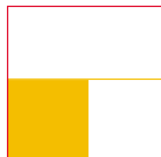
PART VI



Summary

Until the macroeconomic crises of the 1980s, most Latin American countries relied on a wide array of industrial and investment policies as the main tools to expand their industrial bases and develop new sectors. For the most part, these policies were based on the premise that domestic firms had to be given preference in the local markets, and that government intervention could be tailored to the needs of individual sectors. Common features of such policies included selective import tariff and non-tariff protection, a gamut of financial and fiscal subsidies, direct government ownership of a variety of enterprises, and all types of restrictions on foreign direct investment.

By the mid-1990s, most of these policies had been dismantled or fallen into disuse, and since then a new vintage of industrial policies has emerged. The new policies do not aim to circumvent market outcomes and create an artificial environment for the development of domestic firms. Instead, they address salient market failures either by providing public goods, or through interventions that increase the supply of goods with positive externalities, which tend to be under-provided by the market. These new industrial policies reckon that competitive advantages are to a large extent created, and that building a more competitive economy demands an integral approach inasmuch as competitiveness is not merely the result of individual actions by businesses.

Recent policies take advantage of the coordinating role of government through policies to promote exports, output growth and investment, and higher productivity and greater competitiveness. An example is clusters and networks. On the basis of their power to coordinate, governments now act as external catalysts to facilitate the consolidation of clusters and networks around an existing base of leading private firms.

Chapter 17 provides a detailed description of current industrial policies in Latin America. Not surprisingly, given today's more competitive world economy, export promotion is a major aim of the new policies. In the more policy-proactive countries of the region, a large variety of financial instruments have been devised to ensure that all the stages of the export business can be financed through expedient channels, most often at rates that strictly reflect market conditions. Exports in most countries are also granted fiscal incentives such as tax refunds and drawbacks, temporary admission of imports, and export processing zones. While a few subsidies to exports still remain, the dominant trend is towards their elimination.

Policies to promote investment also include a range of financial and fiscal incentives. Fifteen countries of the region have public sector financial corporations or development banks that provide medium- to long-term loans and other financial services. In some cases, temporary participation in equity of new firms in selected sectors is permitted. Although the late 1980s and early 1990s saw widespread repeal of tax incentives and subsidies, national governments in five countries still offer tax incentives for investments in less developed regions, and 18 countries grant fiscal incentives to various productive sectors.

Surprisingly, the sectors most commonly favored by these incentives are not new or high technology sectors, but tourism and primary sectors such as oil, mining and forestry. This suggests that the landscape of industrial policies is still varied, mixing new interventions that focus on addressing market failures and coordinating disperse economic agents with old tendencies to grant benefits to specific sectors on a case-by-case basis. The process of adopting the new industrial poli-

cies is very much a work in progress, so it would be premature to pass judgment on its effectiveness.

Much more sweeping have been changes in the treatment of foreign direct investment (FDI) throughout Latin America. Since the early 1990s, when the region adopted non-discriminatory policies in treatment of FDI, dismantled restrictions on the repatriation of profits and capital, and opened infrastructure sectors to private participation, most Latin American countries have seen significantly increased flows of FDI. While the net effect for these countries has been a subject of heated debate, the benefits would appear to outweigh any negative effects. FDI generates knowledge spillovers that benefit firms and sectors, improves the quality and diversity of inputs, and acts as a catalyst for expanding export sectors. Although FDI may displace domestic firms or increase the cost of certain inputs, such positive effects tend to predominate, provided the host country has a sufficiently high level of human capital.

Chapter 18 addresses the main question of what countries can do to make themselves more attractive to foreign investors. To evaluate the impact of the different FDI policy options, the chapter isolates the influence of factors that are not amenable to policy action. This is done by applying a "gravity model" that takes into account the size of the recipient economy, its proximity to the source country, and other factors that facilitate bilateral investment, such as a common language or past colonial links. The most important ways that government can influence the FDI environment are through policy actions that affect taxes on foreign corporations and ensure the quality of several types of public institutions. Relying on tax policies to influence FDI, however, could result in destructive competition between potential recipient countries and end up throwing all the benefits of FDI over to foreign corporations. Countries should instead focus on improving the institutional and policy fundamentals that make them attractive to foreign investors. This involves reducing excessive regulation, enforcing property rights, and controlling corruption. These broad policies not only have a much greater impact on FDI than do specific policy measures such as special tax treatment, but they also have significant positive effects on competitiveness.