FOREIGN DIRECT INVESTMENT IN LATIN AMERICA
THE 1990S AND BEYOND

DRAFT

Balasundram Maniam (Corresponding Author and Presenter)
and
Landon Buck

Sam Houston State University
Department of General Business and Finance
P.O. Box 2056
Huntsville, TX 77341, USA
936-294-1290
maniam@shsu.edu

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ABSTRACT

Over the past decade Latin American countries have been extremely attractive to foreign investors due to low wages and tax incentives. This region experienced a surge in growth in the mid 90's, however the UN Conference on Trade and Development (UNCTAD) reported that Foreign Direct Investment (FDI) inflow to Latin America and the Caribbean fell by 33 percent to $56 billion in 2002.

Governmental policy and economic reform played a large role in attracting FDI into the Latin American community. These factors are discussed along with additional factors that encouraged rapid growth in this area. Specific cases such as Argentina, Brazil, and Mexico are explored and the benefits FDI has brought to the region are discussed. The final portion of this analysis is the recent trends in Latin American FDI and predictions for the future.

INTRODUCTION

Recent years have seen an ever increasing amount of FDI going to developing countries. In 1997, developing countries share of FDI totaled 38% of the global total. Latin American countries in particular saw an incredible 44% increase of net inflow in 1997. While the increase in FDI inflow to Latin America did not reach that of Asia, the leading recipient of FDI, there is growth significant enough to inquire to the root of the rapid growth. The recent influx of foreign investment has also had positive impacts on many of the economies in Latin America. FDI has increased the job opportunities and in many cases the wage rates. Multinational companies that have expanded into the area have also provided trade opportunities for local firms by providing means of export. Roads, ports, and telecommunication systems have been improved as a result of foreign investment which will benefit not only foreign companies but local citizens as well. While there has been trouble in some of the economies the influx of FDI into this region has been beneficial to Latin America as well as the world economy.

LITURATURE REVIEW

Many articles have been written describing the determinants of FDI in Latin America. Ramirez (2002) discussed the policy changes that were made in Mexico during the 1990s. The study the reviews the changes made under both the De la Madrid and Salinas de Gortari administrations. The conclusion is drawn through a co-integration analysis that the policy changes had a positive effect on FDI flows to Mexico.

Arbix and Laplante (2003) review some of the changes in policy reform that made in Latin America and how some transnational companies exploited these markets after the policies were put into effect. The Brazilian case is also studied and it is found that companies invested in Brazil only to streamline production which in turn reduced the number of jobs available in Brazil. It was concluded that investments were made to exploit the domestic markets in Brazil.

Festervand, in a 2002 study, analyzed ten Latin American nations to develop profiles on how each nation was perceived to investing corporations. It was found that Argentina, Brazil,
and Peru have the most strategically opportunistic positions. Mexico was not used in this study therefore one is not able to determine how it ranks from this study.

Feldstein (2002) studied what occurred in Argentina recently that has caused problems for their economy. During the 1980s the peso was pegged to the US dollar to help cure hyperinflation. This created problems when the deficit rose and pesos were being converted to dollars and there was not enough dollars in the Central Bank to cover the currency.

Farrell, Remes, and Schulz (2004) discuss various methods that countries can use to attract FDI. A strong economy with a healthy local market is necessary to attract FDI and protect local markets from the increased competition. The quality of the labor force and infrastructure are also important. This article also mentions various policies that studies show do not attract FDI. Examples of these include local content and joint venture laws and it is mentioned that countries should abandon incentives and regulations in order to focus on improving the economy.

Love and Lage-Hildalgo (2000) studied the factors that have made Mexico a popular destination for foreign capital. Cheap labor and the large market both had positive impact on FDI. The economic crisis of the 1980s required Mexico to open its economy along with the development of NAFTA also helped increase the attractiveness of the economy. The study also showed that short run change rates have an effect on the timing of investment decisions in Mexico.

