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## FOREIGN INVESTMENT AND BANKING IN LATIN AMERICA

Alfredo Morles Hernández\*

Foreign investment has been a key factor in the economic history of Latin America, and logically has been channelled to those sectors of the economy promising the highest profit to the investor. Banking has been one of the fields where foreign investment has played an important role. However, investment in banking generally occurs when previous successful investments in other areas create a need for expanded, and perhaps more sophisticated banking services. This has been the case in Argentina with the beef industry, in Chile with the copper mining industry and in Venezuela with the oil industry, just to mention some examples.

The purpose of this paper is to show — in a very broad perspective — the kind of legal treatment the banking business is now receiving in Latin America and the trends for the future. I will not review the existing legislation of the Latin American countries, but rather examine the situation in some countries to highlight contrasting points of view.

### PERTINENT DATA ABOUT FOREIGN INVESTMENTS IN LATIN AMERICA

As much as 70% of foreign private investment in Latin America is estimated owned by U.S. corporations and nationals, compared to 20% on the eve of the first World War.<sup>1</sup>

The total amount of private long-term "direct"<sup>2</sup> worldwide U.S. investments by year-end 1968 was \$64.9 billion dollars. Of this amount, \$43.5 billion were in developed countries, \$18.8 billion in less-developed

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countries and \$11 billion in Latin America.<sup>3</sup> By the end of 1969 the latter figure had risen to \$14 billion.

American income receipts from Latin America totalled \$1.8 billion by 1970, of which \$1.1 billion came from direct investment.<sup>4</sup>

These figures have been cited to show the preponderant influence of the U.S. in the area, the significant role played by direct investments in the overall data, and, the importance of Latin America to the U.S. in terms of trade and investment. An official U.S. Government publication states:

The area [Latin America] is of great importance to U.S. business and possesses a growth potential that offers promising opportunities for further expansion and diversification of U.S. trade and investment. In 1970, U.S. exports to the region aggregated 6.5 billion [dollars] equivalent to 15.1% of the worldwide total. As of year-end 1969, U.S. direct investments in the area were 14 billion, or 20% of the total for all areas.<sup>5</sup>

As far as banking is concerned, foreign bank houses have a preponderant position in Paraguay where they represent 39% of the system. They also account for an important percentage in Peru—17%. In Mexico, the foreign banking units represent less than 1% of the total units; in Brazil the figure is 2%, in Colombia 4%, in Uruguay 6%, in Venezuela 7%, and in Argentina 8%.<sup>6</sup>

Local deposits in foreign banks are high in Paraguay—64% of all bank deposits. The proportion for other countries is: 30% in Bolivia, 14 to 15% in Venezuela and Peru, and 13% in Argentina and Chile.<sup>7</sup>

Foreign banks' capital and reserves, compared to total capital and reserves invested in the sector, represent 40% in Paraguay, 23% in Bolivia and 11% in Argentina. It is not as large in other countries.<sup>8</sup>

## THE ATTITUDE TOWARD FOREIGN INVESTMENT

In the early stages of foreign investment in the developing countries there was an "open door" policy towards practically any sort of business venture. In some cases, this policy resulted from the belief that foreign capital would create the conditions for a growing economy and generate employment and wealth. In other cases it was the result of the political or economic pressures exerted by a more powerful nation. This explains why historically foreign capital has participated in practically all economic areas in Latin America. Public utilities were a preferred target of the

foreign investor for a long time but foreign capital is phasing out rapidly in this area; exploitation of natural resources has always been and continues to be a favorite sector; and, as is well known, manufacturing and commerce have experienced a great expansion lately. The above applies to Latin America as a whole based on the overall amounts of foreign capital invested in the area. It may not be true in specific cases, like Chile or Peru, where significant events concerning foreign holdings are taking place.

This "open door" attitude continues to be the policy of the largest country in Latin America — Brazil — where *local treatment* is guaranteed to foreign investments by the law on foreign investments. The pertinent provision of the statute reads:

Foreign capital invested in this country shall receive identical treatment before the law, and under the same conditions, as that accorded Brazilian capital, all discrimination not provided for in this law being prohibited.<sup>9</sup>

To a lesser extent it also is the policy of Argentina although of late this country is de-emphasizing foreign investments and a drive to Argentinize the economy is evident. The Central Bank of Argentina has ruled that the establishment of foreign banks in the country will, in the future, be dependent upon improved foreign financial and commercial relations. Foreign banks must actually and permanently invest in the country the capital assigned to local subsidiaries which will be subject to the jurisdiction of Argentine courts and Argentine laws. The new regulations were apparently promulgated to curb a drain on the foreign exchange reserves by foreign banks and financial firms.<sup>10</sup>

Other thinking, however — quite different from the "open door" policy outlined above — is gaining more and more converts among the Latin American republics. Based on the assumption that true independence can only exist when the national economy is free from foreign control, and on the belief that the process of development can be considerably stimulated by the influx of foreign capital, the concept of *selective* investments is on the rise.

