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Current Trends and Problems in Foreign Investment in Latin America

*William Glade**

One of the minor curiosities in the history of economic thought is how little attention was given, during most of the years since the publication of *The Wealth of Nations* in 1776, to the process of foreign investment. To be sure, at the time Adam Smith was writing international commerce, with some flows of human capital through emigration to colonies, still constituted what had been almost the sole streams of cross-border transactions since antiquity, though both flows often involved technology transfer as well. Yet a century or so later, when both foreign direct and portfolio investment had made an emphatic appearance on the world scene, the attention of economists was still largely directed elsewhere. Even in the magisterial work of Alfred Marshall, who wrote in the emerging financial center of the world, foreign investment is barely mentioned, let alone explained systematically.

In terms of the conventional explanatory framework, one is left, despite clear evidence to the contrary, to infer that relative factor scarcity prompts elevated factor returns and that these differences in the marginal productivity of capital motivate its transfer from firm to firm, industry to industry, sector to sector, region to region, and country to country. Marx alone offered a somewhat more ample glimpse of the explanatory possibilities, but it would be decades before mainstream economists picked up on Marshall's observations on agglomeration effects and Coase's exploration of the boundaries of the firm to cobble together more systematic explanations of what had been, from the last quarter of the nineteenth century onwards, the most transformative current of transactions in the world.¹

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1. Hobson, Schumpeter, and assorted followers of Marx explored aspects of international capital movements under the rubric of imperialism, but in no case was a satisfactory theoretical exposition put forward.

It is not the purpose of this paper to recite the advances of theory that have brought us to a much better understanding of what foreign investment is about. Rather, we shall use this accumulating body of insight, as it refines the Marshallian understanding, to examine how changing conditions shape the cross-border movement of capital into, within, and out of the Latin American region. The hope is that this examination will be helpful in clarifying what has happened in Latin America since "the fall"-- since the debt crisis of the 1980s undid an entire development policy paradigm and set most countries back for years.²

I. Recent Developments in Capital Flows.

There are interesting possibilities for theoretically oriented comparative analysis in the fact that today's resurgence of capital flows into Latin America follows by just about a century the original massive movements of capital into the region. Earlier foreign inflows, which began with the struggle for independence, had been small in scale, sporadic, and largely unsuccessful, whether as loans to new and unstable governments or efforts, motivated by pent-up avarice, to promote speculative mining ventures to exploit mineral deposits long controlled by Spain.

Both *fin-de-siècle* movements could be considered transformative and are clearly tied to fundamental restructurings of the economic systems into which the capital came. And both were tied to modernization projects devised by the region's elites--the *científicos* and positivists in the late nineteenth century and the *técnicos* in our own times--who worked with policy templates designed in the industrial and financial center of the world economy.³ As such, the two great waves of capital transfer were associated with no small measure of institutional recomposition in the capital-importing regions.

Both inflows also took place within the context of profound changes in the world economy, involving dramatic alterations in the volume and geographical spread of international trade, as well as its composition. In both periods, the changes reflected an ever widening application of new production technologies and business organization, in tandem with significant improvements in the means of transport and communication.

Today, globalization has become something of a mantra, but it nevertheless identifies the extent of the impact of such technological changes as the computerization of information and production. These changes, in turn, brought into being world-spanning systems of finance, marketing, production, and management, knit together in structures far more complex, but also more supple, than the forms of vertical and horizontal integration around for many decades.

Two other *fin-de-siècle* parallels are worth noting. In both periods, unlike the intervening era, capital flow comprised both foreign direct and portfolio transfers. And each period--separated by an era that began with the Great Depression that brought down all

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2. It could be argued that the loss of output and the severity of the financial and fiscal disorder were in the long run beneficial in that they forced a complete rethinking of policy and eventually set the region on a more promising growth path.
 3. To identify local advocates of modernizing policies as elites implies no dispraise, for those who install national policy are by definition elite, though their preference schedules for the allocation of both private and public resources may differ considerably from those of sub-elite groups.
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capital markets and ended with the Debt Crisis—is punctuated by financial crises: e.g., the Baring Crisis, the Debt Crisis, and the Peso Crisis. No doubt there will be other disruptions of financial markets in the future, raising anew the policy debate over the use of assorted controls to reduce volatility.

There are important differences, however, between the foreign investment boom of a century ago and that targeted on emerging markets today. And both periods of heightened investment flows differ substantially from what took place in the intervening era of import-substituting industrialization (I-S-I). Much has been written about the policy errors of the half-century that began with the Depression and ended with the Debt Crisis of the early 1980s. There is no doubt a great deal in this period that merits criticism: runaway protectionism, financial repression, macroeconomic populism, chronic inflation, recurrent balance of payments troubles, excessive regulation and pervasive rent-seeking behavior, unemployment and underemployment, and growing inequality, for starters. This said, most of the reason that our *fin-de-siècle* differs so profoundly from that of a century ago can be attributed to a whole range of changes that occurred in Latin America during the I-S-I period. The remainder of this essay sketches out the major lines of this argument and ends by raising an issue that is becoming the overriding policy question today, one not raised at all during the foreign-investment heyday of a century earlier. The issue, slightly recast in today's terms, is that of the relation between capital imports and sustainable development, a problematic relationship that began to surface about midway through the era of inwardly oriented development.⁴ Slightly recast in today's terms, the issue is that of the relation between capital imports and sustainable development.

II. Investment Revival.

The numbers themselves are impressive, especially in light of the gloom that settled over the region and the international investment banking community when the bottom fell out in 1982. In those not-so-long-ago days, there was fear that the wave of defaults and reschedulings and the steep discounts applied to Latin America's huge external debt would deter foreign investment for years to come. Yet, ways were found to deal with the debt overhang, and with notable exceptions, governments around the continent surmounted the ingrained policy biases of a feckless bureaucracy and undertook politically unpopular programs for stabilization and economic restructuring. The way to structural adjustment was neither easy nor direct, and occasionally, as in Venezuela, there were episodes of policy recidivism. The pioneering restructuring experiment in Chile, for example, was installed by an authoritarian regime, but macroeconomic management continued essentially uninterrupted when elections returned the nation to center-left democratic rule. In contrast, the policy turn-about in Argentina and Brazil came under left-of-center democratic leadership, not unlike that of Felipe Gonzalez in Spain. In Peru, reform was introduced by a

4. The now classic *The Growth and Decline of Import Substitution Industrialization in Brazil*, which appeared in the mid-1950s in the influential ECONOMIC BULLETIN FOR LATIN AMERICA, saw industrial momentum being choked off by income distribution patterns and the rising import coefficient of investment. The concern over sustainability of growth gave impetus to both regional integration schemes and Brazil's and Colombia's export diversification drives in the 1960s.

president who was elected by attacking a rival advocating the very same policies. In Mexico, the way was doubly difficult, for under de la Madrid the country edged its way into a new economic policy while beginning, with great timidity, a political opening. It is instructive that the government relied more on reinterpreting policy than on actual legislative changes when it put out the welcome mat for foreign capital. And owing to the sensitivity of the issue, the government could not quite bring itself to enunciate openly its program of privatization, employing instead the oblique term "disincorporation" to bowdlerize its policy declarations.

