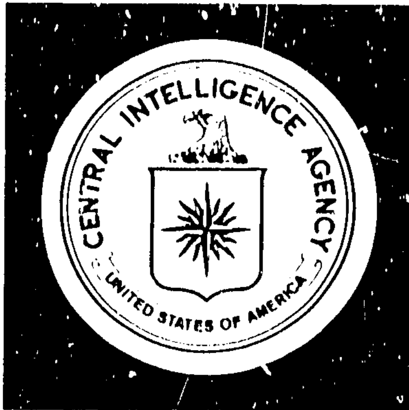
CIAOER IM 74-011 OUO 1 of 1

Approved For Release 2000/04/19 : CIA-RDP85T00875R001700070011-1

Prospects for Multinational Enterprise in Latin America Aug 74

Approved For Release 2000/04/19 : CIA-RDP85T00875R001700070011-1

FOR OFFICIAL USE ONLY



Intelligence Memorandum

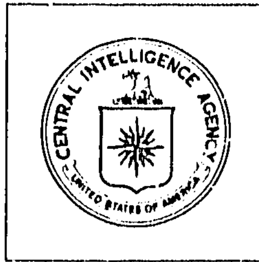
Prospects for Multinational Enterprise in Latin America

FOR OFFICIAL USE ONLY

ER IM 74-11
August 1974

Copy No. [illegible]

Approved For Release 2000/04/19 : CIA-RDP85T00875R001700070011-1



Prospects for Multinational Enterprise in Latin America

Difficult years lie ahead for multinational enterprises in Latin America and the Caribbean because of conflicting national and corporate goals. Many governments now are actively involved in planning for economic development. They want to expand local employment, increase exports, and gain access to modern technology. Investment by multinational enterprises can play an important role in achieving these aims, but governments want it on their own terms. Many of them feel that local control over the actions of multinational enterprises has been reduced by the size, power, and geographic dispersion of their operations.

In order to reassert local authority, many governments have been defining areas for participation by foreign business, limiting foreign equity shares, and restricting what are usually considered to be management prerogatives. Formal and informal restrictions are most widespread in extractive industries, where governments are concerned that nonrenewable resources be exploited to the best advantage of the local economy. In the next few years, the most successful firms will include:

- existing firms, particularly those in manufacturing, that accommodate the desires of the local governments, and

- new entrants willing to adopt flexible arrangements such as joint ventures or to provide consulting and technical services.

Even adjusting to government desires will not guarantee protection from nationalization, especially if the firms' operations are in key economic sectors. The potential for conflict between multinationals and governments is the greatest in natural resource exploitation. It is here that national sensitivities are greatest because of the key position of the mineral industry in many countries.

The ability of Latin American governments to create and sustain rapid rates of economic growth and a reasonable degree of political responsibility will do much to determine the future nature and extent of the multinational presence. Stability and prosperity better enable local governments to deal confidently and responsibly

Note: Comments and queries regarding this memorandum are welcomed. They may be directed to [redacted] of the Office of Economic Research, Code 143, [redacted]

25X1A

25X1A

Approved For Release 2000/04/19 : CIA-RDP85T00875R001700070011-1

with the multinationals and to blunt the sharp edges of local nationalism; conversely, multinational corporations are then more able and willing to contribute to economic growth and to benefit from it. Mexico and more recently Brazil have created these conditions, and the results in the growth of US investment are quite apparent.

Approved For Release 2000/04/19 : CIA-RDP85T00875R001700070011-1

FOR OFFICIAL USE ONLY
Approved For Release 2000/04/19 : CIA-RDP85T00875R001700070011-1

DISCUSSION

Introduction

1. The rapid expansion of multinational corporations (MNCs) in the last three decades has produced a new and powerful phenomenon on the world economic scene. Traditional foreign direct investment typically had involved the establishment of subsidiaries to produce products for sale in local markets or to exploit local resources for their own use. The unique characteristic of MNCs is their global outlook, with firms in one country supporting company activities in another. They are large, with annual sales of hundreds of millions – sometimes billions – of dollars. They often conduct business in numerous countries, control vast resources, operate in markets with few buyers or sellers, and maintain their positions by developing new technology or special skills or by using product differentiation or advertising. They often exert a significant influence on the rates and patterns of capital formation in host countries. Their economic (and political) impact has been especially profound in less developed countries.

