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Transnationalization *and integration of* production *in Latin America*

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Trade among the ALADI countries has grown with exceptional vigour so far in the 1990s, especially in the branches of metal products, machinery and equipment, chemical products, and foodstuffs, beverages and tobacco. In order for this dynamic growth to be sustainable in the long term, these countries must develop their intra-industry trade by promoting reciprocal supply in those branches. The bulk of transnational productive capital in Latin America is concentrated in those branches, and it is in the metal products, machinery and equipment sector that the swiftest increase in intra-industry trade takes place and the link between the growth of intra-regional trade and a strong presence of transnational capital is most marked. In the motor industry –which is a textbook example of these features– the existence of systems and agreements which include elements of preference, and in whose formulation the companies themselves have played a leading role, has been essential for their survival and growth. Examples of this are the rules governing trade in this field between Argentina and Brazil and the areas subject to the regulations governing assembly-type ("maquila") activities in Mexico. When shaping future strategies for open regionalism and the most suitable arrangements for attracting foreign direct investment without giving rise to an improductive struggle among the prospective recipient countries, what has been observed in the motor industry suggests that it is not only through economic liberalization but also through special conditions agreed between the firms involved and the members of a given integration scheme that transnational productive capital can be attracted and retained.

I

Introduction

Mutual imports among the ALADI countries, measured as a percentage of their total imports, rose from 10% to 17% between 1990 and 1993. Why did this increase take place, and how sustainable can it be in the long term?

There are increasingly clear indications that these tendencies derive from a more than proportional impact of the elimination of trade barriers among countries which, because of their relative proximity in geographical terms and their greater physical integration, are registering lower and lower transport costs. We could speak of the enhanced overall result of two individual phenomena: the "liberalization effect" and the "economic proximity effect" (Garriga and Sanguinetti, 1994). The impact on mutual trade has been all the stronger because the recent free trade agreements have further accelerated the intra-regional liberalization of the Latin American countries.

Side by side with the free trade agreements, however, systems of exceptions have continued to operate, notably in the case of the motor industry. At the subregional level, mention may be made of Protocol 21 between Argentina and Brazil, while at the hemispheric level there are the export processing zones and the regulations governing assembly-type operations between Mexico and the United States, which continue to apply, at least temporarily, even after the entry into force of MERCOSUR and the North American Free Trade Agreement (NAFTA). The transnational corporations are leading actors in this growth of trade and are reorganizing their intra-regional and intra-hemispheric forms of production specialization in order to take advantage of the economies of scale and of specialization offered by these expanded markets. Although this process does benefit from the general liberalization of markets, its main boost comes from the forms of managed and compensated trade established under the systems of exceptions mentioned earlier.

The influence of the strictly economic elements referred to above is accompanied by that of others which are harder to quantify, such as cultural or language affinity, or the easing of political tensions between neighbouring countries which has been observed with the return to democratic regimes in Latin America.

With regard to the long-term sustainability of the relative expansion of mutual trade, this will depend to a large extent –at least in the strictly Latin American area– on the capacity of regional supply to satisfy the increased Latin American demand for imports inherent in a process of sustained growth. In other words, it will depend on the ability of that supply to evolve towards manufactures or services with a high income-elasticity of demand.

The growth potential of the regional market easily exceeds that of the external markets to which most of the regional supply is directed. The long-term growth capacity of the Latin American economies is a good deal higher than that of the developed countries. In the present conditions of liberalization, however, a definite pattern of intra-industry trade is needed if all the countries participating in a mutual trade scheme are to satisfy their needs with mutual exports and thus stimulate this type of development. Unlike inter-industry trade –which is the typical form of trade between central and peripheral countries– intra-industry trade makes possible the sustained growth of trade among countries with more or less similar levels of development and relative factor endowments, through the proper use of economies of scale and specialization.

