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U.S.-LATIN AMERICAN ECONOMIC RELATIONS

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

ONE HUNDRED SECOND CONGRESS

SECOND SESSION

APRIL 2 AND 29, 1992

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U.S. – LATIN AMERICAN ECONOMIC RELATIONS

THURSDAY, APRIL 2, 1992

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The Committee met, pursuant to notice, at 10:00 a.m., in room 2247, Rayburn House Office Building, Honorable Lee H. Hamilton (vice chairman of the Committee) presiding.

Present: Representative Hamilton.

Also present: Richard F Kaufman, general counsel; and Paul Taylor, professor staff member.

OPENING STATEMENT OF REPRESENTATIVE HAMILTON VICE CHAIRMAN

REPRESENTATIVE HAMILTON. The Joint Economic Committee will come to order.

We meet today for the first of two Joint Economic Committee hearings on U.S.-Latin American economic relations in the 1990s.

As U.S. foreign policy adjusts to sweeping international changes, the nations of Latin America have begun to receive greater attention in U.S. economic policy. It seems an opportune time to review the status of U.S.-Latin American economic relations and to consider how the United States might play a constructive and beneficial role in Latin America's economic future.

Today, our focus will be on trade issues. A second hearing on April the 29th will address Latin America's economic recovery, the debt situation, and ways in which the United States might contribute to economic reform in the region.

We will attempt to broaden the debate on U.S.-Latin American trade beyond the issue of the possible North American Free Trade Agreement. While the proposed North American Agreement will certainly serve as a reference point, we would like to focus on the possibility of increased trade integration throughout the Americas.

Testifying first will be David Malpass, Deputy Assistant Secretary for Economics in the Bureau of Inter-American Affairs in the U.S. Department of State.

After we have heard from Mr. Malpass and have had an opportunity to ask a few questions, we will hear from three private sector specialists. I will introduce them later on in the hearing.

Before we begin, Congressman Armey who is unable to attend the hearing would like to submit a statement for the record, and without objection that will be done.

[The written opening statement of Representative Armey follows:]

WRITTEN OPENING STATEMENT OF REPRESENTATIVE ARMEY

I am pleased that the focus of the hearing today is U.S. trade with the Nations of the Americas. I want to welcome Deputy Assistant Secretary David Malpass, formerly of the Joint Economic Committee, as well as our distinguished panel of three exports on today's topic. I look forward to their suggestions concerning ways in which Congress might enhance our trading relationships with our neighbors of the Americas. In the excitement caused by the momentous changes in Europe and the new Confederation of Independent States, the strides of market liberalization made by our trading partners in the Americas is perhaps underappreciated.

In a recent, related JEC hearing, we discussed the General Agreement on Tariffs and Trade (GATT). The focus of GATT trade difficulties were Europe and Japan, but our trade relationship with Latin America is important as well. The current efforts by some to use Mexico and the North American Free Trade Agreement (NAFTA) as a campaign lightning rod is a sign that trade issues with our Latin neighbors need more careful attention. In the Uruguay Round GATT negotiations, agricultural exporting countries have only recently made efforts to liberalize trade in agriculture. American efforts to advance the liberalization of GATT in the areas of protection of intellectual property and increased market access is also important to trade among the countries of the Americas.

If the GATT talks are ended without a new agreement, a likely result could be a drift toward protectionism, bilateral agreements, intensified regional trading blocs, and possible trade wars. U.S. exporters may have missed as much as $130 billion in potential exports to Latin America during the debt difficulties of the 1980s. Helping to stabilize the continental trade position of those economies, and lifting trade barriers, would help U.S. exporters, as well as increase the prospects of U.S. investment in the region. U.S. merchandise trade with Latin America is now more than $100 billion a year.

The new commitment of virtually all governments in Latin America to economic liberalization and democracy has made regional negotiations for freer trade more meaningful. The NAFTA is an essential first step in what will likely be a lengthy but productive movement toward economic integration of both American hemispheres. The President's Enterprise for the Americas Initiative recognizes the special relationship, as well as the vast potential that the U.S. shares with the countries in the Americas. I welcome this chance today to start thinking critically about how Congress can contribute positively to this process.

