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SPANISH INVESTMENT IN LATIN AMERICA[1]

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Executive Summary

- Between 1995 and 2004 the Spanish economy has grown by an average of 3.28% per year, one of the highest in the European Union. This figure is higher than that of most of the large economies of the world, including the United States, Japan, Germany, the United Kingdom, France and Italy, but not as high as Canada's.
- Spain's GDP per capita is likely to exceed the EU's average before 2010. Spain has become one of the most open economies in Europe:
    - Spanish exports grew by 50% between 1996 and 2003.
    - The relationship between external trade and GDP grew from 42.3% in 1994 to 64.8% in 2003.
- Spain's foreign direct investments (FDI) increased by 8,294% between 1980 and 2000, the fifth largest percent growth among the top home economies in the world and the largest outside of East Asia.
- Spain became the second home of FDI in Latin America during the 1990s, behind the U.S. The seven largest Spanish firms alone had assets worth US$283 billion.
- Spanish FDI in Latin America was highly concentrated in five sectors (banking, telecommunications, public utilities, oil and natural gas) that absorbed almost 70% of total Spanish FDI in Latin America in the 1990s. Most of the investments in these sectors were made by seven large firms: BBVA, SCH (banking), Telefónica (telecommunications), Endesa, Iberdrola, Unión Fenosa (public utilities), Repsol-YPF (oil and natural gas).
- These investments were in part the result of a defensive strategy by the managers of these firms to adjust to growing competition in Spain, which resulted from the elimination of protectionism within the European Union in these sectors, and an offensive strategy to produce and sell their goods and services in markets in which the managers believed the Spanish firms had an advantage over their competitors.
- The Spanish managers believed the main advantage of their firms in Latin America was their ability to provide the goods and services required by the governments of Latin America to modernize the sectors in which they operated. They believed that their past experience modernizing their sectors in Spain could be easily applied in Latin America.
- The strategy of the Spanish government to facilitate these investments comprised the liberalization of financial flows, a reform of the tax system to prevent double taxation, the creation of public funds to subsidize or finance Spanish FDIs, a system of public insurance to protect investments from the risks of the host country, and bilateral and multilateral treaties for protection of investment.
- The wave of the large Spanish investments in Latin America finished in 2001, but Spanish firms are developing new strategies, such as the search for partners in Europe, North America and East Asia.
- Canadian investors need to learn more about Latin America. The conditions today are different from those that led to the severe crises of the 1980s. Macroeconomic indicators are positive and there are strong legal guarantees for investors.

Introduction

The large foreign direct investments (FDIs) of Spanish firms in Latin America need to be looked at from the broader perspective of the growth of the Spanish economy and important changes in specific industries and firms. The so-called "Spanish miracle", the phenomenal growth of the Spanish economy since the 1960s, is the result of a longer process of economic development that began in Spain in the 1870s and was partly interrupted between the 1930s and the 1960s by the Spanish Civil War (1936-1939) and the post-civil war political and economic measures of the administration of Francisco Franco, who favored the elimination of political dissent in Spain and the consolidation of his regime over a strategy of long-term economic growth. With the exception of the period 1930s-1960s, the Spanish government tried to maintain a fairly liberal economic regime that favored free trade and free capital flows. The heavy involvement of the state in the economy during the Franco years included the development of large state-owned enterprises and the creation of national monopolies in many industries, especially in public utilities, telephone, oil and energy. The liberalization of the Spanish economy that began in the 1960s accelerated after democratization (1975), especially when Spain joined the European Communities in 1986.

