William Chislett

Spanish Direct Investment in Latin America: Challenges and Opportunities

Real Instituto Elcano
de Estudios Internacionales y Estratégicos

William Chislett

was born in Oxford in 1951. He reported on Spain's 1975-78 transition to democracy for *The Times*. Between 1978 and 1984 he was based in Mexico City for *The Financial Times*, covering Mexico and Central America, before returning to Madrid in 1986 as a writer and translator. He has written books on Spain, Portugal, Chile, Ecuador, Panama, Finland, El Salvador and Turkey for *Euromoney Publications*. The Writers and Scholars Educational Trust published his *The Spanish Media since Franco in 1979*. Banco Central Hispano published his book *España: en busca del éxito* in 1992 (originally published that same year by *Euromoney*), *Spain: at a Turning* Point in 1994, and *Spain: the Central Hispano Handbook*, a yearly review, between 1996 and 1998. Banco Santander Central Hispano published his dictionary of economic terms in 1999 and his *Spain at a Glance* in 2001. He wrote the section on Latin America for *Business: The Ultimate Resource* (Bloomsbury, 2002), and in 2002 the Elcano Royal Institute published his book *The Internationalization of the Spanish Economy*. He is married and has two sons.

Praise for previous books on Spain

One of the great attractions is the author's capacity to gather, analyze and synthesize the most relevant economic information and explain its implications concisely and directly.
Guillermo de la Dehesa, Chairman of the Centre for Economic Policy Research (CEPR), El País

Stylish and impressive.
Eric Hobsbawm

My staff found it to be an extremely valuable resource.
Richard Gardner, former US Ambassador to Spain

A triumph of selection, concision and exposition.
Professor Alex Longhurst, University of Leeds, International Journal of Iberian Studies

For up-to-date information and perceptive analysis presented in an elegant and incisive style, academics, economists, journalists and Hispanophiles in general are in William Chislett's debt.
Paul Preston, Professor of International History, London School of Economics

Most skilful in combining information with readability ... my vade mecum for contemporary Spain.
Sir John Elliott, former Regius Professor of Modern History, University of Oxford

No one surveys the data more comprehensively, digests it more efficiently, relates it more lucidly or presents it with more critical intelligence.
Felipe Fernández-Armesto

Spanish Direct Investment in Latin America: Challenges and Opportunities

William Chislett

Published by the Real Instituto Elcano
de Estudios Internacionales y Estratégicos

www.realinstitutoelcano.org

Design and layout: Olivé | López | Lara

Printed by: Gráficas Monterreina, S.A.

Legal number:

Free copy. No sales allowed.

For my sons Tomás and Benjamin, born in Mexico, residents of Spain, university students in the United Kingdom… *citizens of the world.*

Spain was the first multinational.

Henry Kamen, author of *Spain's Road to Empire, The Making of a World Power, 1492-1763*.

Our country —our countries— are in a deep sense more a fiction than a reality.

Mario Vargas Llosa, writing on Latin America.

Acknowledgements

This book follows on from The Internationalization of the Spanish Economy, which was published by the Real Instituto Elcano in September 2002, and explores in much greater detail Spanish direct investment in Latin America. In order for the reader to better understand the factors behind this investment drive, which has enabled Spain to join the select ranks of net investor countries and represents a significant structural change in the economy, I look at investment in the broadest context possible. This book is thus as much about Latin America as it is about Spain. I am particularly grateful to Emilio Lamo de Espinosa, the Institute's director, for his continued confidence in me, to Paul Isbell, the Institute's Senior Analyst for International Economics and Trade, and Carlos Malamud, Senior Analyst for Latin America, for their support and guidance, and to Javier Noya, Analyst for Perception and Foreign Image of Spain.

I would also like to thank the following people: Mónica Algaba, press office, ICEX; Alfredo Arahuetes, Professor of International Economics, Faculty of Economic and Business Sciences, Universidad Pontificia Comillas, Madrid; Anthony Axon; Terry Baker-Self, research editor of The Banker; Manuel Balmaseda, Chief Economist, Spain, Banco Bilbao Vizcaya Argentaria; Cristina Bergón, analyst, Santander Central Hispano Bolsa; Jorge Blázquez, senior economist, Banco Bilbao Vizcaya; Alvaro Calderón, Economic Affairs Officer, Unit on Investment and Corporate Strategies, Economic Commission for Latin America and the Caribbean (ECLAC); Ramón Casilda; Antonio Cortina, deputy head of the research department of Santander Central Hispano; Andrew Crawley, Integration, Trade and Hemispheric Issues Division at the Inter-American Development Bank; Julián Cubero, economist, Banco Bilbao Vizcaya Argentaria; Thomas Dauterman for copiously editing the text; Carlos Doussinague, manager, industrial portfolio of Santander Central

Hispano; Felipe Fernández-Armesto, for sending me the manuscript of his book The Americas, a Hemispheric History (Phoenix Press, 2003); Fernando Fernández, Rector of the European University of Madrid, for reading the manuscript; Carlos Manuel Fernández-Otheo, Complutense University, Madrid; Domingo García, head of the Madrid Stock Exchange's research department; Lola González, Strategic Planning Director, Y&R, Spain; Keith Grant; Steve H. Hanke, Professor of Applied Economics at Johns Hopkins University; Carmen Hernansanz, Chief Economist Banking and New Economy, Banco Bilbao Vizcaya Argentaria; Edward Holland, manager, international media relations of Telefónica Móviles; Mariano Morcate, Santander Central Hispano; Carmen Moyano, Banco Bilbao Vizcaya Argentaria; Antonio Pareja, General Manager of Planning and Resources, Endesa; Emilio Ontiveros, Dean of Business Studies, Universidad Autónoma, Madrid; Raúl Peralba, Chairman of Positioning Systems; Paolo Passerini, Eurostat; Rodrigo Park, Banco Río (Grupo Santander); Dr Rogelio Ramírez De la O, President of Ecanal, Mexico; María Ritter, press office, Repsol YPF; Javier Santiso, Chief Economist, Latin America, Banco Bilbao Vizcaya Argentaria; Miguel Sebastián, Chief Economist of Banco Bilbao Vizcaya Argentaria; Luciana Taft, economist, Banco Bilbao Vizcaya Argentaria; José Luis del Valle, Director of Strategy, Iberdrola; Claudio Véliz; Katharine Venus, Standard & Poor's, London; and Carlta Vitzthum, Madrid correspondent of the Wall Street Journal. Lastly, I would like to thank Bloomsbury Publishing Plc for permission to quote from the country profiles of Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela which I wrote for inclusion in Business: The Ultimate Resource™ and which are © Bloomsbury Publishing Plc 2002.

I found the following publications particularly useful: *Foreign Direct Investment in Latin America, the Role of European Investors* (Inter-American Development Bank, 2001); *Foreign Direct Investment for Development, Maximizing Benefits, Minimizing*

Costs (OECD, 2002); *International Investment Perspectives* (OECD, 2002); *Integration and Trade in the Americas* (Inter-American Development Bank, 2002); *Foreign Investment in Latin America and the Caribbean, 2001* (Economic Commission for Latin America and the Caribbean); *Latin America at a Glance* (Economist Intelligence Unit, 2003 edition); *Americas Review 2002/03* (The World of Information); *Latin Watch* (Banco Bilbao Vizcaya Argentaria); *Empresas Multinacionales Españolas* (ICE 799, April-May 2002, Spanish Ministry of Economy); *Economía Exterior* (Number 22, Autumn 2002); *La Década Dorada, Economía e Inversiones Españolas en América Latina 1990-2000* by Ramón Casilda (University of Alcalá, 2002) the magazine *Latin Finance*; and *Palapa*, a web guide on what the international press says about Latin America, published by Ronald Buchanan. For general economic and political history I recommend Edwin Williamson's *The Penguin History of Latin America* (Penguin, 1992), Carlos Fuentes' *The Buried Mirror* (André Deutsch, 1992) and Hugh O'Shaughnessy's *Latin Americans* (BBC Books, 1988).

William Chislett
Madrid and Buendía, March 2003
chislett@arrakis.es

Contents

Preface

Not so long ago, Spain was a major net importer of capital. Recently, however, the country has become the leading investor in the Southern Cone, second only to the United States in the Latin American region as a whole. Spain’s €$80bn invested in Latin America accounts for half of all EU investment in the region between 1992 and 2001. In that brief time, Spain also became the eighth-largest net direct investment country in the world.

Such trends demonstrate the emergence of Spain as a key international economic actor and one of the world’s principal influences in Latin America. During the 1990s, Spanish firms—particularly utilities, telecommunications companies and large banks—made Latin America their principal regional target for multinational activity and investment. This constituted a major strategic bet on Latin America during a period of significant economic expansion in the world economy. It also proved beneficial both for Spanish companies, many of which came to generate as much as one-third of their net income from their investments in the region, and for Latin American countries, which experienced faster economic growth and higher per capita income during this period.

An increase in the domestic savings rate and an expansion of inward foreign investment are important keys to capital formation, economic growth, and modernization. Moreover, the transfer of technology, which is a secondary effect of foreign direct investment, helps to transform the industrial fabric of a country and increase its interantional competitiveness—provided, of course, that sound macroeconomic policies are implemented. Therefore, beyond the Spanish geostrategic interest in the region, rooted in profound historical and cultural links, the increase in Spanish FDI has been one of the key elements behind the recovery of the Latin American economy after the “lost decade” of the 1980s.

Spain has also placed special emphasis on the creation and strengthening of sound political and economic institutions capable of underpinning the development process and facilitating the transformation of Latin American societies. Democratic consolidation, one of the pending issues in developing countries, has clearly advanced in Latin America. The fact that democracy did not collapse in Argentina during the recent economic crisis, together with Luiz Inácio Lula da Silva's presidential election in Brazil, is a clear manifestation of the continuing consolidation of democracy in Latin America. Spain has demonstrated its commitment to this process not only by providing economic assistance and maintaining its significant investment positions during turbulent times, but also by fostering the expansion of political freedoms and the integration of Latin America within the world economy.

With the Argentine crisis and the world slowdown in 2001, many people began to question the wisdom and sustainability of Spain's massive investment effort during the 1990s in Latin America. Such criticism became more intense as many Spanish firms began to register losses, particularly in Argentina, but also in other countries. Time will likely demonstrate, however, that Spain's concentration on Latin America during its first wave of international economic expansion was a sound strategy. While Spanish firms may restructure their positions in Latin America, they will not be withdrawing from the region. Their commitment is a long-term venture, and they will be there to contribute to Latin America's next sustained economic expansion and they will, in turn, benefit from it.

The story of Spanish investment in Latin America has been one of the most significant developments in Spanish international and economic affairs in recent years. As a result, the Elcano Royal Institute for International and Strategic Studies, one of

Spain's leading international affairs think tanks, has decided to invest its efforts in the publication of a book on this topic.

This is the second book that the Elcano Royal Institute for International and Strategic Studies has published by William Chislett, the dedicated collaborator of the Elcano Royal Institute and veteran international journalist with extensive experience in Latin America and Spain. As in the case of his first book, The Internationalization of the Spanish Economy, Chislett's new book—Spanish Direct Investment in Latin America: Challenges and Opportunities—fulfils one of the Institute's primary goals: to provide policy-makers, academics, opinion-makers, the media and lay readers with important and timely data and analysis on international issues of particular relevance to Spain's foreign and international economic policies.

Eduardo Serra Rexach

Chairman

Chapter 1

Overview

***Exhibit 1.1* Spain's Direct Investment Inflows and Outflows, 1990-2002**

($ bn)	1990-95*	1996	1997	1998	1999	2000	2001	2002
Inflows	10.7	6.6	7.7	11.8	15.7	37.5	21.7	19.6
Outflows	3.5	5.4	12.6	18.9	42.0	54.6	27.8	NA

(*) Annual average.
Source: World Investment Report 2002 (UNCTAD).

Spain has invested more in Latin America over the last decade than any other country in the world except for the United States, whose economy (as measured by the size of its GDP) is 15 times larger and in whose "backyard" the region lies. Spain accounted for €80.4 billion of the €161.7 billion total foreign direct investment (FDI) by the European Union in Latin America between 1992 and 2001, compared with €97.7 billion by the US. Between 1997 and 2000, Spain's investment drive was the most intensive of any OECD country and it was because of it that Europe was the leading investor in Latin America in certain years. This direct investment effort in an area that for more than three centuries was largely under the Spanish crown is the principal factor behind Spain becoming a net direct investor, one of the most significant and strategically important economic changes in the country's recent history (see Exhibit 1.1). Spain was the world's eighth-largest net direct investment country between 1992 and 2001 (see Exhibit 1.2). However, this drive has been fraught with risks, as has been painfully exposed by Argentina's meltdown, which has hit some of Spain's multinationals particularly hard.

After the decline of the Spanish empire, following the independence of its colonies in the 19th century, Spain returned late to the region. Before the First World War, Britain funded two-thirds of the foreign investment: it controlled over half the tonnage of Argentine and Brazilian ports; the railways, which linked the ports to the centres of production, were largely a British preserve; and Wheetman Pearson, the British MP, was lampooned as the "member for Mexico" because of the scale of his interests in the country[1]. Elevated to the peerage in 1910, he emblazoned his coat of arms with the image of a Mexican peon. Between the beginning of the 20th century and the outbreak of the First World War, US investment in Latin America more than trebled. Britain was still

[1] See *The Americas, a Hemispheric History* by Felipe Fernández-Armesto (Phoenix Press, 2003).

***Exhibit 1.2* Net Outflows by Country, 1992-2001 (€ mn)**

United Kingdom	389.8
Japan	349.7
France	291.6
Germany	135.1
Switzerland	120.2
Netherlands	80.8
Italy	37.1
Spain	**36.7**

Source: OECD.

dominant, but the US moved into second place, eclipsing the Germans and greatly exceeding the French. The US became the biggest foreign investor in the region after the Second World War, initially concentrating on the manufacturing sector, particularly in foods, chemical products, machinery and equipment, and in the exploitation of natural resources, mainly mining and hydrocarbons.

The first wave of Spain's outward investment in the 1960s and early 1970s was very modest, accounting for a mere 0.1% of international FDI flows[2]. It occurred at a time when Spain took its first timid steps to open up its economy and relaxed controls on capital outflows, moving away from the autarky that followed the country's 1936-39 civil war. The bulk of the investment went to EC countries, followed by Latin America. Spain's share in international flows increased to 0.3% in the 1970s when investment in Latin American and Caribbean countries accounted for more than half of the country's total outflows, while that to EC countries and the United States lost relative share. Financial and commercial activities accounted for around three-quarters of Spanish direct investment in Latin America and there was also some investment in manufacturing. Spanish outward FDI reached an annual average of US$260 million during the 1970s.

The Latin American external debt crisis, sparked by Mexico's default in 1982, plunged many of the region's economies into recession and changed the characteristics of Spain's FDI in Latin America. By 1985, the region's share of Spanish outward investment fell from more than 50% to 20%. Initially, the region's decline in commercial and industrial activities boosted the importance of financial activities, which was the only

[2] See the chapter on Spain by Alfredo Arahuetes in *Foreign Direct Investment in Latin America, the Role of European Investors* (Inter-American Development Bank, 2001) and *Las Inversiones Directas de las Empresas Españolas en America Latina desde 2001, Retirada o Repligue* (Elcano Royal Institute, July 2002).

form of FDI to survive the crisis. Non-financial institutions then began to invest as new business groups emerged in Spain and created financial services companies to carry out most of their foreign investment activities (cement, construction and tourism).

Spain's accession to the EC in 1986 triggered a substantially larger wave of outward investment. By then the Spanish economy was much stronger and more liberalized and had become an attractive target of inward investment by other EC countries. Spanish companies and banks, freed of constraints on investing abroad, began to offset the growing competition in their relatively mature domestic markets with selective outward investments. The liberalization of the domestic market in Spain as European single market directives began to unfold made the big Spanish companies more conscious of the need to reposition themselves within this more competitive environment. Initially, other EC countries were the main destination for this investment (60% of flows), followed—at a considerable distance—by Latin America, for whom the 1980s was a "lost decade".

Investment in Latin America averaged US$310 million a year between 1986 and 1993 (see Exhibit 1.3). The first major investments were those of Telefónica (telecommunications) in Chile and Argentina in 1991 and banks in several countries (see Exhibit 1.4 and Chapter 2). Telefónica was fully privatized by 1997 and looked to Latin America as its natural market for expansion. The move abroad was aptly symbolized by Telefónica's decision to drop "de España" from its name. No longer did the telecommunications group view Latin America as just emerging markets; they were seen as a natural extension of its domestic market.

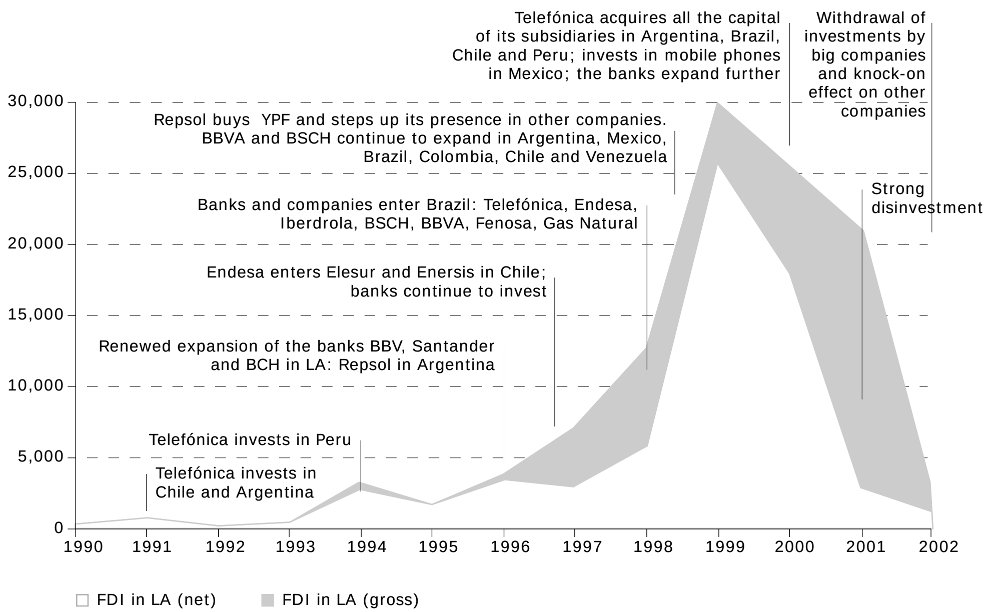
The real change of direction and the consolidation of Latin America as the preferred destination of Spanish FDI took place between 1994 and 1999, when investment surged to an

Exhibit 1.3 **Geographical Distribution of Spanish Direct Investment in Latin America, 1986-93**

Country	US$ mn	%
Argentina	854	34.1
Brazil	228	9.1
Chile	482	19.2
Mexico	312	12.5
Venezuela	340	13.6
Other countries	290	11.6
Total Latin America*	2,506	100.0

(*) Excluding Puerto Rico, Panama and Caribbean offshore centres.
Source: Calculated by Alfredo Arahuetes on the basis of BICE data, various years.

Exhibit 1.4 **Direct Investments by Spanish Companies in Latin America, 1990-2002 (US$ mn)**



Source: Alfredo Arahuetes (in Foreign Direct Investment in Latin America, the Role of European Investors, IBD, 2001) and calculations based on data of the Directorate General of Trade and Investment, Economy Ministry.

Exhibit 1.5 **Geographical Distribution of Spanish Direct Investment in Latin America, 1994-99**

Country	US$ mn	%
Argentina	21,055	36.0
Brazil	16,444	28.1
Chile	8,884	15.2
Colombia	3,769	6.4
Mexico	2,347	4.0
Peru	3,378	5.8
Venezuela	1,489	2.5
Other countries	1,158	2.0
Total Latin America*	58,524	100.0

(*) Excludes Puerto Rico, Panama and Caribbean offshore centres.
Source: Calculated by Alfredo Arahuetes on the basis of BICE data, various years.

annual average of US$9.7 billion (see Exhibit 1.5). Argentina was again the main destination of investment, with Repsol's purchase of YPF for US$14.9 billion in 1999 accounting for close to 20% of Spain's total investment in Latin America between 1992 and 2001. Spain's total outward investment in 2000, the bulk of it in Latin America, represented 9.7% of GDP, compared with inward FDI in Spain of 6.7% of GDP. Spain's share of total world outward direct investment in 1997-2001 was higher every year than its annual market share (just under 2%) of world exports of goods. Most Spanish investment was not in the manufacturing sector but in services sectors, especially energy, telecommunications and banking, which during the 1990s also became the new focus of US investment in Latin America.

Today, some Spanish companies rank among the largest corporations in Latin America:

- Telefónica is the largest telecommunications group in the Spanish- and Portuguese-speaking world;

- Repsol YPF is the region's biggest non-government-controlled producer of oil and gas;

- Endesa is the leading private-sector electricity multinational in Latin America;

- Dragados is the leader in transport infrastructure concessions;

- Santander Central Hispano, which has the region's leading financial franchise as measured by net attributable income generated in the region, and Banco Bilbao Vizcaya Argentaria have between them 23% of bank deposits in the whole of Latin America and 40% of pension funds.

In 2000 (the latest year for which comparative data are available), subsidiaries of Repsol YPF, Telefónica and Endesa were among the 30 largest affiliates of transnational companies in Latin America in terms of sales. With sales of US$8.6 billion and exports of US$1.9 billion, Repsol YPF's operations in Argentina ranked third after the Mexican plants of General Motors and DaimlerChrysler. That same year, Telefonica's sales in Latin America accounted for 57% of its total sales and Repsol YPF's for 25%.

The strong Spanish presence in Latin America gives Madrid a privileged position in the region's economy. The emotional ties between Spain and Latin America are also strong. It is estimated that up to one million Spaniards fled the country after the 1936-39 civil war and that around 200,000 remained in exile[3]. The flow of emigrants into Spain for economic reasons is now very much from Latin America. Unlike other EU countries, Spain has a permanent institutional link with Latin America. It is a member of the Iberoamerican Community of Nations, and between 1991 and 2002 it participated in 12 summit meetings of heads of state and government. These meetings, however, have achieved very little apart from an annual expression of good intentions. At the 2002 meeting, José María Aznar, Spain's prime minister, asked Brazil's former president, Fernando Henrique Cardoso, to draw up plans for a more effective Latin lobby like the (formerly British) Commonwealth of Nations or even the European Union. The idea is to have a secretary-general of weight and influence. During its presidency of the EU in 2002, Spain hosted the 2002 summit of the heads of state and government of Latin America, the Caribbean and the European Union.

[3] See *Exilio* (Fundación Pablo Iglesias, 2002) and *Las emigraciones de la guerra civil de 1936-1939*, 3 vols, by Javier Rubio (Librería Editorial San Martín, Madrid, 1977).

As a founder member of European Monetary Union, whose single currency is bound to play an increasing role as a source of investment and financing, Spain is ideally placed as a bridge between the Euro zone and Latin America, between US dollar and euro flows into the region. The Hispanic factor is increasingly important in the US[4]. According to the 2001 census, the 37 million Hispanics comprised 13% of the total population, up from 9% in 1990, 7% in 1981 and 4% in 1970 (when the census used the term Hispanic for the first time) compared to 36.1 million African-Americans. This growth in the Hispanic population to become the largest ethnic minority is the result of what the Mexican writer Carlos Fuentes calls the "silent reconquest" by Mexican immigrants (Mexico lost one-half of its territory to the US in 1848) and the higher fertility rate of Hispanic women. The average age of Hispanics in the US is around 26, compared with the national average of 35.3. Time and demography are working in favour of the Hispanic population, which has now probably reached a critical mass in the US. The US has the world's fifth-largest Spanish-speaking population after Mexico, Spain, Colombia and Argentina, and Hispanic consumers' spending has been increasing at a much faster pace than the growth in white consumers' buying power. According to census analysis by the University of Georgia, Hispanics' buying power more than doubled between 1990 and 2001, from US$207.5 billion to US$452.4 billion, far outstripping the 67.4% growth in white consumers' buying power[5].

Spain has also forged closer economic links with Latin America by establishing at the Madrid Stock Exchange, the largest in the Spanish-speaking world and the fourth-biggest in Europe, a market in euros for blue chip Latin American shares and fixed-income securities (Latibex). This market, with a capitalization of €64,499 million at the end of 2002, the third-

[4] See *Cultura y Economía Hispana como Nuevo Horizonte de Colaboración* by Emilio Cassinello (Real Instituto Elcano, 2002).
[5] See "*US Grapples with 'Language of Love*" by John Authers (*Financial Times*, January 13, 2003).

largest Latin American market after Sao Paulo and Mexico City, offers European investors the possibility of trading stocks in a single currency, in their own time zones and through an electronic trading and settlement system to which they are already accustomed. For Latin American companies and Spanish banks and companies based in the region, Latibex raises their profile in Europe and opens the door to funding in euros (see Exhibit 1.6).

Changes in Latin America

Latin America is spoken of as if it were a homogeneous whole, but in reality the region is characterized by sharp contrasts as well as similarities. Perhaps one of the most striking regional differences is that related to the mixture of European and native races among the inhabitants. There are countries, such as Bolivia and Guatemala, that still have a large percentage of pure native inhabitants, mixed societies like Mexico and Brazil with a small percentage of pure European and native inhabitants, and countries with a large percentage of European descendants, like Argentina, Costa Rica and Chile. Most countries, however, have a similar political structure based on a republican system, with a presidential head of state and an elected Congress formed by one or two legislative bodies. Jurisprudence is based on the Napoleonic code rather than the English civil code. This difference can be significant when contracts are drawn up between practitioners of the two systems. The Napoleonic code is more prescriptive and tends to override individual agreements. English law, on the other hand, generally concedes primacy to the agreements between the parties.

Because of its enormous size (there are six time zones between Tijuana, the western-most continental city, and Recife, the eastern-most city), Latin America covers most of the world's climates and geography. Several deserts exist, from the Altar Desert in northern Mexico to the Atacama Desert in Chile. There is a cordillera running down

***Exhibit 1.6* Companies Listed on the Euro Market for Latin American Stocks (Latibex)**

Company	Sector
América Móvil	Telecommunications
Aracruz Celulose	Paper and forestry
Banco Bradesco	Investment
BBVA Banco Francés	Financial
BBVA Bancomer	Financial
Banco Río de la Plata	Financial
Banco de Chile	Financial
Bradespar	Investment
Cemig	Electric power
Copel	Electric power
D&S	Retail
Eletrobrás	Electric power
Endesa Chile	Electric
Enersis	Electric
Gerdau	Steel
Net Serv. Comunicação	Telecommunications
Petrobras	Oil and gas
Santander Bancorp	Financial
Suzano Papel & Celulose	Paper and pulp
Suzano Petroquímica	Petrochemicals
Telmex	Telecommunications
Vale do Rio Doce	Mining
Volcan	Mining

Source: Latibex.

the entire Pacific coast, from northern Mexico to southern Chile. Volcanic activity is present in various parts of this mountain chain. To the east of it, in South America, lies the great Amazon basin from which flows the world's largest river, the Amazon. Some large plains exist to the east, which are very productive agriculturally. In the Central American isthmus, the mountain chain dominates the landscape and forms the divide between the Atlantic and Pacific Oceans.

Latin America has long been associated with military coups (some of them verging on the surreal), guerrilla insurgency, scandalous levels of corruption and underdeveloped economies dominated by commodities (the so-called banana republics). As the historian Felipe Fernández Armesto points out, the region has come to be signified by unhappily naturalized words: *junta, pronunciamiento, cacique, guerrilla, cartel, caudillismo*[6]. Readers of the "magical realism" novels of Gabriel García Márquez who know Latin America well often find his fictional world close to the real one. The region, however, has undergone profound transformation over the last decade, ranging from sweeping market and democratic reforms to intensified links with the world's major economies[7].

---

[6] See *The Americas, a Hemispheric History* by Felipe Fernández-Armesto (Phoenix Press, 2003).

[7] Readers who want to know one theory why it is that Latin America is still marked by economic penury while the US and the UK have become economically powerful are recommended to read *The New World of the Gothic Fox* by Claudio Véliz (University of California Press, 1994). Véliz adopts the richly suggestive metaphors of foxes and hedgehogs, developed by the Oxford philosopher Isaiah Berlin, to describe opposite types of thinker, and applies it to the culture, economic system, and history of the English- and Spanish-speaking Americas to illuminate the causes of their vast differences. The British brought to the New World an ability to thrive on diversity and change, forged by the Industrial Revolution and reflected in their vernacular Gothic style. Their descendants became the "Gothic foxes" of Berlin's metaphor. The Iberians, by contrast, brought a cultural tradition represented by the vast baroque dome, a monument to their successful attempt to arrest the change threatening their imperial moment. The Spanish New World became a society of "Baroque hedgehogs", single-minded, systematic, rationalistic. Spain became a fox in the latter part of the 20th century. Also revealing is Chapter 20 of *The Wealth and Poverty of Nations* by David S. Landes (W.W. Norton & Company, 1998).

As a result, Latin America, unlike most of Africa, is a region which the world cannot ignore and "write off". It generates 5% of global GDP, imports around US$250 billion of goods a year, has an external debt of more than US$700 billion–mostly in the hands of investors from developed countries–and its stock of foreign direct investment amounts to more than US$500 billion. In 2000 the entire African continent (excluding South Africa) received US$7.2 billion of FDI inflows from OECD countries (0.7% of the total), compared with US$68.3 billion (6.4%) in Latin America. Africa, amazing as it may seem, received the same as Finland (with a population of 5 million) that year.

The macroeconomic fundamentals of Latin America as a whole have become sounder as a result of greater fiscal discipline and liberalization. For example, the average rate of inflation in Latin America (including the Caribbean) dropped from a mighty 872% in 1993 (swollen by Brazil's hyperinflation of 2,477%) to 6% in 2001, real GDP growth averaged 2.8%, the average general government budget deficit was around 3.5% of GDP, and external debt as a proportion of exports dropped from 263% to 178%. Per capita income rose 55% in the 1990s after falling 20% in the 1980s. In purchasing power terms, per capita income increased 29%. Exchange rates are still volatile, but less so than in the past, and two countries have joined Panama in adopting the dollar as their currency. Ecuador switched to the greenback in 2000 and El Salvador in 2001.

The corporate sector is also much more dynamic. The number of Latin American companies listed on the New York Stock Exchange and Nasdaq has climbed from one in 1990 to more than 100 today. In addition, democracy is more firmly rooted; Cuba's Fidel Castro is the only dictator left in the region. All of these factors have tended to facilitate economic stability and help make the region a more stable market for investment. Four Latin American countries were in the 2002 ranking of the world's 49 most competitive economies drawn up by the International Institute for Management and Development (IMD): Chile in 20th place, above Spain's 23rd position; Mexico (41st), Venezuela (48th) and Argentina (49th).

Nevertheless, the region is still plagued by very high levels of corruption (see Exhibit 1.7). The US revoked the visa of former Nicaraguan President Arnoldo Alemán in 2002 after he was accused of stealing US$100 million while in power. Poverty, reflected in the continued low level of human development, is widespread (see Exhibit 1.8). The Economic Commission for Latin America and the Caribbean estimated in its *Social Panorama of Latin America 2001-2002* that 214 million people live in poverty (income per capita of less than US$2 per day) or extreme poverty (less than US$1). According to the United Nations Children's Fund (Unicef), almost half a million children in Latin America die each year of curable ailments, including dehydration and respiratory illnesses. The number of children orphaned by the spread of AIDS reached 195,000 in 2002, putting Latin America and the Caribbean second only to sub-Saharan Africa[8].

Every country in Latin America except Chile and Uruguay scored less than five on a ten-point corruption perception scale in the 2002 ranking drawn up by the Berlin-based group, Transparency International. Only Chile has a degree of corruption comparable to that of developed countries: it was ranked 17th out of 102 countries with a score of 7.5, ahead of Spain, which was in 20th position with 7.1. Paraguay tied as the third most corrupt country in the world. Out of the 173 countries in the 2002 UN Human Development Index (UNHDI), Argentina, in 34th position, was the nearest to Spain (21st), while Peru, the poorest country, was ranked 82nd. Argentina's position, however, was based on data before its devastating crisis in 2001.

---

[8] See *The State of the World's Children 2003 (UNICEF, December 2002).*

Exhibit 1.7 **Corruption Perceptions Index**

Rank*	Country	CPI 2002 Score
17.	Chile	7.5
20.	**Spain**	**7.1**
32.	Uruguay	5.1
45.	Brazil	4.0
	Peru	4.0
57.	Colombia	3.6
	Mexico	3.6
59.	Dominican Rep.	3.5
62.	El Salvador	3.4
67.	Panama	3.0
70.	Argentina	2.8
71.	Honduras	2.7
81.	Guatemala	2.5
	Nicaragua	2.5
	Venezuela	2.5
89.	Bolivia	2.2
	Ecuador	2.2
	Haiti	2.2
98.	Paraguay	1.7

(*) Out of 102 countries.
Note: The score relates to perceptions of the degree of corruption as seen by business people and risk analysts, and ranges between 10 (highly clean) and 0 (highly corrupt).
Source: Transparency International.

Exhibit 1.8 **UN Human Development Index for Selected Latin American Countries and Spain**

Ranking [1]	Life Expectancy at Birth (years) 2000	Adult Literacy Range (% age 15 and above) 2000	Gross School Enrolment Ratio (%) 1999	GDP per Capita (PPP US$) 2000	Gini Income Distribution Index[2]
21. Spain	**78.5**	**97.6**	**95**	**19,472**	**32.5**
34. Argentina	73.4	96.8	83	12,377	NA
38. Chile	75.3	95.8	78	9,417	56.6
54. Mexico	72.6	91.4	71	9,023	53.1
68. Colombia	71.2	91.7	73	6,248	57.1
69. Venezuela	72.9	92.6	65	5,794	49.5
73. Brazil	67.7	85.2	80	7,625	60.7
82. Peru	68.8	89.9	80	4,799	46.2

(1) Out of 173 countries.
(2) The Gini Index measures inequality over the entire distribution of income or consumption. A value of 0 represents perfect equality, and a value of 100 perfect inequality. The surveys for this information took place between 1987 and 1996.
Source: UN Human Development Report, 2002.

There has been a marked improvement in average life expectancy—one of the components of the UNHDI—thanks to improved health care. It rose from 64 years in the early 1980s to 70.4 years in 1999, although there were wide differences[9] . Haiti had the lowest life expectancy at 53 years; Brazil's was below average at 68; and Mexico's was above average at 73. There has also been a moderation of the demographic problem, with a significant decline in Latin American birth rates. In Mexico, for example, couples now have 2.3 children, down from six in the early 1970s, according to census data from the National Population Council. Over the next few decades, there will be no shortage of young people in the workforce, but the population will be more stable, consequently easing the strain on infrastructure.

Despite these problems and the fact that the region as a whole was in recession in 2002, Latin Americans have not lost faith in the democracy that has been gradually restored to varying degrees. This is another positive factor for investors. The 2002 Latinobarometro poll of 17 countries showed more support for democracy than in 2001 in all countries except for Uruguay and Costa Rica, both still at high levels, and Peru (see Exhibit 1.9). However, in all but four countries support was lower than it was in 1996, and when the results are adjusted to take into account the countries' populations they suggest that only half of Latin Americans are convinced democrats. The return of populist leaders (Venezuela and Ecuador) constitutes a real threat to democracy. Latinobarometro has conducted similar opinion surveys regularly since 1996, so the poll is good at capturing changes in opinion over time and between countries.

The widely varying rankings for corruption and levels of human development, and even more so the macroeconomic performance of individual countries (see Chapters 3-6),

[9] See *Health in the Americas (Pan American Health Organization, 2002).*

Exhibit 1.9 **Is Democracy Preferable to Any Other Kind of Government?***

	1996	2000	2001	2002	Change since 1996
Honduras	42	64	57	57	15
Venezuela	62	61	57	75	13
Mexico	53	45	46	63	10
Nicaragua	59	64	43	63	10
Uruguay	80	84	79	78	-2
Ecuador	52	54	40	49	-3
Costa Rica	80	83	71	77	-3
Chile	54	57	45	50	-4
Argentina	71	71	58	65	-6
Peru	63	64	62	57	-6
Guatemala	51	45	33	45	-6
Bolivia	64	62	54	56	-8
Brazil	50	39	30	37	-13
Paraguay	59	48	35	45	-14
El Salvador	56	63	25	40	-16
Panama	75	62	34	55	-20
Colombia	60	50	36	39	-21

(*) Percentage of respondents who said "yes". Ranked by increase in support for democracy. Not including those who answered "It doesn't matter." and "Don't know."
Source: Latinobarometro.

underscore another very important change in Latin America: the region, unlike Europe, is less and less a homogeneous bloc in economic terms. The major economies—Mexico, Brazil, Chile, Venezuela and Argentina—are increasingly decoupling from each other, both in terms of real economic links and in the minds of the investment community, which is becoming more discriminatory. For example, Mexico has moved more in sync with the US economy since forming part of the North American Free Trade Agreement (NAFTA) in 1994 with the United States and Canada. While Europe and North America are increasingly melding into one large market, Latin America is fragmenting economically. Brazil, Chile and Mexico have pressed ahead with reforms and greater integration into the global economy (and this has helped to boost their share of the region's GDP from 57% in the early 1970s to close to 80%), while Argentina and Venezuela are beset by economic and political problems that hinder growth. Brazil (32% of the region's total GDP) and Mexico (42%) have demonstrated a stronger resilience than in the past to emerging market crises, despite their lingering vulnerabilities. The two countries between them account for more than half the population of Latin America. Mexico and Chile are investment-grade countries, which means the risk of debt default is minimal and institutional investors, including US pension funds, are therefore more likely to invest in their financial markets.

Factors Determining Investment Decisions

Corporate Spain's decision to invest in Latin America is motivated by many more factors than the sharing of a common language (apart from Portuguese-speaking Brazil, although Spanish is increasingly being taught in Brazilian schools) and culture, both of which make the region a natural market for expansion. These factors, important though they are, do not explain sufficiently why Spain's multinationals and a significant group of medium-sized companies should decide to invest so much in this part of the world and run more than their fair share of risks. All investments run risks, but those in Latin America, a region long characterized by economic and political instability, are particularly risky.

A number of locational factors have played a key role in the investment drive, such as the privatization of state companies in telecommunications, electricity, water and gas, as well as the liberalization of financial systems and, in some cases, the privatization of state banks. Telefónica and Repsol and the banks Santander Central Hispano (SCH) and Banco Bilbao Vizcaya Argentaria (BBVA) were attracted by privatizations at attractive prices in a rapidly expanding and underdeveloped market that still has a high degree of protectionism. Spanish companies beat off competition and acquired seven of the nine largest privatized companies in Latin America between 1997 and 1999. Apart from SCH and BBVA, the bulk of investment has come from a group of large oligopolistic and privatized companies (Telefónica, Repsol and Endesa, themselves once state monopolies or oligopolistic companies).

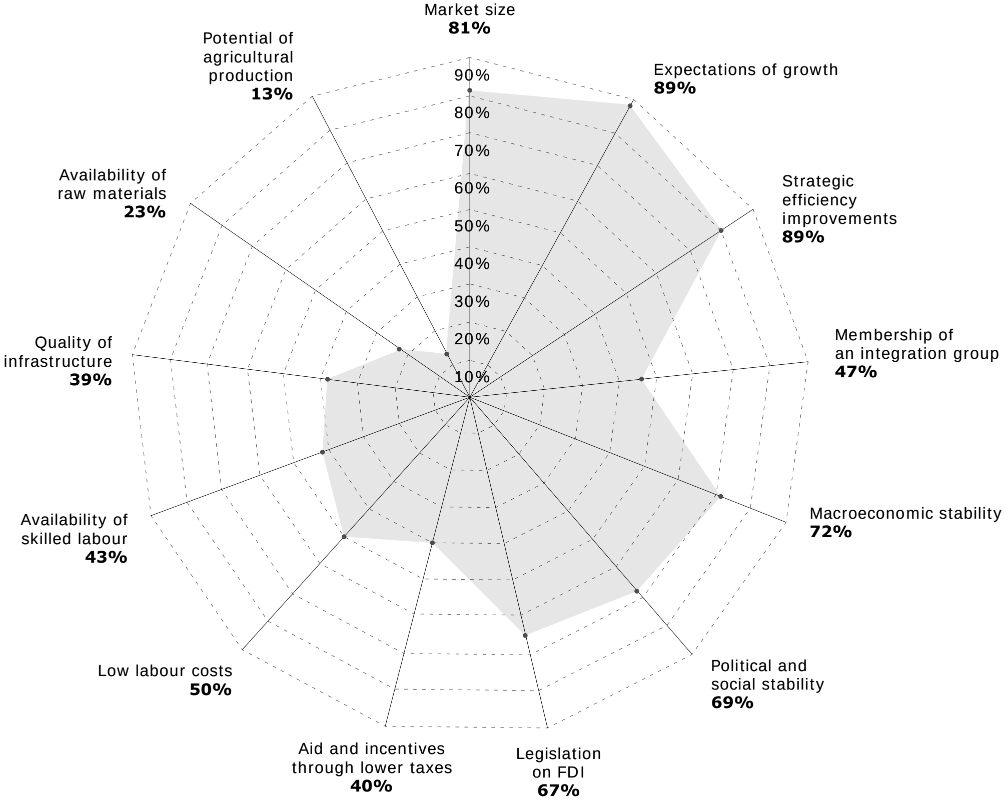
The banks, for example, have been able to buy market share in Latin America much more cheaply than in mature European markets. BBVA's Research Department roughly calculated, on the basis of the stock market capitalization of each country's biggest banks and their share of deposits at the end of 1999, that a 1% share of the German deposit market in 1999 cost US$2.2 billion if this was attained by purchasing shares in the major listed banks. The same share would have represented an outlay of US$196 million in Argentina or US$205 million in Mexico.