The selective approach is based on a coordinated policy which designates which sectors of the economy will be nationalized, which will be left to private investors, and within the latter which of these will be open to foreign capital. The most encompassing attempt to establish such a system is the Common Regime for Treatment of Foreign Capitals

in the Andean Group, better known as the Andean Investment Code.<sup>11</sup> Colombia, Ecuador, Bolivia, Peru and Chile are the signatories of this agreement, approved in Lima in December 1970. It is to take effect in each country according to the provisions of its respective instrument of ratification.

In between Brazil with its open door policy toward foreign investment and the Andean Group with its selective criteria, may be placed Mexico, Venezuela, Costa Rica and Panamá. Let us now examine each one of the countries mentioned, as well as the Andean Group, to perceive the legal framework surrounding foreign investment in the banking area.

## BRAZIL

Foreign capital invested through the establishment of a foreign bank in Brazil enjoys the same liberal treatment provided other foreign investment by the law on foreign investments, but the following limitations should not be overlooked. Specifically:

1. Foreign banks authorized to operate in Brazil shall be subject to the same limitations and restrictions that the law of their principal place of business imposes upon Brazilian banks.<sup>12</sup>
2. Foreign banks whose principal place of business is established in localities where existing legislation restricts the operation of Brazilian banks are prohibited from acquiring more than thirty per cent (30%) of the voting shares in Brazilian banks.<sup>13</sup>

Expatriation of profits earned by foreign investors was somewhat limited by Law 4131 of 1962 but those restrictions were modified by subsequent Law 4390 of 1964. Only restrictions applicable to activities which produce luxury goods or services remain. Exceptionally — whenever a serious disequilibrium occurs in the balance of payments, or there are sufficient reasons for foreseeing that such a situation may be imminent — the Government may impose restrictions, for a limited period, on remittance of profits abroad. In any event, it may be affirmed that all the situations involving profit-remittance are accorded liberal treatment.

Foreign investors and enterprises may resort to local credit. They can also get guarantee or credit facilities offered by governmental credit institutions under certain conditions, namely, when they have already started operations and intend to make new investments in fixed assets of enterprises engaged in essential activities undertaken in regions of prime economic national interest.

Foreign loans must be filed for approval with the Central Bank, the objective being to prevent short-term foreign loans from upsetting the balance of payments.<sup>14</sup> Duly registered loan agreements are not subject to remittance restrictions on interest and amortization payments previously stipulated.

### THE ANDEAN GROUP

The Common Regime for Treatment of Foreign Capitals, i.e., the Andean Investment Code—in Article 42—contains the rules to be applied to foreign investment in banking. These rules are:

1. No new direct foreign investment shall be allowed in banking, insurance or any other financial institution.
2. Existing foreign banks will not be permitted to receive deposits from local sources. This provision will take effect three years after ratification of the Code.
3. Existing foreign banks willing to continue receiving deposits from local sources will have to become national corporations. In order to become a national corporation a foreign concern will have to sell no less than 80% of its stock to nationals in the three years period mentioned before.

The use of foreign credit is subject to governmental approval and profit remittance abroad is carefully regulated by the Code. At the same time, the resort to local credit by foreign investors will be allowed only exceptionally, and only for short-term loans.

The Code recognizes that foreign capital can contribute considerably to the economic development of Latin America when it creates capitalization. At the same time it adopts the policy of giving preference, in the process of development, to national capital and enterprises. Foreign direct investments in banking and credit institutions are obviously not welcome in the Andean Group countries.

### MEXICO

By an amendment to the General Law of Credit Institutions and Auxiliary Organizations which took effect on December 31, 1965,<sup>15</sup> foreign investment in any form in the capital of such organizations was totally prohibited. This provision applies only to new foreign participation.

Foreign capital invested in existing banks was not affected by the amendment, which means that previously existing bank branches or subsidiaries were left untouched, as were also equity or portfolio investments in local banks.

New foreign investments in institutions controlled by foreign capital need governmental authorization.

The use of local credit by enterprises directly or indirectly controlled by aliens was recently limited, as well as the acquisition by financial institutions of shares and other securities issued by such enterprises.<sup>16</sup>

Loans in foreign currency or from foreign sources to public entities (governmental agencies) require a permit issued by the Ministry of Finance and Public Credit only under certain conditions. The same applies to transactions in foreign currency with national credit institutions. This measure was taken to preserve the foreign prestige of Mexico, taking into account the multiple offers of financing coming from abroad, all deserving most careful consideration.