This role of intra-industry trade in Latin American integration and in the encouragement of economies of scale and specialization is not something new for ECLAC. Fully thirty years ago, it noted in this respect that: "Economies of production scale which cannot be enjoyed because of market limitations are of significant importance in major industrial activities connected with the production of consumer durables, capital goods, and basic intermediate products. These economies depend on various factors, such as indivisibility of investments, lack of propor-

□ This article is based on Di Filippo, 1994.

tionality between increased production capacity of plant and the cost of the necessary equipment, and the possibility of incorporating modern technology and some degree of specialization when working at high scales of production". "Regional integration will directly help to solve all these development problems due to market size. In proportion as this process advances, the types of production located in each of the individual member countries will be able to enjoy the potential demand of the entire integrated area. They will consequently be able to set up modern plants with optimum dimensions and suitable levels of specialization, and it will be possible to proceed with industrialization in other branches where this is currently not possible within national markets alone" (ECLAC, 1965).

This view set forth by ECLAC in the mid-1960s has now been modified in two respects. Firstly, economic integration is no longer taking place as part of a process of import substitution industrialization: the aim now is to be compatible with a broad process of opening up to the world economy and to contribute to this. Secondly, intra-industry trade is no longer promoted through sectoral economic complementation agreements, with strong intervention by government bureaucracies in the distribution of production tasks among countries, but now takes place through the increasingly prominent role of private enterprise (ECLAC, 1994 a and b). Even in those days, however, ECLAC's message was that, in order to be sustainable, the process of trade integration in Latin America needed a more than proportional growth rate of mutual intra-industry trade. Today, this same basic proposal –which came into conflict with the principle of static comparative advantages in vogue at that time– is increasingly confirmed by the most recent academic lines of thought (for example, Krugman and Obstfeld, 1994, chap. 6).

We will give the title "production integration of Latin America" to the establishment of an intra-regional division of labour which makes possible the development of an increasingly diversified supply of industrial products by all the participants. The empirically verifiable expression of the advance of this process of production integration will be the growth of intra-industry trade, not only among the Latin American countries but with the rest of the world as well.

This article provides background information on the leading role played by transnational corporations in the production of the goods –basically metal products, machinery and equipment and chemical products– which currently form the bulk of the intra-industry trade of the Latin American countries.

II

Forms of production integration

In a previous paragraph, we described production integration as the establishment of an intra-regional division of labour which makes possible the development of an increasingly diversified supply of industrial products by all the participating countries.

A first form of production integration is the intra-firm variety, which takes place among subsidiaries of the same transnational corporation. This form is often called "international production" in studies on transnational corporations (UNCTAD, 1993), and gives rise to intra-firm trade in the strict sense.

A second form of production integration is practiced between transnational corporations of developed countries (or their subsidiaries) and local firms to which they subcontract certain production operations, subject to very precise technical specifications. Here, different types of alliances and agreements are entered into which involve close technical and production links between the transnational subsidiaries and the local subcontractors, and these relationships are known as "new forms of international investment" (Kuwayama, 1992). In the motor industry, the interrelations deriving from these alliances are extremely complex.

Both of the forms considered so far have two features in common: they involve intra-industry trade, and they usually give rise to special trade arrangements with full exemption from customs duties (as in the free zones) or with tariffs calculated only on the basis of the value added to the part or component to be reimported by the original exporter (as in the case of assembly or "maquila" operations). These special forms of tariff treatment are, on the one hand, a recognition of the fact that what is involved is not trade in the classical ("Ricardian") sense, while on the other hand they imply mutual preferences which are typical of integration agreements or can promote them. In addition, some of the sectoral agreements currently in force include clear elements of managed or regulated trade. These forms of trade are very frequent between developed and developing countries, and may be de facto forerunners of integration agreements, as in the inclusion of Mexico in NAFTA. They also occur between Latin American countries, involving transnational subsidiaries and local manufacturers of motor parts, as in the case of the agreement on the motor industry between Argentina and Brazil.

