FOREIGN DIRECT INVESTMENT IN NORTH AMERICA UNDER NAFTA

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l'Intégration Continentale (GRIC) ou des membres du Centre Études internationales et
Mondialisation (CEIM).
This paper aims to analyze changes in foreign direct investment (FDI) capital flows in North America from 1990 to 2000. I would like to examine whether FDI has the same regionalizing tendencies as foreign trade. However the process in that case is more complex; since centripetal forces (incoming flows to North America) as centrifugal (outgoing flows) are both at work. With Mexico as a point of reference, I will also analyze some of the main characteristics and tendencies of FDI, as well as its impact on the Mexican economy.

Introduction

Neoliberal globalization is a process that began in the 1980s with deregulation and trade liberalization. Globalization is a complex phenomenon that covers three dimensions: the international mobility of goods and services, the mobility of productive capacities through FDI, and the mobility of financial capital. The domination or prevalence of one of these dimensions, define the three following stages of economic globalization since the order established by the Bretton Woods Agreement to the present day (Michalet, 2000): 1

- The international configuration between national States defined in the Bretton Woods Agreement was dominated by the foreign trade of goods and services (1948-1960).
- The configuration characterized and dominated by private flows of FDI made by transnational corporations (1960-1982).
- Neoliberal globalization dominated by financial capital flows (1982 to date).

Neoliberal globalization involves a new regime of accumulation, with financial domination (Chesnais, 2000) 2, which has increased the financial fragility of both “internal” financial systems and the international monetary and financial system.

This regime of accumulation with financial domination is characterized, amongst other traits, by the predominance of non banking financial firms (pension funds, mutual funds, insurance companies etc.) and the weakening of

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commercial banks, which are forced to compete in disadvantageous conditions with non banking financial intermediaries (banks no banks) in order to attract deposits. This translates into a process of banking deintermediation. Capital markets become more prominent than banking credit in financing enterprises.

This new regime of accumulation radically changes the way corporations are managed. These large companies follow a fundamentally financial logic. Their profitability and the incomes derived from stock options do not depend so much on the productive and internal strength of the firm, but on its increased value on the stock market. The opinion of institutional investors in financial markets becomes the main barometer of how corporations and governments should behave. Mergers and acquisitions, that were popular over the last decade, were decided not only on the basis of productive or trade potential, but more importantly on their repercussions on market share value. These mergers were a powerful lever that propelled stock market boom of the 1990s.

I will begin with the hypothesis that changes to the productive systems of Canada and Mexico, in addition to the structure, composition, and geographical orientation of foreign trade flows, have been determined fundamentally by the movement of foreign capital.

Since the trade liberalization of both countries, and mainly since the signing of the North American Free Trade Agreement (NAFTA), the strategies of the primary transnational corporations were as follows:

«Global» corporations that follow a global logic focused on the world market and/or the North American market, combining this with the restructuring of internal private groups in Canada and Mexico in order to adapt themselves to globalization process determine: 1) changes in asset ownership, 2) the sector and geographic location of investment and 3) the geographic destination of produced goods (foreign market vs. domestic market: North American market vs. world market). FDI has, in this way, contributed to strengthening «transnational» regions in North America (e.g. the north of Mexico – the south of the United States: The northeast of the United States – the southeast of Canada).

NAFTA is a good example of this kind of integration, as it has been the main field of experimentation for Neoliberal globalization, whose operating rules are established by US financial capital with the support of dominating groups and the Canadian and Mexican governments. In the trade agreement between Canada and the United States, and subsequently, NAFTA, a series of rules were approved for foreign investors granting unlimited freedom, as well as a series of privileges. For the United States, the trading area of North America is transcendent, not only in outlining the rules of future continental integration in the context of the Free Trade Area of the Americas, but also in the size of its investments, as well as its trade in Canada and Mexico. 13 percent of US direct investment is in these two countries and a total of 65 percent of its investments in the American continent (Deblock, Brunelle and Rioux, 2001). 3

The basis of foreign capital operations is found in chapters 11 and 17 of NAFTA.

