Journal of Globalization, Competitiveness & Governability / Revista de Globalización, Competitividad y Gobernabilidad / Revista de Globalização, Competitividade e Governabilidade
E-ISSN: 1988-7116

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The Financing of FDI In Latin America*

AREA: 2
TYPE: Specific Cases

La financiación de la IDE en Latinoamérica
O financiamento do IED na América Latina

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Foreign direct investment (FDI) is often seen as a major source of financing for emerging markets in recent years. It is certainly true that FDI provides very important financing for such countries, but the actual financing may be very different from how it is portrayed. For example, about half of FDI flows each year are made up of retained earnings of existing affiliates, rather than new funds inflows. And the financing for other FDI flows may come from local as well as foreign sources. The funds themselves may not even get to the host country. In sum, it is important to understand the financial aspects of FDI, for both policy and strategy reasons, even while the phenomenon itself is primarily a question of the transfer ownership and control of companies to foreign firms.

En los últimos años, la inversión directa en el exterior (IDE) muchas veces se ha visto como una fuente importante de financiación para los mercados emergentes. Es cierto que la IDE proporciona una financiación importante para estos países, pero la financiación real cambia enormemente en función del punto de vista. Por ejemplo, aproximadamente la mitad de los flujos anuales de IDE están formados por ganancias retenidas de afiliados existentes, y no de nuevas aportaciones de fondos. La financiación de otros flujos de IDE pueden provenir de fuentes locales o extranjeras. Los fondos pueden ni llegar al país de acogida. En resumen, es importante comprender los aspectos financieros de la IDE, tanto por motivos políticos como de estrategia, incluso si el fenómeno en sí es fundamentalmente una cuestión de transferencia de propiedad y control de empresas a empresas extranjeras.

O investimento estrangeiro directo (IED) é muitas vezes encarado como uma fonte importante de financiamento para os mercados emergentes nos últimos anos. É certamente verdade que o IED faculta financiamento muito importante para esses países, mas o financiamento real pode ser muito diferente do modo como é retratado. Por exemplo, cerca de metade dos fluxos de IED em cada ano são constituídos por rendimentos retidos de filiais existentes, e não de afluxos de novos fundos. E o financiamento de outros fluxos de IED pode vir tanto de fontes locais como estrangeiras. Os fundos propriamente ditos podem nem mesmo chegar ao país de acolhimento. Em suma, é importante compreender os aspectos financeiros do IED, tanto por razões políticas como de estratégia, mesmo quando o fenómeno em si é antes de mais uma questão de transferência de propriedade e de controlo das companhias para firmas estrangeiras.

DOI
10.3232/GCG.2008.V2.N3.07

* An earlier version of this paper was published as Grosse, R. 2006. The Financing of FDI in Latin America. Journal of Emerging Markets, 11(2): 15-26

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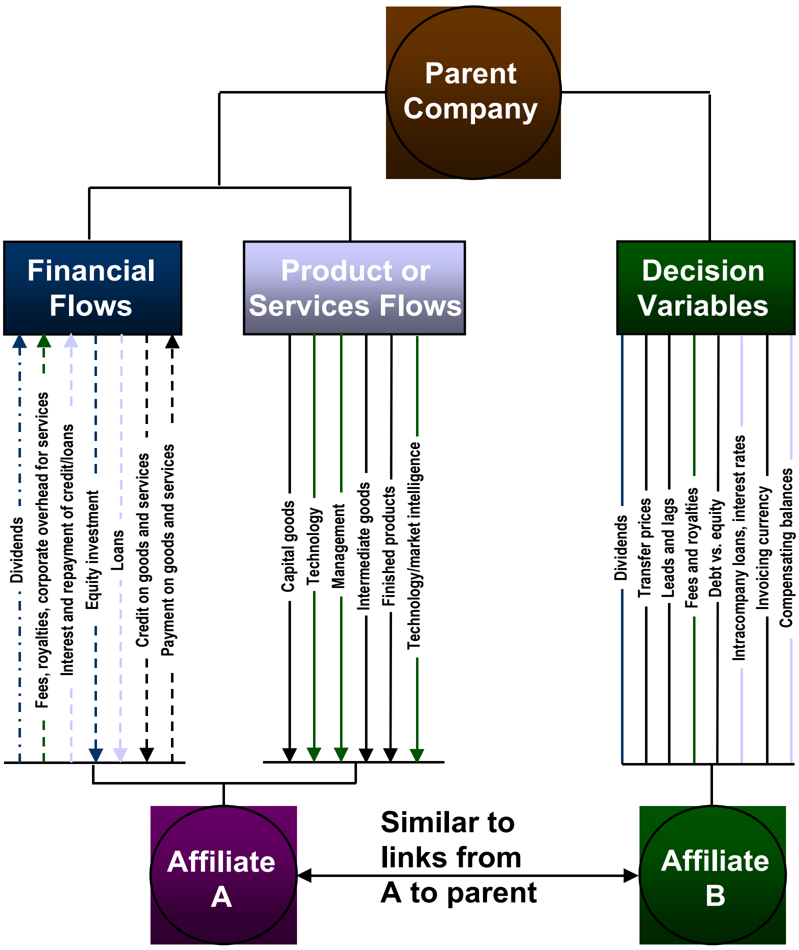
1. The Financing of FDI in Latin America