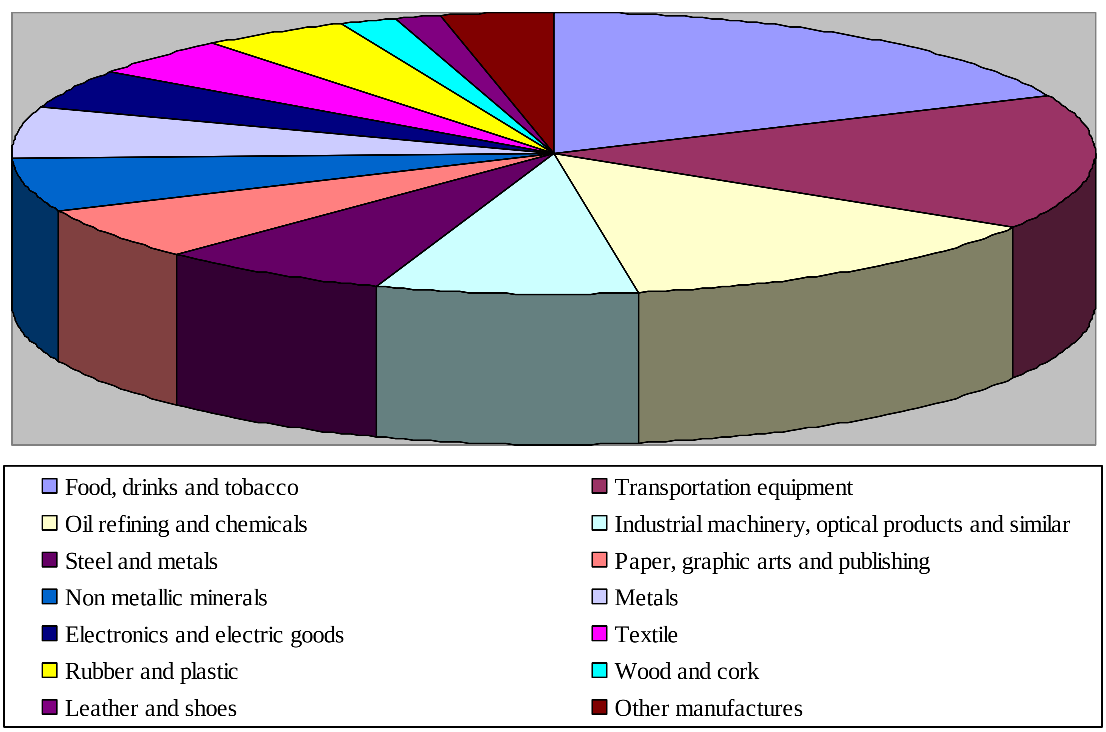
The "integration of Spain in Europe" has been regarded as the country's main achievement in modern history by the leaders of Spain's main political parties, including Partido Socialista Obrero Español (PSOE, center-left), Partido Popular (PP, center right), Izquierda Unida (IU, leftist coalition that includes the Communist Party of Spain) and the nationalist parties of the Basque Country, Galicia and Catalonia. Integration was perceived by political, cultural and business elites as the best way to consolidate Spain's young democracy and to promote the modernization of the economy. Spanish ascension to the European communities accelerated the process of liberalization of the Spanish economy. Spain and the European Community signed a preferential trade agreement in 1970.

In 1981 the European Community began to give funds to the Spanish government to help mitigate some of the costs of adjustment and the Spanish government began to take unilateral measures in preparation for accession that included increasing economic flexibility, industrial restructuring and intensifying trade liberalization. In addition, the actual accession after 1986 forced the political and economic actors to adopt economic policies and business strategies consistent with membership and the *acquis communautaire* (which included the customs union, the value added tax –VAT-, the Common Agriculture and Fisheries Polices, and the external trade agreements; and later the Single Market, the exchange rate mechanism –ERM-, and the European Monetary Union –EMU-) that aligned Spanish agricultural, industrial, monetary and financial policies with those of the member states.

In a context of strong support among Spanish citizens for integration, membership became a facilitating mechanism that allowed the governments to prioritize economic rather than social modernization and hence, to pursue difficult economic and social policies (i.e., to reform their labor and financial markets), with short-term painful effects. Moreover, the decision to comply with the EMU Maastricht Treaty criteria led to the implementation of macro and microeconomic policies that resulted in fiscal consolidation, central bank independence, and wage moderation. A significant dynamic effect was the strengthening of the competitive position of Spanish firms. A strong pillar of the strategy of the Spanish government to increase the competitiveness of its firms has been to open the Spanish economy by eliminating restrictions to trade and investment (within the framework allowed by the European Union). By the 1980s Spain was already facing increasing competition for some of its main exports –clothing, textiles and leather.- This situation convinced the Spanish leaders to shift toward more capital-intensive industries requiring greater skills in the labor force but relying on standard technology –e.g. food, drinks and tobacco, transportation equipment, chemicals, industrial machinery and optics, steel and metal manufacturers, paper, graphic arts and publishing, and non-metal minerals, among others (see graph 1).

The consolidation of these reforms generated a rate of economic growth of 3.28% per year on average for the period 1995-2003, one of the highest in the European Union. As a result, the convergence of Spain with the European Union in terms of gross domestic product (GDP) per capita improved significantly from 74.2% of the EU's average in 1980, to an estimated 97.4% in 2005 (see tables 1 and 2).

Graph 1 Spanish GDP by areas of economic activity, 2001



Source: Spanish Statistics Bureau (Instituto Nacional de Estadística –INE-).

Table 1 Average annual GDP growth, 1995-2003, percent

Canada	***4.61***
Spain	***3.28***
United States	3.18
United Kingdom	2.80
European Union	2.15
Germany	1.28
Japan	1.27

Source: Eurostat.