The following dispositions are established:

- Foreign investors must be treated in the same way as national investors.
- Contracting parties must be granted most-favored-nation status, that is the obligation to treat investors from the signatory nations no less favorably than investors from other nations.
- Foreign investors must be given “appropriate and efficient protection” of intellectual property rights.
- The establishment of comportment standards for FDI is forbidden for national product content, as well as the preferential trading of goods and services on national territory, establishing exporting minimums such as mechanisms strengthening the trade balance, in addition to any other obligations regarding technology transference.
- Total freedom of FDI capital movement and portfolio investment flows is granted, in addition to the transference of utilities, dividends, royalties, interest, asset sales, administrative and other costs.
- The expropriation of assets considered of public interest is greatly limited, if they are not discriminatory. Appropriate compensation will be given equivalent to the “fair market value” of the investment, and this will be paid exponentially and in the hard currency of the G7 nations.
- In the case of disputes, the signatory nations have the right to appeal to an international tribunal of their choice, which removes the decision-making capacity from national tribunals.

These rules allow the signatory nations to keep a Neoliberal course of trade liberalization and eliminate all restrictions of foreign capital operations. Their application greatly limits the possibility of establishing an active and independent industrial policy or to protect determined sectors and economic activity. Since the 1980s, both Canada and Mexico have abandoned their former nationalist and regulatory foreign investment policies. Intellectual property rights, although attempt to guarantee the protection of innovation and fight piracy, are an obstacle that conserve the advantages enjoyed by oligopolies. This triggers high prices and incredible profits for transnational corporations.

NAFTA-approved FDI regulations constitute a model for transnational corporations and financial trade on a world scale. NAFTA served as a basis for the World Investment Agreement presented in 1995 by the Organization of Economic Cooperation and Development (OECD). It currently serves as a base for the continental negotiations of the Free Trade Area of the Americas.
FDI TENDENCIES IN NORTH AMERICA

The United States and Canada are just as much capital exporters as importers, whereas Mexico is basically a capital importer.

I will analyze both FDI inflows and outflows from the United States and Canada. In the case of Mexico, I will analyze inflows. This study includes information on FDI stocks, as this source is thought to show adjustments to long-term tendencies clearly.

The United States

Capital Inflows

Over the last 20 years the United States has become a net capital importer, despite being the largest capital exporter in the world. In 2000, 272.9 billion dollars of FDI entered the United States, with 113.8 billion dollars leaving the country. Accumulated FDI increased to 1.23 trillion dollars, slightly less than the 1.24 trillion dollars placed by the United States around the world.

As you can see from the figure 1, despite the increased integration of North America and the intensification of intraregional trade, the relative position of Canada and Mexico in accumulated FDI in the United States did not change as a result of the signing of free trade agreements. The participation of Canada stayed between eight and nine percent of the total. The position of Mexico, despite quadrupling in absolute terms during the last decade (from 575 million dollars in 1990 to 2.47 billion dollars in 2000) continues to be insignificant in relative terms; 0.2 % of the total FDI placed in the United States.

The most significant change during this period is the increase of European investment. Europe’s FDI increased from 247.3 billion dollars in 1990 to 890.6 billion dollars in 2000. Europe’s participation increased over nine percentage points, increasing during this period from 62.6 to 71.9 %. The participation of Japan and the Asian Tigers, inversely, fell by almost eight percentage points from 23.5 to 15.7 %. This is due to the effects of the Japanese financial crisis of the 1990s and the Asian crisis of 1997 to 1998 that is apparent in the stunted growth of FDI flows from this region.

Capital Outflows

The US’s FDI in Canada and Mexico increased significantly between 1990 and 2000. In the case of the former, FDI stock from the United States almost doubled during the last decade, increasing to 69.5 billion dollars in 1990 to 126.4 billion dollars in 2000. In the case of Mexico, the increase is much more marked, with the increase of FDI, during the same period, more than tripling from 10.3 billion dollars to 35.4 billion dollars. Nevertheless, the position of both countries weakened in relation to other regions, in particularly Europe,
Japan, and the Asian Tigers and Dragons, contrary to what happened to foreign trade flows, which are mainly intraregional flows. Canada as a destination for US Foreign Direct Investment on a global level fell from 16.7% in 1990 to 10.1% in 2000, with Mexico (in global terms marginal) receiving increased investment of a little more than half a percentage point, from 2.2% to 2.9% of the total.