Notwithstanding the hesitancy and circumlocution, the reconstitution of the economic environment was such as to renew the appeal of the region for foreign investors more rapidly than might have been supposed in the wake of the economic derailment of 1982. Fortunately, the recently-issued *World Investment Report* (WIR) provides an abundance of data for tracking what has been going on.⁵

Flows of capital into Latin America in 1996 increased by 52 percent, reaching a level of almost \$39 billion, the most received by any developing area. Even in the turbulent months of 1994 and 1995, when Mexico's economic collapse sent tremors throughout the region, foreign direct investment registered small, steady increases. Brazil alone attracted \$9.5 billion in 1996; Mexico, another \$8 billion. By way of contrast, flows of foreign direct investment into Central and Eastern Europe, including Ukraine and the Russian Republic, stood at only \$12 billion in 1996, having reached \$14 billion the year before. The disparity between the two regions suggests that although they are comparable in per capita income terms (albeit the former centrally planned economies have generally superior human capital), Latin America holds a considerable edge in its investment readiness or capital absorptive capacity.

Briefly, the story told by these figures is as follows:

Latin America is again a major recipient of foreign direct investment in a growing variety of fields. Indeed, the fields into which inward foreign investment has come are more diversified than in *either* of the two previous eras of foreign investment. Like a century earlier, capital is returning to minerals projects and to public utilities, but as in the I-S-I period, it continues to flow into manufacturing as well. Moreover, services figure prominently in the picture: e.g., commercial and investment banking, telecommunications, and air transport. But capital is also attracted into a variety of other specialized fields. Lincoln National/Lincoln Life's purchase of a 49 percent share of Seguros Serfin of Mexico, for instance, is but one of a new wave of acquisitions by foreign companies in the insurance markets of Latin America. In Monterrey, Mexico, both Carrefour of France and H.E. Butt of the United States inaugurated modernized supermarkets to penetrate the Mexican market. In 1997 CBS Telenoticias, the world's largest pan-regional Spanish language news network, signed an agreement with the second largest Brazilian television network, the Sistema Brasileira de Televisão, to share news gathering and production resources. Nasdaq and Sun Microsystems bought a two-thirds interest in the Chilean electronic stock exchange. More examples are cited later in support of the contention that this investment represents a major amplification and elaboration of the region's business structure, i.e., its organizational capital.

5. *World Investment Report, 1997: Transnational Corporations, Market Structure, and Competition Policy*, U.N. CTAD, U.N. Doc. [TD] UNCTAD/ITE/IIT/5 (1997).

Whereas portfolio investment, a mainstay of the boom period that linked Latin America with the world economy a century ago, shied away from Latin America in the mid-century decades, it too made a come back as the 1980s wore on.⁶ And whereas the former inflow of portfolio investment was chiefly placed in government securities to build infrastructure, in today's reincarnation much is also going into the purchase of shares in Latin American corporations or into short-term instruments to take advantage of interest rate differentials. A major share of the build up of foreign-owned assets today, as always, comes out of the on-going operations of these firms in their Latin American locales: through reinvested profits, local borrowing, the sale of shares in local stock exchanges, and mergers and acquisitions.

Beyond these developments and the general emergence of Latin American policymakers from the intellectual ghettos of Third Worldism, there are four aspects of the contemporary investment process particularly relevant to what has been accomplished in the region: the multiplication of alternatives in transnational business relationships, the strengthening of the region's capital markets, the effects of privatization, and the growth of foreign investment by Latin American companies.

III. Forms of Cross-Border Business Collaboration.

Foreign investment today takes place within an architecture of complementary international business relations that is evolving rapidly. For much of the early history of Latin America's international economic involvement, the choice was, from the standpoint of foreign business, whether to export to Latin American markets (and, if so, to decide what form of representation in the market to establish) or to set up wholly-owned production facilities there. In time, the evolution of local manufacturing added to the decisional options: whether to invest in an enterprise jointly held with local capital (but maintaining control), or to license technology and, sometimes, to couple licensing with a management contract.

A casual regard for intellectual property rights and the unreliability of Latin American judicial processes often made it risky to move away from these forms of business presence in an overseas market involving advanced technology. It was not unusual, therefore, for companies to defend the integrity of their proprietary technology by transferring methods and product designs lagging behind what was being used in their home markets in Europe, North America, or Japan. As the contestability of Latin American markets had not gone very far before the 1980s, such practices generally sufficed to consolidate a foothold in the markets of the region and to collect the rents that protectionist policies provided. Indeed, it was frequently the case that foreign-based multinationals, which were able to orchestrate the business networks they developed in each of the major markets in

6. Although in the aftermath of the crisis investors beat a quick retreat to the markets of the West and Asia, the outlook for a return to Latin America brightened remarkably when governments embraced the "neo-liberal" project, to use the dismissive term that is current among the remnants of the Latin American left and their *yanqui* camp followers. Regrettably, this conventional critique elided the differences between democracy and populism, an elision that inflicted huge economic damage on the region before the 1982 denouement. See RUDIGER DORNBUSCH & SEBASTIAN EDWARDS, *THE MACROECONOMICS OF POPULISM IN LATIN AMERICA* (1991), for a thorough diagnosis of the problems of the populist I-S-I period.

Latin America, were the chief beneficiaries of regional integration, for local firms lacked comparable pan-regional information networks and had no ready access to distributional systems in markets beyond the borders of their own countries.

Today, however, the range of alternative organizational forms for entering Latin American markets is notably broadened. Within today's more capacious institutional structure, in which there is growing respect for the rights of intellectual property and more accumulated capital of all sorts (material, financial, human, and organizational), the repertoire of relational alternatives now reaches beyond wholly and partly owned subsidiaries to embrace joint ventures with local firms (private, public, or mixed), subcontracts for outsourcing, licensing agreements (for technologies, product specifications, and trademarks), franchising, strategic business alliances, and so on. An expanding array of associational alternatives, in other words, now facilitates inter-firm collaboration in marketing, production, research and development, and, in minerals fields, exploration.