Table 2 Convergence of Spanish GDP per Capita with the EU, 1980-2005 (percentage)

	1980	**1990**	**1995**	**2000**	**2002**	**2005**
European Union	100.0	100.0	100.0	100.0	100.0	100.0
Canada			***113.0***	***117.5***	***118.53***	***132.0***
Spain	***74.2***	***77.8***	***87.6***	***91.9***	***94.7***	***97.4***
Germany			119.5	112.3	108.6	106.8
United Kingdom			110.6	114.3	117.8	119.6
United States			153.6	155.7	152.1	159.0
Japan			124.6	116.1	112.3	118.8

Source: Eurostat

Key Sectors and Host Regions

Since the Spanish government eliminated gradually the restrictions on FDI by Spanish enterprises between 1977 and 1992, Spanish FDI reached important proportions, making Spain the twelfth home country for FDI in the world in 2000 by "stock". The "position" or "stock" of Spanish FDI abroad grew from US$1.931 billion in 1980, to US$15.652 billion in 1990, and to US$160.202 billion in 2000 (see table 3). This meant an increase of 8,294% in this period of twenty years, the fifth largest percent growth among the top home economies in the world (see table 4).

Although the growth in amount of Spanish FDI abroad in this short period of time was very large, what made these investments even more interesting was the fact that they were very highly concentrated in two geographic areas mainly, the European Union and, especially, Latin America (see graph 4), where Spanish FDI flows surpassed those coming from the United States in 1999 and 2000. The United States was the main home to inward FDI in Latin America since the mid-twentieth century.

Table 3 FDI Outward stock, by home country, in 2000, in US$ million

Country	***1980***	***1990***	***2000***
United States	220,178	430,521	1,244,654
United Kingdom	80,434	229,294	901,769
France	23,599	120,179	496,741
Germany	43,127	148,457	442,811
Hong Kong China	148	11,920	384,732
Belgium and Luxembourg	6,037	40,636	339,644
The Netherlands	42,135	102,608	325,881
Japan	19,610	201,440	281,664
Switzerland	21,491	66,087	232,045
Canada	***23,777***	***84,829***	***200,878***
Italy	7,319	57,261	176,225
Spain	**1,931**	**15,652**	**160,202**
Sweden	3,721	49,491	115,574
Australia	2,260	30,507	83,220
Singapore	3,718	7,808	53,216
Finland	737	11,227	53,046
Taiwan Province of China	97	12,888	49,187
Denmark	2,065	7,342	46,111
Norway	561	10,888	44,133
South Africa	5,722	15,027	33,557
China	39	2,489	27,212
Korea, Republic of	127	2,301	25,842
Argentina	6,128	6,105	20,189

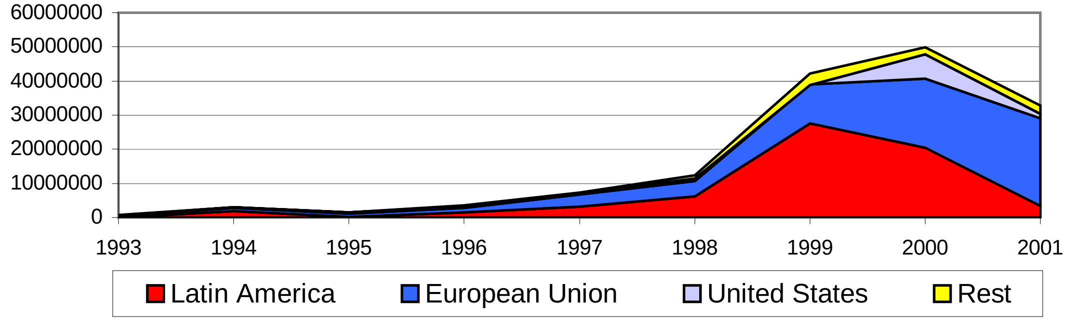
Source: United Nations, *World Investment Report* (New York, 2001), 307-311.