The third form of production integration to be examined here was actually the first to be observed in the region, namely, the process of complementation of supply in specific branches of final products, which gives rise to trade in products that belong to the same branch or activity but have different specifications. This type of intra-industry trade was strongly developed, for example, when the countries of the present European Union specialized in very specific ranges or niches of production within broader branches of manufacturing. All these countries produced machinery, household appliances and transport equipment, for example, but all of different types and quality levels. In this way, they were able to expand their trade in manufactures in a more balanced and dynamic manner, taking advantages of economies of scale and specialization. They were also able to compete in the rest of the world with their products and managed to secure complementary market niches.

This balanced growth did not occur in other important lines of trade in the period since the war. In its early studies, ECLAC clearly highlighted the unbalanced nature of the trade between the central countries and the countries of the periphery, which exchanged primary commodities for manufactures: unbalanced because of the long-term disparities in the growth rates of demand for these two types of products. Nor was it structurally viable to hope to maintain a balance in the mutual trade of countries which were traditional commodity producers, because the lack of diversity –and of diversification– of the exportable supply rapidly sapped the dynamism of such trade.

III

Foreign direct investment and the recipient markets

When an effort is made to identify the links between integration and the behaviour of foreign direct investment (FDI), the inflow corresponding to the transnational corporations already installed in the region immediately stands out. In this respect, estimates corresponding to the early 1990s indicate that the accumulated FDI in the member countries of the Latin American Integration Association (ALADI), at book value, amounted in 1990 to US$92 billion at current prices, while the inflow in the same year was approximately US$7.5 billion at current prices (about 8% of the accumulated FDI). Of this total stock of foreign capital, 73% corresponded to Brazil and Mexico (87% if Argentina and Chile are added).

In this section, an attempt will be made to answer a number of questions regarding the links between the presence of transnational corporations in Latin America and the regional integration process. The generalizations made are based on the analysis of five countries –Argentina, Brazil, Chile, Colombia and Venezuela– which are considered to be fairly representative of the tendencies observed in ALADI. The situation of Mexico –which was left out of this analysis for lack of information– has special features which will be analysed later on, in section VI.

At this point, some of the main questions may be raised. Which are the production sectors that account for the bulk of FDI in Latin America? In which of these sectors does the ALADI market account for a major share of total exports? For which of these sectors has the ALADI market grown faster than markets outside the region?

The answer to these questions is that in the countries in question (except for Chile) half or more of the total FDI is located in the manufacturing sectors, and, within these, mainly in the metal products, machinery and equipment sector (ISIC division 38) [1] and in chemical products (ISIC division 35). The more rapid growth of the ALADI market for these product branches has increased the interest of the transnational corporations in expanding their supply in this direction. For decades past, both branches have received transnational investments in connection with the domestic markets of a number of these countries, and now the transnationals are restructuring their operations to take advantage of the supra-national scale of the markets emerging under the terms of the integration agreements signed in the 1990s.

Another branch of manufacturing which is worthy of mention is foodstuffs, beverages and tobacco (ISIC division 31). Although to a lesser extent, this branch also absorbs a by no means insignificant percentage of manufacturing FDI. Moreover, recent press reports indicate an increase in the presence of big transnationals in this field. The proportion of total exports in this branch absorbed by ALADI is not more than 20% (except in the case of Colombia), but the share accounted for by the regional market is growing faster than total exports in this category.

The weight of these three branches (ISIC divisions 31, 35 and 38) in total exports of manufactures varies considerably from one country to another.

Thus, in Venezuela these branches account for 78% of total exports of manufactures, because of the weight of the petrochemicals industry. In Argentina, they form 70.3% of total manufactured exports, with foodstuffs, beverages and tobacco predominating. In Brazil, they represent 73.1% of such exports, mainly due to exports of metal products, machinery and equipment. In Colombia they account for 42.6% of total exports of manufactures, with chemical products predominating, and finally, in Chile, they form only 21.8% of manufactured exports because that country's main manufactured export line is basic metal industries, where the contribution of FDI is very small and most exports are to countries outside the region (see table 2 below).