2. Latin American governments have become increasingly concerned about the role of powerful MNCs in their economics. They see MNC operations in their countries as only part of a global corporate picture and as frequently unresponsive to national goals. Many governments are now consciously attempting to direct economic development through planning. Although the extent of planning varies from country to country, most governments want foreign investment for what it can contribute to the desired pattern of economic development. Foreign participation is often acceptable only on these grounds.

3. The difficulty of reconciling corporate and host country goals increases the potential for conflict between governments and MNCs. Governments are adopting increasingly restrictive regulations covering these firms. National sensitivities are rising, especially in regard to the exploitation of natural resources, and companies operating in key sectors are being forced out. Thus the prospects for MNCs will depend on their willingness and ability to adjust to the new business climate.

4. The Latin American political and economic environment is only part – albeit an important one – of the considerations for US firms. Investments elsewhere to gain access to important markets, to provide new sources of raw materials, or to secure higher profits are often more attractive and less risky. During the 1960s, for example, US business invested heavily in manufacturing in EC countries in order to maintain continued access to EC markets. Funds also flowed into mining in Australia and Canada to feed US industries' growing need for raw materials. Higher investment flows to other regions reduced the Latin American share of US direct foreign investment from 26% in 1960 to 17% in 1972.

Approved For Release 2000/04/19 : CIA-RDP85T00875R001700070011-1
FOR OFFICIAL USE ONLY

Business Climate for Multinational Enterprises

National Attitudes

5. The business climate for MNCs in Latin America and the Caribbean has been shaped by certain negative attitudes toward foreign business, which are expressed more sharply in some countries than in others. Foreign investors have often been accused of exploiting host countries to increase profits without considering the countries' economic interests. They have been accused of removing local resources for their own benefit, paying low taxes, investing in activities that are largely capital intensive, bringing in their own managers but little technology, and exerting undue influence over local governments.

6. On the other hand, many Latin governments and business leaders are aware of the economic importance of MNCs in the area. They recognize that often the MNCs have brought in financing not available from domestic sources, have expanded employment, have increased exports, and have introduced advanced management and marketing techniques. Nations needing capital and advanced technology continue to seek MNC participation often in contravention of their own statutes, although non-US investors frequently are preferred to US corporations because of a desire to reduce a predominant dependence on the United States.

Provisions for Local Control

7. Current foreign investment policies of most Latin American countries aim at restricting foreign participation in basic industry and infrastructure and guaranteeing favorable terms for themselves. Such policies are only the most recent manifestation of Latin American government intervention. Some railroads and other public utilities were nationalized earlier in this century. In more recent years, public investment and creation of government enterprises in such key sectors as petroleum and steel have been used to reduce foreign influence. Legislation also has been passed regulating foreign ownership shares and profit remittances.

8. Basic industries, such as petroleum in Mexico and Brazil, often are reserved for the state. In Peru, industries eventually to be in the hands of the state include steel, nonferrous metallurgy, chemicals, and banking. In Mexico, transportation, communications, and some mining and, in Brazil, airlines, shipping, and mass media must be owned by nationals. In Mexico, all firms not reserved to the state or to Mexican ownership must have at least 51% local ownership after periods negotiated with the companies. Meanwhile, a portion of the profits must be distributed to the employees as shares in the company.

9. Some governments also regulate capital flows and the conditions of transfers of technology. Peru limits profit remittances to 14% of invested capital; Argentina, 12.5%. Rules governing transfers of technology are aimed at gaining some local control over its use and the prices charged for importing it. In Mexico, for example, all technology transfer contracts must be registered. Registration is

Approved For Release 2000/04/19 : CIA-RDP85T00875R001700070011-1

denied if the contract restricts exports of goods using the technology, limits local research and development, or establishes excessively long periods of payment for the use of a particular technology.

Flexible Interpretations

10. In practice, each country interprets the laws to the benefit of its own national interests. Generally, interpretations tend to be flexible and foreign investors are often treated more favorably than the law allows, particularly when foreign investment provides new technology, employment, and exports.

