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***Macroeconomic Instability and the  
Strategies of Transnational  
Corporations in Brazil: Standstill,  
Retrenchment or Divestment?***

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TEXTOS PARA DISCUSSÃO



Universidade Federal do Rio de Janeiro  
Instituto de Economia Industrial

Textos para Discussão

*Macroeconomic Instability and the Strategies of  
Transnational Corporations in Brazil:  
Standstill, Retrenchment or Divestment ?*

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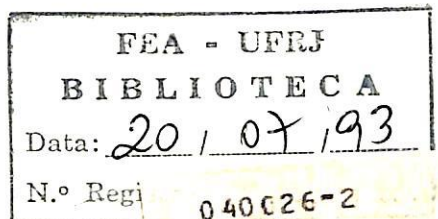
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**Contents**

1. Introduction .....	5
2. The "Brazil risk" .....	7
3. Trade Strategies .....	11
4. Financial Strategies .....	14
5. Industrial Strategies .....	17
6. Conclusions .....	20
7. Notes .....	27

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**Macroeconomic Instability and the Strategies of  
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Retrenchment or Divestment?**

*1. Introduction*

The strategies of enterprises depend on the interaction of heterogeneous factors at different levels (product line, competitors, market contestability, buyers, suppliers, targets, evaluation of the environment, ownership-specific advantages and disadvantages, the values of the decision-makers, etc)<sup>1</sup>. Hence, the impact of macroeconomic instability in particular circumstances needs to be carefully assessed on a case-by-case basis.

The general definition of *strategy*, which underlies the analysis in this study, is that "strategy includes a set of decisions on the relative choice regarding the use and the valorization of resources"<sup>2</sup>.

With respect to the strategic behaviour of TNCs, it is relevant to keep in mind that it depends not only upon goals and targets, but also on the predominance of different, although complementary, perspectives. The "industrial strategy" aims at strengthening the competitiveness through the choice of technology and products, as well as market control; whereas, the "financial strategy" emphasizes the management of the firm's assets<sup>3</sup>. In the context of macroeconomic instability, it is also important to consider the trade strategies of TNCs which have a bearing on balance-of-payments adjustment.

The basic objective of this study is to analyze the strategic reactions of TNCs vis-a-vis the macroeconomic instability of Brazil since the early 1980s. The central argument is that, although TNCs are still keeping a "qualified optimism" with respect to the Brazilian economy, they seem to have adopted, in general, a **retrenchment strategy** with respect to Brazil in the recent past.

There are some reasons for that, much more related to past experience than future prospects.

The behaviour of TNCs involve different combinations of strategies. Here, the scope for generalization is very limited. However, in the context of long-term macroeconomic instability, it is likely that there is a predominance of the financial and trade strategies over the industrial strategy. Given the significant permissiveness of the domestic market and the trade barriers in Brazil, the argument can be advanced that TNCs have been much more prompt in adopting financial strategies than industrial strategies.

The nature of the Brazilian macroeconomic instability (in a cause-and-consequence relation with high interest rates and financial profits) have increased further the "revealed preference" for financial strategies rather than industrial strategies. Moreover, trade strategies have become an important element of TNCs's behaviour due, in part, to government adjustment policies (export subsidies and import controls) and, in part, to the need to look for external markets to offset the shrinkage of the domestic market. Hence, TNCs seem to have only started to upgrade their industrial strategies as a reactive phenomenon to the very deep crisis that the Brazilian economy has had in the last three years.

This study proceeds in the following manner. After this introduction, Section 1 presents an analysis of the question: *How is the "Brazil risk" perceived by TNCs?* The emphasis is laid on macroeconomic problems and the strategic behaviour of TNCs. Section 2, 3 and 4 examine the following question: *How do TNCs respond to macroeconomic instability in Brazil?* More specifically, Section 2 examines the role of TNCs in the process of external adjustment of the Brazilian economy. In this regard a particularly sensitive issue relates to the trade strategy of TNCs in so far as the external disequilibrium and strong inflationary pressures are the basic elements of macroeconomic instability. Section 3 deals with financial strategies used by TNCs to overcome the macroeconomic problems, mostly, the inflationary process and high real interest rates. Section 4 presents a discussion of issues related directly to the industrial

strategies of TNCs, and largely due to the shrinkage of the domestic market.

The last section presents a summary of the main conclusions of the study. As far as TNCs' general strategy for Brazil is concerned, one concludes that TNCs seem presently to be in a intermediary phase between a "standstill strategy" and a "divestment strategy", more specifically, TNCs are adopting a "retrenchment strategy".

With respect to the empirical evidence, analysis and conclusions, a word of warning is in order here. The empirical evidence presented in this study is based on scattered data and information that have been found in the Brazilian press, mostly in the last few years, as well as in the specialized literature on TNCs in Brazil. In this regard, the scope for generalization is rather limited. It would obviously be misleading to describe general patterns of strategic behaviour on the basis of the fragmentary evidence discussed in the paper. Without doubt, the strategic behaviour of TNCs *vis-a-vis* macroeconomic instability in Brazil should be the subject of further research so as to extend the analysis both in scope and in depth<sup>4</sup>.

## 2. The "Brazil Risk".

This section deals with the impact of macroeconomic instability on transnational corporations in Brazil. In this regard, one examines a basic question : How is the "Brazil risk" perceived by TNCs?

As mentioned, care must be taken in interpreting the evidence discussed in this section. The information presented here is not based on a systematic survey as well as empirical studies on strategies of TNCs in Brazil are scarce. The analysis in this section is systematic to the extent that it aims at bringing together the information available in the specialized literature and in the press with respect to the strategic behaviour of TNCs. One needs to interpret with great caution the public declarations, expectations and intentions put forth by executives of TNCs which are used in studies and press articles.

In addition to the normal commercial risks associated with any business activity, transnational corporations are faced



with three different types of risk which have a bearing on their strategies<sup>5</sup>. They are the foreign exchange risk, the political risk and the administrative risk. The first one involves the transactions in different currencies related to trade and financial flows. The political risk is associated with the fact that the TNC has important sources of economic and non-economic power and, therefore, governments (mainly in less developed countries) tend to be concerned about their sovereignty and the building up of countervailing forces. The administrative risk is related to the set of rules, laws and procedures which specifically regulates TNCs' operations (profit remittances, performance requirements, etc).