Representative Hamilton. Mr. Malpass, we are delighted to have you, sir. Your statement, of course, will be entered into the record in full, and we would appreciate it if you would summarize that statement and then we will have a few questions.

We are very pleased to have you and we look forward to your testimony.

STATEMENT OF DAVID MALPASS, DEPUTY ASSISTANT SECRETARY FOR INTER-AMERICAN AFFAIRS, U.S. DEPARTMENT OF STATE

Mr. Malpass. Thank you very much, Mr. Chairman. I am pleased to be here. I am particularly pleased to have the opportunity to testify today before the Joint Economic Committee. I believe the Committee has an important role in looking ahead at important economic situations in the world.

My testimony today is on a topic that affects U.S. citizens as well as people throughout the hemisphere: trade liberalization in Latin America and the Caribbean.

In my written statement, I have described the economic backdrop which led to our current trade policy with Latin America. Second, explained the vision President Bush laid out for us. Third, identified the mechanisms moving us toward the vision. Fourth, given substantial detail on actual changes in trade policy now taking place in Latin America. And fifth, outlined some of the challenges before us.

At the end of the 1980s, Latin America's trading system was in disrepair. Mexico and Chile had taken concrete steps to rewrite the rules of the game, but few others had.

After years of high tariff and nontariff barriers and relatively inconvertible currencies, trade had fallen to minuscule levels by world standards. Countries traded little with their neighbors and found themselves uncompetitive in world markets.

In 1990, the region's exports to all of its neighbors within Latin America and the Caribbean were just one third of its exports to the United States, and living standards had fallen to 1977 levels.

This paucity of trade and economic activity hurt the United States, too. U.S. exports to Latin America peaked in 1981 at $42 billion and did not recover that level in real terms until 1989.

With the changes underway in Latin America, the opportunity for the United States is clear. U.S. trade with Latin America is growing rapidly, over 16 percent in 1991, which is more than twice the growth in our total exports.

In his 1990 speech announcing the Enterprise for the Americas Initiative, President Bush committed the United States to a new economic partnership with Latin America, working toward the ultimate aim of a free-trade system throughout the hemisphere.

To explain U.S. interest in such a partnership, he cited the mutual advantage that comes from increased trade. Both sides of the trade prosper. The President made clear that the primary responsibility for achieving growth lies with each individual country.

He also made clear that U.S. interaction with the region would increasingly be based on trade rather than aid.

President Bush's speech and subsequent directives were a clear blueprint from which the rest of the government could work. Latin America's positive response cemented this new economic partnership.

Our goal is to see that people in Latin America and in the United States do better economically through increased trade and improved investment relationships.

I would like to identify for the committee four mechanisms at work in moving us toward the long-term goal of hemispheric free trade.

First, the Uruguay Round of GATT negotiations will create a more advanced starting point for hemispheric trade liberalization.

Second, a sound NAFTA agreement, now under negotiation, will yield increases in trade and jobs in our three countries, pointing us toward the broader goal of hemispheric free trade and helping to set standards for future efforts.

The third mechanism, arguably the most important one, is Latin America's own liberalization effort. To reach the goal of hemispheric free trade, sweeping changes have to occur in Latin America. I am pleased to observe that the process is in full swing, and I will give some details in a moment.

The Enterprise for the Americas Initiative, or the Bush Initiative, as it is known in Latin America, created a fourth mechanism for moving toward the goal. We now have 16 agreements with 31 countries in the hemisphere for the explicit purpose of working toward a more liberal trading environment.

Under these agreements, we regularly hold trade and investment councils with each of the countries to look for concrete ways to speed the liberalization process.

Let me emphasize that this approach will not establish an exclusionary trading bloc. The United States remains committed to the multilateral trading system and to the GATT.

