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THE FUTURE OF DIRECT FOREIGN INVESTMENT IN LATIN AMERICA

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The Future of Direct Foreign Investment in Latin America

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Introduction: Some Obvious Points

The topic of foreign investment in Latin America is so fraught with misunderstandings and emotional overtones that it seems wise to start with some generalizations on which agreement is almost assured. This will be followed by a look at some misconceptions in this field. The paper will close guessing at future trends.

Latin American policies toward direct foreign private investment (DFI) arise, at a given point in time, mainly from the interplay of circumstances in the world economy with a given Latin American country's needs at its stage of development. The historical experience of each country will also weigh heavily on the host country's perception of benefits and costs of foreign investment.

A key feature of the world economy of the 1960's was the existence of several major centers of capital and modern technology, such as the U.S., Western Europe, Japan and Eastern Europe. This situation opened the way for a gradual breakup of old commercial "spheres of influence", and the creation of a competitive and multilateral world trading community. Recent difficulties in the world monetary system show that there are important adjustment problems on the road to that free-trading, multilateral goal. Furthermore, one may fear that the very rapid expansion of large multinational corporations (MNC's) could, in a few years, turn that relatively competitive world market into

one dominated by a handful of oligopolies, controlling both finance and trade. One cannot dismiss a priori either the fear that the 1970's will witness a return toward protectionist neo-mercantilism nor the scenario where an expanding world economy is managed from a few boardrooms located in New York, London and Tokyo.¹ But I still find more likely an extension into the 1970's of the (on the whole) healthy 1960's competitive trends in world commerce and finance.

For Latin American, of course, this would be very fine indeed. The major Latin American countries are entering fairly sophisticated stages of industrialization, not very far behind those of Italy, Spain and Eastern Europe, at which point selected foreign technology in specific activities can be helpful. The more potential suppliers of that technology, the better.

Most Latin American countries are also keenly aware of their need to expand and develop new, or non-traditional, export lines, a task which would be difficult or impossible in a stagnated world economy, and costly in one dominated by few oligopsonistic buyers.

But besides the need for advanced technology and new export outlets, Latin American countries have kept alive their old aspiration to consolidate their political and cultural independence by greater control over their economic life. Most of these countries are getting ready to join the Atlantic and world communities as full-fledged members, without the need of "special relationships" with hegemonic powers. Such a transition, of course, is not without (at least short term) costs. Concessional aid, for example, may gradually become a thing of the past for the more advanced Latin American countries (although donor countries, regardless of Latin

American decisions, may cut it off anyway!). This more stand-offish, business-like attitude is what one could expect as Latin America approaches the per capita income levels of Southern Europe within a multilateral world economy. Note also how the traditional dependence of Latin American exports on the United States market has declined from an unusually high 49 percent of the total in 1952, to 42 percent in 1958 and to 34 percent in 1968.

One could go further and put forth the hypothesis that when DFI expressed as a percentage of host country's total assets, or in per (host country) capita terms, reach "high" levels, sharp and violent political reaction is very likely to be generated. Mexico in 1910, Cuba in 1959, and Canada (and Puerto Rico?) in 1971 shared that characteristic.

Under these circumstances, I expect that most Latin American countries will increasingly ask, not whether DFI is intrinsically "good" or "bad", but rather which investments fit better into host country's needs and plans, and under what conditions can one obtain those investments. Few would argue with the proposition that DFI can, under certain circumstances, benefit both investors and host countries. Today we see some socialist countries of Eastern Europe expanding their agreements with foreign capitalistic firms, while the popular front government of Chile has certainly not closed the door to all DFI, as witnessed by its automobile policy.

But it is also true that DFI, under present Latin American conditions, will not automatically yield results favorable to host country development. It is not only that, as the Indians of both North and South America found out, and as put by Ragnar Nurkse: "Foreign business investment is not always a happy form of encounter between different civilizations."² In the words of another distinguished economist, it is also noted that:

"...since private international capital movements are motivated by expected net private return, and since the relation of net private return to gross social return is heavily influenced by taxes and other governmental policies, there is no a priori reason for placing much confidence in the principle of freedom of private international capital movements as a guarantor of economic efficiency in the international allocation of world investment resources."³

In other words, if foreign investors can borrow from host country's credit resources at interest rates which are often negative in real terms, make profits sheltered behind effective rates of protection which reach 100% and above, benefit from holidays and exemptions from import duties on their raw materials, and remit profits abroad at overvalued exchange rates, there may be doubts as to the net benefits which the host country receives from such an activity.

This may or may not be typical of a given country at a given time. But it warns us that in the area of DFI, whether one deals with its economics or its politics, there is a great need for careful empirical analysis and cool pragmatism. Contrary to the usual stereotype, emotionalism and false heroics on this issue are not limited to Latin Americans only.

Some U.S. Misconceptions Regarding DFI in Latin America

With distressing frequency, U.S. publications (even hardnosed business publications) and commentators use a disturbing rhetoric when dealing with the topic of U.S. investments in Latin America. Latin American leaders who argue for some new restriction on DFI, are quickly labeled "anti-foreign" or "anti-American", without giving the reader an idea whether the regulation makes sense or not, and whether the one-to-one association of a particular business with the U.S. national interest is justified. If these publications

used the same standards to report U.S. economic news, one can imagine their editions after President Nixon's August 15th, 1971 speech. They would have ran headlines of the following sort: "Xenophobic Republican Boss announces Pearl Harbor in Reverse--Anti-European steps also Taken".