While the United Nations forecasts that the population of Europe will drop over the next 50 years (from 727 million to 603 million), the population of Latin America (including the Caribbean) is expected to increase from 519 million in 2000 to 806 million in 2050. The region's economic growth potential is also higher than Europe. The structural reforms undertaken in many countries should enhance the scope for growth.

Spanish companies have invested in Latin America with domestic markets in mind. Many sectors of the Spanish market have already reached a high degree of maturity, in sharp contrast to Latin American countries. According to a survey covering 107 Spanish companies with investments in Latin America, prepared by the Special Office in Europe of the Inter-American Development Bank (IDB) and conducted by Spain's ICEX in 2000-2001, the two main determinants of the companies' investment decisions were the size of the market and its growth prospects (see Exhibit 1.10). Also significant was the search for efficiency improvements in their global production/marketing strategies. They also noted that markets should have macroeconomic, political and social stability and that legislation should ensure fair treatment for foreign investment. The above factors are essential, in contrast with the relatively low importance given to other factors, such as membership of an integration grouping, support or incentives through lower taxes, cheap labour, the availability of skilled labour, the quality of infrastructure and the availability of raw materials and agricultural production[10].

[10] In his book, *Explaining International Production* (Unwin, 1998), John Dunning suggests that companies invest directly because they have ownership advantages, are attracted by the locational factors of recipient countries, and decide to exploit advantages based on the internalization of activities rather than undertaking them through the market. Companies' ownership advantages (technology, organization and/or management advantages, know-how, brand names and marketing) offset the costs and disadvantages that firms face in investing directly in relatively unknown environments. According to Dunning's theory, intangible assets comprise the main determinant of direct investment. This is the case with such medium-sized Spanish companies as Viscofan (plastic and collagen wrapping) and the publishing companies Planeta and Santillana, but larger companies, like the banks Santander Central Hispano and Banco Bilbao Vizcaya Argentaria and Telefónica, have established a brand image, possess organizational and management advantages, and maintain an aggressive internationalization strategy.

Exhibit 1.10 **Decisive Factors for Spanish Investment in Latin America***



(*) Percentage of "yes" responses in the total.
Source: Inter-American Development Bank Survey 2000-2001.

The most serious obstacles and disincentives for Spanish companies that invest in Latin America are local bureaucracy and regulations, political and economic stability, and violence (see Exhibit 1.11). The survey respondents also cited as less serious problems: difficulty in repatriating profits, high taxes, the lack of skilled resources, undeveloped capital markets, poverty and social problems, and poor infrastructure.

The companies also needed to diversify their risks beyond Europe, whose economic cycle is very similar to Spain's, and investments in Latin America have a strategic importance in an increasingly economically globalized world, enhancing Spain's position vis-à-vis other large European and US companies. In addition, Spain has an excess supply of skilled managers and access to cheap capital after joining EMU, enabling companies to pay euro interest rates to obtain emerging market premiums.

Main Recipients of Spanish Investment in Latin America

Argentina, Brazil, Chile and Mexico have absorbed around 85% of Spanish direct investment in Latin America, 12% corresponds to Colombia, Peru and Venezuela, and the rest has gone to Bolivia, Cuba, Ecuador, El Salvador, Guatemala, Honduras and Nicaragua (see Exhibit 1.12).

The country that received the most Spanish FDI between 1992 and 2000 was Argentina. The country (see Chapter 3) became particularly attractive after 1994 because of the opportunities spawned by privatization of the energy and telecommunication sectors. The next country in importance was Brazil (see Chapter 4), where investment was small relative to the size of the Brazilian economy until the "Real Plan" took effect in 1994 and the country began to liberalize the economy and privatize. Today, Brazil has the largest volume of Spanish investment because further investments have been made there, while divestments have occurred in crisis-hit Argentina.

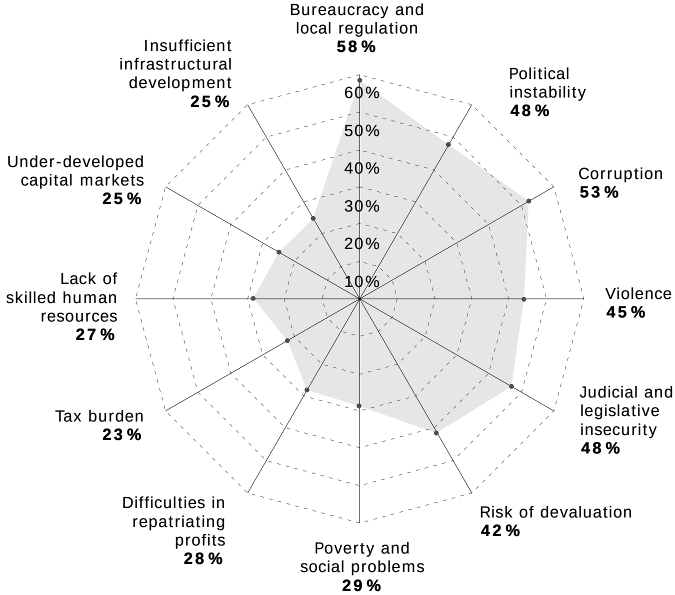
Chile (see Chapter 4) has received a level of investment that is high for the size of its economy. The country, which pioneered many of the reforms that galvanized Latin America in the early 1990s, has the most developed economy in the region. Up to 1993, Spanish FDI in Mexico stood out from that in other countries as it was mainly concentrated in commercial activities, the metal processing industry and insurance (see Chapter 5). The absence of Spanish investment in banks because of severe restrictions has dramatically changed as a result of liberalization of the financial system after the 1994-95 exchange-rate crisis. The relatively smaller level of Spanish investment in Mexico compared to the size of the country's economy (its GDP at market exchange rates is similar to Spain's) is due to Mexico's membership of the North American Free Trade Association (NAFTA) as of 1994. NAFTA has boosted US and Canadian investment in Mexico.

Trade with Latin America and Competition between the European Union and the United States

The whole of Latin America takes around 5% of Spain's total exports, half the 10% share that is absorbed by tiny neighbouring Portugal (see Exhibit 1.13). One reason for the low level of trade is that Spanish companies, particularly the large ones, have "jumped the tariff wall" with their direct investment, designed to produce for the local markets, making export market access less crucial[11]. Indeed, the Spanish presence has not made much difference to export capacity, though EADS-CASA, the Spanish military transport subsidiary of the

[11] See *El Cambiante Triángulo Transatlántico* by Paul Isbell (Economía Exterior, Madrid, summer 2001).

Exhibit 1.11 Greatest Obstacles to Spanish Direct Investment in Latin America*



(*) Percentage of companies rating the issue as highly important.
Source: Inter-American Development Bank Survey 2000-2001.

Exhibit 1.12 Main Source and Destination of Direct Investment in Latin America, Cumulative Inflows, 1992-2001

(€ mn)	Argentina	Brazil	Mercosur	Colombia	Venezuela	Andean Community	Chile	Mexico	Total
EU-15	39,485	67,380	107,456	4,010	6,712	16,409	10,678	20,682	161,701
Spain	**26,281**	**26,292**	**53,488**	**2,667**	**1,607**	**8,232**	**7,816**	**9,197**	**80,479**
France	5,002	9,995	15,246	229	1,594	2,554	555	1,628	20,247
Netherlands	615	9,067	9,326	-424	1,064	1,715	1,492	2,579	15,932
UK	1,626	4,757	6,000	552	-126	1,152	349	3,666	13,175
Germany	2,116	3,625	5,851	502	1,275	1,673	418	1,751	9,966
Portugal	29	9,543	9,573	0	2	16	11	32	9,773
Italy	1,308	2,808	4,061	28	74	88	47	144	4,412
Other EU	2,508	1,293	3,913	455	1,222	979	-10	1,684	7,715
US	9,124	32,561	36,799	2,615	10,740	3,522	9,166	46,389	97,732

Note: Mercosur consists of Argentina, Brazil, Paraguay and Uruguay, and the Andean Community comprises Bolivia, Colombia, Peru and Venezuela.
Source: Economic Commission for Latin America and the Caribbean, Eurostat and the Bureau of Economic Analysis for US data.

Exhibit 1.13 **Spain's Trade with Latin America and Percentage of Total Exports and Imports, 1999-2002***

(€ mn)	1999	% of Total	2000	% of Total	2001	% of Total	2002	% of Total
Exports	5,299	5.0	5,991	4.8	6,409	4.9	5,407	4.5
Imports	4,797	2.8	6,315	3.7	6,598	3.8	6,865	4.5

(*) First 11 months.
Source: ICEX.

European arms manufacturing giant EADS, was chosen in November 2002 by the Brazilian national defence council for two aircraft contracts worth €600 million. Latin America is also not a large trader. In 2000, the region accounted for 6.2% of world imports of goods (4.1% in 1991) and 5.8% of world exports (4.1% in 1991), compared with 34.6% and 35.9%, respectively, for the European Union. The EU's figures include intra-EU trade. Excluding this, the EU's share of world trade (exports and imports of goods) was 14.1% in 2000.

The main products that Spain exports to Latin America are chemicals, vehicles and car parts, components and accessories (see Exhibit 1.14). The structure of exports has changed little over the last decade. Spain's largest export markets are Mexico and Brazil (see Exhibit 1.15). The principal imports from Latin America are fuel and lubricants, seeds and fruit, fresh and frozen fish and seafood (see Exhibit 1.16). The fastest growing "import" has been immigrants from Latin America: the number of legal Latin American residents in Spain (i.e. with their papers in order) rose from 83,257 in 1991 to more than 200,000 in 2003. This number could increase dramatically in the coming years as an estimated 850,000 descendants of Spaniards in Latin America are eligible under a law approved in January 2003 to return to Spain. The law allows children and grandchildren born of Spanish women outside Spain to claim citizenship, a right previously limited to descendants of men.

The US began to compete with the European Union more strongly around 1990 when George Bush senior announced his vision for a Free-Trade Area of the Americas (FTAA). With 34 countries, 800 million people and 40% of the world's GDP, the FTAA would be the world's largest trading bloc. The enlarged European Union as of 2004, with 25 countries, would have a population of more than 455 million and generate 22% of the world's GDP. The two sides have been hard on one another's heels, partly because of the emergence of a more solid constituency to push for closer trans-Atlantic trade relations

Exhibit 1.14 Spain's Main Exports to Latin America by Product*

Product	% of Total Exports to LA
Chemicals	13.6
Vehicles	8.1
Car equipment, components and accessories	7.7
Books and publications	5.4
Defence and military security	3.6
Steel products	3.0
Electrical materials	2.8
Clothing	2.8
Electronics and computers	2.8
Ceramic flooring and paving	2.4

(*) First 11 months of 2002.
Source: ICEX.

Exhibit 1.15 Spain's Main Latin American Export Markets*

Country	% of Total Exports to LA
Mexico	39.2
Brazil	17.3
Venezuela	10.5
Chile	7.0
Argentina	5.0
Colombia	4.8
Peru	2.6
Ecuador	2.5

(*) First 11 months of 2002.
Source: ICEX.

Exhibit 1.16 Spain's Main Imports from Latin America by Product*

Product	% of Total Imports from LA
Fuel and lubricants	27.6
Fresh and frozen fish and seafood	11.0
Seeds and fruit	10.8
Food for animals	9.0
Non-processed products	7.9
Flowers	4.6
Chemicals	4.4
Steel products	3.4
Semi-processed metallic products	2.0
Meat	1.7

(*) First 11 months of 2002.

following the entry of Spain and Portugal into the European Community (EC) in 1996[12]. EC enlargement in 1986 broadened the focus of European attention to the South, having previously centred mostly on the former colonies of the first wave of member states. Another factor was the crisis in Central America during the 1980s which brought European attention to the isthmus, and thereafter to the whole of the region. The EC, and particularly Spain, established a position independent of the US and the Soviet Union and made a major commitment to the pacification and reconstruction of Central America through the San José peace process (explicitly mentioned in the preamble to the 1987 Esquipulas Peace Agreement).

The North American Free Trade Agreement (NAFTA) process between the US, Mexico and Canada proceeded in parallel to Europe's Maastricht Treaty negotiations (which set the entry conditions for European Monetary Union and the launch of the euro). The first Summit of the Americas, held in Miami in 1994 under President Clinton, coincided with both the birth of NAFTA and the EU's decision to achieve a free trade accord with Mercosur (Latin America's largest trade bloc, comprising Argentina, Brazil, Paraguay and Uruguay), which had still not been achieved by early 2003. The EU's first free trade agreement with a country in the Western Hemisphere was with Mexico, entering into force in July 2000. A similar deal was struck with Chile in April 2002. In July 2002, President George W. Bush won "fast-track" trade negotiating authority (now known as Trade Promotion Authority or TPA) from the House of Representatives, ratified by the Senate in August. This is a procedure which allows the White House to strike trade deals which Congress may then vote for or against, but may not amend. Created in 1974, Congress gave fast-track authority to five successive presidents but it lapsed in 1994. Chile and the

[12] See the first chapter of *Integration and Trade in the Americas* (Inter-American Development Bank, 2002).

US announced a free trade agreement in December 2002 that will come into effect in 2004. The deal eliminates all barriers on about 85% of the US$8.8 billion in trade between the two countries. The remaining trade restrictions will be phased out over 12 years.

The renewed permission and Washington's proposal for the World Trade Organization to agree to worldwide cuts in farm subsidies and tariffs on manufactured goods are giving a fresh impetus to the long-stalled FTAA, negotiations for which could be completed by 2005. The US began negotiating a free trade agreement with Central America in 2003 as an extension of NAFTA.

Impact of Argentina's Crisis

Argentina's dramatic crisis cast a cloud over Spanish direct investment in the whole of Latin America and raised questions about whether companies should have diversified their risks more. Argentina accounts for more than one-third of total investment in Latin America. Its economy imploded after the largest-ever sovereign debt default, the currency fell 58% against the euro in 2002, the banking system was on the verge of collapse and unemployment reached more than 20%. The crisis tested the nerve of many a company chairman. According to a report prepared for the Spanish Chamber of Commerce in Argentina, the net worth of the 11 main subsidiaries of non-financial Spanish companies (Telefónica, Endesa, Repsol YPF, Gas Natural, Dragados, Mapfre, Aguas de Barcelona, Indra, Acesa, Prosegur and Molins-Uniland) dropped by 83% between September 2001 and September 2002 to US$2.5 billion[13]. These companies have so far weathered what Emilio Botín, the chairman of Santander Central Hispano, called a "perfect storm".

[13] See "Las filiales españolas pierden el 83% de su valor" in *El País* (December 1, 2002).

Mango, however, decided to pull out of Argentina in 2003 and close its four clothing shops. The decision was an easy one because of its very small presence in the country; this is not the case for the 11 main firms and the two big banks.

The country's meltdown and its knock-on effect severely dented corporate earnings in 2001 and 2002. Companies remain profitable, but much less so than in the past when double-digit growth in profits was the norm. Repsol's net attributable income dropped 58% in 2001, as it had to set aside €2.7 billion in extraordinary provisions and write-offs for its holdings in Argentina, where it owns YPF, the country's biggest oil and gas producer. In 2002 its net attributable income surged 90.4% to €1.95 billion, but largely because of asset disposals (extraordinary income rose 183% to €648 million). The soaring net income hid a 32.5% drop in operating income, which fell to €3.32 billion, mainly under the impact of the Argentine economic crisis. That of Santander Central Hispano (SCH), which has the region's largest financial franchise, grew 10% in 2001, compared with increases of 25% in 1999 and 2000. The net attributable income of Banco Bilbao Vizcaya Argentaria (BBVA) rose 6% in 2001 (22.6% in 1999 and 27.8% in 2000). Argentina's crisis, in particular, and Latin America's problems, in general, dragged down the earnings of both banks in 2002: BBVA's net attributable income fell 27.3% to €1,717 million and Santander Central Hispano's dropped 9.6% to €2,247 million. The net attributable income of all of Spain's commercial banks declined 12% in 2002, largely due to Latin America. BBVA took an extraordinary charge of €374 million in 2002 to cover exchange rate losses incurred on the sale of its Brazilian bank and to amortize the goodwill on its operations in Venezuela, Colombia and Peru, all non-investment grade countries. Had it not been for these charges and provisions for early retirement, its net attributable income would have fallen 9%. Both SCH and BBVA, which account for close to 40% of the total assets of the Spanish banking system, took a prudent approach towards Argentina, putting the country into quarantine and ringfencing

Exhibit 1.17 **Share Price Performance of Main Spanish Companies in Latin America vs FTSE Indices, 2002**

Spanish Company	% Fall on Madrid Stock Exchange	% Fall in Corresponding FTSE Index
Santander Central Hispano	30.5	27.7 (FTSE Eurotop 300 – Banks)
Banco Bilbao Vizcaya Argentaria	34.4	27.7 (FTSE Eurotop 300 – Banks)
Telefónica	43.2	35.6 (FTSE Eurotop – Telecommuinications
Endesa	36.5	14.8 (FTSE Eurotop 300 – Electricity)
Iberdrola	8.7	14.8 (FTSE Eurotop 300 – Electricity)
Repsol YPF	23.0	23.0 (FTSE Eurotop 300 – Oil Integrated)
Gas Natural	3.4	10.1 (FTSE Eurotop 300)

Source: Bolsa de Madrid and FTSE.

their troubled operations. They have written off all their investments in the country and adopted an equity method accounting presentation, isolating Argentina below the operating income line and thus making its contribution to consolidated earnings zero.

The fall in value of SCH's assets in Latin America, which were eroded by Argentina's financial crisis and the depreciation of currencies across the region, led the bank to go on a massive selling spree in 2002 in order to replenish its depleted capital and reserves. It sold: 11.7% of its Banesto domestic bank; 3% of Royal Bank of Scotland, its closest strategic ally; 24.9% of Serfin Santander (Mexico) to Bank of America; and equity stakes in some industrial companies. These operations enabled SCH to increase its BIS ratio from 10.8% in September 2002 to 12.6% at the end of the year (and a record level of 13.8% including the operation, finalized in 2003, with Bank of America). A minimum ratio of 8% is the international yardstick.

BBVA's capital strength was less eroded by its Latin American ventures in 2002 than SCH's, but it also sold equity stakes in some companies, including Repsol and Telefónica. Its BIS ratio stood at 12.5% at the end of 2002. Even financial groups with no direct investment in Latin America—such as savings banks that have not expanded abroad—have had to make large write-offs in the region. This is because some of them have stakes in companies which have invested heavily in Latin America.

The share prices of Spain's blue chip companies, in particular, took a knocking because of the so-called "tango effect". Companies with interests in Latin America account for around three-quarters of the Bolsa de Madrid's total trading volume. Telefónica's share price plummeted 43.2% in 2002, compared with a drop of 35.6% in the FTSE Eurotop 300 – Telecommunications index (see Exhibit 1.17). In stark contrast, the share price of Banco Popular, Spain's fifth-largest bank, which has stuck to its profitable retail banking in Spain and has no exposure to Latin America, increased by 5.6% in 2002. Popular's net income rose 12.1% in 2002, and its market share in the commercial banking sector reached more than 10% for the first time and a year ahead of schedule. Popular's return on equity of 27.5% in 2002 was amongst the highest in Europe.

Debt ratings have also been eroded by Latin America's woes. For example, Moody's revised its long-term outlook on the electric utility Endesa in September 2002 from stable to negative and cut the rating of its Chilean businesses by two notches to Baa3, its lowest investment grade. In December it downgraded SCH's long-term rating to A1 from Aa3 and its financial strength rating to B- from B. Moody's said that although the Brazilian situation had somewhat stabilized since the ratings were put under review for possible downgrade in August and SCH had in the meantime taken some decisive steps to mitigate the possible negative effects of adverse scenarios on its Brazilian franchise, it could not rule out the likelihood of materially more difficult operating conditions in Brazil that could end up having a more severe impact on the bank's significant presence in the country. SCH owns Banco do Estado de São Paulo (Banespa), and this investment—by far its largest in Latin America (see the section on Banking in Chapter 4)—represents a significant share of SCH's core capital. Aside from the uncertain Brazilian outlook, SCH's strong and stable fundamentals were fully compatible with an Aa rating, said Moody's.

It is easy to be wise in hindsight, as many analysts have, and criticize the level and pace of Spanish investment in Latin America and exposure to risk. In retrospect, it does look as if companies and banks grew too fast. In the case of the banks, as always, the motive was the herd instinct. By remaining outside the herd they ran risks. They worked on the theory that if you are in the herd and things are good, then you do not fall behind your peers. If they are bad, everybody suffers equally and you are protected by the fact that your problems are systemic, not individual. This instinct applies equally to investments in the new economy and investments in new markets (Latin America). The big companies and banks that invested in Argentina also suffered to some extent from the “Stockholm syndrome”, an expression coined in the 1970s to describe the puzzling sympathy of four kidnapped bank employees towards their captors. Moreover, the big companies showed a certain arrogance in believing they knew better than the markets as regards the sustainability of the currency board and its peso-dollar peg and did not fully heed the warning signals emitted in the form of the risk premium, even from within their own camp. Instead, in Argentina at least, they extensively played the political card believing they could influence decisions in their favour. The reality proved them wrong and showed them the limits of corporate power in the real world. The capacity for policy reversal was also underestimated. Other factors that influenced investment decisions, particularly in the case of the banks, were transferring the battle for supremacy and size from the home market to the international market, coupled with internal conflicts following mergers. Some small and medium-sized firms also invested in Latin America with very little research and preparation, simply following the big companies and assuming that all would be well.

The Argentine debacle also raised questions about the effectiveness of the International Monetary Fund (IMF) to prevent and resolve financial crises (see Chapter 3). Former IMF Chief Economist Michael Mussa argued in a study that the IMF bore a heavy responsibility for the economic collapse of Argentina[14]. Several crucial requirements have emerged from it for the future management of the Fund:

---

[14] *Argentina and the Fund: From Triumph to Tragedy* by Michael Mussa (Institute for International Economics, July 2002).

- installation of better mechanisms to assure responsibility and accountability;
- encouragement of internal discussion and dissent, including to countervail the tendency of many staff to give unreasonable benefit of the doubt to member countries;
- more active involvement of the Fund's Executive Board (as opposed to its management and staff); and
- critical evaluations of Fund programmes, especially in countries with high levels of Fund financial support, by the newly created independent evaluation office.

Spain was not the only country to sharply reduce its investment in Latin America. Total FDI inflows into Latin America (including the Caribbean) fell in 2002 for the third year in a row, tumbling an estimated 27% from US$85 billion to US$62 billion, and continued to fall in 2003, according to UNCTAD. The challenge for Spain now is to consolidate its strong positions in many countries and seek out new opportunities when and if they arise.

Chapter 2

The Players

The bulk of Spain's direct investment in Latin America has been made by fewer than 20 companies. They are mostly big companies in oligopolistic sectors and privatized companies that operate in regulated markets. They have commanding or strong positions in their domestic market in telecommunications, electricity, energy and financial services (see Exhibit 2.1). A second, and larger, group consists of smaller companies with advantages in technology, know-how, organization and management, brand names and marketing (see Exhibit 2.2).

The really big players are: Telefónica (telecommunications); the banks, Santander Central Hispano and Banco Bilbao Vizcaya Argentaria; Repsol YPF (oil and gas); and the electricity companies Endesa, Iberdrola and Unión Fenosa (see Exhibit 2.3). They have tended to establish majority control of their operations in Latin America. All can be said to be global players as a result of their investment in the region. In the case of Telefónica and Repsol, their investment has put them among the world's top 20 non-financial transnational corporations (TNCs), ranked by foreign assets (see Exhibit 2.4).

Spain's share in the total foreign assets of the top 100 TNCs was 3.4% in 2000 (latest figure available) and its average transnationality index (TNI) was 41.6% compared to 76.9% for the UK, 48.6% for Italy and 77.3% for Finland. The TNI is calculated as the average of foreign assets to total assets, foreign sales to total sales and foreign employment to total employment.

Telefónica

Telefónica, the biggest Spanish investor in Latin America, enjoyed a monopoly in Spain to varying degrees until the telecommunications sector was completely liberalized in December 1998. The company is still very much the dominant force in its domestic mar-

Exhibit 2.1 **Main Spanish Companies Investing in Latin America**

Company	Sector
Santander Central Hispano	Financial institution
Banco Bilbao Vizcaya Argentaria	Financial institution
Mapfre	Insurance
Telefónica	Telecommunications
Repsol YPF	Hydrocarbons
Iberia	Transport
Endesa	Electricity
Iberdrola	Electricity
Unión Fenosa	Electricity
Dragados	Construction
Ferrovial Agroman	Construction
SACYR	Construction
Empresa Nacional de Celulosa	Paper
Aguas de Barcelona	Water
Gas Natural	Gas
Tabacalera	Tobacco
Azucarera Ebro	Foodstuffs

Source: The chapter on Spain by Alfredo Arahuetes in Foreign Direct Investment in Latin America, the Role of European Investors (Inter-American Development Bank, 2001).

ket. Liberalization has not dented its position very much, although the Spanish market is crowded and fiercely competitive. Telefónica had the largest market capitalization of companies listed on the Bolsa de Madrid in 2002 (€41,461 million, 9.9% of the total) and was also the most traded share (€102,261 million, 23% of the total volume). It forms part of the Euro Stoxx 50 (along with Endesa, Repsol YPF, Banco Bilbao Vizcaya and Santander Central Hispano), and since September 2002 it has been included in the FTSE4 Good Global Index, one of the main benchmark indices for institutional investors with socially responsible investment criteria. Other Spanish Companies that form part of the FTSE4 index are Bankinter, Gas Natural and Santander Central Hispano.

Telefónica's first Latin American investments were in Chile in 1989, Argentina in 1991 and Peru in 1994, buying companies that were privatized (now named Telefónica CTC Chile, Telefónica de Argentina and Telefónica de Perú). The company entered Brazil in 1996 as head of a consortium that paid US$655 million for 35% of the voting shares of CRT in the southern state of Rio Grande do Sul. Telefónica was fully privatized as of 1997, and since then it has stepped up its investment in the region and become the leading telecoms operator in the Spanish- and Portuguese-speaking world (see Exhibit 2.5). It acquired controlling stakes in three regional operating companies in the 1998 auction of Brazil's Telebras system, the largest being Telesp, the fixed-line operator in Sao Paulo state, the country's economic engine. In 2000, it acquired all the capital of its operations in Argentina, Brazil, Chile and Peru and in 2001 acquired Motorola's cellular assets in Mexico. Telefónica spent US$30.5 billion acquiring companies between 1990 and 2002.

In 2002 it had more fixed lines in Latin America (21.6 million) than in Spain (18.7 million) and 21.3 million mobile customers (18.4 million in Spain). In fixed lines, Telefónica is the leader in Latin America with a market share of 26% in June 2002

Exhibit 2.2 Other Spanish Companies Investing in Latin America

Company	Sector
Fagor	Electrical goods
Ficosa	Auto parts and components
Grupo Antolín	Auto parts and components
Gestamp	Auto parts and components
Talleres Fabio Murga	Steel shots and steel grits
Tafisa	Wood
Acerinox	Metal processing
Viscofán	Plastic and collagen wrapping
Inditex	Clothing
Ibereucaliptus	Paper
Sol Meliá	Tourism
Homasi	Tourism
Iberco	Tourism
Hoteles Mayorquines Reunidos	Tourism
Maninvest	Tourism
Iberostar Hoteles	Tourism
Roca Radiadores	Bathroom fittings and heating
Planeta	Publishing
Santillana	Publishing
Salvat	Publishing
Catalana de Cementos Portland	Non-metallic mining industry
Valenciana de Cementos Portland	Non-metallic mining industry
Corporación Uniland	Non-metallic mining industry
EPSA	Engineering
SOS Arana Alimentación	Foodstuffs
Pescanova	Fisheries
Pesquera Cabo Mayor	Fisheries
José Pereira e Hijos	Fisheries

Source: The chapter on Spain by Alfredo Arahuetes in Foreign Direct Investment In Latin America, the Role of European Investors (Inter-American Development Bank, 2001).

Exhibit 2.3 Direct Investment of the Main Spanish Companies in Latin America, 1997-2002

(US$ mn)	1997	1998	1999	2000	2001	2002
Telefónica	934	4,700	2,100	17,700	1,800	300*
Santander Central Hispano	1,249	1,156	1,565	8,257	1,395	962
Banco Bilbao Vizcaya Argentaria	613	2,905	549	2,781	855	1,254
Repsol YPF	687	85	15,169	1,311	2,584	1,596
Endesa	2,228	629	3,603	148	21	21
Iberdrola	947	–	264	595	736	643
Unión Fenosa	–	208	346	1,023	297	402
Gas Natural	350	50	0	400	150	150
Aguas de Barcelona	23	136	288	91	5	198
Total	7,031	9,869	23,884	32,306	7,843	5,526

(*) September 30.
Source: Economic Commission for Latin America and the Caribbean and companies.

Exhibit 2.4 The World's Top 20 Non-Financial TNCs, Ranked by Foreign Assets[1]

Ranking				US$ mn				Employment No. of Employees		
				Assets		Sales				
Foreign Assets	TNI[2]	Company	Country	Foreign	Total	Foreign	Total	Foreign	Total	TNI[2] (%)
1	15	Vodafone	UK	221,238	222,326	7,419	11,747	24,000	29,465	81.4
2	73	General Electric	US	159,188	437,006	49,528	129,853	145,000	313,000	40.3
3	30	ExxonMobil	US	101,728	149,000	143,044	206,083	64,000	97,900	67.7
4	42	Vivendi	France	93,260	141,935	19,420	39,357	210,084	327,380	59.7
5	84	General Motors	US	75,150	303,100	48,233	184,632	165,300	386,000	31.2
6	46	Royal Dutch/ Shell	UK/ Netherlands	74,807	122,498	81,086	149,146	54,337	95,365	57.5
7	24	BP	UK	57,451	75,173	105,626	148,062	88,300	107,200	76.7
8	80	Toyota	Japan	55,974	154,091	62,245	125,575	–	210,709	35.1
9	**55**	**Telefónica**	**Spain**	**55,968**	**87,084**	**12,929**	**26,278**	**71,992**	**148,707**	**53.8**
10	47	Fiat	Italy	52,803	95,755	35,854	53,554	112,224	223,953	57.4
11	57	IBM	US	43,139	88,349	51,180	88,396	170,000	316,303	53.5
12	44	Volkswagen	Germany	42,725	75,922	57,787	79,609	160,274	324,402	59.4
13	64	ChevronTexaco	US	42,576	75,922	57,787	117,095	21,693	69,265	47.2
14	52	Hutchison Whampoa	HK, China	41,881	56,610	2,840	7,311	27,165	49,570	55.9
15	23	Suez	France	38,521	43,460	24,145	32,211	117,280	173,200	77.1
16	93	Daimler Chrysler	Germany/ US	–	187,087	48,717	152,446	83,464	416,501	24.0
17	11	News Corp.	Australia	36,108	39,279	12,777	14,151	24,500	33,800	84.9
18	4	Nestlé	Switzerland	35,289	39,954	48,928	49,648	218,112	224,541	94.7
19	62	TotalFinaElf	France	33,119	81,700	82,534	105,828	30,020	123,303	47.6
20	**87**	**Repsol YPF**	**Spain**	**31,944**	**487,763**	**15,891**	**42,563**	**16,455**	**37,387**	**29.3**

(1) Ranking in 2000.
(2) The transnationality index (TNI) is calculated as the average of the following three ratios: foreign assets to total assets, foreign sales to total sales and foreign employment to total employment.
Source: World Investment Report 2002 (UNCTAD).

Exhibit 2.5 Telefónica and Telefónica Móviles – Main Presence in Latin America

Country	Company	Customers
Argentina	Telefónica de Argentina (TASA)	4.2 million
	TCP Argentina	1.6 million
Brazil	Brasilcel	13.7 million
	Telesp	12.8 million
Chile	Telefónica CTC Chile	2.7 million
	Telefónica Móvil	1.7 million
El Salvador	TEM El Salvador	231,000
Guatemala	TEM Guatamela	97,000
Mexico	Telefónica Móviles México	2.2 million
Peru	Telefónica del Perú	1.8 million
	Telefónica Móviles Perú	1.2 million
Puerto Rico	NewCom Wireless Puerto Rico	169,000

Source: Telefónica. Information at end of 2002.

(excluding 2.7 million lines at Venezuela's CANTV). It is also the second-largest cellular operator, after América Móvil, with an 18% market share (including its joint venture with Portugal Telecom in Brazil and excluding 2.5 million subscribers at CANTV—see Exhibit 2.6).

Like other Spanish companies heavily involved in Latin America, Telefónica was hard hit by the region's problems. It made a net loss of €5.58 billion in 2002, as a result of the write-off of more than €16 billion of goodwill relating to its Argentine companies, its US Internet portal Lycos, and its third-generation mobile telephony licences in Europe. Argentina's contribution to group revenues fell from 12.6% in 2001 to 3.7%, while Latin America's contribution dropped from 43% to 35%.

As a result of the elimination of Telesp's customer waiting list two years ahead of the regulatory objectives, the Brazilian regulator Anatel authorized Telefónica in 2002 to provide nationwide local telephony services, as well as national and international long-distance services. Telesp was Brazil's first fixed-line operator to receive such authorization. Until then, it was only allowed to provide local telephony and domestic long-distance services within Sao Paulo state. Anatel certification was also a requisite for going ahead with the mobile telephony joint venture between Telefónica Móviles and Portugal Telecom (PT) in Brazil, which took place in October 2002. Brasilcel is Brazil's, as well as South America's, largest cellular operator, with around 17 million subscribers (more than 50% of the market) and a potential market in Brazil of more than 94 million. Both groups are pioneers in Brazil's cellular market in using the latest technological developments to offer their customers a range of voice products and services, mobile data transmission and mobile Internet access.

Brazil and, increasingly, Mexico are the focal points for Telefónica. In May 2002 Telefónica Móviles acquired 65% of Pegaso and became the second-largest mobile

Exhibit 2.6 **Telefónica – Market Share in Latin America in Fixed Lines and Mobile Phones[1]**

Fixed Lines (mn)	Market Share (%)	Mobile Phones (mn Subscribers)	Market Share (%)
Telefónica (21)[2]	26	América Móvil (27)	30
Telemar (15)	18	Telefónica-PT[3] (17)	18
Telmex (14)	17	Versión (9)	10
Brasil Telecom (9)	11	BellSouth (8)	9
Versión (4)	5	TIM (6)	7
Telecom Argentina (3)	4	Others (25)	27
Others (18)	18		

(1) At June 30, 2002.
(2) Excluding 2.7 million lines at CANTV in Venezuela.
(3) Excluding 2.5 million subscribers at CANTV in Venezuela.
Source: Telefónica.

company in Mexico with more than two million subscribers (10% market share), but a long way behind the leader, Telcel.

Telefónica's listed Internet arm, Terra Lycos, has investments in Latin America. Terra Lycos was formed in 2000 after Terra Networks, Spain's leading access and portal player, merged with Lycos, the Nasdaq-listed web portal, and created the world's fourth-largest Internet company. Lycos' position in North America, Asia and Europe complemented Terra's strengths in Spain and Latin America. Telefónica is the main shareholder with a 39% stake in 2002. Terra Lycos generates most of its revenues in the US (more than half), followed by Latin America (close to 30%) and Spain (less than 20%). The main access markets in Latin America where Terra Lycos is present are Brazil and Mexico. Exposure to Argentina is insignificant (less than 1% of total revenues). The company had 253,000 ADSL subscribers in Latin America (125,000 in Spain) in 2002. Among its main brand sites are Invertia, one of the leading financial information sites in Latin America and Spain, and its joint ventures include Bumerman, an employment and human resources portal. Terra Lycos faced an uncertain situation because of several problems—loss of market share in the portal business, conflicts of interest with Telefónica (particularly evident in the ADSL market) and Bertelsmann's decision not to continue financing a large portion of the US online operations (through a contract worth US$675 million from November 2002-October 2005, equivalent to 37% of its portal revenues in the period)[1].

Telefónica threw Terra Lycos a lifeline in February 2003 when it made the company the sole provider of its value-added Internet services.

[1] See *Terra Lycos, Bursting Bubbles* (Santander Central Hispano Bolsa, November 14, 2002).

Repsol YPF

Repsol added YPF to its name after it bought the Argentine oil and gas giant in 1999 for just over US$15 billion, the largest single investment by a Spanish company and one which turned the company overnight into an integrated and fully diversified energy group and the largest non-government-controlled oil producer in Latin America. Repsol YPF has operations in 12 Latin American and Caribbean countries (see Exhibit 2.7). The company was ranked 94th in the Global 500 ranking issued in 2002 by the US magazine Fortune based on income, profits, assets, invested capital and employees. It was the only Spanish company to make it into the top 100. Santander Central Hispano was ranked 136th, Telefónica 151st, Banco Bilbao Vizcaya Argentaria 192nd and Endesa 358th.

Like Telefónica in telecommunications and Endesa (see below) in electricity, Repsol YPF is also by far the biggest player in its domestic market. The company, established as Repsol in 1987 as part of a complete restructuring of the oil and gas businesses owned by the state, was fully privatized by 1997. It is an integrated company engaged in all aspects of the energy business, including exploration, development and production of oil and natural gas, transportation of petroleum products and liquefied petroleum gas, oil refining, production of petrochemicals and product marketing.

After acquiring a controlling stake in Astra, Argentina’s fifth-biggest energy group, in 1996, Repsol used it as a vehicle for expansion. Astra bought 45% of Pluspetrol Energy in 1998, giving Repsol control of the Ramos gas field in northwestern Argentina, the country’s second-largest. Repsol moved into the bottled-gas distribution business in Argentina by purchasing Algas, one of the four main companies in the sector. This was then followed by the mega-purchase of YPF, which the Argentine government privatized. Repsol has many eggs in the crisis-hit Argentine basket (see Exhibit 2.8).

A more stable framework for the oil sector in Argentina began to be established in the third quarter of 2002, which will help Repsol YPF to weather that country's crisis. The government's measures included maintenance of the free availability of 70% of export proceeds, no limits on crude oil exports and a reduction in the diesel export tax from 20% to zero.

Repsol YPF is also the leading private company in oil and gas production in Venezuela, with over 100,000 barrels of oil equivalent per day from the Quiriquire, Mene Grande and Quiamare la Ceiba fields, and 8.5 million cubic metres of natural gas per day from Quiriquire field.

The company exercised its option in 2002 to buy 20% of the production and reserves from the Iron Horse natural gas field in offshore eastern Trinidad. This brought Repsol's stake in the field, where one trillion cubic feet of gas was discovered, to 30%.

Santander Central Hispano

Santander Central Hispano (SCH), the product of the merger of three banks and the largest financial institution in Spain in terms of assets (€324.3 billion in 2002), has Latin America's leading financial franchise (see Exhibit 2.9) in terms of net attributable income generated in the region. Even taking into account Argentina's crisis, Latin America generated €1,383 million of net attributable income in 2002 (43.7% of the total contributed by all business areas excluding the corporate centre). This figure does not

Exhibit 2.7 Repsol YPF – Operations in Latin America, 2002

	Exploration	Production	Refining	Marketing	LPG	Chemicals	Gas & Power
Argentina	√	√	√	√	√	√	√
Bolivia	√	√			√		√
Brazil	√	√	√	√		√	√
Chile				√	√		√
Colombia	√	√					√
Cuba	√						
Ecuador	√	√		√	√		
Guyana	√						
Mexico						√	√
Peru	√		√	√	√		
Venezuela	√	√					
Trinidad & Tobago	√	√					√

Source: Repsol YPF.

Exhibit 2.8 Repsol YPF - Selected Operating Data, 2002

	2002		2002		2002E
Crude oil reserves (1)		**Refining capacity** (4)		**Sale of petroleum products** (7)	
Spain	4,242	Spain	740	Spain	26,785
Argentina	1,399,601	**Argentina**	334	**Argentina**	8,001
Rest of the world	614,853	Rest of the world	160	Rest of the world	15,305
Gas reserves (2)		**Crude oil processing** (5)		**LPG sales** (7)	
Spain	–	Spain	31.9	Spain	2,102
Argentina	9,431,883	**Argentina**	15.2	**Argentina**	363
Rest of the world	8,773,896	Rest of the world	5.7	Rest of the world	780
Hydrocarbon production (3)		**Number of service stations** (6)		**Natural gas sales** (8)	
Spain	2,647	Spain	3,653	Spain	18.5
Argentina	261,293	**Argentina**	1,940	**Argentina**	2.2
Rest of the world	101,166	Rest of the world	1,036	Rest of the world	6.2

E= Estimate
(1) Thousands of barrels of crude oil. (2) Millions of cubic feet of gas. (3) Thousands of barrels of oil equivalent.
(4) Thousands of barrels per day. (5) Millions of tonnes of oil equivalent. (6) Service stations located at both sides of a road are considered two points of sale. (7) Thousands of tonnes. (8) Billion Cubic Meter (BCM). The refining capacity of processed crude and sales are calculated with consolidation criteria.
Source: Repsol YPF.

Exhibit 2.9 Santander Central Hispano – Market Shares in Latin America[1]

Country	Loans (%)	Deposits (%)	Ranking	Pension Funds[2]	Ranking	Mutual Funds[2]	Ranking
Argentina	7.7	7.2	3	22.5	1	18.6	1
Bolivia	10.9	14.5	1	–	–	–	–
Brazil	4.2	4.5	4	–	–	4.5	9
Chile	25.5	22.8	1	11.1	5	21.2	2
Colombia	2	3.2	6	12.1	5	3.9	6
Mexico	12.8	14.9	3	9.0	4	13.3	3
Paraguay	1.1	1.2	6	–	–	–	–
Peru[3]	–	–	–	27.3	2	–	–
Puerto Rico	11.0	12.0	2	–	–	24.2	2
Uruguay	8.5	6.8	7	17.9	2	–	–
Venezuela	14.2	13.2	1	–	–	8.8	4
Total Latam	**10.9**	**10.4**	**2**	**12.3**	**3**	**9.8**	**5**

(1) Figures at December 2002 or latest available. (2) Market share by assets. (3) The sale of the retail business of Banco de Crédito del Perú was completed in November 2002.
Source: Santander Central Hispano.

