Financial Flows for Regional Integration

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Much of the discussion on both regional and multilateral integration rightly focuses on trade aspects. However, also crucial in the integration process – especially regionally but also multilaterally – are its international financial aspects; even though crucial, these financial aspects tend to be insufficiently emphasised in many of the studies on integration, as well as in policy discussions of the subject.

There are at least three major aspects in which international financial flows and mechanisms play a very important role in regional integration.

1 Financial mechanisms are created explicitly with the purpose of enabling or facilitating trade integration. In the case of the Latin American and Caribbean (LAC) region, these mechanisms include, for example, the Latin American Integration Association (LAIA) payments and clearing arrangements, as well as the Banco Latinoamericano de Exportación (BLADEX). The relevant question that needs to be addressed is whether the mechanisms created operate efficiently and whether they are sufficient and on appropriate terms (e.g. maturities) to meet the needs of integration.
2 Regional integration can be more or less spontaneously stimulated by intra-regional direct investments. Such flows have played a particularly large role in the market-driven integration processes of Asia; they are also, however, playing a fairly important role in the move toward the policy-driven process of Western Hemisphere integration. Insufficient research and data compilation hinders full understanding of this phenomenon.
3 Last, but perhaps most importantly, regional integration leads to a process of increased investment from outside the region. This dynamic effect of investment creation for the country or region relates to the additional flows of foreign investment from outside the region generated by three factors linked to regional integration: (a) preferential and stable access to a significantly larger market; (b) potential regional complementarities in terms of resources and productive capacity; and (c) a decline in uncertainty on economic policies which countries will follow, called the "lock-in" or "candado" effect. (This latter effect has been especially highlighted

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in the context of Mexico's entry into NAFTA.)[1] Flows from outside the region have positive effects in terms of growth (especially clear in the short term), and hopefully on an increase in productive capacity in the medium term, but may have very problematic effects, in particular on overvaluation of the exchange rate, which may somewhat undermine a country's efforts at increasing exports, both within and outside the region.

This paper starts by describing, analysing and evaluating the financial mechanisms explicitly created to support regional integration within Latin America and the Caribbean. The next section of the paper examines the scale and composition of intra-regional investment flows in the LAC region and attempts to analyse their impact. We then briefly analyse the impact of regional integration on flows from outside the region, as well as their effects. Given the importance of NAFTA, special, but not exclusive, emphasis is placed on flows to Mexico. The final section discusses policy implications for Latin America and the Caribbean as well as for the Western Hemisphere.

I Financial Mechanisms Created to Support LAC Integration

Different schemes for collaboration in the financial and monetary field were created together with the initial regional agreements in the LAC region. These schemes have been mainly geared towards the creation of mechanisms that facilitate payments derived from transactions between countries in the region; some such schemes (and particularly the LAIA Clearing and Payment mechanism) have been modernised and revitalised to support the improved integration schemes better. To a lesser extent, and relatively more recent, are efforts to create schemes to finance exports, both within and outside the region.

Latin American Clearing and Payments Arrangements

The effectiveness of a payment and clearing system is based on several factors: (a) there must be a substantial demand for the use of the system for settlement of intra-regional trade; (b) there must be an effective system to minimise the arrears problem; and (c) the majority of member countries should not be in a permanent debtor-creditor position. In Latin America, the LAIA Reciprocal Payments and Credit Agreement is not just the only mechanism that fulfils these conditions, but it is also the only mechanism still performing payments arrangements in the region.

1 See, for example, J. Ros, "Beneficios comerciales y movilidad de capital: estudios recientes sobre las consecuencias de TLC", *Comercio Exterior*, México, Junio, 1994.

Table 1 **LAIA Payments and Clearing Arrangements, and LAIA Imports 1966-93**
(millions of dollars)

Year	Anticipated Payments	Number of Central Banks Participating	Total Transactions (1)	LAIA Imports (2)	% (1/2) (3)	Net Settlement in Foreign Exchange	% (3/1)
1966	0	7	106	985	10.76	31	29.25
1967	0	7	333	1008	33.04	94	28.23
1968	0	9	392	1062	36.91	130	33.16
1969	0	10	482	1301	37.05	81	16.80
1970	15	11	560	1354	41.36	110	19.64
1971	24	11	695	1485	46.80	136	19.57
1972	9	11	979	1664	58.83	189	19.31
1973	10	12	1398	2312	60.47	281	20.10
1974	78	12	2276	3930	57.91	387	17.00
1975	3	12	2385	4006	59.54	662	27.76
1976	105	12	2923	4641	62.98	652	22.31
1977	170	12	3936	5793	67.94	887	22.54
1978	56	12	4457	5772	77.22	1135	25.47
1979	300	12	6421	8439	76.09	1630	25.39
1980	682	12	8643	10529	82.09	2021	23.38
1981	869	12	9331	12199	76.49	2554	27.37
1982	633	12	7770	10620	73.16	2245	28.89
1983	309	12	6371	7711	82.62	1809	28.39
1984	155	12	6776	8533	79.41	2052	30.28
1985	62	12	6726	7533	89.29	1499	22.29
1986	14	12	6673	7674	86.96	1066	15.97
1987	65	12	7492	8496	88.18	1269	16.94
1988	61	12	8753	9914	88.29	1458	16.66
1989	162	12	10137	11147	90.94	2513	24.79
1990	472	12	10020	12381	80.93	3469	34.62
1991	769	12	11610	15620	74.33	2866	24.69
1992	2347	12	13772	19960	69.00	3845	27.92
1993	3293	12	13176	n.a.*		3824	29.02

* Not available.
Source: Compiled by the authors, based on several LAIA publications and on UNCTAD, "Regionalisation and Integration into the World Economy: Latin American Experience in Trade, Monetary and Financial Cooperation", 31 Aug. 1994, Geneva.

Since 1986, the LAIA payments arrangement has been recovering from the debt crisis and the consequent financial squeeze of the 1980s.[2] As can be seen in Table 1, since 1986 both LAIA imports and the total transactions channelled through the clearing system have increased significantly (except for 1993, when the level of transactions channelled through the clearing system

2 For a good analysis of the mechanism's problems during the years of debt crisis, see ECLAC, "La cooperación regional en los campos financiero y monetario". In: *Serie Financiamiento del Desarrollo*, 5 December 1990, Santiago de Chile.

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fell fairly marginally). It is, however, interesting to note that the ratio of transactions through the clearing system to intra-LAIA imports has declined, from 91% in 1989 to 69% in 1992, as intra-LAIA imports grew faster than transactions going through the clearing system. The greater availability of foreign exchange, due mainly to the surge in private capital inflows in the early 1990s, would seem to be the main explanatory factor.

The Payments Agreement of LAIA which had been created in 1965 was modified in 1982; it has been signed by the Central Banks of Argentina, Bolivia, Brazil, Colombia, Chile, Ecuador, Mexico, Paraguay, Peru, Uruguay, Venezuela and the Dominican Republic. The system was designed to have three parts. Firstly, the Multilateral Payments Clearing Mechanism compensates multilaterally the trade operations. This compensation is done every four months, for all direct transactions between persons or companies resident in the countries of the region. On the due date of a transaction, the exporter has to be reimbursed by its commercial bank against presentation of valid documentation. The exporter's commercial bank then obtains reimbursement from his country's central bank, and the latter enters credit in favour and a debit to be charged to the importer's central bank, for whose account it has settled the amount due. At the end of each four-month period, "multilateralisation" takes place, as bilateral positions are assessed and cleared, resulting in a single debtor credit balance for each central bank, to be transferred or received as the case may be. The Central Bank of Peru and the Federal Bank of New York are the agent and common correspondent through which debit and credit balances are settled. The system is mandatory and thereby automatic in some countries like Chile, Ecuador, Mexico and Venezuela.