Bonelli (1999) describes the progress Brazil has made in attracting FDI since the late 1980s. A regression analysis was performed to determine the relationship between FDI, size of the economy, competitiveness within the country, and the size of previous stock of foreign capital. The results show that a one percent increase in manufactured exports increased FDI inflows by one percent. A one percent increase in the volume of foreign capital results in a .75 percent increase in FDI inflows.

Urbiztondo (1998) studied the policies put into effect in Argentina to protect certain sectors of trade. In particular the regulatory bodies (ENARGAS, ENRE, ETOSS, and CNT) that were created to regulate trade in the public utilities sector. Each body had different guidelines however the main goal of each was to reduce the opportunistic behavior of companies investing in the public sector of Argentinean utilizes.

FACTORS LEADING TO GROWTH IN LATIN AMERICAN FDI

The Economic Commission for Latin America and the Caribbean (ECLAC) has determined three factors that have affected FDI inflows by transnational countries in recent years. The first factor is that as globalization has advanced the international market which required changes to trade policy. This has lead to new technological requirements and new rules and regulations in the areas of trade. These factors have led to new competition which has altered the quality and scale of investments in this area. The second factor found was that new national policies have changed the business environment, which in turn provided investment decisions for both new entrants and current players in the market. Increased competition has therefore led to higher levels of investment. The third factor found by the ECLAC was that as a result of the changed environment, the transnational companies have had to implement new strategies to take advantage of national policies and the trends in the international marketplace. In other words strategies have been made to include opportunities available in Latin American economies (UNCTAD, 1999).
The economies of developing countries, such as those in Latin America, have had to make changes to take advantage of the opportunities of the increasing foreign investment. Many changes were made by the governments of Latin American economies to increase the attractiveness to investment.

One of the methods that increased FDI growth in this region was the increase in economic freedom. Bengoa and Sanchez-Robles (2003) studied the relation between economic freedom, FDI, and growth in Latin America between the years of 1970-1999. Latin American countries were used for the study for the fact that they are developing countries with a minimum level of human capital and financial stability. Economic freedom encourages foreign investment which will in turn lead to economic growth according to this study. Two indicators of economic freedom are used in the study, the Fraser Institute and the Heritage Foundation. Results from the Fraser Institute show that Panama, Costa Rica, Guatemala, and Uruguay exhibited the highest degrees of economic freedom while Brazil, Peru, and Nicaragua were on the low end. Several other factors were found to be relevant to growth in FDI. One factor was the market size of the host country. Another factor was the economic policies in the host country. The authors document that countries which adopted export-oriented policies had a positive increase in FDI inflows. The results of the study showed that economic growth and FDI are always significantly and positively correlated. It can be concluded that to encourage growth in Latin American economies policy makers need to encourage FDI (Bengoa and Sanchez-Robles, 2003).

The following table shows the index of Economic Freedom in Latin America constructed by the Fraser Institute. The higher values represent greater degrees of economic freedom. The standard deviation shows that there is volatility in the degree of freedom over time especially in Peru, Nicaragua, Chile, Argentina, and Bolivia which had a rather high standard deviation.