11. In Peru, mining companies that did not meet investment timetables lost their concessions, but the laws are frequently loosely applied, especially for small firms. Mexico tends to interpret loosely its requirements for 51% local participation. It does enforce sections of the foreign investment law restricting particular industries to the state or to national ownership. Venezuela appears to be strictly enforcing the new President's executive decrees concerning the phasing out of most foreign capital in marketing and services and is moving to nationalize iron mining. Although Brazil has relatively few laws restricting foreign investment, the government has usually required majority national ownership in mining and supports large state-owned firms in such basic industries as steel. Brasilia, however, may be reevaluating this position because of the world energy situation and is considering allowing foreign participation in the domestic search for oil.

The Position of Multinational Corporations in Latin America

12. Multinational corporations usually prefer to have wholly owned subsidiaries in foreign countries. Increasingly, they are being forced to accept partners. In Brazil, for example, US Steel and Nippon Steel are minority owners with the government mining corporation, Cia. Vale do Rio Doce, of the Cerra dos Carajas iron mining project. Many manufacturing firms also have taken local partners but tend to retain control. Ford operations in Brazil fall into this category. Even if majority ownership is in local hands, companies can be flexible, safeguarding their interests by influencing management and using their voting power in shareholder meetings.

Value of US Direct Private Investment

13. US direct private investment in Latin America and the Caribbean has grown about 5.7% annually since 1960. In 1972, the book value of this investment was US $16.1 billion (see the table); Venezuela, Brazil, Mexico, Panama,[1] and Argentina accounted for about 60%.

1. Most of the investment in Panama represents bookkeeping operations of international trading companies. These investments do not result in significant capital investments to that country.

Approved For Release 2000/04/19 : CIA-RDP85T00875R001700070011-1

Book Value of US Direct Private Foreign Investment in the Western Hemisphere, by Sector[1]

Million US $

	1960					1972				
	Mining and Smelting	Petroleum	Manufacturing	Other	Total	Mining and Smelting	Petroleum	Manufacturing	Other	Total
Western Hemisphere total	2,527	5,637	6,346	4,989	19,494	5,021	9,255	17,104	10,538	41,917
South America	781	2,432	1,079	1,457	5,746	576	2,300	3,526	2,230	8,630
Argentina	[2]	[2]	213	260	472	[2]	[2]	836	555	1,391
Brazil	10	76	515	353	953	136	169	1,745	440	2,490
Chile	517	[2]	22	200	738	[2]	[2]	[2]	110	110
Colombia	[2]	233	92	100	424	[2]	327	262	150	739
Peru	251	79	35	81	446	416	[2]	90	208	714
Venezuela	[2]	1,995	180	394	2,569	[2]	1,546	539	599	2,683
Other	3	49	23	69	144	24	258	54	168	503
Mexico	130	32	391	243	795	124	32	1,385	451	1,993
Central America	32	104	20	600	756	34	423	272	1,339	2,069
Panama	17	56	9	323	405	19	265	162	977	1,423
Other	15	48	11	277	351	15	159	110	362	646
Caribbean[3]	259	405	29	326	1,019	797	1,188	334	1,121	3,441
Canada	1,325	2,664	4,827	2,363	11,179	3,490	5,311	11,587	5,397	25,784

1. Because of rounding, components may not add to the totals shown.
2. Included under Other.
3. Including (1) all the Caribbean Islands except Cuba; (2) the Caribbean mainland entities of Belize, Guyana, Surinam, and French Guiana; and (3) the Bahamas and Bermuda.

Approved For Release 2000/04/19 : CIA-RDP85T00875R001700070011-1
FOR OFFICIAL USE ONLY
Approved For Release 2000/04/19 : CIA-RDP85T00875R001700070011-1
FOR OFFICIAL USE ONLY

Approved For Release 2000/04/19 : CIA-RDP85T00875R001700070011-1

14. US investment in the Caribbean has grown rapidly in recent years. Since 1960 the US share of the area's investment has grown from 12% to 21%. Large amounts of funds going to the Caribbean have been channeled into mining and smelting operations, particularly bauxite ventures in Jamaica.[2] By 1972, one-half of all investment in mining in the area was in the Caribbean. At the same time, funds also flowed quickly into petroleum facilities in the Caribbean.

