the early 1990s was chilled by the Asian financial crisis, such that the original expectations were frustrated and the objectives of Korean foreign policy in Latin America became less clear (Kim, 2005). As a result of certain difficulties, such as intra-bureaucracy complications and limited coordination of public and private sector activities, Latin America resumed a low profile within the Korean foreign policy environment (Kim, 2005). In this respect, the Korean government could manifest a clear interest in the region and thereby pursue a clearer and more consistent Latin American and Caribbean policy.

A recent initiative in Latin America holds out certain potential to change this situation. In June 2001, the Republic of Korea and Mexico established a 21st Century Commission with the purpose of launching a new strategic partnership in 2005. That has not happened; however, the diagnosis of the Commission's analysis is worthy of examination in this light. The partnership was to be comprehensive in scope but strategically-oriented towards several mutually complementary long term goals.

In that context, a few lines bear citation:

> "In particular, Korea possesses strong international competitiveness in the engineering technologies for many sophisticated industrial products while Mexico has attained international competitiveness in the processing of raw materials, parts and components for many consumer and industrial products. These complementarities make ample room for industrial cooperation and technology transfer, involving Korea's direct investment in Mexican industries as the most important means of such cooperation.
>
> Labor-intensive assembly operations have been the main area for such relations. The time has come for the upgrading of Korea's investment in Mexico towards higher technological content and higher value-added.
>
> […] Given the lack of integration in Mexico's productive chains, particularly in the maquiladora industry, Korea and Mexico should engage in a program to develop the supporting industry in Mexico. There is no doubt that such a program would offer benefits to both countries, since Mexican exports would have more domestic value added, and Korean investments in Mexico would benefit from the availability of timely, cheaper, world quality local inputs." (Mexico-Korea 21st Century Commission, 2005).

To be effective, such a programme must be based on concrete initiatives to deal with both the particular problems faced by the investing TNCs and the development aspirations of the host countries in the areas of technology transfer, production linkages, human resource training and enterprise development.[60]

For example, joint efforts in the Mexican and Brazilian electronics industry might focus on the implications of the digitalization of the television industry, such that initiatives like the new LG Electronics plasma panel plant in the Reynosa complex can be identified early and supported, so that others follow suit. In the automotive industry, it would be useful to enhance cooperation to define the best ways to foment local supplier networks in Mexico or Brazil in order to attract more inward FDI from the leading Korean automotive TNCs. In the textile and apparel industry, host countries should cooperate with local industry to see how the competitive advantages of Korean assemblers can be best used in the context of CAFTA-DR. The purpose of active and integrated policies is precisely to deal with such situations in a coherent fashion. Success here could provide the basis for extending such cooperation to other focal points of Korean FDI in the region.

In other words, there is a real need for a renewed agenda on Korean FDI in Latin America and the Caribbean. That agenda could be defined by means of face-to-face meetings of Latin American policymakers with Korean TNCs and policymakers to produce greater transparency, build confidence and identify opportunities for effective cooperation. Such cooperation holds the promise of converting Korean FDI in the region into a transmission belt for the successes of the Korean development trajectory.

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[60] In the case of Mexico, for example, cooperation with the Government of Japan appears to be far more advanced in the area of developing suppliers for the automotive and electronics industries. With regard to the latter industry, the Director–General of Bancomext, the Mexican foreign trade bank, concluded that it is necessary to attract the principal manufacturers of flat panels and semiconductors and their main suppliers to Mexico (Reyes, 2006).

Chapter IV

PORTUGAL: INVESTMENTS AND CORPORATE STRATEGIES IN LATIN AMERICA AND THE CARIBBEAN

In the early fifteenth century, Portugal began a fruitful process of exploration and territorial expansion that cemented its position as a naval and commercial power. Its activities spanned the Atlantic and Indian Oceans and its presence extended from the coast of east Africa to India. Not long after the arrival of the Spanish in America, Portuguese explorers discovered the territories that would later be known as Brazil and the result was that, along with Spain, Portugal became the leading commercial power of the time. Later, from the sixteenth to the nineteenth centuries, Portugal lost a great many of its colonies in Africa and Asia, and the independence of Brazil in 1822 marked a significant reduction of the country's international presence.

Portugal has experienced a particularly positive dynamic over the last 40 years, stimulated by its 1986 entry into the European Union and the period of far-reaching reform, modernization and infrastructure investment that followed. All this was reflected in rapid economic expansion and a GDP growth rate that was among the highest in the OECD. It was against this background that large Portuguese firms began to seek out new growth opportunities outside the country's borders, particularly in Latin America and former colonies in Africa and Asia.

Portuguese direct investment in Latin America grew very strongly in the latter half of the 1990s, with annual flows rising from virtually nothing in the first half of the decade to an average of almost US$ 1.8 billion in 1996-2000. The leading investment destination was Brazil, which received over 95% of flows into the region.

As the economic situation in Latin America worsened towards the end of the 1990s, however, Portuguese investors, and large companies in particular, began to slacken the pace. In 2001, Portuguese outward direct investment was still at record levels, but the share of Latin America fell significantly. From that time on, Portuguese companies began consolidating their operations in the region. The original outward investment drive, centred on Brazil, had provided Portuguese businesses with valuable experience which they now drew upon to extend their operations to more sophisticated markets, especially in the European Union.

A. PORTUGUESE OUTWARD DIRECT INVESTMENT: AN OVERVIEW

Traditionally, Portugal was always a net recipient of FDI and its companies had only a very limited presence in international markets. The little foreign investment that was undertaken by Portuguese companies went almost exclusively to other countries in Europe (France, Spain and the United Kingdom) and the United States.

With the consolidation of the European integration process and adoption of the euro as the single currency, the Portuguese economy matured and risk levels fell accordingly, making it easier to internationalize (Braz, 2002). At the same time, the size of the domestic economy, growing external competition and certain regulatory obstacles forced the leading private-sector business groups and some

of the State enterprises then being privatized to seek new opportunities for growth. Faced with the possibility of being taken over by larger companies from elsewhere in Europe, many firms diversified their businesses and began to explore the possibility of expanding beyond the country's borders. In these circumstances, the Portuguese government threw its weight firmly behind the internationalization of the country's leading business groups.[1]

Broadly speaking, the Portuguese companies that expanded abroad most vigorously had a large domestic market share (in some cases they were natural monopolies in certain business), enabling them to generate large surpluses. These resources were supplemented by the financing they were able to raise for their internationalization efforts thanks to favourable stock market conditions. In an initial phase, Portuguese firms entered markets in neighbouring countries (chiefly Spain), Portuguese-speaking former colonies in Africa, and Brazil. Between 1991 and 1995, Spain was the leading destination for Portuguese outward direct investment, accounting for over 40% of the total.

Portuguese outward direct investment experienced an unprecedented upsurge in the latter half of the 1990s, exceeding inward FDI for much of the period, even though this also grew considerably (see figure IV.1).[2] Between 1995 and 2000, outward direct investment by Portuguese companies rose from 525 million euros to an all-time high of 8,827 million euros (see table IV.1). During the same period, the total stock of Portuguese outward direct investment grew more than sevenfold to 21,012 million euros (see figure IV.2). The strong rise in outward investment gave Portuguese companies a more solid presence in their traditional markets in Europe and Africa, but the greatest dynamism was in Latin America, essentially because of the success of the Real Plan and the start of the privatization programme for public-sector enterprises in Brazil.

Thus, with conditions in the Portuguese economy favourable, and in the face of a saturated and highly competitive European market, Brazil, one of the world's top 10 economies by GDP and a country that offered all the advantages of a shared history and language, began to emerge as the leading option for large Portuguese firms.[3] Brazil was particularly attractive not just because it was a gateway to Latin America, but also because it had a large domestic market and high growth potential in its own right. The result was that the destinations of these capital flows became more geographically diverse. Between 1995 and 2000, the European Union share fell from 78% to 42% and Brazil emerged as the preferred market of Portuguese investors (see table IV.1). Portuguese outward direct investment in other Latin American countries also increased, but remained at relatively modest levels (Braz, 2002).

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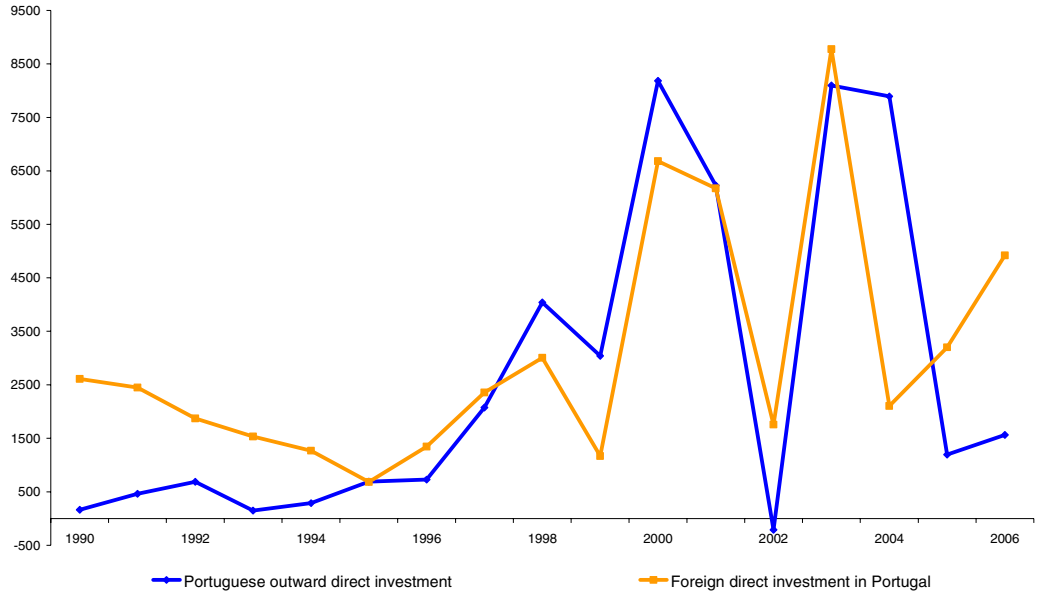
1 On 15 April 1997, Council of Ministers Resolution No. 61/97 established guidelines and a system of support for the internationalization of Portuguese companies. This process was described by the resolution as a fundamental strategic element in the economic development of Portugal within a very challenging three-dimensional (global, European and national) environment.

2 Between 1996 and 2003, Portuguese outward direct investment increased 11-fold while inward FDI virtually sextupled.

3 The memory of earlier setbacks for some large Portuguese groups in Angola and Mozambique held back Portuguese outward investment in Africa (Braz, 2002).

Figure IV.1
PORTUGAL: OUTWARD AND INWARD DIRECT INVESTMENT, 1990-2006 [a]
(Millions of dollars)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of statistics from International Monetary Fund, *Balance of Payment Statistics* [CD ROM], January 2007.

[a] Preliminary estimates based on information from the Bank of Portugal were used for 2006.

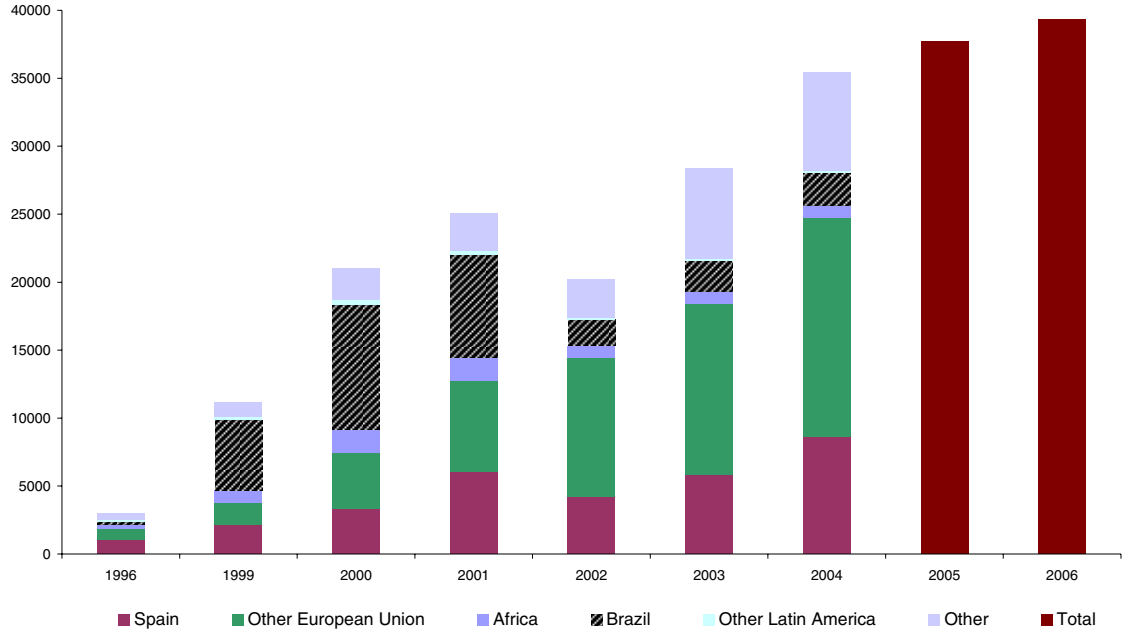
Table IV.1
PORTUGAL: OUTWARD DIRECT INVESTMENT, BY DESTINATION COUNTRY, 1995-2006 [a]
(Millions of euros)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 [a]
European Union [b]	410	156	783	1526	-1 623	3 781	5 454	2 679	3 070	5 360	1 664	940
Denmark	0	0	1	-2	0	0	1	1	2 207	2 222	42	4
Netherlands	2	4	112	526	-1 256	1 575	1 139	4 266	-114	804	736	498
Spain	265	55	253	366	-706	1 817	3 116	-1 104	928	2 182	399	424
Other European Union	143	97	417	636	339	389	1 198	-484	49	152	487	14
Africa	25	72	89	315	307	940	156	-580	-3	89	55	43
Latin America	26	247	594	4 091	1 522	2 962	1 169	-2 373	-17	327	-978	-100
Brazil	24	289	574	4 082	1 501	2 926	1 122	-2 325	-22	292	-987	-118
Other	64	86	362	-2 312	2 789	1 144	218	116	4 063	633	181	304
Total	525	561	1 828	3 620	2 995	8 827	6 997	-158	7 113	6 409	922	1 187

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Bank of Portugal, Estatísticas Online, BPStat, Eurosistema [online] http://www.bportugal.pt, 25 January 2007 and Eurostat, Statistics in Focus [online] http://epp.eurostat.cec.eu.int, 25 January 2007.

[a] January-November 2006.
[b] European Union of 25 countries.

Figure IV.2
PORTUGAL: STOCK OF OUTWARD DIRECT INVESTMENT, BY DESTINATION COUNTRY, 1996-2006 [a] [b]
(Millions of euros)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Bank of Portugal, Estatísticas Online, BPStat, Eurosistema [online] http://www.bportugal.pt, 25 January 2007.

[a] The breakdown by destination country for the stock of Portuguese outward direct investment is not available for 2005 and 2006.

[b] January-November 2006.

Between 1995 and 2000, flows of Portuguese direct investment into Brazil quickly increased from 24 million euros to some 3 billion euros, peaking at 4 billion euros in 1998 (see table IV.1). During this period, Brazil received 51.2% of all Portuguese outward direct investment flows, followed a long way behind by Spain with 11.2% (see table IV.1). Between 1996 and 2000, Brazil's share in the stock of Portuguese outward direct investment rose from 6% to 44% to stand at almost 9.2 billion euros (see figure IV.2). Driving these figures was the great interest aroused among Portuguese investors by the Brazilian privatization programme. Meanwhile, Portugal's share of Brazil's FDI stock rose from 0.3% to 4.4% between 1995 and 2000, making it the country's sixth-largest external investor after the United States, Spain, the Netherlands, France and Germany, and the largest in per capita terms (see table IV.2).

Table IV.2
BRAZIL: STOCK AND FLOWS OF FOREIGN DIRECT INVESTMENT, BY GEOGRAPHICAL ORIGIN, 1995-2006 [a]
(Percentages and millions of dollars)

	Stock [a]		Flows (annual average)	
	1995	**2000**	**1996-2000**	**2001-2006**
United States	26.0	23.8	24.4	19.3
European Union	31.0	42.5	46.1	47.4
France	4.9	6.7	8.4	6.2
Germany	14.0	5.0	1.8	4.5
Italy	3.0	2.4	1.3	1.8
Netherlands	3.7	10.7	9.2	18.1
Portugal	0.3	4.4	6.4	3.5
Spain	0.6	11.9	17.2	6.7
United Kingdom	4.5	1.4	1.8	1.7
Switzerland	6.8	2.2	1.1	2.7
Japan	6.4	2.4	1.6	3.7
Other	30.0	29.1	26.9	29.9
Total	100.0	100.0	100.0	100.0
Total (millions of dollars)	41 696	103 015	20 739	19 475

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the Central Bank of Brazil (http://www.bancocentral.gov.br).

[a] Data from the foreign capital censuses of 1995 and 2000.

The upsurge of Portuguese direct investment in Brazil was driven by companies that occupied a monopoly position in their home market and had only recently been privatized (wholly or partially) or were still under State control. The largest investments were in telecommunications (Portugal Telecom (PT)), electricity, water and sewage (Electricidade de Portugal (EDP); Águas de Portugal (AdP)), cement (Cimentos de Portugal (CIMPOR)) and banking (Caixa Geral de Depósitos (CGD)). Of these, AdP and CGD are State-owned companies, while PT, CIMPOR and EDP were mainly or wholly privatized. Later, some private-sector firms, ranging from large groups to small and medium-sized enterprises, followed in the footsteps of the first companies to internationalize, many of them partners of public-sector enterprises in Portugal. Thus, investments in electricity and telecommunications attracted cable and software suppliers (Braz, 2002).

In sectoral terms, the internationalization of Portuguese firms took place mainly in those areas where the Brazilian privatization programme was most attractive, namely telecommunications and electricity. This is where the major investments by PT and EDP went. Although these were the businesses that attracted the largest and most visible investments, however, there were a great many smaller-scale operations that helped increase sectoral and geographical diversification (Braz, 2002). In fact, the official statistics give a somewhat distorted picture, particularly when it comes to real-estate activities and business-to-business services, which account for over 80% of Portuguese outward direct investment (see table IV.3). Nonetheless, figures from the Central Bank of Brazil bear out what was said above, at least in the case of the South American country that received the largest Portuguese investments during the outward investment boom (see table IV.4). In 2000, telecommunications, electricity, gas and water and retailing accounted for some 70% of Portugal's FDI stock in Brazil.

Table IV.3
PORTUGAL: OUTWARD DIRECT INVESTMENT, BY ECONOMIC SECTOR, 1996-2006 [a]
(Percentages)

	1996-2000	2001-2006	1996-2006
Manufacturing	4.1	3.2	3.6
Trade	1.8	4.3	3.2
Transport and communications	1.5	0.1	0.7
Electricity, gas and water	4.8	-0.3	2.0
Financial activities	2.7	9.3	6.4
Real-estate activities and business-to-business services	83.0	80.6	81.6
Other	2.3	2.7	2.5
Total	100.0	100.0	100.0

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Bank of Portugal, Estatísticas Online, BPStat, Eurosistema [online] http://www.bportugal.pt, 25 January 2007.

[a] January-November 2006.

Table IV.4
BRAZIL: STOCK OF PORTUGUESE FOREIGN DIRECT INVESTMENT, BY ECONOMIC ACTIVITY, 1995-2000 [a]
(Millions of dollars and percentages)

	1995		2000	
	Amount	Percentage	Amount	Percentage
Commodity extraction activities	138	0.1	3 488	0.1
Manufacturing	2 039	1.9	427 065	9.5
Chemicals	26	0.0	169 993	3.8
Non-metallic mineral products	0	0.0	155 739	3.5
Rubber and plastic products	0	0.0	33 125	0.7
Other manufactures	2 013	1.9	68 207	1.5
Services	104 433	98.0	4 081 550	90.5
Telecommunications and mail	5 229	4.9	1 753 431	38.9
Retailing	2 077	1.9	756 967	16.8
Electricity, gas and water	0	0.0	696 557	15.4
Information technology and related activities	21 156	19.8	342 596	7.6
Financial intermediation	0	0.0	272 986	6.1
Business-to-business services	41 856	39.3	168 934	3.7
Wholesaling	29 529	27.7	47 314	1.0
Other services	4 586	4.3	42 766	0.9
Total	106 610	100.0	4 512 102	100.0

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of statistics from the Central Bank of Brazil (http://www.bancocentral.gov.br).

[a] Data from the foreign capital censuses of 1995 and 2000.

The official statistics could be misleading in some ways and might actually be understating the scale of the phenomenon. Some Portuguese investment abroad was carried out through subsidiaries in other countries (mainly Spain and the Netherlands) or financial centres such as the Cayman Islands. This is particularly significant in the case of the Netherlands, since most Portuguese investment in that country does not remain there but goes on to other destinations.[4] The distortions produced by financial centres can be appreciated both from Portugal's outward investment figures and from the amounts of foreign investment received by Brazil (see tables IV.1 and IV.2). Furthermore, some subsidiaries of Portuguese companies raised financing locally or reinvested some of the profits generated in the recipient economies. In the case of Brazil, currency instability led many Portuguese firms to raise funds in the local market, sometimes in dollars, because of predictions that the local currency would appreciate over the medium term. Lastly, a substantial proportion of Portuguese outward direct investment is hard to identify because many medium-sized and small businesses invest outside of Portugal as physical persons, mainly in real-estate and tourism projects. Initiatives of this type have become increasingly important in recent years.

At the start of the present decade, a new pattern of Portuguese outward investment began to establish itself. In 2001, Portuguese direct investment abroad began to contract as a result of the deteriorating international economic situation and its local and regional repercussions, with a particularly sharp downturn in 2002 (see figure IV.1). The economic and political crisis in Argentina and the uncertainty associated with the presidential elections in Brazil undermined confidence in Latin America, and corporate strategies altered accordingly. Furthermore, many Portuguese firms found that they needed to consolidate the large investments made, especially in Brazil. In these circumstances, investment began to be concentrated predominantly in European Union countries, while other destinations such as Latin America and Portuguese-speaking countries in Africa fell sharply down the ranking. Between 2001 and 2006, the European Union share was 85%, the main destinations being the Netherlands (33%), Spain (27%) and Denmark (20%) (see table IV.5). In this period, the Latin American expansion of Portuguese firms was abruptly discontinued, and in fact a great deal of investment was withdrawn, especially from Brazil (see tables IV.1 and IV.5).

Table IV.5
PORTUGAL: OUTWARD DIRECT INVESTMENT, BY DESTINATION COUNTRY, 1995-2006 [a]
(Percentages)

	1995-2000	2001-2006 [a]	1995-2006 [a]
European Union [b]	27.4	85.3	59.3
Denmark	0.0	19.9	11.0
Netherlands	5.2	32.6	20.3
Spain	11.2	26.5	19.6
Other European Union	11.0	6.3	8.4
Africa	9.5	-1.1	3.7
Latin America	51.4	-8.8	18.3
Brazil	51.2	-9.1	18.0
Other	11.6	24.5	18.7
Total	100.0	100.0	100.0

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Bank of Portugal, Estatísticas Online, BPStat, Eurosistema [online] http://www.bportugal.pt, 25 January 2007 and Eurostat, Statistics in Focus [online] http://epp.eurostat.cec.eu.int, 25 January 2007.

