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# Latin America: Trends in Foreign Direct Investment

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An Intelligence Assessment

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# Latin America: Trends in Foreign Direct Investment



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**An Intelligence Assessment**

This paper was prepared by  Office of  
African and Latin American Analysis. It was  
coordinated with the Directorate of Operations. 

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**Latin America: Trends  
in Foreign Direct  
Investment** [redacted]

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**Key Judgments**

*Information available  
as of 5 January 1988  
was used in this report.*

Many Latin American leaders seek to reverse the recession in foreign direct investment of the mid-1980s, but progress almost surely will be slow and insufficient to offer regional debtors substantial financial relief. Annual inflows of investment have fallen to about 40 percent of their 1981 peak level precisely when they have been especially needed to help offset dwindling commercial bank loans. Although there were numerous contributing causes of the decline, the primary factors were a regionwide economic recession and deficient economic management on the part of Latin American governments. [redacted]

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Numerous governments in the region have taken some modest steps in the past year or two to make their investment environments more appealing to foreign business. These steps include easing regulatory restraints, cutting bureaucratic redtape, and even implementing small amounts of economic reform, such as trimming the public sector. Also, technocrats have devised imaginative financial schemes, such as debt-for-equity swaps, as catalysts for increased investment flows. For the most part, nevertheless, these actions have been limited in scope and have not constituted dramatic policy changes. [redacted]

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The beginnings of a rebound for foreign investment flows was evident in 1987, and we foresee the development of conditions that should sustain a gradual recovery through the early 1990s. An expected moderate revival of Latin America's economies will be likely to increase the region's attractiveness to foreign investors. In addition, Latin American governments, caught between domestic political pressures to boost economic growth and the constraints caused by scarce foreign capital resources, probably will maintain their efforts—within the bounds of preserving national proprietary interests—to attract more foreign investment. [redacted]

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On balance, we believe Latin American countries collectively may increase their annual foreign investment receipts by the early 1990s to as much as double the 1986 level, but will not likely do appreciably better. Longstanding sensitivities against foreign economic domination probably will prevent dramatic improvements of the policy climate conducive to sharp surges of investment. Regional annual inflows of \$6 billion—roughly double the 1986 dollar amount—would fall substantially short of the 1981 level in nominal terms and probably only one-half that year's total in real terms. [redacted]

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There is also a considerable chance, however, that the economic and political climate for foreign investment in the region could suffer renewed setbacks, restraining foreign investment flows over the medium term at current depressed levels. For example, continued turbulence on global stock markets could have a dampening impact on Latin American economic growth. Upcoming changes in government leadership in some major Latin American countries could bring in their train more nationalistic shifts in policy. 

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A doubling of foreign investment flows by the early 1990s would help Latin American debtors meet their continuing large needs for foreign financing, but even that amount would not significantly ease their debt problems. Most major Latin American debtors would continue to be in the position of having either to obtain sizable amounts of new commercial loans or to depress further their imports of goods and services. A stagnation of foreign direct investment simply would intensify the precariousness of these countries' financial positions. 

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**Latin America: Trends  
in Foreign Direct  
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**Scope Note**

This paper is the first look by the Directorate of Intelligence at the potential for foreign direct investment to again become—as it was before the early 1970s—a major source of funds for capital-starved Latin America.



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This paper examines the effects of various foreign and domestically driven variables on recent foreign investment trends and assesses the likelihood that changing government attitudes and other factors will affect the investment climate in the region.



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## Latin America: Trends in Foreign Direct Investment



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### Introduction

Numerous academic studies have noted that the potential importance of foreign direct investment to Latin America is greater now than ever because of the effects of the debt crisis in hobbling the region's economies.<sup>1</sup> Investment could become a major source of foreign finance at a time when most Latin countries are hard pressed to expand their export earnings and international commercial bank lending to the region is diminishing. Moreover, unlike commercial lending, nearly all direct investment is accompanied by capital goods imports, transfers of technology, and managerial know-how. Although foreign direct investment in Latin America remains considerably depressed from levels recorded in 1981, there is a growing recognition of the potentially large payoffs from foreign investment on the part of Latin American governments, some of whom have taken practical steps to encourage increased equity inflows.

This paper analyzes the decline in foreign direct investment after 1981, assessing the principal elements underlying the deterioration of the investment climate as well as the costs associated with the investment slide. It then examines the recent signs of a positive shift in attitudes among regional governments toward foreign investment and the tentative liberalization of some investment controls, and weighs the impact that evolving government initiatives will have on the investment outlook for the region. Finally, it addresses the likely effects of prospective foreign investment developments on the Latin American debt problem.

### Hitting the Skids in the 1980s

Direct investment flows to Latin America peaked in 1981 at \$7.5 billion, following a prolonged period of steady and often rapid growth. Foreign investors were

<sup>1</sup> For purposes of this paper, the term "Latin America" encompasses all of the independent countries of the Caribbean Basin—including those that are non-Latin-language speaking nations—as well as the countries of South and Central America.

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### Foreign Direct Investment: An Attractive Alternative for Latin America's Debtors

*Although foreign direct investment traditionally has offered Latin American countries significant benefits in the form of transfer of capital, technology, management, and marketing skills, its advantages are strengthened considerably as a result of the regional debt crisis. Aside from the potentially much greater volume of funds it makes available, financial experts point out that foreign direct investment has a number of comparative advantages over commercial loans:*

- It does not add to the debtor country's often already huge foreign debt and interest burdens.
- It is used much more often than commercial loans to expand debtor countries' productive capacity.
- It is provided for much longer periods of time than conventional bank loans.
- It generates income payments that depend on the investment's commercial success and, therefore, correlate more closely with debtor countries' abilities to pay.

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attracted to the region by its abundant natural resources, large market, and relatively cheap labor.

