

PUBLIC POLICY AND PRODUCTIVE
TRANSFORMATION SERIES
N° 10 / 2013

Towards a new
agenda in Foreign
Direct Investment
**TRENDS AND REALITIES
IN LATIN AMERICA**

Towards a new agenda in Foreign Direct Investment

Trends and realities in Latin America

**Public Policy and Productive Transformation Series
No. 10 / 2013**

**Michael Penfold
José Luis Curbelo**

**Towards a new agenda in Foreign Direct Investment.
Trends and realities in Latin America**

Public Policy and Productive Transformation Series

Depository collection number: if7432012330842

ISBN for whole work: 978-980-6810-67-9

ISBN for Volume: 978-980-6810-88-4

CAF Publisher

This series is coordinated by the Vice-Presidency of Development Strategies and Public Policy of CAF

Jose Luis Curbelo

Vice-President of Development Strategies and Public Policy

Michael Penfold

Director of Public Policy and Competitiveness

Translator

Cathryn Johnson

Public Policy and Productive Transformation consists of a series of documents aimed at disseminating successful experiences and cases in Latin America as a tool for producing knowledge for the implementation of better practices in the field of business development and productive transformation.

Editorial production: Cyngular

The ideas and proposals contained in this issue are the exclusive responsibility of the authors and do not reflect the official position of CAF.

The digital version of this publication can be found at:
www.publicaciones.caf.com

© 2013 Corporación Andina de Fomento
All rights reserved

Index

Foreword	7
Executive Summary	9
Introduction	11
Characteristics of FDI in Latin America	15
Investment flows	15
Origin of the investment	17
Sectorial behavior	19
Territorial dynamics	21
Some tendencies of FDI in Latin America	23
Economic liberalization	23
Competitiveness	25
Venture capital	25
Research and development	26
China as an investor	26
The multilatinos	27
The new FDI agenda in Latin America	29
Bibliography	31

Index of graphs

Graph 1. Flow of foreign direct investment in latin america	16
Graph 2. Incoming stocks by region as a percentage of GDP	16
Graph 3. FDI inflows as a percentage of GDP	17
Graph 4. FDI origin in Latin America	18
Graph 5. Average sectorial distribution of FDI in Latin America	20
Graph 6. FDI Net Income by components. Average for Latin America	21
Graph 7. Flows of FDI in relation to degree of opening (average 2006-2011)	24
Graph 8. WEF relationship with FDI as a percentage of GDP in Latin America	24

Foreword

Productive transformation has been one of the areas that CAF, as the development bank of Latin America, has fostered as a necessary condition for reaching a high and sustainable level of development in the region.

The experience and expertise generated in each project over the last decades have made the Institution to become a Latin American point of reference in areas of competitiveness, Corporate Governance, local and business development and productive inclusion.

The public policies necessary to drive productive transformation are based on the development of those capacities aimed at the implementation of good practices and on specific supports for improving business management and productivity. Thus, CAF makes its knowledge and expertise available and offers efficient support to a variety of sectors while, at the same time, creates documentation and research on success stories that are relevant to the region

“Public Policy and Productive Transformation” consists of a series of policy documents aimed at disseminating those experiences and successful stories in Latin America, as an instrument for spreading the knowledge that CAF makes available to the countries in the region so that better practices with respect to business development and productive transformation can be implemented.

L. Enrique García
Executive President

Executive Summary

Latin America is currently in a favorable economic situation, given the very uncertain conditions of the global economy. A central element behind this great economic dynamism has been the renewed interest recovered by foreign investment in continuing to increase its participation in Latin America. But despite the macroeconomic situation, the microeconomic and social inadequacies remain evident, therefore, foreign investment looms large in contributing to offset -and even overcome- many of these weaknesses.

This study presents three main aspects: the behavior of foreign investment in Latin America that is characterized based on various indicators, the relevance that Asian investments have been acquiring with a special focus on China, as well as the investment of the “multilatinas” as a mechanism of intra-regional integration, and finally, the identification of new challenges which the Latin American countries are going to have deal with in order to increase FDI and, above all, to impact in the different economies of the region.

Key words: Foreign Direct Investment (FDI), investment flows, multilatinas

Introduction

Latin America is currently in a favorable economic situation, given the very uncertain conditions of the global economy. In particular, the region shows relatively high growth rates, co-exists in an environment of democratic opening and, with certain exceptions, has achieved a reduction in its poverty rates. A central element behind this great economic dynamism has been the renewed interest recovered by foreign investment in continuing to increase its participation in Latin America.

Many of the developed countries, both from North America, Asia and Europe, have begun to see in Latin America a central ally in the construction of their strategies for stimulating the growth of their various economies, which has increased foreign direct investment (FDI) even in sectors which go beyond the exploitation of natural resources and in areas related to telecommunications and financial services. This is undoubtedly encouraging news, but it also constitutes an opportunity to promote a new cycle of changes and assume new challenges which must be tackled by the various countries with responsibility and without complacency.

Latin America has achieved economic growth, after more than a decade of reforms, mainly due to a responsible fiscal policy, a strengthening of the regulatory frameworks of the financial sector and obviously to the high world commodity prices which have enabled them to increase their traditional exports considerably. This external situation, so positive in the context of an adequate macroeconomic policy, has paid off, making the region even more attractive.

But despite these macroeconomic triumphs, the microeconomic and social inadequacies remain evident: the region maintains high levels of inequality and poverty; the quality of employment is precarious given the high rates of informality; public institutions are still weak, which is evidenced by high crime rates and the low levels of public approval of the functioning of the rule of law; the industrial sector is highly dependent on the production of goods and services of low value added; investment in infrastructure is scarce; rates of innovation and entrepreneurship are low and financial access continues to be a limiting factor for entrepreneurial development. Furthermore, Latin America has lagged behind in the adoption of new technologies which is evidenced by the low penetration rates of information technology (IT) as well as in those areas oriented towards promoting energy efficiency and the development of a green economy.

In this context, foreign investment looms large in contributing to offset -and even overcome- many of these weaknesses. The type of investment that is attracted, in the event that countries

continue in their effort to strengthen their political and legal institutions, maintaining sustainable fiscal policies and reducing extreme poverty levels, can contribute perfectly to facing these challenges related to entrepreneurial development. Interestingly, foreign investment in the region shows some positive contrasts in regard to its behavior in the decade of the nineties – a decade which was also characterized by high investment, although marked by the privatization processes of numerous state assets in a context of fiscal adjustments and trade liberalization.