Foreign direct investment (FDI) has been heralded in recent years as the solution to emerging markets' needs for financial capital, since it is not nearly as volatile as portfolio investment flows or as bank lending, each of which dried up during the Latin American debt crisis of the 1980s, the Tequila Crisis in 1994-5, the Asian Crisis of 1997-8, the Argentine crisis in 2001-3, as well as in the current global crisis resulting from the US sub-prime mortgage defaults. FDI indeed is much more stable than the purely financial flows – a quick look at the evidence shown below in Figure 1 does confirm this fact[1]. But FDI is much more than a financial transfer; it is most importantly a change of ownership and control of productive assets.

Figure 1: Financial Flows Related to Foreign Direct Investment



1. A comparison of FDI, bank lending, portfolio investment, and official financing in emerging markets appears each year in the World Bank's Global Development Finance, http://publications.worldbank.org/GDF/. See Appendix Figure A-1.

Key words

Emerging markets, Foreign direct investment; foreign firms

Palabras clave

Mercados emergentes, Inversión extranjera directa; empresas extranjeras

Palavras-chave

Mercados emergentes, Investimento estrangeiro direto; empresas estrangeiras

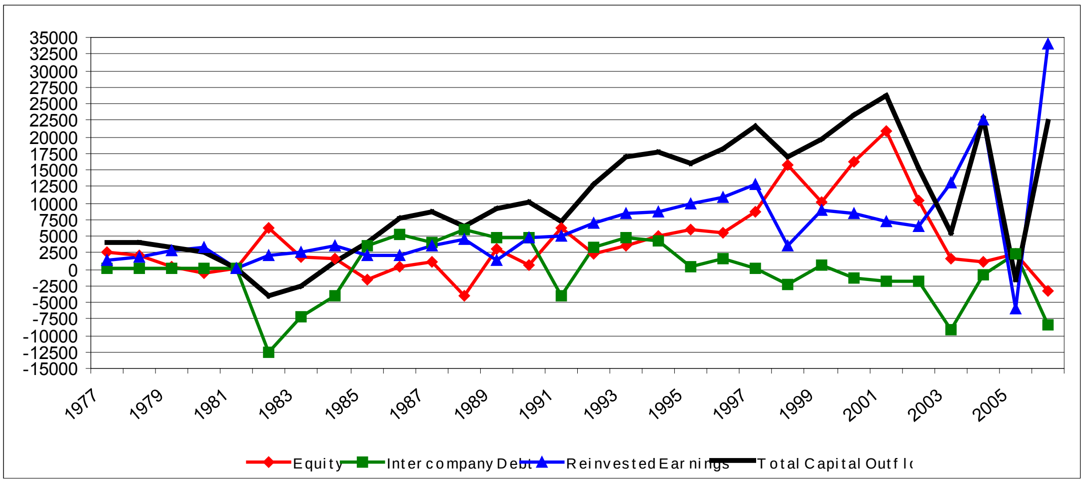
JEL Codes

F200; F230; F300

In fact, we could argue that foreign direct investment is mistakenly viewed as a financial flow, similar to cross-border bank lending or to international bond issue. Seeing FDI as a financial flow is an incorrect perception, since FDI is actually a transfer of ownership and control of a company, which may be financed in many different ways. For example, foreign direct investment in a company owned by local investors in an emerging market may take place by a foreign multinational firm buying the shares of the company and paying the local owners via a wire transfer to a bank in New York. In this way, foreign direct investment in the emerging market occurs, since the company is now owned by the foreign multinational firm, but the financial flow may never get to that emerging market, unless the former company owners decide to transfer some or all of the money to their own country.

The financial impact of FDI is fairly complex. US data show that about half of foreign direct investment in emerging markets is financed from retained earnings of the firms[2]. This implies that the investment is financed by the foreign company itself -- but through earnings generated in the host country. The remainder of the FDI that occurs may be financed by bank borrowing, by new capital invested from the home office, or by other means of obtaining funds, such as bond issuance, local or overseas. Figure 2 portrays this situation, illustrating the lack of direct correspondence between FDI values and financial flows to a host country.