Even in the 1970s, investment flows rose in US dollar terms at an 18-percent annual average rate despite:

- Tightened controls by a number of Latin American governments who increasingly feared that foreign enterprises would dominate local business activity, exploit natural resources, and intrude in local politics.
- A shift by Latin American governments to commercial loans as a source of foreign capital—because of their lower cost and no-strings-attached status

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**Table 1**  
**Latin America: Foreign Direct Investment Flows**

Million US \$

	1970		1973		1975		1978		1981		1984		1986	
	FDI	GDP (percent)	FDI	GDP (percent)	FDI	GDP (percent)	FDI	GDP (percent)	FDI	GDP (percent)	FDI	GDP (percent)	FDI	GDP (percent)
<b>Total</b>	<b>1,094</b>	<b>0.85</b>	<b>2,292</b>	<b>1.00</b>	<b>3,287</b>	<b>1.05</b>	<b>3,917</b>	<b>0.97</b>	<b>7,513</b>	<b>1.19</b>	<b>3,253</b>	<b>0.49</b>	<b>3,100<sup>a</sup></b>	<b>0.37</b>
Argentina	11	0.05	10	0.03	0	0.00	273	0.55	944	1.60	268	0.43	574	0.75
Bolivia	-76	NA	5	0.36	53	2.55	12	0.45	76	2.09	7	0.13	25	0.40
Brazil	407	1.21	1,341	1.86	1,190	1.10	1,882	1.28	2,313	1.03	1,556	0.70	350	0.15
Chile	-79	NA	-5	NA	50	0.41	177	1.04	362	1.64	67	0.31	184	0.65
Colombia	39	0.59	23	0.24	35	0.25	68	0.37	228	0.80	561	1.75	673	1.75
Costa Rica	26	2.93	38	2.68	69	3.50	47	1.73	66	1.73	52	1.23	62	1.25
Dominican Republic	72	5.33	35	1.35	51	1.34	64	1.46	80	1.17	69	0.88	50	0.60
El Salvador	4	0.40	52	3.23	13	0.56	23	0.74	-6	NA	12	0.33	NA	NA
Ecuador	89	4.97	6	0.25	95	2.51	49	1.01	60	0.59	50	0.45	70	0.55
Guatemala	29	1.68	35	1.05	80	1.68	127	1.92	127	1.29	38	0.39	65	1.65
Haiti	3	0.65	7	1.10	3	0.36	10	0.87	8	0.49	5	0.29	5	0.25
Honduras	8	1.19	7	0.71	7	0.54	13	0.71	-4	NA	21	0.69	30	0.55
Jamaica	161	14.50	75	3.40	-2	NA	-27	NA	-12	NA	12	0.29	NA	NA
Mexico	323	1.02	457	1.08	609	1.00	824	1.06	2,537	1.54	390	0.22	905	0.50
Panama	33	3.33	36	2.19	8	0.36	0	0.00	6	0.15	103	2.20	-4	NEGL
Paraguay	4	0.69	9	1.03	14	1.11	20	1.05	32	0.70	5	0.08	31	0.45
Peru	-70	NA	70	0.83	316	2.25	25	0.15	125	0.62	-89	NA	22	0.10
Trinidad and Tobago	83	8.20	66	5.77	203	14.79	129	6.15	258	7.68	111	3.32	-22	NEGL
Uruguay	0	0.00	0	0.00	0	0.00	129	2.88	49	0.70	3	0.05	-5	NEGL
Venezuela	-23	NA	-85	NA	418	1.83	67	0.21	184	0.43	42	0.10	16	0.05
Other	50	2.00	110	8.00	75	3.00	5	0.20	80	2.00	-30	NA	NA	NA

<sup>a</sup> Estimate—complete data not available.

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compared with equity funds—after petrodollars began flooding world financial markets in the mid-1970s.

Even though direct investment declined as a share of foreign private capital inflows from more than 50 percent in 1970 to about 25 percent in the early 1980s, it maintained a relatively stable 1-percent ratio to total Latin American GDP and continued to make significant contributions to Latin America's economic development. [redacted]

After 1981, Latin America's receipts of foreign equity capital slumped badly as the climate for investment deteriorated. Although foreign direct investment to all the Third World stagnated, Latin America's share had fallen from more than 50 percent to about 40 percent in 1986, [redacted] Financial press reports indicate that a growing number of multinational companies have claimed substantial declines in profitability and have curtailed or closed their operations in Latin America. As a result, annual net flows of foreign direct investment to Latin America during the period 1982-86 fell to slightly more, than 40 percent of the amount recorded in 1981. The \$3 billion registered in 1986 was a mere 0.4 percent of regional GDP, the smallest such ratio in several decades. [redacted]

Although direct investment has been down across the board, the region's largest economies suffered the heaviest declines. Mexican and Brazilian annual receipts fell \$1.6-2 billion between 1981 and 1986, while Argentina suffered a drop of \$400 million. The US Embassy in Mexico City notes that foreign investors cut back their business activities in Mexico substantially after 1982 because of what they viewed as a worsening business climate. According to these reports, a number of major US firms liquidated their affiliates in Mexico as a result of their growing inability to sustain profitable operations. Press and US Embassy reporting has described an even more serious crisis of confidence on the part of foreign investors in Brazil. In 1986, Brazil's foreign direct investment receipts not only were the smallest in nominal terms since 1970, but also were exceeded for the first time by outflows of profit and dividend remittances. [redacted]

**Factors Behind the Poor Investment Climate**

[redacted] numerous causes of Latin America's worsened investment climate after 1981—including restrictive regulations, violence and security concerns, labor problems, and sagging world commodity prices. On the basis of extensive evidence, however, we believe the principal explanations for souring foreign investor attitudes and the plummeting investment flows during 1983-86 can be boiled down to the following two factors—debt and recession, and government policies. [redacted]

**Debt and Recession**

The contraction of international commercial lending to Latin America coupled with the region's rising interest payments and falling primary product export prices contributed substantially to the decline in new investment, especially during the years immediately following the outbreak of the debt crisis in 1982. As recounted in numerous US embassy reports, many governments in the region reacted to their weakening external payments and liquidity positions by suppressing domestic demand and slashing imports. Since much of Latin America's foreign equity investment has been directed toward manufacturing for large and protected domestic markets, the dampened consumer demand discouraged foreign businessmen and caused them to look for better opportunities elsewhere. Indeed, one year after Mexico and Brazil experienced their largest annual post-World War II economic declines, each suffered a precipitate drop in equity inflows. Inflows of foreign equity, however, generally did not rebound with the Latin American economic recoveries since 1984, but rather stabilized in a range of \$3-4 billion for the region as a whole. [redacted]

The reduced availability of commercial loans also had other less evident—and probably less powerful—effects on Latin America's foreign investment receipts. Because multinational affiliates had relied to a significant extent on foreign bank funds to expand their activities in Latin America, [redacted] the curtailment of commercial lending probably led some foreign firms to trim their

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**Brazil and Mexico: Key Players**

*Mexico and Brazil, traditionally the two largest beneficiaries of foreign direct investment in Latin America, also have felt most acutely the overall decline of equity flows to the region and almost certainly will remain the trend setters. For example, the two countries, which together have received more than 60 percent of the region's investment since 1980, alone accounted for more than 80 percent, or \$3.6 million, of the \$4.4 million drop in Latin America's foreign direct investment receipts between 1981 and 1986. We believe that Mexico has begun to recover somewhat from its foreign investment slump, but we cannot judge whether Brazil's decline is yet bottoming out.* [redacted]