With regard to the contrasts, the following transformations can be identified: a) greater diversification in the origin of the FDI (which was initially highly concentrated in foreign investment originating from Europe and the USA) towards greater participation from Asia, especially China, and also foreign investment originating from Latin American companies which have expanded to other countries (known as “multilatins”); b) The region has started to see the entry, although very incipient, of foreign investment linked to the venture capital industry, oriented towards the identification of dynamic and innovative companies and sectors; c) the growth in domestic markets, especially of the middle class, has been an important source of attraction for foreign investment in the area of services, for the purpose of taking advantage of the expansion in consumption, as well as physical infrastructure (airports, ports, telecommunications, highways, etc.) and social (health) needs, raising the standards both of educational demand as well as supply; and d) the specific decision, albeit in incipient form, of some foreign companies to install Research and Development Centers in countries such as Mexico, Chile, Panama and Brazil, in which they have expanded their operations, which could result in the strengthening of the potential for innovation and increase the technological content of some non-traditional sectors within the Latin American economies.

However, the continuities in the behavior of foreign investment are equally outstanding: a) the increased growth in FDI is concentrated in sectors linked to the export of *commodities* based on natural resources (energy, mining and agriculture) and also in services; b) FDI oriented towards using Latin American countries as export platforms in non-traditional sectors remains scarce; and c) the dynamism of FDI is closely linked to the opportunities generated by changes in government policies; in the nineties by the privatization processes and currently by the processes of concessions or public-private investment projects in infrastructure and services and in the opening up of capital intensive sectors, such as oil, gas and mining.

To illustrate each of these points, the chapter has been divided into three parts. In the first section the behavior of foreign investment in Latin America is characterized based on various indicators. The second, contains an analysis of the relevance that Asian investments have been acquiring, with a special focus on China, as well as the investment of the “multilatins” as a mechanism of intra-regional integration, respectively. In this same section some incipient elements relating to FDI are dealt with, such as the installation of Research and Development

Centers by multinational companies and the emergence of a venture capital industry which has begun to channel investment resources towards local sectors and companies with innovative potential. The chapter concludes with the identification of new challenges which the Latin American countries are going to have deal with in order to increase FDI and, above all, to impact in the different economies of the region.

Characteristics of FDI in Latin America

Several works have been carried out to identify the determining factors of foreign investment in Latin America (Stein and Daude 2001; Fernández Arias and Hausman 2000; Levy Yeyati, Daude and Stein 2004; Stein and Daude 2007). In these studies, several variables are analyzed that would appear to be statistically significant, among them the institutional quality of the countries, the size of the economy, the geographical proximity, linguistic similarities and time difference (Stein y Daude 2001). Other works with greater scope, both in the sample of countries as well as the evolution over time in the behavior of foreign investment, have identified commercial variables, among them, the number of free trade agreements as well as the degree of liberalization of the economies, as aspects which have a strong impact on the attraction of investments (Buthe and Milner 2008).

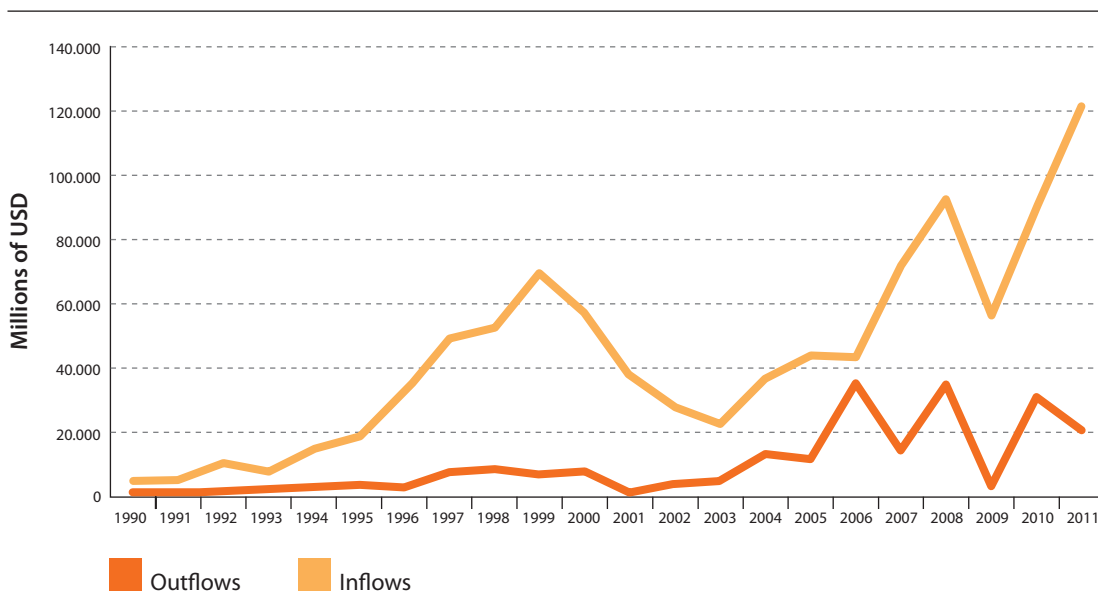
Investment flows

In general terms, Latin America has shown relatively high foreign investment figures during the last decade (see graph 1); FDI has even been growing consecutively, with the exception of a single year (2008) which showed a decrease as a consequence of the global financial crisis. By the year 2011, foreign investment in Latin America had not only recovered, but it achieved its maximum historic levels, exceeding 120 billion dollars, with Brazil, Mexico and Colombia as the countries which attracted the greatest amount of flows in that year.

In terms of GDP, the story is less positive for Latin America. The weight of the stocks of foreign investment in terms of their size within the Latin American economies is lower than in some other regions of the world, such as those of Southeast Asia or Eastern Europe, in which stocks of FDI have reached levels of more than 50 per cent of GDP. In the case of Latin America, said stocks have represented almost 30 per cent of GDP. However, the figure is particularly high, above all, when compared with China, where the stock reaches almost 10 per cent of GDP. (see graph 2). This behavior does not change significantly, with regard to the annual flows of investment against GDP, in comparison with Eastern Europe, Southeast Asia and China.