15. On a country basis, the largest flows since 1960 have been to Brazil; in 1972, it was the largest recipient of US investment in the area. The largest share of capital flows to Brazil since 1960 has entered manufacturing. Investment in Venezuela grew slowly through 1972; in Chile it declined 85% as US copper mines and other enterprises were nationalized. In 1973, US investment in Peru also dropped with the nationalization of some US firms.

16. US firms are involved in many sectors of Latin economies. In 1960-72, funds flowed into the manufacturing sector most rapidly, raising its share of total US investment in the area from 18% to 34%. The share in extractive industries fell from 50% to 34%.[3]

17. US investors are the largest single source of foreign capital in Latin America and the Caribbean. US investment represents about two-thirds of total foreign investment in Mexico; in Argentina, nearly one-half. Although Brazil's rapidly expanding economy has attracted sizable amounts of private capital from Europe and Japan, the United States still accounts for more than one-third of foreign investment.

Recent Trends

18. In recent years, investors have adopted new organizational arrangements and shifted to new sectors to ensure continuing participation in Latin American markets. Joint ventures with private individuals in manufacturing and service enterprises and with governments in extractive industries have become increasingly important. Management and technical assistance contracts or consulting services constitute even newer forms.

19. Investors also have had to accede to government demands to reduce the number of foreign managers and train locals for managerial, supervisory, and technical positions. Experience suggests, however, that such accommodations are not sufficient to prevent long-established foreign companies from being nationalized. Chile nationalized US copper mines, and Venezuela recently announced that the 1983 reversion date for the oil industry would be advanced. Caracas also indicated that it will require firms engaged in internal commerce to place 80% of their shares

2. The share in the Caribbean will change sharply as a result of recent Jamaican actions against foreign bauxite holdings.
3. The loss of copper investments in Chile also affected the relative shares.

Approved For Release 2000/04/19 : CIA-RDP85T00875R001700070011-1

for sale on the local market. Among the firms affected by this action is a largely locally managed Sears, Roebuck and Company subsidiary in which employees held 20% of the equity.

20. Firms operating in what are considered to be key economic sectors are prime candidates for nationalization, even if new and progressive. For example, the Peruvian government nationalized several fishing firms in 1973.

21. The terms of nationalization are seldom completely satisfactory to either party. Governments often use book value as their guide to the value of assets; companies push for current market value. Settlement is often reached when the government wants to attract new foreign management or technical assistance. This presumably was an important factor in Peru's compensation agreement with the United States for firms nationalized after 1968.

Prospects

Existing Firms

22. Although the situation will vary from country to country, it is all but certain that the Latin American environment will become increasingly uncomfortable for existing MNCs. Much will depend on how new government policies and controls are implemented in two key countries – Argentina and Venezuela. Rapid and sweeping implementation could produce an absolute decline in the book value of US investment in Latin America because of divestitures and the impact on reinvestment. A more measured pace, particularly if accompanied by rapid economic growth, could result in little change in the recent rate of growth of new US investment in the area.

23. Where they are permitted to do so, existing MNCs will remain in operation to salvage as much of their investment as possible. Many will be able to hang on, and some to prosper. The most successful are likely to be those that contribute directly to local economic development – e.g., by supplying advanced technology and management skills and increasing employment.

24. On the whole, manufacturing enterprises, particularly those producing for export, will fare better than extractive enterprises because the nationalistic pressures for local control over the latter are greater. Many companies will be forced to reduce their share of ownership by divesting to the state or to local capital, with compensation that will often be inadequate. On the positive side, as local citizens acquire a larger stake, they will provide a local source of capital and a growing political buffer between the company and the state.

25. Former owners often are interested in continuing association with the nationalized firms. If they can be assured of a continuing supply of raw materials, some firms in extractive industries may participate under management or technical

Approved For Release 2000/04/19 : CIA-RDP85T00875R001700070011-1

assistance contracts. If part of the compensation is in bonds, such association is important in guaranteeing future payment. Governments also frequently want continuing association. Although managers and technicians can be hired, the former owners' long experience with the company is advantageous in insuring smooth operation. Participation by former owners may also ease marketing problems.