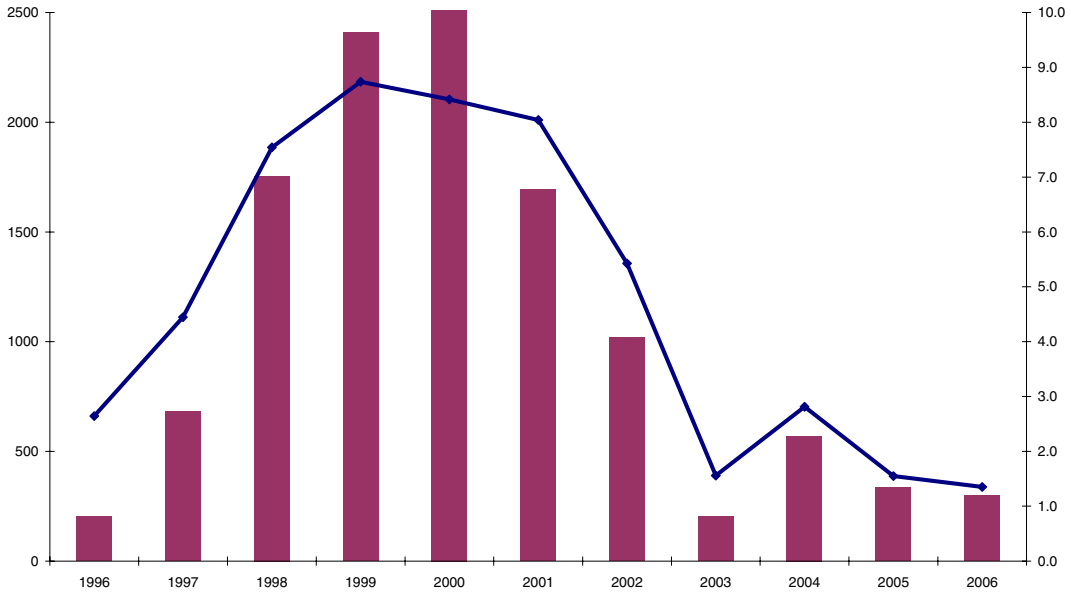
[a] January-November 2006.

[b] European Union of 25 countries.

[4] This is because of the special treatment given by the Dutch authorities to conglomerates, which they term "special purpose entities". This has turned the Netherlands into a major recycling centre for Portuguese investment. In 2003 alone, Portuguese companies sent on some 1.3 billion euros of funds held by them in the Netherlands to other destinations (*Expresso*, 28 August 2004).

Between 2001 and 2006, according to statistics from the Central Bank of Brazil, Portugal's share of FDI inflows into Brazil fell from 8% to 1.3% (see figure IV.3).[5] Given the characteristics of Portuguese outward direct investment and the difficult international circumstances, the sharp contraction of flows to Brazil is no great surprise. In fact, following an initial phase of major investment led by the largest Portuguese groups (PT, EDP, CIMPOR and Sonae) and a second stage driven by smaller companies (Grupo Cintra, Grupo Pestana and others), a very probable explanation is that companies have been concentrating on maturing and consolidating the investments made in earlier years. Also, many Portuguese companies have used local sources, reinvested profits and Brazilian government incentives to finance their investments (ICEP Portugal, 2005, p. 14). Another feature of the situation has been the arrival in particularly attractive sectors such as tourism of new investors differing greatly in size and corporate culture from their forerunners.

Figure IV.3
BRAZIL: PORTUGUESE FOREIGN DIRECT INVESTMENT, ANNUAL INFLOWS AND SHARE OF THE TOTAL, 1996-2006
(Millions of dollars and percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the Central Bank of Brazil (http://www.bancocentral.gov.br).

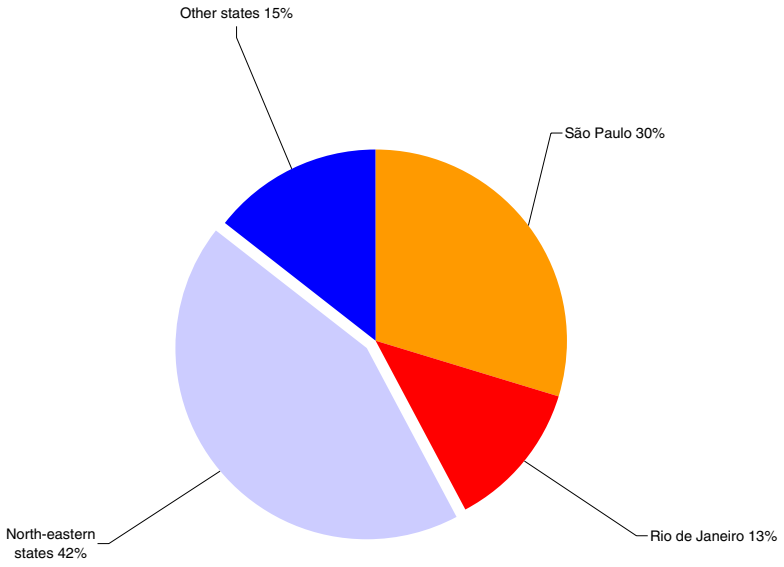
Certain major qualitative changes are now beginning to be identified in Portuguese investments in Brazil. Gradually, a large percentage of Portuguese firms have succeeded in positioning brands of their own in the Brazilian market, especially PT (with Vivo) and Grupo Pestana. Other companies never used local brands to advance their businesses, examples being Logoplaste, Grupo Cintra and, more recently, Grupo Vila Galé (*Portugal Digital*, 25 October 2005). Meanwhile, a great many companies have brought in major strategic changes, strengthening or redefining their core business in Brazil. Companies have concentrated closely on the businesses that have yielded the best returns for the least risk, thus ensuring they continue to prosper in the Brazilian market. This is the case with the Portuguese financial groups that

[5] Between 2001 and 2006, Portugal fell from eighth to twelfth place in the ranking of the largest investors in Brazil.

moved from commercial banking to the investment banking segment and thence to direct involvement in property and tourism projects. Thus, the Brazilian experience has been very valuable for Portuguese companies and over time has undoubtedly helped them improve their strategies and the way they operate in difficult and complex markets.

One of the most significant features of Portuguese investment in Brazil is its geographical distribution. Unlike other foreign investors, the Portuguese have given the preference to less traditional locations. Although the State of São Paulo has hosted more subsidiaries of Portuguese companies than any other single state, it is the north-eastern states as a group, and particularly the State of Ceará, that have received the most Portuguese investment (see figure IV.4). This tendency has been the result of two main factors: the surge of investment in tourism-related real-estate projects, and the incentives provided by state authorities to attract Portuguese capital (ICEP, 2005, p. 12).

Figure IV.4
BRAZIL: PORTUGUESE FOREIGN DIRECT INVESTMENT, BY STATE, 2005



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of statistics from Instituto das Empresas para os Mercados Externos (ICEP), *Os investimentos portugueses no Brazil*, São Paulo, 2005.

During the period of economic and political uncertainty, Portuguese companies like EDP stayed in the country and took the opportunity to adjust their corporate strategies. Some have recently pulled out of Brazil, either because they had become discouraged by the difficulty of doing business there or because better investment opportunities came up in other regions of the world. In future, Portuguese companies would probably be well advised to identify market niches carefully and develop a strategy suited to the local environment, since the great majority of them are not large enough to operate in mass markets. The cases of PT, EDP, CIMPOR and Sonae can be seen as exceptions.

In summary, Portuguese outward direct investment grew strongly in the second half of the 1990s, with Brazil as the epicentre. On the whole, these investments were chiefly made for business expansion purposes (using brands that were little known internationally or, preferably, acquired brands) by

companies which in most cases did not yet have a truly international dimension, although some were important in their home market.

The experience was not an easy one for Portuguese firms, particularly in Brazil. Many companies did succeed in grasping the realities of the country and making the vital adjustments to their corporate strategies required for their plans to be sustainable. Others failed to adapt to what is a very difficult market, however, and were forced to withdraw from the country. It is very clear that a great deal more than a (partially) shared language, history and culture is required to ensure the success of a business venture. Indeed, the force driving the Portuguese outward direct investment boom was the modernization of the Portuguese economy in the context of European integration and the economic liberalization policies introduced in Brazil.

Thus, Portugal is still at a very early stage in its internationalization. Generally speaking, the companies involved have been motivated by the desire to increase their scale or to take advantage of opportunities as they arise. In some cases, however, there has been real strategic thinking by Portuguese investors, who are setting their sights progressively higher. This is the case with more recent investments in European Union countries, particularly Spain.

B. THE MAIN ATTRACTIONS FOR PORTUGUESE DIRECT INVESTMENT IN LATIN AMERICA AND THE CARIBBEAN

Some characteristics of Portuguese outward direct investment can be identified from this overview: it is a recent phenomenon, centring on a handful of business areas in a limited number of countries, and it has been led by a small group of major companies. These are some of Portugal's largest firms, enjoying positions of leadership in their respective businesses in the domestic market. Furthermore, there are overlapping interests in the ownership of the largest Portuguese companies, which means that the decision-making core is even smaller (see table IV.6).

The fact that this is such a circumscribed phenomenon may make it easier to understand. To see what has been happening, it is necessary to look more closely at the corporate strategies of the companies driving these international capital movements. In the Portuguese case, at least two groups of companies can be distinguished. First, there are large enterprises in which the State plays or has played a central role. Generally speaking, the internationalization of their activities coincided with privatization and with the growth of competition in their domestic market. For these companies, the size of the local economy and the vigorous worldwide trend towards consolidation and concentration in many industries made international expansion not so much an opportunity as an imperative for survival. Second, diversified private-sector groups made investments in different business areas in both manufacturing and services, particularly retailing, financial services, property development (mainly for tourism), engineering and construction, plus some processing activities with little technological content.

Table IV.6
PORTUGAL: LARGEST NON-FINANCIAL COMPANIES, BY SALES, 2005
(Millions of euros)

	Company	Business	Main shareholders	Sales
1	GALP Energia, SPGS SA	Oil	Portuguese State (7%), ENI (33%), Amorim Energia (33%), Iberdrola (4%), CGD (1%)	11 137
2	Energias de Portugal SA (EDP)	Electricity	Portuguese State (20%), Iberdrola (10%), Caja de Ahorros de Asturias (6%), CGD (5%), Banco Comercial Português (3%)	9 677
3	Rede Eléctrica Nacional SA (REN)	Electricity	Portuguese State (50%), EDP (30%), CGD (20%)	...
4	Sonae SGPS	Retailing, property, manufacturing and telecommunications	Efanor Investimentos SGPS (53%)	6 392
5	Portugal Telecom SGPS SA (PT)	Telecommunications	Telefónica (10%), Brandes Investment Partners (9%), Banco Espírito Santo (8%), CGD (5%)	6 284
6	Jerónimo Martins SGPS SA	Retailing and foods	…	3 828
7	Transportes Aéreos Portugueses SA (TAP)	Air transport	Portuguese State	…
8	Cimentos de Portugal SGPS SA (CIMPOR)	Cement	Teixeira Duarte (23%), Manuel Fina (19%), Lafarge (13%), Credit Suisse (13%)	1 535
9	Teixeira Duarte Engenharia e Construções SA	Construction	Teixeira Duarte family (52%)	629
10	Brisa Auto-Estradas de Portugal SA	Construction	…	560

Source: Economic Commission for Latin America and the Caribbean (ECLAC).

The following section will analyse the experiences of some of Portugal's leading companies, grouped by business area, with the aim of uncovering the basic factors driving the internationalization of Portugal's business elite and the role played by Latin America in this process.

1. An alliance with a regional leader in the highest-growth segment of telecommunications services: the experience of Portugal Telecom

Portugal Telecom (PT) is currently the largest private-sector business conglomerate in Portugal, with total sales of 6.3 billion euros. The company provides fixed and mobile telephony, Internet, cable television and other related services to over 40 million customers around the world, most of them in two strategic markets, Portugal and Brazil. PT is the leader in Portugal, offering a full range of voice, multimedia and data services, and it is also the market leader in the mobile telephony segment in Brazil where, in partnership with Telefónica of Spain, it operates the largest mobile telecommunications company in Latin America, Vivo.[6] The Portuguese firm is also strongly positioned in a number of African countries (Angola, Cape Verde, Morocco and Sao Tome and Principe) and Asia (Macao Special Administrative Region and Timor-Leste), many of them former Portuguese colonies. PT has thus become one of the European Union's leading integrated telecommunications operators (see table IV.7).

[6] Telefónica holds a 9.7% equity stake in PT (PT, 2006a, p. 60).

Table IV.7
EUROPEAN UNION: LARGEST TELECOMMUNICATIONS COMPANIES, BY SALES, 2005
(Millions of euros)

	Company	Country of origin	Total sales
1	Deutsche Telekom	Germany	59 604
2	France Télécom	France	49 038
3	Vodafone	United Kingdom	43 031
4	Telefónica	Spain	37 882
5	Telecom Italia SpA	Italy	29 919
6	BT Plc	United Kingdom	28 610
7	KPN (Konin) NV	Netherlands	11 811
8	Portugal Telecom	Portugal	6 284
9	TDC A/S	Denmark	6 252
10	Belgacom SA	Belgium	5 384

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from Bloomberg and the companies themselves.

International investment has been turning into a key factor in the dynamic and consolidation of PT in the regional and global context it operates in. This process has also helped strengthen Portugal's role as a link between Europe, Latin America and Africa (PT, 2005, p. 12).

Consolidation of the telecommunications assets owned by the Portuguese State intensified in the early 1990s, when they were grouped into Comunicações Nacionais (CN).[7] A single national telecommunications operator was created in 1994 by the merger of Telecom Portugal, Empresa Pública Telefones de Lisboa e Porto (TLP) and Teledifusora de Portugal (TDP) to form Portugal Telecom (PT). Following this, the privatization of the company, which was planned in a number of stages, quickly began.

In the first phase in 1995, 27.3% of the company's equity was transferred to private investors by floating shares on the Lisbon, London and New York stock exchanges. A further 21.7% was sold off a year later, leaving 49% of PT in private hands. In 1997, following approval of the sectoral delimitation law that allowed the State to reduce its holding in PT, the private-sector share of the company's equity rose to 75%. In 1999, a further 13.5% held by the State was sold off and there was a capital increase. Following these two operations, the State reduced its holding in the company from 25.2% to about 11%. Lastly, in December 2000, the fifth and final phase of the privatization was concluded, leaving virtually the whole of PT's equity in private hands, the exception being 500 class A shares held by the State (golden share). The purpose of the State's retaining a golden share was to protect the public interest in a business deemed to be strategic.[8]

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[7] At that time, the telecommunications network in Portugal was run by three operators: Empresa Pública Telefones de Lisboa e Porto (TLP), which operated the telephone service in the Lisbon and Porto areas; Telecom Portugal, which had inherited the telephony assets of Correios, Telégrafos e Telefones (CTT) and was responsible for all other communications within the country and to Europe and the Mediterranean area; and Companhia Portuguesa Rádio Marconi (CPRM), which handled intercontinental traffic. In 1991, Teledifusora de Portugal (TDP) was created with the mission of operating and maintaining the transmission and distribution infrastructure.

[8] As of 2006, the largest shareholders in PT were Telefónica (9.7%), Brandes Investment Partners (8.5%), Banco Espírito Santo (8.4%) and Caixa Geral de Depósitos (5.1%).

Even as it was being privatized, PT began to face growing competition in the domestic market following the granting of licences to private-sector mobile telephony operators (Braz, 2002, p. 280). And while it already had something of an international presence in the form of small operations in former Portuguese colonies, PT started to project itself more vigorously abroad with a view to freeing itself from the constraints of the domestic market and projecting itself as a global player in one of the world's most dynamic markets (see table IV.8).

Table IV.8
PORTUGAL TELECOM: MAIN ASSETS, 2006
(Millions of euros and thousands of customers)

	Company	Business	Stake	Sales	Customers
Europe					
Portugal	Rede Fixa	Fixed-line	100.0	2 050	4 418
	Telecomunicações Móveis Nacionais (TMN)	Mobile	100.0	1 455	5 493
	PT Multimedia	Multimedia	58.4	627	2 412
Latin America					
Brazil	Brasilcel (Vivo)	Mobile	50.0	2 037	28 726
	Telesp Celular	Mobile	66.1	…	…
	Tele Centro Oeste	Mobile	52.5	…	…
	Global Telecom	Mobile	100.0	…	…
	Tele Sudeste Celular	Mobile	91.0	…	…
	Celular CRT	Mobile	68.8	…	…
	Tele Leste Celular	Mobile	50.7	…	…
	UOL	Internet	25.0	…	1 540
Africa					
Morocco	Médi Télécom	Mobile	32.2	…	4 259
Cape Verde	Cape Verde Telecom (CVT)	Fixed-line and mobile	40.0	…	171
Angola	Unitel	Mobile	41.1	…	1 700
Sao Tome and Principe	Companhia Santomense de Telecomunicações	Fixed-line and mobile	51.0	…	25
Namibia	Mobile Telecommunications Limited (MTC)	Mobile	34.0	…	556
Asia					
Timor-Leste	Timor Telecom	Fixed-line and mobile	34.0	…	45
Macao Special Administrative Region of the People's Republic of China	Companhia de Telecomunicações de Macau (CTM)	Fixed-line and mobile	28.0	…	465

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Portugal Telecom (PT), *2006 third quarter results*, Lisbon, 9 November 2006 (http://www.telecom.pt).

With this in view, PT signed a number of agreements with other global operators to enhance its international competitiveness. In early 1997, the company signed up to a cooperation accord with Telefónica of Spain, an agreement with Telecomunicações Brasileiras SA (Telebrás) and a strategic alignment with Concert, an alliance involving British Telecom (BT) of the United Kingdom and MCI of

the United States.[9] The collaboration accord with Telefónica and the creation of the Aliança Atlântica with Telebrás aimed at mutual cooperation, a common strategy and joint international investments in Latin America and Africa to develop their competitive advantages and natural interests in these markets (PT, 1998, p. 7).

A vital phase in the company's internationalization strategy began in 1998 when it participated successfully in the telecommunications privatization process in Brazil. To prepare for its arrival in the country and in compliance with earlier undertakings, PT carried out a number of operations. First, it acquired 1% of Telefónica and bought ordinary shares in Telebrás and Telecomunicações de São Paulo SA (Telesp) worth approximately US$ 77 million (*PT press releases*, 19 March 1998). It then acquired a minority stake in Companhia Riograndense de Telecomunicações (CRT), the main operator in the state of Rio Grande do Sul in the fixed-line and mobile telephony segments.[10] CRT, controlled by Telefónica, was one of the four Brazilian telecommunications companies that were outside the Telebrás system, and the first to be wholly privatized. PT spent US$ 375 million on this operation, the largest acquisition by a Portuguese company on the American continent up to that time (*PT press releases*, 25 June 1998).

Thus, when the sell-off of Telebrás began, PT's presence in the Brazilian market and its partnership with Telefónica proved particularly important to its successful participation in this process. In July 1998, PT took control of Telesp Celular, the largest mobile telephony operator in São Paulo, Brazil and Latin America, and bought a large equity stake in the São Paulo fixed-line telephony company Telesp Fixa, for which it paid US$ 3,124 million. This operation was by far the largest acquisition abroad ever by a Portuguese company (*PT press releases*, 29 July 1998).

For US$ 3,085 million, PT acquired a majority stake in the holding company (Telesp Celular Participações) which controlled Telesp Celular. Telesp Celular had a 90% market share in the State of São Paulo, the country's richest with 1.6 million users and a waiting list of about 3.5 million people (*PT press releases*, 29 July 1998). Although PT's offer was for 100% of Telesp Celular's controlling position, the Portuguese company quickly began negotiations to reduce its share and tried to bring in other strategic partners. PT kept 51%, transferring 36% to Telefónica and the remaining 13% to Brazilian groups, whose involvement was particularly valuable because of their knowledge of the local market (*PT press releases*, 3 August 1998). In these circumstances, PT had high expectations of being able to capitalize on the rapid growth of mobile telephony and repeat in Brazil the successes it had achieved in Portugal, where it had introduced groundbreaking services —particularly prepayment, in which it was a global pioneer.

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[9] These agreements involved the acquisition of 6.25% of PT during the third privatization phase by Telefónica (3.5%), BT (1%), Telebrás (0.75%), MCI (0.5%) and Aliança Atlântica (0.5%). PT also undertook to acquire a financial stake in Telefónica (1%) and Telebrás (PT, 1998, p. 7 and *PT press releases*, 16 April 1997).

[10] The creation of a subsidiary, Celular CRT SA, was approved in June 1998, and all the assets and liabilities associated with the mobile telephony business were transferred to this company. This was done to comply with the requirement that fixed-line and mobile telephony operators should be different companies.

At the same time, as part of the same consortium as controlled CRT, PT acquired a stake in the holding company (Telesp Participações) which controlled fixed-line telephony in the State of São Paulo. Telesp Participações controlled two operators, Telesp Fixa and Companhia de Telecomunicações do Brazil Central (CTBC). This investment was particularly attractive because of the low penetration (16%) of fixed-line telephony in the State of São Paulo and the enormous pent-up demand reflected in a waiting list of more than 5 million (*PT press releases*, 29 July 1998). This acquisition would also allow PT to generate major synergies with its other operations in Brazil, particularly Telesp Celular.

Table IV.9
COOPERATION BETWEEN PORTUGAL TELECOM AND TELEFÓNICA

1997	Collaboration agreement for exploring and developing investment opportunities in Latin America and Africa
1998	Establishment of a joint venture to enter markets in northern Africa and eastern Europe, plus emerging markets in Asia Joint participation in the privatization of the Telebrás system in Brazil
1999	Second mobile telephony licence in Morocco, through the Médi Télécom consortium
2000	Equity swap between Telesp (fixed-line) and Telesp Celular (mobile)
2001	Partnership in Brazil to create a mobile telephony joint venture, pooling all the assets owned by the two firms in the country, with 50% apiece
2002	Migration to the new regulatory systems for PCS mobile telephony (SMP). Formalization of the joint venture in Brazil (BrasilCel) with the transfer of all PT's and Telefónica's holdings in mobile telephony operators to BrasilCel. Acquisition of Tele Centro Oeste (TCO) and the decision to implement a wide-ranging investment plan including incorporation of CDMA technology
2003	Reorganization of BrasilCel and launch of Vivo to replace local brands in Brazil
2004	Telefónica increases its stake in PT significantly, from 4.8% to 9.7% To improve and extend their management control, PT and Telefónica launch a public tender offer for the shares of some of their subsidiaries in Brazil
2005	New company structure created by grouping all Brazilian subsidiaries under a single brand, Vivo
2006	The public tender offer by Sonae SGPS for PT raises some doubts about the survival prospects of this cooperation partnership

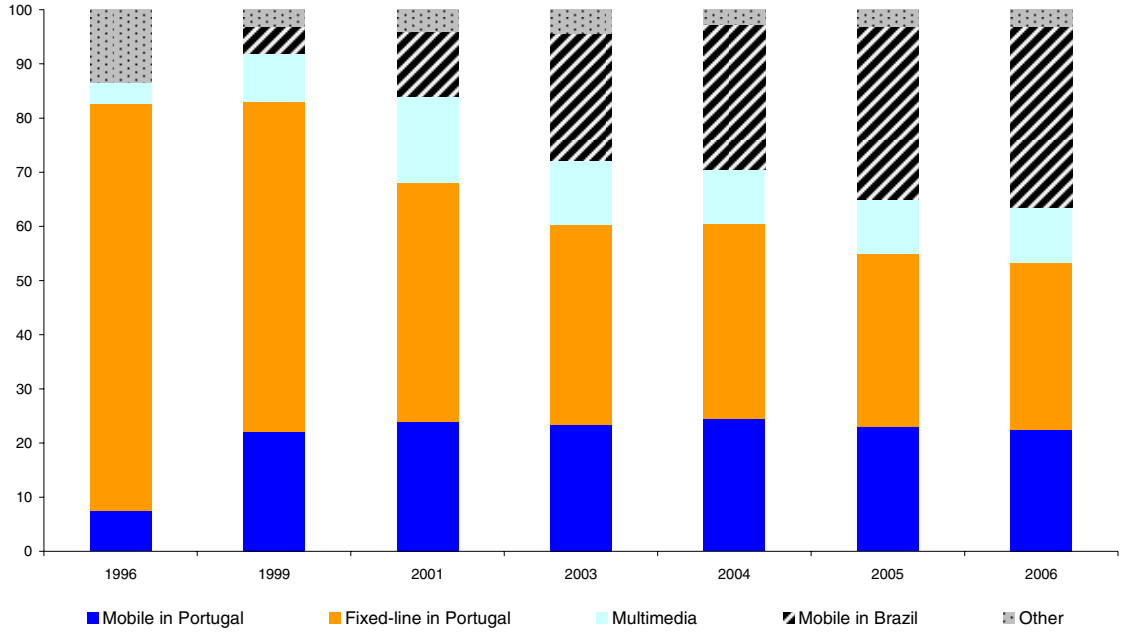
Source: Economic Commission for Latin America and the Caribbean (ECLAC).