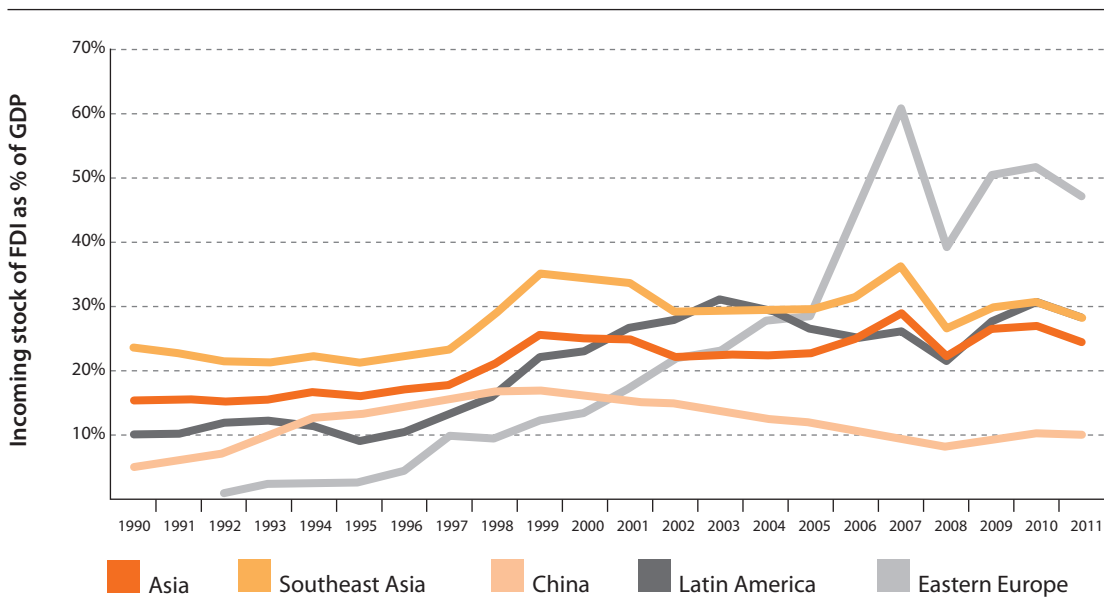
During the last five years, a large part of the annual flows of FDI in Latin America have been concentrated in a small group of countries: Brazil, Mexico, Colombia, Chile, Peru and Panama. In terms of the importance of FDI within their economies, the performance of some of them clearly stand out, especially when these countries are compared over the last three five-year periods (1996-2000; 2001-2005; 2006-2011). As a result, some countries such as Chile, Panama,

GRAPH 1. FLOW OF FOREIGN DIRECT INVESTMENT IN LATIN AMERICA



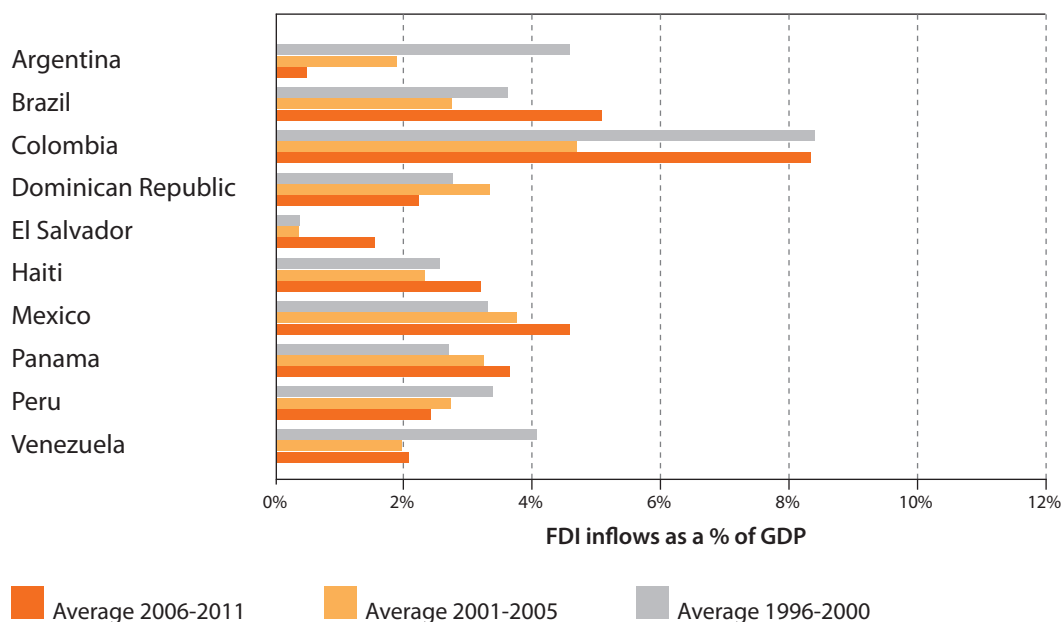
Source: UNCTAD (2011)

GRAPH 2. INCOMING STOCKS BY REGION AS A PERCENTAGE OF GDP



Source: UNCTAD (2012)

GRAPH 3. FDI INFLOWS AS A PERCENTAGE OF GDP



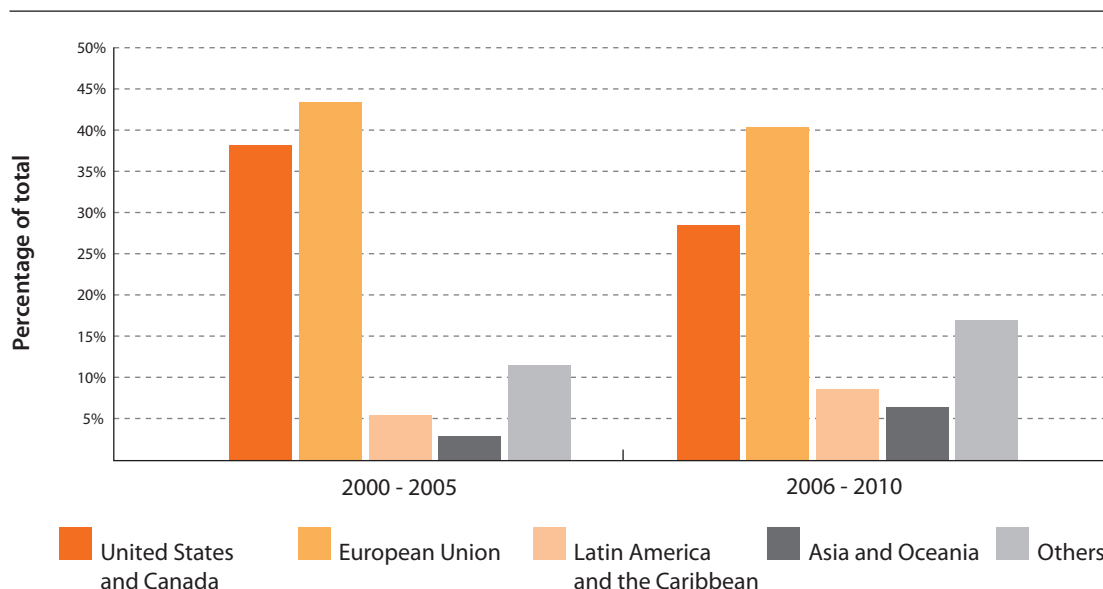
Source: UNCTAD (2012)

Brazil and Mexico have shown high levels of attraction of foreign investment. This process has been continuous during these three periods. In the cases of Panama and Chile, FDI is close to or higher than 8 per cent of GDP; and close to 3,5 per cent and 2,5 per cent of GDP in the cases of Brazil and Mexico, respectively. In the cases of Colombia, Uruguay and Peru there has been a significant increase in FDI upon comparing the importance of the amounts they attracted in the period 1996-2000 in relation to the high levels of attraction achieved for the period 2006-2011. In the cases of Uruguay and Colombia, FDI for 2006-2011 reached 5,5 per cent and 3,5 per cent of GDP respectively. Finally, countries like Venezuela, Bolivia, Paraguay and Argentina have shown a significant fall in the importance of FDI as a percentage of GDP throughout these three periods (see graph 3).

