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ON FINANCIAL COOPERATION BETWEEN CHINA AND LATIN AMERICA AND THE CARIBBEAN

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Note: These notes are for a guide for an oral presentation, they are not for a complete record of the discussion.

- The economic, political and institutional ties between Latin America and China have become closer as the Chinese economy has grown. Indeed, as a result of its rapid economic growth, China now plays a systemic role in the world economy.
- The financial cooperation between China and Latin America can be approached from different angles.
- I have chosen this time, Foreign Direct Investment.

Foreign direct investment .

Recent trends*

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- *Global FDI flows in 2018 fell 13%*

- (FDI) flows in 2018, fell 13 per cent to $1.3 trillion. This third consecutive decline was mainly due to large-scale repatriations of accumulated foreign earnings by US multinational enterprises , following tax reforms introduced by that country at the end of 2017.

- According to UNCTAD, FDI flows to developed economies were the lowest since 2004.
- The fall was 27 per cent. " Inflows to Europe halved to less than $200 billion, due to negative inflows in a few large host countries as a result of funds repatriations and to a sizeable drop in the United Kingdom.
- Inflows in the United States also declined, by 9 per cent to $252 billion" said the UN institution.

- FDI flows to developing countries remained stable, rising by 2 per cent.

- FDI flows to Africa rose by 11 per cent to $46 billion, despite declines in many of the usually larger recipient countries.
- The increase was supported by continued resource-seeking inflows, some diversified investments and a recovery in South Africa after several years of low-level inflows.

- In developing Asia, the largest recipient region, were up 4 per cent. In a sign of continued dynamism, greenfield Project announcements in the region doubled in value, recovering from their 2017 pause.

- FDI flows to economies in transition continued their downward trend in 2018, declining by 28 per cent to $34 billion, driven by a 49 per cent drop in flows to the Russian Federation.

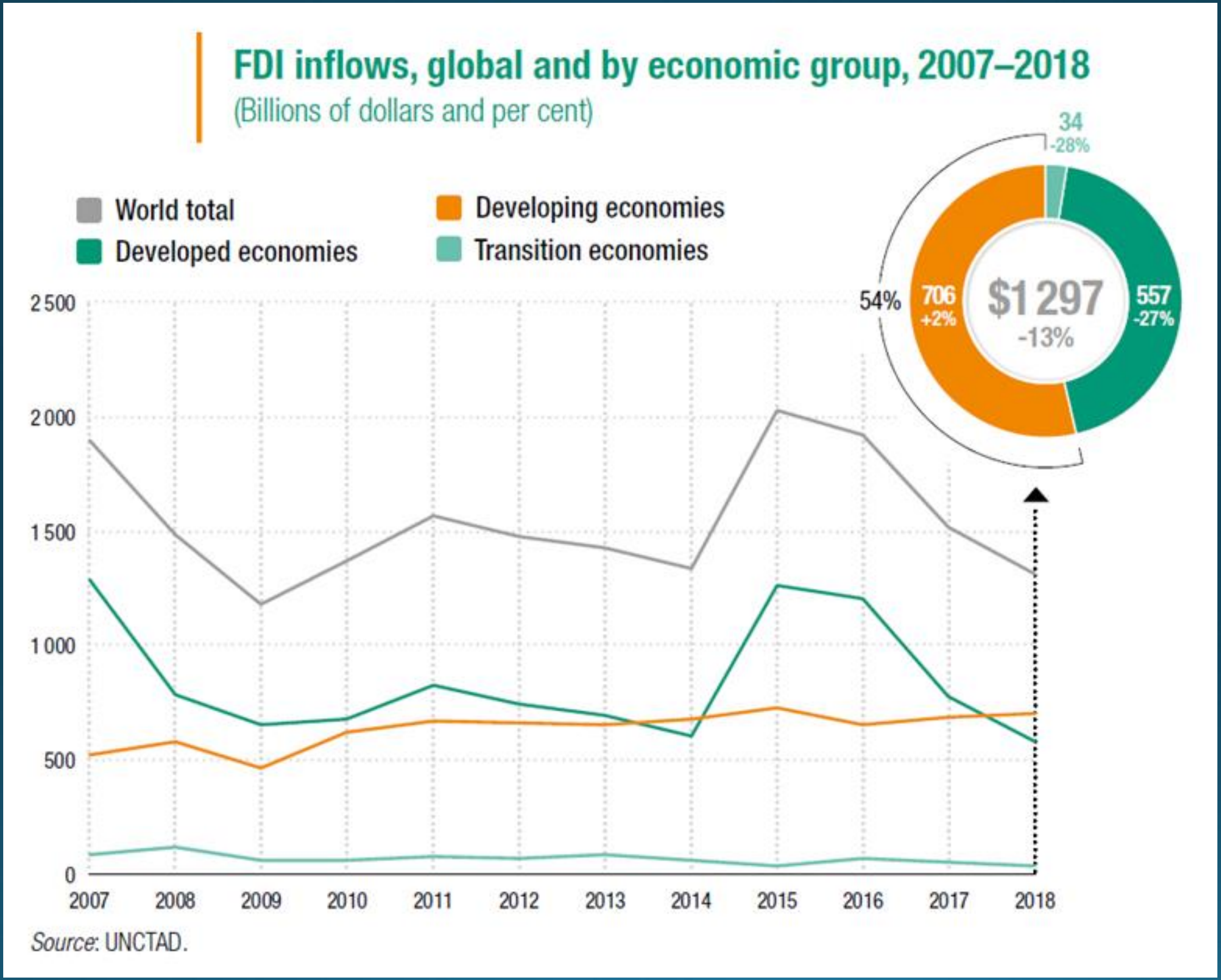
- The tax-driven fall in FDI was cushioned by increased transaction activity in the second half of 2018.