Thus, PT's first large international equity holding proved highly successful for the company. In fact, this small European telecommunications firm had achieved a solid position in the economic and industrial heart of Latin America's largest country, in a market with excellent growth prospects. Activities in Brazil were extremely dynamic in the early months, and the importance of PT's international operations increased as a result, particularly those linked to Telesp Celular (see figure IV.5).[11]

[11] Between 1997 and 1998, the mobile telephony penetration rate in the State of São Paulo rose from 3.8% to 7.8% (PT, 1999). In 1998, Telesp Celular's mobile telephony subscriber base grew by 41% to 1.8 million, giving it a market share of 67% in the concession area.

In these circumstances, PT initiated a wide-ranging investment plan (US$ 660 million in 1999) which included network modernization and the incorporation of CDMA digital technology. This enabled it to improve service quality and launch new products and services, particularly prepayment systems, significantly increasing its customer base (PT, 2000, p. 21) (see figure IV.6). In 1999, Telesp Celular brought in two prepayment plans: Baby, the first to be available in Brazil, and Peg&Fale, aimed at lower-income segments (PT, 2000, p. 20).[12]

Figure IV.5
PORTUGAL TELECOM: TOTAL SALES BY BUSINESS SEGMENT, 1996-2006 [a]
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Portugal Telecom, *Annual Report*, various issues, Lisbon, and Portugal Telecom, *2006 third quarter results,* Lisbon, 9 November 2006 [online] http://www.telecom.pt.

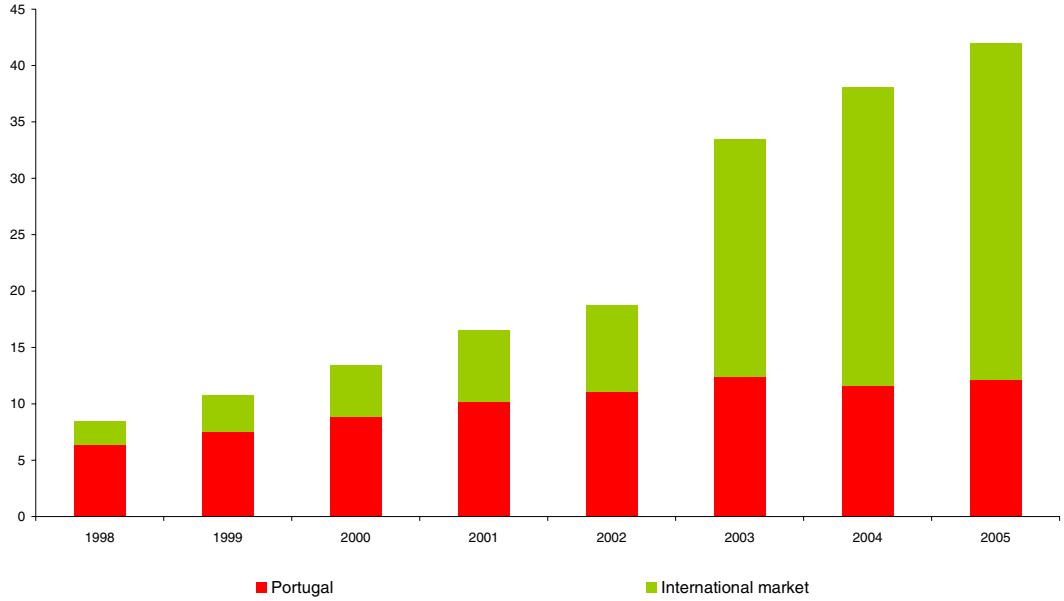
[a] January-November 2006.

Thus, even as it was itself being privatized, and ahead of the liberalization of the Portuguese telecommunications market, PT's acquisitions in Brazil allowed it to move further towards its goal of steady, diversified growth through a strategy of maximizing synergies between different geographical and business areas.[13] In addition, PT had some unique cultural, linguistic and historical advantages, experience with mobile telephony in competitive environments and synergies (bilateral traffic and investment) that allowed it to compete successfully in Brazil.

[12] By late 1999, the two prepayment programmes had over 863,000 customers, representing 79% of all new customers and 30% of all Telesp Celular users (PT, 2000, p. 20). By December 2000, the company had over 4.3 million customers, more than half of them using the prepayment system (PT, 2001, p. 21).

[13] Fixed-line telephony began to be liberalized in Portugal in 2000, when new operators were allowed to enter the market and access customers directly using their own infrastructure and indirectly by selecting a national and international long-distance carrier (PT, 2001, p. 12).

Figure IV.6
PORTUGAL TELECOM: TOTAL CUSTOMERS IN PORTUGAL AND ABROAD, 1998-2005
(Millions)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Portugal Telecom, *Annual Report*, various issues, Lisbon.

In the early part of the present decade, PT sought to carry on strengthening its position in the Brazilian market by increasing its stake in Telesp Celular, acquiring new assets to complement its existing ones and deepening its relationship with the Spanish company Telefónica.

In the first half of 2000, PT increased its stake in Telesp Celular to 30% through a number of market operations, including a public tender offer for all the shares not held by the controlling group. This cost the company some US$ 900 million (*PT press releases*, 21 January and 13 June 2000).

In the second half of the year, PT and Telefónica agreed to swap the stakes they held in Telesp Celular and Telesp (fixed-line telephony), respectively.[14] In addition, PT carried out a capital increase for Telesp Celular, subscribing to almost the entirety of the new issue. Thus, once the National Agency of Telecommunications (ANATEL) had approved both operations, the Portuguese company's stake in Telesp Celular rose from 30% to 41% (PT, 2001).

Simultaneously, acting through Telesp Celular, PT came to terms with Centrais Telefónicas de Ribeirão Preto (CETERP), controlled by Telefónica, to acquire CETERP Celular, a Band A mobile telephony operator in the Ribeirão Preto region located in the north-east of the State of São Paulo (*PT press releases*, 20 July 2000).[15] Once acquired, CETERP Celular was absorbed by Telesp Celular, and the

[14] Under the agreement, Telefónica swapped its 35.8% stake in Portecom Participações, the consortium controlling Telesp Celular, for the 23% indirectly owned by PT in SP Telecomunicações Holding (which controlled Telesp). Telefónica also paid the Portuguese company US$ 59.8 million (Telefónica, 2001, p. 158 and *PT press releases*, 20 July 2000).

[15] In December 1999, Telesp, controlled by Telefónica, acquired 73% of CETERP, a fixed-line and mobile telephony provider, for US$ 183 million (Telefónica, 2001, p. 161). In October 2000, Telesp made a public

Portuguese company was able to offer its mobile telephony service throughout the State of São Paulo. PT also sold its stake in the fixed-line telephony company CRT, for which it received US$ 183 million, although it retained its interest (7.3%) in CRT Celular (PT, 2001).

In January 2001, acting through Telesp Celular, PT acquired 83% of Global Telecom (GT), the Band B operator (second operator) in the states of Paraná and Santa Catarina, which adjoin the State of São Paulo and are among the richest areas in Brazil, for US$ 1.21 billion. GT operated with CDMA technology, making it fully compatible with Telesp Celular, and this meant that tried and tested products and services (such as the Baby prepayment system) could be introduced, generating major synergies (PT, 2002).

Lastly, PT took some steps towards further diversification of its activities in Brazil. During 2000, the Portuguese company entered the multimedia segment and acquired Internet businesses such as Zip.net, Banco1.net and Investnews for 489 million euros (PT, 2001, p. 176).[16] PT also controls 21.1% of the Folha UOL consortium, which publishes the Folha de São Paulo newspaper and owns stakes in DEDIC and PrimeSys.

In this way, PT reaffirmed its strategy of concentrating on mobile telephony, a segment with high growth potential, in the State of São Paulo, the region with the greatest urban density and highest level of industrial development in South America. With these acquisitions, PT further consolidated its leadership position, scaled up its business and reaped the synergies from the good geographical and technological fit between its assets (both used CDMA). It also succeeded in establishing a platform for the development of new businesses in the Brazilian telecommunications market, as well as creating major synergies between related segments.

Early in 2001, PT took a great step forward with its expansion in the Brazilian telecommunications market. In January, PT and Telefónica signed a strategic agreement to create a 50-50 joint venture that would run the two companies' assets in the Brazilian mobile telephony segment. The partnership comprised Telesp Celular and Global Telecom on the PT side, Tele Sudeste Celular in Rio de Janeiro and Tele Leste Celular in Bahia and Sergipe on the Telefónica side, and CRT Celular, in which the two companies were partners, in Rio Grande do Sul (see table IV.10). To strengthen the agreement, furthermore, Telefónica undertook to purchase a further 5% of PT's equity, bringing its stake up to 10%; and PT had the option of raising its stake in Telefónica to 1.5% (*PT press releases*, 24 January 2001). However, the deteriorating global and regional economic situation, exacerbated by the Argentine crisis and the devaluation of the Brazilian currency, delayed the creation of the joint venture.

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tender offer for the remaining equity as required by the privatization rules. Subsequently, in compliance with the rules applying to the Brazilian telecommunications market, CETERP sold its CETERP Celular subsidiary to Telesp Celular, controlled by PT. In addition, CETERP was merged into Telesp. The CETERP operation was one of the measures taken to meet the service quality and expansion targets set by the regulator before the deadline, putting Telesp, and thus Telefónica, in a position to offer other services and enter other regions of Brazil rapidly (Telefónica, 2001, p. 21).

[16] In December 2000, PT established a strategic alliance with two financial institutions, Banco Bradesco SA (Bradesco) and União de Bancos Brasileiros SA (Unibanco), with a view to strengthening its position in the Brazilian telecommunications market. As part of this accord, PT paid US$ 281 million for 100% of Unibanco Sistemas SA (BUS), the company which took over the telecommunications networks of Unibanco and Bradesco, along with the respective licences to provide these services (PT, 2001, pp. 55-56). In June 2000, PT paid US$ 35 million for 50% of Investnews, a company that owns the exclusive Internet rights over all news content produced by the financial newspaper *Gazeta Mercantil* (PT, 2001, p. 66).

Table IV.10
STRUCTURE OF THE STRATEGIC AGREEMENT BETWEEN PORTUGAL TELECOM AND TELEFÓNICA, JANUARY 2001
(Percentages)

Portugal Telecom - Telefónica			
Telesp Celular	**Tele Sudeste Celular**	**CRT Celular**	**Tele Leste Celular**
41.2% [a]	81.6% [a]	36.6% [a]	10.8% [a]
85.1% [b]	75.7% [b]	55.8% [b]	21.9% [b]
Global Telecom			
83.0% [a]			
49.0% [b]			

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Portugal Telecom, *Annual Report 2000*, Lisbon, 2001, p. 15.

[a] Percentage economic interest.
[b] Percentage voting rights.

In these circumstances, PT explicitly chose to centre its strategy on organic growth, strengthen its leadership in the Portuguese market and try to bring its Brazilian operations into profit (PT, 2003, p. 9). The company continued to be the leader in Portuguese telecommunications, positioning itself as one of the best operators in Europe (see table IV.7). Besides this, its growing presence in Brazil was clear evidence of its determination to improve its position in geopolitically favourable markets with significant cultural affinities (PT, 2004, p. 10).

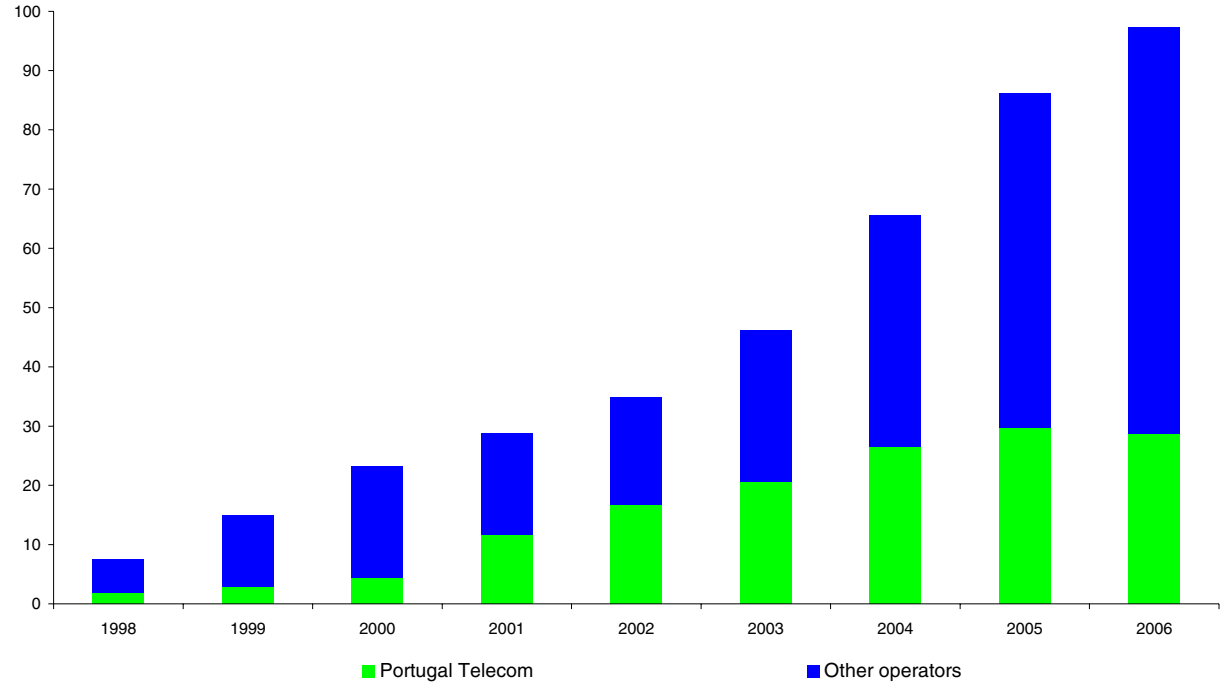
Anticipating greater competition in the future,[17] PT sought to improve its position in the Brazilian market by drastically rationalizing costs, expanding its customer base (essentially with prepayment products), developing new products and services such as WAP and encouraging customers to migrate from the analogue to the digital service (PT, 2002, pp. 15-16). In this way, Telesp Celular produced a sound operating performance and carried on increasing its market share in the State of São Paulo (PT, 2003, p. 38). In addition, PT went ahead with the capital increase it had announced for Telesp Celular to reduce its debt and allow it to implement an aggressive business plan. In mid-2002, Telesp Celular increased its capital and most of its shares were purchased by PT, allowing the Portuguese company to increase its stake in its Brazilian subsidiary from 41% to 65% (*PT press releases*, 9 September 2002).

As the overall economic situation shifted, opening up good prospects for the mobile telephony business in the Brazilian market, and new rivals made their appearance, an effort was made to establish the joint venture as quickly as possible. Acting through Telesp Celular, PT acquired the remaining 17% of GT for US$ 82 million while, to keep the two companies' stakes in the new firm equal (50%), Telefónica acted through Telefónica Móviles to buy 15% of Telesp Celular from the Portuguese firm for 200 million euros (PT, 2003, p. 7).[18] In December 2002, ANATEL finally approved the creation of the joint venture, and both companies transferred their stakes in the Brazilian mobile telephony operators to the new firm, named BrasilCel (*PT press releases*, 6 and 30 December 2002). In this way, the new firm become the largest provider of mobile telephony services in Brazil (with three times as many customers as its nearest rival) and Latin America, with some 17 million subscribers and a potential market of over 90 million

[17] In 2002, the Mexican firm América Móvil bought out its partners in Telecom Américas and concentrated on expanding strongly in Brazil (ECLAC, 2006a, p. 147).
[18] The joint venture thus came to hold a 65.1% financial stake and 99.7% of voting rights in Telesp Celular (PT, 2003, p. 7).

inhabitants, and with a market share of over 60% in the states it served, which represented more than 70% of Brazil's GDP (PT, 2003, p. 12) (see figure IV.7).

Figure IV.7
PORTUGAL TELECOM: TOTAL MOBILE TELEPHONY CUSTOMERS IN BRAZIL, 1998-2006 [a b]
(Millions of customers)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Portugal Telecom, *Annual Report*, various issues, Lisbon; Agência Nacional de Telecomunicações (ANATEL), *Relatório anual 2005*, Brasilia, December 2005; and TELECO, Informação em Telecomunicações [online] http://www.teleco.com.br, 25 January 2007.

[a] January-November 2006.
[b] The joint venture with Telefónica (BrasilCel) was created in December 2002, after which it began to operate under the Vivo brand.

This alliance consolidated PT's leadership of the Brazilian mobile telephony market and allowed it to target resources and capabilities on developing its business in the region and to benefit from substantial operating synergies. The economies of scale and solid leadership position enjoyed by the two companies in this market also did much to offset the cost of migrating from the existing mobile concessions to the new PCS licences.

PT and Telefónica quickly acted to achieve greater geographical coverage in the Brazilian market. In early 2003, BrasilCel took over Tele Centro Oeste (TCO), the leading operator in the centre-west and north of the country (see map IV.1).[19] With this acquisition, BrasilCel was able to cover all the

[19] The acquisition of 100% of Tele Centro Oeste (TCO) was carried out by Telesp Celular in three stages: (i) the acquisition of ordinary shares owned by a Brazilian company, Fixcel, which represented 61.1% of TCO voting rights, at a cost of 404 million euros; (ii) a subsequent public tender offer for the remaining ordinary shares; (iii)

country's main cities. PT and Telefónica set out to establish a homogeneous identity for their mobile telephony businesses in Brazil by creating a new name that would cover all their assets in the country. Thus, Vivo became a single brand in 20 states and the Federal District of Brasilia, covering 85% of Brazil's territory and 74% of its population, or 86% of the country's GDP. This gave the joint venture a market share of some 50% nationally and 57% in the concession areas (see figures IV.6 and IV.7 and map IV.1) (PT, 2004, pp. 14 and 34). Indeed, just nine months after its launch, Vivo was already the largest mobile operator in the southern hemisphere (*PT press releases*, 10 December 2003).

Map IV.1
PORTUGAL TELECOM-TELEFÓNICA ALLIANCE IN BRAZIL: GEOGRAPHICAL COVERAGE OF THE VIVO BRAND, 2005

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of TELECO, Informação em Telecomunicações (http://www.teleco.com.br).
Note: NBT: Norte Brasil Telecom; TCO: Tele Centro Oeste; CRT: Companhia Riograndense de Telecomunicações; Telefónica Celular SE/BA: Tele Leste Celular; Telefónica Celular ES/RJ: Tele Sudeste Celular.

Despite having more than 20 million customers and establishing itself as the company with the most users in the whole telecommunications sector, Vivo began to lose market share to its main rivals, Telecom Italia (TIM), América Móvil (Claro) and Grupo Telemar (Oi) (see figure IV.8). In a market that was growing explosively, the complexity of the alliance between PT and Telefónica may have contributed to this performance. A decision-making system that had to coordinate the objectives of both firms, identify and remove duplications of functions and seek out new synergies certainly complicated the first phase of their joint operations in Brazil. In this situation, other companies achieved better results and

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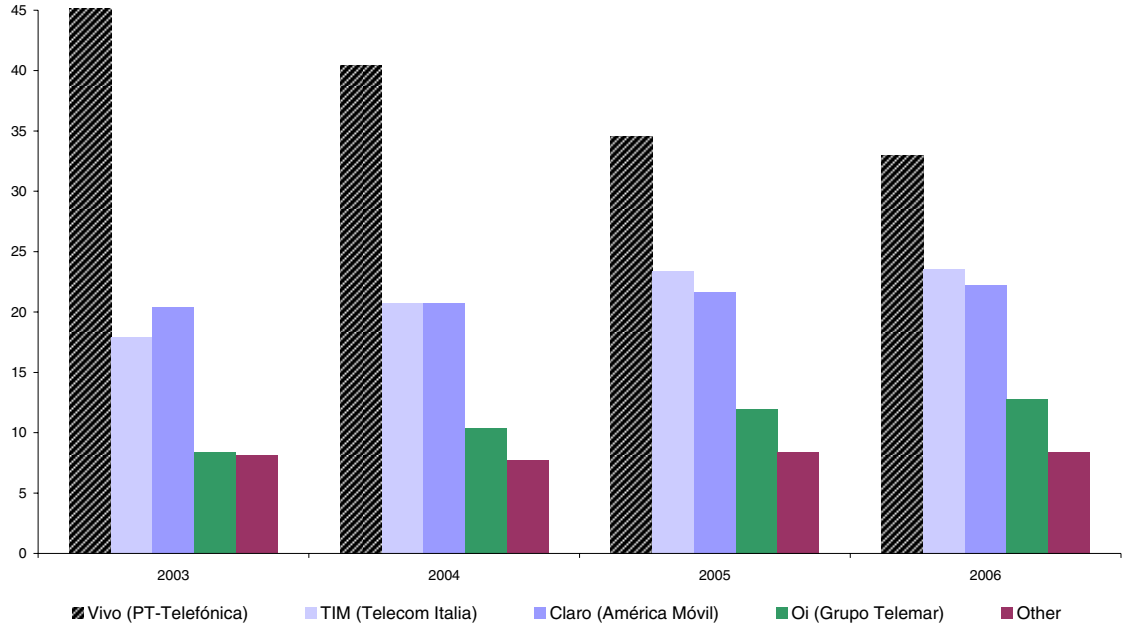
the integration of TCO into Telesp Celular by incorporating the remaining shares (PT, 2004, p. 14). TCO is present in 11 states and the country's capital, Brasilia. TCO was formed by two operators: (i) TCO, the leader in the centre-west region, which includes the cities of Brasilia and Goiania; (ii) Norte Brasil Telecom (NTB), which holds a Band B licence in the north of the country, covering cities such as Manaus and Belém.

began to challenge Vivo's hitherto undisputed leadership in Brazil (see figure IV.8). To cope with this situation, BrasilCel carried on investing in new forms of provision, concentrating particularly on launching innovative products and services based on CDMA technology as a way of expanding its customer base.[20]

Figure IV.8
BRAZIL: MARKET SHARES OF THE LEADING MOBILE TELEPHONY OPERATORS, 2003-2006 [a]
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of TELECO, Informação em Telecomunicações (http://www.teleco.com.br), 25 January 2007.

[a] January-November 2006.

To cement the alliance between the two Iberian companies, Telefónica also increased its stake in PT. During 2004, the Spanish company undertook a number of market operations that raised its stake in PT from 4.8% to 9.7% at a cost of some 475 million euros (*Jornal de Negocios*, 12 April 2005). Increasing its stake in this way brought Telefónica close to the limit set by the two companies in their 2001 agreement, which provided that the Spanish company could take ownership of up to 10% of PT (PT, 2006a, p. 60).