Figure 2: Sources of FDI Increases by US MNEs in Latin America



Values in millions of current US dollars.
Respective "Equity" values already include "Intercompany Debt" values during 1977-81.
SOURCE: U.S. Department of Commerce Web site. "U.S. Direct Investment Abroad."
http://www.bea.doc.gov/bea/di/di1usdbal.htm

Notice that the financial flows cannot even be fully identified in this Figure. For example, the new "Equity" that may be invested in the foreign affiliate can come from the parent company's own funds, or from bank borrowing in the home country or in the host country by the parent firm. Although not common in emerging markets, this means that a parent firm

2. See US Department of Commerce, www.osec.doc.gov, and more specifically http://www.bea.doc.gov/bea/di/di1usdbal.htm.

could actually borrow locally to fund its increase in capital investment in an affiliate. (This is more common for funding FDI that goes into major financial markets such as the US or UK.)

Just as problematic is intercompany debt, which could be funded by bank borrowing that the parent firm undertakes, in the home or host country or elsewhere. When this debt is passed on to the affiliate, it appears to come from the parent. While this is true in a legal sense, the origin of the funds may be a one-off bank loan from any country chosen by the parent firm. The point of this paper is to illuminate the financial flows that are involved with paying for foreign direct investment. The necessary condition for foreign direct investment is for some amount of ownership and some degree of control to be obtained by the foreign company that carries out the investment in a local company, new or existing. There is no necessary cross-border financial flow that must accompany this investment, although typically some amount of funds or other financial value is indeed transferred to the target country where the FDI takes place. While the issue may seem rather insignificant, on the contrary it may demonstrate a major hole in an emerging market country's international financing strategy, since the funding of FDI may come from local sources.

This is all the more important in the early 21st century, when most of worldwide FDI is in the form of acquisitions of existing companies[3]. If foreign direct investors are not setting up new companies, then there should be some concern about what value they are adding to a host country's economy. Since it does turn out that a major part of FDI is funded by MNE resources and not host country resources, the verdict is not a condemnation of MNEs – but the implications for public policy are clearly that host governments should pursue policies that optimize the foreign sourcing of funds for FDI, thus raising the financial spillover of the investment into the host economy.

2. A Careful Dissection of FDI Flows

Foreign direct investment is the purchase of controlling ownership in a company in one country by a company in another country. This simple definition does not capture all of the nuances of FDI that one may wish to explore, but for our financial purposes it is adequate. The purchase of controlling ownership[4] may take place through creation of a new company (i.e., greenfield investment), through the acquisition of an existing company from its previous owners, or through some intermediate step such as formation of a joint venture with a local or a second foreign firm.

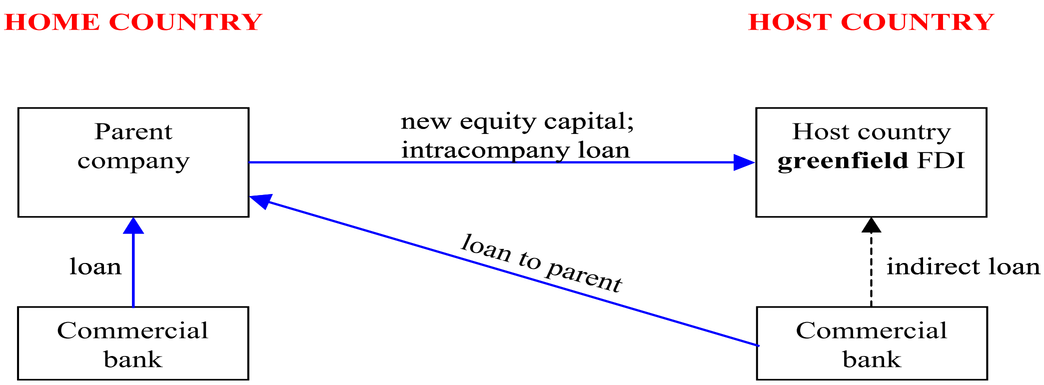
The funds flows associated with this investment may cross national borders or not, depending on the situation. A greenfield investment generally is financed through a transfer of funds in from the home country or from a financial center, although this is not a necessary

3. See, for example, UNCTAD's World Investment Report 2000, which focuses specifically on the issue of cross-border mergers and acquisitions. http://www.unctad.org/Templates/WebFlyer.asp?intItemID=2435&lang=1

4. The purchase of controlling ownership may imply anywhere from a tiny percentage such as 10 percent, all the way up to 100 percent. For statistical purposes, the US Department of Commerce uses the 10 percent figure to classify investment as FDI (if the percentage is 10 percent or higher) or portfolio (if the percentage of ownership is less than 10%.) Conceptually, we are interested in investment that brings the foreign direct investor some degree of control, shared or complete, over the affiliate.

condition. Nevertheless, if the firm does not already have activities in the target country, it is likely that funding will be brought in from elsewhere for the greenfield investment. This simple situation may be complicated when the company has an existing presence in the host country, for example an existing subsidiary in another business or another location within the country. Then it may be decided to use locally-obtained bank financing, or retained earnings from the other affiliate, to undertake the greenfield investment. Figure 3a depicts this situation.

