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LATIN AMERICAN ECONOMIC PERSPECTIVES WITH SPECIAL REFERENCE TO FINNISH INTERESTS AND OPPORTUNITIES

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Abstract: In the 1990's, economic conditions have become substantially better in South America. Many countries in the region have opened their trade policies and privatized their economies. The prospects for growth during the next decade appear encouraging. This, however, will require national and foreign investments beyond current levels.

Both the European Union countries and Latin America are implementing measures to increase their mutual economic relations. Finland, like the rest of the EU countries can turn what were previously regarded as marginal economic relations with Latin America into profitable operations. Interviews in Finnish companies and conversations with people from various fields in Latin America showed that there is a growing interest towards expanding economic relations. There is, however, a need for more information on the economic opportunities for Finland and Latin America.

Keywords: Latin America, Finland, economic relation, investment, integration, structural changes, natural resources, mining.

Tiivistelmä: Etelä-Amerikan taloudelliset olosuhteet ovat kehittyneet suotuisaan suuntaan viimeksi kuluneiden seitsemän vuoden aikana. Useat alueen maista ovat vapauttaneet kauppapolitiikkaansa ja yksityistäneet talouttaan. Seuraavaa vuosikymmentä koskevat taloudellisen kasvun näkymät ovat rohkaisevia. Niiden toteutuminen vaatii kuitenkin nykyistä suurempia sekä kansallisia että ulkomaisia investointeja.

Sekä Euroopan unioni että Latinalaisen Amerikan maat toteuttavat parhaillaan toimenpiteitä, jotka lisäävät näiden alueiden keskinäistä taloudellista vuorovaikutusta. Suomi voi muiden EU-maiden mukana kohottaa aikaisemmin varsin marginaaliset taloussuhteet tuloksellisiksi ja kannattaviksi liiketoimiksi. Haastattelut sekä suomalaisissa yrityksissä että useiden eri vaikuttajatahojen kanssa Latinalaisessa Amerikassa osoittivat kasvavaa mielenkiintoa laajentuviin taloussuhteisiin. Kuitenkin tarvitaan huomattavasti lisää tietoa ja asiantuntemusta taloudellista mahdollisuuksista sekä Suomessa että Latinalaisen Amerikan maissa.

Asiasanat: Latinalainen Amerikka, Suomi, taloudelliset suhteet, investoinnit, integraatio, rakennemuutos, luonnonvarat, kaivostoiminta.

FOREWORD

Since its establishment, the Government Institute for Economic Research, VATT, has focused research activities "on identifying long-term growth factors in the Finnish economy and the challenges posed by internationalization". Through contact with diverse groups of the public and private sectors in Finland, VATT's management identified the need for the provision of information on the socio-economic and sectorial conditions of selected South American countries from the perspective of Finnish interests and opportunities.

VATT's proposal in this particular project, commissioned by the Ministry of Trade and Industry, was to make use of the experience of the report's author, in order to design innovative cooperation projects to increase the presence of Finland in South America.

The research work has been carried by Gonzalo Oroza collaborated by researchers Piroska Borsos (Ministry of Finance) and Kalle Laaksonen (Pellervo Economic Research Institute). Markku Tapio, from the Ministry of Trade and Industry participated in the chapter on privatisation. Antti Romppanen (VATT) and Severi Keinälä (Confederation of Finnish Industry and Employers) read the manuscript and made useful comments.

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Reino Hjerppe

ETELÄ-AMERIKAN TALOUDELLISET NÄKYMÄT OVAT ROHKAISEVIA

Latinalaisen Amerikan maiden uuden talouspolitiikan mukaisesti alueen maissa pyritään parantamaan valtiontalouden tasapainoa sekä kehittämään taloutta markkinatalouden suuntaan. Yksityistäminen, valtiontukien, ulkomaankaupan tariffien ja kiintiöiden poisto sekä vakautta luova lainsäädäntö ja hallintouudistukset ovat keskeinen osa politiikkaa, jolla luodaan poliittiset ja taloudelliset olosuhteet houkutteleviksi sekä kotimaisille että ulkomaisille investoinneille.

Maailmanpankin mukaan Latinalaisen Amerikan taloudellisen kasvun näkymät ovat lupaavia. Kasvu voi seuraavan vuosikymmenen aikana olla jopa 6 prosenttia vuodessa. Korkean taloudellisen kasvun aikaansaaminen edellyttää kuitenkin hintakehityksen vakautta sekä ulkomaankaupan tasapainon vahvistumista. Lyhyellä ja keskipitkällä aikavälillä haasteet ovat kovat. Useimmat maat ovat velkaantuneita ja maiden sisäistä tasapainoa rasittavat jyrkät tuloerot, minkä seurauksena köyhyys on edelleen suuri ongelma. Suotuisen kehityksen turvaaminen edellyttää voimavarojen suuntaamista infrastruktuurin kehittämiseen, työvoiman koulutukseen sekä kansainvälisen kilpailukyvyn parantamiseen.

Etelä-Amerikan taloudelliseen kehitykseen vaikuttaa tulevaisuudessa yhä enemmän integraation eteneminen, erityisesti MERCOSUR-alueen kehitys. MERCOSUR-markkina-alueen kehityksessä otetaan oppia Euroopan unionin yhdentymisestä, ja yhteistyö näiden maaryhmien välillä on tiivistymässä.

Suomalaisten yritysjohtajien näkemyksiä liiketoiminnasta Etelä-Amerikassa

Suoritetun haastattelukierroksen yhteydessä kävi selvästi ilmi, että yritykset ja yritysjohtajat, joilla on kokemusta liiketoiminnasta Etelä-Amerikassa, ovat panneet merkille alueen maissa ja maiden harjoittamassa talouspolitiikassa tapahtuneet suuret muutokset. Muutokset ovat synnyttäneet positiivisia odotuksia sekä suotuisan talouskehityksen että liiketoiminnan laajentamisen suhteen.

Muutaman vuoden suotuisa kehitys ei yritysjohtajien mukaan ole luonnollisestikaan ehtinyt poistaa kaikkia ongelmia tai liiketoiminnan esteitä. Alueen perusongelma on edelleenkin köyhyyden hidas väheneminen, mikä ylläpitää mahdollisuutta yhteiskunnallisten levottomuuksien syntymiseen.

Muita keskeisiä ongelmia ovat muun muassa viranomaisten päätöksenteon hitaus ja byrokraattisuus, markkinoiden suhteellinen sulkeutuneisuus; esimerkiksi Brasilian markkinoille pääseminen ei ole helppoa, sekä projektien rahoitusvaikeudet.

Kokemuksen perusteella yritysjohtajat korostivat muun muassa seuraavien seikkojen tärkeyttä pitkäjänteisen liiketoiminnan kannalta:

- paikallisen kielen, kulttuurin, liiketapojen ja yleensä tapakulttuurin tuntemus,
- huolimatta siitä, että alueen liiketoimintakulttuuri on joskus spontaania ja lyhytjännitteistä, pitkäjänteisen ja menestyvän toiminnan edellytyksiä ovat hyvät ja kestävät suhteet paikallisiin asiakkaisiin ja yhteistyökumppaneihin; paikallistuntemuksen merkitystä ei siten voi ylikorostaa,
- vaikka suomalaisilla yrityksillä on periaatteessa hyvät mahdollisuudet tulokselliseen toimintaan useilla aloilla, voi menestyksen aikaansaaminen viedä aikaa. Sen vuoksi olisi toiminnan oltavat riittävän pitkäjänteistä ja toiminnasta vastaavien henkilöiden riittävän pitkään sitoutuneita hankkeisiin.

Etelä-amerikkalaisia näkemyksiä tulevaisuuden yhteistyömuodoista ja -alueista suomalaisen liike-elämän kanssa

Viidessä Etelä-Amerikan maassa, Argentiinassa, Chilessä, Perussa, Paraguayssa ja Boliviassa haastateltujen yritysjohtajien ja talouden muiden intressiryhmien edustajien näkemykset alueen taloudellisesta kehityksestä ja harjoitetusta politiikasta olivat hieman ristiriitaisia. Valtaosa haastatelluista kuitenkin piti valittua linjaa väistämättömänä ja välttämättömänä suotuisalle talouskehitykselle ja myös köyhyyden vähentämiselle. Talouspolitiikan omaksuttu peruslinja on siten vähitellen vakiintumassa alueen maissa.

Suuri osa haastatelluista (102 henkilöä) ei ollut aikaisemmin ollut tekemisissä suomalaisen liike-elämän kanssa, ja myös informaatio Suomesta ja Suomen talouden mahdollisuuksista oli suhteellisen niukkaa. Pohjoismaista tunnettiin Ruotsi ja ruotsalaiset tuotteet selvästi parhaiten.

Suomalaisten hyvä teknologiaosaaminen on jo osittain tunnettua myös Etelä-Amerikassa. Haastateltavat uskoivatkin taloudellisen yhteistoiminnan laajenevan aloilla, joilla voidaan soveltaa suomalaista osaamista; muun muassa metsäsektorilla, kaivostoiminnassa, kalateollisuudessa, ympäristötekniikassa sekä infrastruktuurissa.

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EXECUTIVE SUMMARY

Economic Prospects for South America are Encouraging

1. The political and economic transformation in Latin America started before the collapse of the centrally planned economies. Governments in the region initiated a pragmatic process towards an open and market-friendly economic system. The new policies included two main aspects; attaining equilibrium in government finances and making the structure of economies more responsive to market forces.

Privatization, removal of subsidies, tariffs and quotas on foreign trade and reforms of legal systems have had a central role in improving the attraction of domestic and foreign investment. Governments have been encouraged in their policies to correct a state-dominated and closed model by the events in eastern Europe. It would have been difficult to believe in the 1980's that Latin America's growth would be among the fastest in the world in the 1990's.

Over the next few years, Latin American countries are expected to deepen the process of privatization, deregulation and trade liberalization. However, not all of the challenges facing the governments are completely under their control. For example, the receptivity of the industrialized countries, particularly United States and the European Union, to the proposals for debt reduction and new credit flows, as well as for freer and increased access for the region's products to their markets is difficult to predict. Despite some progress in servicing debts, the region is still one of highest burdened in the world, at the end of 1997.

2. In the short term, the crucial question is how to maintain both price stability and a sustainable balance of payments position while growing at sufficiently high rates to reduce poverty. Growth has been too slow in several countries to improve the situation of the poor or to increase employment opportunities for the expanding population, specially in urban areas, or to stimulate new productive investments and commercial activities.

3. According to the World Bank, Latin America has the potential to reach an average annual growth of around 6 per cent over the next decade. To achieve such a sustainable growth, accumulation of capital and labour has to be complemented by development of infrastructure, education of the labour force, strengthening of international competitiveness and reduction of the uneconomic enterprises of the public sector.

A significant factor which will influence the performance of the economies in the region is the possibility of gaining access to modern technologies and know-how on terms that will facilitate further restructuring of production patterns so as to achieve long-term international competitiveness.

Latin American countries will face numerous challenges during the next decade and beyond:

- Despite a generally strong recovery of domestic investment in most of Latin American countries, savings and investment remain too low to generate sustained economic growth. In the longer term, higher investment requires higher domestic savings; the region cannot rely on foreign capital alone.
- There is a need to consolidate the reform process with the aim of creating a framework that will allow investors and workers to operate efficiently to compete in the world economy. The new reforms will have to improve microeconomic incentives for the most dynamic sectors of the economy.
- A sustainable growth depends mainly on larger exports and access to markets in the rich countries.
- Reforms will have to deal with investment in education and human resources, reducing inequality of income distribution, improving infrastructure, modernization of the state and control of corruption.

4. Privatization has been an important instrument of economic policy in both developed and developing countries, as well as in the countries in transition. Different countries have had different priorities in their privatization objectives. In Latin America privatization has usually been a part of a wider economic strategy based on the trade liberalization model. As a consequence of economic crisis in the course of the 1980s Latin America turned toward economic reforms which included opening up economies to foreign trade and investment, reducing the role of the government, promoting new exports and taking steps against inflation. This calls for further structural adjustments.

5. When 34 leaders of the continent met in Miami, for the December 1994 Summit of the Americas, a central agreement was reached which would affect the region in the years to come. The accord includes the objective of establishing a hemispheric free trade area guaranteeing sustainable development which conserves the environment. Meanwhile the regional integration processes will continue and strengthen. In South America the most important is Mercosur, with Argentina, Brazil, Paraguay and Uruguay as full members and Bolivia and Chile as associated members.

Mercosur is the world's fourth largest integrated market. The integration process is most dynamic in the industrialised area of Mercosur that runs in the form of a banana from Rio de Janeiro to Santiago, passing through Sao Paulo, Curitiba, Porto Alegre, Montevideo and Buenos Aires. The area has a population of 120 million people with a GNP per capita of above USD 8000. The population is highly concentrated in big cities, from which three have over 10 million people and ten over one million. This area has the same size as the four Nordic countries - Finland, Sweden, Norway and Denmark - together, with a GNP per capita far above that in Eastern and Central Europe, greater than in Greece and around the same as in Portugal.

Mercosur is far from being a real common market, but member countries have committed themselves to continuing negotiations aimed at full common market institution by the year 2006. This long-term objective includes the free movement of labour and capital between the Mercosur countries. They will also have to coordinate their economic, legislative, environmental and infrastructure and technology policies.

6. The great majority of the Latin American countries currently represent increasing investment opportunities. Investment conditions have drastically changed in the region due to the introduction of flexible regimes facilitating the repatriation of benefits and the massive incentives of participating in the privatization of state enterprises. The positive business climate is reflected in the growth of foreign investment, though with ups and downs like in most emerging markets worldwide where potential returns and risks can be very volatile.

7. Consolidation of democracy and economic recovery have received recognition from the European Union, so that a more dynamic approach from the EU and from the governments and enterprises of member countries is being gradually implemented.

Europe and Latin America are highly complementary in economic terms. Relative factor endowments have always pointed to a high potential for specialization based on comparative advantages: Latin America in land and other natural resource-intensive products such as agricultural raw materials and minerals, and Europe in capital-intensive, high technology industrial products.

Latin America has partially satisfied European need for raw materials, while offering attractive, and now fast growing markets for Europe's consumer and capital goods exports. Cultural affinities, similarity of tastes and understanding of each other's needs imply potential for intensive cooperation between these two areas in the economic, social and political spheres.

Finnish Business and Prospectives in South America

8. Interviews with executives of 20 medium and large-size Finnish enterprises were conducted between December 1996 and March 1997. The interviews were informal and emphasis was given to experiences and present opportunities of making business in Latin America.

The sample of executives was too small for analytical purposes, but some central ideas and opinions can easily be detected. One of these unanimously accepted view is that the whole Latin America's and South America's business environment has improved rapidly during the 1990's.

The main arguments in comparing the region's past and present conditions from the perspective of interests and opportunities for their enterprises were:

Past:

- Political instability scared investors; democratic institutions were more an exception than a rule.
- Economic conditions were unstable; inflation had devastating consequences in several countries.
- Repatriation of foreign investment benefits was not free; investors had not constitutional guarantees for their operations.
- Local markets were closed or discriminatory for certain countries and products.
- Trade obstacles, such as high tariffs and varying trade taxes depended on temporary political changes.
- Finnish trade objectives were planned for the short-term.
- South America was considered geographically remote from Finland.
- Trade risks were high - and financial guarantees were difficult to get.
- The languages and cultures of the region were considered distant to the Finnish mentality. High school programmes did not include systematic teaching on Latin America.
- Economic relations consisted, for the most part, of simple import-export agreements.

Today

- Democratically elected governments in all South American countries.
- Progress of the democratic process in most public and private institutions, though the process is still in an initial phase.
- European Union's and Latin America's political, economic and cultural relations are expanding to a great number of activities.
- Finnish government's interest in the region has clearly grown during last years.
- Globalization, Finland's EU membership, education programmes, expanded knowledge of spanish and portuguese, and advanced communication systems have rapidly brought South America nearer to Finland.
- Economic policies have become sound and more stable, long-term business commitments in the region are possible, low inflation rate.
- South America has opened its rich and varied natural resources, (energy, minerals, fertile lands, fishing, forests) to foreign investment.

- Finnish enterprises rate the region at a par with huge potential markets, particularly in the Mercosur region.

What has not changed

The great majority of interviewees consider that the most salient unchanged negative feature affecting business interest in the region is the slow progress in poverty reduction, and as a consequence the situation hides a potential factor of social unrest.

- As in the past, a complicated and vast bureaucracy is still prevailing in the region.
- Markets are not equally open; especially Brazilian markets are considered very difficult to enter.
- Projects' financing continues to be a difficult issue.

9. Most executives had detailed information on the major reforms which took place at the end of the 1980's and early 1990's, when the countries of the region confronted high inflation, debt crisis and stagnation. In their opinion, reform programmes have been successful in reestablishing access to international financial markets and establishing an environment which is more conductive to economic growth and will permit a sustainable development in the longer term.

A minority of interviewees do not feel fully confident with the economic prospects of South America and the effectiveness of the reforms. They consider that the region's early stages of rapid economic growth this decade were due to the boom phase of adjustment policies - mainly reflecting elements which are not a real indication of the rate of growth in the longer term.

10. There are some basic principles that need to be learned before even considering business operations in the area:

- The understanding of local languages, culture, business customs and local habits is decisive for the successful everyday management of a business.

- Success demands reliable and regular contacts with local producers and clients. The business culture is sometimes spontaneous and short-termed. The formation of long-term contacts demands patient work.

- Finnish enterprises have good opportunities in the region, but they have to take into account that starting there is not easy. Instead of complaining on local difficulties they have to enter local markets and look for solutions there. Finnish personnel has to be prepared to stay in the region for at least five years.

- Most difficulties faced by foreign enterprises can be expected from local bureaucracy; particularly in the smaller economies with low level of institutional development. This is not the case in Chile or Argentina where institutional level is comparable to that of the Nordic countries.

11. Mercosur was cited, by all the interviewees, as the most attractive region from the perspective of Finnish industry interests and opportunities in South America.

Brazil was placed as the most promising market area for Finnish investments and operations. Brazilian economy inspires strong confidence in the future and most interviewees believe that the country is emerging from a long period of economic difficulties to a period of steady growth.

Chile inspires the biggest sympathies among interviewees. Chile was also the best known of the South American countries. Chile's business environment is perceived as the most "European" and best organized in the region. A general comment was that Chile's well functioning infrastructure makes the country a preferred partner.

Argentina was placed in the third position according to the interest of interviewees. Like Brazil, Argentina awakes contradictory views among interviewees. It was generally recognized that the government has a strong commitment with economic stability and has succeeded in reducing inflation rate. Argentina's monetary and fiscal discipline was also distinguished. The most important reason that makes Argentina an interesting country in the view of Finnish enterprises is, however, that local market is very large and dynamic and provides access to Mercosur.

Bolivia, Peru and Paraguay were not placed as first priorities for Finnish enterprises. Peru and Paraguay are not perceived by Finnish enterprises as politically stable countries and infrastructure underdevelopment in Bolivia diminishes investment interests and opportunities in diverse sectors of industry. Expansion of activities in those three countries will follow naturally the strengthening of economic relations with the South American larger economies. "After all, we can not forget that Bolivia's and Peru's natural resources are among the richest and most varied in the world".

12. The answers to the question; what do you think is the most relevant characteristic of the Finnish industry to cooperate with South America?, were unanimous: Finland has become a modern industrial economy during a very short period after the Second World War. A dynamic metal and engineering industry developed parallel to the strong forest industry. All this was possible due to the existence of rich natural resources, forests and minerals, in Finland's territory. South America is blessed with the richest natural resources in the world. Finland has the technology to create value added from these resources and to participate in the industrial expansion of this part of the world.

Finnish state export credits and guarantees to South America were perceived as very expensive. A majority of the sample's enterprises use export credits from international organizations. Finnish credit and guarantee mechanisms were criticized for their inflexibility and unchanging practices in connection to the new economic situation in the emerging economies of Latin America.

In order to promote Finland's export activity to South American countries, the sample's enterprises argued in favor of a more dynamic attitude from the part of the Finnish Foreign Trade Association. This institution should, according to the unanimous opinion of the sample's executives, strengthen its activities there and increase the number of trade commissioners or market officers in the big cities of the area.

13. Interviewees, without exception, consider that bilateral official assistance programme has to be reinforced with a longer term vision. Although they recognized the significance of the European Union assistance programme, interviewees emphasized Finland's bilateral aid as a necessity in the relations with poorer regions of South America. Unanimously, the sample's executives responded that humanitarian aid activities have to be continued and view that active involvement of the state contributes decisively in the creation of Finland's positive image in South America.

14. Interviewees had a general knowledge and a diffuse interest on the European Union's Latin American strategy and policies, but surprisingly, they knew very little about the Union's finance mechanisms and instruments at their disposal when planning investment and trade expansion to the area.

South-American Opinions about the Future of the Region and on Co-operation with Finnish Business Sector

15. During his visit to five countries in South America, the researcher had the opportunity to discuss with more than one hundred of persons belonging to a diversity of occupations about the future of the region and business relations with Finland.

Opinions about the market-oriented economic reforms made during the last fifteen years in most countries in Latin America differ. Persons working in high positions of the private sector and owners of small-and medium size enterprises (SME), unanimously agree that the economic and social reforms in their countries are an indispensable process. Eighty per cent of the high governmental officials are strongly in favour of the reforms while twenty per cent support the process with reservations. As a group, those most opposed to the whole reform process were trade union representatives.

A clear majority of interviewees agreed that the main economic and social problem in Latin America is how to accelerate growth and, at the same time, improve social conditions of the people. Most groups of the sample considered that ensuring economic and investment growth should reduce poverty and keep unemployment level low. Only trade union representatives and one third of the researchers were skeptic on that remedy.

16. Opinions on privatization process follow a very similar distribution compared with those referring to the main results of the structural changes in Latin America. A slight difference is that almost one third of those persons working as government officials do not support privatization without reservations. Two thirds, however, believe that privatization will promote growth and increase productivity, reduce costs and encourage the opening of markets.

Private sector representatives are unanimously in favor of the privatization process. For them privatization means the creation of genuine competition that has resulted in greater investments and lower prices for consumers. In the longer term it will create more jobs because privatized companies tend to have better access to capital and they perform more efficiently.

Trade union leaders and members are strongly against privatization, because it results in "higher unemployment and the creation of private monopolies".

17. Answers do not reveal a clearly positive attitude towards development of regional integration in the future, only the group of government officials and that of researchers believe strongly that the process will be enhanced. For them, integration is a consequence of globalization and liberalization; "there is no country in the world that can develop its economy isolated from the rest of the countries".

Private sector executives are a little more cautious on the perspectives of integration compared with their unanimous support to the recent structural reforms. Their general argument was that Latin America is the region that has been most active in trade liberalization and integration expanding, but "many countries are confronting problems because the process is moving very slowly and large economies in the industrialized world are not implementing fully the free trade commitments".

18. Only a small fraction of 102 interviewees responded that they have or have had a relationship with Finnish enterprises or institutions. All of them considered that mutual understanding has been good or excellent.

When discussing the general knowledge of Nordic countries, the best known by the sample -by a clear margin- was Sweden, with 80 per cent of the answers. In Chile and Bolivia, Finland was the second best known among the Nordic countries.

19. The answers on the acquaintance of European Union's financing channels showed that the majority of governmental officials and executives in the private sector and owners of SME's had some knowledge on the objectives and mode of operations of these mechanisms.

20. More than two thirds of the sample had some opinion on the question: what is the mode of operations you would prefer in connection with Finnish enterprises? Answers revealed a clear preference for the subsidiary alternative - establishment of production plants and sales - among governmental officials, politicians and researchers. Private sector representatives - executives, owners of SME and independent professionals - indicated their preference for joint ventures and secondly for subsidiaries.

Of those who had opinions on the wished mode of operation, 90 per cent considered that the main problem to co-operate with Finnish enterprises or institutions was the lack of information about Finland's industry and negotiation mechanisms, and the insufficiency of Finland's commercial and economic representation in their countries. Factors like physical distance, cultural differences, trade barriers, competitiveness, market difficulties, or lack of interest were not considered by any group or country as significant problems.

21. While the groups of government officials, and private sector executives named forestry and mining as first priorities, researchers named technology, research and education as the sector where the Finnish co-operation could be most effective. The groups of consultants and independent professionals, and owners of small and medium enterprises also listed technology, research and education as the number one in the rank, together with the infrastructure sector.

Sectoral preferences by countries were the following: Argentina, forestry and mining; Bolivia, mining technology and research; Chile, technology, research and education; Peru, mining, environment technology and infrastructure; Paraguay, forestry and forest technology.

Mutual Interests

22. Finnish enterprises want to enter or, in case they have been already operating there, reinforce their presence in South America for several reasons:

There has been evolving for some years, a new awareness of the strong emerging of most of the economies in the region. Foreign investment is seen as a part of an extensive, expanding, efficient nonpolitical system providing financial and technical assistance as part of the region's development programmes.

Finnish enterprises are prepared to play an increasing role in the region. Particularly they can introduce advanced technology for modernizing the forest, mineral, fishing, environment, and infrastructure sectors in South America. The modernization of these sectors, in general, is resulting in increases in the region's national products, expansion of the productive capacity and diversification of the industrial sector.

This permits, in turn, the growth of the Finnish enterprises involved, and the consequent increases in their income. At the same time, expanding operations in South America permits these companies to develop their technological diversities and competitiveness, and to expand Finland's international connections and magnitude of operations in any part of the world.

23. For a long period, cooperation between the industrial world and developing countries (presently called emerging economies) was characterized by a mutual lack of confidence. Today, and specially in the case of South America, cooperation is not perceived as "official assistance" or "development aid", but rather, as fair business relations where one part offers a positive investment climate, natural resources and regional markets (South America); and the other part offers investment and technology (Finland).

From the perspective of the South American countries the diversification of exports to more value added products linked to natural resources is vital. From the perspective of Finnish industry, expansion of operations in the region means new opportunities to develop their technological diversities and competitiveness, and to expand Finland's international connections and magnitude of operations in South America.

1 INTRODUCTION

The majority of Latin American countries have opted for free markets and are engaged in a series of structural reforms which demand continuous efforts from societies and their governments. The adjustments are taking much longer than was initially imagined, and the results, at least until now, are a mixture of success and failure. Yet market liberalization is considered as a step in the right direction.

Confidence in Latin American economies is strengthening throughout the world, and some countries in the region are receiving full attention from foreign investors. Parallel to the expansion and diversification of relations between the European Union and Latin America, also Finland has started to show more interest towards Latin American economic process, particularly from the perspective of Finnish interests and possibilities.

It is now acknowledged that economic activity is essentially global and that individual national economies are more interdependent than their governments or their peoples. Today, there is a whole complicated net of interdependent relationships and a very dynamic environment in which a growing number of nations - not only the traditional poles of high economic significance - are all interacting significantly. However, the pace of these economic changes differs from one region or nation to another.

In spite of periods of strong growth since the late 1980's, there is still poverty in Latin America and in several cases poverty has expanded. The pursuit of growth without the application of measures for social equity is politically destabilizing, with unpredictable and often violent reactions. Consequently, reduction and elimination of massive poverty lies at the core of development itself. It is critical to the survival and continuation of a sustained economic progress in Latin America.

Economists participating in policy making, working in business, or in the public sector, or universities and research institutions are increasingly concerned with problems like unemployment and skewness of income distribution that affect the community as a whole.

For industrialized countries in general, and the European Union and Finland in particular, expansion of their economic activities with Latin American countries requires conditions of tranquillity and social acceptance for their investments. If medium- and long term strategies are not considered as a more comprehensive process than economic growth alone, and joint efforts to solve structural problems are not included in the cooperation process between Europe and Latin

America, the present phase of economic recovery runs the risk of becoming a mechanism for multiplying existing inequalities.

The main purposes of the study are:

– to provide detailed and comprehensive information for Finnish business sectors interested in the region,

– to identify key issues and problems from the examination of previous Finnish business ventures in Latin America.

– to determine the rationale for Finnish participation in economic and commercial activities in the selected countries.

This study seeks to shed light on the structural changes and economic prospects for Latin America particularly against the background of the interests and opportunities of Finnish enterprises and institutions.

The study has two parts. The first includes an evaluation of the economic reforms and their implications on economic prospects for the region both in the short term and the long term. The approach is focused on the specific characteristics of selected South American countries, their normative and institutional framework for business operations and on a sectorial analysis from the viewpoint of Finnish interests.

The second part comprises a round of interviews, conducted in winter 1997, with about twenty Finnish enterprises which have experiences with Latin America. The experiences of some companies are mainly from import-export trade with Latin America, others have also established production units there. The interviews tell of growing interest towards a stronger presence in the Latin American markets.

The author also had the opportunity to discuss both global issues and specific aspects related to Finland with more than one hundred people - in Argentina, Bolivia, Chile, Peru and Paraguay - during his visit to the five South American countries, in spring 1997. The interviewees included high government officials, private sector executives, social researchers, consultants and independent professionals, trade union leaders and workers and owners of small and medium size enterprises (SME's). The results of these interviews are reported in the second part of the study. This part also identifies investments sectors and evaluates priorities in order to rank them according to the expectations and opportunities for Finnish enterprises.

PART I LATIN AMERICA IN THE 1990'S

2 WHAT HAS CHANGED?

The relatively homogenous group of developing countries in the 1950's and early 1960's is at present a profoundly diverse set of regions and countries, ranging from the dynamic economies of the South East Asia to poor countries particularly in sub-Saharan Africa, which have been economically stagnant for several decades.

Latin America as a physical region shows similar contrasts as other parts of the developing world; there are cold highlands, temperate areas and tropical jungles. The continent includes large countries and small nations, overpopulated and underpopulated; countries that are endowed with large natural resources and others without significant resources. Some nations are among the world's fastest growing and others are decades behind them. The region represents a great variety of production capacity, industrial development, export potential and diversification, ability to absorb investment in productive activities, saving capability, human capital, institutional structures, governmental organization and so forth.

Latin America's geographic division is the result of long history of conquests and wars; the present nation-states have a common colonial past. The countries have important shared characteristics. Their historical and cultural background, duration of independence, national unity, international relations, present ideological practices, social mobility, business environment, and prevalent value systems, make Latin America a continent with less contrasts than other regions of the developing world.

For decades the dominating economic model in Latin America has been a closed economy promoting import substitution and the prominent political characteristics have been militarism and populism.

In the past, governments with populist programs exercised severe control on foreign investment, and promised justice in income distribution, active generation of jobs, substantial rises in salaries and ambitious social welfare reforms. The programs generally resulted in serious inflationary problems and external financial imbalances, and despite their sometimes sincere intentions, improvements in the social climate were not achieved. The result has been that the successor, whether elected or military, introduced stabilizing programs to impose austere fiscal and monetary policies, and wage reductions. This increased unemployment, reduced the productive capacity and intensified repressive institutions.

In the mid 1990's, there are no authoritarian military dictatorships or populist governments hostile to the private business sector. Is it then possible to maintain a reasonable balance in the economy which permits improving employment, even income distribution and modernization of the productive capacity without creating inflation and external imbalance?

To achieve such an equilibrium is difficult even in industrialized countries such as Finland, where the adoption of anti-inflationary policies has had a social cost in the form of increased unemployment. In the case of Latin American countries - at least in the short term and medium term - it does appear to be very difficult. Particularly in countries with demographic pressures and lack of appropriate infrastructure, achievement of urgent social and egalitarian objectives is unlikely to be rapid. Only in the medium and longer term can the answer be positive, provided that internal and external resources combine favorably. Improving the distributive process in the long term will require the creation of a solid regional economic base which can attract investments from rich countries in Europe, North America and Asia.

At present, it is clear that the economic potential of the Latin American countries is better than it was during the 1980's. Almost all countries in the region have recently exhibited good economic performance and some have done exceptionally well, particularly Chile.

2.1 The New Internationalism and Development Cooperation

The North-South dialogue that was initiated with the New International Economic Order's (NIEO) declaration in the late 1970's, very soon came to a dead-lock. One reason was that the rich, but at that time stagnated industrial countries could not afford international trade reforms raised in the NIEO document and massive resource transfer to the poor countries as stated in the Brandt Commission Report (1982).[1]

The Brandt Commission Report symbolized the end of an era rather than the start of a new one. Later, in the 1980's, the global approach to North-South issues changed from a human concern and a certain public guilt regarding poor countries and former colonies to a sentiment of moralism and deception influenced by the existence of corrupt dictatorships, particularly in Latin America and Africa.

The 1990's is the decade of strengthening democracy in Latin America. The response of industrialized countries to the challenges of global poverty and international inequalities has, however, faltered even in the "like-minded" countries like Finland or Canada where development aid's volume has declined very sharply. While the volume of development aid falls, it is also increasingly influenced by political and commercial concerns rather than the poverty relief.

The humane internationalism approach has been replaced by a liberal internationalism according to which all nations pursue their own national interests in international relations. The general opinion has been in favor of the liberal approach with a strong commitment to an open, multilateral trading system. The most that the developing countries can hope for present, is that the industrial countries themselves respect the rules associated with global free trade practice. Policy-makers in Latin American countries have, in some cases, assumed unilateral decisions to open their economies to the outside world.

To a large degree, this is the result of the changing international economy, particularly the expanding unemployment and the erosion of the values of the welfare statism, in the industrial countries; the strong emergence of the newly industrialized countries, and the globalization of production and financial markets. All in all, industrial countries are more unwilling to give special advantages to countries in Asia or Latin America. The problems of world poverty will remain unsettled unless they can be linked to the internal reforms of the developing countries. Agricultural protectionism and desire to promote arms exports, are an obvious contradiction to the public statements of development cooperation policies of industrialized countries.

The OECD's Strategy

The OECD's "Development Cooperation" report (1996)[2] examines this new global context and concludes that industrial countries have to rethink their development cooperation structures. According to the report, there are three priorities for donor countries:

- find new ways to increase the availability of financial resources, including development assistance,
- carefully and critically examine the priorities for allocating development assistance resources,
- together with developing countries, find new ways to increase the efficiency and effectiveness of development programs.

Significant economic factors are also the following:

- donor countries have also to direct aid to reduce the foreign debt of developing countries,
- take into account the importance of trade reforms as an opportunity for developing countries to increase their own export earnings,

- to ensure that aid for the development of the private sector encourages foreign direct investment and other private financing,
- reduction of military expenditure in developing countries would be seen as a favorable condition.

The OECD report also recommends to consider that a growing number of Asian and Latin American countries now have access to private capital. In those countries where concessional aid is needed, donors should give more support for human development priorities and do all they can to avoid increasing aid dependency. With this aim, OECD countries must widen the technical assistance to strengthen the technical capabilities of developing countries, encourage the south-south technological exchange, as well as increase the quality of public management and responsibility of the public authorities.

In the new international context - according to the OECD' Development Assistance Committee - regional cooperation is more significant than ever. Regional cooperation institutions and mechanisms need to be rationalized to avoid an overlap in efforts, guarantee coherence of operations and save human and financial resources.

2.2 Ideology of Reforms

A few years before the end of the twentieth century there are no doubts that the only revolution that leads to favorable development in poor countries is the intensification of production and expansion of exports to generate enough wealth for the welfare of the society. In an increasingly interdependent world with a globalized economy, this challenge requires new investments for efficient and competitive production. A basic condition to achieve this is the consolidation of democracy in the political arena and the promotion of a free economy in the economic arena.

There have been significant fluctuations in Latin America. In the economic area alone most of the countries have experienced socialist formulas, liberal models, controls and populist regimes. At present, when a new millennium is beginning, the technological revolution has decreased the importance of ideologies and shortened the road to prosperity. Rapid change is based on individual incentives, with emulation being the main incentive for action.[3] (Latin Trade, 1997) The reforms are based on the so called neo-liberal principles.

What is neo-liberalism? Is it just privatization of state entities and stabilization of the macro economy? Or is it wider - reaching reforms aimed at creating efficient economies that guarantee true competition and improved living conditions for the average citizens of Latin America?

Although the region has taken clear steps toward liberalization, there are still many to be taken in order to create sound economies with sustained, long term growth. Privatizing a state company reduces state expenditure, but to replace a state monopoly with a private one will not necessarily help the consumer.

It is good to reduce fiscal deficits - but not at the cost of the impoverished population. Many governments in Latin America are reducing the deficit by passing the bill to the general population in the form of higher taxes. While governments are right to reduce subsidies of basic services, such a reduction should be done in a gradual way and parallel to tax reductions and increases in purchasing power.

Governments also need to radically change their policies on enterprises. Too many small companies are facing trouble in obtaining reasonable loans due to a banking system that primarily serves a minuscule elite. Further liberalization of the banking sector - and competition from foreign banks - should help enhance the capability of Latin American banks to address the needs of the population in general.

The unilateral view with which the United States manages its relations with Latin American nations is facing a growing criticism in the region. Most recently it was criticized by a number of regional political leaders during a conference in the USA, in April 1997. The meeting under the title of "The Agenda for The Americas in the 21 Century" sought to analyze and fortify the goals established by the Americas Summit of 1994.

The ex-President of United States Jimmy Carter criticized the U.S. government for not having given more emphasis to the region. The Bolivian President, referring to the unilateralism of Washington, said that the USA intended to be "the sun, and the other countries the rest of the system" in the America's free trade association project. He acknowledged that since December 1994, a number of set-backs had occurred regarding the free trade plan, such as the Mexican crisis, and indicated that the USA should act like the European Union, which continuously initiates and strengthens relations with the MERCOSUR countries, and the USA needs to decide if it will become an active member in the Inter-American free trade zone or if it will opt out.[4] (Bolivian Times, 1997)

What Latin America needs is a truly open and free market that benefits everyone - the poor and rich, the small and big companies. Not a return to populism or a neo-liberalism that only benefits a privileged group.

3 RECENT EXPERIENCES OF SELEDTED LATIN AMERICAN COUNTRIES

The political and economic transformation in Latin America started before the collapse of the centrally planned economies. Governments in the region initiated a pragmatic process towards an open and market-friendly economic system. The new policies included two main aspects; attaining equilibrium in government finances and making the structure of economies more responsive to market forces.

After the disastrous economic management of military dictatorships, civil governments had to redefine the role of central governments by cutting expenditures, restructuring tax systems and privatizing state industries. From the 1950's, Latin American governments had spent heavily on populist social security schemes, bought modern military equipment and employed large numbers of people in vast bureaucracies.

Privatization, removal of subsidies, tariffs and quotas on foreign trade and reforms of legal systems have had a central role in improving the attraction of domestic and foreign investment. Governments have been encouraged in their policies to correct a state-dominated and closed model by the events in eastern Europe. It would have been difficult to believe in the 1980's that Latin America's growth would be among the fastest in the world in the 1990's.

3.1 Some Common Features

For nearly four decades after World War II, most of the Latin American countries pursued inward-oriented policies, based on a protectionist system. This stressed import substitution of consumer goods and primary commodities but induced large foreign purchases of production goods. Resources were redirected away from agriculture and primary production toward manufacturing. Barriers were used against competing imports to protect industries that were in many cases state owned.

