

Why do Investors Invest?

The Rationale of South African Firms in Latin America

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Summary

Politics and policy are increasingly becoming key determinants of foreign direct investment (FDI) in the developing world. Nowhere is this more so than in the extraction industry, where technological advancements have enabled multinational corporations to pursue natural resource deposits in the most difficult geographical locations and transport the extracted resources anywhere in the world. Political stability, and favourable economic policies and legislation — not to mention solid institutions — distinguish one resource-rich developing country from another, and will ultimately determine which countries attract FDI and which fail to do so.

Despite their common wealth in natural resources, Latin America and Africa have progressed very differently over the past 30 years. Latin America has attracted far more FDI than Africa, which has contributed to higher economic growth with broad-based infrastructure and human development that exceed the levels in Africa. Political and economic instability are factors — among many — that have hampered FDI inflows and development in Africa.

Between 1990 and 2003, average annual growth rates in Asia, Latin America and Africa were 6%, 2.7% and 2%, respectively. FDI inflows between 1991 and 1996 averaged US\$59.5 billion per year in Asia, US\$27 billion per year in Latin America and just US\$4.6 billion per year in Africa. This is a clear reflection of the link between FDI and economic growth in developing regions.

The case of South African companies in Latin America illustrates how investment decisions have shifted from a rationale based largely on comparative advantage dynamics — focused on existing natural resource potential — to one that is based largely on the nature or style of government involvement and intervention in the economy, political trends, socioeconomic developments, institutional infrastructure and operational competitiveness. Such factors can be influenced and improved by sensible government policy.

South African companies have opted for the relative stability of the Latin American political economy over that of Africa in some of their investment decisions —

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particularly in the mining sector. As a result, companies of South African origin have accumulated assets amounting to roughly US\$18 billion in Latin America over the past 30 years.

With some notable exceptions reflected by recent investments in the beverage industry, financial sector, and printing and publishing, South African business interests in Latin America are almost exclusively in the realm of the resource extraction industry.

Anglo American Corporation pioneered South African business interests in Latin America. At its peak in the early 1990s, the company was the largest diversified mining company in Latin America and its regional investments have grown to exceed US\$5 billion.

Anglo American's entry into and growth in Latin America were strongly influenced by the policy environment of the region. This not only drew ongoing investment to the region, but also determined in which countries Anglo American decided to pursue interests and operate. The growth of the company's investments in Chile, in contrast to its nearly non-existent presence in Argentina and investment withdrawal from Zambia in 2001/02, illustrates this point. Ironically, both Argentina and Zambia implemented free market reforms but Zambia has, until now, failed to create the long-term investment appeal that Chile has.

Chile is by far the most stable and successful economy in Latin America, measures in terms of its constant GDP per capita growth rates. With a small market and a copper-dominated economy, Chile offers useful policy guidelines for similar resource-rich African countries in need of FDI to unleash their economic potential. Chile has managed to successfully attract sustainable FDI through effective political and economic reform coupled with institutional evolution, which have made it a more feasible and competitive investment location.

Introduction

What drives investment and how are investment decisions made? It is widely accepted that significant inflows of foreign direct investment (FDI) precede economic growth and development, making this question ever more important in the developing world, where countries are still struggling to overcome enormous socioeconomic challenges and ultimately achieve economic prosperity.

But FDI is in scarce supply. Countries around the world are competing for the same pool of investment, with most significant FDI still flowing between developed countries that have stable and advanced political economies. Some reports do indicate a significant increase in FDI flows to and between developing countries. But this group includes China and some of the other rapidly developing and already modernised Asian 'tigers', which tends to distort the reality of FDI in the developing world.² At last count, China was the largest recipient of FDI in the world, overtaking the United States in 2004 and receiving approximately US\$60 billion of FDI in 2005.

² While the annual net inflows of FDI in the developing world have increased by about 300% since the early 1990s, in 2005 developed countries attracted over US\$570 billion of FDI. This was more than double the amount that went to developing countries (US\$273 billion), of which more than 22% went to a single country — China (*World Investment Report, 2005*).

This is due more to the immense size of the Chinese market, the country's abundant labour supply, and its incessant growth and development than a favourably competitive investment environment.³

The role of the state in creating a favourable investment environment and attracting investments through policy and strategy initiatives is now more important than ever. Investments gravitate toward economies that offer a greater number of opportunities relative to the perceived risk incurred through profit realisation. For this reason, foreign investors compare the investment opportunities and operating environments of different economies from around the world and seek those that offer the highest potential profits. This process can simply be referred to as a company's global strategy, and it is undertaken by multinational corporations (MNCs) to diversify risk, maximise profit, minimise costs and maintain a competitive edge over rivals.

The influence of the political economy in the investment decision-making process of MNCs is growing in significance. Africa and Latin America are two regions that share a range of similarities. Both are well endowed with natural resources, but are crippled by acute socioeconomic and political problems, and have a history of war and conflict, colonialism, and exploitation.

However, despite these similarities, Latin America has managed to integrate itself more effectively into the global economy, and has attracted higher levels of FDI than Africa, which has allowed the former to capitalise on some of its natural resource potential. This, it could be argued, is a direct result of positive political economy dynamics in Latin America, which have delivered a more favourable investment climate.