Figure 3a: Alternative Financing Methods for Greenfield FDI

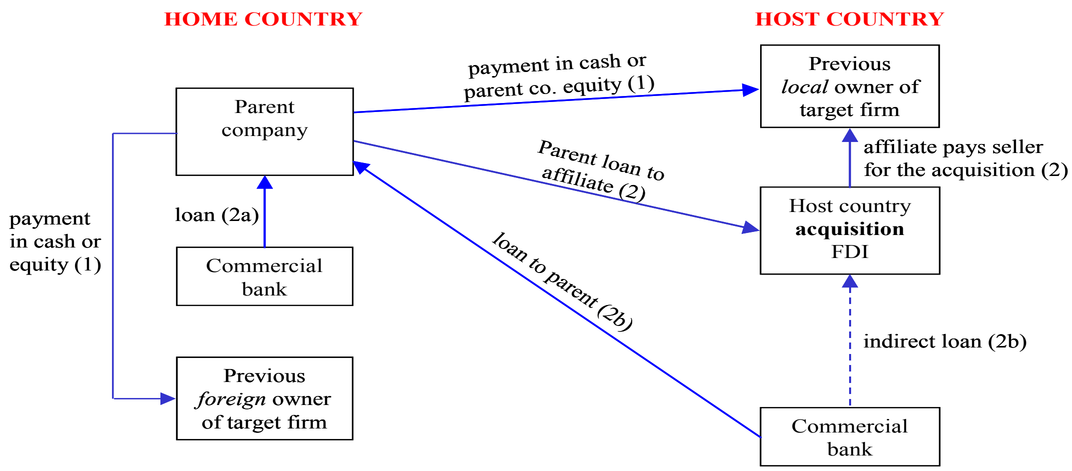


At the other extreme of the investment spectrum, the FDI may be an acquisition of an existing firm. If the existing firm is a local firm, then the FDI may replace local owners with foreign owners. The local owners may be paid in stock shares of the foreign company, and may never bring any of the payment into the host country (other than the shares themselves). The local owners may be paid in cash, which they deposit in an overseas bank account, once again never necessarily bringing any of the funds back to the host country. Or the local owners may be paid in some financial instrument that they do bring back to the host country, and which thus does constitute a financial inflow.

If the acquisition involves one foreign company buying a local affiliate from another foreign company, then the likelihood of funds flowing to the host country is much smaller. The foreign seller may just receive funds or shares in the buyer, or some other security that it accepts as payment, and no new funding may ever enter the host country. This is clearly the least financially attractive kind of FDI from the host country perspective, but it is growing in significance as a type of FDI in the 21st century. According to the United Nations Division of Transnational Corporations, acquisitions accounted for approximately 60% of FDI in Latin America in during the decade 1990-1999[5]. The financing of acquisition FDI is depicted in Figure 3b

5. The percentage of acquisitions in total FDI is far higher in industrial countries, exceeding 90% for the decade.

Figure 3b: Alternative Financing Methods for Acquisition FDI



3. Four Large FDI Examples in Latin America

Some of the interesting and perhaps surprising financial aspects of foreign direct investment in Latin America can be illustrated with specific examples. This section presents four such examples, ranging from an investment that brought 100% of the value into the host country, to another investment in which all of the funds remained offshore. (An FDI project in which one foreign owner buys out another existing foreign owner of a subsidiary technically does not qualify as 'new' FDI, but it is often discussed and presented as if it were an addition to FDI in the host country.)

3.1. Citibank's Acquisition of Banamex (Banacci) in Mexico ($US 12.5 billion)

A very visible foreign direct investment took place in Mexico in 2001, when Citibank purchased Mexico's largest bank, Banamex, and its other financial group divisions including the stockbroker, Acciones y Valores. This total investment was for $US 12.5 billion. It followed a string of foreign bank acquisitions of almost all of Mexico's commercial banks, leaving multinational banks such as Citibank, Banco Santander, HSBC, and BBVA as the largest banks in the country. These various acquisitions of existing Mexican banks were financed in several ways; our discussion here just focuses on the Citibank example.

Citibank already had a major presence in Mexican commercial banking, with its own (limited) branches and clients built up since 1929. In 1998 Citibank acquired a mid-sized Mexican bank, Confia, toward the end of the period of the Tequila Crisis that pushed all of Mexico's domestic banks toward or into bankruptcy. The acquisition of Banamex then put Citibank into a position of leadership in the entire market, with only BBVA (which had acquired Bancomer) in the same size category. Between them, Banamex and Bancomer hold about half of Mexico's financial sector assets and liabilities.

The acquisition of Banamex was financed by a payment of $US 6.25 billion in cash to Banacci shareholders, and issue of $US 6.25 billion in shares of Citigroup to those same shareholders. This means that Citigroup paid $US 6.25 billion in cash to the shareholders of Banacci, those shareholders presumably being mostly Mexican investors, so that the funds went largely to Mexico. The new shares that were distributed to those shareholders also presumably went to Mexico, obviously not as cash, but rather as ownership of shares in the foreign institution, Citigroup[6]. In this situation, most of the financial value of the acquisition was indeed transferred to the host/recipient country[7].