*The de la Madrid administration has gradually overcome the impact of the nationalistic actions taken near the end of the previous administration. Inflows of foreign equity had risen steadily for several decades until the early 1980s despite longstanding Mexican misgivings about foreign-owned economic activities and increasing government controls over them. The most significant restrictions were imposed in the mid-1970s, according to the US Embassy in Mexico City, and include foreign ownership limits of 49 percent—except in special instances of national interest—and government guidelines for foreign technology transfers. It was not until 1982 that Mexico's receipts of foreign direct investment began to plummet, however, because of the discouraging signal President Lopez Portillo sent to potential investors by nationalizing the country's commercial banks and*

*because of the onset of financial difficulties and a deep recession. Despite the continued poor state of the Mexican economy, the de la Madrid administration already has managed to stimulate some resurgence of equity inflows mainly by instituting an attractive debt-for-equity swap program and expanding the maquiladora border industries.* [redacted]

*In Brazil, President Sarney has been worried about the foreign investment decline, but his administration has so far been unable to reverse it. Over the past two years, a number of multinational companies either have pulled up stakes or curtailed their investments in Brazil, citing erratic government policies, price controls, import restrictions, and threats of an expanded market reserve policy. Major foreign auto makers, for example, have responded to increasingly unprofitable operations in the Brazilian market by deferring sizable amounts of scheduled investment. For example, the US Embassy in Brasilia has reported that an important aspect of the heralded 1986 agreement between Volkswagen and Ford for a joint venture known as "Autolatina" in both Brazil and Argentina is the strengthening of both firms' competitiveness by better utilizing existing plant facilities and thus avoiding the need for large new investments. Foreign firms may begin to rebuild their investment operations in Brazil in 1988 provided the Constituent Assembly does not incorporate major additional restrictions in the new constitution and an eventual new government gains control of an unraveling economy.* [redacted]

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operations. In addition, some foreign businessmen have made the case that general liquidity problems have reinforced Latin inclinations to maintain rigorous profit remittance restrictions. [redacted]

**Economic Management**

Reports from US embassies [redacted] have indicated that growing anxiety among many foreign businessmen regarding what they view as poor Latin

American economic management also has been largely responsible for the drop in direct investment flows, especially since 1984. Businessmen claim that weak fiscal, monetary, and foreign exchange policies have fed large external payments deficits and high domestic inflation, both of which severely jeopardize the profitability of foreign business activities. They also

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**Central America and the Caribbean:  
The Small Players**

*Flows of foreign direct investment to the Central American and Caribbean region plummeted sharply in the aggregate after 1981, although the trend principally reflected the experience of Trinidad and Tobago. Largely as a result of the decline in petroleum prices in the mid-1980s, international oil companies cut their investments in Trinidad and Tobago's petroleum sector to the bone.*

*Most other countries of Central America and the Caribbean saw their direct investment receipts either hold at fairly constant levels or show some backsliding in the 1980s as a result of insurgencies, political turmoil, depressed growth, and acute financial difficulties. Government policies encouraging foreign investment have helped some countries considerably, notably Costa Rica and the Dominican Republic. Furthermore, the Caribbean Basin Initiative (CBI)—a US program of trade and tax concessions designed to help 27 Caribbean and Central American countries expand employment and raise living standards—has attracted the attention of many investors to the region. The program's centerpiece consists of 12-year, duty-free access to US markets for a wide range of agricultural and manufactured goods.*

*Substantially rising inflows of direct investment will not materialize in the region until political violence and insurgency subside, primary commodity prices show a stronger recovery, or more progress is made in economic diversification and reform. Dependence on earnings from primary product exports like sugar, bauxite, bananas, and coffee is still widespread.*

cite excessive reliance on import controls and price controls as having badly hampered their operations and squeezed profits in some instances.

The economic policy environment, in our judgment, has been especially difficult in those countries that have returned to civilian government in the early-to-

**Table 2**  
**Latin America: Real GDP Annual Growth**

Percent

	Latin America	Argentina	Brazil	Colombia	Mexico
1970-79	6.0				
1980	5.7	1.5	7.9	4.3	8.3
1981	1.3	-5.9	-1.9	2.3	7.9
1982	-0.8	-5.1	0.9	0.9	-0.5
1983	-3.1	3.4	-3.2	1.0	-5.3
1984	3.2	2.4	4.5	3.2	3.7
1985	3.5	-4.4	8.3	2.8	2.8
1986	3.7	5.4	8.2	5.1	-3.8
1987 <sup>a</sup>	2.3	1.5	2.5	4.5	1.5
1988-91 <sup>b</sup>	3.0				

<sup>a</sup> CIA estimate.

<sup>b</sup> Projected.

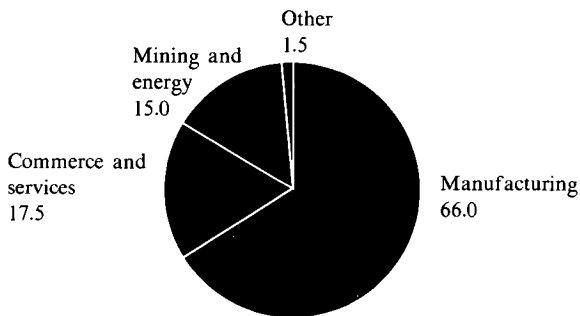
mid-1980s, including Argentina, Brazil, Guatemala, Honduras, Peru, and Uruguay. To varying degrees, the new civilian leaders have depended on expansionary fiscal and monetary policies and rigorous price controls to strengthen their domestic political positions and, accordingly, have aroused considerable foreign business uncertainty. Efforts to avoid growth-limiting austerity measures when at all possible have led most of these governments to pay insufficient attention to needed economic reforms, such as streamlining the public sector, broadening capital markets, and liberalizing trade regimes. For example, the US Consulate in Sao Paulo repeatedly noted last year that the major causes of the continuing decline in foreign investment in Brazil are uncertainty regarding the Sarney administration's vacillating economic policies, rising labor costs, and government price freezes.

Regulatory policies aimed specifically at limiting and guiding new foreign investment continued to have a restraining effect on investment receipts, although they probably did not play an appreciable role in the

**Figure 1**  
**Cumulative Foreign Direct Investment**  
**by Sector, Yearend 1985<sup>a</sup>**

Percent

Total=50 billion US \$



<sup>a</sup> Based on official statistics for Brazil, Chile, Colombia, and Mexico, which collectively accounted for more than 75 percent of Latin America's total receipts of foreign direct investment.

