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2009, A Crisis Year: Foreign Investment in Latin America

LSE Ideas

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Since the early 1980s, foreign investment has become the main source of foreign capital for developing and least-developed countries. With the drastic reduction of bank loans, direct and portfolio investment are the most important alternatives to fund public and private needs of capital. Foreign investment is particularly important for least-developed countries and small developing countries. As a consequence, growth and development in many regions of the world depend on foreign capital, and any shortage could have detrimental consequences. Unfortunately, the economic crisis that started in 2008 seems to be contracting the total amount of FDI; particularly this seems to be the case in Latin America, as has been reflected in the latest report of the Economic Commission for Latin America and the Caribbean. This brief article aims to analyse this report and its implications for the region.

In 2008, foreign investment to developing countries – including Latin America – reached its historical peak ([ECLAC, Foreign Direct Investment in Latin America and the Caribbean 2009](#), p. 23) (The impact of China on these figures should not be underestimated, because this country alone accounts for 15.7 % of world FDI; see [UNCTAD, World Investment Report 2009](#), pp. 247-249). While developed countries suffered a huge contraction in investment, developing countries performed very well in 2008. This resilience, nevertheless, was connected to three main factors: business planning, commodity prices and growth. Since many of these projects were already in progress – growth in the region being relatively higher than in the OECD membership – they were finally executed rather than cancelled. In addition, many undertakings were linked to natural resources, a sector that was booming before the crisis due to the increasing demand and prices. In 2009, this positive scenario faced a challenge posed by the political decision of developed countries to attract and preserve capital, especially through incentive packages. This change of attitude was followed by direct consequences resulting from the slowdown of the world economy: economic uncertainty and recession in the OECD countries, a decrease in commodity prices, and less growth in Latin America and the Caribbean.

As a consequence, FDI inflows into the region fell to USD 76.68 billion, down 42% from the record high in 2008 ([ECLAC, p. 7](#)). While all sectors contracted, natural resource projects suffered the most, particularly because of the already mentioned decline in demand and price. Foreign investment directed to provide services remained the most important importing sector and manufacturing projects regained the second place. This decrease affected projects aimed to provide local markets with goods and services (market seeking / serving investments), and efficiency seeking investments, which goal is to perform one or more functions in the production process at a given location and re-export the goods to other production facilities or the final markets. It is worth to remark that both before and after the crisis, the region does not perform well in attracting capital-intensive foreign projects. In spite of the number of manufacturing projects, most of them continue to target low or medium technology functions. Investment in research and development remains particularly low ([ECLAC, p. 10](#)). This dynamic shows that foreign capital to the region has two main objectives. First, substantial inflows are directed to the provision of goods and services to the local markets, but mostly using technology and marketing techniques developed in other jurisdictions. Second, an increasing amount of flows, particularly from the U.S., are exploiting location advantages – such as lower salaries – to perform labour intense functions in Mexico, Central America and the Caribbean.

In terms of recipient countries, Mexico was the most affected country with 51% decrease of inward FDI flows, followed by Argentina (50%), Brazil (42%), the Caribbean (42%), Colombia (32%), Central America (32%), Peru (31%) and Chile (31%) ([ECLAC, pp. 7-8](#)). The most affected country was Venezuela with negative inflows of 3.105 billion, but this figure is mostly a result of the nationalisation process rather than the economic crisis. As expected, the most important recipients in absolute terms are basically the biggest economies (in GDP terms): Brazil, Chile, Mexico, Colombia, Argentina, Peru, Dominican Republic, Panama, Costa Rica and Uruguay ([ECLAC, p. 66](#)). Nevertheless, this does not tell much about the importance of foreign investment for each economy. When analysing the relationship between GDP and total FDI inflows, the ranking of major recipients is led by Chile, followed by Panama, Dominican Republic, Costa Rica, Peru, Uruguay and Colombia ([ECLAC, p. 33](#)). The GDP / FDI coefficient indicates the high ability of these countries to attract FDI, beyond the size of the host economy, but also shows some potential dependency on foreign savings. Regarding outward FDI inflows by Latin

American and Caribbean countries, the three main capital exporting countries are Brazil, Mexico and Chile. The majority of these projects are located within the region. In 2009, however, this ascendant tendency suffered a sharp reduction of 69% compared to 2008. The reason for this decline is attributable to a net disinvestment of Brazil of around USD 10 billion (in 2008 it had invested for USD 20 billion) ([ECLAC, p. 10-11](#)). Both capital importers and exporters in the region seem to confirm the investment development path hypothesis advanced by John Dunning and Rajneesh Narula. According to this argument, countries would only attract few foreign investments until they reach a certain level of development. Later on, when they achieve higher positions in the developing ladder, they will also become capital exporter countries.

The 2009 report by ECLAC is optimistic about the positive effect of FDI inflows on the recipient economies in the region. It does mention, however, that there is a stronger impact of FDI as a source of financing than as a transmitter of knowledge and technology. In this regard, the report concludes that FDI should be treated as part of a more “comprehensive development strategy” ([ECLAC, p. 58](#)). Positive externalities are not an automatic consequence of FDI; they depend on both the right public policy and a strong domestic private sector. For Latin America the remaining challenge is to attract more high value FDI that is related to more capital intense functions in the production process. This relates not only to research and development, but also to headquarter activities such as finance and marketing.

As the report puts it clear in the end, FDI continues to be the main source of capital for developing countries and any decline is therefore bad news ([ECLAC, p. 64](#)). The slowdown of the world economy makes efficient seeking investment less attractive, while market seeking and serving projects will be on hold until the region goes back to a growth path. As a final remark, it is necessary to remember that if developed countries actively seek to attract capital, this could further reduce the amount of investment in developing countries ([UNCTAD, Assessing the impact of the current financial and economic crisis on global FDI flows, pp. 47-50](#)). In fact, whenever developed countries required capital, the rest of the world suffered a consequent scarcity in their financing expectations (the post-war period and the 1980s are two examples). Presently, the world economy has changed and many emerging economies are also capital exporters, such as Brazil, Mexico and Chile. Yet, it is not clear whether they could take the lead as main investors in the region in case of a slowdown of extra-regional FDI. For the less developed economies in the region, this is a crucial question.

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