Exhibit 2.10 Santander Central Hispano – Main Investments in Latin America[1]

Country	Main Banks	% Share	US$ mn
Argentina	Banco Río de la Plata	98.85	2,469
Brazil	Banespa	98.01	
	Banco Santander Brasil	95.90	
	Banco Santander Meridional	96.91	7,166
Chile	Banco Santander Chile	83.92	2,200
Mexico	Banca Serfin[2]	98.82	
	Banco Santander Mexicano[2]	98.82	2,626
Puerto Rico	Banco Santander Puerto Rico	88.27	199
Venezuela	Banco de Venezuela	97.65	763
Other	Banco de Santa Cruz (Bolivia)	95.97	
	Banco Santander Colombia	97.43	
	Banco Santander Central Hispano – Perú[3]	0.00	
	Banco de Asunción (Paraguay)	98.09	
	Banco Santander Uruguay	100.00	1,218
Total[4]			**16,641**

(1) Figures at December 2002 or latest available.
(2) Agreement on December 11, 2002 to sell 24.9% to Bank of America.
(3) The sale of the retail business of Banco de Crédito del Perú was completed in November 2002.
(4) Accumulated gross investment in banks, pension fund companies and other subsidiaries.
Source: Santander Central Hispano.

include amortization of goodwill, the cost of financing investments or the special reserve for Argentina, all of which are included in the corporate centre.

Its business relationship with the region dates back as far as 1857, when Banco Santander was founded and its bylaws stated that foreign trade financing was one of its main functions. Today, foreign trade financing is a tiny part of SCH's universal banking business. Its push into Latin America was stepped up substantially after Banco Santander merged with Banco Central Hispano in 1999. This was the first bank merger in the Euro zone after the introduction of the single currency, a move which sparked the start of a fresh wave of consolidation in European banking. As a result of the crisis in Argentina, where SCH owns Banco Río de la Plata and has market shares of 7% in deposits and 22% in pension funds, the focus is increasingly on Brazil, Chile and Mexico (see Exhibit 2.10). These are attractive markets (see Chapter 7). As is the case with Banco Bilbao Vizcaya Argentaria, SCH's continued presence in Argentina depends on whether a viable financial system emerges from the ashes of the shattered economy. Their banks in the country were technically bankrupt in 2002.

SCH's largest investment is in Brazil, where it bought Banespa, the third-largest private-sector banking group, in 2000 for US$3.7 billion. The cost of this investment has since risen to US$4.8 billion after SCH increased its equity stake. In Mexico, it controls Santander Serfin, the third-largest financial group, 24.9% of which was sold to Bank of America in 2003. In terms of market share, Chile is the bank's most prominent market in Latin America (26% of deposits and 21% of mutual funds).

While some of its banking investments in Latin America have proved to be profitable so far, SCH's online financial services portal Patagon was an expensive disaster. SCH bought a controlling stake in Patagon in March 2002 for US$550 million at the height of the dotcom boom, with the aim of developing a financial portal for Latin America and Europe. It then injected US$242 million into the company to cover losses and fund its Latin American expansion. It talked of a potential market of 500 million customers. Patagon was run as an independent company with 775 employees, headquarters in Miami, and its own proprietary technology and back-office systems. It posted a pre-tax loss of €16 million in 2001 with 243,500 customers and deposits of €1.9 billion. In May 2002, SCH sold 100% of Patagon America (the Latin American division) to Patagon co-founders and executives Wenceslao Casares and Guillermo Kirchner for just US$9.8 million and it paid US$22 million for their 11.4% stake in Patagon Europe, whose units in Spain and Germany are more successful. SCH took a €700 million charge in its 2002 results, including €616 million of goodwill associated with the business. Patagon made a small profit in 2002.

Banco Bilbao Vizcaya Argentaria

Banco Bilbao Vizcaya Argentaria (BBVA) is also the result of the merger of three banks, the last one in 1999 and hard on the heels of the creation of Santander Central Hispano (SCH). BBVA's roots are in the Basque Country (Banco de Bilbao and Banco Vizcaya).

The battle for supremacy between BBVA and SCH is being fought out as much in their domestic market as abroad. While SCH outstrips BBVA in overall market share of loans in Latin America, BBVA is the region's leader in pension funds (see Exhibit 2.11). In Argentina BBVA controls Banco Francés, the country's second-largest privately owned bank. Its largest investment is in Mexico, where it controls BBVA Bancomer, the country's leading financial group (see Exhibit 2.12). BBVA generated net attributable income of €666 million in 2002 in Latin America (28% of the total). This figure does not include amortization of goodwill, the

Exhibit 2.11 Banco Bilbao Vizcaya Argentaria – Market Shares in Latin America[1]

Country	Loans (%)	Deposits	Ranking	Pension Funds[2]	Ranking	Mutual Funds[2]	Ranking
Argentina	6.3	9.4	2	20.4	2	2.2	14
Bolivia	–	–	–	51.4	1	–	–
Brazil	1.6	1.3	9	–	–	0.7	11
Chile	6.6	6.9	4	31.5	1	7.2	9
Colombia	6.6	7.2	4	43.5	1	4.4	NA
Ecuador	–	–	–	68.8	1	–	–
El Salvador	–	–	–	48.2	2	–	–
Mexico	23.3	28.8	1	21.7	2	20.1	2
Panama	6.5	4.6	5	50.0	1	–	–
Paraguay	10.7	9.8	5	–	–	–	–
Peru	16.4	22.3	2	25.5	3	26.3	2
Puerto Rico	7.8	7.7	5	–	–	–	–
Uruguay	11.7	8.5	6	–	–	–	–
Venezuela	16.4	14.5	3	–	–	35.7	1
Total Latam	**9.4**	**12.1**	**1**	**27.1**	**1**	**5.8**	**6**

(1) Figures at December 31, 2002. (2) Market share by assets.
Source: Banco Bilbao Vizcaya Argentaria.

Exhibit 2.12 Banco Bilbao Vizcaya Argentaria – Main Investments in Latin America[1]

Country	Main Banks	% Share	Investment (US$ mn)
Argentina	BBVA Francés	68.17	1,533
Brazil	BBVA Brasil[2]	100.00	1,553
Chile	Banco BHIF	66.10	897
Colombia	BBVA Ganadero	95.36	1,119
Mexico	BBVA Bancomer	54.65	3,896
Panama	BBVA Panama	98.76	29
Paraguay	BBVA Paraguay	99.99	27
Peru	BBVA Continental	45.74	291
Puerto Rico	BBVA Puerto Rico	100.00	349
Uruguay	BBVA Uruguay	100.00	111
Venezuela	BBVA Provincial	55.33	572
Total[3]			**10,377**

(1) Figures at December 31, 2002.
(2) Sold in January 2003 to Bradesco.
(3) Accumulated gross investment in banks, pension fund companies and other subsidiaries.
Source: Banco Bilbao Vizcaya Argentaria.

cost of financing investments or the special reserve for Argentina, all of which are included in the corporate centre.

Between them, SCH and BBVA have eight of the 25 largest banks in Latin America in terms of Tier 1 capital strength (see Exhibit 2.13). Bancomer tops the list.

Endesa

Endesa was formed in 1944 when Spain built up basic industries through the National Institute of Industry (INI), the holding company formed after the 1936-39 civil war. Endesa, fully privatized by 1998, is the dominant player in Spain where it has 42% of total installed capacity. It agreed to merge with Iberdrola, the second-largest power company in terms of market share, but the two companies called off the marriage in 2001 after the government imposed strict conditions on the recommendation of the National Energy Commission which they said made tying the knot not worth the effort.

Endesa's first foray into Latin America was in 1992 when it acquired a stake in Argentina's Yacylec (see Exhibit 2.14). Energy-hungry Brazil (which had to ration electricity in 2001 because of a drought that reduced the output of hydroelectric plants) is the main attraction for Endesa. The company entered the country through Enersis, the Chilean holding company that built up a considerable share in the electricity markets of other countries. Endesa established a strategic alliance with Enersis in 1997 and took a 32% stake in the company, and the two companies then headed a consortium which was awarded the Brazilian distributor Coelce. Endesa increased its stake in Enersis in 1999 to 64% and took management control. Enersis is Latin America's largest listed electricity group and has been used as the repository for the majority of Endesa's investments in the region as well as its

Exhibit 2.13 Ranking of Spanish Banks in the Top 100 Latin American Banks by Tier 1 Capital Strength[1]

Ranking	Strength Tier 1 Capital (US$ mn)	Size Assets (US$ mn)	Soundness Capital Assets Ratio (%)	Profits Real Profits Growth (%)	Return on Assets (%)	Cost/ Income Ratio (%)	BIS Capital Ratio (%)	NPL to Total Loans (%)
4. Grupo Financiero BBVA Bancomer	3,179	46,546	6.83	140.7	2.29	60.25	15.66	NA
12. Banco Río de la Plata	1,062	9,948	10.68	-99.2	0.02	67.12	13.63	2.46
13. Grupo Financiero Santander Mexicano	1,018	23,154	4.40	92.1	1.13	78.32	16.00	NA
14. BBVA Banco Francés	924	8,421	10.98	-140.0	-1.27	57.82	NA	NA
15. Banco Santiago	821	10,303	7.97	24.2	1.70	49.13	12.74	1.32
16. Grupo Santander Banespa	820	12,562	6.53	na	3.86	59.20	NA	NA
24. Santander Chile	551	8,917	6.18	15.0	1.92	44.50	11.30	1.36
25. Banco de Venezuela	549	3,570	15.37	-5.5	2.59	53.49	17.64	3.60

Note: The banks in positions 12, 13, 15, 16, 24 and 25 are majority owned by Santander Central Hispano and those in 4th and 14th position are owned by Banco Bilbao Vizcaya Argentaria.
(1) Figures for 2001.
Source: The Banker, August 2002.

Exhibit 2.14 Endesa – Main Presence in Latin America

Country	Company	Installed Customers/Capacity
Argentina	Dock Sud	820MW[1]
	Yacylec	507kv
	Costanera	2,302MW
	CBA	320MW
	El Chocón	1,320MW
	Edesur	2.1 million
Brazil	Cerj	1.7 million
	Coelce	1.9 million
	Cacloeira Dourada	658MW
	Brazil-Argentina interconnector	1,000MW
Colombia	Betania	540MW
	Emgesa	2,500MW
Chile	Endesa Chile	4,000MW
	Chilectra	1.3 million
	Rio Maipo	0.3 million
Peru	Etevensa	322MW
	Edegel	1,000MW
	Edelnor	0.9 million
	Piura	151MW

(1) Under construction.
Source: Endesa.

financial vehicle. Endesa has an overall market share of around 10% in those countries in Latin America where it operates. The region generated €1,268 million of net operating income in 2002 (11% less than in 2001 in euro terms) and 35.4% of Endesa's total operating income Excluding Argentina, operating income would have been 3.8% higher.

Faced with a prolonged downturn in the region, Enersis announced in October 2002 that it would issue fresh equity, cut debt and sell non-essential businesses, including Rio Maipo, Chile's fourth-biggest electricity distributor. The move was seen as a pre-emptive strike against further downgrades on its €8.4 billion debt pile (out of Endesa's total consolidated debt of €23 billion in September 2002), some of which ran the risk of being called in by banks if the group's operating and financial situation deteriorated further. Moody's, the ratings agency, revised its long-term outlook on the parent from stable to negative in September 2002 and cut the rating of Endesa's Chilean businesses by two notches to Baa3, its lowest investment grade. Endesa reduced its 2002-06 investment plan by €3.3 billion to €9.7 billion. It also increased the target for asset sales to €6 billion (€4 billion by the end of 2004). Endesa's market capitalization dipped during 2002 below that of its rival Iberdrola, which has less debt and fewer assets in Latin America. Its share price plummeted 36.5% in 2002. Endesa's net attributable income fell 14.1% in 2002 to €1,270 million, largely because of heavy provisions. It wrote down most of its investments in Smartcom, a Chilean telecommunications operator, and its entire operation in Argentina.

Endesa is helping to build a US$320 million single electricity grid for Central America by 2005. A 1,830km, 230kv line will connect Guatemala, Honduras, El Salvador, Nicaragua, Costa Rica and Panama. The region has an abundance of hydroelectric resources and is close to gas producers. However, the small size of each country has stymied investment in large projects, leaving it reliant on small, oil-powered generators.

Iberdrola

Iberdrola, Spain's second-largest electricity company in terms of market share, participates in the management of more than 25 companies in Brazil, Mexico, Bolivia, Chile, Guatemala and Uruguay. It is the largest distributor in the northeast of Brazil, with around 6 million customers (see Exhibit 2.15).

In Brazil, Iberdrola focuses on distribution in the north and northeast of the country (it has minority stakes, but operates the businesses) and it is slowing down investment in generation (which has to be financed locally without recourse to the parent company). Construction began in 2001 at the 520MW Termopernambuco power station, which will be the biggest electricity generator in that part of Brazil. In Mexico, Iberdrola is seeking growth in generation at low risk (tariffs and fuel costs are dollarized, clients are the Federal Electricity Commission and large companies, gas supplies are guaranteed and gas costs are passed through). It is the leading independent generator of electricity in Mexico. By 2005 Iberdrola aims to have 2,700MW of installed capacity in Mexico, with a total investment of €1.5 billion. The company's profit was one of the least affected by its investments in Latin America –net income rose 6.3% in 2002 to €962.6 million.

Unión Fenosa

The main market for Unión Fenosa is Mexico, where it is one of the leading private–sector electricity producers, with 1,550MW of combined cycle gas capacity (see

Exhibit 2.15 Iberdrola – Main Presence in Latin America

Country	Company	Installed Generating Capacity/Customers
Bolivia	Electropaz	0.3 million
	Elfeo	0.04 million
Brazil	Celpe	2.1 million
	Coelba	3.1 million
	Cosern	0.7 million
	Itapebi	450MW
	Termopernambuco	540MW*
Guatemala	Eegsa	0.6 million
Mexico	Monterrey	1000MW
	Enertek	120MW
	Femsa-Titán	37MW*
	La Laguna	500MW**
	Altamira	1036MW*
Chile	Ibener	124MW

(*) Under construction. (**) Awarded.
Source: Iberdrola.

Exhibit 2.16 Union Fenosa – Main Presence in Latin America

Country	Company	Installed Generating Capacity/Customers
Colombia	Electrocosta, Electricaribe	1.28 million
	EPSA	1,038MW/0.37 million
Costa Rica	La Joya	50MW
Dominican Republic	Edenorte and Edesur	0.73 million
	Palamara and La Vega	190MW
Guatemala	Deocsa and Deorsa	1.0 million
Mexico	Tuxpan	1,000MW
	Naco-Nogales	300MW
	Hermosillo	250MW
Nicaragua	Disnorte and Dissur	0.46 million
Panama	Edemet and Edechi	26MW/0.33 million
Uruguay	Conecta	0.003

Source: Unión Fenosa.

Exhibit 2.17 Gas Natural – Main Presence in Latin America

Country	Company	Customers (mn)
Argentina	Gas Natural BAN	1.2
Brazil	CEG/CEG RIO	
	Gas Natural SPS	0.6
Colombia	Gas Natural ESP	
	Gasoriente ESP	
	Gases de Barrancabermeja ESP	
	Gas Natural Cundiboyacense ESP	1.3
Mexico	Gas Natural Mexico	
	Gas Natural Metrogas	0.8

Source: Gas Natural.

Exhibit 2.16). The Hermosillo power plant (250MW) was the first one to start operating in 2001 as a result of the opening-up of electricity production to the international private sector. Two other combined-cycle plants are scheduled to start operating in 2003, Naco-Nogales (300MW) and Tuxpan (1,000MW). Unión Fenosa also owns Grupo Aeroportuario del Pacífico, which manages 12 airports along the west coast of Mexico.

Unión Fenosa was seeking to bring in partners for its Mexican generation plants as part of a plan to cut its debt and refocus on its core energy business.

Gas Natural

Gas Natural, Spain's former gas monopoly, had 3.9 million natural gas customers in 2002 in Argentina, Brazil, Colombia and Mexico (see Exhibit 2.17). The company entered Argentina in 1992, and in 1997 it teamed up with Iberdrola, Enron and Pluspetrol and won the tender for the privatization of Brazil's CEG and CEG Rio. These companies distribute piped gas to the metropolitan area of Rio de Janeiro and throughout the rest of the state and have a potential market of 14.5 million people. Gas Natural also has the concession for distributing piped gas in the southern area of the state of Sao Paulo. In Mexico, Gas Natural distributes gas in eight states.

Dragados, Ferrovial Agroman, SACYR and OHL

Prominent among other players are the construction groups Dragados, Ferrovial Agroman, FCC, SACYR and OHL. Dragados is the world leader in the infrastructure concessions field, both on its own and through Áurea, a company of which it is the core shareholder (see Exhibit 2.18).

Dragados built the Santiago air terminal in Chile, the Palmira airport that serves the city of Cali in Colombia and offshore platforms in the Gulf of Mexico. Other concessions in the construction stage or already built include a toll road in Ecuador, railroad modernization and operation in Colombia, operation of 12 airports in Mexico and a free-flow toll road in Chile. In 2002, it won the turnkey contract along with the French company Technip to enlarge the Repsol YPF refinery in La Lampilla (Peru). Áurea's concessions include the northern access road into Buenos Aires, the Teodoro Moscoso Bridge in Puerto Rico and the Bogotá-Villavicencio road in Colombia.

Ferrovial Agroman has four toll roads in Chile and it manages nine airports in Mexico and the Antofagasta airport in Chile. SACYR won the largest contract, worth around US$360 million, put out to tender in 2001 by the Chilean government to build, maintain and operate a stretch of the Southern part of the Americo Vespucio ring road in Santiago, Chile. It also operates other highway concessions in Chile. OHL is also very active in Chile, operating the Los Libertadores and Sol highways. It also has highways in Brazil (316km) and Argentina.

Empresa Nacional de Celulosa (Ence)

Ence, the leading owner of eucalyptus timberland in Europe and the world's second-largest producer of eucalyptus-based pulp, has 147,000 hectares of both company-owned and syndicated timberlands, more than 50,000 hectares of which is in Uruguay. Its subsidiary in Uruguay, Eufores, is the country's largest exporter of pulping wood. Eufores led the construction of the M'Bopicuá logistics terminal in the area of the Black river near the town of Fray Bentos which was due to start operating in 2003 and make it easier to export wood from the west and north-central parts of the country.

Exhibit 2.18 Spanish Construction and Infrastructure Companies in Latin America

Country	Company	Activity
Argentina	Áurea	Northern access road, Buenos Aires (119km), last year of concession 2020
	OHL	Eceiza-Cañuelas motorway, operation
Brazil	OHL	Motorways (316km), operation
Chile	Dragados	Norte-Sur toll road, last year of concession 2031*
	OHL	Autopista del Sol (140km), operation
	OHL	Autopista Los Libertadores (82km), operation
	Ferrovial Agroman	Temuco-Río Bueno toll road
		Santiago-Talca toll road
	Sacyr	Construction and operation of Américo Vespucio Sur motorway
		485km of motorways built or under construction
Colombia	Áurea	Bogotá-Villavicencio road (86km), last year of concession 2013
		Eldorado airport runway, last year of concession 2015
	Dragados	Fenoco, railroad modernization/operation, last year of concession 2030
		Palmira airport, last year of concession 2020
Ecuador	Dragados	DHM toll road, last year of concession 2016*
Mexico	Dragados	Operation of 12 airports, last year of concession 2050
Puerto Rico	Áurea	Teodoro Moscoso Bridge, last year of concession 2027

(*) Under construction.
Source: Company reports.

Exhibit 2.19 Mapfre – Main Presence in Latin America

Country	Subsidiary
Argentina	Mapfre Argentina
Brazil	Vera Cruz
Colombia	Mapfre S.G. Colombia
Chile	Mapfre Chile Seguros
El Salvador	La Centro Americana
Mexico	Seguros Tepeyac
Paraguay	Mapfre Paraguay
Peru	Mapfre Peru
Puerto Rico	Mapfre USA
Uruguay	Mapfre Uruguay
Venezuela	La Seguridad

Source: Mapfre.

Aguas de Barcelona (Agbar)

Agbar is the operating partner of the company responsible for managing the drinking water supply and sewer systems in Saltillo, Mexico, and at the end of 2001 it inaugurated the first wastewater treatment plant in Santiago de Chile. Aguas Andinas, whose main shareholders are Agbar and the Suez Group, engages in total water management (catchment, drinking water distribution and waste water treatment) in the basin of Santiago de Chile, serving a population of more than five million. Agbar increased its indirect shareholding in Aguas Andinas from 15.9% to 25.6% in January 2003. Agbar also has interests in Argentina (solid waste collection, street cleaning, provision of hospital services and private health care) and other countries.

Mapfre

Mapfre, Spain's leading insurance group, has 11 subsidiaries in Latin America (including Puerto Rico) through Mapfre América, its non-life insurance holding company. It ranks as one of the largest foreign non-life groups in the region with a market share of more than 4%. The region generates around 25% of Mapfre's total premium income including that from Mapfre Caución y Crédito, Mapfre Re, Mapfre Asistencia and Mapfre América Vida (see Exhibit 2.19).

Iberia

The Spanish flag carrier was the first airline in Europe to fly to South America. In 1946 it inaugurated flights between Madrid and Buenos Aires. The journey took more than 30 hours and the DC4 carried 44 passengers. Today, Iberia, part of OneWorld, the alliance of eight airlines that includes British Airways and American Airlines, has 300 weekly flights between Europe and Latin America to 22 destinations—more than any other airline. It has an overall share of the Europe-Latin America market of around 16%.

In 1991, before it was privatized, Iberia embarked on a costly venture when it bought Aerolíneas Argentinas, the Argentine flag carrier. Between 1991 and 1996 a total of Ptas216 billion (€1.3bn) was invested in the airline, in addition to the Ptas114 billion contained in the rescue plan implemented in 1999 by Sepi, Spain's state holding company. The plan, very similar to that applied to re-float Iberia in 1995, was rejected by the mechanics' union APTA. Clashes and demonstrations resulted in Sepi blocking the payment of wages and prompting the suspension of payments. The airline suspended payments in June 2001 to seek protection from creditors after Repsol YPF threatened to ground the carrier's flights because of unpaid fuel bills. Sepi put the company, which it had been saddled with after the privatization of Iberia in 2000, up for sale. Three weeks after the September 11 2001 attacks in the US, Sepi pulled off a coup when Air Comet, an Argentine charter airline owned by three Spanish businessmen, agreed to assume half of Aerolineas Argentinas' US$1.2 billion debt and inject US$50 million to re-capitalize the company. Aerolineas Argentinas made a small profit of €12 million in 2002.

Sol Meliá

Sol Meliá is the leading hotel company in Latin America and the Caribbean and the largest resort hotel company in the world. It has 74 hotels in Latin America and the Caribbean including 18 in Brazil, seven in Colombia, 22 in Cuba and 11 in Mexico. This empire began in 1956 when the 21-year-old Gabriel Escarrer Juliá began to operate and rent his first hotel on the island of Majorca. International expansion began in 1987 with the building of a hotel in the then largely unknown, but now very fashionable, destination of Bali. Three of its hotels abroad—the Gran Meliá Mexico Reforma (Mexico City), the Gran Meliá Caracas and the Meliá Playa Conchal (Guanacaste, Costa Rica)—are included in the exclusive club “The Leading Hotels of the World.”

Other Players

Other companies active in Latin America include:

- Tafisa has chipboard, melamine-coated board and medium-density fibreboard operations in Brazil.

- The stainless steel producer Acerinox has trading companies in Argentina, Brazil and Chile.

- Inditex, through its six fashion chains—ZARA, Pull & Bear, Massimo Dutti, Bershka, Oysho and Stradivarius—has 55 stores in Mexico, 20 stores in Venezuela, eight in Argentina, seven in Brazil, three in Chile and two in Uruguay.

- Aldeasa has shops in airports in Chile, Peru, Mexico, Venezuela and Colombia.

- Three auto parts and components companies—Ficosa, Grupo Antolín and Gestamp—have production facilities in Brazil, Argentina and Mexico.

- Talleres Fabio Murga is one of the world’s leading producers of steel shots and grits with a plant in Brazil.

- Roca Radiadores, the heating, bathroom fittings, air conditioning and tile group, has a subsidiary in Argentina.

- Viscofán, which produces plastic and collagen wrapping for such foods as hot dogs and sausages, has two plants in Brazil.

- Duro Felguera, an engineering and construction company for capital equipment and industrial plants, has subsidiaries in Brazil, Colombia, Mexico and Venezuela.

- Elecnor, a project and infrastructure development group, has subsidiaries in Central and South America.

- Fagor, the domestic appliances group, has a factory that makes refrigerators in Argentina.

- Three publishing companies—Planeta, Santillana and Salvat—produce books in Argentina, Brazil, Colombia, Chile and Mexico, among other countries.

- Iberpapel, the paper group, owns forests in Argentina and Uruguay.

- Prosegur, the leader in the Spanish security market, operates companies in Argentina, Bolivia, Brazil, Chile, Panama, Paraguay, Peru and Uruguay.

- Indra, the leading IT company in Spain, has companies in Argentina, Chile and Venezuela.

- Cementos Molins and Uniland have cement and concrete plants in Argentina, Mexico and Uruguay.

Chapter 3

Argentina

Argentina – Basic Data

Population:	37.9mn (2002)
Population growth:	1.2 % per year (1998-2002, average)
Land area:	2.7mn square km
Currency (peso):	Ps1/US$1 (2001, year-end); Ps3.22/US$1 (March 5, 2003)
GDP:	US$105bn (2002, market exchange rate); US$265.4 (2002, at PPP, US$ at 1996 prices)
GDP per capita:	US$2,770 (2002, market exchange rate); US$10,450 (2002, at PPP, US$ at 1997 prices)

Source: Economist Intelligence Unit.

Until the year 2000, when it was overtaken by Brazil, Argentina was the country that attracted the most Spanish direct investment, not just in Latin America but in the entire world. Between 1992 and 2001, Spain accounted for 54% of total foreign direct investment of €48.6 billion by the EU and the US (see Exhibit 3.1). During the 1990s the big Spanish companies, Iberia, Repsol, Endesa and Telefónica, and the two largest banks, Santander Central Hispano and Banco Bilbao Vizcaya Argentaria, took part in the privatisations in the air transport, energy, electricity, telecommunications and banking sectors, winning most of them. Many medium-sized companies also made investments. Repsol's purchase of the oil company YPF in 1999 for US$14.9 billion was the largest ever purchase by a foreign company in Latin America, substantially exceeding Citigroup's acquisition of Banamex, Mexico's second-largest bank, in 2001 for US$12.5 billion.

Economic and Political Background

In the early part of the 20th century, Argentina was one of the world's richest countries, thanks to the fabulous wealth of its agricultural sector. Its per capita GDP of US$3,797 in 1913 when it was one of the world's ten richest countries was US$1,500 higher than that of Spain[1]. In 2002, GDP per capita at market exchange rates was US$2,770 (US$7,116 in 2001), compared with just over US$16,000 in Spain, the result of a four-year recession (the economy contracted 11% in 2002) and a long succession of corrupt and incompetent governments. Its pace of impoverishment was the fastest of any country in the world in times of peace. Photographs in the press of stunted, emaciated children dying of malnutrition in 2002 in a country that is the world's fourth-biggest exporter of food shocked the outside world. Children pictured in the north-eastern

[1] See *The World Economy, A Millennial Perspective* by Angus Maddison (OECD Development Centre, 2001).

Tucuman province had the bloated stomachs, blotchy skin and dry hair associated with severe protein deficiency. The murder rate in Buenos Aires and its suburbs–home to nearly one-third of the country's population–nearly doubled from four to seven per day in 2002, according to police statistics.

Argentina has tried everything from the import-substitution policies of the populist demagogue Juan Domingo Perón (president from 1946 to 1955) to free-market reforms, such as open trade in the 1990s, but all efforts have ended up impoverishing the population. Argentina might have been the US or, at least, the Canada of South America, according to the historian Felipe Fernández-Armesto[2]. A great future was repeatedly predicted for the country from the mid-19th century onwards. Its repeatedly shattered hopes and frustrated expectations are reflected in tango songs and the wailing melancholy of the *bandoneón* (an accordion-like instrument), and in the popular saying, "Argentina has had, has and always will have a great future."

Argentina returned to democracy in 1983 after a long period of military rule. Between 1930, the year of its first military coup, and 1982, when the generals led the country into war with Britain after invading the Falkland Islands, the country had 24 presidents. Hyperinflation was the dominant economic feature of the 1980s, with the country staggering from one stabilization programme to another. The devaluation was so large in 1985 that the value of the country's currency evaporated and it was necessary to create a new monetary unit, the austral. Inflation peaked at 4,924% in 1989. The peso replaced the austral, and was pegged from April 1, 1991 to January 6, 2002 at one-to-one to the US dollar under a currency board, a system which Argentines called

[2] See *The Americas, a Hemispheric History* by Felipe Fernández-Armesto (Phoenix Press, 2003).

"convertibility." Inflation plummeted to below 10% in the 1990s and the abandonment of statist ideology during the 1989–99 presidency of Carlos Menem in favour of market economics and liberalization resulted in a period of rapid growth (an average of 6.1% from 1991-97, the highest in Latin America, after an average of -0.4% in 1979-89).

It was during the 1990s that Spanish companies made most of their investments. More than 200 companies and service concessions were privatised, including YPF, the giant oil monopoly, bought by Repsol, Aerolíneas Argentinas, the flag carrier, acquired by Iberia, and ENTEL, the largest telephone company, bought by Telefónica. As for the banks, Banco Bilbao Vizcaya Argentaria (BBVA) bought Banco Francés and Santander Central Hispano (SCH) acquired Banco Río de la Plata (see Exhibit 3.2).

But the currency board established was not an orthodox one, although it was accepted by the International Monetary Fund (IMF)[3]. An orthodox currency board has no leeway to sterilize foreign currency inflows or offset outflows and cannot engage in discretionary monetary policies. This was not the case in Argentina. In addition to an active monetary policy, the central bank engaged in a wide range of other activities–including the lending of last resort liquidity operations and the regulation of commercial banks' reserves–that are prohibited under currency board orthodoxy.

The economy went into recession in 1999 as a result of inconsistent economic policies emanating from a corporatist political system that gives much power to such corrupt social agents as the trade unions and of the cumulative impact of four external shocks: the prices of

[3] The failings of the currency board are taken from *Argentina: Caveat Lector*, a paper presented by Steve H. Hanke at the Cato Institute's Monetary Conference on October 17, 2002.

***Exhibit 3.1* EU and US Direct Investment in Argentina, 1992-2001 (cumulative inflows in € mn)**

EU-15	**Spain**	France	Netherlands	UK	Germany	Portugal	Italy	Other EU	US	Total
39,485	**26,281**	5,002	615	1,626	2,116	29	1,308	2,508	9,124	48,609

Source: Economic Commission for Latin America and the Caribbean, Eurostat and the Bureau of Economic Analysis for US data.

***Exhibit 3.2* Main Spanish Companies in Argentina**

Spanish Company	Sector	Subsidiary
Repsol	Oil and gas	YPF
Santander Central Hispano	Banking	Banco Río de la Plata
Banco Bilbao Vizcaya Argentaria	Banking	BBVA Francés
Telefónica	Telecommunications	Telefónica de Argentina (TASA)
		TCP Argentina
Endesa	Electricity	Dock Sud
		Yacylec
		Costanera
		CBA
		El Chocón
		Edesur
Gas Natural	Gas	Gas Natural Ban
Mapfre	Insurance	Mapfre Argentina
Aguas de Barcelona	Water	Aguas Argentinas
		Aguas Cordobesas
		Aguas de Santa Fe

Source: Company reports.

Argentina’s commodities exports stopped rising; the cost of capital for emerging economies began to rise; the dollar appreciated against other currencies; and Brazil, Argentina’s main trading partner, devalued. The currency board made it difficult to respond to these shocks. Had most of Argentina’s trade been with the US, pegging the peso to the dollar might have made sense. However, much of Argentina’s trade was with Europe and Brazil. A strong (many would say, overvalued) dollar meant an overvalued peso as it was pegged to the greenback[4], and when the euro was falling it was harder for Argentina to export to Europe.

The fiscal position deteriorated, exacerbated by the privatisation of the social security system in the 1990s, a move encouraged by the IMF. With that reform, money that had been “inside the budget” moved “outside”. International markets and investors became particularly nervous in June 2001 when the government tinkered with the currency board: it introduced a floating exchange rate for foreign trade by establishing a system of subsidies for exporters and tariffs for importers. But by raising the idea of devaluation, it spooked foreign investors. Joseph Stiglitz, the former chief economist of the World Bank and one of the 2001 Nobel Prize winners for economics, summed up the vicious circle created by the fixed exchange rate in the following way: “As it became clear that a devaluation was inevitable, lenders in pesos insisted on even higher interest rates to compensate them for the exchange rate risk. The higher interest rates not only heightened the risk of devaluation, but contributed to a new risk of default, which in turn led to even higher interest rates to compensate for that risk.”[5]

When foreign investors stopped buying Argentine bonds, local pension funds were strong-armed in August 2001 into buying government paper and banks into swapping

[4] See *Argentina, Shortchanged* by Joseph Stiglitz (Washingtom Post, May 12, 2002).
[5] Ibid.

their holdings of government paper for low-interest loans. The IMF was also persuaded to lend US$8 billion, on top of the US$14 billion committed earlier. These actions triggered a run on the banks: between July and November Argentines withdrew US$15 billion. Coupled with the burden of a ballooning foreign debt from US$83.7 billion in 1994 to US$150.3 billion in 2001 (five times annual exports), the government of President Fernando de la Rúa imposed tight restrictions on the public's access to dollars and to bank deposits in December.

Outside the US, Argentines hold more dollar bills per person than anyone else in the world. Across Argentina the greenback is king. Its hourly rate appears on television screens along with the temperature and the traffic report. The restrictions sparked riots and looting, which left 29 people dead and forced the president to resign. The crisis claimed five presidents in two weeks until a government of "national salvation" was formed in January 2002, headed by Eduardo Duhalde, the losing Peronist presidential candidate in 1999. Such was public anger at the discredited political class that it was not unusual for lawmakers to be insulted or spat on in public. In fact, Jorge Capitanich, a former Cabinet chief and senator, called for all congressional and presidential candidates to take mental and physical exams.

Shortly before Duhalde took over, the government sent shockwaves through the world's financial system by defaulting on US$95 billion of its US$115 billion commercial debt, the largest sovereign debt default in history. Duhalde abandoned the convertibility system on January 6, 2002 and "pesofied" the economy and bank balance sheets asymmetrically. Dollar deposits were seized from banks and converted into pesos at the rate of 1.4 pesos per dollar while bank loans made in dollars were converted into pesos at one peso per dollar in a populist move to reduce consumers' personal debt service cost, but which hurt the banks more. Unable to withdraw deposits for a year, Argentines nevertheless saw their savings wiped out as the peso depreciated by 58% against the euro in 2002. According to Steve H. Hanke, professor of applied economics at Johns Hopkins University, Argentina's currency has depreciated against the dollar by a factor of more than 11 trillion since the country's central bank was established in 1935.

Economic Policy

According to former IMF Chief Economist Michael Mussa, the failure to run a sustainable fiscal policy (a long-standing problem of Argentina) was the most important policy mistake, as it led to sovereign default and undermined both Argentina's Convertibility Plan (exchange rate peg to the dollar) and its banking system[6]. This failure was clearly avoidable, especially when Argentina's economy was performing well. From 1993 to 1998, when Argentine GDP advanced 26% and the government enjoyed substantial fiscal benefits from privatisation and the Brady bond restructuring, the ratio of government debt to GDP nevertheless rose from 29 to 41%, demonstrating an addiction to fiscal laxity that would prove fatal in the far less advantageous circumstances that prevailed after 1998. When times were good, however, the IMF failed to press Argentina to run a sustainable fiscal policy and thus it bears heavy responsibility for the critical failure in this vital area.

Dr Mussa maintains that the Convertibility Plan probably would have survived had it not been undermined by fiscal imprudence. The requirements for a credible new Argentine economic programme, he says, are: reasonable economic assumptions, fiscal discipline that recognizes both Argentina's dire situation and the limits on available financing, a monetary

[6] See *Argentina and the Fund: From Triumph to Tragedy* by Michael Mussa (Institute for International Economics, July 2002).

policy that avoids hyperinflation, responsible efforts to resurrect the banking system, and fair treatment of external creditors and other claimants on defaulted contracts.

No progress, however, was made on striking a serious deal with the IMF. The best that could be achieved after a year of stalled negotiations was a controversial decision by the IMF in January 2003 to roll over US$6.8 billion in debts, driven through by the dominant Group of Seven industrialized countries over the heads of the fund's protesting management. Five directors representing countries on the 24-person IMF board abstained in the vote. Just before the decision Argentina agreed to pay US$799 million it owed to the Inter-American Development Bank and US$796 million in accumulated arrears to the World Bank, the sister institution of the IMF. This enabled the IMF to resume its support. Non-payment of these loans had put Argentina in the same company as Iraq, Zimbabwe and Liberia, which have also defaulted to multilateral lenders.

Argentina's game of brinkmanship and blackmail paid off: to paraphrase Rudi Dornbusch, the late Massachusetts Institute of Technology economist, the Argentines dialed 1-800-BAIL OUT and the G7 made the IMF take the call.[7] The agreement gave Argentina US$3 billion in loans to allow it to repay past borrowing coming due to the IMF between January and August 2003. It also extended by one year existing loans of around US$3.8 billion due before August. Argentina owes around US$13 billion to the IMF.

The deal, however, dented the IMF's credibility and sent signals to other problematic countries that intransigence pays off. Horst Köhler, the director general of the IMF, warned his political masters of the "exceptional risks" they were taking. The G7's interventionism

---

[7] See *"Argentine 'Blackmail' Tests the IMF's Credibility"* by Alan Beattie (Financial Times, January 20, 2003).

made a mockery of the US administration's self-proclaimed hands-off approach in such matters. Spain, not a G7 member, also pressed the IMF to show leniency as it feared that any deterioration in the fragile situation, after a year of stalling negotiations between the IMF and Argentina, would put its major investments in Argentina at risk.

The philosophy behind the roll-over was that it provided some breathing space until after the April 2003 presidential elections, when it was hoped that a programme to restore fiscal and external viability would be achieved with the new government.

A first step in returning to normalcy was taken shortly before the IMF deal with the lifting, one year after it was implemented, of the *corralito*, consisting of curbs on cash withdrawals from current and savings accounts in pesos, although the ban remained on time deposits of more than 10,000 pesos (€2,800). The move unlocked 21 billion pesos in deposits. That sum was worth US$21 billion when the freeze was imposed, and the peso was pegged at one US dollar. After the peso was floated in early 2002 and plummeted against the US dollar, the deposits dropped to less than US$6 billion. In a severe blow to the cash-strapped government in March 2003, Argentina's Supreme Court overruled a decree that forcibly converted billions of dollars in savings into pesos (known as the *corralón*). The ruling only affected US$247 million of deposits, but it could open the door to litigation and force the government to repay all depositors who lost money as a result of the conversion.

The trade surplus almost tripled in 2002 to US$16.4 billion. The surge in the surplus, however, was due to a 56% fall in imports–made much more expensive by the devaluation–and not to growth in exports (which declined 5%). Exports were held back by the lack of financing as a result of the debt default, which cut off foreign credit, and Argentina's banking crisis, which drastically reduced the banks' role as creditors. The

Exhibit 3.3 **Main Economic Data for Argentina, 2000–03F**

	2000	2001	2002E	2003F
GDP (%)	-0.8	-4.4	-11.3	4.1
Consumer prices (%, year-end)	-0.7	-1.5	41.0	23.0
Current account (% of GDP)	-3.1	-1.6	9.2	10.9
Reserves (US$ bn, year-end)	31.4	14.9	9.6	12.0
Exchange rate (year-end vs US$)	1.0	1.0	3.6	3.30
Fiscal balance (% of GDP)*	-2.5	-3.3	-1.4	-1.1
30-day BAIBOR interest rate (year-end)	10.7	6.3	27.9	25.0
Real effective exchange rate (1997=100)	116	119	51	60
BBVA-MAP Raw Materials Index Argentina (June 1995=100)	87	85	104	100

(*) Central government balance. Excluding privatization receipts.
E = Estimate; F= Forecast.
Source: Research Department of Banco Bilbao Vizcaya Argentaria, March 2003.

devaluation, which cut travel costs enormously, also gave the country's tourism industry its first surplus in ten years (US$570 million against a deficit of US$1.4 billion in 2001). There was also better news on the inflation front: the consumer-price index rose 0.2% in December, the lowest monthly rise during 2002, but inflation still increased 41% for the whole year (see Exhibit 3.3). Although there were signs of stabilization in the economy–industrial output is expected to rise by 3%-9% in 2003, after a fall of over 10% in 2002, and the peso began to appreciate–these have not yet translated into any real recovery. Even by the government's own reckoning, the number of people living below the poverty line rose to 57.5% of the population in October 2002, up from 53.0% in May.

Any lasting solution to the Argentine economy needs to address four political issues: (1) the distribution of power between the provinces and the central government; (2) the deregulation of the labour market; (3) eroding the power of Mafia-like unions; and (4) the modernization of political parties, particularly the Peronists. "What is really lamentable is that society as a whole refuses to accept any responsibility for what has happened," says Carlos Malamud, a leading analyst on Latin America.[8] Until it does, there is no chance Argentina will stop being a roller-coaster economy.