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*decline* of these flows after 1981.<sup>2</sup> Financial counselors explain that many of these regulations have been on the books for years, running the gamut from entry limitations, including the exclusion of foreign investment from certain economic sectors; through performance requirements, such as tying special tax incentives to the fulfillment of particular ownership or export conditions; to restrictions on remittances that affect the amounts of dividends, royalties, or fees that a foreign firm may repatriate. For example, the Andean Pact's Decision 24 has since the early 1970s generally excluded foreign investment from selective areas reserved for national enterprises and established procedures in many others for gradually transferring at least 51 percent of the ownership to national investors.<sup>3</sup> In Brazil and Mexico, restrictive controls as noted in the inset, have long hindered direct investment flows.

<sup>2</sup> See appendix for a country survey of Latin America's foreign investment regulatory controls.

<sup>3</sup> The Andean Pact is a subregional economic integration organization—including Bolivia, Colombia, Ecuador, Peru, and Venezuela—established in 1970 to promote economic and trade cooperation and development.

**Table 3** Percent  
**Latin America: Gross Domestic Investment**  
**as Percent of GDP, 1980-85**

	1980	1983	1986
Argentina	23	15	12
Brazil	27	22	16
Chile	24	9	15
Colombia	20	22	18
Costa Rica	28	19	23
Dominican Republic	25	19	21
Ecuador	27	17	17
Guatemala	11	9	8
Mexico	27	20	18
Panama	24	18	14
Peru	17	15	12
Uruguay	19	11	8
Venezuela	29	17	20

**The Impact on Domestic Economies**

An annual contraction of foreign equity flows of some \$4.5 billion on top of a more than \$20 billion decline in yearly commercial borrowings from 1981 to 1986 ravaged Latin America's balance of payments and further constrained the region's capacity to import. Moreover, government efforts to boost exports substantially to strengthen their depleted liquidity positions often failed, and regional export earnings have remained fairly constant because of weak demand in industrialized countries and sagging commodity prices. As a result, the Latin American countries in the aggregate were forced to slash their imports—including substantial amounts of US-origin capital equipment and raw materials that were crucial to sustain industrial growth—from \$105 billion in 1981 to some \$65 billion annually during 1983-86. A number of countries—including South America's Southern Cone countries of Argentina, Chile, and Uruguay—cut their import bills by one-half or more. Meanwhile, regional governments drew down \$12 billion, or about one-third, of their international reserves between 1981 and 1986.

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The slide in the inflows of foreign equity has also been a significant contributor to the region's total investment decline in the 1980s, according to Latin American economists. Domestic saving rates in the Latin American countries generally have not risen to offset the fall in the inflow of investment from abroad and in most instances have declined. Faced with diminished foreign capital receipts, governments generally have preferred to safeguard the wage and other current spending components of their budgets and to place a disproportionate amount of the adjustment burden on reduced public investments. [redacted] many of the same countries that experienced the largest reductions in new foreign investment—including Argentina, Brazil, Chile, Mexico, and Uruguay—also suffered the sharpest declines in total domestic investment (see table 3). As the share of domestic investment in GDP has slipped, the task of sustaining growth has become more difficult for regional governments. [redacted]

**Raising the Appeal of Foreign Investment**

A number of Latin Americans have come to recognize the harmful impact on their economies of dwindling foreign investment and the potential benefits to be gained in restoring these equity inflows. Accordingly, there have been several encouraging signs in the past year or two that a more favorable climate for foreign direct investment may be taking shape in Latin America. Notably, government attitudes have become more receptive to increased foreign equity, and technocrats have devised increasingly innovative financial and investment schemes. Conditions could change down the road, however, to reverse this trend. [redacted]

**Easing Government Restraints**

Government leaders in a number of Latin American countries—including Argentina, Colombia, Ecuador, Guatemala, Jamaica, and Mexico—recently have put more emphasis on the private sector and market incentives than did their predecessors. These leaders have publicly asserted, according to press and US embassy sources, that greater flows of foreign private investment are desirable, especially in light of the declining prospects of gaining large amounts of new

commercial money. A growing number of Latin Americans are admitting that, contrary to the old shibboleth that direct investment concedes an unacceptable degree of foreign control, equity flows actually involve less foreign intervention than commercial loans because of the rigorous austerity programs required to obtain the latter. [redacted]

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Many Latin American governments, including some of the larger recipients of foreign direct investment, took tentative steps in 1986 or 1987 to make the investment environment more appealing to foreign business. For example, Mexico's de la Madrid administration issued two new resolutions waiving at times legal requirements that foreign businesses limit their investment in Mexican enterprises to 49-percent ownership, and has simplified the administrative procedures for approval of foreign investment proposals. The extent to which Mexico's next president will choose to carry on these policies after de la Madrid steps down in December 1988 is uncertain. Also in 1987, Argentina's President Alfonsin signed a law opening up to foreign investors potentially productive petroleum-bearing onshore tracts previously reserved to the Argentine national oil company. Buenos Aires later authorized foreign companies to remit profits and dividends at substantially more advantageous exchange rates than previously. [redacted]

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The Andean countries have made some of the most significant strides to ease controls over foreign-owned businesses:

- Bogota has opened up almost all sectors of Colombia's economy—including the financial sector—to majority foreign ownership and has authorized 100-percent, foreign-owned companies in many instances.
- Ecuador's President Febres-Cordero has reopened the mining, petroleum, and other sectors to foreign business activity, eased requirements to transfer ownership to local interests, and facilitated profit repatriation.

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- The Venezuelan Government liberalized its foreign investment legislation by relaxing requirements that foreign firms divest to minority positions, increasing allowable profit remittances, and reducing bureaucratic impediments to foreign investment tenders.