Secondly, LAIA also created reciprocal credit lines between their central banks, (at interest rates that approximate 90% of the daily average US "prime rate"), which are liquidated every four months. The LAIA Reciprocal Payments and Credit Agreement was amended in 1991, with the introduction of a two-tier Automatic Payments Programme for transitory financing of balances of multilateral compensation. The programme offers central banks automatic access to the credit or debit status of other central banks, as well as a short-term credit facility that extends the settlement period for central banks with difficulties in their liquidity position. This facility allows a delay in payment of debit balances of a central bank over an additional four-monthly period; this programme may be used, by the same central bank, as much as twice during two-year periods.

Thirdly, the LAIA Payments Agreement has a system of guarantees. The guarantees contemplated in the Agreement are those concerned with convertibility of national currencies into US dollars, transferability of the latter, and reimbursement and payment of operations processed. The

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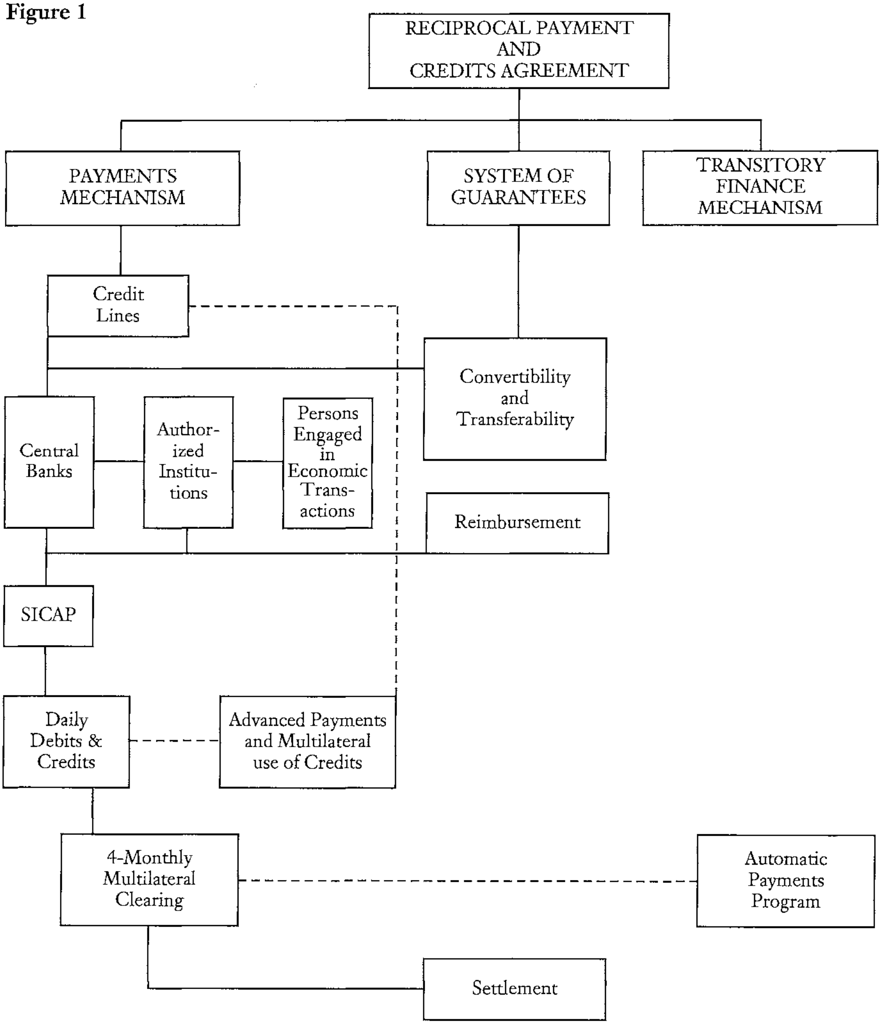
reimbursement guarantee is especially important because of the certainty it affords the exporter of timely collection of monies due, thus constituting a first supporting element of intra-regional trade[3] (the different elements in the LAIA Reciprocal Payment and Credit Agreement, as well as their interconnections, can be seen in Figure 1).

Figure 1



3 For a clear detailed account, see LAIA, "Reciprocal Payments and Credits Agreements", January 1993.

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Some recent modifications have reportedly[4] improved the operation of the LAIA payments system. To enlarge the scope of eligible transactions through the system, in 1991 LAIA authorised member countries to channel payments which originated from triangular trade; this allows the commercial bank of the exporter to anticipate the reception of funds and continue to offer financing to other customers; it also allows the commercial bank of a third member country to place available credit in a convenient manner. In 1993, transactions through this scheme amounted to only US$69 million.

An additional mechanism recently introduced by LAIA is the Financial Discounting of trade documents originated in transactions previously channelled through the system. The mechanism provides funding for exporters with the guarantee of the LAIA Payments Agreement. The estimated amount of transactions through this mechanism amounted to US$1.1 billion in 1993. It should be emphasised, that while some LAIA countries have incorporated this mechanism in their domestic rules, others (like Venezuela) explicitly forbid it or (like Chile) have suspended it.

As can be seen in Table 1, the significant volume of transactions of the LAIA Reciprocal Payments and Credit System is an important achievement. During the period of its functioning, the total transactions that went through the LAIA agreement reached a figure of US$155 billion; net settlements in foreign exchange reached US$39 billion. As a consequence, there was a saving of use of foreign exchange of approximately 75%.[5] This important saving of foreign currency clearly is beneficial, as it allows it to be used for other purposes, hopefully developmental ones. Amongst other benefits from the LAIA Payments Agreement are: (a) reduction of risk contingency and greater expediency on payments; (b) reduction of the cost of commercial transactions through the elimination of the traditional triangular banking process with institutions outside the region, plus eliminating the need for credit insurance on exports; (c) increased links between commercial banks as well as central banks of the region. The latter has facilitated the development of other financial integration mechanisms; and (d) the overall efficient operation of the guarantee mechanism has strengthened confidence in the regional commercial banking systems.

A final point relating to the LAIA Reciprocal Payments and Credit Agreement which is worth noting is that during the last few years there has been a growing tendency towards increasing anticipated payments, i.e. payments to be made before the compensation period finishes (see again

4 See, for example, UNCTAD, "Regionalisation and Integration into the World Economy: Latin American Experience in Trade, Monetary and Financial Cooperation", 31 Aug. 1994, Geneva.

5 Own estimates, based on Table 1 and LAIA data.

mechanism. The failure in the 1980s of the latter two mechanisms seems to an important extent linked to the fact that in these, each country gave global credit lines without bilateral limits. In contrast, the LAIA mechanism was based on many bilateral credit agreements, which limited the maximum debtor position of one country with another; this prevented resources being concentrated in a few countries which then may be unable to pay back, disrupting the operation of the whole mechanism.

The main challenge now is either to revitalise the Central American and Caricom mechanisms, drawing on the lessons of their own experience and of the far more successful experience of the LAIA mechanism, or alternatively – which may become increasingly relevant in the medium term as regional integration hopefully broadens to include an ever growing number of countries in the region – to increasingly broaden the LAIA mechanism to include the Central American and Caribbean countries as well as others in the region.

Mechanisms for Intra-Regional Trade and Investment Financing

Latin American regional trade financing has traditionally been carried out by five main institutions: the Latin American Export Bank (BLADEX), the Central American Bank for Economic Integration (BCIE), the Andean Development Corporation (CAF), the Latin American Reserve Fund (LARF), and the Inter-American Development Bank (IDB). Of these institutions, BLADEX specialises solely in trade financing; the others also cover other fields, such as investment financing.