FDI in Latin America has increased steadily in relation to economic growth over the past 30 years. Unfortunately, the same cannot be said of Africa. The ratio of investment to gross domestic product (GDP) in Africa is low and has declined since 1975, averaging below 15% of GDP earnings per year. In Latin America, the investment rate has hovered around 25% since 1975. The result is that Latin America currently attracts over US\$68 billion of FDI annually, compared to Africa's US\$18 billion per year.⁴

As in the case in Africa, mining is a core industry in the Latin American economy. The size of the Latin American mining industry is estimated at well over US\$70 billion, and is growing rapidly, with new projects emerging in Argentina, Colombia and Venezuela. South African-based mining companies account for about 15% of the investment total. In 2004, Latin America attracted the largest regional mining investment in the world. The region attracted 35% of global mining investments, which amounted to US\$36 billion. Africa, which attracted US\$15 billion of mining investments that year, was third after Latin America and Oceania.⁵

³ China does not rank high in the various competitiveness indices. On the World Economic Forum's Competitiveness Index in 2005, China ranked 49 out of 117 countries measured. Chile was 23rd, Thailand 36th, South Africa 42nd and India 50th. On the Business Competitive Index, which focuses on the microeconomic factors that determine countries' ability to sustain current levels of productivity and competitiveness, China was ranked at 57, well behind Chile (29), South Africa (28), India (31) and Brazil (49).

⁴ See *World Investment Report, 2005*.

⁵ See 'Engineering and Mining Journal, 2005'

Overall, the cumulative total of investments of South African origin in Latin America — across all sectors — were well over US\$10 billion at the end of 2003.⁶ New investments from South African-based companies (SABMiller and Naspers in particular) have driven this up to around US\$18 billion since then.

Led by the Anglo American Corporation,⁷ South African business interests in Latin America have focused predominantly on the mining sector. Notable exceptions do exist in the areas of wood, paper and pulp, fisheries, beverages, finance and even in the retail sector. But mining or mining-related investments still account for well over 90% of South African commercial activities in Latin America.

It is for this reason that Anglo American, which became one of the largest and most successful foreign investors in Latin America, has become synonymous with South African business interests in that region. Ironically, even at the height of its prominence, Anglo American South America (AMSA, as it became known) was not seen as a foreign entity in the Latin American market, and was even regarded by many as a local company. This was a key element in Anglo American's success, which will be discussed in greater detail in a later section of this paper.

It can therefore be said that if one is to understand South African business investments in Latin America, the experience of Anglo American in the region should be carefully tracked and well understood. This is a company that entered a relatively unexplored territory more than 30 years ago based on the geological potential of the largest market in the region (Brazil), coupled with significant changes in the economic policy, legislation and political environment of that country. The emergence of feasible partners and the need for Anglo American to undergo greater international diversification were some of the strategic company-related factors that influenced the organisational decision-making and drove Anglo American to invest in Latin America.

While mineral deposits were the initial draw-card to the region, it is clear that economic policy, investment incentives, political and social stability, and a favourable operating environment underpinned by functional institutions drew Anglo American deeper into Latin America and laid the foundation for long-term investments that are still growing today. The company, perhaps unknowingly at times, navigated its way around Latin America based on the political economy dynamics of individual countries and the region.

From Brazil, the company expanded aggressively into Chile, where the presence of copper and a favourable investment climate made for a profitable and relatively risk-free venture. Other countries in the region — notably Argentina — have been less accommodating, and this is reflected in the relatively minor presence of Anglo there.

The experience of South African companies in Latin America does reveal interesting policy options and alternatives for African policy makers seeking to attract and retain

⁶ These figures are based on estimates from Mark Venning, a prominent Latin America–South Africa business consultant based in Santiago, Chile.

⁷ Anglo American has since listed on the London Stock Exchange and is thus technically no longer a South African company. But for the purposes of this study, Anglo American will be discussed as a 'company of South African origin'. It is still often considered a South African company, given its history, prominence and ongoing operational presence in the South African economy.

FDI. The Chilean experience offers the best example in this regard. While its copper deposits are by no means better than in other parts of the world — Zambian copper is of a higher quality — Chile has, through policy and institutional reform, created a more competitive investment location that has lured much-needed FDI from other parts of the world (including Africa) to its shores. Clearly there are lessons to be learned from Chile and other Latin American countries that also have immense natural resource and mining potential. The experience of South African companies — and in particular Anglo American — provides some insight into this.

The Latin American Investment Environment in a Global Context

Latin America has always been a significant recipient of FDI in the developing world. Its vast supply of natural resources and treasure trove of mineral and base-metal deposits have ensured constant inflows of FDI into primary activities and the commodity sector. In recent years, the large Latin American consumer and labour market, and macroeconomic reforms have added some diversity to FDI flowing into the region. This is most evident in the manufacturing, telecommunication, food and beverages, and, to a lesser degree, information and communications technology (ICT) sectors. But the most significant investments remain in natural resources and extraction (or related) industries, including mining, steel, hydrocarbons and gas, petroleum, agribusiness, etc.

