

Doing Business in Latin America

edited by
Lyal White

**Doing Business
in Latin America**

Erratum

(The following text was unintentionally excluded from the printed manuscript. Apologies to both the editor and sponsors)



Doing Business in Latin America: Introduction

Much appreciation goes to the Anglo American Chairman's Fund and DaimlerChrysler for the sponsorship of the Latin America project at SAIIA, and, in particular, DaimlerChrysler for the sponsorship of this publication.

Also, many thanks to Dr Greg Mills whose unwavering support and interest in the Latin America project has driven it to new heights. Having initiated the Latin America project nearly 10 years ago, Dr Mills has seen it grow and ensured that research emanating from the project is at the centre of public and policy debate. The high profile of the Latin America project can be largely attributed to his vision and the endless hours of energy he has dedicated to his work and the organisation.

*Lyal White
February 2005*

Doing Business in Latin America

Edited by
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Foreword

It is my privilege and pleasure to write a foreword for this volume examining the costs and benefits of doing business with Latin America.

The Latin American programme was one of the first research projects — and certainly the longest-standing — established at the South African Institute of International Affairs (SAIIA) after 1994 and under my directorship. With the funding support of the Anglo American Chairman's Fund and, more recently, DaimlerChrysler, along with the active participation of the embassies of the Latin American countries in South Africa, the programme has been at the cutting-edge of a range of issues pertinent to Southern Africa's foreign relationships — both inter-governmental and inter-personal, the latter especially in the business domain and other non-governmental sectors including among universities, think-tanks, and cultural organisations.

Since 1994, SAIIA has run a number of conferences advancing the shared interests of Latin America and Southern Africa, including those on South-South relations in 1997, and those focusing on the potential between the Mercosur and Southern African Development Community (SADC) groupings held in Johannesburg and Sao Paulo in 1998 and 2000 respectively. This compendium reflects the growing interest of SAIIA's research programme in inter-regional commercial ties, which will bind the two regions no matter the political winds or flavour.

For Latin America and Africa share many similarities. Of course there are key differences, both between states within these regions and between the regions themselves, in terms of their economic reform policies and practices. Both face an agenda characterised by new issues and new players. This has been, and is, changing the regional political and economic landscape as well as the nature of interaction necessary in the global context.

The 1980s and 1990s in both regions were characterised by the transition from military or undemocratic regimes to democracy; and by the shift from the travails of import substitution, burgeoning debt, economic uncertainty and crisis to market economics. These changes were to a great extent linked to international and regional political

developments. The end of the Cold War, the emergence of a new consensus on economic orthodoxy, and the spread of democratic systems and values were influenced and reinforced by the pace and depth of globalisation.

The 1990s became, in Latin America, the era of so-called 'neo-liberal' reforms, characterised by privatisation, currency exchangeability, fiscal austerity and strict monetarist measures. These brought inflation under control, encouraged foreign direct investment, and increased regional co-operation and integration. In Latin America, regional integration took the form of the Mercosur trade agreement between Argentina, Bolivia, Brazil, Chile, Paraguay and Uruguay, the North American Free Trade Agreement (NAFTA), the Andean Pact, and discussions preliminary to setting up a continent-wide Free Trade Area of the Americas (FTAA). In Africa, a similar drive has occurred through initiatives such as the Economic Community of West African States (ECOWAS), SADC, the East African Community (EAC) and the Common Market for Eastern and Southern Africa (COMESA). Much of this integration has been underpinned by strategic business-government co-operation and the end of state control, which has widened the role of the private sector in economic affairs.

At the start of the 21st century, both continents for the most part face the challenge of *consolidation* of economic and political reforms rather than *fundamental transition*. The introduction of the template of liberal market reforms — known in Latin America as the 'Washington consensus' and in Africa as 'structural adjustment' — has had its successes. But these policies are viewed by many as also having their costs; with notable failures, such as the emergence of serious social problems (including poverty and crime) and 'jobless growth'. While around 40% of Africa's 800 million people live on less than US\$1 per day, around 200 million of Latin America's 500 million inhabitants are similarly indigent.

While many countries have been able to set in motion the first two of the three stages of such reform (inflation and macro-economic stabilisation and liberalisation leading to the emergence of a functioning market economy), they have been less successful in terms of the third stage, that of export-led growth. This may be because no one country in Latin America (even Chile, which arguably comes closest) or in Africa has implemented the full neo-liberal market

orthodoxy; though this may be because the overall political environment has made it impossible.

In some Latin American countries, the democratisation process has been less than perfect, with the emergence of so-called *democraduras* ('democratorships'), dependent on presidential powers and exhibiting high levels of corruption. Unhappiness with this state of affairs has led to more frequent and more visible manifestations of popular discontent and civil society mobilisation. This would appear to be an increasing, not decreasing, aspect of political life in many Latin American and, indeed, African countries, such as in Argentina and Zimbabwe. It has also led to concerns over what should be on the agenda in planning 'second generation' structural reforms, in areas such as labour policy. Domestically and transnationally, what should be the role of civil society in consolidating democracy — both within and between states? There are also critical questions to be asked about the nature of the relationship between democracy and economic reforms, and democracy and governance. Are unpopular reforms possible in democracies? Or are they impossible without democracy? Which is the better example: Chile, Mexico or Argentina?

This has led in both regions to a debate concerning the role of the state and its institutions, and their relationships with other sectors, including those regionally and further afield. The shift in the debate has included a move from one about 'trickle-down' and 'spill-over' theories of economic growth towards issues of public spending and social cost. How can the 'neo-liberal' free-market reforms of the 1990s be 'adjusted' to deliver social rather than just economic benefits? What are the limitations on the expansion of small- and medium-sized enterprises in developing economies, seen by many as the pistons in the engine of growth providing employment? What can be done to expand the activities of bigger business, the flywheel of prosperity? Also, how can these policies accommodate an increased focus on issues of human rights, accountability and transparency, judicial reform and the eradication of corruption?

In many of these areas of transition and debate, Latin America has been ahead of many developing regions including Africa, but it has not been a linear path of development and reform, as the recent setbacks in Argentina and Peru illustrate.

I believe that this volume will contribute to a greater understanding of Latin America in Southern Africa and *vice versa*. The authors and

editor should be congratulated on its production at a nascent time in both our inter-regional relationships and domestic reform processes.

Greg Mills
SAIIA National Director
February 2005

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Doing Business in Latin America: Introduction and Overview of the Region

Lyal White¹

According to current macro-economic indicators, Latin America appears to be emerging from its economic slump and is set to record a growth rate of 4.6% in 2004. This is a marked improvement on the 1.8% it achieved in 2003, and an economic contraction of 0.1% in 2002.

Economic growth in Latin America in 2004 was driven largely by Argentina's impressive recovery, growth in Venezuela (hedged by rising oil prices), and the gradual, but consistent, improvement in Brazil's economic performance since 2002. Other countries such as Mexico, Chile and Colombia have also experienced an increase in economic growth in line with the worldwide trend towards economic recovery after 2001.

The recent economic growth cycle in Latin America is one that has been witnessed before. It is based on the pricing and export of commodities. The spiking of oil, copper and soya prices has benefited Venezuela, Chile and Argentina respectively, and allowed the region as a whole to record a favourable balance of trade. Exports have increased and investment is starting to flow back — though at a slower rate than required.

In 2003 Latin America and the Caribbean attracted just under \$37 billion worth of net foreign direct investment (FDI) inflows, less than half the amount that was recorded in 2000.² Because economic growth is almost entirely dependent on foreign capital, the primary concern for the region's leaders is sustained economic growth. Differently put, Latin America's greatest challenge is not so much to achieve impressive economic growth following five years of recession, but rather to find ways to sustain the level above 5%. Only if they can achieve this will governments be able to alleviate poverty and start to address the high levels of economic inequality in the region.

¹ LYAL WHITE is the Senior Researcher for Latin America and Asia at the South African Institute of International Affairs (SAIIA).

² See Economic Commission for Latin America and the Caribbean (ECLAC), *Foreign Investment in Latin America and the Caribbean, 2003*.

Annual growth rates and the regional distribution of FDI inflows around the world provide a useful tool for comparative analyses between developing regions. Between 1990–2003 the annual growth rate in Latin America averaged 2.7%, while Asia's was 6% per year. Again, between 1991–1996 Latin America attracted an average of about \$27 billion per year in FDI, compared with Asia's staggering \$59.5 billion.³ FDI is clearly a prerequisite for growth in emerging economies. Chile seems to have grasped this more quickly than its neighbours. Since 2001 it has attracted more than double Argentina's annual inflows of FDI, even though the latter has an economy twice the size of Chile's.

Latin America is a region of contrasts. Its wealth and diversity of natural resources is unmatched by those of any other region in the world, giving it enormous potential. With over 500 million people and a GDP approaching \$1.7 trillion in 2004, it has the market size, economies of scale and geographical location to surge ahead of all other developing regions in terms of economic development.

Recent positive developments in Latin America include macro-economic growth, and, most notably, the widespread upholding of democracy, which is firmly entrenched in Latin American society. Although Argentina and Venezuela have experienced social chaos recently, the citizens and ruling parties of these countries chose to follow the democratic processes stipulated in their respective constitutions. The outcome may have been debatable as far as various interest groups were concerned, but nobody could dispute the democratic principles that had been followed.

But economic, social and political challenges in Latin America remain. All of these shape the business and investment environment in which the private sector operates, and in which foreign investors must learn to work effectively.

Politically, a clear shift to the left has taken place. From 'Lula' da Silva, the charismatic unionist who is now president of Brazil, to the indigenous groups in the Andes, the political sentiment of the centre left is gaining ground. These newly-emerged leaders of the left promote a break from the neo-liberal reforms⁴ 'imposed' on their

³ See ECLAC, *Productive Development in Open Economies*, 2004.

⁴ Based on a conference and subsequent well-known report called the Washington Consensus, these were market orientated structural adjustment programmes

countries during the 1990s, but offer little in the way of an alternative that will ensure sustained economic growth and investment attraction. Whether this left-wing swing in Latin American politics is yet another example of ideologically-fuelled campaigning rhetoric that is unaccompanied by substantive action remains to be seen. But already there are murmurs from Argentina — now under the leadership of Nestor Kirchner — that this may indeed be the case.

Closely related to the shift in political sentiment is the crisis of ideas in Latin America. This relates mostly to economic thought and planning in the region. Five years ago, market-friendly reforms following the neo-liberal economic orthodoxy were the norm. Today, neo-liberalism is a whisper from the past referred to as an 'imperialist evil' on the streets of Buenos Aires and Caracas.

Unfortunately deeper economic reform remains to be carried out in Latin America. Perhaps an alternative to the Washington Consensus that will incorporate intensive social programmes and is more inclusive of the population in general will be the answer to Latin America's cyclical economic woes. However, if these issues (including a possible 'new wave' of neo-liberal reforms) are not debated, new alternatives will never be found. Then Latin America will continue to spiral further and further away from the ability to compete with the growing markets of other developing regions in Asia and Eastern Europe.

Apart from the need for continued investment to create an environment ripe for sustained economic growth, economic reform in Latin America needs to focus on poverty alleviation and income inequality. It is simply unacceptable that a country endowed with a wealth of food commodities, like Argentina, should have more than 40% of the population living below the poverty line. Currently 44% of the Latin American population live on less than \$2 a day, an increase in the poverty rate since 2000.

stipulated by the International Monetary Fund (IMF) and supported by the US. They were formulated in such a way as to liberalise the economy, establish macro-economic stability, encourage foreign investment and greater global trade integration. In particular, inflation and debt — which had hamstrung Latin American economies for more than a decade — were targeted, using policies of fixed or managed exchange rates, interest rates and a widespread privatisation drive.

Latin America has the highest economic inequality ratio in the world. Between 1990–2003, when Latin America grew by 2.7% per year, per capita income increased by only 1%. In Asia over the same period, per capita income grew by 4.5%.⁵ This is a fundamental flaw in the nature of economic growth in Latin America, and one of the reasons behind the yawning gap between the rich and the poor in the region.

Unemployment is another growing problem in Latin America. Whereas levels are far lower than in South Africa — regional unemployment is around 8% — an estimated 52% of the economy is in the informal sector, resulting in extremely high levels of under-employment.

Despite these challenges, Latin America offers enormous investment and business potential for South African investors. South African companies have already invested in excess of \$8 billion in Latin America, mostly in the mining sector, over the past 30 years. If one knows where to look; how to approach and enter the Latin American market; is able to grasp the differences in business practice from country to country; and is aware of the threats and challenges (as well as opportunities) involved, the potential for South African investors is huge.

This book offers a critical assessment of Latin America, and, more precisely, business practice in Latin America. It is a collection of perspectives from leading economists, analysts, political scientists, lawyers and business practitioners from both Latin America and South Africa, and is based on a conference that took place at SAIIA toward the end of 2003 which was sponsored by DaimlerChrysler. Additional articles have been incorporated to provide a more comprehensive overview that also raises some of the issues that have emerged in Latin America during the course of 2004.

The book, which contains a total of 10 edited articles, is divided into five broad areas. In the first section, Guillermo Mondino and Pieter Haasbroek give an overview of the Latin American region and the South Atlantic investment climate. Mondino provides a critical analysis of the political and economic developments in Latin America during 2003, and expresses some concern relative to the future development of the region, despite the recent economic turnaround.

⁵ *Ibid.*

Haasbroek, on the other hand, uses the theories of location 'attractiveness' versus 'repulsiveness' — closely related to competitive and comparative advantage — to compare the investment climates in the Southern Cone of Latin America and in Southern Africa.

A substantial section of the book is dedicated to the business perspective. James Lennox from the South African Chamber of Business (SACOB) takes a brief look at the much-debated SACU–Mercosur free trade agreement (FTA). This subject has been discussed extensively in SAIIA research over the years, but the process has made little progress since talks concerning a possible FTA between the two regions were first launched nearly eight years ago. Lennox's article outlines the economic realities, and difficulties, that the South African business sector will encounter if an FTA with Mercosur is concluded. While a SACU–Mercosur FTA seems to be the most obvious means of creating a commercial link between Southern Africa and Latin America, deeper analysis reveals that the economic feasibility of the agreement is far more complicated than was initially thought. The idea of a SACU–Mercosur FTA is prompted by a political will arising from South–South solidarity, but its economic viability is disputed by both business and labour interests. The reasons are the constraints such an agreement would put on competition and the labour market in South Africa, and the lack of congruence between South African industrial policy and Latin America's.

Mark Venning, a prominent business consultant and strategic advisor based in Chile, indirectly contributes to the SACU–Mercosur debate by offering an alternative approach to business in Latin America. Having operated in Argentina, Brazil, Peru and Chile over the years, Venning suggests that Chile is the best point of entry for South African companies opening businesses in Latin America. His argument is supported by the findings of investment analysts, economists and international rating agencies. Chile is ranked alongside many developed countries on various indices, including the World Economic Forum's (WEF) Competitiveness Index, Transparency International's Corruption Perception Index and the IMF Index of Trade Restrictiveness. In contrast, all of these rate the other Latin American countries in the lower half of the spectrum.

The third contribution from the business sector is that of Gavin Keeton from Anglo American, who paints a slightly different picture of

Latin America from the perspective of a mining company that has achieved remarkable success in the region over the past 30 years.

The next section, covered by Emile Myburgh and Sven Herlin, describes some of the legal requirements attached to doing business in Latin America, particularly in Brazil and Chile. This is an area often overlooked by South African businesses entering Latin America, and is the most frequent cause of problems (and of negative perceptions of the region). The technical proficiency of Myburgh and Herlin in these areas, and their experience in assisting South African companies to enter the Latin American market provide a unique insight into the pros and cons of dealing with the many facets of commercial law in Latin America.

Argentina, once the darling of neoliberal reformers, has undergone dramatic social and political changes during the last four years. At loggerheads with the IMF over debt repayment, Argentina is struggling to persuade its international creditors and potential investors that it can offer a stable socio-economic environment. The government hopes in this way to establish Argentina as a long-term investment destination. Gladys Lechini and Pedro Romero address this issue, and briefly describe the policy alternatives available under the Kirchner administration.

Finally, the book includes a section on Colombia, a country often neglected by South African policy makers and business practitioners, which describes it in a positive light. Despite ongoing violence and civil war, which are characterised by ruthless kidnappings and the activities of Colombia's infamous drug traders, the business potential of Colombia is impressive, and is improving under the leadership of Alvaro Uribe. He is the most popular president in Latin America, and has earned approval ratings hovering between 70–80% since he took office in 2002. This is unsurprising, given that under his leadership the economy has grown by more than 4% per year, unemployment has decreased and general security has improved substantially — the number of kidnappings decreased by more than 30% in 2003 and again in 2004. Colombia has a wealth of natural resources that are largely unexploited because of the 40 years of civil conflict it has undergone. It is the oldest democracy in Latin America, and has a sophisticated, cultivated urban society. These contribute to creating a favourable business environment in the country. Colombia seems to be emerging as an attractive investment destination, and one which

South African businesses should explore. Fred Jacobsen offers an introductory overview of the country, whilst Elias Eliades discusses the risks and opportunities involved in doing business in Colombia.