We see the EAI and the GATT as complementary, with both pushing toward more openness in trade. Indeed, we have encouraged Latin American countries to open their markets not only to the United States but across the board, according to the most-favored-nation principle.

We believe maximum trade liberalization will enhance the development of Latin America.

In moving toward free trade with any particular country or group of countries, we will take into account a variety of economic and political factors, including a country's institutional capacity to fulfill the long term and serious commitments involved, whether it has a stable macroeconomic climate and market-oriented policies, and how open it is to international trade.

In this respect I am encouraged by the considerable progress that countries in Latin America have already achieved in both stabilizing and reorienting their economies.

Creating a system of free trade in the hemisphere is likely to be a process taking some years. We will, of course, consult closely with Congress throughout this process.

In my testimony, I give considerable detail on both cuts in tariffs and on the dramatic reductions in import licensing requirements and similar nontariff barriers.

To save time, Mr. Chairman, let me cite here just two examples.

With regard to tariffs, five countries in Latin America–Argentina, Bolivia, Chile, Mexico and Venezuela–now have average tariffs in the 9 to 12 percent range and few or no quantitative restrictions.

On import licensing requirements, Honduras announced just weeks ago that it would abolish them. There are a number of other examples stated here.

In addition to most-favored-nation type liberalization, Latin America is reducing barriers among neighbors, creating early prospects for increased competition and efficiency.

In the past, Latin America's integration groupings were characterized by high-trade barriers protecting their markets. Today, regional economic groupings give hope that they will be liberalizing and outward-looking.

In my written statement, I go into considerable detail about the accomplishments and plans of each of the major groupings.

To summarize, let me just note that two regional groupings—the Andean Pact and the Central American Common Market—have committed to implementing free trade among themselves this year, as well as to adopt common external tariffs with maximum rates of 20 percent in general.

The three northern tier countries of Central America–El Salvador, Guatemala and Honduras–are moving even more quickly toward their own customs union. MERCOSUR, the Southern Common Market, comprising Argentina, Brazil, Paraguay and Uruguay, anticipates similar changes, although some years away.

The countries of the Caribbean Common Market—CARICOM—are also committed to strengthening their economic integration, although we are concerned that their progress toward trade liberalization lags substantially behind that of groups in Latin America.

In addition to progress on trade liberalization, Latin America's exchange rate systems are moving in a positive direction, facilitating the expansion of trade.

Inflation is down dramatically, currencies are far more stable, and reserves are increasing.

My written statement provides data on all these developments, but I do want to point out here the progress in making many currencies convertible. Argentina, Mexico and Venezuela virtually abandoned exchange rate controls. Chile, Colombia, the Dominican Republic, El Salvador, Guatemala, Nicaragua, Peru and now Jamaica all have substantially convertible currencies.

Honduras and Costa Rica are making rapid progress toward liberalizing their currencies, as well.

Looking forward, the calendar of Latin American trade events is full. The year 1992 is a critical year for trade in many respects, for the Uruguay Round, the NAFTA and also for Latin America's regional groupings, particularly for the commitments undertaken in the Andean Pact and in CACM, the Central American Common Market.

For MERCOSUR, the target data is still some years away, the end of 1994. But liberalization needs to keep pace with the agreed schedule in order to meet that target, particularly for Brazil, whose economy dominates the region and whose barriers are generally higher than its neighbors.

CARICOM still has some fundamental issues to address. I am concerned that the current structure of the common external tariff would keep the region from achieving the competitiveness and growth which it so badly needs and wants.

We will be discussing these issues when we hold our first meeting of the Trade and Investment Council with the CARICOM tomorrow.

I encourage the Committee to follow these developments over the coming years. If they are successful, economic activity in Latin America will increase, creating jobs and improved living standards, and building markets for U.S. exports.

Our progress should be measured by this increase, not by the number and complexity of the agreements signed.

Some serious challenges remain, of course, Mr. Chairman. Common external tariffs—wonderful progress when compared to the past—are still too high. Exceptions granted to specific industries are too large. Most economies need more competition to break up corporatism and cartels.