A few examples, all in the service sector, illustrate some of the possibilities for extending inter-firm relations beyond traditional alternatives. Both J.P. Morgan and Merrill Lynch took the underwriting lead in a global consortium to place ADRs of the privatizing Peruvian telephone company among foreign investors, a type of transaction repeated many times over in the management of the privatization process, which itself is sometimes designed by foreign firms.⁷ Salomon Brothers, Goldman Sacks, Lehman Brothers Holding, and CS First Boston have all been active as underwriters for Latin American securities in overseas markets, sometimes in connection with privatization programs. Still earlier, United States firms figured prominently as investment fund managers in the privatization of the Chilean social security system, managing what were, at the outset, portfolios of investments in Chilean securities. In 1996, Nasdaq organizational technology was transferred to the new Brazilian over-the-counter exchange, SOMA, which quickly increased the number of company listings in the organized securities markets of that country through an extensive network of some eighty brokerages around the country. In the same country, Varig Airline signed in late 1997 information technology services agreements with IBM and SITA, the former as a facilities outsourcing contract and the latter as a managed voice and data network services contract. These strategic business alliances should lower information technology costs substantially for the airline and improve cash flow and efficiency. (Varig, the largest airline in Latin America, is also negotiating membership in the Star Alliance, an operational agreement that includes such companies as United Airlines, Lufthansa, SAS, Air Canada, and Thai Airways.)

Increasingly, a variety of critical business services--engineering firms, marketing and advertising specialists, investment banking, and accounting and consulting firms--are available locally, and not uncommonly, as in the case of the accounting and consulting firms, are overseas affiliates of the companies that supply such services at home. This fact

7. When Telefónica del Perú stock was offered on the U.S. capital market in mid-1996, it constituted the fourth largest international sale of Latin American corporate stocks, falling behind, in declining order of size, the YPF (Argentine oil company) offering of 1993, and the Telmex flotations of 1991 and 1992. Following the Peruvian telephone stock offering in size, as of that date, were the 1993 offering of Televisa (1993), the ICA construction and engineering company (1992), and Grupo Tribasa (1994), all of Mexico. Four of these mega offerings were part of privatization programs.

and the maturation of the Latin American economies make for a significantly richer repertoire of cross-border inter-firm agreements. This richer repertoire, in turn, not only supplements an increasing variety of trading relationships and assists in stretching management systems across national boundaries, but also allows for an increasingly nuanced adaptation of relationships to investor preference, corporate strategy, and changes in the investment environment.

Even the old boundary between portfolio holdings in local corporations and the controlling stockholding interest that converts corporate assets into direct investment becomes blurred as control itself is spread over a more complex set of decisional processes. Today, for example, Latin American operations not only count on firms in the United States, Canada, Japan, or Europe to supply cheaper capital, trademarks, permission to use patented products and production technologies, marketing programs, and systems of financial control, but they may also, in the more competitive business environment of today, depend heavily on the MNCs based in developed countries for access to a future stream of R&D outputs, to suppliers of intermediate goods located abroad, and to their world-wide marketing networks. The key importance of this last consideration is illustrated by the recent purchase of a substantial interest in the Grupo Modelo brewery of Mexico by Anheuser Busch, which will strengthen Modelo's position in 130 export markets and, presumably, weaken the position of competing Brazilian brewers in those markets (Anheuser-Busch was rebuffed in Brazil when it attempted a similar acquisition). A particularly compelling case of all these relational advantages is afforded by the extensive reorganization of the automotive industries of Mexico and Brazil as they move from sales of outdated products in protected internal markets to exporting.

IV. Capital Market Strengthening.

The introduction of foreign mutual funds and other professionally managed financial reserves (e.g., from insurance companies) into Latin American capital markets drastically upgraded the quality of surveillance operating in those markets, as has the spread of foreign-based commercial banks that contain investment banking divisions: e.g., Citibank, the Banco Bilbao Vizcaya, Banco Santander, the Bank of Montreal, and many others.⁸ The population of these useful foreign monitors is growing. As of 1986, for example, there were, according to Lipper Analytical Services, only twenty-six dedicated emerging market funds world wide, with assets of \$1.8 billion, though even this figure was remarkably high considering the perilous conditions of developing country economies in the wake of the debt crisis. Be that as it may, by 1995 the number of such funds had risen to 1,254 and the assets managed to \$109 billion. Whether this growth represents excessive exuberance, the fact is that the multiplication of relatively well-informed market decisions this growth breeds is conducive to an improved allocation of capital among and within the several national economies of Latin America that participated in this massive transfer of capital and the organizational technology that accompanies it.

Moreover, as Kent Hargis noted at the 1996 meetings of the American Economics

8. Foreign banking houses now control 15% of the Mexican banking sector and have minority stakes in other Mexican financial institutions.

Association, the participation of foreign institutional investors, who bring professional money management skills to bear, "has been a key force in the development of Latin American stock markets since 1990 while the accelerating trends of institutionalization and globalization . . . will increase the importance of these investors for the future development of stock markets in emerging economies."⁹ Such vehicles as closed-end country funds and American Depositary Receipts compliment the greater accessibility of national capital markets resulting from the reduction of investment restrictions throughout the hemisphere.

Scarcely less beneficial is the growing interpenetration of national and foreign capital markets, wherein the listing of Latin American corporate securities imposes more exacting disclosure and authentication standards than are customary in Latin America. In the case of companies meeting the requirements for issuing ADRs, for example, the disclosure requirements for such listings in effect force the companies to reveal authenticated information that comes close to what is standard in the U.S. stock market and light-years ahead of what is customary in Latin American markets, even that of Chile which is far and away in advance of the others.

Moreover, prudential considerations on the part of mutual funds managers, managers of insurance company reserves, and pension fund managers, in combination with the due diligence requirements under which all these operate, constitute another source of pressure to extract and verify additional information from Latin American companies, which have hitherto not been very forthcoming, for a variety of reasons, in the information they make available domestically. Even now, the risks for minority shareholders in most Latin American corporations are compounded by the prevailing tradition of business secrecy and the lack of legal protection for shareholders outside the controlling cliques. Needless to say, this is a situation that also imposes risks, in a not much alleviated degree, on local institutional investors and hampers their development, though Chile made commendable headway in correcting these problems.

In three ways, the growing recourse to external funding seems likely to redound to the benefit of local capital markets, strengthening them for the key economic function they perform in deploying local capital. Both small investors, of the sort sought in public policies aimed at creating participatory capitalism, and Latin American institutional investors stand to gain.