<table>
<thead>
<tr>
<th>Country</th>
<th>Average</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>5.45</td>
<td>1.93</td>
</tr>
<tr>
<td>Bolivia</td>
<td>5.95</td>
<td>1.82</td>
</tr>
<tr>
<td>Brazil</td>
<td>4.38</td>
<td>0.78</td>
</tr>
<tr>
<td>Chile</td>
<td>6.48</td>
<td>1.89</td>
</tr>
<tr>
<td>Columbia</td>
<td>5.05</td>
<td>0.45</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>6.63</td>
<td>1.09</td>
</tr>
<tr>
<td>Dominican Republic</td>
<td>5.49</td>
<td>1.14</td>
</tr>
<tr>
<td>Ecuador</td>
<td>5.79</td>
<td>1.00</td>
</tr>
<tr>
<td>El Salvador</td>
<td>5.54</td>
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<tr>
<td>Guatemala</td>
<td>6.61</td>
<td>0.87</td>
</tr>
<tr>
<td>Honduras</td>
<td>6.48</td>
<td>1.05</td>
</tr>
<tr>
<td>Mexico</td>
<td>5.92</td>
<td>0.87</td>
</tr>
<tr>
<td>Nicaragua</td>
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<td>2.43</td>
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<tr>
<td>Panama</td>
<td>7.31</td>
<td>0.56</td>
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<tr>
<td>Paraguay</td>
<td>6.34</td>
<td>0.84</td>
</tr>
<tr>
<td>Peru</td>
<td>4.57</td>
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<tr>
<td>Uruguay</td>
<td>6.55</td>
<td>0.31</td>
</tr>
<tr>
<td>Venezuela</td>
<td>5.94</td>
<td>1.0</td>
</tr>
</tbody>
</table>

Source: Bengoa and Sanchez Robles, 2003
Economic freedom plays an important role in the attractiveness to investment in a country. Generally, countries with greater economic freedom will enjoy higher levels of foreign investment as they appear more attractive. However, economic freedom is not the only determinant in attracting foreign investment. Governmental policy on investment and trade plays an important role in the world economy and impacts the amount of investment in foreign countries.

Taylor (2000) reviews governmental policy and the effects on FDI. The author states that government policy on FDI can be more complex than trade policy and these complexities make empirical estimation difficult. The results from the study showed that there is a significant relationship between the FDI openness of a country and the investment level. The study shows that with a one percent increase in the openness of a country there will be a 3 to 4 percent increase in investments from the US country. The study also showed that there is a positive and significant relationship between trade openness and US FDI. US multinational investment flows also differ across industries. For example there is a difference between the petroleum industry and the manufacturing industry. The study also showed that other factors relate to FDI inflows in a country. GDP has a positive coefficient of relationship of nearly one, in that a one percent increase in GDP leads to a one percent increase in investment flows. However, wages and inflation are negatively related to FDI (Taylor, 2000, pg. 635-648).

Governmental policy is extremely important in attracting foreign investment, although many other factors come into play. Trevino (2002) shows FDI dollar inflows of seven Latin American countries (Argentina, Brazil, Chile, Columbia, Mexico, Peru, and Venezuela) which were studied over the 1988-1992 time period. Traditional variables as well as indicators of microeconomic, macroeconomic, and institutional market reform were used in the model for the study. Several hypotheses were confirmed using multi-variate regression. The first hypothesis proven was that as a country’s account deficit increases the host country’s inward FDI increases. The second hypothesis proved that the countries with larger market size (GDP) also had higher inflows of FDI. The third hypothesis Trevino proved was that countries with greater capital market liberalization also showed higher FDI inflows. The final hypothesis proved that larger amounts of privatization (not including FDI in privatized companies) the greater the inward FDI in that country. Trevino also describes that macroeconomic reform allows governmental policy to reduce inflation and stabilize the economy. In contrast, microeconomic reform causes a shift towards private sector markets to increase competition. This is done by lowering price controls and reducing restrictions on entry and exit of the market. Institutional reforms change the states role to a facilitator in historically privatized economies to encourage private sector growth (Trevino et al, 2002). The following table (nest page) shows FDI inflows into this region from 1990 to 2000.

Governmental policy and economic reform all play an important role in the attractiveness of a country to investment, but there are other factors to consider. For instance, a country may have a very open trade policy but if employees are difficult to manage in a country an investing company will look elsewhere. This brings up the topic of industrial relations.
Figure 2: Latin American Countries - Net FDI Inflow (1990-2000; Millions of Dollars)