Table 4 Position or stock of FDI by country of origin, first twenty-two home economies, percent variation, 1980-2000

Country	***% Variation***
Hong Kong China	259,954
China	69,774
Taiwan Province of China	50,708
Korea, Republic of	20,348
Spain	***8,296***
Norway	7,866
Finland	7,197
Belgium and Luxemburg	5,626
Australia	3,682
Sweden	3,105
Italy	2,407
Denmark	2,232
France	2,104
The Netherlands	1,738
Japan	1,436
Singapore	1,431
United Kingdom	1,121
Switzerland	1,079
Germany	1,026
Canada	***844***
South Africa	586
United States	565
Argentina	329

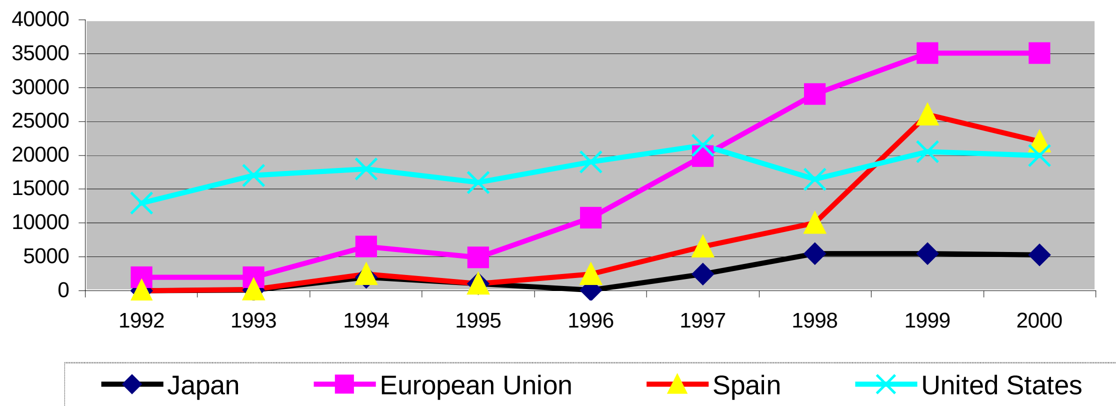
Source: United Nations, *World Investment Report*, New York, 2001, 307-311.

Graph 2 Flows of Spanish FDI by destination, 1993-2001 (millions of dollars)



Source: Spanish Ministry of the Economy (Dirección General de Comercio e Inversiones, Secretaría de Estado de Comercio y Turismo).

Graph 3 Inward FDI flows in Latin America and the Caribbean, 1992-2000 (millions of dollars)



Source: EUROSTAT and U.S. Department of Trade.

By the turn of the century, the largest seven Spanish multinational enterprises (names below) had assets worth US$283 billion and 128 million customers in Latin America, and they had become prominent actors in the economies of the region. For the Latin American societies, the Spanish FDI since the 1990s was very important, because in most cases Spanish firms operated in activities that were deemed as basic public services. The main firms and sectors were Telefónica in telecommunications, Banco Bilbao Vizcaya Argentaria (BBVA) and Banco Santander Central Hispano (SCH) in banking, Endesa, Iberdrola, and Unión Fenosa in public utilities, and Repsol-YPF in oil and gas. These were the largest firms in Spain in terms of market capitalization in 2005 and they generated about 70 percent of the amount of FDI that Spanish firms invested in Latin America since 1990 (if we include "holding" societies) (see table 5). This is important, because it shows that Spanish FDI in Latin America was highly concentrated in the hands of seven firms.

Table 5 Sectoral allocation of Spanish FDI in Latin America, 1980-2000, percentage

	1980-1984	*1985-1989*	*1990-1994*	*1995-2000*	*2001-2004*
Energy	0.12	0.23	9.20	22.70	17,39
Telecommunications	0.73	2.26	25.14	5.84	13,98
Banking and finance	48.86	57.48	40.29	13.17	21,49
Holding			17.09	27.33	
Total	49.71	59,96	74,63 (91,72)	41.71 (69.04)	52,86

Source: Dirección General de Comercio e Inversiones, Secretaría de Estado de Comercio y Turismo, Spanish Ministry of the Economy.

Table 6 Geographic distribution of Spanish investment in Latin America and the Caribbean by country

	BBVA	**BSCH**	**Endesa**	**Iberdrola**	**Repsol-YPF**	**Telefónica**	**U. Fenosa**
Argentina	■	■	■		■	■	
Bahamas		■					
Bolivia	■	■		■	■		■
Brasil	■	■	■	■	■	■	
Islas Caimán	■	■	■				
Chile	■	■	■	■		■	
Colombia	■	■	■		■	■	■
Costa Rica	■						■
Cuba	■						
República Dominicana	■	■	■				■
Ecuador	■				■		
El Salvador	■	■				■	
Guatemala	■			■		■	■
México	■	■		■		■	■
Nicaragua	■						■
Panamá	■	■	■				■
Paraguay	■	■					
Perú	■	■	■		■	■	
Puerto Rico	■	■				■	
Trinidad y Tobago					■		
Uruguay	■	■				■	
Venezuela	■	■			■	■	

Source: Annual reports of the companies.