In the first place, particularly in this age of decreasing-cost movement of information, the increased transparency of corporate finance required for dealing with external intermediaries filters back to at least the major national investors and the burgeoning financial press, enhancing the efficiency of Latin American capital markets insofar as local allocations of capital are concerned. There is no reason to think this a small externality, for national savers/investors can draw on the externally divulged information and also use the behavior of ADR prices and portfolio trends among European and U.S. institutional investors as a reference for making judgments in their own national markets. By the same token, when social security reforms allow pension reserves to be invested by professional management (sometimes with foreign ties), there is additional impetus to transparency in national security exchanges. In addition, the group of national institutional investors

9. Kent Hargis, *Foreign Investors Stimulate Stock Market Development in Latin America* (1996) (paper given at annual American Economic Association meetings in New Orleans).

being spawned by the spreading reform of social security systems can also use overseas stock quotations as reference prices and can draw on the information revealed to overseas capital markets as a way of tracking how local firms' performance is being judged by foreign professional money managers.

In short, inasmuch as overseas revelations of financial information are instantly transmitted back to Latin American capital markets, the direct effect is to increase substantially the transparency of these markets both at home and abroad. The local impact, moreover, is strengthened in some instances by an important complementary development: namely, the appearance and spread of the electronic exchanges. Though sometimes (as in Venezuela) bitterly resisted by those who monopolized access to national capital markets, the spread of these systems for the first time opened up the possibility of capital markets that are truly national in scope and through which the information gleaned from the interaction with foreign capital markets can be disseminated nationally.

Second, because the issuing companies meet the test of listing in overseas securities exchanges, the securities of these companies will almost inevitably tend to be perceived as superior goods by local investors. Indirectly, this should, in time, put pressure on other local listers in the national *mercados de valores* to match the information provided by companies with ADRs in order to lower the risk discount levied on their shares by purchasers of IPOs in the national market because of the lesser information provision. Competition for investor dollars (or pesos or whatever) is probably, in the long run, the most efficacious way to pressure local corporations to be more forthcoming in the information provided shareholders and the investing public. In at least the case of larger national companies, even those unlisted abroad, they, too, are increasingly subject to scrutiny by the foreign institutional investors who follow developments in Latin America and elsewhere--an ever more numerous group--and as this information filters back as an externality to investors in the local stock exchanges, the imperfections in the market should gradually abate. Lastly, the new orientation of Latin American enterprises serves to buttress the effects of improved capital markets, for export performance in competitive markets overseas provides an especially valuable gauge of corporate capability for watchful investors.

Finally, to the degree that restrictions on all capital movements, outward as well as inward, are being reduced, Latin America's local securities markets are increasingly in competition with foreign exchanges as a destination for investment funds from every source, including those generated by other Latin American economies. There is even hearsay evidence that some major Latin American corporations include highly liquid foreign short-term securities as instruments in their cash flow management, and this, too, puts additional pressure on local companies to do better in the area of information disclosure--and ultimately, of course, to perform better, keeping management, technology, product development, marketing, and so forth up to global standards or at least a good approximation thereto. In this context, it is not just the multinational enterprises that span national borders in their financing, production, and marketing systems that are caught in this web of surveillance. Rather, thanks to the world-spanning activities of the institutional investors, the information providers that service their needs, and the other financial intermediaries that themselves operate across national boundaries, increasingly even the larger firms in Latin America find themselves, willy nilly, caught up in a globally integrated system of finance.

While the growing linkage between national capital markets and those of the money-center countries has not been without its problematic aspects, most conspicuously in the enhanced vulnerability of national capital markets to sudden large-scale flights of portfolio

capital, especially of funds invested in short-term government securities, the evolving relationship has on the whole been quite constructive, and not only in increasing the supply of savings available for Latin American investment. On the whole, one can argue, the new development made for much greater transparency and assisted in the maturation of local capital markets, both directly and indirectly.

A key aspect of this heightened transparency and maturation is being driven by the interregional competition for funds. The globalization of capital, in other words, makes Latin American companies rivals of a growing number of capital-seeking firms not only in the industrially advanced countries, but also in the Asian countries and the former centrally planned economies, to say nothing of other newly industrialized economies such as Turkey, Israel, and South Africa. To meet this competition as well as that stemming from firms domiciled in the industrial center but operating in Latin America, Latin American markets will increasingly, especially after the recent Asian debacles, have to show convincing movement toward a strengthened regulatory framework, a development that is crucial for consolidating their integration with the markets of the money center countries.

Indeed, owing to the intensity of inter-regional rivalry, Latin American capital markets are having to increase their performance in all respects, not least in the conditions they offer to the investing institutions that are the major suppliers of funds. The stakes are considerable, for the volume of assets managed by institutional investors in the largest industrialized countries grew from \$2.4 trillion in 1980 to \$17 trillion in 1994.¹⁰ Further, the allocation of U.S. pension funds' assets to foreign securities rose from less than 1 percent of their portfolios in 1980 to just under 10 percent by 1995, having reached \$790 billion in total international investments in the preceding year, according to the World Bank.¹¹

As Hargis observes, there is an additional systematic effect from the institutional changes that are operating today, thanks to which the size of the securities market in at least the major countries can reasonably be expected to grow. This growth comes from two sources: (1) the higher stock prices that result from the larger participation associated with information disclosure and lowered risk and (2) the entry of more firms into the market as its money-mobilizing capacity demonstrably improves. The entry of additional firms, in turn, increases the benefits of diversification and, through that, broadens the participation of suppliers of investment funds, even as governments design privatization programs so as to enhance this development.

The situation, though bright, is not without its problems, even leaving to one side the volatility that may originate in short-term capital flows. One can already see the emergence of a three-tiered capital market in the major Latin American economies, with (1) prime Latin American users of funds directly tapping foreign sources in the U.S. and the Eurocapital market or securing funds with equivalent information disclosure in national markets, (2) less favored companies that are confined to raising funds, on a relatively more costly basis, in local markets only, and (3) firms that enjoy little or no access whatever to organized security markets and that face, consequently, the highest costs of capital acquisition of all. When this tiering is added to the advantageous access to bank lending (and for-

10. *Id.*

11. WORLD BANK, PRIVATE CAPITAL FLOWS TO DEVELOPING COUNTRIES: THE ROAD TO FINANCIAL INTEGRATION (1997).

eign collaborations) enjoyed by firms that belong to the major investment or financial groups dominating most if not all the Latin American economies, the tiering of the economy is likely to become even more pronounced as time passes.

Even so, the increased integration of national with international markets seems, *per se*, a step in the right direction inasmuch as it lowers the supply price of capital (for the privileged borrowers), moves the local capital market to a higher equilibrium level, and promotes general economic growth, even if there is a collateral tendency to increased concentration of assets and income. What is more, the beneficent effects of increased allocative efficiency in capital markets is not merely a gain for now. Instead, the workings of the international capital markets into which Latin American countries are now plugged means that current efficiency in the use of capital confers a benefit over the longer term as well—a dynamic benefit in that efficient capital markets almost necessarily imply increasing efficiency in product markets. Countries that fail to liberalize these latter will find themselves handicapped in accessing the former.