This may seem like an exaggeration. Yet, this last May, The New York Times, no less, ran a story announcing that the Argentine government was reversing "its shrill policy of economic nationalism", and had ousted "the xenophobic Minister of Economy, Aldo Ferrer..."⁴ It so happens that Dr. Aldo Ferrer has a long and distinguished international career, particularly in Inter-American institutions. As a senior adviser to the Inter-American Committee on the Alliance for Progress, incidentally, he wrote a paper on the role of foreign investment in Latin American development jointly with that other well-known "xenophobe", Dr. Roberto Campos of Brazil.⁵

Parts of the statements by the Council of the Americas on the new foreign investment code of the countries participating in the Andean Common Market represent another example of overreaction and purple rhetoric. They also contain threats which are worse than offensive: they are not credible. As put by the Vice-President and general counsel of ELTRA Corporation of New York in a recent article:

...a sense of detachment could have prevented the Council of the Americas, representing major U.S. business interests in Latin America, from coming forth with the hasty and inaccurate statement that the 'fade-out joint venture' formula is an 'unworkable and unrealistic proposal on the basis that foreign investors do not invest to go out of business'. There are any number of modalities of 'doing business', and if U.S. businessmen cannot prove versatile, surely those from Western Europe and Japan will!⁶

To this one could add that the symbolism of pictures showing Fiat trucks being produced in Ford's old assembly plant in Chile should not escape U.S. firms. More tangible is the fact that ten European and Japanese auto-makers recently answered Chile's call for bids to form partnerships,

in which the Chilean government would own at least 51 percent of the equity.

New forecasts or threats of a "drying-up" of willingness to invest sound particularly hollow when one reads about new contracts of Occidental Petroleum Corporation and other U.S. investors (not to mention non-U.S. investors) with Peru, less than three years after the air was filled with the same warnings motivated by the Peruvian-I.P.C. quarrel. Perhaps private settlement of that dispute has been reached, but to the naked eye it looks as if Peru has backed down less than the investing community. Mexican history, of course, provides other similar examples.

But perhaps the most spectacular rhetorical fireworks belong not to the private but to the public sector. Latin Americans who during 1969 read in the opening lines of the Rockefeller Report on the Americas that: "We went to visit neighbors and found brothers", heard recently that high U.S. officials, talking presumably about those same neighbors, say that "We don't have any friends there anyway."⁷

It is not entirely clear why the topic of DFI arouses such strong emotions, not only in host countries, but also in investor countries. It may arise partly from confusing foreign investment with pure foreign aid, in spite of the clear fact that DFI has to do with business, risk, and profit, not charity. Another possible reason for exasperation at measures which restrict DFI inflows into Latin America is summarized in the question: "How can a developing area, which is capital-poor, reject it?" The question, however, admits many answers. First, as noticed earlier, the major contribution DFI can make to the present stage of Latin American development (in most of the countries) is not really as a supplier of capital nor

foreign exchange, but as a provider of specialized techniques and talents. Secondly, and more fundamentally, host countries should desire something more than an indiscriminate increase in the inflow of the packages of capital, technology and skills associated with DFI. They should try to control, in particular, the allocation of such an inflow, as well as the conditions under which it is contracted, so that the social return of the investment to the host country will exceed its costs. Of course, these calculations are not always carefully done, but on principle we are back to the need to analyze each project, and such things as its contribution to developing local technology, better knowledge of marketing channels, effects on local entrepreneurship, etc. Thirdly, even when there is a positive net return to the host country from a particular DFI project, that country may not allow it for the sake of minimizing foreign presence in its economy, or in some sector of it. Surely, this is a trade-off every sovereign country has a right to choose; in fact, not all members of the Western community have the same degree of openness to DFI, and this is no impediment to mutually profitable trade and other financial links.

One also reads in the U.S. other arguments regarding DFI which dim rather than increase understanding. It is, for example, sometimes pointed out that, after all, total earnings of U.S. investments in Latin America have averaged only 12 percent of the bookvalue of that investment, a not exploitative figure. (The data for these calculations are obtained from company balance sheets.) This figure by itself, I am afraid, casts very little light on DFI issues. We all know about accounting conventions; in particular, there is considerable worry in Latin America about over-invoicing

of imports from headquarters to subsidiaries, especially in pharmaceuticals, royalty and patent payments, etc., as ways to decrease book profits in host countries and increase them at headquarters. It has been noted in several countries that some plants show year after year accounting losses, and yet headquarters makes further investments into them. The problems raised by intra-corporate sales and pricing techniques are, of course, not limited to Latin American-U.S. relations; furthermore, they do not always work to the disadvantage of host countries, as it appears in the case of oil.⁸ But the point is that one should not debase discussions regarding DFI using book profit rates carelessly.

Another line of thought which I find mystifying is one which implies that those wishing to control DFI are only or mainly "elite groups", bent on increasing their own power and status, if necessary at the expense of the masses. No doubt those types exist in Latin America (and elsewhere). But even stretching the use of "elite groups" into the realm of tautologies, the argument will give a dangerously misleading impression of Latin American feeling on this issue. The Venezuelan and Chilean Congresses, both democratically elected and encompassing many ideological groups, have recently passed with near unanimity laws which restrict foreign investment in oil and copper, respectively. One could say that everyone in Congress is a member of the "elite", and acts mainly to work out his own impulses and psychic needs. Does anyone really believe that?

If the "elite" hypothesis were correct, one would expect moves to broaden political participation to improve the investment climate. Such a move seems to be occurring in Argentina this year, and here is how it has been reported from Buenos Aires:

For United States investors here, who have an estimated one billion dollars at stake, the news of the lifting of the ban on political activity last Thursday night has raised some gloomy prospects.