On the other hand, the position of the United States in Europe has continued to strengthen with European integration. Europe’s involvement in US FDI stock increased from 44.5% in 1982 to 52.1% in 2000. In the same way, during the same period, the position of Asia increased, although to a lesser extent from 13.6% to 16% (Figure 2).

Canada

Capital Inflows

Canada has historically been a net capital importer and increased economic integration with the United States was forged by North American FDI in Canada. Since the Inter-War period, when British hegemony went into decline and US hegemony emerged, US investment has been dominant. Canada’s tendency to be a net capital importer changed in the 1990s, when its FDI capital outflows began to surpass its inflows. In 2000, FDI total stock in Canada was 291.5 billion Canadian dollars, whilst outward Canadian FDI totaled 301.4 billion Canadian dollars.

Blomström and Kokko (1997) argue that free trade agreements with the United States and Mexico have increased growth faster than FDI interregional and intraregional flows. They maintain that: 1) since the US-Canada Free Trade Agreement, and subsequently NAFTA with Mexico, US FDI flows to Canada effectively increased from 1992, especially as a result of the devaluation of the Canadian dollar and 2) Canadian investment flows to the United States lessened, faced with increased flows to the European Union and other regions.

Information gathered during this study proves the validity of this thesis. In the case of capital inflows, US flows increased, not only as a result of the devaluation of the Canadian dollar at the time, but also as a consequence of investment repositioning caused by NAFTA in North America. US FDI stock in Canada increased 2.2 times from 84 billion Canadian dollars in 1990 to 186.2 billion Canadian dollars in 2000. As a percentage of total stock, it increased from 64.2% in 1990 to 69.5% in 1999. During 2000 there was a significant slowdown in US flows to Canada. Given the historically limited economic relationship between Canada and Mexico, and the distinct capital importing character of the latter, total stock of Mexican FDI is only 3.2 billion Canadian dollars, 0.05% of the total (Figure 3).

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The relative involvement of Europe in Canada is declining, although it did increase notably in 2000. This indicates that Europe has been more interested in penetrating the US market directly and using Mexico as an export platform, than investing in Canada. In the case of Asia, the relative involvement of Japan and the Asian Tigers in FDI in Canada increased, although the process lost momentum with the Asian crisis of 1997 to 1998.

Capital Outflows

NAFTA did not imply increased Canadian FDI outflows to the United States. On the contrary, the relative involvement of the United States in Canada’s FDI outward stock fell from 61% of the total in 1990 to 52.2% in 2000 (Figure 4). This is not the case with Mexico; despite its marginal position, it increased involvement from 0.2% to 1%.

It is noteworthy to mention the importance given by Canada to Southern Cone nations. The involvement of Central and South America in its FDI stock increased substantially from 2.4% in 1990 to 5.9% in 2000. Regarding Canada’s FDI comportment in other regional trade blocs, its involvement in Europe remained stable, yet increased in Asia during the first half of the 1990s, although it lessened slightly during the second half of the decade.

Mexico

Capital Inflows

FDI stock in Mexico in 2000 was 127.6 billion dollars, an increase of 321.9% from the 1990 total of 30.2 billion dollars. During this period, there were significant changes to the composition of FDI inflows from the countries of origin. The most significant change was the growing prominence of investment from the two NAFTA partners, especially since the agreement went into force. The total involvement of the United States and Canada went from 64.3% in 1990 to 68.3% in 2000 (Figure 5). Despite the predominance of interregional flows compared to intraregional flows in the case of the United States and Canada, for Mexico the latter are more significant owing to the investment repositioning strategies by transnational corporations from Canada and the United States. These Mexico-based corporations are searching for the comparative advantages of setting up branch offices or assembly plants on the northern Mexican border.

The weight of US FDI continues to be predominant. Mexico’s involvement in FDI stock increased from 62.9% in 1990 to 65% in 2000.

Canadian investment in Mexico has increased significantly over the last seven years. In June 2000, there were 1,195 companies operating with Canadian capital, representing 6.2% of the total. From 1994 to 2000, FDI capital inflows from Canada increased to 2.7 billion dollars—4.2% of the total. Canada is currently the seventh largest investor in Mexico, after the United States, Holland, the United Kingdom, Germany, Japan and Spain, in this order.
The relative position of Europe in Mexico’s FDI stock has not changed since the last decade. European countries currently participate with 24% of total assets in Mexico. Japan is facing a similar situation. Owing to Japan’s financial crisis, its interest in Mexico has diminished.