Within these broad categories it is always possible to define a more disaggregated list of factors which affect the general business environment<sup>6</sup>. Among these factors it is worth pointing out the following: political stability, currency exchange regulations, availability of labour, financial inducements by government, barriers to trade, size of market, market growth, price stability and performance requirements<sup>7</sup>. Nevertheless, it seems that there is a consensus that market size and growth are the most important locational determinants of foreign direct investment<sup>8</sup>.

As far as the location-specific advantages of Brazil are concerned this is an important conclusion. By and large, market size and growth have been two basic attributes of the modern economic history of Brazil. Moreover, the general investment climate has historically been very favourable towards foreign capital and enterprises. In this regard, it is worth noting that Brazil ranked 12th in a list of 60 less developed countries, classified according to their risk in 1988-89<sup>9</sup>. Most of the countries in the first positions were either the newly-industrializing countries of South-East Asia or the oil-exporting countries.

Without doubt, macroeconomic instability has become a significant locational disadvantage for Brazil since the early 1980s. Indeed, most of the evidence found in the press indicates that the main reasons for changes in strategies vis-a-vis Brazil, as a host country for foreign direct investment, are the following: macroeconomic instability and government intervention<sup>10</sup>.

As far as macroeconomic instability is concerned, it is worth emphasizing that the most basic and direct factor which affects TNCs is the stagnation of the domestic market during the "lost decade", mostly the deep recession of the period 1981-83 and the stagnation of the period 1988-92. In this regard, it might be said that, although the executives of TNCs have a clear perception that the external disequilibrium and the inflationary process are key macroeconomic problems, these two issues affect TNCs' perceptions and strategies in so far as they are the basic determinants of expenditure-switching and, mainly, expenditure-reducing policies aiming at macroeconomic stabilization.

Of course, this is not to say that TNCs are not influenced by the external debt crisis and the high inflation rates. As regards the debt crisis, one can say that the structural balance-of-payments disequilibrium has not led to any significant restriction on profit remittances or on any kind of capital transfer by TNCs<sup>11</sup>. In this connection it may be noted that the basic legal instrument (Law N. 4131), which regulates foreign capital, has in its article 28, a provision which allows government to limit profit remittances in the case of serious balance-of-payments disequilibrium!

Nor can the fact be ignored that TNCs have significant economic and non-economic power which, in one way or another, allow them to overcome the basic problem brought about by a uncontrolled inflationary process, namely, the transfer of income among social groups or economic agents. In this regard, it may be pointed out that the oligopolistic industries in which TNCs predominate, such as, transport equipment, pharmaceutical products, rubber, have been among those with a remarkable record of abusive pricing practices<sup>12</sup>.

As far as government intervention is concerned, there are two different aspects which have a major influence on TNCs. The first one is very much related to the previous discussion about the use of business practices and pricing policies (mostly, via market power) to overcome the problems brought about by a strong inflationary process. Of foremost importance for TNCs is

price control. This is, probably, the issue most often found in the public displays of TNCs' positions.

The second issue is related to policy predictability. More specifically, in the context of significant macroeconomic instability, TNCs are faced with a lack of policy predictability which has been the outcome of government failure to deal with the stabilization problems of the last decade or so. According to Joseph Mathews, Finance Director of Atlantic: "It is very difficult to convince our shareholders to invest in a country where the rules of the game are changed every time"<sup>13</sup>.

It is interesting to note that, despite the political changes in the recent past - mostly, the transition from a military regime to a civilian regime, and the impeachment of the first-elected president of Brazil in the last forty years -, political instability is not seen, in general, as an obstacle for foreign direct investment in Brazil. According to Zeke Wimert, president of the American Chamber of Commerce: "The political crisis has affected neither the foreign investments in Brazil, nor the multinational enterprises operating here"<sup>14</sup>. Perhaps, on account of the historical record, executives of TNCs have a strong confidence on the capacity of the Brazilian political elites for conciliation and reform!

Moreover, it is hardly possible to overrate the value of the basic legal instruments regulating foreign capital in Brazil with respect to the building up of a favourable investment climate. Since 1964 there has been no systematic complaints by TNCs about the Brazilian legislation. According to Fernando Albino de Oliveira, lawyer and expert on legal aspects related to foreign direct investment: "In spite of being old, the [Brazilian] law is extremely liberal to the extent that it does not define areas of enforcement, allows the free flow of currency and do not put major obstacles for investments"<sup>15</sup>. Only in the last couple of years, and in the context of both the liberalization policies and the chaotic administrative changes of the Collor administration, representatives of TNCs started to put pressure on government so as to change this legislation.

In this regard, it is worth noting that some of the administrative procedures, mostly related to the registration of reinvestments,

have been changed according to the request made by TNCs. The supplementary income tax of 40-60% on profit remittances has also come to an end. The income withholding tax of 25% has also been reduced to 15%<sup>16</sup>.

Taking the TNCs' perspective, it might be said that there have been many positive, valuable factors in the Brazilian economy, factors that are in the long run likely to contribute to create a favourable investment climate and, therefore, a "qualified optimism". Here a couple of quotations seem justified. According to Claudio Sonder, chairman of Hoechst, "Our confidence in Brazil in the long run is greater than our disappointment in the short run"<sup>17</sup>. Tadahisa Ando (an enthusiastic Manager of the Mitsubishi Corporation) goes even further and asserts that "Brazil has a very positive investment perspective, the future seems bright"<sup>18</sup>. Thus, in the context of great macroeconomic instability, TNCs have what can be called a "qualified optimism" regarding the Brazilian economy.

### 3. Trade Strategies

The balance-of-payments problem of Brazil has been characterized by extraordinary trade surpluses and enormous external debt service (both of approximately US\$ 130 billion since 1981). Consequently, from a financial standpoint, the external debt was "paid" with the trade surpluses.

In the last 15 years or so, TNCs have dramatically changed their foreign trade performance, from a strong trade deficit in the mid-1970s to a significant trade surplus nowadays. This change in the strategic behaviour of TNCs has been to a very large extent determined by government policies oriented to macroeconomic stabilization. Moreover, during the 1980s the stagnant domestic market led TNCs to look for alternative outlets for their production in the external market. The export drive became a matter of specific interest for the TNC.