In light of these individual moves, the five members of the Andean Pact approved in early 1987 a major reform of the Decision 24 restrictions against foreign investment. As a result, according to US embassy reporting, the number of foreign companies required to transfer majority ownership to local companies has been reduced substantially and those foreign companies still subjected to the transfer requirement are given considerably more time to do so. Most important, individual governments are now allowed to set their own rules governing the entry of foreign investment and the amount of profit foreign businesses can remit abroad. [redacted]

For its part, the Sarney government in Brazil, unhappy with the recent drop in investment inflows, has been working on a plan to attract more foreign investment through increased inducements. According to the press, the plan would include the establishment of tariff- and regulation-free export zones, tax breaks for some investors, and a reform of bureaucratic procedures for reviewing investment applications. Enactment of the plan is uncertain, however, as it will still depend on the blessing of the Constituent Assembly. Many of the more nationalistic members of the assembly not only oppose liberalization measures but are also urging the incorporation of tighter restraints on investment in the new constitution they are helping to draft. [redacted]

US embassy and financial press sources also note some improvement of the regulatory environment among the region's smaller countries. In the Central American isthmus, the Governments of Costa Rica and Guatemala are attempting to entice more foreign investment through favorable regulatory treatment. Inspired by the Caribbean Basin Initiative, the Dominican Republic and Jamaica are relaxing their investment restrictions and are offering tax and tariff concessions to encourage greater foreign business activity in those island economies. [redacted]

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### ***Foreign Direct Investment—An Emotionally Charged Issue***

*Despite the emergence of a new generation of Latin American leaders more sympathetic to foreign direct investment, strong nationalistic sentiment continues to thrive throughout much of the region and to find expression through various influential interest groups. Often these groups—including politicians and technocrats, industrial elites, and labor groups—are well positioned and carry sufficient clout to combat and weaken policy initiatives they deem harmful. For example, the US Embassy in Mexico City notes that a number of officials in the Mexican Government frown on foreign investment and are dragging their feet in processing applications, despite the campaign of President de la Madrid's administration to accelerate foreign investment flows. Nationalistic elements in the Brazilian governing party, the PMDB, are also resisting President Sarney's efforts to invite more equity capital from abroad, according to the US Embassy in Brasilia. Even in Quito, where the Febres-Cordero government has been especially aggressive in its quest for expanded inflows of equity, many influential Ecuadoreans are proponents of state-led economic development and oppose liberalized private-sector investment policies.* [redacted]

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### **Evolving Financial Schemes**

Latin American governments, in cooperation with foreign banks and businessmen, have begun to devise imaginative financial schemes designed to encourage increased foreign investment while providing some relief from the countries' onerous debt burdens. By far the most prominent of these are the so-called *debt for equity swaps* (see inset). A leading Latin American economic news service estimates that swap transactions in the region probably amounted to \$2-2.5 billion in 1987. Although neither debtor governments nor foreign private investors can judge accurately how much the investment generated by the swap schemes adds to direct investment totals, they agree that a substantial part of it represents new investment financing. As US investment counselors have pointed

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out, purchasing bank debt at a discount makes otherwise marginal investments in many countries reasonably attractive to foreign businesses. [redacted]

Chile and Mexico have been implementing debt swap programs for more than 18 months, and each has already converted more than \$1.5 billion in equity. Chile's program has become the most successful in the region because of its clear-cut rules and minimal conditions for foreign investor eligibility. In roughly two and one-half years, Chile's swap transactions have trimmed 8 to 10 percent from the country's \$20 billion medium- and long-term foreign debt. About one-third of the dollar value of the swaps has generated new foreign investment, while the rest involved Chilean nationals. [redacted]

Mexico's swap program has been somewhat different in that the government allows only foreign investors to participate, regulates the dollar amount of conversions over time, and negotiates the terms of each contract on a case-by-case basis. Mexico has been involved in the region's largest swap deals, including agreements with Volkswagen to convert \$280 million to equity and with Chrysler to convert \$100 million to equity. Mexico City has curtailed swap transactions since October, however, because it claims that the 1987 average monthly flows of \$100 million contributed to the rapid acceleration of the money supply and price increases. [redacted]

[redacted]

A number of other Latin American countries are inaugurating or preparing similar debt-to-equity conversion schemes, although some probably will offer less attractive terms than Chile or Mexico:

- Ecuador completed several swaps under a modest program limited to private-sector debt launched in March 1987, but foreign investors participated in only a minor share. Quito suspended the program in August to review its effectiveness and plans to reintroduce a more liberalized version to attract more foreign investors after the currently beleaguered sucre stabilizes.

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*Debt-for-Equity Swaps: A Growing Latin American Phenomenon*

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*The debt-for-equity swap has been gaining momentum in Latin America in the past year as debtors and creditors have found it a useful device for easing the debt problem and investors are drawn to it as a source of cheaper financing. In a typical conversion of debt to equity, a multinational company or other private investor buys a certain amount of a Latin American country's debt from an international commercial bank at a discount and redeems the debt instrument at the debtor country's central bank at full face value—or near full face value—in local currency. The company then invests the proceeds in the local Latin American economy. Alternatively, international commercial banks may swap their debts for equity investments of their own, but generally prefer to avoid that practice because of their lack of experience and expertise in managing nonfinancial enterprises. The discounts for Latin American debt available on secondary markets vary widely from 85 percent for Peru's debt to little more than 10 percent for Colombia's debt. [redacted]*

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*The swaps generally offer significant benefits for all participants. The creditor banks converting their own debt to equity—which so far have predominantly been European and small- or medium-sized US regional banks—probably view a swap as a middle ground between remaining caught in a cycle of debt reschedulings and new money demands on the one hand, and simply writing off the debt and taking an outright loss on the other. Accordingly, the smaller banks free themselves from the pressure the large money-center banks exert to participate in future loans. Many debtors welcome the benefits of increased foreign equity financing and relief from debt servicing, although a number remain concerned that the domestic monetary effects of swaps could aggravate already difficult inflation problems. [redacted]*

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- Argentina has revised its previously restrictive and lackluster swap program—for example, by dropping a requirement that the investor match its swapped proceeds with an equal amount of new funds—to make the process more flexible and attractive to foreign investors. Still, the US Embassy questions the government’s commitment to implement a successful program.
- Brazil approved a new program in November 1987 for converting debt to equity either through auctions or by way of a new bond scheme. Because the plan to replace commercial bank debt with bonds is part of the ongoing debt talks, the details of a swap mechanism for this part of the program are still to be negotiated between Brasilia and the banks.
- Venezuela has announced the framework of a debt-equity swap program. Although a government commission is still working on the details, the US Embassy in Caracas believes the financial incentives to investors will largely be offset by restrictions on dividend repatriation and by disadvantageous exchange rates.
- Elsewhere in Latin America, Bolivia, Costa Rica, the Dominican Republic, Honduras, Jamaica, and Uruguay have announced that they are establishing their own versions of a swap program. [redacted]