This book is by no means a definitive guide to doing business in Latin America, but it offers sound insights into the Latin American region, and a starting point for South African businesses interested in entering this vast new market.

With the ongoing support of DaimlerChrysler, SAIIA plans to build on its previous Latin American research and release further studies and compilations that will provide a realistic view of Latin America and focus on issues relevant to business interests. This, it is hoped, will help to improve economic and commercial linkages between Southern Africa and Latin America.

Much appreciation goes to DaimlerChrysler for sponsoring the Latin America project at SAIIA, and, in particular, this publication. Thanks go to the authors for their contributions, and for the opinions they expressed verbally and over electronic mail to supplement their offerings. Elizabeth Sidiropoulos and Leanne Smith added invaluable editorial input and brought this publication to fruition. Special thanks must go to Ambassador Elias Eliades for his constant support, enthusiasm and ideas — not to mention the extra hours spent on translation — which were driven by his passion for Latin America and his desire to help develop tangible links between Southern Africa and Latin America.

Lyal White
February 2005

Section One
Comparing the Business Environment in
Southern Africa and Latin America

Latin America At A New Crossroad: Unlikely To Be the Last

Guillermo Mondino¹

It is difficult not to be optimistic about the short-term prospects of Latin America. But that involves the hope that at this juncture, the many factors that have made this region one of the slowest-growing areas in the world can change. I suppose one could summarise much of what will follow in this paper as: 'things look good at present, but the chances are that another opportunity will be missed'. What follows is a closer look at this situation.

International environment

The current set of very positive international conditions is proving a powerful driving force for local economies in Latin America. The strong recovery in the US, the economic performance of Asia and the mediocrity, yet still positive situation in Europe and Japan are all contributors to optimism about the short-term gains to be made.

The Latin American region is crucially dependent on commodity prices. Oil (which is sustaining high price levels), agricultural commodities (which are making a strong showing) and even mining and industrial products are going through better than average times. There is no question that the terms of trade for the region are, overall, some 20% above what they were only a year ago. This has provided a very strong injection of income for Latin America. Perhaps most important for the region is the state of world capital markets. The very low interest rates (which will presumably continue) and abundant liquidity create an extremely favourable economic environment for the region.

The recent economic history of the Latin American countries has been closely linked to fluctuations in capital flows. It is difficult to separate the role of this factor from other local conditions, yet it is clear

¹ GUILLERMO MONDINO is with *IERAL* de Fundación Mediterránea and *MacroVision* Consulting. He is a prominent economic consultant and is a international guest lecturer at Yale University.

that it is a fundamental push factor as well as a catalyst for growth. In the 1980s, most of Latin America experienced falling real GDP per capita — minus 0.6% a year on average between 1981–1990. This was a time of significant capital outflows that were exacerbated by the debt crisis. The 1990s got off to a much better start: between 1991–1997, growth averaged 2.3% a year. This was a period when, with varying degrees of zeal, the countries of the region embraced economic reforms, restructured their external debts, and opened their capital accounts to foreign investments. It was also a period of formidable strength for capital flows originating in core countries like America and Europe. The fundamental change was the discovery of emerging markets by institutional investors in Wall Street as a means to diversify risks, and the creation of the Brady debt instruments.² Whether the demand was created by reforms and growth in productivity, which made investment attractive, or whether it was motivated by the need to diversify portfolios, the fundamental result across the Latin American countries was a new ability to finance current account deficits.

A natural result of the new environment was stronger growth. Those countries that had reformed more aggressively benefited the most, and experienced the fastest growth. The laggards encountered continual macro-economic difficulties and registered very low, if any, per capita GDP growth. Nevertheless, the region's average was better than it had been during the previous 'lost decade' and the outlook appeared promising. Nevertheless, as an antidote to some of the excessive optimism this caused, it must be borne in mind that Latin America's performance was significantly poorer than that observed in East Asia, where annual growth averaged 6.4%.

The booming capital markets came to a sudden stop in mid-1998. The sequence of shocks that started in Mexico '94, then Thailand and Asia, and concluded in Russia, brought the markets to a full stop. Brazil's exchange rate devaluation and macroeconomic dislocation in

² The Brady Plan, first articulated by US Treasury Secretary, Nicholas F Brady, in 1989, was designed to address the 1980s debt crisis in less developed countries — mostly in Latin America. The basic instrument used or principles of the Brady Plan included debt relief in exchange for assurance of collectability in principle and interested collateral debt relief was linked to economic reform and resulting debt should be highly tradable to allow creditors to diversity risk throughout the financial and investment community.

early 1999 confirmed that conditions had changed dramatically. Indeed, the Argentine crisis of 2001–2003, Uruguay's difficulties, the Venezuelan drama, and the rocky political transition in Brazil, from Enrique Cardoso's government to the leftist Ingacio 'Lulu' da Silva, created a massive regional recession. From 1998–2002, Latin America's growth performance deteriorated sharply. Real GDP fell at an average annual rate of about a quarter of a percent.

The international environment has changed very much from that observed in the period 1998–2002. Liquidity has been restored and interest rates are low (1%, as compared with 5–6% during the previous period). The countries in the region are accountable to outside creditors, with high levels of debt that make them extremely vulnerable to alterations in liquidity and rates. This creates significant risk perceptions. Even in highly liquid markets, the appetite for investments in Latin America is more subdued than it was in the early 1990s.

Another interesting international phenomenon has been the disinflation observed around the globe. Productivity has remained strong and growing, even during the recent US slowdown. This means that, all else being equal, there is significant room for growth without inflation. If the aggregate demand has slackened, the result is zero or even falling prices. This phenomenon is transmitted internationally as a result of globalisation. Emerging countries, especially in Latin America utilise depreciation in real exchange rates to counter the pressure of high productivity and competitiveness. This means that currencies can devalue and domestic inflation can remain low. Another dimension arises from the internationalisation of production, and China in particular. As the trade in goods (and even services) increases, low wage labour disciplines the labour markets in both the developed and the emerging countries. Greater wage restraint reduces the non-accelerating inflation rate of unemployment (NAIRU) and allows inflation to stay low. The combination of these two disinflationary effects creates international conditions where growth with low inflation is achievable. Latin America is no stranger to this phenomenon.

All of these international factors mean that significant political and economic blunders would have to be committed in the region to prevent it from entering a period of positive economic results.

Domestic policies

The governments of the 1990s showed varied degrees of commitment to reform, but overall, the zeal to continue has been lost throughout the region. It is remarkable, but although today we have somewhat better macro-economic policies, with floating exchange rates and larger fiscal efforts, the micro-economic environment has deteriorated almost everywhere. In contrast, owing to both domestic and international conditions, macro performance across the continent looks better than the micro-economic fundamentals should warrant. Unfortunately, either the micro-economic policies and reforms need to catch up or the macro-economic progress will deteriorate.

The region is wide and the economies of the countries it contains are varied. There are cases like Venezuela where everything, from the politics to the economics, is chaotic. Yet thanks to the high and sustained oil prices, the country shrank by only 8–10% in 2003. Earlier that year analysts estimated an economic contraction closer to 15%. Then there is Brazil where macro-economic policies have been brave, well-chosen and consistent. That country managed to avoid what looked like an inevitable catastrophe between the end of 2002 and 2003. It is now recovering, and there is cause for optimism in 2004, when GDP is expected to grow by 4%. Yet the country lacks a good agenda for micro-economic reforms. Those changes that have been made have tended to be half-hearted.

There are many other examples of acceptable macro-economic policies and poor micro initiatives. Perhaps a more extreme case is Argentina, where the situation does not appear to be worrying from the macro-economic point of view. There, the fiscal effort is stronger and appears more sustainable than it has been. Also, monetary policy is healthy and the exchange rate floats, inducing competitive gains for local industry. Yet, many of Argentina's micro-economic policies are of poor quality. Banking institutions meet with many difficulties; infrastructure lacks a regulatory framework and has uncompetitive prices; the tax policy is distorted and requires reform. Argentina also has a fairly poor commercial policy, bad fiscal arrangements and a disorganised labour market. Nevertheless, the recovery from the appalling previous year, when output fell 11%, yielded growth above 7% in 2003 and should reach at least 5% in 2004. How much is attributable to sheer rebound, how much to good domestic policy

management and how much the international economic environment is hard to say. Perhaps an uninformed guess that each contributed a third is a fair approximation.

Other examples of countries with macro-economic policies that are more consistent than their micro-economic policies are Peru or Ecuador. Both showed some growth of the order of 2–3% during 2003, but their performance in 2004 has been quite mediocre. (Perú was the stellar performer in the region in 2002, but its performance in 2003 was relatively poor.) There seems to be very little action taking place in Mexico, but the balance seems to be tilted in favour of its macro-economic policies. The experience of all of these countries illustrates how difficult it is for micro/sector reforms to move forward.

Although the micro-economic sectors in the region require reform, most of the Latin American countries also need to work on certain macro-economic areas. While fiscal policy is better than it was before, it still has some way to go. Two factors are significant.

- One is that almost all Latin American countries have high levels of indebtedness. With the exception of Chile, all of them have debts above the ideal targets estimated by the International Monetary Fund (IMF) (20–30% of GDP). This makes them vulnerable to international liquidity conditions, to domestic policy shocks and to other factors affecting the exchange rate. Hence, they should all be on a structural path that will lead to the reduction of debt. This can be achieved only by introducing proper growth policies that reduce debt to GDP ratios, a favourite debt burden indicator. They should also aim at structural fiscal surpluses. No country in the region, with the exception of Chile, has anything that even remotely resembles a structural surplus. It is true that in other parts of the world there are few countries with such policies. Yet Latin America has a particular reason to aim for this kind of protection. The region has a degree of vulnerability and a history of debt crisis that is astounding (six debt defaults by Brazil, five by Argentina, with the latter far from being resolved, and so on).
- The second factor is the ability to take advantage of transitory situations to build a healthier economic and business environment. If the region is undergoing economic transition, then it should not make any permanent commitments to increasing its spending. On the contrary, it should save. If domestic policies are producing an expansionary phase in the business cycle, then fiscal policies should

make sure that expenditure remains manageable when the contraction returns. Ecuador, Argentina and Uruguay (to a lesser extent) have been expanding government spending as if their economies were growing at a stable rate, when much of the growth may not last. Good times, or in Latin America better times, are periods when its countries ought to take advantage of the opportunity to reduce debt burdens. Chile did it in the 1980s and 1990s. Nobody is doing it nowadays.

Reform fatigue

A favourable economy creates political opportunities to create economic reforms. Yet almost everywhere in the region there is significant reform fatigue, even though reforms were not extensively applied in the recent past. On the contrary, countries like Venezuela, Ecuador, Colombia, Uruguay and even Mexico and Brazil advertised their virtuous intentions but did relatively little in the way of thorough reforms. Nevertheless, at present the social and political systems seem to share an anti-reform sentiment. Joseph Stiglitz and the anti-globalisers may well interpret this as a victory.

Local politics have turned centre-left or, put another way, towards neo-populism. Most governments understand the need for more careful macro management, but all share a fairly strong anti-reform agenda. Toledo in Perú, Gutierrez in Ecuador, Chávez in Venezuela, Kirchner in Argentina, the rebellious movements in Bolivia, and even Lula in Brazil share this sentiment. Uribe in Colombia and Batlle in Uruguay appear to go against the stream. Nevertheless, the popular vote in both the latter countries show that reform means reduced support at the polls (Uribe has just lost a referendum on social security and other reforms, and Batlle will probably be ousted by the anti-reformist Vazquez next year). In other words, sentiment is fairly strong against the process of further reform. Therefore everything seems to indicate that the opportunity to address the problems that have caused so many frustrations in the past will be missed.

Does this mean that the region is doomed? That it will have another dramatic combination of shocks like the Argentina-Brazil episodes of 2002? Maybe. But it seems unlikely. The progress that has been made in macroeconomic management and the greater caution exercised by international creditors are credible factors that will reduce

vulnerability to strong swings. The economies are not going to move into the high current account deficits / external debt build-up of the past. Brazil, which is showing a mild current account surplus is likely to turn it into a moderate deficit in 2004 and 2005. Argentina, with its whopping debt crisis and capital outflows, is likely to reduce its massive current account surplus of 7% (10% if the default is taken into consideration) to a more reasonable 2%, conditional, of course, on the debt being restructured and confidence being rebuilt. Venezuela is a different story. There, capital outflows will continue while the political system attempts to sort out its current dramatic difficulties. On the other side of the spectrum, countries like Ecuador, with large current account deficits, get most of their financing from foreign direct investment. Thus, overall, the misplaced optimism caused by recoveries financed by international lending institutions is clearly evident.

Politics

Domestic economies will remain volatile, partly because in Latin America, more than almost anywhere else, political and economic situations are intermeshed. On of the reasons for the extensive reform fatigue is the persistence of governmental practices that, given almost 20 years of democracy, should have been abandoned many years ago.

Venezuela is without question the most politically traumatised of the large Latin American countries. President Chavez is bad news. The country's façade of democracy hides a totalitarian regime. Chavez, like Castro, represents an ideology that captures the imagination of the immature Latin left. He has fundamentally divided Venezuelan society and promoted a revolutionary approach that combines populism, socialism and dictatorial practices. He would like to export the 'bolivarian' revolution to other countries and generously supports insurgent movements in other nations. He has destroyed his country's economy, having achieved the remarkable feat of being the first Venezuelan president to have record-breakingly high oil prices and a collapsing domestic economy simultaneously. Capital flight is unstoppable and assets are worthless. The survival of Venezuela as a political entity is now in question. The political opposition, fragmented as it is, is pushing for a referendum to force the president out of office. The government is answering with its own referendum. The truth is

that Chavez enjoys the support of at least 35% of the population and is by far the most popular politician in the country. Hence, even if he loses and is ousted, whoever comes next is likely to be less popular and will have to wrestle with a still powerful Chavez in exile. Clearly, Venezuela is in a lose-lose situation.

Colombia has its own problems. It has a statesman-like president with a vision and excellent technical groups who enjoys significant popularity and support in Congress. Yet he has just lost a referendum on economic reforms, and the country is in the midst of an extremely difficult civil war. This notwithstanding, the future of the Republic does not appear to be in peril. If Colombia could solve the dramatically difficult problems of guerrillas, drugs and crime, nothing could stand in their way. It is a hardworking, well-organised country that is extremely attractive to foreign investors. Yet its internal problems appear, at times, overwhelming.

Brazil has the most charismatic leader in the region. President Lula has very strong personal popularity, even though he has had to put together a tough economic adjustment programme to avoid defaulting on the national debt. The economy has been in recession and unemployment has increased during the 10 months that he has been in government. This is not a long time, but in populist Latin America it can be sufficient to lose support for a leader. However, Lula has manoeuvred quite intelligently, and uses his popularity to promote unpopular policies. Fortunately, the consistency of his macro-economic policies is starting to pay off, and recovery has begun. Also, his strong stance on international affairs has catapulted Brazil into the position of unquestionable leader of the region. With America, Brazil leads the discussions over the FTAA. This, in my opinion, is not necessarily good news, since Brazil has traditionally taken a more rigid mercantilist approach to trade, which is even more apparent today. Another factor is that Brazil is likely to gain a seat in the UN Security Council. Domestically, Brazil has fairly advanced nuclear-powered military weapons. Its business environment is positive, although its close shave with debt default, the recent recession and the serious social problems reduce its attractiveness to foreign investors.

Argentina presents a different picture. It has a president who is very popular (with 75% approval ratings) and has restored firm control over the country. Unlike Lula, Kirchner has no clear vision of where he wishes to take the country. His image is that of an effective doer

rather than a visionary. Unquestionably, his public statements smell of populism, and sometimes sound closer to Chavez than to Lula. Yet his bark is worse than his bite. His approach to business practice has been very unfocused and, in the time since he came into office, he has done very little to resolve the difficult structural problems the country faces. Yet he has amassed significant political power, which, interacting with a rebounding economy and falling unemployment, should make for political consolidation in the near future. The question remains whether he is going to use these advantages effectively.

Chile is an outlier in the sub-continent. During the 1980s, the country introduced many economic reforms, and the democratic governments that followed maintained the pace of progress, extending it to social policies and ensuring an open, competitive system. The country has continued to open up to international trade and has signed several free trade agreements, the latest one with the US. It has also introduced very healthy macro-economic initiatives, such as an effective inflation-targeting monetary policy framework, a floating exchange rate and a structural fiscal policy objective for the government. Chile has not only remarkable economic but also political stability. President Lagos, while a socialist, resembles a European one like Tony Blair or Felipe Gonzales. The economy is recovering from a couple of slow years, and will probably achieve 4% growth in 2004. Lagos's presidency should turn in a solid performance.