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
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<td>Argentina</td>
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<td>5315</td>
<td>6522</td>
<td>8755</td>
<td>6670</td>
<td>23579</td>
<td>11957</td>
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<tr>
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<td>85</td>
<td>393</td>
<td>474</td>
<td>731</td>
<td>957</td>
<td>1016</td>
<td>695</td>
</tr>
<tr>
<td>Brazil</td>
<td>1703</td>
<td>4859</td>
<td>11200</td>
<td>19650</td>
<td>31913</td>
<td>32659</td>
<td>30250</td>
</tr>
<tr>
<td>Chile</td>
<td>1207</td>
<td>2957</td>
<td>4634</td>
<td>5219</td>
<td>4638</td>
<td>9221</td>
<td>3676</td>
</tr>
<tr>
<td>Columbia</td>
<td>818</td>
<td>968</td>
<td>3113</td>
<td>5638</td>
<td>2961</td>
<td>1140</td>
<td>1340</td>
</tr>
<tr>
<td>Ecuador</td>
<td>293</td>
<td>470</td>
<td>491</td>
<td>625</td>
<td>814</td>
<td>690</td>
<td>740</td>
</tr>
<tr>
<td>Paraguay</td>
<td>99</td>
<td>103</td>
<td>136</td>
<td>233</td>
<td>196</td>
<td>95</td>
<td>100</td>
</tr>
<tr>
<td>Peru</td>
<td>796</td>
<td>2056</td>
<td>3225</td>
<td>1781</td>
<td>1905</td>
<td>1969</td>
<td>1193</td>
</tr>
<tr>
<td>Uruguay</td>
<td>---</td>
<td>157</td>
<td>137</td>
<td>126</td>
<td>164</td>
<td>229</td>
<td>180</td>
</tr>
<tr>
<td>Venezuela</td>
<td>836</td>
<td>985</td>
<td>2183</td>
<td>5536</td>
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<td>3187</td>
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<tr>
<td>Mexico</td>
<td>5430</td>
<td>9526</td>
<td>9186</td>
<td>12831</td>
<td>11312</td>
<td>11786</td>
<td>12950</td>
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<td>27789</td>
<td>41301</td>
<td>61125</td>
<td>66025</td>
<td>85571</td>
<td>67191</td>
</tr>
</tbody>
</table>

Source: Arbix & Laplane (2003)
* Yearly Average
** Estimate

Industrial relations also have an impact on the level of investment into a country. US multinational corporations have historically invested in countries with an overall higher level of education in order to find more highly skilled workers. These companies have also tried to minimize the amount of unionization in the countries invested in. By involving the employees or reducing union involvement the performance of the enterprise is increased. Cook (1997) examined the influence of industrial labor relations factors on foreign direct investment. US foreign direct investment was examined in nine industries and nineteen OECD-member countries. The factors examined included government regulation and policy regarding layoffs, contract extensions, works councils, education, compensation, union penetration, and centralization of collective bargaining. He assumed that investment in a country was based on profit maximization and that lower production and service cost in markets offered advantages. Companies look at both the location advantages and cost effectiveness before investing in the country. While low labor cost is a major goal it is important that the work force can achieve optimal efficiency and that employment can be maintained at productive levels. The results of the study conclude that industrial relations variables strongly influence the distribution of US FDI. For example, the author concludes that for a one year increase in education of the workforce there is a $415 million increase in FDI per country. Union involvement is negatively related to FDI. For one percent increase in union activity the level of investment decreases about $98 million per industry. FDI is also positively related to countries requiring works councils. US companies invested an average of $7 billion more per industry on countries requiring works councils. Countries with strict policies on the termination of employees have also been less attractive. However, countries requiring employee committees and works councils have seen more investment. This is due to the benefits these items provide (Cooke, 1997).

Beyond economic openness, governmental policy, and industrial relations there are several other factors that impact a company’s decision to invest in a foreign country. Transportation, communication, and information technology infrastructure must be in place for large multinational companies to invest in an area. Factors such as roads and bridges are
extremely important to the investment decision as there must be some means to export in the manufacturing sector. Market size of the host country is also very important. Investing companies are looking for a large market to improve economies of scale to increase profitability. Taxes, the political climate, and the absence of regulations in the marketplace also have a great impact on the attractiveness of a country. These seemingly insignificant factors play an important role in attracting FDI in Latin America (Cooke, 1997).