V. The Special Role of Privatization.

Privatization, to put it most succinctly, provides a major impetus to the deepening and widening of capital markets in Latin America, multiplying the connections between these markets and those of the money center countries. Not only has the increase in investment options made these markets more genuinely contestable, at a time when family enterprises and the large business and industrial conglomerates are increasingly turning to professional management and developing a wider shareholder base, including foreign partners who can demand and get information from previously secretive owner-managers. But the supply of a large volume (owing to the capital intensity of erstwhile parastatals) of blue-ribbon or gilt-edged securities in public utilities and basic industry also enabled the markets to meet much better a variety of investor needs for portfolio balance and diversification. The results in some instances are quite impressive. The case of the renovation of the YPF petroleum company is mentioned below, but it could be noted, as a sort of best-practices exercise, that after its privatization in 1992 (which attracted even capital from India), the Mexican iron and steel industry modernized and grew from its rank as the twentieth largest in the world to the fourteenth largest by 1996, after a growth spurt of almost 10 percent annually.

The privatization process has, for example, done wonders for the portfolio form of cross-border capital movements. Though foreign portfolio capital also flowed into the shares of companies that grew up private, the privatization movement is particularly important for both national and foreign institutional investors, as well as for inducing first-time, risk-averse national individual investors into the market. Of potentially enormous importance is the fact that it provided a strong attraction for foreign investment in Latin America—not only inward but outward. Here the evidence is overwhelming.¹²

12. A growing body of evidence supports the following observations in the text. See, for instance, WALTER T. MOLANO, *THE LOGIC OF PRIVATIZATION: THE CASE OF TELECOMMUNICATIONS IN THE SOUTHERN CONE OF LATIN AMERICA* (1997); *PRIVATIZING MONOPOLIES; LESSONS FROM THE TELECOMMUNICATIONS AND TRANSPORT SECTORS IN LATIN AMERICA* (Ravi Ramamurti ed., 1996); and *BIGGER ECONOMIES, SMALLER GOVERNMENTS; THE ROLE OF PRIVATIZATION IN LATIN AMERICA*, (William Glade ed., 1996).

On the inward side, the attraction of foreign capital, technology, and management systems into, say, the telecommunications field has already had a marked effect on system expansion and the improvement of service in Mexico, Chile, Argentina, Venezuela, and Peru. There is every reason to expect that the rolling front of telecommunications privatization in Brazil will produce like results. To judge from the piecemeal measures implemented so far, such as the winning bid of a consortium led by Bell South for the cellular telephone contract covering the city of São Paulo, the market already anticipates that this will be the case. A similar story is readable in the energy field: in Chile, Argentina, Brazil, Peru, and elsewhere. Venezuela, it should be noted, has been outstandingly successful in its energy sector. Most of the major oil companies of the world returned to that country to undertake operations in partnership with PDVSA, which, now freed from a brief episode of political meddling in management, is mounting a huge investment program to double capacity by 2006. Even in Mexico, in which state control of the energy industry retains a peculiarly iconic significance, the palpable need to reform this exclusionist policy led the country to admit foreign and local private investment into the generation of electric power and the distribution of natural gas. Around the continent, in fact, companies like Enron and Houston Industries are undertaking investment projects that should redound to general benefit.

In Mexico, the privatization of the railway system and the ports similarly increased the range of investment options for both domestic and foreign capital. Originally, the reprivatization of that country's banks was managed in a way that ensured domestic control, and the NAFTA's provisions allowed for only a very gradual admission of foreign capital into this field. Nevertheless, the recent financial crisis, which caused nonperforming assets to skyrocket and produced a severe decapitalization of many Mexican banks, forced the authorities to admit foreign financial enterprises more rapidly than they were expected to come in, both to recapitalize the large financial conglomerates and to introduce improved management of loans and other financial assets. From Spain have come the Banco Santander and the Banco Bilbao Vizcaya, taking controlling interests in the Grupo Financiero InverMexico and the Grupo Financiero Probusa, respectively. From the United States, Citibank notably expanded its longstanding presence in the Mexican market. From Canada have come the Bank of Montreal and the Bank of Nova Scotia, the former well on its way to becoming, through merger with the Royal Bank of Canada, a major player in North American financial markets. Elsewhere in the region, foreign banks are no less active in setting up shop or, more generally, buying control of major local financial institutions.

There are, to be sure, many instances of suboptimization in the way privatization programs were carried out. But over the longer run, since the privatized companies are increasingly operating in contestable markets, the errors made heretofore will tend to wash out. Several cases in point come from the earliest Latin American privatizer, Chile. The failure to appreciate the need for sounder regulatory frameworks led to failure in the first wave of reprivatization in banking; incautious behavior led the reprivatized banks into receivership in less than a decade of private management. When the erstwhile bankrupts were again returned to the private sector, it was in the context of a newly devised regulatory/supervisory system that deterred reckless management. Hence, Chilean banks largely, at least thus far, escaped the problems recently afflicting their counterparts in Argentina, Brazil, Mexico, and Venezuela. The first round of telecommunications privatization in Chile was likewise one that had to be corrected; the first purchaser, a foreign investor with-

out experience in the industry, proved incapable of modernizing the system and operating it in a financially responsible way. Yet, since markets are faster at correcting management error than is the laborious, and sometimes politically difficult, process of privatization, it was much easier to resell the Chilean telephone company than it had been to bring the public enterprise to market in the first place.

Similarly, privatization failures elsewhere--e.g., in Argentine and Mexican airlines and in Mexican toll roads--have come to light with almost lightning speed compared with the lingering ill health of so many parastatals throughout the continent. When market judgments are allowed to function (instead of public bailouts of the politically preferred), the results are generally salutary. It is also evident that when simulated privatization is employed, compelling state-owned enterprises to meet the performance standards of commercial firms, the results are likewise beneficial. When the gigantic CVRD mining concern was finally put on the market, its years of successful management made it a singularly attractive property. In the case of PDVSA, the almost exuberant diversification of the company and the competence of its management made it a paragon of excellence among the once-lengthy inventory of state-owned enterprises in Latin America. Thanks to its business and technical acumen, it had, as mentioned previously, no difficulty whatever in tapping international capital markets for its financial needs and in finding foreign partners to supply the state-of-the-art technologies needed to develop Venezuelan reserves in optimal fashion.