There is hardly any banned-until-now political party that does not favor a sharper nationalist course at the expense of foreign interests.⁹

One may note a sharp contrast: while the historical record of DFI is very much alive in the Latin American mind, it tends to be ignored or downplayed in the U.S. It is an inevitable fact that in social history the sins of the father will haunt even the innocent son, and a greater historical perspective in the part of U.S. observers could be helpful for taking a more detached view of day-to-day DFI crises. U.S. publications are not incapable of taking such a detached and long run view of DFI frictions between investors and host countries; I just find them more perceptive and cool when dealing with, say, the relations between Koreans and Southeast Asians and Japan, or between Algeria and France, than those between Latin America and the U.S. In fact, they can sound downright enthusiastic about Algerian and Asian reactions to the French and Japanese.¹⁰

If nothing else, the coexistence in time of many different ways "of doing business" should give some perspective in facing Latin American changes in the rules of the game for DFI. From reading the U.S. press one gets the clear impression that the investment climate for foreign corporations is better in Rumania and Yugoslavia, and even in the USSR, than in most Latin American countries. At first, this sounds crazy. On second thought, it illustrates the simple point that in the field of DFI the direction of change often gets more attention than the average level of treatment. Rough guidelines with a gradual tendency to become softer seem to be preferred to weak ones tending erratically to get tougher. If this is so, in most of

Latin America things will get worse for traditional United States investors, before they get better for those willing to operate in the new climate.

Some Latin American Misconceptions Regarding DFI

The case for closer control over DFI is not helped by fallacious or misleading arguments which one often hears from Latin American sources, or from those sympathetic to Latin American aspirations. The prize for confusion in this area has to go to the "decapitalization" or the "they-take-out-more-than-they-put-in" argument.

This argument compares the amounts of fresh DFI inflows for a given period with outflows for profit remittances, dividends, etc., generated by the stock of DFI established in the host country. It is pointed out that the latter sums exceed the former for Latin America; the implication is that DFI is bad for the region, draining it of its surplus, and, therefore, the region would be better off without DFI.

Note that this line of thought compares fresh investments with outflows generated by old investments, and says nothing regarding the allocation and output (or surplus-generation) of those investments. Suppose, for example, that in a given country accumulated DFI is \$100 Million and it is all located in the export sector producing every year \$30 Million of exports. Suppose further that during the last fifteen years no new DFI has come in, but profit remittances have amounted to \$10 Million per year. It will then be argued that the host country will have been "decapitalized" by \$150 Million during that period, and that profit remittances have exceeded the original investment. This is "bad".

Compare the previous situation with another, where for fifteen years new DFI has come in at a rate of \$10 Million every year, and that no profit remittances have taken place yet. Presumably this is "good", even though the investments may all go to produce Coca-Cola and Corn Flakes, at domestic prices twice as high as those in the world market.

The point is that the often-given comparison of fresh DFI with profit outflows is useless to judge whether or not a given country is benefitting from DFI. If the rate of new DFI inflows is constant, and the rate of profit annually remitted abroad is positive, sooner or later outflows will exceed inflows. And if the period is made long enough, the sum of annual profits or interest on a given investment will always exceed the original sum put in, whether one talks about DFI or a personal savings account. This will happen in DFI which may be, for other reasons, good, bad or indifferent for host countries.

If the host country's economy is diagnosed to be limited primarily by an acute foreign exchange constraint, the direct and indirect balance of payments effects of DFI, and not only inflow minus profit outflow, should be brought in, including its impact on exports and net import-substitution, both measured at world market prices. But more generally, other economic effects will have to be taken into account, in a full benefit-cost analysis, in trying to assess how DFI will change the host economy. That a given project saves or generates foreign exchange, or does not, should not necessarily be a decisive reason to accept or reject the proposal. One should also be on guard against the danger, noted by Benjamin I. Cohen, that fresh DFI in export lines could create new enclaves of small net benefit to host economies.

Joint-ventures have many features appealing to host countries, when compared with those of fully-owned subsidiaries of MNC's. But insistence that all DFI must come in the form of joint ventures can have significant costs, under present world market circumstances.¹¹ Some MNC's simply will not touch joint venture and may be more interested in investing in industrialized countries (including Eastern Europe) than in bargaining with LDC's; this may not matter much when there are several potential investors in the field (GM/autos), or when the MNC main asset is a brand-name of doubtful social product (Kelloggs), but can delay entrance into specialized fields (IBM/computers). Other MNC's may be persuaded to give in to joint-ventures especially when the host country has a large domestic market, but at the price of letting them charge the mixed offspring higher sums for technology from headquarters. Those MNC's also generally show less zeal in promoting exports from their joint-ventures than from their fully-owned subsidiaries. Under the cover of good-will, they use more local and less foreign credit, and their retained earnings are lower. Their contribution to local entrepreneurship can be more apparent than real if rigid rules encourage phony, or induce drawing on experienced, local partners. Finally, some foreign investors may quite eagerly seek joint ventures in the hope of obtaining favorable treatment in tax and other matters which can be very onerous to host economies. In short, willingness to enter into joint ventures will not necessarily separate "good" from "bad" MNC's from the host country viewpoint, and very rigid rules in this area can involve important opportunity costs, both because of what is kept out and of what comes in. But let me grant the difficulty in separating "very rigid rules" from "realistic rules of thumb".