GLOBALIZATION VS. REGIONALIZATION
IN THE LOGIC OF FDI

The information presented in this paper confirms that the tendencies to globalize and regionalize in FDI flows are juxtaposed:

- The larger part of capital outflows from Canada and the United States is located in other regions: the European Union, other European nations, and Asia; mainly China and Southeast Asia.

- The same behavior is seen in other regional trade blocs (the European Union and Asia), as seen with the comportment of capital inflows in both Canada and the United States, where the relative presence of European and Japanese capital increases.

- A part of the capital outflows from Canada and the United States—the smallest—respond to a strategy of redistribution within North America through competitive advantages. This tendency is confirmed by an analysis of capital inflows from Mexico, where the relative importance of Canada and the United States as investors increases compared to capital from other parts of the world.

Over the last two decades, the behavior of FDI flows indicates that the most powerful transnational corporations follow a logic of globalization. Global companies, whose perspective is a world market—not circumscribing to a determined national market. In other words, the profitable reproduction of this capital is only conceivable in the context of a growing global economy. This is valid not only for US transnational corporations, but also for the Europeans, Japanese, and for some of the emerging nations. These global players are the driving force behind trade liberalization and of unlimited operation of capital all over the world.

Neoliberal globalization is unable to progress on the multilateral basis desired by the most traditional exponents of free trade (Bhagwati, 1991) and can only do so through agreements based on regional integration as is the case of North America and the European Union or the de facto constitution of regional trade blocks, as is the case of Japan and Southeast Asia.

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+ It is known that trade agreements in the European Union and NAFTA are different, since they have respond to different purposes and historic processes; however, they have similar roles in the context globalization and competition in the world market.

7 NAFTA is located in the context of what the Economic Commission for Latin America and the Caribbean (CEPAL) has defined as “Open Regionalism”—regionalism that does not necessarily oppose globalization. See German de la Reza and Raul Conde (2000). *Nuevas Dimensiones de la Integración. Del TLCAN al Regionalismo Hermisférico*. Mexico, UAMI, Plaza y Valdés Ed. P. 257
US trade implements a policy of advancing global trade liberalization, by using all levels or means; unilaterally, bilaterally, multilaterally or regionally; if and when there is trade liberalization is dependent on the interests of the United States and must be in agreement with the rules established by them.

Global corporations belonging to the three signatory nations use the main strategy of positioning themselves within rival trade blocs in order to benefit from trade preferences that stem from integration and increase their markets within this area. Nevertheless, together with the centrifugal forces deriving from FDI there are also centripetal forces at work. Each regional bloc is the space used by transnational corporations from in/out of the region, and to increase competitiveness have moved specific activities or stages of their processes to the “periphery” (Mexico does this, and to a lesser extent Canada under NAFTA; Portugal, Greece, and Spain; Malaysia, Indonesia, the Philippines, and Thailand, in the Asian bloc). As a result of this there are also intraregional FDI flows.

The Logic of Interregional Flows

In the case of interregional flows, the strategy involves positioning oneself in the space of rival trade blocs, with the objective of betting on trade protection toward third nations (tariff and no tariff barriers) and enjoying the advantages derived from integration (Blomström y Kokko, 1997) 8.

Nations that export capital are global players, that follow a logic of reproduction that is not from a specific regional bloc, but from the world market as a whole. This is why FDI flows within the three signatory nations prevail over the movements of other nations. This FDI attempts to avoid the protection of regional trade blocs towards third nations, placing its capital within the integrated space, instead of exporting goods from other spaces.

The result is what Kindleberger (1966) 9 calls “the creation of investment” as a response to the “trade diversion” caused by non-multilateral free trade agreements. Bhagwati (1991) 10 defines this type of foreign investment as quid pro quo (one thing for another) and according to him, it plays the most important role in transnational strategy (particularly Japanese transnational corporations in the United States). The fact that the majority of FDI goes between the “triade” is a proof that in the context of international trade of corporate mercantilism in force, the decisive factor is the competitive advantages derived from the economies of scale generated by “agglomeration” at the dynamic poles of the system.