VI. The Rise of Latin American Outward Investment.

No account of foreign investment in Latin America today would be complete without recognition of yet another significant development: to wit, the growing amount of foreign investment by firms domiciled in Latin America itself. For years, of course, Latin American economies experienced periodic capital flights whenever the political horizon darkened, the likelihood of a devaluation increased, or investment expectations soured for other reasons. Most often this diaspora capital parked in bank accounts, short-term securities, or other fairly liquid assets. Moreover, going back for many years, a very few Latin American companies, like Bunge and Born or the Banco do Brasil, built an extensive network of offices outside the region to conduct their business more efficiently. Today, however, outward foreign investment by Latin American investors is occurring in a sophisticated range of ventures, both within and outside the region, and taking place not for the reasons that prompted capital flight so often in the past, but for solid business reasons.

The cross-border capital flows emanating from Latin American bases are not exactly new, dating, it is believed, to the early 1930s. But until they began to expand in the 1970s and early 1980s, they were properly viewed as curiosities. By one estimate, such investments, called South-South investments, rose to somewhere between \$5-10 billion on a global basis (not just for Latin America).¹³ At that time the chief sources of Latin

13. LOUIS T. WELLS, *THIRD WORLD MULTATIONALS. THE RISE OF FOREIGN INVESTMENT FROM DEVELOPING COUNTRIES* (1983). A somewhat later study, UNITED NATIONS CENTRE ON TRANSNATIONAL CORPORATIONS, *TRANSNATIONAL CORPORATIONS IN WORLD DEVELOPMENT: TRENDS AND PROSPECTS* (1988), produced a higher estimate of around \$15 billion U.S., again on a global basis.

American outward foreign investment were Mexico, Brazil, Argentina, Venezuela, Colombia, and Peru. By the time of the UN study, Brazilian firms had invested in as many as thirteen foreign countries. There was a hiatus in this expansion when most of the economies of the region were caught up in the debt crisis, but by the 1990s it clearly resumed and was deemed worthy of note in the CEPAL Review.¹⁴ Disregarding the Panamanian total, which included shipping under flags of convenience, the largest Latin American investment was in the United States: mainly from Venezuela (\$13.1 billion), in the form of overseas downstream operations of the state petroleum company. But Mexico and Brazil both had investments in the United States of \$2.9 billion and \$1.6 billion, respectively.

A representative sampling of foreign holdings as of the time of the CEPAL survey included Argentine firms in a wide variety of fields: yarns, footwear, agroindustry, chemicals, candies, industrial equipment and machinery, pharmaceuticals, dairy products, and so on in sixteen different countries. The grain trading firm of Bunge and Born is, of course, among the major players in that field. Brazilian investments abroad covered production in soluble coffee, apparel manufacture, paper and cardboard packaging, engine parts and pistons, steelworks, and others. Mexican foreign holdings included assets in foodstuffs, cement, metal products, chemicals, oil industry equipment, mining, oil refining, carpet manufacture, telephone equipment, glass products, and others. Improbable as it may seem, a Mexican-based sushi franchise operation even expanded into Guatemala and Panama and plans for further outlets to provide its Mexicanized Japanese dishes in Colombia, Spain, and the United States.

In any event, according to the previously cited *World Investment Report 1997*, intra-regional foreign direct investment by Latin American firms reached some \$7 billion in the 1990s, with Chile in the lead of capital suppliers (almost \$5 billion), followed by Brazil and Argentina, each having invested a bit under \$1 billion in other Latin American economies. As these capital transfers often flow into integrated operations characterized by new levels of technological and organizational complexity, the business ties among Latin American countries and the information systems that buttress those ties are knitting the region more closely together than ever before, while consolidating its links with the rest of the world.

There are really no accurate and up-to-date figures detailing this phenomenon, but the *World Investment Report 1997* provides some information that, faute de mieux, suffices to suggest some general dimensions.¹⁵ While only one Latin American corporation, *Petroleos de Venezuela*, numbered (#88) among the one hundred largest transnational or multinational corporations, the fifty largest MNCs based in developing countries include, besides the Venezuelan oil company, the second largest of the fifty, the following: Cemex

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14. Wilson Peres Nuñez, *The Internationalization of Latin American Industrial Firms*, CEPAL REV. 49, 55-74 (1993).
 15. The shortcomings of the *World Investment Report 1997*, good as it is, derive mainly from the fact that few, if any, developing countries regularly collect statistics of the sort needed for mapping the spread of outward foreign investment from those countries. But there are other difficulties. A listing of the largest transnational enterprises, for example, shows only two publishing or media combines, an Australian and a Canadian. Left out are such giants as Hachette, Bertelsmann, and so on, but no explanation is given for these curious omissions.
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cement company of Mexico (#3), YPF petroleum company of Argentina (#8), Petrobras oil company of Brazil 9 (#14), Companhia Vale do Rio Doce mining conglomerate of Brazil (#17), Televisa television production and broadcasting of Mexico (#18), Panamerican Beverages of Mexico (#21), Gruma food conglomerate of Mexico (#22), Brahma brewery of Brazil (#24), Sadia Concordia foods of Brazil (#41), Vitro glass products of Mexico (#43), CMPC pulp and paper of Chile (#44), and Grupo Celanese chemicals of Mexico (#46). Smaller in size but interesting as a straw in the wind is the recent entrance by the Mexican company Maseca into the British market. Mexico's leading tortilla maker, Maseca has nineteen facilities in its home territory, five in Central America, two in South America, and ten in the United States. Behind developments such as these there are many remarkable stories.

Cemex of Mexico, for instance, blossomed into the third largest cement company in the world, conducting its operations in North America, Europe, and South America. Until recently it planned to begin operations in Asia as well. As testimony to the institutional capacity of Latin American firms, the CEMEX purchase of a major Venezuelan cement producer put a troubled company back on its feet and made it into an excellent operation.¹⁶ For years the Argentine petroleum parastatal, YPF, exemplified about every shortcoming one could recount in the inventory of parastatal deficiencies. Yet, the turnaround, under Argentine private capital, was stunningly brief and in short order the company purchased a Texas oil company, acquiring thereby reserves in a number of foreign locations outside the Americas. Meanwhile, the Mexican Televisa giant, partly in combination with Venevision of Venezuela and Brazilian partners, put together a network of continental proportions, including production facilities in the United States, where it also owns broadcasting stations. Its products, the *telenovelas*, which are serialized dramas, even achieved popularity, along with those of Brazilian program producers, in European markets. On a smaller scale, the Elektra conglomerate (electronics, appliances, and discount retailing) of Mexico not only began to open stores in Guatemala, but also acquired a television network in El Salvador (to extend its TV Azteca operations) and made plans to develop a beeper company to cover all of Central America.