Latin American Export Bank

The Latin American Export Bank (BLADEX) started operating on January 1979, and has since maintained its headquarters in Panama City. The driving force behind the creation of BLADEX was the growing recognition among the Latin American governments of the need for the promotion and diversification of Latin American exports. BLADEX responded to the rationale that an active financial mechanism was needed in order to provide additional finance that matched the growing exports of manufactures and semi-finished goods that already had relevance in the total aggregate of Latin American production.

The creation of BLADEX was encouraged by the Inter-American Development Bank and supported by the World Bank's International Financial Corporation, which actually invested in the capital of the new institution. Today the Bank is constituted by five types of shareholders, as shown in Figure 2.

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Figure 2 **BLADEX Type of Shareholders**

Class A	Class B	Class C	Class D	Class E
• Central banks • Banks with government majority capital • Other govern-ment institutions	• Latin American commercial banks • Financial insti-tutions with a majority of Latin American capital	• Private and commercial banks • Financial institutions	• International organisations • International Finance Corporations	• Natural or legal persons

The Bank's main sources of funds are interbank deposits, borrowed funds and floating rate placements. In late 1994, the interbank deposits accounted for 50% of total financial liabilities. The other main sources of funding for the Bank are short-term and medium-term borrowings. The Bank provides short-term pre-export and post-export financing at competitive rates, mainly to shareholder banks for on-lending to exporters. It also finances imports originating within and outside the region, as long as they contribute to generate future Latin American exports.

The Bank is focused on short-term business, therefore its medium-term lending activities have had a modest growth since its establishment. Nevertheless, according to its 1993 report, there is increasing demand for the financing of exports of capital goods, which usually requires medium-term financing. The Bank has begun to raise medium-term funding (though still on a fairly small scale) with the intention of gradually increasing its medium-term lending. The management of the Bank believes that there are interesting business opportunities in the area of trade-related medium-term financing, which the Bank could pursue on a very selective and limited basis. Indeed, it would seem worth stressing that one of the main (if not the main) gaps in intra-Latin American financing is for medium-term lending, to support exports of capital goods and the development of infrastructure. BLADEX could play an important role here by expanding into this important area.

During 1993, the Bank's lending activities continued to achieve consistent growth, reflecting a strong demand for trade finance in all Latin American markets. Total loans grew by 35%, reaching over US$3 billion. This fact can largely be explained by the improving economic performance of most Latin American countries, coupled with free trade agreements. The distribution of the Bank's credit portfolio by country shows that Brazil, Mexico, Argentina, Chile and Colombia accounted for 86% of the total portfolio, reflecting the natural correlation to the size of these countries' economies and the volume of their total foreign trade (see Table 2).

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Table 2 **BLADEX Credits by Country**[a]
(thousands of dollars)

Country	1991	1992	1993
Argentina	251,497	288,070	408,026
Barbados	3,880	6,733	7,246
Bolivia	–	–	22,986
Brazil	492,222	649,297	960,682
Colombia	41,417	151,817	258,159
Costa Rica	21,345	20,972	27,935
Chile	129,691	219,567	185,458
Ecuador	15,600	30,656	38,449
El Salvador	1,233	20,275	13,077
Guatemala	2,850	8,786	24,871
Haiti	–	–	–
Honduras	4,375	5,294	2,665
Jamaica	36,643	17,376	15,242
Mexico	507,886	620,015	852,446
Nicaragua	6,613	12,878	1,650
Panama	6,283	13,703	10,424
Paraguay	2,211	350	2,348
Peru	82,394	91,329	89,249
Dominican Republic	29,518	56,990	94,648
Trinidad and Tobago	311	5,792	10,000
Uruguay	2,751	34,125	12,892
Venezuela	13,271	70,611	46,129
Others	1,200	6,800	4,594
Total	**1,653,191**	**2,330,936**	**3,089,176**

[a] Includes loans, letters of credit and acceptances.
Source: BLADEX, Annual Report, 1993, p. 24.

Central American Bank for Economic Integration

The Central American Bank for Economic Integration (BCIE) finances investment projects, especially sub-regional infrastructure programmes, and funds projects that create economic complementarity and expand intra-regional trade.

The scale of its lending has been relatively modest, as from its inception in 1961 until the end of 1992, the Bank has lent a mere US$1.7 billion. Recently, the Bank's financial situation was strengthened thanks to external support (the Bank will benefit from recent international initiatives to support the Central American sub-region, particularly from the European Union and the IDB), and to the inclusion of two new extra-regional partners, China and Venezuela.

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Andean Development Corporation

The Andean Development Corporation (CAF) has provided support to the Andean region. It grants medium-term and long-term credits for investment and pre-investment projects; it finances non-traditional exports among the Andean countries and towards other countries; it also facilitates imports from third countries into the Andean region, whereby the CAF assures the risk taken by the bank, via the Mechanism for Confirmation of and Financing of Letters of Credit and Imports (MECOFIN). In 1993, reportedly the institution committed loans of US$2.1 billion.[7] In the same year CAF launched its programme of share participation in private enterprises of member countries and the guaranteeing of bond issues. Thus CAF seems to be adapting flexibly to countries' new needs and to changes in the international financial environment.

Latin American Reserve Fund

The Latin American Reserve Fund (LARF), available to all LAIA member countries, was created in March 1991, on the base of the Andean Reserve Fund, which had operated since 1978.

The main objective is to provide balance of payments credits for the financing of member countries' adjustment policies. For this purpose, total financial support amounting to US$3.7 billion was extended over the 1978-91 period, with the largest part (US$2.1 billion) granted in the form of six-monthly short-term credits and the rest (US$1.6) going to medium-term balance of payments credit support. The main benefit that member countries obtain from the LARF seems to be that it grants member countries rapid access to credit at levels well above individual contributions. The main source of LARF's resources is its own assets and deposits made by member countries' central banks; this distinguishes it from CAF, which funds itself mainly on the international financial markets.

In addition, in 1992, the institution established a facility which offers credit lines that can be used by commercial banks for export financing to member countries. This, together with the Discounting of Banking Acceptances, – through financing intermediaries – allows the LARF to support trade finance operations, both within the sub-region and also with non-LARF member countries.

Another important function that LARF performs is to provide an attractive alternative for countries to invest their reserves. As ECLAC, op. cit., shows,

7 See UNCTAD, op. cit.

in most years the yield in assets invested in this institution was significantly higher than in US Treasury Bills.

Inter-American Development Bank

The Inter-American Development Bank (IDB) is a major financing institution in the region. Its total lending in recent years has been almost as high as World Bank lending to the LAC region.[8] To the extent that a fairly important proportion of its loans go to fund infrastructure, it has very directly supported both regional integration and integration with the world economy. In the field of trade finance, the IDB has approved 43 export financing loans of a cumulative total portfolio of US$1.6 billion; these were granted both from the Bank's ordinary resources and from the Venezuelan Trust Fund. The IDB has recently launched a "Proposal for the establishment of a Regional Network of Export Credit Rediscount Facilities", to provide pre-shipment and post-shipment export financing for the short, medium and long term. Besides its fairly limited role in funding trade, the IDB will play an important role in supporting the regional integration process. An obvious key area is the financing of inter-national transport and communications networks, with special emphasis on investment in the connection between networks existing at a national level.

To conclude this section on mechanisms for intra-regional trade and investment financing, it seems worth stressing that the different institutions that fund trade and investment within the region have on the whole performed fairly well, meeting important needs, and have adapted rather well to changes in those needs.