Origin of the investment

The origin of FDI in Latin America has changed significantly upon comparing the periods 2000-2005 and 2006-2011. In the first period, both the European Union as well as the United States had a very high percentage weight in terms of their participation as originators of FDI. In particular, the European Union had a clear leadership in the process, representing almost

GRAPH 4. FDI ORIGIN IN LATIN AMERICA



Source: CEPAL (2011)

45 per cent of the origin of the annual flows. In the second period, the European Union maintained its leadership, but despite that it declined in importance with 40 per cent of the total amounts. The investments from the United States fell from 37 per cent in 2000-2005 to almost 28 per cent in 2006-2011.

Curiously, the emergence of other alternative sources of origination marked the dynamism of foreign investment in Latin America during this second period.

The participation of Asia in FDI passed from 11 per cent in 2000-2005 to almost 17 per cent in 2006-2011. Furthermore,, Latin America began to observe in both periods the expansion of the companies known as “multilatinas”, which have been dominated by processes of strong expansion of their markets within the region itself, through the extensive use of FDI mechanisms (Santiso 2008; Guillén and García Canal 2011; Guillén and García Canal 2012). In the period 2000-2005, the Latin American origination of FDI represented little more than 10 per cent of the annual flows; while for the second period, these flows reached almost 17 per cent of the total amounts received by the different countries. In other words, in the period 2006-2011, both the Asian as well as the Latin American sources grew strongly in terms of relevance, while the FDI from Europe and the United States –which continued to represent the greatest proportion of funds-, experienced a clear decrease in terms of their relative relevance.

Sectorial behavior

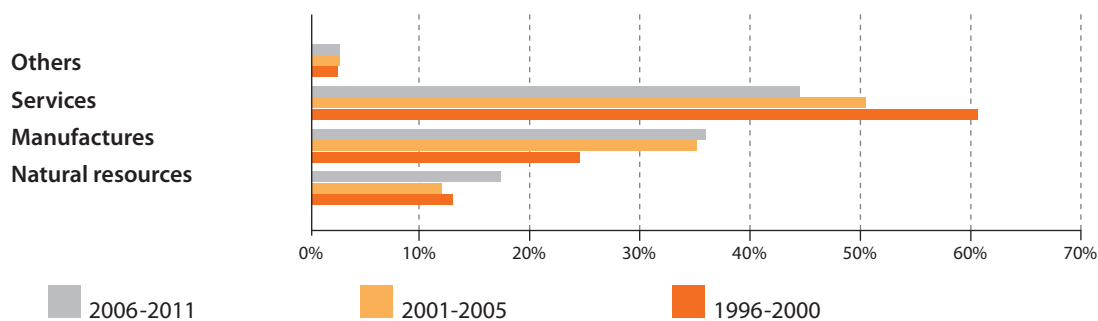
The sectorial behavior of the FDI has shown some interesting changes, particularly when it is compared with the nineties. These changes are particularly striking given the growing external dependency of the region of the exports based on natural resources, among them, petroleum, gas, mining and food, as well as the high prices of these commodities in the international markets.

During the nineties, the FDI in Latin America was highly concentrated in the attraction of investments in the service sector, mainly due to the opportunities generated by the privatization processes and the opening applied to the financial, telecommunications and public service sectors (electricity and water). In this same period, the FDI also took advantage of opportunities in the manufacturing sector, especially to capitalize the opportunities of the economic opening that certain markets such as Brazil, Argentina, Mexico, Venezuela and Costa Rica represented. It should be stated that during the nineties Mexico had a high performance in the attraction of investments in manufacturing oriented towards exports, taking advantage of its commercial integration with the United States and Canada. This way, 43 percent of the FDI in Latin America was concentrated in the service sector and 42 percent in the manufacturing sector. The FDI in industries based on natural resources hardly represented 12 percent; much of this regional investment was concentrated in Venezuela, given the opening process of the petroleum industry which characterized this country during the middle of that same decade and that was reversed soon afterwards.

By the end of the first decade of the millennium, some new sectorial trends began to be observed. Although the proportion was maintained (although declining) of investments attracted by the service sector (which represented 40 percent of the FDI for the period 2006-2011), it is possible to identify an evident fall in the importance of FDI in the manufacturing sector (which came to represent 32 percent of the total flows of the FDI in the region for that same period). On the other hand, the FDI in natural resources increased significantly, representing in this same period 28 percent of the total flows of FDI in Latin America.

Several causes explain these trends. In the service sector, there has been a clear transition from the specific opportunities which were generated by the privatization processes, especially in the financial and telecommunications sector, towards a growing expansion of the internal markets marked by the growth of the middle classes and the reduction in the poverty gaps (Birdsall 2012; Lustig, Birdsall and McLeod 2011). This new social and economic reality has created *downscaling* opportunities which have allowed many of these foreign companies to reinvest to increase the expansion of their services to the various sectors of the population, even the lowest income sectors.

GRAPH 5. AVERAGE SECTORIAL DISTRIBUTION OF FDI IN LATIN AMERICA



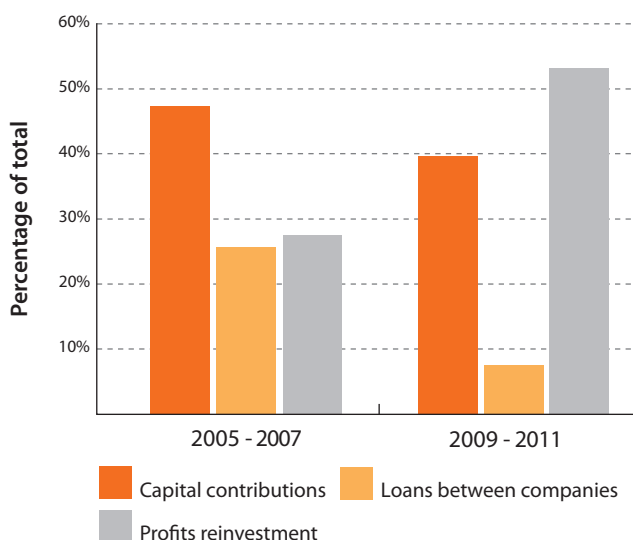
Source: UNCTAD (2012)

The growth of the purchasing power of the new middle classes has increased the attraction of the internal Latin American markets becoming even more demanding. This has not only had an impact on the service sector but also on the manufacturing sector. The growth in purchasing power has forced the mass consumption industry to invest more in innovation; especially, in a greater knowledge of the new trends of these markets, as well as in the design of adequate processes and products which cannot always be imported from more developed countries. Likewise, these same industries, to be able to adapt themselves to the low cost requirements of these new middle classes, have had to develop new production and distribution schemes that require a greater investment on the part of the different multinational companies.