Encouraging Sixties and Seventies

For a time, the inward-strategy showed encouraging results. During the two decades previous to the 1980's, Latin America experienced a sustained expansion in production, investment, consumption and trade. The region's GDP grew by 5.6 per cent in the 1960's and 5.9 per cent in the 1970's. Investments quadrupled in real terms, expanding mainly through capital inflows from foreign public and private sources. Latin American countries participated in the rapid expansion of world trade although imports from industrial countries grew more rapidly than exports.

The prevailing economic policies of the time - backing import substitution, subsidization of uncompetitive domestic industries and expansion of the military and other public sector at expense of the private, and financing of disproportionately high military expenses - proved to be unsustainable in the late 1970's.

The absence of effective export efforts acted to intensify external imbalance. The balance of payments was maintained by foreign borrowing and investment. The industries which were established during the 1950's and 1960's continued to rely heavily on protection in domestic markets. Without competitive pressure and technological progress they did not improve efficiency.

The late 1970's brought several foreign trade setbacks. Oil and commodity prices rose and then fell abruptly. Temporal booms of single commodities - oil in Mexico, copper in Chile, tin in Bolivia, coffee in Brazil, etc. - led to the appreciation of exchange rates which hindered the expansion of exports from other sectors. At the same time, many governments (Argentina, Brazil, Bolivia, etc.) increased spending and foreign borrowing expecting to repay the debt with future earnings from primary commodity exports. When primary commodity prices fell, other sectors were unable to increase exports and offset the adverse consequences of the decline in the country's terms of trade.

Eighties - Full of Crises

During the 1980's the value of the export sector - though not the volume - in most Latin American countries fell or stagnated. The region's relative position in world trade declined considerably. In 1960, the share of Latin American exports was 7.7 per cent of world exports, in 1980 it was 5.5 per cent, and in 1988 that figure declined to 3.3 per cent. The region's share of imports, correspondingly, declined from 7.6 per cent in 1960, to 5.9 per cent in 1980 and to 3.3 in 1989. The current value of Latin American foreign trade, which amounted to more than USD 200bn in 1981, declined to USD 160bn in 1987. Smaller export earnings resulted from an abrupt decline of commodity prices in the world market despite significant increases in the volume of shipments. As a consequence, imports had to be financed with foreign debt.

Latin American countries tried to restore their trade balances by recessive adjustment policies, but only a few managed to simultaneously control inflation and reduce external deficits. External debt servicing costs put an extra burden on public sector finances and the current account balance. This obligated governments to focus more on correcting short-term imbalances than on achieving growth and promoting structural change.

The largest economies of the region - Brazil, Argentina and Mexico - suffered deterioration throughout the 1980's and problems with inflation, debt servicing and foreign trade affected the entire region. The period 1981-85 saw a real GDP growth of only 0.5 per cent, with 13 countries of the continent having negative growth rates. There was a temporary recovery in 1986-87, with average growth rates of 3.8 per cent and 3.0 per cent respectively, but the next years of 1988 and 1989 showed negligible growth of less than 1 per cent. Measured in terms of the region's per capita gross domestic product, there was a decline of 8 per cent over the decade. This undermined much of the modest progress achieved during the previous two decades to improve living standards and levels of social welfare.

Latin American economies, with Brazil in first place, found themselves in an spiral of uncontrolled inflation, growing foreign debt and large budget deficits. Annual inflation in the period from 1980 to 1990 reached historical levels, such as 2750 per cent in Brazil, 3080 per cent in Argentina, 7500 per cent in Peru, 14300 per cent in Nicaragua, and 23000 per cent in Bolivia.

By the end of the 1980's Latin America had transferred more than USD 220bn abroad to service its debts and pay dividends to foreign investors. Recession, unemployment and falling real wages completed the picture. In 1990 the average income in Latin America was roughly one third of the average in the industrialized world. This figure was substantially worse than in 1960, when corresponding income level was at 41 per cent.

Although the national economies declined, populations continued to increase; there were 360 million people in Latin America in 1980, by 1989 there were about 450 million. The economically active population grew by around 3 per cent per year. Moreover, the 1980's showed a deterioration in the quality of jobs and a rapid growth of the informal labour market. The cuts in public spending and the decrease in real wages resulted in the expansion of poverty from 110 million people in 1980 to 180 million in 1989. Other indications of the economic and social decline of the region during the 1980's were the increased delinquency in large cities and the expansion of migrants from these countries, particularly to the United States and Canada.

In the two decades previous to the 1980's, expansion of productive capacity was based on relatively high levels of investment rates, at around 25 per cent of the gross domestic product. Contrary to the 1960's and the 1970's, when international investment, not only from the USA but also from Japan, to Latin America was very dynamic in various sectors of production industries from minerals to shipbuilding and cars and from steel to chemical industry, decline in the terms of trade and the rise in the external debt service resulted in an abrupt fall of potential investment resources in the 1980's.

The region's net capital inflows expanded significantly in 1974, the first year of petro-dollars recycling. They averaged USD 35bn annually in the years 1979-82. Then they dropped abruptly and averaged USD 6.5bn annually during 1983-86. This trend was specially damaging when compared to the doubling of investments between 1960 and 1970, and a doubling again between 1970 and 1981. The negative transfer of financial resources began in 1982, when the total capital inflows - private and public - became smaller than interest payments and profit remittances.

External capital, which was needed to compensate the reduced availability of foreign exchange due to lower export earnings became scarce and expensive. The only alternative open to the countries that wished to honor their previous financial commitments, at least by paying interests on their debts, was to cut imports. At the end of the decade, the region's imports were 40 per cent below the figure for 1981.

The remarkable success of the newly industrialized countries in Southeast Asia during the 1980's provided a sharp contrast to Latin American countries' performance. Comparisons revealed spectacular differences between the two regions. (See Table 3.1) Meanwhile, however, the contrasts encouraged new thinking among reform-minded governments in Latin America.

Table 3.1. Economic performance by regions. Average annual change in the 1980's, %

	Real GDP	Inflation	Gross domestic investment	GDP per capita
Latin America	1.6	192.1	-2.0	-0.5
East Asia and Pacific	7.8	6.0	10.6	6.2
Middle East and North Africa	0.5	7.5	..	-2.6
Sub-Saharan Africa	2.1	20.0	-4.3	-1.0
OECD	3.1	4.2	4.3	2.5

Sources: United Nations; the OECD Observer No 183, August September 1993.

3.2 Argentina's Reforms

Argentina's structural changes over the past decades have particularly influenced the industrial sector. Economic policy was heavily based on import substitution from the 1930's until the late 1970's. Since then, significant macroeconomic and political reforms have taken place. The economy is currently more open in terms of trade, finance, movement of capital etc. The establishment of Mercosur (cf. chapter 6) has given support to the development of the economy. It widens markets and poses challenges in terms of competition. More intense competition has arisen due to the growing globalization of the economy. In Argentina, Mercosur is viewed as an irreversible integration process.

The current situation in economic and political life is stable compared to the most critical periods of hyperinflation in 1989 and 1990. The country took important measures in order to stabilize the economy. One of them was to capitalize the foreign debt and use it as an instrument to finance new investments. This included the process of privatizing state-owned companies.

The closed nature of Argentina's economy and the nationalism of the seventies and eighties were two of the main reasons for the loss of its importance in world markets. The chronic fiscal deficit was financed by foreign debt and inflation was running at 3 500 per cent a year toward the end of the eighties. Consequently, long term investments were curbed and the movement of capital was restricted. Different monetary policies failed to pull the country out of its decline. Strong trade unions and violence opened the way to successive military takeovers which placed Argentina at the top of the ranking of countries with greatest risks.[5] (Minera Argentina, 1997)

In 1989 Argentina's Government introduced wide-sweeping economic reforms in order to reactivate the economy and curb inflation; they also applied a new economic programme designed to bring normality to economic activity and productivity. Among the reforms adopted by the Government from 1990 onwards, the following had special relevance:

a) The adoption of a market economy model. This was characterized by:

- freedom of prices, domestic and foreign trade, exchange rates, national and foreign investment as well as all types of transactions in the financial and capitals markets.
- the Government would play a subsidiary role, centered on defending competition, transparency in monopolistic activities and protecting social rights.
- the deregulation of all economic activity.

b) Financial Solvency by means of the Law governing Convertibility of the Currency. This obliges the Central Bank to totally back up the currency with gold, foreign currency and other external assets. The Central bank is obliged to sell foreign currency at the rate of 1 peso in exchange for 1 dollar.

c) Balancing public accounts:

- the strict fulfillment of the budget
- the privatization of public companies
- reforms to the National Administration
- restructuring of the State Banking organization
- reforms to the Social Security System
- consolidation and restructuring of the public debt.

d) A simple and efficient tax system:

- Value Added Tax in all sectors of the economy, except for some social services. A tax rate of 21 per cent, or 27 per cent in cases of public services for companies.
- Provincial and municipal taxes on gross income, energy and property depending on each Federal Province. Taxes should be replaced by sales taxes to reduce production costs.

Economic Results

Inflation went down from 1993 onwards to one-digit levels, and real GDP grew as a result of the sustained increase in purchasing and investment.

Greater inflow of capital and a greater stability in prices stimulated consumption, which increased substantially between 1992 and 1994. Investment increased considerably, reaching 21 per cent of the GDP in 1993, compared to 14 per cent in 1990. This growth was financed with external savings.

Argentina became a member of the Southern Common Market (Mercosur) in 1991, together with Brazil, Paraguay and Uruguay. Mercosur applies uniform customs duties throughout all member countries beginning in 1995. Even prior to this date, its repercussions were felt as trade within the region tripled between 1991 and 1995.

Argentina has made a recovery from the Mexican spill-over effect of its peso crisis of December 1994. Output has expanded rapidly over 4 per cent in 1996 though employment growth has not seen a significant increase. One very serious issue in the Argentinean economy is the unemployment rate of 17 per cent. The Government has imposed labour reforms and high structural unemployment will persist if its proposals are not implemented.

Prices have been stable over the rapid growth period although demand has increased. Inflation will remain stable contributing to continuing good expectations of trade performance. Argentina has an advantage for fast growth in 1997, and enjoys price, interest rate and exchange rate stability.

All in all, Argentina has promising prospects as long as the country keeps the track of sustainable growth, interest rates continue to ease and the fiscal deficit shrinks. The promotion of macroeconomic stability is crucial for the continuation of strong capital inflows and a trade surplus. The implementation of sound policies encouraging entrance to competitive international markets is reflected in Argentina's strong recovery from the past crisis.

Inflation is low and bank deposits, foreign reserves, and the stock exchange have increased to new records; debt spreads have fallen; and foreign direct investment is soaring. The economy's evident weakness is the unemployment rate, though in 1997 figures show a fall to 16 per cent, down from a peak of 18 per cent in 1996.[6] (Financial Times, September 17, 1997)

Table 3.2. Argentina: economic indicators

	Average 1990-94	1995	1996e	1997f	1998f
Real GDP, % change	6.8	-4.6	4.3	6.0	5.5
Consumption*	6.2	-5.1	4.7	3.7	4.1
Investment*	3.4	-3.8	1.6	4.4	4.5
Net trade*	-2.8	4.4	-1.9	-2.1	-3.0
Consumer prices %	148	3.4	0.2	0.8	1.9
% Dec/Dec	103	1.6	0.1	1.2	2.5
Producer prices %	96	6.5	3.2	1.5	2.5
Public deficit % of GDP	-0.7	-1.3	-2.0	-1.4	-0.6
Exchange rate, unit/USD	0.91	1.00	1.00	1.00	1.00
Merchandise trade balance (USD bn)	1.0	2.2	1.6	-1.1	-4.3
Exports	13.1	21.0	23.8	26.2	28.2
Imports	12.1	18.7	22.2	27.2	32.5
Current account balance (USD bn)	-3.5	-2.4	-4.0	-7.5	-12.6
% of GDP	-1.6	-0.9	-1.4	-2.4	-3.7
International reserves, (USD bn)	9.7	14.3	18.1	18.8	18.3
Total external debt, (USD bn)	72.0	97.5	101.3	102.9	107.4
Short term**	14.0	15.1	13.9	12.6	13.6
Total external debt, % of GDP	32	34	34	33	31
Total external debt, % of exports***	372	325	311	293	281
Interest payments, % of exports***	24	19	19	17	17

* Contribution to growth of GDP.

** Debt with original maturity of less than one year (includes interest arrears).

*** Exports of goods, services, and net transfers.

Sources: World Financial Markets, IDB, Latin Trade.

Profits and business optimism will keep spurring fixed investment. Although the trade balance is going to deteriorate continued productivity will keep exports growing. This shift in growth drivers suggests that the economy may be headed toward sustainable growth for the first time in decades. However, Argentina's political system and institutions such as the judiciary and social security have to keep pace with the economic reforms in the longer term.

3.3 Brazil's Economic Policy

During the four decades between 1940 to 1980, Brazil experienced high GDP growth rate of 7 per cent annually despite serious macroeconomic and political difficulties. Outstandingly, real per capita GDP increased from USD 490 to USD 2 450 (in 1989 prices). However, in the 1980's economic growth slowed down, output per capita fell and development was unstable.

Inconsistent policies took place from early 1970s to the mid 1980s. Huge import substituting and export promoting programs were the core of Brazil's adjustment strategy to the oil shocks and the public sector was mainly responsible for the required investment effort. In the same time the public sector had significantly diminishing incomes. This led to a large public debt. Public enterprises had, however, access to foreign loans which got them to neglect their self-financing capacity. Prices for goods produced by public enterprises did erode and in the short term inflation pressures were avoided. Reduced prices in the public sector delayed the required adjustments in the private sector.

Until 1979 the government resorted more and more to foreign and domestic borrowing. The domestic public debt and pressures on interest rates increased the transfers to the private sector. Finally, the external debt crisis of 1982 aggravated the public sector's position. Private sector's enterprises were arranged by permissions to the absorption of foreign exchange risks by the Central Bank.

Resulting from this the only way out was and still is the establishment of stabilization schemes, fiscal reform and inflation control. The implementation of a political democratization process in early 1990s did not cure economic stagnation, high inflation and economic pessimism.

Government's Reform Strategy

The current government has reached popularity through successful reduction of annual inflation to single-digit levels. The primary tool in the disinflation process has been the maintenance of a strong Real though it harms the competitiveness of the country's tradable goods sector. Government's strategy is often referred to as the real plan which created a new currency. The plan has brought inflation down from 2 700 per cent in 1994 to single digit figures in 1997. The president has enhanced the importance of significant reforms in the administrative and social fields. This will pose challenges even though he has wide political support.

The Brazilian economy has experienced fast growth in 1996-97. Even some phenomena of overheating are feared. The economy still has deficit problems. However, the Real-policy is consistent and country's credibility is high. Brazil implemented favorable policies to boost exports by easier tax treatment and special credit lines. Its trade deficits might lead to rising of non-tariff barriers on imports. However, a significant capital inflow from foreign direct investment has a key role in the economy.

The macroeconomic outlook in terms of inflation and output is favorable for 1998. The exchange rate policy is stable and imports will accelerate due to the rise of economic activity. FDI will finance a large portion of the current account deficit.

Lower inflation has enhanced foreign direct investment in various sectors. Multinationals, but also, small and medium size foreign enterprises seek for a niche in an rapidly emerging market with huge potential. FDI has risen fast and in 1994 Brazil received USD 2.2bn of FDI, in 1995 USD 3.9bn compared to USD 9.4bn in 1996. These figures show firm reassessment of the Brazilian market among the international companies.

Foreign investors have shown interest to the Brazilian local markets where their competitiveness has increased. As in many Latin American countries, productivity of domestic industry has not been as favorable as thought. This is due to high non-salary labour costs and poor infrastructure. The overvalued exchange rate (between 10 and 30 per cent) and these two mentioned reasons of low productivity explain partly weak exports and high imports. Brazil's inflation program has led to tight monetary policy and a strong currency. The government will have to adopt a more flexible exchange rate policy.

The current policy mix - loose fiscal, tight monetary, strong currency - will not change soon. Election campaigning started in 1997. This will hamper constitutional fiscal reforms and preclude their implementation before 1999. And the political priority to keep inflation down will deter changes in exchange rate policy. That will leave interest rates and credit conditions as the key tools to orientate the economy, principally with an eye on keeping foreign reserves stable.

The role of trade and current accounts is to accelerate the pace of economic growth. The quality of the trade deficit and of its financing is even more relevant than its size. The quality of Brazil's trade deficit has improved because capital and intermediate imports account for about 80 per cent of imports or

USD 73.0 billion. The composition of financing has also improved, as about 70 per cent of the financing is direct investment. Two years ago, 70 per cent of this financing was portfolio flows.

Even at USD 15 billion, the trade deficit would be only 2 per cent of GDP in 1997. The current account deficit would likely end the year at USD 34 billion or 4.5 per cent of GDP, roughly half the size of Mexico's current account deficit prior to the 1994 peso devaluation.[7] (Lehman Brothers, 1997)

Table 3.3. Brazil: economic indicators

	Average 1990-94	1995	1996e	1997f	1998f
Real GDP, % change	1.0	4.2	2.9	3.5	4.5
Consumption*	1.9	9.5	2.8	5.3	5.1
Investment*	-0.1	2.1	1.0	1.2	1.2
Net trade*	-0.8	-7.3	-0.9	-3.0	-1.8
Consumer prices, %	1402	66.0	15.5	7.2	6.4
% Dec/Dec	1164	22.0	9.1	6.9	6.0
Producer prices, %	1413	58.8	6.3	8.4	5.6
Public deficit, % of GDP	0.5	-4.8	-3.9	-3.5	-3.8
Exchange rate, unit/USD	0.19	0.97	1.04	1.12	1.20
Merchandise trade balance (USD bn)	12.1	-3.4	-5.5	-13.3	-18.6
Exports	36.2	46.5	47.7	50.6	53.6
Imports	24.1	49.9	53.3	63.9	72.3
Current account balance (USD bn)	-0.2	-18.0	-24.3	-34.5	-42.4
% of GDP	-0.1	-2.5	-3.3	-4.5	-5.3
International reserves, (USD bn)	21.1	49.7	58.4	57.2	52.6
Total external debt, (USD bn)	137.1	173.1	187.1	197.4	211.2
Short term**	30.9	43.7	46.6	49.4	52.4
Total external debt, % of GDP	31	23	24	25	26
Total external debt, % of exports***	307	279	291	297	301
Interest payments, % of exports***	21	18	21	21	21

* Contribution to growth of GDP.
** Debt with original maturity of less than one year (includes interest arrears).
*** Exports of goods, services, and net transfers.

Sources: World Financial Markets, IDB, Latin Trade.

3.4 The Economy of Chile

Chile experienced a 17-year long authoritarian regime. An open democratic regime was established in 1990. In 1991, a six-year expansion started under conditions of moderate inflation without macroeconomic imbalances and with policies reducing debt.

Chile's recovery since 1984 consisted of rapidly increased exports, the depreciation of the exchange rate, the consolidation of internal financial stability, and overall supportive macroeconomic policies. Non-traditional exports such as fish, fruits, paper and timber strengthened. The growth was export and investment led. This was possible also due to the structural reforms of the 60s and 70s. The agrarian reform and modernization took place in 1965-73.

Chile is seen as an important financial success in Latin America. The country has been capable of controlling inflation with two important tools. In 1982, a policy was run where devaluation included deindexation of wages. Due to high unemployment (over 20 per cent in 1982), workers did not attempt to catch back real wages after the crisis of 1982, so the classic price-wage-exchange rate spiral was absent in Chile. Another tool consisted of debt-relief schemes for borrowers from the banking system, purchasing risky loans by the Central Bank, and the recapitalisation and subsequent sale of intervened banks to small investors. Local financial markets were largely involved of Central Bank's bonds.

In 1995 Chile's GDP was approximately USD 62.5 billion, which is the equivalent of a per capita income of USD 4 500, and USD 9 500 in PPP estimate.[8] (World Bank, 1997) GDP grew at a rate of 8.5 per cent in 1995, and 7.2 per cent in 1996. The country's economy is experiencing an expansive cycle, which started in the middle of the 1980s and is expressed in growth of GDP, foreign trade, employment and public revenues.

The country's labor force is 5.2 million people. The national unemployment rate was 4.5 per cent in the beginning of 1996.

The rise in the Consumer Price Index (CPI) during 1996 was 7.2 per cent, continuing the decreasing trend of the past years. For 1997 the government's objective is inflation no higher than 6 per cent. Price stability is the main objective of the Government and the Central Bank, due to the importance of this factor in internal saving and investment, which are both pillars of the economy's growth in the medium term.

Foreign Trade and Exchange Trade Policy

The general tariff rate for imports has been 11 per cent since 1991. As of that date the Central Bank established a reserve requirement of 20 per cent on foreign capital brought into Chile. The objective of that measure is to prevent the inflow of short-term capital that takes advantage of the difference in interest rates.

The price of the dollar is determined by the supply and demand for foreign exchange in the market, with a price range that is defined by the Central Bank. When the price exceeds the limits of the range, the Bank intervenes by buying or selling foreign currency to prevent excessive variations in price. Because of successive surpluses in the Balance of Payments, the real value of foreign exchange has dropped between 1990 and 1994, which has created some problems for exporters.

Purchases of dollars by the Central Bank in the foreign exchange market to stabilize their price has resulted in the accumulation of approximately USD 14.8 billion in monetary reserves, which is enough to finance 12 months of imports. It is estimated that the level of monetary reserves will remain at about 15 billion dollars.

Stabilization of the exchange rate is complemented with other instruments like tariffs, foreign exchange reserve and interest rates. Interest rates in the Chilean financial system are relatively high (between 6.5 per cent and 7 per cent), because the Central Bank uses this variable to curb internal spending and to control inflation.

Chilean foreign debt at the end of 1995 was approximately USD 21.8 billion, eighty-five per cent of the debt is medium and long term. During 1995 the Central Bank prepaid approximately USD 1.3 billion of foreign debt.

In 1996 the balance of payments ended with a surplus, as it had in previous years. This is the result of a positive trade balance (more exports than imports) and the continuous flow of capital into the country, through investments and loans.

Exports increased 39 per cent in 1995. This increase was largely due to the favorable price of copper. In 1996 exports decreased but they are estimated to increase again in 1997.

Copper is the most important export product. In 1995, copper represented 40 per cent of total Chilean exports, and the mining sector as a whole represented 49 per cent of the total exports.

Table 3.4. Chile: economic indicators

	Average 1990-94	1995	1996e	1997f	1998f
Real GDP, % change	6.4	8.5	7.2	5.0	6.6
Consumption*	4.5	8.0	5.1	3.5	5.7
Investment*	2.7	5.5	3.5	1.4	5.8
Net trade*	-0.8	-5.0	-1.4	0.2	-5.0
Consumer prices %	17.4	8.2	7.4	5.9	5.1
% Dec/Dec	15.8	8.2	6.6	5.5	5.2
Producer prices %	14.1	7.6	6.2	2.0	4.0
Government balance, % of GDP	1.7	2.6	2.0	1.4	1.8
Exchange rate, unit/USD	385	407	424	430	445
Merchandise trade balance (USD bn)	0.7	1.4	-1.2	-0.8	-3.0
Exports	9.6	16.0	15.3	17.0	18.2
Imports	8.9	14.7	16.5	17.8	21.2
Current account balance (USD bn)	-0.8	0.2	-2.5	-2.1	-4.4
% of GDP	-1.9	0.3	-3.3	-2.6	-4.9
International reserves, (USD bn)	9.0	14.1	14.8	16.5	17.0
Total external debt, (USD bn)	19.3	21.7	22.7	24.2	26.6
Short term**	3.3	3.4	3.8	4.0	4.4
Total external debt, % of GDP	46	32	29	28	28
Total external debt, % of exports***	147	108	114	109	110
Interest payments, % of exports***	11	6	7	7	7

* Contribution to growth of GDP.
** Debt with original maturity of less than one year (includes interest arrears).
*** Exports of goods, services, and net transfers.

Sources: World Financial Markets, IDB, Latin Trade.

Imports also increased significantly in 1996, due to the population's greater purchasing power and the appreciation of the Chilean currency. The main import product is crude oil.

Free Trade Agreements

In October 1996, the Mercosur countries added "associate member" Chile, one of Latin America's most advanced economies.

With some 225 million consumers and USD 12 trillion in GDP Mercosur has dramatically expanded the global business location area. Some 95 per cent of intra-Mercosur trade is duty free, with all remaining tariffs slated to fall by December 31, 1999. With Mercosur's expansion, South America's GDP growth will rank second in the world by the year 2000, after the Asia-Pacific countries.

Since December 1995, more than a dozen Asian, European and USA manufacturers have announced USD 13 billion in major new Mercosur location projects. Chile gave Mercosur credibility boost, and it has been already exercising considerable investment influence in the past years.

Chilean firms have invested USD 3 billion in foreign ventures, buying, for example, electricity companies in Argentina and Peru, railways in Bolivia and banks in Argentina, Bolivia and Peru.

Chile and its Pacific ports offer Mercosur-based operations significant new Asia-Pacific distribution possibilities.[9] (Investment Review, 1996)

Chile is negotiating to join NAFTA. The USA administration shares the view that an accord with Chile is a vital first step toward expanding USA trade interests in a region that is rapidly becoming a major growth area. "The United States simply cannot afford to sit on the sidelines while others share in the fruits of Latin America's remarkable growth," USA's president said.[10] (International Herald Tribune 02/28/1997)

In addition to Nafta (initial negotiations) and Mercosur (associate member) Chile is a member of the APEC group of the Pacific Rim, and has a number of bilateral agreements. Some of them have been operating for years. Agreements were signed with Mexico and Argentina in 1991, and with Venezuela, Bolivia, Colombia and Peru in 1993-94. Chile has a cooperation agreement with the EU, 1996. The intention is to commit EU and Chile to a "third generation" cooperation agreement, reaching for beyond current arrangements.

Trade liberalization should eventually cover all sectors. More general economic cooperation include investment, services, intellectual property, customs and telecommunications, amongst others. The EU-Chile Agreement is officially mixed, since it covers some areas where only EU's member states, and not the Community, have jurisdiction.[11] (European Report, May 1996)

3.5 Recent Trends in the Bolivian Economy

The Bolivian economy grew by 4 per cent in 1996, compared to an average growth rate for Latin America of 3.2 per cent. The most important sectors in this growth were electricity, gas, water, construction and public works. Manufacturing grew at a rate of 4.2 per cent, and represented the largest contributor to the GDP (17.0 per cent), replacing the agricultural and livestock sector, which occupied the second position. The industries which showed the greatest growth between 1995 and 1996 were manufacturing of non-metallic mineral products and textiles. In 1997, GDP growth will reach 4.5-5 per cent level.

In 1996 there was a substantial increase in foreign investment, which rose by over USD 530 million, becoming an important source of investment funding in Bolivia. Foreign reserves reached USD 644 million in 1996; equal to 6 months of imports. As a result of negotiations with the Paris Club, the Government was remitted USD 148 million of its debt and a further reduction of USD 576 was allowed, significantly improving the country's solvency.

A new Central Bank law was approved to guarantee the Bank's independence and long-term macroeconomic stability. Decrees were also passed for putting into practice the private financial funds, which aim to give greater access to economic resources as well as strengthening the financial system.

The decentralization of state administration, approved in 1995, introduced a new economic management system, transferring most of the responsibility for support services to the regions. Administration, supervision and running of social services, sports, culture, tourism, agriculture and fisheries, became the duty of local government.

The structural reforms which began in 1985 have been important to sustain overall economic stability, streamline public funding, improve the insertion of the country in world markets, recover growth and the confidence of all elements of the economy. After 1993, a second generation of reforms were initiated to strengthen thóse begun in 1985. These new reforms affected the capitalization of public companies in sectors such as electricity, telecommunications and transport.

To ensure long-term, sustained development, the Government approved in 1995 regulations concerning environmental protection, water and atmospheric pollution, environmental management, disposal of hazardous substance and solid waste as the fundamental pillars for achieving a balanced growth with a rational management of natural resources.

Foreign Investment

The "capitalization" (Bolivian way of privatization) includes Bolivia's five main state companies, in telecoms, electricity, transport, and oil and gas. The state ceded a 50 per cent shareholding and management control to foreign investors, in return for explicit investment pledges; these totaled USD 1.7 billion, to be spent within seven years.

Foreign investment is climbing quickly, and privatisation is expected to act as a magnet for more. Oil and gas offer one big prospect. Work has begun on a USD 1.9 billion pipeline from eastern Bolivia to Sao Paulo in Brazil, 3 150 kilometers away. Private-sector firms will drill around 50 deep wells a year, five times as many as the state-owned oil company managed. The Brazil pipeline alone should add one extra point to Bolivia's growth rate.

Another boom area could be agro-industry, but to develop further it needs better transport links.

Investment sums are not huge. But they are big in relation to Bolivia's economy. Government suggest that a stable 5.5 per cent GDP's growth is feasible for the next years.[12] (The Economist, August 1997)

Table 3.5. Bolivia's privatized firms

Sector/firm	Foreign investor	USD m*
Electricity		
Guarachi	Energy Initiatives (USA)	47.1
Corani	Dominion Energy (USA)	58.8
Valle Hermoso	Constellation Power (USA)	33.9
Telecoms		
Entel	STET (Italy)	610.0
Railways		
ENFE	Cruz Blanca (Chile)	39.1
Aviation		
Lloyed Aereo Boliviano	Vasp (Brazil)	47.5
Oil and gas		
Andina	YPF/Perez Companc/Pluspetrol (Argentina and Spain)	264.8
Chaco	Amoco (USA)	306.7
Transportadora Boliviana de Hidrocarburos	Enron (USA) and Shell (Great Britain/Netherlands)	263.5
Total		1 671.4

* Amount of pledged investment in return for 50 per cent shareholding.
Source: Finance Ministry in the Economist, August 9th 1997.

3.6 Economic Trends in Peru

In the early nineties, production expanded rapidly, reaching a spectacular peak of 13 per cent in 1994. This figure dropped to 7.7 per cent in 1995 and 2.8 per cent in 1996 as a result of the induced cooling of the economy. Persistent deficit in the balance of trade reached 2 billion dollars in 1996. As a result of fiscal and monetary discipline, the estimated inflation for 1997 is 10 per cent, third lowest in the region.

Thanks to economic adjustments, the economy is undergoing a clear stabilization process, but unemployment and poverty are still widespread. Government and businessmen share the challenge, from here to the year 2000, of reducing poverty by 50 per cent, as well as creating employment, providing better salaries, and overcoming surcharges and other competitive disadvantages.[13] (Cámara de Comercio, 1996)

Table 3.6. Peru: economic indicators

	Average 1990-94	1995	1996e	1997f	1998f
Real GDP, % change	3.2	7.0	2.8	4.5	5.0
Consumption*	1.7	5.5	1.2	1.4	1.7
Investment*	2.7	5.7	-1.0	4.3	2.8
Net trade*	-1.2	-4.2	2.5	-1.2	0.5
Consumer prices, %	315	11.1	11.5	10.9	9.7
% Dec/Dec	242	10.2	11.8	10.0	9.5
Producer prices, %	277	10.5	9.4	9.5	9.0
Public deficit, % of GDP	-3.1	-2.7	0.0	-1.0	-0.4
Exchange rate, unit/USD	1.49	2.31	2.61	2.90	3.00
Merchandise trade balance (USD bn)	-0.3	-2.1	-2.0	-2.6	-2.9
Exports	3.7	5.6	5.9	6.7	8.0
Imports	4.0	7.7	7.9	9.4	10.9
Current account balance (USD bn)	-1.8	-4.2	-3.6	-3.4	-3.7
% of GDP	-4.3	-7.2	-5.8	-5.5	-5.5
International reserves, (USD bn)	3.3	6.7	8.6	8.9	9.9
Total external debt, (USD bn)	27.5	31.5	32.2	31.0	31.7
Short term**	7.9	9.3	10.4	5.9	6.4
Total external debt, % of GDP	64	52	52	52	47
Total external debt, % of exports***	503	388	371	327	278
Interest payments, % of exports***	31	31	25	16	14

* Contribution to growth of GDP.

** Debt with original maturity of less than one year (includes interest arrears).

*** Exports of goods, services, and net transfers.

Sources: World Financial Markets, IDB, Latin Trade.

The real GDP growth forecast has been lifted from 3 per cent to 5 per cent in 1997 and 1998. This reflects the strong rebound of the economy. In 1997 the central feature of the first half was that sectors that had been average performers during 1996 showed a sudden strength.

Two main risks, however, could jeopardize the sustainability of faster economic growth. The first risk concerns the current account deficit. It is likely to be lower in 1997 than two years ago. Keeping it under control will be critical to sustaining future economic growth, given the likelihood of reduced foreign direct investment as the privatization programme ends. Exports must grow more rapidly than imports in order to balance the trade deficit. The extremely adverse social conditions still prevailing in the country pose the second risk, as a consequence of the very modest progress to date in the government's fight against poverty.

Foreign Investment

European, Asian, American and Chilean enterprises are entering the Peruvian market and strongly competing with national enterprises by offering more attractive and sophisticated products to the consumer.

A similar process started in Chile some years ago, allowing the economy to sustain a very rapid pace of growth. Due to this, Chile is now not only receiving investments, but also making them. This process is already taking place in Peru: Peruvian enterprises are investing in the Latin American markets.

Foreign direct investments in Peru are offering new sources of employment and introducing new technology and training. The influx of capital allows enterprises to modernize plants and create more competitive projects and products, build international contacts, obtain new technology and acquire the know-how necessary to compete in the world economy.

The level of amalgamations and take-overs have increased in the country due to the number of multinationals wanting to invest in Peru. The Lima Stock Exchange has experienced a real boom as a result of structural reforms undertaken in the last four years. For three years already, the Lima Stock Exchange has attained records in prices, volume of transactions, and market capitalization.

To guarantee future foreign investment in the country, the current administration has entered into a series of international agreements that grant security and stability to the investor.

In 1991, Peru signed the Multilateral Investment Guaranty Agency (MIGA) Constitutive Agreement, whereby investment is protected against non-commercial risks: expropriation without proper indemnity; restrictions on the transfer of currency; exchange limitations on the remittance of profits and repatriation of capital; damage caused by civil upheaval; and any other act whereby the investor is deprived of the free control and possession of investments in Peru.

With regard to the Andean Pact, Decision 291 of the Cartagena Agreement Commission has established a common regime for the treatment of foreign capital, and for the treatment of trademarks, patents, licenses and royalties, that are still in force even after Peru's partial rupture with Andean countries in 1997.

Several bilateral investment promotion and protection agreements have also been signed with Switzerland, France, South Korea, Thailand, Bolivia, the Czech Republic, and Paraguay. Negotiations are currently under way with Italy, Holland, Spain, Sweden, Germany, Belgium, Argentina, China, Vietnam and Romania. An agreement was signed with the Overseas Private Investment Corporation (OPIC), to insure US investments.[14] (Peru Investments, 1997)

3.7 Paraguay

Paraguay has an economic system based on free trade. A free currency exchange system, free import and export, tax exemption on investments and free transfer of capital have been introduced. At the same time a strict monetary stabilization programme has been put into effect with tax adjustments designed to control inflation. There are no price controls or other types of restrictions.

The new national laws include the limited participation of the state in entrepreneurial activities and grant private initiative a more prominent role in investment and economic activity. This practice has been established by the new private investment law that grants fiscal exemptions and administrative and legal facilities to foreign and national investors.

A law for the privatization of State enterprises has been passed which establishes procedures for the transfer of the State operated steel, alcohol, railway and shipping companies among others, to the private sector. The Paraguayan financial legislation permits the opening of banks, financial undertakings and insurance companies without restriction, except for compliance with operational and supervisory regulations.

Among the reforms designed to create compatibility with the market economy, a law was promulgated, which introduces important reforms to the tax system. The new Law has established for the first time in Paraguayan tax history, a value added tax (VAT). The VAT replaces numerous outdated and complicated taxes that incurred high administrative costs. Also, the income tax system was amended to include an individual tax for certain taxpayer categories. Income tax applies to corporations and business. Personal income tax does not exist.

In international relations, Paraguay has achieved important agreements for cooperation and commerce, including the Mercosur Treaty, signed in Asuncion in 1991 by the Presidents of Argentina, Brazil, Paraguay and Uruguay. Paraguay has also signed investment guarantee agreements with European and Asian countries. In 1992, Paraguay and the United States of America signed a memorandum of understanding in Asuncion to promote commerce and investment between the two countries.

Natural Resources

Paraguay has a surface area of 406 752 Km^2 and 4 767 107 inhabitants. It has borders with Argentina, Bolivia and Brazil. The country has modern highways that permit easy communication within the country and access by land, railway and air to the Atlantic as well as Pacific Ocean.

Paraguay possesses abundant hydroelectric energy provided by the Acaray, Itaipú and Yacyretá power stations, with countrywide supply networks. Paraguay is negotiating with Argentina for the possible construction of the Corpus dam, which, if it materializes, will add 2 500 000 kilowatts of power to the Paraguayan electrical system.

Paraguay has substantial natural resources including those for forestry, agriculture and cattle-raising. With the raw materials obtained from agricultural sources Paraguay offers a wide range of investment opportunities related to the industrialization of agricultural and food production.

At present an ambitious multi-lateral project known as the "Hydrovia" is being considered, which will require substantial private investment and is designed to make the 3 500 km of the Paraguay and Paraná Rivers permanently navigable, from Puerto Cáceres (Bolivia) to Puerto Nuevo Palmira (Uruguay). The geographical position of Paraguay's Hydrovia, and other projects such as the Paraná-Tieté Hydrovia in Brazilian territory and Bioceanic Corridor (that will join the Atlantic and Pacific Oceans), will facilitate communication between the countries of the region and will make the country an advantageous alternative as a center of production, supply and for rendering services. The Hydrovia Project is part of a River Integration Plan between MERCOSUR member countries and Bolivia.

Investment Climate

Paraguay offers important options for private investment in many industries (forestry, textiles, vegetables oils, dairy and meat products, leather and hides, assembly of electronic appliances, as well as wood, beef and other products). The principal products of Paraguay are agricultural including cotton, soybean, sugar cane, meat, wood, vegetable oils, corn, rice, tobacco, manioc (cassava), fruit and vegetables.

In the rural development programme, the preservation of the environment is considered within the environmental protection policy of the Government.

Laws approved by the national Congress in 1991-94, grant substantial tax exemption for both foreign and national capital investments. This includes tax exemption for the formation of corporations and companies, the issue and transfer of stock, purchase and sale of bonds, debentures and other securities of those corporations and enterprises. The laws also include tax exemptions for the import of capital goods, raw materials and other items covered by the investment project.

The law exonerates 95 per cent of corporate income tax, taxes on dividends and profits for the corporation or company for a period of 5 years. Included in the benefits granted by regulations are tax exemptions on rent, lease, profits, rights of use of brands and invention patents, models and industrial drawings, and other forms of transfer of technology, for a period of years. The Law 60/90 also concedes facilities for engaging in leasing operations.[15] (Ministry of Commerce, 1997)

These benefits will be extended to 10 years if the investments are a result of capital repatriation or if the companies are situated in the regions being earmarked as preferential development areas.