In these circumstances, BrasilCel and Telesp Celular acted in concert to launch public tender offers for some of their subsidiaries in Brazil as a way of enhancing and extending their management

[20] PT also transferred its experience in the Portuguese market to its international operations. Indeed, Telecomunicações Móveis Nacionais (TMN) was the first operator to provide video calling services on third generation (3G) devices in Portugal (PT, 2005, p. 66). In 2004, Vivo launched a number of new services and products that served to differentiate it from its rivals and place it at the forefront of innovation in the Brazilian mobile telephony market. Capitalizing on the technological advantages of the CDMA network, Vivo invested in expanding 1xRTT, a 2.5G technology, and began to roll out EV-DO, a third generation services network (PT, 2005, p. 75).

control.[21] The intention was to strengthen Vivo's position in the Brazilian market and give it a greater stake in the growth of its subsidiaries. In October 2004, the joint venture between PT and Telefónica acquired more than 99% of the shares targeted by the public tender offer, at a cost of US$ 215 million to BrasilCel and US$ 320 million to Telesp Celular (*PT press releases*, 9 October 2004). The cost of executing these offers was split equally between PT and Telefónica. In addition, Telesp Celular approved a capital increase of more than US$ 1.1 billion and used some of these funds to raise its stake in Tele Centro Oeste Celular.[22] The new asset structure turned Vivo into the world's tenth-largest mobile telephony operator (PT, 2005, p. 70).

In late 2005, the business was restructured once again with a view to simplifying the organizational structure of the Brazilian subsidiaries operating under the Vivo brand name and thus enhancing operational efficiency and generating synergies. In this operation, all the subsidiaries were taken over by Telesp Celular, which was renamed Vivo Participações SA (*PT press releases*, 5 December 2005). At a time of growing competition, this corporate restructuring would allow the Vivo brand to consolidate as the leader in the Brazilian mobile telephony market. Nonetheless, the company was unable to turn the situation around, basically because it did not operate with GSM technology, the most widely used in the country. To remedy the situation, it announced an ambitious plan to invest 400 million euros in the development of a GSM mobile telephony system in parallel with its CDMA system, to be completed within three years (*Cinco Días*, 31 July 2006).[23] By late 2006, Vivo had a market share of about 29.5% in Brazil (39.3% in the regions where it operated), giving a total of 28.7 million customers (PT, 2006c, p. 38) (see figure IV.8).

Notwithstanding the drop in its market share, it is important to emphasize the degree of customer loyalty achieved by the new Vivo brand. In this phase of rising penetration, recognition and acceptance of the brand by the Brazilian population has been essential, basically because the rapid growth in the mobile telephony market has been driven by prepayment customers, accounting for 81.7% of the company's total user base as of late 2006.

PT's good results and successful international expansion caught the interest of international investors. In early 2006, Sonaecom SGPS SA, a subsidiary of one of Portugal's largest industrial groups, Sonae SGPS, launched an unsolicited and thus hostile bid for PT shares with a view to gaining control of the company (*PT press releases*, 7 February 2006).[24]

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[21] BrasilCel launched public tender offers for Tele Sudeste Celular, Tele Leste Celular and Celular CRT. At the same time, Telesp Celular made a public tender offer for Tele Centro Oeste Celular (*PT press releases*, 25 August 2004).

[22] The capital increase was completed in January 2005. The resources were used to: (i) pay off a bridging loan made by Banco ABN Amro Real to finance the public tender offer for some of Tele Centro Oeste Celular's equity, and (ii) pay off other short-term borrowings. Following official approval of the capital increase, the controlling group increased its stake in Telesp Celular from 65.1% to 65.7% (*PT press releases*, 5 January 2005).

[23] The European GSM technology is the undisputed world leader in mobile telephony. Three out of every four mobile telephony subscribers in the five continents, or more than 1.3 billion people, use this standard. In early 2005, there were 151 million mobile telephone users in Latin America. Of these, 68 million were connected to networks using the old United States TDMA standard and 44 million to infrastructure employing the European GSM standard, while 39 million were on networks operating the new United States CDMA mobile standard (*Cinco Días*, 31 July 2006).

[24] Sonaecom manages the Sonae group businesses in the communications and telecommunications segments in Portugal, including *Público* newspaper and three operators, Optimus (mobile telephony), Novis (fixed-line telephony) and Clix (Internet).

The PT board took the view that Sonaecom's offer of 16.3 billion euros (including PT's liquid debt) substantially undervalued the company (PT, 2006b, p. 2). The argument against the offer highlighted the lack of information about its financing and the excessive debt that would have to be taken on by the new controllers of the company, jeopardizing its future capacity and perhaps leading to the break-up of PT (40 million customers and 30,000 employees in 14 countries).[25] According to analysts, Sonaecom might well liquidate PT's assets in Brazil (50% of Vivo) if its offer were successful. Again, the Sonaecom bid would create an unprecedented degree of concentration in the Portuguese mobile telephony market, giving rise to great regulatory obstacles. Lastly, it was emphasized that the bidders did not have a long-term strategy for the company (or much international experience in the business) in what was a highly competitive, dynamic sector requiring high levels of investment. In late 2006, the Portuguese competition authority announced that it had no objection to the operation (*Público*, 5 December 2006).

In early 2007, Sonaecom improved its offer from 9.5 to 10.5 euros per share, conditional upon its securing at least 50% plus one of the shares and a change in the company's articles of association.[26] The Portuguese firm once again rejected the offer, however, and adopted a more vigorous strategy, outlining plans for a generous dividend and a share buyback worth 6.2 billion euros if the bid should fail.

PT's main shareholders took up opposing positions. Telefónica aligned itself with Sonaecom and favoured an end to the limitations imposed by the company's articles of association. This support showed Telefónica's belief that the bid would succeed and that it would be able to acquire the other 50% of Vivo as a result. Ever since the bid was launched, analysts had been speculating that Telefónica would sell its stake in PT and acquire the company's assets in Brazil, in order to consolidate its corporate image in Latin America.

In March 2007, however, an extraordinary general meeting of PT rejected the proposed change in the articles of association and thereby condemned the Sonaecom bid to failure. Telefónica was left in an awkward position vis-à-vis the other shareholders and the PT directors, which could affect the strategic relationship the two companies have been building up in recent years, particularly in Brazil.

To sum up, even as it was itself being privatized, this small Portuguese telecommunications company saw in the Brazilian privatization programme the opportunity it needed to free itself from the constraints it was under because of its lack of international experience. In an industry that was beginning to show signs of vigorous consolidation and concentration, the company urgently needed to expand beyond the borders of Portugal.

In Brazil, PT took control of the main mobile telecommunications company in the State of São Paulo, among other assets. In this way, the Portuguese firm began to specialize in the wireless segment of the country's wealthiest markets, and set out to achieve national coverage. It was aided in this by a fruitful alliance with the Spanish company Telefónica. It quickly scaled up its business, taking advantage of the synergies yielded by the good geographical fit of its businesses and its use of a single technology.

The global crisis in the industry and the deterioration of the regional economic situation forced PT to concentrate on its domestic market, temporarily shelving its plans for expansion in Brazil. In the

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[25] Sonaecom announced that it would carry out a 1.5 billion euro capital increase to support the public tender offer, leaving doubts as to how it would finance the remaining 14.8 billon, representing over 90% of the value of the transaction (PT, 2006a).

[26] PT's articles of association limit voting rights to 10% of shares, meaning in practice that a new shareholder acquiring a majority equity stake would not control the company.

latter country, PT sought to increase the returns on its operations, keep ahead of rising competition (the entry of América Móvil into the market), increase its customer base (with growth coming essentially from prepayment plans) and develop new products.

It was when it clinched its alliance with Telefónica that the company really consolidated in the Brazilian market. Working within a common corporate identity (the Vivo brand), the two companies strengthened their stakes in local subsidiaries through public tender offers and extended coverage to most of the country. However, the frictions resulting from Sonaecom's bid have raised doubts about the continuity of the strategic alliance between PT and Telefónica in Brazil.

2. Energy firms: internationalization strategies centred on neighbouring countries

As in the great majority of European countries, Portugal's electricity sector used to operate as a State monopoly. In 1976, Electricidade de Portugal (EDP) was created from the merger of 13 companies that had been nationalized the year before. In the early 1990s, in line with the reforms that were beginning elsewhere in the European electricity sector, EDP began a profound restructuring, changing its legal status to that of a limited-liability company (*sociedade anónima*) and creating independent subsidiaries to operate in the areas of electricity generation, transmission and distribution (EDP, 2006b, p. 18). In 1997, the Portuguese Government began privatizing the company. As part of these developments, in October 2004 the company changed its name to Energias de Portugal SA (EDP). By 2006, six phases of the privatization process had been completed and the State controlled about 25% of the company's equity through various mechanisms.[27]

EDP is currently the largest electricity generator and distributor in Portugal. It also owns 30% of Rede Eléctrica Nacional SA (REN), Portugal's electricity transmission company.[28] Internationally, the firm has become a significant player in Brazil and Spain. Thus, EDP has rapidly become one of Portugal's largest business groups and one of the leading European operators in the electricity sector, with an installed capacity of over 13,290 MW and sales of some 9.68 billion euros (see table IV.11).

In the late 1990s, profound structural changes took place in the European electricity sector, forcing companies to act in a highly dynamic environment and conduct their operations in very different circumstances, including both regulated and competitive markets. With the experience it had acquired as a service provider in the electricity sector and the progress it had made in terms of efficiency and competitiveness, EDP implemented a strategy of consolidating and retaining its leadership in the Portuguese market, internationalizing its operations and diversifying into other business areas. EDP's goal was to work its current assets and capabilities harder by participating in high-growth markets, and to continue building a multi-utility platform so that it could capture synergies between the electricity, water and natural gas businesses. In an increasingly liberalized electricity market, furthermore, it sought to enhance customer loyalty and diversify the risks associated with the regulation affecting its activities.

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[27] The Portuguese State holds 20.5% of EDP's equity directly through Participações Públicas (SGPA) SA, known as Parpública, and 4.9% indirectly through the State-owned bank Caixa Geral de Depósitos (EDP, 2006a, p. 148). Other major shareholders include Iberdrola (9.5%), Caja de Ahorros de Asturias (CajAstur) (5.5%) and Banco Comercial Português (BCP) (2.9%) (EDP, 2006b, p. 16).

[28] In 2000, during the period of change in the electricity sector, the Portuguese State retained ownership of 70% of REN, leaving the remaining 30% for EDP (EDP, 2001, p. 25).

Table IV.11
EUROPEAN UNION: LARGEST ELECTRICITY COMPANIES, BY SALES, 2005
(Millions of euros)

	Company	Country of origin	Total sales
1	E.ON AG	Germany	51 854
2	Électricité de France (EDF)	France	51 051
3	RWE AG	Germany	40 518
4	Enel SpA	Italy	32 272
5	Endesa SA	Spain	17 508
6	Vattenfall AB	Sweden	13 898
7	Electrabel SA	Belgium	12 218
8	Iberdrola SA	Spain	12 060
9	Energie Baden-Württemberg AG (EnBW)	Germany	10 769
10	Energias de Portugal (EDP)	Portugal	9 677
11	Essent NV	Netherlands	6 325
12	Unión Fenosa SA	Spain	6 099

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from Bloomberg and the companies themselves.

To make this multi-utility strategy a reality, EDP looked for strategic partnerships with other companies that would allow it to operate competitively in segments where it had no previous experience (see box IV.1). Locally, the main agreements were those with GALP Energia, Águas de Portugal (AdP), Brisa (the country's largest motorway operator) and the financial group Banco Comercial Português (BCP), while internationally it entered into agreements with the Spanish electricity company Iberdrola and the United Kingdom's largest public water supply and sewage company, Thames Water.

EDP thus embarked upon new ventures in the areas of telecommunications, water distribution and sewage, and natural gas. Taking advantage of the opportunities offered by the liberalization of the Portuguese telecommunications market, EDP went into partnership with BCP and GALP Energia to initiate fixed-line telephony operations through ONI, subsequently extending these to the mobile segment.[29] Given the powerful synergies between its different activities, EDP looked for new business opportunities in the water and sewage sector, both in Portugal and abroad (EDP, 2000, p. 47). Thus, the Portuguese company and its strategic partner Thames Water created Águas e Saneamento de Portugal SA (ValorÁgua) to bid for public service concessions in the domestic market, and acquired 51% of Empresa de Servicios Sanitarios del Libertador (ESSEL) in the VI Region of Chile, a stake which they shared equally between them (EDP, 2001, p. 44). Lastly, EDP strengthened its position in the Portuguese natural gas sector by taking an equity stake in GALP Energia.[30] With this operation, EDP sought to boost the development of electricity production projects and consolidate its position as a service provider in the business of household natural gas distribution, as well as strengthening its presence in the energy market of the Iberian peninsula (see box IV.2).

[29] On 1 January 2000, the Portuguese market was opened up to fixed-line telephony operators (EDP, 2000, p. 45). As of mid-2006, the main shareholders in ONI were: EDP (56.6%), BCP (23.1%), Brisa (17.2%) and GALP Energia (3.2%) (*EDP press release*, 22 June 2006, http://www.edp.pt).

[30] In January 2000, EDP increased its stake in GALP Energia from 3.3% to 14.3%. GALP Energia is a consortium created as part of the restructuring of the Portuguese energy sector (EDP, 2001, p. 43).

Box IV.1
ÁGUAS DE PORTUGAL: EXPANDING CAUTIOUSLY ABROAD

Águas de Portugal (AdP) was created in 1993 to develop municipal water supply and sewage systems. In the late 1990s, AdP began to diversify by entering new market segments and initiating the international expansion of its operations. Almost simultaneously, the Portuguese company began operating in Brazil, Cape Verde, Mozambique and Timor-Leste.

Like other Portuguese companies that were beginning to expand beyond the country's borders, AdP sought to establish partnerships with other companies to help it remedy its lack of international experience and improve its ability to adapt to the peculiarities of national markets. Some of its largest operations were in former Portuguese colonies in Africa. In Cape Verde, acting in partnership with Energias de Portugal (EDP), it emerged as the winner in the privatization of ELECTRA, an electricity production and distribution and water and sewage services firm. In Mozambique, AdP took part in a public tender process jointly with the French firm Saur and won the contract to run water supply systems in the cities of Maputo, Beira, Quelimane, Nampula and Bemba, serving a population of 2 million.

In Brazil as in Africa, AdP looked for a partner to help it break into the world's largest Portuguese-speaking market. Accordingly, it went into partnership with the local group Monteiro Aranha and created Empresa Brasileira de Águas Livres SA (EBAL), in which each partner held 50% of the equity. The purpose of EBAL was to grow with the Brazilian market and participate in the concession and privatization process that was then beginning in the country's water sector. In 1998, the Portuguese company formed part of the consortium that won a 25-year concession to run the water supply and sanitation system of the Região dos Lagos and the State of Rio de Janeiro (the concession includes the urban areas of the municipalities of Búzios, Cabo Frio, Iguaba Grande, São Pedro da Aldeia and Arraial do Cabo, and involves the provision of services to 390,000 people). The winning consortium was led by local investors, namely Monteiro Aranha with 32.5%, PEM Engenharia with 20% and PLANUP with 40%, while AdP, acting through EBAL, had a minority stake (7.5%). Monteiro Aranha chose to reposition its business, however, and as a result AdP came to control 100% of EBAL. In 2001, lastly, the Portuguese company bought out its Brazilian partners and took control of PROLAGOS, the company set up to run operations in the concession area. In 2002, all AdP activities in Brazil were grouped into a newly formed company, Águas do Brazil (AdB).

To sum up, AdP implemented a cautious strategy of international expansion in those markets where it found the strongest affinities of culture and language. Alliances with other operators were crucial in freeing AdP from the constraints imposed by its lack of international experience.

Source: Economic Commission for Latin America and the Caribbean (ECLAC).

Box IV.2
GALP ENERGIA: TOWARDS AN IBERIAN ENERGY MARKET?

In 1999, GALP Energia was created as part of the restructuring of the Portuguese energy sector, to operate in the areas of oil and natural gas. The following year, the company was partly privatized and two international strategic partners were selected: ENI of Italy and Iberdrola of Spain. Like most of the world's hydrocarbon companies, GALP Energia set out to improve its oil position (oil being its main production input) through a policy of selective investments focused on the acquisition of stakes in high-potential blocks, preferably in Portuguese-speaking countries and in partnership with other international oil companies (GALP Energia, 2006, p. 22).

At the beginning of the present decade, GALP Energia obtained its first significant results in oil production in Angola. In Brazil, the Portuguese firm worked with Petróleo Brasileiro SA (Petrobras) to acquire some stakes in blocks situated in Bahia de Santos.

Nonetheless, GALP Energia chose to take advantage of its experience and installed capacity in the fuel refining and distribution segment by focusing its expansion strategy on the Iberian peninsula. Its first step was to acquire 5% of Compañía Logística de Hidrocarburos SA (CLH), which facilitated the development of a strategy in this area in the Spanish market. In 2004, it strengthened its presence in the neighbouring economy by acquiring a subsidiary of the British firm BP, which brought it an active customer base and a logistical platform that allowed it both to extend the value chain and to get closer to the final customer. In the same area, it carried out a swap with Compañía Española de Petróleos SA (CEPSA) and Total of France, exchanging 79 sales outlets in Spain for 78 service stations in Portugal. Lastly, GALP Energia acquired 100% of Empresa de Petróleos de Valencia, owner of

Box IV.2 (concluded)

the logistics area in the port of Valencia, from Total of France. In 2005, GALP Energia had 837 service stations in Portugal and 223 in Spain (GALP Energia, 2006, p. 26).

To sum up, GALP Energia is building on its experience in fuel refining and distribution by moving towards the creation of an integrated logistical network in the Iberian peninsula. With support from the company's strategic partners (ENI and Iberdrola), further progress can be expected in the coming years.

Source: Economic Commission for Latin America and the Caribbean (ECLAC).

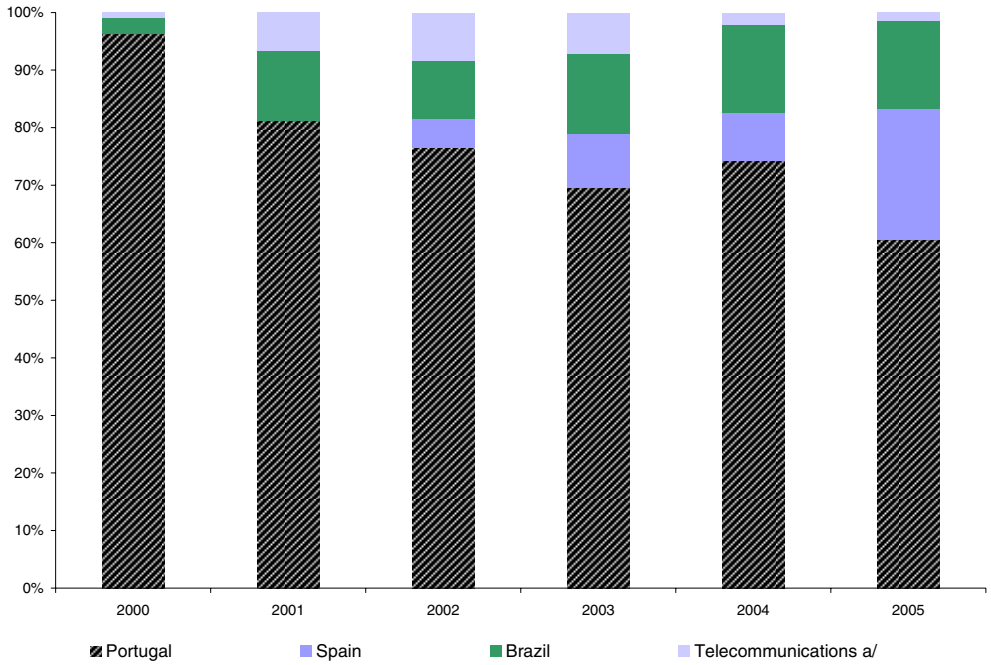
In terms of internationalization, EDP set its strategic sights on markets with critical mass and high growth potential where the company could capitalize on its competitive advantages. In an initial phase, the Portuguese firm focused on Latin America (basically the electricity sector in Brazil, although Chile and Guatemala were also included), Africa (Cape Verde, Morocco and Mozambique) and Asia (Macao Special Administrative Region), most of the markets concerned being former Portuguese colonies.[31] In a second stage, EDP concentrated on Spain, seeking to capitalize on the opportunities arising from full liberalization of the Spanish market and the future Iberian Electricity Market (MIBEL) (see map IV.2). Thus, EDP quickly took a position of leadership in the effort to internationalize the Portuguese economy (EDP, 2000, p. 9). In the late 1990s, EDP's operations beyond the country's borders began to acquire significant scale, representing some 10% of total assets and more customers than the firm had in Portugal itself (EDP, 2000, p. 39). This tendency strengthened over the following years (see figure IV.9).

Map IV.2
ENERGIAS DE PORTUGAL (EDP): INTERNATIONAL PRESENCE, 2006

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of EDP, *Annual Report 2005*, *Institutional Report and Report on Corporate Governance*, Lisbon, 30 March 2006 [online] http://www.epd.pt.
Notes: The boundaries and names shown on this map do not imply official endorsement or acceptance by the United Nations.

[31] In Macao Special Administrative Region, EDP became the largest individual shareholder in the Companhia de Electricidade de Macau (CEM). In Morocco, where it acted in concert with the Spanish group Dragados, it succeeded in winning the concession to supply electricity, water and sewage services in Rabat, the country's capital. EDP subsequently sold its stake in that consortium to the French group Vivendi (*EDP press release*, 22 October 2002). In Cape Verde, acting in partnership with Águas de Portugal (AdP), it emerged as the winner in the privatization of 51% of ELECTRA, a company that produces and distributes electricity and water and provides sanitation services (EDP, 2000, p. 43).

Figure IV.9
ENERGIAS DE PORTUGAL (EDP): SALES BY ACTIVITY AND COUNTRY, 2000-2005
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from Energias de Portugal (EDP).

[a] Operations in the telecommunications area are confined to the Portuguese domestic market.

The start of the present decade brought another clear shift in the corporate strategy of EDP, based on the reorganization and consolidation of the businesses the company operated in. First, EDP began to concentrate more on its traditional core business, the electricity sector, and on the Iberian peninsula, an area which the company now treats as its domestic market because of the ongoing integration there (see box IV.3). Internationally, meanwhile, EDP sought to expand its presence in the companies in which it owned equity in the Brazilian market (EDP, 2003, p. 5).

The growing importance of electricity as a destination for the company's operational investment, to the detriment of other activities such as telecommunications, is a clear reflection of the new emphasis in EDP's corporate strategy (see table IV.12). Also evident is the growing importance of the Iberian peninsula as the epicentre of the company's investment effort, of particular note being the large investments in Spain that gave it control of electricity assets (Hidrocantábrico) and natural gas distributors (Naturgas) (see box IV.3). Outside this subregion, Brazil continues to play a prominent role in the strategy of the Portuguese company, which has increased its stakes in electricity distributors and developed new generating capacity. The Iberian peninsula has now become the main centre of the company's operations, however (see table IV.13).

Box IV.3

LOOKING TO EUROPE? THE CREATION OF AN ELECTRICITY MARKET IN THE IBERIAN PENINSULA

Since 1996, when it began the process with the publication of a European Union directive, the European Commission has been working to liberalize the energy sector and promote the creation of a single market for electricity in the European Union. The process has continued, and from 1 July 2007 member States are required to open up their markets for all users, allowing them to choose their electricity supplier freely (*Official Journal of the European Union*, 15 July 2003).

A number of physical and administrative barriers to the integration of electricity markets have arisen, however, such as a lack of cross-border interconnection capacity and incompatibility between local regulations for the sector. The initial result has been the creation of subregional markets, like that of Spain and Portugal. In late 2001, the two countries' governments signed a protocol adopting a number of measures to integrate the Iberian market for electricity. The Iberian Electricity Market (MIBEL) was originally supposed to come into force on 1 January 2003, but technical and regulatory issues and changes of government have repeatedly delayed the basic agreements needed to implement it. With MIBEL, the Iberian peninsula will become a single domestic market for electricity companies in the two countries. EDP began its preparations for this well in advance.

EDP was quick to realize that establishing operations on both sides of the border would give it substantial competitive advantages. In 1998, as a first measure, EDP entered into a strategic partnership with the Spanish electricity firm Iberdrola. Two years later, however, the announcement of a possible merger between Iberdrola and another Spanish company, Endesa, put an end to the agreement with EDP. Between September and October 2003, EDP sold its shares in Iberdrola, completely cutting its ownership links with the company.