However, two caveats need to be made. First, there are important gaps in the provision of trade credit. Perhaps the largest gap is insufficient medium-term financing to fund exports of capital goods, both within the region and outside it,[9] as well as to fund large inter-regional infrastructure projects. As regards the latter, given its important expertise in the area, the IDB should clearly play a key role, where possible supplemented by private capital. As regards the funding of exports of capital goods, it would seem important to define what institutions at a regional level should take a lead in this important area, as well as to what extent such funding would be most efficiently provided by one or several regional institutions, and/or by national export credit agencies, as occurs in all developed countries, and as exist in the region

8 For more details, see, for example, S. Griffith-Jones et al. "An Evaluation of IDB Lending 1979-1992", IDS Research Report, Sussex, 1994.

9 Interview material.

for Mexico and Argentina. (Because the experience of Bancomext is so interesting in this context, we include a brief description of its operations and functions in Annex 1.) Indeed, the provision – at a country and/or regional level – of sufficient credit and/or credit guarantee, especially of a medium-term and long-term nature, seems currently an important gap in the financing of trade in LAC countries.[10] Similarly, there seems to be insufficient credit for financing of exports by small and medium enterprises. In this context, the creation of agile and appropriate mechanisms for funding non-traditional exports could represent a large potential for the region, and especially exercise an important effect on intra-regional exports.

A second caveat is that the number of institutions providing finance for trade in the region is fairly large, and seems to have some overlapping of functions. Particularly when and if trade integration progresses towards a truly regional or hemispheric scale, some streamlining of institutions that finance trade within the region may be desirable. However, such streamlining should be carefully carried out, so that no important functions or country links are cancelled, unless it is clear that they will be adequately performed amongst the remaining public or private institutions.

II Intra-Regional Foreign Investment Flows

An important distinction made in the literature on economic regionalism is that between market-driven (or de facto) versus policy-driven (or de jure) regionalism.[11] The classic example of policy-driven regionalism is European integration, while the main example of market-driven regional integration is the Asian experience. Within this latter process, intra-regional foreign direct investment (FDI) has played a key role in supporting both rapid economic growth in that region and stimulating rapidly growing intra-regional trade. Indeed, while in the 1980s 70% of investment flows from underdeveloped countries were channelled to the developed world, the majority of Asian FDI flows went to developing countries in Asia, mainly for investment in export-oriented manufacturing.[12]

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10 Interview material; see also, CEPAL, "El regionalismo abierto en América Latina y el Caribe", Santiago de Chile, 1994.

11 See P. S. Mistry "Regional Integration and Development: Panacea or Pitfall?" FONDAD, 1996. World Bank, "The New Regionalism and its Consequences", March 1994, mimeo, International Economics Department. C. Oman, *Globalisation and Regionalisation: The Challenge for Developing Countries*, OECD, Paris, 1994.

12 See W. Peres, "The internationalisation of Latin American industrial firms", In: *CEPAL Review 49*, April 1993, Santiago de Chile. P.E. Tolentino, *Technological Innovation and Third World Multinationals*, Routledge, London, 1993.

The Latin American and Caribbean regions seem to be in an intermediate position. Though to an important extent integration within the LAC region and with the US is policy-driven, there is emerging an increasingly dynamic undercurrent of largely de facto or market-driven investment flows which encourage integration. As the growth of these intra-regional investments is a new phenomenon, information on them is still quite patchy; efforts at analysing their impact are even more rudimentary. In what follows, we will attempt to systematise the data, emphasise certain peculiarities of this phenomenon, and provide a framework for analysing its impact.

It is only recently that Latin America and the Caribbean have seen outward FDI increase, despite the fact that the first outward Third World investment originated in the region; thus, amongst the first developing countries' TNCs on record was an Argentinean textile manufacturer, Alparagatas, and a food manufacturer, Bunge y Born. These investments were channelled to other South American countries, especially Brazil.

Table 3 FDI Outflows, annual averages
(millions of dollars)

Country / Territory	1975-77	1978-80	1981-83	1984-86	1987-89	1990-91
LAIA	**169.0**	**686.5**	**272.5**	**276.3**	**392.7**	**605.1**
Argentina	-0.3	-192.0	-45.0	–	–	–
Bolivia	–	0.5	0.1	–	1.5	1.6
Brazil	147.0	687.0	256.7	88.7	278.7	332.5
Chile	1.7	15.0	–	–	–	–
Colombia	12.3	171.0	56.7	20.7	33.0	20.0
Paraguay	8.3	5.0	–	–	–	–
Uruguay	–	–	2.7	3.0	-0.9	–
Venezuela	–	–	1.3	164.0	80.3	251.0
Central America	**-0.4**	**7.2**	**3.7**	**4.1**	**3.8**	**3.3**
Costa Rica	-0.4	7.2	3.7	4.1	3.8	3.3
Caribbean	**1.4**	**8.1**	**3.0**	**8.3**	**4.0**	**1.4**
Barbados	0.7	0.8	1.0	2.1	2.1	1.4
Netherlands Antilles	0.7	7.3	0.7	-0.2	2.5	–
Trinidad & Tobago	–	–	1.2	6.3	-0.6	–
Total	**170.0**	**701.8**	**279.2**	**288.7**	**400.4**	**609.7**

Source: UNCTAD, Division on Transnational Corporations and Investment, "World Investment Directory, Vol. IV: Latin America and the Caribbean", New York, 1994.

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According to UNCTAD data (see Table 3), average annual outflows of FDI from countries in the LAC region (excluding Mexico) reached US$610 million in the 1990-91 period, a level almost four times higher than during the 1975-77 period. After the decline of outflows in the early eighties, there was strong growth in annual average FDI outflows from countries in the region between 1984-86 and 1987-89, with further increases occurring in the 1990-91 period. Though data available from other sources indicate somewhat higher outflows, the trends shown in Table 3 are the same as those given in other sources. The key point is that a recovery of growth in the region, the prospects of increased integration, the opportunities offered by privatisation and greater availability of foreign exchange (due mainly to a massive surge in capital flows from abroad) have increased the propensity to invest abroad in the early 1990s of the countries in the region.

As can be seen in Table 3, it is the member countries of the LAIA, the relatively most industrialised countries of the region, which are practically the only source of outward FDI from the region, representing around 99% during 1987-91.

Latin America's outward direct investments tend to be heavily concentrated in certain destinations. For Brazil, Mexico and Venezuela the main recipient country is the United States; Colombian, Chilean, Argentinean and Peruvian outward investments are directed primarily to other Latin American countries.[13] Particularly in the case of Chile there has been very rapid growth of outward FDI in the early 1990s, concentrated in the acquisition of important assets in the privatisation of companies, especially in Argentina and Peru (see Table 4). Mexico has become a dominant source of FDI in the Central American region (especially Guatemala). Brazil, as well as more recently Argentina, is a significant source of FDI in Paraguay and a number of the Mercosur countries. Venezuela and Colombia have also become an important source of FDI for a number of smaller countries in the Andean Pact. The cases of Mercosur and the Andean Pact just mentioned would seem to show the significance of intra-regional investment following de jure integration. On the other hand, the Chilean outward investment mentioned above, which was largely concentrated in Argentina, preceded any major increase in formal integration between the two countries.

Reportedly, the early 1990s have been characterised by a further increase in outward FDI, and an increase in the share of such investments undertaken in other LAC countries.[14]

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13 Data from Peres, op. cit. and Table 4.

14 UNCTAD, "World Investment Report: Transnational Corporations, Employment and the Workplace", UNCTAD, Geneva, 1994.

Table 4 **Geographical Distribution of Outward FDI Stock, by home country** (percentage)

Home Country / Year	**All Developed**	**North America**	**Western Europe**	**Other Developed**	**All Developing**	**LAC**
Brazil (1990)	54.1	36.4	17.2	0.4	45.9	44.1
Chile (1992)	6.2	0.7	5.1	0.4	93.8	80.9
Colombia (1990)	24.6	20.7	3.9	-	75.4	71.6
Peru (1990)	20.0	100.0	-	-	80.0	74.0

Source: UNCTAD, Division on Transnational Corporations and Investment, "World Investment Directory, Vol. IV: Latin American and the Caribbean", New York, 1994.