In the Latin American ambiance it is tempting to believe every story putting the foreign investor in a bad light, and to support every scheme to reduce his profit. Yet clearly there are better and worse ways of doing the latter, from the viewpoint of host country's welfare, as emphasized by Paul P. Streeten; higher wages for privileged workers of MNC's are less desirable in general than higher taxes which can benefit via public expenditures larger and less favored groups in the population. Foreign investors may become exasperated at a new charge against them: that they pay wages which are too high! But in fact the charge, which should be extended to host country labor policies, has some substance, especially in countries with a widespread unemployment problem. And, obviously, keeping facts straight is a precondition for sensible decision-making. (Before 1959 it was widely believed in Cuba that foreign oil companies had actually discovered vast amounts of oil in the island, but their world-wide strategy led them to keep those discoveries secret, as reserves. Alas, the story now appears untrue).

Domestic Latin American Needs and Their Influence on Policies Toward DFI

Much experimentation is going on in Latin America regarding policies toward DFI. Brazil relies on public command of monetary, fiscal and foreign exchange policies to control DFI, and uses "positive" incentives and measures to induce opening up of closed companies, foreign and national, to public participation. The Andean countries, on the other hand, have adopted a code which calls for tighter regulations over DFI. Some of the smaller countries, devoid of much bargaining power, desperately try to induce inflows by "wide-open" policies, taking full-page ads in The New York Times

which produce embarrassment to other Latin Americans. Cuba continues to have nothing to do with any DFI, following a spartan (but not laconic) style. There are, furthermore, numerous proposals on what to do about DFI. Even in a given Latin American country, the social, political and economic needs are many and often conflicting, pushing policy toward DFI in different directions, and frequently in contrary ways for different sectors within the same country. Rather than survey this vast and heterogeneous field, this section will discuss briefly some sectoral and general trends which seem in need of greater clarification.

The felt need to control basic sectors of the economy will be enough to maintain the pressure to nationalize, one way or another, major foreign-owned activities in the field of traditional natural resources, especially when such activities are of key importance to the host country. As ex-President Eduardo Frei has recently put it:

The degree of awareness and development reached by these nations has led them to feel that it is against their interests and their very identity to allow natural resources, which are essential to them either as raw materials for their industry or as prime export items in their economies, to remain in foreign hands. Thus, the nationalization of these resources will be unavoidable...12

Ever since the colonial powers plundered the mineral and natural resource wealth of Latin America, starting in the 16th century, Latin Americans, have felt that they were not getting a high enough share of the pure rents generated by those God-given natural resources. Furthermore, and granting that the prices at which those resources may be sold in world markets may remain erratic, most countries do not wish to maintain a situation where one more (to them) exogenous force, the foreign corporation, can introduce decisions affecting their control of foreign exchange receipts, regarded as an elementary precondition to rational planning. Those feelings should not

be impossible to understand in the U.S., where Alaska wants to own and operate the oil pipeline which will dominate its economic life, where Puerto Rico is pressing copper corporations for more favorable deals, and where Montana legislators complain that Anaconda's New York leadership treats that state like a colony.

So every shift in bargaining power can be expected to be used by Latin American countries to push a little further toward local control. Note how Venezuela, which 14 years ago was "wide open" to DFI, has skillfully used Middle East circumstances to gain a greater share of its oil and gas revenues, as well as greater control over that industry. The history of Chilean copper is another example, more complex, of this trend.

The production and marketing of certain natural resources, such as oil, copper and aluminum, generate high gross profits which are the result of two separate influences: pure rents from rich natural deposits, and the oligopolistic control of the industry. As a first approximation, one may view the sharing of pure rents as a conflictive zero-sum game between host countries and foreign corporations; both countries and corporations, however, have a common interest in not allowing too much competition in the industry. Because of this and other reasons, one can expect that foreign companies will continue playing some role in this field. For example, although the Chilean copper situation is still unclear, Cerro Corporation may end up not only settling amicably with the Chilean government, but could also provide technical help to the nationalized copper mines of that country. But clearly, the days of the 99-year concessions are gone in most (but not all!) of Latin America.

If host countries feel confident that they can now run old export lines, based on natural resources, they are likely to welcome some foreign investment for the sake of expanding new or non-traditional exports, particularly in manufacturing, but not excluding agricultural activities nor "new" natural resources, like timber or iron ore. (What is a new natural resource in one country may be an old one in another.) Over the long run Latin American countries, acting jointly if possible, would do well to devote resources toward developing their own marketing channels and outlets, and picking up expertise in the sale of non-traditional exports. But that process may take some time, and in the meanwhile the ready-made facilities of MNC's for world-wide connections loom appealing. It has already been reported, for example, that IBM was in 1969 the largest exporter of manufactured goods from both Argentina and Brazil. Even here, however, the bargaining will typically be tougher than sixty or twenty years ago; if nothing else, there are now more foreign investors who can be induced to bid for export projects, as the Monroe Doctrine carries over less and less to economic matters.

There is a danger in too close a link-up between new Latin American exports and DFI. Investing countries may be tempted to condition access to their markets to favorable (discriminatory) treatment to their investors in exporting host countries. This is one, among many reasons, why a system of hemispheric preferences would be far inferior to a generalized trade preference scheme. (It is hard to visualize Japanese-Latin American joint ventures tapping much of the U.S. market under hemispheric preferences.) And I would add that it is also inferior to just freezing trade restrictions at their pre-August 15, 1971 levels. Latin America has too much to gain,

both economically and politically, from a non-discriminatory world trading community, to toss away multilateralism for the sake of some short term advantage.