Geography and Resources

The country is the third-largest in Latin America after Brazil and Mexico. It extends from the snow-capped Andes in the west to the Atlantic Ocean in the east and shares borders in the north with Bolivia, in the northeast with Paraguay, to the east with Brazil and Uruguay, and to the west with Chile.

[8] See *"Certezas e incertidumbres de la crisis argentina"* by Carlos Malamud (El País, December 20, 2002).

Around 70% of the population, 80% of agricultural production and 85% of industrial activity is in the pampas zone, which covers parts of the provinces of Buenos Aires, Santa Fe, Córdoba, and La Pampa. This temperate region produces wheat, corn, soya (world's third-largest producer), grapes (world's fifth-largest wine producer), and alfalfa, among many other crops, as well as large cattle herds for beef and dairy production. There are many more cattle and sheep than people; beef and lamb are major exports.

With around 3.1 billion barrels of proven oil reserves, Argentina is a significant player in Latin American oil markets. It is the fourth-largest producer after Venezuela, Mexico and Brazil. Exploration and production activity in Argentina are completely open to the private sector, and Repsol YPF is the dominant producer. Government pressure to reduce its position resulted in several asset swaps with other major Latin American oil companies, including Brazil's Petrobras, Chile's ENAP, and Argentina's (historically privately owned) Pérez Companc. Although Argentina is regarded as having reached its full production potential, in 2001 the Neuquén provincial government launched a licensing round for 19 blocks in the Neuquén basin. Repsol YPF won several blocks.

Argentina has the third-largest proven reserves of natural gas in Latin America (after Venezuela and Mexico), at over 26 trillion cubic feet (Tcf), and probable reserves are much higher. Argentina overtook Venezuela to become the region's second-largest natural gas producer in 1999 (Mexico is the largest producer).

Communications and Energy

The transport system is well developed but unevenly distributed. Four branches of the Pan-American Highway run from Buenos Aires to the borders of Bolivia, Brazil, Chile, and Paraguay. About a quarter of the roads are paved. Áurea, a subsidiary of Dragados, and OHL has been active in building and operating motorways in Argentina.

The country is self-sufficient in oil. There are also substantial natural gas deposits and coal is mined in the Río Turbio area. Installed electricity generating capacity has been increasing with the development of dams. The Pacyreta dam on the Paraná River on the border between Argentina and Paraguay is one of the largest hydroelectric projects in the world. The number of wind farms is also on the rise, and they are forecast to generate around 10% of local demand by 2010. There are agreements with Chile, Argentina and Brazil for integrating their respective energy grids, creating a common market in electricity between the countries. Nuclear capacity has also been developed (around 10% of the domestic electricity generated comes from three nuclear energy plants).

The telephone duopoly, controlled since 1991 by the incumbent companies Telefónica de Argentina (TASA), the subsidiary of Telefónica, and Telecom de Argentina (owned by France Telecom and Telecom Italy) ended in 2000, opening Latin America's third-largest telecommunications market to new players. However, the economic crisis produced a shrinking of the market: operators were disconnecting clients unable to pay their bills at the rate of 3,600 a day during 2002. TASA registered losses in 2002 of US$1.08 billion. This was the result of the devaluation of the peso against the dollar and the freezing of prices for public services following the passing of emergency legislation. The devaluation of the peso generated losses of US$774 million for the group. These results did not include other activities such as Internet, data transmission and telephone directory businesses. TASA moved its corporate headquarters in 2003 from the upscale Puerto Madero district to a cheaper location in the San Telmo neighborhood, as part of an effort to reduce costs. The company paid US$42/square metre in 1996 when it first moved into its building in Puerto Madero. In contrast, Telefonica is now paying US$4.50/square metre. Despite the contraction of the market, TCP Argentina, owned by Telefónica, was still the country's second-largest cellular operator in 2002, with an estimated market share of 25%.

Banking

The freeze on deposit withdrawals for a year from December 2, 2001, known as the *corralito*, and the asymmetric "pesofication" of bank balance sheets put the banking system under considerable stress. During the 1990s, prior to these measures, the banking system was robust and able to withstand the country's recession without major incident. The system was well capitalized and could have withstood significant losses in the value of its assets, but it could not survive a set of interventions that destroyed the franchise value of the banks (such as the *corralito*) and expropriated its capital (such as "pesofication", which converted bank dollar loans into pesos at the rate of one to one, the same rate as that applied under the old convertibility regime, while deposits were converted at the rate of 1.40 pesos per US dollar)[9]. By the end of 2002, there were 3.6 pesos to the dollar. The windfall loss from these measures exceeded the capital of the consolidated banking system[10].

The public sector commercial banks, where political influence in the allocation of credit weakened their ability to retain the respect of depositors in bad times, were also to blame. These banks were the ones with the worst asset quality and the poorest indicators

[9] See "Resolving Argentina's Financial Crisis" by the Latin American Shadow Financial Regulatory Committee (The Banker, June 2002).
[10] See *Argentina: Caveat Lector* by Steve H. Hanke (paper presented on October 17, 2002).

of operational efficiency. They suffered heavily when flight to quality became rampant. The banking system's problems as a whole included tight liquidity, negative cash flows (due to the fact that the banks' large cross-border indebtedness was no longer matched with dollar collections on the banks' asset side), deteriorating loan portfolios and rising corporate insolvency. The decline in bank deposits and reserves, together with the increased risk, virtually dried up lending activity, one of the mainstays of banking.

Some foreign shareholders (Canada's Scotiabank and France's Crédit Agricole) walked away from their small local subsidiaries. The Spanish banks were in a much more complex position because of the larger size of their operations. Banco Río de la Plata, owned by Santander Central Hispano, and BBVA Francés, owned by Banco Bilbao Vizcaya Argentaria, between them had more than 15% of total deposits in 2002. Their continued presence in the country depended on whether a viable and profitable financial system would eventually be restored.

The non-performing loans (NPLs) of Banco Bilbao Vizcaya in Argentina rose from 4.04% of total lending in 2001 to 37.44% in 2002. Santander Central Hispano did not make public its NPLs figure. Many of the banks' assets were in bonds in 2002 on which the government had defaulted. The government has to restructure its debt before banks can clean up their balance sheets. Argentina's crisis dragged down the earnings of both banks in 2002: BBVA's net attributable income fell 27.3% to €1,717 million and Santander Central Hispano's dropped 9.6% to €2,247 million. The Argentine factors that hit earnings included further extraordinary provisions. Both banks have taken a very prudent approach towards Argentina, writing off all their investments in the country and recording the contribution to consolidated earnings as zero.

Chapter 4

Brazil and Chile

Brazil

Brazil is the largest recipient of Spanish direct investment in Latin America and in the world as a whole. Between 1992 and 2001 Spain accounted for 26% of total EU and US direct investment in Brazil of €99.9 billion (see Exhibit 4.1). Telefónica has close to 13 million fixed-line subscribers and is the dominant player in mobile phones, Santander Banespa, owned by Santander Central Hispano (SCH), is the third-largest private-sector banking group, the electricity companies Endesa and Iberdrola have between them more than 9 million customers, and Gas Natural has 600,000 customers (see Exhibit 4.2).

The country overtook Argentina as the main recipient of investment as of 2000, largely due to Telefónica acquiring all of the capital of its subsidiaries and SCH's purchase of Banespa.

Economic and Political Background

Brazil is the world's fourth-largest democracy. The military returned to their barracks in 1985 and a new constitution was ratified in 1988, the seventh since independence from Portugal in 1822. Luiz Inácio Lula da Silva (universally known as Lula), the leader of the Workers' Party (PT), the largest left-wing party in Latin America, won a momentous victory in the October 2002 presidential election. This was his fourth shot at the presidency. Lula, one of 22 children of an illiterate farm worker, rose from shoe-shine boy to mechanic to leader of the Sao Paulo car workers' union. He organized strikes in the late 1970s that undermined Brazil's military dictatorship. He won 53 million votes (61%), against 33 million (39%) for José Serra, his centrist opponent.

Brazil – Basic Data

Population:	175mn (2002)
Population growth:	1% per year (1998-2002, average)
Land area:	8.51mn square km
Currency (real):	R2.32/ US$1 (2001, year-end); R3.56/ US$1 (March 5, 2003)
GDP:	US$437bn (2002, at market exchange rate); US$1,248bn (2002, at PPP, US$ at 1996 prices)
GDP per capita:	US$2,481 (2002, at market exchange rate); US$7,610 (2002, at PPP, US$ at 1997 prices)

Source: Economist Intelligence Unit.

Exhibit 4.1 **EU and US Direct Investment in Brazil, 1992-2001 (cumulative inflows in € mn)**

EU-15	**Spain**	France	Netherlands	UK	Germany	Portugal	Italy	Other EU	US	Total
67,380	**26,292**	9,995	9,067	4,757	3,625	9,543	2,808	1,293	32,561	99,941

Source: Economic Commission for Latin America and the Caribbean, Eurostat and the Bureau of Economic Analysis for US data.

Exhibit 4.2 **Main Spanish Companies in Brazil**

Spanish Company	Sector	Subsidiary
Telefónica	Telecommunications	Brasilcel
		Telesp
Santander Central Hispano	Banking	Banespa
		Banco Santander Brasil
		Banco Santander Meridional
Endesa	Electricity	Cerj
		Coelce
		Cachoeira Dourada
		CIEN
Iberdrola	Electricity	Celpe
		Coelba
		Cosern
		Itapebi
		Termopernambuco
Gas Natural	Gas	CEG/CEG RIO
Repsol YPF	Oil and gas	Various
Tafisa	Wood	Pien
Mapfre	Insurance	Vera Cruz
Sol Meliá	Hotels	18 hotels

Source: Company reports.

Although the PT only won 92 of the 513 seats in Congress, the governing alliance has a total of 228 seats. Lula's victory should be seen not so much as a dramatic move to socialism in Brazil, but as a backlash against the inability of the policies of economic orthodoxy, known as the "Washington Consensus", to produce sustained economic growth and restore the degree of social mobility that existed in Brazil during the boom period of the 1960s and 1970s. Real per capita GDP in Brazil in 2002 was only slightly above its 1982 level, because of sluggish growth in the economy and a population rising by 2 million a year. Lula's triumph, at the very least, ushered in a new and more complex era in relations between Brazil and the US, the hemipshere's two biggest countries.

Services generate 60% of GDP, industry 32% and agriculture 8%. The industrial sector, created during the 1960s and 1970s under a policy of import-substitution industrialisation (ISI), is the most developed in Latin America. The ISI model, however, made the economy inward-looking and inefficient and began to lose steam in the late 1970s, but it was not until 1990 that rapid trade liberalization began, following a large devaluation of the real. However, Brazil remains the most protectionist country in Latin America.

The principal exports are coffee (world's largest exporter), sugar cane (world's largest exporter), soyabeans (second-largest after the US), orange juice (Brazil supplies around 85% of the world market for orange juice concentrates), tobacco, cocoa, cattle (around 10% of total world trade), iron and steel products, and transportation equipment. Agricultural products account for around one-third of total exports. The share of exports in GDP, however, is still small (14% in 2002). One reason for this is severe under-investment, particularly in infrastructure, which has resulted in high costs and inefficiencies in transport and communications. The leading markets are the US, Argentina, and Germany. Brazil is a member of the Mercosur free trade group with Argentina, Paraguay and Uruguay.

The economy began to be opened up in the 1990s, particularly during the presidency of Fernando Henrique Cardoso (1995-2002), when the government moved away from the development policies of previous administrations. These policies covered not only state entities but also wage, price and credit policies, and subsidy and fiscal incentive programmes. The government retains an important economic role, but it has been gradually reducing its presence in the economy and concentrating on public health, safety and education. Brazil's income distribution is one of the most skewed in the world (the wealthiest 10% of the population has 48% of the income and the poorest 10% has 0.7%, according to the 2002 World Development Indicators of the World Bank, based on the situation in 1998). However, there have been some substantial improvements in certain poverty indicators: infant mortality, for example, was reduced from 40 per 1,000 live births in 1993 to less than 30 in 2000 and, for the first time in history, almost all Brazilian children are going to school (the proportion of children aged seven to 14 in school rose from 86% in 1992 to 96% in 2000).

The engine of economic growth is, increasingly, the private sector. In the electricity sector, state entities began to be privatised in 1995. In the oil and gas sector, the last government discussed the privatisation of Petrobras, the state-owned oil giant. It lost its monopoly rights in oil exploration, refining, extraction and distribution in 1998, when the National Petroleum Agency announced that over 90% of Brazil's oil basins were to be sold. Full privatisation of Petrobras, however, requires a constitutional amendment. Petrobras and Vale do Rio Doce, the world's largest iron ore miner, made it into the FT Global 500 in 2002, based on market capitalization.

The state's monopoly in telecommunications was ended in 1995; the Telebras telephone monopoly was split up and sold in 1998 in the largest privatisation so far. In the transportation sector, the government privatised all seven railway companies in 1997-98 and has either privatised or turned over to the states most of the federal highway network.

Economic Policy

Until the early 1990s and the advent of trade liberalisation and the "Real Plan", Brazil was one of the West's most closed and inflation-ridden economies. The plan brought inflation down from a peak of 2,500% in 1993 to negative 1.8% in 1998 and 6.0% in 2000, when the central bank incorporated inflation-targeting to its monetary policy. The economy averaged real annual GDP growth of 2.2% in 1997-2000 and slowed down in 2001 (1.5%) and 2002 (an estimated 1.5%). In January 1999 massive capital flight led the Central Bank to switch from a fixed to a floating rate currency regime and the real plummeted. The International Monetary Fund (IMF) and G7 nations came to the rescue with a three-year fiscal stabilisation plan and US$41.5 billion in assistance. The fiscal deficit reached 10% of GDP in 1999, dropped to 3.5% in 2000 under the impact of reforms and a return to higher growth by the resilient economy, and rose to 10.4% in 2002 because of a hefty debt service bill (see Exhibit 4.3).

In August 2002, a US$30 billion aid package from the IMF was intended to calm markets nervous at the prospect of a left–wing triumph. However, the real fell further and by the end of October, when Lula had won the second round, it had lost 40% of its value since the beginning of 2002, and the yield spread over US Treasuries offered by Brazilian bonds–the most widely accepted measure of country risk–was above 20 percentage points, a rating that implied a high likelihood that it would follow Argentina and default on its domestic debt. But there are some notable differences between Brazil and Argentina. While Argentina had a tough fixed currency peg,

Exhibit 4.3 **Main Economic Data for Brazil, 2000–03F**

	2000	2001	2002E	2003F
GDP (%)	4.4	1.5	1.5	1.9
Consumer prices (%, year-end)	6.0	7.7	12.5	10.9
Current account (% of GDP)	-4.2	-4.6	-1.7	-1.2
Reserves (US$ bn, year-end)	33.0	35.8	37.8	46.0
Exchange rate (year-end vs US$)	1.96	2.31	3.55	3.25
Fiscal balance (% of GDP)	-4.5	-5.3	-10.4	-5.6
SELIC interest rate (year-end)	15.8	19.0	25.0	21.5
Real effective exchange rate (1997=100)	62	58	49	57
BBVA-Raw Materials Index Brazil (June 1995=100)	84	77	80	90

E = Estimate; F = Forecast.
Source: Research Department of Banco Bilbao Vizcaya Argentaria, March 2003.

Brazil's currency has been floating since January 1999. Argentina broke its agreements with the IMF, but Brazil has complied with commitments and reinforced fiscal discipline. Brazil posted a consolidated primary budget surplus of 4.06% of GDP in 2002, higher than the 3.88% mandated in the IMF deal. The surplus, which excludes interest payments, was the best result since 1994. Other important differences with Argentina are that Brazil has a more independent central bank and a better functioning political system.

Lula began well in January 2003 when his government took office. He appointed market-friendly officials to the key positions of finance minister and head of the central bank, pledged to overhaul the ailing public pension system, which has long been a drain on government finances, and to grant the central bank operational autonomy from the finance ministry. The previous government tried to reform the pension system and failed to do so, partly because of opposition from Lula's party. The central bank raised its basic interest rate to combat the threat of inflation–a policy that the PT was calling disastrous almost until Lula took office. The Bovespa stock market index, which fell 46% in dollar terms in 2002, surged in January 2003, and the real, which depreciated 35% against the dollar in 2002, strengthened. Risk premiums on Brazil's sovereign bonds over US Treasuries nearly halved between October 2002 and January 2003 to around 12 points.

Brazilian companies began to return to international capital markets, raising more than US$1 billion in January 2003, and banks raised more than US$900 million with international bond issues. These deals marked a departure from the credit crunch in 2002 that dramatically increased financial costs and put several Brazilian companies on the verge of bankruptcy. The uncertainty over Lula's economic policy direction produced a cutback in even short-term lines of commercial credit, forcing companies to amortize their foreign debt and buy dollars.

At the same time, Lula set the more socially-aware tone of economic policy by postponing a US$750 million defence programme by a year to finance emergency hunger eradication projects. The “swords for ploughshares” decision underscored the government’s pledge to begin social welfare programmes to help overcome Brazil’s income inequalities. Lula also launched a Zero Hunger programme, intended to give 46 million people help of various kinds, including €15 a month for an average family to spend on food. Reconciling in the eternal “country of the future” (as it calls itself ironically) the much-needed “social revolution” with even more conservative policies so far than the previous centrist government is a Herculean balancing act, and one which could come unstuck (see Chapter 9).

Geography and Resources

Brazil occupies nearly half of South America and touches all the other countries on the continent except Ecuador and Chile. It is a country of great rivers, such as the Amazon and the Paraná (a great tributary of the Río de la Plata). The Iguaçu Falls are one of the country’s most famous natural wonders. In such a vast territory the differences in climate and vegetation are considerable. The Amazon basin, which covers some 40% of the territory, has the world’s largest tropical rainforest. Over the past 30 years or so, more than 15% of the Brazilian part of Amazonia has been deforested, an environmental disaster (about a third of the Amazon rainforest is over the border in other countries). Trees have been felled to clear pasture for cattle raising, encouraged by subsidies and tax incentives. A law passed in 1998 introduced stiff penalties for cutting trees without permission from Ibana, Brazil's environmental protection agency, but it has made little difference to the rate of deforestation, the highest in the world.

The country is rich in natural resources. In addition to an abundance of agricultural products, Brazil's timber reserves are estimated to be the third-largest in the world, in particular pine and eucalyptus, which mainly supply local pulp and paper industries, while hardwoods are felled for exports. Minerals include iron ore, bauxite, manganese, coal, zinc, lead, copper, gold and tin. Brazil is the world leader in the production of tantalite (used in alloys for strength and higher melting points, in glass to increase the index of refraction, and in surgical steel, as it is non-reactive and non-irritating to body tissues). The country's dominant position in coffee is gradually dwindling as other producers, notably Vietnam, are making incursions into Brazil's world market share (41% in 1955 and 21% in 2000).

Brazil is virtually self-sufficient in oil (third-largest producer in Latin America after Mexico and Venezuela). Offshore fields account for over 80% of known reserves. Petrobras aims to double production to around two million barrels a day by 2005. All price controls and import restrictions on gasoline and diesel fuel were removed in January 2002 in the final step towards full liberalisation of the petrol market. This enabled private oil companies, which distributed fuel purchased at government-set wholesale prices, to import and trade at free-market prices.

Communications and Energy

Transport has always been one of Brazil's big problems. Except in the south and the far north, mountains make access from the coast to the interior difficult. As a result, roads were built rather than railways, which run mostly in the coastal districts. But only 160,000km of the 1.5 million of roads are paved. Of these, more than 75% are in "precarious" condition. Some 65% of Brazil's freight is carried by lorry; similar to small countries such as Belgium but more than twice the level of the US, Russia and China. OHL operates a 316km stretch of motorway. For the more remote regions, air travel is vital, particularly in the Amazonian forest. The country's rivers provide 43,000km of waterways, along most of which there is a regular goods and passenger service of river craft. Most imports reach Brazil by sea and pass through the inefficiently run ports, where bureaucracy can be a serious impediment. The main port is Santos, Latin America's largest.

The telecommunications sector is the second-largest in the developing world after China. Before the state telecoms firm was privatised in 1998, telephone lines were so scarce that people would pay thousands of dollars for them.[1] Teledensity is still low at less than 15 fixed lines per 100 inhabitants. This gives Telefónica, which has a strong position (particularly in the state of Sao Paulo, the powerhouse of the economy), tremendous scope for expansion. In October 2002, Telefónica and Portugal Telecom (PT) formed Brasilcel, a joint venture mobile telephony company, the leader in Brazil with around 13 million subscribers. This company operates in areas which generate more than 70% of Brazil's GDP, and where it commands more than a 60% market share. Brasilcel agreed in January 2003 to acquire the mobile phone operator Tele Centro Oeste for just over US$1 billion, raising their market share to more than 50%. The total number of mobile phone customers increased to 16.8 million, more than three times those of the next biggest carrier in Brazil, Telecom Italia Mobile. The deal filled in nearly all the gaps

[1] See *Can Lula Finish the Job?* in the Economist (October 5, 2002).

in coverage, leaving only one state in the north, Minas Gerais, where Brasilcel must depend on a roaming agreement with a local carrier.

Telefónica's fixed-line operator Telesp (12.8 million lines in 2002 compared with 5.9 million in 1998) began operating national long-distance service from Sao Paulo in 2002, complementing its international long-distance service. In both services, Telesp has the second-largest market share behind Embratel (26.4% in international long distance and 24.8% in national interstate long distance in September 2002). In Sao Paulo itself, Telesp is the leader in interstate long distance with a market share of around 80%.

The precarious state of the electricity system was exposed in 2001 when the government, faced with an energy shortage, imposed emergency rationing measures to cut consumption by 20% and avoid regular blackouts. An exceptional drought drained the country's hydroelectric dams, which supply virtually all electricity. The dams fell to as little as 4% of capacity. Another factor was the failure to expand the transmission grid, limiting the capacity to export electricity from dams in the south (not stricken by drought) to the industrial and power-consumer areas. It is estimated that Brazil's generating capacity of 80 million kW must grow by at least 5% a year to keep pace with demand. At a projected cost of US$1,000 per kW, this calls for annual investment of US$4 billion, leaving aside additional spending on long-distance transmission and local distribution. Endesa and Iberdrola are well placed to participate in the expansion of the power network provided the Lula government clears up the uncertainty over how the market will work and establishes clear rules. The 24 distributors and generators between them made a net loss of US$1.5 billion in the third quarter of 2002. Almost all have debts in dollars and have been squeezed by the sharp fall in Brazil's currency. Investment was at a standstill during 2002.

Banking

Foreign banks have invested heavily in the country and own more than 25% of total banking assets. By far, the largest acquisition was Santander Central Hispano's US$3.7 billion purchase in 2000 of Banespa which, together with an earlier purchase of Banco Meridional, made Santander Banespa the third-largest private-sector banking group with a market share in deposits of 4.5%. Banco Bilbao Vizcaya Argentaria had a much smaller bank, with a paltry market share in deposits of 1.4%, which it sold in January 2003 to Bradesco, the largest private-sector bank. The sale represented a halt to BBVA's "flag-planting conquest of Latin America".[2] The deal was worth €757 million between a cash payment and a 4.5% stake in Bradesco. At a multiple of 1.2 times book value, BBVA got a good price for a subsidiary with a return on equity of about 8%–far below most rivals–and a seat on the board. If the Brazilian economy improves under Lula, BBVA might decide to increase its stake.

While Argentina is a headache for SCH, Brazil has so far not presented too many problems. SCH was heavily criticized in November 2000 when it paid five times book value for a 30% (since increased to 98%) stake in Banespa, a sickly Sao Paulo state bank[3]. Its bid was four times the minimum asking price and three times that of the nearest competing bid. Since then, the value of the investment in dollar terms has been hard hit by the depreciation of the Brazilian currency–from R$1.2 per dollar at the time of the purchase to R$3.3 per dollar at the end of 2002. The return on investment in US dollar terms was an estimated 10.5% in 2002.

[2] See the *Lex* column (Financial Times, January 13, 2003).
[3] See "Freed from the Kiss of Death" by Brian Caplen in The Banker (March 2002).

Santander Banespa's main presence is in the south/southeast of the country, where almost 60% of the population lives and which generates 76% of Brazil's GDP. Brazil generated net attributable income of €801.8 million in 2002, 20.5% more than in 2001 (partly due to the increased stake) in euro terms and a rise of 41.6% excluding the exchange-rate impact. A major factor behind the improvement at Banespa has been the very large reduction in the number of employees, from 22,000 to less than 15,000 without a head-on battle with Banespa's famously belligerent unions. The cost/income (efficiency) ratio for Brazil as a whole improved from 49% in 2001 to 42% in 2002, and the recurrence ratio (fees and commissions/personnel and general expenses) from 51.9% to 63.1%. ROE was 45.3% and the non-performing loans (NPLs) ratio was 2.9%, down from 4.3% in 2001, and NPL coverage rose from 175% to 189.2%.

Moody's however, downgraded to A1 from Aa3 the long-term ratings and to B- from B the financial strength rating of SCH in December 2002, largely because of the Brazilian situation. Banespa is by far SCH's largest investment in Latin America and represents a significant share of SCH's core capital. Moody's said that the Brazilian market, as a whole, was "largely vulnerable to a sharp negative change in investor sentiment that could aggravate further the existing financial risks faced by the government and consequently increase the structural risk attached to SCH's presence in the country." It added that even without the harshness of an extreme Argentina-like scenario, SCH's economic capitalization could be impacted by a material impairment of its Brazilian investment.

The structure of the Brazilian financial system has changed significantly since the mid-1990s. Among the most positive features is the Central Bank of Brazil's gradual strengthening of the system, including improvements in the regulatory framework, supervision and transparency. In 2002 the Bank imposed stricter rules on financial institutions for reporting securities held as proprietary assets or as managed fiduciary funds. These are mainly federal government bonds, many with maturities running to 2006. Mark-to-market reporting is the rule. This means that all funds now use similar rules for reporting on asset values, making performance statistics more comparable.[4]

Issues that require attention involve the large presence of public-sector banks, mandatory allocation of lending, low level of financial intermediation and the effectiveness of the legal framework. Asset quality is also a key analytical aspect to be followed closely. Although there has not yet been a sharp rise in non-performing loans (NPLs), in the current context of economic and financial pressures, NPL ratios are likely to deteriorate. Moreover, Brazilian banks have significant concentrations of government securities on their balance sheets, and if the economy deteriorates further the banks would suffer the consequences in terms of asset quality and solvency.

The country, surprisingly, is on the cutting edge in the development of secure e-commerce technology and has created one of the most advanced home-banking systems in the world. The use of Internet in banking is higher than in Asia.

---

[4] This brief analysis draws on *Latin Banking Guide & Directory 2002* (LatinFinance and Citibank supplement, August 2002).

Chile – Basic Data

Population:	15.5mn (2002)
Population growth:	1.2% per year (1998-2002, average)
Land area:	756,626 square km
Currency (peso):	Ps656//US$1 (2001,year-end); Ps756.27/US$1 (March 5, 2003)
GDP:	US$62.5bn (2002, at market exchange rate); US$142.1bn (2002, at PPP, US$ at 1996 prices)
GDP per capita:	US$4,150 (2002, at market exchange rate); US$10,310 (2002, at PPP, US$ at 1997 prices)

Source: Economist Intelligence Unit.

Chile

Spanish direct investment in Chile (almost 40% of total EU and US direct investment of €19.8 billion between 1992 and 2001, see Exhibit 4.4) is higher than one would expect for an economy of its size (4% of the region's total GDP). The country's solid record of sustained growth, its high level of competitiveness (according to some indicators, ahead of Spain's) and its political stability have made Chile an important centre for some of the main Spanish investors in Latin America. Endesa controls Chile's Enersis, the holding company for its Latin American electricity interests, Santander Central Hispano is the dominant player in the banking market and Telefónica has both fixed-line and mobile telephone customers (see Exhibit 4.5).

Economic and Political Background

The 1973 coup by General Augusto Pinochet, which overthrew the leftist government of Salvador Allende, brought to an end 150 years of practically uninterrupted civilian and democratically elected governments. Democracy returned in 1989 following a referendum and elections, although the military still enjoy a privileged position. Defence, including military pensions, represents around 16% of total public expenditure, a very high figure. The Pinochet regime replaced the largely state-run economy with a free-market system, pioneering many of the reforms that later galvanised Latin America, notably privatisation, export-led growth, debt-equity swaps and private pension funds. Chile is an associate member of Mercosur, the free-trade bloc comprising Argentina, Brazil, Paraguay and Uruguay. It was the first country in Latin America that benefited from the "fast-track" trade negotiating authority granted to President Bush in August 2002. This procedure allows the White

***Exhibit 4.4* EU and US Direct Investment in Chile, 1992-2001 (cumulative inflows in € mn)**

EU-15	**Spain**	France	Netherlands	UK	Germany	Portugal	Italy	Other EU	US	Total
10,678	**7,816**	555	1,492	349	418	11	47	-10	9,166	19,844

Source: Economic Commission for Latin America and the Caribbean, Eurostat and the Bureau of Economic Analysis for Economic Data.

***Exhibit 4.5* Main Spanish Companies in Chile**

Spanish Company	Sector	Subsidiary
Santander Central Hispano	Banking	Banco Santander Chile
Banco Bilbao Vizcaya Argentaria	Banking	Banco BHIF
Endesa	Electricity	Enersis
		Endesa Chile
		Chilectra
		Rio Maipo
Aguas de Barcelona	Water treatment	Aguas Andinas
Mapfre	Insurance	Mapfre Chile Seguros
Telefónica	Telecommunications	Telefónica CTC
		Telefónica Móviles
Repsol YPF	Oil and gas	Marketing, LPG, gas & power
Iberdrola	Electricity	Ibener

Source: Company reports.

House to strike trade deals which Congress will then either vote for or against, but may not amend.

Chile has been the star economy of Latin America. Economic growth averaged 6.5% per year in the 1990s, and even during the sharp global slowdown in 2001 and 2002 the economy posted growth of 2%, well above the regional average (see Exhibit 4.4). Extreme poverty today, according to the World Bank, only affected 4% of the population, while poverty in general had been cut by half over the last ten years, falling to 21% (or 17%, depending on how one measures the poverty line). Services generate 60% of GDP, agriculture 8% and industry 32%.

Chile's success story is due to a remarkable political transition from a military dictatorship to a center-left coalition that has maintained the basic thrust of economic policies, albeit with an increasing social element; a well-educated and honest administration (Chile is ranked better than Spain in the corruption index drawn up every year by Transparency International, see Exhibit 1.7) and very good marketing of its economic reforms at a time when the country was a unique example of sound economic practices in Latin America.

The International Institute for Management Development (IMD) ranked Chile the 20th most competitive economy in the world in 2002, ahead of France (22nd), Spain (23rd) and Italy (32nd). Chile also leads Latin America in the UN Human Development Index. Mining, forestry and fresh fruit are the biggest export industries. Copper has long been the biggest single export. In the 1980s Chile emerged from almost nowhere to become the southern hemisphere's leading fruit exporter. The main export markets are the US, Japan and the UK.

Exhibit 4.6 **Main Economic Data for Chile, 2000–03F**

	2000	2001	2002E	2003F
GDP (%)	4.4	2.8	2.0	2.8
Consumer prices (%, year-end)	4.5	2.6	2.8	2.8
Current account (% of GDP)	-1.5	-1.9	-0.7	-0.7
Reserves (US$ bn, year-end)	14.7	14.2	15.4	15.7
Exchange rate (year-end vs US$)	573	661	710	700
Fiscal balance (% of GDP)*	0.1	-0.3	-0.8	-0.9
Official interest rate (year-end)	5.0	6.5*	3.0	2.8
Real effective exchange rate (1997=100)	89	80	80	79
BBVA-MAP Raw Materials Index Chile (June 1995=100)	68	62	60	71

(*) Central government.
E =Estimate; F= Forecast.
Source: Research Department of Banco Bilbao Vizcaya Argentaria, March 2003.

The 1973-90 military-led government reduced the state's share of GDP from 39% to 16%. Over the next decade the state's share remained virtually unchanged.

Economic Policy

Liberalisation and continuity in economic policy have made Chile the best-performing Latin American economy and the one that has best withstood contagion from crises in neighbouring countries (see Exhibit 4.6). The economy, however, is still too dependent on copper (close to 40% of exports) and the swings in its price. To counter this, the government has operated a counter-cyclical fiscal policy since 1989. Whenever the copper price is above a certain level, the government puts part of the earnings of the state-owned Codelco into a stabilisation fund, which it draws on when the price is low. Inflation has been single-digit since 1994. Fiscal surpluses were generated during most of the 1990s. Tax revenue is quite strong by Latin American standards at 18% of GDP. Sound finances earned the country an investment-grade credit rating. Income distribution, however, has hardly improved. The top 10% of the country's earners received 40.7% of the income in 2000 while the poorest 10% received only 2%.

A significant factor behind the relatively healthy public finances has been the creation of private pension fund administrators (AFPs) to supplant the state social security system, and the promotion of private health insurance to supplement public health care (ISAPREs). Banco Bilbao Vizcaya Argentaria is the leader in the pension fund business, with a market share of 32% in 2002.

As an export-oriented economy, Chile has a strong external sector. The trade account was in surplus in 1973-2002, apart from three years when the deficits were largely due to changes in the international prices of Chile's main export commodities (copper, fishing, forestry and fresh produce).

Slower economic growth has made the government of Ricardo Lagos rein in spending and commit itself to a structural surplus budget policy. This means restricting expenditure to a level that would give a budget surplus of 1% of GDP if output were growing at its full potential (estimated at 4%) and the price of copper was running at its estimated average for the next ten years. It has also floated the exchange rate and opened up the capital markets. Despite being an open economy, Chile had capital controls and a confusing exchange rate policy with multiple taxes on capital inflows during the 1990s. These were introduced to discourage short-term speculative investment and were credited with having insulated Chile from the international financial contagion suffered by Latin America on repeated occasions. The last remaining controls on cross-border capital flows were lifted in 2001, as they were anachronistic in a globalized business environment and a disincentive to foreign investment.

The government launched the biggest sovereign bond deal in Chile's history (raising US$1 billion) in January 2003 as part of its ongoing efforts to enhance its international financial reputation and distinguish itself from its troubled neighbours. Chile is one of the few Latin American countries whose credit quality has remained stable; the pricing of the bond was tighter than expected at 163 basis points over US Treasuries. Proceeds from the debt issue will be used to repay existing debt and cover a fiscal deficit that the government expects to be 0.7% of GDP in 2003. This will be the third consecutive budget shortfall, in marked contrast to the 1990s when budget surpluses were the norm in Chile.

Chile is having to adjust to a new world in which it now has to compete more fiercely for foreign investment with other Latin American countries (Mexico and Brazil) and where its dependence on mining and primary goods may become an obstacle to a return to higher growth rates.

Geography and Resources

Chile curves snake-like down 4,300km of coastline between the Pacific and the Andes. The country is 362km wide at its broadest point and 97km at the narrowest. It is so narrow that at some points it is possible to see the snow-capped peaks of the Andes in the east and the Pacific in the west—at the same time. Chile borders on Peru to the north, the South Pole to the south, Bolivia and Argentina to the east, and the Pacific to the west. It is the only country in the world whose borders are dictated solely by nature (the Antarctic, the Pacific, the Atacama desert and the Andes).

Agriculture employs about 12% of the workforce. The main export crops are maize, beans, asparagus, onions and garlic. Table grapes, wine, citrus fruits, avocados, pears, nectarines and nuts are also strong exports. The mining sector, led by Codelco, the world's largest copper producer and the mainstay of the economy, generates close to 10% of GDP. Chile has around 20% of the world's copper reserves. There is also mining of silver, gold (the El Indio mine is one of the highest grade mines in the world), iron ore, lithium, manganese and mercury.

Communications and Energy

SACYR won the largest contract (worth around US$360 million) put out to tender in 2001 by the Chilean government, to build, maintain and operate a stretch of the southern part of the Americo Vespucio ring road in Santiago, the capital. OHL is also very active in Chile, operating two motorways, while Ferrovial Agroman operates four.

Probably out of gratitude to lorry drivers, whose strike in 1973 crippled the Chilean economy and helped the military to power, the “leftist” railways were starved of money and became run-down during the dictatorship. This situation began to change in 2001 under an investment programme by the state-run EFE to develop and improve passenger-train suburban services into Santiago from towns on the line south. EFE is responsible for the southern system, the most populous area, and Ferronor runs the network covering the mining areas between Iquique in the northern First Region to La Calera in the Fifth Region. Almost all (95%) of Chile’s foreign trade is handled by ports. About 80% goes through the four main ports—Antofagasta in the mining north, Valparaiso and San Antonio in the central part of Chile and San Vicente in the south.

Chile produces around 40% of domestic energy consumption. Hydropower is the main source, with dams supplying more than 60% of power to the main central Chile grid. The largest project under way and scheduled to be inaugurated in 2004 is the 570MW Ralco project, owned by Enersis, Endesa’s power sector holding company and Chile’s leading generator. Enersis was seeking a buyer in 2003 for its 172MW Canutillar hydro plant subsidiary. Canutillar was one of a number of assets that Endesa wanted to sell as part of a plan to generate income to shore up its balance sheet. Imported natural gas is the single fastest-growing energy source. With the completion of pipelines from Argentina and, in the future, Bolivia’s highlands, its share of energy is expected to eventually reach 28%. Coal reserves are located in the centre and southern central regions and in the far south. Reserves of crude oil are minimal, although there are offshore fields at the Straits of Magellan and onshore at Tierra del Fuego.

The telecommunications industry was transformed during the 1990s by privatisation and deregulation. The number of fixed telephone lines is around 33 per 100 inhabitants (24.5 in 2000), the highest teledensity in Latin America, and about 15 out of every 100 Chileans have a mobile phone. Telefónica had 2.7 million fixed-line customers in 2002, through Telefónica CTC Chile, and 1.7 million mobile telephone customers. CTC's market share in domestic long distance was 39% in 2002 and 32.2% in international long distance.

Banking

The largest private-sector commercial bank is Banco Santander Chile, owned by Santander Central Hispano, with a market share of 23% in deposits in 2002, 11% in pension funds and 21% in mutual funds. Banco Bilbao Vizcaya Argentaria's Banco BHIF has 7% of the deposits market, 32% of pension funds and 7% of mutual funds.

The banking sector is a far cry from 1982, when the financial system almost collapsed because of loose intra-group lending practices and the country's economic problems that led to a sharp devaluation. Solvency ratios are in line with international requirements and credit risk indices and non-performing loan rates are low by Latin American standards. Chilean banks are the most insulated from the economic and political problems affecting much of Latin America. Additionally, they benefit from the country's financial environment, which is less risky and more transparent than those of other countries[5]. The largest banks–Banco Santander Chile and Banco de Chile–have consolidated their market position through mergers, leaving them in control of around half the market.

[5] Ibid.

Banco Santander Chile generated net attributable income of €229 million in 2002, 20.6% lower than in 2001 because of the sale of insurance companies, the expiry of tax credits and exceptional charges relating to the bank's merger with Banco Santiago. The efficiency ratio improved to 41.6% from 44.9% in 2001 and ROE stood at 19.4%.

The financial system is indexed to inflation through a unit of account called the UF. As a result, Chilean banks have the lowest degree of dollar-denominated deposits in Latin America, accounting for only 10% of their total deposits in 2002 compared with 60%-75% in countries such as Argentina, Uruguay and Paraguay. The low percentage of dollar-denominated deposits in the Chilean system shows that the public has confidence in the government's economic policies and in the local economy. The Chilean banks are benefiting from low levels of dollar-deposits in terms of balance sheet risk management, as they can fund their peso-denominated loans with peso deposits. Banks in Latin American countries with a high degree of dollar deposits have to fund local-currency loans with dollar deposits, which increases their exposure to currency swings.

Chapter 5

Mexico

Mexico – Basic Data

Population:	101.8mn (2002)
Population growth:	1.6% per year (1998-2002,a average)
Land area:	1.9mn square km
Currency (peso):	Ps9.14/ US$1 (2001, year-end); Ps11.20/ US$1 (March 5, 2002)
GDP:	US$632.1bn (2002, at market exchange rate); US$872.2bn (2002, at PPP, US$ at 1996 prices)
GDP per capita:	US$6,207 (2002, at market exchange rate); US$9,096 (2002, at PPP, US$ at 1997 prices)

Source: Economist Intelligence Unit.

Mexico

Mexico has less Spanish direct investment than one would expect for an economy of its size, accounting for 13.7% of total EU and US direct investment of €67 billion in the country between 1992 and 2001 (see Exhibit 5.1). This is largely due to the country's membership of the North American Free Trade Agreement (NAFTA) as of 1994, which initially made Mexico particularly attractive for direct investment by US and Canadian companies and for relocation of companies. Navistar International, for example, said it would close its heavy truck assembly plant in Canada in 2003 and transfer the work to Mexico, leaving 2,200 people without work. Spanish investment is concentrated in the banking, telecommunications and electricity sectors and can be expected to grow as the Mexican economy becomes more stable and integrated into the US economic cycle and NAFTA opens up windows of opportunity (see Chapter 9). Banco Bilbao Vizcaya Argentaria controls BBVA Bancomer, the largest financial group in Mexico, Santander Central Hispano is the majority shareholder of Grupo Financiero Santander Serfin, the third-largest financial group, Telefónica has more than 1.2 million mobile phone customers, and Iberdrola and Unión Fenosa operate in the electricity sector (see Exhibit 5.2).