ANALYSIS OF POLICY CHANGES IN BRAZIL, ARGENTINA, AND MEXICO

While the factors that attract FDI into a country are important it is also important to see how various Latin American countries have used these factors and what the impact of the factors have been. Brazil, Argentina, and Mexico are three countries that have overcome serious economic problems which have affected the flow of FDI into these countries. Some of the countries have overcome these problems, as in Brazil, however some of the countries are still in the recovery process.

Brazil is one of the Latin American countries that have seen a dramatic increase in FDI inflows in the past couple of decades. High interest rates paid on government debt spurred portfolio investments in 1992. This was followed by investment inflows from Trans-National Companies (TNCs) that reached record heights due to the economic stabilization and privatization in the country. In 1997 the inflows were nearly US $ 1.7 billion. Most of this success in Brazil is due to the changes made by Brazilian legislation to govern inflows of foreign investment. An example is the Brazilian privatization program which abolished the restrictions on the amount of foreign capital allowed in privatization. This was a very popular investment avenue in Brazil following the Asian crisis due to the low risk involved over the long term.

Privatization has not been the only means of FDI inflow to Brazil. Bonelli (1999) indicated that a majority of US owned affiliates have increased export propensities throughout the years increasing from 18.6 percent in 1966 to 40.3 percent in 1993 in developed countries. In 1997 Brazil was the largest recipient of FDI inflows in Latin America with nearly US $17 billion in inflows that year. Bonelli also reported that prospects for the following two years were also bright for foreign investment due to electrical utilities expected to be privatized during 1999-2000 (Bonelli, 1999).

While some of this policy was beneficial, reducing inflation and generating growth in export markets, the same policy resulted in lower GDP growth rate. A majority of the FDI generated in the 1990’s was of second and third rate transnational corporations seeking efficiencies of production which in turn cut jobs in those areas (Arbix and Laplane, 2003). It can be concluded that not all policy to attract FDI is necessarily good, there must be some regulation and even then problems could arise.

Economic integration with MERCOSUR and other economic reforms adapted since the 1980s were also forces of changes made in the late 1990s. These policy reforms replaced traditional inward-oriented policies with policy that was aimed at liberalization to enhance world trade flow and technology enhancement. The Central Bank of Brazil implemented some of these liberalizing policies. One of these policies allowed financial institutions to keep unlimited amounts of foreign exchange. A second policy was introduced to allow foreign investors access to fixed income bonds and securities in Brazil for the first time. While only a few examples, it is clear that policy was being introduced to increase attractiveness to foreign investment.

Argentina provides a much different example as opposed to Brazil. Foreign direct investment in Argentina was for the most part constant from the 1920s to the 1960s excluding
During the 1970s the degree of FDI inflow decreased, recovering in the 1980s. The economic policies in place from the 1940s to the 1980s actually hindered foreign investment. Policies were implemented to protect different sectors of trade, policy changes were made in the extractive industries, and threats were made of repudiation to foreign debt. Another example of Argentina’s attempt to curtail foreign investment was the Convertibility Law of 1991 which tied the peso to the US dollar and forced the Central Bank to hold reserves for all circulating currency.

Excessive foreign debt and an overvalued exchange rate, fixed at one peso to one dollar, were the two main causes of a major financial crisis in Argentina. The peso was pegged to the dollar for the fact that it helped cure hyperinflation in the 1980's. This move also encouraged price stability and created strong economic growth for a short period of time. Policy makers feared that if the tie between currencies was broken that it would lead to inflation. After the election of Carlos Menem, the once state-dominated economy would encourage privatized industry and foreign investment, which led to economic growth from 1991 to 1994. However with the peso pegged it was as good as a dollar to most Argentineans. However as the countries deficit rose people became worried and began converting pesos to dollars. The government had enough dollars in the central bank to cover the currency in circulation. However, there was not enough to cover the amount in checking and savings accounts. This led the central bank to shrink the money supply and increase interest rates. There was only one problem with this tactic; the government would not allow a high enough increase to reduce speculation. This led to an increase in debt to foreign banks which led to a default to the tune of $155 billion in 2001, which in turn led to the devaluation of the peso a month later.