It is known that the process of import substitution has been rather disorderly in most Latin American countries. In some sectors, duplication of plant facilities behind excessive protection lead to unused capacity, inefficiency and high costs. Often, as in automobiles and other durable consumer goods, foreign investors are conspicuously present and have not always refrained from clamoring for protection. There is a great need for rationalization in this area, and in many cases it is likely to come via direct government action, rather than more slowly working market forces. Argentina, Chile and Peru have recently taken steps to rationalize their auto industry.¹³ This could lead to frictions, but it must be borne in mind that some kind of rationalization in high cost, excessive capacity import substituting activities is quite desirable from the viewpoint of economic efficiency.

There is indeed the need to re-think in Latin America the whole traditional policy of protectionism. It is not only that it has yielded excessive protection; it has also lacked a clear set of objectives. Protectionism typically leads, at least in the short run, to inefficiency in the use of resources, as well as to income redistribution in favor of the protected entrepreneurs, at the expense of the rest of society. It is possible that "infant entrepreneurs" will eventually justify those subsidies by their "learning by doing". Notice that I put the emphasis on entrepreneurs, not on industries. If this is accepted, I see little to justify Latin American countries subsidizing foreign entrepreneurs in protected industries, as

those foreign entrepreneurs are hardly "infants", and, by definition, are in activities which cannot pay their own way without protection. Protected industries, if they are going to be encouraged at all, should then as a rule be reserved to national entrepreneurs to be, so to speak, their training ground, and in that way justify their social cost. The same would apply to special subsidies to protected industries via credit, tax rebates, etc. Ideally, effective tariffs, or the tariff-equivalence of other measures, should be gradually lowered even to infant-entrepreneurs, but while they remain, say above 20 percent for a given activity, that activity should be reserved to national entrepreneurs, unless very special circumstances or national objectives dictate otherwise.¹⁴ Furthermore, national entrepreneurs who in the past have benefitted from protection would not be allowed to sell out to foreign investors, unless they return to the national Treasury the accumulated difference between the effective protection they received and the 20 percent limit. But I suspect that the unpopularity of this proposal among foreign investors will be easily exceeded by the enthusiasm with which it will be rejected by Latin American protectionists.

Another illustration of the need for closer coordination between DFI and protectionist policies is given by bans of "luxury" imports leading to their domestic production by foreign firms. A rationale may be given for banning soft drink imports while allowing the establishment of a Coca-Cola plant within the country, but such rationale is likely to be weak. (Even when they do not receive protection, one may doubt the usefulness to the host country of DFI whose major strength is a world-famous brand name for manufactured consumer goods created by persistent advertising.)

A rationalization of protectionist policy would also help to check another negative influence exerted by foreign business on Latin American economies, this time not through DFI but through meretricious peddling of capital goods. More than one Latin American white elephant has been conceived in unholy marriage between heavily protected local entrepreneurs, often managers of public enterprises, and unscrupulous foreign, very frequently European, suppliers of machinery and equipment.

The previous paragraphs should be enough to dispell the notion that because more and more of DFI is going to promote Latin American industrialization, in contrast with old-fashioned DFI in export-oriented natural resource exploitation, the need to control DFI has lessened. From a purely economic viewpoint, in fact, it may well be that the "old-fashioned" DFI provided greater benefits to host economies.

Latin American ability to generate domestic savings has outstripped its capacity to produce indigenous technological advances, and even to apply knowledge available from the rest of the world. But it is strongly felt that this is no reason to neglect a close scrutiny of royalty and patent agreements, not all of which are deemed to bring in desired knowledge at least cost. Government revision of royalty agreements between Colombian and foreign firms is said to have successfully reduced outward payments without sacrificing the technological inflow over the last few years. The Colombian regulations on licensing technological transfers markedly influenced the relevant parts of the Andean foreign investment code. Now Argentina has also introduced comprehensive regulations in this field, adding the interesting twist of requiring fees for technological transfers to be based, not on sales, but on the profits of Argentine firms.

These measures can partly be interpreted as attempts to improve host country bargaining power in areas where international markets are thin and imperfect, and where the knowledge of those markets in the part of individual Latin American firms is weak. Just the fact that the new regulations state that all patents, trademarks and agreements for sale of technology will have to be registered and approved by the government, improve the negotiating position of local firms vis-a-vis foreign suppliers. I am told that many a Colombian firm has hinted to that country's committee on royalties their willingness to have proposed agreements rejected by the government, for the sake of a second bargaining round with foreign suppliers. Such committees also keep tabs on the costs to host countries of technological transfers from parents to subsidiaries, and can reject agreements which restrict the freedom of host country firms to export, or to buy foreign goods from the cheapest source. In other words, they also serve as a mild form of anti-trust, combatting clauses which act in restraint of free trade. Note that these measures go beyond trying to deal with distortions within the host country; they are meant to handle far from competitive world markets.¹⁵

Another obvious way in which Latin American countries can increase their bargaining power is by acting jointly in negotiations with foreign investors, so as to avoid self-defeating competition among themselves. Remember the history of corporate regulation within the U.S., when the Massachusetts law was undercut by competition from "loose" New Jersey and Delaware, or note the pointless recent competition among states of the U.S. in their tax laws, which has eroded their tax-base without much

net effect on total investment.¹⁶ These considerations provide the rationale behind the desire of countries forming the Andean Common Market to have common foreign investment guidelines. Just as such a market, in its early stages, calls for a common minimum external tariff, it makes sense for it to have some kind of a common minimum code for DFI.