Regarding natural resources related industries, the emergence of public policies more favorable to the entry of foreign capital in sectors such as petroleum and mining, accompanied by the discoveries of new deposits in various Latin American countries, including Colombia, Brazil and Peru, have promoted a large inflow of FDI. This is particularly true for the countries that consolidated a regulatory framework that permits the participation of private investment in various large scale projects, such as for example, Chile, Peru, Colombia, Brazil and Peru. On the other hand, other countries such as Argentina, Bolivia and Venezuela, which modified their public policies to seek a more strategic control of these industries by the State, have experienced disinvestment processes. Despite this, the investments in the exploitation of natural resources which the first group of countries has been able to attract, in other words, those with more open investment frameworks have been truly large.

Finally, in the period 2005-2007, the central component of FDI in Latin America was provided by capital contributions. In effect, more than 48 percent of the net income of foreign investment was of this nature. Between the years 2009-2011 this same percentage had reduced to 40 percent, increasing instead the importance of the reinvestment of the profit (which came

GRAPH 6. FDI NET INCOME BY COMPONENTS. AVERAGE FOR LATIN AMERICA



Source: CEPAL (2011)

to represent more than 50 percent of all the components of the net income of FDI). This quantitative change reflects the perception by the foreign companies in Latin America of a fall in the risk levels and a greater desire to finance their expansion in the region through reinvestment processes. This is undoubtedly an obvious change and a process that can have positive long term effects on the economic and productive performance of the region. However, as we will see later, the FDI in Latin America continues to respond more to the search for high returns derived from opportunities that arise from changes in the regulatory frameworks (privatizations or opening of sectors), than the attractiveness itself of the countries with regard to their competitive improvements.

Territorial dynamics

There is very little information regarding the geographic location of the FDI and its agglomeration patterns in Latin America. However, the data presented until now permits some hypotheses to be derived. The first is that given the high percentage of foreign investment in the service sector, it is possible to assume that it follows market expansion criteria, thus it should be concentrated in high growth urban zones. The second hypothesis is that foreign investment in natural resources, especially petroleum, gas and mining, tends to be concentrated in geographically isolated zones with few spillover effects on the rest of the economy.

Both realities suggest that the FDI must be favoring two clearly differentiated territorial spectra: high urban concentration zones that demand services and geographically isolated zones with access to natural resources. This localization pattern of FDI –with little emphasis on manufacturing industries with export potential and with a bias that rather favors territorial centers with large internal markets or access to natural resources-, could be contributing to produce certain territorial inequalities.

In fact, some recent studies (CAF 2010; CEPAL 2009) have identified that the territorial dynamics in Latin America are marked by two problematic processes: a) lack of economic convergence between the territories with lowest and highest incomes; and b) inequity with regard to the opportunities of individuals depending on their geographical birthplace, mainly due to the difference in the quality of the public services and barriers to the mobility between jurisdictions. In this sense, the territorial dynamics suggested with regard to the agglomeration patterns of FDI observed in Latin America, may not in themselves necessarily be contributing directly to resolving or counteracting both problems.

This new reality leads us to believe that the subject of foreign investment and the territorial dynamics, and in particular the role that could be played by the intermediate cities, are an indisputable matter of public policy. The intermediate cities in Latin America can help to offset some of these imbalances to the extent that public policy favors greater investment in public services, an increase in the investment in physical and social infrastructure and an adequate insertion of these emerging urban spaces into the international markets. However, to validate this assertion or understand the channels through which FDI can aggravate or resolve these territorial imbalances is an issue that requires a rigorous empirical work that is beyond the scope of the present study.

Some tendencies of FDI in Latin America

This chapter does not seek to identify the determinants of FDI in Latin America, but it does attempt to discern some dynamics that would seem to be regionally guiding this process. As we will see, some data suggests that not all the countries have been able to match their attraction potential with their performance in terms of FDI, while other countries appear to have had an exemplary performance. Equally, some of these trends are new and permit the establishment of some differentiated patterns compared with previous decades.

For this we would like to identify four processes that are very striking: the high relationship between economic liberalization and FDI; the low relationship between competitiveness indicators and FDI; the emergence of venture capital investments directed towards the search for innovative business ideas or companies with high growth potential; the decision of some multinational companies to expand their investment spectrum towards Research and Development Centers; the growing presence of Chinese investment throughout the region, especially in South America; and the emergence of the “multilatin” as a new source of investment.

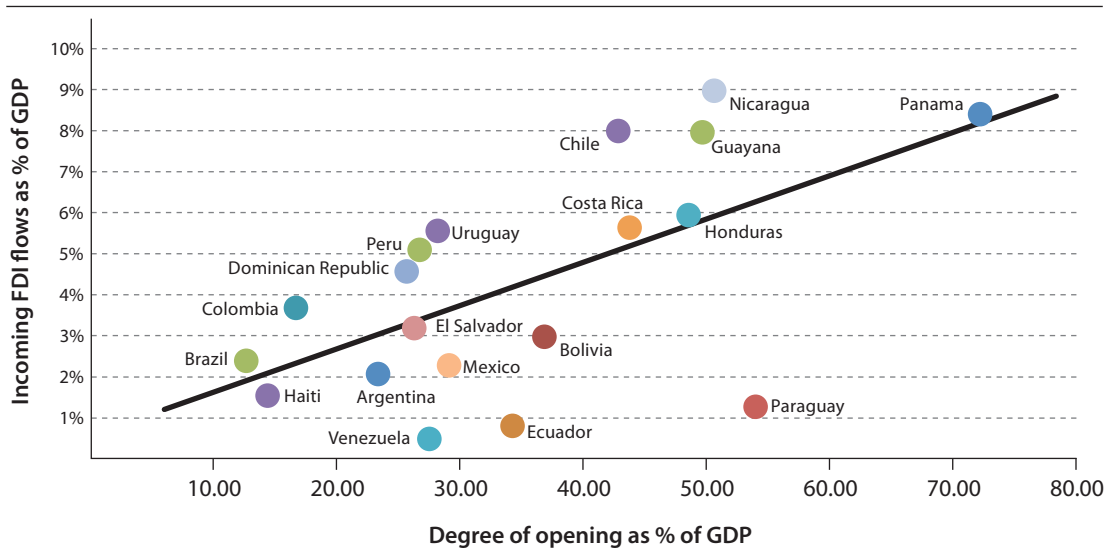
Economic liberalization

As shown in the following graph, there would seem to be a high correlation between the degree of economic liberalization of the countries (measured in terms of imports plus exports versus GDP) and their performance in the attraction of FDI. This is a new relationship, since in similar studies for the decade of the nineties (Stein and Daude 2001) a high correlation between commercial integration processes and investment levels was not observed. Those Latin American countries with greater degrees of liberalization currently show higher attraction levels of foreign investment¹.