Indeed, transnational enterprises have played a significant role in the Brazilian foreign trade. Since the late mid-1970s TNCs have changed their trade position, from deficit to surplus, owing to increases of their exports as well as to government

import controls. The data for the period 1978-86 show annual average exports and imports by subsidiaries and affiliates of transnationals in Brazil of US\$ 5.7 billion and US\$ 3.0 billion, that is, an annual average superavit of US\$ 2.7 billion, which corresponded to approximately 2/3 of Brazil's trade superavit in the period<sup>19</sup>. The available data for 1986 also indicate that majority-owned subsidiaries in Brazil accounted for 18% of total exports and 26% of total imports (excluding oil), whereas the share of TNCs in total manufactured exports was 28%<sup>20</sup>. If one takes into account enterprises that are minority-owned affiliates, the share of transnationals on manufactured exports is approximately 40%<sup>21</sup>. As a result, there has been, as in the second half of the 1970s, an increase of the ratio of exports to total production of firms in Brazil, national and transnational alike<sup>22</sup>.

It is important to point out that since the mid-1970s the foreign trade behaviour of TNCs in Brazil was characterized by the fact that they benefited from extraordinary export incentives and subsidies. Export promotion mechanisms have been extensively used from the early 1970s until the late 1980s, especially during the military regime<sup>23</sup>. As a matter of fact, transnationals received special incentives through mechanisms that were especially created so as to stimulate the expansion of their exports. On the basis of the available empirical evidence, it can be said that the average subsidy/export ratio for transnationals was approximately 50%<sup>24</sup>. As a result, transnationals received export subsidies of at least US\$ 30 billion during the 1980s, that is, more than one-fourth of the total external debt of Brazil.

In addition to give a non-negligible contribution to the balance-of-payments adjustment through trade surpluses, TNCs have also played a major role in moving upwards Brazil's pattern of comparative advantage. In view of the enormous incentives and subsidies given by the military governments and the overwhelming presence of transnationals in the most dynamic sectors, it is no surprise that TNCs became responsible for a very significant share of exports of dynamic or technology-

intensive products and for the upgrading of Brazil's export structure<sup>25</sup>.

It is worth emphasizing that the trade performance of transnationals in Brazil was to large extent determined by policy measures. In the early 1970s, before the first oil shock, the motivation of the military to promote an outward-oriented model of economic growth - based on rapid export expansion and deeper penetration of transnational enterprises -, was determined by economic, political and military-strategic factors<sup>26</sup>. As a matter of fact, the situation started to change with the disequilibria caused by the first oil shock in 1974. In the context of a deep disequilibrium in the balance of payments, the policymakers, military and technocrats alike, started to apply measures aiming at reducing "external vulnerabilities". As a result, they began to use an enormous and complex set of incentives and subsidies to stimulate exports. In addition, there were important tariff and non-tariff barriers, which meant a strong control of imports, and these barriers were also very powerful instruments to promote the structural reforms. That is, the external disequilibrium of the second half of the 1970s and the debt crisis of the 1980s were the main determinants of government policies, which affected significantly the trade performance of transnationals in Brazil.

Moreover, during the last decade the trade performance and behaviour of TNCs were to a large extent influenced by the sluggish domestic market. In this regard, the low level of imports was also directly determined by a stagnant economy, whereas the export drive was an alternative outlet for domestic production.

In the last couple of years, however, the policy of trade liberalization has had a bearing on TNCs' strategies. On the one hand, one can say that in these last two years trade liberalization has not had a significant and direct impact on the performance of enterprises because of the gradual approach of trade policy. On the other hand, there seems to exist a consensus that the modernization of industry in Brazil does require a reduction of tariff and non-tariff barriers inasmuch as protectionism has



significantly contributed to market permissiveness, which has hindered competition and productivity growth.

As far as trade liberalization is concerned, it is worth pointing out that it has brought about a "reverse import substitution". Hence, there has been a reduction in the local content of manufactured goods inasmuch as TNCs are replacing domestic sources of supply by imports. This process involves stopping the verticalized production by TNCs - de-verticalization has been a phenomenon mentioned by TNCs executives in the recent surveys -, or bringing to an end the relations with local producers and suppliers. As an example, Xerox has been able to reduce the local content of photocopy machines from 90% to 40%, which implied a cost reduction of 30%<sup>27</sup>. Mercedes-Benz aims at reducing the local content to 50%<sup>28</sup>. Here, it might be added that another consequence of trade liberalization is the reduction of the trade surplus of TNCs.

Indeed, the foreign trade behaviour and performance of TNCs in Brazil have continuously changed since the mid-1970s. The external adjustment of the Brazilian economy led the governments to induce TNCs, through different mechanisms ("stick and carrot" approach), to increase their exports and reduce imports. This phenomenon occurred even during the periods of expansion of the economy (mostly, in 1974-80)<sup>29</sup>. During the last decade, however, recession had become an important determinant of TNCs' trade strategies.

#### 4. Financial Strategies

As a result of a recessive environment and great uncertainty, there has been a clear downward trend of the net flows of foreign direct investments into the Brazilian economy since the early 1980s. The net flows of foreign direct investment have become increasingly negative since the mid-1980s. Moreover, it seems that the remittance ratios have increased in the last few years<sup>30</sup>. As a matter of fact, the reduction of foreign investment is a consequence of the decrease of capital expenditures by TNCs in their plants in Brazil. Data for a sample of 58 large TNCs show

an average yearly reduction of 3.1% of fixed assets and 2.4% of total assets during the period 1984- 89<sup>31</sup>.

Given the macroeconomic instability, TNCs have also adopted a clear strategy of sharp reduction of their levels of indebtedness<sup>32</sup>. As a matter of fact, this is a general phenomenon associated with the strategies of large private enterprises, transnational and national alike, since the early 1980s. Indeed, the present levels of indebtedness of the large private enterprises in Brazil are very low. Moreover, there has been a restructuring of the assets of large TNCs in terms of growing diversification of investments in associated firms. The strategy of minimising financial risks involves the distribution of the portfolios of TNCs<sup>33</sup>. This trend is more evident after 1984.

Of foremost importance is the capacity of TNCs to increase their gross profit rates ("mark-up") during strong inflationary and recessive periods. This phenomenon is not a "privilege" of TNCs in so far as large local firms have also benefited from pricing mechanisms to maintain their levels of profit.