Conclusion

The region has a short-term future that looks bright and could yield remarkable opportunities. Yet the chances are that because of political, social and even economic challenges few of the significant changes needed to catapult the Latin American countries to strong, sustainable growth will actually be made. So the current upswing may well turn out to be yet another missed opportunity. Yet the results are not altogether grim. Out of each slow period, the countries have learned some lessons that enable them to improve the management of their economies. This means that booms and busts will continue to be a trademark of Latin American countries. But it is also likely that booms will be less marked and busts shorter and, hopefully, less dramatic.

In short, Latin America will remain an important component of the emerging world, and characterised by dramatic opportunities and perils.

Latin America and South Africa: Is Latin America A More Favourable Investment Destination Than Southern Africa?

Pieter Haasbroek¹

On leaving the cinema after seeing Fernando Meirelles' brilliant *City of God* in Johannesburg, I noticed how many who shared my experience were looking almost happy, or at least very relieved. But how could this be possible after they had been exposed to such a harsh portrayal of criminal violence in the slums of Rio de Janeiro? I believe they had been comparing the situation in South Africa with what they had just seen, and had decided that perhaps South Africans are not so badly off after all.

Since then I have read reports on how well we have fared under South Africa's new government. More children than ever are going to school. Literacy levels are increasing, and the health services are reaching out to every community. The government has built more than a million houses for the poor, and provided thousands of people with drinkable water from taps, with electricity and with sanitation. It is spending more on social security, on pensions and on child allowances. It has improved tax collection and has cut tax rates. The Finance Ministry is managing monetary matters so well that the rate of inflation has sunk to a level last seen in the eighties. And the rand is not longer falling, but has strengthened. Even employment figures are showing considerable improvement. These advances give us good reason to believe that South Africa has become a better place for us all to live in.

Why then, are so many South Africans emigrating? In particular, why is this so prevalent among highly skilled professional people, administrative staff and managers? In the first half of 2003 the number of emigrants increased by 42% over the same period in the previous year. Is it because other countries have become irresistibly attractive to them? I do not believe it. More than 40% of South Africa's businessmen said in a poll that they would leave the country if they were given an opportunity to go into the same business elsewhere.

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Some of them could be heading for Latin America right now, because they believe it offers a better economic environment.

A group of our own Barloworld managers traveled to Latin America recently to identify business opportunities there. They visited Brazil, Argentina and Chile, bypassing the other exciting locations of Venezuela, Bolivia and Colombia. They came back very impressed, saying that the business should consider establishing a presence in that part of the world.

Chile, they reported, has enjoyed a whole decade of strong economic growth, attributable in large part to the country's main export, copper. The country's social development is illustrated by the fact that almost a third of all school leavers go on to tertiary education. Chile's government is centrist-socialist and very stable. Company tax is low, between 15–17%, and large multinational corporations such as Nestlé, Unilever and Citibank have established head offices there. The countryside, our managers said, is really beautiful, almost like Switzerland in places.

Argentina, with a population of 40 million and contributing 10% of Latin America's economic value annually, has a government system our managers found peculiar. There are 23 states in its federation, and the federal government has little control over the provincial governments. Although the union leaders are left-wing and closely connected with the politicians, the workers are right-wing. However, labour relations are generally good. Although the construction industry is in a state of disarray, other sectors look very promising. South African businesses might do worse than consider locating some of their operations in Argentina, as Anglo American has done.

How did Barloworld managers find Brazil, the location of *The City of God*, with its violent gangs and corrupt policemen? They spoke to a representative of Prosegur, the biggest security firm in Brazil, which provides guarding services, surveillance and protection for cash in transit. He told them about the crime syndicates that operate from helicopters, and of Rio's 'Red Commandos.' Brazil is a stressful place to do business in. However, an airport handling company reported that it has not lost a single container over the past three years. Nestlé said they had not been so lucky; theft of their lorries or their loads remains a problem. Because of the insecurity of the environment, insurance is very expensive. Half of domestic expenses are security costs, and executive cars are armoured. Companies arrange for their

General Manager's car to be followed by an armed guard in a second vehicle.

The managers seem to have been somewhat overwhelmed by Brazil. The business environment there has a dynamic completely different from anything they encountered elsewhere, because it forces companies into a very daunting set of interrelationships with government, suppliers and competitors. Considerable managerial versatility would be required to cope with Brazil's challenges.

To weigh up South Africa's attractions to businesses as against Latin American ones, an appropriate theoretical model of location choice is needed. How can a company decide on a location for its investment and for its business?

In 1996, Professor Stephane Garelli of IMD, a leading international business school, contrasted business 'attractiveness' with what he called: 'aggressiveness', both representing alternative ways of enhancing the economic competitiveness of a country. It was a complicated issue. A country could be geared either to serve an 'economy of proximity' or an 'economy of globality'. That is, a state may try to attract business enterprises to its economy, which will add value to its resources and create jobs in the process. Or the country may encourage its own business enterprises to expand aggressively into international markets, in other words, adopt an economy of globality. (This would illustrate an economy of proximity.)

It was not an entirely satisfactory distinction. Many countries find that their particular problem is how to keep business enterprises within their domestic borders. As the world economy opens up, the 'relocation of assets' becomes increasingly possible, and may result in the business corporation itself moving its headquarters to a location in another country.

As a consequence, South African corporations that have added value to South African materials and employed South African workers (the economy of proximity) now happily move to Australia or Chile, where they do the same for their foreign hosts. (To their surprise, trade unions and the government in South Africa frown upon this globalisation of business operations.)

The authors of the *World Competitiveness Yearbook* approached the attractiveness of countries from the perspective of the different activities of a firm: manufacturing; research and development; and

services and management. Many businesses have found that it is no longer necessary to perform all their functions in the same place: they can be distributed in different countries. Multinational corporations deliberately allocate each type of activity to the country that offers the most competitive economic environment for that aspect.

Which business activities does South Africa attract? The easy answer is those related to South Africa's resource base. Mining takes place where the mineral deposits occur. Value can be added here by processing the mineral ores; but ore can also be exported. The services rendered to the mines are location-bound, but the provider — like Barloworld through its Caterpillar business — can operate wherever there are mines; from South Africa to Angola, and from Spain to Siberia. As we have been very successful in Spain and Portugal, language is unlikely to pose a barrier to our entry into Latin America.

Manufacturing will be located where the competitive advantages are greatest for the specific kind of product. The decision on where to build a factory is based on considerations of where it can be done at the lowest cost. For many years, governments designed their industrial policies with exactly this factor in mind. They fostered the development of *infant industries in their countries* by means of tax holidays, subsidies and tariff protection. Some even banned trade unions to ensure that the labour costs of their manufacturers do not come under pressure from organised wage demands.

This was before trade liberalisation became fashionable. World-wide, rapid communication brought transparency; now the World Trade Organisation (WTO) blows the whistle on government efforts to bend international rules. And pressure on governments to accept common labour standards is mounting.

Although there is much less scope nowadays for government intervention in the hope of increasing the attractiveness of the country to businesses, some of the roles only governments can play are crucial for both attracting and retaining business interests. The International Monetary Fund (IMF) has identified five factors for success related to government, the first of these being the quality of governance. Generally businesses are not attracted to countries where there is civil unrest, or the violence that springs from political conflicts. (Many Latin American countries suffer from political instability.) On the other hand, because of the security offered by a stable political environment, businesses may operate quite profitably under a despotic ruler. The

relationship it has with the government inevitably affects the nature of the business. When governance is not transparent and intervention is arbitrary, the relationship breeds corruption. Businesses will lobby for special treatment, and the rule of the political party in power will replace the rule of law. Under such circumstances, businesses that are not prepared to involve themselves in corrupt practices will be driven out of the country, and those that are will remain.

The second IMF requirement is macro-economic stability. Governments can help to bring it about by adopting sound monetary and fiscal policies. The tax dispensation, in particular, has an important bearing on business profits. Apart from South Africa's relatively high company tax rate, a plethora of additional taxes and levies places a heavy burden on businesses. Another concern is the probability of a sudden tax change in the system. To foster business and investor confidence, the economic policy of the country should be as predictable as possible.

Countries that have been opened to trade by their governments have generally been more successful economically than those that erected tariff barriers to protect domestic industries. And where basic education and training have improved the skills levels of the local population sufficiently, the economy performs better than in countries where governments fail in their educational responsibility. South Africa's difficulties in making its education and training system cost-effective have resulted in a serious shortage of skilled workers.

The IMF's final requirement is high quality investment. This depends on conditions such as the protection of property rights, effective regulation of monopolies and of the financial system, promotion of competition and the privatisation of state enterprises. On the surface, South Africa's institutional base seems to be sound. However, some recent policy initiatives, such as government intervention aimed at black economic empowerment, are posing a threat to business.

The IMF's recommendations suggest necessary but not sufficient conditions for the success of a country. Returning to the issue of the attractiveness of a location to producers, it stands to reason that all costs, both direct and indirect, are measurable. Therefore manufacturers whose future success depends on the accuracy of their appraisal of the cost of doing business in the country must be able to compute them. A country either offers a low cost location to business

or it does not. We know that the cost of doing business in South Africa is relatively high. It is lower in certain Latin American countries.

The first cost element noted by a business intending to establish an enterprise in a specific location is the wage structure. It has to be related not only to countervailing power positions in collective bargaining but to productivity differentials. Indeed, the costs of collective bargaining and of its failures (in the form of strikes) should be added to those of the ruling labour standards in the country. Industrialists have often asked: 'If you offer us all the labour costs of Germany and not even half the productivity, why should we bring our factories to South Africa?'

The cost of financing the enterprise — both its normal operations and new investment — may be higher or lower in the new location. The real after-tax return on investment should be substantially higher in emerging economies than in the G7 advanced economies, to make up for the higher degree of risk. If this figure does not exceed the cost of capital (interest, taxes and so on.) by an acceptable margin, the investment is not sound. The cost of capital has come down significantly in South Africa during the past year. However, returns have been disappointing, particularly in manufacturing, and because of the strong rand exchange rate, export earnings have fallen.

South Africa has from time to time attracted yield-searching portfolio investment, but foreign direct investment (FDI) is unfortunately flowing elsewhere. Brazil, for example, has been one of the world's main recipients of FDI. In this very important sense, the Brazilian economy is more attractive than South Africa's.

Government involvement in the economy may place private businesses at a disadvantage, for example in the capital market, where public borrowing can crowd them out. In South Africa the government has cut back on its borrowing, and even reduced the number of civil servants. However, the problem with government intervention in the economy lies elsewhere, namely in excessive regulation. The consequences of controls instituted hastily and on an ad hoc basis are usually not foreseen. Businesses find the cost of compliance with all the regulations in South Africa extremely burdensome. Another problem we experience is poor performance by inefficient government enterprises, and their abuse of their monopolies. Increasingly, government bodies are meddling in the plans of private businesses, or preventing the establishment of

competing enterprises. This can force businesses to relocate to more friendly economies.

The attractiveness of a country, therefore, is largely in the hands of its government. It is of little use to a potential investor to expound upon the country's healthy climate, its scenic beauty and its interesting mix of cultures if the cost of doing business is high. Its infrastructure may be acceptable, but a high rate of crime is not. A different language may not present an insurmountable barrier, but can one do business in a corrupt society? And how can a company make business decisions if it is continuously confronted by a meddling bureaucracy? Good government attracts all kinds of business activities to a country; but bad government repulses it. In the final analysis the relative attractiveness of the Latin American economies and that of South Africa hinges on these factors.

Section Two
A View from Business

The SACU–Mercosur FTA: A Business Perspective

James Lennox¹

Introduction

A free trade agreement (FTA) with Mercosur may offer a number of opportunities related to market access. However, the economic challenges of engaging with Mercosur seem to outweigh the benefits — at least according to the research reports that have been released.

Mercosur — comprising Argentina, Brazil, Paraguay and Uruguay — is collectively about six times the size of the Southern African Customs Union (SACU). It has production costs and economies of scale which enable it to out-compete just about any sector in Southern Africa. Labour is cheaper in Mercosur, as are the prices of primary exports and manufactured products. Manufacturing, as in the automotive, clothing leather and textiles industries is well developed, and if that were not enough, Mercosur produces the same products as SACU, at the same times of the year. SACU and Mercosur are clearly competitors in international markets.

However, from a business perspective, the ongoing debate as to whether or not to enter into a FTA with Mercosur revolves around the issue of Brazil.

South Africa and Brazil are strategic partners, and have a clear political affinity. This 'political will' provided the initial impetus for economic engagement and the discussion of a possible bilateral trade relationship eight years ago. However, the economic implications of the relationship have subsequently become clearer. A number of complications have arisen in the commercial interaction between the two giants of their respective regions.

With this in mind, and setting perceived political imperatives aside, the future of South African trade with Brazil centres on three critical issues, namely:

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- increased intra-group co-ordination and integrated manufacturing and procurement by global companies;
- the trading environment in South Africa, which contributes to the competitiveness of South African exporters; and
- the trading environment in Brazil as it affects South African exporters.

This paper intends to focus on business practice in Latin America, and will therefore concentrate on the third issue, making only brief comments on the first and second.

The role of global companies

With the increasing integration of global manufacturing and procurement in sectors such as the automotive industry, tariff reduction is an important factor in the countries where they have a presence. (This is seen from the point of view of cost rather than market access or protection.)

Trade agreements can create intra-industry or even intra-company competition. On the positive side, such agreements can help companies (such as automotive producers or other manufacturers) to take real advantage of the economies of scale created by the free flow of goods.

The impact of global companies on multilateral trade and bilateral agreements is not covered in this paper, but it is an increasingly important factor in the ongoing debate on globalisation and the economic viability of trade agreements.

The trading environment in South Africa

Since 1994 South African business has had to adjust to a dramatically changing environment, and transform itself from an inward-looking to an outward-looking sector of the economy. An avalanche of domestic legislation, accelerated integration into the global economy (primarily through tariff reductions for imports), a volatile currency and increased competition has left the majority of South African businesses punch drunk. Most of these are struggling to absorb and implement the changes in their operations required by the new dispensation, which have left the private sector by and large sceptical

of any further liberalization. This is particularly the case with respect to countries or regions producing goods similar to theirs, but operating from a much stronger domestic market base and exporting goods in competition with their own products in international markets.

Efforts to increase local competitiveness have been impeded by both the administered price environment in South Africa and the lack of investment in transport infrastructure by the state. Other constraints are the negative impact of exchange rate volatility, and the number of illegal goods finding their way into the South African market.

South African corporations have adapted to the changed environment with increasing success. Sectors of the South African economy serving niche markets in developed countries have also thrived, but many other businesses continue to struggle to remain in export markets, or have diverted their production toward the buoyant domestic markets. Many companies have gone out of business.

The trading environment in Brazil

South African exporters, like many from other countries outside Latin America, have found dealing with Brazil and other Mercosur countries extremely problematic. Doing so is certainly not for the faint-hearted. The most common areas in which problems are experienced include *import policies, customs regulations, standards and contractual law*.

The decision by the Mercosur countries to allow considerable exceptions to the common external tariff has resulted in the reduced competitiveness for imports ranging from agricultural products to Information Communication Technology (ICT) equipment. They have also imposed additional taxes and charges on products in the clothing and textiles sector.

Once arrived in Brazil, products can attract state-imposed and levied excise taxes, particularly where a domestic producer of the same goods exists. In 2002 the Brazilian government introduced a new tax law that dramatically increased the duties on certain products, and discriminated against foreign producers. Imports of some products in sectors such as *machinery, motor vehicles, clothing and consumer products* are prohibited, and import taxes of up to 60% are also levied on most manufactured retail goods purchased by individuals.

Further costs and difficulties are imposed by the onerous requirements placed on importers by the import licensing system. This includes fees payable for the documentation necessary to apply for an import licence. Determining whether a product requires an import licence is an almost impossible task for the South African exporter unless a registered importer is used to interpret the system. Companies exporting to Brazil require the information such an agent can provide to determine whether or not minimum prices apply to a product.

The potential for misuse of various customs regulations could be construed as a non-tariff barrier. It provides another reason to decide not to trade with Brazil. That country's various packaging and labelling requirements are also problematic, particularly when applied to small unit size products. The additional cost entailed by compliance reduces the competitiveness of South African products when such requirements are unique to Brazil.

Opportunities to expand trade in services is hampered by the prevalence of counterfeit goods, such as CDs and other illegitimate products, whose sales exceeds those of the equivalent in the legitimate market. Most South American countries suffer from excessive levels of intellectual property abuse. although attempts are being made to address this issue. Merchant marine taxes, accompanied by constraints on capacity and high shipping rates, also affect South Africa's ability to increase its trade with Brazil and the rest of South America.