3.2. Telefonica's (Spain) Acquisition of Pegaso PCS in Mexico ($US 884 million)

The telephone company, Telefónica, was one of the first major Spanish firms to launch the 'reconquest' of Latin America, this time by corporations rather than by a political empire. From the end of the 1980s, Telefónica acquired controlling interests in fixed-line and mobile telephone operators throughout Latin America. In 1989, it purchased control of Entel, the national phone company in Chile, and the following year bought controlling ownership in half of the Argentine fixed-line phone company as well. Further acquisitions occurred in Venezuela, Peru, Brazil, and elsewhere, such that Telefónica now has the largest network of telephone operating companies in Latin America.

In 2002 Telefónica, acquired 65% of the shares of Mexican mobile phone company, Pegaso PCS, from a consortium of international investors, including Citibank, Sprint, Leap Wireless, and AIG. This step put Telefónica into second place among mobile phone companies in Mexico, behind Carlos Slim's Telmex, with about 2.5 million customers relative to Telmex's 25 million mobile customers.

The acquisition was paid as $US 70.5 million in cash to the US-based shareholders, plus assumption of approximately $US 810 million in Pegaso's debt. This gave Telefónica 65% of the total shares of Pegaso. The Burillo Group, headed by Alejandro Burillo Azcarraga, the founder of Pegaso, kept its 35% stake in the firm[8]. Telefónica had entered Mexico in 2001, by purchasing four wireless companies from Motorola for US $ 1.8 billion[9]. The transaction described here involved one foreign multinational firm buying out another, with no new financial flows into the host country, except perhaps for post-acquisition investments by the acquirer, Telefónica[10].

3.3. SAB Miller's acquisition of Bavaria in Colombia ($US 7.8 billion)

SABMiller (the merger of South African

6. http://www.citigroup.com/citigroup/press/2001/010517a.htm

7. A similar transaction occurred when HongKong Bank (HSBC) acquired Banistmo, based in Panama, in 2006. This $US 1.77 billion transaction included branches of Banistmo in six Central American countries. The all-cash payment went to the shareholders of Banistmo in Panama. See: http://www.hsbc.com/1/2/newsroom/news/news-archive-2006/hsbc-to-expand-into-central-america-by-acquiring-group-banistmo

8. See, Ayres, Chris, "WIRELESS COMPANY IS CONSOLATION PRIZE", Financial Times Acquisitions Monthly (April 19, 2002).

9. That transaction brought no new funding into Mexico, since it led to the Spanish company Telefónica paying the US-based Motorola for the acquisition.

10. This example is paralleled by a number of others, such as the 2006 purchase by Telmex of Verizon's telephone operations in the Dominican Republic, Puerto Rico, and Venezuela. This $US 3.7 billion acquisition did not bring any new funds into those markets, because one multinational firm (Telmex) just bought out the interest of another (Verizon) in each instance. See: http://search.ft.com/ftArticle?queryText=%22Telefonos+de+Mexico+SA+de+CV%22&page=4&id=060403007556&ct=0&nclick_check=1

Breweries and US-based Miller), ranks second globally behind InBev (the merger of Brazil's Ambev and Belgium's Interbrew) and ahead of Heineken in beer brewing. To begin building a major business in Latin America, SABMiller bought 71.8% of Colombian brewer, Bavaria, in 2005. This purchase was made from majority shareholder Grupo Santo Domingo, Colombia's largest conglomerate.

The acquisition included issue of $US 3.5 billion in shares of SABMiller to Grupo Santo Domingo, along with two seats on the executive board of SABMiller. Santo Domingo owned 15.1 % of SABMiller shares as a result of the transaction. SABMiller also paid $US 2.4 billion in cash to minority shareholders of Bavaria affiliates in Peru and Colombia, and assumed $US 1.9 billion in Bavaria's outstanding debt. The total transaction cost SABMiller $US 7.8 billion, once the additional shareholders in Bavaria were bought out.

This transaction led to shares in SABMiller going to the Colombian group, plus payments of cash to shareholders in Colombia and Peru, and agreement to pay debts of Bavaria in the future – presumably out of Bavaria's future earnings. So, a maximum of $US 2.4 billion of cash went to shareholders in Colombia and in Peru, while another $US 3.5 billion of shares went to Colombia to the Grupo Santo Domingo. Assumption of the existing debt did not give rise to any funds transfer at the time of the acquisition.

3.4. Anglo American's Acquisition of La Disputada Copper Mine in Chile ($US 1.42 billion)

As a result of its decision to exit non-energy businesses, Exxon-Mobil announced a decision to sell its La Disputada copper mine in Chile during 2001. The process took more than a year, and ultimately the South African firm, Anglo American Corp., purchased the mining property for $US 1.3 billion, plus the right to up to $US 120 million of additional payment depending on possible increases in the price of copper. Exxon had purchased the mine in 1978, as part of its diversification strategy into non-energy minerals and metals at that time.