Latin American outward FDI tends to be fairly heavily concentrated in the secondary and tertiary sectors, with a fairly important concentration in certain sub-sectors. Over 95% of Venezuela's investment in the US is in petroleum refining and related industries. Mexican investment is heavily concentrated in non-metallic minerals industries, mainly in glass (Vitro) and cement (CEMEX). Brazilian investment is heavily concentrated in the production of cars, clothing and marketing.

The scale and motivation of some of these investments can be illustrated by the case of the two major Mexican investments abroad, which mostly were undertaken through the acquisition of existing firms. The most important take-over of a US firm by a Mexican conglomerate was by Vitro, which in 1989 bought the second largest glass container manufacturer in the United States. The cost of the acquisition was estimated at over US$900 million. Reportedly the main motivation was the need to guarantee its international expansion.[15] The Mexican cement conglomerate CEMEX first took over its major domestic competitor to prevent its being acquired by one of the largest world producers, and then went abroad. The argument given to justify such a strategy was to increase cost-efficiency through economics of multi-plant operations and improvement of distribution channels. CEMEX purchases abroad included not only a major plant in the US, but also the two largest Spanish cement producers. After its investments in the 1990s (estimated at US$1.8 billion) CEMEX became the fourth largest cement producer in the world. The scale of these firms' investments shows that they are following strategies whose main elements for defining the structure of their industries and their competitive positions are determined in the integrated Mexican-US economic area. As a result of this broadened regional – and in some cases

15 A. Calderón, M. Mortimore and W. Peres, "Mexico's Integration into the North American Economy: the Role of Foreign Investment", In: IRELA, *Foreign Direct Investment in Developing Countries: the Case of Latin America*, Madrid, 1994.

global – perspective, these Mexican firms are becoming major international players in their sectors.

For the most advanced economies in the region, the late 1980s and early 1990s have seen increasing outward FDI in the tertiary sector, particularly in banking and financial services, as well as wholesale and retail trade. These outflows have been directed to less industrialised countries within the region, stimulated by regional economic integration and the removal of FDI barriers. The tertiary sector has been dominant in the outward FDI of Colombia and Peru. The tertiary sector has also dominated outward FDI of Chile, most recently with privatisation opportunities within the region enabling Chilean firms to expand their investment in utilities.

More generally, one of the main factors that has encouraged an important surge in intra-regional investment is the privatisation of state companies. Outstanding examples were the purchase of 80% of the Argentinean company SOMISA by a consortium consisting of the Argentinean group TECHNIT, the Chilean company CAP, and the Brazilian SIMINAUS and VALE DO RIO DOCE. Another important example was the sale of Quellaveco copper deposits in Peru for a small amount to the Chilean company MANTOS BLANCOS, which has promised to invest more than US$500 million.

Chilean Investment

Reportedly, Chile has in recent years become the most active Latin American country undertaking FDI in the region. By October 1994, the stock of Chilean FDI in the region amounted to more than US$1.1 billion, of which almost US$700 million (over 60%) was in Argentina; indeed, in Argentina, there are more than 50 companies owned by or linked to Chilean corporations. A large part of this stock was acquired in 1992 through participation in the Argentinean privatisation programme. The Argentinean Economic Ministry reports that 60% of the sales of public companies were to foreign investors; Chilean investors played an important role in this process, accounting for 6 per cent of total sales. The most significant sectors for Chilean investment in Argentina are electricity and gas; recently, Chilean investors have also acquired an important share in the privatised electrical companies of Peru; as a result, Chilectra has become the largest company in Latin America for distributing electricity. Also significant in Chilean investment in Argentina, as well as in other neighbouring countries, are the privatised pension fund administration companies.[16]

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16 *El Mercurio, Edición Internacional*, 17-23 Nov. 1994, Santiago de Chile. These figures are based on Central Bank data; other estimates are far higher. For more details, see: A. Calderón and S. Griffith-Jones "Los flujos de capital extranjero en la economía chilena: renovado acceso y nuevos usos", mimeo, CEPAL, 1994.

A very interesting feature in the process of outward regional investment by Chilean companies (which may well be relevant for the case of other Latin American companies) is that this outward regional investment is to an important extent funded by resources obtained on the international capital markets, and especially those obtained by placement of Chilean shares on the New York stock exchange, via American Depositary Receipts (ADRs).[17] Furthermore, it would seem that an important part of the financial resources obtained by Chilean companies via ADRs and also via other mechanisms, such as international loans, have been dedicated to – and were obtained specifically with the purpose of – the financing of their outward regional FDI, especially in investments in privatisations in Argentina and Peru. It could indeed be argued that on a fairly limited scale Chile becomes a "recycling centre" for financial resources, which come from the international capital markets (especially the US ones) and are then channelled towards Chilean outward regional investment. On a small scale, it could be said that Chile has become a regional financial centre.

A second important feature of much Chilean outward foreign investment to the region (which may also be important for other countries) is that outward investment often seems to be associated with export of "know-how" in management and technical aspects, to an important (though not exclusive) extent linked to the fact that economic reforms began significantly earlier in Chile[18] than in neighbouring countries, and to the fact that the economic reforms (in aspects such as privatisation) follow very similar patterns to, and are to a certain extent modelled on, those carried out earlier in Chile. This is particularly clear in the case of the electricity and gas sector, as well as that of private pension fund administration companies, because in these cases privatisation in Chile had occurred in the 1980s, which has allowed an important period of experience.

It is the link between these three aspects – the renewed access on an important scale to international capital markets in the early 1990s of Chilean companies, the expertise previously acquired by Chilean companies related, to a fairly important extent, to early privatisation, and finally the opportunities offered by the recent processes of privatisation in neighbouring countries – which provided important incentives for the rapid growth of Chilean regional outward FDI. The liberalisation by the Chilean Central Bank in 1991 of the mechanisms through which outward investment could be carried out significantly facilitated the process. It is interesting that this liberalisation was to a great extent spurred by an important increase in

17 See A. Calderón and S. Griffith-Jones, op. cit., especially Table 8, and case studies.
18 Interview material.

From: Regionalism and the Global Economy: The Case of Latin America and the Caribbean
FONDAD, The Hague, 1995, www.fondad.org

foreign reserves, also linked to the beginning of the surge of capital flows to Chile, as well as to several other Latin American countries.[19] Thus, both at a microeconomic and at a macroeconomic level, the increase in Chilean outward investment, mainly in the region, is related to, and to a certain extent underpinned by, the surge of flows from global capital markets. Here the processes of globalisation and regionalisation clearly complement each other.

Balance of Payments Impact

An important issue, still insufficiently explored, is the extent to which Latin American firms' foreign investment activity affects and will affect in the medium term the home country's balance of payments, and ultimately the welfare of its population.

There is as yet insufficient information available to allow such an evaluation for intra-Latin American investments. However, a first rough evaluation can be made of the balance of payments impact of Latin American FDI in the US. Indeed, as can be seen in Table 5, for each of the years 1988-1992, the impact of Latin American foreign affiliates in the US on the trade balance of the US was negative. Although this does not mean that the source country is the sole beneficiary, this information added to that of available studies[20] would seem to indicate in a preliminary way that Latin American foreign investments in the US contributed to improve those countries' trade balance. A fuller understanding of the balance of payments impact of such FDI would, however, need to examine flows on the capital account (including capital flows and profit remittances) as well. Indeed, a word of caution may be important here. A recent study by the Federal Reserve Bank of New York[21] suggests that US companies recently purchased by foreign capital have on average had losses.