The priority attention warranted by these three branches is due to their great capacity for supplying the domestic markets of the countries where such industries are installed. Their present and future competitiveness is supported first of all by the domestic markets themselves and subsequently by the supranational markets emerging from the present integration agreements, on the basis of which they can launch themselves into the hemispheric or world markets. Consequently, their rate of growth is closely linked with the rate of development of the countries of the region. Although the income-elasticity of demand for foodstuffs with some degree of processing is lower than that of the other two branches, if the region registers sustained growth of the product, together with an improvement in income distribution, the prospects for growth of the foodstuffs, beverages and tobacco branch would nevertheless be quite promising. It is in these three branches that the closest links are to be observed between FDI and Latin American economic integration.

The data presented in tables 1 and 2 below (compiled at the national level) show that, even before the wave of agreements signed in the 1990s, there was a substantial recovery of intra-regional trade as from 1985, when the relative slump in that trade reached its lowest point.

This change in direction of exports was particularly marked in the case of metal products, machinery and equipment and chemical products, where transnational corporations predominate. In the 1990s, the formal entry into effect of integration agreements gave further strength and stimulus to a process which had begun in the second half of the 1980s. The cases of intra-industry trade analysed below confirm that the transnational corporations to some extent anticipated the signing of those bilateral or subregional free trade agreements and began their own process of *de facto* integration either before or at about the same time. Consequently, if there was a growing process of absorption of these products in the ALADI market even before liberalization became a general phenomenon, it is easy to understand the rapid growth of this trade as a result of the implementation of the policies which are being applied in the 1990s.

[1] United Nations International Standard Industrial Classification (ISIC), Statistical Papers, Series M, No.4, Rev.2.

IV

Analysis of national case studies

In this section, we will look at five Latin American countries –Argentina, Brazil, Chile, Colombia and Venezuela– in order to determine the branches which have received most FDI (table 1), the main destinations of the exports of those branches, and the branches which have grown most rapidly in the ALADI market (table 2).

This analysis was carried out as follows. An analysis was made of the branches corresponding to ISIC divisions that absorbed more than 5% of the FDI in the production of goods, and within them two major groups were distinguished. On the one hand, there were the branches which accounted for the bulk of the manufacturing FDI, much of whose production goes to the ALADI market. These branches were chemical products and metal products, machinery and equipment (ISIC divisions 35 and 38). On the other hand were the other primary or manufacturing branches, with proportions of foreign capital which varied according to the countries and with exports directed mainly to markets outside the region. Within this second group, in which natural-resource- intensive activities predominate, there are some branches (such as foodstuffs, beverages and tobacco) which receive a growing share of FDI and are increasing their penetration of the ALADI market.

1. Argentina (1985-1989)

Up to the end of 1993, there were no more recent estimates for this country, broken down by branches of economic activity, which could be compared with

Total exports of the chemical products and metal products, machinery and equipment branches increased by US$260 million, while exports to ALADI rose by US$376 million. Of the overall increase in Argentina's total exports of manufactures, 32% was due to exports by these two branches to ALADI.

2. Brazil (1985-1991)

Of the total FDI in the production of goods accumulated by the end of this period, only a meagre 4.3% corresponded to the primary sector, thus highlighting the fact that in that country export agriculture is fundamentally in Brazilian hands. If FDI in some natural-resource-intensive manufactures is added to this figure, this gives a total of 23.3%. The percentage of total exports corresponding to these branches was 55.3%, while exports to destinations outside the region came to between 79% and 94% of the total, depending on the branch in question.

The chemical products and metal products, machinery and equipment branches accounted for 65% of total FDI in the production of goods. The exports of these two branches represented 32% of total exports of goods, went to more diversified destinations, but the proportion of sales to ALADI was not particularly high.

In terms of export growth, however, the ALADI market has been vital for the expansion of these branches. The net increase in total exports for the two branches in question was US$1 155 million, while the increase in sales to ALADI came to US$1 690 mil-