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8 Magnus Blomström and Ari Kokko (1997).
The Logic of Intrarregional Flows

In this case direct investment aiming to benefit from the comparative advantages of labor costs, transaction costs (transport costs and less rigid tax systems) and less strict environmental laws, generate agglomeration processes in the regional spaces where they are located (Hanson, 1998). This is the case of FDI flows that have entered Mexico since trade liberalization of the mid 1980s and specifically since the signing of NAFTA. Investment during this period was mainly derived from the automotive and auto part industry, as well as assembly-for-export industry, especially electronics, computers, and manufactured goods. Between 1994 and 1998, the assembly-for-export industry absorbed 12.6% of registered FDI flows (Dussel, 2000).

Transnational corporations and the assembly-for-export industry are the nuclei of the Mexican export sector. The involvement of exports in total sales of US branch offices in Mexico increased from 27.3% in 1992 to 46.3% in 1997. Owing basically to the action of direct investment detonated by NAFTA, Mexico, according to Dussel, has become:

- The third largest exporter to the United States, after Canada and Japan.
- The largest supplier of electronic goods (televisions, personal computers, printers, etc.) to the US market since 1998, totaling 19.6% of US imports.
- The third largest supplier of automotive products, second only to Canada.
- The main exporter of manufactured goods, absorbing 13.8 of US imports in 1998, against barely 2.8% in 1990.

With the signing of NAFTA, it was hoped that the assembly-for-export industry would gradually disappear and be replaced by a more stable export industry. But instead of the industrialization of the assembly-for-export industry, there has been a boom. Electronic, computer and manufactured goods, auto parts, etc.—complete branches of the manufacturing industry—operate almost entirely as assembly-for-export, with limited ties to the domestic market. In this way, while employment in the manufacturing industry remained stagnant from 1994 to 2000, at 1,372,253 jobs increasing barely to 1,483,899, employment in the assembly-for-export industry increased from 600,585 to 1,242,779, during the same period. (Vidal, 2001).

Export production has concentrated in the northern border area. It has caused a dragging affect for investment, towards the north of Mexico and towards the south of the United States. From 1994 to 1998, 15.6% of FDI concentrated in

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the north of Mexico and increased from 21% of the total to 29.8%, whilst jobs in the manufacturing industry in the metropolitan area of Mexico City fell from 46.4% to 28.7% over the same period.

The centripetal movement to the north of Mexico is not limited to foreign investment in this region, but also causes a dragging movement and the repositioning of other investments made by national and international companies that formerly operated in the central region and aim to approach the US market and benefit from the economies of scale generated by a process of agglomeration in the northern border area. Around the exporting pole “backwards” or “forwards” activities come together and not only on the Mexican side of the border—as a consequence of low levels of integration of the assembly-for-export industry and the export sector with the domestic productive system, above all on the US side of the border. Regional productive chains of a transnational nature are produced that substitute national productive chains, formed during the stage of import substitution.

Growing integration between Canada, the United States, and Mexico over the last two decades involves the strengthening of historic tendencies creating a North American regional bloc, under the hegemony of the United States that could extend to the rest of the American continent under the influence of the Free Trade Area of the Americas that seeks to convert it into a free trade area by 2005.

Increased integration of the North American continents has caused the significant restructuring of domestic productive systems. Regionalization has allowed the modernization of the export sector of the economy, but at the price of marginalizing the rest of the productive system, which continues to be dependent on national or local markets.

The heterogeneous structure of the system, structural dualism, has become more pronounced, leaving large sectors and social groups on the margins of the benefits of globalization. The exclusion is not only social, but also geographic. Wealth tends to concentrate in the north, whilst the south of Mexico is becoming poorer and is marginalized by the state of affairs brought about by Neoliberal globalization.
CONCLUSIONS

Transnational corporations and financial capital are the dominant forces behind Neoliberal globalization.

Under NAFTA transnational corporations follow a globalizing logic in regards to markets and profitability, which determine major changes to the productive systems of Canada and Mexico, as well as the composition and direction of foreign trade and the main changes to asset ownership, that is capital structure.