After a period of analysis, EDP entered into a new agreement with Caja de Ahorros de Asturias (CajaAstur) and launched a public tender offer for the Spanish electricity firm Hidrocantábrico, ending up with some 35% of the company. The main shareholders in Hidrocantábrico subsequently reached agreement on the management of the company, giving control to EDP.[a] In July 2004, in accordance with the company's existing strategy for its international operations, EDP increased its stake in Hidrocantábrico from 40% to 96%, at a cost of 1.2 billion euros.[b] EDP thus consolidated its position as the third-largest electricity company in the Iberian peninsula, behind Endesa and Iberdrola.

The acquisition of Hidrocantábrico represented a great opportunity for growth in a strategically important market. The dynamic of the Spanish market and the geographical continuity between the two countries make this the natural direction for EDP to expand in —all the more so once MIBEL is in place.[c] By acquiring Hidrocantábrico, EDP has managed to adapt and position itself ahead of the full operation of this agreement, becoming the only Iberian firm to have built up experience in producing and distributing electricity on both sides of the border. What is more, its position could be cemented yet further by the good fit between EDP and Hidrocantábrico assets.[d]

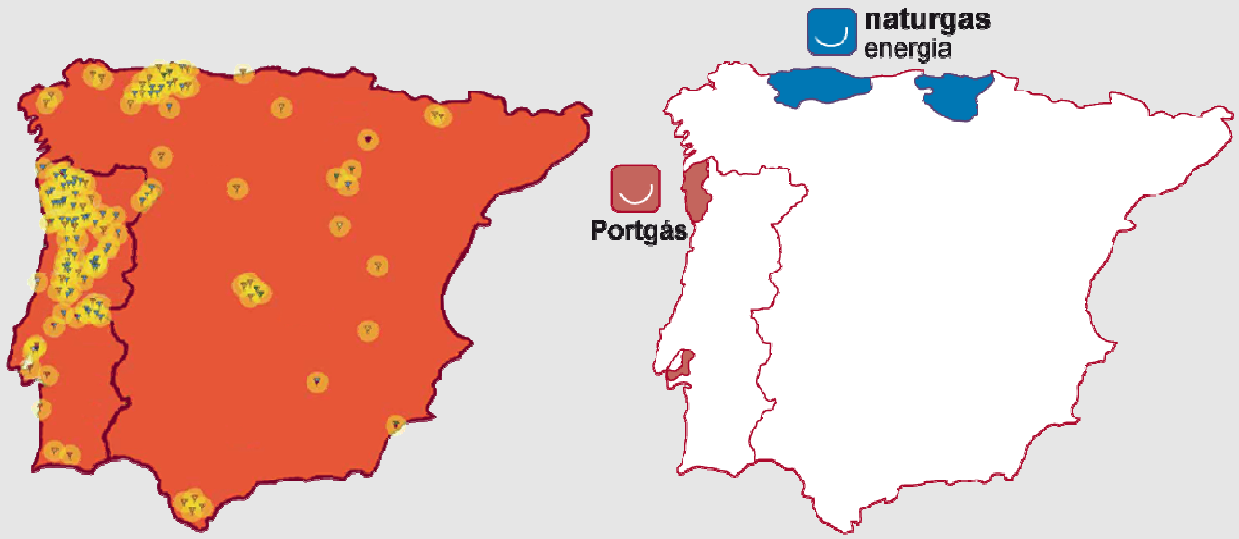
At the same time, EDP tried to use the solid position it had attained with Hidrocantábrico to create integrated businesses in the natural gas and electricity sectors across the peninsula. This strategy was particularly important in that natural gas was soon to become the main generating fuel for the Spanish peninsular system. In 2003, Hidrocantábrico acquired 62% of NaturCorp, a natural gas distributor in the Basque region, for 573 million euros. The company was subsequently renamed Naturgas Energía SA (Naturgas). In Portugal, EDP and the Italian group ENI SpA tried to take over Gas de Portugal (GdP), which would have enabled the Portuguese company to enter the natural gas business in its domestic market. The European Commission blocked the operation, however (*Bulletin of the European Union*, 9 December 2004). Despite this setback, EDP carried on trying to strengthen its position in the Iberian market and to consolidate Naturgas as an integrated energy operator and leader in the natural gas sector in the Basque region. To this end, Naturgas has been taking full control of the natural gas distribution companies in which it holds equity.

Naturgas has now established itself as Spain's second-largest natural gas company, attaining a market share of 12% in distribution and 6% in trading. In the Basque region, Naturgas is the leader in both activities, as well as being the second-largest electricity trader in this region (*EDP press release*, 3 May 2006). From this position, EDP has improved its access to natural gas contracts, a factor that has been crucial to the success of its new generating capacity in the Iberian peninsula, and has achieved major synergies thanks to the good operational and strategic fit between Hidrocantábrico and Naturgas.

Box IV.3 (concluded)

EDP: OPERATIONS IN THE IBERIAN PENINSULA

(a) Electricity **(b) Natural gas**



Source: Economic Commission for Latin America and the Caribbean, on the basis of EDP, *Relatório e contas*, various years.

[a] This agreement gave EDP 40% of Hidrocantábrico's equity, while Energie Baden-Württemberg AG (EnBW) and CajaAstur were left with stakes of 35% and 25%, respectively. The agreement was approved by the competition authorities of Spain and the European Union (EDP, 2002, p. 101).

[b] This acquisition was financed with a capital increase of 1.2 billion euros carried out in the Portuguese market. This operation was one of the largest financial transactions of the year anywhere in Europe, the largest capital increase ever seen in Portugal and the largest investment ever made by a Portuguese company in Spain (EDP, 2005, p. 105).

[c] In April 2004, the governments of Spain and Portugal signed an agreement for the creation of MIBEL. The agreement continues to be subjected to further revisions, however, delaying implementation.

[d] Firstly, Hidrocantábrico's production is primarily thermal (85%), the reverse of EDP's situation, which reduces the risks associated with hydroelectricity. Secondly, EDP has a very solid position in trading, again in clear contrast to Hidrocantábrico.

EDP's first steps outside the borders of Portugal were in markets where there were strong links of culture and language, particularly Brazil. The Portuguese firm was one of the first and most active participants in the Brazilian privatization plan, and this enabled it to become one of the leading investors in the electricity sector of South America's largest economy (EDP, 2001, p. 8).

Table IV.12
ENERGIAS DE PORTUGAL (EDP): OPERATING AND FINANCIAL INVESTMENT, BY ACTIVITY AND COUNTRY, 2001-2006
(Millions of euros)

	2001	2002	2003	2004	2005	2006 [a]
A. Operating investment [b]	907.7	1 339.8	1 003.3	1 222.0	1 577.6	900.6
1. Energy [c]	568.2	940.6	891.0	1 136.7	1 507.0	879.3
(a) Iberian peninsula	478.5	818.0	757.7	851.8	1 087.6	660.8
Portugal	478.5	733.2	687.2	736.7	740.3	323.9
Spain	0	84.8	70.5	115.1	347.3	336.9
(b) Brazil	89.7	122.6	133.3	284.9	419.4	218.5
Generation	40.8	55.6	58.7	195.5	255.4	81.7
Distribution	47.2	66.8	74.2	89.2	163.4	136.6
Other	1.6	0.3	0.4	0.2	0.6	0.2
2. Telecommunications	310.0	353.8	87.3	53.9	34.1	14.2
3. Other	29.5	45.4	24.9	31.3	36.6	7.0
B. Financial investment [d]	553.3	967.9	181.8	1 350.1	568.2	…
1. Energy [c]	471.4	921.5	100.2	1 324.9	568.2	…
(a) Iberian peninsula	262.4	541.6	100.2	1 324.9	568.2	…
Portugal	0	21.0	0	124.1	58.8	…
Spain	262.4	520.6	100.2	1 200.8	509.4	…
(b) Brazil	209.0	380.0	0	0	0	…
2. Telecommunications	69.6	0	0	0	0	…
3. Other	12.3	46.4	81.5	25.2	0	…
C. Total (A+B)	1 461.0	2 307.7	1 185.0	2 572.1	2 145.8	…

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from Energias de Portugal (EDP).

[a] January-November 2006.
[b] Development and acquisition of fixed assets.
[c] Includes electricity in Portugal and Brazil and electricity and natural gas in Spain.
[d] Acquisition of equity stakes in companies.

Table IV.13
ENERGIAS DE PORTUGAL (EDP): OPERATIONAL INDICATORS FOR LOCAL, REGIONAL AND GLOBAL ACTIVITIES, 2005
(In MW, GWh and thousands of customers)

	Maximum output (MW)	Electricity produced (GWh)	Electricity distributed (GWh)	Electricity customers (thousands)	Natural gas customers (thousands)
Iberian peninsula	12 023	41 734	53 031	6 492	843
Portugal	8 921	25 237	43 784	5 907	149
Spain	3 102	16 497	9 247	585	694
Brazil	531	2 756	23 061	2 972	-
Total	12 554	44 489	76 093	9 462	843

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of EDP, *Annual Report 2005*, *Institutional Report and Report on Corporate Governance*, Lisbon, 30 March 2006 [online] http://www.epd.pt.

To gain experience, EDP began cautiously as a participant in consortia seeking to take control of distribution companies. The Portuguese firm quickly began to implement a more active strategy, however, increasing its presence in companies it already had stakes in (and thereby becoming a significant player in this segment), exploring new power generation initiatives and making investments in other Latin American countries (Chile and Guatemala).

In late 1996, EDP took a minority stake in a distributor, Companhia de Eletricidade do Estado do Rio de Janeiro (CERJ) (now AMPLA), through which it subsequently acquired interests in other privatized companies such as Companhia Energética do Ceará (COELCE).[32] The following year, it made its first major investment in the generating segment, taking a 25% stake in the Luís Eduardo Magalhães (Lajeado) hydroelectric plant. The company also made its first Latin American investment outside Brazil as part of a consortium led by Iberdrola of Spain and involving TECO Energy Inc. of the United States which acquired 80% of Empresa Eléctrica de Guatemala SA (EEGSA) for US$ 520 million.[33]

Having established a "bridgehead" in Brazil, EDP commenced the most active phase of its expansion in the country. In 1998, in an auction in which they were the only bidders, EDP and Companhia Paulista de Força e Luz SA (CPFL) acquired Empresa Bandeirantes de Energia (EBE), an electricity distribution company in the State of São Paulo and one of the firms into which Eletropaulo had been divided.[34] A year later, EDP bought 73.1% of IVEN SA, an investment company, for US$ 535 million, thus acquiring an indirect stake in the Brazilian distributors Espírito Santo Centrais Elétricas SA (ESCELSA) and Empresa Energética do Mato Grosso do Sul (ENERSUL) (*EDP press release*, 25 August 1999, [online] http://www.edp.pt).[35] In this way, the Portuguese company acquired a presence in electricity distribution in four Brazilian states (Rio de Janeiro, São Paulo, Espírito Santo and Mato Grosso do Sul), serving more customers than in Portugal and attaining a market share of some 15% (EDP, 2000, p. 40).

In a context of greater instability in the international economy and increasing competition in its domestic market and Europe generally, the Portuguese firm began to recast its strategy. This meant further restructuring of EDP's companies and businesses in Portugal and abroad. Faced with the prospect of integration between the electricity markets of Spain and Portugal, furthermore, the company sought to strengthen its strategic presence in both countries (see box IV.3). These changes resulted in a major shift in its core business, which was now focused on the electricity sector in the Iberian peninsula (see table IV.14).

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[32] In April 1998, CERJ participated in the consortium led by Endesa of Spain and Enersis of Chile which acquired COELCE (ECLAC, 2005, p. 86).

[33] The winning consortium consisted of Iberdrola (49%), TECO Energy Inc. (30%) and EDP (21%).

[34] CPFL and EDP had considered participating separately in the EBE auction. The night before, however, they decided to join forces to acquire the company for the reserve price, as they were the only bidders. The consortium formed by EDP (56%) and CPFL (44%) acquired 74.9% of the distributor's ordinary shares for US$ 860 million (*Jornal do Brazil*, 18 September 1998; *Folha de São Paulo*, 18 September 1998; and ECLAC, 2005, p. 86).

[35] At the time of this acquisition, the investment company IVEN SA owned 52.3% of ESCELSA, which in turn controlled 64.9% of ENERSUL's equity (*EDP press release*, 25 August 1999 [online] http://www.edp.pt). Thus, IVEN SA controlled 34.1% of ENERSUL, a company which held a 30-year concession to generate and distribute electricity in the State of Mato Grosso (ECLAC, 2005, p. 138).

Table IV.14
ENERGIAS DE PORTUGAL (EDP): MARKET SHARE, BY SEGMENT AND COUNTRY, 2006
(Percentages)

	Electricity				Natural gas [a]	
	Power generation		Distribution	Trading	Distribution	Trading
	Conventional	Wind				
Iberian peninsula	16	9	19	15	8	6
Brazil	1	-	8	10	-	-

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of EDP, "Estratégia da EDP. Compromisso para a criação de valor: risco controlado, eficiência superior e crescimento orientado", London, 19 July 2006 [online] http://www.edp.pt.

[a] Naturgas, of which EDP is a joint owner, is the second-largest natural gas operator in Spain, with a market share of 12% in distribution and 6% in trading.

Seeking to build a solid and competitive platform from which to meet the challenge of the forthcoming Iberian Electricity Market (MIBEL), EDP acquired a controlling interest in the Spanish company Hidroeléctrica del Cantábrico (Hidrocantábrico) in late 2002. With this operation, the company hoped to exploit the synergies resulting from its presence in Portugal and Spain (EDP, 2002, p. 6).

In Brazil, the company implemented a far-reaching restructuring programme that included at least three core elements: reorganizing its activities in the country, gaining management control of the distributors in which it held equity, and expanding its presence in the generating segment.

Having taken the decision to concentrate on the electricity sector and raise financing for the restructuring, EDP sold a number of assets deemed non-strategic, such as those in the telephony, sewage and drinking water sectors, along with some of its less attractive international operations (in Chile and Morocco).[36] One of the largest operations was the sale of EDP's stake in Iberdrola (EDP, 2004, p. 14).

Thus, EDP's operations in Brazil began to undergo major changes at the beginning of the present decade. First, EDP replicated the model applied in Portugal by seeking to simplify the structure of its operations in the country, grouping them into a holding company named EDP Brazil. The purpose of the restructuring was to create synergies between the different companies in which EDP had an interest, facilitate the reinvestment of locally generated resources in projects to expand production, and raise funds on the local financial market, thereby reducing currency risk (EDP, 2003, p. 43). This strengthened EDP's strategic capacity in Brazil and paved the way for integrated management of the company's different activities in the production, distribution and trading segments.

Wishing to consolidate its position in the Brazilian electricity distribution segment, EDP sought to take management control of the companies in which it held equity. To attain this objective it was necessary to make some adjustments to the company's presence in the country. First, EDP reduced its

[36] In December 2001, EDP sold its 25.5% holding in ESSEL to Thames Water Plc for 78 million euros (*EDP press release*, 21 December 2001). As part of the same agreement, EDP acquired the 50% that Thames Water Plc held in ValorÁgua, thus obtaining full control of the company (EDP, 2002, p. 100). In November 2006, EDP sold the whole of ONI to the United States company Win Reason for 160 million euros. To realize this operation, EDP first had to buy the 44% of ONI's equity held by Brisa, BCP and GALP Energia, in addition to taking on all of ONI's bank debt. The operation is expected to be completed in early 2007 (*Invierta*, 9 November 2006 [online] http://www.invierta.com).

interest in CERJ by accepting a public tender offer from the Spanish company Endesa.[37] Second, the Portuguese firm made a public tender offer for EBE, increasing its holding from 17% to 54% and thus taking operational and managerial control of the company (EDP, 2001, p. 50). Not long afterwards, the Brazilian regulator for the sector, the Agência Nacional de Energía Eléctrica (ANEEL) approved the break-up of EBE into two independent companies: Bandeirantes Energia, controlled by EDP, and Companhia Piratininga de Força e Luz, which remained in the hands of CPFL. Third, in late 2001 EDP signed an agreement with the Opportunity Investment Fund which enabled it to secure a majority of voting rights in IVEN SA and thus ensure management control over ESCELSA and ENERSUL. EDP later launched a public tender offer for the 17% of IVEN SA equity that was owned by minority shareholders.

In the midst of its consolidation, EDP was severely affected, like most of the electricity companies operating in Brazil, by the economic, climatic and regulatory difficulties afflicting the country (ECLAC, 2005, p. 143). These difficulties affected revenues, owing to falling demand and the devaluation of the local currency, and spending, as it became more expensive to meet financial commitments incurred in other currencies.[38] The situation was particularly difficult for distributors, since they bought in some of their energy in dollar-denominated prices and this led to cost increases that could be passed on to final users only in part and after a time lag.

EDP's progress in the generating segment centred on hydroelectric production. In 2001, the Luís Eduardo Magalhães hydroelectric plant (Lajeado, 903 MW) began operating; the Portuguese firm held 28% of INVESTCO, the consortium behind the project. That same year, EDP was a member of the consortia that won the concessions to build and operate the hydroelectric plants of Peixe Angical (452 MW) and Couto Magalhães (150 MW) (EDP, 2002, p. 4). At the same time, EDP was beginning to explore new options in the area of thermal production. In 2001, the Fafen thermoelectric plant (situated in the Pólo Petroquímico de Camaçari in the State of Bahia) came into operation; this had been built in partnership with Petróleo Brasileiro SA (Petrobras), EDP holding an 80% stake.[39] As a consequence of the Brazilian energy crisis, furthermore, the local authorities launched the Priority Programme for Thermoelectric Power (PPT). This proved attractive to EDP and some of the companies it held stakes in (CERJ, ESCELSA and ENERSUL), which expressed their interest in a number of the projects proposed (EDP, 2001, p. 49).[40] Delays in finalizing the regulations and problems with natural gas supplies increased the risk associated with investments in thermoelectric plants, however, which meant that none of these projects came to fruition and Fafen Energia came to be classed among EDP's non-strategic assets. The Portuguese company eventually sold 80% of the Fafen power plant to Petrobras for US$ 35.4 million.

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[37] In August 2000, EDP sold Endesa all the shares it owned apart from the controlling block in CERJ, reducing its stake from 23% to 19% (EDP, 2001, p. 48). EDP currently owns 7.7% of CERJ (now called AMPLA), the reduction being due to capital increases in which the Portuguese company has not participated (EDP, 2006b, p. 92).

[38] In 2001, Brazil's federal government approved a programme of restrictions on electricity use in response to a drought, and this remained in force until February 2002. The objective was to reduce demand, and the resulting behaviour patterns outlasted the programme.

[39] This project was originally designed as a power station to supply electricity and steam to the Fábrica de Fertilizantes Nitrogenados (Fafen) owned by Petrobras. Surplus production was meant for other customers in the Pólo Petroquímico de Camaçari. When it proved impossible to sell the steam to other companies, however, the project underwent some alterations so that the surplus steam could be turned into electricity (EDP, 2003, p. 44).

[40] The objective of the Priority Programme for Thermoelectric Power was to meet the country's electricity needs from 2003, and for this it proposed the construction of 55 thermoelectric plants with a total output of some 15,000 MW.

The company's impetus in this segment was checked by Brazil's deteriorating political and economic situation. In fact, EDP had to reschedule the projects to build the Couto Magalhães and Peixe Angical hydroelectric plants (EDP, 2003, p. 3).[41] While the former was shelved indefinitely, in the second case negotiations were begun with financial institutions, chiefly the Banco Nacional de Desenvolvimento Econômico e Social (BNDES), to see how the project might be made viable. Construction finally resumed in October 2003, after Eletrobrás became involved in the project, and was completed in 2006 (EDP, 2004, p. 10 and *EDP press release*, 18 September 2006 [online] http://www.edp.pt).[42]

In October 2002, EDP completed the first phase in the restructuring of its activities in Brazil. Thus, EDP Brazil SA took direct control of the generating assets, Enertrade Comercializadora de Energia SA and the distributor Bandeirantes Energia SA (EDP, 2003, p. 42). In 2003, the Portuguese firm concentrated on restructuring the electricity distribution companies over which it had operational control (EDP, 2003, p. 3). At the end of that year, EDP completed the second phase of the process by transferring direct control of IVEN SA, the company which controlled ESCELSA and ENERSUL, to EDP Brazil (EDP, 2004, p. 95).[43] The idea was that integrated management of the distribution companies would allow EDP's businesses in Brazil to operate more efficiently.

In early 2004, as EDP was making its strategic preference for the Iberian peninsula explicit, in Brazil a new regulatory framework was being enacted with the objective of restoring the possibility of medium- and long-term planning in the electricity sector.[44] The new law provided private- and public-sector actors with incentives to build and maintain generating capacity in order to guarantee a supply of energy at moderate rates, by means of competitive public energy auctions (EDP, 2006a, p. 75).[45]

In this context, EDP moved ahead with restructuring and decided on the strategic direction for its activities in Brazil: self-sufficient operations and greater autonomy for local managers (EDP, 2004, p. 93).

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[41] In the case of the Peixe Angical hydroelectric development, this rescheduling meant postponing the start of commercial operations. The hydroelectric plant's three generators finally came on stream between June and September 2006 (*EDP press release*, 18 September 2006 [online] http://www.edp.pt). In the case of the Couto Magalhães hydroelectric development, construction was scheduled to begin in early 2004 and production in mid-2007 (EDP, 2003, p. 44). In 2003, however, Couto Magalhães failed to complete the environmental, energy and engineering studies phase, and work was suspended. In these circumstances, ANEEL was asked to terminate the concession contract on an amicable basis (EDP, 2004, p. 96). During 2006, work on Couto Magalhães remained suspended while the regulator's response was awaited (EDP, 2006a, p. 82).

[42] Once the negotiations had concluded, Furnas Centrais Elétricas SA (Furnas), a subsidiary of Eletrobrás, acquired a 40% interest in Peixe Angical, leaving EDP Brazil with the remaining 60% (EDP, 2005, p. 115). Meanwhile, BNDES provided about 40% of the project's total financing, some US$ 750 million (*EDP press release*, 18 September 2006, http://www.edp.pt).

[43] This process left EDP Brazil with 24% of IVEN's total equity and 70% of its voting shares (EDP, 2004, p. 95).

[44] In December 2003, EDP presented its business plan for 2004-2006, whose main objectives included: (i) consolidating the competitive position of the company in the Iberian peninsula, (ii) strengthening the company's assets by integrating the natural gas business, and (iii) maximizing the economic value of existing investments, mainly those in Brazil and in the telecommunications area. It was estimated that the plan would involve some 3.25 billion euros of investment, of which more than 75% would go on maintaining and expanding electricity generating capacity in Portugal and Spain and on extending and modernizing the distribution network in Portugal (EDP, 2004, pp. 18 and 19).

[45] The new electricity industry model law created two different sectors for energy trading. The procurement of energy for distribution companies takes place within what is known as the regulated procurement sector and is based on energy auctions, while the market for producers, unregulated consumers and energy trading companies is called the unregulated procurement sector and has more flexible trading rules. The law also established a requirement for vertical unbundling of companies to separate distribution from generation and transport.

To achieve this, the company initiated a process involving a number of steps that were not necessarily sequential. First, integrate all the company's activities in Brazil into a single organization, EDP Brazil. Second, persuade minority shareholders to migrate from the distributors (ESCELSA, ENERSUL and Bandeirantes) to EDP Brazil. Third, float EDP Brazil on the São Paulo stock exchange (BOVESPA) and design a mechanism to ensure share liquidity. Fourth, hive off generating assets that were still integrated into the distributors ESCELSA and ENERSUL (EDP, 2005, p. 114).