- The value of cross-border merger and acquisitions (M&As) rose by 18 per cent, fueled by United States MNEs using liquidity in their foreign affiliates that was no longer encumbered by tax liabilities,UNCTAD said.

- In 2019, FDI is expected to see a rebound in developed economies as the effect of the tax reforms winds down. Greenfield project announcements also point at an increase.
- Despite this, projections for global FDI show only a modest recovery of 10 per cent to about $1.5 trillion, below the average over the past 10 years.
- *The underlying FDI trend for 2019 remains weak.*
- Trade tensions also pose a downward risk for 2019 and beyond.
- The underlying FDI trend has shown a very small growth since 2008.

- Explanations include declining rates of return on FDI, increasingly asset-light forms of investment and a less favourable investment policy climate.

- The long-term slide of greenfield investment in manufacturing halted in 2018, with the value of announced projects up 35 per cent from the low value in 2017. Among developing countries – where manufacturing investment is key for industrial development – the growth was mostly concentrated in Asia and pushed up by highvalue projects in natural resource processing industries.



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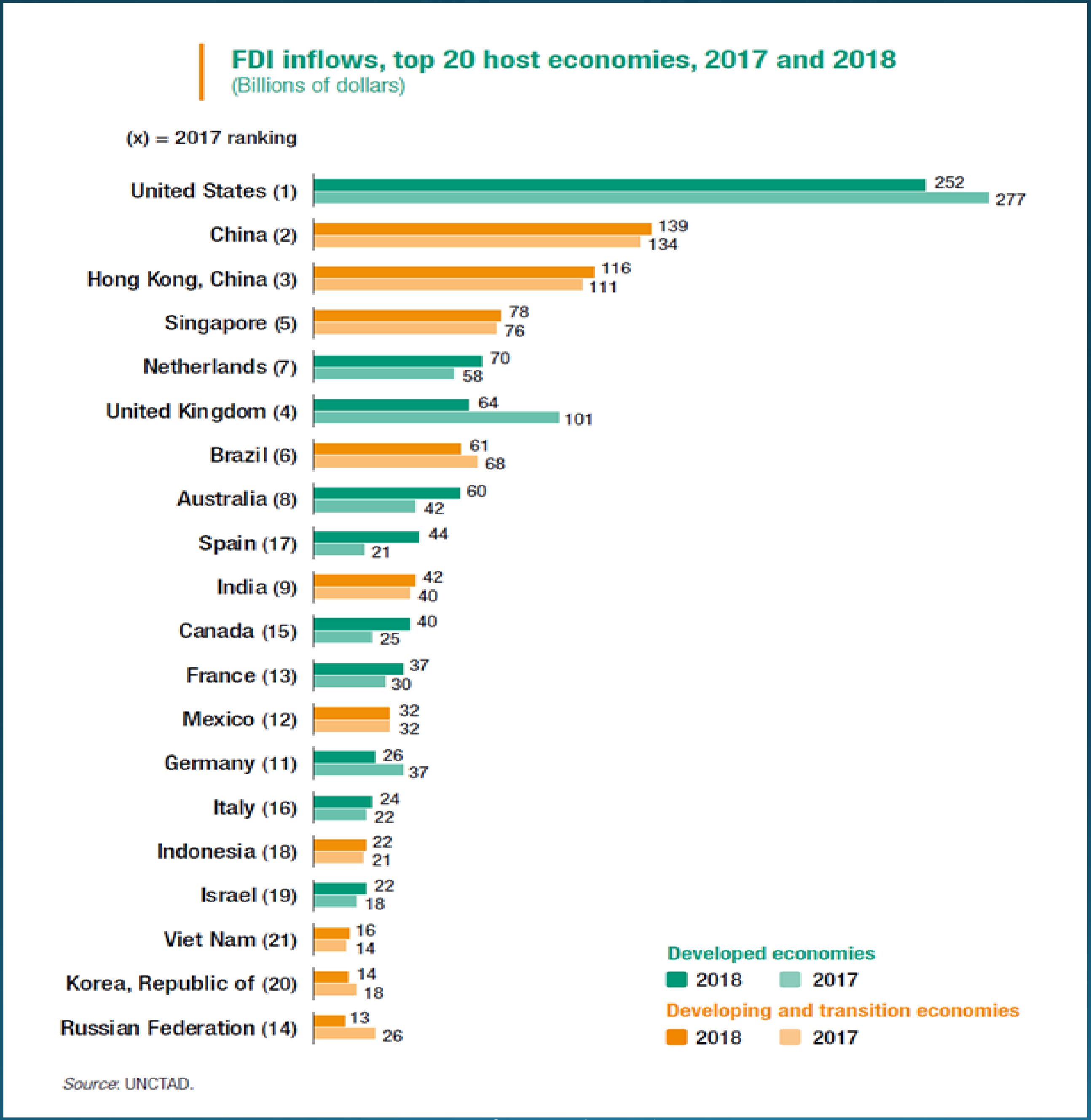