The acquisition by Anglo American was paid in cash, which the firm raised through existing bank lines of credit and from internal funds. The payment was made to Exxon-Mobil outside of Chile, resulting in no cash inflow to Chile from the transaction. (Chile's government did receive a tax payment on the transaction, due to the appreciation of the company's value since Exxon's original purchase, resulting in an inflow of $US 40 million.) Thus, this transaction was essentially the trading of an asset (the copper mine) between two foreign investors, with no new foreign direct investment involved[11].

With the global growth in demand for natural resources of the early 2000s, a number of other mining acquisitions have taken place in recent years in Latin America. In 2007, for example, China Aluminum Company (Chinalco) bought out the Peruvian copper holdings of Canadian firm Peru Copper Corporation, with payment in cash of $US 792 million to the Canadian parent firm. None of these funds went to the target country, Peru[12].

11. See, Johannesburg Stock Exchange, "Anglo American completes acquisition of Disputada", announcement (November 14, 2002). Document jsexch0020021114dybe000ru.

12. See: http://www.forbes.com/2007/06/11/peru-copper-chinalco-markets-equity-cx_af_0611markets10.html

4. A Case Study: FDI in Argentina in the Late 1990s and Early 2000s

Argentina's experience exemplifies that of Latin American countries in general in the last few years. FDI entered the region in large and growing amounts almost everywhere since the beginning of the 1990s. Particularly important in the FDI flows were privatizations and reshuffling of ownership of state-owned enterprises, especially in the electric power, telephone, and other public utility sectors. In Argentina, the national telephone system was sold in two large pieces to consortia including foreign investors (to Telefónica of Spain with partners Bell South, Motorola and Clarín; and to Telecom France with partners STET, JP Morgan and Perez Companq). The electric power generation and distribution systems were sold to various foreign investors, typically with local partners, including major economic groups such as Perez Companq and Clarín.

One very interesting and very visible privatization was that of YPF, the national oil company. The initial privatization was carried out in July of 1993, when YPF was sold in an initial public offering to literally thousands of investors in the open market. The government hired and installed a team of managers who took YPF through a huge and painful restructuring of its business and then the public sale of the company. Once YPF began to operate in the private sector as a listed company, it continued to sell the remaining government shares over time. The privatization itself was not an example of FDI, since foreign investors only purchased small percentages of YPF shares or depositary receipts. However, in 1998, the Spanish oil company, Repsol, decided to purchase control of YPF, and did so by buying 14.99% of YPF shares from the government's remaining 20% stake, so that Repsol obtained controlling interest in YPF at that time for a price of $US 2.01 billion[13].

In mid-1999 Repsol raised its stake in YPF to 97.5%, by making a tender offer for all the ADRs in New York and GDRs in London, along with shares in the Buenos Aires stock exchange, that it did not already own. The total cost of this tender was $US 13.1 billion. These share acquisitions were financed by Repsol borrowing through a bridging loan in the euromarket ($US 9 billion), in addition to issuing Eurobonds for a total value of € 5.65 billion (at the time, worth $US 6.27 billion). The bridge loan was retired through the Eurobond issue and a subsequent equity issue of € 5.655 billion in June of 1999[14].

The net result of these purchases made Repsol the owner of almost 98% of total outstanding YPF shares, with only small shareholdings outstanding to investors who failed to participate in the tender offer in 1999. The total foreign direct investment replaced portfolio investment by those investors who had purchased ADRs or GDRs back in 1993, accounting for about 40% of total YPF shares. These investors probably did not reinvest their funds in Argentina once they sold their depositary receipts to Repsol, so no new investment went into Argentina at that time[15]. That is, the investors in New York and London who had originally purchased shares of YPF in the ADR and GDR offerings there chose to sell those shares to Repsol, thus receiving Repsol's cash, but not (necessarily) sending any funds to

13. The transaction was actually completed on January 20, 1999.

14. ABN/AMRO analyst report, "ABN/AMRO Oil & Gas Sector Report", Repsol, 1999. p. 53. Also described in Repsol/YPF Form 20F filed with the US Securities and Exchange Commission, 1999.

15. Of course, the original portfolio investment in the ADRs or GDRs was an international investment, bringing new funds into Argentina to pay for the depositary receipts. Those flows were recorded in 1993, and did not appear subsequently in the 1999 FDI process.

Argentina. All that happened was a change of foreign owners of those shares – but the new foreign owner was a direct investor rather than a portfolio, passive investor. This accounted for approximately $US 10 billion of the total direct investment by Repsol, and thus for no new money coming into the country. The shares that were purchased from shareholders in the Buenos Aires stock exchange (about $US 3 billion of the total) did likely bring new funds into Argentina, assuming that the sellers kept the funds in the country.