The above are a few of the non-tariff barriers preventing free access to the Brazilian market. They impose additional costs (over and above common tariff lines) that hamper fair trade and commercial interaction between Brazil and South Africa.

Despite these barriers, trade between the two regions has grown. However, the rates are well below potential. Many issues need to be resolved before the full benefits of a trade agreement can be realised.

		<i>Argentina</i>	<i>Brazil</i>	<i>Paraguay</i>	<i>Uruguay</i>	<i>Mercosur</i>
1999	<i>Imports</i>	1,121.4	1,376.1	15.5	35.4	2,678.0
	<i>Exports</i>	457.7	947.5	33.1	51.5	1,703.1
2000	<i>Imports</i>	1,335.5	2,053.3	5.5	111.1	3,674.1
	<i>Exports</i>	658.0	1,373.6	32.0	49.1	2,112.7
2001	<i>Imports</i>	1,963.0	3,378.0	10.8	115.8	5,467.6
	<i>Exports</i>	653.4	2,274.3	27.5	89.0	3,044.2
2002	<i>Imports</i>	2,384.0	4,918.6	20.6	108.5	7,491.7
	<i>Exports</i>	359.6	1,809.5	42.8	57.4	2,269.3
2003	<i>Imports</i>	1,934.3	4,523.1	14.4	63.8	6,535.6
	<i>Exports</i>	291.5	1,156.5	11.8	42.0	1,501.8

Concluding remarks

The SACU–Mercosur FTA has become something of a controversial issue in South Africa. Studies indicate that both local business and domestic labour will not benefit from such an agreement. This in turn suggests that FTAs should not be pursued with less developed countries, and that further research into such agreements is required before those taking part in the negotiation proceed any further.

This paper has focused on some of the more pertinent concerns raised by the FTA with Mercosur that is currently being contemplated. This analysis is by no means complete, but provides a starting point for debate and discussion of some of the matters likely to affect business and the South African economy in general.

Mercosur is simply more competitive than South Africa. Its production is more cost-effective and over the past four years — through exchange rate fluctuations, which have seen a weakening of Mercosur currencies against a strengthening of the South African rand — Mercosur exports have become increasingly cheap in international markets.

The Brazilian commercial environment is complicated. Even local operators struggle to understand and stay abreast of new legislation or tax requirements. This combination of a highly competitive local market, a complicated operating environment and bureaucracy, not to mention unusual standards and requirements, has created negative perceptions in South African producers interested in the Brazilian

market. In particular, the number of non-tariff barriers to entry into Brazil should to be addressed by South African negotiators before the SACU–Mercosur FTA talks can proceed with the support of the South African business sector.

South African Business Prospects In Latin America

Mark Venning¹

South America offers enormous opportunity for South Africans, both for exporters and for those companies that want to expand geographically by means of investment. Many readers may think that Latin America is distant, but it is not. A flight from Buenos Aires in Argentina to Cape Town takes eight hours, and currently costs under R4,000 return, for an economy class ticket. A container sent from Cape Town to Buenos Aires costs less than the equivalent conveyed from Johannesburg to Cape Town.

Economists will present the argument supporting better business relations with Latin America by pointing out that it has the highest gross national income (GNI) per capita of all developing country regions, and continues to attract more private capital (\$72 billion in 2001) than any other developing country region. The region also has the highest life expectancy at birth (71 years) and the lowest military spending among developing regions — 1.3% of the gross domestic product (GDP). But although this information is both true and interesting, from my point of view the most instructive facts about Latin America are those relating to the history and current situation of South African-owned businesses which have set themselves up in Latin America, or which have made investments in the region.

South African businesses that have been built up in Latin America have involved years and decades both of research and of on-the-ground experience. Some lessons which I have learnt from assisting many of these companies over the last 10 years, are as follows:

- Latin America has generally been a good region in which to invest and/or to conduct business for over 20 years.
- The size of individual Latin American economies should not determine where South African businesses trade or invest. There is a clear relationship between the size of the economy and the underlying levels of risk associated with doing business there. The bigger the economy, the more risky the business environment.

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- The level of underlying business, political and economic risk rather than the size of the market is the prime factor to consider when deciding on where to begin doing business in the region.
- Local partners are not a vital requirement for success.
- Local staff are fundamental to success.
- The greatest risk area for South African exporters over the last 10 years has been exchange rate volatility, both in South Africa and in Latin America. Therefore, currency stability is an important risk factor that requires analyses prior to entry.
- Chile is the least risky country in which to conduct business in Latin America.

South African experience in the region bears out the above. Below is a rough table, providing a snapshot of some South African investments in Latin America.

South African investments in Latin America				
<i>Company</i>	<i>Investment</i>	<i>Primary country</i>	<i>Local partner</i>	<i>Current view</i>
Anglo American	+ \$4 billion	Chile	Bought out	Expanding
BHP/Billiton	+ \$5 billion	Chile	No	Expanding
Tigerbrands	+ \$20 million	Chile	Yes	Expanding
Scaw Metals	+ \$100 million	Chile	No	Expanding
Boart Longyear	+ \$20 million	Chile/Peru	Bought out	Expanding
Delkor	- \$20 million	Chile	No	Expanding
Amcoal	+ \$100 million	Colombia	No	Expanding
NOSA	- \$20 million	Chile	No	Expanding
Fraser Alexander	- \$20 million	Chile	No	-
Foodcorp	- \$20 million	Chile	No	Sold out
Mr. Price	- \$20 million	Chile	Bought out	Closed down
Shaft Sinkers	- \$20 million	Chile	Yes	Closed down
I&J	- \$20 million	Argentina	-	-
Mondi	+ \$100 million	Brazil	Yes	Sold investment

In addition, the following companies have investments or are actively looking for them and for major trade opportunities in the region: Sasol, Columbus, Sea Harvest, Barloworld, Marlin Granite, LTA-Grinaker, Sappi, Mondi, Tongaat, Bell, Chemserv, AECI, Verref

and others. The majority of these companies have been directing their attention to Chile.

Clearly Latin America is now on the business map for South African companies. However, the majority of local companies are newcomers to the region and should tread carefully. Many failures are attributable to the will to conduct business quickly.

With a high level of opportunity comes an equivalent level of risk for the newcomer to the region. Perhaps one of the greatest risk enhancers is entering the region with the attitude that they will teach the South Americans a thing or two, that they are the experts, or that they are doing Latin America a favour by being there in the first place. Indeed, arrogance in South African businessmen is perhaps the leading cause of lost opportunities and of financial loss.

South America is highly competitive and, especially in Argentina and Brazil, highly protective of local industry. It is also very different from South Africa. Not only is the language different but also the business cultures and customs vary greatly, not only between countries but between regions within countries. It is necessary to understand these nuances prior to embarking on aggressive selling or investment activities. The easiest way for a potential investor to understand how business is conducted is to spend time talking to South Africans who already operate businesses in the region; to approach bilateral chambers of commerce, the South African Institute of International Affairs (SAIIA) and business consultants who specialise in South African/South American business; and to use international merchant banks where this is warranted.

Nigeria is different from South Africa. The same sort of differences exist between Brazil and Chile, or Argentina and Colombia. Latin America is not one region, but a large continent. So where does one begin? Of course this depends largely on what business the potential investor is in and whether or not a particular country offers opportunity for those goods and services. However, certain generally applicable rules can be adduced. For first time entrants there is no doubt the Chile should be the first port of call because it is by far the least risky country in the region from all perspectives. South African investment in Chile of many billions of dollars attests to its attractiveness. (This is discussed in some detail in a separate chapter.) Further investment tends to depend on where an investor's Chilean business logically leads. (My general second preference is Peru.)

If a company decides to attempt entry into South America, it should be made a priority. It is insufficient to visit two or three Latin countries onto the end of a US business trip and spend barely a day in each. In such circumstances, business investors arrive tired but aggressive, seeking the quick opportunity. More often than not, they find one — or one finds them. The result is often disappointing, because the South Africans have failed to calculate the export price correctly, or have hastily accepted a Latin America partner who has not been checked out properly.

Some examples of common mistakes made by South African companies which have led to large losses are as follows:

- They have made an agreement to deliver a product to the client's warehouse, but VAT (payable on all imports) has not been included in the quotation.
- They have made an agreement to deliver a product to the client without calculating the myriad taxes payable (particularly in Brazil).
- They have formed a local company to sell South African products and services, but the business plan has not taken the withholding tax payable on remittance of profits back to South Africa into account.
- They have signed an agreement to form local company with a local partner. The South African company sends funds over to capitalise the company and the partner is never seen again, or is seen in a new Mercedes. (The rule is — control your investments.)
- They have not considered historical social liabilities in the purchase price for a local company. (This is particularly applicable to Brazil and Argentina). These liabilities can far exceed the company's value.
- They have set up a local company to produce and export to neighbouring states and countries without considering the taxes payable on interstate business, and non-import taxes levied on imported goods (as in Brazil and Argentina). These can be as high as 40% of free on board (FOB) value.
- They have appointed a small local partner without the ability to fund working capital requirements to distribute South African goods. The South African company ends up providing the working capital by means of increased credit, and devaluation puts the company out of business.

- They have not structured their plans to cater for the potential sale or inter-company transfer of a locally acquired company, and therefore have not made allowances for the capital gains tax payable.

All of the above were very costly to the companies involved, and all could have been avoided easily by talking to the right people beforehand, doing adequate research and making correct structuring and cost calculations. Inevitably the result of such errors have been that those responsible for them, once back in South Africa, have blamed South American corruption, red tape and inefficiency. None of these were the root cause of their losses. This often gives 'doing business in South America' an underserved bad name.

There are major market and investment opportunities for South Africans in Latin America as long as they put the required effort and resources into doing research prior to entry. There are fortunately many success stories. These have generally been the result of hard and sustained effort over time; the identification and use of trustworthy local representatives, or the hiring of local staff; the use of correct legal and business advice; and an approach to the region or country that gives it prior importance. In almost all cases success has resulted from using Chile as a starting point, gaining experience via this first investment, and then venturing into the rest of the continent. A bold first move into Brazil or Argentina is almost guaranteed to carry with it a high cost of entry.

What of the rand's strength? How does this affect business? Clearly, South African exporters are far less competitive now than they were a few years ago. All currencies in South America, apart from the Chilean peso, have seen substantial devaluations over the past few years, whilst the rand has substantially re-valued. As an example, in 2001 one could get R12 for one Argentina peso. The rate at the end of 2004 was approximately R2 to one peso, which means that the customer needs six times as many pesos to purchase a rand-based product today as in 2001. As a result, South African exports to Argentina have fallen by 80% over this period.

Looked at dynamically, however, the relative weakness of Latin American currencies in relation to the rand also presents opportunities. Goods imported from Latin America are now far more competitively priced than previously. However, the real opportunity in my view is the window it opens for South African businesses to

invest in the region and expand the geographic base of their production and sales. American dollar company valuations in the region have fallen significantly over the past two years, at a time when the rand has almost doubled in value. Today a South African will get much more company for the rand than ever before, so that for businesses wanting to invest abroad, it may be well worth looking at Latin America as a potential target. It currently offers excellent value for South African investors.

To sum up: the large mining-related companies and industrial conglomerates have led the way into Latin America. The time is now right for medium-sized businesses to begin the process of exploring this vast and exciting market. South African companies should put South America on their list of objectives and treat it as a priority. Research the business environment there thoroughly, and seek advice from those who have already been through the experience of trading or investing in Latin American countries. There is a vast market waiting to be exploited.

The relative merits of Chile as a starting point and base in South America

The following is my personal view of how best to pursue business opportunities in the South American region. The minimisation of risk is seen as a priority, and a long-term relationship with the region as the ultimate goal.

Over the past 10 years I have seen as many unsuccessful and costly forays into South America by South African companies as ventures that have been prosperous and rewarding. Experience has taught me certain generally applicable lessons, some of which were not at all obvious at first glance. In this short chapter, I will present an overview of my experience, and make recommendations that may assist in the decision-making process of companies interested in doing business in South America.

Should South African companies be doing business in South America?

The answer is undoubtedly 'YES'. South America offers an enormous and largely untapped opportunity for South African companies. The

'ABC' (Argentina, Brazil and Chile) countries alone have a combined GDP of over six times South Africa's, and it is the continent closest to Africa. Recent economic and political changes in South America and South Africa have resulted in a mutual readiness to engage in bilateral trade and investment unsurpassed for the last 30 years.

It is important to understand why South America is not a traditional market for South African goods, services and investment. Simply, the political environments in South America and South Africa led to almost total trade separation of each continent from the other for almost 30 years:

The 1960s and the early 1970s were characterised by closed and highly protected South American economies. Military governments were in power, and rampant inflation and the language barrier combined to render the region a 'no go' area for all but a very few South African companies. Although the situation began to change for the better in the mid 1970s and early 1980s, the strong anti-apartheid stance adopted by Brazil and Argentina meant that the doors to South American business opportunities remained shut for South Africans. The 1990s saw radical changes to this scenario in all respects. However, the managers of South African companies, having had no contact with the region for the best part of three decades, did not regard South America as a priority. They had little knowledge of the markets, and had few of the skills necessary to exploit the obvious potential of the continent. Instead they concentrated their export efforts on Europe, the US and the Far East.

Persuading South African businessmen of the benefits offered by the enormous South American market remains a formidable challenge. Because it is new ground for the majority of South African businesses, we have to encourage not only first time entry into the region, but give advice that will reduce the risk — even at the expense of quick returns, in order to improve the prospects of long term success.

It goes without saying that South America is no more a homogeneous continent than is Africa. Each country has its own distinct business culture. In particular Brazil should be viewed as a separate continent on its own, and Spanish-speaking South America as another. One should then break down Brazil into its different states, and the Spanish-speaking zone should be divided by country. Once this has been done, an analysis as to where a company should be located, and in which sectors, can begin.

Selecting the right start-up country and industrial segment

The logical place to begin the analysis is by comparing macro economic data and other statistics and indicators relating to the sectors and countries of interest. As a result of such analysis, many companies prioritise on country and sector size, and therefore concentrate their initial efforts on Brazil or Argentina. They have often been burned — and put off the region as a whole as a result of one bad experience. I believe that numbers alone (and I refer to statistics, forecasts and even company financial statements in South America) generally tell only a very small part of a complex story. They can be enormously misleading as a guide to deciding where a company should focus its efforts. These are all big economies, and each of them individually offers substantial opportunity. It is a mistake to discard countries as not worth investigating simply because they are relatively small.

A more cogent question to ask is whether the company's preferred sector within a specific country is big enough to warrant attention. If the answer is 'yes', that country should be put on an equal footing with the other countries that have produced a positive response to this question. Priorities should be ordered in terms of the level of risk rather than sector size.

Any South African company should be able to make a sound assessment of the risks and opportunities that will be relevant to any of their core business units in each specific country. They will analyse market size, growth, competition, synergies with existing operations, similar businesses in other countries, costs of production, protectionism, foreign investment rules, the merits of local versus expatriate staffing and so on. It is possible to produce a sound analysis based on careful research, but it must include local knowledge, which is fundamental to the understanding of the business environment.

Understanding non-industry-specific risks

What the above preliminary analysis does not take into account are the nuances specific to each of the 'ABC' countries which are capable of causing serious disruption to business operations. Many of these factors are intangible. The table below provides the results of studies

by reputable organisations which have tried to quantify these risk factors. These indexes have been produced by the World Economic Forum (WEF), Transparency International (TI) and the Economist Intelligence Unit (EIU).

Results of studies to quantify intangible variables				
<i>Risk Area</i>	<i>Chile</i>	<i>Argentina</i>	<i>Brazil</i>	<i>South Africa</i>
Level of corruption (TI)	1	4	3	2
Macro-economic environment/ system (WEF)	1	4	3	2
Macro-economic stability (WEF)	2	4	3	1
Level of technology (WEF)	1	3	4	2
Public institution functionality (WEF)	1	4	3	2
Overall global competitiveness (WEF)	1	4	3	2
Growth competitiveness (WEF)	1	4	3	2
Business Readiness (EIU)	1	2	3	n/a
Best place to do business in the next five years (EIU)	1	2	3	n/a
Overall cost of doing business (EIU)	1	2	3	n/a
Country (sovereign) risk (EIU)	1	4	3	2
Transparency and its effect on cost and availability of capital (Price Waterhouse)	1	4	3	2
1 = Best; 4 = Worst; n/a = not available				

As a result of the above, one must conclude that the general level of risk is far lower in Chile than in any of the other countries. To put this in perspective, the WEF global competitiveness index in 2004 indicates the following:

- Chile is the 22nd most competitive country in the world, just behind New Zealand, Hong Kong, Australia, Estonia and Austria.
- South Africa at the 41st falls behind the Czech Republic, Hungary, Cyprus and Greece.
- Brazil at 57th falls behind Morocco, India and Namibia.
- Argentina is 74th in the ranking, behind Sri Lanka, Dominican Republic, Algeria and Indonesia.