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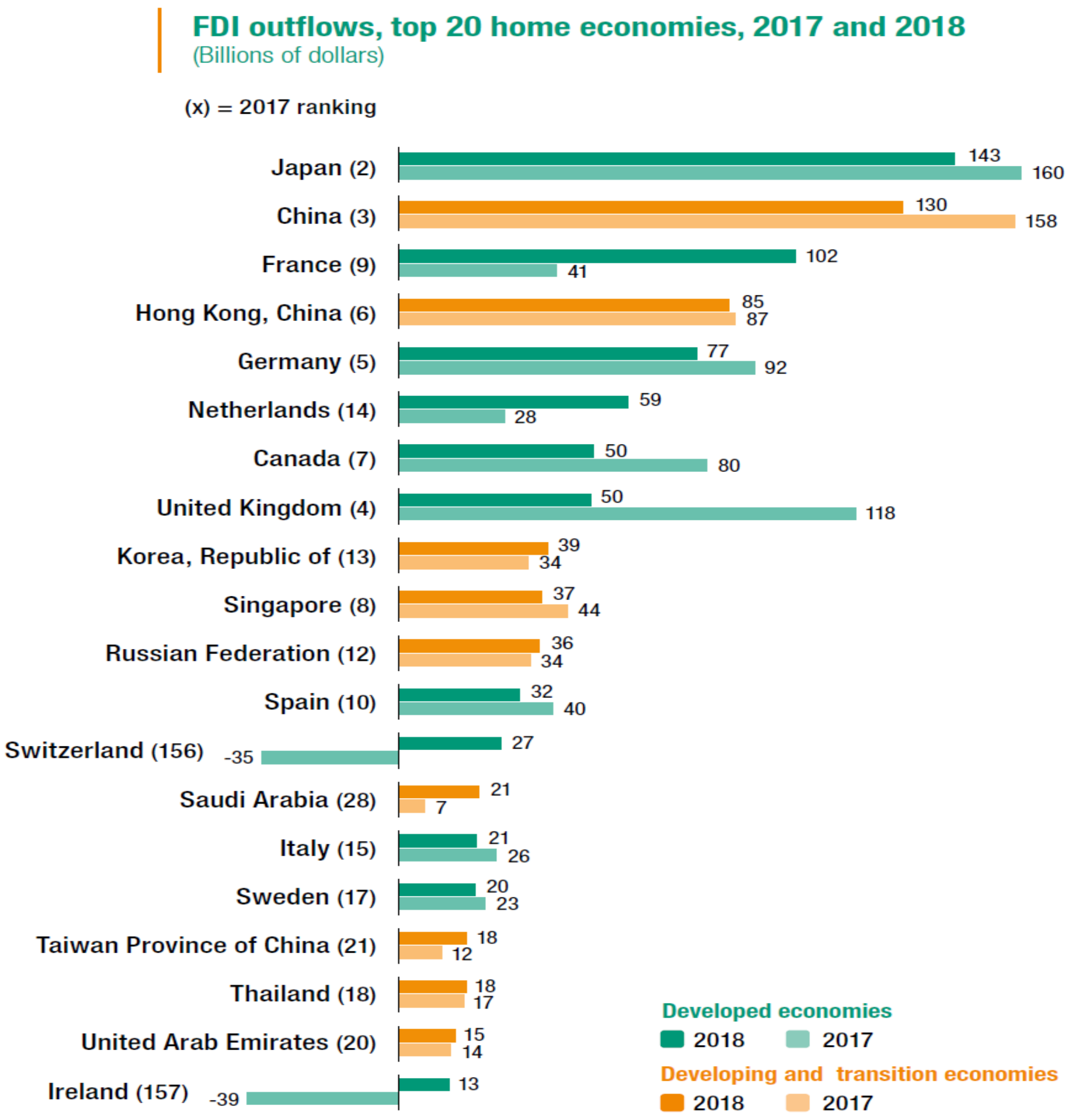

Source: UNCTAD.