The purchase of the government's shareholdings in 1998 did imply direct financial transfers from abroad to Argentina, as Repsol paid the government for those shares and financed the purchase with funds from abroad. This $US 2.01 billion thus was a transfer of funds to Argentina, different from the bulk of the investment.

4.1. Some Additional Argentine Examples

To give a broader picture of FDI into Argentina in the late 1990s and early 2000s, a handful of examples were pursued in more detail through interviews with company executives. They include an energy company with existing business that it built up through an acquisition; a telecom company that entered the market for the first time; a pharmaceuticals company with long experience in Argentina; and a bank that had entered Argentina in the early 1990s.

The energy company entered Argentina long ago, and had used retained earnings to build its FDI in the country over time. When a specific acquisition was undertaken in 2001, the $US 60 million needed to finance this increase in FDI was obtained through bank borrowing. The borrowing was done through a commercial bank loan in the Bahamas, where tax treatment allowed the full interest expense to be realized by the parent as an operating cost, and no interest withholding tax was involved. The borrowing was at a low interest rate in dollars, which also was attractive to the firm. So, in this case, the FDI was financed through foreign bank borrowing, in which a total of $US 60 million was brought into Argentina in the form of a loan payable to that foreign bank in Nassau.

Another case of FDI into Argentina was a telecom company that entered in the mid-1990s, as with most foreign telecom investments in Latin America. The state-owned telephone monopolies were privatized throughout the region during that decade, and additional foreign firms entered as well, especially in the cellular telephone business. In this instance the firm invested more than $US 1 billion to set up its greenfield investment. Approximately half of the funds came from an equity injection and the other half from international bank borrowing by the parent. Thus, the entire investment constituted a capital flow into Argentina. (Parenthetically, the debt financing turned out to be very burdensome, since the affiliate has yet to make a profit, but the interest payments must be made in any event.)

The pharmaceuticals company had a long history in Argentina, operating both formulation plants (that produce final drugs formulated into pills, liquids, powders, etc.) and a local distribution network. The company had acquired several local and foreign firms in Argentina in recent years. Two of these acquisitions were for $US 80 million and $US 50 million. In both cases the parent pharmaceuticals company borrowed the funds from a commercial bank in Nassau and then re-loaned them to the subsidiary in Argentina. Debt service was thus from the Argentine affiliate to the parent, and then on to the bank in Nassau. This funding enabled the Argentine affiliate to obtain a much lower interest rate than borrowing locally in Argentina, and the parent chose debt rather than equity to carry out the acquisitions.

The commercial bank was one of the several foreign banks that have essentially taken over the Argentine financial system since the early 1990s. It initially invested in Argentina by buying controlling interest in one of the local banks. The foreign bank subsequently, in the late 1990s, bought 80% of one of the largest local commercial banks, in three separate transactions worth a total of about $US 1.4 billion. These transactions were financed approximately half by a foreign bank loan and the other half by issuing new shares of stock in the parent bank. In each case the funds/shares were paid to the local business group that owned the bank.

This direct investment into Argentina demonstrates the common characteristic that it has been done through acquisition of existing firms in the country for the most part. It is also quite indicative of the ways in which FDI was financed in the late 1990s and early 2000s, namely through foreign bank loans, through issue of new equity in the parent firm, through purchase of existing stock shares in the open market, and occasionally through direct internal funding from the parent. The particular projects described above were not simple expansions of existing activities in Argentina, which often were funded through retained earnings, but rather they were new ventures. And finally, it bears repeating that these investments were largely made by companies with existing operations in Argentina; FDI by large companies around the world is much more frequently into countries where they already operate, rather than into new, unexplored markets.

5. Lessons

A key reality concerning FDI into Latin America, and in general in the 2000s, is that it is not greenfield investment in new businesses, but largely it involves acquisitions of existing businesses by foreign investors. Many times the investment is a kind of portfolio adjustment, in which one investor trades an asset (company) with another. For example, one international telephone company decides to expand, while another decides to contract in a particular country, so the first one acquires the business of the second one. And as a result of this ownership-shifting, it turns out that frequently little or no new funding comes to the country in which the FDI takes place. The table below summarizes the examples presented in the text above.