III The Surge of Private Flows into the Region and the Link with Regional Integration

As is well known, there has been a major surge in private capital flows into the LAC region[22] in the 1990s. An important proportion of these flows came into Mexico (see Table 6).

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19 See, for example, S. Griffith-Jones et al., "The Return of Private Capital to Latin America", In: J.J. Teunissen (ed.), *Fragile Finance: Rethinking the International Monetary System*, Fondad, The Hague, 1993.

20 Quoted in Peres, op. cit.

21 *Financial Times*, November 5, 1994.

22 See R. Ffrench-Davis and S. Griffith-Jones (eds.) *Coping with Capital Surges: the Return of Finance to Latin America*, Lynne Rienner and FCE, Boulder, 1995.

Table 5 United States: External Trade of Non-Bank US Affiliates of Foreign Firms (millions of dollars)

Source Country	1988 Exports from US	1988 Imports from US	1989 Exports from US	1989 Imports from US	1990 Exports from US	1990 Imports from US	1991 Exports from US	1991 Imports from US	1992 Exports from US	1992 Imports from US
Brazil	148	186	134	186	196	211	216	551	483	811
Mexico	84	803	131	821	157	811	125	904	377	883
Venezuela	74	n.a.*	141	2,886	257	4,637	n.a.*	n.a.*	n.a.*	n.a.*
Other	1,217	n.a.*	1,274	609	1,027	603	n.a.*	n.a.*	n.a.*	n.a.*
Latin America Subtotal	**1,542**	**3,806**	**1,681**	**4,501**	**1,637**	**6,262**	**1,698**	**5,666**	**2,397**	**6,054**
Panama	266	523	331	544	247	547	280	181	602	140
Latin America Total	**1,808**	**4,329**	**2,012**	**5,045**	**1,883**	**6,809**	**1,978**	**5,847**	**2,999**	**6,194**
World Total	**69,541**	**155,533**	**84,263**	**169,745**	**91,137**	**180,647**	**96,933**	**178,702**	**100,615**	**182,152**

* Not available, suppressed to avoid disclosure of data of individual companies.
Source: United States Department of Commerce, "Survey of Current Business", several numbers.

Table 6 Net Capital Flows to Latin America[a] (billions of dollars and percentage)

	Total Net Flows						Percentage of GDP					
	1977-81	1983-90	1990	1991	1992*b*	1993*b*	1977-81	1983-90	1990	1991	1992*b*	1993*b*
Latin America and the Caribbean	29.4	10.1	21.6	37.0	59.4	64.2	4.5	1.3	2.0	3.2	4.7	4.7
Argentina	1.9	1.8	1.5	3.0	10.9	10.0	2.0	2.3	1.1	1.6	4.9	4.1
Chile	2.6	1.5	3.1	1.4	3.5	2.8	12.7	7.0	10.3	4.2	8.6	6.3
Mexico	8.2	0.8	11.6	21.9	24.7	28.5	5.1	0.3	4.8	7.6	7.5	8.3

a Includes long and short-term capital, unrequited official transfers and errors and omissions.
b Preliminary figures.
Source: ECLAC, "Policies to improve linkages with the global economy. Report for the XXV sessions' period", Chapter IX, Santiago de Chile, 1994.

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A number of reasons, both domestic and international, explain this surge of capital flows to the LAC region. These include, on the international side, very low US interest rates and recession in the industrial countries in the early 1990s, and changes in US capital market regulations. On the domestic side, they include far greater macroeconomic stability, the elimination of the debt overhang via Brady deals and other mechanisms, as well as profitable opportunities provided by the development of domestic capital markets, privatisation programmes and relatively high real interest rates.

Clearly the prospects of regional integration, and especially integration into NAFTA, have been an important factor encouraging such inflows, particularly into Mexico. This seems to be particularly the case for foreign direct investment flows. Indeed, shorter term profitability factors are the key to the very rapid growth of portfolio flows to the LAC region in general, and to Mexico in particular, even though the prospect of "locking" structural reforms and macroeconomic stability via NAFTA reduces perceived country risk for Mexico, and therefore also contributes to increase its attractiveness for portfolio flows; so does the signing of memoranda of understanding and co-ordination of efforts with US regulators, efforts facilitated by the prospects and reality of NAFTA. However, it is FDI flows which would seem to respond more strongly to longer-term considerations; in this context, Mexico's entry into NAFTA provides a more reliable access to the huge North American market. Reportedly, the rules of origin and local content negotiated within NAFTA afford enough flexibility to enable the participation of investors from all over the world.[23] This was largely because the opinions of companies already operating in Mexico, especially automobile companies, prevailed in the discussions. Indeed, though foreign direct investment in Mexico by US and other multinational companies was already important before NAFTA (de facto integration), NAFTA increased Mexico's appeal to investors of diverse origins as a platform for exporting manufactured goods, particularly to the North American market. Volkswagen and Nissan have taken important decisions in this regard; it is expected that increased integration could also lead some North American subsidiaries in Asia to transfer their operations to Mexico.

Table 7 shows how significantly FDI to Mexico has increased since NAFTA was announced and approved. Total FDI grew from US$1.7 billion in 1988 to US$2.6 billion in 1990, and reached US$4.9 billion in 1993, with a further important increase reported for 1994. (It should be mentioned that in the early 1980s there was also a surge of FDI, with inflows averaging around

23 See A. Gurría "Capital Flows: the Mexican Case", In: R. Ffrench-Davis and S. Griffith-Jones, op. cit.

US$3 billion in 1980-81; this surge, however, was brief and was then dampened by the debt crisis.)[24]

Table 7 **Mexico: Foreign Investment Flows**
(millions of dollars)

	1990	1991	1992	1993
Total New Foreign Investment	**6,004**	**17,504**	**22,404**	**33,332**
Direct Investment	**2,633**	**4,761**	**4,393**	**4,901**
New Investment	1,115	3,422	3,012	4,108
Re-Investment	1,070	1,408	1,020	1,135
Inter-Company Accounts	448	-69	360	-342
Portfolio Investment	**3,371**	**12,743**	**18,011**	**28,431**
Stock Market	1,995	6,332	4,783	10,717
Securities denominated in new pesos	–	3,396	8,117	6,868
Securities denominated in foreign currencies	1,376	3,015	5,111	10,847

Source: Personal elaboration based on information from the Banco de México.

Table 7 also shows the spectacular rise in portfolio investment flows during the 1988-93 period from 0 to US$28 billion (even though these fell very significantly in 1994). As pointed out above, portfolio flows respond mainly to short-term factors, and may be extremely volatile. However, NAFTA may have encouraged the surge of foreign investment in the Mexican stock market in 1993. Nevertheless, the fact that portfolio flows fell in 1994, precisely the year when NAFTA started, would seem to show the somewhat tenuous link between portfolio flows and NAFTA. It could be argued that the fall in portfolio flows in early 1994 could have been far sharper without the existence of NAFTA and the mechanisms it creates. Indeed, when fairly major outflows of portfolio flows were threatening in April 1994 to lead to an important devaluation of the Mexican peso, the US, Canada and Mexico reached an agreement to establish an exchange stabilisation fund of US$8.8 billion. This mechanism was, however, unable to prevent a dramatic outflow and major devaluation in December 1994, when portfolio capital left Mexico on a very large scale.