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Foreign direct investment

Latin America and the Caribbean *

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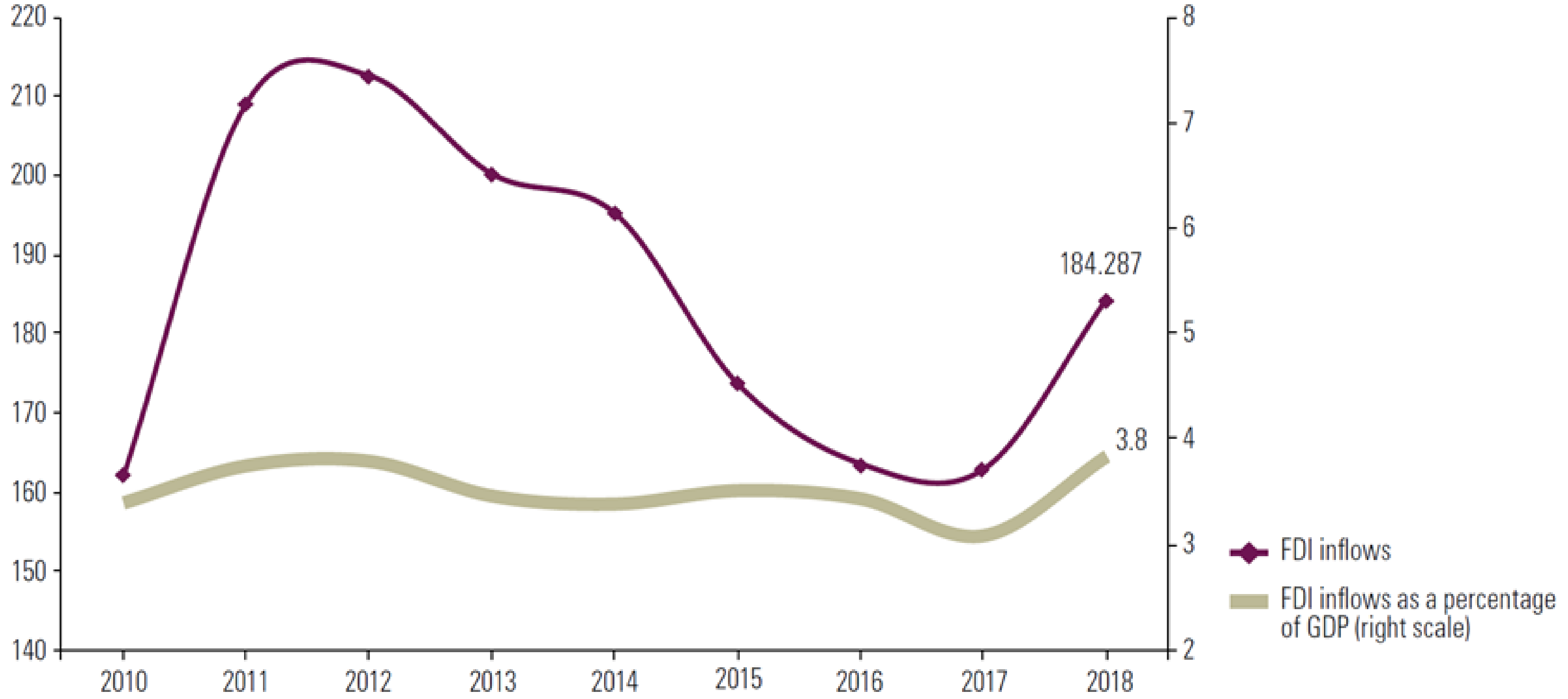
- Foreign Direct Investment (FDI) in Latin America and the Caribbean increased by 13.2 percent in 2018, totaling 184.287 billion U.S. dollars and putting an end to five years of declines.

- These findings were delineated in "Foreign Direct Investment in Latin America and the -- 2019," a report presented by the UN Economic Commission for Latin America and the Caribbean (ECLAC) in Santiago, Chile.

- "In an international context of a reduction in FDI flows and strong competition for investments, national policies should not be oriented towards returning to the amounts recorded at the start of the decade, but rather towards attracting ever more FDI," the organization's Executive Secretary Alicia Barcena said.

Latin America and the Caribbean: FDI inflows, 2010–2018

(Billions of dollars and percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures as of 23 July 2019.

Note: Information based on the sixth edition of the *Balance of Payments and International Investment Position Manual* (BPM6) (IMF, 2009), except in the cases of the Bahamas, Barbados, Ecuador, Guyana, Haiti, Honduras, Paraguay, Peru and Suriname. No information has been available for the Bolivarian Republic of Venezuela since 2016.