The macroeconomic instability led TNCs also to take advantage of relatively high interest rates in Brazil during the last decade. In this regard, the financial profits have become an increasing source of resources for TNCs. This "defensive financial strategy" implies, *inter alia*, that TNCs have looked for greater flexibility regarding the use of their resources, as well as they have been able to keep significant internal funds (mostly from financial gains) for capital accumulation. According to an analyst, "the intensification of the 'recessive and inflationary' behaviour of both the private local and foreign capital must have been a major determinant of their adjustment policies of since 1988"<sup>34</sup>. That is, large local firms and TNCs have benefited from macroeconomic instability via financial profits and pricing mechanisms (mark-up increases).

As far as the foreign exchange risk is concerned, it is important to bear in mind that the crawling-peg system adopted in 1968 was only eliminated in 1990. Hence, one can say that gains and losses from currency changes were minimized in the short-run on account of the predictability - via foreign exchange indexation - of the exchange rates. This is not to say that the



risks were null all over the period. There were instances of strong devaluations (around 30%) which created risks. Besides, it is worth noting that there has been a clear trend of overvaluation of the Brazilian currency since the mid-1980s. In this connection it has to be noted that TNCs (mostly the automobile firms) have persistently complained about the valuation of the Brazilian currency during the last decade<sup>35</sup>.

Since 1990 the foreign exchange rate policy (a “bastard floating system”) has also created a new element of uncertainty and instability. Hence, it may be said that the foreign exchange risk for TNCs would have increased since 1990. There is no evidence that TNCs are adopting new systems for managing exchange rate exposure in Brazil. However, the forward exchange market and the de-regulation of the exchange market have allowed them to reduce their exposure. TNCs can also engage in hedge operations through, for instance, the purchase of *export notes* that minimize their economic exposure as a result of unexpected changes in exchange rates<sup>36</sup>.

Among the changes in regulation, it is worth noting that “companies with a registered foreign participation can open foreign exchange accounts, which can be credited with new foreign direct investments and re-investments, reserve profits, consolidated surplus, profit remittances, and returns and gains from profit remittances. Deposits are at LIBOR and normally require 90 days notice for withdrawals, or 30 days in the cases of deposits from profits or dividends and sales of investments and participating capital stocks”<sup>37</sup>.

Moreover, it is likely that TNCs have increased the use of transfer pricing mechanisms in their external trade transactions as a way of divestment. There are some reasons for that. First, the great relative importance of TNCs in Brazil’s external trade. Second, TNCs have billions of dollars of assets in Brazil, whose economy has been stagnated. Third, despite the domestic market crisis, TNCs have been able to obtain profits. Fourth, TNCs seem to have an excess of internal funds that are been mostly oriented to financial investments and investments in associated firms.

On the basis of the above considerations, one can advance the argument that TNCs seem to be adopting a “standstill strategy” in Brazil in the last few years. The financial strategy has involved a clear reduction of inflows of foreign capital and a net transfer of resources to their parent companies. A “defensive financial strategy” has been used to manage internal funds which have been oriented to the domestic financial and capital markets so as to benefit from high interest rates. Financial profits have offset the reduction of operational profits caused by the recessive situation. Moreover, TNCs have used their market power and, via the pricing formation mechanism, have been able to obtain relatively high mark-ups in a stagnated and unstable economy.

## 5. Industrial Strategies

The industrial strategic behaviour of TNCs may be better understood if one makes a distinction between the technological-organizational restructuring and the investment-production strategy.

The first issue has been analyzed in a rather systematic way in recent works<sup>38</sup>. The evidence available indicates that there has been an increase in the technological and organizational gap, both of large local firms and subsidiaries of transnational corporations. These firms tend to have a similar behaviour with respect to their perceptions about the the urgent need to modernize in terms of R&D activities, new organizational procedures, more efficient production techniques, scale and scope economies, more qualified labour-force and the increase of competitiveness<sup>39</sup>.

On the other hand, the evidence shows the low level of diffusion of modern technical procedures, such as, the industrial automation and organizational innovations, such as, the just-in-time relations with suppliers. To illustrate, Autolatina (Ford + Volkswagen) have only started a just-in-time organizational network with suppliers on a large scale in 1992<sup>40</sup>. Here, one of the objectives is to reduce costs through lower stocks. In addition, Autolatina is aiming at a reduction of its degree of



verticalization. The introduction of new organizational techniques is intended to allow the largest car producer in Brazil to achieve greater competitiveness.

The evolution of the economic crisis since the end of the 1980s seems to have shaken TNCs so that they became probably more conscious about the urgent need of restructuring. As a result, TNCs seem to be engaged in strategies aiming at greater efficiency through "important managerial changes, the rationalization of the production process, the introduction of new organizational techniques, output specialization and the reduction of vertical integration"<sup>41</sup>. Without doubt, this process of structural adjustment in the context of a deep recession involves, first of all, the sizing down of plants and, secondly, the closedown of factories. Both strategies imply the dismissal of workers.

To illustrate this last aspect, Dow Chemical stopped the production of some chemical products (e.g., varnishes) in Brazil because of the recession. Alcan has closed one of the two furnaces of its aluminium factory in Bahia. Even joint-ventures operations with Sanbra, which produced cleansing preparations, have been discontinued. Ford seems to take a strategy of divestment in Brazil after its minority association with Volkswagen and, also, decided for closing up of a car engine plant in São Paulo in 1991<sup>42</sup>.

Nevertheless, the modernization and restructuring of TNCs in Brazil also involve strategies actively oriented to the reduction of costs, improvement of product quality and greater productivity. In this regard, TNCs are active in the formation of joint-ventures, for instance, in mining (mostly, gold production)<sup>43</sup>.

Moreover, some analysts are even forecasting a wave of fusions and acquisitions in Brazil in the near future<sup>44</sup>. However, the evidence is insufficient to support this argument. Suffice it to say here that there important examples of recent fusions in industries, such as, chemicals and metallurgy. The fusion of Shell Chemicals and the Italian Montecatini of their divisions of polypropylene and polyethylene will very probably lead to a fusion of their operations in Brazil through their respective subsidiaries (Polibrasil and PPH)<sup>45</sup>. The fusion of Hoesch AG and

Fried Krupp AG in Germany have led to a restructuring of their respective subsidiaries in Brazil (Hoesch Indústria de Molas Ltda e Krupp Metalúrgica Campo Limpo Ltda). There has already been the fusion of some departments (e.g., data processing) and the definition of a single policy vis-a-vis their common suppliers<sup>46</sup>.