For this reason, and because the entry of many of these firms occurred through the privatization of state-owned enterprises, their arrival was very visible, acquiring social and political significance. As a result, some of the political complaints against structural reforms, adjustment, and liberalization, turned into anti-Spanish cries of neocolonialism. Spanish firms also had a direct impact on many firms in the region, through the provision of credit, energy, or telecommunication systems. In other words, the competitiveness of many of the Latin American enterprises came to depend, to a certain degree, on the competitiveness of the products and services that the Spanish firms provided to them.

From the Spanish point of view, the FDI of Spanish firms in Latin America was important too, economically mainly and, to a lesser extent, politically and socially. Spanish FDI in Latin America was 0.96% of Spain's gross domestic product (GDP) in 1997, rose to 1.63% in 1998, 4.62% in 1999, and 3.97% in 2000 and then dropped precipitously to 0.48% in 2001.

This precipitous drop after 1999 was in part due to the crisis that hit Argentina and the somber prospects for economic growth in the region as a whole and to the end of the big wave of investments by the seven largest Spanish MNEs mentioned above. The annual flows of FDI from Spain to Latin America in 2003 and 2004 (the last two years for which the Spanish government provided official statistics) were only 27% of the flows in 1999.

The weight of the three main sectors stabilized around 50% of Spanish FDI in Latin America. But some sectors, led by SMEs, became more important, especially the chemical industry, food and drinks, paper, automobile manufacturing, construction and hotel management and hospitality (see table 7). The main hosts for the firms operating in these industries were the large economies, mainly the Southern Cone countries (Argentina, Brazil, Chile and Uruguay), Venezuela and Mexico.

Table 7 Sectoral allocation of Spanish FDI in Latin America, 2000-2004, percentage

Sector	***2000-2004***
Banking and finance	21.49
Energy	17.39
Telecommunications	13.98
Chemicals	6.99
Food and drinks	6.52
Trade	4.07
Non-metal mineral products	3.94
Paper	3.54
Automobile manufacturing and components	2.57
Metallurgy	2.21
Wood, cork and baskets	1.85
Construction	1.75
Hotel management and hospitality	1.38
Air and space transport	1.30
Computer activities	1.12
Other	9.90

Source: Dirección General de Comercio e Inversiones, Secretaría de Estado de Comercio y Turismo, Spanish Ministry of the Economy.

Objectives and Strategies

These seven Spanish firms were driven by a set of industry-specific and firm-specific advantages. When their managers perceived that the conditions of operation in Latin America were similar to those in Spain, they invested in Latin America too. These conditions held in basic infrastructure sectors which had been heavily regulated by the state in Spain until the 1970s, 1980s, or 1990s. The firms were sometimes state monopolies (Telefónica and Repsol), other times they were partly state-owned firms with concessions to operate under conditions of monopoly over a specific geographic region (Endesa, Iberdrola and Unión Fenosa), and in the case of the BBVA and SCH, they were large firms operating in a sector shielded from foreign competition by law.

In the 1990s, the Spanish government began to liberalize these sectors, under the pressures of the European Union. First, the government began to privatize its state-owned firms gradually, Telefónica and Repsol among them. In 1997, the Spanish state sold the last stakes it held in both firms. The second process was the liberalization of the markets in which these firms operated (banking in 1978, and telecommunications, public utilities and oil markets in the second half of the 1990s). When the managers of the firms involved in these sectors learnt that liberalization was inevitable, they began to prepare for it. They believed the potential entrance of foreign competitors in Spain would make them lose market share. However, the fall of entry barriers was happening also outside of Spain. Therefore, they decided to expand outside of Spain by making FDIs to compensate for the potential loss of business in Spain.

When analyzing where to invest, they looked for countries in which they could find an environment as similar as possible to the one they had had in Spain in terms of development needs, so that they could replicate the same corporate experience they had had in Spain. They believed this similarity of environment would give them an advantage. Central and Eastern Europe, Africa, Asia and Latin America were opening up. In most of them, the development needs were similar to those in Spain. However, Latin America had an additional advantage, a shared culture. Therefore, the top managers of the Spanish firms concluded that they would have a better knowledge of the market there.

The governments of Latin America began a series of processes of liberalization and privatization in the late 1980s. Among the firms being privatized were those in banking, telecommunications, public utilities, oil and natural gas. One of the main reasons behind the privatization and liberalization of these sectors was the need to attract new technology. The productivity of the telephone, public utility, and oil firms had declined drastically since the 1970s in most countries, and in the 1990s the governments found themselves short of money to undertake the large investment projects needed to upgrade infrastructure. In other words, the expectations of economic growth generated demands for more energy. Technological developments increased the costs of upgrading the telecommunications infrastructure. The banking crises generated the need to regenerate the financial infrastructure. The governments did not have the resources to invest in improving services in these sectors. As a result, they could not make the investments required and decided to invite private firms, many of them foreign, to provide these services. The seven Spanish firms that took over most of the Latin American firms in these sectors believed they had the knowledge and technology to introduce the reforms required by the Latin American regulators.