Economic and Political Background

The 1910 revolution overthrew the dictatorship of General Porfirio Díaz, who had seized power in 1876. It was followed by a long period of strife and disorder until the creation, in 1929, of the Institutional Revolutionary Party (PRI), which united the warring factions and removed the military from politics. The PRI, the world's longest-ruling political party, kept control through regular—and generally rigged—elections, by not allowing presidents to stand for more than one six-year term and by buying the

Exhibit 5.1 **EU and US Direct Investment in Mexico, 1992-2001 (cumulative inflows in € mn)**

EU-15	**Spain**	France	Netherlands	UK	Germany	Portugal	Italy	Other EU	US	Total
20,682	**9,197**	1,628	2,579	3,666	1,751	32	144	1,684	46,389	67,070

Source: Economic Commission for Latin America and the Caribbean, Eurostat and the Bureau of Economic Analysis for US data.

Exhibit 5.2 **Main Spanish Companies in Mexico**

Spanish Company	Sector	Subsidiary
Banco Bilbao Vizcaya Argentaria	Banking	BBVA Bancomer
Santander Central Hispano	Banking	Santander Serfin
Telefónica	Telecommunications	Telefónica Móviles México
Iberdrola	Electricity	Monterrey
		Enertek
		Femsa-Titán
		Altamira
		La Laguna
Unión Fenosa	Electricity	Tuxpan
		Naco-Nogales
		Hermosillo
Gas Natural	Gas	Gas Natural Mexico
Aguas de Barcelona	Water	Aguas de Saltillo
Mapfre	Insurance	Seguros Tepeyac
Sol Meliá	Hotels	11 hotels
Inditex	Clothing	14 franchises

Source: Company reports.

loyalty of different social groups. It became known as the "perfect dictatorship" until it was defeated by the centre-right National Action Party (PAN) of Vicente Fox, a former Coca-Cola executive, in the historic July 2000 presidential election. The PRI, however, remains the largest party in Congress.

In 1994 Mexico, the largest Latin American economy, became the first developing country to join the Organisation for Economic Co-operation and Development (OECD); that year it also formed part of NAFTA. The very same day that NAFTA came into force, the pipe-smoking, Balaclava-wearing, self-styled "Insurgent Sub-Commander" Marcos led an uprising by Indian Zapatista rebels in the impoverished, indigenous southern state of Chiapas. Nothing better epitomised the modern and ancient worlds that Mexico straddles. The Zapatistas' struggle has not completely died down, and more than 40 million Mexicans are still poverty-stricken today.

NAFTA has incorporated Mexico into the world economy in a similar way to Spain's membership of the European Union. It has increasingly tied the Mexican and US economies together. Some analysts take the view that Mexico should no longer be considered part of Latin America – not in the geographic sense, but economically.[1] There are five main reasons for regarding Mexico as a case apart:

- The high degree of openness and competitiveness of the Mexican economy (its combined exports and imports represent 50% of GDP, up from 30% before it joined NAFTA). The country's share of world exports rose from 1.6% in 1995 to

[1] See the presentation *America Latina, Todo Pasa y Todo Queda* by Miguel Sebastián at the Forum of Latin American Investments (November 5, 2002, Casa de America, Madrid, (http://ws3.grupobbva.com/BBVA/dat/me/tlwwmiguelsebasTodo.pdf).

2.6% in 2001. Over the same period, Latin America (excluding Mexico) lost global market share.

- Its diversified export base (oil exports' share in total exports of goods has dropped from 70% in 1985 to 8% today). No other emerging country has achieved such an impressive reduction in its reliance on exports of raw materials. Not even Chile's export structure is focused so much on manufactured goods.

- Its external debt measured against GDP has plummeted from around 80% in 1986 to around 25%, thanks to the combination of moderate current account deficits, massive inflows of foreign direct investment and sustained economic growth.

- The six-year electoral and economic cycles have decoupled. Between 1976 and 2000 the changeover of presidents every six years was always accompanied by exchange-rate volatility. This ended in 2000 when the PRI lost power after more than 70 years to Vicente Fox of the PAN.

- Mexico is rated low risk by rating agencies (see Exhibit 5.3).

Already about 90% of Mexico's trade, nearly 90% of its foreign tourism, more than 75% of foreign investment and over 95% of the remittances of Mexican workers living overseas come from the US. An estimated 10-12 million legal and illegal Mexican immigrants live in the US. Neither the US economic slowdown nor the terrorist attacks of September 11, 2001 have reduced the flow of immigrants to the US; it is estimated that more than a million people arrived from Mexico between 2000 and 2002. The ties between the two countries are now so strong that it has produced

Exhibit 5.3 **Foreign Currency Long-Term Issuer Credit Ratings of Latin American Countries**

Country	Rating	Level of Risk
Chile	A-	Low
Mexico	BBB-	Low
Colombia	BB	Medium
Peru	BB-	Medium
Bolivia	B	High
Brazil	B+	High
Uruguay	CCC	Very high
Venezuela	CCC+	Very high
Ecuador	CCC+	Very high
Argentina	SD	Very high
Paraguay	SD	Very high

Source: Standard & Poor's, March 2003.

attempts at a high political level to change Mexico's well-known nationalistic demagoguery. Jorge G. Castañeda, the former foreign minister, said the clash between Mexico's pro-American sentiment and anti-American rhetoric was creating a "brutal national schizophrenia".[2] "On the one hand, the immense majority of the country's population has a direct, personal, immediate interest in having a good relationship with the United States, and at the same time it is being asked to be anti-American", he said. There is still a yawning gap between Mexico's reality, and the old-guard anti-American rhetoric of the opposition PRI.

Mexico is the world's eighth-largest producer of cars and fifth-largest maker of trucks. NAFTA has also spurred foreign direct investment in Mexico: it rose from US$4.6 billion annually in the five years before NAFTA to US$11.8 billion annually in 1996-2000. It peaked at US$24.7 billion in 2001 owing to Citibank's US$12.5 billion acquisition of Banamex, the country's second-largest bank. The foreign investment flow could increase to an estimated US$25 billion a year if the energy industry is liberalized. Another advantage of NAFTA is that it has allowed Mexico to grow at higher rates than before 1995 without suffering balance-of-payments crises, as had been its experience from the 1970s through 1994[4]. The country had the largest number of firms (six) of any Latin American country in the 2002 FT Global 500 league, measured by market capitalization (see Exhibit 5.4). This was the same number as Spain. The Spanish-owned BBVA Bancomer was in sixth place among the largest companies in Mexico.

[2] See *Drop Anti-American Stance, Mexico's Foreign Minister Says* by Andrés Oppenheimer (Miami Herald, November 21, 2002).
[4] See *Mexico: NAFTA and the Prospects for North American Integration* by Dr Rogelio Ramírez De la O (C.D.Howe Institute, November 2002).

Exhibit 5.4 **Mexico's Six Largest Companies in the Global FT500 Ranking**

Company	Global FT 500 Rank	Sector	Market Value (US$ mn)[1]
Teléfonos de México	136	Telecommunications	32,421
América Móvil	278	Telecommunications	16,040
Wal Mart de México	295	General retailers	14,897
Telecom Carso Global	466	Telecommunications	9,837
Cemex	470	Construction & building materials	9,801
BBVA Bancomer	476	Banking	9,723

(1) Market capitalisation at March 28, 2002.
Source: Financial Times.

Free-market reforms, however, have done little to close the huge divide between the privileged few and the poor. Some 10% of Mexicans at the top of the pyramid control close to 40% of the nation's wealth, and 40 million people are poverty-stricken.

Services generate two-thirds of GDP, industry close to 30% and agriculture the rest. Manufacturing comprises base metals, construction materials, paper and paper products, textiles and apparel, food processing, cars, household appliances and machinery. The principal exports are oil and oil products, cars and a wide range of agricultural and manufactured goods. One of the drivers of the manufacturing-based economy are *maquiladoras*, the assembly plants concentrated on the border with the US that make goods from imported materials for re-export. A free-trade deal with the European Union similar in coverage to NAFTA came into force in July 2000.

The state, traditionally heavily involved in the economy, has gradually loosened its control since the re-privatization of the banks and the privatization of Telmex, the telephone company, in the 1990s. Pemex, the hugely overstaffed state oil company, and the Federal Electricity Commission (CFE) remain off limits for political reasons.

Economic Policy

Mexico triggered the external debt crisis in developing countries when it defaulted in 1982, shaking the world financial system and plunging the country into a profound economic crisis. Two decades later, orthodox economic policies and stabilization programmes had achieved a degree of macroeconomic stability not seen since the 1960s as well as more manageable external debt ratios (see Exhibit 5.5 and the Appendix). "Mexico's vulnerability appears to have declined markedly," said Alan Greenspan, US

***Exhibit 5.5* Main Economic Data for Mexico, 2000-03F**

	2000	2001	2002E	2003F
GDP (%)	6.6	-0.3	0.9	2.0
Consumer prices (%, year-end)	9.0	4.4	5.7	3.9
Current account (% of GDP)	-3.1	-2.9	-2.2	-2.4
Reserves (US$ bn, year-end)	33.6	40.9	46.3	52.0
Exchange rate (year-end vs US$)	9.57	9.14	10.31	11.08
Fiscal balance (% of GDP)*	-1.1	-0.7	-1.3	-0.5
28-d Cetes interest rate (year-end)	17.6	6.8	7.0	7.3
Real effective exchange rate (1997=100)	114	120	115	108
BBVA-Raw Materials Index Mexico (June 1995=100)	137	131	132	116

E= Estimate; F = Forecast.
Source: Research Department of Banco Bilbao Vizcaya Argentaria, March 2003.

Federal Reserve Chairman.[5] "This country now seems to be viewed by international investors as a relative safe haven within the region." The country enjoys investment-grade status. Moody's Investor Services rated Mexico's sovereign debt Baa2—its second-lowest investment grade—in January 2003, and Standard & Poor's gave it a BBB-minus. This status makes a group of major Mexican corporates accessible for a large pool of US institutional investors who are constrained from investing below investment grade.

The main structural reforms Mexico needs to undertake in order to complete the transition from a highly regulated economy to a market economy include the restructuring of both the labour market and key industries, such as financial institutions, energy and telecommunications, and improving the fiscal structure, which is still heavily dependent on oil revenues from the state-owned Pemex[6]. The diverse nature of these reforms and the complex political arrangements they require suggest that change in Mexico, and therefore its greater integration with the rest of North America, will be gradual and incremental, not sudden or dramatic. These reforms would improve conditions for greater North American integration because they would create new opportunities for business, which typically benefits from international integration and synergies across national borders.

The economy dipped into recession in 2001 when it felt the pinch from the US recession, just as it had previously benefited from America's ten-year boom, and returned to growth in 2002. The central pillar of President Fox's 2000-06 economic agenda, and the key issue for enhancing Mexico's capacity to meet its growing social needs, was to have been a sweeping tax reform, but the government's proposals were watered down in

[5] Address given in Mexico City, November 12, 2002.
[6] See *Mexico: NAFTA and the Prospects for North American Integration* by Dr Rogelio Ramírez De la O (C.D.Howe Institute, November 2002).

2001 under pressure from opposition parties who control the Congress. At 11%, Mexico's tax revenue as a proportion of GDP is behind even India's (20% in the US and 18% in Brazil). Tax evasion is widespread.

The government sought convergence of the Mexican rate of inflation with that of the US in 2003. It was aiming for a budget deficit of 0.5% of GDP in 2003, tightening the already conservative fiscal policy. Underlining its improved economic fundamentals, although inflation increased in 2002 to 5.7%, the government issued US$2 billion of sovereign debt at record–low spreads in January 2003. The spread of 246 basis points over comparable US Treasury notes beat the previous record of 270 bp.

Geography and Resources

Mexico borders the US states of California, Arizona, New Mexico and Texas to the north, and Guatemala and Belize to the south. The Rio Grande forms a large part of the northern border. On the west is the Pacific Ocean and on the east the Gulf of Mexico and the Caribbean. Most of Mexico consists of a broad central plateau, which is highest in the south and rises to between 910 and 2,440 metres above sea-level. The highest mountain, Citlaltepetl, near the east coast, is a snow-capped cone 5,700 metres high. It and most of the other great peaks, such as Popocatepetl and Ixtacihuatl, were once volcanoes. Volcanic activity still occurs. As in most volcanic countries, earthquakes are quite common in Mexico, especially near the Pacific coast. The last big one was in 1985; it left thousands dead, injured and homeless in Mexico City.

Agriculture contributes less than 5% of GDP, but it employs about one in five working Mexicans. This is a massive imbalance and one of the factors behind the still high poverty rates. Farming is small-scale. About half of the total arable land is held by *ejidos*, rural communities farming on small individual/collective lots. The only large commercial farms are in the export-oriented regions of the north-west and some coffee estates in the south. The main crops are maize, sorghum, wheat, rice, barley, potatoes, soybeans and dry beans. The principal export crops are coffee, cotton, fresh fruit, tobacco and tomatoes. Under NAFTA, tariffs on almost all agricultural imports from the US ended on January 1, 2003. This opened the floodgates to massive imports of food, particularly of poultry, swine and cereals, and will have a major impact on poor subsistence farmers and mid-sized farmers, intensifying the pressure to seek work legally or illegally in the US. Food imports from the US doubled from US$3.6 billion a year before NAFTA took effect to US$7.4 billion in 2001, but there was also a similar rise in food exports to the US to nearly US$5.3 billion, mostly products made by large Mexican and transnational food processing companies. Among the most notable winners are companies like Maseca, which has become the world's largest producer of cornmeal and tortillas, and Sigma, which imports cheap pork parts and poultry pastes from the US to make sandwich meats.

Mexico has considerable mining potential, but it is estimated that less than 15% of areas have been explored. The sector currently only contributes around 1% of GDP. The country is the world's largest producer of silver and there are also big deposits of uranium and gold. Other minerals include celestine and sodium sulphate, mercury, antimony, cadmium, zinc, lead, copper, manganese, graphite, feldspar and barite.

Over half (55%) of the population of around 100 million is mestizo, 29% Indian and 16% white. The rate of population growth has declined significantly, but it still adds more than 1 million people to the country every year. Mexico's 10–12 million immigrants in the US sent home an estimated US$10.5 billion in 2002, the country's third-largest source of income after oil and tourism. The 37 million Hispanics in the US comprised 13% of the total US population in 2001, up from 9% in 1990, 7% in 1981 and 4% in 1970 (when the census used the term Hispanic for the first time). Mexico accounted for more than a quarter of all the foreign-born residents in the US, according to the March 2000 Current Population Survey. That share is the largest any country has held since the 1890 census, when about 30% of the US's foreign-born population was from Germany.

Communications and Energy

The government's efforts have gone into the building of roads, particularly encouraging the private sector to build toll roads. Other parts of the transport system are also being improved: in October 2002 the Spanish group Construcciones y Auxiliar de Ferrocarriles (CAF) won the US$478 million tender, together with Canada's Bombardier, to built 45 trains with nine carriages each for Mexico City's underground. The first trains are scheduled for delivery in 2004.

The telecommunications sector, following the privatisation of Telmex and the loss of its monopoly, grew four times faster than the economy between 1990 and 1999. Many new service concessions have been granted for local and long-distance wired and wireless services. The number of mobile lines (13 million) overtook fixed phone lines (12.3 million) in 2000. Teledensity is still very low, although the number of fixed lines almost doubled between 1990 and 2000 to 12.5 per 100 inhabitants. The backbone network was almost 100% digitalised by 2000. As in Brazil, Telefónica's scope for expansion is huge. In May 2002 Telefónica Móviles acquired 65% of Pegaso and became the second-largest mobile company in Mexico, with more than 2 million managed customers, displacing Grupo Iusacell, acquired in 2001 by Vodafone and Verizon, but a long way behind the leader Telcel (19.4 million customers). The integration of Pegaso enables Telefónica Móviles to extend its presence to the whole of Mexico and to gain access to Mexico City, the country's most attractive market with a population of around 20 million and an estimated wireless active penetration rate of 17% in September 2002. Mexico's stability and potential for growth make the country one of Telefónica's strategic priorities in Latin America.

Mexico has the second-largest proven crude oil reserves in the Western Hemisphere after Venezuela, at 26.9 billion barrels, and it is the world's fifth-largest oil producer (including crude, lease condensate, natural gas liquids and refinery gain), behind the United States, Saudi Arabia, Russia and Iran. The country is becoming an increasingly important exporter of oil to the US and is vying to become its single largest supplier. Mexico has sometimes moved ahead of Saudi Arabia in supplying oil to the US but has remained behind Canada. Pemex aimed to increase production to 3.5 million barrels per day in 2003, close to its capacity. Both Pemex and the International Energy Agency, a coalition of 24 oil-producing countries, forecast that Mexico's ability to produce oil will peak by 2010 and then decline. Proven, probable and possible reserves of hydrocarbons have dropped from 65 billion barrels in 1990 to less than 44 billion barrels, and only half of that can be readily extracted. Mexico's natural gas supply is already 100 million cubic feet per day short because of declining production and inadequate pipelines to move imports. The shortage threatened to hurt electricity and petrochemical plants, both of which depend on gas for operations.

Foreign investors, including Spanish companies, are very interested in gaining a foothold in Mexico's huge reserves, which have been closed to foreign companies since the oil industry was nationalised in 1938. Article 27 of the Mexican constitution dictates that all hydrocarbons remain the property of the nation and that no private investors be given franchises or concessions or engage through risk contracts in exploration. Pemex wants to reverse the decline in natural gas production by offering US$8 billion in development contracts to private companies. This has sparked protests by opposition congressional members who say the plan violates Mexico's constitution. President Fox, however, lacks the two-thirds majority in Congress to change the law.

The energy ministry puts the price tag to upgrade oil refining capacity to meet domestic demand at US$19 billion. Although Pemex has modernized its operating plants and improved the quality of its fuels, it is still necessary to import refined products for domestic consumption. Pemex has not built a new refinery since the late 1970s. Additional financing beyond the above-mentioned US$19 billion will be needed to improve pipelines and other infrastructure. Pemex is severely strapped for cash. Nearly every peso of its profits goes to the government, and in 2001, after paying US$28.8 billion in taxes (almost 40% of all government revenue) on sales of US$46.5 billion and royalties, it lost US$3.5 billion. The company, which provides around one-third of total government revenues, warned in January 2003 that it faced collapse at some point in the not-too-distant future unless there was major restructuring or tens of billions of dollars in foreign investment[7].

The company loses at least US$1 billion a year to corruption, according to executives. Pemex’s last director, Rogelio Montemayor, and its union boss, Carlos Romero Deschamps, each stand accused of stealing tens of millions of dollars from Pemex for the PRI’s 2000 presidential campaign against Fox. Pemex’s chief in the early 1980s, Jorge Díaz Serrano, served five years in prison for embezzling US$34 million and its long-time union

[7] See *“Mexico’s Corrupt Oil Lifeline”* by Tim Weiner (New York Times, January 21, 2003).

boss, Joaquín Hernández Galicia, was released from prison in 1999 after serving seven years for amassing enough weapons to run a private army.

Oil and gas account for some 90% of primary energy requirements, with the rest coming from hydroelectricity and geothermal power. Energy demand—particularly for electricity, which is growing at 6% per annum—is rising faster than total GDP, making it necessary to undertake large investments in the future. Excess power capacity has fallen to dangerous levels (in 2002 less than 2% of the energy used in 2001, when it ought to be closer to 6% to absorb power surges). Power cuts have been on the rise. Forty per cent of the generating facilities are more than 30 years old and need to be replaced. Pemex said it would launch the first round of multiple service contracts for private sector participation in the natural gas sector in 2003.

The Fox government wants to open up the nationalized electricity industry to much more competition, but the reforms are bogged down by partisan politics. Energy reforms also ranked at the top of the agenda of President Ernesto Zedillo (1994-2000), but he failed to get his package through a Congress controlled by his own PRI. The industry is almost entirely in state hands apart from the 5,000MW of capacity (out of the country's total capacity of more than 40,000MW) built by private generators since 1992, when a partial liberalization took place. The reforms required constitutional changes. The assets of the Federal Electricity Commission (CFE) and the Light & Power Company (LyFC) would remain in government hands, but in an open market system where an independent regulatory body is given control of the national grid and private investors are freely permitted to generate and sell power to big industrial consumers. Sale to residential users would remain the domain of state companies. Iberdrola and Unión Fenosa have a significant presence; Iberdrola was awarded the contract in

August 2002 to build, operate and maintain the 500MW La Laguna II combined cycle power plant in the state of Durango.

Banking

The banking system was re-privatized in the early 1990s, after being nationalized in 1982. The banking crisis of 1994-95, caused by the turmoil of peso devaluation and lax lending regulations, led to a government bail-out that cost an estimated US$100 billion (20% of GDP). Today, more than 80% of the banking system's assets are owned by a handful of European and US financial institutions: Banamex, the largest bank, is owned by Citigroup, BBVA Bancomer by Banco Bilbao Vizcaya Argentaria (BBVA), Santander Serfin, the third-largest, by Santander Central Hispano (SCH) and Bank of America, and Bital, the fourth-largest, by HSBC of the UK. Between them, SCH and BBVA have around 44% of the deposits market. It should be noted, however, that barely a fifth of all Mexicans hold any bank account.

This foreign investment—eight years after the Zedillo government first cleared the path for majority foreign ownership of Mexican banks—contrasts with the foreign ownership of bank assets in Chile and Argentina, which is below 50%, and less than 30% in Brazil. It was not until October 2002 that the Mexican monetary authorities authorized the first new domestically-owned bank (Banco Azteca, part of the Salinas Group) to operate since the financial implosion of 1994-95.

In the autumn of 2002, SCH ended its experiment in preserving two banking franchises (Banca Serfin and Banco Santander Mexicano) with competing products and different cultures and merged them into a single financial group. The creation of Grupo

Financiero Santander Serfin followed SCH's retreat from the battle for control of Bital[8]. The decision not to enter a bid for full control of Bital signalled a general retrenchment and consolidation of SCH's interests throughout Latin America in response to heightened regional risk. The rapid integration of the Mexicano and Serfin networks, facilitated by the previous harmonization of banking systems and technology, minimized restructuring costs and enabled the unified bank to achieve savings by streamlining its branch network and improve its cost-to-income (efficiency) ratio. The ratio improved to under 50% in 2002. Mexico generated net attributable income of €681 million in 2002, 16.4% more than in 2001 in euro terms and 24.1% excluding the exchange-rate impact. Non-performing loans (NPLs) represented only 1.3% of total lending at the end of 2002, down from 1.5% in 2001, and coverage increased from 170.2% to 265%.

In December 2002 SCH agreed to sell 24.9% of Grupo Financiero Santander Serfin to Bank of America for US$1.6 billion (2.9 times book value). One of the main factors behind this strategic alliance is the desire of both banks to gain more Mexican-American customers in the US and increase their market share of the remittances (US$10.5 billion in 2002) sent to Mexico every year. Remittances make a significant impact on the Mexican economy and have outstripped tourism as a source of foreign funds.

The deal opens up new business opportunities in corporate banking—there are 5,000 US companies in Mexico, only 1,400 of which were customers of Santander in 2002. The increasing intertwining of Mexico's economy with the US makes for a financial services market with huge potential. SCH is strong in Mexico, while 75% of the Hispanic population lives in the US states where Bank of America is most active (California, Texas,

[8] See the article "Two Become One" by Robert Taylor in the October 2002 issue of *The Banker*.

Arizona, Nevada and New Mexico). SCH will compete for this market with several other international players. Legislation from the US Congress has made it easier for immigrants to work through banks. Per capita transfers to Mexico and Central American countries grew at an average of 12.3% per year from 1999 to 2001, and if they keep growing at this rate they will reach US$25 billion by the end of the decade, according to a report by the Pew Hispanic Centre and the Inter-American Development Bank's Multilateral Investment Fund. Most of this money is sent home through expensive telegram transfers or in cash by trucks (for a 10% commission). The report suggested that as more banks accept a Mexican consular card as valid identification to open accounts, banks could capture a larger share of the remittance market. This would bring more immigrants into the formal banking system. Immigrants would then benefit from the ability to deposit and borrow money. It is estimated that half of the Mexicans in the US do not have bank accounts.

The sale of the stake to Bank of America at almost three times book value was a profitable deal for SCH. Indeed, the US$1.6 billion paid went a long way towards recouping the US$2.2 billion Santander invested in Mexico over three years. The sale was also another factor that enabled SCH, which had been under extreme capital pressure because of Argentina's crisis and uncertainty in Brazil, to comfortably meet its core capital target ratio of 5.5%.

In the third quarter of 2002, BBVA separated Mexico from the rest of the Latin America division in order to give greater visibility to this country, whose economic cycles are closer to those of the US than the rest of Latin America. Mexico generated net attributable income of €429 million in 2002, 7.8% more than in 2001, compared to €237 million for the rest of Latin America. Mexico's ROE was 32.2% as against 8.0% for the rest of Latin America. The NPL ratio was 4.22%, up from 3.37% in 2001, and coverage was 288.3%. BBVA increased its stake in Bancomer, its Mexican bank, to 54% from 51.5% in November 2002.

BBVA was exploring potential acquisitions in California, Texas and Florida in order to also tap the growing Mexican immigrant market. The group already offers Mexicans in the US limited services, such as money transfer facilities. The idea of a financially integrated North America has great appeal to the financial sector, which would benefit from the reduced cost of capital and from access to larger amounts for development than are now available. But Mexican institutions are not ready or willing to contemplate dollarization.[9] One reason is that Mexico has had bad experience in the past with fixed exchange rates and pegs to the US dollar; they resulted in massive devaluations and loss of confidence once trade deficits reached high, unsustainable levels. A second reason is that stability does not require a fixed exchange rate: Mexico was able to reduce inflation from 52% in 1995 to 4.4% in 2001 under a floating rate regime. Moreover, this regime provided flexibility to accommodate external shocks from crises in Asia, Russia and Brazil. The third reason is that surrendering monetary policy to the US Federal Reserve would take away from the Mexican authorities one of the major instruments of monetary policy. The Fed might also find it awkward to be exposed to acting as Mexico's lender of last resort–an important risk of dollarization.

The private pensions industry is also attractive for Spanish banks. Between them, BBVA and SCH have more than 30% of managed pension funds in Mexico. With 78% of the 100 million population under the age of 40, Mexico is a large potential market for

---

[9] See *Mexico: NAFTA and the Prospects for North American Integration* by Dr Rogelio Ramírez De la O (C.D.Howe Institute, November 2002).

pensions. The industry received a boost in October 2002, when some 26 million self-employed workers and government employees were authorized to invest in private pension funds, known as Afores. Previously, the Afores were limited to the 28 million employees of private companies. Pension fund assets have been growing at a rate of more than US$6 billion a year and in October 2002 stood at US$47 billion. The Afores were still barred from investing in equities in 2002, but at the beginning of the year they were allowed to invest abroad as regulators sought to avert over-reliance on Mexican government debt.

Declining interest rates and strong competition have put interest margins under pressure; however, banks have been able to offset this shortfall with higher fees and commissions.[10] As most banks clean up their balance sheets and non-performing loans are provided for in full, provisioning levels have decreased, benefiting bottom-line results. The main need for the financial system is greater lending activity, which has not picked up despite a favourable interest rate environment. Consumer credit in 2000 accounted for only 0.8% of GDP, against 6.6% in the US, and 5.2% in Chile and Brazil. Various factors, ranging from banks' aversion to risk and high selection standards to low credit demand, are among the causes of declining loan portfolios. Banks are worried about the legal framework governing lending which overprotects the borrower. They want new laws that make it easier for them to collect collateral in default. Mortgage payments became tax deductible in 2003, which should stimulate demand.

Mortgage lending, when regulated more to the liking of banks, is an area with huge potential. The government set a target of building 750,000 homes a year until 2006 to

[10] This brief analysis draws on *Latin American Banking Guide & Directory 2002* (LatinFinance and Citibank supplement, August 2002).

boost supply; whether this is achieved depended on the corresponding growth in mortgage lending[11]. A federal mortgage bank, known as Fovi, is intended to function like Fannie Mae in the US, providing guarantees that allow mortgage-lenders to raise money from the capital markets. Mortgages so far have come from specialist lenders, known as "sofoles", which were established in 1994 mainly to offer mortgages to people on low incomes. Hipotecaria Su Casita and Hipotecaria Nacional had 52% of the mortgage market in 2002. The number of mortgages granted by Su Casita rose from 477 in 1995 to 58,438 in January 2002. These entities, however, rely almost solely on government financing because they are not allowed to offer deposit or savings accounts. Deutsche Bank plans to issue the first mortgage-backed securities in Mexico in 2003.

[11] See "US-style mortgages to ease Mexican housing" by John Authers (Financial Times, December 4, 2002).

Chapter 6

Colombia, Peru, Venezuela and Other Countries

Colombia – Basic Data

Population:	43.8mn (2002)
Population growth:	1.8% per year (1998-2002, average)
Land area:	1.14mn square km
Currency (peso):	Ps2,301/ US$1 (2001, year-end); Ps2,960/US$1 (March 5, 2003)
GDP:	US$80.8bn (2002 at market exchange rate); US$275.4bn (2002, at PPP, US$ at 1996 prices)
GDP per capita:	US$1,920 (2000, at market exchange rate); US$6,970 (2002, at PPP, US$ at 1997 prices)

Source: Economist Intelligence Unit.

Colombia

Spain accounted for 40% of total EU and US direct investment of €6.6 billion in Colombia between 1992 and 2001 (see Exhibit 6.1). Most Spanish direct investment in Colombia is in the financial sector. Santander Central Hispano and Banco Bilbao Vizcaya Argentaria have a combined market share of around 10% in deposits, and the insurer Mapfre generates a small proportion of its premium income in the country. Endesa and Unión Fenosa generate and distribute electricity, and Sol Meliá has seven hotels in the country (See Exhibit 6.2).

Economic and Political Background

Colombia has been wracked by political violence since the 1950s. During the 1990s an estimated 35,000 people—most of them civilians—were killed or disappeared in the war between, on the one hand, the Revolutionary Armed Forces of Colombia (FARC) and the smaller National Liberation Army (ELN)—the world's oldest Marxist guerrilla movements—and, on the other hand, the security forces aided by bands of right-wing paramilitary vigilantes. Under the US-supported US$1.3 billion "Plan Colombia", the Colombian armed forces aimed to control the rebel-dominated coca-growing regions which supply the bulk of the cocaine used in the United States. President Alvaro Uribe took office in August 2002 and, amid escalating violence, declared a state of emergency. The arrival of US special forces in January 2003 signalled even closer involvement by Washington in the guerrilla conflict. The task of the elite troops was to prepare Colombian troops to fight the rebels, rather than for missions in support of drug eradication, which for many years was the declared aim of US financial support to Colombia. Colombia is one of the US's ten biggest sources of imported oil, and maintaining supplies assumed a new importance because of the uncertain situation in Venezuela and the Middle East.

Exhibit 6.1 **EU and US Direct Investment in Colombia, 1992-2001 (cumulative inflows in € mn)**

EU-15	**Spain**	France	Netherlands	UK	Germany	Portugal	Italy	Other EU	US	Total
4,010	**2,667**	229	-424	552	502	0	28	455	2,615	6,625

Source: Economic Commission for Latin America and the Caribbean, Eurostat and the Bureau of Economic Analysis for US data.

Exhibit 6.2 **Main Spanish Companies in Colombia**

Spanish company	Sector	Subsidiary
Santander Central Hispano	Banking	Banco Santander Colombia
Banco Bilbao Vizcaya Argentaria	Banking	BBVA Ganadero
Mapfre	Insurance	Mapfre S.G. Colombia
Endesa	Electricity	Betania
		Emgesa
Unión Fenosa	Electricity	Electrocosta Electricaribe
		EPSA
Gas Natural	Gas	Gas Natural ESP
Sol Melía	Hotels	–

Source: Company reports.

The economy began to be opened up during the 1990s with the privatisation of ports, highways, electric power generation and distribution firms, telecommunications and banks. Services account for around 63% of GDP, industry 25% and agriculture 12%. The largest industries are food processing, beverages and textiles, followed by chemicals, leather goods, shoes and clothing. The principal exports are crude oil and derivatives, coffee (Colombia is the world's second-largest producer after Brazil), coal (the world's fourth-largest exporter), and exotic items, such as cut flowers (the world's second-largest supplier). The US takes more than one-third of the country's exports, many of which enjoy tariff-free entry to the US market under the Andean Trade Preference Act. Colombia forms part of the Andean Pact, a free trade agreement between Peru, Bolivia, Ecuador and Venezuela.

Economic Policy

Average annual real GDP growth was 3.4% in 1979-99, one of the most sustained in Latin America during that period. In 1999, the economy went into its first recession (-4.1%) since the 1930s. Unemployment reached a record 20%, and the fiscal deficit reached 7.5% of GDP. The International Monetary Fund (IMF) came to the rescue in 1999 with a three-year US$2.7 billion agreement, but Colombia did not draw on any of the funds. The Central Bank adopted an inflation-targeting framework, following its shift to a managed currency float. The economy recovered modestly in 2000, with inflation at close to 9% and a lower budget deficit, and then dipped in 2001 and 2002 (see Exhibit 6.3). Increased military spending has put public finances under pressure. The budget deficit was 4% of GDP in 2002. In February 2003 the IMF approved a two-year US$2.1 billion stand-by agreement. The World Bank also agreed to increase its exposure to Colombia. Overall, multilateral lenders offered US$8 billion over three years, thought to be one of the largest loan programmes ever in Latin America relative to the size of the economy. The government intended to treat the new credit as precautionary.

Exhibit 6.3 **Main Economic Data for Colombia, 2000-03F**

	2000	2001	2002E	2003F
GDP (%)	2.8	1.6	1.7	2.0
Consumer prices (%, year-end)	8.8	7.7	7.0	6.5
Current account (% of GDP)	0.4	-2.0	-1.0	-1.2
Reserves (US$ bn, year-end)	9.0	10.2	10.8	11.3
Exchange rate (year-end vs US$)	2,229	2,291	2,855	2,982
Fiscal balance (% of GDP)	-3.4	-3.3	-4.0	-2.4
30-d BAIBOR interest rate (year-end)	13.4	11.4	7.7	9.5
Real effective exchange rate (1997=100)	83	81	72	72
BBVA-Raw Material Index Colombia (June 1995=100)	83	100	92	78

E = Estimate; F = Forecast.
Source: Research Department of Banco Bilbao Vizcaya Argentaria, March 2003.

Fiscal solvency also depends on reducing the transfers from the central government to local governments and reforming the state pension system. Tax revenue is only around 13% of GDP.

Geography and Resources

Colombia is bounded on the north by the Caribbean Sea and the Pacific Ocean on the west—Panama separates the two waters and connects the country with Central America. Colombia also borders Venezuela, Brazil, Peru and Ecuador. Three ranges of the Andean mountain system cut through the western half of the country—the Western, Central and Eastern Cordilleras, which join to form a single range at the border of Ecuador. Tributaries of the Amazon and the Orinoco rivers cross the lower eastern plain. Over half of Colombia is covered in immense forests. The country is prone to earthquakes: the one in 1999, which devastated the coffee-producing region of Eje Cafetero, killed 1,185 people and left 150,000 homeless.

Mining, mainly oil and coal, generates 5% of GDP. There is also iron ore, nickel, gold, copper and over 90% of the world's top-grade emeralds. The Muzo mine in the Eastern Andes is the world's largest emerald mine.

Communications and Energy

The difficulty of transport is one reason why it has been hard to develop the country. Bogotá, for example, is 2,600 metres above sea-level. Until the Atlantic Railway was built, goods not carried by air had to be loaded and unloaded many times between Bogotá and the Caribbean coast. There are more than 115,000 kilometres of roads, of which only some 14,000 are paved. The government has opened concession projects for the construction, rehabilitation and maintenance of roads. Dragados' subsidiary Áurea has the concession for the Bogotá-Villavicencio road. Dragados built the airport at Palmira that serves the city of Cali and has modernized parts of the railway system.

Hydroelectricity supplies around 70% of the country's power. In order to meet the growing demand for electricity in 2001-10, which is expected to average 5.9% annual growth, Colombia needs to add 6,200MW to its installed capacity. Endesa and Unión Fenosa generate and distribute electricity in the country.

Oil production peaked in 1999 at 815,000 barrels a day (100,000 bbl/d in 1980) following the discovery of new reserves at Cusiana and Cupiagua, and in 2002 output had declined to 580,000 bbl/d. The country has about 1.8 billion barrels of proven reserves and possibly 25 times this amount in potential reserves, but progress in exploration has been slow because of political factors and security considerations. The state oil company, Empresa Colombiana de Petroleoes (Ecopetrol) warned that the country could become a net oil importer by 2005 if sufficient new deposits were not discovered. In the face of falling oil production, Ecopetrol planned to fire 1,200 employees (16% of the total) by 2005 and sell its stakes in regional energy companies.

The government improved the terms of association contracts in 1999 between foreign firms and the Colombian Petroleum Corporation in a bid to attract greater foreign investment and meet the goal of producing 1.5 million barrels a day by 2010. Repsol YPF has some production and exploration activities in the country. The much faster cost recovery significantly enhances a typical project's expected rate of return. The telecommunications market opened for long-distance and international calling in 1998, with two private consortia competing with the state telecom monopoly. Teledensity is the third highest in Latin America after Chile and Argentina. There are close to 20 fixed lines per 100 inhabitants, most of them in the largest cities, and over 2 million cellular phone subscribers. The network is expected to be fully digital by 2005. Colombia is one of the few large Latin American markets that has not attracted Telefónica.

Banking

Colombia's banking crisis in the late 1990s, following a credit boom and insufficient supervision, led to the closure, merger or takeover of 70 financial institutions in 1997-2000 (one-third of the country's total). Politicians plundered state-owned banks and under restructuring their number was reduced from nine to four. Estimates of the total financial cost of bailing out the banks ranged from 6% of GDP to as much as 15%. The largest privately-owned banks are Bancolombia, Banco de Bogotá and BBVA Banco Ganadero. Minimum capital requirements for the creation of new financial entities were increased as of 1999 and supervision tightened.

Like most markets in Latin America, Colombia suffers from slow lending activity[1]. Profit generation has thus been constrained, and yet banks have reported improved earnings. This was partly due to the fact that banks have taken a slower approach to loan-loss reserve provisioning, even though the 1998 crisis underscored the benefits of having ample reserves. Colombian financial institutions post among the lowest reserve coverage ratios in Latin America. The ratios of the Spanish banks in the country, however, are much better than the industry's average and compare well with international standards.

[1] This brief analysis draws on *Latin Banking Guide & Directory 2002* (LatinFinance and Citibank supplement, August 2002).

Peru – Basic Data

Population:	26.7mn (2002)
Population growth:	1.6% per year (1998-2002, average)
Land area:	1.29mn square km
Currency (nuevo sol):	Ns3.51/US$1 (2001, year-end); Ns3.47/US$1 (March 5, 2003)
GDP:	US$55.8bn (2002, at market exchange rate); US$123.7b2 (2001, at PPP, US$ at 1996 prices)
GDP per capita:	US$2,085 (2002, at market exchange rate); US$4,970 (2002, at PPP, US$ at 1997 prices)

Source: Economist Intelligence Unit.

Peru

The profile of Spanish direct investment in Peru is similar to that in Colombia, but the banks' presence is stronger and Telefónica bought the main telephone company, Compañía Peruana de Teléfonos (CPT), when it was privatized. It was this acquisition in 1994 that triggered the wave of Spanish investment in Latin America. BBVA Continental Perú, controlled by Banco Bilbao Vizcaya Argentaria, is the country's second-largest bank and, together with Banco Santander Central Hispano Perú, the fourth-largest bank, they control more than one-quarter of total deposits and half the pension funds market. The insurer Mapfre obtains a small amount of its premium income from Peru, and Endesa generates and distributes electricity there (see Exhibit 6.4).

Economic and Political Background

Between 1968 and 1980, under left-wing military government, there was extensive nationalization. With the return of civilian rule in 1980, the government became engaged in a protracted conflict with Shining Path, one of the world's most ruthless terrorist movements, which continued until 1992. During this period an estimated 25,000 people died and 10,000 disappeared.

The 1990 victory of Alberto Fujimori ushered in free market reforms and led to almost a decade of growth. The authoritarian Fujimori was re-elected in 1995 and in 2000 beat Alejandro Toledo for an unprecedented third term, though the result was very controversial. Fujimori went into exile that year to his native Japan, from where he resigned by fax, while Vladimiro Montesinos, his disgraced spy chief, fled abroad. He was

Exhibit 6.4 **Main Spanish Companies in Peru**

Spanish Company	Sector	Subsidiary
Santander Central Hispano	Banking	Banco Santander Central Hispano Perú
Banco Bilbao Vizcaya Argentaria	Banking	BBVA Continental
Telefónica	Telecommunications	Telefónica del Perú
		Telefónica Móviles de Perú
Endesa	Electricity	Edegel
		Edelnor
		Piura
		Etevensa
Mapfre	Insurance	Mapfre Perú

Source: Company reports.

captured after eight months on the run and imprisoned in Peru to face charges of massive corruption, drug-trafficking and money-laundering.

Toledo, a centrist Harvard-educated Native American, narrowly won the June 2001 presidential election. His *Perú Posible* party faced a daunting task in rebuilding institutions–almost all of them corrupted–and alleviating some of Latin America's most extreme poverty. More than half the population is below the poverty line. According to the World Bank, the wealthiest 20% of the total population has more than half of the national income.

Services generate 56% of GDP, industry 37% and agriculture 7%. Manufacturing is centred mainly in Lima and Callao and includes food processing, fishmeal (used for animal feed and fertiliser), chemicals, petrochemicals, rubber, plastics, basic metallurgy, cement, textiles and paper products. The principal exports are mining (almost 50% of the total), fisheries and agricultural products, such as mangos and limes. The main markets are the US and Japan. Peru is one of the world's largest producers of the coca leaf, most of which is shipped to neighbouring Colombia, Brazil and Bolivia for processing into cocaine.