Feldstein (2002) cites three reasons the currency was not devalued sooner. First, was a fear that devaluation would result in rapid inflation. Second, was fear that dollar-denominated debt would lead to bankruptcies and default not only for personal debt, but also for the central and provincial governments. The third reason was there was hope that the economy would eventually improve.

The Argentinean monetary crisis is not the only reason for the recent downturn of FDI inflows to Argentina. The 1990s saw an even more drastic increase in FDI inflows to Argentina which began with the privatization of public utilities between 1990 and 1993. This trend of increasing FDI inflows in the service sector returned, resulting in similar conditions of that before World War II. The other sector leading FDI trends in Argentina was the extractive sector with automotive manufacturing claiming 20 percent and mining following with 10 percent. Urbiztando (1998) describes the different regulatory bodies created in the four major public utilities. The Ente Nacional Regulador de Gas (ENARGAS) and the Ente Nacional Regulador de la Energia Electrica (ENRE) regulate many firms with their budget depending on money generated from penalties imposed on the firms. The members of these two committees are approved by Congress. The Ente Tripartito de Obras y Servicios Sanitarios (ETOSS) has the opposite characteristics; composition is political, it regulates only one firm, and penalties cannot be kept to finance the organization. The Comision Nacional de Telecomunicaciones (CNT) is mainly controlled by two firms and this organization has less autonomy relative to the political forces. The purpose of these regulatory bodies is to reduce the opportunistic behavior of companies investing into the public sector of Argentinean utilities (Urbiztando, 1998).

It is clear that with the increased regulation in the public service sector and the economy struggling to regain strength after the monetary crisis that Argentina did not look like the safest investment at the approach of the new millennium. The events of the 1990s would have similar
effects on Mexican foreign investments. During the 1990s many factors improved the prospects of Mexico for investment including the North American Free Trade Agreement (NAFTA), cheap labor, and the attractiveness of ease of exports to the US.

Mexico had many features that made it very attractive to investors during the 1990s. One of these factors was the ability of the economy to support technological development and growth. Love and Lage-Hildago (2000) suggest that there is evidence that FDI causes a “spillover effect” on labor productivity in Mexican firms. The study also mentions that the economic crisis in the 1980's led Mexico to open its economy to investment. The major factor in this development was the North American Free Trade Agreement (NAFTA) which required both trade and FDI liberalization. An econometric study of the locational attractiveness of Mexico for inward FDI was performed of which one of the objectives was to examine whether US FDI inflows are determined solely by cheap labor or whether the market itself determines attractiveness. A summary of the results concluded that cheap labor and the market size are both factors that determine the amount of investment. The study also showed that in the short run exchange rates has an effect on the timing of investment decisions in Mexico (Love and Lage-Hildago, 2000).

Changes in the legal environment of Mexico also stimulated FDI as deregulation programs were put in to effect and liberalization and privatization were implemented. Other issues that increase the attractiveness of FDI are access, in the means of ports, roads, airports, as well as cheap energy and an educated, low-wage work force. New leadership also increased the attractiveness of Mexico. Many business sectors, such as mining, petrochemicals, and banking, were off limits to foreign investment under the De la Madrid administration. However many of these type of regulations were liberalized under the Salinas de Gortari administration during the 1980's. The passage of NAFTA in 1993 made further provisions for the rights of foreign investment. An empirical analysis was performed to explain the variation in FDI flows to Mexico which concluded that policy changes had a positive effect on FDI flows to Mexico (Ramirez, 2002).