As regards FDI to Mexico, Table 8 shows its composition by country of origin. There is as yet no clear pattern emerging here of the impact of NAFTA. Indeed, the share of FDI originating in the US first fell sharply in

24 Data based on Gurría, op. cit.

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1992, only to rise sharply in 1993; the share of FDI from Japan has fallen quite consistently in recent years. Flows from Canada seem to have a relatively constant share. Trends for the share of European flows are a bit unclear, with British investment apparently increasing. Overall, we see an increase (in absolute values) from practically all countries, with the exception of Japan.

We can therefore conclude that Mexico's entering into NAFTA has so far been associated with a fairly important increase in FDI and that a causal link seems important; it is also – very weakly – associated with a surge of portfolio flows, but the causal links are less clear.

Table 8 New Foreign Direct Investment in Mexico by Country of Origin
(millions of dollars)

Country	1990	%	1991	%	1992	%	1993	%
United States	2,308.0	62.0	2,386.0	66.9	1,651.7	45.1	3,503.6	71.5
United Kingdom	114.4	3.0	74.1	2.0	426.8	11.8	189.2	3.8
Germany	288.0	7.7	84.6	2.3	84.9	2.3	111.4	2.2
Switzerland	148.0	3.9	68.0	1.9	315.2	8.7	101.7	2.0
Japan	120.8	3.2	73.5	2.0	86.9	2.4	73.6	1.5
France	181.0	4.8	500.5	14.0	68.9	1.9	76.9	1.5
Spain	10.8	0.2	43.5	1.2	37.2	1.0	63.5	1.2
Canada	56.1	1.5	74.2	2.0	88.4	2.4	74.2	1.5
Sweden	13.3	0.3	13.8	0.3	2.0	0.1	2.4	0.1
Italy	4.6	0.1	1.9	0.1	7.5	0.2	4.6	0.1
Others	477.2	12.8	244.8	6.8	830.1	23.0	699.6	14.0
Total	**3,722.2**	**100.0**	**3,564.9**	**100.0**	**3,599.6**	**100.0**	**4,900.7**	**100.0**

Note: Excludes portfolio investment and the amount of foreign capital that resulted from authorisations granted by the CNIE to invest in companies traded on the Mexican Stock Exchange. Figures may not add up because of rounding.
Source: Personal elaboration based on information from the Banco de México.

The link between integration with a major market and increased FDI seems also to be shown by other experiences. As Table 9 shows, after Portugal and Spain joined the EC, FDI to those countries increased very significantly, apparently showing the close link between increased FDI and regional integration with a very important market. However, it should be stressed that participation in a regional market is not a sufficient condition for a developing country to attract FDI. As Table 9 shows, after Greece joined the EC, it did not experience a large increase in FDI inflows. However, the southern enlargement of the EC does show on balance a net important positive effect of integration on FDI flows.

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Indeed, in the case of Mexico, and also in the case of a possible accession of Chile to NAFTA, it seems clear that the main benefits of joining NAFTA for the Latin American economies are not obtained via effects from trade,[25] but via effects from increased capital flows. Thus models prepared to measure such impacts of NAFTA for the Mexican economy estimate fairly small effects (of around 2.0 to 3.0% of Mexican GDP) for trade creation, which include both the classic effects via inter-sectoral reallocation of resources to sectors with comparative advantage and the benefits resulting from economies of scale and increasing returns to scale. Once estimates for additional higher foreign investment are added, the total impact of NAFTA increases fairly significantly, with estimates reaching a range of 5.0 to 8.0% of GDP.[26] The key problem with measuring precisely the effect of additional FDI flows is the uncertainty about their magnitude.

Table 9 **Average FDI Flows and Rates of Capital Formation in Selected Countries** (percentage)

	1976-80	1981-85	1986-91
Greece (1981)*			
FDI inflows/gross domestic capital formation	5.4	6.0	8.0
FDI inflows/GDP	1.5	1.3	1.5
Portugal (1986)*			
FDI inflows/gross domestic capital formation	1.5	3.0	10.7
FDI inflows/GDP	0.4	0.9	3.0
Spain (1986)*			
FDI inflows/gross domestic capital formation	2.8	5.3	9.2
FDI inflows/GDP	0.7	1.1	2.2

* Years in parenthesis reflect date of joining EC.
Source: Based on "World Investment Report", United Nations, New York, 1993.

A final point needs to be made here. Additional FDI and other capital flows, linked to regional integration, have important economic benefits, both of a macroeconomic kind (by providing foreign exchange that allows higher growth) and a microeconomic kind (by facilitating improvement of technology and management). However, there are also risks in capital flows, especially clear in non-FDI flows. Thus, surges in capital flows can – and recently have – led to overvaluation of currencies, which discourages exports,

25 See Ros, op. cit.
26 See for example D. Brown, A. Deardorff and R. Stern, "A North American Free Trade Agreement: Analytical Issues and a Computational Assessment", mimeo, 1991.

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even though increased exports are precisely a key aim of regional integration. Increased capital inflows may also partly replace domestic savings, and therefore lead only partly to increased investment. If insufficient capital inflows are channelled into increased investment in tradeables, the country could be creating balance of payments problems for the future. If an important proportion of inflows is devoted to increased investment in tradeables (more likely in the case of FDI), their long-term effects are more likely to be beneficial. Above all, as recent events in Mexico have shown, portfolio and short-term capital flows can be incredibly volatile, with very negative effects on countries' economies.

We therefore can conclude that the main welfare effects of regional integration (and especially of NAFTA) are related to the impact of increased foreign inflows. Though there is evidence of such an impact, its magnitude is somewhat unclear, as are its long-term effects. However, as regards the latter, cautious optimism seems justified by preliminary evidence, though euphoric conclusions clearly are not. Unfortunately, events in Mexico in December 1994 confirm many of the concerns of more pessimistic analysts.

IV Conclusions and Policy Issues

Financial mechanisms and flows play a key role in supporting economic integration. In the case of Latin American and Caribbean integration, a number of institutions were explicitly created to facilitate trade (payments and clearing arrangements) and finance it (e.g. BLADEX). Most of these mechanisms and institutions have functioned fairly effectively, even though the 1980s put special pressure on them; unfortunately, payments and clearing arrangements in Central America and in the Caribbean have not been able to recover from their crisis in the 1980s, while the LAIA mechanism clearly has. As integration becomes increasingly regional (and probably hemispheric), it may be appropriate to think in terms of a regional payments and clearing arrangement, based for example on the broadening of the successful LAIA mechanism. Such a payments and clearing mechanism could both sustain and encourage full regional integration.

The institutions, such as BLADEX, CAF, the BCIE, CAF and LARF, which provide credit for intra-regional trade have on the whole worked well, as have export credit agencies in individual countries, the most important of which is BANCOMEXT.

Relevant policy issues are the following:

- Is there a gap, with insufficient medium-term and long-term finance, provided either by these institutions and/or private capital markets to fund exports of capital goods? Is it necessary to complete private financial markets in this field?

- If there is such a gap, what institution/s should best increasingly focus on these financial activities, which will help fund intra-regional trade, that is more technology and skill-intensive?
- What modalities of collaboration between public and private institutions/ mechanisms would best suit these needs and be the most cost effective from the point of view of using public funds?
- To what extent should regional financial institutions undertake such tasks, or would they be better achieved via national export credit agencies, as occurs in the industrial countries?
- Should existing regional and sub-regional credit institutions possibly be streamlined to avoid overlapping in certain functions, and also to increasingly sustain a more regional and – hopefully – a more hemispheric integration process? (However, any streamlining would have to be carefully studied and carried out, to avoid disrupting any essential functions.)