During the period under analysis (1990-2000) two distinct FDI logics were followed that were interrelated. The first was positioning within rival trade blocs (the European Union and Asia), betting on protectionism, benefiting from trade preferences determined by integration agreements, and taking advantage of dynamic competitive advantages. The second tendency concerned Canada and above all Mexico, and this was the repositioning of investment in North America, in order to benefit from the comparative advantages of labor costs, transport costs, and more lenient environmental laws. Another strategy was to take advantage of the financial crises and the privatization of state-run companies, in order to acquire inexpensive assets, especially in the energy, trade, and finance sectors.

In the case of Mexico, FDI operations have increased transnationalization, the assembly-for-export industry, and the growing service industry of its increasingly dominated, heterogeneous, and unarticulated financial and productive system. The main problem of Neoliberal globalization, driven by transnational corporations and financial capital, is not only that it makes inequalities more prominent within the countries, but its intrinsic nature is also unstable, which is a source of recurrent financial and economic crises as observed during the last two decades. The problem with Neoliberal globalization is believing that trade liberalization and deregulation will automatically lead to regulation via the market.

It is true that economic globalization is an irreversible process. But we will not get very far; instead, we will move backward, if we fall into the trap of believing that to resolve problems, we must continue the indiscriminate trade liberalization of markets until they behave as dictated by neoclassic handbooks.

On the other hand, in order to correct irregularities and inequalities, we must look for an active and democratically decided place in globalization, and apply alternative development strategies of a global nature that keep in mind national and local level necessities. These should further South-South integration and radically reform the monetary and international financial system—not just “plombery” as advocated by the IMF with its “new internal financial architecture.” It implies the creation of genuinely democratic international bodies that make the global regulation of direct investment and capital flows possible, resolving foreign debt through its cancellation; and organizing and administrating ordered transference from surplus countries to those of the periphery of the system.
All this implies not a smaller state, but a bigger and better one, on both international and national levels. The market as organizing factotum of the economy, is pure metaphysics. According to Perroux (1982), “A market, is only conceivable within society. A society only exists through a finality (the State), which puts determined objectives in order.” 14

14 Ibid. p. 409
FIGURE 1.

**Investment in U.S.A By Country of Origin (Historical Basis)**

**1990**
- Asia: 24%
- Europe: 63%
- Mexico: 0%
- Canada: 7%
- Others: 6%

**2000**
- Asia: 16%
- Europe: 72%
- Mexico: 0%
- Canada: 8%
- Others: 4%
FIGURE 2: U.S.A.

**Foreing Direct Investment From U.S.A Abroad (Historical Basis) 1990**

- **Europe**: 50%
- **Canada**: 16%
- **Mexico**: 3%
- **Others**: 16%
- **Asia**: 15%

**Foreing Direct Investment From U.S.A Abroad (Historical Basis) 2000**

- **Europe**: 52%
- **Canada**: 10%
- **Mexico**: 3%
- **Others**: 19%
- **Asia**: 16%
FIGURE 3: Canada

Investment in Canada By Country of Origin (Historical Basis)
1990

- U.S.A: 65%
- Europe: 27%
- Asia: 6%
- Others: 2%
- Central and South America: 0%
- Mexico: 0%

Investment in Canada By Country of Origin (Historical Basis)
2000

- U.S.A: 65%
- Europe: 29%
- Asia: 5%
- Others: 1%
- Central and South America: 0%
- Mexico: 0%
FIGURE 4 Canada

**Foreign Direct Investment From Canada Abroad (Historical Basis)**

**1990**
- U.S.A: 62%
- Europe: 23%
- Asia: 7%
- Others: 6%
- Central and South America: 2%
- Mexico: 0%

**2000**
- U.S.A: 51%
- Europe: 21%
- Asia: 8%
- Others: 13%
- Central and South America: 6%
- Mexico: 1%
FIGURE 5: México

Investment in Mexico by Country of Origin (Historical Basis)

1990

- U.S.A: 63%
- Europe: 25%
- Others: 6%
- Japan: 5%
- Canada: 1%

2000

- U.S.A: 65%
- Europe: 24%
- Canada: 3%
- Japan: 4%
- Others: 4%