The fusion activities have also affected large local firms in Brazil. The production of locomotive was a duopoly of General Electric and Villares until two years ago. The deep recession led both enterprises to decide for establishing a single plant, with the transfer of the equipments of Villares to the plant of General Electric in Campinas, São Paulo. There is now an evident monopolistic market structure.

The restructuring of TNCs has also been based on fusions and strategic alliances involving subsidiaries of TNCs in other countries of Latin America. The recent trade agreements, such as, Mercosul, have created better conditions for this intra-regional restructuring of TNCs. For instance, Dow Chemical is restructuring its production of synthetic rubber latex in Argentina and Brazil<sup>47</sup>. The trade agreement with Argentina has also a specific protocol on road motor vehicles and parts and accessories which, without doubt, allows TNCs the restructuring of production and the redeployment of resources. TNCs like Scania, Cummins, Mercedes-Benz, Fiat, Ford, Volkswagen, and Volvo have benefited from the protocol in order to expand their intra-firm transactions. In this regard, it is worth noting that Volvo (Brazil) and Renault (Argentina) have, recently, announced an agreement of cooperation<sup>48</sup>. The protocol on parts and tires has benefited several TNCs with subsidiaries in Brazil and Argentina, such as, Pirelli and Cibié<sup>49</sup>. The protocol on capital goods has also benefited the restructuring process of TNCs in so far as they control half of this industry in Brazil<sup>50</sup>.

The strategic behaviour of TNCs has also involved the take-over of local firms. As a matter of fact, the long and deep recession of the last few years has facilitated the formation of joint ventures as well as the take-over of local firms. As an example of a take-over involving a medium-size firm, one can mention the case of the American trading company United

Manda Inc. that bought the very last national producer of cigarettes (Companhia Sudan de Produtos de Tabaco), whose market share is 4% and, consequently, domestic production is now the hands of TNCs (with the predominance of BAT and Phillip Morris)<sup>51</sup>. The acquisition of a relatively large firm, leading producer of cleansing products (Orniex SA), by an Italian TNC (Brill Spa) is another interesting example inasmuch as Orniex is a profitable enterprise<sup>52</sup>.

Moreover, TNCs are taking advantage of recession and the fragility of local firms to penetrate into some markets. That is the case, for instance, of national private trading companies of cacao operating in the Southern region of Bahia that are going bankrupt. TNCs dealing with commodities are benefiting from this situation to become important buyers of cacao in this region<sup>53</sup>. Moreover, the end of the market reserve mechanism in the informatics industry has brought about several partnerships between local firms and TNCs.<sup>54</sup> Microelectronics is likely to be one of the most important industries for investment opportunities (most probably via joint-ventures and acquisitions) in Brazil in the near future.

In addition to the above changes in TNCs' strategic behaviour, it is worth noting that there has also been changes in terms of product mix. In this regard, and despite the recession and macroeconomic instability, Unilever through its subsidiary Gessy Lever is introducing a "global product" in Brazil - a soap called Dove. The main reason for this initiative is that Brazil has a large domestic market even for sophisticated products<sup>55</sup>.

A number of reasons have been advanced to explain why TNCs have adopted the above mentioned strategies. Without doubt, recession and macroeconomic instability are the major determinants.

## 6. Conclusions

These general concluding remarks should be preceded by a comment: the fragmentary empirical information presented in the last two sections, used to provide some evidence in support

of the arguments, should best be seen as suggestive or illustrative.

Foreign capital has had a bearing upon the long-term evolution of the Brazilian economy. It means that, regardless of short- or medium-term fluctuations and changes, foreign capital and firms have been faced with a propitious and liberal environment in Brazil. In view of the historical record and taking a long-term perspective, there is no doubt that Brazil has always been an effective and potential market for foreign interests.

Indeed, the market size and the potential market growth have been the main locational-specific advantages of the Brazilian economy. Moreover, there are institutional, social, political and even cultural factors in Brazil that have a major and positive influence on TNCs' expectations. The institutional and legal framework are quite liberal. The non-discriminatory and even favourable treatment received by foreign goods, services and investors is part of a socio-cultural process with strong roots in migration flows. Lastly, there is in Brazil a predominance - obtained both by consent and by force -, of values and beliefs, that have been internalized by the elites and, probably, by the other social groups. This *hegemony* is a valuable locational-specific advantage which implies, *inter alia*, the predominance of the "logic of the market" (including, market power) and the "logic of capital".

In this connection it is important to point out that TNCs have a significant economic power in Brazil. The extent to which the economic and non-economic power in Brazil is concentrated in a handful of enterprises is indicated, for instance, by the fact that the 25 largest subsidiaries of TNCs are responsible for 52% of the total sales of the 550 largest non-financial transnationals in Brazil<sup>56</sup>. Here, it may be added that the largest 53 exporters and importers among TNCs were responsible for 20% of Brazil's total manufactured exports and total imports<sup>57</sup>. Most of the technology-intensive industries are controlled by TNCs. Even though TNCs tend to predominate in industries in which the size of the enterprises is important, TNCs are also present in industries with the predominance of small and medium-size



enterprises. Indeed, foreign capital - small, medium and large-size TNCs -, permeates Brazilian manufacturing<sup>58</sup>. TNCs account for an average share of 73.7 percent of production, 74.3 percent of employment, 55.1% percent of capital and 7.9 percent of establishments of industries with the predominance of large-size enterprises. By contrast, in industries with the predominance of small enterprises, TNCs represent 29.3 percent of production, 26.0 percent of employment, 13.5 percent of capital and 1.4 percent of the number of establishments<sup>59</sup>. By and large, the degree of predominance of TNCs in manufacturing tends to increase with the predominance of larger enterprises in industry. Without doubt, these aspects represent important economic sources of transnationals' power in Brazil. As a matter of fact, transnational enterprises have a great number of economic and non-economic sources of power in a developing country like Brazil<sup>60</sup>.