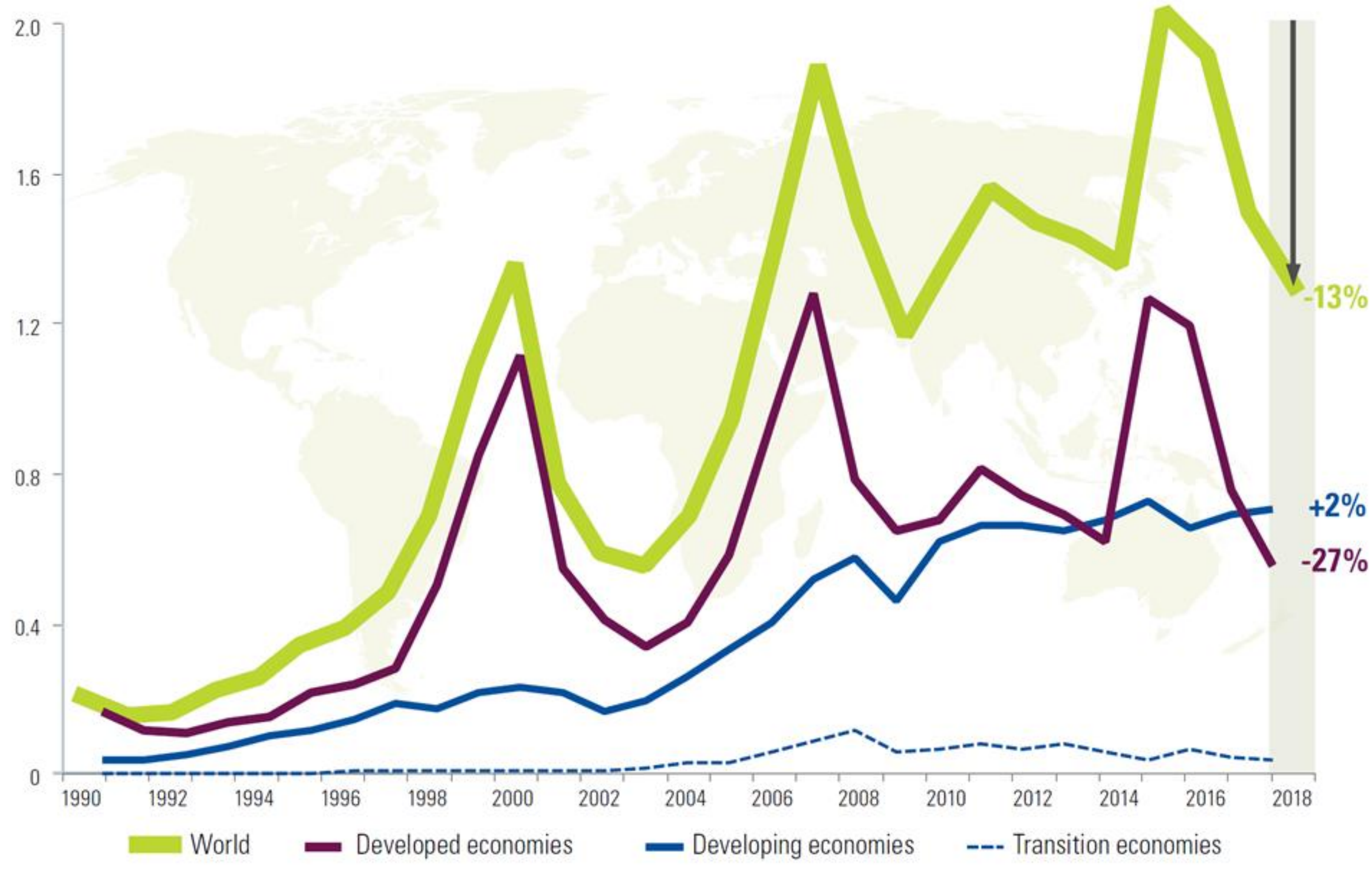
- The study shows a fall in FDI was steepest in developed economies (-27%), while flows into the developing economies increased slightly (by 2%). The latter, as a result of the changes mentioned above, grew to account for 54% of global FDI flows, the highest percentage ever recorded. In contrast, in the transition economies, inflows dropped by 28%, and even more steeply in the case of the Russian Federation (-50%) as already mentioned.

- The absolute-value variations between 2017 and 2018 demonstrate the drop of FDI in Europe . The United States also saw a fall in 2018 (-9%), from US$_277 billion to US$_252 billion.

- Among the developing economies, FDI increased in Asia (+4%), Africa (+11%) and Latin America and the Caribbean (+13%).

- The region now receives 14% of all FDI flows, more than the average for 2008–2012, when the world economy was marked by the commodity price supercycle.

Global FDI inflows, by groups of economies, 1990–2018
(Trillions of dollars)