Three other important policy issues arise. Firstly, how should the rapidly increasing needs to fund intra-national infrastructure (in its broadest sense, to include sectors such as telecommunications and "information superhighways") essential to support trade integration be best met? In this context, it should be remembered that to an important extent the European Investment Bank (created at the same time as the European Community was formed) was largely geared to funding infrastructure to support European integration. It would seem that particularly the IDB, possibly with the support of the World Bank, should take a leading role in such funding, given its expertise in the field. Creative forms of collaboration and co-financing with private capital flows need to be found; and the European Union experience, with the recent creation of a 3 billion ECU European Investment Fund to guarantee private investment in very large intra-national infrastructure projects, provides an interesting example which could be adapted to the needs of Western Hemispheric integration.

Secondly, should further measures be taken to encourage intra-regional FDI and investment from outside the region? To what extent are these flows increased by the prospect of increased integration? To what extent are their effects welfare-enhancing in the medium to long term? To answer those questions better, a fuller understanding of the scale and the impact of such flows seems essential, and careful evaluation needs to be undertaken by national governments as well as regional institutions like ECLAC and/or the IDB.

Last but not least, there is the forgotten financial agenda in the Western Hemisphere integration process which may need to be brought into the discussion. Should financial compensatory mechanisms (used for example for labour retraining) be designed on a significant scale to compensate sectors and regions which suffer dislocation from trade integration? Even further, should certain financial mechanisms be created which support integration by reducing extreme inequalities between countries? This may sound radical or even utopian in the context of today's discussion in the Western Hemisphere, but it was, and still is, a central part of the West European integration process, implemented both through credit mechanisms (e.g. the European Investment Bank) and through fiscal mechanisms (e.g. the Structural Funds).

It seems that in the context of Western Hemispheric integration, compensatory mechanisms operate mainly via differential schedules in the liberalisation of trade. Though valuable, a question that needs addressing is whether that is enough to provide long-term support from all sectors and social groups for the integration process.

We can conclude that the policy agenda for the financial aspects of regional integration is a rich and complex one, with very central issues for the success of the integration process.

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Annex 1 Export Financing in Mexico

The Banco Nacional de Comercio Exterior (Bancomext) is responsible for promoting supplementary export financing, with particular emphasis on small and medium-scale enterprise and potential exporters. It operates as a bank of first level by directly financing exporters through its network offices, and at the second level by conducting export support operations through commercial banks. The participation of Bancomext in export financing is considerable. During the 1991-1992 period, it covered 60% of short-term and pre-shipment and post-shipment financing and 100% of long-term financing of investment projects. Almost 75% of loans were channelled to manufacturing firms and export services. To facilitate the access of small and medium-scale enterprise to export loans, Bancomext reformulated its export guarantee to include provision for immediate, unconditional payment. It also introduced credit cards for use by exporters and other financial instruments, that would be accessible to indirect exporters, since Mexico's experience with national letters of credit had not achieved the desired results.

Table 10 Financing by Bancomext 1992-1993
(millions of dollars and percentage)

	1992	1993	Increase (%)
Short-Term	**7,310**	**10,581**	**45**
Production	5,212	6,550	26
Sales	2,098	4,031	92
Long-Term	**1,665**	**3,013**	**81**
Investment Projects in Mexico	1,648	2,933	78
Export Projects	17	80	371
Subtotal	**8,975**	**13,594**	**51**
Guarantees	937	1,010	8
Total	**9,912**	**14,604**	**47**

Source: Bancomext, "Annual Report 1993", Mexico, 1993.

As Table 10 shows, in 1993 Bancomext provided resources for US$14,604 million to support the foreign trade activities of the country, a figure 47% above the one reached in 1992. According to Bancomext, this was due to the stability of the country's macroeconomic framework and to the improvement in the efficiency of the bank itself. Interest rates of the main financial products were reduced. This allowed the bank to continue offering internationally competitive interest rates and terms of payment which, together

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with improved coordination with the financial institutions, contributed to a twofold increase in the number of users to 14,907 in relation to 1992.

Direct exporters and their suppliers were granted short-term credit for a total of US$10,581 million. Of this figure, US$6,550 million were channelled to the production of export goods and US$4,031 million to their sale process.

Long-term financing reached a total of US$3,013 million of which US$1,046 million corresponded to investment projects, US$512 million to imports of capital goods, US$175 million to acquire national equipment units, US$1,200 million to the restructuring of passive of firms with financial problems, and US$80 million to external sales of capital goods. Extension of guarantees reached US$1,010 million.

International Projects

Among others, Bancomext authorised the following credits:

- Mexpetrol of Argentina: credit of US$30 million for exploration and exploitation of oil wells in that country.
- Unión de Empresas del Cemento: credit to buy a cement plant in Mariel Cuba, through the investment-debt swap mechanism.
- Programme FICE-Bovine Meat between Bancomext and the Ministry of Finance: US$10.9 million for the establishment of a financial mechanism to support exporters of meat to Mexico in Central America.
- Credit lines were established with Banco Do Brasil, Petrobas, Banco Mercantil de Venezuela and Banco Sud for a total of US$40 million for the promotion of non-oil exports to South America.
- Export of digital telephone exchanges to modernise the telephone system of Guatemala City and its suburban zones. Bancomext provided support through the credit line with the Central American Bank of Economic Integration (BCIE).
- Joint-Venture between Mexpetrol and a US company for the exploitation of the oil field "Las Casas" in Guatemala. Bancomext provided credit to the Mexican part and participates as shareholder with the firm that will develop the project.
- Perforation of geothermic wells in Colombia by a Mexican company associated with a Colombian one. In El Salvador, Mexican firms were assigned nine projects of generation and transmission of energy.
- Hotel El Prado in Santo Domingo: construction by three Mexican groups.
- Export of 200 units of passenger transport (public service) to a transport cooperative in Guatemala. The Guatemalan commercial banks will support this project with resources from the line Bancomext-BCIE.
- A Mexican firm was given the construction of a dam in the Dominican Republic.

Table 11 Bancomext: Financial Instruments to Support Exports

Instruments	Objectives and Terms of Payment
Productive Cycle (Export Card, CTI, CAPTA, FIME, and CCC/EDC). Beneficiaries: direct and indirect exporters of primary products of the agricultural and fishing sectors; producers of capital goods and firms in the services sector.	Short-term credits, up to 360 days destined to give immediate access to financing for working capital, purchase of machinery and equipment by exporting firms.
Sales (VEXPO, VENEXI, VELPLA and FACTUR). Beneficiaries: direct and indirect exporters; producers and/or commercialisers of capital goods; firms working on real estate projects that generate foreign exchange and buyers of export spaces in fairs or offices in business centres.	Short-term and long-term credits up to 20 years for sales of capital goods. Includes indirect exporters.
Equipment Units (UNE, EXIM and TRANSPORTISTAS). Beneficiaries: Transport firms and those firms included in the sectors supported by the bank that engage in buying machinery.	Medium-term credits for the purchase of machinery and equipment (5-10 years).
Investment Projects (PROIN, TECNO, DTI and INVA). Beneficiaries: direct and indirect exporters who engage in joint ventures with foreign firms or in the construction of industrial estates, tourism projects, business centres or export fairs.	Long-term credits, up to 20 years, for export-oriented investment, technological development, construction of industrial estates, tourist infrastructure and the establishment of strategic alliances with foreign firms.
Factoring (COFIN) (Financial Consolidation). Beneficiaries: direct and indirect exporters.	Long-term credit, up to 20 years for the restructuring of credits provided by intermediate financial institutions.
Promotional Activities. Beneficiaries: all firms in the list of sectors supported by the bank.	Short and medium term (1-5 years) for activities oriented to the promotion and commercialisation of Mexican goods and services (i.e. participation in fairs, publicity campaigns, market studies etc.).

Sources: ECLAC, "Open Regionalism in Latin America and the Caribbean", Santiago de Chile, 1994. Bancomext, "Annual Report 1993", Mexico, 1993.