Table 1: Some Major FDI Projects in Latin America in Recent Years

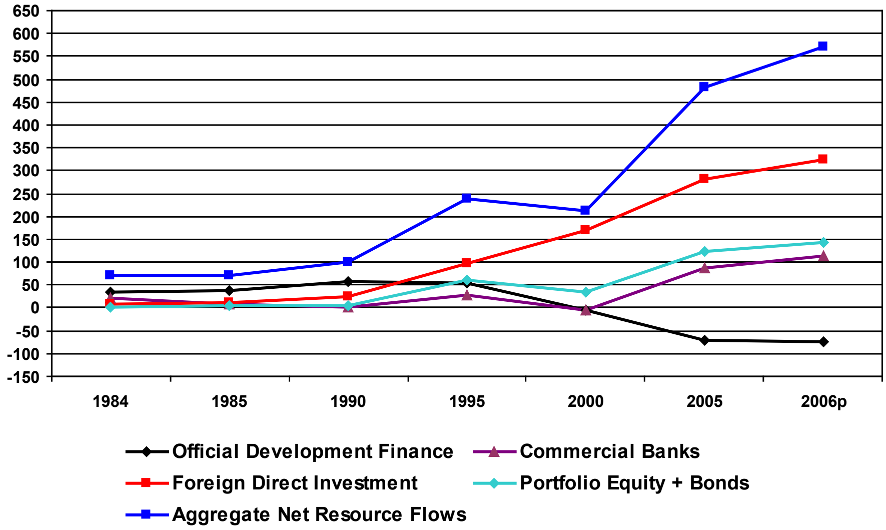
Country/year	Acquirer/acquiree	Value of transaction	Funds flows into host country
Argentina/1999	Repsol/YPF	$US 13.1 billion	$US 3.0 billion
Mexico/2001	Citigroup/Banacci	$US 12.5 billion	$US 6.25 billion
Colombia/2005	SABMiller/Bavaria	$US 7.8 billion	approx $US 5.9 billion
DR,PR,Ven/2006	Telmex/Verizon	$US 3.7 billion	0

Panama/2006	HSBC/Banistmo	$US 1.77 billion	$US 1.77 billion
Chile/2002	Anglo American/ Exxon	$US 1.42 billion	0
Arg 1999	bank	$US 1.4 billion	$US 700 million
Argentina/2002	Petrobras/Perez Com-panq	$US 1.08 billion	$US 689 milllion
Arg mid-1990s	telecom	$US 1.0 billion	$US 1,000 million
Mexico/2002	Telefónica/Pegaso	$US 884 million	0
Peru/2007	Chinalco/Peru Copper	$US 792 million	0
Brazil/2002	Telmex/Telecom Ame-ricas	$US 556 million	$US 200 million
Arg 2000	pharmaceuticals	$US 130 million	$US 130 million
Arg 2001	Energy	$US 60 million	$US 60 million
Totals	---	$US 46.7 billion	$US 19.7 billion (42%)

Notice that of about $US 47 billion of FDI that took place in these examples, less than half of this investment actually brought new funds into the receiving country. Almost two-thirds of the FDI was financed by purchase of existing shares from other foreign shareholders, or by transferring shares of the investor's home-country company to the sellers of the affiliate company in Latin America.This means that simple data on foreign direct investment as a financing source for economic development need to be interpreted with great care. If these data are representative of FDI in general in Latin America, then the overall amount of funding coming into the region is far less than it appears. This is not a criticism of the investors, but rather a criticism of the over-simplifiers who mis-state the financial impact of FDI on host countries.

Another feature of FDI -- not evident from the discussion of companies above -- is that about half of it comes from retained earnings of the MNE affiliates. As noted earlier, Figure 4 shows that a very large part of the value of FDI, approximating one-half on average, is simply funds reinvested in existing affiliates. These are not new funds entering the country, but rather existing funds which are the earnings of local affiliates of MNEs that are not sent abroad. On an aggregate basis, this amount has to be considered as fundamental to interpreting the financial flow impact of FDI. Half of the value of annual FDI is thus coming from local sources (i.e., retained earnings of local affiliates) – though it could be considered as funding that would not have existed if the MNEs had not operated those businesses locally. Alternatively, one could argue that local firms might have undertaken the same investment themselves, and that FDI is just replacement of local investment. This replacement argument has been fairly widely rejected, in surveys of direct investors and in studies of aggregate investment activity. In sum, the importance of retained earnings as a financing source for FDI should not be ignored.

Figure 4: Funds Flows to Emerging Markets



Source: World Bank, Global Development Finance 2007 & World Debt Tables
http://siteresources.worldbank.org/INTGDF2007/Resources/3763069-1179948748801/GDF07_completeFinal.pdf

For foreign direct investment to have the greatest financial impact, it must be financed from abroad, and it must involve new (greenfield) investment or replacement of local investors with foreign investors, rather than just trading assets between foreign investors. Whether or not this happens is an empirical question, but for public policy the answer is to push direct investors to bring in new funds when possible. Foreign direct investment clearly is a major source of foreign finance for emerging markets in the early 2000s. Its impact may be much more important in transferring skills and knowledge than in finance, but the financial part of the picture merits careful examination and evaluation.

Foreign direct investment is an especially desirable form of financial flow, because it involves generally a long-term commitment to a country. That is, direct investors do not close down their operations (usually) when rates of return increase in some other country, or when a devaluation of the currency makes returns (temporarily) less attractive. These kinds of decision often are made by portfolio investors ('hot money' investors). Even foreign bank lenders tend to reduce funding to countries facing financial difficulty, where loan repayments might be affected; whereas foreign direct investors tend to remain in markets for the long run. Figure A-1 demonstrates the stability of FDI flows relative to these other sources of foreign finance in emerging markets.

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