In 2005 Latin America attracted well over US\$68 billion of FDI (US\$44 billion of which was in South America). The region therefore attracted about 24% of the total FDI flowing to the developing world, and only 8% of the worldwide total,⁸ placing it roughly on a par with China. This is well below the figure for the FDI boom at the end of the 1990s, when at its peak Latin America accounted for over 40% of FDI in the developing world, and in 2000 attracted nearly US\$98 billion of FDI. Between 1993 and 1998, seven of the top 15 developing country recipients of FDI were from Latin America. But following a period of FDI decline at the turn of the century, the region is now less economically volatile and seems to be regaining its appeal to foreign investors. The United Nations Economic Commission for Latin America and the Caribbean (ECLAC) report on *Foreign Investment in Latin America and the Caribbean 2005* attributes this upturn in investor confidence to the following:⁹

- ongoing economic growth in Latin America and the United States;
- the demand for natural resources driving up commodity prices;
- an increase in mergers and acquisitions, as well as some greenfield investments;
- political and institutional stability — though this is currently at risk in the Andean region; and
- slight improvements in the business environment assessments for the region — though it still lags far behind the Asia–Pacific region.

FDI flows in South America are traditionally more volatile than the rest of Latin America. FDI is concentrated in the mining and hydrocarbons sectors. In 2005 flows

⁸ This has decreased from 12% in the 1980s and 10% in the 1990s, which may indicate that the region is starting to be sidelined in the face of global investment patterns, and suggests the need for nuanced approaches to attracting investments and creating a competitive investment environment. Investment data indicates that Chile is clearly ahead of the curve in this regard.

⁹ Available at <http://www.eclac.cl>.

were up 18% from the previous year. Brazil is by far the largest recipient of investment in South America (US\$15.2 billion in 2005), but Chile is credited as the most stable and transparent destination of the sub-region. This is evident from the fact that most of the investments that flowed into Chile during 2005 were in fact reinvestments, and there is a real sense of diversity, with new investments flowing into public-private partnerships (particularly infrastructure and ICT) and 'new services' such as call centres.¹⁰

In contrast to Chile, the Andean region is plagued by uncertainty. However, Colombia is the clear exception and is the leading recipient of FDI in the Andean region. The government has pledged investor security in the country, and the largest investment in 2005 was in the brewing industry — SABMiller's acquisition of Bavaria. Investments in Colombia are traditionally in the hydrocarbons and mining sectors.

Global Distribution of Net FDI Inflows, 1991–2005 (US\$bn)					
	1991–95 (annual ave.)	1996–2000 (annual ave.)	2001–05 (annual ave.)	2004	2005 (prelim. figs. incl. financial centres)
Worldwide total	231.7	814.1	754.3	695.0	896.7
Developed countries	148.8	601.2	514.6	414.1	573.2
Developing countries	80.4	203.2	212.4	243.1	273.5
Africa	4.9	9.4	19.6	18.7	28.9
Latin America and the Caribbean	22.4	83.0	65.7	68.9	72.0
Asia and Oceania	53.1	110.7	127.2	155.5	172.7
China	22.8	42.7	54.8	60.6	60.3

Source: ECLAC (2006) *Foreign Investment in Latin America and the Caribbean 2005*

But Venezuela and Bolivia have taken an alternative route. In Venezuela, the government has started applying the 2001 Hydrocarbons Act, which prohibits private companies from owning a majority shareholding in oil deposits. Companies opting to continue operations in the country have to sign new contracts with the government-run Petroleos de Venezuela (PDVSA), which may control up to 70% of the operational activity. Many smaller stakeholders pulled out of the country as a result, but those with larger interests have remained. Given the current price of oil, Venezuela still remains profitable, despite policy uncertainty. Bolivia, meanwhile, has also nationalised its hydrocarbons and gas industry in much the same way as Venezuela.

¹⁰ Ibid.

Such uncertainty around political leadership and policy reform, and the impact it has on FDI flows in the Andean region, were articulated in the ECLAC report:

... the subregion is now faced with a situation in which new political leadership could change relations between countries and TNCs [transnational companies], with negative implications for some types of investment, due to the legal uncertainty generated by shifts in the 'rules of the game'.¹¹

Spread of FDI in South America, 1991–2005 (US\$bn)					
	1991–95 (annual ave.)	1996–2000 (annual ave.)	2001–05 (annual ave.)	2004	2005 (excludes financial centres)
Latin America and the Caribbean	20.206	70.639	58.586	61.503	68.046
South America	11.797	53.171	34.672	37.669	44.525
Chile	1.666	5.667	5.088	7.172	7.209
Andean community	3.686	10.747	9.701	7.674	16.916
Mercosur	6.445	36.757	19.883	22.822	20.399
Brazil	3.782	11.561	2.981	4.274	4.662

Source: ECLAC (2006) *Foreign Investment in Latin America and the Caribbean 2005*

The History of South African Investments in Latin America

Until recently, South African companies had a relatively small presence in Latin America. With the exception of Anglo American, South African businesses were largely unknown in the region, and existing South African investments were traditionally almost exclusively in the mining or mining-related sectors. However, recent investments and acquisitions do indicate a shifting trend of South African investments in Latin America.

According to Mark Venning, a South African business consultant based in Santiago de Chile, mining (or mining-related) companies of South African origin have invested in excess of US\$10 billion in Latin America. Other sectors such as retail, paper and packaging, fisheries, and beverages/breweries account for as much as US\$8 billion — thanks to the SABMiller acquisition of the Colombian-based Bavaria, valued at around US\$7.8 billion, last year.