The effects of the establishment of MERCOSUR are an improvement in the possibility of productive specialization for a market of more than 200 million inhabitants, with the further possibility of supplying external markets with products from Paraguay. The expectations of the economic agents for the future of the country are very positive and officials of the government and the private sector are convinced that Paraguay will become, in the medium term, an important business center in South America. (Interviews, 1997)

4 ECONOMIC OUTLOOK FOR LATIN AMERICA

4.1 Short-term Outlook

According to a survey of 60 forecasters, published in September 1996 (Financial Times, 1996), Latin America was expected to grow at 3 per cent in 1996, and 4.3 per cent in 1997. The OECD June 1997 outlook is more optimistic: 4.7 per cent growth in 1997 and 4.3 per cent in 1998.

The short-term growth prospects for the region are reasonably good, with increasing confidence in Argentina, Chile, Peru, Mexico and Brazil. (See Table 4.1) However, and at least in the short-term, poverty reduction will remain unresolved.

Table 4.1. Latin America: Key economic indicators[a] 1995-98

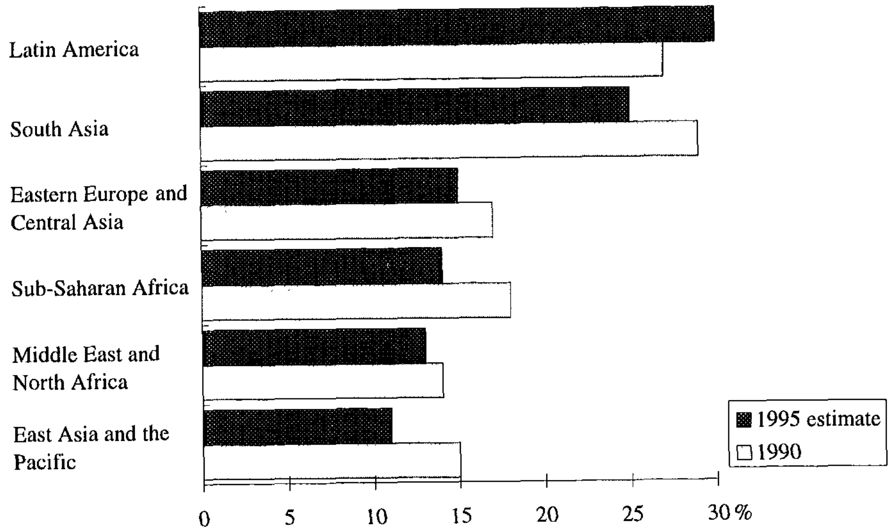
	1995	1996	1997e	1998f
Latin America				
GDP	2.1	3.2	4.7	4.3
Trade balance (USD bn)	-10.1	-9.0	-16.0	-19.0
Current account balance (USD bn)	-31.4	-35.8	-47.7	-52.2
Consumer prices	16.7	16.5	9.9	8.4

a) The figures given for GDP and consumer prices are percentage changes from previous period.
Sources: United Nations Economic Commissions for Latin America and the Caribbean: IMF, and OECD Secretariat projections, in OECD, World Economic Outlook, June 1997.

Over the next few years, Latin American countries are expected to deepen the process of privatization, deregulation and trade liberalization. However, not all of the challenges facing the governments are completely under their control. For example, the receptivity of the industrialized countries, particularly United States and the European Union, to the proposals for debt reduction and new credit flows, as well as for freer and increased access for the region's products to their markets is difficult to predict. Despite some progress in servicing debts, the region was still the highest burdened in the world, at the end of 1995. (See Figure 4.1.)

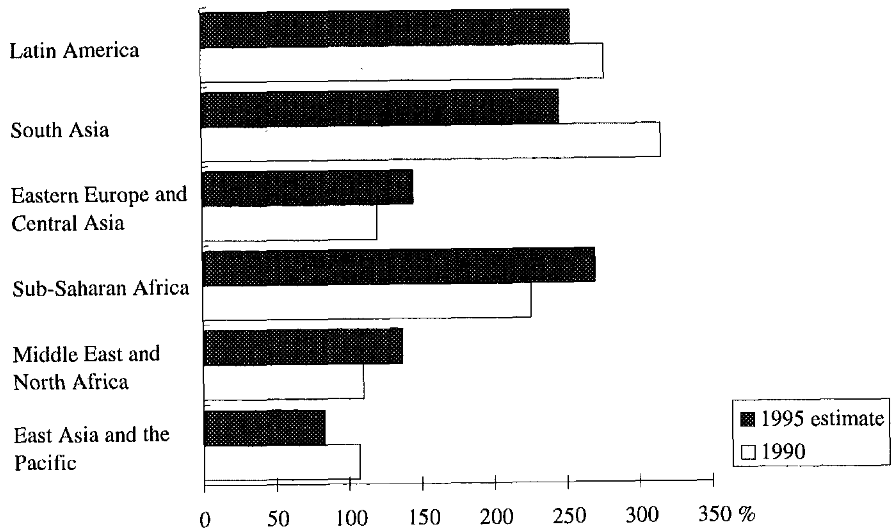
The estimated net investment flow of around USD 50bn for 1996, was about at the same level as in the peak years in the early 1990's, and a greater part of this volume is now longer term foreign direct investment.

Figure 4.1a Debt-service ratios[1] in Latin America and other regions, 1990 and 1995



[1] Interest and principal paid as per cent of exports of goods and services.
Source: World Bank.

Figure 4.1b Foreign debt as per cent of exports in Latin America and other regions, 1990 and 1995



Source: World Bank.

The control and reduction of inflation remains a policy priority in the region. Failures to control budget deficits will increase risks of adverse financial market reactions, aggravated by the fact that domestic savings are still low and external debt levels remain high, both in the public and private sector. Assuming that fiscal policies remain in balance, inflation is likely to continue to fall in the region and current account deficits should stabilize at the 1996 level of around 3 per cent of the GDP. Export volume will grow reflecting increased productivity and expanding production capacity, but export value will depend on price developments for the most important commodities of the region.

As mentioned before, the crucial question remains how to maintain bòth price stability and a sustainable payments position while growing steadily at sufficiently high rates to reduce poverty. The real problem the governments will face in the short term is consequently political. Growth has been too slow in several countries to improve the situation of the poor, or to increase employment opportunities for the expanding population, specially in urban areas, or to stimulate new productive investments and commercial activities. It is more and more difficult for the region's governments, particularly in Argentina, Peru, Mexico, and Brazil, to persuade their electorate that orthodox neo-liberal economic policies are the appropriate remedy, particularly when some governments have undertaken the reforms at least partly as a result of pressures from international creditors.

The possibility of a revival of centrally planned strategies or a return to large state enterprises seems unlikely in the Latin American countries. But ongoing restructuring will not bear fruits unless governments are supported by national political and social consensus. If the fruits of the reforms are too long postponed, if economic changes benefit only a few, if rising poverty continues, and if corruption comes to be considered as part of the business, then the losers from the reforms will look for diverse alternatives, which are not predictable.

There is no danger of return to the closed economies of the 1945 to 1985 era; the question is to what degree Latin America will continue to open. Democracy holds across the region, but the majority of people feel that they have been left out of economic development. There will be temptations for some form of populism while this situation persists. People are forgetting what it was like to live with chaos and hyperinflation, and now they are thinking about the cost of the goods they can not afford.[16] (Latin Trade, 1997)

However, as a consequence of the reintegration of Latin America into the world economy, it will be much harder for the military to cast themselves as the saviors of the nation.

4.2. Long-term Growth Prospects

According to the World Bank, Latin America has the potential to reach an annual average growth of around 6 per cent over the next decade. (See Table 4.2.) To achieve such a sustainable growth, accumulation of capital and labour has to be complemented by development of infrastructure, education of the labour force, strengthening of international competitiveness and reduction of the uneconomic enterprises of the public sector.[17] (World Bank, 1996)

Table 4.2. Latin American growth projections

	Early 1990's	1998 - 2003
GDP[a]	3.4	6.3
Savings[b]	19.9	28.0
Private	13.8	19.5
Public	2.2	6.0
Foreign	3.9	2.5
Investment[b]	19.9	28.0
Infrastructure	3.0	4.5
Schooling[c]	4.9	6.2

a) Average annual growth rate.
b) Per cent of GDP.
c) Average years of schooling.

Source: Long Run Prospects for LAC: Rapid Growth is Possible; in World Bank Latin American and the Caribbean Region Technical Department: Latin America after Mexico, August 1995.

The World Bank study argues that the determinants of private saving are expected to evolve in the right direction. Overall savings should approach 28 per cent of GDP compared with an average of 20 per cent in the early 1990's. Enhancing savings and investment by 8 percentage points would raise annual growth figures. Productivity is also expected to increase as a consequence of higher education, deregulation and openness of the economy, also contributing to the region's growth.

Privatization is expected to be particularly important in Brazil, Argentina, Peru and Mexico and a number of other countries, not only as a source of revenue, but also as an instrument for increasing productivity and investment. Some countries (Bolivia, Argentina) are likely to follow the example of Chile by increasing the role of the private sector in the management of pensions and social security systems.

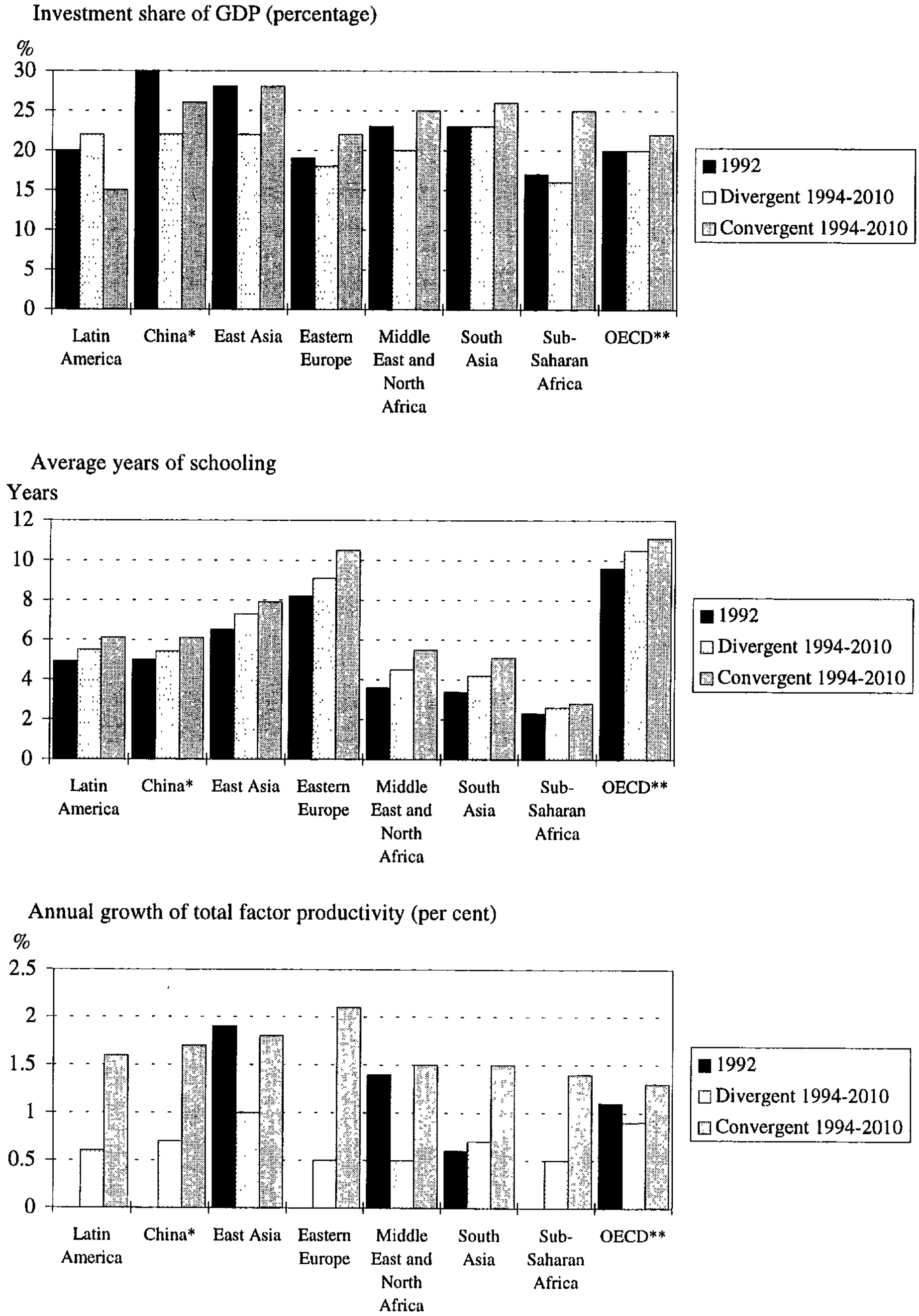
The World Bank office for Latin America estimates that a massive USD 60bn infrastructure investment - private in the case of infrastructure or public in the case of social services - will be needed every year between 1995-2005 period. To achieve such high investment volumes will require what the Bank's office calls "the second generation of reforms" to be incorporated in the macroeconomic policies of the area. These reforms should reach into the daily lives of the people; better educated, with more proficient systems for environmental and consumer protection, health and justice, and with fewer citizens living below the poverty line; the medium- and long term prospects for sustained economic growth will be stronger than ever before.

Two global scenarios were developed by the World Bank: the first one, called "divergent scenario", is largely based on the persistence of past trends that lead to widening differences between some regions; the second one, "convergent scenario", explores the potential implications of strong national policy actions, combined with deeper international cooperation. The divergent scenario assumes that trends in investments continue at the recent rate or deteriorate, that school enrollment decreases prematurely, and that overall productivity of labor does not rise substantially. (See Figure 4.2.) On the contrary, the convergent scenario assumes that investment rates rise, school enrollment increases and investments in infrastructure, technological transfers contribute to improvements in labour productivity.

Global integration interacts with domestic capital and human resources to bring large gains in the case of convergent scenario, and both per capita GDP and exports rise rapidly. (See Figure 4.3.)

Future developments are not all under the control of the Latin American governments; the results of national efforts to achieve sustainable growth will be closely related to the external environment. Among the several factors which will decisively affect the performance of the Latin American economies are the degree of openness and implementation of free trade principles and, more difficult to predict, the international price level for the region's most important primary commodities. Another important factor which will significantly influence the performance of the economies in the region is the possibility of gaining access to modern technologies and know-how on terms that will facilitate further restructuring of production patterns so as to achieve a genuine international competitiveness.

Figure 4.2. Assumptions for growth projections: Latin America and other regions, 1994 - 2010

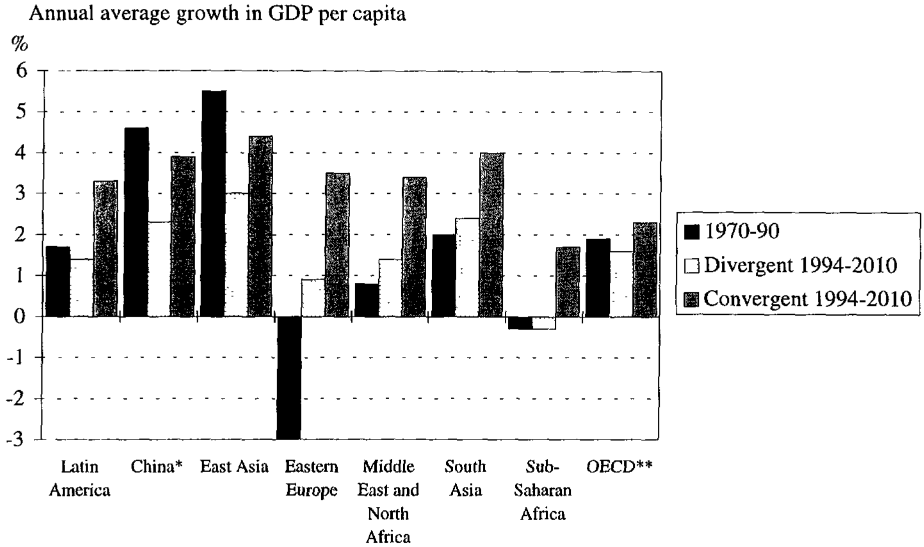


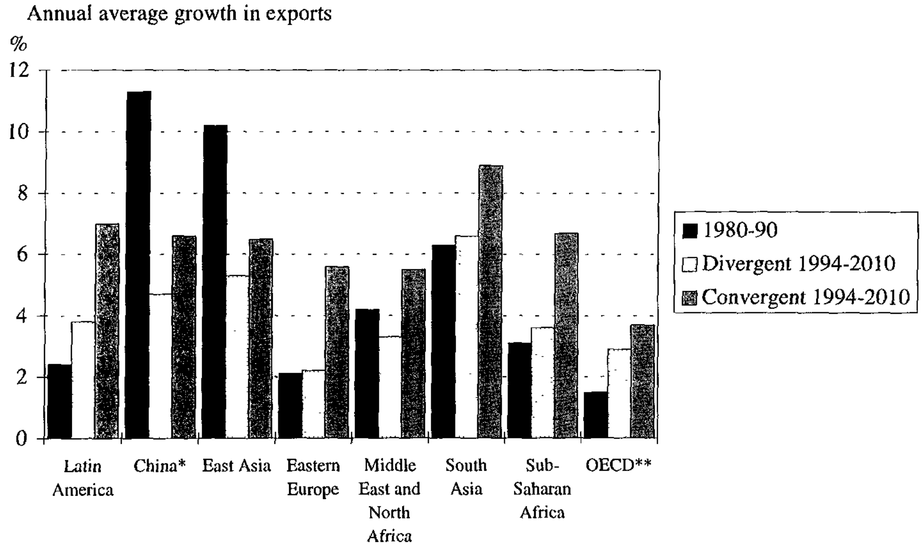
* Includes Hong Kong

** Includes Australia, Canada, European Union, Japan, New Zealand.

Source: World Bank staff estimates, in World Bank: World Development Report, 1996.

Figure 4.3. Assumptions for growth projections in Latin America and other regions, 1994 - 2010





* Includes Hong Kong
** Includes Australia, Canada, European Union, Japan, New Zealand.
Source: World Band staff estimates, in World Bank: World Development Report, 1995.

If Latin American countries go through the next years without a major disaster, growth could start accelerating. Over the next three or four years, if governments persist with their policies, in the sense that they keep their budgets under control and do not create a large deficit, then there could be growth and it would help get rid of some poverty.

4.3 Real Competitiveness

Some conditions which will decisively influence the long-term competitiveness of Latin America countries are: investment in education and human resources, raising domestic saving rates, encouraging investment in infrastructure, adjustment of government policies and reducing inequality of income distribution.

Educational Trends

There are considerable differences among the countries of the region regarding educational trends and problems they have to face. In the present decade, particular emphasis is being placed on the promotion of education not only as a basic social service, but also as the most important condition to strengthen technical progress. From an international perspective, the process is only beginning in Latin America.

The percentage of GDP dedicated to research and development in the region is only a fifth of that allocated by the OECD countries, and a third of that of the countries of South-east Asia.[18] (ECLAC, 1992)

The significant differences in science and technology expenditures in Latin America and the East Asian NIE's directly affect the composition of the region's foreign trade. The ratio of exports to the gross value of production in the main sectors of technical progress - capital goods, machinery and transport equipment - is far lower in Latin America than in the newly industrializing economies (NIE) of East Asia and the more developed countries of southern Europe.

Despite recent efforts, the region's human resources training is still weak, particularly in the face of new challenges in the international economy. Sustained quantitative and qualitative expansion of education will be needed to support the region's development.

Table 4.3. Science and technology indicators, by regions[1]

	Latin America	OECD[a]	NIE[b]	Southern Europe[c]
Per capita research and development expenditure (USD)	10	448	23	44
Percentage of GDP allocated for research and development	0.5	2.5	1.4	1.0
Research and development expenditures per engineer or scientist (USD)	34 858	141 861	50 160	60 647
Engineers and scientists per 100 000 economically active persons	650	115	185	..
University graduates per 100 000 inhabitants	156	592	478	191
Percentage of university graduates in engineering and technology	19.5	15.6	19.6	17.5
Research and development expenditures by activity (%)				
Basic research	20.9	14.1	21.1	19.0
Applied research	52.4	26.5	30.4	39.7
Experimental development	26.7	59.5	48.5	41.2

1. Different years between 1988 and 1990.
a) Excluding Spain, Greece and Portugal.
b) Newly industrializing economies, including Hong Kong, Korea, Singapore, Philippines and Thailand.
c) Includes Spain, Greece and Portugal.

Source: Joint ECLAC/UNIDO Industry and Technology Division, on the basis of official information; in ECLAC and UNESCO: Education and Knowledge; Basic Pillars of Changing Patterns with Social Equity; Santiago, 1992.

Saving Rates

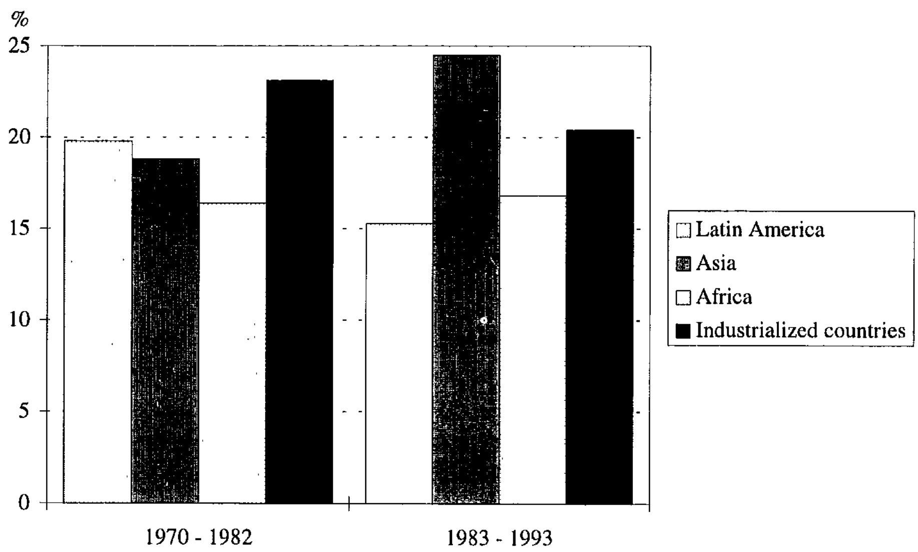
Concerns about saving rates tend to underline the importance of efforts to enhance domestic savings in order to reduce reliance on foreign capital. Domestic savings are not being increased at the same pace as in the South-east

Asian countries. Latin American dependence on external financing seems set to continue during the 90's although at a declining rate.

Over time, nearly all Latin American countries should be potentially capable of sustained growth largely on the basis of their own resources. At present, and with changing intensity, the national economies require a net inflow of resources from abroad. Whether the inflow of external funds is helping development progress in all the countries of the region obviously depends on how the funds are used. Thus growth of the saving rate in the Latin American countries depends primarily upon decisions relating to internal economic policies.

The large capital flights in the region during the past decade are an indication of how sensitive capital is to the degree of security offered by domestic policies. An unfavorable environment for productive investment, the instability of economic policies and the credibility of exchange rates are all factors affecting how effectively personal and enterprise savings can be utilized in national investment projects.

Figure 4.4. National savings (as percentage of GDP)



Source: World Bank in Financial Times, p. 15, 27.6.1995

Shifts in investment and saving ratios can be achieved over time by means of government policies. Chile has successfully outpaced the national savings and investment gap problem, partly through the establishment of successful private pensions funds. The national savings rate was highest in Chile at 24 per cent of GDP, and lowest in Bolivia at 6 per cent in 1996. As an average over the period 1983-93, Latin America national savings were 15.3 per cent, clearly lower than that of Asia at 24.5 per cent, and the industrialized countries at 20.4 per cent. (See Figure 4.4.)

Adjustment Policies

Today's Latin American economic situation is the result of both a long-term evolutionary process and recent events that have brought about some fundamental and lasting transformations. It has become commonplace to discuss the economic shocks of the 1980's and the unsuccessful intention for cooperation among the national economies of the continent in several past decades. Less attention is usually paid to the longer-run adjustment process that has been transforming individual national economies for many years.

Contrary to the 1980's, many governments in Latin America are at present using external and domestic finance in support of structural adjustments, rather than as a substitute for them. With different degrees of intensity, most of the economic policies in the region recognized the long-term nature of the problem and commenced adjustment policies long ago. But the economic trends in the individual countries did not automatically reverse themselves as a result of the varying regional economic situation. Policies which merely borrowed time are now facing problems that are becoming more intractable. Adjustment processes will have to take place, sooner or later, in an international environment in which those societies resisting change may face bigger penalties from the powerful economic poles in the world.

The undergoing structural changes have very important consequences for the economies and politics of the region, and long-term projections. Some of these countries presently rank among the most liberal and open economies worldwide, offering prospective investors and businessmen a free market environment. Adjustment policies in most of Latin America's national economies are laying the foundations for sustained growth with more manageable inflation in the next decade. What remains to be seen is if the region's democracies can strengthen the painful policies without jeopardizing political stability and, at the same time, can efficiently struggle against poverty in their societies.

Inequality and Economic Growth

Although efforts to eradicate poverty must be country specific, approaches should be integrated as a key element in national development strategies. A better understanding is needed in the region: that investment in human capital of the poor - as experienced in other parts of the world - is not only morally right but is good economics.

In a study about the relationship between inequality and economic growth[19] (World Bank, 1996) the researchers assume that there is some evidence that great inequality might hold back a country's growth prospects. For example, Latin America economies, characterized by the most unequal distribution among the regions of the world, have generally grown more slowly than those where income is more evenly distributed such as the East Asian countries. On a scale of 0 to 1 where 1 implies absolute inequality (one household getting a country's entire income), Latin America is clearly the world's most unequal region, with a coefficient of around 0.5.

In the past decade, there were a number of cases of political unrest in the region. Most of the Latin American countries were facing a difficult economic situation and severe pressures on their governments to adopt austere budget allocations for activities that were not considered priorities. The central argument was that poverty is a long-term problem and that current account and foreign debt problems were short-term emergencies. In other words, poverty eradication can wait. This fatal and basic misjudgment has proved to be a mistake.

If a large share of the national population is uneducated, malnourished and ill, how can it make a reasonable contribution to a country's economic and social development? Compared with those fortunate who live in Finland, for example, the poor of even the more dynamic economies in Latin America have an infant mortality rate 6 to 8 times higher, a life expectancy one quarter lower, an adult literacy two-thirds less; and four million children with less protein than the necessary level to permit optimum development of the brain.

For the first time in their history, the middle-income Latin American countries could have the resources - with or without external assistance - to meet the basic needs of the poor sectors of their societies through a poverty-oriented growth approach. In fact, it is the only alternative for the continuation of the growth process. Priorities must obviously be established but education and health care emerge as priority areas.

There are sectors of the economy where the market alone does not provide solutions or where government will continue to have to play a significant role. Among the diverse sectors in which such actions are needed to reach development objectives in the region, there is one which needs to be emphasized; development of human resources as a prerequisite for increasing social equity, competitiveness and environmental sustainability.

To conduct this new phase of development in the Latin American countries, the State has to be reoriented. In addition to its responsibilities in the production sector, it has to promote social equity and further environmental sustainability. To these ends, the State's central role is to design the new policies and institutions to finance development.

The structural changes that have reduced the State's participation as the administrator of national companies will have a positive effect in decreasing the number of opportunities for illicit enrichment. But it will not completely eliminate them; the corruption culture has penetrated all levels of the State's structure.

The problem with corruption is that it is not a new phenomenon in any country's political arena. The problem is that corruption is expanding in a culture in which the dishonest public servant-politician can commit acts of corruption, knowing that his chances of being punished are extremely low.

Women, Education and Poverty

The illiteracy rate and educational drop-out rate among Latin American women continues to be a source of concern for specialists who see the low level of women's education as one of the causes of continuing poverty. According to CEPAL (Comisión Económica para América y el Caribe), when women are less educated, they are more likely to fall into a situation of poverty. Completing high school or studying for more than ten years gives approximately an 80 per cent chance of not falling into a state of poverty.

The Latin American rate of school drop-out among women reaches 30 per cent and, on average, they study for eight years. The rate of women registered in schools is 86 per cent. This decreases to 44 per cent at the high school level. Illiteracy rates are also high. It is estimated that around 20 per cent of women in the region are illiterate. But, as this is an average, there are some countries in which the situation is more serious. In general, Central America has the highest levels of illiteracy: in Nicaragua it is 33 per cent; El Salvador, 30 per cent; Honduras 27 per cent.

But the problem of women's education does not end with these statistics. An Interamerican Development Bank[20] (IADB, 1996) report highlights the high rate of grade repetition among poor girls and boys throughout the region. According to the study, children whose parents have little education and low income are more likely to follow the same pattern. This is even worse if the children live in rural areas and speak indigenous languages. In Bolivia, indigenous children repeat classes twice as often as children living in urban areas. This is another factor which leads parents to withdraw their children from school, even more likely if the child is female.

According to UNICEF, women with a higher education are better citizens in all aspects: they are more in control of their lives, have more job opportunities and better pay. They are more competent mothers and know how to plan and raise a family. In Peru, for example, the rate of deaths per births among children is 280 death per 100 000 births. For women with a high education, the rate is 49 deaths per 100 000 births; for illiterate women, the level reaches 489 deaths per 100 000 births. According to CEPAL, a mother's level of education influences the educational achievements of her children by approximately 40-50 per cent and it influences their economic capacity by 25-35 per cent.

A study carried out by the International Labor Office[21] (ILO, 1996) indicated that in Latin America 15 million children were working, many of them in conditions dangerous for their health, safety and emotional stability. The ILO study stated that half of Latin America's working children are between the ages of 6 and 14 years old and receive miserable salaries.

In numerical terms, these statistics would seem relatively modest in the light of the 250 million children working in the world, however, when shown in more simple terms, the statistics are more alarming: one in every five Latin American children works. The survey coincided with a period of regional growth, characterized by scarce employment, increase in informal activities, reduction in the role of the State as an employer, stagnation of real incomes and the persistence of poverty in most Latin American countries. The statistics indicate that the 20-25 per cent of children that work in Latin America form a labor force representing an average of less than 5 per cent of the region's active economic population.

The ILO investigation establishes that the majority of these children work in dangerous conditions - subjected to physical and emotional abuse and exhausting working days, far above the legal limits. The agricultural sector has a concentration of almost 60 per cent of this child labor population, usually working under inadequate conditions and exposed to dangerous chemical substances and machinery. The ILO report added that child labor is rapidly extending to towns and cities - a direct result of Latin America's urbanization.

Challenges in the Next Century

What are the growth prospects for Latin American countries in the 1990's and beyond? Overall in Latin America there is a wide consensus about the need for open economies, stable prices, and fiscal austerity. The turnaround from the period of protectionist policies, high inflation, fiscal deficits, and debt crises has been significant. Stable macroeconomic policies are the decisive starting point.

Latin American countries have to face numerous challenges during the 1990's and beyond. Among the most important that can be mentioned:

- Despite a generally strong recovery of domestic investment in most of Latin America, investment and savings remain too low to generate sustained economic growth. In the longer term, higher investment requires higher domestic savings; the region cannot rely on foreign capital alone.
- There is a need to consolidate the reform process with the aim of creating a framework that will allow investors and workers to operate efficiently to compete in the world economy. The new reforms will have to improve microeconomic incentives for the most dynamic sectors of the economy.
- A sustainable growth depends mainly on larger exports and access to markets in the rich countries.
- A second cycle of reforms will have to deal, at least with the need for improving infrastructure, modernization of the state, educational programs and control of corruption.

Bad memories of the past decades will persist in the Latin American countries. If they are not to return, the enterprises of rich countries have to offer more than eagerness of rapid profits for their operations in the region, and Latin American governments will need to give their poorest more than just promises.

5 PRIVATIZATION AND OPENING OF MINING SECTOR

The state had formerly a tight grip in Latin American economies. As part of structural reforms vast privatization programmes have been implemented in many countries. These offer promising investment opportunities for domestic and foreign investors.

Natural resources in South America are plenty and the mining sector is in many countries the leading export sector. It has been closed for foreign and often for private domestic investors alike. In this respect changes have been implemented and are still going on.

In this chapter main privatization programmes in South America are presented and compared with those in Finland. This offers a description of two different processes. The situation in mining sector in four main mining countries is also analysed, from the perspective of the new regulations after privatization.

5.1 Privatization in Selected Countries

The term "privatization" is used to describe a range of different policy initiatives designed to alter the balance between the public and private sectors. One can identify three main approaches to privatization.

The first and most common usage of the term refers to a change in the ownership of an enterprise (or part of an enterprise) from public to private sector. Denationalization, or divestiture, can proceed in a number of different ways. In the industrial countries where capital markets are well developed, it can be brought about by the sale of all, or part, of the privatized enterprise's equity to the public. But, in most less developed countries where capital markets are rudimentary or non-existent, denationalization is more likely to involve the sale of the enterprise as a complete entity. It may also take the form of joint-ventures, which introduces private sector involvement to public enterprise. In extreme cases, divestiture may involve the abandonment or formal liquidation of state-owned enterprises.[22] (Cook, Kirkpatrick, 1988)

A second model of privatization involves the liberalization, or deregulation, of entry into activities previously restricted to the public sector enterprises. The removal of restrictions on market entry is usually intended to increase the role of competition, and the degree to which private enterprises are successful in entering the hitherto protected markets: a variant of privatization will have occurred, even though no transfer of ownership of assets has been involved.

The third way in which the word privatization can be used is where the provision of a good or service is transferred from public to private sector, while the government retains ultimate responsibility for supplying the service. Franchising, or contracting-out, of public services and the leasing of public assets to the private sector are examples of this form of privatization.

Governments throughout Latin America have been implementing privatization of state-owned enterprises as a means of cutting government deficits. Unprofitable parastatals have been jettisoned with the hope that private management will reverse their negative results. Profitable assets have been liquidated to raise funds for current expenditures. However, there are many differences between countries as the following review will show.

5.1.1 Argentina

Argentina's privatization program, which was launched by the Government of Carlos Menem with the passage of the State Reform Law in August 1989, is being carried out in the context of a comprehensive program of state and market reform. The main instruments of this reform have been comprehensive structural changes of the public sector, privatization of state-owned enterprises and re-creation of competitive markets to promote efficient resource allocation. Some relatively small privatization's (especially privatization of companies and banks that had gone into state receivership when they became insolvent) were carried out before 1989. But they were not included in the overall economic reform program.[23] (OECD, 1996)

The State Reform Law authorizes the divestiture of enterprises identified by the Argentine Congress as open to privatization. It permits the privatization of all or parts of most state-owned enterprises, granting of service contracts, sale of assets or shares, award of exploitation permits, and licensing of goods or services. The executive branch was also authorized to swap debt to equity, offer tax concessions, assume the debt of a company being privatized, and appraise the value of the assets being sold off. Provisions to allocate a portion of the shares of each company to its employees were also included. Trade unions representing the workers of some companies have submitted bids and been awarded some of the privatized firms.

Most of the companies and public services involved in the privatization programme operate in vital sectors of the economy with important links to other sectors. Due to the problems arising from overhearing, inappropriate pricing and mistaken investment priorities, the majority were running serious losses that had a very negative impact on the national treasury. The operating deficits also resulted in severe deficiencies in both maintenance and necessary investments critical to the development of the Argentine economy.

Pursuant to the State Reform Law, the Federal Government has privatized a broad range of state-owned enterprises and assets, including the national telephone, electricity, water, steel, oil, gas and airline companies, television stations, railway lines, toll roads, grain elevators, petrochemical companies, oil rights, real estate, shipbuilding and defense industry concerns.[24] (Gonzáles-Pita, 1996)

Major State Enterprises

The major sectors in which state enterprises have been privatized by the Federal Government have been the followings:

- The privatization of The Empresa Nacional de Telecommunications (ENTel) was launched in 1990. First this company was divided into two parts, North and South, each having its respective region plus one-half of the city of Buenos Aires. International calling and data transmission were turned over to joint ventures of the two companies. In designing this privatization, the government placed a high priority on expanding service. The new companies were given monopoly rights in the provision of local and long-distance service for seven years. In return the new companies agreed to comply with an investment plan. Now of the 90 per cent of the shares in private hands, foreign investors account for a little less than 50 per cent.
- An 85 per cent share of Aerolineas Argentinas was purchased by a consortium of investors from Spain and Argentina led by Iberia. The Government will retain a five per cent stake in the company and ten per cent will be turned over to the employees.
- Electricity generation, transmission and distribution were divided into their component parts. In the area of generation, power plants were turned into private companies that will be required to compete for sales to regional distributors or large consumers. The tasks of transmission and distribution are natural monopolies that were offered to the private sector under a system with regulated rate ceilings. The high tension transmission system serving the entire country was reorganized under a new company, which was also privatized. Other regional companies have either been privatized or are in the process of privatization. The two vertically integrated electric power companies serving Greater Buenos Aires, SEGBA, and Agua y Energía Electrica, serving much of the rest of the country, were split up. Most of the power stations belonging to the two companies were privatized.
- The natural gas production, transportation and distribution system were separated with the breakup of the state transportation and distribution company. Before restructuring, Gas del Estado purchased gas from the producer and transported it by trunk pipeline to either large consumers or to smaller pipelines through which it reached the consumer. The new

organizational structure consists of two regional gas transportation companies, north and south, as well as eight regional distribution companies. Considerable foreign direct investment was also attracted to this privatization. (OECD, 1996)

- The Federal Government has completely reorganized the petroleum sector. Prices have been deregulated, restrictions on exploration, drilling, and marketing have been lifted and the national oil company, Yacimientos Petroliferos Fiscales (YPF) was rationalized and privatized. The reorganization of the company included the sale of assets in excess of its needs (both in terms of petroleum reserves and physical plants such as refineries, pipelines, processing plants, shipping lines and other holdings), a reduction in personnel and a managerial overhaul. The reorganization of the company turned its large losses into significant profits. Legislation to privatize YPF was approved separately by congress. Shareholdings were divided into three groupings: 51 per cent to the national Government, 39 per cent can be acquired by the provinces, and up to 10 per cent will be turned over to the employees.
- The rail system consists of approximately 35 000 kilometers of primary track, mainly radiating out from Buenos Aires, and 8300 kilometers in secondary lines. The usage of both freight and passenger services had been declining due to the poor condition of the system. For many years the system has been running very high operating deficits that had to be covered by the Treasury. As in the cases of electricity and natural gas, the system has been separated by offering concessions on individual lines for cargo services and for passengers. The most important foreign involvement in this sector is through the participation of major foreign railroad companies as operators of the services rather than as shareholders, although some of them hold minority stakes in the consortia. (OECD, 1996)

The Argentine privatization programme has now run most of its course. However, there are still business units to be privatized, including thermal and hydroelectric power stations, an interprovincial electric grid, one remaining cargo line, a shipping line, ports and port services, river channel maintenance and several factories operated by the defense ministry.

Both from the point of view of the financial results obtained by the national government and the quality of the private operators now running the privatized utilities, the program may be considered on the whole, a success.

5.1.2 Bolivia

Bolivia's economy has in past decades been characterized by pervasive state intervention, recessionary cycles deepened by the international debt crisis and volatile commodity prices, and hyperinflation which peaked at an annual rate of 23000 per cent in 1985. The situation began to stabilize in the same year with the implementation of Bolivia's "New Economic Politics of Stabilization", the first neo-liberal reform program in Latin America. This program consisted of the progressive liberalization of prices, tight fiscal and monetary policies and a restructuring of the public sector.