To strengthen financial markets, policy-makers tried to attract firms with better programs to prevent defaults, as well as with the knowledge to diversify and widen financial and banking services. The Spanish banks participated actively in the development of pension fund management programs, mutual funds, the capitalization of the stock exchange and development of capital markets, the extension of banking services to more sectors of the population, etc. In the telephone industry, the governments wanted firms capable of extending the network, introducing the latest technologies to improve the quality of service, and new products, such as Internet and mobile telephony. It was important also to improve the productivity of the firms. Telefónica played this role. The same was true about the public utilities. The new entrants, specifically Endesa, Iberdrola and Unión Fenosa, were expected to provide the resources to increase generation of electricity, in order to keep up with domestic demand, and to improve the efficiency of the systems, in order to reduce environmental impact, reduce energy losses, and extend the service to new areas. The increase in oil generation, as well as the development of the natural gas industry, from production to distribution, including the construction of natural gas-based electricity in combined cycle power plants, was the response of Repsol-YPF and its subsidiary Gas Natural to the demands of the Latin American regulators.

The SMEs that moved to Latin America in the second wave follow different strategies, and it is difficult to analyze them together. Most of them are relatively small family-owned firms that have grown in Spain since the 1940s and since the late 1990s decided to embark on an aggressive strategy of expansion outside of Spain. They chose Latin America given the cultural proximity and the perceived needs of the Latin American markets. Some of them made investments in Latin America to follow their partners from Spain who had already invested there. Others did not follow their partners, but they could benefit from the financial support of the large Spanish banks, BBVA and SCH, who encouraged Spanish SMEs to invest in Latin America by providing credit for their new Latin American ventures. The banks saw in the promotion of new Spanish FDIs in Latin America an opportunity to deepen business relationships with some of their “good clients”. In other words, they believed these were reliable partners.

Firms in the automobile industry took advantage of the fast development of the automobile industry in Spain since the 1960s. They became suppliers to the large North American and European automobile firms that opened plants in Spain and now decided to move to other markets, to continue to provide automobile supplies to their clients. They opened subsidiaries in Latin America, as well as in Eastern Europe. The firms in the chemical industry concentrate in the more developed countries.

The food and drink industry has been in Latin America for a long time, mainly through exports from Spain. Since the mid-1990s they decided to open production and distribution facilities in Latin America to develop a more aggressive strategy of growth.

Some firms in the tourist and construction industries can hardly qualify as SMEs, because some of them have grown considerably since the 1980s. Most of them, however, are still family businesses. Those in the hotel industry benefited from the large growth of tourism since the

1960s in the East and south of Spain. In the 1990s, they began developing new tourist infrastructure in Latin America and they began to promote some tourist destinations in Latin America and the Caribbean among European, North American and Latin American tourists.

Spanish construction firms are mainly involved in large public works, such as road construction and operation (toll roads), and construction of power plants (some are part of the process of modernization of infrastructure and construction of new power plants undertaken by the large Spanish energy firms, as well as the hotels built by the Spanish firms in the tourist industry).

Role of the Spanish Government in Promoting Spanish Firms

The Spanish government played an important part in the process of internationalization of Spanish firms, by setting a deregulatory legal framework between 1977 and 1992, and pushing several publicly–owned Spanish companies to make investments outside Spain. The first step was the reduction of the legal requirements that outward capital flows had to go through. Until the mid–1970s, Spain had strong control mechanisms over capital movements to prevent capital flight, and investments outside the country had to be approved by the Spanish Council of Ministers. Reforms were introduced in 1977, 1979, 1986 and 1992 to make Spanish legislation comply with the stipulations of the European Union, which made the notification of the FDI for statistical purposes the only requirement (with no need of approval).

The incorporation of Spain into the European Union in 1986 was a powerful stimulus for Spanish exports to the EU and for FDI in Spain (by companies from the EU as well as from outside it). Inward FDI in Spain increased by 1,433% between 1985 and 1995, from US$8,939 million to US$128,859 million, and turning Spain into the sixth home of FDI in the world.

In addition to the liberalization of financial flows, the strategy of the Spanish government comprised a reform of the tax system, a number of public funds to subsidize or finance Spanish FDIs, a system of public insurance to protect investments from the risks of the host country, and bilateral and multilateral treaties for protection of investments. A tax reform to prevent double taxation was implemented in 1990, in compliance with EU Directive 435. The Spanish legislature exempted Spanish firms from the payment of taxes on distributed dividends, and deducted from the tax payable in Spain the amount that their subsidiaries already paid in the host country, when this amount was lower than that stipulated by Spanish law.