Privatization began in 1994 with Compañía Peruana de Teléfonos (CPT), which was acquired by Telefónica, and then the programme withered. The Toledo government restored it but then postponed it as of June 2002 after riots in Arequipa, the second-largest city, over the privatization of two small electricity generators that had been sold to Belgium's Tractebel, the only bidder. Privatizations under Fujimori raised US$9 billion. Not all of the proceeds were squandered: US$1.8 billion was spent on anti-poverty programmes, around the same to pay off debt, and US$2 billion went into a contingency fund to pay state pensioners. But US$1.5 billion went on arms purchases, which involved huge kickbacks stashed in foreign bank accounts. As a result, privatization earned a bad name as well as being identified by the poorest sectors of society with higher utility tariffs and job losses. Those privatizations that have taken place, however, such as Telefónica's purchase of CPT, have greatly improved the access to services. Telefónica has reduced the delay in installing a telephone line from three years to less than a month.

Economic Policy

Liberalization during the 1990s unleashed a period of high growth and low inflation. However, real per capita GDP was almost the same in 2002 as in 1970. Growth averaged 0.5% a year in 1979-88 and then accelerated to 4.3% in 1989-99. The economy dipped into recession in 1998 (-0.5%) and recovered a path of growth with low inflation as of 1999 (see Exhibit 6.5). The fiscal balance has been in deficit since 1998. Tax revenue represents only 14% of GDP. The International Monetary Fund helped Peru in 1991 to regain access to the international capital markets after the default during the 1985-90 government of Alan García.

The government adopted a more socially oriented economic policy while remaining committed to macroeconomic stability and honouring the foreign debt. Promises that looked populist included the creation of 2.5 million jobs in 2001-05 through an emergency employment programme and by promoting intensive farming, food-processing, tourism, foreign investment and construction.

Geography and Resources

Peru is bounded by Ecuador and Colombia to the north, by Brazil and Bolivia to the east, and by Chile to the south. To the west is the Pacific Ocean. Two chains of the Andes

Exhibit 6.5 **Main Economic Data for Peru, 2000-03F**

	2000	2001	2002E	2003F
GDP (%)	3.6	0.2	5.2	4.3
Consumer prices (%, year-end)	3.7	-0.1	1.5	2.3
Current account (% of GDP)	-1.6	-1.1	-1.9	-2.3
Reserves (US$ bn, year-end)	8.2	8.6	9.8	9.0
Exchange rate (year-end vs US$)	3.52	3.44	3.56	3.61
Fiscal balance (% of GDP)	-3.2	-2.5	-2.3	-2.1
Interbank interest rate (year-end)	9.3	3.3	3.6	5.0
Real effective exchange rate (1997=100)	89	93	95	92
BBVA-Raw Material Index Colombia (June 1995=100)	86	89	88	93

E = Estimate; F = Forecast.
Source: Research Department of Banco Bilbao Vizcaya Argentaria, March 2003.

Mountains, running parallel to the Pacific coast, divide the country into three very different regions: (1) the coastal zone; (2) mountainous areas consisting of very high chains called cordilleras, high plateaux and deep valleys; and (3) heavily forested slopes east of the mountains leading to the low-lying Amazonian plain. The Atacama Desert, to the south, is one of the driest places in the world. In contrast, on the borders of Peru and Bolivia, is Lake Titicaca, the world's highest navigable lake (3,809 metres above sea-level). The country is subject to earthquakes; a huge one measuring 8.1 on the Richter scale killed more than 100 people in 2001 and left an estimated 74,000 homeless. Peru also suffers from the effects of El Niño, a disruption of the ocean atmosphere system in the tropical Pacific with major consequences for weather and climate.

The cold Peru current flowing north along the coast is rich in fish. Peru is one of the world's leading fishing nations. Indians living high in the *sierra* grow maize, potatoes, beans and wheat to feed themselves. In the river valleys of the coastal belt cotton and sugar are the chief crops. Coffee and quinine are grown in the eastern lowlands. The agricultural sector employs around 30% of the population, but its contribution to GDP is small (7%).

When it was part of the Spanish Empire (1535-1821), Peru, the head of one of the two viceroyalties into which the empire was divided, was famous for its gold and silver, and they are still mined in large quantities: the country is the world's second-largest silver producer. The Yanacocha mine in Cajamarca, a joint venture between Newmont Gold of the USA and Peru's Buenaventura, is Latin America's largest gold mine and one of the world's lowest-cost gold producers. The country is virtually self-sufficient in oil, and copper (fifth-largest producer), lead, zinc, vanadium (used for hardening steel) and bismuth are also mined.

Communications and Energy

The country's topography makes transport difficult in Peru, and successive governments, with limited funds available, have been restricted in their capacity to improve infrastructure. There are 72,900km of roads, less than 10,000km of which are paved. Highways between the coast and mountain regions are often blocked by landslides in the rainy season. A build-operate-transfer (BOT) concessions system was introduced to encourage private-sector investment in transport, energy, water and sanitation. The maintenance and development of railways and the main highways are expected to be auctioned to private operators through BOT concessions.

Around 80% of electricity generating capacity is hydroelectric, the remainder being fossil fuel. With more investment in its oil industry, Peru could stop importing crude. The country's offshore basins are largely unexplored. Repsol YPF has exploration and refining activities in the country. Telefónica bought Compañía Peruana de Teléfonos (CPT), the main telephone company, when it was privatized in 1994, four years before the telecommunications market was opened to full competition. The renamed Telefónica de Perú had 1.8 million fixed-line customers in 2002 and Telefónica Móviles Perú had 1.2 million mobile telephone customers. The latter company is the market leader with an estimated share of 57% (almost the same share that Telefónica Móviles has in Spain).

Banking

Two banks were privatized in the 1990s (Interbank and Continental), leaving the system entirely in the hands of the private sector, apart from Banco de la Nación and COFIDE, a second-tier bank. Close to half the total capital of banks is owned by foreign entities.

Banco Bilbao Vizcaya Argentaria and Santander Central Hispano own the second and fourth largest banks (BBVA Continental and BSCH Perú). Santander scaled back its activity in 2002 and sold its retail banking business to Banco de Crédito del Perú.

The financial system is slowly getting back into shape, following the country's return to a more stable economic and political environment.[2] Banks are more liquid, having reduced new lending in past years as a way to protect themselves from the recessive environment and leading to the low funding cost that prevailed in 2002. Consumer lending started to grow again, taking advantage of the funding cost.

[2] Ibid.

Venezuela – Basic Data

Population:	25mn (2002)
Population growth:	1.7% per year (1998-2002, average)
Land area:	912,050 square km
Currency (bolivar):	Bs763/US$1 (2001, year-end); Bs1,598/US$1 (March 5 2003)
GDP:	US$92bn (2002, at market exchange rate); US$141.5bn (2002, at PPP, US$ at 1996 prices)
GDP per capita:	US$3,789 (2002, at market exchange rate); US$5,740 (2002, at PPP, US$ at 1997 prices)

Source: Economist Intelligence Unit.

Venezuela

Spanish direct investment in Venezuela, which accounted for close to 10% of the total anount of €17.1 billion by the EU and the US between 1992 and 2001 (see Exhibit 6.6), is largely confined to the banking and oil industries (see Exhibit 6.7). Santander Central Hispano's Banco de Venezuela is the country's biggest bank. This bank and Banco Bilbao Vizcaya Argentaria's BBVA Provincial have a combined market share of 30% in deposits. Repsol YPF has some exploration and production activities in the country. It produces around 100,000 barrels a day of oil equivalent (60% gas and 40% crude/condensates).

Economic and Political Background

Hugo Chávez, a leftist army officer imprisoned for the failed 1992 coup he led, broke the mould of Venezuelan politics when he became president in 1999. His Movement for the Fifth Republic was swept to power with support from the impoverished and politically inarticulate section of society, fed up with the corrupt *ancien régime* of the two traditional parties that had ruled the country after the military dictatorship ended in 1958. A new constitution bordering on the totalitarian was drawn up and the legislature and judiciary reorganized. Chávez was in the tradition of left-wing nationalist officers in Latin America (for example, Omar Torrijos in Panama) and also part of the region's long history of *caudillos*. Emigration to the US by the disaffected middle classes and capital flight intensified after Chávez came to power. His policies irritated the Bush administration and antagonised the Venezuelan business and land-owning class.

Chávez survived a coup in April 2002, and also faced down a 63-day strike by the private sector and the state-run oil industry, the mainstay of the economy, between

Exhibit 6.6 **EU and US Direct Investment in Venezuela, 1992-2001 (cumulative inflows in € mn)**

EU-15	**Spain**	France	Netherlands	UK	Germany	Portugal	Italy	Other EU	US	Total
6,712	**1,607**	1,594	1,064	-126	1,275	2	74	1,222	10,470	17,182

Source: Economic Commission for Latin America and the Caribbean, Eurostat and the Bureau of Economic Analysis for US data.

December 2002 and February 2003, which crippled the country. But it remained to be seen whether he would be able to hold office for the full term (2006) or whether his "*revolución bolivariana*", named in homage to the Venezuelan-born South American independence leader of the early 19th century, Simón Bolivar, would produce even more political upheaval. The bitterly divided country faced the prospect of imploding.

Services generate around 60% of GDP, industry 34% and agriculture 5%. The main home market industries are textiles, beverages, food processing and paper/pulp. Heavy industries that use local inputs are aluminium refining, petrochemicals (ammonia, sulphuric acid, fertilisers and plastics), cement and steel.

The state's presence in the economy is largely through the giant oil monopoly Petróleos de Venezuela (PDVSA), Venalum and Alcasa (aluminium) and Pequiven (petrochemicals). The 1999 constitution enshrined state ownership of PDVSA and of mineral rights over the country's subsoil as being of strategic economic importance to the country, limiting the possibilities for private sector involvement in the oil sector. This situation was reinforced by a new hydrocarbons decree law passed in 2001 which included a controversial provision requiring all activities relating to exploration, extraction, collection and transport to be performed by the state directly, through companies majority or exclusively owned by the government.

Economic Policy

Economic policy has veered between the orthodox and the populist, but neither approach has done much to improve competitiveness. The International Institute for Management Development (IMD), a Swiss business school, ranked Venezuela 48th in its 2002 ranking of the world's 49 most competitive countries (44th in 1997). Despite fabulous mineral wealth,

Exhibit 6.7 **Main Spanish Companies in Venezuela**

Spanish Company	Sector	Subsidiary
Santander Central Hispano	Banking	Banco de Venezuela
Banco Bilbao Vizcaya Argentaria	Banking	BBVA Provincial
Repsol YPF	Oil and gas	–

Source: Company reports.

or perhaps because of it, growth has rarely been strong and often sluggish, especially in the inefficient non-oil economy. Oil revenue, depending on the price, has accounted for up to 80% of export income, over a fifth of GDP and half of the government's income. Average real GDP expanded 0.5% in 1979-89 and 2.3% in 1989-99. The economy went into recession in 1999 (-6.1%), picked up in 2000 (+3.2%), thanks to the rise in oil prices, which were three times the budgeted level of US$9 per barrel, and plunged again in 2002 and further in 2003 (see Exhibit 6.8). The bolivar was floated in early 2002 and by the end of the year had fallen 37% against the euro.

When oil prices are high the external sector—and thus the economy as a whole—is buoyant. The current account surplus was a massive 13.4% of GDP in 2000 and dropped to about 8.5% of GDP in 2002 because of lower oil prices and reduced output. With the external and fiscal accounts vulnerable to volatility in world oil prices, the creation of a Macroeconomic Stabilisation Fund, which sets aside a percentage of oil revenue when the price is above a certain level, acts as a cushion against lower oil prices. However, it requires efficient management if it is to serve its purpose and not fall prey to political whims. Venezuela needs to diversify its sources of revenue away from oil. The country, moreover, has a low tax collection record even compared with some of its regional peers (revenue represents less than 13% of GDP).

The outlook for the economy in 2003 was bleak. In addition to the strike's economic effects, the government imposed exchange controls when oil exports dried up. Chávez used the controls in a country that imports more than 60% of its goods as a weapon to punish his enemies—a category that included some of Venezuela's biggest businesses but not Spanish companies—and introduced price curbs on basic foods and essential items, providing some protection for his working class supporters. Oil output dropped from its normal level of

Exhibit 6.8 **Main Economic Data for Venezuela, 2000-03F**

	2000	2001	2002E	2003F
GDP (%)	3.2	2.7	-8.9	-11.6
Consumer prices (%, year-end)	13.4	12.3	31.2	49.6
Current account (% of GDP)	13.4	3.5	8.5	5.6
Reserves (US$ bn, year-end)	20.4	18.5	14.8	11.1*
Exchange rate (year-end vs US$)	699	758	1,420	2,350
Fiscal balance (% of GDP)**	-1.8	-4.0	-3.0	-6.9
Certificado Participaciones rate (year-end)	13.9	19.5	26.8	15.1
Real effective exchange rate (1997=100)	124	131	99	81
BBVA-Raw Material Index Venezuela (1995=100)	163	116	159	130

(*) Including FIEM. (**) Central Government balance.
E = Estimate; F = Forecast.
Source: Research Department of Banco Bilbao Vizcaya Argentaria, February 2003.

around 3 million barrels a day to 200,000 bbl/d in December 2002 and slowly picked up in 2003. The government needs large investments to keep the “black gold” flowing, and it was by no means certain where the money would come from. Most of the country’s oil is particularly heavy crude that is technically complex to harvest.

Geography and Resources

Venezuela is bounded on the north by the Caribbean and has a coastline of 3,000km, with many islands. To the west is Colombia, to the east Guyana, and to the south Brazil. It has high mountains, tropical rain-forests, and hundreds of rivers. The great Orinoco River rises in the south and makes a wide curve to flow through the centre of the country. North of the Apure River and part of the Orinoco are grassy plains called *llanos*, where cattle are raised. In the southeast are the Guyana Highlands, which are covered with forests and little explored, and high on the River Carrao are the Angel Falls, the highest falls in the world (979 metres). The country is subject to tropical storms. The one in December 1999 killed some 30,000 people.

The country has vast mineral wealth which is largely undeveloped except for oil. Venezuela has the largest proven reserves of oil in the Western Hemisphere and the sixth in the world (estimated at 77 billion barrels). The US has become increasingly reliant on oil imports from Venezuela in recent years. The Oriental and Maracaibo basins occupy a prominent position in the ranking that groups the ten largest basins in the world, which concentrate 60% of total global hydrocarbons. There are also huge reserves of natural gas and other minerals (iron ore, bauxite, gold, diamonds, coal, lead, nickel and phosphates). PDVSA signed an agreement with Royal Dutch Shell and the Mitsubishi Corporation in December 2002 to start developing a US$2.7 billion liquefied natural gas project intended to make Venezuela a net gas exporter by 2007. The mining sector (excluding oil) contributes around 1% of GDP.

The chief agricultural products are coffee, cocoa, sugar, tobacco, cotton and maize. The arrival of oil in the 1920s triggered a gradual decline of the rural economy in favour of industrial development of towns. Venezuela stopped being self-sufficient in food production in the 1980s. One of Chávez's priorities was to try to readdress the balance. The National Agrarian Institute estimated that half of the country's 500,000 or so farms occupied less than 2% of arable land, while at the other end of the scale 1% of the farms held 46% of the land—and this in a large country where only 12% of the population lives in the interior and there is plenty of space. The former two-party system did nothing to improve the lot of landless peasants. A controversial decree law came into effect in December 2001, charging a tax on idle or underutilized land and defining the types of land subject to expropriation.

Communications and Energy

Venezuela has an estimated 95,725km of roads, one-third of which are paved. There are few railways, with the notable exception of the 160km track from Puerto Cabello to Barquisimeto and Acarigua and a system to transport iron ore from mines to Puerto Ordaz. There has long been talk of developing a railway system, but by 2002 nothing had happened. Spanish companies would be well placed to do this. Travel by boat on the Orinoco and its tributaries is still the only means of transport for many people.

Venezuela was one of the first countries in Latin America in which mobile phones outnumbered those that depend on fixed-line connection. The monopoly over basic telephony long held by CANTV, came to an end in 2000 when licences to operate in the fixed-line market were granted.

Banking

Despite consolidation in the aftermath of the severe 1994-95 banking crisis, which saw nearly half the sector fall into state hands, and despite a flurry of mergers in 2000, triggered by the 1999 recession, the banking sector remains overcrowded. The two largest private-sector banks, Banco de Venezuela and Banco Provincial, are owned by Santander Central Hispano and Banco Bilbao Vizcaya Argentaria, respectively. Santander increased its attributable net income in 2002 by 14% to €166.5 million. ROE was 43.7%. Non-performing loans represented 6.1% of total lending and coverage was 95%.

The banking system was going through a difficult period in 2003.[3] Several factors, including the steep slide in the bolivar, exchange controls, the gradual deterioration of economic variables and the unstable political environment, affected the banks. In this context, the banks suffered from a liquidity crunch, with capital outflows and substantially lower deposits. Credit demand was low and high interest rates curbed customers' capacity to service their debts, thus affecting asset quality system-wide. The system's ratio of non-performing loans increased to more than 10% in 2002. The NPL ratio was expected to continue to rise in 2003; many private companies were seeking to renegotiate their loans after remaining shut during the two-month strike. There was also the risk that the government, starved of funds,

[3] Ibid.

Exhibit 6.9 **Main Spanish Companies in Other Countries**

Country	Spanish Company	Sector	Subsidiary/Activity
Bolivia	Santander Central Hispano	Banking	Banco de Santa Cruz
	Banco Bilbao Vizcaya Argentaria	Pension funds	Market leader
	Repsol YPF	Oil and gas	Exploration and production
	Iberdrola	Electricity	Electropaz
			Elfeo
Costa Rica	Unión Fenosa	Electricity	La Joya
Cuba	Sol Meliá	Tourism	22 hotels
	Repsol YPF	Oil and gas	Exploration
Dominican	Endesa	Electricity	Cepm (generation)
Republic	Unión Fenosa	Electricity	Edenorte and Edesur (distribution)
			Palamara and La Vega (generation)
Ecuador	Banco Bilbao Vizcaya Argentaria	Pension funds	Market leader
	Repsol YPF	Oil and gas	Exploration and production
	Dragados	Construction/concessions	Toll road
El Salvador	Banco Bilbao Vizcaya Argentaria	Pension funds	Market leader
	Telefónica	Mobile telephony	Telefónica Móviles El Salvador
	Mapfre	Insurance	La Centro Americana
Guatemala	Iberdrola	Electricity	Egas (distribution)
	Unión Fenosa	Electricity	Deocsa and Deorsal (distribution)
	Telefónica	Mobile telephony	Telefónica Móviles Guatemala
Nicaragua	Unión Fenosa	Electricity	Disnorte and Dissur (distribution)
Panama	Unión Fenosa	Electricity	Edemet and Edechi (distribution/generation)
	Banco Bilbao Vizcaya Argentaria	Banking	BBVA Panamá
Paraguay	Santander Central Hispano	Banking	Banco de Asunción
	Mapfre	Insurance	Mapfre Paraguay
Puerto Rico	Santander Central Hispano	Banking	Banco Santander Puerto Rico
	Banco Bilbao Vizcaya Argentaria	Banking	BBVA Puerto Rico (Holding)
	Áurea	Infrastructure concessions	Teodoro Moscos Bridge
	Telefónica	Mobile telephony	NewCom Wireless Services
	Mapfre	Insurance	Mapfre USA
Uruguay	Santander Central Hispano	Banking	Banco Santander Uruguay
	Ence	Wood and paper	Eufores
	Mapfre	Insurance	Mapfre Uruguay

Source: Company reports.

would default on its domestic debt with the banks. Venezuela's domestic debt tripled between 2000 and 2002 to around US$6 billion, accounting for an average of 40% of banks' assets.

Other Countries

Bolivia, Cuba, the Dominican Republic, Ecuador, El Salvador, Guatemala, Nicaragua, Panama, Paraguay, Puerto Rico (considered here as part of Latin America) and Uruguay account for 3% of Spanish direct investment in Latin America. Most of the investment is in electricity, hotels, infrastructure and banking and pension funds (see Exhibit 6.9).

Chapter 7

Investment by Sector

Spain’s direct investment in Latin America is largely concentrated in the banking, oil, telecommunications and electricity, water and gas sectors. These sectors accounted for 57% of gross direct investment in the region between 1993 and 2001 (see Exhibit 7.1). A significant share (34%) is also accounted for by portfolio companies, but there is little specific information on the final destination of these funds. Latin America is by far the main destination of worldwide Spanish investments in energy, water and oil, and is the preferred area for services, especially banks, transport and telecommunications. Europe, however, is the main destination of investment in manufacturing, followed at a considerable distance by Latin America. This pattern is the result of two complementary forces: the privatization of companies in Latin America during the 1990s, which did not affect the manufacturing sector, and the existence of the European Single Market, which has caused Spanish manufacturing firms to concentrate on Europe.

The traditional hegemony of banking, with the investments made by Santander Central Hispano and Banco Bilbao Vizcaya Argentaria, was broadened during the 1990s to include pension fund management companies. The second leading destination was oil extraction and derivatives processing following Repsol’s strategic decision to develop a broad presence in various countries in the region. Its position was consolidated after it bought Argentina’s YPF in 1999. Telecommunications occupied third place; however, Telefónica’s strategy in 2000 to acquire all the capital of its affiliates has made it the industry with the largest volume of direct investment. The fourth most important sector is electricity, water and gas, where the main companies (Endesa, Iberdrola, Unión Fenosa, Aguas de Barcelona and Gas Natural) have pursued international growth strategies in various countries.

Banking and Insurance

The expansion of Spanish banks in Latin America is one of the most striking elements of the internationalization of the Spanish economy in recent years (see Exhibit 7.2). The consolidated external assets of the Spanish banking system with emerging markets rose fifteenfold between the fourth quarter of 1985 and the third quarter of 2002 to US$150.5 billion, compared with a 2.4 rise for other BIS reporting countries. In well under a decade Santander Central Hispano (SCH) and Banco Bilbao Vizcaya Argentaria (BBVA) have become the region's leading financial groups as measured by overall market share. This move took place at a time when economic reforms and trade liberalization unleashed market forces that fostered cross-border links among individual economies and restructuring for banking and financial services. The once fragmented national banking industries are gradually evolving into a regional industry dominated by an emerging elite of financial institutions. These institutions possess the asset size, capitalization, marketing skills and advanced technology required to exploit the region's vast, untapped demand for financial services.

The two banks have jointly invested more than US$27 billion in Latin America, including Puerto Rico, and between them in 2002 accounted for 22% of the region's deposits, 40% of funds in private pension schemes and 15% of mutual funds. SCH's exposure to Latin America is considerably more than BBVA's (gross investment of US$16.6 billion by the end of 2002 as against US$10.4 billion), particularly in Brazil. SCH, the biggest banking group in Latin America, and BBVA, the leader in private pension fund management, now employ far more people in the region than they do in Spain. Even with zero contribution to earnings from Argentina because of that country's crisis, Latin America generated €1,383 million of net attributable income in 2002 for SCH

Exhibit 7.1* Sectoral Distribution of Gross Direct Investment Flows from Spain to Latin America, 1993-2001

(US$ mn)	1993	1994	1995	1996	1997	1998	1999	2000	2001	1993-01	%
Primary sector											
Agriculture, livestock and fisheries	–	18	33	9	19	24	24	52	70	249	0.2
Oil and fuels processing	–	–	–	443	–	36	13,446	1	277	14,203	12.6
Manufacturing											
Food, beverages	12	10	–	7	48	54	93	726	1,074	2,024	1.8
Textiles and clothing	–	–	–	–	2	2	4	11	34	53	–
Paper and publishing	15	4	39	37	73	52	16	23	401	660	0.6
Chemicals	2	5	28	5	14	26	75	414	11	580	0.5
Other manufacturing	–	134	31	105	245	229	439	165	603	1,951	1.7
Services											
Construction	10	52	58	46	200	171	29	1,022	287	1,875	1.6
Commerce	–	–	15	27	11	131	978	108	272	1,542	1.4
Transport/ communications	106	2,211	162	181	497	158	2,083	8,289	2,125	15,812	14.0
Electricity, water and gas	9	51	106	224	809	2,324	1,572	761	348	6,204	5.5
Banks, insurance, funds	155	217	296	1,713	3,770	1,391	3,288	10,460	6,579	27,869	24.7
Hotels and other	–	–	33	38	55	35	67	412	244	884	0.8
Portfolio companies	301	755	1,239	1,621	2,962	8,386	7,739	4,486	11,56	39,056	34.6
Total	610	3,457	2,040	4,456	8,705	13,021	29,853	26,930	23,890	112,964	100.0

(*) Excludes Panama and Caribbean offshore centres.
Source: Complied by Alfredo Arahuetes on the basis of data from BICE, various years.

***Exhibit 7.2* Spanish Banks in Latin America**

Country	Bank	Subsidiary
Argentina	Santander Central Hispano	Banco Río de la Plata
	Banco Bilbao Vizcaya Argentaria	BBVA Francés
Bolivia	Santander Central Hispano	Banco de Santa Cruz (Bolivia)
Brazil	Santander Central Hispano	Banespa
		Santander Brasil
Chile	Santander Central Hispano	Banco Santander Chile
	Banco Bilbao Vizcaya Argentaria	Banco BHIF
Colombia	Banco Bilbao Vizcaya Argentaria	BBVA Ganadero
	Santander Central Hispano	Banco Santander Colombia
Mexico	Banco Bilbao Vizcaya Argentaria	BBVA Bancomer
	Santander Central Hispano	Grupo Financiero Santander Serfin
Panama	Banco Bilbao Vizcaya Argentaria	BBVA Panama
Paraguay	Santander Central Hispano	Banco de Asunción
	Banco Bilbao Vizcaya Argentaria	BBVA Paraguay
Peru	Banco Bilbao Vizcaya Argentaria	BBVA Continental (Peru)
	Santander Central Hispano	Banco Santander Central Hispano Perú
Puerto Rico	Santander Central Hispano	Banco Santander Puerto Rico
Uruguay	Santander Central Hispano	Banco Santander Uruguay
	Banco Bilbao Vizcaya Argentaria	BBVA Paraguay
Venezuela	Santander Central Hispano	Banco de Venezuela
	Banco Bilbao Vizcaya Argentaria	BBVA Provincial

Source: Santander Central Hispano and Banco Bilbao Vizcaya Argentaria.

(43.7% of the total contributed by all business areas excluding the corporate centre). This figure does not include amortization of goodwill, the cost of financing investments or the special reserve for Argentina, all of which are included in the corporate centre. Applying the same criteria, BBVA generated €666 million (28% of the total).

The push into the region came at a time when the two banks were financially very strong, the Spanish market was very mature and globalisation and the euro meant that size was needed to play the game. The banks had to learn to invest abroad, and Latin America was just the opportunity to grow and progress along the learning curve. The region offered good opportunities for banks with a certain critical mass seeking increased size and competitiveness, entry into expanding markets, global utilisation of resources and organisational and technological capacities, and appropriate risk diversification based on the corresponding rate of return[2]. The Latin American market's underdevelopment, attractive margins, high potential rates of return and improved supervisory and regulatory systems in an environment of liberalization opened up the kind of business opportunities that had existed in Spain 20 years before the expansion abroad. For example, the eight-percentage-point customer spread (the difference between the lending and deposit rates) in Mexico in 2002 was similar to that in Spain in the late 1980s.

Latin America as a whole has a very underdeveloped financial sector, as measured by the size of the sector in terms of the ratio of M3 to GDP and banking penetration (see Exhibit 7.3). M3 is the broadest measurement of money supply and includes time deposits, savings and money market funds held by institutions. The percentage of the

---

[2] This section draws on *The Spanish Banks' Strategy in Latin America* by Carmen Hernansanz and Miguel Sebastián (BBVA Working Paper 3/00).

population that has a bank account in Spain is double that of Latin America. The reason for this may be the small number of branches, as the number of customers per branch is in some cases 27 times higher in Latin American countries than in Spain (see Exhibit 7.4). Unlike in Europe, therefore, there is considerable potential for the expansion of branch networks so that customers have easier access to banking products and services. However, the degree of development of the banking sector as measured by deposits as a percentage of GDP varies considerably from country to country. Chile, on this basis, is the most developed country with 43% (Spain's figure is 118%) and Venezuela (15%) the least developed (see Exhibit 7.5).

There is tremendous scope for financial intermediation to grow. Commercial bank lending to the private sector in Latin America is, generally speaking, at a low level, particularly in a big market like Mexico (see Exhibit 7.6 and Chapter 5).

Latin America is also the ideal place for Spanish banks because of a shared language and cultural affinities. This provides several advantages. It makes it possible to sell the same products, using common marketing techniques. For example, deposits linked to lotteries have been as successful in Latin America as in Spain. The use of the same language facilitates the transfer of know-how, and the installation of the same IT platforms is conducive to the exchange of employees between the parent bank and its subsidiaries, thereby accelerating integration and the diffusion of the business culture.

The macroeconomic situation in Latin America today is also similar to that of Spain during the 1980s and early 1990s, so that the managers of the banks have a wealth of experience from which to draw lessons for their operations in the region (see Exhibit 7.7).

Exhibit 7.3 M3/GDP*

US	78
Euro zone	80
Spain	**96**
Latin America	46

(*) Excluding Peru and Venezuela, 2001.
Source: European Central Bank, US Federal Reserve, Latin American central banks, IMF.

Exhibit 7.4 Banking Penetration

	Pop over 18 with Current Account (%)	Customers per Branch (‘000)
Spain	**95**	**1**
Argentina	35	8
Brazil	48	19
Chile	50	8
Mexico	35	13
Peru	37	27

Source: Banco Bilbao Vizcaya Argentaria.

Exhibit 7.5 Deposits as a Percentage of GDP and per Capita GDP*

Country	Per Capita GDP in PPA	Deposits/GDP (%)
Argentina	10,661	23.87
Brazil	6,270	26.94
Chile	9,021	43.26
Colombia	5,966	22.52
Mexico	8,052	18.14
Peru	4,533	25.97
Spain	**19,363**	**118**
Venezuela	5,565	15.10

(*) December 2001.
Source: International Monetary Fund and Bank of Spain for Spain.

The banks' foray into Latin America coincided with the surge in foreign direct investment by Spanish companies in the region. While the banks' strategy is not one of tracking these firms into the region, the fact that they are customers of the banks is an added benefit.

Lastly, one should not forget that by becoming much bigger the banks are in a stronger position to protect themselves from takeovers on their home ground and to play a bigger role in the drawing up of the future European banking map. As brands, SCH and BBVA now have an internationally recognised value, although their investments in Argentina, in particular, and in Brazil, to some extent, are currently regarded as more of a liability than an asset. The banks have been able to buy market share in Latin America much more cheaply than in mature European markets. BBVA's Research Department roughly calculated, on the basis of the stock market capitalisation of each country's biggest banks and their share of deposits at the end of 1999, that a 1% share of the German deposit market in 1999 cost US$2.2 billion if this was attained by purchasing shares in the major listed banks. The same share would have represented an outlay of US$196 million in Argentina or US$205 million in Mexico.

Banks no longer need a large physical presence to do business outside their home countries, thanks to technological advances. The fact that the Spanish banks decided to acquire large networks shows that their strategy is to replicate the universal banking model that has proven so successful in Spain. Cross-selling, a particular skill of SCH and BBVA, is easier when you have critical mass. By establishing themselves in countries, the Spanish banks are able to influence the market much more directly and set the pace. For example, in the first nine months of 2002 Santander Serfin in Mexico issued close to 600,000 of its innovative Serfin Light credit cards, which provide no

Exhibit 7.6 **Financial Intermediation in Selected Countries (% of GDP)***

	Domestic Credit Total				Domestic Credit to Private Sector			
	1994	1995	1997	1999	1994	1995	1997	1999
Argentina	26.2	27.6	30.0	34.4	20.0	19.7	21.6	24.2
Brazil	57.7	36.6	40.0	47.6	45.5	30.8	25.9	28.4
Mexico	34.5	28.1	28.7	22.0	34.9	25.3	17.9	14.4
Spain	**107.1**	**106.8**	**110.1**	**115.9**	**77.7**	**77.1**	**84.2**	**92.9**
United States	75.1	76.7	78.2	82.7	61.7	63.9	65.6	71.2

(*) Monetary survey.
Source: IFS, IMF.

points, air miles or insurance but an interest rate far below that offered by the main rivals. The other banks were forced to match the offer. As a result of this product, Santander Serfin's market share in this segment of business reached almost 13% by the end of 2002.

Nonetheless, there are risks in the region's banking industry as Argentina's crisis and Brazil's uncertainty have painfully highlighted. The Argentine financial system's situation remains highly critical following the massive devaluation of the peso in 2002, the sovereign default, the imposition of restrictions on deposit withdrawals and cross-border transfers and the *pesofication* of the previously highly dollarized economy[3]. For banks, this de-dollarization was carried out asymmetrically (dollar assets converted into pesos at 1:1 peso-dollar parity, while deposits were converted at 1.4 pesos per dollar). By the end of 2002 the peso had reached 3.3 to the dollar. In addition, *pesofied* assets and liabilities were to be indexed to rising inflation, and deposit maturities were extended from one to four years. Both these measures virtually erased the financial system's equity and had tremendous tangible and intangible costs. Although the government announced that some of these losses would be compensated for with new government bonds, these bonds are of dubious value since the Argentine sovereign is in default. The banks' problems include tight liquidity (despite the restrictions on withdrawals), negative cash flows (due to the fact that the banks' large cross-border indebtedness is no longer matched with dollar collections on the banks' asset side), deteriorating loan portfolios, insolvency and a questionable future even if they manage to overcome their more immediate difficulties. Some foreign shareholders (Canada's Scotiabank and France's

[3] This description of the problems is taken from *Views on the Major Latin American Banking Systems* (Standard & Poor's, August 2002).

Exhibit 7.7 **Macroeconomic Situation in Spain and Latin America (%)**

	Spain Avg 1980-95	Latam Avg 1996-2002E
Inflation	7.9	10.6
GDP growth	2.5	2.2
Maximum growth	5.6	5.5
Minimum growth	-1.2	-0.5

Source: BBVA Research Department. Estimates for 2002.

Crédit Agricole) started to walk away from their local subsidiaries in 2002. This is very much a last resort option for the Spanish banks as they have so much more at stake than other foreign banks in Argentina. There are also political ramifications to consider (see Chapter 9).

The impact of Argentina's crisis so far on SCH's and BBVA's earnings has been considerable. Both banks have had to set aside large provisions to cover potential loan losses and the decapitalization of their Argentine banks. On top of this, the banks have also been hit by the strong depreciation of currencies in Brazil, Chile, Mexico and Venezuela and trading losses stemming from the volatility of markets.

The depreciation of currencies against the euro depressed the value of Latin American assets on the balance sheets of Spanish banks in 2002. The Argentine peso fell 57% against the euro in 2002, the Brazilian real 45%, the Venezuelan bolivar 54%, the Mexican peso 27% and the Chilean peso 24%. SCH strengthened its eroded capital base by selling 11.7% of Banesto, a leading Spanish bank that is part of its group, 3% of Royal Bank of Scotland and 24.9% of Serfin Santander (Mexico) to Bank of America.

Despite all the problems, however, both banks reported improved earnings in most countries, and Spanish banks in general remain among the most profitable in Europe. Mexico generated net attributable income of €429 million in 2002 for BBVA, 7.8% more than in 2001, compared with €237 million in the rest of Latin America. Mexico's ROE was 32.2% as against 8.0% for the rest of Latin America. SCH's net attributable income from Mexico was 16.4% higher at €681 million. In Brazil, BBVA sold its small bank, with a market share in deposits of 1.4%, to Bradesco, the largest private-sector bank.

Exhibit 7.8 **Risk Performance of Santander Central Hispano in Latin America, According to Bank of Spain Criteria**

	NPL Ratio (%)		NPL Coverage (%)	
	December 2001	December 2002	December 2001	December 2002
Brazil	4.30	2.86	175.0	189.2
Mexico	1.49	1.31	170.2	265.2
Chile	3.01	4.23	113.1	93.8
Puerto Rico	2.45	2.37	101.9	106.4
Subtotal	2.57	2.62	141.2	144.5
Venezuela	5.69	6.10	110.3	94.6
Rest	6.99	16.83	106.1	71.8
Total	3.33	4.07	128.8	113.8
Total excluding Argentina	3.18	3.07	133.2	140.1

Source: Santander Central Hispano.

Exhibit 7.9 **Risk Performance of Banco Bilbao Vizcaya Argentaria in Latin America, According to Bank of Spain Criteria**

	NPL Ratio (%)		NPL Coverage (%)	
	December 2001	December 2002	December 2001	December 2002
Brazil	3.16	2.91	96.1	105.6
Chile	2.23	2.06	119.3	130.6
Colombia	5.28	4.15	190.3	257.9
Peru	7.16	5.48	171.6	169.5
Puerto Rico	2.69	2.36	71.8	77.0
Venezuela	6.20	7.44	114.8	132.0
Panama and others	2.61	3.31	414.5	339.3
Latin America exc. Argentina	4.03	3.65	139.3	154.0
Mexico	3.37	4.22	319.6	288.3
Total Latin America excl. Argentina	3.66	3.97	232.0	234.8
Argentina	4.04	37.44	326.1	43.3
Total Latin America	3.73	7.04	252.0	141.4

Source: Banco Bilbao Vizcaya Argentaria.

Exhibit 7.10 **Per Capita Premiums (US$ mn) and Premiums as a Percentage of GDP***

Country	Per Capita Life Business	Per Capita Non-Life Business	Total Business as % of GDP
Argentina	68.8	118.3	2.60
Brazil	10.8	53.2	2.14
Colombia	11.6	34.0	2.38
Mexico	53.2	59.4	1.81
Peru	8.0	13.9	1.06
Spain	491.0	433.0	6.25
Venezuela	3.5	107.2	2.19

(*) Figures for 2001.
Source: Swiss Re.

Santander Banespa generated net attributable income of €801.8 million in 2002, 20.5% more than in 2001 and a rise of 41.6% excluding the exchange-rate impact. In Chile, SCH generated net attributable income of €228.9 million, 20.6% lower than in 2001 because of the sale of insurance companies, the expiry of tax credits and exceptional charges related to the bank's merger with Banco Santiago.

The two banks are now concentrating on their respective core markets of Brazil, Chile, Mexico and Puerto Rico, scaling down operations in less profitable Latin American markets and neutralizing earnings in Argentina until the definitive regulations emerge in that country and the economy is back on an even keel. In those countries where neither the size of the financial system nor market shares are sufficient to develop a universal banking model, the banks are reducing their presence and focusing on a more selective banking model. SCH, for example, decided to exit from large-scale retail banking in Peru in 2002 and sold its retail banking business to Banco de Crédito del Perú.

In this context, risk management in Latin America has assumed even greater importance. Despite the deteriorating environment, the two banks have non-performing loan (NPL) and NPL coverage ratios that are substantially better than those of local banks in the region. Wisely, the Bank of Spain insists that they apply their prudent regulations and not the less stringent local rules. SCH's overall NPL ratio (bad debts as a percentage of total loans) for Latin America rose from 3.33% in 2001 to 4.07% in 2002; excluding Argentina it dropped from 3.18% to 3.07% (see Exhibit 7.8). Total NPL coverage (provisions as a percentage of bad debts) for Latin America dropped from 128.8% to 113.8%; excluding Argentina it increased from 133.2% to 140.1%. BBVA's NPL ratio for Latin America including Argentina increased from 3.73% in 2001 to 7.04% in 2002 (see

Exhibit 7.11 Combined Market Share of BBVA and SCH in Pension Fund Assets

Country	Market Share (%)
Argentina	42.9
Bolivia	51.4
Chile	42.6
Colombia	55.6
Ecuador	68.8
El Salvador	48.2
Mexico	30.7
Panama	50.0
Peru	52.8
Uruguay	17.9
Total Latam	**39.4**

Figures for 2002.
Source: Banco BIlbao Vizcaya Argentaria and Santander Central Hispano.

Exhibit 7.12 Pension Fund Assets (% of GDP)

Country	% of GDP
Chile	55.0
Bolivia	11.0
Argentina	7.4
Peru	6.6
Uruguay	6.1
El Salvador	5.5
Mexico	4.3
Costa Rica	0.1
Spain	**6.7**

Source: AIOS for Latin American countries and Inverco for Spain.

Exhibit 7.9). NPL coverage dropped from 252% to 141.4%. Excluding Argentina the NPL ratio was 3.97% (3.66% in 2001), with coverage of 232% (234.8% in 2001).

SCH and BBVA are active in bancassurance in Latin America, using their networks to capture insurance business. The growth potential is enormous: per capita premiums are very low by European standards (see Exhibit 7.10). Even with 12% growth in premiums in Mexico in 2002, which was more than double the rate of inflation and more than ten times GDP growth, premiums per capita were still less than a tenth of the average for the Group of Seven most economically advanced nations. The main Spanish non-banking player in the region's insurance market is Mapfre, which has affiliates in 11 countries.

Pension Fund Management

Spanish banks have also moved into pension fund management in Latin America and between them have a market share of 40% (see Exhibit 7.11). In 1982, during the Pinochet dictatorship, Chile introduced the world's first privately managed, fully funded pension system. Since then, eight other Latin American countries have adopted privately run systems of one type or another—and to varying degrees of success[4]. Chile and Mexico are the only countries that have fully privatized their pension schemes. Others have hybrid schemes or have stuck with a state system with voluntary private schemes, as Brazil has done.

Spain introduced private pension funds in 1988 and these assets today represent around 7% of GDP. The number of participants is close to 6 million in a population of more than 20 million aged between 25 and 64. There is tremendous scope for growth in

[4] This section draws on *Patching Up the Pension Fund Folly* by Maria O'Brien (LatinFinance, October 2002).

this area in Latin America: Chile, with pension fund assets representing 55% of GDP, has the largest volume measured on this basis (see Exhibit 7.12).