In 1993 the Government launched the "Plan de Todos" (Plan for All) aimed towards achieving economic growth etc. A central element of the plan, designed to reduce the state's role in the economy and to attract private investment, was the "capitalization" of state-owned enterprises (SOEs) - an innovative variant on the process of privatization. In contrast with typical privatization, in a capitalization the state does not receive any proceeds from the sale of stakes in SOEs. Rather, an increase in capital equivalent to 50 per cent of the SOE is put forward by the strategic investor who receives complete management control of the company and may use the money invested to expand and modernize the company. The Government's remaining 50 per cent stake is distributed to a trustee in the name of all adult Bolivians and will serve as a basis for the establishment of the country's national retirement system.[25] (Cretegny, 1996)

The capitalization program covers six principal Bolivian industries based on the existing state-owned companies: ENDE (electricity), ENTEL (telecommunications), ENFE (railway), ENAF (minerals and smelting), LAB (air transportation) and YPFB (oil and gas). These are the largest government corporations operating in Bolivia and each has required substantial inflows of new direct investment.

The capitalization program is considered to be proceeding successfully. A 50 per cent stake in ENDE, the state electricity company was sold to three US-led consortia. STET of Italy bought 50 per cent of ENTEL, Bolivia's international and national long-distance telecommunications monopoly. The Bolivian flag carrier, LAB went to Brazil's VASP airline for a combination of cash and new planes to add to the aging fleet. This unusual offering was required due to specific characteristics of LAB, which is strongly unionized. ENFE, the Bolivian railway company, was transferred to private hands at the end of 1995 when Cruz Blanca - a Chilean operator - purchased 50 per cent of the Andean and Eastern rail networks.

The capitalization of the Bolivian state oil and gas company, YPFB, was scheduled to take place in 1996. YPFB is being offered as five separate companies, two upstream exploration and production companies, one oil and gas transport company which will handle exports to Argentina and Brazil and two refining and marketing companies. The decision to split YPFB was motivated by the desire to break up the oil and gas monopoly and also make the company more attractive for potential investors.

In addition to the major companies scheduled for capitalization, the government has implemented a privatization program for smaller Bolivian companies. A number of these have been privatized to date with proceeds from the sales directed towards development in the regions where the companies are located.

In conclusion, it can be said that Bolivia's capitalization and privatization program has continued to build on the country's process of economic reform and liberalization. The current program has succeeded in attracting private investments, while at the same time laying the foundation for a national pension system.

Although the upcoming 1997 Bolivian presidential elections may slow further prospects for economic reforms in the short-term, the capitalization and privatization program will probably not be affected. The Bolivian economic reforms appear to be widely accepted by the large majority of the country's population as well as by international investors and institutions. (Cretegny, 1996)

5.1.3 Brazil

In Brazil initial privatization efforts were made in the 1980s. They were aimed at raising financial resources to invest in infrastructure and economic growth. Such initiatives were unsuccessful: the government failed to come up with viable economic and privatization plans, coupled with a political antagonism regarding the break-up of state-owned monopolies, and resulted in failed attempts of constitutional and legislative reform aimed at stimulating private investment and privatization.

The privatization effort was revived in 1990, with the enactment of Law no. 8 031, which established the National Privatization Program (PND). This program was established to transform the economy into a free-market system to provide a regulatory framework for the privatization process, and reduce outstanding public debt.[26] (Schnell, 1996)

The PND has several objectives designed to modernize the Brazilian economy. The program was aimed at:

- changing the government's strategic role in the economy by transferring to the private sector those activities that were improperly managed by the public sector;

- stimulating investment in state-owned companies to be transferred to the private sector; and
- strengthening Brazilian capital markets by encouraging an increase in public offerings and private sector participation in the ownership of companies to be privatized.

Another objective of the PND has been to reduce the amount of outstanding, non-performing public debt by permitting such debt to be used as a form of payment for privatization's. Public debt instruments that may be used as privatization currencies include:

- indebtedness of, or guaranteed by, the federal government and public sector entities; securities representing agrarian debts;
- obligations of the national development fund;
- debentures of state-owned companies undergoing liquidation; and
- mortgage notes issued by the federal savings bank.

The PND established the National Privatization Board (CND), which is responsible for overseeing the entire privatization process. The selection of state-owned companies to be privatized is made by the CND and formalized by Presidential decree. Shares of companies to be privatized are deposited into the National Privatization Fund (Banco Nacional de Desenvolvimento Econômico e Social: BNDES), the manager of the Fund has primary responsibility for implementing privatization.

In the beginning of 1995, legislation was used to create a framework to give enterprises permission to provide public services (concessions Law), including, among other public services, the generation and distribution of electricity. Pursuant to the Concessions Law, the state canceled 34 projects for the construction of hydro-electric power plants that had not been completed on time, placing these on the list of projects to be auctioned to existing and new enterprises. An additional 70 to 80 concessions for the construction of hydro-electric power plants are subject to cancellation and auction. BNDES is expected to play a major financing role for private power projects.

In 1995, pursuant to the Concessions Law, additional legislation dealing with the electric power sector was established (Power Sector Law). The new law enables private "independent power producers", which in the past generally were not permitted to generate electricity, to obtain permission to generate electricity for sale to public utility units and certain other large consumers.

Several constitutional amendments have been adopted by Brazilian congress to promote privatization. In August 1995 an amendment to the Brazilian constitution eliminated the distinction between "Brazilian corporations" and

"Brazilian corporations of national capital". This amendment abolished the different treatment given to corporations controlled by Brazilians and non-Brazilians. At the same time another constitutional amendment enabled the private sector to perform telecommunication services previously reserved for the government. A third amendment to the constitution abolished the government's monopoly over activities in the petroleum sector. (Schnell, 1996)

Privatized Companies

About 50 companies have been privatized during the PND's five-year existence, including those in the steel, petrochemical and fertilizer industries. This privatization has generated in excess of USD 13 billion in revenues or debt reductions for the government. To date, international participation in this privatization has been modest. However, there is strong international interest in a new series of proposed privatizations recently announced by the government.

Privatization in the major sectors of the economy can be described as follows:

- In the electric power industry the first privatization took place in July 1995 with the sale of Espírito Santo Centrais Elétricas (Escelsa), a distribution company, through the auction of shares in the Rio de Janeiro Stock Exchange. In October 1995, legislation was enacted to enable the privatization of a second distribution company, Light - Servicos de Electricidade SA. Pursuant to such legislation, Light was reorganized into two companies, Light/Rio and Light/Par. In addition to the privatization of Escelsa and Light, the government has planned to privatize the distribution and generating facilities of Centrais Eléctricas Brasileiras SA (Eletrobás), the Brazilian state-owned electric power holding company.
- Privatisation of Rede Ferroviária Federal SA (RFFSA), the Brazilian state-owned railway company with estimated assets of US 16 billion, is expected to divide RFFSA into six businesses, each corresponding to regional track lines. It is anticipated that these regional track lines will be transferred to the private sector through permission to private enterprise or leasing contracts. (Schnell, 1996)
- The petrochemical companies Companhia Petroquímica do Pólo de Nordeste (Copene: the largest petrochemical company in the state-owned Petrobrás-family), Companhia Petroquímica de Camacari (CPC: the largest manufacturer of PVC in Brazil), Salgema Indústrias Químicas SA (Salgema), Companhia Química do Recôncavo SA (CQR), Nitrocarbono SA, Companhia Brasileira de Poliuretanos (CBP), Pronor Petroquímica SA (Pronor) and Deten Química SA (Deten) were privatized in 1995. Four petrochemical companies remained still to be privatized in 1996.

- In the banking sector, Banco de Crédito Real de Minas Gerais (Banco Credireal) was the first state bank to be privatized, in 1996. The next bank privatized will be Banco Meridional SA.
- The privatization of the telecommunications sector is expected to follow that of the electric power sector. It is anticipated that the cellular telephone, satellite program and data transmission businesses will soon be privatized too.

Despite the relatively slow pace of privatization, Brazil is prepared to undertake a large-scale international program to privatize state-owned companies. International investors have shown strong interest in the large amount of privatization scheduled for the next few years. This is no coincidence because some of the most attractive companies - CVRD, Electrobás and Telebrás - have already been on the list for privatization. However, the future of Brazil's privatization program is far from secure, because the proposed program has encountered strong political opposition within Brazil.

5.1.4 Chile

Chile has been a pioneer in privatization in Latin America and is one of the few countries that has undertaken a massive divestiture of state-owned enterprises in a relatively short period of time. Several episodes of privatization were undertaken between 1973 and 1989. Each of these episodes offered different types of enterprises and featured different methods of sale and mechanisms for financing the purchase of shares.[27] (Bosworth-Dornbusch-Labán, 1994)

In the first privatization phase, from 1973 to 1981, a few emerging economic conglomerates purchased the majority of the enterprises and financial institutions on offer. The military government, driven by the need to reduce the enormous fiscal costs of operating losses in the state-owned enterprises, made an immediate goal to reform the state-owned enterprise-sector, which was greatly expanded through nationalization by the Allende government between 1970 and 1973. With the economic crisis of 1981-83, most of these enterprises and banks, together with the largest pension fund management companies, returned to the state. As enterprises became insolvent, they ended up in the hands of their creditor banks, which were seized by the state. As a result, a significant part of the productive sector was unintentionally renationalized.

The main mistake made during this process was to allow the formation of business conglomerates through the sale of state-owned assets, purchased with soft financing provided by the state or with funds obtained by abusing the implicit insurance of bank deposits. One lesson which can be drawn from this experience is that successful privatization must avoid schemes of soft financing by the state that allow the formation of conglomerates on the basis of debt. At the same time, lending by banks to affiliated firms must be strictly controlled.

Episode two was a revised privatization programme which was started in 1985. Learning from the earlier bankruptcies, the government sought to ensure more diverse ownership and less indebtedness. The government offered no credit for purchases, except for the sale of small packages of shares in financial institutions to individuals. It encouraged foreign participation by allowing foreign investors to exchange debt for shares in new enterprises, at prices more favorable than those in the secondary market. The government established legislation to restrict inside trading, guarantee the rights of minority shareholders, prevent banks from taking equity positions, and regulate loans to affiliated parties.

Second Round of Privatization

Although the number of the enterprises to be privatized was small compared to the 1970s, the type of enterprises involved made this second privatization episode much more important in its consequences for the role of the state in the economy. First, some of the enterprises are among the largest in the country and were created to accelerate the country's development in areas such as metallurgy, long-distance telecommunications, information science, and electricity generation or as support for particular activities, such as helping farmers build sugar-beet refining plants. Second - some of the enterprises are natural monopolies raising the issue of the separation of regulation and ownership.

The arguments given for the second round of divestitures were explicitly more ideological. The minister of finance mentioned five reasons in 1985: private property is important as the foundation of a free society and of a market economy; a certain gain in efficiency was going to be achieved in these enterprises under private control; the reprivatization and recapitalization of the banks and enterprises affected by the financial crisis; a deepening of the stock market would have a stabilizing effect on the capital market; and the spreading of shareholding.

The government set the stage for this privatization phase by taking a number of policy actions in preparation for divestiture. First, the pension funds were allowed to invest in shares of joint-stock corporations in the beginning of 1985. Pension funds became active participants in the privatization of those state-owned enterprises whose shares were offered and traded in the Santiago Stock Exchange, and became an important source of demand for the enterprises being privatized, especially the largest ones.

Second, the government reformed the regulation of public utilities, establishing new legislation for the electric power industry and telecommunications. The new electricity regulatory law set the procedures and formulas for periodic rate-setting, rules for obtaining licenses for the building and operating of generating plants and distribution systems, and the role of regulatory authorities. In telecommunications, the new law opened up the sector to competition by private investors in local telephone service and defined the role of the regulatory institution. In 1987 a new reform determined the rules and formulas for the periodic setting of rates and established the obligation for licensees to provide service in their areas. In 1988 the regulation of water and sewage services was reformed on very much the same model as the electric power industry and telecommunications.

Third, a number of state-owned enterprises were restructured prior to divestiture. The two largest electricity companies (ENDESA and Chilectra) were transformed into holding companies by separating distribution and generation-transmission into different subsidiaries. In the case of ENDESA, some hydroelectric plants were turned into subsidiaries operating only as generators. Other enterprises also created subsidiaries that were later privatized separately. Government services such as water and sewage and the postal and telegraph services were transformed into joint-stock corporations.

The second round of the privatization program advanced quite rapidly. When the democratic government took office in March 1990, it was almost completed. Twenty of twenty-three enterprises had been fully privatized. CORFO (Corporación de Fomento de la Producción), the development corporation created in 1939 to promote the country's industrialization, maintained a significant but minority percentage of shares in one, and no progress had been made in the other two. Among all the enterprises included in this privatization phase, private shareholders held more than 90 per cent of equity capital in twenty-nine of them, in one enterprise that share was 68 per cent, in four others the private sector was a minority shareholder, and five were still fully state-owned. The total proceeds from the sale of shares between 1985 and 1989 amounted to USD 1.5 billion in 1991 dollars. (Bosworth-Dornbusch-Labán, 1996)

When President Eduardo Frei's government took office in March 1994 it pledged to revive the privatization process which was dormant during the former government because of the suspicion surrounding the privatization process under the ex-military regime. However, the democratic government which took office in the beginning of 1990 was quite innovative in privatization by enacting concession laws that allow the private sector to participate in building, operating and transferring infrastructure projects. This opened the area of public infrastructure to investment from the private sector, where it had previously been reserved for the government.

The commitment of President Frei's government to privatization had a modest start in May 1994 with the sale of CORFO's remaining 24 per cent stake in the airline Lan-Chile.(11, p. 205) Next was a 51 per cent stake in Ferrocarriles del Pacifico, the freight unit of the state-owned railway company, Empresa de Ferrocarriles del Estado, which was sold to the consortium headed by Chile's Cruz Blanca SA (67.5 per cent) in association with the investment fund, Fondo de Inversiones Estrella Americana (29 per cent) and San Pablo Bay Railways (2.5 per cent). CORFO sold a 30 per cent stake in Empresa Electrica del Norte Grande SA (Edelnor) to Southern Company of the United States and various smaller investors on the local stock exchange, and also sold a 6.7 per cent stake in Chile's second largest hydro-electric plant Colbun Machicura SA. In 1994 CORFU received USD 173 million through the sale of state-owned utilities.

CORFU still owns 28 companies, a direct contrast to the 488 companies and 19 banks it owned under the socialist government of Allende in 1973. These companies and banks were sold off over the preceding 17 years of military rule, leaving CORFO with the water utilities, two electric utilities, minor transport company and the heavily-loss making coal industry.[28] (Sanders, 1995)

The government still owns important companies in tradable sectors. It is probable that privatization will continue in Chile, though the speed may be slower than expected.

5.1.5 Summary

During the past decades privatization has been an important instrument of economic policy in both developed and developing countries, as well as in the countries in transition. Different countries have had different priorities in ordering their privatization objectives, according to their political situation. Main reasons for privatization have been:

1. to promote economic efficiency by fostering well-functioning markets and competition;
2. to redefine the role of the State in order to allow it to concentrate on the essential task of governing;
3. to reduce the fiscal burden of loss-making public enterprises, in order to help regain fiscal control and macroeconomic stability;
4. to reduce public debt;
5. to release limited State resources for the financing of other demands, for example in the area of education;

6. to generate new investment, including foreign investment;
7. to mobilize domestic resources for development, and deepen domestic financial development; and
8. to spread and democratize share ownership.

In Latin America privatization has usually been part of a wider economic strategy based on the trade liberalization model. As a consequence of economic crisis in the course of the 1980s Latin America turned toward economic reforms which included opening up economies to foreign trade and investment, reducing the role of the government, promoting new exports and taking steps against inflation. This set of "neo-liberal" ideas came to the fore and called for structural adjustments.

Chile pioneered privatization in Latin America. Its first privatization phase was begun by the military government in 1973, principally as a reaction to the nationalization by the Allende government between 1970 and 1973. In this phase and especially in the second round which started in the middle of the 1980s the reasons were explicitly ideological. But in addition to the reduction of the role of the State in the economy privatization was aimed at economic efficiency and development of a domestic capital market. In Chile, pension funds became important participants in the privatization effort as they constituted, and still do, an important source of demand for shares, since they were authorized to invest in equity in 1985. Chile, by privatizing the State pension system and associated life insurance companies, created the first group of institutional investors in Latin America.

In Mexico the first privatization program was launched in the beginning of the 1980s as a result of the deep financial crisis. Since then over 1000 of Mexico 's state-owned companies have been privatized and so resources have been released for substantial increases in public expenditure on social services, including education and infrastructure development. Mexico provides an interesting example of private sector involvement in road projects, as it has introduced a program of road tolls - the first of its kind in Latin America.

In Argentina, particularly since 1989, the public sector has been subject to a far-reaching program including substantial reductions in spending and in the fiscal deficit as well as rapid and effective progress in privatizing state companies. The privatization program assisted the Government in reducing expenditure and improving the public accounts. Instead of draining public revenues to cover losses, the newly privatized companies are paying taxes. The debt-equity swaps involved in the privatization program did not require any cash outlay and yet reduced debt service payments, thus increasing state solvency while reducing investment risk.

In Brazil initial privatization efforts were made in the 1980s aimed at raising financial resources to invest in infrastructure and economic growth. The National Privatisation Program was established as late as 1990 to transform the economy into a free-market system in order to provide a regulatory framework for the privatization process, and reduce outstanding public debt. Despite the relatively slow pace of privatization, Brazil is prepared to undertake a large-scale international program to privatize state-owned companies. Private pension funds have also played a major role in Brazil's privatization program.

In Bolivia the Government launched the "Plan de Todos" (Plan for All) in 1993, aimed towards achieving economic growth. A central element of the plan, designed to reduce the state's role in the economy and to attract private investment, was the "capitalization" of state-owned enterprises. The capitalization and privatization program has succeeded in attracting private investments, while at the same time laying the foundation for a national pension system.

In Colombia, the privatization process has been more conservatively paced and less extensive in comparison with other Latin American countries. In Peru and Venezuela the privatization process has progressed quite rapidly during the 1990s.

5.1.6 Privatization in Finland

The interview round in five Latin American countries (See Chapter 10) revealed that particularly government officials and private sector executives are interested in the Finnish privatization process. Therefore this report includes information on this matter.

Initial Steps During the 1980s

In Finland privatization has been part of an economic reform aimed at:

- liberalizing the economy by eliminating regulation and increasing competition
- changing government-owned companies' operating principles in a more market- and customer-oriented direction and/or
- transferring ownership from the public to the private sector, either partially or entirely.

A central feature of the Finnish economy has been the lack of competition in the domestic market. The measures for improving competition were taken in the late 1980s by renewing the legislation concerned. In 1987 the Parliament adopted new Acts on competition, including an Act on the Office of Free Competition. The office is responsible for promotion of competition.

In the 1980s many reforms were started for rationalizing the central administration of the state. On one hand, the norms and provisions, regulating the functions of the civil servants were reduced and, at the same time, a great deal of the decision making power was delegated to the provincial and local level. On the other hand, a customer- and profit-oriented thinking was introduced and intensified in the public sector. This process is still going on.

One result of this process was the reform concerning unincorporated state enterprises. In 1987 a new Act (627/87) on unincorporated state enterprises came into force. On the basis of the new legislation many state institutions, which previously were included in the state budget, have obtained a more commercial and independent form of operation.

In Finland privatization cannot be understood in the same way as in other Western European or Latin American countries. In those countries state-owned enterprises have for the most part been nationalized, which in Finland has never happened. All Finnish state-owned enterprises have either been established greenfield or, in some cases, bought at a market price and in full cooperation with the sellers. Consequently the state-owned enterprises have never been in Finland such a political issue as in many Western European countries. This has been reflected in privatization which has been regarded as a pragmatic rather than an ideological question.

Privatization or transfer of industrial companies to the private sector has not been avoided if it has been required by the industrial policy or for some other reasons. However, as late as at the end of the last decade the Government adopted a positive stand toward the extension of State-owned companies' ownership base in order to promote capital funding provided that the state retains a majority holding. The years 1988 and 1989 were in a sense historical since for ensuring the State-owned companies' capital supply Finnair Oy, Outokumpu Oy, Rautaruukki Oy and Valmet Oy were partially privatized by effecting public issues and by allowing them to become listed in the Helsinki Stock Exchange.

During the last decade there were two privatization cases in which the state has totally relinquished its ownership. These cases were quite solitary even if the principal reasons were necessary structural arrangements and the fact that there are no more real needs for holding state ownership in certain sectors.

Establishment of Privatization Process in the Early 1990s

In 1991, the Government noted that there was no need to maintain state ownership of existent level in any of the industrial and energy companies, when their significance from the point of view of industrial policy and for the national economy is taken into consideration. The special tasks which used to be given to these companies in the past - creating basic industry, achieving and maintaining national self-sufficiency in various fields of production, and developing trade with former Soviet Union within the framework of a clearing system - were no longer timely.

At the same time the Government set the general goals which must be taken into consideration in extending the ownership base of state-owned companies. These goals which were adopted also by the present government in 1995, were defined as follows:

- Ensuring the supply of risk capital for the companies and strengthening the companies' capital structure.
- Widening and deepening of the domestic capital market by stimulating stock saving activities in Finland so as to maximize the extent and stability of the domestic ownership in companies.
- Attracting foreign capital to Finland.
- Strengthening Finland's industrial basis and structure, e.g. through ownership arrangements with a view to restructuring important sectors.
- Promoting domestic competition.
- Obtaining revenues to the State budget.

The former Government identified also the main principles to be observed in privatization process. These principles which, for the most part, have been pursued by the present Government, too, are essentially as follows:

- All measures of privatization or ownership arrangements are taken separately for each company. Instead of an overall privatization programme the Government will proceed on a company-by-company basis. For example an additional authorization for expanding an ownership base is asked by the Government from the Parliament separately for each company. According to the Act on the State's Exercise of its Partnership Authority, the Parliament's approval is needed, if the government will relinquish a two-thirds majority of shares and votes, a simple majority of votes or a one-third minority of shares and votes in a company. In this way the Parliament has a chance to voice its opinion and to take a stand regarding the Government's plans and measures for every company.

- Privatization of state-owned companies should be aimed at creating as broad and stable ownership base as possible. This means mainly that the state-owned companies should seek to find new investors and owners who are interested in making long-term investments. Particularly, share holdings of Finnish people and Finnish institutional investors will be promoted.
- Share issues and offers will be addressed to state-owned companies' personnel and personnel associations (e.g. personnel funds) in connection with as many public issues and sales of the Government's shares as possible.
- In determining the value of shares and in price-fixing the company's net assets and rate of return should be taken into account. On the other hand, in setting the issue price one should pay attention to the development of aftermarkets.

Implementation and Results

Implementation of the established privatization process in its present form was started in November 1993 by a share issue of Rautaruukki Oy. The main aim was to improve the debt-equity ratio of the company; besides that, the State obtained proceeds by selling off part of its subscription rights. In April 1994 Rautaruukki Oy effected another share issue, which was now extended to international investors as well. This time the sole purpose was to strengthen the company's capital structure. These two share issues together supplied Rautaruukki with a risk capital of some 1.2 billion marks, which improved the company's equity ratio by over 9 percentage points. The share of foreign owners in the company's stock rose to about 16 per cent.

Outokumpu Oy effected an international share issue in December 1993 for the sole purpose of strengthening its debt-equity ratio. In June/July 1994 the company effected another international issue, whereby the State got an opportunity to obtain proceeds by selling off parts of its shares, giving up its majority holding in the company at the same time. The two share issues provided the company with a risk capital of around 2 billion marks and increased its debt-equity ratio by 11-12 percentage points. The share of foreign owners in the company rose to about 32 per cent.

Through its share issue in May/June 1994, which was mainly effected in order to strengthen the capital structure, Valmet Oy acquired (mainly from international capital markets) a total of some FIM 650 million of new risk capital. The share issue increased the share of foreign shareholders to about 28 per cent of all the owners and improved the Group's equity ratio by around 7 percentage points.

In May/June 1996 Valmet Oy effected a secondary offering which included an open-price offering targeted at Finnish and international institutional investors and a fixed-priced offering targeted at public investors and employees. Private citizens in the public offering were given without payment one bonus share for every 10 shares subject to a minimum holding period of one year. Employees of Valmet were offered 2 bonus shares for every 10 shares held for the 12 months. As a result of this offering the state reduced its stake in Valmet from the level of 59 per cent to approximately 20 per cent. In other words, Valmet Oy was privatized. After the pricing of the offering Valmet's share was listed in the New York Stock Exchange. In connection with the offering a share buy-back-scheme was applied pursuant to Valmet's Articles of Association. Through this secondary offering, including also the redemption, the Government obtained about 2.4 billion marks of proceeds.

The exclusive aim of the international share issue effected by Kemira Oy in October/November 1994 was to strengthen the debt-equity ratio of the Group. The company raised risk capital at the same time, and improved its equity ratio by about 7 percentage points. Foreign shareholders came to represent approximately 22 per cent of the owners of the company. In October 1996 Kemira Oy effected a global offering of shares of which about two thirds were offered by the Government and the rest by the company. As a result of this offering the State obtained about FIM 855 million of proceeds and the company almost FIM 400 million of equity capital. The company's debt-equity ratio increased by 2-3 percentage points and the share of foreign owners rose to more than 25 per cent of shares. The offering included a bonus incentive scheme, whereby private individuals will receive one bonus share from the state for every 10 shares held for the 12 months following the offering. Employees will receive an additional bonus share for every 20 shares held. The offering as a whole as well as its retail succeeded and the company obtained more than 13 000 new owners.

The share issue effected by Finnair Oy in January 1995, too, aimed exclusively at an improved debt-equity ratio within the Group. The company thus obtained over FIM 400 million of risk capital and raised the debt-equity ratio of the Group by 6 percentage points.

In November 1995 Neste Oy effected a combined offering targeted at Finnish people and institutional investors. As a large and well-known Finnish Company, Neste offered an excellent opportunity to develop the domestic stock market. About one third of shares were offered by the Government with a bonus incentive. Private individuals received one free bonus share for each 10 shares purchased provided that the shares remained in the purchaser's possession for 12 months following the offering. The bonus issue was a success and Neste received about 25 000 new shareholders in all. The company raised approximately 670 million marks as equity capital and increased its debt-equity ratio by 2-3 percentage points. The Government obtained about 350 million marks of proceeds.

Structural arrangements between Oy Sisu Ab and Valmet Oy in 1995 were aimed at a branch rationalization which strengthens the competitive position of the whole industrial sector both at short term and, in particular, at long term. The merger between Enso-Gutzeit Oy and Veitsiluoto Oy in 1995 was targeted at improving competitiveness of Finnish forest industry.

In addition, during the 1990s four minor state-owned companies have been privatized completely: Suomen Malmi Oy, which is producing geotechnical services, was privatized in 1991 by selling the state's majority to the management, as well as the Telephone Company of Kokkola and the State Catering Centre which were transferred to the private sector in 1992 and 1993 by selling the state's ownership to the private competitor. VTKK Group operating in data processing, was privatized in 1995 and 1996 by selling state's ownership to the competitors.

As a result of the privatization process established in the early 1990s the companies have raised a total of over 6.9 billion marks of new risk capital, and proceeds to the State have been in all about 6.2 billion marks. So, during the 1990s a total of some 13.1 billion marks has been cut off from State shareholdings for improving the capital structure of the companies and for covering the State's budgetary expenditures. Annually the amount of new risk capital raised by the companies and proceeds to the Government have developed as follows:

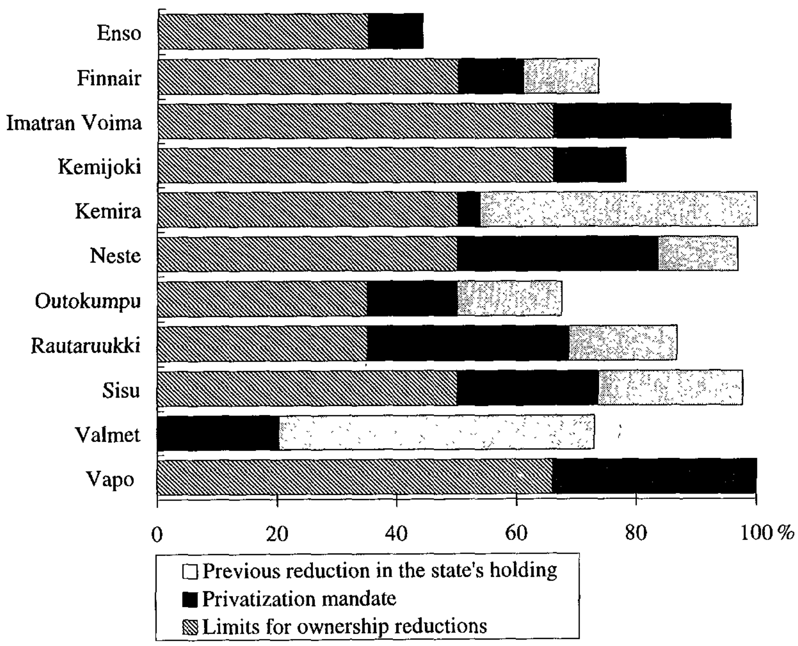
Table 5.1. Privatization in Finland, 1990-96

	Risk capital FIM bn	Proceeds to the State FIM bn
1990	0.00	0.00
1991	0.00	0.02
1992	0.00	0.00
1993	0.32	0.24
1994	5.16	0.52
1995	1.08	1.53
1996	0.38	3.84
Total	6.94	6.15

The Government has used authorizations from the Parliament worth some 2-3 billion marks for contributing to restructuring in forest and engineering manufactures through ownership arrangements. So, up to now a total of authorizations from the Parliament worth some FIM 15-16 billion has been utilized in privatization process of this decade. About 45 per cent of this has gone to strengthen companies' capital structure, about 40 per cent to procure funds for the state and the remainder to carry out branch arrangements.

On the whole, it can be observed that the measures of privatization process carried out during this decade have predominantly served the aim of strengthening the companies' solidity and , at the same time, helped to attract foreign capital to Finland. But, particularly, in 1996 privatization process made progress for the benefit of the State's budget. So, the emphasis of the privatization process has changed after the companies' capital structure has become strong enough. To obtain revenue to the State has reached a more important position among the general targets. The other target the signification of which essentially has grown since the start of privatization process is a stimulation the domestic capital market by promoting stock investments of Finnish people and institutions.

Figure 5.1. State's share of share capital, privatization mandate, 1996 (percentage)



Source: Ministry of Commerce and Industry, Helsinki, 1997.

At the start of the privatization process of this decade the former Government had a mandate from the Parliament worth approximately FIM 20 billion. In 1994-96 the Parliament has approved further authorizations in such a way that the present Government has a mandate the total value of which is judged to be 20-25 billion marks. Among individual companies, however, there is a great deal of variation, as clearly shown by figure 5.1. It is expected that in Finland privatization process will continue as pragmatically as by now on condition that the market is developing favorably.

Summary

Briefly, Finland's privatization process can be characterized as follows:

1. Privatization is not an end in itself. Privatization process which took initial steps in the 1980s but was established as late as in the early 1990s is now a part of economic policy.
2. All measures of privatization are taken by the Government on a company-by-company basis within the authorizations of the Parliament. Additional authorization for privatization is asked from the Parliament separately for each company, instead of having an overall privatization programme.
3. At the initial stage of privatization the most important targets were to strengthen the capital structure of the companies and, at the same time, to attract foreign capital to Finland. During the privatization process the companies concerned have raised a total of some FIM 6.9 billion of new risk capital on domestic and international capital markets. Of all authorizations from the Parliament used by the Government so far about 45 per cent has served the target of increasing the companies' solidity.
4. Particularly, in 1996 the priority order of the targets has changed: now the authorizations of the Parliament are, principally, used for obtaining proceeds to the state budget. In all about 40 per cent of the authorizations utilized to date has been used for the benefit of the state budget, in 1996 even about 90 per cent. At the same time the development of the domestic capital market has become more and more important.
5. The Government has, to date, cut off from the State shareholdings a total of some FIM 15-16 billion of which approximately 15 per cent has been used for contributing to structural arrangements in forest and engineering industries.

5.2 The Mining Sector in Latin America

5.2.1 Argentina

The economic crisis in the country towards the end of the eighties was succeeded by a change in economic planning. Following the example of other economies in the region foreign investment was encouraged in order to reactivate new sectors of the economy; especially in the least developed area which was also one of the most attractive for investors: mining.

New Mining Policy

A new mining policy was brought into force which would put mining on the same level as the rest of the productive activities and raise its international competitiveness. Special attention was paid to the particular investment characteristics of mining with reference to the risk that investors would be running and time required for full activity.

The following targets were set for mining:

- low risk investments
- increase productive investments
- increase exports
- introduce new technology
- create new sources of work
- train human resources
- reinforce regional economies
- reconcile the participation of the sector in the GDP in the same proportion as its resources
- prevent geological risks.

So that this policy would have lasting consequences, the objectives and instruments necessary for its application were established by law.

Government forecasts for the five-year period between 1996 and 2000 indicate the following:

- over one hundred new companies will continue exploring national territory and opening up new areas of production.
- annual pre-investments (for exploration) of USD 135 million.
- over USD 534 million in investments annually in new productive projects.
- annual mining output over USD 1 500 million.

- mining exports of more than USD 1 100 million in 1999, a figure which is significantly higher than the current USD 70 million.

In the opinion of many persons in the mining industry, certain aspects have still to be corrected: the challenges for mining corporations from a lack of experience in the banking sector, the way in which local bureaucracy handles this type of business, inadequate communications infrastructure and the lack of qualified mining personnel and legal insecurity.

The Mining Law

In the Republic of Argentina the ownership of mines, exploration and exploitation rights are governed by the Mining Law which is the same for all provinces within the Federal Republic.

The Mining Law was put into practice in 1886 and over the past 110 years it has been modified several times, the last adaptation being performed recently in order to adapt legislation to the sector's real development.

According to the Mining Law, the Government has sovereign right and jurisdiction over all mines, establishing what is known as "original title". However, it may not exploit them or use them except for what is established in the Mining Law. In this regard, the Law grants private parties the power to search for mines, exploit and use them as though they were the owners.

Notwithstanding the government's jurisdiction, mining property is not public property because it can be subject to exclusive use by private persons. The government as sovereign entity and representing the interests of the public is legally entitled to grant mining permission to those who discover new deposits.

The government is obliged to maintain the license as long as three conditions are met: a) payment of an annual royalty, b) investment of a minimum amount in capital and c) reasonably intensive exploitation. If the investor does not fulfill any one of these conditions, the title reverts back to the government. Once the license has been lost, the mine is considered to be vacant and any party interested in the license may request it. The concession runs for an unlimited period of time and is irrevocable, but the concession does expire if any of the requirements and conditions are not fulfilled.

Together with the discoveries, the government may also grant abandoned mines to private parties. The yearly subscription for ownership is established by law and its amount is fixed. So far as capital investment is concerned the miner is obliged to invest in equipment for the mines, buildings, roads, power plants, machinery and works for the exploitation and processing of ores.

The Law recognizes the property of the mine and the adjoining facilities for its exploitation, something which entitles it to be legally transferred and mortgaged, thus being considered as one whole entity. The law regulates the formation of mining companies which are constituted either by registration of a mine by one or more persons, by part of a registered mine being acquired or because of a special company contract.

Foreign investment is governed by Law 22 208. Foreign investors may invest in Argentina under the same terms and conditions as nationals. In this way, there is no discrimination between local and foreign investment. According to an amendment no type of approval or official registration is necessary. Therefore, the investor may decide whether he registers or not his investment with the Department for Economic Coordination of the Ministry for the Economy. Registration did grant certain additional benefits related to currency convertibility, which are not enjoyed by non-registered investments. However, with a market of free currency exchange and the program of currency convertibility in force since April 1991, this difference is no longer relevant from a practical point of view.

Foreign investors may acquire foreign currency and remit funds overseas without any restrictions whatsoever. There are no limits to capital repatriation nor the remittance of profits.

5.2.2 Mining in Chile

Chile has large mineral reserves, both metallic and nonmetallic. Mining has always played a predominant role in Chile's trade with the rest of the world.

The country has approximately 28 per cent of the world's copper reserves and significant reserves of selenium (21 per cent), molybdenum (20 per cent), rhenium (40 per cent), lithium (58 per cent), iodine (23 per cent), and boron (4 per cent).

Chile is the largest producer and exporter of copper in the world. Chilean production was 3 million tons of fine copper in 1996. This production represented 27 per cent of the total world production of mined copper of 11 million tons. It is estimated that at the end of the century Chilean production will reach four million tons, which would represent 30 per cent of a world total of around 13 million tons.[29] (MBM, 1997)

Besides copper, Chile is also a leading producer of potassium nitrate and sodium nitrate, and it is second in the world in production of rhenium, lithium, iodine and molybdenum; fifth in production of boron; seventh in selenium; eighth in silver and tenth in gold.

Production of other minerals in Chile includes iron, manganese, zinc and lead, nonmetallic minerals like calcium carbonate; sodium chloride or rock salt; boron, which is abundant in the salt deserts; filtering minerals like diatomite; lapislazuli, a mineral that only exists in Chile and Afghanistan, and several other non-metallic minerals.

Chile also produces moderate amounts of energy products, especially oil, natural gas and coal. The largest hydropower basins are located in the southern region.

Mining is one the most important, dynamic sectors of economic activity in Chile. It represents almost one half of the country's foreign trade and foreign currency revenues. Its share of GDP is 8 per cent, which is a significant figure considering that the labor force employed in the sector is only 2 per cent of the country's total.

The private mining sector in Chile has experienced accelerated growth, as a result of the extraordinary geological conditions of the territory and the positive environment for investments. As a result of favorable legislation, the Chilean mining sector is particularly attractive for both local and foreign investors, and mining exploration has been experiencing a boom since the middle of the 1980s.

Structural Changes in the Mining Sector

The ownership of mining production is undergoing substantial change in Chile. It started in the 1970s and the progressive privatization of mining production will continue into the twenty-first century.

The copper companies grouped in Codelco remain in the hands of State: Empresa Nacional de Minería, Empresa Nacional de Petróleo and Empresa Nacional del Carbón.[30] (Minera Chilena, 1996)

The scope of foreign investment is limited almost exclusively to copper and gold projects, and their by-products. Chile's other major resources - its world class nitrate and iron ore deposits - are controlled almost entirely by local companies.

Given the country's long history of mining, the democratic government decided to promote mining as a way to earn money and stabilize the economy. Barriers to foreign investment were dropped, substantial tax relieves - machinery imported for mining is, for example, exempt from VAT - were allowed, and the so-called "Codelco Law" was passed, allowing foreign investor to participate in mining projects associated with state concessions. The government also set up the Comité de Inversiones Extranjeras to encourage foreign investment and make it easy for investors to obtain permits and necessary approvals for their various projects. Although several miners returned to Chile during the dictatorship period, most major companies waited for the restoration of democracy.

Foreign producers have entire access to the copper and gold mining. Enthusiasm for copper exploration, however, seems to be muted not only because it is an expensive endeavor, but because, all of the largest, lowest-cost reserves are controlled by state-owned giant Codelco.