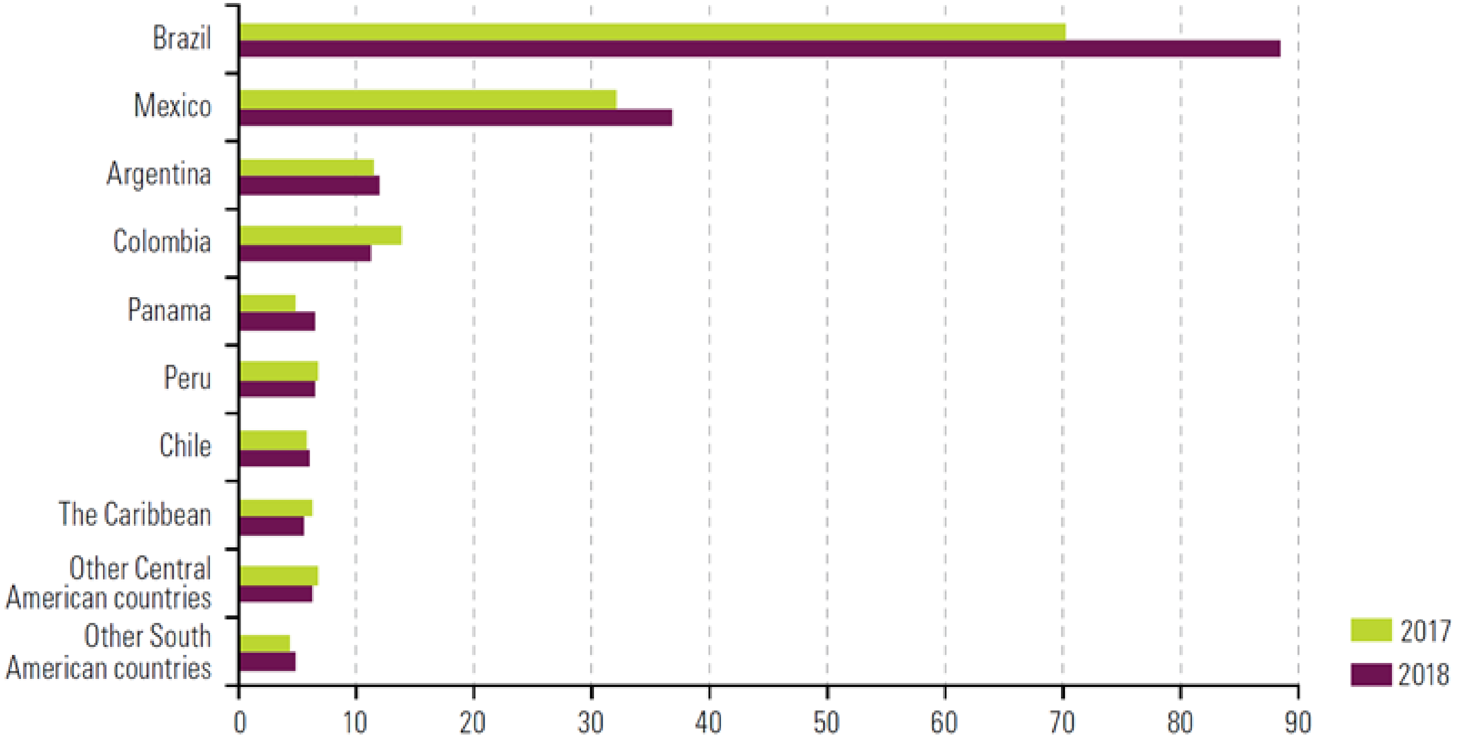
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Conference on Trade and Development (UNCTAD), *World Investment Report, 2019*, Geneva, 2019.

- The ECLAC´s study shows great heterogeneity in national results. Investment inflows increased in 16 countries compared to 2017, whereas in 15 other countries, they declined.

- "Most of the growth in FDI in 2018 is due to greater investment in Brazil (88.319 billion dollars, 48 percent of the regional total) and Mexico (36.871 billion dollars, 20 percent of the total)," the document stated.

Latin America (selected countries and subregions): FDI inflows, 2017–2018

(Billions of dollars)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures and estimates as of 23 July 2019.

Note: Information according to Balance of Payments and International Investment Position Manual (sixth edition), published by the International Monetary Fund (IMF, 2009), except in the cases of Bahamas, Barbados, Ecuador, Guyana, Haiti, Honduras, Paraguay, Peru and Suriname. No information has been available for the Bolivarian Republic of Venezuela since 2016.

- The two countries are followed by Argentina with 11.873 billion dollars, up by 3.1 percent; Colombia with 11.352 billion U.S. dollars, down by 18 percent; Panama with 6.578 billion dollars, up by 36.3 percent, and Peru, with 6.488 billion dollars, a 5.4 percent decline.

- Additionally, the ECLAC report specifies that FDI outflows from Latin American transnational companies declined in 2018 for a fourth straight year, totaling 37.870 billion dollars.

- The majority of FDI came from Europe and the United States of America and China.*

- The identification of the origin of FDI through national account data is imprecise, because it refers to the immediate provenance of the funds in question, but it does not reveal the source of the capital that entered the regíón through third markets. With this caveat, it can be said that the origin of investments has remained stable in recent years: has most of the capital entering the region came from Europe and the United States.

Europe a stronger presence in the Southern Cone, mainly in Brazil where it was the source of 74% of the capital inflow, while the United States was the main investor in Mexico and Central America .

- Trans-Latin firms have a strong presence in Colombia, surpassing even the inflows from the United States, and in Central America.
- By the amount involved in mergers and acquisitions operations occurring in 2018, the United States and Europe regained the leadership they had lost to China in the previous year . Chinese firms made a number of strategic investments in infrastructure and lithium mining, but on a smaller scale than in 2017, so their share as a source of these mergers and acquisitions shrank (from 37% of all cross-border mergers and acquisitions in the region in 2017 to 19% in 2018).
- The three leading origins display different sector profiles.

- China focused on acquiring firms in the extractive industries and agribusiness, power generation, utilities (electricity, gas, water) and infrastructure.