In the last decade, macroeconomic instability has had significant effects on TNCs' performance and strategic behaviour in Brazil. By and large, TNCs have been quite fast in responding through trade flows - a phenomenon largely due to government policies, controls, subsidies and incentives from the mid-1970s until the late 1980s, and deep recession on account of expenditure-reducing policies in the last few years. TNCs have also had a speedy response in terms of financial strategies in the context of macroeconomic instability characterized by high inflation and high interest rates. TNCs have adapted themselves to the situation via, for instance, a significant reduction of indebtedness, and they have benefited from macroeconomic instability through substantive financial profits. As far as industrial restructuring is concerned, it seems that TNCs have been operating in slow-motion. The high degree of market permissiveness (i.e., great market power *cum* trade barriers), as well as the success of TNCs' financial and trade strategies are likely to be the main reasons for this type of industrial strategic behaviour.

The argument that TNC is going to invest in Brazil as soon as the stabilization problems are overcome can be misleading<sup>61</sup>. First of all, TNCs have a high level of financial liquidity and,

therefore, it is likely that the new capital expenditures will be carried out with internal funds in national currency. That is, no direct balance-of-payments effect, except for a reduction of profit remittances. Secondly, the level of idle capacity is quite high in most sectors in Brazil. In this regard, it will happen that recovery will be based on present installed capacities rather than new investments. Thirdly, a new wave of private investment implies a time gap after the achievement of macroeconomic stabilization. It means that the inflow of substantive resources from parent companies is not foreseen in the near future.

Moreover, it is worth mentioning the "hostage argument". According to some analysts, TNCs have a stock of billions of dollars in Brazil and, therefore, an attempt of massive withdrawal implies that their sunk costs would be very high. It means that a strategy of divestment could not be undertaken on a large scale. However, it seems of dubious value to analyze investment strategies of TNCs in terms of a binary question: *Leave the country or not leave the country?*

This binary perspective conflicts bluntly with the history and theory of foreign direct investment. Both foreign direct investment and divestment involve a long-term perspective. By and large, locational-specific advantages or disadvantages tend to change gradually over time. They are much more stock-related factors than flow-related factors (i.e., one often deals with location-specific *endowments*)<sup>62</sup>.

Parent companies have reduced significantly their investments in their subsidiaries in Brazil. There has also been a net transfer of resources to the home country. By and large, transnational corporations are not using their internal funds to expand their fixed assets. These internal funds have been reinvested in the financial and capital markets, as well as there seems to exist diversification of risks with investments in associated firms. On the other hand, there are no massive divestment flows<sup>63</sup>.

By and large, one has the impression that TNCs adopted a "standstill strategy" with respect to Brazil all over the last decade. This strategy involved "stopping investments, low levels of production, high prices and waiting for events"<sup>64</sup>.

Moreover, the basic argument is that TNCs have adopted a *retrenchment strategy* in the last few years. That is, TNCs are moving from the *standstill strategy*, which seems to have predominated since the early 1980's, to a *retrenchment strategy* brought about by the deep economic crisis of the last three years. Hence, while it is true that TNCs recognize the urgent need to engage in deep restructuring, it is probably even truer that they are keeping a low profile with respect to the Brazilian market.

The fundamental question is the following: Why have TNCs not shifted from a *standstill strategy* to a more drastic *divestment initiative*? In other words: Why are TNCs in a rather transitional phase, adopting a *retrenchment strategy*?<sup>65</sup>

The simple answer is that, in part, the market size and potential of Brazil are still major locational advantages. In part, it may have been that TNCs are having reasonable rates of rentability for their capital invested in Brazil, mostly through financial market operations and the exercise of market power, and, perhaps, through transfer pricing mechanisms in their foreign trade activities.

At this point the reader may very naturally ask: If there had been no persistent pattern of sky-high interest rates in Brazil in the last few years, would TNCs have carried out a more open and aggressive *divestment strategy*?

The same type of question might be asked with respect to the transfer pricing mechanisms (external trade) and the price formation mechanism in the domestic market (via mark-up): If there had been no excessive market power, would TNCs have kept their "standstill strategy" in the context of great macroeconomic instability?

These questions deserve answers. Given the depth and the scope of the macroeconomic crisis in Brazil, it is likely that TNCs would be undertaking more open and active divestment strategies if there had been no market permissiveness (TNCs extraordinary market power) and absurd monetary policies (extremely high interest rates) in the last few years. The core of the problem is that these mechanisms do reinforce stabilization problems!

Here, it is worth digressing for a moment on the comparative behaviour of TNCs and large domestic groups. The evidence suggests that in growth periods there seems to exist no significant differences in the performance of TNCs and large domestic enterprises regarding profitability, growth rates, productivity, choice of technology, technological spill-overs, external trade and so on, when differences in size and product mix are taken into account<sup>66</sup>. During periods of macroeconomic instability and stagnation, however, it may happen that the greater degree of freedom of TNCs, with respect to the transfer of resources across national frontiers, has a bearing on TNCs' financial strategies. That is, net transfers of resources to the parent company appears as an alternative channel for the use of subsidiaries internal funds. This alternative is rather limited in the case of domestic groups.

Hence, one can advance the argument that, as far as trade and industrial strategies are concerned, TNCs and large domestic groups seem to be undertaking the same strategies in the last few years, mainly, on account of a common environment<sup>67</sup>. Notwithstanding the similarity of aspects of the financial strategies (e.g., lower indebtedness) of large domestic groups and TNCs, the latter have relied on net transfers of resources to parent companies. In this regard, the origin of ownership matters!

To conclude, the "qualified optimism" of transnational corporations with respect to Brazil is largely due to past experience, rather than future expectations. For how long will TNCs keep on adopting a "retrenchment strategy"? Given that this situation is not a static one, it is relevant to put forward other related questions: For how long will TNCs keep moving away from a "standstill strategy" and, most probably, in the direction of a "divestment strategy"? What are the main determinants of foreign direct investment which have a bearing on this phenomenon? What factors can be influenced by government policies? How global changes and global strategies of TNCs are affecting the behaviour of subsidiaries in Brazil? What constraints and opportunities are being created for a peripheral economy? What are the policy implications with

respect to TNCs? Is it time for promoting greater liberalization or introducing performance requirements? These will go on being key questions in the political and economic agenda, mostly, in so far as macroeconomic instability persists in Brazil in the future.