The Spanish government made a total of US$754 million worth of credit for FDI available through the Instituto de Crédito Oficial (ICO), the Ministry of Trade and Tourism, the Instituto de Comercio Exterior (ICEX), and the Spanish Company of Finance for Development (COFIDES). The state–owned Compañía Española de Seguro de Crédito a la Exportación (CESCE), began insuring the FDI of Spanish companies in 1974. The ‘Bilateral Agreements for Reciprocal Promotion and Protection of Investments’ (BARPPIs) sought to create a positive investment climate between Spain and the host countries. Between 1990 and 1995, Spain subscribed a BARPPI with most Spanish speaking countries of the Western Hemisphere.

Since Spanish FDI in Latin America peaked in 1999, led by the seven large MNEs discussed above, the government focused on the promotion of FDIs by SMEs. In addition to publicizing all of the mechanisms discussed above among SMEs, the government created a new fund to provide credit for FDIs by SMEs only. ICEX began to play a more active role through a series of programs that targeted SMEs mainly. ICEX uses the Spanish trade offices around the world to publicize Spanish firms, for export or FDIs. They identify "target markets" (those with growth potential or those in which they believed Spanish firms had the potential to do well) and organize "business fairs". These fairs bring together representatives of Spanish SMEs. The goal is to familiarize them with the new markets and to try to facilitate contacts with local firms, in order to develop trade or investment links. Some of these fairs are restricted to a specific industry. Some fairs are open to firms in all industries.

ICEX also provides consulting services to small firms who do not have the resources to hire consultants in new markets. It organizes periodic courses, seminars and workshops in which experts (academics, consultants, civil servants, etc.) in legal, economic, political and cultural issues meet with potential investors to discuss the characteristics of specific host markets. ICEX also provides scholarships for young executives to participate in courses related to the internationalization of business.

Future Prospects for Spanish Foreign Direct Investment in Latin America

The first wave of large investments in Latin America for Spanish firms finished with the Argentinean crisis of 2001, opening a second wave or second generation of FDIs. The crisis caused great losses to the Spanish firms, leading many managers to realize that, in spite of similarities between the environments in which they operated in Spain and in Latin America, there were still great differences. The slowdown of the Latin American economies and the periodic crises, such as Argentina's, in part due to macroeconomic imbalances and to the failure to consolidate the structural reforms initiated in the early 1990s, made the managers of the Spanish firms more cautious. They reduced their investments in Latin America, concentrating in Europe and the United States. Since 2001, no more large takeovers took place. The large firms that made the largest investments consolidated their strategies by continuing to increase the efficiency of their subsidiaries, but they refused to takeover new firms.

Among the new entrants in the second generation of Spanish MNEs there are two types of firms. First, those that had business ties to the first movers by way of supplying inputs, and, second, firms that had no relationship to the early entrants. The firms in the first group decided to invest in Latin America to be able to supply products or services to the first generation Spanish MNEs in Latin America, as they did in Spain. Those in the second group were small and medium enterprises, with no relation to first generation Spanish MNEs, whose managers decided to invest in Latin America to expand their market. The motivation for these investments was similar to those of the first generation: the managers believed that their products and services were competitive and would find a new niche in the Latin American markets. They also believed that the similarity between their industries in Latin America and Spain made it easy to adjust to the new market.

This pattern is likely to continue in the years to come. However, if there are no crises in any of the largest Latin American economies, some of the largest Spanish MNEs may still try to take over other local firms to expand. Some of them have not entered the main markets, or have not developed a strong subsidiary in them. This is the case of BBVA in Brazil, Endesa in Mexico, Telefónica in Venezuela and Mexico, and Repsol-YPF in Brazil, Mexico and Venezuela, partly due to regulatory constraints. Therefore, the expansion of Spanish firms in these countries will depend on whether the governments modify the legal framework regulating the participation of foreign firms in these industries. This is the case of the oil industry in Mexico and Venezuela. The largest investments would be concentrated in the largest economies, mainly Brazil and Mexico and, to a lesser extent, Argentina, Chile and Venezuela.

The Spanish firms in Latin America (especially the banks) are also trying to attract FDI from other regions to Latin America, mainly from Europe and North America and since 2002, from Asia, mainly Japanese and, to a lesser extent, Chinese firms. The managers of Spanish firms believe they bring to the joint venture their knowledge of the Latin American markets and their relations with local business, and political, economic, and social actors, among others.