Behind the trends reviewed in this section, one can detect not only "growing nationalism", but also growing sophistication in the part of Latin American policy makers, even though the new regulations can sometimes substitute new irrationalities for old ones. Of all the "gaps" separating the developing from the developed, one of the widest has been the gap in knowledge and bargaining "know-how" when a host country sat to negotiate with a foreign investor (witness the negotiations between post-Sukarno Indonesia and foreign investors). For Latin America this gap is narrowing and hopefully one will soon see in each country scores of officials trained in both foreign business schools and even in MNC's, who then put their experiences to work for their countries by negotiating new contracts with foreign investors. There is much Latin America can learn from a close study of the modus operandi of the MNC's, even where the development model being followed is one hostile to the philosophy of MNC's.

All of this implies that in the future no empty references to the "sanctity of contracts" should impede a flexible approach to recontracting and renegotiations, as new circumstances emerge in host countries and in the world economy. The concept of renegotiating contracts is hardly novel for the industrialized countries; note, for example, frequent Pentagon renegotiations with its contractors. Note also how scores of labor contracts

as well as international commitments had to be put aside by the Presidential announcement of August 15, 1971. But this takes us into the subject matter of the next section.

U.S. and International Reactions to Latin American Policies toward DFI:

Minimizing Friction

Latin American policies toward DFI, old and new, are very likely to remain the major source of friction between the U.S. and Latin America for the foreseeable future. There is no issue where differences in the intellectual and emotional climate, North and South, are more marked. With other foreign investors, such as Europeans and Japanese, with fewer investments, less historical deadweight and more modest hemispheric political roles, the climate is better, although not exempt of tension. (My colleague Benjamin Cohen tells me that South Koreans view U.S. investors very much in the same light as Latin Americans view the Japanese.)

While friction is, in the nature of things, inevitable, it need not lead to apocalyptic results. Let me first look at some recent events in this field, and conclude with some reflections on a few ideas which may avoid over the long run a rerun, on a more massive scale, of the Cuban-U.S. hysterics of 1959-61.

A first thing to note is that U.S. policies in this area during 1969 and 1970 were quite reasonable, under the circumstances. One can cite the non-application of the Hickenlooper amendment in the IPC-Peruvian dispute and, going outside the region, the quiet diplomatic settlement of disputes between U.S. investors and Algeria. The "low profile" had a good chance of becoming a successful U.S. Latin American policy, in spite of misguided criticism of it as "do-nothing". Better steady "do-nothing"

than the previous unstable mixture of warm rhetoric, some tied aid, and an occasional invasion.

Unfortunately, during 1971 and the "low profile" appears to be changing to an ugly, tough one. The symptoms have been:

(1) Threats to use international and bilateral concessional aid as a weapon in disputes between U.S. business firms and Latin American governments. This goes beyond even the Hickenlooper ammendment, which at least gave some "grace period" for settlement, and left multilateral organizations out of those disputes.

(2) Denial of access to near-commercial credit, such as that provided by EXIMBANK, to countries which were in the process of negotiating settlement with foreign investors. While that type of credit is not an inevitable component of international transactions in goods like commercial airplanes, it is sufficiently common to make the denial or postponement of a routine request come close to economic boycott.

(3) After much talk of trade preferences, in fact granted earlier this year by Europe and Japan,¹⁷ and in spite of substantial and steady U.S. trade surplus with Latin America,¹⁸ new Latin American export drives were dealt a blow, whose negative psychological impact is perhaps more important than its real incidence, by the 10% import surcharge announced by President Nixon this August 15. It would indeed be ironic if after years of preaching the need for export-promotion in Latin America by many people, including international and U.S. aid agencies, and just when the message is getting through, the major industrialized countries turn protectionist. Is the fate of Latin America to be always out of step, turning away from the world market when it is booming, as during the post war, and toward it

just when it turns protectionist? At any rate, Latin American export-pessimists received much ammunition by the August 15th announcement.

These are very disturbing symptoms, one could almost say provocations, which could unleash an unfortunate cycle of reprisals and counter-reprisals, leaving both sides politically and economically worse off at the end, and destroying institutions and rules of the game within which mutual adjustments can occur.

Over the last few years, several proposals have been put forth to smooth the tensions which exist between MNC's and host countries.¹⁹ A few ideas arising from those proposals, and some new ones, may be mentioned.

One hears how truly "multinational" U.S. corporations with foreign investments are becoming, and how this trend represents a great advance over narrow nationalisms. But if at every sign of friction with a host government those companies run to enlist the power of the U.S. government on their side of the fight, their claim to "multinationality" will be regarded, with good reason, as hollow. Private foreign investors cannot have it both ways (for very long). In a way, this point reflects the very old mistrust of conservative economics for mixing up in shady proportions government with private enterprise, which should apply to international as well as national businesses. It suggests that government intervention in this area, via institutions such as the Overseas Private Investment Corporation (OPIC), either do too little or too much. If the U.S. government deems that certain foreign investments do clearly involve the U.S. national interest, then the U.S. government should become an open and declared partner in the venture, and should take clear responsibility for every aspect of the contract. This is what the French government does, as I

understand it, with French investment in oil. During the oil crisis of 1970-71, private oil MNC's took on a quasi-public role, and the U.S. lifted anti-trust regulations so they could present a common front. Similar considerations could apply where DFI provides industrialized countries with access to raw materials deemed strategic, for which open and competitive markets may be impossible even to imagine. But for those foreign investments which do not involve the U.S. national interest unambiguously, then the U.S. government should leave risk taking as well as profits fully to the private entrepreneur.