## Notes

- 1- For an overview of models of business strategies, see Patrick Joffre and Gérard Koenig, *Stratégie d'Entreprise. Antimanuel*, Paris, Economica, 1985, chapter 1.
- 2- Morvan, *op. cit.*, p. 424.
- 3- Yves Morvan, "Les stratégies des grandes firmes et des groupes", in Richard Arena et al. *Tratté d'Economie Industrielle*, Paris, Economica, 1988, p.428.
- 4- Two recent studies have carried out a more systematic analysis of the internal restructuring of TNCs in the last few years, Ricardo Bielschowsky and João Carlos Ferraz, "Perspectivas do comportamento tecnológico de empresas nacionais e transnacionais na indústria brasileira", Rio de Janeiro, Instituto de Economia Industrial/UFRJ, mimeo, 1990; e Ricardo Bielschowsky, "Transnational corporations and the manufacturing sector in Brazil. Technological backwardness in the eighties and signs of an important restructuring in the nineties", Santiago, Chile, Joint ECLA/TCMD Division, mimeo, 1992.
- 5- Pierre Jacquemot, *La Firme Multinationale: Une Introduction Economique*, Paris, Economica, 1990, p. 94.
- 6- For a fuller discussion of the environmental determinants of foreign direct investment, see Jean-Louis Mucchielli, *Les Firmes Multinationales: Mutations et Nouvelles Perspectives*, Paris, Economica, 1985, p. 63-74.
- 7- See, UNCTC, *The Determinants of Foreign Direct Investment. A Survey of Evidence*, New York, United Nations Centre on Transnational Corporations, for a recent survey of ownership and locational specific factors.
- 8- Neil Hood and Stephen Young, *The Economics of Multinational Enterprise*, London, Longman, 1979, p. 79. See, also, UNCTC, 1992, *op. cit.*, p. 59.
- 9- Jacquemot, *op. cit.*, p. 99.
- 10- *Gazeta Mercantil*, 29 September 1989, 1 December 1990, 18 January 1992, *Jornal do Brasil*, 24 April 1991, 30 September 1992.
- 11- Even when the Collor administration froze the savings and heavily taxed financial assets, transnational corporations benefited from special treatment of their remittances of profits and dividends retained in the Central Bank (US\$ 1.8 billion), which were paid by installments by mid-1991.
- 12- The Minister of Justice intends to take legal action against pharmaceutical firms which have had abusive price increases. Most of these firms are subsidiaries of TNCs, which control 73% of total sales of pharmaceutical products in Brazil. *Jornal do Brasil*, 25 October 1992. As



regards the automobile industry, there are several instances of price increases well above the general price indices in the last decade. See, for instance, *Isto É*, 18 November 1987, p. 58 on Autolatina. For a defense of the automobile industry, see the article of the director of Autolatina, Jacy de Souza Mendonça, "A realidade dos investimentos, remessa de lucros e custos", *Gazeta Mercantil*, 14 October 1989.

13- *Jornal do Brasil*, 21 April 1991.

14- *Gazeta Mercantil*, 29 July 1992.

15- *Gazeta Mercantil*, 10 July 1992.

16- GATT, *Trade Policy Review Mechanism. Brazil*, Report by the Secretariat, Geneva, General Agreement on Tariffs and Trade, C/RM/S/29A, 14 September 1992, p. 52.

17- *Isto É*, 18 November 1987, p. 65.

18- *Gazeta Mercantil*, 1st December 1990, p. 1.

19- BNDES, *O Capital Estrangeiro na Indústria Brasileira: Atualidade e Perspectivas*, Rio de Janeiro, Banco Nacional de Desenvolvimento Econômico e Social, 1988, p. 111.

20- Maria Helena Zockun, *A Importância das Empresas Brasileiras de Capital Estrangeiro para o Desenvolvimento Nacional*, São Paulo, FIESP/CIESP, 1987, p. 21. The data on imports excludes oil, given that oil foreign trade is a state monopoly.

21- Larry N. Willmore, "Controle estrangeiro e concentração na indústria brasileira", *Pesquisa e Planejamento Econômico*, Rio de Janeiro, Vol. 17, No. 1, April, 1987, p. 161-89.

22- Bielschowsky (1992), *op. cit.*, Table 11, p. 15.

23- Renato Baumann, "Comportamento recente do capital estrangeiro: algumas considerações gerais", in IPEA/IPLAN, *Para a Década de 90: Prioridades e Perspectivas de Políticas Públicas, Setor Externo*, Brasília, Instituto de Planejamento Econômico e Social, 1989, p. 55-72.

24- Renato Baumann, "Ajuste externo: experiência recente e perspectivas para a próxima década", in IPEA/IPLAN, *Para a Década de 90: Prioridades e Perspectivas de Políticas Públicas, Setor Externo*, Brasília, Instituto de Planejamento Econômico e Social, 1989, p. 12. The average export subsidy/manufactured exports ratio was 59% during the periods 1969-78 and 1978-88. According to data from Zockun, *op. cit.*, p. 57, manufactured products represented 85% of total exports by transnationals in 1986. Applying this ratio to the export subsidies/manufactured export ratio (59%) and assuming that non-manufactured exports received no subsidies, one finds an average ratio of export incentives and subsidies to total exports for transnationals of 50%. Data found in BNDES, *op. cit.*, p. 111, indicate that transnational enterprise exported an annual average

value of US\$ 5.75 billion in the period 1978-86. For the 1980s, it is possible to say that total exports by transnationals was about US\$ 60 billion.

25- Reinaldo Gonçalves, "Competitividade internacional, vantagem comparativa e empresas multinacionais: o caso das exportações brasileiras de manufaturados", *Pesquisa e Planejamento Econômico*, Rio de Janeiro, Vol. 17, No. 2, August 1987, pp. 411-436.

26- Reinaldo Gonçalves, "The Brazilian military, transnational corporations and external indebtedness", *Life & Peace Institute*, Uppsala, Sweden, 1992.

27- *Gazeta Mercantil*, 24 June 1991.

28- *Gazeta Mercantil*, 4 November 1992.

29- Reinaldo Gonçalves, "Empresas transnacionais y el comercio exterior de Brasil", in *Dos Estudios sobre Empresas Transnacionales en Brasil*, Estudios e Informes de la CEPAL, No. 31, Santiago, Chile, 1983, p.5-50.