Certain other factors that have not been quantified above are also worth considering. Chile can boast:

- unparalleled and sustained economic growth based on an open and liberal economic model;
- extremely transparent import, export and foreign investment regulations;
- a flat import duty structure of 8%, lower than that applied between Mercosul countries;
- a tax system that is easy to understand, with a flat corporate tax rate of 16%;
- the highest purchasing power parity (PPP) adjusted income per capita in the region;
- its emergence as a regional financial centre and base for many regional operations;
- the highest percentage of imports and exports to GDP in the region;
- a highly diversified geographical spread of both imports and exports with low reliance on inter-regional trade, resulting in lower risk of 'contagion' from economic problems in neighbouring countries;
- the lowest level of foreign debt to both exports and GDP in the region;
- a hard-working, well-trained and ambitious work force; and
- *the safest capital is Santiago on the continent.*

Big is not always best

For the decision-makers in South African business, the simple rule of thumb is biggest is not best:

- Numbers tell only part of the story. Don't be over-impressed by macro economic or even industry-specific facts and figures comparing the countries.
- Big also means more competitive, potentially more protectionist and usually more nationalist from a micro economic perspective.
- Brazil is not a country, it is a continent. Compare each state in Brazil with Argentina and Chile.
- The bigger the country, the higher the 'school fees' to be paid by new entrants.

- The bigger the country, the more difficult it is to understand how the economy and business really works. Assuming you can speak the necessary languages, Chile may take a few months to understand. Brazil and Argentina will take at least a number of years.
- Risk assessment is the most fundamental component in the comparison of business opportunities, not merely the forecast return. The reduction of the level of risk and its adequate assessment are as important as the business itself.

Both Brazil and Argentina have traditionally prided themselves on their *relative self-sufficiency*, and though they are no longer closed economies, significant informal barriers to entry have been developed in order to protect local vested interests. Perhaps more important, high levels of corruption and an inordinate amount of red tape make these countries singularly unattractive as starting points for trade and investment in the region. The complexity of import and tax regulations and the high cost of entry are generally substantially underestimated by companies entering these markets. Protectionism still thrives in both Brazil and Argentina though its name and its form have changed.

Chile is export and import driven, whereas Argentina and Brazil are sustained by internal markets that create barriers to entry for foreign products and services, as already noted. Chile's manufacturing sector is sustained by the use of foreign products and services. Therefore Chilean businessmen are open to any product or service of good quality and price.

Although entering Brazil and Argentina must be a long-term objective for companies, they are not necessarily the best countries in which to start operations in the region. Nor are they the best choices for a regional operation base. It is not a coincidence that the few South African companies with substantial South American experience have established their regional headquarters in Chile. Both Anglo-American and Billiton have their head offices in Santiago, and each has over \$3 billion in the Chilean mining sector. Anglo has put a similar amount into Brazil, Argentina, Peru and Venezuela. South African companies not in the mining sector are also beginning to make inroads. Scaw metals has a \$20 million investment in Chile, and is about to commit a further \$100 million. Boart Longyear has, I estimate, invested over \$30

million in the region and Mr Price, which has subsequently decided to withdraw from Latin America, had eight clothes stores in Santiago. In addition Tiger Oats, Frazer Alexander and others have established a tangible presence there. The success rate of South African ventures in Chile has been high. This alone has provided strong impetus for further investment in Chile and, more importantly, in the region. Furthermore, the relative strength of the Chilean and the South African economies are often complementary. This provides an easier road to the development of bilateral trade and business relations than would be the case between South Africa and Brazil or Argentina.

Chile is the best place for South African companies to 'cut their teeth' in the region, assuming of course that the right business opportunity can be found.

I also suggest that regardless of where the initial business opportunity is located, consideration should be given to using Chile as the regional base from the outset. Should attractive opportunities arise first in other countries, they must clearly not be discarded, but the due diligence process should be extremely rigorously followed. The team involved should include trusted contacts ideally with in-depth South African and South American business experience. In addition, the examination of the legal requirements must be completed. Results must be viewed in the context of historic economic and political dynamics, the effects of which are often not easy to quantify.

I have devoted 10 years to stimulating South African business interests in South America, simply because the opportunities are enormous. My view is that a cautious and well-considered first step will lead to a long-term relationship with the region that is rewarding to both parties.

The Experience Of South African Mining Companies in Latin America

Gavin Keeton¹

The experience of South African mining companies in Latin America must be seen in the context of the increasingly global nature of the mining industry. Only a decade ago all the world's major mining houses were clearly identifiable as Australian, British, American, South African, Chilean or Brazilian. But today this has changed. While global operations may be concentrated in a particular region and corporate cultures may have a certain national hue, operations and exploration are increasingly located across a number of different regions. Stock market listings are often in dual markets, or, as in the case of Billiton and Anglo American, in an international market other than the company's national base.

Product diversification is also a growing, albeit not universal, trend. While the focus in the US is still for single product producers, outside America there is growing support amongst fund managers for the protection offered against the product cycle by a diversified product portfolio. Rio Tinto and Anglo American have, of course, long belonged in this camp. The positive market response to the BHP-Billiton merger to form the largest of the mining companies that follows diversity both in product and region lends further support to the argument that the diversified model is likely to become more dominant in the future.

Anglo American likes to see itself as having been something of a pioneer in the development of the regionally diverse model. As early as 1972 — a time of hyperinflation and great economic and political upheaval for the region — we made our first investments in gold in Brazil. A decade later we expanded into Chile. To date Anglo American has invested some \$5 billion in the region, \$3.3 billion of which went to Chile. Some 15% of our net operating assets are now in South America, making it our second largest area of mining activity after South Africa by a comfortable margin. Operations include mining copper in Chile and Peru; gold, nickel, niobium and industrial

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minerals in Brazil; gold in Argentina; nickel and coal in Venezuela; and coal in Colombia. Through Scaw Metals' sole ownership of MolyCop and part ownership (50%) of Proacer, the Group also produces grinding balls for the mining industry in Chile, Peru and Mexico. Internal studies suggest that Anglo American is amongst the 10 largest foreign investors in South America. After *Companhia Vale do Rio Doce* (CVRD) in Brazil, Anglo American may well pip BHP–Billiton as the largest private mining investor in the region.

BHP–Billiton's assets in the region are partly the result of its South African (that is, Billiton) and partly its Australian (in other words, BHP) parentage. Its mining assets include copper mines in Chile and Peru, nickel in Colombia and aluminium in Brazil; and it is one of Anglo American's partners in coal in Colombia. Rio Tinto, by contrast, has a surprisingly small presence in Latin America, producing borax in Argentina, iron ore, gold and nickel in Brazil and, through a 30% stake in the giant (but BHP–Billiton managed) Escondida mine, copper in Chile.

For the diversified South African mining companies — Anglo American and Billiton — Latin America is clearly an important area of investment. But it is also a sector of recent and planned growth. In Chile, Billiton is currently spending \$400 million in expanding Escondida, while Anglo American (along with its partners Falconbridge and Mitsui) is allocating \$654 million to enlarging the Collhuasi copper mine. In 2002, Anglo American purchased Disputada, a copper mine in Chile, for \$1.3 billion. It has spent well over \$200 million on extending its other operations across the region. Both Anglo American and BHP–Billiton have important exploration activities and are planning to initiate large-scale projects in the region.

But investing in mining in Latin America is not for the faint-hearted. Of course mining companies, depending upon the geological location of viable deposits, cannot be as choosy about where they establish their mines as can a manufacturer. And South African companies were precluded until quite recently for political reasons from operating freely in some of the other major global mining areas, such as Australia and Canada. But there is something to be said for the South African pioneering spirit and the experience the local mining operations have gained in dealing with the difficult political, economic and social problems of this country, as well as the technical problems associated with deep level hard rock mining. These have encouraged our mining

companies to be more willing to tackle the sometimes difficult and opaque economic, political and social environments associated with doing business in Latin America. Put differently, we punch above our weight on that continent.

Political and economic instability have long been a feature of Latin America. In this regard it is worth noting that six of the 10 largest countries in South America have elected new presidents over the last two years or so. Not all of these heads of state have good democratic credentials. The longest-serving leader in the region is President Chavez of Venezuela, and the readers are likely to be well aware of the economic fallout that followed recent attempts by opposition parties to remove him from office.

After a decade of relative tranquillity, the region has experienced political volatility because of the economic upheaval which began with the pressure for, and eventual depreciation of, the Brazilian real, and a spillover in Argentina. Together Brazil and Argentina make up 75% of South American gross domestic product (GDP), and the impact of their economic woes has inevitably been felt by the rest of the region. The significant exception has been Chile, but even in that country growth has fallen significantly below the 7% per annum regularly enjoyed for most of the past two decades.

Within the economic and political volatility of the region a growing impatience is being felt with more than a decade of liberal orthodox economic policies that have resulted in little tangible improvement in the economic circumstances of the majority of the population. This is reflected by a clear swing in political terms away from centre-right to centre-left governments. This change is often less apparent in economic policy terms, where centre-left governments have thus far in practice continued with the liberal economic policies of their predecessors.

There is also a growing suspicion of foreign investors in the region, especially in mining. That this mistrust is nothing new is illustrated by the fact that although orthodox free market policies were applied throughout the Pinochet regime in Chile, no attempt was made to privatise the state-owned copper producer, Codelco, which still dominates copper production in that country. In the same way CVRD in Brazil, despite having been privatised in 1997, remains firmly under the control of a combination of state and Brazilian nationalistic interests. (BHP-Billiton recently sold their strategic minority interest in

that company.) In Chile this suspicion has resulted in a growing call for the introduction of mining royalties (which has been taken sufficiently seriously to have been debated in parliament recently), a subject that is very familiar to a South African audience. Most politicians are conscious of the negative impact that such royalties will have, not only on mining but on Chile's hard-earned reputation with foreign investors for providing the favourable and stable legal and fiscal regime that has underpinned the successful growth model of that country for more than two decades. But few politicians appear willing to take a publicly stand on an issue that has strong voter appeal.

How can foreign mining companies best deal with these tensions in a region that is so important to their global operations?

The first general point to be made here is that mining companies generally do not sell significant proportions of their output in their domestic markets. Hence, mining operations are often relatively insulated from domestic economic turmoil. Indeed, to the extent that economic problems tend to lead both to undervalued domestic currencies and the imperative to increase foreign exchange earnings, mining companies, along with other exporters, have sometimes benefited. It is only when these upheavals have affected the ability to convert foreign exchange — as is currently the case in Venezuela — that mining operations have been severely hampered.

In addition, Anglo American attributes much of its early success in the region to the alliances forged both with major local partners such as the Bozano-Simonsen and Hochschild groups and with various state and provincial governments. It was these partnerships that enabled us to manage what were often perplexing institutional, political and business dynamics. But such a model for doing business has been challenged by a global move towards companies wholly owning their operations so as to control the cash flows. So a further policy of Anglo American has been to employ locals to run our Latin American operations. Patrick Esnouf, the chairman of Anglo American South America, a South African, has been a permanent resident in the region for 16 years. In a recent interview he noted:

Unlike some of our rivals, we've eschewed the send-in-the gringos approach and have put in place local management and empowered them. It's people, after all, who are able to predict, rather than merely respond to, changing conditions in the local environment which often defy Anglo Saxon

logic. This is probably the key ingredient in our continuing success in South America.

An added benefit is the expertise which our Latin American colleagues have been able to transfer to our operations elsewhere in the world. Two recent examples are the appointment of a Chilean national to a senior position in our Base Metals head office, and a Brazilian to take charge of our technical research laboratories in Johannesburg.

Many readers will be aware of the encouraging rise in global commodity prices in recent months, and the generally bullish prognosis which most commentators give for commodities for the foreseeable future. In October 2003 the *Financial Times* dedicated a full page special to the growing need of commodities in the world economy, 'Commodities: The next five to ten years will reverse the downward trend of the past twenty.' There are a number of reasons for this optimism, including the current improvement in growth in the developed world, the US in particular. But also important is that it is expected to occur against the background of an industry in which increases in capacity have been modest for a number of years. There are several reasons for this, including increased consolidation and producer discipline in a number of commodities. But, more generally, mining is seen to be a sector that was starved of capital during the era of the technology and dot-com bubbles. Investors are now anxious to put capital into a sector believed to have a positive future, and into companies which produce real earnings and pay regular dividends to their shareholders. This desire is increased when the emergence of China as an economic force is added to the already positive industry mix. China's high rates of growth, and the concentration therein of fixed investment and infrastructure construction, is generating a seemingly insatiable demand for almost all commodities. Commodity producers are therefore seen as a way in which investors can gain exposure to China — something that is almost impossible to achieve directly.

One consequence will inevitably be new mines. Producer consolidation and the rigid focus of investors on returns of capital should ensure that this expansion is orderly. Both South Africa and Latin America stand to benefit, by virtue of their rich mineral deposits. However, the rigid focus of producers on investment returns and their increasingly global nature mean that investment in specific localities is

not assured. That some countries should now be raising the bar which prospective investors must clear to succeed is unfortunate. But mining is a long-term business. Fortunately its companies have much experience in dealing with local difficulties and negotiating their way past seemingly insurmountable barriers. These skills will be much needed in both South Africa and Latin America. South African mining companies are uniquely equipped to use them in both regions.

Section Three
The Commercial Legal Environment in
Latin America

Understanding Legal Business Practice in Brazil

Emile Myburgh¹

It may be stating the obvious to say that any person opening a business in Latin America will need to appoint a lawyer in the relevant country. It is surprising how many businesses ignore this basic wisdom when undertaking a new venture abroad, often at great expense. However, many businesses are already aware of the enormous potential for South Africa in Latin America, and many concerns are already successfully trading there.

Apart from the obvious drawcard of offering opportunities to make money, the Latin American countries, and Brazil in particular, have many attractions. There can hardly be a better location in which to do business than Rio de Janeiro. Argentina is also exceptionally inviting destination for business trips, offering superb music, especially excellent cuisine (in particular its prime beef). Economies of scale also come into play: São Paulo State, with a population of around 35 million, half of which live in São Paulo City, has an economic output nearly double that of South Africa (at \$231 billion). This constitutes about 40% of Brazil's total GDP, and nearly 30% of Mercosur's GDP.

Other countries, like Bolivia and Peru, are much in need of advanced technology to alleviate poverty and to improve infrastructure to promote economic growth. This could provide an opening for South African business interests.

However, doing business in Brazil is quite different from visiting it as a tourist. Having lived in Brazil for two years, and experienced the frustrations of doing business there, I offer the following brief description of some of the different ways in which a business investor can introduce products to Brazil. Although a number of difficulties are associated with accessing the Brazilian market, which is the largest in Latin America, I sincerely believe that it is the logical entry point for most goods intended for Mercosur and the broader region of Latin America.

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Options for entry

Agents and representatives

An appropriate option for entry is to find an agent who will buy the goods and then sell them to Brazilian retailers. This presents few complications, apart from the need to ensure that the goods are sold with a Letter of Credit, regardless of any protestations by the agent. It is not wise to sell on terms, unless the seller has the utmost faith in the agent, or does not mind running the risk of losing his or her money. An untrustworthy agent can cause enormous problems if it becomes necessary to demand the return of goods. The additional complications posed by language, whether Portuguese or Spanish, as the case may be, may prove insurmountable. This could leave an inexperienced business person with an unwarrantedly negative impression of Brazil or even of South America as a whole.

In Brazil, an agent needs to be registered at the Foreign Trade Secretariat (SECEX) of the Brazilian Ministry of Industry, Commerce and Tourism. SECEX uses a computerised registration system for imports arriving in Brazil, which greatly simplifies the process. Certain products (including weapons, pharmaceuticals, textiles and radioactive materials) need special import licences from the applicable government agencies before they may be shipped to (as opposed to offloaded in) Brazil.

Representatives

An alternative to employing an agent is for the person attempting to sell goods in the Latin American market to find a representative, which provides more control over his or her activities. Agency agreements in Brazil are regulated by two laws: 4886 of 1965 and 8420 of 1992. A written agreement must be concluded between the business and the agent, to ensure the certainty of the terms. According to law 8420 of 1992, such a contract should contain specifications of:

- the general conditions of the representation;
- a description of the nature and features of the products;
- the duration of the contract;

- an indication of the area or areas in which the representation will be required, and permission (or not) for the represented company to perform direct sales of its own in the indicated area, or areas;
- the granting (or not) of the exclusivity of the selling area (total or partial);
- the commission payable to the commercial representative and its payment schedule, conditional (or not) on the effective collection of the buyers' payments;
- the exclusivity (or not) of the represented company's products; and
- the indemnity to be paid to the commercial representative in case of the unjustified termination of the contract, which sum cannot be less than the equivalent of one-twelfth of the total remuneration paid to the commercial representative throughout the duration of the contractual relationship.