BBVA and SCH have more than 40% of the Argentine market, which is now in ruins. Argentina committed two basic errors in the creation of its private pension system: it failed to adequately finance the transition from the pay-as-you-go scheme to privately managed systems, and the pensions funds were stuffed with government junk bonds. Argentina's financial crisis and the collapse of its banking system highlighted the vulnerability of pension funds to default and government interference. Pension funds in Latin America are still very heavily dependent on government debt, and few have graduated to any significant extent to investing in shares. In Chile, portfolio managers hold around 35% of their assets in bonds. In El Salvador, the pension funds can only invest in government securities. Diversification, however, is easier said than done. Pension funds cannot tolerate much risk; there is little corporate debt of sufficient quality, stock markets have taken a hammering and government bonds have proved to be a sound investment.

The Chilean system, where the Spanish banks have a market share of more than 40%, has been a relative success, although the government still has to pay a minimum pension to around half of all retirees as the state is committed to making up the difference between a person's pension savings and the legally defined minimum pension. BBVA Provida Chile has a market share of 32% and almost 2.7 million participants. In Mexico, BBVA has 4.2 million unit holders through Afore Bancomer. The Chilean system became more sophisticated in August 2002 when it introduced a choice of funds similar to 401 (k) retirement accounts in the US. Individual savers can choose between five types of funds in which to invest their savings with different levels of risk.

Construction

Latin America has enormous infrastructure needs, be it roads, bridges, airports, rail, electricity, water, sanitation or energy, and they are proving to be fertile ground for Spanish construction companies (see Exhibit 2.18 on page 73). Latin America accounted for 39% of the total international activities of Spanish construction companies in 2001, according to SEOPAN, the organization that groups them together.

The region's gap in infrastructure growth relative to that of the seven successful economies of East Asia, measured by East Asia's infrastructure stocks per worker relative to those of Latin America, grew by 40-50% for road length, 50-60% for telecommunications, and as much as 90-100% in terms of power generating capacity over the 1980-97 period[5]. Little investment was made during the 1980s, a "lost decade" for Latin America in many areas. Lagging telecommunication assets, power generating capacity and road networks have all contributed to the region's loss of ground in terms of output per worker. Poor road and telecommunications networks raise transport and, more generally, logistics costs, which have been shown in comparative studies to exceed the international norm by wide margins. The reduced profitability in turn discourages private investment.

Many Latin American governments began to open up utility sectors to private domestic and foreign investment during the 1990s. Fiscal constraints and growing dissatisfaction with the poor efficiency, quality and coverage of service provided by state-owned utilities generated the necessary political momentum for privatization and

---

[5] See *The Output Cost of Latin America's Infrastructure Gap* by César Calderón and Luis Servén (July 2002, www.udec.cl/enech2002/paper23.pdf).

liberalization. The number of countries that have pursued or are pursuing utility sector reforms and are trying to rely on increased private-sector investment has grown dramatically. These reforms generated total investments (private plus linked to the government) of US$290 billion between 1990 and 1999, which represented almost half of all private investment in the infrastructure sector in all developing countries,according to a World Bank study[6]. The work that remains to be done is still huge, and much of the funding will have to come from outside the region. Almost 60% of the US$170 billion of revenues from privatization in Latin America during the 1990s was captured as general revenue by governments and not re-invested in infrastructure. According to one estimate, the annual investments needed for 2000-05 are US$57 billion, equivalent to 2.6% of Latin America's GDP. Maintenance is estimated at US$35 billion per year.

Electricity, Water and Gas

Latin American countries began to reform their electricity sectors in the early 1980s, led by Chile. Countries experimented with a wide variety of systems, ranging from administered systems to those which give the market a broader role. Regulatory reform was undertaken before privatization, so issues of regulatory interpretation did not arise at first[7]. Before the reforms, the region's politicians often pressured regulators into setting tariffs below economically sustainable levels. The result was poor-quality service and power cuts, as the state-owned companies were often starved for funds for investment or even maintenance of equipment. The electricity needs are enormous: the International

---

[6] *Accounting for Poverty in Infrastructure Reform* by Antonio Estache, Vivien Foster and Quentin Wodon (World Bank, 2002).
[7] See *Regulating the Electricity Sector in Latin America* by Ronald Fischer and Pablo Serra (muse.jhu.edu/demo/eco/1.1fischer.pdf).

Finance Corporation, the private-sector arm of the World Bank, estimated that it needs to install 100,000MW of new generating capacity by 2010.

Spain's three main power companies, Endesa, Iberdrola and Unión Fenosa, all have large investments in Latin America, particularly Endesa, which is the region's leading private-sector electricity multinational (see Exhibit 7.13). The region is poised to become a real force in the global electricity industry if the large number of proposed power plants come on stream in the next few years and the countries continue to work together to build more international interconnections. Crisis-hit Argentina is the most liberalized electricity market, with 60% of generation, 100% of transmission assets and 70% of distribution owned by the private sector.

Most of the South American countries are heavily dependent on hydroelectricity. Latin America produces 20% of the world's hydropower, with Brazil having the largest share. Mexico has the most fossil-fuel electricity generating capacity in the region. Nuclear power exists in only three countries (Argentina, Brazil and Mexico). Sugar cane biomass is the most important source of commercial biomass. In an average year, the Andean countries and Brazil satisfy about 80% of their energy needs through hydroelectricity. Even Venezuela, with its abundant oil resources, derives more than 60% of its energy from hydroelectricity. This dependence leads to high supply uncertainty caused by variations in annual rainfall. The electricity shortage in Brazil (where hydroelectricity generates close to 90% of power) in 2001 had a major impact on economic growth and business: Flextronics International of Singapore, a manufacturer of info-tech equipment, cancelled an US$85 million investment to build two new plants because there was no guarantee it could get a steady supply of electricity.

***Exhibit 7.13* Electricity, Water and Gas Companies in Latin America**

Country	Company	Activity	Subsidiary
Argentina	Endesa	Electricity	Dock Sud
			Yacylec
			Costanera
			CBA
			El Chocón
			Edesur
	Gas Natural	Gas	Gas Natural BAN
	Aguas de Barcelona	Drinking water and water treatment	Aguas Argentinas
			Aguas Provinciales de Santa Fe
			Aguas Cordobesas
Bolivia	Iberdrola	Electricity	Electropaz
			Elfeo
	Unión Fenosa	Electricity	TDE
Brazil	Endesa	Electricity	Cerj
			Coelce
			Cacloeira Dourada
			Brazil-Argentina interconnector
	Iberdrola	Electricity	Celpe
			Coelba
			Cosem
			Itapebi
			Termopernambuco
	Gas Natural	Gas	CEG/CEG RIO
	Aguas de Barcelona	Drinking water and water treatment	Aguas de Guariroba
Chile	Endesa	Electricity	Endesa Chile
			Chilectra
			Río Maipo
	Iberdrola	Electricity	Ibener
	Aguas de Barcelona	Integrated water cycle	Aguas Andinas
Colombia	Endesa	Electricity	Betania
			Emgesa
	Unión Fenosa	Electricity	Electracosta, Electricaribe
			EPSA
	Gas Natural	Gas	Gas Natural ESP
	Aguas de Barcelona	Drinking water and water treatment	Aguas de Cartagena

Continued from previous page

Country	Company	Activity	Subsidiary
Costa Rica	Unión Fenosa	Electricity	La Joya
Cuba	Aguas de Barcelona	Drinking water and water treatment	Aguas de La Habana
Dominican Republic	Endesa	Electricity	Cepm
	Unión Fenosa	Electricity	Edenorte and Edesur
			Palamara and La Vega
Guatemala	Iberdrola	Electricity	Eegsa
	Unión Fenosa	Electricity	Deocsa and Deorsal
Mexico	Iberdrola	Electricity	Monterrey
			Enertek
			Femsa-Titán
			Altamira
			La Laguna
	Unión Fenosa		Tuxpan
			Naco-Nogales
			Hermosillo
	Gas Natural	Gas	Gas Natural Mexico
	Aguas de Barcelona	Drinking water and water treatment	Aguas de Saltillo
Nicaragua	Unión Fenosa	Electricity	Dosnorte and Dissur
Panama	Unión Fenosa	Electricity	Edemet and Edechi
Peru	Endesa	Electricity	Etevensa
			Edegel
			Edelnor
			Piura
Uruguay	Aguas de Barcelona	Drinking water and water treatment	Aguas de la Costa

Source: Company reports.

Under a crisis plan, residential and corporate users in an area containing four-fifths of Brazil's population had to cut electricity consumption or face higher charges and blackouts. Distribution has been almost completely privatized, but most generation and virtually all transmission assets remain under government control.

Mexico, the other giant market in Latin America, also needs to generate more power and, like Brazil, does not have the money itself. Some analysts have forecast a power crisis as of 2004. The Energy Ministry says generating capacity must double by 2008 to keep pace with demand, which is growing at more than 6% a year. Officials estimate the upgrade will cost Mexico US$50 billion, money that the Fox government believes would be better spent improving education and combating widespread poverty. As a result, it is trying to open up the power sector to private investment. Mexico nationalized its power industry in the 1960s, sending Canadian and British investors packing. The proposed reforms, which mean changing the constitution, have generated lots of sparks between the government and opposition parties.

The World Bank estimates that 125 million people in Latin America do not have access to safe water and 200 million are without adequate sanitation. In Brazil alone, only one in four households is connected to any kind of sewage system. The rest goes untreated into rivers, lakes or the sea. According to Inmetro, the Brazilian government's standards office, the level of faecal coliform bacteria found in seawater during 2002 at places along Rio de Janeiro's fashionable seafront was more than eight times the safe limit. At some beaches on Sao Paulo state's coast, the level was more than 16 times the limit. Luis Inácio Lula da Silva of the left-wing Workers' Party (PT), winner of the October 2002 presidential election, made sanitation a central issue of his campaign. Limited progress was made under the 1995-2002 administration of President Fernando Henrique

Cardoso. About 40 private concessions were granted and a National Waters Agency (ANA) was established, responsible for overseeing water quality in rivers.

As in electricity, the water sector has been opened up to privatization. Aguas de Barcelona has a significant share of the drinking water and water treatment market in Santiago, the capital of Chile. Water privatisation is a controversial issue in Latin America and is one of the issues that anti-globalization activists most oppose.

In natural gas, Latin America holds around 6% of world reserves and contributes around 4% to world production. The largest reserves are in Mexico and Venezuela. Argentina is also a major gas producer. Gas Natural has subsidiaries in Argentina, Colombia and Mexico. The natural gas infrastructure is being expanded. According to the US Department of Energy, natural gas consumption in the region will reach 13 trillion cubic feet by 2020, five times its 1995 level. To meet this demand, many transborder natural gas projects are being conceived and developed.

Media and Publishing

Spanish publishers were pioneers in the internationalization of Spanish companies: they began to set up companies in Latin America, particularly in Mexico and Argentina, in the 1950s and 1960s. Planeta, for example, began to operate in Latin America in 1964. Publishing in Spain during that period was not very profitable: the country's degree of cultural development was generally low and many types of book were banned for political reasons under the 1939-75 dictatorship of General Franco. Many intellectuals, identified with the Spanish Republic that was defeated in the 1936-39 Civil War, went into exile. The Casa de España was founded in Mexico in 1938 by President Lázaro

Exhibit 7.14 **Main Presence of Spanish Publishers and Media Groups in Latin America**

Country	Spanish Company	Subsidiary
Argentina	Grupo Planeta	Editorial Planeta
	Grupo Planeta	Emecé Editores
	Grupo Prisa	Santillana
	Grupo Recoletos	El Cronista (newspaper)
Bolivia	Grupo Prisa	Santillana
Brazil	Grupo Prisa	Santillana
Chile	Grupo Planeta	Editorial Planeta
	Grupo Recoletos	El Diario Financiero (newspaper)
	Grupo Prisa	Santillana
		GLR Radio Broadcasting Latin Group
Colombia	Grupo Planeta	Editorial Planeta
	Grupo Prisa	Santillana
		Caracol Radio
Dominican Republic	Grupo Prisa	Santillana
Ecuador	Grupo Planeta	Editorial Planeta
	Grupo Prisa	Santillana
Guatemala	Grupo Prisa	Santillana
		GLR Radio Broadcasting Latin Group
Mexico	Grupo Planeta	Editorial Planeta
	Grupo Prisa	Santillana
		Radiopolis
Panama	Grupo Prisa	Santillana
		GLR Radio Broadcasting Latin Group
Peru	Grupo Prisa	Santillana
Puerto Rico	Grupo Prisa	Santillana
Uruguay	Grupo Planeta	Editorial Planeta
	Grupo Prisa	Santillana
		Radiopolis
Venezuela	Grupo Planeta	Editorial Planeta
	Grupo Prisa	Santillana
		Radiopolis

Source: Company reports.

Cárdenas to give a home to Spanish Republican intellectuals. It was the forerunner of the Colegio de México, Mexico's best known liberal arts college.

Latin America's population of some 200 million represented an attractive market for publishers who first exported their books to the region and then began to set up companies in different countries. In the 1950s, Argentine publishers (for example, Losada, Emecé, Sudamericana and Frabril) exported literature to Spain and Mexican companies (Fondo de Cultura Económica) non-fiction works. This situation was reversed in the 1970s when publishers in Spain became stronger, as a result of economic change and some opening–up of the political system. Exports to Latin America took off, while imports of books from the region tailed off. The value of the Spanish book market is around US$400 million, with Mexico being the largest importer.

Today, several Spanish publishers have a strong position in Latin America, particularly Grupo Planeta, the largest publishing house in Spain, Portugal and Latin America and the seventh in the world, with more than 20 publishing companies (see Exhibit 7.14). Its Barsa Planeta for direct sales operates in Argentina, Brazil, Chile and Mexico, selling collectables (books, computer programmes and multimedia products) through a sales force of around 6,000 people. Ediciones Altaya, with branches in Argentina, Brazil and Mexico, sells collections ranging from flamenco music to computer science.

Also strong in Latin America is Santillana, the publishing division of Grupo Prisa, the multimedia group whose newspaper *El País* is Spain's leading daily (average circulation of 435,690 copies in 2002 and 725,690 on Sunday). Like Planeta, Santillana has been in Latin America for several decades, selling education and training textbooks. In 2002, 77% of Prisa's total revenue of €1,216 million was generated outside Spain

Exhibit 7.15 Top Six Oil Producers*

	Mt	% of World Total
Saudi Arabia	421	11.8
United States	354	9.9
Russia	347	9.7
Iran	186	5.2
Mexico	**179**	**5.0**
Venezuela	**173**	**4.8**

(*) 2001 figures.
Source: International Energy Agency.

(73% of international revenues came from Santillana, 10% from printing and the rest from radios). In general interest books Prisa has six labels–Aguilar, El País-Aguilar, Alfaguara, Alamah, Taurus and Punto de Lectura, some of which print in various countries. Prisa also prints editions of *El País* in Mexico and Argentina and it has stakes in radio stations in Colombia, Chile, Costa Rica, Mexico and Panama. Grupo Recoletos, another media group 79% owned by Pearson of the UK, has stakes in newspapers in Argentina *(El Cronista)* and Chile *(El Diario)* and a mandate to acquire more media assets in Latin America.

Oil

Latin America holds close to 12% of the world's proven oil reserves and accounts for 10% of total crude oil production. Venezuela, one of the founding members of OPEC, and Mexico, a non-OPEC member, have the largest proven reserves, at 77.7 billion and 26.9 billion barrels, respectively, and they are the sixth- and fifth-largest producers and the fifth- and ninth-largest exporters (see Exhibit 7.15). Argentina, Brazil, Colombia, Ecuador and Peru also produce oil.

Most countries, with the notable exception of Mexico, whose oil industry was nationalized in 1938, allow foreign companies to bid on oil exploration, development and production sharing concessions. The Fox government would like to open up the oil industry to foreign investment but has met with stiff resistance. In 1998, the Brazilian government opened to foreign investment oil exploration, oil field development and production in 397 different areas, and in 1999 YPF, Argentina's state-owned oil company, was privatized and sold to Spain's Repsol. Its US$15 billion purchase of YPF was the largest single investment by a Spanish company and overnight turned Repsol into an

Exhibit 7.16 **Repsol's Expansion in Latin America***

	Argentina	Bolivia	Brazil	Chile	Colombia	Ecuador	Guyana	Mexico	Peru	Trinidad & Tobago	Venezuela	Cuba
1. Productive activities												
Oil and gas												
Exploration blocks (number)	31	13	7	–	5	–	1	–	4	–	1	6
Production blocks (number)	84	25	1	–	1	3	–	–	–	3	6	–
Hydrocarbon reserves (‘000 boe)	3,079	1,293	53	–	7	69	–	–	–	236	257	–
Oil production (millions of barrels)	160	7	–	–	2	3	–	–	–	2	15	–
Gas production (billions of cubic feet)	570	89	–	–	–	–	–	–	–	42	106	–
2. Other activities												
Oil												
Refineries (number)	4	–	2	–	–	–	–	–	1	–	–	–
Own oil pipelines (number)	2	–	–	–	–	–	–	–	–	–	–	–
Other oil pipelines (number)	2	–	–	–	–	–	–	–	–	–	–	–
Own petrol stations (number)	2,892	–	23	51	–	57	–	–	71	–	–	–
Other petrol stations (number)	813	–	144	72	–	57	–	–	87	–	–	–
Liquified gas plants (number)	1	–	–	1	–	1	–	–	1	–	–	–
Gas												
Gas pipelines (number)	2	–	–	–	–	–	–	–	–	–	–	–
Distribution (number of companies)	2	–	3	–	1[a]	–	–	–	–	–	–	–
Liquefaction plants (number)	–	1[b]	–	–	–	–	–	–	–	2+1[c]	–	–
3. Electricity generation												
Plants (number)	7	–	–	–	–	–	–	–	–	–	–	–

a Consortium
b Project.
c Project under way.
(*) Figures for 2002
Source: Repsol YPF.

Exhibit 7.17* Telefónica Group – Market Size

(´000)	Fixed Lines	Mobile Customers
Argentina	4,222	1,617
Brazil	12,839	13,742
Chile	2,757	1,849
El Salvador	–	213
Guatemala	–	97
Mexico	–	2,419
Peru	1,850	1,239
Puerto Rico	–	169
Spain	18,705	18,412

(*) Information at the end of 2002.
Source: Telefónica.

integrated and fully diversified energy group. Repsol's main Latin American presence by far is in Argentina (see Exhibit 7.16).

Telecommunications

Latin America has embraced the privatization of its telecommunications sector like no other in the world. In nearly every country, the major telecommunications operator is either fully or largely owned by a multinational, often Spain's Telefónica (see Exhibit 7.17). Telefónica has invested more than US$30 billion in Latin America, chiefly in Argentina, Brazil and increasingly Mexico.

In 2002 Telefónica had more fixed lines in Latin America (21.6 million) than in Spain (18.7 million) and 21.3 million mobile customers (18.4 million in Spain) including its joint venture in Brazil with Portugal Telecom (PT). Telefónica made a net loss of €5.58 billion in 2002, as a result of the write-off of more than €16 billion of goodwill relating to its Argentine companies, its US Internet portal Lycos, and its third-generation mobile telephony licences in Europe. Argentina's contribution to group revenues fell from 12.6% in 2001 to 3.7%, while Latin America's contribution dropped from 43% to 35%. In fixed lines, Telefónica is the leader in Latin America with a market share of 26% in June 2002 (excluding 2.7 million lines at Venezuela's CANTV) and the second-largest cellular operator after América Móvil with a market share of 18% (including Brasilcel, its joint venture company with Portugal Telecom in Brazil and excluding 2.5 million subscribers at CANTV). Brasilcel agreed in January 2003 to acquire the Brazilian mobile phone operator Tele Centro Oeste for just over US$1 billion, raising its market share in the country to more than 50% and making it the largest operator in South America.

The level of efficiency of the companies owned by Telefónica has improved considerably since it bought them, the result of staff reductions and investment in infrastructure. The number of fixed lines per employee at Telesp in Brazil, for example, rose from 339 in 1998, when Telefónica acquired the company, to 1,314 in 2002. At CTC Chile the number increased from 108 in 1991 to 980 in 2002.

Privatization has generally led to network growth, shorter waiting lists and better quality service, but in 2001 there were still only 86 million fixed lines for a population of 527 million. Teledensity (the number of telephones per 100 people) ranged from a low of 3.7 in Nicaragua to a high of 25 in Costa Rica, with Brazil and Mexico, the largest markets, at 23 and 13.5, respectively. There is massive unmet demand for virtually all telecom services in Latin America, making it a very attractive region for investment. The key developments are[8]:

- Overall telecoms revenues, including fixed and mobile services, were estimated at US$65 billion in 2002, up from US$51 billion in 2000.

- The most significant infrastructure change has been the number of new undersea fibre networks creating new broadband routes.

- The number of Internet users is expected to increase from 26 million in 2001 to 44 million in 2003.

- Internet host computers are growing at a faster pace in Latin America than any other region of the world.

[8] I am grateful to Paul Budde Communication for this overview.

Exhibit 7.18 **Sol Meliá's Hotels in Latin America**

Country	Number of Hotels
Argentina	1
Brazil	23
Colombia	7
Costa Rica	4
Cuba	22
Dominican Republic	3
Guatemala	1
Mexico	11
Panama	1
Peru	1
Uruguay	1
Venezuela	2

Source: Company reports.

- The number of cellular subscriptions (including the Caribbean) reached 86.8 million in 2001, surpassing fixed lines.

- Wireless Internet in the region took off in 2001, growing from an estimated 100,000 subscribers to 2 million.

- E-commerce revenues in Latin America are estimated to have totalled US$3.6 billion in 2000, with an expected increase to US$67 billion by 2004.

Other Sectors

Most other investment is in tourism, an area where Spain's expertise has proved to be very fruitful in Latin America. Spain overtook the US in 2001 to become the world's second-largest tourism destination, with a 7.2% share of the global market. Tourism generates 12% of Spain's GDP and directly employs more than 1.4 million people (roughly one in every ten people with a job). The Spanish company that has invested the most in tourism in Latin America is Sol Meliá (see Exhibit 7.18).

Hispasat, the Spanish satellite communications company, 74% owned by the private sector and 26% by the state, has built up a significant presence in Latin America (see Exhibit 7.19). It is the only European satellite system with transatlantic capacity that has simultaneous coverage of all Latin American countries. More than 15 million households in Latin America and 3 million in Spain and Portugal receive TV programmes via Hispasat. The company is developing, in conjunction with the Brazilian telecommunications operator Telemar, the satellite Amazonas, which will be launched at the end of 2003 and located in the orbital position 61º West. The range of

***Exhibit 7.19* Hispasat's Landing Rights in the Americas**

Argentina	Guatemala
Belice	Guyana
Bolivia	Honduras
Brazil	Mexico*
Canada	Nicaragua
Chile	Panama
Colombia	Paraguay
Costa Rica	Peru
Cuba	Surinam
Dominican Republic	Uruguay
Ecuador	USA
El Salvador	Venezuela*

(*) In advanced negotiations as of November 12, 2002.
Source: Hispasat.

telecommunication services that this satellite will offer, through a total of 63 equivalent transponders, includes the broadcasting of contents, Internet access, broadband services, as well as the traditional satellite telecommunications services. The satellite's Pan-American coverage will include the entire American continent, and the transatlantic capacity will allow connections between the Americas, Europe and North Africa.

Chapter 8

The Image of Spanish Companies in Latin America

The image abroad of Spain's companies, and hence of its products, has improved notably since the death of General Franco in 1975, as a result of the successful transition to democracy and to a free market economy. There have also been landmark events that have enhanced Spain's image as a modern country, most notably the 1992 Olympics in Barcelona and the World Exposition in Seville. The country's film directors have won Oscars (José Luis Garcí, Fernando Trueba and Pedro Almodóvar), the writer Camilo José Cela won the 1989 Nobel Prize for Literature, there is a bevy of top-notch opera singers (Plácido Domingo, José Carreras, Montserrat Caballé) and several internationally renowned architects (Ricardo Bofill, Santiago Calatrava and Rafael Moneo). Spanish is also a language that is very much on the rise worldwide and is increasingly the second language that children are learning after English. But when consumers evaluate Spain with subjective criteria in surveys that measure country perceptions/stereotypes, the image is out of step with the country's new economic, political and cultural reality. This matters because the country of origin is an extrinsic attribute that influences consumer assessment[1].

Latin America takes around 5% of Spain's total exports, and one of the factors behind this surprisingly tiny share (half that of Portugal) is the generally poor, though much improved, image of Spanish products (as revealed in surveys). The image problem, however, has not affected the flow of Spanish direct investment into Latin America. Far from it: Spain has invested more in the region than anywhere else in the world. Buying a company, however, is not the same as exporting a product. But now that the bulk of the investment process is over and a handful of companies and banks

---

[1]See the chapter *Image and Spanish Country of Origin Effect* by J. Enrique Bigné in *Advertising and Identity in Europe* edited by Jackie Cannon, Robin Warner and Patricia Odber de Baubeta (Intellect, 2000).

are very much part of the Latin American corporate landscape, the image issue assumes greater importance.

The predominant stereotypical image of Spain in Latin America, because of its colonial past, is that of “new conquistadors”, words that the US and UK media love to deploy in an almost hackneyed fashion when describing Spain’s investment push abroad and whose widespread use has made it even more difficult for Spain to shake off its “black legend” image. National and cultural stereotypes are known to influence the perception and evaluation of brands. It is impossible to objectively gauge the extent to which companies have behaved as if they were conquistadors, although there is anecdotal evidence to suggest that some executives have conducted themselves arrogantly. Surveys, however, do show that Spain is viewed as being much more arrogant in Latin America than in Europe (see Exhibit 8.1). Some analysts attribute the bad image to the predominance of Spanish companies in Latin America in former state-owned utilities (electricity, water and telecommunications), which makes them an obvious target for social discontent in times of economic crisis.

Crisis-hit Argentina was the country where Spain invested the most until 2001, when Brazil overtook it as the main destination of investment. Foreign companies in Argentina have been blamed by some sectors of society, seeking a scapegoat, for “plundering” the country and contributing to the crisis, and yet Repsol YPF was the country’s most respected company in the 2002 ranking drawn up by the *Financial Times* (see Exhibit 8.2). YPF, the Argentine energy conglomerate bought by Repsol in 1999 for US$14.9 billion, enjoyed a good reputation and Repsol has built on this. Repsol has also been helped by adding YPF to its name and using it worldwide, and not just in Argentina, instead of eliminating it and appearing colonial. No other

Exhibit 8.1 The Image of Spain in Europe and Latin America

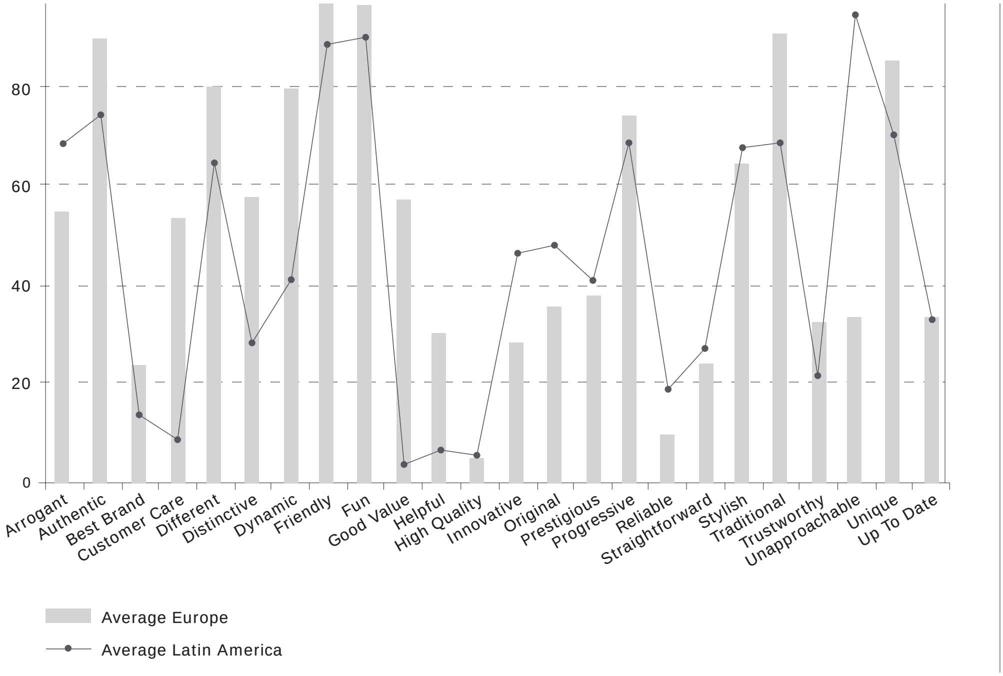


Exhibit 8.2 Ranking of the Most Respected Companies in Argentina

1. Repsol YPF	= 6. Molinos
2. Arcor	8. Ford
3. Perez Compac	9. Techint
4. Techne Vision	=10. Grupo Techin
5. Coca Cola	= 10. Telecom
= 6. IBM	

Research conducted by PriceWaterhouseCoopers.
Source: Financial Times. January 16, 2003.

Spanish company, however, made it into the rankings for Brazil and Mexico, the two other countries that are the focus of Spanish investment, and Repsol YPF did not make it into the worldwide ranking. Spain's only entry in the global ranking was Airbus Industrie, the engineering company owned by UK, German, French and Spanish interests, which was in 38th place out of 90.

Surveys show that Spain's image and position in the minds of buyers does not correspond to a nation that is the world's eleventh-largest economy (the ninth among OECD countries), the sixth-largest international investor (the second in Latin America), the second-biggest tourism destination and the sixth-largest car producer. The quality of Spain's road and train infrastructure, for example, puts the UK to shame, but most of the outside world does not know and appreciate this. While Germany has a positive image as its products are viewed as innovative, expensive and of high quality, surveys show that Spanish goods are still generally seen as cheap, poorly designed and unreliable. This negative image, which affects the setting of prices, is accurate in some areas; the problem is that it also affects those areas where Spain can match the best.

The producers of cava, for example, complain that their sparkling wine is still regarded as a cheap alternative to champagne, although the finest cavas are just as good as the finest champagnes.[2]

In Latin America, with its close cultural and historical ties and linguistic affinity, Spain is particularly admired for its political and economic modernization (some 30 years ago Argentina could boast that its economy was more developed than Spain's; now it is a

[2] See "*Spanish Brands Seek More Sparkle*" by Leslie Crawford (Financial Times, January 6, 2003).

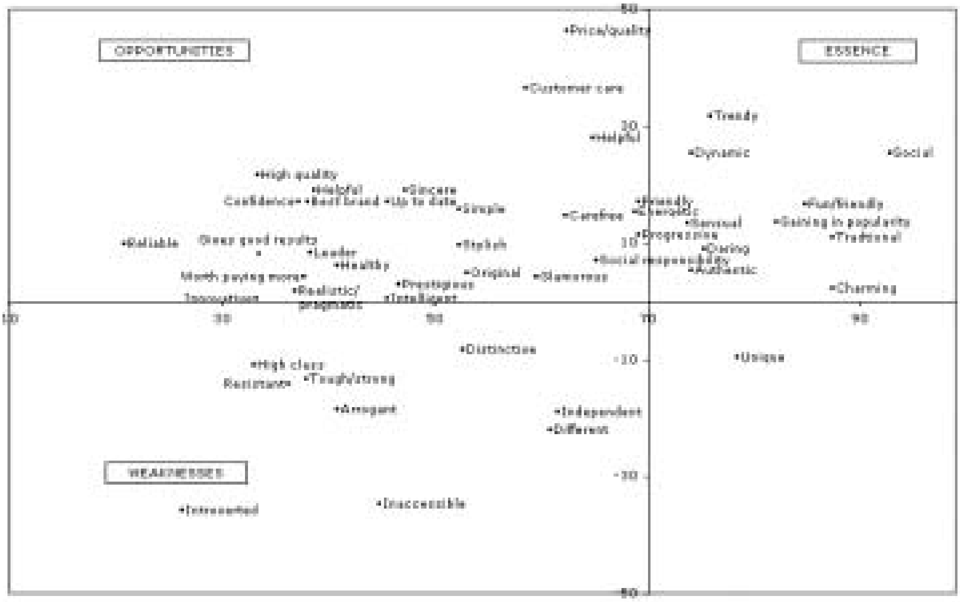
basket case). A study by Young & Rubicam (Y&R) conducted in 2000-2001 highlighted the similarities and differences between Spain's image in Latin America and in Europe. Using the same terminology, Y&R divided the results from its brand asset valuator into three areas – opportunities, essence (differentiating values) and weaknesses. The most striking difference is that in Latin America Spanish companies are now regarded as innovative, while in Europe the predominant image is still that of a friendly, sociable and fun country. The image in Europe is, to a large extent, linked to factors related to the tourism industry, whereas that in Latin America is the result of the wave of Spanish investment over the past decade (see Exhibits 8.3 and 8.4). Paradoxically, despite the cultural proximity, Spain is viewed as emotionally distant in Latin America[3].

Spain's economic and trade offices abroad carried out the first ever survey in 2001 to find out which were the country's best-known brands globally and by geographic area. In Latin America, the best-known brands were Iberia, the flag carrier, and the banks Banco Bilbao Vizcaya Argentaria and Santander Central Hispano, all of them in the service sector (see Exhibit 8.5). Not a single one, however, is among the world's 100 best-known brands, drawn up every year by Interbrand. Having just one very well-known global brand can make a big difference, as it acts as a locomotive pulling behind it other lesser-known brands, particularly if they are in the same sector. Finland, for example, whose global share of goods exports is half that of Spain's at around 1%, has one such brand in the Interbrand list – Nokia, the world's largest manufacturer of mobile phones.

These companies and the other major investors in Latin America—Telefónica, Endesa, Iberdrola and Repsol YPF—are playing a major role in helping Spain to achieve a

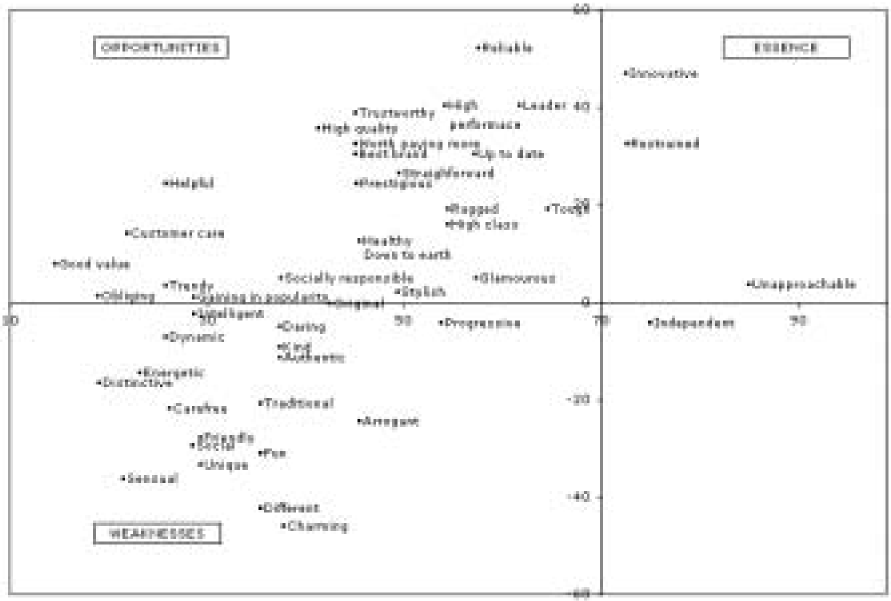
[3] See page 225 of *La imagen de España en el exterior* by Javier Noya (Elcano Royal Institute, 2002).

Exhibit 8.3 **Image of Spain in Europe**



Source: Young & Rubicam.

Exhibit 8.4 **Image in Latam**



Source: Young & Rubicam.

Exhibit 8.5 Best-Known Spanish Brands in Latin America

Brand	No. of Mentions[1]
Iberia	8
Banco Bilbao Vizcaya Argentaria	8
Santander Central Hispano	8
Zara	4
Freixenet	4
Telefónica	4
Terra	4
Repsol YPF	3
Seat	2
UFESA	2
Isabel	2
Barcelo	2
Mapfre	2

(1) The only brands included are those that were among the five most mentioned in the survey conducted by Spain's economic and trade offices abroad. The figures in the right-hand column refer to the number of times these brands were mentioned among the five best-known brands, both globally and by geographic area.

Source: Juan José Durán in his chapter "El capital comercial y la internacionalización de la marca" in Las marcas renombradas españolas, un activo estratégico para la internacionalización de España (Foro de Marcas Renombradas Españolas, 2002).

critical mass of well-known global brands, which should help all Spanish companies to compete more successfully in international markets. These companies, in particular, have an important mission in promoting a new image of Spain that is not synonymous with the traditional one of cheap package holidays, successful though it is for the country's dynamic tourism industry.

As regards institutional support, the Elcano Royal Institute, the Association of Well-known Spanish Brands, the Foreign Trade Institute (ICEX), the Ministry of Foreign Affairs and the Association of Media Executives (DIRCOM) established in 2002 the Spain Brand Project, aimed at creating an image that responds to the new economic, social and cultural reality. The Elcano Royal Institute is in the process of setting up a Permanent Observatory of Spain's Image Abroad.

Chapter 9

Prospects

Latin America is going through another of its financial and economic crises, and the way in which this one is resolved is of crucial importance for Spain, because of the very high level of investment it now has in the region. No country's corporate sector, apart from the US's, stands to win or lose more than Spain's.

The significant deterioration in global financial sentiment, the US slowdown, the fall in the terms of trade by non-oil exporting countries, the sharp depreciation of currencies and political turmoil in some countries pushed the region as a whole into recession and made 2002 an *annus horribilis* (see Exhibit 9.1). The litany of sad statistics included foreign direct investment that hit its lowest level since 1996, risk aversion that led to a severe credit crunch, gross domestic product that dropped below 1997 figures, formal unemployment (i.e. excluding the shadow economy) at an historic high of more than 9% and a doubling of inflation to 13%. 2002 was also the first year since the late 1980s in which the region registered net outflows of capital.

For the five years since 1998, when the impact of the Asian financial crisis was first felt in Latin America, regional output shrank by an annual average of 0.3%, compared with growth of nearly 2% in 1990-97. This period, during which per capita income declined, was the worst since the "lost decade" of the 1980s debt crisis. The most dramatic situation is in Argentina, whose economy contracted 11% in 2002 after defaulting on US$95 billion of its US$115 billion commercial debt, the largest sovereign debt default in history. Its pace of impoverishment in 2002 was the fastest of any country in the world in times of peace.

As well as the economic deterioration, there has been substantial change in the political scene. Latin America now has four high-profile left-leaning heads of state, two

Exhibit 9.1 **Economic Forecast for Latin America, 2002-07**

	2002	2003	2004	2005	2006	2007	Avg 2002-07
Real GDP growth (%; average)	-1.1	1.9	3.0	3.4	3.7	3.5	2.4
Inflation (%; average)	9.5	11.4	8.4	5.8	4.8	4.6	7.4
Current-account balance (% of GDP)	-1.8	-1.5	-1.7	-2.1	-2.2	-1.9	-1.8
External financing requirement (US$ bn)	-137.7	-12.3	-115.1	-118.9	-120.5	-140.9	-126.0

Source: Economist Intelligence Unit, February 2003.

of which, Brazil's Luiz Inácio Lula da Silva, a former union leader universally known as Lula, and Ecuador's Lucio Gutiérrez, a former army colonel and coup plotter, came on the scene in 2002. They joined Cuba's Fidel Castro, the grand old man of the Latin American left, and Venezuela's embattled Hugo Chávez. For hawks in the Bush administration and conservatives on Capitol Hill, in particular, the emergence of more leftist leaders, who have openly criticized US policy, has raised concerns about a new pan-Latin American movement with socialist overtones. Washington fears an "axis of populism" in its backyard, but the four leaders are very different political animals and are unlikely to mount coordinated and concerted opposition to the US. For example, Chávez failed to win the backing of Lula to include Cuba, Russia or China in a group of countries trying to resolve Venezuela's political crisis. Brazil aided Venezuela during its devastating strike from December 2002 to February 2003 by supplying oil, but Chávez ignored Lula's advice to negotiate with his opponents.

Latin America today can be likened to a train with giant engines on either end—pulling in opposite directions[1]. The region's two giants, Mexico and Brazil, have been pulling toward better democracy and growth economies, while the two lesser giants, Argentina and Venezuela, entered a dark tunnel. The outcome of this struggle between more or less free market capitalism and populist nationalism will determine whether the Spanish companies that invested in Latin America have a bright long-term future in the region, as they believe they do, despite all the problems, or whether their strategies were mistaken.