Although the mineral deposits are huge, there are also big problems to overcome

- the rapidly diminishing availability of water
- an impending deficit of sulfuric acid, the key ingredient of heap leaching
- an upsurge in environmental and other mine regulatory processes, including mine safety related issues.

Although Chile's gold and copper deposits are spread over nearly the entire length of the country, many of the most productive copper mining operations are located in the Atacama desert, where water resources are scarce. This is a serious problem for the traditional mines, which use an average of one to the three tons of water for every tons of ore processed.

Securing water supplies may soon be as important as securing mineral rights; it has been, for istance, (RTZ, 1996) calculated that the water source near their Escondida project will dry up by 2005. A large company is planning to pump water from Bolivia. Few companies, especially those looking to mine low grade ore, can afford that scale of infrastructure investment.

Over the past few years, the pro-mining government of Chile has had to address an increasingly local environmental movement. The government has approved several resolutions on diverse types of pollution, and created several entities - including The Regional Environment Commission, The Regional Administrative Authority, Conama The National Environment Commission and a mining division of SEREMI, Regional Ministerial Secretaries; all with different degrees of environmental responsibility.

Despite the boom of miners into Chile, most newcomers feel that there are ample opportunities for them to do business. With projects than range from greenfield surface sites, through expansion plans for 80-year-old underground mines, to high tech mines of the future, virtually all mining equipment manufacturers, engineering consultants, and mine service providers can find good business opportunities in Chile.

5.2.3 Mining Potential in Bolivia

Since colonial times, Bolivia has been a prominent mining country. In spite of its long tradition as a producer of silver and tin, it is estimated that only 10 per cent of the enormous mining potential of the country has been fully exploited. To the west, and in the areas of Potosí, Oruro and La Paz, several of the most important mineral areas of the Andes can be found, where tin, gold, silver, antimony, wolfram, zinc, and lead are mined.

In the extensive Precambrian region along the eastern belt, and in an area which covers almost a third of the country, lie what are considered to be one of the largest deposits of semi-precious minerals in the world, which still have to be mined on a large scale and with an entrepreneurial approach.

To break with traditional mining the government is doing its best to attract investments which will be devoted to exploration work in several areas. No systematic exploration work has been carried out over the last thirty years.

The Corporación Minera de Bolivia has taken a greater interest in the exploration and mining of the deposits through joint ventures with high-profile multinational companies, in order to attract economic resources and modern technology for large-scale exploitation.

State mining was established in 1952, the year in which the Corporación Minera de Bolivia - COMIBOL was created. Nowadays it has a total of two thousand mining properties covering an area of one million hectares. At present, COMIBOL is directly operating only two mines; Colquiri and Huanuni. Within this new policy, Comibol is being transformed into a holding corporation, transferring its most productive units to private companies and creating joint ventures and capitalization systems for reactivation of its mines. Other small mining deposits are being transferred to cooperatives owned by the unemployed mine workers. Despite the Government's reduced level of participation, from 1994 onwards, the importance of mining is still a preponderance for the Bolivian economy.

Private mining which includes the Asociación de Mineros Medianos, the Cámara Nacional de Minería and the Mining Cooperatives is growing at a fast pace. This is due, fundamentally, to the favorable conditions granted by the Government for investment, joint-venture contracts for the exploration and mining of new deposits and mines that where operated by COMIBOL.

New Mining Policy

A new mining policy has been designed to attract private investment including legal regulations which guarantee the formation of joint-venture companies, a free-market environment, low customs duties, freedom of currency convertibility, encouragement, recognition and protection of investments, incentives and security for those operations which will guarantee modern systems for the development of mines, deposits and facilities ready to begin working, studies concerning the potential of the mines, support services for the exploitation and the concentration of minerals, social housing projects and promotion of human resources.

To guarantee a rapid and long-term expansion of the metallurgical and mining sector, the government approved the following regulations:

- modernization of the Mining Law,
- new tax legislation for the metallurgic and mining sector,
- new Investments Law.

The current Mining Law reflects the country's traditional mining practices and can be considered, for all practical purposes, as a suitable legal vehicle for the development of mining. Nevertheless, the strategy contemplates the introduction of some modifications which will make investing in the sector more attractive and expedite.

These modifications are basically:

- the introduction of a modern and efficient system for requesting and registering mining concessions,
- the opening up of areas to foreign private investment for locations less than 50 km from international borders, which until now have been restricted, and where many of the country's more attractive prospects are to be found,
- the establishment of the proper legal framework required for forming joint ventures between state-owned and private mineral-metallurgical companies, both domestic and foreign, for the development of the country's mineral resources.

A tax of 25 per cent on mining companies' profits is currently in force, with a further tax of 2.5 per cent on net annual sales. The tax on profits may be credited to the sales tax, the greater of the two is the real tax to be paid. Remittance of profits overseas is taxed at 12.5 per cent.

The new system, which evolved from reviews of tax laws in the most successful mining countries in the world, presents an alternative to the old tax system, and is devoted essentially towards motivating investment in the sector by taxing profits declared on the mining operation. The model applies a low rate during the capital recovery period.

The new investments law drafted by the Government covering investments gives guarantees to investors, for long-term stable conditions regarding regulations and taxation systems, freedom of currency convertibility and the repatriation of profits.

One of the Government's main concerns is the protection of the ecology in areas where mining takes place and mitigating the serious impact of traditional mining. In 1995, the Secretary for the Environment, put together, analyzed and drafted the regulatory laws, which were finally approved in 1996. The Government recently approved the regulations regarding an assessment of environmental impact, atmospheric pollution, water contamination and activities with hazardous substances.

The fundamental objective of the environmental policy is to search for a balanced solution between progress and ecology, provide for a better coexistence and reduce the damage already done by traditional mining.[31] (Minerá Boliviana, 1996)

5.2.4 The Peruvian Mining Sector

Peru is widely considered to be one of the most important mineral regions in the world. It has a favorable geology, a large variety of existing deposits and a great potential to develop its copper, gold, lead, zinc and silver production.

The Andean metallogenetic province in Peru is one of the most attractive areas to explorers in Latin America. In general, Peru's epithermal gold districts are still unexplored and there are possibilities of finding important silver and gold deposits.

The surface of Peru's metallogenetic provinces has only been partially explored. The results so far show that grass roots exploration using modern processes and technology is a good investment opportunity, particularly in the search for porphyry copper deposits and bulk-tonnage gold deposits.

Before 1975, there were no known major gold deposits in Chile and the prevailing idea among geologists was that no such deposits existed. However, further exploration revealed the existence of important and feasible gold-copper prospects, like El Indio and Escondida. The Chilean exploration results proved that it is possible to find large copper and gold deposits in the Peruvian Andes.

According to initial estimates, the size of some of iron deposits, located along the shoulders and crest of the Andes, may reach several million tonnes. There are huge world-class phosphate and potash deposits along the Sechura Desert, in the far northwest coastal region of Peru. These deposits, owned by Minero Peru, have been under intermittent investigation since the late 50's, but have never been properly developed.

Legal Framework

The joint venture has established itself in Peru as an efficient instrument to attract investment and open international trade channels. A joint venture must be registered with the Single Taxpayers' Registry although it is not subject to income tax or to the business equity tax.

The local know-how is being combined with foreign capital, resulting in larger profit potential in the medium term. USA, Canada, French, Chile, and Brazilian capital has already become associated with Peruvian capital to participate in new development projects involving the Andean mining reserves.

The legal framework applicable to foreign investment in the country is contained in special Legislative Decrees. The Constitution allows foreign companies to repatriate their entire capital and profits, even royalties and payments for the use and transfer of technology.

At present, the corporate tax rate is 30 per cent. Remittance of profits is tax-exempt. Exporters also enjoy a general sales tax payback system, which grants a tax credit during the productive process. Investors in Peru's mining sector enjoy a special treatment regime described in the General Mining Law.

Peru's mining legislation guarantees quick access to the country's mining concessions under a modern national enterprise registration system. The concessionaire's title is revocable and perpetual, provided validity mining fees have been paid. The concessionaire is free to plan the investment schedule, as well as the production programme. Peruvian legislation acknowledges every type of contractual association for the exploration, development and exploitation of mineral deposits. Additionally, there are no limitations on the commercialization of mining products locally or internationally.

According to the Constitution, investors and the State can enter into contracts that have the strength of law ("law-contracts") with foreign investors for a period of ten years, in order to guarantee the following:

To the investor:

- tax regime stability,
- exchange rate regime, use of the most favorable rate,
- free remittance of capital, profits, dividends and royalties,
- non-discrimination alongside domestic investors.

To the company receiving the investment:

- worker contract stability,
- stability of the special regimes aimed exclusively at exportation.

In addition, mining investors may enter to "investment guarantees" and "promotion contracts", which provide the following:

- free commercialization of mining products locally and abroad,
- free remittance of profits, dividends and financial resources,
- free availability of the currency generated by exports,
- free convertibility of the domestic currency generated by the local sales of mining products, into foreign currency,
- non-discrimination in exchange matters, specifically regarding Central Reserve Bank regulations and the exchange rate applicable to conversion operations,
- tax stability, according to the legislation in force at the time the investment program is approved, including: income tax, compensation and/or tax returns, import duties, and municipal taxes,
- at any time, mining investors have the opportunity to opt for the general tax regime, if this is more favorable, which will be binding for the rest of the contract term: this option is only available once.

To sign these contracts, a minimum investment is required, depending on the type of project. Small or medium-scale mining projects require a USD 2 million minimum investment, and the term of the contract is 10 years. For projects with an initial capacity of more than 5 000 mt/day, a minimum investment of USD 20 million is required. For existing companies or state companies included in the privatization process, a USD 50 million investment is required. In the latter two cases, the duration of the contract is 15 years, and the investor is granted the additional benefit of claiming up to a 20 per cent annual rate of depreciation for equipment and fixed assets. It should be stressed that Peru has honored its mining contracts signed under past legislation contemplated by the 1950 Mining Code, as well as under subsequent laws.[32] (Mineria, 1995)

Privatization

The mining sector privatization programme has made good progress. State companies have been auctioned at market prices and paid for in cash. In addition, the possibility of authorizing the use of alternative payment methods - such as debt instruments - has already been approved for some cases.

Peru offers opportunities to the international business community, guaranteeing non-discriminatory treatment and a transparent privatization process. For this reason, the special privatization committees (CEPRIs) have established a bidders' pre-qualification process, with the assistance of internationally renowned consulting firms.

The privatization process in the mining sector is still open to investment on two fronts: through the purchase of mines currently under production, including all their facilities, or through participation in the new projects, of established enterprises.

To obtain the best possible investment programme, state companies to be included in the privatization process are selected on the basis of their business capacity and efficiency. For that purpose, the State has restructured the companies through personnel reduction and/or financial reorganization programs.

Peruvian environmental legislation has adopted certain recommendations made by international organizations in order to make environmental protection compatible with sustainable development, keeping in mind the peculiarities of each mining zone in Peru.

6 REGIONAL INTEGRATION IN LATIN AMERICA

Regional integration in the form of Free Trade Agreements (FTA) is one of the most salient issues in international economic relations in the 1990's. In the last two years 19 Asia-Pacific Economic Forum members have pledged to remove all regional trade barriers by the year 2020; the European Union has welcomed three new members; 34 American countries agreed in 1994 to create a free trade area by 2006; and the four countries of Mercosur have made special arrangements with Chile, Bolivia and similar agreements are expected with Venezuela and the rest of the Andean Community members. These developments coincide in time with the attempts to create a global trading order in the form of a World Trade Organization. Since 1992, 60 FTAs have been notified to the GATT and the WTO. Presently 80 FTAs of a total of 145 which were established after the Second World War are in force. (See Figure 6.1) Opinions about the regional FTAs role in the process of global trade liberalization are clearly divided.

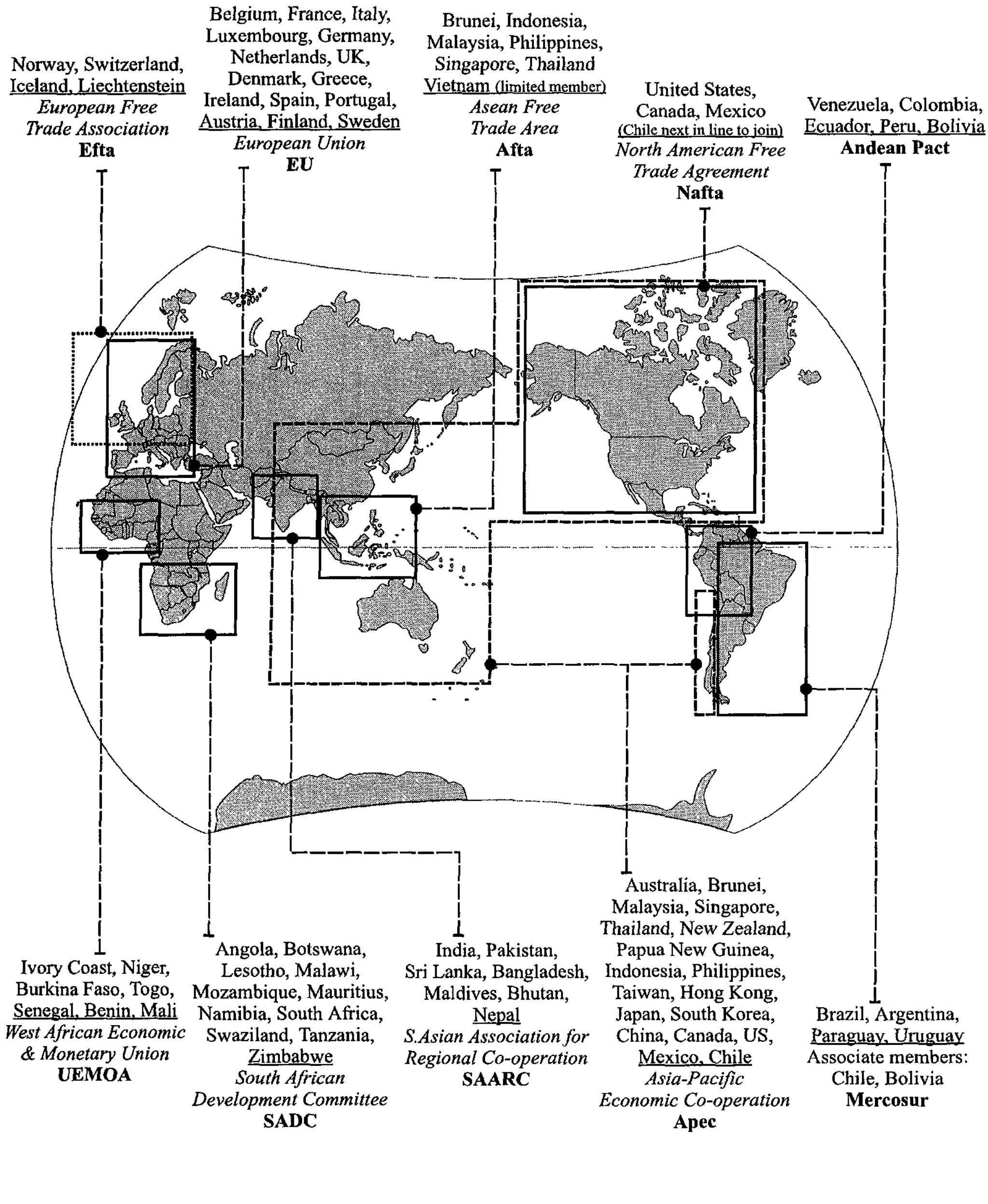
Those who consider free regional trade as a contradictory process to global free trade, fear that businesses will bring free trade to members but at the same time, increase protection against non-members. In the past two decades, regional trade groups were formed more by political reasons than for economic principles. In the case of Latin America, free trade areas were designed to encourage import substitution rather than to expand international free trade. Those in opposition to the proliferation of regional FTAs fear the more likely result will be to fragment the global economy into mutually exclusive blocs, as it has in the past.[33] (Bhagwati, 1996)

Supporters of regional trade areas sustain that regional integration promote free trade by acting as a building block which can eventually be unified in a multilateral agreement. In accordance with this view, regional agreements now tend to free rather than control trade and investment flows. There is evidence to support both claims.

Experience shows that geographic proximity is a basic condition for integration and that the relative levels of development of the economies involved closely influence the results.

Economist Paul Krugman[34] (1996) has suggested that regional free trade areas have done more creation than diversion because they are "natural". Krugman's argument is that, although trade is based on comparative advantage, it is influenced by the realities of geography. Since neighbor countries usually trade a lot with each other anyway, a free trade agreement between them will divert little. On the contrary, FTAs between countries that are geographically on different continents will succeed in creating little trade while diverting plenty.

Figure 6.1. The main regional trade groups



Source: Financial Times, September 1996.

Liberal economists remain concerned that regional blocs could become substitutes for multilateralism. Researchers have found, for example, that trade within the EU, Mercosur and the Andean Pact is not "natural" because it is much larger than they could expect comparing predictions based on the size of the economy, geographical distance, and common borders. In the 1990's Mercosur intraregional trade expanded significantly. (The Economist, 1995)

The creation of the European Union, for example, has resulted in a big increase in intraregional trade. This can suggest that there has been some diversion but the World Trade Organization points out that obstacles to free trade with EU non-members have also decreased. Trade with non-EU countries has risen as a proportion of GDP, even though it has fallen as a proportion of total trade.

Supporters of FTAs argue that they share the goal of freer world trade, and that FTAs might help to reach this objective by three ways: first, regional deals can include the liberalization of issues not yet covered, or covered only poorly by the WTO, like the protection of foreign direct investment. Second, regional forums are more flexible because they involve fewer countries. Third, regional trade deals force liberalization of the economy, particularly in developing countries.[35] (Cable and Henderson, 1995)

Supporters of multilateralism prefer to describe FTAs as preferential trading areas, where discriminatory trade policies make no sense while production is increasingly globalized. The argument that FTAs create trade rather than divert it from competitive non-members, is based on the relative expansion of intra-regional trade and extra-regional trade. However, the latter might well have expanded even faster if trade liberalization had been non-preferential. There is also little evidence that regional agreements are more rapid to negotiate; the idea of Chile's accession to the Nafta has been postponed for many years, and APEC speaks about a free-trade agreement for the year 2020. A third argument against supporters of FTAs is that Mexico along with the rest of the Latin American countries had already unilaterally liberalized much of their economies, before applying to Nafta or to the regional arrangements in South America.

Although this dichotomy - multilateralism versus regionalism - seems to be exaggerated, as long as free trade regions proliferate, trade policy links among countries of different regions become increasingly tangled, and it is difficult to dismiss the danger of the multilateral system fragmenting into blocs. The main question is whether the national policies of the countries of these regional groups favor liberalism or interventionism - above all in the United States and the European Union. These national policies in turn, are likely to be influenced by how governments in industrialized countries respond to the economic dynamism and competitive challenges of developing countries, particularly in East Asia and Latin America.[36] (Jonquieres, 1995)

At present, there are a number of arguments sustained by the United States and the European Union which are more political than related with free trade practices. For example, the United States and the EU are pressuring Latin American countries to maintain international labour and environmental standards or reduce the areas where the coca-leaf is cultivated. Even though they are morally fully justified, these issues have little to do with trade liberalization. In some cases, these preconditions for free trade can raise costs in the industries where developing countries have some comparative advantage. In fact, it is hard to believe that producers in industrialized countries are more concerned with the pollution or the treatment of foreign workers in remote areas than in the maintenance and strengthening of the appropriate conditions for the profitability of their operations.

When 34 leaders of the continent met in Miami, for the December 1994 Summit of the Americas, a central agreement was reached which would affect the region in the years to come. The accord includes the objective of establishing a hemispheric free trade area guaranteeing sustainable development which conserves the environment (accords were also reached on a range of issues such as preserving and strengthening democracy, eradicating poverty and discrimination). Less than two weeks later, devaluation in Mexico caused a financial crisis that seemed further to damage prospects for Americas-wide free trade. At present, less controversial issues are being addressed and negotiations will get under way in two to four years. Agreements could be implemented by the year 2005. It is estimated that by that time, the Americas will become the world's largest market, with 850 million consumers spending USD 13 trillion on goods and services.[37] (Summit of the Americas, 1994)

In the 1960's Latin American countries established several sources of trade integration, starting from the Latin American Free Trade Association (LAFTA) and at the end of the decade, the Andean Pact. Most of the schemes collapsed, in part or completely, or stagnated. In 1980, Lafta became a loose "integration association" (LAIA), with scope for bilateral special arrangements, but far from approaching a free trade agreement. In 1990, the ten countries of the LAIA failed to agree on any of the main regional integration issues, apart from some individual cases for reduction of export-import tariffs.

Regional trade ties are presently being oriented more to serve as stepping stones toward hemispheric free trade rather than closing non-member countries out. In general, subregional schemes in Latin-America are lowering their barriers to trade with the rest of the world. New efforts are being made to strengthen the interregional ties by reviving old initiatives or forming new trade agreements. The tendency is to establish basic principles consistent with the rules of the World Trade Organization, and not to erect trade barriers to third countries. (For other FTAs and preferential pacts, see Annex 1)

6.1 Andean Pact (Andean Community)

The Andean Pact was established by the Cartagena Agreement in 1969. The initial aim of the Pact was to "accelerate the development of member States through social and economic integration, to achieve a fairer distribution of wealth in the Andean region and increase exports." The original members were: Bolivia, Colombia, Ecuador, Peru, Venezuela and Chile. Chile withdrew from the Pact in 1976 because of policy disagreements and Peru halted active participation in 1992, then resumed full participation in 1994.[38] (ALADI, 1995)

The countries of the Andean Pact have a total population of over 100 millions, or 21 per cent of the Latin American population. The Group's total GDP is over 190 billion dollars, or one fifth of the Latin American GDP. Average (PPP)[39] (Andean Pact, 1996) GDP per capita varies from USD 7890 in Venezuela, to USD 2520 in Bolivia. The countries of the Pact have an external debt of 88 billion dollars which amounts to 45 percent of the area's GDP, so member countries must devote between 5 and 10 percent of their GDP to pay it. (See Figure 6.2)

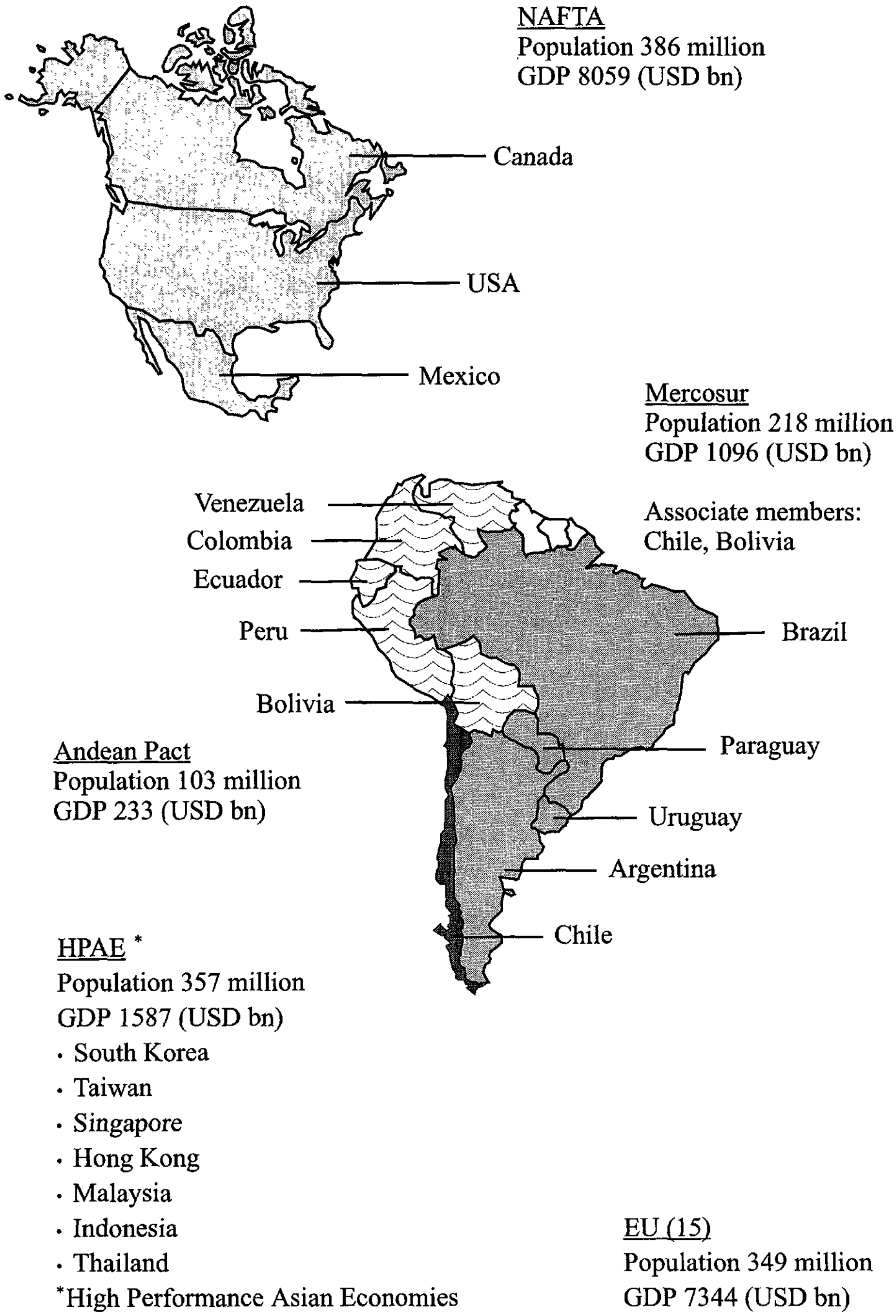
Table 6.1. Andean community macroeconomic indicators, 1996

Country	Inhabitants (millions)	GDP (USD bn)	GDP per capita (ppp) (USD)
Bolivia	7.5	6.5	2520
Colombia	36.1	76.1	6130
Ecuador	12.0	17.9	4220
Peru	25.0	57.4	3770
Venezuela	22.0	75.0	7890
Total	102.6	232.9	

Sources: IDB: Economic and Social Progress in Latin America, 1996 and World Bank Atlas, 1996.

The Andean Pact was initially intended as a scheme for regional industrial development rather than for trade integration, though it had a rudimentary form of a common external tariff system.

Figure 6.2. Macroeconomic indicators of regional trade groups, 1996



Trade diversion was the final objective, though this was never implemented. Most programs stopped half way; they were confined to tariffs and thus did not threaten multilateralism; they were too superficial and fragile to have much impact on the world trade system. Some negative effects may have arisen in some cases, for example when the Andean Pact limited the operation of multinational enterprises through regulations that resulted in a severe reduction of foreign goods, technology and investment.

Welfare losses caused by excessive regional import substitution were concentrated on the Andean countries themselves. They did not significantly affect the trading partners for whom the markets of the regional groupings were of minor importance. Instead, the five member countries - Venezuela, Colombia, Ecuador, Peru and Bolivia - lowered tariffs among themselves and started local industrial plants, deciding jointly which country should produce what. As a result the countries of the Andean Pact paid high prices for low quality products of the region. The regional negotiations were done on a product-by-product basis instead of covering all sectors of the economy. Important sectors of the economy were excluded or privileged according to the domestic and political interest within each country.

Since 1989, the Andean countries have taken steps toward a sub-regional common market. At the sixth Summit of the Andean Pact Council in 1991, the member governments agreed to accelerate the integration process, the Andean Free Trade Area was established in 1992 and a common external tariff came into force at the beginning of 1995. Revision of the Pact involved not only trade in goods but also liberalization in other areas; for example, liberalization of maritime and air transportation as well as foreign investment and capital mobility in the area. This new scheme led to an agreement to establish a free trade area between all the Andean countries.

The Group's recent negotiations tend to support a common tariff and customs union abolishing export subsidies and lowering tariffs for third countries. The union partially came into operation in 1995, but despite some progress integration remains slow and the common external tariff arrangements are still complex. The approved non-discriminatory treatment for foreign investors has been operating for the last few years and, as a consequence, the Andean Pact countries now have individual and collective legislation to encourage foreign investment.

Despite a strong political will in the beginning of the 1980's, the growth in trade was due more to bilateral efforts - particularly between Venezuela and Colombia - than to a significant degree of economic and trade integration within the group. Although trade between Andean Community countries accounts for only 10 percent of members' total foreign trade, it has in recent years expanded steadily, from USD 1.8bn in 1991 to USD 4.6bn in 1995. (ALADI, 1996) This progress can be seen as the first concrete result of external trade liberalization policies and operation of a free trade area among four of the five member countries (Bolivia, Colombia, Ecuador and Venezuela), and creation of a common external tariff in Venezuela, Colombia and Ecuador.

Recently, the influence of the Mercosur bloc in the Andean countries trade has been growing significantly, especially in the case of Bolivia, with 60 per cent of her total trade with Mercosur, around 5 times more than with the Andean Pact countries. Bolivia applied for Mercosur membership in 1994 and at the beginning of 1997 the government signed an agreement. Although the five countries of the Andean Pact have reaffirmed their political intention to enhance the Pact, there have been no substantial results in relation to economic and trade integration. In March 1996, in a move to revitalize the Pact, the presidents of the five countries announced the creation of the Andean Community, modeled on the European integration process. Given the reluctance to make concessions and make the commitment to compromise that the area's regional integration demands, there are difficulties in reaching successful completion of the process. The Andean Pact has signed cooperation agreements with the European Union, the United States, Brazil and Argentina.

6.2 The Southern Cone of South America, Mercosur

The formation of a common market in the southern cone of South America, Mercosur, started in the mid-1980's with a deal between Argentina and Brazil. The Pact took its present shape with the incorporation of Uruguay and Paraguay in the Treaty of Asunción, signed by the four countries on March 26 1991. This Treaty was complemented by the Protocol of Ouro Preto, at the end of 1994, that gives the Mercosur group a legal status comparable to that of the European Union. The protocol completed the procedures for the free trade and customs union of the common market. It also gives Mercosur an international legal status allowing it to negotiate with third countries and international institutions.

In its current composition (December 1996) of Argentina, Brazil, Paraguay, Uruguay, and Chile and Bolivia as associate members, Mercosur has nearly 220 million inhabitants with a total GDP of USD 1100 bn. Brazil represent 3/4 of the area's population and 2/3 of the economic weight. (See Table 6.2.) The Mercosur countries' output in 1996 was roughly equivalent to the following Asian countries' total GDP: Korea, Hong Kong, Singapore, Malaysia, Thailand, Philippines and Vietnam.

Table 6.2. The Mercosur - macroeconomic indicators in 1996

Country	Inhabitants (millions)	GDP per capita (ppp) (USD)
Brazil	162.7	5 400
Argentina	34.7	8 310
Bolivia*	7.2	2 520
Chile*	14.3	9 520
Paraguay	5.3	3 650
Uruguay	3.2	6 630
Total	227.6	

* Associated member.

Sources: The World Factbook 1996 - US Government.
World Bank: World Development Report, 1996.
Latin Trade: Macro-Economic Report, 1997.

The integration process is more dynamic in the industrialised area of Mercosur that runs in the form of an arc from Rio de Janeiro to Santiago, passing through Sao Paulo, Curitiba, Porto Alegre, Montevideo and Buenos Aires. (See Figure 6.3.) The area boasts a population of 120 million people with a GNP per capita of above USD 8000. The population is highly concentrated in big cities, from which three have over 10 million people and ten over one million. This area has the same size as the four Nordic countries - Finland, Sweden, Norway and Denmark - together, with a GNP per capita far above that in Eastern and Central Europe, greater than in Greece and around the same as in Portugal.

Figure 6.3. The most dynamic area of Mercosur

Mercosur Objectives

The establishment of Mercosur was based on three requirements: the liberalization of intra-regional trade, the formation of a common external tariff and common trade policy towards third countries, and the coordination and harmonization of national macro-economic policies and legislation to avoid distorting the operation of a common market.

The basic priorities of Mercosur are:

- to enlarge the existing domestic markets.
- to achieve economics of scale.

- to foster competition which in turn will improve the allocation of the means of production.
- to secure access to sub-regional markets.
- to improve and diversify trade.
- to emphasize welfare improvement through the use of a low common external tariff.
- to increase the bargaining power of member countries.[39]

In 1994 the Governments of the four member states undersigned the Protocol of Ouro Preto in order to implement the following objectives:

- to accelerate the economic development processes through integration.
- to create a Common Market that widens the current scope of their domestic markets, through the free circulation of assets, services and productive factors between the members; and establishment of a Common External Tariff.
- to achieve an adequate placement in the international market for the member countries through the consolidation of a large economic area.
- to promote scientific and technological development of the member states.
- to modernize their economies and improve the quality of available goods and services in order to improve the living conditions of their inhabitants.
- to strengthen friendship and solidarity ties between their people.

Member countries are looking for:

- investment and interest protection of economic units (private and public) through mechanisms established in the Asunción Treaty, Ouro Preto Protocol and the Brasilia Protocol on solving controversies.
- generation of greater export capacity toward other countries.
- possibility of accessing the world market with greater facilities, through common road, rail and river projects.
- increase in productive efficiency by being forced to make production more competitive.
- increase in direct investments through an increase in the market.
- simplification and standardization of procedures.
- removal of unregistered or illegal commerce through the elimination of tariffs.

- economic balance with neighboring countries through the formation of links in the productive chain of an enlarged market.

As an institutional organization, Mercosur has various levels for decision-making, presidential, ministerial and technical, according to the nature of the problems to be resolved. Mercosur had a provisional framework until 31st December 1994, in which the period of transition established by the Asunción Treaty was fulfilled. This has now been substituted by a new framework approved under the "Ouro Preto Protocol".

The Common Market Group is the executive agency of Mercosur, managed by the Ministers of Foreign Affairs. This political body has the following functions:

- ensure compliance with the Treaty.
- take the necessary steps to ensure compliance with decisions adopted by the Council.
- propose measures toward the application of the Commercial Reduction Program; the coordination of the macro-economies and negotiations with third party countries.
- set work programs which ensure advances toward the formation of the Common Market.

The Administrative Secretary of the Common Market Group produces all documents and communications regarding the activities of the Mercosur. This secretariat is located in Montevideo.

As an economic block, Mercosur permits the member states to face, with better probability of success, the defense of the interest of the communities in this part of the continent and to form a common front to deal with important topics such as "the Free Hemispheric Trade Zone" planned for the year 2005 established during the Summit of Miami, and negotiations with the World Trade Organization and with the European Union.

Evaluation of the Asunción Treaty

Since the Asunción Treaty was signed, the following achievements have been made, among others:

- advances in policy standardization that works towards the formation of Mercosur through negotiations undertaken in different sub-working groups and specialized meetings.

- implementation of the role of Administrative Secretariat of Mercosur, and deciding that the meetings will be held in the headquarters of the Secretariat in Montevideo.
- establishment of different gates in ports and airports for passengers from member states.
- conclusion of the Common Regulation project against disloyal practices in trade with third party countries.
- establishment of common minimum requirements of competence and control over: issue of securities, institutional investors, stock markets and intermediaries, independent external auditors, compensatory systems, liquidation and custody.
- approval of specific projects related to three high-priority areas; technical procedures, agriculture and customs houses, which are coordinated by Brazil, Paraguay and Uruguay, respectively, as well as the support project for modernization and reconversion of small producers from Mercosur, within a framework of cooperation of the European Union with the MERCOSUR.
- culmination of the Second Semiannual Plan, made up of 16 Projects, within a cooperation framework between Mercosur and IDB, as well as the beginning of the Third Semiannual plan made up of approximately 9 projects, with the object of assisting the implementation of Mercosur, especially in coordination and standardization of macro-economic policies.
- beginning of cooperation between the United States and Mercosur, on compensatory rights, anti-dumping, tariff barriers and economic policies.
- establishment of a sanitary agreement, in order to adopt joint measures with regards to sanitary matters, to protect health and life of inhabitants and animals, as well as the hygiene of crops and vegetables.
- approval of a regulation intending to allow protection against dumping or subsidies originating from countries outside the Common Market of the South.
- the four member states reiterated the removal of tariff and non tariff barriers, as from 1^{st} January 1995, which now offers member countries access to an unrestricted enlarged market of approximately 200 million inhabitants, with a gross domestic product of more than 1 200 million dollars, and being considered as one of the emerging markets of the world.
- with relation to the Common External Tariff of Mercosur for "extra zone" imports, a consensus of 90 per cent agreed on a universal tariff that oscillates between 0 and 20 per cent. For the import of capital goods

originating from Mercosur non-members, a maximum rate of 14 per cent was agreed upon; and the convergence period from the current national tariff levels to said tariff level was extended until the year 2001. For computer products the maximum common external tariff will be 16 per cent, and the convergence period will be extended until the year 2006.

- regarding foreign trade zones, an agreement was reached to establish commercial foreign trade zones in the four countries, and the products that leave these zones, will be able to enter Mercosur by paying the common external tariff for imports from third party countries.
- the trade Commission was established with intergovernmental power to assist the executive agency of Mercosur, ensure the application of the instructions of the common commercial policy for the operation of the customs union, and effect a follow-up and inspection of the topics and matters related to common commercial policies as well as intra-Mercosur commerce and that with third party countries.[40] (Pro-Parguay, 1996)

Mercosur Expansion in the Future

In June 1996, Mercosur signed a free-trade agreement with Chile as an associate member, and a similar agreement with Bolivia at the beginning of 1997. Negotiations are being held with the Andean Group setting a framework for individual deals with Venezuela, Colombia, Ecuador and Peru and it has been suggested that Mexico also wishes to become an associate member of Mercosur.

The agreement Mercosur-Chile is a big move to expand free trade in South America. The inclusion of the most dynamic economy of the region permits the Mercosur countries access to a market of more than 14 million people and to Chile's Pacific Ocean ports, important gateways to commerce with the emerging Asian countries. Mercosur membership gives Chile the opportunity to export light industrial products like textiles, shoes and paper to a large market where the new member, with cheap labor and low financing costs, is expected to be very competitive. Under the agreement, which came into effect in October 1996, Chile lowered tariffs on a large proportion of its trade with the rest of Mercosur. During 1996 Mercosur-Chile tariffs were cut by 30 per cent on both sides, and from the year 2000 tariffs will fall to zero over a period of four years. A limited list of Chile's food and agricultural imports from Mercosur will have special treatment and tariffs on most of these products will start to decline in 2006 to reach zero by the year 2011. To qualify for tariff preferences, goods must have Mercosur or Chilean production content of at least 60 per cent.[41] (The Economist, 1996)

Mexican government officials declared that "current negotiations to put trade relations on a multilateral basis with the Mercosur countries were a transitional step to negotiating a full free trade accord."[42] (Financial Times, 1996) In the case that Mexico becomes an associate member of Mercosur, this country would not have to apply the external tariff regime of the union because of its membership of the Nafta, but it will not require four separate bilateral agreements for its foreign trade with the Mercosur members. Prospects for such an agreement are very significant because they represent a bridge between Mercosur and Nafta and an initial step towards a free trade area embracing the whole continent from Alaska to Tierra del Fuego.