The contract has to be written in Portuguese, and the agent must be registered at the Commercial Representatives Council of the state, where he or she will operate. It is worthwhile to require an agent under consideration to produce proof of his or her registration. In addition, to avoid the burdensome provisions of Brazilian labour laws (which are comparable to those in South African), it is advisable to appoint a Brazilian company with at least two partners as the representative, and to avoid giving direct orders to the partners and employees of the company.

What happens if a business has no such agreement? If anything goes wrong, a South African business may find itself in a very unpleasant situation, even if the fault lies entirely with the representative. The business may be liable to pay to the representative as damages one twelfth of all the commissions that he or she has earned during the course of the association. It may also end up being subject to a labour law claim. Brazilian law is likely, in the absence of a written agreement, to view an oral contract for representation as a labour contract, which will leave the contracting business liable for even more damages. I have seen cases where exporters have made contracts with representatives directly, without using Brazilian lawyers, because their in-house legal teams or South African attorneys had drafted a representative agreement for them; or, even worse, had no contract. In both cases these businesses ended up having to pay out large amounts of money when the relationship went sour.

When a company sells goods through a representative, it is also advisable for it to run background checks on potential buyers. The reason for this is quite obvious — if the firm knows that the buyer operates from respectable premises, has no judgements against his (or his company's) name, and is a reputable person or company, the seller is far more likely to be paid. There is a difference in Brazilian law between agents and representatives. Agents buy the goods and are responsible for finding buyers, while representatives merely facilitate sales, and earn a commission on any successful transactions that he or she negotiates. Especially in the latter case, it is important for the business to find out whether the buyer is a creditworthy person. This kind of service is usually rendered by a Brazilian lawyer, but a representative may also be required to perform such screening in advance of concluding a deal.

Creating a company in Brazil

For various reasons it may be advisable to set up a company in Brazil. The two most popular company forms are the private limited liability company (*limitada*) and the corporation (*sociedade anônima*). The *limitada* is by far the most popular business entity, and is very similar to South Africa's close corporation, in that it is very simple both to create and to administer. The *sociedade anônima* is akin to a public company in South Africa.

One of the biggest advantages of setting up a Brazilian company is that it allows a South African business to participate in public procurement bidding. As a registered Brazilian company, a South African firm can enjoy exactly the same rights as any Brazilian company wholly owned by Brazilians, even if the former is wholly foreign owned. The rationale for establishing a Brazilian company is further justified if the intention is to manufacture goods locally for sale in Brazilian territory. This also applies to exports to the other Mercosur countries and the rest of South America. It also has the advantage of avoiding high import duties and delays while goods are being cleared at the port.

A company is also a perfect vehicle for joint ventures in Brazil. These are for companies manufacturing defence machinery or other heavy industrial goods. In this case it should be remembered that, in terms of the new Brazilian civil code, control over a *limitada* is exercised by

partners holding at least 75% of the shares (or quotas, as they are referred to in Brazil), otherwise all decisions must be taken by consensus. Therefore, even if a South African company enters into a joint venture, but wishes to maintain control of the *limitada*, the Brazilian party should not be given more than a 25% stake in it. To create a *limitada* a business requires two partners, who may be legal or natural persons, and may both be foreign. (That is, it is not necessary to have a Brazilian partner.) The company is thereafter created by means of a social contract between the partners that sets out the objective of the company, the powers of the partners and the amount of capital. This contract is then registered at the Commercial Registry of the state where the company will be located. The entire process, from the first instruction to a lawyer to completion, takes about four months for an investor from abroad. The principal reason for this relatively slow process is that all documents which are needed to incorporate the company have to be notarised in South Africa, and authorised by the Brazilian consulate. It is not necessary to have the documents apostilled by the High Court. Thereafter the documents are ready to be lodged in Brazil, which takes about two months.

Brazilian law requires all companies to appoint a representative (of a different kind to that mentioned before) in Brazil, who has certain statutory functions. The fees of such representatives, who in practice are usually the attorneys the business uses in Brazil, are quite high. The reason is that the representative assumes personal liability for the due fulfilment of the foreign partners' obligations. Even if the South African firm intends to incorporate its company a year before starting operations, it will be liable for this fee on incorporation, because Brazilian company law imposes some duties on companies which have to be complied with, even by dormant companies. Also, foreign partners, even if they are non-resident, need to obtain Brazilian tax numbers and file annual tax returns.

Other legal considerations

Various other legal issues need to be considered when doing business in Brazil. The most important are visas, tax, intellectual property, foreign capital issues and consumer protection.

Visas

Brazil issues various types of visas to visitors to Brazil. The most important ones for companies are the business, temporary and permanent visas. If a person travelling on a South African passport visits Brazil, he or she does not need a visa for tourist purposes. This is a consequence of the reciprocity principle which Brazil applies: it requires visas only from citizens of those countries which require visas of Brazilian citizens. Consequently American visitors all require visas. If a South African wishes to work in Brazil, he or she will need a temporary visa, which is issued for two years and renewable for two years thereafter, after which it may be exchanged for a permanent visa. The usual principles apply: a foreign worker should not be taking the job of a Brazilian and should demonstrate a skill that no Brazilian possesses. The visa is valid only as long as the person is employed by the company that sponsors the visa. If a South African cannot find anyone to employ him or her in Brazil, he or she can set up a company, invest a minimum of US\$200,000 and create a certain number of jobs. This is covered by an investment visa.

Taxes

The South African company will be expected to pay a variety of taxes when doing business in Brazil. These taxes are collected on federal, state and municipal level. The most significant of these is income tax, which is levied at a rate of 15% on the first 20,000 reals profits per month, or 240,000 reals per year. All profits above that are taxed at 27.5%. Sales taxes like VAT are levied at state level, and differ from state to state. The following taxes also apply:

social contribution on net profits;

- withholding tax on remittances abroad;
- social contribution on invoicing (COFINS);
- contribution to the social integration programme (PIS);
- tax on operations on the circulation of merchandise and services (ICMS);
- service occupation tax (ISS);
- social contribution on corporate profits (CSL); and
- social security contribution on payroll (INSS).

Intellectual property

Brazil has an advanced system of intellectual property protection. The usual protection is given to trademarks, patents, copyright, designs and new technology. It is important to remember that as long as a company's intellectual property is not registered, it does not enjoy common law protection, as it would in South Africa. It is therefore essential to register a company's trademark or patent as soon as possible after commencing the registration process of the company. All intellectual property processes are handled by the Brazilian Institute for Industrial Property, or INPI.

Foreign capital

All foreign capital that is used to set up a company in Brazil should be registered at the Brazilian Central Bank. Failure to do so will result in a substantial fine. Only companies that have registered their foreign capital are allowed to remit profits abroad in the currency in which funding was sent to Brazil. This registration is usually taken care of by the company's attorneys in Brazil.

Consumer protection

Consumer protection is another area that should be well understood by South African businesses prior to entry into the market. Brazil's consumer protection code, which dates from 1990, is very sophisticated, and is based on the European model. It requires the publication of all ingredients of foodstuffs; warnings on all types of alcohol; and prescribes certain standards for household products and services. The code also reverses the burden of proof in the case of complaint, so that it is up to the manufacturer or service provider to prove that whatever a consumer alleges is lacking or faulty is not true. In practice this means that the consumer usually wins any case brought against a supplier.

Conclusion

Is it worthwhile for South African companies to do business in Brazil? The answer is yes. The intention behind this paper is not to portray

Brazil in a bad light, but to help South African companies to know what to expect when entering the Brazilian market, which is a profitable one and well worth the trouble of dealing with the bureaucratic requirements. As one of the world's largest emerging markets, Brazil attracts major FDI. It is therefore a promising destination for South African businesses.

The Tax Regime For Foreign Investors in Chile: The Different Forms Foreign Investments Take

Sven Herlin¹

Introduction

The purpose of this paper is to provide a general brief overview of the main aspects to be addressed if a person or company decides to invest in, or operate as a company in, the Republic of Chile. The word 'company' or 'entity' is used generically in this report to identify the kinds of companies that can be formed in accordance with Chilean law. These include stock corporations (closed/not listed), companies, partnerships, agencies and joint ventures.

A foreigner, whether a company or person, may operate and direct an investment in Chile by various means. These include starting a new business through a Chilean entity formed directly by the investor; through the purchase of the assets of an existing Chilean business; or through the purchase of shares or rights in an existing Chilean open/closed stock corporation or partnership/company, either directly or through a Chilean entity formed by the investor for this purpose. Another option is the formation or direct purchase of shares or other rights of a non-Chilean entity (that is, a foreign holding company), which creates, purchases or owns in any of the above ways a business or company in Chile.

In practical terms, foreign investment projects are usually organised in the form of the following kinds of companies: an open or closed stock corporation which is a subsidiary of the foreign investors; a limited liability company which is a subsidiary of the foreign investors; an agency or permanent establishment of the foreign investing company; or a joint venture with a Chilean company.

The form of organisation of the different options varies in terms of capital structure (rights or shares), management (board or direct management), rights of minorities (shareholders or partners), and legal obligations (external auditors, publication of balance sheet, and so on). The formation of both a stock corporation and a limited liability company

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require the execution of a public deed that contains the by-laws of the company and the fulfilment of other legal formalities (including registration). In the case of open stock corporations there are further requirements, such as authorisation from the government agency that supervises that class of companies. The setting up of an agency involves similar formalities. Joint ventures are not separate legal entities, and are regulated by the applicable joint venture agreement. Joint venture partners often operate in Chile through a jointly formed Chilean stock corporation, partnership or branch office. From the point of view of taxes, there are no substantial differences in the regimes applicable to the different types of entities.

Taxes to which foreign investors are liable

Company tax

An annual tax on profits, called 'first category', at the current rate of 17%, is imposed on the company, regardless of whether it is a stock corporation, limited liability company or an agency of a foreign firm. The tax is assessed on the taxable net income of the company, which is determined in accordance with its books of account, and adjusted with certain additions and deductions for tax purposes. The first category tax paid by the company constitutes a credit against the tax that is generated when profit distributions are made. It must be paid by the partners or shareholders that receive a share of the profits. In this way, the first category tax paid is recovered as a lower tax on dividends or distributions, provided all the profits are distributed. (If distribution is lower, the tax is proportional.)

Taxes paid by a foreign investor not resident in Chile

The general rule is that the distributions or dividends that a company pays to its partners or shareholders are subject to a withholding tax (additional tax) with a rate of 35%. As already noted, the first category tax already paid by the company serves as a credit against the tax on the distribution of profits or dividends. In consequence, the global tax obligation on the investment (considering jointly the tax on the company and that which is levied on distributions of dividends or profits to a person not domiciled or resident in Chile) is 35%. Every year the company pays the first category tax at a rate of 17%, and the difference between that and 35% must be paid on the profits that are distributed and remitted abroad.

Consequently, if a holding company owns a productive company in Chile that in turn distributes profits or dividends to its partners or shareholders, those that are distributed to the holding company (as partner or shareholder of the productive company) are not affected by the additional tax, even if it belongs to a foreign investor. Therefore there can be cash movements from the productive to the holding company, and from this to other business activities, even outside Chile, without requiring the immediate payment of taxes.

Payments abroad

In general, the payments made abroad for royalties, interest or services provided in a foreign country are subject to a withholding tax of 35%, which is applied on the full amount paid. In exceptional cases, a lower rate is levied on some payments. These include interest on loans granted from abroad by specific foreign banks or international financial institutions which are subject to a withholding rate of 4%; on fees for technical assistance services on which a withholding rate of 20% is levied; and commissions paid abroad, which are exempt from tax. In order to qualify for the latter, companies must comply with certain administrative requirements of the Chilean Internal Revenue Service. Capital asset leasing is also subject to a special system of taxation.

Value Added Tax (VAT) regime

Customary sales, services provided and imports of assets are subject to the VAT tax, which is set at an even rate of 19% for all goods and services. Notwithstanding the above, foreign investors may enjoy particular exemptions when importing certain capital assets. The Chilean system operates on the basis of fiscal credits and debits, and the taxpayer company is required to pay the excess of the debits over the credit on a monthly basis.

If during a certain period the company has an excess of credits over debits, the difference can be accumulated for deduction in subsequent periods when it has been properly indexed in accordance with the variations in domestic inflation. Also, and subject to the fulfilment of certain conditions, the law provides a mechanism whereby, if there are surpluses of fiscal credit for a period of six months as a consequence of the import or acquisition of capital assets, it is possible for the company to request the return, in money, of the credit that has not been recovered by means of the normal deductions.

Tax regime for loans from abroad

The formal documents providing evidence of money loan operations, such as drafts and promissory notes, are subject to a Stamp Tax. This is applied on the amount of money involved in the operation, and is set at a rate of 0.134% for each month or fraction of a month, with a maximum of 1.608%. Both local and foreign loans are subject to this tax.

Foreign loans must be channelled through the Formal Exchange Market, in accordance with the provisions of Chapter XIV of the Compendium of Foreign Exchange Rules of the Central Bank of Chile. The Central Bank of Chile has established a compulsory system of *encaje* (cash reserve) for foreign loans, according to which a percentage of the sum loaned (actually 0%) must remain in deposit, not earning interest, in the bank for a period of one year. The compulsory deposit can be avoided by means of an alternative mechanism of purchase and resale of documents to the Central Bank equivalent to the payment of an interest rate on such deposit for one year.

Custom duties regime

All types of goods and services, except a limited number of specifically prohibited items (for example, used cars), may be imported by any individual or entity. The Chilean customs regime applies a general duty at a rate of 6% to most imports. In exceptional cases higher rates, are charged, conversely, a number of treaties and trade associations serve to reduce (or eliminate) the normal customs duty rate for certain products traded with other countries (such as the US, Mexico, Canada, Korea, Central America, other members of Mercosur, the European Union Community and European Free Trade Association (EFTA)).

Customs duties are applied on the Construction Innovation Forum (CIF) value of the imports. However, both the National Customs Service and the Central Bank of Chile may establish different values if those declared by a taxpayer are discrepant with those usually paid for the same assets. VAT that affects imports is calculated on the same basis as the customs duties. Chilean law also provides a system that allows for the deferral of custom duties under certain circumstances.

Alternatives for foreign investment in Chile

The two principal mechanisms under which foreign investments fall are as follows. The foreign investor is free to elect which of these vehicles is

most suitable for the company's particular requirements. The provisions of DL 600, the Foreign Investment Statute, specify that capital can be contributed in foreign currency; or physical assets; or through the capitalisation of profits retained under a foreign investment contract, external loans, or technology. Chapter XIV of the Compendium of Foreign Exchange Rules of the Central Bank of Chile (hereafter referred to as Chapter XIV) applies to the entry of foreign currency into the country. Investments made through Chapter XIV are subject to a very simple procedure of filing in the Central Bank of Chile. The application for an investment under Chapter XIV is formalised by a commercial bank, which acts on behalf of the Central Bank. Once the operation is registered, the funds can be brought into the country. In the event they are already in Chile, they can be liquidated. In practical terms and in normal circumstances, the procedure should not take more than one or two days. Investments through Chapter XIV do not have a special protection system. Consequently, the regime that governs them can be changed according to new legal provisions. It is also subject to the general provisions of the Income Tax Law, as already explained.

In the case of a foreign investment under DL 600, an application for the approval of the investment must be filed with the Foreign Investment Committee (FIC), which falls under the Ministry of Economy, Development and Reconstruction. Normally the funds may be brought into the country and converted to local currency after the application has been approved by the FIC. However, at the request of the investor and for justified reasons, the FIC may allow the entity to transfer the capital to the country immediately after filing the application. In any case, there is no need to wait for the execution of the contract before materialising the investment. The legal protection the DL 600 provides for the foreign investments also comes into force when the application has been submitted. The protection ensures that any subsequent changes in national legislation cannot affect the rights of the investor. This protection lasts indefinitely or for a period established in the pertinent contract. Also, the investor may choose to be assessed under the general tax regime, or to include a system in the contract according to which the company is guaranteed a tax rate of 42% that cannot be altered for a period of up to 10 years, regardless of changes in the general internal legislation during that time. If the foreign investor elects the invariable rate in the foreign investment contract, this specific right may be waived at any time, after which the company will be subject to the general regime described. Other tax protections can be negotiated.

Chile, springboard for South America and other countries

In December 2002, Law No. 19 840 was published in Chile. Among other matters relating to taxes, the new law established norms that would enable companies with foreign capital to make investments in other countries from Chile, making them exempt from taxes in Chile when making such investments. This special tax regime, known as the 'investment platform', seeks to attract foreign capital to Chile which, in turn, may be invested abroad. In this way foreign investors who wish to enter Latin America or eventually other places in the world can use Chile as their investment platform.