Implications for the Canadian Private Sector

Latin America offers great challenges and opportunities for the Canadian private sector. The main challenge is the recurrent periodic economic crises in many Latin American economies. The result of these crises in the past has been very negative for many Canadian firms, who lost a lot of money. As a result, many decided to leave. The magnitude of the losses was so great that few Canadian managers with experience in Latin America in the 1980s saw the bold structural reforms implemented by governments across the region in the 1990s as an opportunity. Rather, they decided to wait and see. Many US firms with similar experiences in Latin America took the same approach. As a result, their managers were astonished when they saw the magnitude of the investments made by Spanish firms, who found little competition from the "more conservative/cautious" North American and European firms.

However, with the exception of Argentina in 2001, the Latin American economies have grown since the early 1990s. Sustained growth is one of the biggest opportunities for Canadian firms. The other one is the opportunity to supply their products and services in markets where competition is low and growth potential is high. This has been perhaps the main strategic success of the Spanish firms: early entrants found little local competition in growing industries.

There are several issues that need to be addressed to promote Canadian FDI in Latin America. The potential investors need to study the recent macroeconomic history of the Latin American economies. They will realize that the conditions today are very different from those that led to the crises of the 1990s. Macroeconomic indicators today are better. They also need to review the legal reforms introduced, in order to redefine the relationship between the state institutions and the private sector. Finally, they also need to review the new legal framework to protect foreign investors. Foreign investments receive most-favored-nation status and, in case of expropriation, there are institutional guarantees for compensation. While there is public animosity among some sectors of the Latin American population against US and Spanish firms (both of them accused of neo-imperialism), the perception of Canadians in Latin America is very positive.

Canadian telecommunications operators face a difficult scenario in Latin America. Early entrants were given a period of monopoly and developed a broad network. The start-up costs for new entrants will be very high because they will have to develop their own infrastructure from scratch. Latin American governments are likely to encourage competition by forcing the incumbents to let new entrants use their infrastructure, but the latter will have to pay for the use of their network. However, Latin American governments intend to introduce more competition to force prices down. This may give new entrants bargaining power to extract a favorable regulatory framework.

The strategy of Spanish firms in the food and drink industry is to take advantage of some of the cultural and culinary similarities between Spain and Latin America. From this perspective, Spanish and Canadian firms may not necessarily be competing in the same sectors. Canadian firms face stiff competition from Spanish firms in the construction and hospitality industries. These “new entrants” have begun aggressive expansion strategies not only in Latin America, but also in North America. Spanish construction firms are building power plants and transportation infrastructure, mainly roads and airports. They take advantage of their connections with the Spanish energy MNEs, developed in Spain. The presence of Canadian firms in the Latin American energy markets is particularly important, since many of the Spanish firms in this industry, especially those developing oil and natural gas fields, will begin to supply larger amounts of oil and natural gas to the United States, and maybe Canada. Some of these Spanish firms have developed joint ventures with US firms and/or Latin American state-owned hydrocarbons firms in the Trinidad and Tobago, Venezuela, and Brazil.

Canadian banks and financial firms have traditionally played a prominent role in Latin America. The Royal Bank of Canada and the Bank of Nova Scotia, for instance, developed large ventures in Latin America and the Caribbean at different times in the twentieth century. The Spanish banks began an aggressive strategy in the early 1990s in many areas, including retail banking, as well as wholesale banking, pension funds, mutual funds, insurance, mortgage, etc. Canadian banks and financial firms would have to make huge investments to be able to compete in retail banking. However, as economic conditions remain stable, they can be prominent players in wholesale banking.

Finally, Canadian firms will have a hard time competing with Spanish firms in some areas in which language creates important market barriers. This is the case of the publishing industry. Since the 1980s, Spanish firms have become the strongest players in this industry in the Spanish-speaking world, taking over from the traditional Argentinean and Mexican leaders. However, many European firms and some North American firms have expanded in Latin America through a Spanish subsidiary. This might also be a reasonable strategy for Canadian firms, in these industries. The growing prominence of the computer and software industry in the share of Spanish FDI in Latin America is in pat due to language and cultural barriers. Several European and North American firms channel their Latin American strategies through a Spanish subsidiary. Canadian firms may also pursue this strategy directly through a subsidiary in a Latin American.

About the Author

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Analyses investment origin and destination patterns, as well as the impacts of investment on economic performance.Â This ECLAC annual report sets out and analyses the main foreign direct investment (FDI) trends in the countries of Latin America and the Caribbean. In the region, FDI inflows were up (by 13.2%) year on year for the first time in five years, at US$ 184.287 billion. This performance is explained by higher flows into just a few countries, however, mainly Brazil and Mexico.