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Using another type of scheme, the Governments of the largest Latin American economies, Mexico and Brazil, have moved to tap foreign risk capital by creating *investment trusts*—or closed-end mutual funds—to facilitate foreign participation in local stock markets. According to the financial press, one such investment trust has been operating in Mexico since early in the decade and has attracted many foreign investors who seek the potentially high returns on Mexican stocks but want to minimize the risks associated with the high volatility of the stock prices. The uncertainty caused by the recent Mexican stock market crash, however, has temporarily damaged foreign investor enthusiasm. The Brazilian Government in 1987 approved a “Brazil Fund,” which it believes can bring in \$150 million in new foreign portfolio investments in the first year, but then postponed activation of the fund in the aftermath of the global stock market upheaval in October. The fund would permit foreign purchases of Brazilian stocks for the first time and exempt foreign investors in the fund from income taxes. The appeal of both Mexico’s and Brazil’s funds probably will resurge eventually, when the global stock market turmoil subsides and investor wariness dissipates. Investment trusts have limited potential elsewhere in Latin America because few other countries have stock markets sufficiently broad or well-developed to support these schemes. [redacted]

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The decisions by major US banks in the summer of 1987 to hike their loan-loss reserves probably will somewhat expand the secondary markets for problem loans to Latin America and accelerate growth of debt-to-equity conversions in the region. For the first time, according to financial experts, a number of large US money-center banks will be able to write down substantial amounts of their own shaky loan exposures to Latin America and convert them at near-market value to equity stakes in the region. Previously, the role of these major banks had been primarily confined to that of intermediary, since non-US banks and smaller US regional banks have provided nearly all of the discounted loan funds for the swap markets. The top US bank lender to Latin America publicly indicated in June 1987 that it plans to convert as much as \$5 billion to equity over the next three years [redacted]



**Other Favorable Trends**

In contrast to the beginning of the decade, when foreign direct investment came predominantly from the United States, many non-US—especially Japanese—businesses are taking an increasingly active interest in Latin America. Between 1980 and 1985, Japan’s total investment in Latin America expanded 150 percent, according to the financial press. A US academic study noted in early 1987 that Japan has seldom committed itself as strongly to investment in a developing country outside of Asia as it did in Mexico in the mid-1980s. This occurred because of, among other things, low labor costs and the proximity of the

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large US market. [redacted] Japanese firms also are studying new investment opportunities in a wide range of industries in Brazil, already by far the largest beneficiary of Japanese investment in Latin America. In recent months, Japanese investment has slowed somewhat in both countries because of political and economic uncertainty. Still, according to US embassy reporting, Tokyo plans to encourage increased Japanese investment in the region to compensate for the financial impact of an anticipated decline in Japan's demand for Latin America's exports. [redacted]

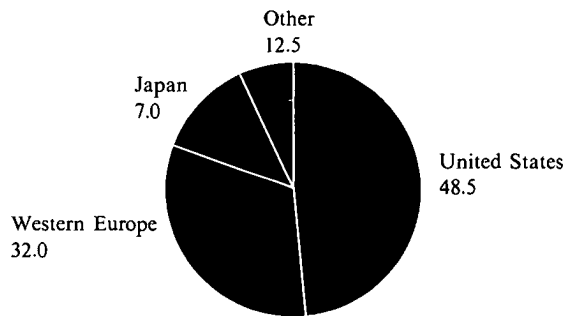
Foreign businesses increasingly are establishing export bases in Latin America to sell industrial goods to home markets or other third countries—especially the United States. [redacted] The rising share of foreign investment devoted to production for export reflects, among other things, a reliable supply of skilled and moderately priced labor and increased incentives extended by regional governments to businesses meeting export performance targets. Moreover, Mexico's export-oriented *maquiladoras* have attracted substantial amounts of foreign investment in the past few years. Foreign investors have responded to the *maquiladora* program, originally set up by the Mexican Government 20 years ago to expand employment along the US border, because of current internationally competitive labor costs in addition to the duty-free imports and other incentives offered by the Mexicans. Other Latin governments, including Brazil and Peru, have indicated they also are considering the establishment of *maquiladora*-style, export-oriented industrial zones. [redacted]

**Outlook**

Although long-cultivated fears of foreign economic domination and preferences for a major governmental role in economic affairs will continue to limit expanded openings to foreign businesses, we believe that investment flows to Latin America gradually will recover. Indeed, in our judgment, the projection of at least one US investment counselor that foreign investment to the region may double from 1986 levels to some \$6.0 billion in the medium term—which we define as five years—is not without some foundation. We expect, when final tallies are in, total 1987 investment receipts will amount to some \$3.5 billion, about 15 percent above 1986. [redacted]

**Figure 2**  
**Cumulative Foreign Direct Investment**  
**by Country of Origin, Yearend 1985<sup>a</sup>**

Percent  
Total=50 billion US \$



<sup>a</sup> Based on official statistics for Brazil, Chile, Colombia, and Mexico, which collectively accounted for more than 75 percent of Latin America's total receipts of foreign direct investment.

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We agree with official [redacted] forecasters that Latin American economic growth probably will increase moderately, thereby attracting rising flows of investment. In late 1987, Data Resources Institute (DRI) and Wharton Economic Forecasting Associates (WEFA) forecast 3-percent average annual growth rates for the Latin American countries collectively—revised down from earlier projections of 3.5 percent because of the effects of the recent global stock market plunge. Although the new projected 3-percent growth would be only one-half the region's 6-percent annual pace of the 1970s, it would be more than double the average rate registered during 1981-86. [redacted]

Despite strenuous resistance by hardcore nationalists, Latin American governments probably will maintain their recent, more liberal and flexible, policy stances

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with respect to restraints on foreign investment as foreign capital becomes increasingly critical to sustain regional growth:

- The steps taken in the past 18 months by Colombia, the Dominican Republic, Honduras, Venezuela, and Trinidad-Tobago to liberalize restrictions on investment will make their domestic markets more attractive to foreign investors.
- In Mexico, the more accommodating government attitude toward foreign businesses and the popular *maquiladora* program suggest a continuing rise in investment receipts. While de la Madrid's term of office expires in December 1988, his likely successor, the ruling party candidate Carlos Salinas, probably will continue his essentially pragmatic and conservative economic policies, according to the US Embassy in Mexico. [redacted]

Moreover, we agree with academic analyses suggesting that some recently installed civilian governments in the region may become more willing to undertake the needed structural adjustments to put their economies on firmer footings as their fledgling democracies mature and their political bases broaden, or as their leaders gain greater self-confidence in economic management. Some early signs include:

- In October 1987, nearly four years into his administration, Argentina's Alfonsin won the praise of foreign businessmen for his courage and commitment to economic reform when he announced adjustment measures to trim the public-sector deficit. Opposition from the recently strengthened Peronist Party has diluted the package by blocking some significant fiscal elements.
- The civilian Governments of Honduras and Uruguay that took over from the military regimes in the mid-1980s increasingly are implementing gradual economic adjustment steps, according to US embassy reporting. [redacted]