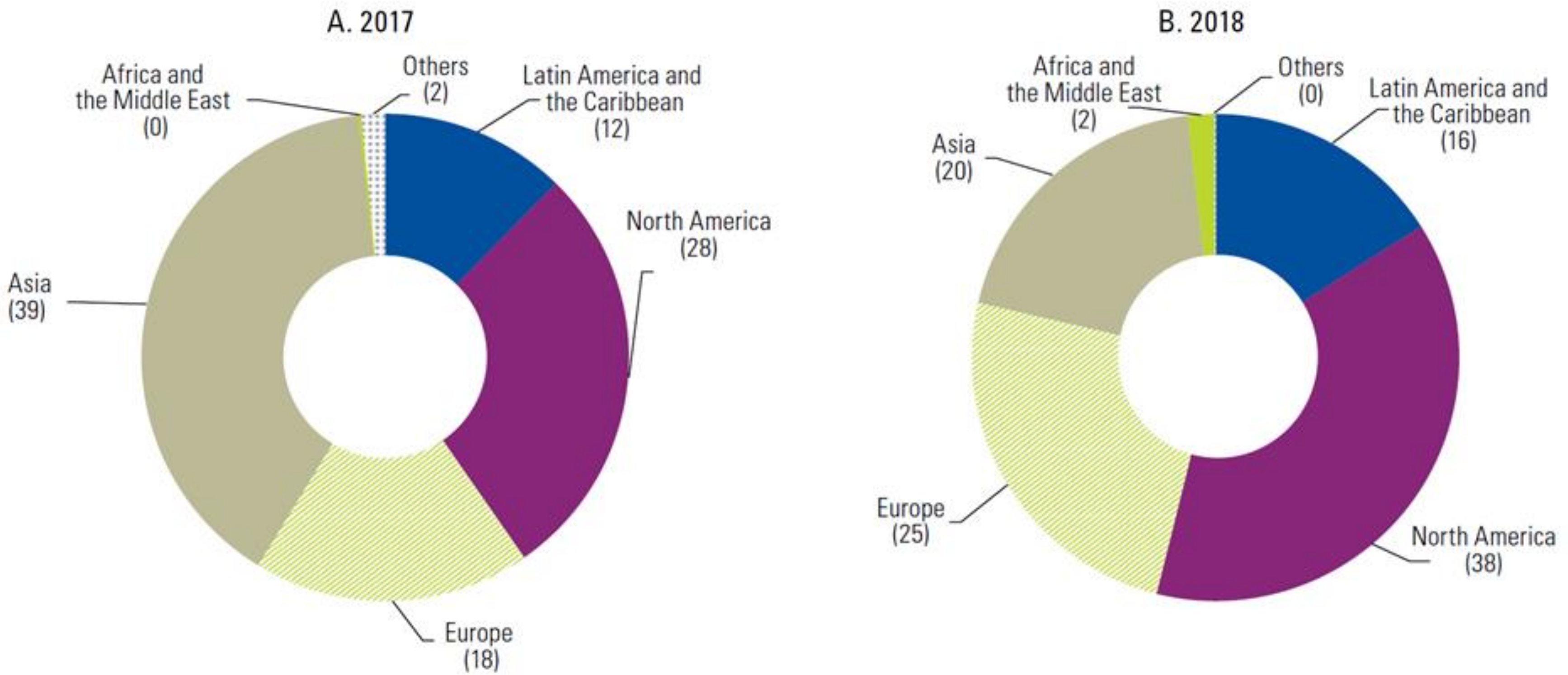
- The United States and Europe were more diversified, making substantial investments in the same sectors as China, but also supporting the development of other industries.

- An analysis of mergers and acquisitions in high-tech industries (Internet, software and telecommunications), shows that North American and European countries have been the key investors while China played a minor role, according to ECLAC figures.
- In 2018, however, the Chinese firm, Didi Chuxing, a virtual ride-hailing platform, acquired the Brazilian firm, 99 Taxi, marking a further step in the firm’s regional market expansion strategy, thus breaking free from the traditional sectoral approach of China’s investments in the region.

- The extension of the Belt and Road initiative to Latin America and the Caribbean also shows China’s strong interest in the region. Many of the Economic Commission for Latin America and the Caribbean (ECLAC) region’s countries, including, had already signed a memorándum of understanding with China under the initiative.
- Such agreements could attract more Chinese investment in infrastructure, industry and services and increase the country’s influence in the region.

Latin America and the Caribbean: cross-border mergers and acquisitions, by origin of the acquiring firm, 2017 and 2018

(Percentages of total amount)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Bloomberg.

- **Investment promotion strategies to attract FDI and best practices therein**

- First,I will review some of Uruguay´s incentives to promote NFIs. Second , expose some achievements and finally, make a couple of remarks on the goals of the strategy.

- The discussion towards FDI has changed considerably in the last three decades as most countries have liberalized their policies to attracts all kind of investments from foreign firms on the expectation that this FDI will rise employment, exports or some kind of knowledge by spillovers to the host country private and public sector.
- Various governments have also introduced several forms of investment incentives to encourage foreign owned companies to invest in the country.

- In the case of Uruguay this incentives includes:
- -Freedom to conduct business in any currency
- -No discrimination between foreign and domestic investors
- -No local counterpart prior authorization o registration required
- -No restrictions on the repatriation of profits
- -Single taxation system throughout the country
- -Corporate income tax exemption on the investment and also VAT and wealth tax an import tax
- -The only free airport and port in Latin America
- We also enjoy some achievements according with international institutions
- -MVD Highest quality of life in Latin America
- -First in Institutional Stability in Latin America
- -First in low Corruption in Latin America and one of the lowest in the world
- -First in Prosperity index in Latin America
- - First in rule of law in Latin America
- - First in income distribution in Latin America (Gini = 0.38)
- -Investment grade rating
- -FDI as % of GDP 5.6% , number 2 after Chile

- After this policies and some achievements,I would like to comment a point which- in my view- is very important.