Until the date of publication of this Law, the foreign investors who had established operations in Chile with the sole purpose of extending them beyond the country, experienced great difficulties. Apart from the taxes they were required to pay in the source country and eventually also in the country of origin of the capital (which would be the final destination of the profits), they had to pay taxes in Chile. This was a strong reason to discourage investors from establishing companies in Chile.

Law 19 840 intends to stimulate investments made by companies established in Chile using foreign capital, by making it unnecessary for them to pay tax twice on profits that are generated abroad. In exchange, the Chilean government expects to profit by the accelerated development of the financial, accounting, legal and other services in the country.

The law creates a special tax regime for stock corporations, whether open or closed, by virtue of which these companies will be considered for the purposes of income tax as not domiciled in Chile for their investment made abroad. This renders them liable to taxes in Chile based only on their income from Chile. Likewise the norm also exempts the shareholders of companies that are domiciled abroad from all taxes on the remittances and distributions of profits or dividends that they obtain from the company and for the partial or full return of the capitals coming from abroad, as well as for the great value they obtain from the company in Chile, and ensures the partial or full return of the capital coming from abroad. To repeat, the companies that fall under this special regime will pay taxes only on their Chilean income.

Conclusion

Internationally, Chile has been recorded as the most reliable and trustworthy country in South America in which to start a business. It offers a good combination of well understood and stable regulations and institutions, is technologically well-developed, has a deep financial market, is politically stable and provides a safe environment for foreign employees.

Chile has been the only country in South America that has persisted in maintaining a permanent open market policy. It has also signed bilateral investment protection and double taxation agreements with the richest economies in the world.

Because of the complexities of doing business in South America, it is highly recommended that prospective investors do proper market research and seek legal advice before committing themselves to entering the Latin American market. Another good way to learn about the region is to ask other foreign investors about what their experiences in South America have been.

The Chilean market has proved to be highly competitive. It can be described as a very good 'lab size market', which can teach the investor about other Latin American markets and enable South African companies to evaluate ways of approaching them. We believe that Chile provides the ideal route to other countries in the region.

Section Four
Argentina's Revival

Argentina Under Kirchner: Solving the Debt Burden and Creating a New Economic Environment for Business

Gladys Lechini and Pedro Romero¹

The regional context

A consensus document consisting of 54 points was signed by the presidents of the region at the thirteenth Ibero American Summit held in La Paz, in 2003. This can be considered as providing a summary of the main political axes established by the Latin-American democracies for the first decade of the new millennium. At the domestic level, it expresses criticism of the strong structural economic reforms of the 1990s emanating from the Washington Consensus, and the poverty, inequality and social exclusion that resulted. The solution proposed, and supported by a general consensus, is the re-instatement of the state as regulator, manager, promoter and controller.

At the international level, there is an appeal to respect the political situation of the region. The document commits the signatories to the principle of non-intervention, the prohibition of the threat or the use of force in international relations, and respect for the territorial integrity of other states. It also contains a commitment to a new agenda in which international terrorism is condemned. Criticism is levelled at both the functioning of the UN (with proposals for extensive reform) and the behaviour of the International Monetary Fund (IMF). These statements also represent a kind of Latin-American consensus aimed at either generating a certain distance from, or breaking away from the neoliberal model² followed in the previous decade.

Only the Venezuelan president, Hugo Chávez, has shown unmistakable signs of his decision to break from the neoliberal model.

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² The West's free market system stipulated by the Washington Consensus and international credit lending agencies.

The Ecuadorian leader, Lucio Gutiérrez, and the Peruvian head of state, Alejandro Toledo seem to have prioritised, with reluctance, the main points of their predecessors' policies. The Bolivian president, Carlos Mesa, is experiencing enormous difficulties in overcoming the paralysis caused not only by the threat of popular dissent, but also by an elite unwilling to abandon its privileges.

The most important governments of the region, those of José Ignacio Lula da Silva and Néstor Kirchner, promised a 'gradual exit from the neoliberal logic' at the very beginning of their terms in office. Nevertheless, a combination of the domestic and international conditions and the political standpoint point to a strategy for national recovery which is not necessarily completely opposed to the previous model. The analysis that follows will focus on what has been done by President Nestor Kirchner's administration, in order to illustrate the gap between his pronouncements (what he declares) and his government's actions.

The construction of political power around the president

The withdrawal of Carlos Menem from the second electoral round meant that Néstor Kirchner came to power with only 22% of the vote and that Kirchner appeared to win by default, and that he would preside over a weak government, that had an an urgent need for political legitimacy. Nevertheless, the president's leadership (which did not follow traditional Peronism³), the way in which he handled his first months in office, and a public exhausted by months of catastrophe made it possible for Kirchner to finish the year with above support of 80% from Argentina's citizens.

Such actions as changes to the functioning of the Supreme Court of Justice, the abrogation of laws which gave immunity to those responsible for the military dictatorship, renegotiations with the IMF, a proposal to cancel 75% of the external debt owed to private creditors, and the idea of forging a Latin-American association that would put an end to automatic alignments between certain countries.

³ Peronism emanates from the father of Argentine politics, Juan Peron and his Peronist Party. Through years of political domination and mixture of political ideology, it earned its own ideological description, Peronism.

The impact of such measures allowed President Kirchner to build up his political support base. As Viviana Gorbato commented, 'the new dispensation tends to substitute the traditional collective support for the leader — as in historical Peronism — with conscious and active support for an ideological project'. This interpretation, if correct, would imply a dependence on the rationality, participation and decision-making of the general public, all characteristics that have been historically rare in Argentina.

The author's opinion, however, is that the president's approach to public opinion can be described as a double game whose purpose is to win legitimacy. The first game aims at taking advantage of his present 'momentum' in the eyes of the public to confront delicate problems such as the poor social situation domestically, the drawing up of a long-term economic project which would include debt renegotiation and the energy crisis. These would stand as a symbol of the new relationship between the state and the private sector.

The second game involves Kirchner's own party and its hegemonic role. It is clear that the majority of his Justicialist Party (JP) governors and political leaders have gained legitimacy independently of the president's status. The necessity therefore, to rely on a ruling party would be a very difficult task for the national executive. In any case, there seems no other option than to resort to the 'Peronist' disciplinary tradition, which assumes alignment with whoever is in government. The president's impressive public support can be used to pressurise the federal provincial regional leaders of the JP, provided it remains constant.

The president's political power has been maintained by a high level of popularity in the face of a fragmented opposition. One could question the reliability of the polls in view of the cost of implementing his government's programme within such a complex environment. On the other hand, it is very difficult to foresee how internal power struggles within the JP can be resolved. The president has now two alternatives: either to build the alliance within the ruling party or to change the rules of the game with new political forces at an equal footing. The success of his influence over governmental decision-making process as well as within his party can be seen as two faces of the same coin. Both have the aim of asserting and consolidating Nestor Kirchner's political power.

The construction of an economic model

Argentina imported all its needs in the 1990s. How long could a country that only consumed, and did not produce, last? The question is part of the government's official stance, and defines the economic standpoint behind its policy. The new model could be defined as an alternative capitalism, with a high degree of autonomy and strong regional connections. In contrast to the prescriptive Washington Consensus and their dire social consequences, the new proposal seems to seek a recovery of the alliance between production and work in a national effort that would include both the private and the public sectors. The establishment of a floating exchange rate, aimed at promoting exports and achieving efficient import substitution (bearing in mind the exigencies of regional integration) is the approved alternative to the convertibility plan which pegged the peso to the US dollar in a straight-jacket monetary regime. To sum up, a new policy that plans and promotes productive activities, together with a market that invests and produces, is the essence of the proposed model. As is the case of political power building, the achievement of consensus is directly connected with the present most serious challenge facing the government: the crisis of foreign debt. This is likely to determine the terms of payment as well as of the implementation of any new economic model.

The government seems to have accomplished a first important step in having gained the approval of the IMF for a first revision of economic targets, which was confirmed by the new director of the IMF, Rodrigo Rato. Having neutralised the resistance of most members of the G7 and having obtained strong support of the US and its regional partners is no small achievement. Rato also added that he expected 'to arrive at an agreement' with President Kirchner, with whom he maintains 'intense and cordial' relations.

However, the conclusion of a new agreement does not seem particularly straightforward. The debate on the need to raise the fiscal surplus for the next year may lead to a confrontation. The most orthodox members of the IMF want Argentina to lift its surplus above its present 3% of the GDP, in order to increase the available resources for restructuring its unpaid debt of \$88 million. The position taken by those countries is shared by other countries that have many citizens holding Argentine bonds in default. On the other hand, the Argentine government has ratified its decision to go no higher than the 3% it has

already committed. It has placed its hopes on the mediating figure of Rato, the agreement reached with Brazil, and US support.

The second (still pending) step in constructing a new economic model for Argentina is linked to negotiations with private creditors who hold of Argentine bonds. The growth of Argentina in 2003 was 8%, with a similar rate expectation for 2004. This is attributable to national production and a rise in the extremely favourable prices at which commodities, particularly agricultural exports, have been sold. Nevertheless, the government knows that in order to maintain growth, the country also needs direct foreign investment. A confrontation with the multilateral financial institutions caused by not solving the private debt issue would not encourage new investors to Argentina.

It is therefore necessary for Kirchner's government to find a quick solution that is acceptable to the private creditors. The agreements seem to be concentrated on two central questions. The first one is related to the debt release levels, and the second to the percentage of holders whose acceptance of the new terms is required to initiate the negotiating process. As far as the debt servicing is concerned, the propositions range from the 30% proposed by the Argentine government and the so called 'Russian level', which does not exceed the 75% proposed by some private creditors. The percentages of acceptance, on the other hand, seem to be more easy to negotiate and an agreement is feasible around 60%.

Interests and types of bonds complete the stage set, in which the government places a good deal of its future economic hopes in implementing an alternative capitalist model, with less social costs.

The reduction of private creditors, added to the interest of the banks, as well as the G7 states in reaching an agreement, makes it foreseeable that the negotiation will be concluded, but not without pressures and costs.

In conclusion, the construction of a new economic model is still subject to the solution of the national foreign debt. In any case, the possibilities of economic expansion, even with new regulations and game rules, will be linked to the attraction of investment and external productive alliances. In this sense, the exchange rate intervention may turn out to be highly tempting.

Conclusion

After a year in power, President Kirchner's government has tried to base its political strategy on a new rationality, which although detached from the policies followed in the 1990s, does not imply isolation and distrust. The major problems it faces, both internal and external, leave little margin for manoeuvring. Nowadays, the civil society is demanding a return to the original social contract and a state which can synthesise its basic requirements for foresight, security and progress. The answer is a productive model combined with vigilant and austere public policies. Governability depends on how the president manages to cope with alliances both within and outside his own party. The JP still appears as a dominant party which tends to convert its internal crises into national problems. The legislative elections in 2005 will be a test case for the success with which of the present government has dealt with all these problems.

The economy in turn, is facing the challenge of possible 'mutation'. But the model of the 1990s, which had great international legitimacy at that time, brought about some irreversible changes in the economic structures of Argentina that are not surmountable by mere statements. The probable economic policy of the future, once the external debt problem has been solved, is linked to the development of a style of capitalism which will allow the state a greater decision-making role. The regional grouping, Mercosur, is not only seen as an economic but as a political means to assure the participation and the opening up of Argentina to the international market in more equal way, sharing costs and benefits. The new economy will require that public and private interests be better integrated. The everyday praxis of the national bourgeoisie — which in the 1990s was for the open market and today is protectionist — appears to be one of the main problems to be solved, because the fear of a return of that 'old type of state' still exists.

The Argentina of today has not yet moved beyond its economic crisis, although the possibilities of success seem more feasible, at least in offering a clear and credible direction to all those, both nationals and foreigners, who are politically and economically interested in its recovery. Its present social deterioration, on the other hand, is likely to take much longer to address.

Section Five
Business in Colombia

Colombia: An Introductory Overview Of The Country

Fred Jacobsen¹

Introduction

Colombia has a favourable geographical location, being strategically positioned near the equator at the north-western tip of South America, and sharing borders with five countries: Venezuela, Brazil, Peru, Ecuador and Panama.

The country covers approximately 1 142 000 square kilometres, and has a population of 45 million. Both in extent and population, this is roughly equivalent to South Africa. Colombia has the fifth largest economy in Latin America: standing at \$81 billion, its GDP represents 4% of Latin America's annual total. With vast coastlines on both the Atlantic (1 600 km) and Pacific oceans (1 300 km), the country is the gateway between North and South America. It also provides easy access to the Caribbean, the eastern and western coasts of the United States (US), Europe, Africa and the Pacific Basin.

Colombia is highly urbanised, with cities and towns to be found throughout the country. It is divided into five geographic regions, which are divided into 32 provinces, called departments. While the population of many Latin American countries is concentrated in just two or three major cities, Colombia's population is well distributed throughout the country, with three of its cities boasting more than two million inhabitants. Bogota, its capital, has over 6.5 million residents. Eleven of Colombia's cities have populations exceeding 500 000, and 22 cities contain more than 100 000 inhabitants. This population distribution has created several market niches, which represent a diversified risk for investors in the country.

Education and Infrastructure:

At the heart of sustainable development

Owing to improvements in the level of education rates over the last 30 years, Colombia's workforce has become one of the country's main

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assets. It has evolved into one of the most highly educated in the Andean Community, and among the best-qualified in Latin America. The adult literacy rate in 2001 was 91.9%, as compared with 88.4% in 1999. Colombia has a vast number of highly-qualified professionals, particularly people trained to take top management positions.

Colombia has the oldest democratic system in Latin America. Despite its recent political problems, the country has preserved the stability of the governmental divisions: the executive, legislative, and judicial functions are clearly separated. This stability provides guarantees that go beyond immediate national interest to assure the consistency of the legal environment for foreign investors.

Since 1991, Colombia has been engaged in an ambitious modernisation and economic internationalisation process that includes several trade agreements. Strategic partnerships with other major economies provide expanded market access for Colombia's products and services. Indeed, through major integration agreements, Colombia has access to a market of 1.11 billion people living outside the country.

Colombia has also made major improvements to its infrastructure since the early 1990s, because modern facilities in specific areas were considered essential to attaining global competitiveness. Deregulation in various industries has allowed both domestic and foreign private sector participation in infrastructure projects, which has resulted in unprecedented progress. The means by which businesses in the private sector can participate in infrastructure projects are: concessions, direct provision of services, association with, or acquisition of, government-owned companies.

Incentives to improve FDI and address mounting challenges

In order to reach adequate levels of economic growth, job creation, and consumer confidence, the Colombian government is currently implementing an economic programme designed to curb the fiscal deficit and help the poorest members of the country's population. This programme has two main pillars: the strengthening of democratic security, and fiscal adjustment and structural reforms. As far as the former is concerned, stability in the country has been seriously undermined by the urban terror campaigns mounted by the drug cartels and the recent political upheavals. Improvement in domestic security in Colombia requires the re-establishment of state control

throughout the whole national territory, the elimination of the illegal drug trade, and the efficient and clean management of public resources. In little more than a year, this policy has been extraordinarily successful. With regard to fiscal adjustment, in the first six months of the present government's term, Congress approved several government-backed bills that included reforms of pension, tax and labour legislation and a significant downsizing of the public sector. Also, in December 2003, Congress approved a comprehensive bill that aimed to address the structural problems of Colombia's fiscal system.

The policies and legislation recently enacted have had an immediate impact on economic growth and business confidence. Up to the third quarter of 2003, GDP had increased by 3.5% and industrial production to 4.2% conversely, consumer prices rose by only 6.5% in 2003, a low figure compared to those of the past.

In order to promote Colombian exports, the government has spared no effort to transform the country into an excellent exporting platform. A pro-business government, rapid economic internationalisation and ongoing privatisation, combined with free trade zones, favourable economic export zones, special import-export systems, preferential treatment for export products, tax holidays and customs/VAT exemptions on raw materials for export products are amongst the benefits that exporters can claim by producing in Colombia.

Other advantages investors can find in Colombia include: skilled management, full compliance with all prevalent international standards, experience in producing high-quality goods and services for sophisticated international markets and a competitive and well-qualified labour force that is superior to those of other Latin American countries.

Overcoming negative perceptions of Colombia as an investment destination

Bringing foreign direct investment (FDI) into Colombia depends on closing the gap between investor perception and reality. While Colombia's general reputation in international markets is usually low, because of the security and drug-trafficking problems associated with

the country, the experience of foreign investors in the country is the exact opposite. Companies like Coca-Cola, Nestle, Colgate-Palmolive, Gillette, Nabisco, Quaker, Unilever, Exxon-Mobil, Shell and Texaco have had a presence in Colombia for more than 45 years. Their record is a long history of success, and currently nearly 100 of the companies listed in the Fortune 500 companies operate in Colombia. Most of these investments are long-term and distributed over different economic sectors such as finance, retail, industry, agriculture, mining, oil and cement production, transportation and telecommunications. In this way, the country has successfully avoided concentrating FDI inflow in just one or two sectors.