Even in Brazil, some resurgence of direct investment flows probably will occur sometime in 1988 or 1989 after revised investment ground rules are clarified in an approved new constitution [redacted]

[redacted] According to the US Embassy in Brasilia, some of the existing proposals for increased controls will probably be deleted or diluted through the upcoming plenary vote in the constituent assembly while others probably will not. If, on balance, only some of the less damaging investment restrictions survive to be incorporated in the constitution, we believe many foreign investors will view Brazil as an attractive investment market over the medium to long term. [redacted]

Finally, US financial analysts have suggested that Latin governments, creditor banks, and multinational corporations probably will expand their use of imaginative financial schemes to foster foreign investment. Conversions of debt for equity in Latin America may continue to grow, in their judgment, because of the decisions of major international banks to augment considerably their loan-loss reserves. In addition, they point out that foreign businesses probably will make increasing use of quasi-equity instruments—including production or revenue sharing through a variety of contract forms such as joint ventures, risk-service contracts, and management or licensing agreements. Through such schemes, Latin American governments may obtain risk capital, including technology and know-how, without allowing foreign control of local economic activities. [redacted]

Although we believe an increase in aggregate investment flows to Latin America is likely, we do not minimize the potential for an erosion of the willingness or ability of foreign companies to build up their Latin American investment capital. The failure of Latin American economies to grow at the level of the DRI and WEFA forecasts, for example, would have a deleterious effect on investment inflows as would continuing assaults on world stock prices, which would reduce the capital resources in industrialized countries available for investment in Latin America. [redacted]

Moreover, the recent improvements in Latin government attitudes toward foreign direct investment could dissipate and render a significant expansion of investment flows less likely. Acrimonious confrontations

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**Table 4**  
**Latin America: External Financing Needs and**  
**Foreign Direct Investment (FDI)**

Billion US \$

	Current Account Deficit	Amortization	Total	FDI	FDI (percent of total)
1970	2.9	1.7	4.6	1.1	24
1973	3.1	3.0	6.1	2.3	38
1975	13.9	3.8	17.7	3.3	19
1976	11.1	4.8	15.9	1.6	10
1977	11.5	7.4	18.9	3.0	16
1978	17.9	12.3	30.2	3.9	13
1979	19.3	16.1	35.4	5.0	14
1980	27.4	14.2	41.6	5.7	14
1981	39.9	14.5	54.4	7.5	14
1982	39.0	13.5	52.5	6.0	11
1983	8.0	10.7	18.7	3.3	18
1984	2.1	9.5	11.6	3.3	28
1985	2.8	9.3	12.1	3.8	31
1986	13.6	9.0	22.6	3.1	14
1987	12.2	9.0	21.2		
1988	12.2	8.2	20.4		
1989	8.6	9.4	18.0		
1990	9.4	12.0	21.4		
1991	10.1	13.3	23.4	6.0 <sup>a</sup>	26 <sup>a</sup>

<sup>a</sup> Projected.

Sources: IDB *Economic and Social Progress in Latin America*, 1987 (historical data) and DRI *Latin American Review*, Second Quarter 1987 (projections for 1988-91).



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between Latin American governments and the industrialized world over debt, trade, or other irritants in their relations could stoke the fires of nationalism and erode domestic support for foreign investment. Policy shifts away from promoting greater foreign investments could occur sometime in the next few years in one or more key Latin countries:

- Some Mexican businessmen fear that PRI candidate Carlos Salinas—who has a thin track record on which to base an assessment with confidence—may prove to be substantially more populist than de la Madrid in his policy leanings, including a disposition to limit foreign investment.
- Argentina's Alfonsín could give in to pressures from the populist Peronist opposition party and shift to a more nationalistic stance if his current moderate policies lead to severe domestic economic deterioration.
- In Brazil, there is a chance that the constituent assembly either will not agree on a new constitution or will approve one that contains highly xenophobic investment provisions, thereby leading to serious national turmoil and the flight of foreign capital.

Deteriorating security conditions resulting from terrorism and insurgency violence could discourage new inflows of investment to some countries, including Colombia and Peru. Colombia, especially, has been one of the region's largest beneficiaries of foreign direct investment in this decade because of its attractiveness to foreign business stemming from the government's good record in managing the economy and its relatively liberal investment regulations, and the country's rich and low-cost mineral fuel resources. Sharply escalating insurgent violence and sabotage of foreign oil and other facilities could deter a number of otherwise interested foreign companies.

### Implications for the Debt

Even the doubling of foreign direct investment to some \$6.0 billion by 1991, while helping Latin debtors meet their continuing large requirements for foreign

financing, would offer no more than a minor palliative to their persistent and onerous debt difficulties. To put projected direct investment flows of this magnitude in historical perspective, they:

- Fall short of the previous peak level of 10 years earlier *even in nominal terms*.
- Would probably amount to about one-half of 1981's total in real terms.
- Would be equivalent to only 0.5 percent of total Latin American GDP in 1991 compared with 1.2 percent in 1981.

Viewed against projections of Latin America's financial requirements by the International Monetary Fund and DRI forecasting service, our expected inflows of foreign investment would contribute only one quarter of the region's external capital needs (see table 4). Because Latin debtors will continue to face substantial financial gaps in spite of rising flows of investment, those that are sufficiently creditworthy probably will have to supplement their investment receipts with additional major borrowings. Others that found themselves unable to obtain substantial new loans would be faced with having to slash imports still further. Latin America's financial difficulties would be compounded considerably should our more pessimistic scenario come to pass and regional foreign direct investment stagnate at current levels. The financial gaps of some debtors would grow dangerously large and threaten to plunge these countries into prolonged stagnation. Also, with respect to a few billion US dollars of yearly debt-for-equity swaps, these transactions pale against the region's \$400 billion debt outstanding and will have little impact on the debt servicing burdens.