- Uruguay is trying to turn to a knowledge based economy. So the FDI who contributes with this objective is very well welcomed. But, some remarks could be important.

- The most powerful arguments in favour of incentives are based on the prospect for knowledge spillovers. Since technology to some extent is a public good, foreign investment can result in benefits for host countries even if the international firms carry out their foreign operations in wholly-owned affiliates.

- These benefits take the form of various types of externalities or “spillovers”.

- For instance, local firms may be able to improve their productivity as a result of forward or backward linkages with firm affiliates, they may imitate technologies, or hire workers trained by the international firms.

- The increase in competition that occurs as a result of foreign entry may also be considered a benefit, in particular if it forces local firms to introduce new technology and work harder.

- However , there is a strong consensus in the literature about why multinationals invest in specific locations . Foreign firms are mainly attracted by strong economic fundamentals in the host economies. Among them are market size and real income levels, skills levels in the host economy, the availability of infrastructure and other resource that facilitates efficient specialisation of production, trade policies, and political and macroeconomic stability.
- The relative importance of the different fundamentals varies depending on the type of investment.

- So in brief, theory suggests that in order to compete successfully in a foreign market a firm must possess some ownership-specific assets in knowledge, technology, organization , managerial and marketing skills.
- A firm blessed with such assets enjoys several possible ways (apart from exporting) to claim the rents that they will yield in foreign markets, including subsidiary production, joint ventures, licensing, franchising, management contracts, marketing contracts, and turnkey contracts.

- The location of FDI may also be influenced by various incentives offered by
- governments to attract firms. These incentives take a variety of forms .
- However empirical research shows that international investment incentives play only a limited role in determining the international pattern of foreign direct investment.Factors like market characteristics, relative production costs and resource availability explain most of the cross-country variation in FDI inflows and in this days risks involved.

- Nevertheless, it is clear that international investment incentives might play a role for firms decisions on the margin.
- The question is :whether the host country’s costs for providing the incentives – in terms of grants, subsidies, and other expenses – are justified?
- Are investment incentives likely to yield benefits that are at least as large as the costs? There are several strong arguments against this type of incentives.

- Firstly, there are obvious problems in identifying those marginal cases that would not enter the host economy without the incentives.

- Secondly, it is difficult make reliable calculations about the expected future benefits in terms of growth, employment, or tax revenue.

- This is particularly complex in cases where FDI projects that are driven by investment incentives rather than economic fundamentals of the host country.

- The reason is that these investors are likely to be relatively footloose, and could easily decide to move on to other locations offering even more generous incentives before the expected benefits in the first location have been realised.

- Thirdly –and most importantly – if foreign investors do not differ in any fundamental way from local investors, subsidising FDI will distort competition and may generate significant losses among local firms.

Concluding remarks

Two final considerations. Spillovers and FDI and Trust FDI and spillovers?

- ***Spillovers***
- By spillovers is meant the positive externalities emanating from FDI, which go beyond the direct benefits that may be adequately reflected in market pricing.
- Foreign direct investment can play an important role in raising a country’s technological level, creating new employment, and promoting economic growth. Many countries are therefore actively trying to attract foreign investors in order to promote their economic development. However, there are different ways to attract FDI.

- ***Spillovers***
- In this paper we have argued that the use of investment incentives focusing exclusively on foreign firms, although motivated in some cases from a theoretical point of view, is not a recommended strategy. The main reason is that the strongest theoretical motive for financial subsidies to inward FDI – spillovers of foreign technology and skills to local industry – is not an automatic consequence of foreign investment. The potential spillover benefits are realised only if local firms have the ability and motivation to invest in absorbing foreign technologies and skills. To motivate subsidisation of foreign investment, it is therefore necessary, at the same time, to support learning and investment in local firms as well.

- Hence, rather than proposing narrowly defined FDI policies, I argue that effective investment incentive packages should be seen as part of the country's overall industrial policy, and be available on equal terms to all investors, foreign as well as local.

- The incentives should focus in particular on those activities that create the strongest potential for spillovers, including linkages between foreign and local firms, education, training, and R&D.

- It should also be noted that the country's industrial policies in general are important determinants of FDI inflows and effects of FDI.

- By enhancing the local supply of human capital and modern infrastructure and by improving other fundamentals for economic growth, a country does not only become a more attractive site for multinational firms, but there is increased likelihood that its private sector benefits from the foreign participation through spillover benefits.

- ***Trust***

Finally, I would like to emphasize that Uruguay is a trustworthy country. In my point of view, trust is crucially important to attract FDI’s.

I am talking about individual, groupal or systemic trust. Economics ignores emotions in its theoretical construction. Trust is one complex emotion which has always been and is particularly important in today´s world.

Thank you

*The points 1, 2 y 3, mainly statistical, are taken in great extent, from UNCTAD and ECLAC ´s reports texts.

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