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Foreign Direct Investment, Trade and Regional Integration in Mercosur*

Marta Castilho
Universidade Federal Fluminense (UFF) and Institute for Applied Economic Research (IPEA), Rio de Janeiro, Brazil
and
Soledad Zignago
University of Paris I, France

1 Introduction

Latin-American countries experienced strong growth in both trade and foreign direct investment (FDI) during the 1990s. The major factors behind this include the recovery of economic growth in the region (mainly because of macroeconomic stabilization) and the multilateral and regional trade liberalization process.

Among a number of different initiatives to achieve economic integration in Latin America, the effort to create a customs union among the eastern countries of the 'southern cone' of South America (that is, Argentina, Brazil, Paraguay and Uruguay, termed the Mercardo Común del Sur, or Mercosur) is the most dynamic. The major economic result has been the intensification of regional trade, which increased fivefold during the 1990s. In addition, trade flows between Mercosur and non-Mercosur countries have also risen substantially. The main external partners of Mercosur are the EU, the USA and other Latin-American countries. The expansion of trade was accompanied by strong growth of FDI inflows to the region. Annual average inflows of FDI rose from

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US$2 billion in 1990 to US$54 billion in 1999. The main investors have been the EU countries, most notably Spain, and the USA.

One can ask if there is a link between the increase in trade and the growth of FDI in the context of trade liberalization and regionalization that occurred in here over the 1990s. In fact, it would be interesting to know, first, if multinational enterprises (MNEs) modified their strategies in the region as a result of Mercosur's creation and, second, if FDI has had a positive impact on imports and exports. These issues are important not only from a microeconomic point of view but also from a macroeconomic one.

The growth of FDI inflows was essential in financing the current balance in Mercosur in the 1990s. However, several issues concerning its long-term contribution to current and trade balance are raised, because the propensity of MNE operating in this region to import has been stronger than their propensity to export. For example, MNEs tend to buy inputs from the parent firm's international network of suppliers, and thus their entry has been accompanied by a rise in imports. On the other hand, the FDI inflows, strongly focused on service sectors, did not generate many exports. From a regional point of view, if the MNE strategies were to exploit the regional market but not to integrate their Mercosur subsidiaries into the international production network, their implementation would not be likely to have a positive direct impact on exports.

However, indirect effects of FDI on trade, such as efficiency improvement, transfers of technology or even the long-term impact of FDI on the financial balance of the relevant host nations (for example, because of transfers between subsidiaries, profit repatriation and so on) can be important. While we do not discuss all these effects in this chapter, we do concentrate on the following issues: the links between FDI and imports; the links between FDI and exports; the influence of Mercosur on MNE strategies, and FDI flows. We do not exhaust these subjects, and, indeed, we are obliged to make some simplified assumptions to derive the conclusions we reach.

No consensus on the link between trade and FDI arises in either the theoretical or the empirical literature. From a theoretical point of view, both flows have traditionally been considered as substitutes: FDI has been seen as an alternative to exports in order to penetrate markets protected by strong trade barriers. Nevertheless, if most of the theoretical approaches emphasise substitution links between these two flows, empirical results often show the existence of complementarities. In an earlier work, we estimated the links between FDI, trade and regional integration