While the examples of outward bound Latin American enterprises can be multiplied manifold, a few more cases may be sufficient to indicate the range and types of operation involved. The giant Mexican agribusiness company, Pulsar International, is expanding its operations in the United States. Mexican construction companies are operating as far afield as Argentina. Brazilian franchising operations, a way of transferring product manufacture and management systems to other economies, now are found in Mexico and Argentina. Chilgener is on the verge of investing in energy projects in Canada and in the United States. When the large Argentine parastatal in steel was privatized, it was Chilean and Brazilian capital, the latter from the newly privatized Brazilian steel industry, that took a controlling interest, while to consolidate the opportunities opening up under MERCOSUL, Brazilian firms in a variety of fields are expanding their operations in Argentina.¹⁷

16. With the Mexican entry, the three largest cement companies in the world (the others being French and Swiss) are running the Venezuelan cement industry.

17. The cross-border participation by Latin American companies in privatization merits a major study, but none has been done as yet. One can note, however, that Chilean companies were involved as purchasers in a number of Peruvian privatizations and Telmex of Mexico participated in the privatization of the Ecuadoran telecommunications company.

Mercosur, in fact, attracted investment from other Latin American sources as well: e.g., Coca Cola Femsa (of Mexico), which purchased 100 percent of the Buenos Aires bottler of that beverage and the substantial investment by Grupo Dina of Mexico in an assembly plant in Argentina for manufacturing urban and interstate buses. When a group of investors in Venezuela tried, over as-yet unyielding opposition from the entrenched stock exchange members, to establish an electronic stock exchange, it was to a Chilean company, with experience in exporting its technology to several smaller Latin American countries, that they turned for technology transfer. Indeed, a small but noticeable current of Chilean and Colombian capital has been pouring into Venezuela since the policy situation began to move past the odd caprice of the early Caldera administration.

Latin American capital flows, moreover, move both in and out of the Venezuela, a development that is spreading (as in the Mercosur investments of Argentina in Brazil and of Brazil in Argentina). Venezuelan Electricidad de Caracas is, for example, bidding on privatization projects in Central America and the Dominican Republic and, with Houston Industries, is developing a joint venture in Cali, Colombia. The Mexican mining company, Industrias Peñoles, was in 1997 the winning bidder for a majority stake in a privatized mineral refinery in Peru, the famous La Oroya operation. On a larger scale still, several years ago Petroleos de Venezuela bought downstream distribution networks in both the United States and Europe to ensure market share for Venezuelan refined products. Mexico, a favored recipient of capital from the United States, also began to invest in the United States. Recently, Pemex entered into a joint venture in refining in Texas with Shell Oil to carry on the refining of more complicated crudes, but before that, as the Televisa acquisition of broadcasting and production facilities in the United States indicates, others, such as Vitro, were buying or establishing production plants to achieve a larger market share in the NAFTA area.

Strategic alliances, initiated by Mexican companies, are formed with increasing frequency with firms from other countries, in fields ranging from steel products to chemicals, telecommunications, aluminum engine blocks, glass products, and others. Less information is available, at this time, on equivalent developments elsewhere, but there is good reason to believe that Brazil, Venezuela, and Argentina, at least, are making significant strides in establishing similar linkages, the value of which is elided in studies of the ordinary capital flows, but which nevertheless make substantial contributions to productivity and output.

In the long run, these business ties within Latin America should help promote a rapid growth of intraindustry and intrafirm trade. They should also go far to consolidate, by providing information networks and organizational infrastructure, the effective intercountry links long sought through the various regional integration schemes the area witnessed since the end of the 1950s. Trade among Latin American countries is increasing in recent years, and while this fundamentally reflects the resumption of growth in per capita incomes and the diminution of trade barriers, the organizational basis built up through intraregional foreign investment and the elaboration of ancillary business ties undoubtedly contributes significantly to the support of this development.

This said, the fundamental significance of this new trend in foreign investment, then, is that it serves as a compelling illustration of the validity of the Marshallian agglomeration factors in economic development--and, by extension, the double role of the externalities in this process: first, in attracting imported foreign capital and, in time, in generating a surplus of capital for export. It also illustrates the insight imbedded in Marshall's discussion of agglomeration that factor productivity depends not so much on relative factor

scarcity as on the quantity and quality of the co-operant factors of production available in a given production environment. In other words, the much decried era of import-substituting industrialization, together with the natural growth of industry that would have occurred even in the absence of policy inducements, generated a vast amount of human and social capital on which these surprising new developments in foreign investment ultimately rest.

The gradual accretion of a much larger and more elaborated structure of international economic relations grows out of this development, while the players participating in the process are increasingly numerous and more complexly specialized--especially with privatization, the widespread transition from family-owned firms to more dispersed shareholding, and the emergence of new firms outside the clusters of those controlled by entrenched economic elites. The instruments for moving funds about in this new system grow ever more differentiated (and will become more variegated still with fiscal decentralization), meeting an increasing variety of investor preferences and borrower needs, and providing a calibration of risk and commitment that is increasingly refined. As the informational infrastructure keeps pace, capital markets are able to play an ever wider role in the management of risk and assisting in the institutional transformation of business organization throughout the Americas. All these changes, clearly, are providing the financial and transactional underpinnings of an economic system that exhibits far more versatility and resiliency than did those ministered to by the Bretton Woods Twins and assorted economic assistance agencies when the great post-war Age of Development was born.

VII. The Issue of Sustainability.

Many of the contributions of contemporary foreign investment flows were mentioned already or reinforce those the process made historically. What stands out most strikingly is that these flows were broken out of the enclave patterns that dominated the foreign investment process a century ago. They also, on the whole, promise to make more enduring and socially widespread contributions than the rent-seeking foreign investments attracted during the I-S-I period, for to a degree not previously reached they serve to integrate its production capacity into the global world system wherein the transnational flows of resources that Latin America can tap through this connection vastly exceed anything the region has known heretofore. By promoting rapid accumulation of human capital and organizational capital alongside material capital, these capital movements created a new pattern of comparative advantage--reflected, for example, in the striking growth and diversification of Latin American manufacturing exports--that reflect these new additions to the region's resource endowment. No longer do exports rest, as they did a century ago, on the gifts of nature.¹⁸ The agglomeration effects that Marshall perceived, in other words, are fully recognizable in today's ever more complex industrial structures and in the momentous changes in the region's service sector. Institutional capability leaps ahead, and the production possibility frontier is pushed out farther than was envisaged in even the most optimistic expectations when the deliberate industrialization undertaking began.

18. See, for example, Montague Lord, *Manufacturing Exports*, in *ECONOMIC AND SOCIAL PROGRESS IN LATIN AMERICA 1992* (Inter-American Development Bank ed., 1992).