The major investors in Latin America—the banks Santander Central Hispano (SCH) and Banco Bilbao Vizcaya Argentaria (BBVA), the electricity companies Endesa, Iberdrola

[1] Editorial in *The Christian Science Monitor*, November 21, 2002.

and Unión Fenosa, the oil and gas group Repsol YPF and the telecommunications conglomerate Telefónica—all view their presence in the region as long-term and strategic; and, unless there is a radical and sustained change of direction in economic policies, the reasons that initially justified investing in the region (see Chapter 1) remain valid. At the same time, the big banks have drawn one lesson, at least, from their experience so far in Latin America: they concentrated too much on the region to the detriment of their home markets, where their market shares declined in some areas in 2002. A senior executive at Santander even went as far as to say that the policy of closing 1,600 branches in Spain between 1999 and 2002 was a mistake and that customers were "disoriented" by the changes and some had transferred their accounts to other banks.[2]

It is very important to bear in mind that the outlook for Latin America varies considerably from country to country. This is because the region, unlike Europe, is less and less a homogeneous bloc in economic terms. As a whole, Latin America, for example, is the only region in the world with a significant current account deficit, the product of insufficient exports and very high exchange rate volatility.[3] At the individual level, however, some countries have relatively low deficits, export successes and relative exchange rate stability. It is worth noting here that one of the major factors behind East Asia's quick recovery from its crisis in the late 1990s, sparked by the devaluation of the Thai bhat, was that exports returned to being the engine of growth. Until Latin America can achieve this, it will continue to suffer from stop-and-go periods of growth. No country's exports represent more than 28% of GDP other than Chile. Trade openness is important because countries that are relatively open tend to

---

[2] See *"El SCH reconoce como un error haber cerrado 1.600 oficinas"* (El País, December 20, 2002).
[3] See *America Latina: ¿Qué ha salido mal?* by Fernando Fernández Méndez de Andes (Political Exterior, Autumn 2002).

suffer less during emerging market crises[4]. One of the factors behind the fall in Mexico's country risk has been the sharp rise in the volume of its exports and the substantial diversification of the products sold abroad.

It should also be remembered that while the big Spanish banks and companies are heavily exposed to Latin America in terms of direct investment, more than 80% of the total credit risk of Spanish banks is in OECD countries and little is in non-investment grade countries (the only investment grade countries in Latin America are Mexico and Chile). BBVA's sale of its Brazilian unit to Bradesco in early 2003 reduced the proportion of its total assets located in non-investment grade countries in Latin America from 10% in 2001 to 5% in 2002.

The major economies—Mexico, Brazil, Chile, Venezuela and Argentina—are decoupling from each other, both in terms of real economic links and in the minds of the investment community, which is becoming more discriminatory. Mexico and Chile are the clearest examples of this change, and it is no coincidence that they are the only countries in the region granted investment grade status by Moody's, Fitch IBCA and Standard & Poor's (see Exhibit 5.3).

Growth in Latin America should recover slightly in 2003, but there are many uncertainties, most notably Iraq and the oil panorama. A war could make international banks and cross-border investors less willing to take on risk, putting pressure on the creditworthiness of countries that rely on external financing.

[4] See *Sudden Stops, the Real Exchange Rate and Fiscal Sustainability: Argentina's Lessons* by Guillermo Calvo, Alejandro Izquierdo and Ernesto Talvi (Inter-American Development Bank, March 2002, http://www.utdt.edu/~summer/Calvo.pdf).

Exhibit 9.2 **Comparative Risk Ratings of Main Latin American Countries***

Country	End-2001	End-2002
Argentina	65	82
Bolivia	61	62
Brazil	57	63
Chile	24	21
Colombia	54	55
Ecuador	66	68
Mexico	49	48
Paraguay	72	76
Peru	50	50
Uruguay	49	56
Venezuela	53	66

(*) A score of 0-24 signifies that a country faces no significant constraints on international financial transactions. Economic policies are appropriate and effective. A score of 25-40 indicates that a country faces no difficulties in foreign transactions, but its economic policies or political structure may give rise to some concern. A score of 41-59 is given to countries with a record of foreign-exchange crises or political problems and persistent but controllable macroeconomic imbalances. A score of 60-79 is assigned to countries with serious economic or political problems. Debt rescheduling is possible. A score of 80-100 indicates that a country faces severe economic and political crisis, often undergoing violent political upheaval.

Source: Economist Intelligence Unit

The country that raises the most concerns is Argentina, which, more than one year after it defaulted, had still not reached a definitive agreement with the IMF to put its house in order. Its risk rating, according to the Economist Intelligence Unit, rose from 65 at the end of 2001 to 82 at the end of 2002, putting it in the worst category (see Exhibit 9.2). Much will depend on what kind of government emerges after the April 2003 presidential election. Having won breathing room from the IMF in January in the form of a one-year roll-over of US$6.8 billion of debts with no fresh funds, it is by no means certain that a future Argentine government will not continue to play the card of brinkmanship and get its own way. The ruling Peronist Party was deeply divided and planned to put up three candidates for the election, only one of whom, the former president (1989-99), Carlos Menem, aged 73, appeared to favour the IMF programme; the other two hinted they would re-nationalize the railway system and petroleum and mining resources.

The stopgap programme with the IMF focuses on monetary and fiscal discipline, avoiding policy reversals (the capacity for which is very limited, as the Argentine crisis highlighted) and rebuilding legal uncertainty. The lame-duck government of President Eduardo Duhalde promised to raise the primary budget surplus target—a surplus excluding interest payments and an indication of the government's capacity to pay debt obligations—to 2.5% of GDP for 2003, up from 0.7% in 2002. To prepare the ground for the new government, the authorities were asked to formulate the needed fiscal structural reforms to broaden the tax base, improve tax administration and reshape relations between the central government and the provincial governments. The 24 provinces have to achieve a 0.4% primary surplus, a substantial improvement from the 0.5% deficit of 2002. They also have to stop issuing bonds that have been widely used to pay local government employees and suppliers. In February 2003, Argentina had more than a dozen such methods of payment, which functioned almost identically to cash and accounted for an estimated 25% of all money in circulation. The programme assumed real GDP growth of 2-3% for 2003 (-11% in 2002) and inflation remaining at around 35%.

Honouring the terms of the agreement may well prove to be a pipe dream. Less than one month after the interim agreement, the outgoing government said the most difficult policy changes required by the agreement would have to be deferred until after the April election. This would be too late for the measures to take effect in 2003. Another sticking point is utility rates. The Duhalde government raised electricity and gas rates by about 9% and similar rises in telephone and water rates were on the way. The IMF wants much higher rate increases. Equally protracted and intricate will be the restructuring of about $50 billion of debt to foreign investors. Associations of private bondholders expressed concern about the IMF's interim deal with Argentina, fearing it would reduce pressure for the new administration to negotiate in good faith with its creditors.

Argentina’s crisis has affected not just the country but also the region’s financial markets more dramatically than many expected. The country’s collapse has yet again shown that banks, companies and investors in general pay relatively little attention to political developments.[5] However, because they are unquantifiable, political risks are difficult to manage. Risk management systems are by their very nature backward-looking and reactive, and no number of brilliant mathematicians developing techniques can predict when policy reversal will occur.

Argentina’s meltdown has also exposed the crying need in Latin America for institutional reform.[6] For the past ten years or so most Latin American countries have

[5] See *“Playing for High Stakes”* by Maria O’Brien in LatinFinance (December, 2002).

embarked on policies known as the "Washington Consensus". They include fiscal discipline, tax reform, interest rate liberalization, a competitive exchange rate, trade liberalization, an open-doors policy to foreign direct investment, privatization and secure property rights. But these policies, generally speaking, have not achieved the results for which they were designed—namely higher economic growth, greater job creation and more equitable income distribution than in the past. The most notable exception, significantly, is Chile, and this is because it is really the only country in Latin America than can claim to have a properly functioning democracy. Hence, the growing call now for "second generation" institutional reforms regarding the civil service, the justice system and political parties, without which the "Washington Consensus" policies will not produce the desired fruit. Corruption remains rampant in most countries.

The critical sectors for Spain in Argentina are oil and gas, where Repsol YPF is very much the dominant player, telecommunications (Telefónica) and banking (Santander Central Hispano and Banco Bilbao Vizcaya Argentaria). Repsol's ailing fortunes have been helped by the windfall from higher world oil prices and the last government's decree guaranteeing the right to keep 70% of its export revenues in dollars outside the country. Repsol YPF also made itself less vulnerable to a hostile external environment by reducing its debt in 2002 by more than €9 billion, bringing the 2005 target forward by more than three years. In relative terms, Repsol reduced its debt by 55%, with a debt-to-capitalization ratio of 29.2% in 2002 as against 42.9% in 2001. Telefónica lowered its net debt by €6.4 billion in 2002 to €22.5 billion, making it one of the most solvent operators in Europe.

---

[6] See "*La reforma institucional pendiente en América Latina*" by Jorge Castañeda (El País, February 11, 2003).

As regards the banks, the lifting of the one-year freeze on withdrawals from savings and current accounts took place smoothly at the end of 2002, with high interest rates and a stabilized foreign exchange rate persuading most depositors not to seek refuge in the dollar. The signs of confidence became more palpable and banks' liquidity situation improved.

However, in March 2003 the Argentine Supreme Court overruled a government decree that forcibly converted billions of dollars of savings into pesos in January 2002 (known as the *corralón*). The ruling only affected US$247 million of deposits belonging to the province of San Luis, but it could open the floodgates to a torrent of claims and force the government to repay all depositors who lost money as a result of the conversion. The move was a severe blow to the cash-strapped government, which is already in hock to its international creditors. Over a million enraged Argentines were struggling to retrieve the dollars they had deposited. Nito Artaza, Argentina's most popular comedian, is one of them, and he emerged as the unlikely leader and spokesman for a national movement called Defrauded Argentine Savers. He played to packed houses that roared as he imitated and ridiculed the politicians and financiers who led the country to ruin.

Only Spanish companies with small investments in Argentina (e.g. the clothing chain Mango) have so far pulled out of the country. The rest were waiting to see what the new government would do and were hoping for a serious IMF agreement. At the same time, Argentina is now a very inexpensive country in which to invest and there will be bargains. Brazil's state-owned oil company Petrobras paid US$3 billion in November 2002 to buy 58.6% of Argentina's Perez Companc (Pecom).

Spanish companies have invested more in Brazil than in Argentina (the countries were neck and neck in 2001 with US$26.2 billion each, but Brazil overtook Argentina in 2002).

Repsol YPF planned to invest a further US$200 million in Brazil in 2003. The company is very much interested in greater energy integration between Brazil, Argentina and Bolivia as it operates in all three countries. Integration would allow larger quantities of natural gas produced in neighbouring Bolivia and Argentina to enter Brazil, whose consumption is forecast to treble in the foreseeable future. Repsol YPF already exports gas from Argentina to Brazil, supplying the power station of Uruguayana in the state of Río Grande do Sul.

Brazil's economic fundamentals are better than Argentina's, but Lula is walking a fine line. His dilemma is how he can satisfy both the aspirations of his Workers Party and of the international financial community, epitomized by his attendance in January 2003 at both the World Social Forum in Pôrto Alegre, Brazil, the focal point of the anti-globalization movement, and at the World Economic Forum in Davos, Switzerland, the high table of globalization. Lula delighted Wall Street at the beginning of his four-year term of office by appointing market-friendly people to key economic posts and making all the right noises about economic orthodoxy. Inevitably, the radical factions of his party, whose core element is the industrial working class, are not happy with his shift to a centrist and more realistic strategy, although he also launched massive food and housing programmes. Interestingly, the Workers Party did badly in the state of Rio Grande do Sul, whose capital is Pôrto Alegre, and lost the governorship to a centrist party after reneging on an agreement that would have brought a Ford Motor Company plant.

The 1995-2002 government of the social democrat Fernando Henrique Cardoso, Brazil's last president, admirably eliminated high inflation, pressed ahead with privatization, trade liberalization and the encouragement of foreign direct investment and increased social spending. As a result, some of the country's dreadful social indictors began to improve—but not fast enough for a population whose real GDP per capita in 2002 was only slightly above its 1982 level. Brazilians have not seen an improvement in either their absolute or their relative standards of living. Lula's impoverished background—selling peanuts on the street at the age of seven, working in a dry cleaner's at 12 and eventually rising to the top of the labour movement—gives him tremendous moral authority in the eyes of the poor, and if anyone can hold the line between economic orthodoxy and going some way towards satisfying their frustrations it is Lula. The path of moderation is one that has been successfully followed by other "socialist" parties around the world, including Spain and Chile during the 1990s. Lula would like a social pact between the government, the unions and employers along the lines of Spain's 1978 Moncloa Pact.

In times of crisis, there is a tendency to lump problematic and neighbouring countries together and assume that because one has defaulted on its debt others will do the same, particularly in an emerging market as volatile as Latin America. It is therefore important to stress some of the significant differences between Brazil and Argentina. The list drawn up by John Williamson[7], the British economist of the Washington-based Institute for International Economics who coined the phrase "Washington Consensus", includes:

- There is none of the feeling among Brazilians that they are being systematically ripped off by the political class, like the feeling that poisons any plan of action in Argentina.

- A far greater willingness to pay taxes. The total tax burden is around 36% of GDP in Brazil (higher than in the US) as against 15% in Argentina.

[7] See *Is Brazil Next?* by John Williamson (Institute for International Economics, August 2002).

- The absence of any significant use of the dollar to denominate internal contracts in Brazil, which means that currency devaluation does not threaten the financial solvency of large parts of the corporate sector and banking system as it did in Argentina.

- A healthy banking system (due in part to past bailouts, but bailouts that have already happened and whose cost is therefore included in debt statistics). The capital-to-risk-weighted assets ratio for most banks in 2002 was still above the minimum requirement of 11%.

- A stronger fiscal situation.

- Substantial assets that can be privatized, whereas almost everything conceivably privatizable has already been sold off in Argentina.

- A much less brittle macroeconomic policy regime, with a floating exchange rate coupled with a successful policy of inflation targeting instead of a currency board with a peg to a totally inappropriate currency.

There are several other factors, however, that should be taken into account:

- Brazil has a more explosive social situation.

- It has a strong tradition of government intervention in the economy.

- There are significant protectionist tendencies among local businessmen.

• Central government is weak and the federal states have important financial responsibilities and liabilities.

The key issue facing Brazil, after completing a complex political transition in an exemplary fashion, is its burdensome debt structure and whether it is sustainable[8]. The government's foreign-currency-denominated debt, although only a small part of the total, is still significant at more than US$80 billion of the public debt of US$250 billion, and Brazil's companies have foreign-currency debts of around US$96 billion. As a whole, Brazil was already using more than 90% of its export earnings to service its foreign debt. If foreign banks called in their credit lines, Brazil would soon run out of foreign currency and be unable to service this debt.

The debt burden is very vulnerable to movements in the exchange rate. The devaluation and depreciation of the real since January 1999 has accounted for virtually all the increase in the ratio of debt to GDP over that period. Brazil has the fragile debt dynamics that were present in the defaults in Russia (1998), Ecuador (1999) and Argentina (2001), but it is free from the other vulnerabilities associated with a fixed exchange rate, a weak banking system and primary budget shortfalls.

The government has limited control over the domestic debt as three-quarters of it is indexed either to the exchange rate or to the overnight interest rate.

While the possibility exists for some corporate default, sovereign default seems unlikely[9]. Some analysts, however, regard a sovereign default as unavoidable and the

[8] See *Make or Break,* a survey of Brazil by Peter Collins (The Economist, February 22, 2003).
[9] See *Can Brazil Resist?* by Paul Isbell (Elcano Royal Institute, July 2002).

only question is when. The public sector net debt, even at more than 50% of GDP (30% in 1994), should not be too difficult to continue to roll over, as less than 5% is held by non-residents. One could argue that the total debt load is similar to that of Argentina before the tragic denouement of its crisis, but Argentina went down after more than three years of sharp recession, whereas Brazil has not been in recession: even in 2002 GDP grew by 1%. Much does depend, however, on the international economic context, which remains uncertain. Clearer signs of recovery in the US, with a concomitant rebound in investor confidence, would help Brazil.

Also in contrast to Argentina, Brazil's net inward foreign direct investment, even in 2003, should continue to cover a greater share of the current account deficit.

Given that interest rates—both for bonds and internal credit—remain hostage to movements of the Real, a default possibility would basically be a self-fulfilling scenario. If the markets decided to bet against the Real, the debt burden would become increasingly more difficult to deal with; if the Real continues to stabilize or appreciate, as it did in early 2003 after Lula took office, the debt situation should not deteriorate, assuming that fiscal policy does not loosen. Far from loosening it, the government raised its primary budget surplus target for 2003—a surplus that excludes debt service—to 4.25% of GDP, above the 3.75% target agreed with the IMF as part of a $30 billion loan agreement with the outgoing government in 2002 (the largest programme in the Fund's history). It is the most austere target Brazil has sought to achieve, and it required an adjustment of some $2 billion, either through spending cuts or higher taxes. The surplus, which was 4.06% of GDP in 2002, higher than the 3.88% mandated in the IMF deal, was being closely watched by Wall Street as an indicator of the country's ability and determination to service its debt. The signs were that Lula realized that the main victims of a default-induced recession would be his own supporters, and that only if pushed by the markets would he pull the plug. Many analysts believed the most likely and best scenario was an orderly restructuring of the debt. A default is not inevitable and depends largely on investors' expectations.

Paradoxically, because Argentina is isolated from the global market, its incipient recovery in 2003 was less vulnerable to a loss of international confidence than Brazil. Should sentiment in international capital markets worsen as a result of the geopolitical scenario, Brazil would suffer to a greater extent than Argentina. It does not make much difference if Argentina's country risk rises from its already very high level because it has no access to international markets anyway.

Other major issues facing the Brazilian government are to reform the inequitable and costly social security system (the deficit in its pension obligations is more than 5% of GDP) and whether to bow to the demands of some of its supporters and halt or reverse the privatizations that have partly liberalized power generation and distribution. Brazil's electricity market is in a mess and several utilities faced possible insolvency in 2003, including some belonging to AES Corporation of the US, but reportedly not those belonging to Endesa and Iberdrola. The problem is that revenues, which are collected in the Brazilian currency, are shrinking because of falling consumption and some of the utilities have large debts contracted in US dollars.

The major Spanish investors in Brazil, Telefónica and Santander Central Hispano, are consolidating their strong positions. Despite the uncertainty, Brasilcel, the joint venture company owned by Telefónica and Portugal Telecom, agreed to acquire during 2003 the mobile phone operator Tele Centro Oeste for just over $1 billion, raising its market share to 54%. Santander Banespa, the third-largest private-sector bank, is well capitalized although, like other such banks, its balance sheet would be affected by any government debt-management operation. The banks in Brazil are directly exposed to sovereign risk because government securities account for, on average, 30% of their asset base. The policy concerning troubled banks, in the past at least, has generally involved the liquidation of smaller banks and the treatment of the large banks on a case-by-case basis.

The other problematic country is Venezuela, where the level of Spanish direct investment (US$1.6 billion in 2001) is much lower than in Argentina and Brazil. As a result of the two-month strike in large parts of the private sector and in the state-run oil industry, the country's economic lifeblood, the economy was forecast to shrink by as much as 15% in 2003 after more than 5% in 2002. Exchange controls were imposed in 2003, and were being used to punish the government's business opponents. The prices of basic foods and other essential items were also controlled, ensuring cheap food for Chávez's supporters in poor areas and to insulate them from higher inflation. Chávez called 2003 the "year of the revolutionary offensive". There were no declared plans, however, to expropriate the foreign multinationals.

Santander Central Hispano and Banco Bilbao Vizcaya Argentaria, which between them have close to 30% of total deposits, were vulnerable to a default by the government, starved of funds, on its domestic debt with the banks. Venezuela's domestic debt tripled between 2000 and 2002 to around US$6 billion, accounting for an average of 40% of banks' assets. To finance its fiscal gap, the government issued bonds on the domestic market, but banks were reluctant to buy them.

---

[10] See *Mexico, un ex-emergente?* by Jorge Blázquez and Javier Santiso (BBVA Research Department, 2003).

As Mexico becomes increasingly integrated into the US economic cycle as a result of the North American Free Trade Agreement (NAFTA), so its attractiveness for Spanish companies will increase. A case can be made for Mexico no longer being an emerging market.[10] Even in a "bad" year like 2002, foreign direct investment (FDI) in Mexico continued to increase. FDI totalled US$13.9 billion, 10.9% more than in 2001 and excluding Citigroup's US$12.5 billion purchase of Banamex, the largest-ever foreign acquisition of a Mexican company. Companies already in the country have been boosting their profits and reinvesting them. The level of cumulative Spanish investment in the country (US$9.2 billion in 2001 and increased since then) is low compared to that in Argentina and Brazil. Substantial windows of opportunity are opening up between Mexico and the US, highlighted by Santander Central Hispano's strategic alliance with Bank of America in 2003 to sell it almost one-quarter of Santander Serfin, Mexico's third-largest bank, and together increase their market share of the remittances (US10.5 billion in 2002) sent to Mexico every year from the US.

There is little scope for further acquisitions in the Mexican financial industry because most of it is already foreign owned, but the potential for development is enormous, as it is in Brazil. For example, US and European fund managers were expected to flock to Mexico in 2003 to gain a foothold in the country's mutual fund market after government regulators allowed the funds to invest in foreign equities for the first time. The Mexican mutual fund industry was valued at the beginning of 2003 at about US$30 billion (US$170 billion in Spain). Demographic factors, combined with lower bank deposit rates, should increase demand for mutual funds. Distribution is dominated by the country's three largest retail banks, two of which are Spanish owned (BBVA Bancomer and Santander Serfin) and are in on the ground floor of this incipient industry. The scope in private pension funds is also huge. These funds, created in 1997 and known as Afores, had 29.4 million savers in early 2003—the most of any pension system in Latin America—and assets of US$31.4 billion. With 54% of Mexico's population under the age of 25, the Afores' strong rate of growth should continue for several decades.

Mexico has proved to be a profitable market so far for Santander Central Hispano, with an estimated return on investment in 2002 in dollar terms of 24.2% (10.5% in Brazil and 12.9% in Chile).

There is also tremendous leeway for private-sector investment in the oil, gas and electricity industries if the government manages to change the constitution. The outcome of the mid-term congressional elections in July 2003 will determine whether the government of Vicente Fox will be able to make progress on energy and fiscal reform during the second half of its six-year term of office. Fox has so far not delivered on his promises.

The safest location for Spanish investment is Chile, the country in Latin America that is closest to the western model of a free market economy and liberal democracy. Whereas Spanish investment in Mexico is low for a country of its size, in Chile it is high (US$7.8 billion in 2001). The room for further investment in Chile is not very high; the Spanish banks already dominate the banking sector and Telefónica is strong in telecommunications. Nonetheless, even Chile is going through a period of lower growth.

The crisis in Latin America has made Spain's multinationals retrench in the region. Generally speaking, the banks, and to some extent Telefónica, have decided to concentrate on Brazil, Mexico and Chile and to exit or scale back their operations in other countries. Argentina is a case apart. BBVA sold its Brazilian unit and SCH its retail

Exhibit 9.3 **Foreign Currency Issuer Credit Ratings (Long-Term/Outlook/Short-Term) of Main Spanish Companies in Latin America**

	End February 2001	End February 2003
Banco Bilbao Vizcaya Argentaria	AA-/Stable/A-1+	AA-/Stable/A-1+
Banco Santander Central Hispano	A+/Negative/A-1	A/Stable/A-1
Endesa	A+/Stable/A-1	A/Negative/A-1
Gas Natural	AA-/WatchNeg/A-	A+/Stable/A-1
Iberdrola	AA-/Stable/A-1+	A+/Stable/A-1
Repsol	A-/Stable/A-2	BBB/Negative/A-3
Unión Fenosa	A+/Stable/A-1	BBB+/Stable/A-2
Telefónica	A+/Nergative/A-1	A/Stable/A-1

Source: Standard & Poor's.

banking business in Peru. Endesa's revised 2002-2006 strategic plan intends to reduce investments in the region from an initial €900 million to €500 million and Enersis, its Latin American holding, will divest up to €1 billion in assets in 2002-2003. Moody's Investor Services, the ratings agency, revised its long-term outlook on Endesa from stable to negative in September 2002 and cut the rating of its Chilean businesses by two notches to Baa3, its lowest investment grade. In February 2003, Moody's downgraded to Baa1 from A2 the senior unsecured debt ratings of Endesa and its guaranteed subsidiary International Endesa BV. The downgrades, said Moody's, reflected Endesa's still high levels of debt, some uncertainty over the timing of a number of asset disposals and an overall weak performance at its Latin American subsidiaries. However, the creditworthiness of the major investors in Latin America has not been downgraded very much (see Exhibit 9.3).

Nevertheless, the Latin American experience for Spanish companies so far has been a salutary one, showing the world the dynamic face of an economy that has changed enormously in the short span since it joined the European Union in 1986, and beyond recognition since the end of the dictatorship in 1975. Had it not been for this expansion, it is most unlikely the country would have produced a handful of multinationals that have put corporate Spain onto the world business map. While the ups and downs that go with any such process have been a good learning curve, all in all, the investment drive has been generally positive. However, companies have not found the El Dorado of their dreams.

Appendix

Latin America Exposure of Spanish Companies

Company	Investment in Latam Euro mn[1]	Investment in Latam/ Market Cap (%)[2]
FINANCIALS		
BBVA (*)	**8,259**	**33.35**
- Brazil	542	2.19
- Argentina	414	1.67
- Mexico	4,508	18.20
- Chile	880	3.55
- Colombia	795	3.21
- Peru	377	1.52
- Venezuela	407	1.64
- Others	336	1.36
BSCH (*)	**13,816**	**51.75**
- Argentina	5.59	6.29
- Brazil	18.99	16.90
- Chile	6.09	6.82
- Mexico	7.05	12.29
- Others	5.86	9.45
C. Mapfre	**460**	**32.86**
ELECTRIC UTILITIES		
REE	**52**	**3.47**
Endesa	**3,265**	**28.21**
- Brazil	799	6.90
- Argentina	0	0.00
- Chile	1,186	10.25
- Colombia	1,001	8.65
- Peru	279	2.41
Iberdrola	**2,886**	**22.67**
- Brazil	1,718	13.50
- Mexico	584	4.59
- Others	584	4.59
Fenosa	**1,745**	**49.93**
- D. Republic	543	15.54
- Colombia	573	16.40
- Mexico	286	8.18
- Others	343	9.81
Gas Natural	**1,500**	**18.44**
- Argentina	200	2.46
- Mexico	600	7.37
- Brazil	450	5.53
- Others	250	3.07
Aguas Barcelona	**558**	**42.07**
- Argentina	85	1.04
- Chile	470	5.78
- Brazil	3	0.04
FOOD		
Pescanova PVA	**18**	**16.53**
- Chile	14	13.61

Company	Investment in Latam Euro mn[1]	Investment in Latam/ Market Cap (%)[2]
- Argentina	3	2.93
Ebro Puleva	**155**	**13.88**
Viscofán	**53**	**17.73**
Altadis	**715**	**10.68**
CONSTRUCTION		
OHL	**166**	**10.68**
- Argentina	40	7.50
- Chile	66	7.50
- Brazil	60	7.50
Dragados	**344**	**11.41**
- Argentina	79	2.60
- Chile	134	4.46
- Brasil	46	1.52
- Colombia	3	0.10
- Mexico	80	2.65
- Others	2	0.08
Ferrovial	**272**	**8.02**
- Chile	272	9.04
ACS	**80**	**3.96**
- Argentina	40	1.33
- Mexico	40	1.33
FCC	**80**	**3.03**
- Argentina	40	1.33
- Mexico	40	1.33
Uralita	**13**	**3.83**
TELECOMS		
Telefónica	**32,649**	**77.32**
- Brazil	12,800	30.62
- Argentina	9,800	23.44
- Mexico	2,180	5.21
- Chile	500	1.20
- Peru	4,151	9.93
- Others	3,218	7.70
TEF Móviles	**5,329**	**21.40**
- Brazil	2,780	6.65
- Argentina	810	1.94
- Others	1,739	4.16
Aurea	**225**	**12.18**
Acesa	**134**	**3.50**
TECHNOLOGY & MEDIA		
Terra	**227**	**8**
- Brazil	110	4.00
- Mexico	5	0.20
- Chile	54	2.00

Company	Investment in Latam Euro mn[1]	Investment in Latam/ Market Cap (%)[2]
- Peru	18	0.70
- Others	40	1.40
TPI	**111**	**9**
- Brazil	36	3.00
- Chile	43	3.60
- Peru	31	2.60
Tecnocom	**6**	**15.34**
Amadeus	**23**	**0.95**
Prisa	**152**	**12.22**
- Brazil	83	6.69
- Argentina	1	0.08
- Mexico	65	5.21
- Others	3	0.24
Recoletos	**17**	**2.98**
- Argentina	17	2.98
Indra	**5**	**0.53**
Amper	**45**	**72.96**
Abengoa	**30**	**7.06**
- Argentina	6	1.41
- Brazil	6	1.41
- Others	18	4.23
IRON & STEEL		
Arcelor	**15**	**0.30**
Acerinox	**2**	**0.08**
CAF	**11**	**7.73**
OIL & OTHERS		
Repsol YPF	**12,375**	**77.60**
- Argentina	10,500	65.85
- Others	1,875	11.76
Cepsa	**200**	**1.25**
Ence	**42**	**11.74**
Iberpapel	**8**	**5.06**
Miquel y Costas	**7**	**5.45**
Aldeasa	**16**	**5.50**
- Chile	7	2.55
- Peru	2	0.85
- Mexico	2	0.70
- Others	4	1.40
NH Hoteles	**137**	**14.91**
Sol	**361**	**62.62**
- R. Dominicana	120	42.16
- Mexico	120	42.16
- Venezuela	120	42.16
TelePizza	**5**	**2.43**

Company	Investment in Latam Euro mn[1]	Investment in Latam/ Market Cap (%)[2]
Mecalux	**30**	**49.46**
Prosegur	**322.00**	**51.41**
- Brazil		0.00
- Chile	12.00	4.20
- Argentina	80.00	28.03
- Others	230.00	80.59
TOTAL	**86,920.33**	**36.82**

Note: Investment refers to current book value (i.e. after goodwill writeoffs).
(1) Book value or market price if available. Estimates for 2002.
(2) At March 5, 2003.
Source: Company data and Santander Central Hispano Bolsa estimates.

Statistical Summaries of Main Latin American Countries, 1997-2002

	1998	1999	2000	2001	2002*
Real GDP growth (%)					
Argentina	3.8	-3.4	-0.8	-4.6	-11.0
Brazil	-3.2	-0.1	4.5	1.5	1.0
Chile	3.9	-1.1	4.4	2.8	1.7
Colombia	0.6	-4.1	2.7	1.4	1.2
Mexico	4.9	3.8	6.6	-0.3	1.0
Peru	-0.5	0.9	3.1	0.2	4.0
Venezuela	0.2	-6.1	3.2	2.7	-6.4
Spain	4.3	4.2	4.2	2.7	1.9
Inflation (average %)					
Argentina	0.9	-1.7	-0.9	-1.0	26.2
Brazil	3.1	4.8	7.0	6.8	8.3
Chile	5.1	3.3	3.8	3.6	2.5
Colombia	18.6	10.8	9.2	8.0	6.4
Mexico	15.9	16.5	9.5	6.4	5.0
Peru	7.3	3.5	3.8	2.0	0.3
Venezuela	35.8	23.6	16.2	12.5	22.5
Spain	1.8	2.3	3.4	3.6	3.5
Exports (US$ bn)					
Argentina	26.4	23.3	26.4	26.8	25.5
Brazil	51.1	48.0	55.1	58.2	60.2
Chile	16.4	17.2	19.2	18.5	17.9
Colombia	11.5	12.0	13.6	12.8	12.6
Mexico	117.5	136.4	166.5	158.4	155.6
Peru	5.7	6.1	7.0	7.1	7.6
Venezuela	17.6	20.8	34.0	27.5	23.3
Spain	112.0	112.7	116.2	117.6	118.9
Imports (US$ bn)					
Argentina	29.5	24.1	23.8	19.1	9.8
Brazil	57.7	49.2	55.8	55.6	60.2
Chile	18.4	14.7	17.1	16.4	15.6
Colombia	13.9	10.3	11.1	12.3	12.4
Mexico	125.4	142.0	174.5	168.4	166.9
Peru	8.2	6.7	7.4	7.2	7.3
Venezuela	15.1	13.2	16.1	18.0	11.4
Spain	132.7	143.0	151.0	149.1	153.2
Current-account balance (US$ bn)					
Argentina	-14.5	-11.9	-8.9	-4.5	8.1
Brazil	-33.8	-25.4	-24.6	-23.2	-8.6
Chile	-4.0	-0.3	-1.0	-1.2	-0.6
Colombia	-5.2	0.3	0.3	-1.7	-1.7
Mexico	-16.0	-14.0	-17.7	-17.7	-17.0
Peru	-3.4	-1.5	-1.6	-1.1	-1.0
Venezuela	-3.2	3.5	13.0	3.9	6.3
Spain	-3.1	-13.8	-19.2	-15.1	-16.0
Total external debt (US$ bn)					
Argentina	141.5	145.2	146.1	144.8	135.7
Brazil	241.0	243.7	238.0	233.9	220.3

	1998	1999	2000	2001	2002*
Chile	30.2	34.3	37.0	37.8	40.4
Colombia	33.3	34.7	35.1	36.6	39.0
Mexico	161.4	167.6	150.3	153.8	157.3
Peru	29.8	28.9	28.6	28.0	29.2
Venezuela	37.0	35.9	34.4	34.7	36.4
Spain	334.6	365.9	436.6	465.1	509.7
Debt-service ratio, paid (%)					
Argentina	57.6	75.4	70.7	76.2	74.3
Brazil	74.8	112.8	90.8	69.4	64.8
Chile	30.2	34.3	37.0	37.8	40.4
Colombia	30.8	41.4	28.7	31.0	33.0
Mexico	20.0	25.1	30.2	24.7	21.8
Peru	26.8	46.3	42.8	39.9	49.9
Venezuela	28.2	23.7	15.7	22.9	24.9
Spain	16.9	19.0	23.1	24.1	22.9
Exchange rate (YE; local curr:US$)					
Argentina	1.00	1.00	1.00	1.00	3.39
Brazil	1.21	1.79	1.95	2.32	3.60
Chile	473.8	530.0	572.6	656.2	745.1
Colombia	1,508	1,874	2,187	2,301	2,807
Mexico	9.87	9.51	9.57	9.14	9.85
Peru	3.15	3.51	3.53	3.44	3.60
Venezuela	564.5	648.2	699.7	763.0	1,431
Spain	0.893	0.937	1.082	1.117	1.057

(*) 2002 figures are estimates, except the exchange rate, which is actual.
Source Economist Intelligence Unit.

Population of Main Latin American Countries

	Total Pop (mn)	Growth Rate (% pa)*	Economically Active Pop (% of Total)	Urban Pop (% of Total)	Life Expectancy (Years)*	Infant Mortality Rate*
Argentina						
2000	37.0	1.3	42.7	88	73.1	2.2
2010	41.5	1.1	45.3	91	75.1	1.8
2020	45.3	0.8	47.7	93	76.7	1.4
Brazil						
2000	170.6	1.3	47.0	81	67.9	4.2
2010	192.2	1.1	49.7	83	70.7	3.4
2020	211.9	0.9	50.6	90	73.1	2.6
Chile						
2000	15.2	1.4	39.5	86	75.2	1.3
2010	17.0	1.1	42.9	88	76.7	1.1
2020	18.8	0.9	45.7	92	77.9	0.9
Colombia						
2000	42.3	1.9	40.2	75	70.7	3.0
2010	49.7	1.5	43.9	78	73.2	2.2
2020	56.6	1.2	40.8	82	74.7	1.7
Mexico						
2000	98.8	1.6	41.1	74	72.6	3.1
2010	112.9	1.2	45.3	79	74.3	2.6
2020	125.0	1.0	48.6	81	75.9	2.1
Peru						
2000	25.9	1.7	42.0	73	68.5	4.5
2010	29.9	1.4	46.8	75	71.2	3.2
2020	33.9	1.2	50.0	79	73.8	2.9
Venezuela						
2000	24.1	2.0	39.3	87	72.8	2.1
2010	28.7	1.6	43.6	90	74.7	1.7
2020	32.9	1.2	47.1	93	76.3	1.4
Latin America						
2000	508.1	1.6	42.8	76	70.0	3.6
2010	583.8	1.3	46.2	78	72.3	2.9
2020	653.9	1.1	48.5	83	74.3	2.2

(*) Total population growth, infant mortality and life expectancy data are annual averages of the preceding five years.
Source Latin America Demographic Centre (CELADE).

Various Indicators

	Argentina	Brazil	Chile	Colombia	Mexico	Peru	Spain	Venezuela
GDP per capita (US$, 2002*)	2,770	2,481	4,150	1,847	6,207	2,085	16,120	3,789
Exports as share of GDP (%, 2002*)	24.2	13.7	28.6	15.5	24.6	13.6	28.5	25.3
Imports as share of GDP (%, 2002*)	9.3	10.7	25.0	15.3	26.4	13.0	29.8	12.3
Unemployment (%, 2002*)	22.5	7.2	9.2	17.9	3.0	9.4	11.5	18.2
Mobile phones (subscribers per 100 people, 2002*)	16	19	41	7	26	8	76	9
Personal computers (stock per 1,000 people, 2002*)	79	84	74	54	81	45	232	70
Internet users (‘000, 2002*)	2,472	11,268	2,345	1,730	6,871	710	15,448	1,987

(*) Estimates.
Source: Economist Intelligence Unit and Pyramid Research.

Status Report on Foreign Debt of Main Latin American Countries (US$ bn, unless stated otherwise, 2002)

	External Debt		Ability to Service		Balance of Payments	
Argentina	Total:	135.7	Debt-service ratio, paid:	74.3	Exports:	25.5
	Public sector:	79.5	Interest payments:	8.3	Imports:	9.8
	Private sector:	24.0	Interest paid as % of GDP:	8.0	Current-account balance:	8.1
	Debt as % of GDP:	129.8	International reserves:	9.9	As % of GDP:	7.8
Brazil	Total:	220.3	Debt-service ratio, paid:	64.8	Exports:	60.2
	Public sector:	80.2	Interest payments:	14.1	Imports:	47.0
	Private sector:	97.5	Interest paid as % of GDP:	3.2	Current-account balance:	-8.6
	Debt as % of GDP:	50.1	International reserves:	36.3	As % of GDP:	-2.0
Chile	Total:	40.4	Debt-service ratio, paid:	22.2	Exports:	17.9
	Public sector:	4.7	Interest payments:	1.6	Imports:	15.6
	Private sector:	33.5	Interest paid as % of GDP:	2.7	Current-account balance:	-0.6
	Debt as % of GDP:	65.0	International reserves:	14.7	As % of GDP:	-1.0
Colombia	Total:	39.0	Debt-service ratio, paid:	33.0	Exports:	12.6
	Public sector:	24.3	Interest payments:	1.8	Imports:	12.4
	Private sector:	11.4	Interest paid as % of GDP:	2.3	Current-account balance:	-1.7
	Debt as % of GDP:	48.4	International reserves:	10.6	As % of GDP:	-2.2
Mexico	Total:	157.3	Debt-service ratio, paid:	21.8	Exports:	155.6
	Public sector:	83.1	Interest payments:	10.6	Imports:	166.9
	Private sector:	55.1	Interest paid as % of GDP:	1.7	Current-account balance:	-17.0
	Debt as % of GDP:	24.9	International reserves:	46.6	As % of GDP:	-2.7
Peru	Total:	29.2	Debt-service ratio, paid:	49.9	Exports:	7.6
	Public sector:	19.9	Interest payments:	0.9	Imports:	7.3
	Private sector:	5.0	Interest paid as % of GDP:	1.7	Current-account balance:	-1.0
	Debt as % of GDP:	52.6	International reserves:	10.3	As % of GDP:	-1.8
Venezuela	Total:	36.4	Debt-service ratio, paid:	24.9	Exports:	23.3
	Public sector:	25.7	Interest payments:	2.3	Imports:	11.4
	Private sector:	7.5	Interest paid as % of GDP:	2.5	Current-account balance:	6.3
	Debt as % of GDP:	39.5	International reserves:	11.1	As % of GDP:	6.9

Source: Economist Intelligence Unit.

The Real Instituto Elcano
de Estudios Internacionales y Estratégicos

The Real Instituto Elcano de Estudios Internacionales y Estratégicos is a foundation, independent of both the government and the companies which largely finance it. Its task is to study the interests of Spain and Spaniards in international society and to place the fruit of its labours at the disposal of all Spaniards. In this sense, the Institute defines itself as an institution, which is non-partisan, but not neutral, and develops a strategic and global perspective, with a clearly forward-looking approach. The Institute uses multidisciplinary academic methods and techniques which serve both public and private viewpoints and generate political and social proposals which are at the same time practical and applicable.

The non-neutrality of the Institute is evident in the fact that it actively seeks the achievement of peace in international relations, economic cooperation and solidarity between states and peoples, respect for human rights, and the promotion of processes of democratic transition and consolidation of democratic values.

The Institute's Board of Trustees balances the public and private interests and those of the government and the opposition. It includes the former prime ministers, Leopoldo Calvo-Sotelo and Felipe González; representatives of the ministries of Foreign Affairs, Defence, Economy and Education; the chairmen of large companies that have joined the project contributing in an essential way to its financing, and finally, a member at the proposal of the leading opposition party. Under the patronage of H.R.H The Prince of Asturias, the Board of Trustees is presided by Eduardo Serra, a former Minister of Defence.

As well as the members of the Elcano Royal Institute's Board of Trustees, another group of firms, which also make a significant contribution to its upkeep, sit on the Business Advisory Council as collaborating members. Lastly, an Academic Council made up of academics, politicians, businessmen or personalities from the media, with wide experience in these topics, actively collaborates in the daily life of the Institute.

The aim of the Institute is to be a focus point for thought and generation of ideas that are useful for politicians, leaders of the interested public and private institutions, and public opinion building. The Institute's goals are to analyse the international situation, in order to be able to prepare and produce analyses, studies and reports to help with decision-making; to circulate these studies and analyses, with the aim of structuring and taking part in public and social debate, both nationally and globally; to serve as a forum for meetings and debates, thereby ensuring greater and better communication between public and private agents in the field of international relations and security; and to try to draw together the programmes, projects and ideas of the Spanish strategic community and, as far as possible, of the international one as well.

www.realinstitutoelcano.org