Despite the lack of obvious investment ties between South Africa and Latin America, companies of South African origin have made serious inroads into the region. In

¹¹ Ibid. Despite the nature of the Venezuelan policy environment, Gold Fields of South Africa opted to invest a further US\$360 million in Venezuela through the purchase of Bolivar Gold, owner of a Venezuelan gold mine, in early 2006. This added to the tally of South African mining investments in the region, which, according to Gold Fields and others, is likely to increase in the near future.

terms of sales, in 2004 Anglo American was ranked as the second largest mining company in Latin America after Bhp Billiton plc. It was in 31st position of the top non-financial transnationals in Latin America, followed closely by Phelps Dodge.¹² But measured by market capitalisation or accumulated fixed assets, other diversified mining giants are likely to edge ahead of Anglo in the region. This is certainly the case with BHP Billiton, and perhaps even the Rio Tinto Group and Phelps Dodge. Other South African mining companies, less recognised in the region, such as Gold Fields, are looking to expand their interests in Latin America, and are likely to make their mark in the coming years, if one considers the recent acquisitions in Venezuela and exploration activities elsewhere. SABMiller, a non-traditional South African player in the region, will certainly be ranked as one of the largest transnationals in Latin America in the forthcoming 2005 foreign investor rankings.

Shifting South African Trends in Latin America

South African business interests in Latin America are synonymous with mining. Their expertise and know-how in the mining sector (particularly deep-level gold mining) led South African companies to Brazil, where the geological environment was not much different to that of the Witwatersrand in South Africa.

Anglo American, the first serious South African investor in Latin America, acquired a 49% stake in a Brazilian gold mine, Marro Velho, more than 30 years ago. At the time, Brazil was a booming economy, regarded by many as the emerging market giant of the future — not unlike China today. But the investment environment was still tainted with uncertainty following a period of nationalisation that had left the mining sector without any foreign investment and in desperate need of rehabilitation. The policies of the military government at the time were still relatively unclear, as were its strategies for economic development in the country. Brazilian law required foreign investors to enter the country with a majority Brazilian shareholder. Anglo American was eager to get into the Brazilian (and Latin American) market, and required an appropriate partner that reflected its own values and ambitions.

Under these circumstances, Anglo American forged a number of partnerships and acquired various local companies, which allowed it to penetrate the region beyond Brazil. Such an approach also forced Anglo to diversify into alternative industries. This diversified characteristic reflected the nature of business in Latin America at the time, whereby legislation and the economic situation — weak financial institutions, somewhat erratic monetary behaviour and complicated exchange controls — forced companies to buy into a range of (sometimes unrelated) business interests.

For this reason, Anglo American found itself involved in a range of industries from a banana flakes company in Ecuador to fertilizers and petrol in Argentina. These periphery interests accumulated to the point where Anglo American dedicated an entire office in Latin America to diversified industries. As these investments grew, Anglo American Industries in Latin America began to pursue independent investment interests, and, with the likes of Mondi, undertook major investment projects in areas such as paper and pulp.

¹² See ECLAC (2006) *op. cit.*

But Anglo American's core interests are and always have been in mining. In recent years, Anglo has consolidated its interests and focused more exclusively on the mining sector.

A small number of non-mining companies have shown an interest in the Latin American market over the years. But, with few exceptions, such investments proved unsustainable or failed to grow into anything of substantial significance.¹³ Companies such as Tiger Brands, I&J, Standard Bank and Mr Price have invested in Latin America during the last 10 years. In that time, Standard Bank has withdrawn and re-entered, using Argentina as a base, and Mr Price was present in Chile for only three to four years. Both Tiger Brands and I&J seem to have a slightly longer-term perspective, having entered the market with a feasible local partner and initial investments of around US\$30 million and US\$20 million, respectively.

However, acquisitions made by SABMiller and Naspers do indicate a new shift in South African investments (or those investments with a South African dimension) in Latin America.

SABMiller acquired the Colombian-based Bavaria, one of the largest brewers in Latin America, in 2005, in an effort to gain a foothold in the rapidly growing Latin American beer market. The value of the investment amounted to US\$7.8 billion, the largest South African-initiated investment in the region, making SABMiller the largest single investor of South African origin in Latin America.

Beer Consumption in Latin America, 2004		
Country	Beer market (millions of hectolitres)	Per capita consumption (litres)
Brazil	84.5	47
Mexico	54.8	52
Venezuela	14.8	57
Colombia	14.0	31
Argentina	13.2	34
Peru	6.4	24
Chile	4.3	27

Source: ECLAC (2006) *Foreign Investment in Latin America and the Caribbean 2005*

In May 2006 Naspers acquired a 30% stake in the Brazilian media giant Abril SA for an amount of US\$422 million. The remaining 70% of Abril is held by the Cevita family. Abril is a leading media company in Latin America that publishes some of the most widely read magazine titles in Brazil. Naspers is looking to use Abril as a vehicle into a new and vibrant market, which it may look to expand further into in the future.

¹³ This is a much-debated issue among analysts and practitioners in South Africa and Latin America. It seems that the inability of non-mining interests to 'take off' can be attributed to poor timing — entering the market during a critical downswing — and a blatant lack of understanding of the Latin American political economy and business environment.

Naspers and SABMiller have introduced a new era of South Africa investments in Latin America. South African companies appear to have finally recognised the potential of the Latin American market, and are prepared to invest in non-traditional sectors, where they are able to apply the expertise they have developed in the sometimes difficult and complicated South African and African environments, where they have operated up until now. A more globally integrated and transparent Latin America that has undergone rigorous economic reforms and has well-established democracies — not to mention evidence of policy continuity in countries like Brazil, Colombia and Chile — does not seem as foreign to South African business as the region was in the past.