Looking to the future, Colombia presents an attractive investment opportunity for various reasons. The country has one of the most stable macro-economic environments in the region. This is partly the result of the reliability of its independent Central Bank which has solid international reserves, and partly attributable to disciplined fiscal management on the part of the government.

Risks and Opportunities: The Improving Business Environment in Colombia

Elias Eliades¹

Trade and commerce

The Economic Commission for Latin America and the Caribbean (ECLAC) announced early in August 2004 that²

Latin America and the Caribbean are posting a solid economic recovery and are expected to close 2004 with a 4.5% global growth, up from 2.9% the year before ... The Santiago (Chile) based UN Agency said that most countries in the region [had] succeeded in managing their foreign trade sectors with adequate monetary control and currency exchange policies.

As one of these countries, Colombia has shown a very promising improvement in 2004. With a figure of 3.7% in 2003, it recorded one of the highest growth rates in the region, and it is expected to do even better by the end of 2004. Its improved economic performance, coupled with its prospects for positive growth, caused the credit rating agency *Fitch Ratings* to upgrade Colombia's standing on sovereign debt from 'negative' to 'stable' in May 2004. These positive figures, as well as the fact that Colombia was the only Latin American country which has improved its world competitiveness ranking substantially, have not only given a boost to the business environment but are bound to attract additional foreign investment.

In a report released in 2004 by the World Bank ranking 145 countries, Colombia and Slovakia demonstrated the greatest progress in enacting reforms that made it easier to do business. The report focused on five sets of business environment indicators: starting a business, hiring and firing workers, enforcing contracts, getting credit and closing a business. Furthermore, economic research by Bear Stearns, a New York firm specialising in the stock market, has suggested that Colombia is a model of stability and order as compared

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² See <http://www.eclac.cl/>

with other Latin American countries. It therefore advises its clients to invest 20% of their portfolios in Colombia, since the country has a good debt profile and offers a high return on capital.³ This is corroborated by a report written by Gary Kleiman, an international consultant⁴:

According to the MSCI index, Colombia, Peru and Venezuela were up 26%, 18% and 28% respectively, as economic gains in the oil and mining sectors superseded perennial political strife, and blue chip companies announced continued international expansion and offerings. Colombia's \$18bn market, which now unifies trading on the separate Bogota, Cali and Medellin floors, enjoyed a combination of 4% gross domestic product growth, low single-digit interest rates and 6% currency strengthening against the US dollar. A 30% rise in petroleum earnings has turned last year's trade deficit into a surplus, and expanding foreign reserves have facilitated external debt service. The fiscal deficit is on track to hit the 2.5% of output target agreed with the International Monetary Fund under a multi-year \$2.3 billion agreement, supplemented by \$700 million in annual US aid. Alvaro Uribe, [the] Colombian President, has the hemisphere's top popularity rating, at 80% approval in opinion polls, prompting [a] push for [a] constitutional amendment to permit him to serve a second term. Business executives feel they can now move freely, and a construction boom is under way with the diminished perception of physical risk.

Trade agreements

It is evident that for Colombia's growth to continue, it is necessary to achieve preferential access to the market of its principal trading partner, the US, which absorbs 45% of its exports. In 2003 Colombia's textile and clothing exports to the US were 51% higher than those recorded in the previous year. This increase can be attributed mainly to the Andean Trade Promotion and Drug Eradication Act (ATPDEA), passed in October 2002, which provided Colombian textile and clothing exports with quota-free and duty-free access to the US market. This strong performance has elevated the textile and clothing industry to a prominent position in Colombia's economy. Indeed, textiles and clothing represented the country's fourth-largest export

³ *Embassy of Colombia Bulletin*, August 2004.

⁴ *Financial Times*, *Global Investing: All eyes on large gains for small Andean exchanges – Colombia, Peru & Venezuel*, 30 August 2004.

earner in 2003, surging ahead of one of Colombia's most famous exports, coffee. The major factors contributing to the impressive performance of the textile and clothing industry have been the country's low labour costs, its proximity to the US market, and the industry's vertical structure, which allows for every stage of production from fibres to finished garments. The competition from Asian manufacturers is, however, intense. In order to retain its advantage, Colombia needs to conclude a free trade agreement (FTA) with the US.

The first round of negotiations between the two countries for a free trade agreement (FTA) started in May 2004. Since then three more rounds have been completed. The last one took place in Puerto Rico from 13–17 September, and two more are scheduled to take place before the end of the year. Ecuador and Peru are also negotiating FTAs with the US in parallel, but the negotiations are separate. Bolivia is due to begin similar negotiations later. (Venezuela is the only Andean state which, for political reasons, will not negotiate, at least in the foreseeable future, an FTA with the US). A number of analysts have criticised the separation of the negotiations, pointing out that this gives the individual countries much less political leverage against the US than their combined weight would confer. The very different conditions in each of the Latin American countries, however, render this argument rather weak. Furthermore, in the case of the Andean countries (and particularly that of Colombia) these negotiations cannot be seen only in terms of broadening trade relations and providing greater access to the markets of the participating countries. Colombia, Bolivia, Ecuador and Peru are, together with the US, already parties to the ATPDEA, and the FTA negotiations will have a wider frame of reference. All four countries share the common objectives of fighting against drug trafficking, consolidating democracy and searching for sustained, long-term economic growth. It is very important that these goals are clearly reflected in the final results of the negotiations, which are expected to last until the middle of 2005.

Security and political stability

The security situation in Colombia has improved considerably during the two years of the present administration. Since 2002, when President Alvaro Uribe took office, the level of violence has

diminished dramatically. The Colombian army has driven the Revolutionary Armed Forces of Colombia (FARC) guerillas away from the vast areas formerly under their control, and they have had to fall back on remote strongholds.

The country has recovered, at last, the use of its highways, which until fairly recently were at the mercy of the FARC and the National Liberation Army (ELN) guerilla bands and the paramilitary the United Self-Defence Forces of Colombia (AUC) forces. According to official figures, not only have levels of political violence dropped, but common crime figures follow a similar trend. This is reflected in the popularity polls, where President Uribe has the overwhelming support of more than 75% of the population. He seems to be winning the battle to have the constitution changed in order to permit him to stand for a second consecutive term. His convincing argument is that the four years of a single term in office are not sufficient to enable him to finish the job of putting Colombia on an even keel. The way is still long and none too certain, but Uribe has gained impressive momentum which his political opponents will find it very hard to arrest.

It goes without saying that the improved security situation has helped the economy on its way to recovery. This of course is an additional bonus, which has boosted the president's popularity even further. Colombians take pride in knowing that, unlike the vast majority of other Latin American countries, Colombia has had a remarkable democratic tradition. With the exception of a very brief period between 1953–1957, when a military regime ruled the country, all of its governments have been democratically elected.

Economic advantages

Colombia is strategically located as a middle point between North and South America. It is the only country in South America to have coastlines and, of course, ports abutting both the Pacific and the Atlantic oceans. Already there are plans in motion to build an oil pipeline from the Venezuelan oilfields to the Pacific, which will obviate the necessity for tankers to go through the Panama Canal to reach destinations on the American west coast, and making it possible to use the cost-efficient super tankers.

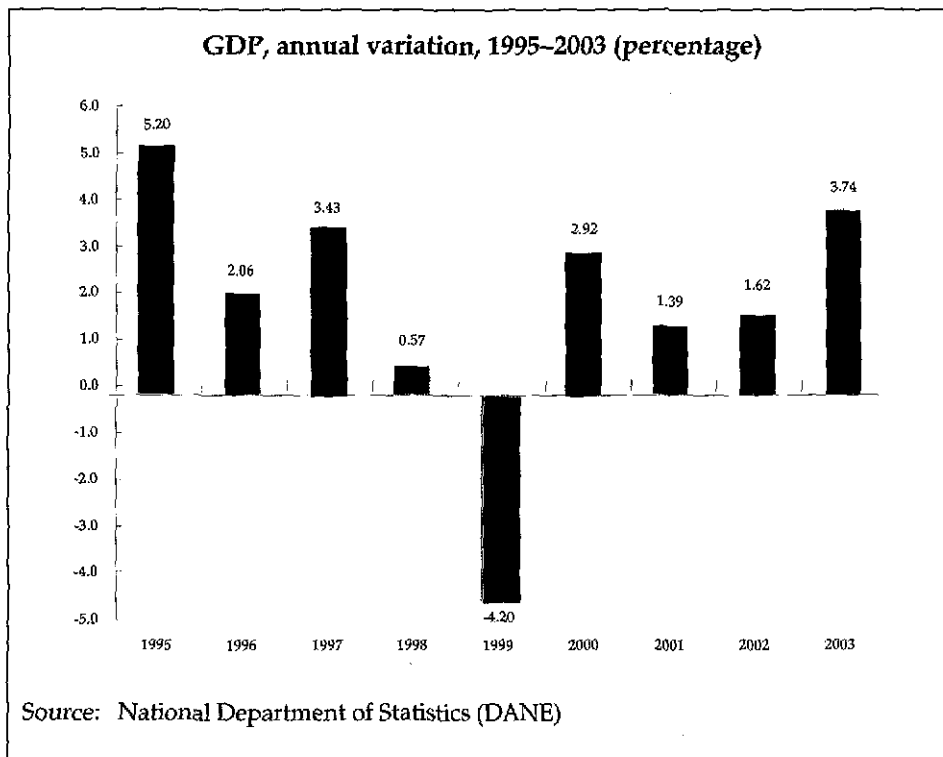
The acceleration of economic growth in Colombia during 2003 was a direct result of a marked increase in demand for goods and services, both internal and external. Other contributing factors were:

- low real interest rates;
- growth in investment;
- the availability of financing credit; and
- a reduction in the inflation rate.

In 2003 the Colombian economy grew 3.7%, in sharp contrast to the 1.6% growth recorded in 2002. This is the highest rate recorded since 1995, when the economy grew by 5.2%. The annual variation during the fourth quarter of 2003 was 4.5%, a figure higher than those recorded during the first (4.1%), second (2.2%) and third quarters (4.1%).⁵

From the supply perspective, the economic sector that showed the largest growth in 2003 was construction, with an annual growth rate of 11.6%; followed by mining and quarrying with 11.0%. The strong activity of the construction sector can be explained by the performance of the building construction sub sector, which grew 19.2%. The good performance of the mining and quarrying sector was due to a 35.9% increase in coal production and a 60.5% increase in metallic minerals production. On the demand side, the economic growth in 2003 was explained mainly by the increase in investment (18.7%). The investment activity was represented by the increase in capital goods imports (15.7%) and the growth in the building construction industry (19.2%)...During 2003 exports grew 4.2%, as a consequence of external sales of gold, coal, yarns, threads and fabrics, printed products, leather and byproducts, among other goods:

⁵ *Colombia Talking Points on the Economy, First Quarter 2004, COINVERTIR, Bogota, Colombia.*



Trade relations with South Africa

Total trade between South Africa and Colombia in 2003 amounted to R427.95 million, of which R 232.56 million represented exports to Colombia and R 104.39 million imports from Colombia. The largest proportion of Colombian products exported to South Africa was unwrought nickel, at 57.2% of the total, while sugar confectionery contributed 19.4%, fabrics 5% and coffee (not roasted) 4.1%. Major exports from South Africa to Colombia during the same period were those falling under the unspecified category (mostly munitions and military weapons), representing 69% of the total, with yarns contributing 6% and machinery 1.3%.

It is obvious that there is a lot of room for improvement in the trade relations between the two countries. Both have certain striking similarities, such as their population figures; their strengthening economies, which have very similar inflation rates; and the revaluation of their currencies. Both countries are doing their best to attract FDI in order to exploit to the maximum their natural and human resources. The Colombian Minister of Mines and Energy, Luis Ernesto Mejia, appealed to members of the energy sector during a conference in Washington DC on 28 September 2004, to invest in Colombia's hydrocarbons industry. He pointed out that his government had made 'some very aggressive changes' in order to reverse the damaging effects of hydrocarbons. Colombia produces about 528,000 barrels of oil a day and consumes about 300,000, which still leaves a margin for exporting oil. The aim, however, is to reach a production level of 700,000 barrels a day, a venture that will require 66 new exploration wells a year and an annual investment of about \$1.1 billion. The Colombian authorities are pinning their hopes on the off-shore Tayrona block. Ecopetrol, the Colombian oil state company, Brazil's Petrobras and the American Exxon-Mobil signed contracts, in August 2004, with Colombia's hydrocarbons regulator ANH for the exploration of the 4.4 million hectare block, which stretches from the waters off the city of Cartagena to the La Guajira peninsula in the country's extreme northeast.

The prospects for the future

In his address to the UN General Assembly on 29 September 2004, President Alvaro Uribe appealed for greater international support for his government's war against the guerillas and the paramilitaries in his country. He said that, while in the past his generation had explained the violence as the direct result of widespread poverty and social inequality, this argument no longer carried weight. He stressed that, on the contrary, terrorist violence was responsible for increased misery and blocked the way toward the elimination of social inequality. President Uribe outlined the results of his government's sweeping reforms, which included heavy subsidies for the poor, job creation measures and legislation to boost economic growth. These had been supplemented by 'democratic security' measures aimed at countering the threat posed by guerrillas, and offering militia members a chance

of reintegrating into society. On the same day, at a meeting in New York with bankers and industrialists, he reiterated his commitment to completing the drastic economic reforms initiated by his government before the end of his term of office. These reforms had already brought tangible results: the financial deficit had been reduced, during the two years he had been in office, from 4.2% to 2.7%, while unemployment had also dropped from 16% to 13% during the same period. Regarding the fight against political violence and drug trafficking, President Uribe reported that violent deaths had been reduced by 41% in 12 months, and that the area under cultivation of narcotic drugs had been drastically reduced from 150,000 to 60,000 hectares.

Despite the impressive record achieved by Uribe in two years as president of Colombia, there are two more to go before he completes his current term. More recently, support for Uribe was illustrated through the constitutional amendment that will allow him the opportunity to run for a second term of office. The key question on which the future success or failure of Alvaro Uribe depends is whether he can sustain the hectic pace he has maintained so far. Right now the opposition forces have not been able to come up with a credible alternative candidate, and it may take some time before they can organise themselves sufficiently. Uribe is a wily and skilled politician whose leadership at the moment is unchallengable. Nevertheless, his future success relies on external factors as well. For example, the US administration is giving Colombia a massive amount of financial and logistical aid under Plan Colombia. Following George Bush's re-election, will he be able to maintain the same level of support, with the US still bogged down in Iraq, at such heavy cost, for the foreseeable future? Will the Colombian security forces, seemingly stretched to their limits, be able to maintain the pressure on the two guerilla organisations and the paramilitaries? It all seems like a game of poker. However, the top cards rest securely in the hands of Washington.

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Mark Venning was seconded to Chile from South Africa by Anglo American in 1992. In 1993 he was appointed Finance Manager of Anglo's mining and industrial group in the region, based in Sao Paulo, Brazil. In 1997 he was asked to lead Anglo's Industrial expansion in to South America, with the specific objective of stimulating and increasing trade and investment by Anglo group companies and he moved back to Chile. In 2000 Anglo decided to dispose of all industrial assets worldwide and AMIC ceased to exist. Mark has represented many South African companies in the region including Tongaat, Grinnaker-LTA, Barloworld, Marlin Granite, Tigerbrands, Boart Longyear as well as with other companies on his own account. During his time in South America he has held the following board level positions: Chairman of Boart Longyear (Brazil) and Honorary Chairman of the South Africa Chile Chamber of Commerce. Director of UGM exploration (Brazil), AMIC (South America) and Interzone International (Chile).

Mark has led and participated in conferences, working groups and formal organisations with the objective of fostering inter regional trade and investment. Motivating multilateral and bilateral free trade agreements remains a focus as does increasing the awareness of the South American potential for South African businesses.

Latin America has a population size of more than 500 million people and a combined economy of around \$1.7 trillion. Economic growth in 2004 was close to 5% following an increase in commodity exports and the recovery of some of the dominant economies in the region.

But, over the past 20 years, economic growth in Latin America has been cyclical. Unsustainable growth rates have earned the region a reputation of being an unstable long-term investment destination. Along with increasing levels of poverty, the worst ratio of inequality in the world and a shifting political sentiment to the left, investors and international lending agencies are treating Latin America with a degree of caution.

Despite this, enormous business potential exists in Latin America. With enough insight and the correct approach to the Latin American market, South African investors are capable of capitalising on the numerous opportunities arising.

There are a number of parallels between Latin America and Southern Africa. South African business leaders and government should take advantage of these similarities and common links, and engage the region as it enters what appears to be a new paradigm of economic changes and a shifting political environment. A decent understanding of the changes in Latin America can only help improve Trans-Atlantic relations.

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