Certainly, it is difficult to establish a causal relationship between both factors, since different variables, among them, institutional factors, may well cause relationship to be spurious (Daude and Stein 2001). However, it would seem evident that the greater integration of the countries with the global economy stimulates the participation of FDI within their economies (Buthe

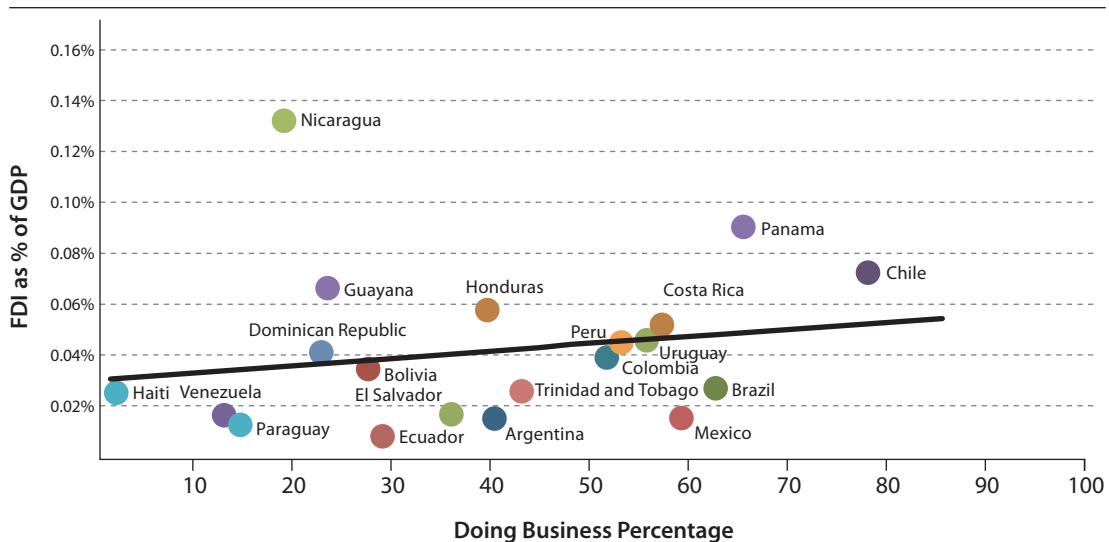
¹ Upon analyzing the graph Nicaragua stands out as a statistical outlier for this period. The fundamental reason for this performance is that Nicaragua has notably improved its commercial opening levels and also its indicators of ease of doing business. Likewise, with regard to investment levels, much of the foreign investment that it is receiving originates from state “multilatin” companies from Venezuela, which has become one of the main partners commercially as well as in investment aspects.

GRAPH 7. FLOWS OF FDI IN RELATION TO DEGREE OF OPENING (AVERAGE 2006-2011)



Source: UNCTAD (2012)

GRAPH 8. WEF RELATIONSHIP WITH FDI AS A PERCENTAGE OF GDP IN LATIN AMERICA



Source: UNCTAD y WEF (2012)

and Milner 2008). Perhaps a possible explanation of this phenomenon is that commercial opening –as well as financial- basically permits easier entry to FDI to capture the potential of that market, due to the elimination of customs barriers and controls on capital inflows. Opening permits the elimination of various institutional barriers that the FDI exploits to capture the market potential of the country involved.

Competitiveness

However, as shown in this other graph, the relationship in Latin America between competitiveness indicators (measured both through the WEF as well as by Doing Business) and FDI is relatively low. Better competitiveness levels would not seem to guarantee on their own greater attraction levels of FDI. This result is somewhat paradoxical, due to the enormous effort and the amount of resources assigned by the countries to improve their investment climates.

A possible explanation is that FDI in Latin America is seeking higher returns –in the framework of acceptable risk levels- regardless of the competitive characteristics of the countries. Once FDI has possibilities to enter a developing country (thanks to its opening and the low probability of being confiscated), it does so based on opportunity and profitability criteria more than for reasons strictly related to competitiveness. It is also possible to think that the causal relationship is the reverse: to the extent to which countries have attracted a certain level of FDI, then pressures start generating to improve and even sophisticate the competitiveness indicators. Besides this, the relationship may not be linear but it may present a relationship related to a certain development threshold based on which these competitive demands are activated by investors.

Venture capital

Latin America, although to a lesser extent than Asia or Eastern Europe, has seen the appearance of new forms of foreign investment, especially under the method of venture capital funds. This phenomenon has been mainly concentrated in Brazil and Mexico and with an incipient presence in Chile, Peru and Colombia. For the year 2011, these funds had committed close to 6,5 billion dollars in investment for the region, which represents close to 5 percent of the total funds invested globally (Ernest & Young 2011; McKinsey & Company 2012).

In terms of amounts, these are scarcely relevant on a global level. Additionally, many of these funds operate more as development capital –oriented towards equity investment in ongoing companies- than in the financing of risk investments per se. However, as a recent phenomenon this process is tremendously significant. For the first time, Latin America begins to receive investment oriented towards identifying dynamic growth companies, as well as the identification of new innovative projects. This is a fundamental boost for business

development that permits the injection of dynamism to the growth of medium companies with high potential. However, the sustainability of this process will depend on the capacity of the countries not only to attract risk capital but also to strengthen their capital markets, as well as their national and regional innovation systems and the existence of a greater flow of business projects that are attractive for this type of investor.

Research and development

One of the most outstanding characteristics of the recent behavior of FDI in Latin America is related to the fact that the most significant component in net income is being provided by the reinvestment of profit. As mentioned previously, this reality shows that the region has been earning the trust of foreign investors with regard to their future growth decisions, which has had an impact on the expansion of the range of activities carried out by multinational companies within the different industries in which they have established themselves.