An African Pioneer: The Experience of Anglo American in Latin America¹⁴

'As with most things, Anglo American's entry into Latin America happened by chance.'

This statement by Julian Ogilvie-Thomson, former chairman of Anglo American Plc, illustrates the point where analysis meets the reality of business. Analysts tend to look for explanations or specific strategies behind decisions, and in so doing sometimes overlook the role of chance, coincidence or individual actions based on 'gut feel'.

Anglo American first entered Latin America in 1973.¹⁵ The gold price was increasing after the gold standard had been abandoned,¹⁶ Brazil was on an upward growth trajectory, and indications from the military government suggested renewed commitment toward the development of the mining industry, which had been identified as the best candidate for long-term investment and economic growth.

Given Anglo American's vast experience in the field of gold mining in South Africa, it quickly identified an opportunity in Brazil where it clearly had a competitive advantage over other potential investors. However, adverse labour union activity and some localised political instability — not to mention the need for specific policy and legislative reforms related to FDI and the mining sector — delayed Anglo American investments in its first mining operation in Brazil until 1975. By that time, Anglo had found a suitable partner in Brazil, and had established the necessary business and political support essential for effective operations in that country and the broader region.

Few at the time realised that the small Anglo American office opened in Rio de Janeiro, which was then called Anglo American Brazil (AMBRAS), and the Marro Vehlo Gold Mine would be the start of the most successful business venture undertaken by Anglo American on a regional scale. Opinions differ as to what the sources of

¹⁴ This section is based on an insightful article by Bob Lyle entitled, 'The Story of AMSA', which appeared in *Opitma* in October 1993, and a range of interviews with key individuals from Anglo American who were instrumental in the decision-making process that led Anglo to Latin America and resulted in the operations of AMSA in the years that followed.

¹⁵ Following a visit by Tim Wadeson, who later became technical director, Anglo American was first invited into a joint venture in a copper mine in Peru in 1967. But a change in government and political instability interfered and scared Anglo off. Gold mining prospects in Brazil a few years later seemed far more appealing.

¹⁶ Between 1970 and 1975, the gold price increased by more than 400%, from US\$35.94 to US\$161.06 an ounce.

prosperity and success for Anglo American operations in Latin America were. But some reflection on the experience of Anglo in the region reveals an interesting success story, which is essentially the result of a combination of factors, both internal or company-related (as a result of leadership and key individuals behind the decision-making process, and the operational culture or nuances in Latin America) and external (i.e. those factors related to the political economy of investment). However, all seem to agree that Anglo American South America (AMSA) became the most successful South African investor in Latin America, and arguably one of the most successful foreign investment initiatives in the region.

In the early 1970s, Anglo American (together with De Beers) was recognised as one of the largest and most reliable mining companies in the world. It was one of the few companies capable of unleashing the resource potential of developing countries that was relatively unexplored at the time. But the fact that Anglo American was a South African company added a political stigma to its international image, and it was not always widely accepted, as a result of the apartheid policies of the then South African government. At the same time, the progressive nature of the Anglo American leadership — particularly Harry Oppenheimer — resulted in an often strained relationship with the political elite in South Africa. The National Party government's antipathy towards Oppenheimer, who was an internationalist at heart, and Anglo American no doubt encouraged the pursuit of investment opportunities abroad.

At the time, Anglo American had few investments outside the African continent. The nationalisation of the Zambian copper industry at the end of the 1960s provided Anglo with offshore capital to create Minorco, which was responsible for foreign investments. While Anglo identified the need for international diversification, the drive to Latin America was largely the result of the activities of prominent individuals in the company, such as Julian Ogilvie-Thomson, who took a special interest in the region based on a vision and personal relationships forged with like-minded counterparts in Brazil and, later, other countries in the region.

Having operated in Africa for more than 40 years, Anglo American was aware of the impact of politics and policy on mining investments in developing regions. Mining, after all, is a highly politicised activity. It is a long-term engagement that involves surface rights, which are essentially property ownership rights, and this is a sensitive issue in any socio-political environment.

For this reason, Anglo American moved very slowly and cautiously in Latin America, always conscious of the political and economic dynamics of the country and broader region in which it was operating. Guy Young, the former chairman of AMSA, has identified three very important characteristics of the company that clearly contributed to the enormous success of Anglo in the region.

- Anglo American chose reliable, like-minded and capable partners that were already well established in Latin America. This helped to diversify Anglo American activities in terms of its business interests and geographical presence in the region. It allowed the company to learn about the business culture and operating environment over a lengthy period of time, while also providing investment security.
- From the outset, AMBBRAS, and later AMSA, assumed the identity of a Latin American company. It kept a low profile and avoided the image of a large foreign investor that had a majority stake in various mines around South America. Anglo American maintained this image, despite the fact that by the end of the 1980s

and early 1990s it had become the largest diversified mining company in Latin America.

- AMSA maintained that it could only establish a stable and permanent presence in Latin America by developing local skills and talents. It created a sense of 'ownership' among local staff and management, and developed a unique company culture that was based on the Anglo American culture adapted to the Latin American environment.