New Entrants

26. The fate of existing companies will obviously have an impact on new entrants. Even if the climate remains hospitable, new business entrants will be undertaking activity in the area on new terms. National sensitivities will continue to grow, and there will be continuing demands for greater local control and for greater participation by local capital.

27. Successful foreign investors are likely to be those most flexible in adopting new methods to participate in Latin American countries. Joint venture arrangements for investment in manufacturing and some service operations are likely to be important. Other significant methods will include consulting and technical assistance companies that have little or no investment in facilities but which contribute technology and skills. These investment forms would lead to an expanded presence for many MNCs even if their share of equity declines.

28. Many foreign firms are willing to adopt new techniques in order to obtain needed raw materials or to enter growing markets, if the profit arrangements are satisfactory. They are also willing to participate in local companies with less than full ownership.

29. Conflicts may arise despite flexibility on the part of the MNCs. Because the requirements of industrial nations for imported raw materials will continue to grow, foreign firms will push for participation in the extractive industries. But, it is here that local sensitivities are the greatest, and where the greatest potential for conflict between host countries and investors exists.

Effect on the Economies

30. A reduction in direct foreign investment need reduce neither the total supply of foreign capital available to Latin American countries nor their rates of growth. Only 20% of the total foreign capital flow to Latin America consists of direct private investment; most of the rest is private credit. In Brazil, for example, where direct foreign investment plays an unusually large role, direct investment represents only about 25% of total capital inflow and less than 10% of domestic investment. Long-term private credit is the most important foreign source of capital in the region; it accounted for more than 50% of the total flow in 1972. Official foreign aid accounted for about 30% of the total.

Approved For Release 2000/04/19 : CIA-RDP85T00875R001700070011-1

Approved For Release 2000/04/19 : CIA-RDP85T00875R001700070011-1

31. Most private credit is attracted by sound indigenous economic policies and by economic success. If these conditions are present, credit is likely to be available even if direct investment is discouraged. If these conditions are absent, all foreign capital inflows will be discouraged. In Argentina, political instability has impeded growth more than fluctuations in the flow of direct foreign investment. Brazil, by contrast, has attracted sizable amounts of foreign private capital because of its rapid growth, sizable market potential, and political stability.

32. Direct private investment remains important to economic growth in certain situations. Where a business is a going concern that produces a fairly simple product with a ready market, such as is the case with most raw materials, it is possible to operate with credit and hired expertise. It is less feasible to do so when a country wishes to establish new industries, particularly those requiring sophisticated techniques of production and marketing. To interest foreign companies in such new undertakings, governments will have to give them a substantial financial stake and considerable freedom of action. This is one important reason why joint ventures are likely to become increasingly important in the area.

Efforts Toward Collective Guidelines

33. Prospects for a regional or worldwide policy toward MNCs in the next few years are dim. The report of the United Nations' Group of Eminent Persons on MNCs suggested developing a code of conduct but did not suggest such a code for raw materials cartels. At the recent meeting of Latin American foreign ministers in Washington, a Group on Transnational Enterprise was established to prepare a report on principles applicable to MNCs for the next ministerial meeting in March 1975. The first Group meeting is scheduled for August.

34. Deep divisions between the United States and the Latin American nations and among the Latins themselves make determining even the scope of the problem and the procedures for tackling it difficult. The United States wants the Group to consider the conduct of both the governments and the MNCs. Additionally, the United States wants to apply international law as a guide to company and country action. The Latins tend to view the problem in a narrower national context, wanting only to control the actions of multinational firms and to apply national rather than international law.

35. Subregional groups have also failed in attempts to regulate the activities of foreign investors. Although the original five Andean Pact members formulated a policy covering foreign companies wishing to participate in intra-Pact trade behind a common external tariff wall, the members cannot agree on uniform application of the rules. Bolivia, Chile, and Colombia believe the code is slowing foreign investment. Each member is now applying only those portions of the code with which it agrees, and discussions aimed at modifying the code are being held.

Approved For Release 2000/04/19 : CIA-RDP85T00875R001700070011-1