The largest economies of Mercosur, Brazil and Argentina, acknowledged the obstacles of advancing too fast in terms of geographic expansion at a cost of dilution of the group. Government officials have made clear that it is still important to deepen the agreement within the four core member countries on aspects such as standardizing labour legislation and free trade in services.

The formation of Mercosur has strengthened the bargaining position of the governments of the region in their trade relations. Brazil in particular wants to consolidate Mercosur as a first step in the creation of a South American free-trade area which can, in the future, negotiate with Nafta as an equal counterpart.

With the inclusion of Chile and Bolivia in 1997, the position of Mercosur in world trade has been enhanced. But the political will of the governments will face difficult obstacles in forming a harmonious unit.

At present, trade restrictions between the member countries are being gradually eliminated. Since the beginning of 1995, around 80 per cent of all products were being traded freely within the Mercosur market and most imports from other regions of the world are subject to a common external tariff scheme. Exceptions include textiles, steel, automobiles and petrochemicals which remain protected by domestic tariffs for a period of four years. Although important progress has been achieved, there have been clear difficulties in reaching agreement over many aspects of trade, industrial and legislative policies. At present, the core members have adopted a less ambitious objective than the full single market originally planned.

Recently, criticism regarding Mercosur trade practices has been increasing in international forums. Unusually, the World Bank's international trade division argued that "Mercosur countries have artificially diverted trade flows by maintaining much higher tariffs and non-tariff barriers on imports from third countries than they impose on trade with each other".[43] (Jonquieres, 1996) According to the study, intra-Mercosur trade has grown most rapidly in capital-intensive products, such as machinery and vehicles, which are strongly protected against imports from third countries and in which Mercosur producers have shown weak international competitiveness.

Economists who believe that preferential trading areas are against multilateralism consider that:

- discriminatory or preferential liberalization is not necessarily beneficial for participants, let alone the rest of the world;
- geographical proximity need not to be the right starting point for preferential liberalization;
- the best way to develop consistent and predictable rules for a liberal global economy is unlikely to be through group discussions that are closed to outside members.[44] (Wolff, 1996)

As a consequence of the political protests of Mercosur member governments, the World Bank softened its criticism and emphasized that Mercosur "had enhanced the credibility of economic reforms by its members and made it more difficult to reverse unilateral liberalization". The World Bank or any other institution should realize that criticism against preferential trade arrangements should also be applied to industrialised countries practices with developing and emerging economies.

Mercosur is far from being a real common market, but member countries have committed themselves to continuing negotiations aimed at full common market institution by the year 2006. This long-term objective includes the free movement of labour and capital between the Mercosur countries. They will also have to coordinate their economic, legislative, environmental and infrastructure and technology policies.

The European Union signed its integration agreements long before people had a clear idea of what they meant. In the case of the Free Trade Area of the Americas, FTAA, a great deal will depend on the US Congress and protectionist sentiments. The tendency is certainly toward greater integration, the opposition to free trade suffered a defeat in the last US elections. Some form of a continental free-trade agreement will take place, but at present, nobody knows exactly what it will contain. The question is not only whether Latin America will be ready; but what the United States will do to bring the countries together - particularly itself and Brazil -, even if the United States extends Nafta beyond Mexico to Chile. It is not only a Latin American question. It is one of the more important issues facing the United States.

The track record for trade liberalization has been good in many countries and has won political credibility. Now the central challenge to Latin American governments is to build on that track record. There is a strong desire amongst Latin American countries to build a free-trade area based on Mercosur. The question is the relative role of the United States in this area. A second aspect of the problem is that although the intention of the creation of the FTAA is increasingly supported by public opinion in Latin America, there is uncertainty over whether social conditions will be good enough to continue with strong free-market policies.[45] (Latin Trade, 1997)

6.3 Protectionism in Latin America

The region is less protectionist than it has ever been. While such optimism could be exaggerated, it underlines an important fact: protectionism has become a negative concept in Latin America. Protectionism may still exist, but it is getting harder to call Latin Americans protectionists. Trade is expanding. With so much trading taking place, the argument is that Latin America cannot afford to be protectionist.

According to the International Monetary Fund (IMF), total imports by the countries of Latin America and the Caribbean grew to USD 217.8 billion in 1995 from USD 101.3 billion in 1989, an increase of 115 per cent. Exports grew to USD 191.5 billion from USD 117.9 billion for the same period, a 62.4 per cent increase.

By contrast, after decades of spectacular growth, the countries of Southeast Asia have been hit by a slowing world economy and a strong dollar, moving the region away from the top of the world export table. Exports from Asia lagged behind the pace of economic growth in 1996. As a result, global exports rose by 4 per cent that year, less than half the rate in 1995. Asia's place has been partially filled by new growth regions. In fact, Latin America is the new trade growth pole.

Latin American countries saw their exports growing faster than their economies. Exports from Latin America grew three times as quickly as overall world trade, with a resurgent Mexico posting a 20 per cent jump in export volume in the period 1995-96. Trade among Latin American states is also growing, most notably in the South American Common Market linking Argentina, Brazil, Paraguay and Uruguay and associate members Chile and Bolivia.

Mercosur's common external tariff (CET), is 16 per cent - far lower than member countries recent tariff rates - and is due to be phased out completely by 2006. In joining Nafta, Mexican tariffs on USA goods dropped to zero. Free trade pacts between Chile and Mexico, Chile and Canada, among the countries of the Andean Pact and other regional deals, have worked similarly. The General Agreement on Tariffs and Trade (GATT) and the WTO have also had similar effects. All of these groups helped eliminate protectionism.

Tariffs have come down so much that Chile - once the only free trader in the region with a uniform 11 per cent customs duty - is not alone anymore. Chile went through the entire Uruguay Round with the 11 per cent tariff. Six years later, they still have an 11 per cent tariff and the others are getting closer.[46] (Latin Trade, 1997)

But non tariff barriers have been tumbling too. As recently as 1991, it was illegal to import foreign-made computers into Brazil. Even foreigners travelling on business had to obtain complicated documents to bring in their machines for short stays. Licenses for the import of almost everything was the rule throughout the region. Until Nafta came into effect, most of the goods imported into Mexico require the approval of complicated permission procedures, which were available or unavailable, depending on how local producers of similar goods felt about their market share. Foreign investment in the region's petroleum industries was essentially forbidden.

It took the industrialized countries 50 years to negotiate the GATT to current levels. In Latin America governments did it in five years and today there are still more non-tariff barriers in the USA than there are in Argentina, Bolivia or Chile.

As recently as a decade ago, nearly all governments of the region were members of the protectionist school. Fernando Enrique Cardoso, who in the late 1970s wrote books promoting economic nationalism, today presides over a government moving rapidly to remove trade barriers, privatize state industries and make the Brazil attractive to foreign capital. Argentine Carlos Menem, Peruvian President Alberto Fujimori, and Venezuela's head of state Rafael Caldera were all either populist protectionists or indifferent to the issue when they took office. All have now opened markets.

There is less protectionism than there used to be but there is still a lot of residual protection in Latin America. Getting tariffs down from 150 per cent to 30 per cent is important but it is more a political statement. Getting them from 30 per cent to zero will be real free trade.

Imported cars, which entered Brazil at a historically low duty of 35 per cent in 1995, experienced a high duty of 70 per cent immediately after the Brazilians showed huge interest in vehicles. The duty has dropped again to 35 per cent for companies with manufacturing plants in Brazil, but the rapid change in altering policies was disruptive for both consumers and vendors.

Since protectionism has become a negative word many Latin American governments seek ways to protect that no one can call them protectionist. For instance, as a tariff and non tariff barriers have fallen, there has been an increase in the use of anti-dumping and countervail actions. These may be legal but most experts believe that they are used, mainly, as protectionist measures. Latin

American countries are following the example of the United States, the region's most prolific user of anti-dumping laws.

The consequences of Latin America's latent protectionism are clear. Five years ago they were trading far below their potential, but their trade could further double if they removed their current protectionist barriers. Just as protectionism's transformation into a negative word shows progress, it also is a sign of more detailed discussion to follow.[47]

7 LATIN AMERICA AND INTERNATIONAL FINANCING

Why is there so much interest in the emerging markets of Latin America? A general answer is that countries as diverse as Argentina, Mexico, Peru or Bolivia are going through a process of changing from more or less regulated economies to free markets. After practicing a closed-door policy for foreign investors during several decades, Latin American countries are now competing with each other to attract capital flows from abroad. In the past, governments in the region have been hostile - with varying intensity in different periods - to unregulated markets, but a clear trend towards relaxation of state control over the economy and trade has continued for several years.

The great majority of the Latin American countries currently represent increasing investment opportunities. The positive business climate is reflected in the growth of foreign investment, though with ups and downs like in most emerging markets worldwide where potential returns and risks can be very volatile.

7.1 Capital Flows to Emerging Economies

Net capital flows (defined as the sum of net debt and net equity flows) to emerging economies totalled USD 240 billion in 1996. The majority of these flows were from the private sector.

In a historic context, current flows are globally increasing. In 1996, private sector flows to emerging economies were about four times the annual amount sustained during the 1978-82 commercial bank lending boom. A wide range of private sector investors are expanding their operations in emerging economies. Commercial banks have begun to lend actively again in the last four years, catching up somewhat with institutional investors. Capital is flowing to a broader set of countries.

The reform and stabilization efforts of Latin American emerging economies are accelerating their performance allowing higher growth rates than those in the OECD. In addition, innovative retirement schemes are raising the pool of savings flowing to institutional investors. The flows are increasingly in the form of equities, especially direct investment providing recipient economies with better protection against higher global interest rates and including technology transfer.

Table 7.1. Net capital inflows to emerging economies[1], USD billion

	1993	1995	1996e	1997f
Total	206	239	239	219
Emerging Asia	91	119	123	98
Latin America	74	69	63	67
Emerging Europe and Africa	40	51	52	54

[1] Countries covered:

Latin America (8):	Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, Venezuela
Emerging Asia (8):	China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan, Thailand
Europe/Africa (9):	Bulgaria, Czech Republic, Greece, Hungary, Morocco, Poland, Russia, South Africa, Turkey

Source: World Financial Markets, New York, June 27, 1997.

7.2 Resource Flows to Latin American Countries

The recovery of investment since 1995 has been a decisive factor for the area's economic growth despite the overall international financial problems that followed the Mexican devaluation crisis of December 1994. The consequent tight fiscal policies have reduced the area's average inflation reflecting a favorable investment environment.

In the early 1980s, certain developing countries, particularly in Latin America, enjoyed privileged access to substantial commercial bank loans. Yet, by the mid-1980s, the debt crisis had effectively excluded many Latin American countries from global capital flows. At present, the total debt of the 25 economies included in Table 7.1 has tripled since 1982-83, but the interest payment/export ratio has fallen by two-thirds.

Table 7.2. Key external debt indicators

	1982-83	1990-91	1997-98f
Total external debt (USD billion)			
25 countries	607	1059	1774
Emerging Asia	167	374	714
Latin America	310	407	608
Emerging Europe and Africa	130	278	453
Debt/GDP ratio			
25 countries	33.7	35.8	29.7
Emerging Asia	20.8	27.1	24.9
Latin America	47.4	39.5	32.1
Emerging Europe and Africa	37.7	51.1	37.7
Debt/exports ratio			
25 countries	193.0	145.0	108.4
Emerging Asia	111.5	99.2	75.3
Latin America	301.9	251.1	180.5
Emerging Europe and Africa	209.2	145.9	128.2

Source: World Financial Markets, New York, June 27, 1997.

A new pattern became apparent in the beginning of the 1990s, with the resumption of large-scale capital flows to the emerging markets of Latin America, in the form of portfolio and direct investment.

Flows of foreign direct investment are growing in the area. Foreign trade and production would probably have expanded at a much slower pace had it not been for the dynamic increase in direct investment. FDI's contribution has been around one third of the total long-term financial flows to the area. Other important sources of financial resources have been net debt flows and portfolio equity flows. The importance of the official financial resource flows and official development assistance (ODA) has been decreasing.

Table 7.3. Long-term net financial flows to Latin America, in millions of USD, 1994

Region/country	Total	Private Total	Net debts	FDI	Official Total	ODA
Argentina	8 975	8 214	5 809	1 200	761	246
Brazil	9 824	11 871	3 717	3 072	-2 047	-57
Paraguay	181	135	-45	180	46	36
Uruguay	508	378	183	170	130	87
Mercosur	*19 488*	*20 598*	*9 664*	*4 622*	*-1 110*	*312*
Bolivia	480	-5	-25	20	486	424
Colombia	1 518	1 860	590	950	-342	260
Ecuador	822	705	171	531	117	135
Peru	3 770	3 214	-88	2 326	556	342
Venezuela	482	70	-735	764	411	152
Andean Group	*7 072*	*5 844*	*-87*	*4 591*	*1 228*	*1 353*
Chile	4 118	4 300	1 638	1 795	-182	61
South America tot.	*30 678*	*30 742*	*11 215*	*11 008*	*-64*	*1 726*
Mexico	16 817	17 394	4 895	7 978	-576	162
Latin America tot.	*51 127*	*49 669*	*15 698*	*20 811*	*1 458*	*4 133*

Source: Global Economic Prospects and the Developing Countries, World Bank, 1996

Prospects for the future

Latin American emerging economies have reformed their markets to achieve international credibility. Improving policies in the financial sector have secured broader country assessment into international markets. In order to continue this trend governments are seeking to ensure the efficient use of capital and to mobilise domestic savings.

Foreign capital has gained good positions in emerging markets and flows are expected to continue. Firstly, foreign investors and domestic borrowers are attracted by the opportunities of developing new markets. Secondly, international and domestic capital markets' operations enhance a wide use of financial instruments. Thirdly, regional cooperation and committed policies with international institutions is being re-enforced.

Latin American countries seek to increase the relative proportion of FDI in total inflows because it tends to be relatively less volatile and speculative in nature than other forms of external finance, as well as being more directly linked to new productive capacity and inflows of technology, organizational techniques and marketing know-how. There is a significant change compared with the

1980's when Latin American governments offered highway, energy and other incentives as electoral tools that led to the start of many projects which, in retrospect, did not make economic sense.

Banks and institutional investors have been directing the majority of their hard currency into energy projects. Power companies and gas companies have established customer bases and can more readily provide estimates on the yearly performance of proposed projects.

In broad terms, investors list the following key elements as necessary to generate more investment from foreign commercial banks and institutional investors:

- The country must have stable financial and political institutions.
- The project must be stable, with an ability to generate adequate cash flows.
- Local partners must be available.
- The project must be suitable to banks' and investors' portfolios.

In 1997 and beyond, some of Latin America's largest amounts of project finance will come from bond market deals that receive ratings from credit agencies. A growing number of local sponsors with little or no involvement in international markets will be seeking capital for projects. For Latin America, an important goal for the 1990's will be to direct the growing interest of foreign and local investors to infrastructure projects.[48] (Latin Trade, 1997)

7.4 Determinants of Foreign Direct Investments

Companies invest strategically and case-specifically. When deciding foreign direct investments, a large number of factors and strategies are involved in the procedure of investment decision making. According to the eclectic-paradigm, the precise character and pattern of the resulting international production will depend on the configuration of the ownership and location assets of firms and of the location advantages of countries. It will furthermore depend on the strategic options open to firms and how they evaluate the consequences of these options (Dunning, 1993).

A specific investment can be attractive due to various reasons; economic factors where profitability is evaluated, type of the market and its recent developments, infrastructure, government policies, investment climate, etc. Latin America has made significant progress and has attracted FDIs worldwide. The region's new reforms, regional integration, open trade policies, and privatization have been the main reasons for the expansion of foreign and domestic investments.

Since 1980 the relatively vastest flow of FDI has come from the U.S.A. Not surprisingly, already during the previous decade, the U.S.A was the principal source of FDI in Latin America, followed by Europe and Japan. (Table 7.4.) By the late 1980s, due to renewed inflows of direct investment, the European share rose and U.S.A. share decreased. However, U.S.A. share totalled 73 per cent in 1990-94.

Table 7.4. FDI flows to Latin America, 1980-1994, accumulated values in millions of USD

	1980-84	%	1985-89	%	1990-94	%
Europe	5 881	40.9	6 326	53.7	10 410	22.6
USA	6 314	43.9	4 704	39.9	33 662	73.2
Japan	2 173	15.1	745	6.3	1 929	4.2
Total	14 367	100.0	11 775	100.0	46 001	100.0

FDIs tend to concentrate by region and source. The U.S.A. is the major FDI investor in Latin America, Europeans in Europe and Africa, and Japan in South and East Asia. Latin America and the Carribean are, however, the main destination for European FDI outside the OECD. The flows have shown steady increase since 15 years and Brazil has been the main recipient of European FDI (40 per cent). Main recipient countries are often also largest economies. (Table 7.5.)

Table 7.5. FDI flows from Europe, USA and Japan to Latin America by integration group; net flows in millions of USD

	1985-1989			1990-1994		
	Europe	USA	Japan	Europe	USA	Japan
Mercosur	4 230	4 465	970	5 074	14 589	772
Chile	585	720	60	987	2 175	33
Andean Group	705	-2 550	-190	2 165	3 857	230
Mexico	565	2 580	-100	1 597	11 158	882
Latin America tot.	6 325	4 705	745	10 410	33 662	1 930

Investment conditions have drastically changed in the region due to the introduction of flexible regimes facilitating the repratriation of benefits and the massive incentives of participating in the privatization of state enterprises. Regional FDI regimes can have important effects in business strategy, encouraging firms to invest in modernization, intervene in regional operations, and pursue more ambitious expansion strategies.

The composition of FDI flows has changed from the manufacturing sector to diverse sectors, particularly natural resources and services which have strongly risen. This shift is due to the liberalization process, less restrictive legislation on foreign capital and the privatization programmes.

8 THE EUROPEAN UNION AND LATIN AMERICA

8.1 Trading Partners of Latin America

The European Union accounts for approximately 18 per cent of Latin America's total trade. The two-way trade grew by 8 per cent in 1996 to an estimated USD 80 billion, according to projections by Latin Trade based on 10-month data from the IMF (Latin Trade, 1997).

Germany is the largest European trading partner with Latin America, accounting for approximately one quarter of yearly trade between the two regions. Last year, German exports stood at approximately USD 11 billion. Other top trading partners are Italy, France, Spain and the United Kingdom, in that order.

While Germany drives the European trade with Latin American countries, it is Mercosur that drives the region's trade with European Union. Trade between Mercosur and EU grew by 21.2 per cent between 1991 and 1995.

Table 8.1. Latin American total trade, 1995 (USD billions)

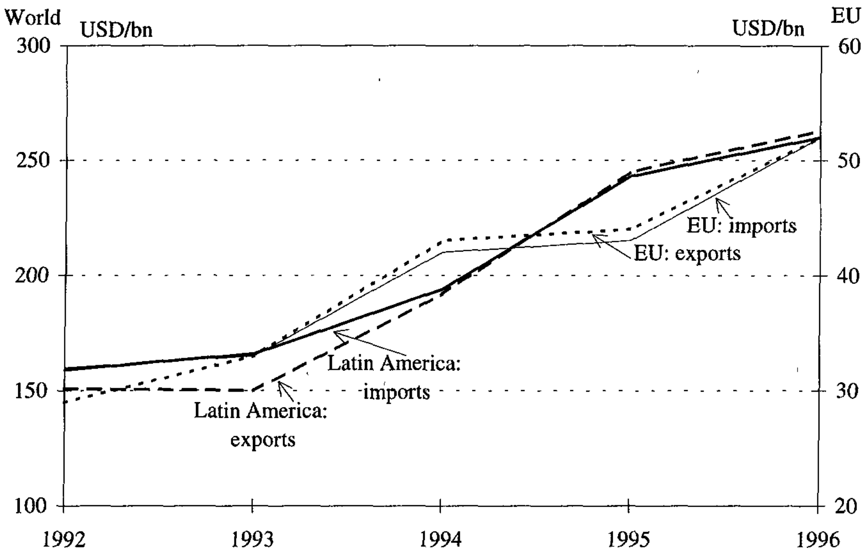
	USA	European Union	Asia	Latin America	Other	World
Argentina	6.1	11.4	4.3	15.2	3.1	40.0
Bolivia	0.5	0.5	0.8	1.3	0.1	2.5
Brazil	20.9	29.6	18.1	17.1	12.1	97.7
Chile	5.8	7.5	9.7	7.4	1.9	32.3
Colombia	8.6	5.3	2.1	5.2	1.3	23.3
Ecuador	3.7	1.9	1.1	2.1	0.7	9.5
Paraguay	1.0	0.7	1.0	2.8	0.1	5.7
Peru	2.9	2.7	2.1	3.6	0.8	12.1
Uruguay	0.6	1.3	0.5	2.9	0.4	5.7
Venezuela	15.1	4.5	1.4	7.2	1.5	29.7
Mexico	108.9	9.9	9.4	5.6	6.2	139.2
Central America	19.4	7.5	14.6	9.2	2.3	56.5
Total	195.8	82.8	64.7	80.2	30.5	454.1

Sources: IMF, Latin Trade.

The United States is the most important single trading partner for Latin America accounting for about half of Latin America's total trade. However, in South American countries EU is more important than USA because majority of USA's trade is with Mexico. Asia accounts for approximately 14 per cent of Latin America's total trade. Japan is the top Asian trading partner, accounting for about half of the region's total trade with Latin America, followed by Korea, Hong Kong, Taiwan and China. Brazil is the largest Latin American trading partner, followed by Panama, Chile and Mexico.

A new trade pattern is also emerging. Foreign multinationals are increasingly setting up manufacturing facilities in Latin America to take advantage of a growing local market as well as the creation of sub-regional trading groups.

Figure 8.1. Latin American trade with the European Union, 1992 - 1996



In 1996, Latin American total trade increased to USD 520 bn, while trade with the European Union grew at a higher rate to USD 105 bn (See Figure 8.1.).

Consolidation of democracy and economic recovery have received recognition from the European Union, so that a more dynamic approach from the EU and from the governments and enterprises of member countries is being gradually implemented. According to Union's officers (IRELA, 5/95) there are three salient elements to explain the current nature of the links between the EU and Latin America: the globalization of economies and markets; a common culture; and the re-approachment between the two regions. As one of its first serious moves towards Latin America, the European Commission's "Guidelines for Cooperation with Developing Countries in Latin America and Asia"[49] (IRELA, 1996) introduced new areas of cooperation according to the mutual interests of both regions and established decentralized methods for the administration of such cooperation.

8.2 Latin America in the EU's Agenda

A new order has appeared in the global agenda as the West-East confrontation does not exist in the same sense as in the post-war period. The European Union has new challenges; it has to react to globalization and thus rebuild its economic relations worldwide.

The European Commission is given a mandate by the Member States and negotiates on their behalf on bilateral, regional and global issues. Negotiating as a bloc, the Union has achieved more success in promoting free trade in the world than they could have achieved by operating as single states. The European Union's international trade network often goes beyond the framework of commercial ties i.e. the relations include high level political contacts, cooperation in the field of technology and education, cooperation between companies and industries and promotion of cultural exchange.

Latin America's cultural identity is heavily influenced by the values that shaped Europe's character and history. Five centuries of relations between the two regions have caused European ideals to penetrate to the core of Latin American societies. The constitution's legal systems and ideas of liberty and democracy found across Latin America are drawn from the philosophical and legal concepts that are Europe's heritage. As a melting pot of immigrants, Latin America has forged a rich identity with contributions of a number of European countries and indigenous civilizations.

Europe and Latin America are highly complementary in economic terms. Relative factor endowments have always pointed to a high potential for specialization based on comparative advantages: Latin America in land and other natural resource-intensive products such as agricultural raw materials and minerals, and Europe in capital-intensive, high technology industrial products.

Latin America has partially satisfied European need for raw materials, while offering attractive, and now fast growing markets for Europe's consumer and capital good exports. Cultural affinities, similarity of tastes and understanding of each other's needs imply potential for intensive cooperation between these two areas in the economic, social and political spheres.[50] (IRELA, 1996)

Various Types of Relations Between the EEC/EU and Latin America

Relations between the two continents are based on cooperation at various levels:

- At regional level: political dialogue since 1990 with the Rio Group

  The Rio Group is an institution for political consultation and cooperation between Latin America and other regions of the world. This mandate is unique and does not only focus on biregional relationship but also on global issues in a general scale. The signatory parties have forged a set of common principles on democracy and good public administration, protection of human rights, environmental issues, combating the drug trade, and common views on the direction of trade.

The first EU-Rio Group declaration took place in December 1990. The sixth Ministerial meeting took place in Paris, the 17 March 1995 and the final draft of the declaration was revised. The seventh Rio Group-European Union meeting was held in April 1997.

The Rio Group's main objectives mainly refer to initiating and maintaining sustainable development, trade issues, the fight against drugs, and coordination of common policies. The dialogue reinforces external relations with the European Union, which is one of the most important investors in the region and the number one considering the development cooperation with Latin America and the Caribbean.

Free trade arrangements between the EU and the Rio Group region are far from perfect though trade disputes have decreased significantly. As in all trade blocs, the agricultural sector is a difficult issue.

EU cooperation with certain Latin American countries has existed long before this political dialogue. The EU has transferred a lot of integration know-how and training expertise. The Union has made significant contribution to the integration process of the continent and dialogue with the Rio Group has enhanced this policy. Regional cooperation nurtures the integration process and both parts benefit as political and economic support promote economic stability and development, encourage integration process and enable fulfillment of potential growth between the trade blocs.

- At subregional level: the San José dialogue with the Central American countries since 1984. (Nine conferences took place between 1984 and 1992).

  In 1984, the EEC undertook to provide financial and technical assistance to the region's countries and adding weight to projects with a regional scope. In 1985, the European countries introduced the possibility for their governments to support, in the appropriate manner, the efforts undertaken to develop and modernize public administrations in Central America and, thus make a supplementary contribution to political stability and to democracy in the region. This led to the signing of the Regional Cooperation Framework Agreement. In 1987, Latin America was better understood through the new members of the Community (Portugal and Spain in 1986). - The support of the EC to sustain democracy in the region was needed.

To ease tension in the region, the EC-Latin American regional cooperation agreement was ratified. Remarkably, this program was confirmed to substantially increase the global assistance that the EC grants to the Central American region, giving priority to regional projects. The various forms of cooperation were to ensure recovery, increased dynamism and restructuring of Central America's economy and its economic integration in the areas of intra-zonal trade, the industrial sector and tariff and customs aspects.

In 1991, the EC undertook to play a part in the initiation of multi-annual programs for promoting human rights in Central America. The EC also backed assistance to refugees, support for environmental protection and against drug trafficking. Meanwhile, the Central American countries wished to benefit from the same trade arrangements accorded to the Andean countries also grappling with the plague of drug trafficking. However, these measures were temporary and concerned only coffee and some tropical products. The level of aid from the EC reached 116 million ECU in 1990.

In 1992, a further enhancement to the implementation of assistance programs for refugees, repatriated persons and displaced persons in the region was made. Both parties decided to review the 1985 regional cooperation agreement and to produce a third generation agreement which would help to enrich cooperation in the economic, social, financial, scientific, technological and commercial fields[51] (Club de Bruxelles, 1994). In 1993, the so-called San Salvador Agreement was signed as a new political and economic regional cooperation agreement.

Parallel to this political dialogue path with Central America, a political dialogue was developed with Latin America via the Rio Group.

- At bilateral level, the Community has concluded cooperation agreements of "third generation" with various countries and groups of countries (the Andean Pact, Central America, Mercosur).

The relations between the EEC/EU and Latin America are divided into three stages or generations of agreements reflecting the complexity of the relations. First trade agreements were signed in the sixties and consisted either of a general trade agreement or a specific commercial agreements, such as voluntary restraint agreements on textiles, or trade agreements on hand-made goods (Club de Bruxelles, 1994). More substantial agreements were signed during the second half of the seventies and the beginning of the eighties. The nineties are represented in the third generation agreements, which contain deeper relations and include clauses on human rights and democracy; as well as extended areas of cooperation.

The generations are divided in the following periods:

First generation: the 1960s and 1970s - Cooperation agreements were signed by EURATOM with Brazil and Argentina in 1968. The most significant stage took place in 1975 when Mexico signed an agreement. The first results of the Lomé Convention were implemented with 46 African, Caribbean and Pacific countries (ACP). The Lomé Convention offered the ACP countries trade advantages without reciprocity, aid through the European Development Fund, and credits through the European Investment Bank. EEC assistance to Latin America consisted mainly of food aid in the 1960s. But other aid forms took place and were developed later on. The Lomé Convention was based on long-term approaches to trade and aid. Its goal was, therefore based on trade preferences, stabilization of raw materials and transfer of aid and technology.

The second generation: the 1980s - The cooperation sphere was extended to cover countries which were not part of the Lomé Convention, in 1981. Agreements were signed with Brazil, the Andean countries and Central America. Lomé II and III were signed during that period. The EIB was authorized for the first time to grant loans to South America. Consequently, new financial tools were established, one of them being the European Community Investment Partners (ECIP).

The political situation in the continent was characterized by authoritarian regimes. This decade was also a period when dictatorships progressively started to vanish. Democratization was supported by the European Community. Humanitarian aid was given to repatriate refugees or displaced people. Stronger commitment was given to this issue as a consequence of the entrance of Spain and Portugal to the EC.

The third generation: the 1990s - At regional level, the Community has been conducting a formal political dialogue with the Rio Group since 1990. The European Union has backed the process of integration from the beginning of Mercosur. On 25 May 1992 The Interinstitutional Cooperation Agreement was signed and aimed to pass on Europe's experience of regional integration. This led to intensive cooperation by both parties of the agreement.

The Community revised its 1981 policy in cooperation and finance and the developing countries of Asia and Latin America were part of much more than only cooperation in the fields of finance and technology (PVDALA). That is, the political dimension was included and thus began to orientate the Community's policy.

Political dialogue, which arose from a common desire to end the conflicts that were devastating Central America at the end of the 1970s and the start of the 1980s, was expanded to include all of Latin America in 1990.

Latin American countries benefit from the generalized system of preferences while 14 countries are covered by specific regional economic and trade cooperation agreements.

Financing Mechanisms

The following programs have been established to promote Latin American and EU's investment operations (IRELA, 1996):

ECIP

Promotes investment from private operators of the Community, mainly in the form of joint ventures with local operators in the mutual interest of all parties involved. One of the four financial tools is the "EC International Investment Partners" launched in 1988. Funds are allocated to enterprises, rather than countries. The management of these resources is in the hands of various banks in order to speed up decision making processes. All development banks in the Community's Member States are familiar with the mentioned financial tools. More than 50 international banks are involved in this program. (See Annex 2)

AL-INVEST

Promotes trade exchanges, transfers of technology and know-how investments in Latin America between companies from both continents. A vast program since 1994 under the supervision of Eurocenters in Latin America and COOPECO in Europe. (See Annex 3)

ALURE

Promotes potential Latin American energy resources. ALURE is, thus, a program on energy cooperation between the EU and LA since 1995.

URB-AL

Aims to promote local level exchange between municipalities and collectives, in various regions of the EU and LA. Towns play an important role in this program where urban issues (administrative issues, resource allocation, social services, the fight against drugs, and most importantly, the fight against poverty) are the most crucial. This program also promotes and supports the decentralization process in Latin America.

FOR CE-RIO

This program was established in 1994 between the Community and the Rio Group countries in order to promote the enhancement of human resources. All sectors are involved here, the public sector, the private sector, and regional integration.

ALFA

Created in 1994 to promote university exchange in the sphere of mutual economic interest. This was a breakthrough and of great advantage to the scientific community. In 1996, 830 universities and research centers were part of this program (IRELA, 1996).

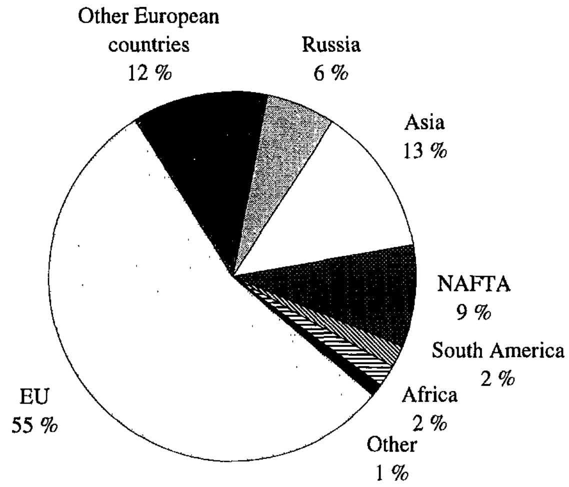
PART II FINLAND'S INTERESTS AND OPPORTUNITIES IN SOUTH AMERICA

9 LATIN AMERICA IN THE PERSPECTIVES OF FINNISH BUSINESS

9.1 Finland's Trade with Latin America

The share of the Latin American countries in the Finnish foreign trade has been rather marginal and volatile depending on the price instability of some primary commodities in the international market.

Figure 9.1. Finland's total exports by area, 1996



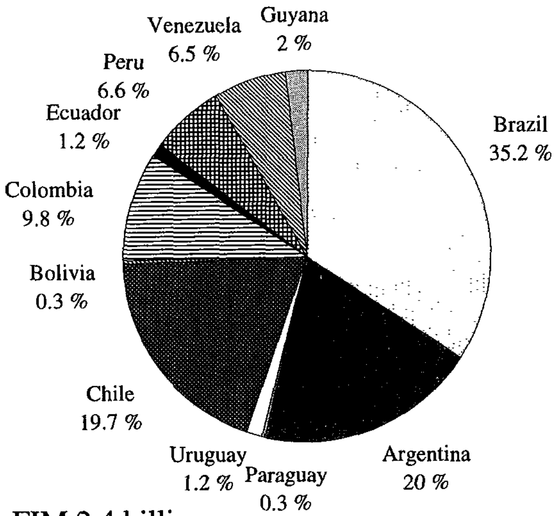
Total: USD 40 billion

Source: Board of Customs, 1997.

The share of imports from the Latin America varied between 1.5 and 2.0 per cent and the share of exports around 2 per cent. The Finnish exports to South America amounted to FIM 2.4 bn in 1996 and the Finnish imports to FIM 2.0 bn. The import growth rate was 24 per cent in 1996 and the export growth rate 4 per cent.

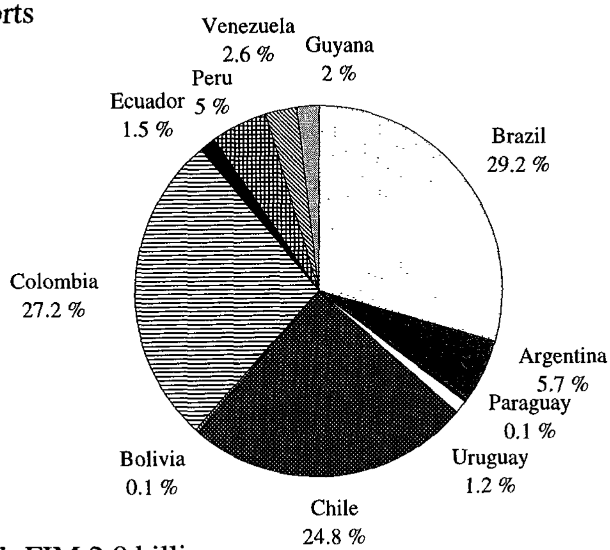
Figure 9.2. Finland's trade with South America by countries, 1996

Exports



Total: FIM 2.4 billion

Imports



Total: FIM 2.0 billion

Source: Board of Customs, 1997.

Exports to Brazil are high compared with other countries in South America. In 1996 the Finnish export to Brazil was FIM 844 million, (forcast for 1997, over FIM 1 bn). Chile and Argentina belong to the second category with export volumes of FIM 473 and 413 million FIM, respectively, in 1996. Other important countries for the Finnish export to the South America have been Colombia (235 million marks in 1996) and Peru (160 million marks).

The figure of imports from South America (Figure 9.2.) shows that the major countries of origin are Brazil, Colombia and Chile. The amount of the import from Colombia was FIM 543 millions in 1996 and the import from Brazil about FIM 542 million, and Chile FIM 495 million. Other important countries were Argentina (115 million marks) and Peru (99 million marks).

Mercosur countries and associate members are clearly predominant in the Finnish trade with South America, both in exports and imports. Their share represents more than three quarters of the total.

In the first half of 1997 exports to South America reached around FIM 1.6 bn and imports around FIM 1.0 bn. In the same period Finnish exports to Mercosur countries represented 82 per cent of the total and 70 per cent of the imports.

The major items of Finnish imports from Latin America are primary commodities or semifinished products. Half of the imports are food products; coffee, cocoa, sugar and diverse fruits and vegetables. Another important category is minerals and metals, around 40 per cent of the total imports from Latin America. Import of equipment and other finished goods is very limited.

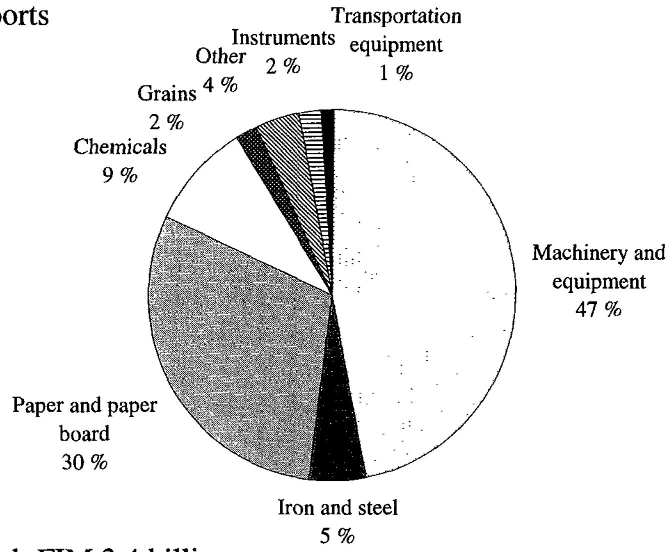
The most important single product from Latin America is crude coffee. The value of coffee imports varies around FIM 600 million per year.

The major import categories from Brazil were in 1996 fruit and fruit products; orange juice, (157 million marks) and coffee, tea, cocoa and spices (147 million marks). Other important products from Brazil were minerals, iron and steel, and motor vehicles.

From Chile the most important category of the import were copper minerals and concentrates representing FIM 400 millions in 1996, plus fruits, wines and vegetables (FIM 41 millions). Together they represent over 90 per cent of the total imports from Chile. The most important import product from Argentina has been oil seeds FIM 60 million, 50 per cent of the total. The import to Finland from Peru consists mainly of minerals and scrap.

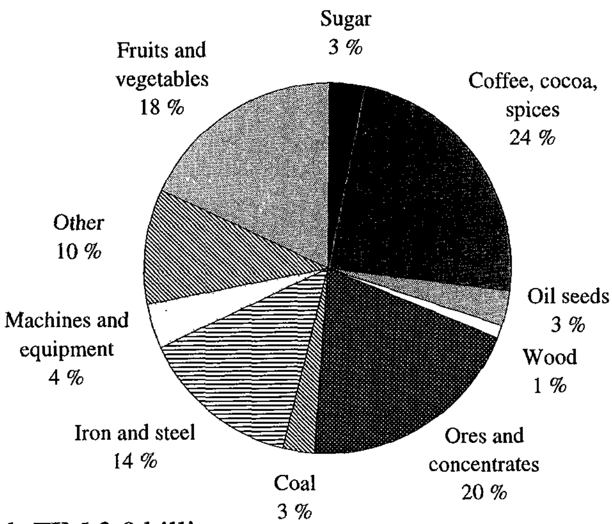
Figure 9.3. Finland's trade with South America by commodities, 1996

Exports



Total: FIM 2.4 billion

Imports



Total: FIM 2.0 billion

Source: Board of Customs, 1997.