The role of personalities and the importance of building a broad range of relationships with governments on a regional scale should not be underestimated. Governments value relationships; and from relationships, transactions will emerge. Business is all about transactions. This approach, which is essentially a carefully crafted balancing act championed by highly committed individuals that are intimately involved in government–business relations, characterised the Anglo American regional model in South America. While Anglo's global model has changed (shifting away from the regional divisions), it is broadly acknowledged that this approach was key to its success in the region – especially in the earlier years.¹⁷

From the outset, Anglo American was aware of the political and economic complexities of individual countries with resource potential in the region. It considered these dynamics in the pursuit of growing investments and partnerships throughout the region. Peru, for example, was said to have the greatest mineral potential in South America. But political instability and security problems kept new investment prospects out of the country until Alberto Fujimori came to power in the 1990s. Argentina, meanwhile, under its complicated federal system, hamstrung the development of its mining sector through a differentiated system of policies and legislation from province to province, which created an environment of uncertainty and inconsistency for potential foreign investors. Anglo American only entered Argentina in 1981 as part of a broader regional partnership.

Brazil and Chile were identified as the best investment environments in Latin America. Brazil, with a combination of mineral and base-metal components, and Chile, with enormous copper deposits, had the natural resource potential necessary for the initial attraction. Both countries had undergone a process of economic nationalisation followed by successful reforms, and while democracy did not exist in either (democracy was a rarity in the developing world at that time), political and social stability prevailed. Most importantly, both countries could guarantee a high degree of legislative and operational certainty with policy continuity, which created an environment that was comparatively less risky than other locations in Latin America (and Africa, for that matter).

Anglo American interests in Latin America escalated after 1981 with the 40% acquisition of Empresas Consolidadas Sudamericanas SA — the Hoschild Group in South America. Less than two years later, Anglo American acquired the remaining 60%. The diversified nature of the Hoschild operations forced Anglo to restructure its South American interests into a new holding company, which was called Anglo American South America (AMSA).

¹⁷ Philip Baum, the chairman and chief executive officer of Anglo Ferrous Metals and Industries, articulated this point about government–business relations in a discussion held in July 2006.

The acquisition of the Hoschild group in South America added a range of diversified interests to the Anglo American portfolio in Latin America, which had before then been almost exclusively confined to Brazil. But Anglo had long been looking to enter Chile more aggressively, eager to tap into the base-metal prospects that the country had to offer. One of the Hoschild assets was the medium-sized copper mine Montos Blancos, which essentially launched AMSA into a long and fulfilling relationship with Chile. Chile is today the largest recipient of Anglo American investments in the region.

According to its 2005 *Annual Report*, Anglo American assets in South America amounted to US\$5.1 billion. The value of Anglo American assets in South Africa is currently US\$19 billion, and US\$4.1 billion in the rest of Africa. In the early 1990s, when AMSA was regarded as the largest mining group in South America, the company had over US\$1 billion in assets and employed more than ten thousand people. But these investments have grown significantly since then, following the general trend in Latin America, as countries reformed their mining and hydrocarbons sectors. Today Anglo American's operations in the Americas account for over 40% of the company's total earnings — far more than South Africa, which currently contributes around 30%.¹⁸ Latin America is by far the largest growth area for Anglo American operations worldwide.

New investments in Argentina, Colombia, Peru and Venezuela have added considerable diversity to the Anglo American pool of investments in South America since the mid-1990s. But it is the nature of the investments — and the sustainable flow — that is more relevant than the quantity. This is particularly the case in Chile, which has managed to attract continued investment from Anglo American for more than 20 years. While the copper potential in Chile was the initial draw-card, favourable policies and strong institutions have made Chile the investment location of choice for Anglo American and other multinational corporations in the resource extraction sector and elsewhere.

Anglo American's commitment to Chile was demonstrated in 2002, when it chose to invest a further US\$1.3 billion in the country through the acquisition of the Disputada mine (now Minera Sur Andes). This was shortly after the company had decided to abandon the Konkola Deep project in Zambia — another copper mine with enormous potential. Much debate surrounded this controversial decision, which many believed indicated Anglo American's intention to slowly withdraw from Africa (this was also shortly after Anglo American had de-listed from the Johannesburg Stock Exchange, opting instead to be listed as a British company).

However, the decision has proven most beneficial to the 'bottom line'. In 2004 alone, Minera Sur Andes made an astonishing 48% return on the purchase cost of the mine. The decision to increase investments in Chile was based on the existing trends and positive experiences of operating in that country — not to mention the anticipated surge in the copper price. Chile has traditionally been a lower-cost destination with an easier operating environment. It has displayed the stability, transparency and law and order that have become fundamental to investments of this nature. Anglo American realised that it would be able to enjoy immediate returns on its investment in Chile, while the same could not be said for Zambia. It is these policies, coupled with institutional and structural reforms (which clearly exist in Chile), that need to be

¹⁸ Anglo American operations in the Americas include its Latin American interests plus the Hudson Bay Zinc operation in Canada.

better understood for the creation of a competitive investment environment that will continue to lure the much-needed investment offered by companies like Anglo American.

The Political Economy of Investing: What Makes Chile Different?

The Disputada mine in Chile, when compared with the Konkola Deep project in Zambia, is a recent example of where policy and politics influence a country's national competitiveness, which override the comparative advantage resulting from the natural endowment of resources. But the trilateral link among Chile, Zambia and Anglo American dates back long before the Disputada–Konkola dispute in 2002. This history and previous experiences no doubt contributed to the final investment decision that was made.