Many factors led the US to pursue investments in Mexico during the 1990s. However, Mexico, Brazil, and Argentina were not the only countries which experienced rapid growth in FDI during the 1990s. Foreign Direct Investment (FDI) flows increased worldwide during that time period, with average flows totaling $336 billion annually between 1990 and 1998. This is in sharp comparison to average flows of only $142 annually between 1985 and 1990. A large proportion of these flows were channeled into developing nations predominantly in Latin America. In this region the percentage of FDI flows rose to 42 percent in 1998 up from 32 percent in 1990. These figures are due to various economic and corporate factors. Some of which include limited export regulations, limited governance of remittance of profits and dividends, and enforceable property rights (Ramirez, 2002).

**FACTORS BENEFITING FDI IN LATIN AMERICA**

While the changes in the policy in Latin America have attracted FDI it has also brought about positive changes for the citizens of the host country as well. One of these changes is the improvement of the transportation and communication system. For example a large firm may construct a large port to increase the speed at which exports expedited. This will benefit the nation in that it provides jobs and also most companies will allow use of the ports on a fee basis. FDI can also help to increase the efficiency of domestic firms. These domestic firms have the opportunity to learn from the multinational firms and to interact. This “learning by watching”
effect can also improve the managerial skills and quality of personnel as local workers and managers see the multinationals prosper.

Another benefit of FDI is that it creates jobs and increases productivity while not competing with the local market. Most critics believe that FDI exploits workers, however foreign companies investing in Latin America paid wages at the market level or higher than domestic companies. FDI is also beneficial in that it does not compete in the local market in most instances, due to the fact that most foreign companies are export oriented. Some of the key components a company looks for in a country it is considering investing in are the quality of infrastructure and labor force, size and growth of the domestic market, and the accessibility of the location. Countries wanting to attract FDI must assure all of these requirements are meet to assure attractiveness to foreign countries (Farrell, Remes, and Schulz, 2004).

In addition to the before mentioned factors there are some regulations that countries sometimes impose that do not work. Local content and joint venture requirements are not needed according to Farrell, Remes, and Schulz (2004). China is producing the whole value chain of components without local content laws. The study also found no evidence that joint ventures are necessary to attract FDI. When a joint venture makes sense they work, but should not be required. Countries should abandon incentives and regulations to focus on improving economic foundations. Having a strong economy will attract investment, while a competitive marketplace will lessen the impact of foreign investment on the local market. By abandoning restrictions and improving the economies, countries can attract FDI which will benefit the country. To further attract FDI, developing countries need to improve infrastructure in means of highways, ports, and efficient power supplies. This will ensure an attractive appearance to export-oriented foreign investment. One of the greatest benefits of FDI is its ability to raise the standard of living in the receiving country. Increased wages and lower priced goods in the local markets coupled with an improved economy will benefit host countries. An example of this can be seen in the price of cars in developing countries which have fallen more than 30 percent from 1995-2001 (Farrell, Remes, and Schulz, 2004).

The FDI influx of Latin America has helped these economies in many ways. One of the outcomes of the recent FDI in this region has been the increase in local standards of living. It has been estimated that 80 percent of foreign investment is made into local markets and not into manufacturing for export. Wal-Mart’s “everyday low prices” have been credited at lowering Mexico’s inflation rate by reducing the margins that retailers were historically charging. Investments in these economies also create new jobs and boost output without hurting the local companies. Reports show that contrary to popular belief the wages paid by foreign companies, whether export oriented or not, pay wages that near if not higher that the wages in domestic firms. The export oriented manufactures are also not competing with the local manufacturers; in actuality they are benefiting them due to the increased exposure to foreign markets (Farrell, Remes, and Schulz, 2004).