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## Appendix

**Latin America:  
Foreign Investment Regulatory Controls**

	Entry Limitations	Incentive Conditions	Remittance Restrictions
Argentina	No sectors are off limits, but central bank approval is required for investment in defense, some public services, mass media, energy, insurance, financial entities, and if investment is over \$20 million; or it involves acquisition of a local company worth over \$10 million. Antipollution decrees limit investment in Buenos Aires.	Incentives granted only if investment is important to national interest.	Dividends remitted abroad are taxed at 17.5 percent. There is no limit on amounts, but an excess profits tax of 15 to 25 percent applies to remittances above 12 percent of registered capital. A tax of 45 percent applies to 60 to 100 percent of the amount of remittances of royalties and fees. All remittances must be made through BONEX—government bond system.
Brazil	All foreign investments and re-investments must be registered with the central bank. Certain sectors are reserved for Brazilian nationals including the information media and petroleum exploration and refining. Foreign investors also are subject to restrictions in other sectors such as banking, informatics, petrochemicals, and mining.	Foreign investors may qualify for special investment incentives by the government—including tax credit or import duty concessions—only if they agree to maintain a certain level of exports or if they establish operations in certain underdeveloped regions of the country, such as the northeast or the Amazon.	Dividend remittances are subject to 25-percent withholding tax. Although there is no limit on the amount that can be repatriated, net remittances above 12 percent of total registered capital are subject to stiff supplementary taxes of 40 to 60 percent. Also, remittances of royalties and fees are limited to 1 to 5 percent of gross sales.
Chile	The only industry closed to foreign investment is petroleum, although risk contracts are assigned. Also, there are no percentage restrictions on foreign holdings. Investments over \$5 million or in the media or public sectors are subject to approval by the Foreign Investment Committee.	Incentives are available for investment in certain regions and in sectors vital to the country's development.	There are no restrictions on remittances, although intentions to remit profits more often than annually must be defended by audited statements. An income tax of 40 percent applies to dividends remitted abroad. Remittances of royalties and fees are subject to a 40 percent withholding tax and central bank approval.
Colombia	New foreign investment law liberalized previously strict rules of the Andean Pact. Most sectors now are open to foreign investors, although all investment still must be approved and registered. Only foreign companies wishing to benefit from Andean trade preferences need to divest to mixed (51-percent local equity) or national (80-percent local equity) status.	Foreign investors are eligible for export incentives and special import regimes for inputs used in export products.	Currently, remittances are limited to 25 percent of capital base and subject to a tax of 30 percent, in most cases. Higher remittances may be permitted in special cases. Royalties and fees must be registered and their tax ranges from 40 to 52 percent.

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**Latin America:  
Foreign Investment Regulatory Controls (continued)**

	Entry Limitations	Incentive Conditions	Remittance Restrictions
Costa Rica	All foreign capital must be registered with the central bank. Foreign firms do not enjoy the same easy access to domestic credit facilities as do local enterprises.	Investments in export-oriented activities are exempt from customs duties and sales or profits taxes. Also, firms located in free zones do not have to pay duties on remittances.	No restrictions on remittances. Dividends are subject to 15 percent withholding tax. Royalties and fees are taxed at 20 percent.
Dominican Republic	Foreign investment prohibited in utilities, forestry, communications, and domestic transportation.	Several industrial free zones provide exemption from income tax, customs duties, and currency controls when goods are exported. To solicit mining concessions, foreign firms must establish Dominican companies.	Profit remittances cannot exceed annually 25 percent of the registered investment base, and are subject to 20-percent withholding tax—free zone operations are exempt. Payments of royalties by a subsidiary to its parent company are prohibited. All contracts for fees must be approved, and the withholding tax is 20 percent.
Mexico	Foreign investment is meant to complement local investment, so the majority of a firm's equity must be Mexican controlled, with exceptions on a case-by-case basis. All projects are approved and regulated by a government commission. Foreign investors are barred from certain activities in the energy, mining, banking, and transport sectors.	Tax, financing, and export incentives are available for companies that set up in the coastal or frontier zones; also, for priority industries such as agroindustry, machinery, and electronic equipment.	Provided a firm is registered and meets certain legal and tax requirements, profits can be remitted abroad—taxed at 55 percent. Royalties and fees remitted under registered contracts are subject to a withholding tax of 21 percent, as well as some foreign exchange restrictions.
Panama	Sectors closed to foreign investment include retail trade, radio, and certain professional activities; public utilities must have a local majority ownership. No government approval is required for other sectors, although a license must be obtained.	Companies located in the free zone are exempt from import and export duties and are accorded special low-income taxes.	Remittances abroad are not limited in any way. Profits remitted are taxed 10 percent; for royalties and fees the tax is 20 to 50 percent.
Peru	Foreign investment must be authorized in advance and registered by the government. Sectors considered essential to Peru's economy and sovereignty are closed to foreign investors.	Foreign companies are allowed to exceed normal profit remittance ceiling if they meet requirements of increasing exports, increased use of local inputs, or developing certain geographical areas. Firms that become mixed or national can get tariff breaks and long-term domestic financing.	Since July 1986 a two-year freeze on remittances has been in effect. Under the Andean Pact rules which normally hold sway, remittances may not be more than 20 percent of capital base. Branch profits are subject to a 15.4-percent withholding tax, as well as a 35-percent corporate income tax. Royalties and fees must be approved and registered.

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**Latin America:  
 Foreign Investment Regulatory Controls (continued)**

	Entry Limitations	Incentive Conditions	Remittance Restrictions
Trinidad & Tobago	No enterprise can be totally foreign owned, and the government favors joint ventures with majority ownerships held by domestic interests. All sectors are open to private enterprise except public utilities.	Foreign investors active in pioneer industries sometimes are accorded exemption from income tax or import duties for five to nine years. Exporters are allowed to deduct from taxable profits part of their sales to non-Caribbean markets.	Central bank regulates and approves repatriation and payment of royalties and fees. Dividend tax is up to 25 percent. Royalties and fees are taxed between 5 and 30 percent.
Uruguay	Some industries—including public utilities and services, port facilities, railroads, and insurance—are closed to foreign and local firms. Foreign investors must register their investment to obtain government guarantees of repatriation and convertibility, but are then unable to obtain medium- and long-term internal credit.	Companies involved in activities declared to be of national interest are eligible for special credit assistance and tax concessions. Firms that locate in designated free-trade zones are awarded tax exemptions.	There is an industry and commerce tax of 30 percent on remitted dividends—may be waived if they are taxed abroad. Profits not remitted after two years are considered capitalized. The 30-percent tax also applies to royalties and fee payments remitted abroad.
Venezuela	Several sectors are barred to foreign firms including petroleum, some petrochemicals, iron ore, and other natural resources. Firms investing in other sectors such as public, professional, and financial services must be controlled by 80 percent national interests. All investments must be registered with the country's investment agency.	Some priority development sectors are exempt from the transformation rules and ceilings on remittances: tourism, agriculture, agroindustry, electronics, informatics, and biotechnology. Exemptions may also be obtained if 80 percent of production is exported outside the Andean market or if operations are within free zones.	Profit remittances cannot exceed 20 percent of registered capital plus a percentage equal to the current LIBOR rate. The remittance tax is 20 percent. Royalties and fee payments are prohibited between parent companies and their subsidiaries. Approved contracts with nonaffiliates are taxed from 18 to 50 percent.



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