In 2005, EDP completed the reorganization of its activities in Brazil and grouped operations into three strategic areas: electricity generation, distribution and trading (see table IV.15 and map IV.3) (EDP, 2006a, p. 12).[46] The main objective of this measure was to comply with the vertical unbundling rules of the new electricity sector model as laid down by ANEEL, which had to be implemented by September 2005. In addition, the changes in the company's name and visual identity implemented in Portugal the year before, when Electricidade de Portugal SA became Energias de Portugal SA, were paralleled in Brazil, so that EDP Brazil became Energias do Brasil (EDP, 2006a, p. 78).

In this way, the entire equity of the distributors (Bandeirantes, ESCELSA and ENERSUL) passed to Energias do Brasil. This involved an equity swap between EDP and minority shareholders in these companies (EDP, 2006a, p. 77). This latter operation had a twofold benefit: it made it possible to adopt a good model of vertical unbundling that avoided fiscal and operational inefficiencies, and it provided greater room for manoeuvre in redesigning the company's organizational structure in Brazil (EDP, 2006a, p. 77). In mid-2005, furthermore, the shares of Energias do Brasil began to be traded on BOVESPA and US$ 480 million was raised, the largest operation of this type that year (EDP, 2006a, p. 78 and p. 112).[47] When the company's equity was floated, EDP kept 62.4% of Energias do Brasil while the remaining 37.6% was traded on BOVESPA, a higher proportion than the required minimum (see figure IV.10).

The most important segment for Energias do Brasil is now distribution, where Bandeirantes, ESCELSA and ENERSUL operate. It distributes energy to a total of around 3 million customers in the states of São Paulo, Espírito Santo and Mato Grosso do Sul, representing a population of almost 10 million inhabitants (EDP, 2006a, p. 83). By 2005, Enertrade had become one of the most active trading companies in the market, especially in the unregulated sector (see figure IV.11).

[46] In the generating business, Energest took over the management of CESA, Costa Rica and Pantanal Energética, keeping two power stations separate (EDP Lajeado and Enerpeixe). In trading, Enertrade, which operates in the unregulated market, was consolidated. In distribution, lastly, the operators are Bandeirantes, ESCELSA and ENERSUL (EDP, 2006a, p. 78).

[47] Once this operation was finalized, the shares issued by Bandeirantes, ESCELSA and ENERSUL ceased to be quoted on BOVESPA (EDP, 2006a, p. 78).

Table IV.15
ENERGIAS DE PORTUGAL (EDP): MAIN ASSETS IN THE LATIN AMERICAN ELECTRICITY SECTOR, 2006

	Company	Percentage control	Generation or transmission capacity or number of customers	Year of entry	Year full-capacity output began
Brazil	**Generation**				
	Luís Eduardo Magalhães (Lajeado) hydroelectric plant	27.7 [a b]	902.5 MW	1997	2002
	Peixe Angical hydroelectric development	60.0 [a c]	452 MW	2001	2006
	Energest [d]	100.0 [a]	276.9 MW	1999	
	- Suíça hydroelectric plant	100.0 [a]	30.1 MW	1999	
	- Mascarenhas hydroelectric plant	100.0 [a]	131.0 MW	1999	
	- Castelo Energética (CESA) [b]	100.0 [a]	58.5 MW	1999	
	- Costa Rica	51.0 [a]	16.5 MW	1999	
	- Pantanal Energética [e]	100.0 [a]	40.8 MW	1999	
	Couto Magalhães hydroelectric development	49.0 [a f]	150 MW	2001	…
	Distribution				
	Bandeirantes Energia SA	100.0 [a]	1 283 000	1998	-
	Espírito Santo Centrais Elétricas SA (ESCELSA)	100.0 [a]	1 031 000	1999	-
	Empresa Energética Mato Grosso do Sul (ENERSUL)	100.0 [a]	658 000	1999	-
	Trading				
	Enertrade	100.0 [a]	-	...	-
Guatemala	Empresa Eléctrica de Guatemala SA (EEGSA)	17.0	680 000	1997	-

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Energias de Portugal (EDP), Annual Report 2005, Lisbon, 30 March 2006 [online] http://www.edp.pt.

[a] Held by Energias do Brasil, the conglomerate grouping EDP's assets in Brazil. In 2005, following a wide-ranging restructuring process, EDP came to control 67.5% of Energias do Brasil equity.

[b] The Luís Eduardo Magalhães (Lajeado) hydroelectric plant was built by Investco SA, a consortium whose participants, besides Energias do Brasil, were Grupo Rede (43.3%), Companhia Energética de Brasilia (CEB) (20%) and CMS Energy (20%).

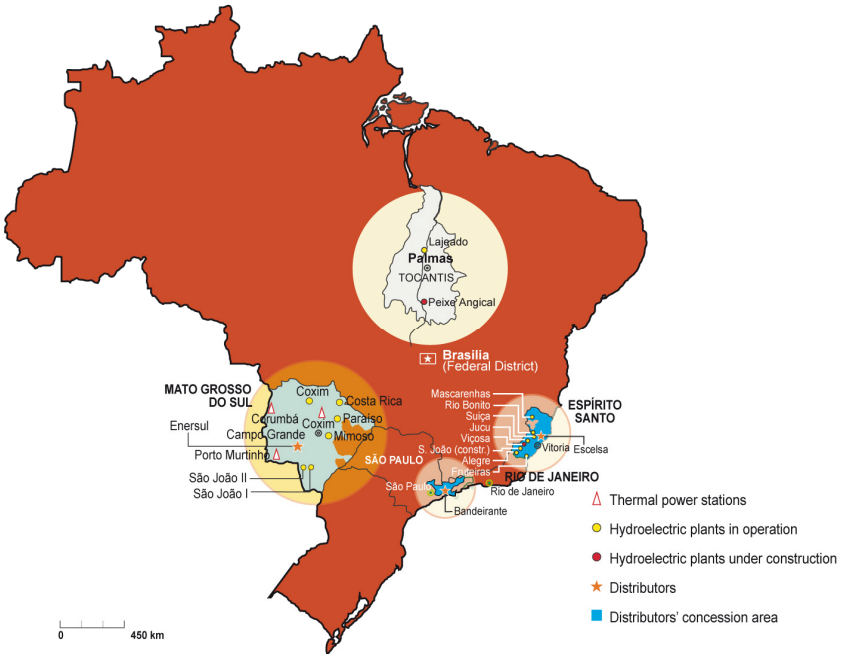
[c] The company responsible for building the Peixe Angical hydroelectric development is Enerpeixe SA, whose equity is divided between Energias do Brasil (60%) and Furnas Centrais Elétricas SA (40%), a subsidiary of Eletrobrás.

[d] Includes the generating assets of the distributor ESCELSA.

[e] Includes the generating assets of the distributor ENERSUL.

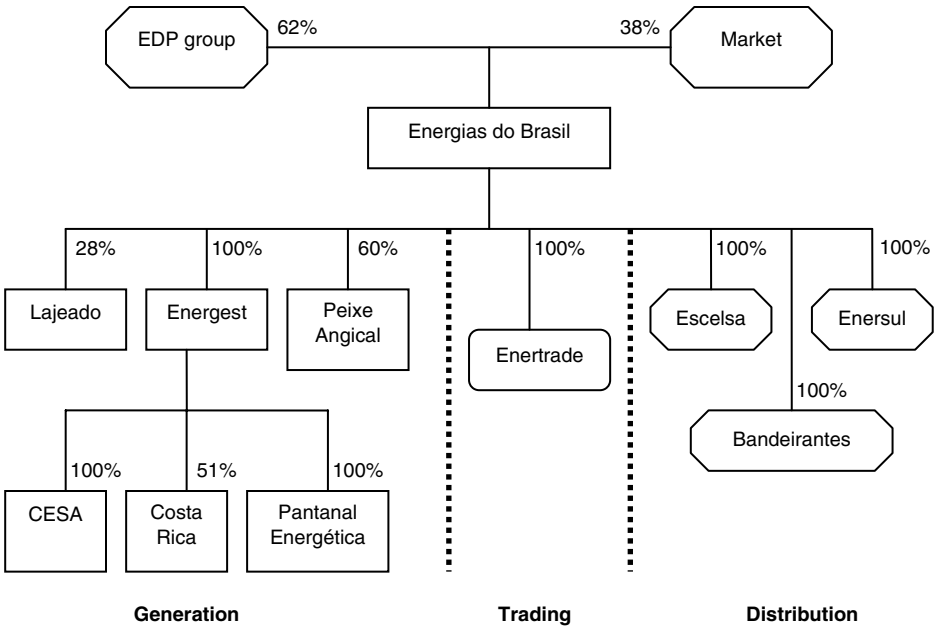
[f] The company responsible for the Couto Magalhães concession is the EnerRede Couto Magalhães consortium, in which Energias do Brasil holds 49% and Grupo Rede the remaining 51%. Work on this plant has been suspended pending a decision by the Agência Nacional de Energia Eléctrica (ANEEL) on the consortium's request for amicable termination of the concession contract.

Map IV.3
ENERGIAS DE PORTUGAL (EDP): OPERATIONS IN BRAZIL, 2006



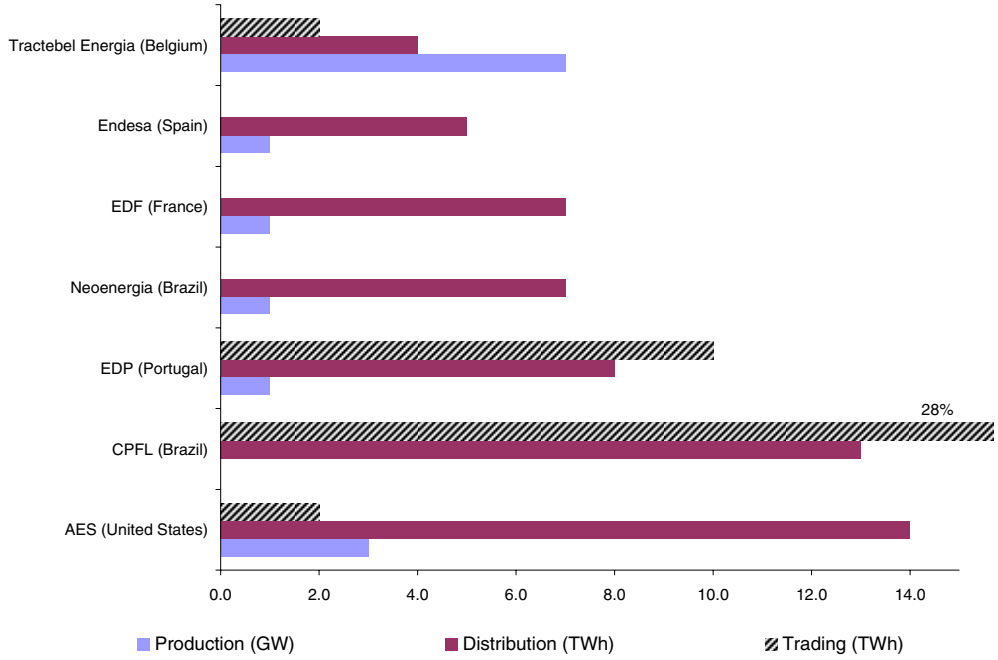
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of EDP, *Annual Report 2005*, *Institutional Report and Report on Corporate Governance*, Lisbon, 30 March 2006 [online] http://www.epd.pt.

Figure IV.10
ENERGIAS DO BRAZIL: STRUCTURE OF OPERATIONS IN THE ELECTRICITY SECTOR, 2006
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Energias do Brasil (http://www.energiasdoBrazil.com.br).

Figure IV.11
BRAZIL: MARKET SHARE OF THE MAIN OPERATORS, BY SEGMENT, 2005
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of EDP, "Estratégia da EDP. Compromisso para a criação de valor: risco controlado, eficiência superior e crescimento orientado", London, 19 July 2006 [online] http://www.edp.pt.

Generating activities have grown strongly in recent times. In late 2005, the installed capacity of Energest was 276.9 MW and it was responsible for running the Mascarenhas and Suiça hydroelectric facilities in addition to three companies, CESA, Costa Rica and Pantanal Energética. The firm received these assets during the corporate reorganization of Energias do Brasil, in April 2005, and the vertical unbundling that took place in June that same year (EDP, 2006a, p. 81). In late 2006, with the completion of the Peixe Angical plant and the fourth turbine at the Mascarenhas facility, the generating capacity of Energias do Brasil reached 1,018 MW (see table IV.16). In addition, Energias do Brasil has two other projects under construction: the São João small hydroelectric station (25 MW), which was intended to come into operation in 2006, and the Santa Fé small hydroelectric station (30 MW), whose inauguration is scheduled for early 2009 (*EDP press release*, 4 October 2006 [online] http://www.edp.pt.

To sum up, EDP's strategy in Brazil has consisted in acquiring diversified, complementary assets to build a presence in all segments: electricity generation, distribution and trading. Starting out from a strong position in the distribution segment, the company has been steadily expanding its generating capacity. Following a difficult period, the situation of the Portuguese company was eased considerably by a review of distribution charges and a debt refinancing operation in which BNDES played a central role. Thus, the company's global strategy currently centres on expanding and strengthening its position in Brazil and reorganizing its asset structure.

Table IV.16
ENERGIAS DE PORTUGAL (EDP): NEW GENERATING CAPACITY IN BRAZIL, 2006

	Installed capacity (MW)	Investment (millions of dollars)	Energy contracts	Start of operations
Lajeado hydroelectric plant	250 [a]	…	Contracts with Bandeirantes and Enertrade up to 2012	December 2001
Energest (12 hydroelectric stations)	266	…	PPA and contracts with EDP distributors	-
Total December 2005	**516**			
Peixe Angical hydroelectric plant	452	740	100% through PPA	June 2006: 151 MW July 2006: 151 MW October 2006: 151 MW
Mascarenhas hydroelectric plant (fourth unit) [b]	50	30	100% in auctions (US$ 51.85 - December 2005)	October 2006
Total December 2006	**1 018**			
São João hydroelectric plant	25	41	100% through PPA	January 2007
Santa Fé hydroelectric plant	30	49	100% in auctions (US$ 55.84 – June 2006)	January 2009
Projects under construction	**55**			

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of EDP, "Estratégia da EDP. Compromisso para a criação de valor: risco controlado, eficiência superior e crescimento orientado", London, 19 July 2006 [online] http://www.edp.pt.

[a] Percentage of installed capacity belonging to EDP (27.65% - 902.5 MW).

[b] In October 2006, Energias do Brasil brought the fourth power plant of the Mascarenhas hydroelectric facility into commercial operation (*EDP press release*, 4 October 2006 [online] http://www.edp.pt).

3. The cement industry: a Portuguese-speaking company in the top ten?

The cement market in Portugal is dominated by two firms: Cimentos de Portugal (CIMPOR) and Companhia Geral de Cal e Cimento (SECIL).[48] Given the concentration and consolidation of the cement industry worldwide, and particularly in Europe, and the saturation of their domestic market, Portuguese producers started to look for opportunities outside their national borders.[49] The pioneer was CIMPOR, which extended its operations to markets chosen for their geographical and cultural proximity to Portugal. In the early 1990s, CIMPOR extended its activities to Spain and then to emerging markets in the Mediterranean basin (Egypt, Morocco, Tunisia), Africa (Angola, Cape Verde, Mozambique and South Africa), Latin America (Brazil) and, recently, China. At the beginning of the present decade, SECIL followed in its footsteps, entering the markets of Angola (2000), Tunisia (2000) and Lebanon (2002).

In the mid-1970s, the Portuguese cement industry was nationalized, leading to the creation of CIMPOR and the transformation of SECIL into a partially State-owned private-sector company. In 1994, the process was reversed and the privatization of the sector began. Thus, SECIL passed wholly into the private sector and CIMPOR completed the first phase of its privatization by transferring 20% of equity to

[48] SECIL was created in 1930 as a result of the merger between Sociedade de Emprendimentos Comerciais e Industriais, Lda. (SECIL) and Companhia Geral de Cal e Cimento and the participation of the Danish companies F.L. Smidth & Co. A/S and Hojgaard & Schultz A/S.

[49] The global market for cement is limited. The ratio between weight and price ultimately makes exports unviable, particularly to far-off destinations. This means that external sales are made only to nearby countries or to places where there is a market for large volumes. Furthermore, cement is perishable.

private investors. The privatization of CIMPOR went through three further stages between 1996 and 2001, by which time the whole of its equity had been transferred to private-sector agents.[50]

As the company's privatization proceeded and competition intensified in the country and the region, CIMPOR began to see the Iberian peninsula as a natural area for expansion. In 1992, it acquired the Spanish cement and concrete manufacturer Corporación Noroeste SA, which had its headquarters in the frontier town of Vigo and factories in Oural and Toral de los Vados. With this operation, the Portuguese firm gained a market share of about 4% in Spain and over 50% in the autonomous community of Galicia (*Cinco Días*, 14 November 2002). Ten years later, CIMPOR took advantage of a planned asset sale by Lafarge, the world leader in the industry, to acquire factories in Córdoba and Niebla, a port terminal in Seville and a package of mining rights, all in the Andalusia region (CIMPOR, 2003, p. 1). This operation cost the Portuguese firm 225 million euros (*Cinco Días*, 14 November 2002). As with the company's first incursion into the Spanish market, the assets acquired on this occasion were also close to the border with Portugal, in this case its southern end, which created the potential for substantial operating synergies. With this acquisition, CIMPOR became the second-largest producer in the Iberian peninsula (after CEMEX of Mexico) and the tenth-largest in the world (*Europa Press*, 16 March 2004 and CIMPOR, 2006, p. 2).

CIMPOR did not confine its internationalization strategy to Spain, however. Rather, it sought to create a balanced external presence by making new investments in emerging economies. Thus, like most major companies in the industry, the Portuguese firm looked for opportunities in markets with high growth potential, even at the cost of higher risk, progressively combining these with its operations in the Iberian peninsula. The Spanish and Portuguese markets had little room for growth, but they had the great advantage of generating hard currency revenues.

On this premise, the Portuguese company sought to combine geographical proximity with cultural and linguistic affinity. Between 1994 and 2000, CIMPOR went into some of the leading African markets in the Mediterranean basin (Egypt, Morocco and Tunisia) and the former Portuguese colony of Mozambique.[51] Since then, during the 2000s, it has continued to expand its presence in Africa (Angola,[52] Cape Verde and South Africa) and entered the world's largest cement market, China[53] (see table IV.17).

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[50] The second phase of the CIMPOR privatization was completed in 1996, when 45% of the company was transferred to private investors. The third stage began a year and a half later, with a further 25% of the company's equity being floated on the market. The State was left with 10% at that time. Finally, in June 2001, the process was completed and the Portuguese State sold all its remaining shares in CIMPOR to the engineering and construction company Teixeira Duarte SA.

[51] In 1994, CIMPOR acquired 51% of Empresa de Cimentos de Mozambique SA, and in 1995 it bought 51% of a Moroccan company, Asment de Témara. In 1998, the company continued to reinforce its internationalization by purchasing Société des Ciments de Jebel Oust in Tunisia. In 2000, CIMPOR entered Egypt, acquiring Armella Cement Company.

[52] CIMPOR acquired 49% of the Angolan cement manufacturer Nova Cimangola in 2004, but sold this stake in 2006.

[53] In late 2006, CIMPOR bought 60% of the Chinese company Shandong Liuyuan New Type Cement Development for 2.1 million euros (*El Economista*, 17 October 2006).

Table IV.17
CIMENTOS DE PORTUGAL: MAIN OPERATIONS, BY COUNTRY, 2006

	Installed capacity (thousands of tons)	Market share (%)	Cement factories	Starting year	Concrete plants
Portugal	6 900	52.2	Alhandra		60
			Souselas		
			Loulé		
Spain	2 700	7.8	Oural	1992	74
			Toral de los Vados	1992	
			Niebla	2002	
			Córdoba	2002	
Brazil	5 745	9.8	Campo Formoso	1997	25
			Candiota	1997	
			Cajati	1997	
			Cimepar	1999	
			Atol	1999	
			Goiás	1999	
Morocco	1 245	8.8	Asment de Témara	1996	4
Tunisia	1 600	24.1	Jbel Oust	1998	-
Egypt	3 810	8.8	Amreyah	2000	
Mozambique	730	83.3	Matola	1994	3
South Africa	1 020	10.1	Simuma	2002	5
Cape Verde	[a]	63.4		2005	-
China	...	...	Shandong Liuyuan	2006	...

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from Cimentos de Portugal SGPS SA (CIMPOR).

[a] In Cape Verde, CIMPOR carries out cement importing, storage, packaging and distribution. It does not produce cement there.

At the same time, CIMPOR was making large investments in the world's largest Portuguese-speaking economy, Brazil. In 1997, the Portuguese firm acquired Companhia de Cimento do São Francisco (CISAFRA) in Campo Formoso (Bahia) and the cement business of Grupo Serrana (Bunge) (two units in Rio Grande do Sul and one in São Paulo), leading to the creation of Sociedade de Cimento do Brazil SA (CIMPOR do Brasil). Two years later, CIMPOR strengthened its position in the country by acquiring three companies from the Brennand group (Cimentos Goiás, Companhia de Cimento Atol and Companhia de Cimento Pórtland) for US$ 594 million (ECLAC, 2001, p. 77). In 2002, it continued to strengthen its presence in north-east Brazil after acquiring Cimentos Brumado (Bahia) from Lafarge of France for 93 million euros (*CIMPOR press release*, 2 May 2002). All this left the Portuguese group solidly placed as Brazil's third-largest producer, accounting for about 10% of local production, and very strongly positioned in the markets of the country's north-east and centre-west (see table IV.18). Brazil is currently the company's largest operation outside the Iberian peninsula, accounting for about 18% of global sales and 15% of revenue (see figure IV.12).

To sum up, CIMPOR has internationalized rapidly, establishing itself as a major player in the Iberian peninsula, a market which accounts for some 60% of total sales, with Portugal representing 34%. Meanwhile, operations further afield in the Mediterranean basin, Africa and Latin America have been increasing in importance (see figure IV.12). Brazil features particularly prominently in this group. In South America's largest economy, the Portuguese firm has succeeded in establishing itself as the third-largest local producer, overtaking the two giants of the world industry, Lafarge and Holcim (see table IV.17). CIMPOR has also been expanding its product range by moving into related businesses such as the manufacture of concrete and other building materials. The company will probably carry on making new acquisitions, with priority going to the emerging markets where it already operates, but without neglecting

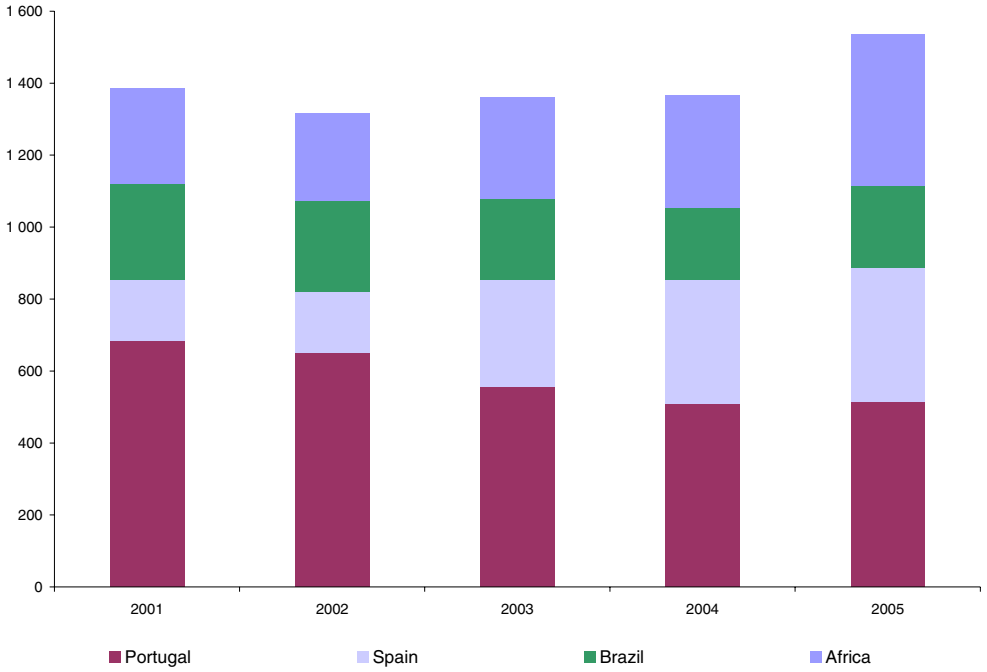
the need to balance this with a good presence in mature, consolidated markets where lower growth potential is made up for by lower levels of risk.