Even under such "arm's length" relationship between government and the foreign investor, it is not unreasonable to expect that the U.S. government will not remain totally indifferent if the existing business of one of its citizens is systematically abused and plundered abroad. India, after all, shows concern over the treatment received by second- and third-generation Hindus in Africa, and Chile watches over her emigrants in neighboring Patagonia. But it is dangerous to use receptivity to fresh DFI as criteria to discriminate among countries in matters relating to trade and aid. There is nothing in the post war multilateral rules of the game, as embodied in organizations such as the GATT, and IBRD and the IMF, which encourages a close link between trade and investment preferences. Even within the common market made up of the 52 United States, while there is free trade in goods and free movement of labor, there remains a considerable amount of state legislation which limit the operations of banks and other financial institutions. Similarly, the world community should be able to create an environment in which each sovereign country can trade internationally as much as it wants and can, while reserving its right to follow

more restrictive policies regarding the capital account of its balance of payments. Furthermore, it does not make much sense for foreign investors to become all worked up about new restrictions over DFI which a Latin American country may impose, when it is known that similar practices are tolerated by foreign investors in countries like Yugoslavia, Rumania, Japan and Sweden.

The 1971 international monetary crisis has dramatized the fact that not even the Atlantic community is yet ready to become an "optimum currency area", within which capital flows would be as smooth as those between London and Manchester. Greater future reliance on more flexible exchange rates and/or tighter controls over the capital account of the Balance of Payments is likely among many industrialized countries. In this setting, it is particularly anachronistic to press LDC's for relaxation of their regulations over certain types of capital flows.

A key characteristic of DFI is that it puts together into an indivisible package capital, technology, management skills, information about foreign markets, etc. Economists know about the inefficiencies created by "tied sales", and anyone who believes in the benefits of free competitive markets should be able to support efforts to give LDC's more options, by creating, probably at low real costs, alternative and separate markets for each of these elements.

In the first place, international private capital markets for LDC bonds should be expanded and strengthened, facilitating access to them by those countries wishing to rely less on concessional aid and DFI. The expansion of international capital markets during the 1960's, and the degree of economic maturity reached by many Latin American countries make this option a promising one for the 1970's. If Hungary can tap the Eurobond market, at least the

seven largest Latin American countries should be able to do the same in growing amounts.

International organizations such as the IBRD, the IADB, and the IFC have done remarkably little in the field of technological transfer. They could step up their efforts to act as clearing houses of information regarding where LDC's could obtain technological inputs in the cheapest way, and not necessarily tied to capital transfers. The socialist countries could be brought in to participate more actively in those licensing markets.

International and regional organizations could also be more involved in backstopping for LDC's in their search for information when those countries are in the process of negotiating with foreign investors. Unfortunately, the practices of some of those organizations have in fact been perverse in the past; using the excuse that international private capital was available, they have refused to lend for host country investments in certain sectors, such as oil. They have thus abstained from helping to diversify not only the sources of capital, but more critically, the channels through which Latin America has access to modern technology and information about the state of particular world markets.

Professor Charles P. Kindleberger has called for a sort of GATT to regulate MNC's, as well as to serve as an international Ombudsman, charged with preserving competition, avoiding inconsistent national regulations of MNC's and for resolution of conflicts. If sponsored by the United Nations, such an institution could be most useful in avoiding many of the difficulties we have reviewed. The idea, incidentally, is far superior to similar ones which have been proposed, but which restrict participation to Western Hemisphere nations. It is also superior to proposals for a multilateral

investment guarantee scheme operated collectively by all OECD members. Such a scheme comes close to providing a framework for an investors' cartel. Indeed, this is exactly the reason why recently The Economist of London advocated that plan.²⁰

The ideas reviewed in these last paragraphs are meant for the long run, and say little about thorny transitional disputes between Latin American countries, foreign investors and the U.S. When viewed in the midst of battle, those disputes can be exasperating and dismaying, although exhilarating for those in search of confrontations. When gloomily contemplating such panorama, it is comforting to review the record of French-Algerian relations. After a bloody war, many frictions and manoeuvres, including going to the brink earlier this year as well as trying to bring other parties into their dispute,²¹ they seem to have worked out a civilized and mutually profitable arrangement. Surely the U.S. and Latin America can do even better. Indeed, the end of total U.S. hegemony in the hemisphere could open the way for a genuine improvement in U.S.-Latin American relations.

Footnotes

- * An earlier version of this paper was presented at a conference on "Trade and Investment Policies in the Americas", October 7-8, 1971, Southern Methodist University, Dallas, Texas. Comments from Benjamin I. Cohen and Richard N. Cooper are gratefully acknowledged.
1. See testimony of Stephen Hymer in Part 4, "The Multinational Corporation and International Investment", Hearings Before the Subcommittee on Foreign Economic Policy of the Joint Economic Committee, Congress of the United States, (Washington: U.S. Government Printing Office, 1970), pp. 906-11.
 2. Ragnar Nurkse, "International Investment Today in the Light of Nineteenth-Century Experience," reprinted in Richard N. Cooper, Editor, International Finance (Penguin Books, 1969), p. 367.
 3. Harry G. Johnson, "Theoretical Problems of the International Monetary System," also in R. N. Cooper, Ed., International Finance, Op. Cit., p. 315.
 4. The New York Times, May 31, 1971.
 5. "Inversión Extranjera y Desarrollo Económico Latinoamericano (Versión Preliminar)," by Roberto Campos and Aldo Ferrer, Washington, D.C., December 26, 1967 (mimeographed).
 6. Laurence Birns and Robert H. Lounsbury, "The Art of Survival in Latin America," Columbia Journal of World Business, Volume VI, Number 4, July-August 1971, p. 43.
 7. The Rockefeller Report on The Americas, The Official Report of a U.S. Presidential Mission for the Western Hemisphere, by Nelson A. Rockefeller (Chicago: Quadrangle Books, 1969), p. 17 (Preamble); and The New York Times, August 15, 1971.
 8. For an interesting discussion of problems raised by intra-corporate sales techniques see Richard N. Cooper, The Economics of Inter-Dependence: Economic Policy in the Atlantic Community (McGraw-Hill Book Company, 1968), pp. 101-05. Cooper suggests a test which perhaps can be applied to Latin America and