Finland's exports to South America include two major product groups. The biggest one is the category "machineries". It is almost 50 per cent of the total export in 1996. The category "paper and paper board" was over 30 per cent of the export. Other important categories were chemicals and related products, iron and steel, and grains.

Finland's total export to South America increased significantly in the first half of 1997. Particularly exports increased to Brazil, Argentina, Chile, Peru and Venezuela.

Exports to Brazil include machineries (380 million marks in 1996) and paper and paper boards (300 million marks). Exports of chemicals and related products were important too. The total amount of this category was about 100 million marks. Finland's export to Chile increased rapidly in 1996 and especially the export of different machineries (283 million marks in 1996). Other important products were paper and paper boards (85 million marks) and chemicals (67 million marks).

Finland's export to Argentina traditionally consists of paper and paper boards (280 million marks in 1996); machinery (71 million marks in 1996) and chemicals (36 million marks). Finland's export to Peru increased rapidly; the item of machineries increased over 50 per cent.

The balance of trade between Finland and South America has been positive for Finland during the last years. In 1995 exports were 700 million marks higher than imports and the corresponding figure for 1996 was FIM 434 millions, and FIM 150 million for the first half of 1997.

9.2 Finnish Direct Investments in Latin America

In the past, Finnish investments have been very modest in Latin American markets. Only after the mid 1990's interest towards the emerging economies of the region has risen. This is the result of a rapidly increasing regional integration and the consequent expectations of local markets growth and the continuation of political stability in the South American countries. Especially Chile has attracted Finnish investments during last years.

Most of the investors are the largest enterprises in Finland, and have early foothold in those markets. One cannot say that distance is attractive but surprisingly it is the least denominated priority when discussing FDIs to Latin America. These companies make use of their competitive advantages.

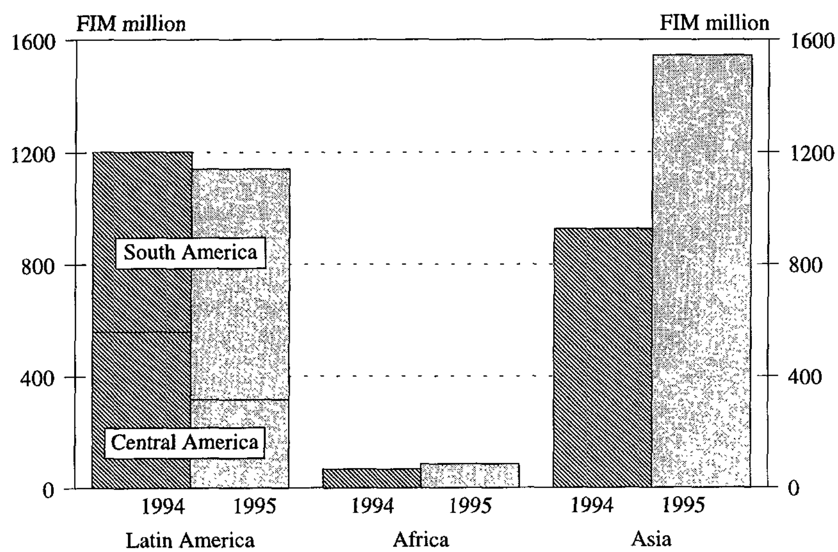
Table 9.1. Finnish direct investments to USA and Latin America, in millions of FIM

	1992	1993	1994	1995	1996
United States	452	1382	694	2073	386
Meksiko	0	0	2	0	7
Brazil	68	51	17	38	0
Chile	82	33	106	187	109
Other LA countries	13	33	4	8	21

Source: Bank of Finland February 1997.

Latin America's share of Finnish direct investments abroad is about the same magnitude as the share of Asia. In 1994 Latin America attracted more direct investments but in 1995 the share of Asia was a little bigger.

Figure 9.4. Finnish direct investments in developing countries



Source: Bank of Finland, Information Services Department, 11 November 1996.

9.3 Finnish Enterprises' Experiences in and Views on Latin America

The current chapter is based on interviews with executives of 20 medium and large-size Finnish enterprises conducted between December 1996 and March 1997. (See Annex 4) The interviews were informal and emphasis was given to experiences and present opportunities of making business in Latin America.[1] Some of the interviewees spoke Spanish and the majority of them had visited South America. Five executives had worked in the region as representatives of their enterprises or as members of international organizations. From the beginning interviewees unanimously acknowledged that there was an urgent need for a study of this kind.

9.3.1 Some Characteristics of Finnish Companies in South America

The companies of the sample have, for the most part, traded with Latin America for a long time. Some of them have a long history of establishing subsidiaries in South America. One good example is Vaisala Oy whose factory in Buenos Aires was established in 1956. This move was due to the promising local markets and high duty level on its exports from Finland. These days, however, the factory is closed.

A remarkable investment was made by Valmet in 1961-62 in the tractor industry. Their factory was located in Brazil and achieved considerable market share in the area. Then, later, production was transferred to SISU Ltd and Sisu was merged into Partek in 1996. A third company that could be mentioned is Cultor Oy which purchased the Swedish EWOS Ltd, acquiring a fish meal product and fish feed factory in Chile and also a share of the fishing fleet belonging to EWOS.

At present, a clear majority of the sample's companies are considering to strengthen their operations in the region by introducing their own production capacities.

The mode of establishing business operations differ from company to company and location depends on the nature of the business. When the production process has to be established in the region, decision on the location of the plant is decisively affected by the whole business environment prevailing in the host country.

The largest companies of the sample have solid headquarter business operations in one country of the region, wherefrom they control operations in other

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[1] When reference is made to the round of interviews, the term used is South America.

countries in the area. The preferred countries to establish regional headquarters are Brazil, Chile and Argentina.

Finnish enterprises are now present in South America in almost every important sector:

1. Forest sector products and technology:

   Ahlström - specialty paper & pulp and paper equipment
   Enso - newsprint and magazine paper, fine paper etc.
   Rauma - forest machinery & pulp technology & valves
   Raute Wood - mechanical wood processing machinery
   Safematic - centralized lubrication and sealing systems
   Sisu - wood harvesting equipment
   Valmet - paper & board processes, machineries & automation.

2. Mining and metallurgical technology and engineering:

   Outokumpu - mining equipment and technology, metals
   Rauma - rock crushing equipment
   Larox - solid/liquid separation & valves
   Tamrock - rock drilling equipment
   Association of Finnish mining technology exporters (Finnminers Group) under the Finnish Foreign Trade Association (FFTA).

3. Telecommunication:

   Nokia - mobile phones, cellular and other networks, etc.
   Tecnomen - messaging systems (fixed, mobile and paging).

4. Energy:

   Wärtsilä Diesel - diesel driven power plants.

5. Transport and transfer technology:

   Sisu - agricultural tractors, container and port machinery
   Kone - elevators and escalators
   Wärtsilä Diesel - diesel engines for marine applications.

6. Foodstuffs industry:

   Cultor - fish feed, food ingredients, industrial enzymes.

7. Others:

   Vaisala - electronic measurement systems (meteorology, etc.)
   Uponor - plastic pipe systems for water and gas distribution
   Kemira Chemicals - Chemicals for water treatment.

9.3.2 Latin American Business Environment from the Finnish Viewpoint; Past and Present

The Finnish enterprises of the sample include mainly three types of operations:

- The first group consists of twelve companies which have a production and sales subsidiary or license representation or joint venture, in one of the major Latin American economies.
- The second group includes four companies which operate through a representation agency established in the United States.
- The third group has a pure import-export relationship (two companies).

The sample of executives was too small for analytical purposes, but some central ideas and opinions can easily be detected. One of these unanimously accepted view is that the whole Latin America's and South America's business environment has improved rapidly during the 1990's. With only one exception, the total of the sample responded that they consider the region as increasingly attractive for some mode of economic cooperation with the Finnish industry.

The main arguments in comparing the region's past and present conditions from the perspective of interests and opportunities for their enterprises were:

Past:

- Political instability scared investors; democratic institutions were more an exception than a rule.
- Economic conditions were unstable; inflation had devastating consequences in several countries.
- Repatriation of foreign investment benefits was not free; investors had not constitutional guarantees for their operations.
- Local markets were closed or discriminatory for certain countries and products.
- Trade obstacles, such as high tariffs and varying trade taxes depended on temporary political changes.
- Finnish trade objectives were always planned for the short-term.
- South America was considered geographically remote from Finland.
- Trade risks were high - and financial guarantees were difficult to get.
- The languages and cultures of the region were considered distant to the Finnish mentality. High school programmes did not include sufficient introduction to a more systematic teaching on Latin America.

- Economic relations consisted, for the most part, of simple import-export agreements.

Today

- Democratically elected governments in all South American countries.
- Progress of the democratic process in most public and private institutions, though the process is still in an initial phase.
- European Union's and Latin America's political, economic and cultural relations are expanding to a great number of activities.
- Finnish government's interest in the region has clearly grown during last years.
- Globalization, Finland's EU membership, education programmes, expanded knowledge of Spanish and Portuguese, and advanced communication systems have rapidly brought South America nearer to Finland.
- Political and economic policies have become sound and stable, long-term business commitments in the region are possible, low inflation rate.
- South America has opened its rich and varied natural resources (energy, minerals, fertile lands, fishing, forests) to foreign investment.
- Finnish enterprises rate the region as huge potential markets, particularly in the Mercosur region.

What has not changed

The great majority of interviewees considers that the most salient unchanged negative feature affecting business interest in the region is the slow progress in poverty reduction, and as a consequence the situation hides a potential factor of social unrest.

In the order of assigned importance by interviewees, the following arguments were cited:

- As in the past, a complicated and vast bureaucracy is still prevailing in the region.
- Markets are not equally open; two large enterprises consider very difficult to enter Brazilian markets.
- Projects' financing continues to be a difficult issue.
- High criminality in the large cities of Brazil (Sao Paolo and Rio de Janeiro) and Peru (Lima) has become a serious threat to personnel working there.

- A relative surprise was that the majority of interviewees do not consider corruption in Latin America as a particularly big threat for establishing business operations there. On the contrary, it was manifested that "corruption practices are more common in Asia or Eastern Europe".

Selected comments:

- The Mexican crisis of December 1994 severely hit the financial markets. After this experience we were ready to revise our strategy there. Fortunately the region has overcome the shock and our projects are being carried as planned.
- With the new legal system our company receives the same treatment as local companies; a situation that you could not imagine ten years before.

9.3.3 Views on Structural Reforms

The sample expressed unanimously its support to the economic reforms carried out in Latin American countries. Free trade, privatization and regional integration were seen as the pillars for the improved economic situation. The group emphasized the necessity of continuing the reform process, as the only means of attracting foreign investment and to modernize and diversify production in the region.

More than half (12) of the executives had detailed information on the major reforms which took place at the end of the 1980's and early 1990's, when the countries of the region confronted high inflation, debt crisis and stagnation. In their opinion, reform programmes have been successful in reestablishing access to international financial markets and establishing an environment more conductive to economic growth. The same group considered that over the longer term, regional economic growth will permit a sustainable development.

A minority of interviewees do not feel too confident with the economic prospects of South America and the effectiveness of the reforms. They consider that the region's early stages of rapid economic growth this decade were due to the boom phase of adjustment policies - mainly reflecting elements which were not a real indication of the rate of growth in the longer term. In their opinion, the slower growth of 1995 was due to external factors, independently of the reforms being implemented and some smaller economies were hit by sudden variations in the international terms of trade and a "confidence crisis" of the international financial markets.

Selected comments

- The reforms managed to survive even severe economic stress and crisis and there was no need to return to pre-reform measures. Economic shocks merely implied temporarily setbacks for the reforms. From this we can draw the conclusion that the region has survived hard economic changes through durable reform policies.
- We can not generalize on the economic projections of the region; a country-specific approach plays a significant role, the cases of Mexico and Argentina are good examples. Both economies experienced the worse effects of the Mexican Tequila Shock in terms of severe recessions; while in the meantime rapid growth occurred in Chile, Brazil, Peru and a number of smaller countries.

9.3.4 Business Culture

The industrial and commercial companies in nordic countries, particularly those from Sweden, have a long tradition in doing business in Latin America. Finnish activities in the region are more recent. However, cultural understanding has proven to be uncomplicated; Latin American habits and mentality seem to be quite "European" in the opinion of the interviewees. A general comment on this aspect was that the relations of Finnish businessmen's with their Latin American colleagues are easy to become a good friendship. Moreover, Latin America was perceived as an easier area to approach than Asia where trade patterns and local cultures, in general, are considered to be more difficult to understand.

According to the opinions of the interviewees who have had previous work experience in South America, there are some basic principles that need to be learned before even considering business operations in the area:

- The understanding of local languages, culture, business customs and local habits is decisive for the successful everyday management of a business.
- Success demands reliable and regular contacts with local producers and clients. The business culture is sometimes spontaneous and short-termed. The formation of long-term contacts demands patient work.
- Finnish enterprises have good opportunities in the region, but they have to take into account that starting there is not easy. Instead of complaining on local difficulties they have to enter local markets looking for solutions. Finnish personnel has to be prepared to stay in the region for at least five years.

- Argentina and Uruguay have a high rate of university enrollment on a world scale, followed by Chile and Brazil. Finnish enterprises can count with well-educated professionals and skilled labor force for their operations.
- Most difficulties faced by foreign enterprises can be expected from local bureaucracy; particularly in the smaller economies with low level of institutional development. This is not the case in Chile or Argentina where institutional level is comparable to that of the Nordic countries. Much of bureaucratic obstacles can be overcome by payrolling experienced local administrative staff.

Selected comments

- Once trust was achieved, it was for life - and that is more an exception than a rule in international trade relations.
- Business contacts became personal contacts with our partners involved. In general, experiences have been positive and the region's businessmen are reliable as long as trust is respected by both sides.
- During a deal everything might seem going well, but in fact one can expect that several meetings will follow. However, once the main points are cleared, negotiations accelerate and long and cautious meetings become unnecessary.
- Bureaucracy affects the rhythm of operations, but once you are there you will get used to it.
- I am not sure how many persons speak spanish in our firm now, may be twenty or twenty five. When we started operations in South America there was only one person who could talk in spanish; it was me.
- Many persons in the Finnish business sector think we know everything about the people, economy, and business environment in Latin American countries. Once we are there we note that we have a lot to learn.

9.3.5 The Most Attractive Countries

Mercosur was cited, by all the interviewees, as the most attractive region from the perspective of Finnish industry interests and opportunities in South America. Mexico was also named as "strategically important" Latin American country in the view of Finnish enterprises.

By countries, the order of attractiveness assigned by the interviewees was as follows:

Position/Country	1st	2nd	3th
Argentina	3	7	10
Bolivia	1	-	-
Brazil	9	2	11
Chile	7	10	3
Paraguay	-	-	-
Peru	-	-	1

The reasons enumerated by interviewees on selectec countries were:

Brazil

The biggest economy in the continent, placed as the most promising market area for Finnish investments and operations, was characterized with contradictory sentiments. The country is blessed with rich human and natural resources. At the same time, there was some doubt if it is an open economy or a protectionist fortress. Brazilian economy inspires, however, strong confidence in the future and most interviewees believe that the country is emerging from a long period of economic difficulties to a period of steady growth. The success of government's plan aimed at reducing inflation and achieving economic growth was recognized. Brazilian industry has proved to be innovative despite the great difficulties to obtain capital from abroad during the years of economic problems.

Privatization is a significant part of the government's economic policies and a means of attracting new investment, both from domestic and foreign companies. Privatization plans include the telecoms network, most of the electric energy industry, roads, railways and ports over the next years. The scale of investments there are really enormous from the financial possibilities of Finnish companies. The most attractive opportunities for Finnish investors are in the modernization of Brazilian industry in the fields of forest, mining, energy and environment.

Finnish main entrepreneurial presence in Brazil involves following companies:

Finnish industry production units in Brazil:

A. Ahlström	Ahlstrom Ltda. Luveira
Kone	Kone Elevadores Ltda.
Neles-Jamesbury	Neles Válvulas Industriais NVI
Nordberg	Nordberg Industrial Ltda.
Sisu	Sisu Logging Equipamentos S.A.
Sisu	Valtra do Brasil S.A.

Manufacturing under license:

Nokia Gradiente Electronica S/S

Sales subsidiaries:

A. Ahlström, Nokia Mobile Phones, Nokia Telecommunications, Safematic, Sunds Defibrator Comercio e Industrial Ltda., Timberjack Industria e Comercio Ltda., Wallac Oy, Wärtsilä Diesel.

Representatives:

Enso, Jaakko Pöyry, Engenharia Ltda., Larox, Rapala, Sisu-Auto, Tamrock, Vaisala, Valmet, Automation Valmet, Paper Machines.

Sources: Finnish Foreign Trade Association and Confederation of Finnish Industry and Employers, 1997.

Selected comments

- Brazil has the biggest and leading markets in various sectors.
- Brazil has a leading role in Mercosur; if we are able to enter Brazilian markets we have the doors open to a market of more than 200 million persons.
- The country has stayed very bureaucratic and competition is tough.
- Customs are high and not coherent despite Mercosur's aims on their harmonization.
- Trade is easier when concentrating on low duty products and in sectors where you do not compete with local industrial products.
- The currency is clearly overvaluated; there are increasing downward pressures on the Real. In case of currency depreciation, investment and capital inflows will decline and Brazil's economy will be less productive.

Chile

The country inspires the biggest sympathies among interviewees. Chile was also the best known of the South American countries. Some of the sample's executives have had Chilean friends among the political refugees, since a long time. Chile's business environment is perceived as the most "European" and best organized in the region. A general comment was that Chile's well functioning infrastructure makes the country a preferred partner. Its open-mindedness to competition and the stability of the legal system were seen as decisive factors when considering the establishment of Finnish production plants there. All in all, the government has committed itself to sustainable reforms and Chile is considered as the best example of a reasonable economic policy.

Interviewees were well aware on Chile's variety of natural resources which could allow their enterprises for a large number of economic activities. Finnish technology and know-how are just suitable to be used and adapted with ample advantages in such areas like minerals and metals, forests and wood processing plants, and fishing and fish industry. One of the central ideas of Chile's export development strategy is the diversification of exports to more value added products linked to natural resources. Here again transfer of Finnish technology could play an important role.

Finnish production:	Outokumpu Cultor
Finnish subsidiaries:	

Auramo S.A.
Bafco, Ponsse Chile
Cultor:
  Ewos Chile S.A.
  Pacific Protein S.A.
Jaakko Pöyry Chileana Ltda.
Larox Chile S.A.
Nordberg Ltda.
	Outokumpu:
	  Minera Outokumpu Chile S.A.
	  Outokumpu Tecnica Chile Ltda.
	  Indepro Ingenieria S.A.
	  Compañia Minera Zaldivar
	Raute Wood-Santiago
	Sunds Defíbrator S.A.
	Tamrock Chile
	Valmet Chile Ltda.
	Wärtsilä Diesel Chile Ltda.

About 60 Finnish companies have representatives in Chile (Ahlström, Enso, Kumera, Neles-Jamesbury, Nokia, Normet, Outokumpu, Rammer, Rauma, Timberjack, Vaisala, Sisu Tractores, Wärtsilä Diesel, etc.).

Sources: Finnish Foreign Trade Association and Confederation of Finnish Industry and Employers, 1997.

Selected comments

- Chile's habits and business mentality is very "nordic" and we can trust that economic cooperation can be carried in a very regular manner. Decisions are made after a long and exhaustive revision of the points in discussion.
- Personal and friendly relations are decisive to succeed in local markets. This is specially important in the case of Chile.
- Chile's active participation in international negotiations has generated rapid infrastructure programmes and has allowed returns in infrastructure investments made by the private sector; foreign or domestic.

- The country's main niche is mining allowing for the manufacture of inputs and capital goods for mining-related engineering services.
- My experience is that Chile is an easy country to invest; bureaucracy is small and corruption has considerably diminished.
- The various seaports on the Chilean coast play an important role, especially now, when Chile has become an associate member of Mercosur.

Argentina

Argentina has had commercial relations with the Nordic countries since more than hundred years. The establishment of Colonia Finlandesa in the province of Misiones, Argentina, in 1904, when 113 Finnish families started a "new life" far from home, represents a unique event in Finland's relation with South America. Economic interest of Finnish enterprises in Argentinian markets is much more recent.

Argentina was placed in the third position according to the interest of interviewees. Like Brazil, Argentina awake contradictory views among interviewees. It was generally recognized that government has a strong commitment with economic stability and has succeeded in reducing inflation rate. Argentina's monetary and fiscal discipline was also distinguished. The most important reason that makes Argentina an interesting country in the view of Finnish enterprises is, however, that local market is very large and dynamic and provides access to Mercosur.

The sample´s main argument against the expansion of operations into Argentina was that political stability in the country is not strong enough.

Like the rest of the South American countries, Argentina has natural resources ranging from energy, proved and potential mineral reserves to fertile lands, forests, and water resources. Hereagain, Finnish technology has a comparative advantage due to its own experiences and know-how in building a modern economy based on its natural resources.

Finnish industry in Argentina

Subsidiaries; production and sales offices:

Uponor	Plastic pipe production (gas and water systems)
Cultor/Genecor	Production of industrial enzyme
Kone	Kone Ascensores S.A. (sales & services)
Nokia Telecommunications	Sales subsidiary
Sisu	Valtra Argentina Tractores S.A. (import & sales)
Tamrock	Sales subsidiary

Representatives:

About 90 Finnish companies including Ahlström, Enso, Larox, Neles-Jamesbury, Nokia, Outokumpu, Rauma, Sisu, Sunds Defibrators, Vaisala, Valmet and Wärtsilä Diesel.

Sources: Finnish Foreign Trade Association and Confederation of Finnish Industry and Employers, 1997.

Selected comments

- The country has been an important trade partner to Finnish companies in the past. Conditions are much better now to expand our relations.
- The economy is becoming more and more stable. We will wait for two or three more years and see how investment conditions develop.
- We are already late in Argentina's mining sector; Canada, Australia and Chile have been very active there. However, local markets for mining machinery and equipment will strongly expand in the future; it is our opportunity.

Smaller economies

With two exceptions, Bolivia, Peru and Paraguay were not placed as priorities for Finnish enterprises. In the first case, one executive considered that Bolivia's mineral potential and the necessity of ample research in the whole range of the geological activities there, could offer multiple opportunities to subsequent operations on a regional scale. The argument to expand activities in Peru was also related to the huge and very diverse natural resources of the country.

Interviewees recognized that the three countries have experienced profound changes in their economy and these changes have opened the doors to investment opportunities in various sectors of economic activity. There is an appropriate business climate in an stable economic context but markets are relatively small and establishing subsidiaries in the neighbor countries should make it possible to expand operations into these three countries.

Peru and Paraguay are not perceived by Finnish enterprises as politically stable countries and infrastructure underdevelopment in Bolivia diminishes investment interests and opportunities in diverse sectors of industry. According to the sample's opinion, expansion of activities in those three countries will follow naturally the strengthening of economic relations with the South American larger economies. "After all, we can not forget that Peru's and Bolivia's natural resources are among the richest and most varied in the world", said one interviewee.

9.3.6 Official Development Assistance

There is a new realism emerging in international cooperation parallel with a rapid transition from a trilateral world comprised by the USA, Europe and Japan to a world where diverse regions including Latin America are playing a larger and more influential role in world economy. At the same time, this means the end of earlier interpretations of development aid and the incorporation of new policies adapted to the new conditions and needs of the emerging countries. Whereas countries like Paraguay and Bolivia need foreign assistance on a sustained and properly oriented basis, the South American larger economies require the adoption of more reciprocal economic policy adjustments to the needs of a changing world economy.

Finnish official assistance to South America has strongly diminished, so that bilateral assistance to the region is today practically limited to some small social sector projects. Most of the development aid is carried out by non-governmental and international organizations. Interviewees recognized that in the past, some Finnish industrial sectors suffered from the official assistance's cut, for example in the area of meteorologic technology and equipment export.

Interviewees, without exception, consider that bilateral official assistance programme has to be reinforced with a longer term vision. Although they recognized the significance of the European Union assistance programme, interviewees emphasized Finland's bilateral aid as a necessity in the relations with poorer regions of South America. Unanimously, the sample's executives responded that humanitarian aid activities have to be continued and view that active involvement of the state contributes decisively in the creation of Finland's positive image in South America. Yet, some criticism was notorious due to the marginality of current activities while most interviewees claimed for more concern and commitment regarding that region.

Selected comments

- Official development aid is important, particularly in those countries where, otherwise, it would be very difficult to start business operations.
- Finnish development aid to Africa has have ups and downs but generally there are a number of projects and motives to be proud of. The same can not be said on Finnish aid to South America; it practically never existed.
- Look at the Swedish companies; they have the doors open in South America and partly because they have had always a coherent political and economic strategy to the region.

– In Latin America the most preferred received country has been from 1980s Nicaragua. FINNIDA did not show sufficient interest enough in similarly poor South American countries.

9.3.7 The European Union

Finland's membership in the European Union was unanimously appreciated as a positive move for business worldwide expansion. The sample's largest enterprises already have some experience through their own European subsidiaries which know how to operate in the Union's bureaucracy. These companies are represented by their own lobbying organizations in Brussels. Smaller companies engage local lobbying organizations when necessary.

Interviewees had a general knowledge and a diffuse interest on the European Union's Latin American strategy and policies, but surprisingly, they knew very little about the Union's finance mechanisms and instruments at their disposal when planning investment and trade expansion to the area.

Increasing relations between the Union and Mercosur are appreciated as a means to enlarge Finnish industry's opportunities in the region. In addition to EU's political role, the majority of interviewees assigned the Union a good capacity in diverse areas such as a reliable source of project information and as a mature example in the process of integration. A minority, however, and mostly those who have had some experience with the EU criticized the Union's "benefactor mentality" and claimed for a more business-minded approach to South American economies.

Selected comments

– Learning how to use finance instruments of the Union is the next thing I am going to do. Perhaps we have in our personnel some experts of this field; I don't know.

– There was no necessity to use the Union's finance mechanism until now; maybe in the future.

– The EU could have a prominent role in the financing of high technology projects in some countries of South America. The region's most advanced countries do not want donations; they want direct investments and fair business negotiations.

9.3.8 Some Other Viewpoints

Sectorial Priorities

Opinions on the sectorial preferences in South American countries followed, obviously, the specific specialty of the sample's enterprises. Thus, answers included the following areas of interest:

- Mining and metallurgical technology and engineering
- Forest sector products and technology
- Energy industry; power generation
- Telecommunications
- Transport
- Environment technology
- Foodstuffs industry
- High-tech know-how
- Health sector

When the question was formulated in the form: what do you think is the most relevant characteristic of the Finnish industry to cooperate with South America?, the sample's arguments were unanimous: Finland has become a modern industrial economy during a very short period after the Second World War. A dynamic metal and engineering industry developed parallel to the strong forest industry. All this was possible due to the existence of rich natural resources, forests and minerals, in Finland's territory. South America is blessed with one of the richest natural resources in the world. Finland has the technology to create value added from these resources and to participate in the industrial expansion of this part of the world.

Physical distance

The physical distance used to be a problem, but this is no longer the case. Business operations are well organized and distance is just a matter of good operational management. Interviewees do not perceive physical distance as a problem in making expansion or investment decision in South America.

Distance can affect bulk trade when the commodity is low priced and freight costs represent a relatively large part of the price. Import-export trade with inland countries is much more difficult due to the additional costs resulting from the intermediate handling of the traded commodities. Physical distance was a prominent factor in the trade of fresh fruit. Today, Finland can import fruits and vegetables from South America anytime of the year due to the good cold storage infrastructure in both ends.

Trade barriers

There is still evidence of trade obstacles. A good example are the varying trade tariffs despite the establishment of non-discriminatory regulations by Mercosur and the rest of South American countries. In some sectors variations are significant. Brazil was most often referred to have altered import tariffs.

Market expansion

Latin American markets are perceived as very fascinating especially after the establishment of Mercosur which enlarged trade opportunities. It is generally believed that Mercosur has enhanced Finnish investment interest and that it creates an increasing and more open trust towards the region.

Financial issues

When large investment projects or vast export schemes are planned, unresolved financial issues are the bottlenecks, according to the experiences of some interviewees. At least in the region's smaller economies, local project partners and clients do not find enough financial support or credit rates are sometimes too high. Particularly in the past, even a good project was not implemented due to major financial complications.

Finnish state export credits and guarantees to South America were perceived as very expensive. A majority of the sample's enterprises use export credits from international organizations. Some of the largest companies had either their own international financial mechanisms or due to their multinational character do not use external creditors. Finnish credit and guarantee mechanisms were criticized for their inflexibility and unchanging practices in connection to the new economic situation in the emerging economies of Latin America.

In general, interviewees conceded that various public institutions provide the necessary and appropriate framework for Finnish trade activities there. Companies may search for information and business advice from the various public institutions established for this purpose. For example, the Ministry of Trade and Industry has multiple contact channels at different levels, both domestic and foreign. The participation of the Ministry is based, for the most part, on the concrete proposals and interests of the Finnish companies, on the business cycle variations, and decisively on the political situation of the target country.

Export promotion

In order to promote Finland's export activity to South American countries, the sample's enterprises argued in favor of a more dynamic attitude from the part of the Finnish Foreign Trade Association. This institution should, according to the unanimous opinion of the sample's executives, strengthen its activities there and increase the number of trade commissioners or market officers in the big cities of the area. Some criticism was posed, particularly by the smaller companies of the sample, to the organization's mode of operation: "the association reminds more a secret club than an export promotion institution", said one executive. (At present, there is a process of change and expansion of the FFTA in South America. This may mean a more concentrated promotion of activities in already important export targets.)

The Finnish Guarantee Board was perceived by a majority of interviewees as rather inefficient compared to its institution mates in Europe. The system needs much more openness, flexibility and rapidity. Thus, a kind of a reform in the system is required. Criticism was posed by the smaller companies of the sample.

Selected comments

- For some particular reason, there is a tendency to send engineers as commercial representatives abroad. I have nothing against engineers. I am an engineer myself, but I consider there is a lot of other requirements; and the most important is the ability to make fluid and rapid contacts with executives of the private and the public sectors in the host country.

  I have been twice in South America. I have never seen a trade commissioner. They did not have enough time to receive me.

9.4 Conclusions

To summarize the conclusions of the framework set forth before it may be best to ask and answer the following questions:

- Do Finnish enterprises want to expand their industrial and commercial operations to South America?
- If yes, what are the enterprises prepared to do to make possible this expansion, and to continue it in the future?

The answer to the first question is yes. Finnish enterprises want to enter or, in case they have been already operating there, reinforce their presence in South America for several reasons:

There has been evolving for some years, a new awareness of the strong emerging of most of the economies in the region. Foreign investment is seen as a part of an extensive, expanding, efficient nonpolitical system providing financial and technical assistance as part of the region's development programmes.

The new business climate where key sectors of economic activity including better infrastructure services has received recognition by Finnish enterprises. They have perceived as well that Latin America has made efforts in privatization, reform of financial instruments, enhancing international business operations and, in general, implementing economic policies in order to play a competitive role in global markets. Thus, investment opportunities are favorable and sustainable capital inflows to the region already exist. Regional integration is perceived as a result of common trade practices, as well as of strong cultural bonds. Strengthening of relations between the EU and Mercosur is perceived as important for current and future engagements in the region. This enforces the possibilities of entrepreneurs to be given opportunities to do business with their counterparts in Latin America.

Latin America has experienced democratization. Though reforms are boosting the economy, many social weaknesses and problems remain. Worst of all are the widening social inequalities and position of the poor. In the interviewees opinion, the problem of income distribution inequalities that Latin America faces are not inherent in the process of reforms made during the last ten to twelve years but are the result of the institutional immaturity of the countries in the region.

In fact, South America - specially Argentina and Peru - is one of the regions in the world with the least interference over foreign investment and private enterprise. However, recently new signals are emerging particularly from part of the powerful catholic church and some international finance institutions like the Inter-American Development Bank calling for economic policies where social objectives can be achieved through capital investment in high-employment sectors, wage rises coupled with rises in productivity, and higher tax collection.

Chile is, again, a good example of how to balance economic and social objectives with a modern, minimal government intervention and, at the same time, generating new business opportunities both for domestic and foreign - and amongst them - Finnish enterprises.

The answer to the second question is:

Finnish enterprises are prepared to play an increasing role in the region. Like any large enterprise in the world, Finnish companies seek to increase their benefits. The purpose involved in this process can be facilitated by expanding activities worldwide. In the particular case of Finnish enterprises, they can introduce advanced technology for modernizing the forest, mineral, fishing, environment, and infrastructure sectors in South America. The modernization of these sectors, in general, is resulting in increases in the region's national products, expansion of the productive capacity and diversification of the industrial sector.

This permits, in turn, the growth of the Finnish enterprises involved, and the consequent increases in their income. At the same time, expanding operations in South America permits these companies to develop their technological diversities and competitiveness, and to expand Finland's international connections and magnitude of operations in any part of the world.

10 LATIN AMERICAN OPINIONS ABOUT THE FUTURE OF THE REGION AND BUSINESS RELATIONS WITH FINLAND

10.1 Interviews in Five Countries

The researcher visited Argentina in 1996 and Bolivia, Chile, Peru and Paraguay in the spring 1997.[2] These five countries represent 26 per cent of the Latin American countries' total GDP, 19 per cent of the total population and 38 per cent of the region's area. All countries of the sample have been able to gain access to foreign investment in relatively substantial amounts and their political willingness to structural change is rather high. In fact, two of them - Bolivia and Chile - were the first countries in the region to implement structural change policies in the 1980's.

The sample includes countries with relatively large populations, such as Argentina, as well as countries with small population like Bolivia which counts with only seven persons per square kilometer. Illiteracy rates and school enrollments vary greatly from one country to another. Whereas in Argentina and Chile a high level of literacy and skills have been achieved long ago, in Bolivia and Peru the percentages of literates and higher education graduates have risen only recently.

The structure of economic activity also varies among the five-country sample. In Bolivia the share of agriculture in the GDP is 20 per cent when it is under 10 per cent in the rest of the countries. A higher growth performance was achieved by those countries that have succeeded in creating a broader industrial base. Chile has been the fastest growing economy over the period 1991-96 with an annual average of over eight per cent. At seven per cent, Argentina's GDP growth average between 1991-96 has been only slightly lower than Chile's although Argentina has had marked swings in its economy. The five countries seem to be able to sustain high total and per capita economic growth in the long term.

During his visit to five countries in South America, the researcher had the opportunity to discuss with a number of persons belonging to a diversity of occupations. The thorough interviews were made with 102 persons according to the following classification:

[2] During his visit to Santiago the researcher had the opportunity to attend the Symposium "Technology Solutions for Productive Mining" organized by Finnminers Group. The conference was held in connection with the state visit to Chile of Mr. Martti Ahtisaari, President of Finland.

Table 10.1. The background of the interviewees in the study

	Argentina	Bolivia	Chile	Paraguay	Peru	Total
Politicians		5	-	1	2	8
Government officials	1	6	4	5	5	21
Executives of private sector	2	4	8	3	7	24
SME owners	5	1	4	1	-	11
Consultants and independent professionals	4	3	3	2	1	13
Researchers	4	5	-	1	4	14
Trade union representatives	2	6	2	1	-	11
Total	18	30	21	14	19	102

The interviewees do not represent a random sample of the populations in the selected countries. They were chosen mostly on the ground that due to their occupation or position the group can potentially influence on the character of the cooperation between their country and Finland. A number of these persons have had some previous connections with Finland.

The interviews had a dual purpose. On the one hand, they aimed to embody a vision about the region's global issues and on the other hand conversations were directed to reveal interviewees' views on the possibilities of cooperation with Finland. In connection with the first purpose, discussions touched the following main issues:

- governmental economic policies
- regional integration process
- privatization
- social and economic problems
- cooperation with the European Union
- democratic process
- foreign investment
- natural resources
- environment
- unemployment
- poverty.

On the possible cooperation with Finnish enterprises and institutions the subjects discussed were:

- past experiences with Finnish enterprises
- knowledge of Nordic countries

- economic significance of different regions
- bottlenecks of cooperation
- modes of operation
- sectorial priorities
- EU's financial mechanisms.

10.2 Views on Structural Reforms

While the first interviews were made, it quickly became clear that the respondents preferred an informal method of working. The procedure of conducting interviews in an informal manner was done mainly because from the beginning it was clear that many of the persons of the sample hesitated to limit their opinions by filling in questionnaires. In many cases, respondents volunteered specific comments and extended themselves on the diverse questions made by the researcher.

What are the main results of the economic and social reforms in Latin America?

The answers presented in Table 10.2 reveal that opinions about the market-oriented economic reforms made during the last fifteen years in most countries in Latin America differ. Persons working in high positions of the private sector and owners of small-and medium size enterprises (SME), unanimously agree that the economic and social reforms in their countries are an indispensable process. Eighty per cent of the high government officials are strongly in favour of the reforms while twenty per cent support the process with reservations.

Table 10.2. Opinions on the economic reforms in Latin America

	In favour	With reservations	Against	No opinion
High government officials (21)	17	4		
Private sector executives (24)	23	1		
Researchers (14)	5	6	3	
Consultants and independent professionals (13)	6	3	2	2
Politicians (8)	3	3	2	
Trade union representatives (11)	1	2	6	2
Owners of SME (11)	7	2		2
Total (102)	62	21	13	6

As a group, those most opposed to the whole reform process were trade union representatives. With one exception, they felt that "neo-liberal reforms are a sophisticated method of exploitation. Reforms aggravate the problem of unemployment because privatized enterprises are reducing labour force as a rule". Most researchers supported reforms with one significant reservation: "The reforms are necessary, but they have to be conducted with more intelligence and honesty." Independent consultants and professionals displayed a little more positive approach to reforms than researchers.

Selected comments:

- There is not a real perception of Latin America's reforms in Europe or North America yet. Too often, for industrialized countries, Latin America is still a group of poor countries needing to be helped. There is not an understanding that most of the region's nations represent powerful processes which have a social and political dynamics of their own.
- Economic reforms have strengthened political pluralism. If economic policy and income-distribution problems can be effectively managed so that the reforms continue to receive political support, Latin America will have a solid foundation of democratic governments at the start of the new millennium.
- With the expansion of foreign investment, there comes a general improvement in the level of development of the Latin American countries.
- The success at reducing inflation is stabilizing the economies.

What are the main economic and social problems and challenges?

A clear majority of interviewees agreed that the main economic and social problem in Latin America is how to accelerate growth and, at the same time, improve social conditions of the people. Most groups of the sample considered that ensuring economic and investment growth should reduce poverty and keep unemployment level low. Only workers and one third of the researchers were sceptic on that remedy.