The benefits to the Latin American economies has been so great that it has prompted countries to initiate further policies to continue trade in this region as cooperation benefits all parties. With the realization that Latin America held an opportunity for US investment the Enterprise for the Americas Initiative (EAI) was developed to encourage economic partnership with the Latin American nations. This presented several advantages for the United States. The first of these was the economic advances that were present for US firms. The EAI would open a major export market and also ignite an outlet for direct investment into the developing economies. This new investment would also help these economies repay existing debt to the US
and stimulate interest opportunities for US financial institutions as high rates of return would be offered on Latin American bond and stock issues. The second benefit of the EAI was the political benefits it created for American commercial interests. This proposal would pave the road to better relations with the Latin American community than the previous decade saw. The US would support these emerging democratic political systems that were beginning to introduce free markets and privatization. The third advantage of the EAI was the United States to create a leverage position with these economies as the powers of this region were shifting. This alliance would provide a powerful advantage to the US in future GATT negotiations. The EAI would be tied to the Inter-American Development Bank (IDB) which would develop lending policies geared towards lending to the Latin American region. In turn, this would create additional benefits to US investors interested in expanding into the Latin American community. The fourth benefit of the EAI is based on the conditional nature of the program. Eligibility to the EAI is based on adjustment to and extensions of processes already underway in the region. Participation in the EAI would allow Latin American countries to make adjustments to take advantage of the incentives the program offers. Countries that take advantage of these incentives would increase their attractiveness a direct investment outlet, foreign trading partner, and source of equity and debt to investors (Carvounis, 1992).

RECENT EVENTS IN LATIN AMERICAN INVESTMENT

The United States has historically been the greatest source of FDI inflows into Latin America; however, recent trends have seen an increase in the flows from European countries and Japan. Economists predict that US-Latin trade will continually increase over the next decade, despite the recent downturn of nearly 5.6 percent in 2001. These predictions may not be well founded as 2002 resulted in the third consecutive year of declining investment into the area. UNCTAD estimates that 2003 will return numbers similar to that of 2002 (UNCTAD, 2003). This could be good news if the numbers will level off. However, with the struggling US economy and lack of newly privatized industries in Latin America the end may be near for the Latin American boom. Investment in the area is likely to continue in the extractive sectors with companies looking to export manufactured goods and minerals from these areas. However, Latin America’s poor financial health, high debt loads, and lack of investor confidence will cause the market to remain vulnerable as the economies recover from the plague of crises over the past five years.

Many of the countries have made great strides in privatization and improved public policy which will continue to attract foreign investment. The Asian region is also in a recovery process, which will generate competition for FDI dollars. However, the Latin American community stands to benefit through commodity imports in the event of Asian growth. Barham (2004) recently stated that “If 2003 was the best year for Latin America’s financial markets since the mid 1990’s the outlook is for another strong year in 2004.” (Barham, 2004). This is, of course, if the world economy and US interest rates are to remain favorable. With low interest rates in the US, investors are looking for high yield opportunities and Latin America presents a great opportunity. Only time will tell what the future holds for FDI in Latin America.

SUMMARY AND CONCLUSION

Latin American governments have made great strides to increase the attractiveness of foreign investment in their countries. Policy changes have been made to ease the movement of exports and improve infrastructure. These changes have not only benefited foreign investment
but have also help the local economy, as local firms have more efficient means to transport goods and communicate in the global market. Foreign export oriented companies have also increased access for local manufacturers to exports goods. Economic reform has helped increase FDI in this region as investors are attracted to stable economies. These factors combined to increase the net FDI inflow into Latin America from $27 billion dollars in 1995 to $85 billion in 1999.

While the 2000-2002 period has seen a drastic downturn in Latin American investment the future shows signs of improvement as many economies recover from the crises of the 1990s. Economists all predict that investment in the area will return but the big question is at what level. With most industries privatized and a slowly recovering US economy the odds are that the level of investment will increase but not at the rates that were seen during the late 1990s. Investors have more options with the recovering Asian market opportunities in Africa. The fate of Latin American investment primarily hinges on the world economy with a large portion hinging on the US economy, as the US has historically been the largest investor in Latin America.

REFERENCES