Table IV.18
BRAZIL: CEMENT PRODUCTION BY GROUP, 1996-2005
(Thousands of tons)

Group	Origin	1996	2005
Votorantim	Brazil	16 615	14 473
João Santos	Brazil	2 450	4 975
CIMPOR	Portugal	1 359	3 682
Holcim	Switzerland	4 145	2 948
Camargo Corrêa	Brazil	1 618	2 902
Lafarge	France	3 806	2 500
Others	-	4 838	5 194
Total		34 831	36 673

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the Sindicato Nacional da Indústria do Cimento (SNIC).

Figure IV.12
CIMPOR: SALES BY REGION, 2001-2005
(Millions of euros)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from Cimentos de Portugal SGPS SA (CIMPOR).

4. Retailing: losing the war with the major international chains

In the late 1950s, Sociedade Gestora de Participações Sociais SA (Sonae SGPS), originally Sociedade Nacional de Estratificados SARL, was created to produce wooden panels for construction (see box IV.4). In the 1980s, coinciding with the country's entry into the European Union, the Portuguese firm began a period of rapid expansion and diversification, entering the food retailing industry in partnership with the French group Promodés (when it introduced Modelo Continente supermarkets) and then the property business, building shopping centres adjacent to its premises. At the same time, the company began to invest in new areas such as telecommunications, information technology, entertainment and tourism. Retailing-related activities currently account for over 60% of group sales (see figure IV.13).

By the late 1980s, Sonae was the largest non-financial conglomerate in Portugal and one of the largest in the European distribution sector. It was then that the company initiated a bold internationalization process, centring on Brazil (see figure IV.14). Its initial link with the country came through a partnership with a local firm, Josapar, on the basis of which it created Companhia Real de Distribuição (CRD) based in the State of Rio Grande do Sul. In 1990, it acted through this company to open the first hypermarket in the city of Porto Alegre. In 1997, the Portuguese group took full ownership of CRD and initiated an ambitious expansion process centred on the states of Rio Grande do Sul, Santa Catarina, Paraná and São Paulo, in the south of the country (see map IV.4). To capitalize on synergies with the retailing business, Sonae also moved ahead in the property development business, specializing in shopping centres (see box IV.5).

Box IV.4
THE ORIGINS OF PORTUGAL'S LARGEST NON-FINANCIAL GROUP

Very early in its existence, Sociedade Gestora de Participações Sociais SA (Sonae SGPS) began to diversify around its main business, wood panelling for construction. To expand the range of products it supplied (melamine coatings and components for furniture and decoration), it acquired companies in the local market. Sonae also began operating in the industrial chemicals sector, producing melamine and phenolic resins.

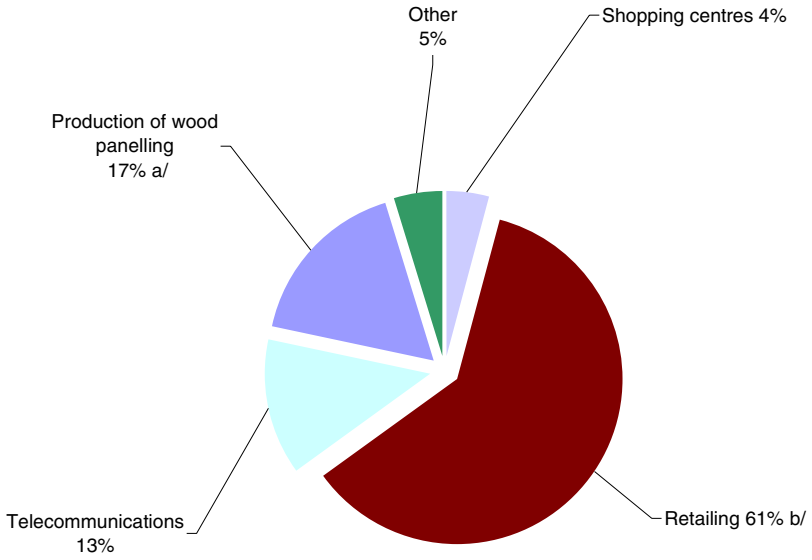
In the 1980s, the company implemented an ambitious expansion project, including major investments to increase installed capacity in component and coating manufacture. In addition, Sonae set out to become the dominant player in the chipboard segment in Portugal by acquiring what was at the time the largest company in the business, Agloma. Between 1987 and 1989, Sonae consolidated its position in the local market by acquiring SIAF and Paivopan and began to internationalize its operations by purchasing Spanboard of Northern Ireland.

By the early 1990s, Sonae was the largest non-financial group in Portugal. As part of the reorganization of the conglomerate, it grouped its wood businesses under Sonae Indústria SGPS, which initiated a major expansion and internationalization of its operations. By acquiring a controlling interest in one of the two largest Spanish groups in the industry, Tableros y Fibras SA (TAFISA) in Valladolid, Sonae Indústria became the leader of the board sector in the Iberian peninsula and one of the four largest producers in Europe. In 1994, Sonae Indústria expanded its operations into Canada, opening a chipboard factory in Lac-Mégantic. At the same time, it initiated trading activities in Brazil and number of African countries (Mozambique and South Africa), soon to be supplemented by production operations. In 1997, Sonae Indústria invested some US$ 100 million in a new medium-density fibreboard (MDF) factory in Paraná, Brazil.

In 1998, acting through its Spanish subsidiary TAFISA, Sonae Indústria acquired 85% of Glunz AG of Germany. With this operation, the Portuguese company became the world leader in the wood derivatives sector. It also expanded its industrial base to Germany and France and extended its product range to include oriented strand board (OSB), softboard and plywood. It also expanded its presence in Spain, basically in resin production. In 2005, Sonae SGPS spun off Sonae Indústria. Once this operation was complete, Sonae was left with 6.7% of SONEA Indústria's equity.

Source: Economic Commission for Latin America and the Caribbean (ECLAC).

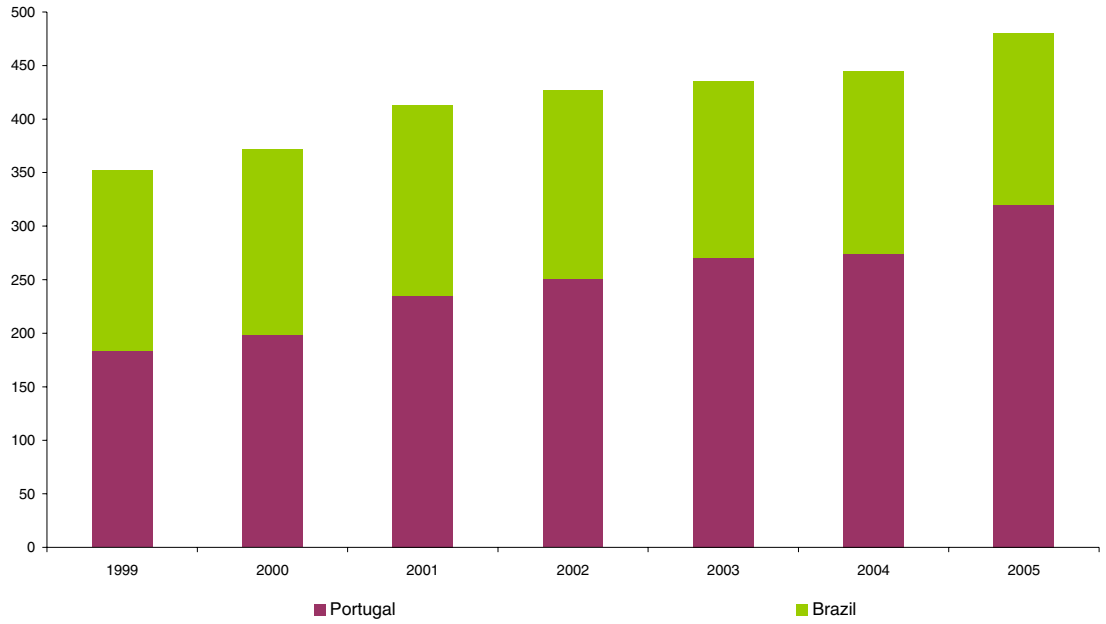
Figure IV.13
SONAE GROUP: SALES BY BUSINESS AREA, 2005
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from Sonae SGPS.

[a] In Brazil this includes only 11 months of 2005, as Sonae's operations were sold to Wal-Mart in December.
[b] In Brazil this includes only the 9 months in 2005 before Sonae Indústria was spun off.

Figure IV.14
SONAE: NUMBER OF RETAIL OUTLETS, BY COUNTRY, 1999-2005 [a]



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from Modelo Continente SGPS SA.

[a] In December 2005, Sonae sold all its assets in Brazil to Wal-Mart of the United States.

Map IV.4
SONAE: MARKET SHARE IN BRAZIL, BY STATE, 2005 [a]
(Percentages)

	(%)
São Paulo	3.4
Paraná	23.1
Santa Catarina	15.4
Rio Grande do Sul	32.3

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from Modelo Continente SGPS SA.

[a] In December 2005, Sonae sold all its assets in Brazil to Wal-Mart of the United States.

Box IV.5
THE SONAE GROUP: FROM SUPERMARKETS TO SHOPPING CENTRES?

Portuguese corporate direct investment in the Brazilian property sector has been dominated by a subsidiary of the Sonae group, Sonae Sierra (formerly Sonae Imobiliária). The company began operating in Portugal in 1989. Sonae Sierra is currently controlled in equal parts by Grupo Sonae SGPS and Grosvenor Plc of the United Kingdom. The company's operations have dovetailed perfectly with the group's activities in the retailing sector.

Sonae Sierra currently owns stakes in 40 shopping centres in Europe (Germany, Greece, Italy, Portugal and Spain) and South America (Brazil), and is implementing 15 new projects in the six countries where it operates (Sonae Sierra, 2006, p. 3). Its internationalization has been based on partnerships with local actors, and Brazil is no exception. In that country, the Portuguese firm forged an alliance with Enplanta Engenharia, a Brazilian company with great experience of shopping centre management. This partnership gave birth to Sonae Enplanta SA (now Sierra Enplanta), half-owned by each company, which began by operating five shopping centres owned by Enplanta Engenharia. Sierra Enplanta now has nine shopping centres in the country, eight in the State of São Paulo and one in Brasilia.

SONAE SIERRA: SHOPPING CENTRES IN BRAZIL, 2006

	Shopping centre	Location	Area (m^2)	Outlets	Opening date
1	Shopping Metrópole	São Bernardo do Campo, São Paulo	24 825	157	1980
2	Shopping Penha	Penha, São Paulo	30 000	247	1992
3	Franca Shopping	Franca, São Paulo	18 000	97	1993
4	Plaza Sul Shopping	São Paulo	26 569	226	1994
5	Parque Don Pedro	Campinas, São Paulo	115 000	370	1997
6	Pátio Brasil	Brasilia, DF	31 600	193	1997
7	Trivoli Shopping	Santa Bárbara, São Paulo	22 000	135	1998
8	Boavista Shopping	St. Amaro, São Paulo	24 000	167	2004
9	Shopping Campo Limpo	São Paulo	20 000	151	2006
10	Manaus Shopping	Manaus, Amazonas	43 126	252	2008 [a]

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Sonae Sierra, *Passionate About Innovation*, Lisbon, 8 November 2006.

[a] Under development.

Box IV.5 (conclusion)

The most important of all these operations would appear to be the Parque Dom Pedro in Campinas, State of São Paulo, one of the cities with the highest per capita income in Brazil. This shopping centre was inaugurated in 2002 with an initial investment of some 80 million euros, making it the largest of its kind in the country (370 outlets, nine anchor stores, multiplex cinemas, etc.).

However, poor GDP growth and the consequent squeeze on consumption have meant that the company's results have come in below its expectations. Sonae Sierra has nonetheless continued with its expansion strategy in Brazil. In 2004, it inaugurated Boavista Shopping in Santo Amaro, one of the most heavily populated areas in the city of São Paulo, for which it invested 20 million euros. It also spent some 11 million euros remodelling the Shopping Penta shopping centre. In 2006, it opened the Shopping Campo Limpo shopping centre in São Paulo, investing 20 million euros, and began the construction of a new shopping centre in the city of Manaus that will cost it 60 million euros (Sonae Sierra, 2006, p. 17). In addition to these operations, the company plans to invest a further 160 million euros by 2010 in building, expanding and remodelling shopping centres in Brazil in the expectation that conditions will improve. Porto Alegre and Florianopolis (Santa Catarina) have been selected as the first cities to benefit from these likely new investments (*Portugal Digital*, 14 December 2005).

In October 2006, Sonae Sierra signed an agreement with a United States firm, Developers Diversified, to sell half its operations in Brazil for US$ 150 million (*El Economista*, 21 October 2006). In addition, the two companies agreed to invest some US$ 300 million between them in acquisitions and new projects in Brazil over the coming three years (*Sonae Sierra press release*, 23 October 2006). According to the company, this commitment will not alter its strategy in Brazil, as happened in the retail segment. In fact, the idea is that the agreement should turn Sonae Sierra into the two shareholders' platform for future shopping centre investment and promotion in Brazil (*El Economista*, 21 October 2006).

Source: Economic Commission for Latin America and the Caribbean (ECLAC).

Retailing used to be highly fragmented in Brazil, with low operating margins and a large investment deficit, and it faced intense competition from the informal sector. As a result, the entry of foreign capital into the industry was seen as highly desirable, and this led to a high level of penetration by international operators: not just Sonae, but also Carrefour and Casino of France, Royal Ahold of the Netherlands and, more recently, Wal-Mart (Calderón, 2006).

In 1998, Sonae entered into a joint venture with a São Paulo firm, Cândia Mercantil Norte Sul, giving birth to Sonae Distribuição Brazil SA (SDB). The partnership lasted just a few months, after which the Portuguese firm acquired the whole of Cândia's operations. To continue strengthening its position in its core markets, furthermore, Sonae quickly made further acquisitions of major operators. In Paraná it took over the chains of Mercadorama (the state's largest), Coletão and Muffatão. In this period, the Portuguese group took control of five of the 10 largest supermarket operators in the State of Paraná and carried through a process of unprecedented concentration in the city of Curitiba (Cardoso de Lima, 2005, p. 15). In Rio Grande do Sul, it bought up the network of Exxtra Econômico e Nacional. Thus, in less than two years Sonae consolidated its leadership in the markets of Brazil's southern region and rose to become the country's third-largest retailer (Sonae Distribução, 2000, p. 6).[54]

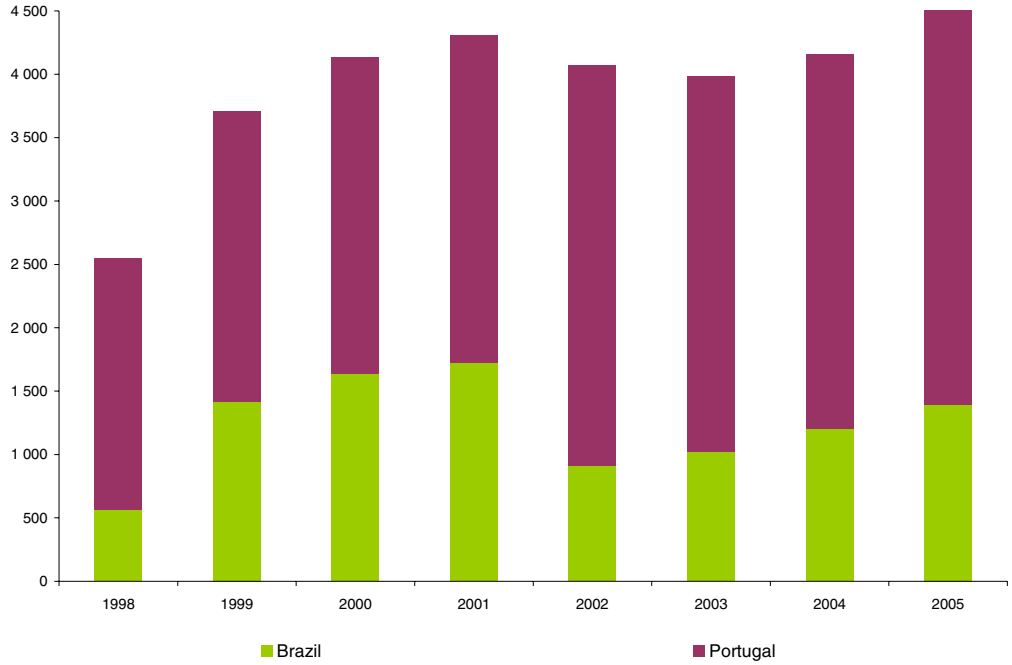
From this solid position, Sonae continued to strengthen its operations and corporate image in Brazil. To do this, it embarked upon a wide-ranging programme of consolidation and rationalization that built on the most widely accepted brands in the subregional markets concerned, such as Nacional and

[54] In 1999, which was a particularly testing time for the Brazilian economy, four chains (Exxtra, Nacional, Coletão and Muffatão) were integrated into Sonae's operations in Brazil, giving it a total of 169 outlets and US$ 1.42 billion in sales, more than double its revenue the previous year. Sonae's operations were concentrated in four states that between them accounted for over 50% of Brazil's GDP (Sonae Distribução, 2000, pp. 14-16).

Mercadorama, and extended the hypermarket format (under the Big name) to all areas where it had a presence. Sonae also continued to standardize operating procedures and systems in its different chains (Modelo Continente, 2001, p. 10). In the early part of the present decade, the Portuguese company achieved strong growth in Brazil by opening new outlets, particularly hypermarkets, and thereby achieving a substantial increase in sales (see figure IV.15).

In 2002, at a time of instability in the world economy, Brazil went through a particularly difficult period dominated by the election timetable and a lack of confidence among consumers and investors. The local currency, the real, continued to depreciate against the euro and interest rates rose steadily, severely affecting business dynamism and the consumption capacity of the population. In these circumstances, Sonae's euro revenues fell sharply, and as a result the rate of installed capacity growth in the Brazilian market was dramatically lower than in earlier years (see figure IV.16) (Modelo Continente, 2003, p. 7). Like most of its peers in the sector, the Portuguese company concentrated on rationalizing its operations in the Brazilian market, which included the closure of some outlets.[55] Sonae dropped from third- to fourth-largest among the country's retailers during this period and its operations remained concentrated in the south of Brazil, especially Rio Grande do Sul (see figure IV.17) (Modelo Continente, 2004, p. 42).

Figure IV.15
SONAE: GROSS SALES, BY COUNTRY, 1998-2005 [a]
(Millions of euros)

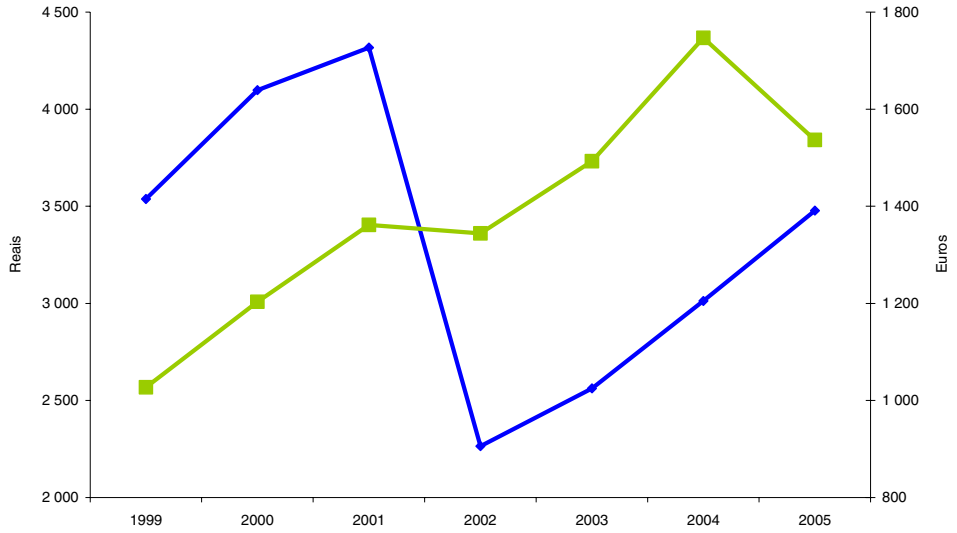


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from Modelo Continente SGPS SA.

[a] In December 2005, Sonae sold all its assets in Brazil to Wal-Mart of the United States.

[55] The company also invested in remodelling its stores and bringing in new specialized retail formats for electronics, household electrical appliances, clothing and fuels (Modelo Continente, 2003, p. 8). In 2004, it also signed an agreement with a financial institution that enabled it to offer credit cards to the customers of its supermarket chains (Modelo Continente, 2005, p. 6).

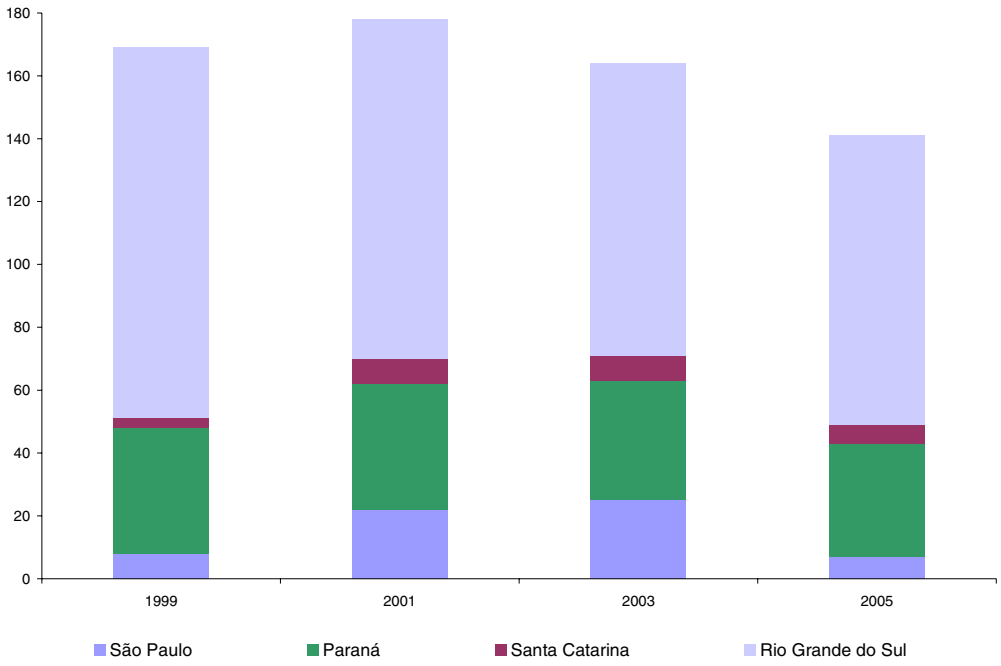
Figure IV.16
SONAE: GROSS SALES IN BRAZIL, IN REAIS AND EUROS, 1999-2005 [a]
(*Millions of reais and millions of euros)*



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from Modelo Continente SGPS SA.

[a] In December 2005, Sonae sold all its assets in Brazil to Wal-Mart of the United States.

Figure IV.17
SONAE: NUMBER OF STORES IN BRAZIL, BY STATE, 1999-2005 [a]



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from Modelo Continente SGPS SA.

[a] In December 2005, Sonae sold all its assets in Brazil to Wal-Mart of the United States.