and U.S. data, and consists of inquiring whether for specific activities, book profits rates are higher for parent firms with Latin American investments than for comparable firms without such investments.

9. The New York Times, April 5, 1971
10. See for example the articles entitled "The Ugly Japanese?" in The Wall Street Journal, May 12, 1971, and "A foreign legion routs the French," in Business Week, May 8, 1971. On the other hand, French publications become highly emotional on Algeria, but take an almost amused tone when dealing with U.S. DFI difficulties in Latin America, as does The Economist of London, which, however, loses its cool over Middle East oil, saying things like:

Once upon a time, had a group of backward countries, with highly unstable governments and a reputation for persistent commercial bad faith, tried to hold the western economies to ransom as the oil producing governments of the Middle East are now doing, they would have seen the gunboats steaming up the Gulf in double-quick time (Editorial, January 30, 1971)

11. This discussion of joint ventures draws heavily on the work of Louis T. Wells, Jr. of the Harvard Business School. See in particular his unpublished paper "Effects of Policies Encouraging Foreign Joint Ventures in Developing Countries".
12. Eduardo Frei Montalva, "The Second Latin American Revolution," in Foreign Affairs, Volume 50, Number 1, October 1971, p. 89.
13. See "Car Output Laws in Argentina, Peru, Chile to Give Nations more Control of Industry," in The Wall Street Journal, June 10, 1971.
14. For more on this point see my "Direct Foreign Investment in Latin America," in Charles P. Kindleberger, Editor, The International Corporation (Cambridge: The MIT Press, 1970), especially pp. 325-29. The 20 percent limit is, of course, arbitrary; it is assumed that the real exchange rate in the host country is not too out of line with the "equilibrium" one.

15. See the impressive work of Constantine V. Vaitsos, "Transferencia De Recursos y Preservación De Rentas Monopolísticas", in Revista De Planeación y Desarrollo (Bogotá, July 1971, Volume III, Number 2, pp. 35-72.
16. See Richard N. Cooper, "National Economic Policy in an Interdependent World Economy," in The Yale Law Journal, Volume 76, Number 7, June 1967, pp. 1293-1297. The use by states and municipalities of their privilege to float tax-exempt securities for the purpose of raising funds for new businesses locating within their borders is another example of harmful competition among political units.
17. My colleague Richard N. Cooper, in a recent unpublished paper, argues that the EEC scheme for generalized tariff preferences will offer, in fact, very little additional incentive to exports of developing countries. But at least that scheme will consolidate LDC gains in the European market, in contrast with the threat of backsliding implicit in the U.S. measures.
18. For many years, Latin American complaints about a negative trade balance with the U.S., and of its composition involving the exchange of unprocessed raw materials for manufactured goods, were rejected by U.S. officials with the (theoretically correct) observations that what matters is the global balance of payments and that there is nothing basically wrong with trading raw materials for manufactures. It is then mildly mind-blowing to read that the U.S. has been using exactly the Latin American arguments regarding U.S. trade with Japan.
19. Within the Latin American context see in particular Albert O. Hirschman, "How to Divest in Latin America, and Why," Essays in International Finance, Princeton University, Number 76, November 1969, and Paul N. Rosenstein-Rodan, "Multinational Investment in the Framework of Latin American Integration,"

in Multinational Investment in the Economic Development and Integration of Latin America (Inter-American Development Bank, 1968). See also Charles P. Kindleberger, American Business Abroad (New Haven: Yale University Press, 1969), especially Lecture 6, and Raymond Vernon, Sovereignty at Bay, The Multinational Spread of U.S. Enterprises (New York: Basic Books, Inc. 1971).

20. The candid line of reasoning is as follows:

The offending host government might always calculate that bygones will be bygones if it waits long enough...To complicate matters, other countries may not have suffered at all from the defaults of a non-paying host government, and will be far quicker to forgive past misbehaviour; their companies would then enjoy a handsome advantage in that country if their guarantee schemes started giving cover there again. All of which points to the need for a multilateral investment guarantee scheme operated collectively by all OECD members, such as the World Bank is now chewing over.

The quote is from an article entitled "From gunboats to insurance" in The Economist, November 6, 1971.

21. The specter of collusion among major industrialized countries became tangible during the most recent Algerian-French dispute, when it looked as if the U.S. gave in to French pressure and threatened to block U.S. imports of Algerian liquefied natural gas until Algeria settled with France. But fortunately for LDC's, differences of interests and rivalries among the rich appear stronger than their desire for a joint venture as reflected in the following excerpts from an editorial in The Wall Street Journal (June 18, 1971):

High-handed treatment by producing countries of international oil companies is not something the United States would want to encourage...Still, there are serious questions about whether the U.S. government should pass judgement on a dispute between Algeria and France...The United States will badly need fuel in the years ahead.