The groups formed by high government officials, private sector executives, and owners of small-medium size enterprises (SME) consider that the most significant challenge in the near future in Latin America will be to train and educate young population. They consider education as the only means "to ensure that benefits of economic growth reach all segments of population".

The opinion of most trade unionists and researchers was that "the key social and economic problem and challenge is poverty". One top politician said that "poverty eradication has been improving only slightly; this task does not belong to the character of neo-liberal reforms".

By countries, answers on the main economic and social problems in the coming years reveal that facing poverty and reform of income distribution was mentioned more often in Chile, the country where government has possibly made the best progress in the improvement of social conditions of the whole population in the region. Development of the infrastructure and greater environmental care were also cited as significant challenges there. Another essential economic challenge facing Chile and Latin America was believed to be the need to expand regional free trade and integration.

The majority of the interviewees in Peru, Paraguay and Bolivia think that the major challenge is the consolidation of stabilization including: political stability, inflation and interest rates under control, and balance between salaries and competitiveness of the economy to ensure expanding foreign and domestic investment. Better education was seen as determinant to reduce the gap between economic classes. More efficiency in the struggle against corruption and violence was also believed as crucial for development.

Particularly in Peru, interviewees spoke about the necessity of continuing efforts to raise domestic saving rate to the level in South-east Asian countries.

Populism expansion was considered as a real possibility if the present reforms do not show rapid results in Bolivia and Paraguay.

In Argentina as a main problem/challenge was posed the need of continued structural reforms including: rationalization of labor laws as an incentive for employers, raising the efficiency of the export industry, establishing better regulations for private investment in infrastructure to reduce costs. Improving quality and efficiency of educational and health systems were seen as a means to stabilize and accelerate economic growth in the long range. Like in Chile, strengthening of free trade and integration mechanisms are also seen as significant challenges for the future.

Selected comments:

- The growing number of urban unemployment will become a source of social and political tensions and resentments even in those Latin American countries where total production and per capita income are expanding rapidly.
- Those nations able to modernize their infrastructure will also become the most attractive to additional investments and capital.
- Sharing growth process with the groups of society will need to include a strengthening of the education and health systems very significantly. Also private efforts for health services and improved judicial systems will be needed.
- Protection of property rights and contract enforcement are needed.

- From a political perspective, the per capita income of Latin American countries should be raised by 3 per cent per annum, then the total income should be growing approximately at 5 per cent per annum. Slower growth would affect political stability.
- Workforce productivity will be a key determinant in job creation. Latin America is not creating enough jobs to meet the demands of growing populations yet.
- The key social and economic challenge is poverty.
- We need to reduce poverty, crime and violence, and unemployment, to raise low wages and to improve democratic environment. We also need basic services for the poor.
- Labor-market efficiency is needed to ensure higher employment growth; small and medium-sized, as well as rural and urban entrepreneurs, need to have access to financial markets, and land reforms need to be implemented thorough market-based mechanisms.
- New markets create new opportunities, which will become available to a greater part of the population. Countries that remain committed to open-market ideals, fiscal stability, and education and training, will offer the best opportunities to their citizens.

How do you see the privatization process?

The answers presented in Table 10.3 reveal that opinions on privatization process follow a very similar distribution compared with those referring to the main results of the structural changes in Latin America. A slight difference is that almost one third of those persons working as government officials do not support privatization without reservations. Two thirds, however, believe that privatization will promote growth and increase productivity, maintain costs at permissible levels and encourage the opening of markets.

Private sector representatives are unanimously in favor of the privatization process. For them privatization means the creation of genuine competition that has resulted in greater investments and lower prices for consumers. In the longer term it will create more jobs because privatized companies tend to have better access to capital and they perform more efficiently.

Trade union leaders and members are strongly against privatization, because it results in "higher unemployment and the creation of private monopolies". Only one person of this group is of the opinion that "if workforce is rapidly absorbed by the new privatized companies then workers will be the most enthusiastic supporters of the process".

Most researchers are in favor of privatization process "with reservations". They observed that if privatization is not done in a moral and correct form, privatized enterprises will not succeed and criticism will be directed to the whole process of reforms.

Table 10.3. Opinions on privatization

	In favour	With reservations	Against	No opinion
High government officials (21)	15	5	1	
Private sector executives (24)	23	1		
Researchers (14)	4	7	3	
Consultants and independent professionals (13)	6	3	2	2
Politicians (8)	4	2	2	
Trade union representatives (11)	1	2	8	-
Owners of SME (11)	9	2		-
Total (102)	62	22	16	2

Selected comments:

- Privatization programmes will encourage new investment and reduce the fiscal deficit caused by state subsidies to inefficient state-owned enterprises.
- Negative impact will be higher unemployment. If labor can be absorbed into the economy over a reasonably short period of time, then the negative impacts will diminish. Another negative impact is the creation of private monopolies.
- High unemployment connected to privatization creates a political obstacle to future privatization. Positive effects are longer-term issues such as increased productivity gains and a more efficient use of the means of production.
- Privatization done with the necessary honesty and care should lead to improved profits and efficiency, and will provide a higher growth rate.
- Privatization means higher investment in infrastructure, more efficient management of public utilities, and long-term fiscal discipline.
- Governments will be able to concentrate on the provision of basic services, such as education and health while maintaining fiscal balance.

How do you see the regional integration process?

More than half of the persons working as consultants and independent professionals, workers and owners of SME's had no opinion regarding integration perspectives in Latin America. Integration was believed to expand in the region if it helps to create jobs and accelerate growth. Specially owners of SME's would like to see some kind of protection in the local markets.

Although answers do not reveal a negative attitude towards development of regional integration in the future, only government officials and researchers believe strongly that the process will be enhanced. For them, integration is a consequence of globalization and liberalization; "there is no country in the world that can develop its economy isolated from the rest of the countries".

Table 10.4. Opinions on the perspectives of regional integration

	In favour	With reservations	Against	No opinion
High government officials (21)	17	4		
Private sector executives (24)	15	5		4
Researchers (14)	10	3	1	
Consultants and independent professionals (13)	3	3	1	6
Politicians (8)	2	4	2	
Trade union representatives (11)	3	2	-	6
Owners of SME (11)	3	3	1	4
Total (102)	62	21	13	6

Private sector executives are a little more cautious on the perspectives of integration compared with their unanimous support to the recent structural reforms. Their general argument was that Latin America is the region that has been most active in trade liberalization and integration expanding, but "many countries are confronting problems because the process is moving very slowly and large economies in the industrialized world are not implementing fully the free trade commitments".

10.3 Latin American Views on Cooperation with Finnish Enterprises and Institutions

Recent official visit to South America headed by President Martti Ahtisaari with the participation of Finnish business interests demonstrated that there exists a consensus on the importance of increasing and diversifying investments and trade with that region. Interest of the Finnish industry can be seen as part of a development strategy to correct a situation where South American countries have been traditionally very distant objectives for economic cooperation. The question now is how to attain a higher level than the one reached so far.

In the past, the applied solution in most Latin American countries when commercial accounts did not balance, was to impose restrictions and protectionist measures on imports and foreign investment. At present, there is a clear change how to conduct economic policy and there is no doubt whether opening or not the doors to foreign investors to participate in their development programmes. The question here is how to attract investment to procure the mutually most convenient contribution considering the low level of domestic savings in the region.

The opinions on selected issues in the exchange of views about how Finnish industry can strengthen its presence in the region, can be summarized as follows:

Do you have some experience in working with a Finnish enterprise or institution?

Only a small fraction (12 per cent) of 102 interviewees responded that they have or have had a relationship with Finnish enterprises or institutions. All of them considered that mutual understanding has been good or excellent. The same persons answered unanimously that their experiences with investment and financing mechanisms of Finland have been satisfactory; only in two cases it was observed that negotiations developed too slowly.

Which Nordic countries are familiar to you?

When discussing about the general knowledge of Nordic countries, the best known by the sample -by a clear margin- was Sweden, with 80 per cent of the answers. In Chile and Bolivia, Finland was the second best known among the Nordic countries, as it was Denmark in Argentina and Peru. Norway was the least known in every country of the sample. Only 9 per cent of the sample responded that they had never heard of the Nordic countries.

Which global region do you consider as most important from the business perspectives of your country?

Mercosur was named in 75 per cent of the answers of all the groups and in three of the five countries of the sample, as the most important region to strengthening economic and commercial relations. In Peru APEC and in Chile Nafta were seen as the most important, Mercosur being second. The importance of Mercosur and other regions of the world varied in the following manner:

Table 10.5. Economic importance of selected integration areas

	Mercosur	Nafta	EU	APEC
Argentina	1	2	3	4
Paraguay	1	2	3	4
Bolivia	1	3	2	4
Peru	2	3	4	1
Chile	2	1	4	3

Are you familiar with the European Union's financing Mechanisms?

The answers on the acquaintance of European Union's financing channels showed that a majority of governmental officials (58 per cent) and executives in the private sector (75 per cent) and owners of SME's (50 per cent) had some knowledge on the objectives and modes of operations of these mechanisms. For the total of Paraguay's and the majority of Bolivia's officials, contacts with EU's financing mechanisms were their "every day's work". The rest of the groups - with few exceptions - had not heard of the existence of these institutions.

What type of business operations you prefer?

More than two thirds of the sample (68 per cent) had some opinion on the question: what is the mode of operations you would prefer in connection with Finnish enterprises? Answers revealed a clear preference for the subsidiary alternative - establishment of production plants and sales - among governmental officials, politicians and researchers. Private sector representatives - executives, owners of SME and independent professionals - indicated their preference for joint ventures and secondly for subsidiaries. Other alternatives mentioned were agencies, licensing agreement, co-operatives, and official assistance aid.

What are the specific obstacles when planning cooperation with Finnish businesses?

Of those who had opinions on the wished mode of operations, 90 per cent considered that the main problem to co-operate with Finnish enterprises or institutions was the lack of information about Finland's industry and negotiation mechanisms, and the insufficiency of Finland's commercial and economic representation in their countries. Factors like physical distance, cultural differences, trade barriers, competitiveness, market difficulties, or lack of interest were not considered by any group or country as significant problems.

What are the sectorial priorities for Finnish involvement?

Table 10.6 reveals the priorities that the various sectors of economic activity had in the opinion of the sample. While the groups of government officials, and private sector executives named forestry and mining as first priorities, researchers named technology, research and education as the sector where the Finnish co-operation could be most effective. The groups of consultants and independent professionals, and owners of small and medium enterprises also listed technology, research and education as the number one in the rank, together with the infrastructure sector.

Infrastructure, which included telecommunications, transport, roads, construction and water supply, was the sector number one for Finnish cooperation according to the opinion of the majority of trade union representatives and politicians.

Obviously, opinions on preferences were affected by the specific activity of the enterprise or institution particularly among those representing forestry and mining activities. Most persons in all groups volunteered comments on the importance of the environmental component in all sectors of economic activity, though this area was not directly named as first priority by any group of the sample. The deterioration of the physical environment was not seen as an inevitable consequence of progress but the result of obsolete technologies and lack of institutional organization.

In total, 96 persons had an opinion on their preferences for co-operation with Finnish enterprises and institutions. The improvement of technological capacity and level of research and education systems in their countries seems to be the most attractive alternative for Finnish involvement. Considering these arguments for future action, the most salient concept that can be regarded is a new approach to cooperation between an industrial country - in this case Finland - and the selected South American countries.

In a sense, the results of the round of interviews - although the sample was small - reflect the new concept of cooperation. At a time of free trade and globalization, diffusion of technology, improvement of research methods and expansion of education opportunities are seen as the most dynamic factors in the relations of industrial and emerging countries, and are becoming a norm of action geared to ensuring the conditions for sustainable development.

From the perspective of the selected South American countries, the diversification of exports to more value added products linked to natural resources is vital. To achieve this goal, interviewees consider that Finnish technology and know-how is appropriate to be used in diverse sectors of the local economic activity.

Table 10.6. Sectorial priorities, (number of persons)

	Forestry	Mining	Energy	Environ-ment	Infra-structure	Technology, Research, Education
High government officials (21)	5	5	1	5	3	3
Private sector executives (24)	6	6	4	2	3	3
Researchers (14)	1	2	1	3	2	5
Consultants and independent professionals (12)	1	2	2	1	3	3
Politicians (8)	0	1	0	2	3	2
Trade union representatives (7)	0	1	0	1	3	2
Owners of SMEs (10)	1	1	2	0	3	3
Total (96)	14	18	10	14	20	21

10.4 Sectorial Preferences by Countries

Argentina: Forestry and mining (See Chapter 5.2.1) were seen as main sectors, where cooperation with Finnish firms could be best attained.

The Argentine forest industry has annual production estimated at around three million cubic meters of wood. The country has more than 20 million hectares considered suitable for forestry operations. Forested wilderness currently occupies 780 000 hectares. Output per hectare is as follows: willows, 300 cubic meters in 10 years; pines, 500 cubic meters in 25 years; and eucalyptus, 400 cubic meters in 8 years. Costs per hectare of land are: USD 80 in the Province of Córdoba, USD 200 in the Province of Corrientes and in the Province of Misiones.

Roughly 90 per cent of the supply of raw wood is found in the Provinces of Misiones, Entre Rios, and Buenos Aires. Related processing operations are frequently located near the forests. Commercial activity is dominated by small to medium-sized companies. The construction of wood furniture is centred around items of traditional folk design made of quebracho wood. The industry is very fragmented, and there are not enough standardised, large-scale manufacturers to produce in large quantities for the export markets.

Argentina annually produces 750 000 tons of cellulose and 140 000 tons of newsprint. Pulp and paper producers - primarily large, integrated companies, producing 100 per cent of paper pulp and 50 per cent of paper - include Celulosa Argentina, Alto Paraná, Papel Prensa, Papelera del Plata, Massuh, Papel Misionero, and Ledesma. The main producers of cardboard and cardboard boxes are Cartocor and Zucamor.

Many foreign firms have established operations in Argentina recently. Union Camp bought 30 per cent of Zucamor, Kimberly-Clark - manufacturer of Kleenex tissues - bought the diaper company Descartables Argentinos; and the Canadian firm Kruger has a pulp production plant. Other foreign companies that recently entered Argentina are the Chilean CMPC, Inland Container from the US, the French Arjo Wiggins, and the German firm, Zellulpapier Waren. (Latin Trade, 1997)

According to the arguments cited by a majority of interviewees, Argentina has comparative advantages in forestry although they are not utilized efficiently. The implanted forest (30000 hectares a year) covers only 4 per cent of the area suitable for forestry. Forestation and re-forestation can expand significantly without interfering other agricultural activities or creating environmental problems.

Selected comments:

- Forest sector in Argentina has optimal conditions for the development and industrialization of those areas which have not yet been developed by foreign investment. Finnish high technology in this industry could have a central role in the sector.
- Opening of the mining sector and the new mining investment law have attracted investments to the sector and large mining projects are underway. Finnish mining industry is late in this process, but Argentina's geological structure most probably contains rich mineral resources that are not yet discovered. There is a need of technology and education in this area.

Bolivia: In Bolivia, mining technology and research was seen as the main opportunity for cooperation with Finland, but also infrastructure and the protection of environment were posed as priorities.

Bolivian economy is still dependent on the exploitation of natural resources. The majority of interviewees considered that foreign cooperation, particularly with Nordic countries, would be very important to implement governments strategy to introduce a sustainable use of natural resources. Both public and private sectors are interested in projects where Finnish enterprises could contribute not only in the conservation but also in the evaluation, development and management of very rich forest and mineral areas.

The country has an urgent need to improve the fields of internal and external communications, power, transport, education, environment and public health. Interviewees consider important the role of international financing institutions together with those countries interested in long-term projects which will benefit the nation as a whole.

As a member of the Andean Pact and associate member of Mercosur, Bolivia is a strategic gateway to markets of around 240 million inhabitants. Foreign investment in infrastructure and productive areas could have regional importance.

Selected comments:

- The Salar de Uyuni (salt lake) contains the world's largest single resources of lithium with significant concentrations of potassium, boron and magnesium. The salt lakes may contain also a number of non-metallic minerals. If we want to develop these areas, foreign technology and investment are essential in the whole process of mining: geology, exploitation and metallurgy.
- Bolivia is committed to develop extensive environmental regulations. The problem is that we do not have the necessary experience. Nordic countries could have an important role in this area.

Chile: According to the opinion of the majority of Chilean interviewees, technology, research and education were the sectors of activity where Finnish know-how can best contribute to attain results. Infrastructure was listed as the second priority, particularly in the areas of telecommunications and transport. Surprisingly mining was not considered as a priority because ”we can conduct mining for ourselves”.

Chile has already a modern infrastructure to insure the country's future growth. The government's infrastructure programme, since many years has been directed to create a proper basis for business opportunities for both foreign and national investors. Government's policy encourages the participation of foreign public and private investors in the financing, construction and operation of public work services in the areas of highways, ports, airports, and water treatment systems.

Chile has the most advanced telecommunication system in the continent. It is hundred per cent private and clearly competitive at an international scale. Although the number of telephone lines is growing exponentially, Chile's telephone lines per capita is still far from the level of Finland, for example. The telecommunication sector remains very attractive and open to national and international investors because it will continue to expand at a much more rapid rate than the national economy.

Selected comments:

– We believe that long-term planning is necessary to attract local and foreign private and institutional investors. There are plenty of investment opportunities for Nordic institutions and enterprises in sectors like national railroads, ports, airports and highways.

– Visits and post-grade study opportunities in Finland for young Chilean professionals is a priority to expand co-operation between our countries. Students and academicians exchange could happen particularly in those fields where Finland has a good reputation, like research in geology, forestry, and fishing industries.

Peru: For the group of government officials and private sector executives mining is priority number one while researchers believe that environment technology and infrastructure are the sectors where Finnish companies could operate.

Peru has a big variety and abundance of mineral resources but the economic stability is increasingly being affected by a tense political atmosphere. A liberal policy is still attracting financial institutions and private enterprises from all-over the world. The great majority of the larger mines have been privatized. Peru needs technology to increase the value added of the mineral and metal production.

At present, there are more than two hundred investments and prospects being studied in the areas of exploration, feasibility studies, expansion and construction of mines. At the same time mining is adapting operations to international developments regarding environmental concerns.

Selected comments:

– Peru's transport infrastructure plan for 1998-2005 has as main objectives to pave 70 per cent of the national road network, repair 25 per cent of state roads, pave the roads to the country's airports and continue rehabilitating the seaports. Most of the projected investment will be made by domestic and foreign financing. The group of academic researchers considered that there is a great need for investment in the area of environment protection, at present mostly under the control of the State. The sector is gradually being opened to private participation. The plans aim to incorporate the most up-to-date technology from the industrial world.

– To protect the environment is a priority in our economic policy because it is considered essential for achieving sustainable economic growth and export competitiveness. To achieve these goals, the participation of every country is necessary, mostly if it is from Nordic countries, like Finland.

Paraguay: Interviewees feel unanimously that forestry is the highest priority to attract foreign investment, in general, and Finnish forest technology in particular.

Exploitation of forest resources is generally carried out on a non-sustainable basis. There is little activity related to re-planting. Paraguay has one of the fastest deforestation rates in the world. Technical cooperation is needed in every area related to forestry.

According to Paraguay´s interviewees, national resource management practices in the past destroyed natural forests. There is a need of reforming national polices creating a "Nordic mentality" to manage tropical forests.

Selected comments:

- In the past, Paraguay was an important regional exporter of forest products. As a consequence of an irrational exploitation, we are facing problems of erosion and floods. However, the forestry sector growth potential is still great. The government has approved a modern legislation that is attracting investment and technology from European countries. Finland has not been very active in local projects. We hope this will be corrected in the future.
- The most attractive investment opportunities for public or private enterprises are in the agricultural sector. Investment is welcomed in food processing industry and processing equipment.

10.5 Conclusions

In this particular period that has already been going on for around a decade, there is a number of new circumstances and old reasons why Finnish enterprises could expand their operations in South America. Although the conditions summarized below apply specifically to the visited countries, reference is made to "South America" because prevailing situation is mostly similar to the whole continent.

1. Politically stable democratic governments, (all governments in South America have been elected democratically, but the grade of democracy implementation varies greatly among them).
2. A common cultural tradition with Europe.
3. Expanding open economies, stable, sound non-discriminatory economic policies.

4. A vast supply of natural resources: energy, forests, minerals, fertile lands, water, regional microclimates.
5. Legal systems with equal treatment to national and foreign companies, free currency conversion and unrestricted remittance of funds.
6. Investing in Mercosur provides direct access to 200 million consumers. Chile, Peru or Bolivia are gateways to all Latin American markets.
7. The region has a growing infrastructure with abundant energy resources, internal communications, world-wide telecommunications, airlines and competitive air freight costs, road and railway transport and large seaports (the level of infrastructure varies greatly; in Argentina, Chile, Brazil and Uruguay infrastructure is competitive with that in Asia or South and Central Europe).
8. A positive business environment, with reasonable taxation and customs duties.
9. In Argentina, Chile and Uruguay a well educated workforce, with a broad range of highly qualified specialists. In Peru, Paraguay and Bolivia a rapidly qualifying labour.
10. Particularly in Chile, modern financial systems with the most up-to-date technology.
11. The region offers an attractive life-style, with very friendly people and beautiful nature.

Opportunities for Finnish operations in Latin America

The visit of Finland's president to three South American countries was considered by interviewees as a constructive initiative to promote trade and, in general, to strengthen both the political and the economic relations between the region and Finland. To develop further this significant opening, there is a need to continue at diverse levels and fields of activity multiple contacts with that region.

Latin American friendship with Sweden is very old. There has been a permanent exchange of information with Swedish institutions since many decades. In the past, Sweden gave to these countries a decisive support for the restoration of democracy and, at present, in a period of democratic expansion Swedish industry emphasizes the development of economic relations with the region.

Finland has not been traditionally so active in South America (there are significant exceptions in the field of mining sector, for example) and cooperation has been modest. It seems to be fair to ask: if Sweden is so active there, why not Finland? Moreover, considered in Latin American economic circles as a "sister country" of Sweden, Finland could utilize in her favor the more than one hundred years of Swedish companies' and institutions' experiences and outstanding reputation.

1. One of the arguments unanimously presented by the interviewees in the countries visited by the author, was that there is not enough information on Finland and Finnish industry, technology, cooperation mechanisms and culture.
2. There are, obviously, diverse remedies to this, and one effective could be the organization of "cluster presentations" for the potential markets in the region. The rare past experiences have proved this to be an appropriate and non-expensive form to make known the characteristics of the companies interested.
3. As the counter-part of these "traveling shows" presentations of local private companies or state enterprises should be arranged; their potential, needs and organization. The events should be organized regularly both in Finland and in South America. Particularly the latter case offers the possibility to reach with information also the public opinion in general.
4. Finnish enterprises will learn by doing and operating in the region. They may face obstacles in the beginning of their operations; therefore it is desirable that those Finnish enterprises which have been operating for a long period in the region should be co-operative with newcomers to overcome the possible bottlenecks.
5. Before their implementation, both large and small operations have to be protected from local political interference. This means that decision to start a project there has not to be based on temporal political affinities - like so many times in the past - but rather on potential efficiency. It is clear that Finnish investments will not solve unemployment or any other kind of social problems there, but they could help to create new incentives and disciplines that could affect positively the whole process of reforms in the region.
6. The practice of massive external financing and modern technology transfer created, in the past, some privileged states in Africa, Asia and Latin America, where oligarchies, employed in top state jobs were able to enrich and empower themselves. As a consequence of structural reforms in the Latin American countries, these practices have become more difficult.
7. However, various foreign enterprises, particularly from USA, have not invested in the region, scared by corruption. In some cases they were already working, but after facing irregularities from the part of local authorities or partners, they abandoned the projects. This has occurred in large state or private ventures. Money from the European Union is abundant but sometimes too loosely assigned. The Scandinavians are known to be exacting regarding

business ethics. This generalized positive opinion should facilitate Finnish investments and activities there.

8. Operations of the Finnish industry in the Latin American countries should focus, as possible, on large, technologically advanced projects that have not only a national but also a regional significance, (economic, social, environmental) consistent with the macro-economic framework of the integration process there. Governmental co-operation and particularly NGO's activities should also include small-and-medium size, technologically simple projects in the social sector.

9. The interchanging of professionals would be a good start and appropriate investment for both parts; particularly of young professionals visiting research institutions and production plants in Finland.

10. There is a need for developing scientific research co-operation between Finnish and Latin American institutions. Academic institutions from Finland and South America could be in charge of planning future collaboration particularly in technical and environmental disciplines so that joint research projects could be developed in the future.

11. Attractive investment opportunities will involve large-scale infrastructure projects. There is a strong need on funding projects that would build social and economic infrastructure in countries like Peru, Bolivia and Paraguay, where poor infrastructure conditions still prevail. The modernization and expansion of these countries' public and private infrastructure is essential for continued economic development. It will require large investments to maintain and expand their electricity, water and sewage systems, telephones, ports, airports, railways and roads.

12. The same model of operation is not appropriate where there exists a developed infrastructure or institutions, such as in Chile and Argentina, particularly in telecommunications, and port and airport facilities. Those countries with privatized telecom and electrical utilities are likely to get significant flows of capital into these sectors, with additional flows into highways, airports and the rest of the transport sector.

13. The best opportunities for investment are in Mercosur region and associated countries, because of their size, their population, the immense foreign-investment interest, high levels of foreign direct investment and the quality of their natural resources. Because Mercosur region is so large, it faces enormous capital needs when it moves to become a globally competitive economy.

14. Mineral processing capacity is planned to increase markedly in Argentina, Peru and Bolivia. Finnish companies, lead by Outokumpu, may be able to participate in these ventures. In fact, the experiences of Finnish companies in

the mineral sector of the region give them a privileged position; the advanced mining and metallurgical technology and the environmentally friendly methods of production may prove to be a firm basis for co-operation and provide large markets for Finnish machinery, equipment and services export.

All in all, it is well to remind that natural resources played an important role in the course of Finland's economic development. The existence of forest and mineral resources provided a basis for starting a strong development. The progress made in the forest, mining and metal industry have resulted in the generation of dynamic high-technology sectors. This experience extends Finnish opportunities in South America.

Concluding remarks

To outline a vision on the perspectives of Finland's economic relations with Latin America - and particularly with the selected countries of South America - it may be well to address the same questions as in the former chapter, from the perspective of the visited area:

1. Do South American countries want Finnish enterprises to invest and operate in the region?
2. If yes, what are these countries prepared to do to enable this to take place, and to continue cooperation in the future?

Here again the answer to the first question is yes.

South American countries are seeking to accelerate their economic growth. Finnish involvement can facilitate this process with the activities of its technologically advanced enterprises in the modernization of diverse sectors of the region's national economies. This interaction has to consider the specific interests of both partners involved because economic relations worldwide are now based according to one's self interests as a normal behavior. Obviously, predominance of one part's self interests do not add to equity and harmony. The main question then is how to combine the objectives of Finnish enterprises and the local sectors of economic activity.

The answer to the second question is that South American countries have already done a lot for this purpose. As earlier described in this paper, there are several and recent examples of countries making major changes in their economic programmes and major improvements in their international economic relations.

For a long period, cooperation between the industrial world and developing countries (presently called emerging economies) was characterized by a mutual lack of confidence. Today, and specially in the case of South America, cooperation is not perceived as "official assistance" or "development aid", but rather, as fair business relations where one part offers a positive investment climate, natural resources and regional markets (South America); and the other part offers investment and technology (Finland).

The major problem facing Latin America is not economic or physical but sociopolitical. This is the consequence of the uneven distribution of power, first between the diverse regions of the world and second within nations. The result is oppression and alienation largely founded in the exploitation of the poor. Then, the focal question of the majority of the sample's researchers, executives of the public and private sectors, trade unionists and independent professionals was: "How can the resources of the region be used most effectively to improve the living conditions of all people in your country?"

At present, acceptance of foreign technology is part of the globalization trend. In the past, technological policies in Latin American countries were subordinate to an industrialization process aimed to the substitution of imports. This implied the region's own isolated research efforts, which tried to bridge the technological gap with the industrial world.

One of the main arguments of the interviewees, both in Finland and in the selected South American countries, was that Finnish technology and know-how is just suitable to be used and adapted with ample advantages in such areas like minerals and metals, forests and wood processing plants, fishing and fish industry, environment technology, and infrastructure modernization, including education and technological research.

From the perspective of the South American countries the diversification of exports to more value added products linked to natural resources is vital. From the perspective of Finnish industry, expansion of operations in the region means new opportunities to develop their technological diversities and competitiveness, and to expand Finland's international connections and magnitude of operations in South America.

ANNEX 1

Other Trade Agreements

- ALADI: Latin American Integration Association includes Mexico and all South American countries except Guyana, French Guyana and Suriname (1960).
- G-3: Mexico, Colombia and Venezuela (1991)
- Argentina - Brazil (1990)
- Argentina - Chile (1991)
- Argentina - Colombia (1991)
- Argentina - Chile (1991)
- Argentina - Chile (1991)
- Argentina - Bolivia (1992)
- Argentina - Venezuela (1992)
- Bolivia - Peru (1992)
- Argentina - Ecuador (1993)
- Brazil - Peru (1993)
- CARICOM - Mexico (1993)
- Chile - Colombia (1993)
- Chile - Venezuela (1993)
- Bolivia - Brazil (1994)
- Bolivia - Chile (1994)
- Bolivia - Mexico (1994)
- Bolivia - Paraguay (1994)
- Brazil - Venezuela (1994)
- Chile - Ecuador (1994)
- Costa Rica - Mexico (1994)
- Chile - Canada (1996)
- MERCOSUR - Chile (1996)
- Mexico - United Kingdom (1996)
- Bolivia - MERCOSUR
- APEC: Asia Pacific Economic Cooperation groups includes Mexico and Chile in 1993.
- ACS: Association of Caribbean States: Cuba, Dominican Republic, Haiti, Panama and all members of the CACM, CARICOM and G-3.
- ECCM: East Caribbean Common Market: Anguila, Antigua and Barbuda, Dominica, Grenada, Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines.

Preferential Pacts

- European Union - English speaking Caribbean (Rome Convention, expanded since 1948).
- Caribbean Basin Initiative: United States with Antigua - Barbuda, Bahamas, Barbados, British Virgin Islands, Costa Rica, Dominicana, Dominican Republic, El Salvador, Antilles, Nicaragua, Panama, St. Kitts - Nevis, St. Lucia, St. Vincent - The Grenadines and Trinidad & Tobago. (1984)
- Canadian - Caribbean Agreement (Caribcan): Canada with Anguilla, Antigua Barbuda, Bahamas, Barbados, Bermuda, Belize, British Virgin Islands, Cayman Islands, Dominica, Grenada, Guyana, Jamaica, Monserrat, St. Kitts - Nevis, St. Lucia, St. Vincent - The Grenadines, Trinidad & Tobago and Turks and Caicos Islands. (1986)
- European Union - Andean Pact (1990)
- European Union - Central American and Panama (1990)
- European Union - Dominican Republic (1990)
- European Union - Haiti (1990)
- Andean Trade Preference Act: United States with Bolivia, Colombia, Ecuador and Peru (1991)
- CARICOM - Colombia (1994)
- CARICOM (1994)

ANNEX 2

Essential Features of ECIP

ECIP is an integrated programme which acts to facilitate all the various stages of joint venture creation.

Facility 1 covers the preliminary phase. As such it provides grants towards projects having as their goal the identification of companies in the EC and in Asia, Latin America or the Mediterranean, who are interested in coming together in a joint investment operation. It can be used where the promoter of the project is either an organisation representing a group of companies (for instance, a federation of industries or a chamber of commerce) or a financial institution that is a member of the ECIP network, or a public agency that represents a group of companies or business interests in general.

ECIP's Facilities 2, 3 and 4 deal with subsequent stages in the joint venture creation process. Facility 2 is concerned with analysis and other preparations made prior to investment. Facility 3 provides for EC co-financing of the investment itself. Facility 4 facilitates any subsequent expenditure on human resource or technical development. These facilities are more specific than Facility 1 in that they only operate to assist specific and concrete joint venture proposals and can only be invoked by the business operators involved themselves.

It should be noted that in all cases the facilities will apply not just to joint ventures in the narrow sense of the term, but also to joint ventures in the wider sense, where the involvement of the European operator is not by way of an investment of capital but by way of a licensing agreement providing for transfers of technology and know-how from the European operator to the company in the eligible country.

The licensing agreement must be long-term, lead to a genuine transfer of know-how and technology, and provide for continued technical assistance by the EC company during the intended period of investment by ECIP. The agreement must be related to activity of the company itself. A mere technical servicing agreement, for equipment supplied by an EC capital equipment supplier, is not sufficient.

ECIP finance is available as a banking product and it is conveyed to the companies through the banking system. The EC has signed agreements with financial institutions (FI) in the target countries and in the European Community. ECIP relies on the services of these FIs assess project proposals, to arrange legal documentation with the companies and to handle the ongoing administration of the transactions. This allows the companies to apply for ECIP through an FI of their choice, possibly near to their centre of operations. For their specific actions under Facility 1, organisations representing a group of companies may work with the EC directly.

Decision taking within the EC is quick; within 20 working days from submission of the case.

Nearly all the developing countries of Asia, Latin America and the Mediterranean are eligible as places of investment. All sectors of the economy are covered - industry, services, agriculture, mining of others. However, projects are assessed in the light of their contribution to the development of the countries, which leads to the exclusion of certain sectors such as arms production, gambling houses, etc.

ECIP financing is provided to eligible projects regardless of whether the initiative for the project comes from operators within the EC of from operators in the target countries.

ECIP is a source of finance only, which means that EC does not itself offer direct technical assistance and that in ever interferes with the management of the project. Private operators maintain complete control.

ECIP aims at small and medium-sized companies but operations from larger companies are also eligible. Large multinationals may not benefit from the scheme.

The nature of the finance includes grant money for identification projects, interest-free advances for preparation of projects and for human resources development, and equity or equity-loans for investment.

Contribution to development

The ultimate objective of ECIP is to promote the development of the country in which the investments takes place. The parameters for assessing the development contributions are as follows:

- impact on the local economy;
- creation of added value;
- promotion of local entrepreneurs;
- transfer of technology and know-how and development of techniques used;
- acquisition of training and expertise by managers and local staff;
- implications on women's professional status and employment opportunities;

- creation of local jobs in circumstances which do not involve exploiting employees;
- impact on the balance of trade and balance of payments;
- impact on the environment;
- manufacture and supply to the local market of products hitherto difficult to obtain or substandard;
- use of local raw materials and resources (European Commission, 1997).[52]

ANNEX 3

Al-Invest: General Context and Objectives

Al-Invest aims to give EU and Latin American companies, especially small businesses, the opportunity to become genuine partners, becoming more competitive through reciprocal market expansion and thus developing internationally, as the current globalization of the world economy requires. Since 1993 the Commission has been cofinancing the 2-year pilot phase of the Al-Invest programme, which has focused on setting up support networks for cooperation based on practical achievements. An evaluation carried out at the end of the pilotphase, while suggesting a number of recommendations for enhancing and improving performance, concluded that the programme was technically excellent and its de-centralized management system well suited to the objectives pursued. Not only do the quantitative results exceeded the targets set with regard to the organization of networks in Latin America and Europe and sectorial and multilateral business meetings, but the project has also launched an original and successful movement based on working methods that to a considerable extent delegate the proposing and implementation of the activities concerned to the European and Latin American private sectors, while creating standing arrangements for coordination and interaction among Al-Invest agents, and between those agents and the Commission.

Principles

- The programme targets business from the 18 Latin American countries and the 15 EU Member States.
- Al-Invest is a decentralized programme, and projects are carried out on the initiative of agents acting on behalf of the business concerned.
- Projects covered by the programme are subject to mandatory cofinancing by the private sectors concerned, which must provide a minimum of 50% of the total cost.
- All projects must come a clearly defined sector of economic activity.
- Projects are subject to continuous assessment, with the designated agents working closely with the companies concerned.
- Projects submitted to the European Commission must involve the participation of agents from at least three EU Member States. Multilateralism will be systematically encouraged.

The originality of the Al-Invest programme lies with the fact that the programme is managed on a participatory basis, and that the initiative lies with the European and Latin American private sectors. A minimum of 50% of each project must be cofinanced by the private sector, thus ensuring the commitment of the latter and guaranteeing the autonomy of the project. The aim is for all projects to be self-financing in the long term.

To achieve these aims, Al-Invest sets up a series of networks of agents providing businesses with access to the programme, primarily the ECE s in Latin America and the Coopecos in Europe. Thus connected, the networks work to complement each other to create opportunities for cooperation and partnership between companies active in various sectors, whether through exchanges of information, technology transfer, subcontracting investment or the creation of joint ventures.

Grounds

The consolidation phase of the programme is justified on the following grounds:

General

- The pilot phase has created a genuine impetus, with high approval ratings and considerable expectations on the part of the Latin American and European private sectors.
- The programme strengthens the bonds of partnership between the European Union and all the Latin American countries, both individually and collectively, reflecting the EU's general strategy in this area.
- The programme meets the needs of the Latin American countries, which are engaged in the consolidation of their democratic systems, a process which involves the development of the private sector and integration into international markets, against the background of market globalization.

Al-Invest resolution

- The aim is to align policy with the new reality now asserting itself in the emerging countries, a reality that Europe must support and encourage.
- Al-Invest raises Europe's profile among Latin American and European businesses.
- The programme fully complies with the principle of subsidarity and is aimed at strengthening civil society. It is based on the use of participatory methods and the promotion of economic and social networks.

Technical

- Al-Invest will crystallize a common working language and methodology among European and Latin American agents. It takes an original and dynamic approach based on simple, uncluttered and professional management procedures with a long-term outlook and answerable to all members of the system.
- The network-based approach ensures that successful projects create a ripple effect, thus helping to consolidate a common culture of enterprise and excellence, notably through transfers of European know-how to Latin America.
- The programme will consolidate the role of the ECEs as focal points of the EU's economic and industrial cooperation with Latin America, acting as conduits gauging the realities of Latin American business and as operational tools for the dissemination of projects.

Economic

- In the light of economic internationalization, Europe's "natural" competitive advantages in Latin American (primarily linguistic and cultural affinities) are no longer decisive as the competition is finding it increasingly easy to overcome such obstacles. The programme is therefore justified on the grounds that our room for manoeuvre is diminishing, and that it will enable European companies to consolidate and expand their presence in Latin America.
- The concept of mutual interest, the system's transparency and its decentralized management methods also give Latin American companies every opportunity to negotiate and develop with their European counterparts on an equal footing.
- Altogether, Al-Invest should generate a minimum of ECU 150 million in new business every year, i.e. at least ECU 750 million over the five-year period (European Commission, 1997).

ANNEX 4

Finnish Companies and Institutions in the Study

Merita Bank
Ministry of Trade and Industry
Confederation of Finnish Industry and Employers
Geological Survey of Finland
Outokumpu Oy - Base Metals
Inex Partners
Kemira Agro Oy
Wärtsilä Diesel
Kvaerner Pulping
Tamrock
Vaisala Oy
Enso Fine Papers
Valmet Paper Machines
The Central Chamber of Commerce
Gustav Paulig Oy
Cultor Oy
Euroscan Group
Primalco Oy
Jaakko Pöyry Group
Oy Sisu Ab

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