# One Step Forward, Two Steps Back

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With some exceptions, foreign investment has fallen far short of stimulating broad-based economic growth and environmental protection in Latin America, according to a report by the Working Group on Development and Environment in the Americas.

The report recommended that national and regional policies aimed at improving national firms' capabilities should be implemented and that the "policy space" for such policies should be accommodated in bilateral, regional, and global trade and investment treaties.

The report, "Foreign Investment and Sustainable Development: Lessons from the Americas," is the product of a series of studies conducted by development and environmental economists from the US, Mexico, Brazil, Argentina, Chile, and Costa Rica.

Drawing on case studies from across the region - Argentina, Brazil, Bolivia, Chile, Costa Rica, Ecuador, Mexico, Uruguay, and Venezuela - the Working Group examined how foreign investment during the reform period has affected economic growth, environmental policy and performance, and the political economy of countries.

The Working Group on Development and Environment in the Americas brings together economic researchers from several countries in the Americas, who have carried out empirical studies of the social and environmental impacts of economic liberalization.

Its co-chair Prof Kevin P Gallagher, Assistant Professor of international relations at Boston University said: "The story of foreign investment in Latin America has been one step forward two steps back. A handful of countries in the region were able to attract unprecedented amounts of FDI, but it wiped out local firms and accentuated environmental degradation as well."

According to the Working Group's report, beginning in the early 1990s, nations in the Americas began to liberalize their regimes for foreign investment. Pursued unilaterally or through regional and bilateral trade and/or investment agreements, a typical set of reforms included the elimination of performance require-ments such as requirements to source from domestic firms or to export a certain percentage of production, restrictions on the ability to exclude certain sectors from FDI and to "screen" foreign investment for development goals, and restrictions on the ability to require joint ventures or research and development facilities.

These policies were advocated by the US, the World Bank, and the International Monetary Fund and endorsed enthusiastically by many governments across the Americas.

They have become enshrined in the 1994 North American Free Trade Agreement (NAFTA) between the US, Canada, and Mexico and became the template for a range of subsequent regional and bilateral accords, including agreements on the US-Chile Free Trade Agreement, US-Dominican Republic-Central America Free Trade Agreement (CAFTA), the US-Peru Free Trade Agreement, and countless numbers of Bilateral Investment Treaties (BITS).

"Investment liberalization of course, has been part of a larger effort broadly referred to as the Washington Consensus," said the report.

The broader reforms include a package of economic policies that promote economic development by opening national economies to global market forces. Over the last twenty years, Latin American countries have reduced tariffs and subsidies, eliminated barriers to foreign investment, restored fiscal discipline by reducing government spending, and have generally reduced the role of the state in all aspects of the economy.

The promise, among others, of following these policies is that FDI by multinational corporations will flow to and be a source of dynamic growth in host countries. Beyond boosting income and employment, the hope was that manufacturing FDI would bring knowledge spillovers that would build the skill and technological capacities of local firms, catalysing broad-based economic growth; and environmental spillovers that would mitigate the domestic ecological impacts of industrial transformation, said the report.

However, most of these promises did not materialize. Economic growth rates for the region have been less than 2% since 1990, the period of the reforms, lower than in the last decades of the import substitution period.

"A major finding is that slow growth is in part explained by the fact that FDI failed to crowd in more total investment into Latin American economies," said the report.

Among the main findings of the report are:

— FDI was concentrated in a small handful of countries in the region. Indeed, Brazil, Mexico, Argentina, Chile and Venezuela received more than 80% of all the FDI in the region;

— Foreign firms by-and-large located in Mexico and the Caribbean tended to serve as export platforms to the United States, whereas those located in South America did so to sell to domestic markets in that region;

— FDI was attracted by traditional determinants, not necessarily whether a nation has a regional or bilateral trade and/or investment treaty or if it can serve as a pollution haven for foreign firms;

— When FDI did come, foreign firms tend to have higher levels of productivity and higher wages and were likely to increase trade in the region; yet FDI fell far short of generating "spillovers" and backward linkages that help countries develop, and in many cases wiped out locally competing firms thereby "crowding out" domestic investment;

— The environmental performance of foreign firms was mixed, sometimes leading to upgrading of environmental performance, and in others performing the same or worse than domestic counterparts.

The Working Group studies documented and analysed the track record in specific countries and sectors.

In Brazil, Argentina, Mexico and Costa Rica, it was found that foreign firms have higher wages, productivity and trade vis-a-vis domestic firms; linkages with national firms and the domestic economy in general are weak, especially in Mexico and Costa Rica; although foreign firms may bring the technologies generated in their headquarters, they do not contribute to an increase in R&D expenditures in the host economies.

Moreover, in Brazil, Mexico, Chile, and Argentina:.

— Virtually all foreign firms transferred environmental management systems to host countries; however, it is not clear that such firms were actually in

compliance with host country laws and in Brazil there is little indication that foreign firms were more likely to be in compliance than domestic firms were;

— There it little evidence that foreign firms are greening their supply chains (given that so many supply chains were wiped out from FDI in the first place);

— In some instances such as the forestry sector in Chile, foreign firms that exported through fair trade certification schemes were "upgrading" to higher levels of environmental standards; and in others, such as in Mexico's electronics sector, foreign firms were not exporting to meet strong standards in Europe given that their chief export market, the United States, does not have such standards.

The Working Group, in agreement with the broader literature on the subject, found that investment regime liberalization-led FDI has had at best a limited success in Latin American countries.

The report said that it comes as no surprise to find that virtually all newly elected governments in Latin America are rethinking the role of FDI in their economies. "While some countries are simply at the stage of starting to debate the issue, others are going so far as to nationalize foreign firms. Yet, most governments are looking for a more balanced approach."

The Working Group argued that what the report makes clear is that new policies are needed and highlighted a number of principles that could be adopted for policy-making:

1. FDI is not an end but a means to sustainable development. Simply attracting FDI is not enough to generate economic growth in an environmentally sustainable manner.
2. FDI policy needs to be conducted in parallel with significant and targeted domestic policies that upgrade the capabilities of national firms and provide a benchmark of environmental protection.
3. International agreements, whether at the WTO or at the level of regional or bilateral trade and/or investment treaties need to leave developing nations the "policy space" to pursue the domestic policies necessary to foster sustainable development through FDI. □□□

*—Third World Network Features*