While Anglo American executives may argue that the Disputada decision was coincidental to the Konkola withdrawal, few will deny that this example does illustrate the globalised nature of Anglo American operations and mining investments in general. It demonstrates the importance of emerging competitiveness in the policy domain among countries that may have previously relied on natural resource potential to attract FDI.

Ironically, it was the nationalisation of Zambian mines in 1969 that provided the seed capital for Anglo American to enter Latin America in the first place, and ultimately Chile, through Minorco. Following the withdrawal of foreign investment, the nationalised mines in Zambia failed to deliver the production potential required to sustain the economic lifeblood of the country. The lack of investment in the industry over a near 30-year period left the mining sector in a desperate state of disrepair. When the Zambian government eventually decided to reprivatise the mining industry in the 1990s, the initial costs were huge, while the copper price was at an all-time low. But the Zambian copper industry had enormous potential, with some of the highest grade copper in the world. This made it an appealing investment opportunity.

Despite Anglo American's enthusiasm for re-entering Zambia, embedded country-specific expertise and even World Bank support, reliable partners were not forthcoming, and ultimately, a hard-nosed business decision had to be made. The Zambian operations were comparatively high-cost and high-risk when viewed against alternatives such as Disputada in Chile. While Disputada was an existing operation that only required investment for continuity, Konkola Deep required huge initial investments to redevelop the mine from scratch. The fact that the Zambian government kept increasing the price of the mine and could not ensure a sustainable supply of electricity did not help the Zambian cause.¹⁹ The reliable policy environment and security in Chile eventually prevailed over the relatively uncertain, high-cost environment in Zambia. This was the contrasting trend that Anglo American had grown accustomed to through its experience in both countries.

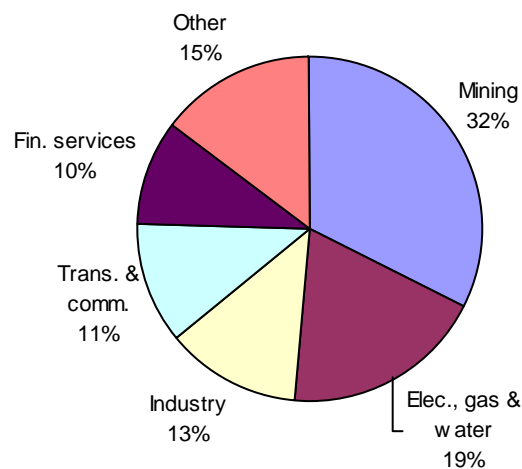
The Chilean reforms, which have delivered impressive and sustainable economic growth, prioritised export-led initiatives and FDI over a 30-year process that has been both comprehensive and complete. Continuity through political transition has been key, as has the importance of economic modernisation, which requires foreign

¹⁹ See Mills, G, 'Why are investment decisions made? The case of Chile and Zambia'. *Business Day*, 21 June 2005.

investment through targeted privatisation initiatives. Chile has been both progressive and cautious in its process of economic reform and global integration, maintaining a transparent and reliable investment environment.

One example of reform and policy continuity related to FDI is the Decree Law 600 of 1974. This is a law binding the Chilean government to ensure a transparent, non-discriminatory and non-discretionary environment for foreign investors. Reforms such as these, created under military rule, have at times been challenged throughout the democratic transition in Chile. But such legislation is intricately interwoven within the Chilean Constitution and supporting institutions, making it very difficult to change what has become a successful investment model. The system is designed to minimise the discretionary powers of the authorities, creating a private market economy governed by rules rather than discretion.²⁰ This is where the Chilean model differs from other successful models in East Asia and elsewhere that have broadly been described as following the development-state paradigm.

FDI in Chile, Sectoral Distribution, 1974–2005



Source: Chile Investment Committee, April 2006

Chile recognised early in its process of economic development and modernisation that export-led growth and ongoing inflows of FDI — or capital accumulation — were essential components. FDI is a key driver of Chile's economy, geared to expand natural resource exports and rejuvenate the country's infrastructure and service sector.²¹ Chile therefore went beyond the rhetoric of neo-liberal reform, which is how some analysts have described the incomplete and shallow reforms undertaken in Zambia and even Argentina, where a reform agenda geared for investment and trade liberalisation was verbalised, but never adequately implemented. Chile went to great lengths to create an economy 'governed by stable rules, written to minimise rent seeking and to reduce investor uncertainty'.²² The simple creation of export promotion agencies and investment committees, and the implementation of some fundamental reforms — such as Central Bank autonomy and a law on government

²⁰ This information was extracted from an unpublished paper by Carbo, V, R Luders & P Spiller (1996) 'The foundations of successful economic reforms: The case of Chile'.

²¹ See Australian Department of Foreign Affairs and Trade, Economic Analytical Unit (2001) 'Investing in Latin American growth: Unlocking opportunities in Brazil, Mexico, Argentina and Chile'.

²² Carbo, Luders & Spiller (1996) op. cit.

probity that regulates the behaviour of public officials — institutionalised a profoundly stable investment environment.