## VENEZUELA

Venezuela is not a member of the subregional Andean Group, although but she is taking steps to ratify the Cartagena Agreement. Hence, the provisions of the Andean Investment Code approved in Lima are not in force in that Latin American republic.

Nevertheless, Venezuela promulgated an amendment to the commercial banking law on December 30, 1970.<sup>17</sup> This amendment brought about a series of restrictions against direct foreign investment in banking. The highlights of that reform follow:

1. Charters of new banks will be granted to Venezuelan nationals only.
2. Branches of foreign banks may not be established in the country.
3. Foreign banks now operating in Venezuela cannot increase their capital, open new branches, receive demand or time deposits in amounts exceeding six times paid capital and reserves, receive saving deposits from Venezuelan residents, receive deposits from governmental agencies, issue negotiable certificates of deposit, or sell foreign exchange—which is controlled by the Central Bank.

4. Foreign banks willing to become domestic banks have to increase local participation in their stock to at least 80%.

5. Foreigners are not allowed to become presidents of banks in Venezuela. Seventy-five per cent of the number of vice-presidents, members of the board, managers and executive officers must be Venezuelan nationals living in the country.

*Sociedades financieras* (investment banks) are allowed to have foreign participation up to 40% of their capital. *Sociedades de Capitalización* were not affected by the amendment. Resort to foreign credit sources is not restricted in Venezuela. There is total freedom of remittance abroad of capital and interest on loans, or any other sums representing capital, interests or dividends. The use of local credit by business associations with 40% of their stock in foreign hands is limited to the amount of their paid capital and reserves.

## COSTA RICA

Law 1644 of September 26, 1953, provides in Article 59 that only state-controlled banks can receive deposits from the general public. This rather unique feature of the Costa Rican Law prevents foreign investors from becoming involved in direct investments in the form of banking ventures. Nevertheless, foreign banking institutions have made inroads into Costa Rica.

## PANAMA

The Panamanian banking system has been growing very rapidly in the last few years. The number of banks doing business in Panama increased from 9 in 1964 to 19 at the end of 1970. Bank deposits in the same period rose from 136 million to 547 million *balboas* (1 balboa equals 1 U.S. dollar).

This rapid growth and the development of Panama as an international financial center led to the adoption of a new banking law<sup>18</sup> and to the creation of the National Banking Commission. According to the new law, all banks engaging in business in Panama must have a minimum capital of \$1,000,000. However, banks intending to do business abroad from an office established in Panama are required to have a capital of \$250,000 only.



Panama has not yet established a Central Bank and the American currency is commonly used as national currency, but the creation of the National Banking Commission with some powers of inspection and control on banking houses is a step in the right direction to up-date the banking legislation.

There are no restrictions on remittance abroad of foreign capital, interests and dividends in Panama. Further, no limitations exist either on resorting to foreign financing or on the use of local credit by foreigners.

The very summary review undertaken above has served, I trust, to highlight recent banking legislation and developments in some countries in Latin America, and how certain statutory provisions and developments affect the foreign banking investor.

## CONCLUSIONS

In general, the area of banking does not seem to be a field in which direct foreign investment is welcomed in Latin America, nor one in which expansion will be permitted in the future. Quite the contrary, the great majority of countries in Latin America appear to be convinced that control of credit institutions by foreigners threatens national interests. Thus, even in Brazil, where the most liberal regime regarding foreign investments exists, foreign investors seem to be wary of getting involved in direct investments in banking.

The case of Panama should be regarded as an exception to the common trend, and thus considered in the context of the traditional international facilities this country has provided in the past such as tax haven, liberal legislation for establishment of corporations, registration of ships and the like.

It should be noted, however, that foreign capital investments are encouraged when they mean transfer of technology, new skills and know-how. Practically all new Latin American legislation on planning and development underlines the importance of foreign participation in industry if the result is to raise the standard of living of the people and to expand the economy. But, this contribution has to fit into the national economic plan of each country. That is why traditional investments in commerce or services, and even in manufacture — when the latter are connected with production of nonessential goods — are now facing some limitations. There will be more restrictions in the future, specially in sectors where there are enough local resources available.

What has been previously stated does not mean that foreign banking business with Latin America is going to disappear. What is going to disappear totally is the possibility of establishing a bank simply by filing the articles of incorporation without the actual transfer of money; or the financing of "foreign investments" with locally raised funds, and the subsequent expatriation of dividends and even of capital which never entered the country from abroad.

International finance transactions with Latin America involving bank loans and credit facilities are growing at a steady pace. So are equity investments. A large amount of money is coming from new monetary centers, such as the London Eurodollar market, or the Nassau or Panama subsidiaries of American and international banks. American banks with large Eurodollar holdings are also competing for business in the area. But, aware of the nationalistic tide, these foreign entities prefer to have an agent on the spot, that is, an office open only for foreign credit transactions against which, generally, no restriction is found. Concurrently, some of these enterprising and forward looking entities have opened Edge Act corporations in strategic places in the United States, such as Miami to handle the business from a more convenient location.