Insofar as market forces guide future patterns of resource allocation even more surely than they have to date and insofar as the discipline of the market will be increasingly relied on to promote efficiency conditions in all aspects of production, much can be left for the quotidian processes of company management to determine, within a context of macroeconomic stability, uninterrupted liberalization, and increasingly fine-tuned regulatory regimes in such key areas as the financial sector. Many of the exotic problems that once engaged the interest of development specialists are today an endangered species over much of the economic territory, albeit with little lament over their impending extinction. While there is still room for discussion, for example, of a possible, if limited, role for controls of capital movements to defend economies from undue fluctuation, even this should decline on the policy agenda as countries work their way toward consistency among exchange rate policy, interest policy, and growth-supporting macroeconomic policy.

It would be gratifying to conclude that this is one of those stories in which the protagonists live happily ever after. Yet, for all the record of achievement, and it is an impressive one, there are at least four inquietudes that must be recognized if the foregoing developments are to be assessed in the proper context. All bear on the longer run viability of the growth path on which the region seems set today, so that eventually, it is to be supposed, they will all affect the investment environment adversely. Although this is not the occasion to examine them in depth, at least a mention is necessary to put the caveats on record.

For one thing, the twinned processes of fiscal and administrative decentralization, necessary if infrastructure of all sorts is to be more widely distributed and fuller advantage taken of resources in place, are not much advanced in many countries, and this fact has implications for the upgrading of both revenue collection and expenditure management, as well as economic renewal through regional development. We tend to view decentralization as *ipso facto* good in most instances, and there are many reasons, including responsiveness and accountability, to support this preference. Given the structures that developed historically in most, but not all, countries, organizational improvement and human capital formation tend to be concentrated in the political/administrative centers, with the result that there may be a long learning process before state and local administration come up to speed in handling new responsibilities. Hence, the efficiency of public investment may well suffer in the early years, and we do well to remember that there is no rule or logic that exempts decentralized governmental entities from the bureaucratic politics, the corruption and inefficiency, and the rent-seeking pressures that plagued central governments for so long. Further, the disparity between the rate at which an economically distressed Mexico produced, between 1982 and 1992, impoverished people and billionaires suggests that a high priority must still be given to fiscal reform at the national level if more effective programs of social investment to reduce these alarming disparities are to be designed and implemented, a problem shared, though perhaps in lesser measure, over most of the continent.

The lessening of interregional disparities within countries, with the aim of promoting human capital and organizational capital formation in areas largely bereft of either, defines a second challenge for policy-oriented analysis, and one that supports the need for fiscal strengthening of the central governments inasmuch as interregional transfers are essential to redressing these imbalances. But in view of the limited success of some of the industrially advanced countries in tackling either of these issues, it seems that a lot of trailblazing lies ahead for the policy communities of most of Latin America. The lag of the Brazilian Northeast and Amazonia behind the more prosperous parts of the country, a problem thought to be critical as long ago as the 1950s, continues to be substantial and may even be

intensified as the more advanced South draws increased benefit from the MERCOSUL. A few regional development initiatives paid off in Latin America, but the record of many is no better than, say, that of the ill-fated Italian Cassa per il Mezzogiorno, now abolished after decades of largely ineffectual operations, or the sundry Appalachian assistance programs of the United States.

A third challenge for significant portions of Latin America comes from the problems of cultural pluralism, which compounds and dimensions the issues of poverty, lagging regions, underemployment, and unemployment. The difficulty of renegotiating a mutually acceptable position for the indigenous peoples in contemporary civil society only recently began to be seriously addressed in the specialist literature, though organizations like Cultural Survival have been sounding the tocsin for years. What is more, it may well be that in cases such as Mexico, Guatemala, Ecuador, Bolivia, and Peru these stresses will grow more acute as a modernizing agricultural sector reproduces what amounts to a modern version of the enclosure movement. Even in countries like Brazil, Venezuela, and Chile, in which smaller populations are involved, the first peoples continue to fall behind in the process of economic revivification, and worse yet, their distinctive cultural resources are very much at risk of being, in effect, confiscated and invalidated by the design of national policies and the operations of the market. At this juncture, it is not clear that any specialists are finding adequate responses, for the problem's complexity transcends the boundaries of labor markets, land tenure systems, sectorial policy, and even patterns of social investment.

Finally, there is the problem of inequality, a problem that gathers in many elements of the foregoing, plus others such as the chronic difficulty in providing gainful employment for the growing labor force and in eliminating the pervasive underutilization of the already existing economically active population. As the economic pace quickens, the segmentation of capital markets, the uneven regional distribution of agglomeration factors, the inadequacies of social investment programs, and the technology-skills complementarities that characterize the face of the new industrial development may all, given the relentless increase in labor force, serve to deepen regional polarization and perpetuate income inequality both structurally and geographically. Thus far, at least, the recovery of foreign investment and the resumption of growth are doing relatively little to boost employment in much of the area. Even the revival of manufacturing is, in the context of increasingly competitive markets, doing little to boost employment. Once the platoons of underemployed public functionaries are added to the ranks, if the public sector is ever successfully pared back, the problem will be even greater, though the fact that these supernumeraries largely survived the economic collapse of the 1980s does not give much hope that bureaucratic legions will be discharged in a time of improvement. If income convergence lies eventually, for theoretical reasons, in the offing, it has, empirically, not yet made a convincing appearance on stage in most of the countries.

Here, as elsewhere, the room for maneuvering is constrained by a continuing need to maintain open economies and to attract additional investment from abroad. Yet, if there is scant alleviation of inequality and problems of unemployment and underemployment, the fact that national elites and growing middle classes benefit from continuing capital transfers will probably not weigh very heavily in popular opinion. The first round of the economic nationalism, which Harry Johnson so devastatingly exposed a number of years ago, came, after all, on the heels of an extraordinary wave of growth. The destructive force of the Mexican Revolution occurred notwithstanding the investment and export led expan-

sion that characterized the Porfiriato, and a great deal of foreign investment, economic and social transformation, and even a tradition of more-or-less democratic rule did not spare Chile the pains of Allende's economic adventurism and what followed. Neither did the exceptional investment and exporting achievements of Peru under Odría avert the macro-economic populism that eventually wrecked the country.

In retrospect, one should not press the parallels too far between the foreign investment boom of a century ago and that we are experiencing today. Nevertheless, as we rethink sustainable development in line with current World Bank explorations of the concept, we have to think as much about how national endowments of social and cultural capital are impacted by trade and investment flows as about the impact of these on natural resources, the physical environment, and the stock of material capital. What John R. Commons long ago called "industrial goodwill," an intangible asset of immense value for boosting productivity through social cohesion and reduced conflict, comes to mind as a useful focus for analytical attention as we address the problem of sustainability. Its absence may well constitute a market failure that could ultimately erode much of what was so painfully achieved in the economic adjustments of the last decade or so.