In 2004, the retail industry recovered strongly along with the wider economy. At the same time, competition began to intensify and the industry concentrated rapidly as the large operators took advantage of the fragility of the smaller chains to make numerous acquisitions. The world leader in the industry, Wal-Mart of the United States, expanded strongly by purchasing the Bompreço chain from Royal Ahold of the Netherlands (ECLAC, 2005, p. 61). In the meantime, Sonae continued with its cautious strategy of organic growth, focused mainly on the hypermarket segment.

Given the circumstances, the Portuguese company began to look seriously at the possibility of withdrawing from the Brazilian market. In mid-2005, it sold 10 Big hypermarkets in the metropolitan area of São Paulo to Carrefour of France for 105 million euros. The Portuguese company initially announced that it would keep the seven outlets it still owned in São Paulo and use the funds raised by the sale to strengthen its position in the south of the country (*Diário de Notícias*, 10 July 2005). At the end of the year, however, Sonae sold all its assets in Brazil, a total of 141 outlets, to Wal-Mart for US$ 750 million (ECLAC, 2006a, p. 26) (see figure IV.17). This was a key operation for the United States retailer, since it had not had a presence in the country's south until then.[56]

Thus, Sonae completely pulled out of retailing in Brazil, a decision it took in the belief that in all likelihood this could not be made profitable enough to justify the opportunity cost of alternative investments (Modelo Continente, 2006, p. 10). From the company's perspective, this problem could only be solved by participating actively in the consolidation of the country's retail industry. To cope with the high levels of informal working in the sector, it would have had to grow substantially to achieve economies of scale. This would have meant heavy investment to acquire new assets and expand its supermarket chains. Yet economic and political volatility, combined with high interest rates, made future investments in Brazil very risky, and it was this that ultimately convinced the firm to pull out of the country (Modelo Continente, 2006, p. 10). In addition, the conglomerate was involved in one of the greatest challenges in its history, a hostile takeover bid for Portugal Telecom (PT), for which it needed liquidity.

5. Property and tourism: smaller investors looking for a place in the Brazilian sun

Investments by Portuguese companies in the property and tourism sector have grown very substantially in the last few years. Brazil is now one of the main recipients of Portuguese capital and the leading destination for Portuguese companies operating abroad. The firms that have invested in these areas vary enormously in size and profile and have implemented their projects throughout the country. They have employed all sorts of mechanisms, operating alone or in partnership with local groups, using their own resources or raising funds locally or externally. Many of these investments are in projects in the tourism sector, which basically revolves around middle- and high-income European travellers.

Portugal has been developing a strong tourism sector since the 1970s, and it now represents some 10% of the country's GDP. Portuguese investors began to pay attention to Brazil because with its ample supply of cheap land, exceptionally good year-round climate and convenience of access and language it represented an excellent alternative to their increasingly saturated domestic market and its high investment costs. Businesses in the sector benefited from a large increase in flights operated by Transportes Aéreos Portugueses (TAP) to Brazil, with some 50 services a week that included daily flights

[56] With this acquisition, Wal-Mart became Brazil's third-largest retailer with 295 outlets in 17 of the country's 26 states, behind Carrefour and Companhia Brasileira de Distribuiçao (CBD), which has the backing of the French group Casino (*The Wall Street Journal Americas*, 15 December 2005).

to Rio de Janeiro, Salvador, Natal and Fortaleza. Thus, Portugal has become the third-largest source of tourists visiting Brazil.[57]

In terms of geographical distribution, most Portuguese tourism investments have been in the north-east of the country, especially the states of Ceará, Bahia and Rio Grande do Norte. Some tourism investments in the south-eastern states of Rio de Janeiro and São Paulo and in Curitiba in the south (State of Paraná) are also of some strategic interest. The majority are gated condominiums built alongside luxury hotels to form resorts with golf courses and other collective leisure facilities. They have involved considerable investment, most of it by the largest Portuguese groups (from the financial, property and tourism sectors) working in partnership with one another or with Brazilian firms. The most active groups include Pestana (the leading Portuguese hotel conglomerate and one of the five largest in Europe), Vila Galé, Oásis Atlântico, Somague Engenharia, Agesco and Espírito Santo (see box IV.6). Many of these projects have been financed by Banco do Nordeste.[58]

The choice of north-eastern Brazil can be put down to three main factors: geographical proximity to Europe, a climate that is attractive to European tourists, and competitively priced services. The region's greatest competitor, in fact, is the Caribbean area (Cuba, the Dominican Republic and Mexico), which is almost three hours' flying time further from Europe, an important factor in the pricing of tourism services.

The largest Portuguese investment in Brazil's property and tourism sector is the Aquiraz Golf & Beach Villas complex under construction in the municipality of Aquiraz, 25 kilometres from Fortaleza in the State of Ceará. The project will cover an area of 280 hectares and will involve the construction of eight hotels, six pousadas, 700 apartments, a golf course and an equestrian centre, among other facilities, at a cost of some 260 million euros (*Portugal Digital*, 16 November 2005 and *Noticias Governo Municipal de Aquiraz*, 21 October 2006). Construction of this tourism complex, which will be the largest in Latin America, began in early 2007 and the first phase is expected to be completed in 2008. The participants in this megaproject are a Portuguese consortium consisting of Banco Privado Portugués (BPP),[59] the Dom Pedro hotel group and the Sol Verde tourism group, and a Brazilian businessman of Portuguese origin, Ivan Dias Branco, with each side holding a 50% stake. BPP is also going ahead with a similar project in the same region (*Diário Económico*, 27 July 2006).

Besides these large complexes, many of the property investments made in the tourism sector are small. Like the former, they are mainly located in the north-east region of the country, basically in the states of Ceará, Bahia and Rio Grande do Norte, and they encompass a wide range of facilities: sophisticated pousadas, small hotels and resorts, medium-sized hotels, etc.

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[57] The cities most visited by Portuguese tourists are those of the Atlantic coast and the north-east, particularly Recife in the State of Pernambuco (27%), Fortaleza in the State of Ceará (25%), Salvador in the State of Bahia (24%) and Rio de Janeiro in the State of Rio de Janeiro (16%) (*Diário Económico*, 27 July 2006).

[58] The Banco do Nordeste (BNB) is owned by the Brazilian federal government and headquartered in the city of Fortaleza, State of Ceará. It is the largest regional development financing institution in South America. BNB operates the Tourism Development Programme in Northeastern Brazil (PRODETUR/NE), created to promote tourism in the region with funding of some US$ 800 million.

[59] Banco Privado Portugués (BPP) has a representation office in São Paulo where it conducts normal private and corporate banking activities. Its operations centre on investments in the property and tourism sector, essentially in the north-east of the country.

Box IV.6

PESTANA GROUP: "THE EUROPEAN WHO SPEAKS YOUR LANGUAGE"

Founded in 1972, Grupo Pestana is currently Portugal's largest hotel group and one of the 200 largest chains in the world. This consortium pioneered the timeshare concept in Portugal and is now Europe's third-largest group in this segment. Through its Pestana Hotels & Resorts (PH&R) chain, it runs 39 hotel complexes (6,500 rooms) in Portugal, Africa and Latin America.[a] The group's internationalization drive has left it with a well-established presence in Argentina, Brazil, Cape Verde, Mozambique, Sao Tome and Principe, South Africa and, recently, the Bolivarian Republic of Venezuela. Over the coming years, the Pestana group plans to continue its international expansion, always concentrating on countries that have affinities with Portuguese culture.

After building up a solid base in its home market, the autonomous region of Madeira, the Pestana group sought to expand its presence in its main business, hotels. This expansion took place both in Portugal and abroad (Brazil, Cape Verde and Mozambique). With a view to offering full tourism packages, furthermore, the Pestana group moved into other subsectors such as gaming, golf courses, charter flights, tourism programmes in Portugal and abroad (Spain, United Kingdom and United States) and vehicle rental. By thus building up its operations in particular geographical regions, the group succeeded in achieving major synergies and economies of scale and consolidating its knowledge of the business, which then equipped it to expand into other areas. In Brazil, the Pestana group's presence has centred on resort hotels in the north-east and in Angra dos Reis (State of Rio de Janeiro) and on the business hotel market in São Paulo, Rio de Janeiro and Curitiba.

The Pestana group was the first Portuguese hotel company to make large investments in Brazil. The consortium now ranks twenty-first among the hotel chains operating in the country, where virtually all the major global operators have a presence. In 1999, the Pestana group acquired the Hotel Rio Atlântica (now Pestana Rio Atlântica) in the city of Rio de Janeiro. Since then it has bought two more hotels (one in Bahia and one in São Paulo) and two resorts (one in Rio Grande do Norte and one in Angra dos Reis). All the hotels have gradually switched to a common identity whereby the Pestana name is coupled with a reference to the unit's geographical location and the slogan "The European who speaks your language".

In 2004, the Pestana group took a further step in its positioning strategy in Brazil by opening a new hotel in Curitiba for business travellers visiting the Paraná capital and acquiring a majority stake in a hotel to be created in the Convento do Carmo in the historic centre of Salvador, Bahia. This latter hotel began operating under the Pousadas de Portugal name.[b] In early 2005, the Pestana group diversified its businesses in Brazil, hitherto centred on luxury tourist hotels, by entering the economy hotel segment and condominium management. It took the first steps in this direction in Curitiba with the Evolution Towers complex and the Smart Residence economy hotel. In 2006, the Pestana group also bought a new hotel in São Luís de Maranhão, its eighth hotel acquisition in Brazil (*Pestana press release*, 29 June 2006).

Thus, the Pestana group has invested more than 100 million euros in Brazil, and this amount could rise over the coming years, since the company aims to build or acquire a further four hotels by 2010 (*Portugal Digital*, 16 November 2005 and *Diario Económico*, 27 July 2006).

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the Pestana group [online] http://www.pestana.com/hotels/pt/pestana/group/about.

[a] The Pestana group owns 23 hotels in Portugal, eight in Brazil (Rio de Janeiro, Angra dos Reis, São Paulo, Bahia, Natal, Curitiba, São Luís and, shortly, Costa do Sauípe), three in Mozambique and one each in Argentina, the Bolivarian Republic of Venezuela, Cape Verde, Sao Tome and Principe, and South Africa.

[b] The Pestana group acquired Pousadas de Portugal in 2003, when ENATUR was privatized. The investment in Brazil was its first attempt to internationalize this brand.

Given the characteristics of these projects, it is very hard to arrive at an accurate estimate of the resources invested by Portuguese businesses. The number of ventures runs into the hundreds, and not all of them have been registered as direct investments with the Central Bank of Brazil. The leading groups include Miramar, Dorisol, Bristol Hotels & Resorts, Hotéis Alexandre de Almeida, Reta Atlântico, Comitur Anteal, Carisma, Beleza Tropical and Euro Constroi.

For all the difficulty of quantifying them, there can be no doubt that these investments have changed the economic landscape of certain cities in Brazil's north-east. In Rio Grande do Norte, for instance, tourism has grown much faster than in other regions over recent years, and this has led to rapid changes in the economic and social environment. Between 2002 and 2004, the flow of domestic and international tourists increased by 18% and 92%, respectively, so that the number of foreign tourists in the state almost doubled in just two years. In 2005, the number of international flights increased and the pace of expansion quickened beyond all expectations, with revenue from international tourism increasing by almost 400%. Tourism became the leading economic activity in the State of Rio Grande do Norte, yielding revenue of some US$ 600 million.

By contrast with this recent past, the current economic situation in Brazil has created some uncertainty about the continuity of such investments. For one thing, low GDP growth and the consequent reduction in the disposable income of middle class consumers of these services could create a glut of rooms and a price war that affects the value of the investments made. For another, the appreciation of the Brazilian currency has been making the country more expensive for foreign tourists, who may opt for other, cheaper destinations, causing these investments to lose value and contract.

Besides projects associated with the tourism sector, there have been innumerable Portuguese investments in property, both residential and commercial. Projects in the residential sector are highly diversified in respect of both the amount and type of investment. As with tourism-related activities, residential property projects are concentrated in the north-east of the country. The leading companies include Organização e Gestão Imobiliária (OGI), Actitud and Luxus. In the commercial segment, the main investments have been in shopping centres, particularly those of the Sonae group (see box IV.5), and the civil construction operations of the Lena group.[60]

In the infrastructure sector, lastly, the leading Portuguese company is Brisa, Portugal's largest motorway operator. In 2001, the firm took an 18% stake in Companhia de Concessões Rodoviárias (CCR). CCR is currently Latin America's largest motorway contractor, running about 1,452 kilometres of highways, or 15% of the concessions farmed out to the private sector in Brazil. Brisa has sought to break into new markets through this Brazilian company, essentially in Chile and Mexico (*Diario Económico*, 29 November 2006).

To sum up, the tourism property sector has been at the centre of a new upsurge in Portuguese investments in Brazil. As the investment impetus of large Portuguese firms slowed down in the late 1990s, much smaller companies with little international experience began to arrive in considerable numbers on the beaches of the Brazilian Atlantic. The great bulk of these investments have been made in the country's north-east, attracted by the natural characteristics of the region, incentives from state governments and the great increase in flights from Portugal to different locations in Brazil. However, this rapid growth could potentially lead to oversupply and price wars that might undermine the value of the investments made.

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[60] The Lena group is highly diversified and has a presence in Angola, Brazil, Bulgaria, Mozambique and Rumania. In Brazil, the group has its centre of operations in the State of Bahia, where it has implemented projects worth some 40 million euros. The group's main subsidiary in the country is Liz Construções, which accounts for about 80% of its business in Brazil, chiefly public works (*Bahiainvest Últimas Notícias*, 6 December 2005 [online] http://www.bahiainvest.com.br). The company is building a theatre and a convention centre in the municipalities of Feira de Santana and Itabuna and a prison in Lauro de Freitas, representing some 14 million euros' worth of investment.

6. Financial services: an unsuccessful wager?

In the financial sector, a number of companies have begun to operate in Brazil in recent years, chief among them being Grupo Espírito Santo, Caixa Geral de Depósitos (Banco Financial Português) and Grupo Banif. This was one of the business areas in which Portuguese investors struggled most. Like other foreign banks, Portuguese firms came up against a market which was far more intractable than they had expected and where large local operators were strongly entrenched.

During the second half of the 1990s, foreign banks increased their presence in Brazil substantially, mainly through takeovers. Between 1995 and 2001, the share of foreign banks in the sector's total assets rose from 7% to 25% (ECLAC, 2005, p. 90). From 2001 on, however, the market share of foreign operators began to decline, essentially because local banks reacted by severely rationalizing their operations and investing heavily in new technology. In these circumstances, many foreign banks modified their market penetration strategies in Brazil, relinquishing control of certain financial institutions to become minority shareholders in locally owned groups.

Like other foreign investors, some of Portugal's leading financial groups took over local banks that were too small for their purposes and tried to grow organically. They quickly realized, however, that this strategy was costly and hard to implement. A small group of firms that took over larger banks had the conditions they needed in place and chose to stay in the Brazilian market.

Of the Portuguese banks that are still operating in Brazil, most preferred to orient their activities towards property and tourism investments, foreign trade and the capital market. Public-private partnerships (PPPs) are a segment much favoured by the leading Portuguese banks. Along with the United Kingdom, Portugal is the country where this infrastructure investment model is most highly developed, and from the point of view of Portuguese banks PPPs could open up interesting opportunities for new business. However, these investments have been held back by delays in shaping the regulatory framework (*Valor econômico*, 27 December 2005).

One Portuguese investor with a longer-standing presence in the Brazilian financial system is the Espírito Santo group. It concentrated on commercial banking in the 1990s, first going into partnership with a local group, Monteiro Aranha, and Crédit Agricole of France in Banco Interatlântico, and then working through the latter to acquire Banco Boavista in Rio de Janeiro. For this operation, the partners took advantage of the benefits offered by the Incentive Programme for the Restructuring and Strengthening of the National Financial System (PROER). However, this was an especially difficult period in the Brazilian economy and they never achieved the scale required to compete with the established banks and the large international institutions that arrived later. In 2000, after huge losses, Banco Boavista was transferred to a local operator, Bradesco. Since then, Espírito Santo group has been shifting its strategy in Brazil by concentrating on large firms, mergers and acquisitions, capital markets, fixed- and variable-income funds and property and tourism projects.[61]

Following a strategy similar to that of the Espírito Santo group, Caixa Geral de Depósitos (CGD) took over Banco Bandeirantes, thus gaining access to a network of over 500 branches in Brazil. The company sought to consolidate as a commercial bank by capitalizing on the size of the Brazilian market and the large Portuguese colony residing in the country and by supporting the Portuguese investors attracted to

[61] Espírito Santo group participated in major operations such as the acquisition of Bradesco by Banco Bilbao Vizcaya Argentaria (BBVA) and that of Tele Centro-Oeste Celular (TCO) by the partnership between Telefónica and Portugal Telecom.

Brazil by the privatization programme. This strategy did not yield the results hoped for. In 2000, CGD established an alliance with a local firm, Unibanco, which came into force after the Portuguese bank had transferred its stake in Banco Bandeirantes to Unibanco in exchange for 12% of the latter's equity. The partnership was marred by conflicts between the parties, leading to its dissolution in 2005.

After this long and painful learning process, CGD recast its strategy in Brazil by turning itself into an investment bank specializing mainly in the financing of foreign trade operations. The Portuguese bank also aims to support Iberian companies in the Brazilian market, the Portuguese colony in Brazil and Brazilian firms in their internationalization efforts. Like other Portuguese financial groups, furthermore, the company has invested in real-estate projects and would consider participating in future PPPs. CGD currently has just eight offices, in São Paulo (4), Rio de Janeiro (2), Paraná (1) and Rio Grande do Sul (1).

Brazil has now become more expensive; asset values have risen substantially and Portuguese companies do not have the financial capacity to position themselves properly in this market. For this reason, Africa has emerged as an alternative with clear competitive advantages. With the pacification of former Portuguese colonies, the high price of oil (which Angola possesses in abundance) and the incipient repayment of external debts, many business people from Angola and Mozambique are returning to their countries, and Portuguese financial institutions are trying to seize this opportunity before others do.

To sum up, Portuguese banks tried to replicate the strategy of other financial institutions from industrialized countries, particularly Spain, and grew fast in Latin America by buying up local assets. The experience was much harder than had been expected, however, and they were forced by rising competition to abandon or scale back their operations in the region. In Brazil, the size of the market, the reaction of the large domestic banks and the instability of the economy severely affected the expectations of Portuguese financial institutions, leading them to scale their activities right back so that they could concentrate on specific niches such as investment banking and property development.

C. CONCLUSIONS

During recent decades, Portugal has been used by transnational enterprises as a platform for exports, most of them going to other European economies. Portuguese firms used to have a very limited presence in international markets, but this situation has changed quickly over the last 15 years as they have actively expanded beyond the country's borders.

The consolidation of European integration and adoption of the single currency helped to strengthen the Portuguese economy. This process also brought a number of reforms, chiefly the liberalization of some key business areas such as telecommunications, energy and the financial sector, which led to a sharp increase in competition in domestic markets.

In these circumstances, large Portuguese companies (which would qualify as medium-sized by European and world standards), many of which were being privatized at the time, were forced to react. One of the measures they took was to try to combine growth with improved competitiveness to avoid becoming the target of an unwanted takeover bid from their European rivals.

Generally speaking, the largest Portuguese companies have traditionally held a large share of the domestic market in their area of business, and some have had the advantage of being natural monopolies in certain activities, allowing them to generate large surpluses. This advantage was supplemented by

favourable stock market conditions, allowing them to access the financing they needed to launch ambitious expansion initiatives.

In relatively mature, saturated local markets, international expansion became not so much an opportunity as an obligation. With few options available in Europe, the first large-scale investments mainly took place in the Iberian peninsula, after which companies gradually expanded into other countries and regions, always showing a preference for those with strong ties of culture and language, primarily Brazil and former Portuguese colonies in Africa. This trend consolidated the main peculiarity of Portuguese outward direct investment: relatively small companies that saw a common language as their main comparative advantage (see table IV.19). This process received explicit governmental support.

Table IV.19
THE LARGEST PORTUGUESE COMPANIES: LOCATION OF MAIN INVESTMENTS

	Community of Portuguese-speaking countries							Spain	Marocco	Other Europe	Other Latin America	Other Asia (Macao SAR)	Other Africa
	Portugal	Brazil	Angola	Cape Verde	Mozambique	Sao Tome and Principe	Timor-Leste						
GALP Energia	X	X	X					X					
Energias de Portugal	X	X		X				X			X	X	
Sonae	X	X		X	X			X		X			X
Portugal Telecom	X	X	X	X		X	X		X			X	
Cimentos de Portugal	X	X		X	X			X	X				X
Grupo Pestana	X	X		X	X	X					X		X
Caixa Geral de Depósitos	X	X		X	X			X				X	X

Source: Economic Commission for Latin America and the Caribbean (ECLAC).

During the 1990s, Portuguese firms were presented with a major opportunity that perfectly matched their needs: the privatizations in Brazil. In the midst of this process, they displayed remarkable decisiveness by acting, either alone or as members of consortia, to acquire some of the most sought-after businesses, especially in the areas of telecommunications and electricity. Thus, Portuguese outward direct investment experienced an unprecedented surge during the second half of the decade, with Brazil as the main recipient. This process was led by a small group of major companies, principally Portugal Telecom (PT), Energias de Portugal (EDP), Cimentos de Portugal (CIMPOR), Sonae and Caixa Geral de Depósitos (CGD) (see table IV.19).

Thus, in a short space of time Portugal became a net exporter of capital and a base for major European service sector companies, chiefly in the areas of telecommunications and energy. This represented one of the most significant structural changes in the Portuguese economy since its incorporation into the European integration process.

At the start of the present decade, a new pattern of Portuguese outward investment began to emerge. Because of the deteriorating international economic situation and its domestic and regional repercussions, investment by Portuguese firms contracted sharply. The economic and political crisis in Argentina and the uncertainty associated with presidential elections in Brazil further undermined confidence in the region, leading to alterations in corporate strategies. In addition, many of the Portuguese

companies involved found that they needed to consolidate the large investments they had made by restructuring their main Latin American subsidiaries. In these circumstances, investment began to be increasingly targeted on other countries in the European Union, chiefly Spain, while the relative importance of Latin America declined substantially.

Even as the largest Portuguese companies checked their international expansion in Latin America, however, smaller firms emulated their earlier behaviour and began a new wave of investments. Indeed, a much larger number of firms arrived in this phase than during the original boom. The new wave of Portuguese investment has been concentrated in the construction and tourism sectors.

Some of the Portuguese companies that led the process have pulled out of Latin America, and particularly Brazil, in the last few months, and others may be forced to do the same. This is true of Sonae, PT and the great majority of banks. This reflects the difficulties faced by Portuguese companies in the Brazilian economy and the limitations of an approach based on ties of culture and language.

The experience of Portuguese companies in Latin America, particularly Brazil, has important policy implications. First, from the standpoint of the companies, internationalization is not a simple process and ought to be based on competitive advantages underpinned by managerial and financial strengths, and by a thorough knowledge of the industry they operate in and the markets into which they mean to expand. Clearly, it is not enough just to speak the same language. As evidence of this, a number of these companies were taken over by transnationals from elsewhere in the world that seemingly had more solid competitive advantages. Many Portuguese companies learned valuable lessons in this process, leading them to carry out profound restructuring in their subsidiaries abroad, relinquish certain markets or pursue further integration in the economic area of the Iberian peninsula. This experience should be an inspiration to the many Latin American companies that are now beginning to expand abroad. Second, the arrival of companies without much international experience or local knowledge can prove costly for Latin American countries. When this happens, the potential benefits of FDI are not realized and, especially in basic infrastructure and service sectors, severe harm may be caused to users and to the systemic competitiveness of the host country. At a time of financial constraint, therefore, the efforts made by a country's authorities to attract foreign investors ought to target companies that offer clear benefits to that country.

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