Until now, this type of investor has been favoring short-term operations and working on the basis of "floating-rate" interest, limiting the use of credit to commercial transactions for which there are temporary, cyclical or chronic shortages in some countries. Nonetheless, as the Eurodollar market becomes institutionalized and competition grows, terms and conditions tend to ease, thus resulting in an expansion of this relatively new banking business.

American banks are largely favored by Latin American depositors. An important part of the foreign exchange portion of the monetary reserves of the Latin American countries is held in dollars in the U.S. In addition, Latin American funds held in U.S. banks for private purposes are of considerable magnitude.

To these must be added the deposits of Latin American correspondent banks which increase substantially the private holdings. Regretfully, this unbalanced situation is not being helped by the credit policy of U.S. banks towards Latin America which has been shaped in conformance with the guidelines promulgated by the Board of Governors of the Federal Reserve System limiting loans and investments abroad. The situation, in my opinion, should be brought into balance by suspending the application of the guidelines as far as Latin America is concerned and by

implementing a program under which additional credit facilities would be open to countries having deposits in U.S. banks, whether in the name of governmental agencies, corporations or nationals. This would be a positive step in the field of cooperation. But let us remember with Raul Prebisch — the noted Latin American scholar — that

it is not just a question of increasing the scope of international cooperation for development but of changing its orientation. The desire of foreigners to find new fields for private capital investment in Latin America is a legitimate one, but it cannot be the principal aim nor the one which most influences policy. The basic objective must be to enable the Latin Americans gradually to do for themselves what the more advanced countries can already do.<sup>19</sup>

Or to put in the words of a leading American banker — David Rockefeller:

Millions of Latin Americans are determined to have a better life in the future than they have had in the past. The obstacles in their way must be removed by men of good sense and good will, north and south.<sup>20</sup>

#### NOTES

<sup>1</sup>Latin American External Debt. Dragoslav Abramovic. 4 Journal of World Trade Law, I 24 (1970).

<sup>2</sup>According to the definition accepted by the U.S. Department of Commerce, "direct" investments represent private enterprises in one country controlled by investors in another country, or in the managing of which foreign investors have an important voice.

<sup>3</sup>Statistical Abstract 1971. Table 1227. U.S. Department of Commerce.

<sup>4</sup>Statistical Abstract 1971. Table 1226. U.S. Department of Commerce.

<sup>5</sup>Overseas Business Report. OBR-71-037. U.S. Department of Commerce.

<sup>6</sup>Guía Bancaria de los Países de la ALALC, Bogotá, 1971.

<sup>7</sup>*Ibid.*

<sup>8</sup>*Ibid.*

<sup>9</sup>Article 2 of Law 4131 of 1962 (I International Legal Materials, 306) as amended by Law 4390 of 1964 (3 International Legal Materials, 1053) implemented by Regulation of February 18, 1965 (4 International Legal Materials, 405).

<sup>10</sup>B.A. Landy. Economic Developments. 2 *Law.Am.* 275 (1970).

<sup>11</sup>English text of the Code may be found in 10 International Legal Materials, 152 and Spanish text in Técnicas Financieras, Año X No. 3, Enero-Febrero 1971, CEMLA.

<sup>12</sup>Article 50 Law 4390 of August 29, 1964.

<sup>13</sup>Article 51 Law 4390 of August 29, 1964.

<sup>14</sup>Resolution No. 125 (1969) implemented by Regulation No. 10 (1969). S.A. Bayitch, *Inter-American Legal Developments*, 2 *Law.Am.* 44 (1970).

<sup>15</sup>*Diario Oficial*, December 30, 1965.

<sup>16</sup>S.A. Bayitch, *Inter-American Legal Developments*, 3 *Law.Am.* 301 (1971). In the same publication appears the news of the elimination in Mexico of the savings and loan associations.

<sup>17</sup>*Gaceta Oficial*, December 30, 1970. On the Venezuelan amendment see: Alfredo Morles Hernandez, *The 1970 Amendment to the Venezuelan Commercial Banking Law*, 3 *Law.Am.* 231 (1971).

<sup>18</sup>*Técnicas Financieras*. Año X No. 3, Enero-Febrero 1971, CEMLA.

<sup>19</sup>Raul Prebisch, *Joint Responsibilities for Latin American Progress*, 39 *Foreign Affairs*, 624 (1961).

<sup>20</sup>David Rockefeller, *What Private Enterprise Means to Latin America*, 44 *Foreign Affairs*, 416 (1966).