Chilean FDI policies are some of the most liberal in the world. Most importantly, the investment regime is characterised by the granting of full ownership in virtually all sectors; the freedom to repatriate earnings; and a somewhat unique national treatment for foreign investors, which carries favourable tax implications. This resulted in a surge of FDI inflows during the 1990s — when democracy and political stability were galvanised in conjunction with economic congruency. The share of total fixed investments rose from 11% of GDP in 1990 to 25% in 1998. During this time, the mining sector attracted 58% of FDI, which ignited copper production, driving Chile's share of world production from 18% in 1990 to 30% by 2000. Copper exports rose from US\$3.9 billion to US\$6.1 billion in the same period.²³ Chile was ranked as the most attractive mining location (out of 64 locations around the world) in the 2005/06 Fraser Institute mining survey.

These are some of the factors and policies that distinguish Chile from other developing world locations, and that have encouraged South African companies to enter the country and continue to invest there. If one looks at the Chilean example, and Latin America in general, the process of reform — and investment attraction in particular — is not that difficult to replicate or emulate, given these countries' political and economic histories and challenges around transition, which are not much different to those of Africa. This is especially relevant for policy makers on the African continent looking to increase investments from South African companies with an increasingly globalised agenda. Reforms that have targeted investment codes in Ghana and Mali have encouraged an increase in FDI from Anglo American and others, and indicate that such an approach is possible on the African continent.

Lessons and Implications for African Policy Making

The history of South African investments in Latin America, which are concentrated mostly in the mining sector, provides valuable lessons for policy makers on the African continent. Resource-rich African countries in many ways compete with countries in Latin America for much-needed FDI. Both Brazil and Chile have demonstrated how FDI can be used to modernise an economy and unlock the enormous potential in the resource extraction industry — and mining in particular.

Both countries have pursued liberal reforms that have prioritised investment policies over an extended period of time. However, Chile is widely regarded as the best and most comprehensive example, advancing well beyond the obvious macroeconomic reforms associated with investment, and placing a strong emphasis (in later years) on institutions and infrastructure to support ongoing market reforms and economic modernisation.

The Chilean experience, which has had a direct impact on South African investments into the broader region, reflects a simple process that improved the competitive advantage of the local investment environment through a collaborative political transition with targeted economic policies that emphasised stability, continuity and transparency.

²³ Australian Department of Foreign Affairs and Trade (2001) *op. cit.*

According to Carbo, Luders and Spiller, some of the positive lessons that can be derived from the Chilean experience include the following.²⁴

- There is an important sequence of reforms. Basic structural reforms to re-establish macroeconomic balances must precede efficiency-enhancing reforms and privatisation. The process is a long one that requires due diligence and patience — from both the practitioners and policy makers in the economy.
- The timing of efficiency-enhancing reforms is important, and other simultaneous reforms are often necessary. This ensures that the maximum mileage is achieved from each of the reforms implemented.
- Good policies must be complemented by good institutions. This enhances their credibility, and ultimately increases the investment and supply response of the reforms. Solid institutional support helps to achieve and sustain stability, efficiency and a competitive investment climate.
- Predictable policies encourage private sector involvement, which is necessary for tangible results from economic reforms. This includes a fair tax regime, basic property rights and various clear-cut incentives. Again, continuity is key.

The investment trend in Latin America, and the experience of South African companies in that region in particular, does reveal a broad set of basic principles that can determine the nature and extent of FDI in a particular country and region. In terms of a policy framework, economic, political and social stability are essential prerequisites. This should be followed by a clear set of rules and regulations regarding entry into and operations in a particular location. Competition policy, tax policy and market regulation (or intervention) have important localised implications. Foreign investors should be treated in a standardised and consistent way. Various international and bilateral agreements do influence the broader dynamics of the investment environment. Following these basic policy requirements, economic incentives and operational facilities that help ease the practice of doing business — such as good infrastructure, social amenities, support services, etc. — in a particular location help to complement the overall investment environment.²⁵

Finally, some critics might argue that the initial reform process that laid the foundation for economic liberalisation and a successful investment policy was implemented during the military dictatorship in Chile in the 1970s and 1980s, making it less relevant for progressive democracies in Africa and elsewhere. But the Chilean reforms continued and advanced under democratic institutions post-1989. This helped to galvanise existing policies and added credibility to successful market reforms. This process of continuity is particularly relevant for African policy makers in reforming countries where, regardless of the political regime, successful economic policies that encourage FDI and economic development must prevail. Democracy should not be seen as a deterrent to liberal economic reforms (which are conducive to FDI inflows), but rather as a tool to reaffirm policy intentions, which can add justified credibility to the policies implemented.

Ricardo Lagos, the former president of Chile — described as ‘the Mozart of the economy’ — stated in a recent address at the University of California, Berkeley, that to instil democracy, a country needs growth and investment. Lagos went on to say that Chile’s success story can be attributed directly to favourable investment flows,

²⁴ Carbo, Luders & Spiller (1996) *op. cit.*

²⁵ See (2003) ‘Investment policies in select large emerging markets: Performance and perception’. Cuts Centre for Competition, Investment & Economic regulation, India.

which was essentially a prerequisite for growth. When asked about liberal economic reforms in general and possible alternatives, President Lagos responded: "The Issue is not *What* to do, but rather *How* to do it. And there are not really many alternatives."²⁶

The truth is that progressive investment reforms that drive growth are not easy, and policy shortcuts to sweeten the taste of a bitter pill are not a feasible option in a world where success is measured, ultimately, by delivery.

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²⁶ This information is based on a public address and discussions with President Ricardo Lagos, who was a visiting professor at the Center for Latin American Studies (CLAS) at the University of California, Berkeley in September/October 2006.