Additional evidence of the increased confidence is the expansion of the spectrum of activities of some multinational companies which have chosen to install Research and Development Centers in certain Latin American countries. This process is still very incipient and requires an adequate public policy (in matters of sector policy as well as science and technology) to be able to stimulate and consolidate the economic and scientific impact of this type of investment.

Although the total investment in terms of R&D in Latin America is comparatively low (Navarro 2010), it is also true that the public component is the most important and the private component presents significantly low levels. However, certain countries, such as Brazil, Mexico and Chile have started to show some changes that deserve to be highlighted (Unesco 2011). The private sectors in Chile and Mexico are financing almost 50 percent of the total investment in R&D. In Brazil this amount is little more than 40 percent. Among these amounts, the increase in private financing reflects the decisions of various multinational companies –such as for example Siemens, GE, Cargill, P&G among others- of opening their research and development centers in some of these Latin American nations. This tendency undoubtedly reflects one of the most positive aspects of the recent dynamic of FDI in the region, since it permits the leverage of innovation processes based on technological transfers with a high productive impact in the economic development of these countries.

China as an investor

Although it is true that the growth of the investment of Chinese origin is a global process that began more than a decade ago, and that reflects the growing economic importance of this country on a global level, it is no less true that in Latin America this is a relatively new process

(Cepal 2010). The presence of Chinese FDI in Latin America, has basically concentrated on the sectors related to the exploitation of natural resources (petroleum and mining) and incipiently in the agricultural and telecommunication sectors.

It is evident that the main “driver” of the Chinese investment has been the need to ensure the provision of certain raw materials considered strategic to guarantee their future economic growth (fundamentally energy) and for which the region plays a privileged geopolitical role (Downs 2011). Besides this, in many of these investment processes, especially in the petroleum sector, the state companies of China have played a preponderant role, financed additionally through their development banking institutions (Downs 2011; Dussel Peters 2012). In this sense, the tendency of a greater presence of Chinese investors in Latin America is not only something new due to its “origin”, but also due to the characteristics of the companies which have driven this process (state companies) and due to their high sectorial focus (raw materials).

In terms of relative importance, the region has become the second geographical destination for China. The countries which have received greatest investments in recent years are Venezuela, Brazil, Argentina, Ecuador and Peru. Of the total amounts, during the last decade, China has invested close to 26 billion dollars, which represents close to 11 percent of its total flows (Dussel Peters 2012). This investment amount involves a total of 862 transactions with an average amount of 300 million dollars. From this number of transactions, only 8 have been carried out by private companies while the rest involve companies with state participation (Dussel Peters 2012). In terms of the amounts of the transactions, the FDI promoted by the state companies represents close to 87 percent of the total invested amounts (Dussel Peters 2012). Most of these transactions are concentrated in sectors related to raw materials, especially petroleum and mining and most recently some operations in the agriculture sector are observed.

The multilatinos

The emergence of the so-called multilatinos reflects how globalization has a reverse side: the growing role of originators of FDI from developing countries towards countries also in the process of development (south-south) and even also of developing country to developed countries (south-north). In fact, of the 100 biggest companies of the emerging markets, 9 of them have their headquarters in Latin America. Cemex, Telcel, Embraer, Votorantim, Vale Do Rio Doce, among others, represent some of the most emblematic multilatin companies.

On a global level, the multilatinos went from originating 0,5 percent of the global amounts of FDI in the period 1970-1990 to 3,7 percent for the period 2000-2009 (López and Ramos 2011). These amounts currently represent 27 percent of the total FDI flows originated in the developing countries since more than 60 percent are being made by companies based in Asia (López and Ramos 2011). Although compared to Asian companies, the multilatinos are far

from wielding the global leadership of this new process, it is no less true that their growth is significant and has, among Mexican and Brazilian companies, its most distinguished examples (Santiso 2008).

In the same manner, and as mentioned previously, more than 17 percent of the FDI received by the region originates within Latin America, which results in the so-called multilatinos acquiring a leading role in the processes of market expansion and productive integration in the region. This tendency of the multilatinos to invest within the region is due to the consolidation of internationalization strategies that usually begin through entry to neighboring countries. This type of expansion tends to take place through merger and acquisition processes and also greenfield investment which are the FDI schemes most commonly used by the multilatinos to begin their operations. The investment decisions of the multilatinos in a determined country have often been the logical stage following greater knowledge of the market thanks to previous export activity. However, on other occasions these decisions of the multilatinos have been guided by strategic diversification decisions of geographical risk that lead large companies to venture to operate directly in neighboring countries with growth potential.

Contrary to the dynamic observed in the case of FDI of China in Latin America, the sectors in which the multilatinos companies show greater activity are more diversified. In particular, investments in food and beverages, engineering and construction, steel and metallurgy, transport, petroleum and mining stand out. Furthermore, this is a process in which there is a growing participation of medium sized companies that attempt to emulate the internalization patterns of the large Latin American companies, through which they tend to be integrated as suppliers. This expansion in the size range of the investors (from large to medium and their greater diversification) is probably showing that the FDI originating from the multilatinos is having a growing regional integration impact.

The new FDI agenda in Latin America

The trends that have been described throughout this chapter show some notable changes in the behavior of FDI in Latin America. These changes are accentuated when compared with the decade of the nineties. In general terms, Latin America continues to increase its attraction for FDI as a result of the consolidation of its economic and commercial liberalization processes. Simultaneously, Latin America achieved greater diversification in the origin of FDI and the presence of new types of investment as well as activities more oriented towards innovation objectives are also evident. These processes have been the result of the appearance of venture capital funds as well as the decisions of multinational companies to install Research and Development Centers in some specific countries. However, foreign investment has shown growth in primary sectors and a decrease in the manufacturing sector. Therefore there are some challenges that deserve to be mentioned as part of a new development agenda.

The first is the need to understand in more detail the territorial dynamic of FDI in Latin America. This has most probably been marked by access to natural resources as well as the expansion of the internal markets –especially of its middle classes- which have stamped a dual dynamic on the behavior of FDI, that is, the search for natural resources irrespective of their geographic location and its concentration in urban zones of high economic growth. A central point to be able to develop adequate public policies is to have a clear diagnosis –maybe in some countries such as Brazil, Colombia, Mexico and Chile- through the construction of agglomeration maps that permit the verification from the territorial point of view of some observable patterns in terms of FDI. In any case, this perspective opens the need for Latin American cities, especially its intermediate cities (as is being done by various cities in Asia and Eastern Europe), to begin to plan on a territorial basis the process of attraction of investments as a mechanism to increase the productivity of these localities, but also as a policy to balance territorial development. This process requires the institutional strengthening of those cities with high potential of investment attraction and also the continued strengthening of the political, economic and administrative decentralization processes of these entities.