30- The average ratio of profit remittances to the stock of foreign direct investment increased from 7.1% in 1977-79 to 7.7% in 1987-89. In 1989 the remittance ratio is 10.8%, and for the first time this ratio is higher than 10%.

31- Júlio Sérgio Gomes de Almeida and Luis Fernando Novais, "A empresa líder na economia brasileira: Ajuste patrimonial e tendências de "mark-up", 1984-89", IESP/FUNDAP, Texto para Discussão, Ano 6, No. 2, June 1991, p. 26. It is worth noting that the sample of 123 local firms show an increase of fixed assets in the period 1984-89.

32- Gomes de Almeida and Novais, *op. cit.*, p. 12 and 30.

33- Gomes de Almeida and Novais, *op. cit.*, p. 18 and 28.

34- Miguel Juan Bacic, "Fragilidade Financeira e Alavancagem: Uma Aplicação no Setor das Maiores Empresas do Brasil (1980-1987)", Tese de Mestrado, Instituto de Economia, Universidade de Campinas, 1990, p. 227.

35- Souza Mendonça, *op. cit.*

36- Export notes are issued by exporters in Brazil and have their face value denominated in foreign currency. They are used to finance the working capital of exporters.

37- GATT (1992), *op. cit.*, p. 51.

38- Bielschowsky and Ferraz (1990), *op. cit.*, and Bielschowsky (1992) *op. cit.*

39- The similarity of the patterns of behaviour of TNCs and large local firms with respect to the technological innovation found in Bielschowsky and Ferraz (1990) was also found in a study by this author on external training, technical assistance, internal training and educational programmes of TNCs and large local firms in Brazil; see Reinaldo Gonçalves, "Technological spill-overs and manpower training: A



comparative analysis of multinational and national enterprises in Brazilian manufacturing", *Journal of Economic Development*, Vol. 11, No. 1, July 1986, p. 119-132.

40- See the interview of Pierre-Alain De Smedt, chairman of Autolatina, in *Gazeta Mercantil*, 17 September 1992. Autolatina has 560 suppliers and the just-in-time programme has started with 110 suppliers. In the short-run, however, the programme will affect between 20 and 30 suppliers. The goal is to reduce the average stock time from 21 days in December 1991 to 7 days by the end of 1992.

41- Bielschowsky (1992), *op. cit.*, p. 21.

42- *Gazeta Mercantil*, 4 November 1992.

43- *Gazeta Mercantil*, 6 October 1992.

44- That is, for instance, the opinion of Peter Hornbostel, an American lawyer with expertise (and probably a lot of vested interests) on this subject; see *Gazeta Mercantil*, 6 October 1992.

45- *Gazeta Mercantil*, 18 September 1992.

46- *Gazeta Mercantil*, 8 August 1992.

47- *Gazeta Mercantil*, 24 June 1991.

48- Fernando Porta, "As duas etapas do programa de integração Argentina-Brasil: Uma análise dos principais protocolos", in Pedro M. Veiga (ed.), *Cone Sul: A Economia Política da Integração*, Rio de Janeiro, FUNCEX, 1991, p. 110.

49- *Gazeta Mercantil*, 26 August 1992.

50- Reinaldo Gonçalves, "La presencia de las empresas transnacionales en Brasil", in *Dos Estudios sobre Empresas Transnacionales en Brasil*, Santiago, Chile, Naciones Unidas, Estudios e Informes de la CEPAL No. 31, 1983, p. 71.

51- *Gazeta Mercantil*, 3 April 1991.

52- *Gazeta Mercantil*, 23 July 1991.

53- *Jornal do Brasil*, 18 December 1990.

54- Olivetti, IBM, Fujitsu, NEC and several other TNCs have been engaged in or are negotiating the formation of joint-ventures in the electronic industry in Brazil. See, for instance, *Gazeta Mercantil*, 4 November 1992.

55- *Gazeta Mercantil*, 17 September 1992.

56- *Balanço Anual 1991*, São Paulo, *Gazeta Mercantil*, 1991.

57- Zuckun, *op. cit.*, p. 21.

58- Reinaldo Gonçalves, *Small- and Medium-size Transnational Corporations in Brazil*. Report prepared for the United Nations Center on Transnational Corporations, New York, 1991.

59- *Ibid.*

60- Reinaldo Gonçalves, "Uma estrutura geral para a análise da base de poder de empresas multinacionais em países subdesenvolvidos", VI Encontro Anual da Associação Nacional de Pós-Graduação e Pesquisa em

Ciências Sociais, Friburgo, Rio de Janeiro, 1982.

61- Reinaldo Gonçalves, "Investimento externo direto e empresas transnacionais no Brasil: Uma visão estratégica e prospectiva", in *Ciências Sociais Hoje*, 1991, São Paulo, Ed. Vértice/ANPOCS, 1991, p. 231-244.

62- John H. Dunning, *Explaining International Production*, London, Unwin Hyman, 1988, especially, Chapter 1, "Trade, location of economic activity and the multinational enterprise: A search for an eclectic approach". See also, Reinaldo Gonçalves, *Empresas Transnacionais e Internacionalização da Produção*, Rio de Janeiro, Ed. Vozes, 1992.

63- For an empirical analysis of the flows of foreign direct investment in Brazil, see Reinaldo Gonçalves, "Investimento externo direto no Brasil e a Tese do Recuo", Rio de Janeiro, Instituto de Economia Industrial, 1993 (forthcoming).

64- William Meissner, member of the Executive Committee of the American Chamber of Commerce, *Gazeta Mercantil*, 16 February 1991.

65- The expression "retrenchment strategy" was suggested by Professor Maria da Conceição Tavares in the Campinas seminar, November 1992.

66- See, for instance, Reinaldo Gonçalves, "Mercado interno e externo: performance comparativa de empresas nacionais privadas e multinacionais na indústria de transformação", *Revista de Administração de Empresas*, Vol. 23, No. 3, July 1983, p. 23-31.

67- The paper by Bielschowsky and Ferraz (1990) presents evidence in support of this argument regarding technological behaviour. The work by Bielschowsky (1992), however, seems to playdown industrial restructuring in local manufacturing enterprises.