A second matter is the need to stimulate a greater link between competitiveness and the investment attraction agenda on a country level and also of the territorial localities. This link necessarily requires the attraction of a greater number of investments –especially in the manufacturing sector and with a greater export focus- that generates sufficient demand to sophisticate the competitive agenda of the countries and drive the territorial development of the localities. This process is irrevocably related to the productive consolidation of those business clusters (new and old) located throughout the entire territory, so that given increases

in the levels of association between the various actors, the attraction of new investments and technological dissemination and adoption, demands that stimulate competitive solutions for the business challenges being faced are generated.

The emergence of the multilatinas as a new investment channel is undoubtedly another matter that arises from this analysis, especially for its regional integration effect as well as its greater sectorial diversification. Some of the multilatin companies, especially the largest ones, have advanced to compete not only regionally but also globally. However, there is evidence that this investment tendency of Latin American origin is not only limited to major companies, but is also being expanded to the medium companies of the region. In this sense, a new agenda must include the most rigorous analysis of the profile of these medium companies and the characterization of their internationalization strategies. This is an area in which the development banking of the different countries -as well as on a multilateral level-, can play a decisive role in supporting the internationalization of this business segment through FDI and not only emphasizing support processes for export activity.

Finally, Latin America observes in an incipient manner the appearance of new forms of foreign investment (venture capital) as well as new related activities (research and development). This leads us to assume that innovation will be one of the central elements of a certain type of foreign investment in the region, especially in those countries that show competitive improvements in their institutional frameworks. Based on this it becomes imperative to document the characteristics and the experience of the venture capital funds and the type of investments that they are carrying out. Furthermore, it is also necessary to document the various business cases that led to the installation of some Research and Development Centers in order to understand the success factors and the public policy requirements that were demanded by the companies. These types of studies are fundamental to be able to promote adequate regulatory frameworks that make the region more competitive and to identify potential innovative sectors in which greater FDI levels could be attracted.

Bibliography

Birdsall, Nancy. 2012. *A Note on the Middle Class in Latin America. Working Paper 303. Center for Global Development.*

Birdsall, Nancy; Nora Lustig and Darryl McLeod. 2011. *Declining Inequality in Latin America: Some Economics, Some Politics. Working Paper 251. Center for Global Development.*

Buthe, Tim and Helen Milner. 2008. *The Political Determinants of Foreign Direct Investment into Developing Countries: Increasing FDI Through International Trade Agreements. American Journal of Political Science Vol 52 (4): 741-762.*

CAF Banco de Desarrollo de América Latina. 2010. *Desarrollo Local: Hacia un Nuevo Protagonismo de Regiones y Ciudades. Reporte de Economía y Desarrollo.*

CEPAL. 2009. *Economía y Territorio en América Latina y el Caribe. Desigualdades y Políticas.*

CEPAL. 2011. *Inversión Extranjera Directa en América Latina y el Caribe 2010.*

CEPAL. 2012. *People's Republic of China and Latin America and the Caribbean: Ushering in a New Era in the Economic and Trade Relationship.*

Daude, Christian and Ernesto Stein. 2001. *Longitude Matters: Time Zones, the location of FDI, and Trade. Inter-American Development Bank. Working Paper.*

Daude, Christian and Ernesto Stein. 2007. *The Quality of Institutions and Foreign Direct Investment. Vol 19 (3): 317-344.*

Downs, Erica. 2011. *Inside China, Inc: China Development Bank's Cross-Border Energy Deals. John L. Thornton China Center Monograph No. 3. Brookings Institution.*

Dussel Peters, Enrique. 2012. *Chinese FDI in Latin America: Does Ownership Matter? Discussion Paper # 3. Working Group on Development and Environment in the Americas.*

Ernst & Young. 2011. *Globalizing Venture Capital. Report.*

Guillén, Mauro and Esteban García-Canal. 2013. *Emerging Markets Rule: Growth Strategies of the New Global Giants*. McGraw Hill.

Guillén, Mauro and Esteban García-Canal. 2011. Multilatinas: Causas y Efectos de su Expansión. *Política Exterior* Vol 25 (144): 128-137

Hausmann, Ricardo and Eduardo Fernández-Arias. 2000. Inversión extranjera directa: ¿Buen colesterol? *Research Department Publications 4204*. Inter-American Development Bank. Research Department.

Levy Yeyati, Eduardo, Ernesto Stein and Christian Daude. 2004. *The FTAA And The Location Of FDI*. Working Papers Central Bank of Chile 281. Central Bank of Chile.

Lopez, Andrés and Daniela Ramos. 2011. Las Multilatinas de Expanden en Asia. Observatorio Económico Red Mercosur.

McKinsey & Company. 2012. *Private Equity Asia-Pacific: Is the Boom Back? Report*.

Navarro, Juan Carlos. 2010. *The Importance of Ideas: Innovation and Productivity in Latin America*. Volume edited by Carmen Pages. *The Age of Productivity*. Palgrave Macmillan.

Porzecanski, Roberto and Kevin Gallaher. 2007. Economic Reform and Foreign Direct Investment in Latin America: A Critical Assesment. *Progress in Development Studies* 7: 217-233.

Santiso, Javier. 2008. La Emergencia de las Multilatinas. *Revista de la Cepal* 95: 7-23.

UNCTAD. 2012. *FDI Outflows by Region and Economy, 1990-2011*.

UNESCO. 2011. *Global Investments in R&D*. UIS Fact Sheet. No.15

Wu, Hongying. 2009. *Has Latin America Become China's Backyard? Contemporary International Relations* 19 (3): 16-26.

The version of this document in Spanish
was printed in June 2013

Latin America is currently in a favorable economic situation, given the very uncertain conditions of the global economy. A central element behind this great economic dynamism has been the renewed interest recovered by foreign investment in continuing to increase its participation in Latin America. But despite the macroeconomic situation, the microeconomic and social inadequacies remain evident, therefore, foreign investment looms large in contributing to offset -and even overcome- many of these weaknesses.

This study presents three main aspects: the behavior of foreign investment in Latin America that is characterized based on various indicators, the relevance that Asian investments have been acquiring with a special focus on China, as well as the investment of the "multilaterals" as a mechanism of intra-regional integration, and finally, the identification of new challenges which the Latin American countries are going to have deal with in order to increase FDI and, above all, to impact in the different economies of the region.

Public Policy and Productive Transformation Series

Public Policies and Productive Transformation consists of a series of documents aimed at disseminating successful experiences and cases in Latin America as a tool for producing knowledge for the implementation of best practices in the field of business development and productive transformation. The Series is aimed at policymakers, public sector agencies, business associations, political leaders, and relevant agents that participate in the process of designing and carrying out public policies related to productive development in the countries in the region.