Legal and regulatory frameworks must be improved, and we must all remain vigilant to maintain the liberalizing nature of all free-trade agreements, whether among Latin Americans themselves or with the United States.

In conclusion, I want to emphasize that the exciting changes going on in Latin America and in the Caribbean are all based on the sound economic fundamentals of expanding the economic pie.

That gives me confidence that these changes are leading to a sustainable revival of growth.

Another cause for confidence is that both we and the Latin Americans are working from a clear and shared vision of a hemisphere, governed democratically and prospering in a framework of market-oriented policies.

The mechanisms to reach that vision are in place and operating.

There are, of course, no guarantees of success, but we have in place the means and the will to reach this vision.

As we work cooperatively with Latin America toward this goal, we also want to keep in close consultation with the Congress, and I welcome this opportunity to present testimony to you today.

[The prepared statement of Mr. Malpass follows:]

PREPARED STATEMENT OF DAVID R. MALPASS

Mr. Chairman:

I am very pleased to have the opportunity to testify today on trade liberalization in Latin America and the Caribbean. The Committee has chosen a particularly timely and relevant topic, one which affects U.S. citizens as well as people throughout the hemisphere.

In my testimony, I will: 1) describe the economic backdrop which led to our current trade policy with Latin America; 2) explain the vision President Bush laid out for us; 3) identify the mechanisms moving us toward that vision; 4) give substantial detail on actual changes in trade policy now taking place in Latin America; and 5) outline some of the challenges before us.

Increased Trade: A Worthy Goal

Trade is at the core of economic growth. Whether delivered by messenger or air-freighted or faxed, trade in goods and services is the basis of efficiency and competition in our economic system.

At the end of the 1980s, Latin America's trading system was in disrepair. Mexico and Chile had taken concrete steps to rewrite the rules of the game, but few others had. After years of high tariff and non-tariff barriers and relatively inconvertible currencies, trade had fallen to miniscule levels by world standards. Countries traded little with their neighbors and found themselves uncompetitive in world markets.

- Latin America's sales to its neighbors represent only about 14 percent of its total exports. In comparison, U.S. exports to Canada and Mexico are twice that–about 28% of our 1990 total exports.
- In 1990, the region's exports to all of its neighbors in Latin America and the Caribbean ($19 billion) were just a third of its exports to the U.S. ($53 billion) and about two-thirds of its exports to the EC ($29 billion).
- Growth in Latin America during the decade of the 1980's averaged 0.9 per year. Per capita income declined by about 10% between 1981 and 1990. Living standards in 1990 were at a level comparable to that attained in 1977.

This paucity of trade and economic activity hurt the U.S. too. U.S. exports to Latin America peaked in 1981 ($42 billion) and did not recover that level in real terms until 1989 ($49 billion).

Today, we have a very different story. With the changes underway in Latin America, the opportunity for the U.S. economy is clear. U.S. trade with Latin America is growing rapidly.

- According to preliminary Commerce Department estimates, U.S. exports to Latin America and the Caribbean over the past two years grew by roughly 29% from $49 billion in 1989 to $63 billion in 1991.
- U.S. exports to Latin America grew more than 16% in 1991. This is more than twice the growth in our total exports (7.3%), three times the growth in our exports to the EC (5.0%), substantially more than to the East Asian newly industrialized countries (12%).
- Our exports to Latin America ($63 billion) are now considerably larger than to Japan (roughly $50 billion)–or any other individual country except Canada.
- If Latin America continues to reform, and therefore to grow, it could well become a $100 billion market by the year 2000. That's roughly what we ship today to Canada or the EC.

A Clear Goal

In his 1990 speech announcing the Enterprise for the Americas Initiative, President Bush committed the U.S. to a new economic partnership with Latin America, working toward the ultimate aim of a free trade system throughout the hemisphere. To explain U.S. interest in such a partnership, he cited the mutual advantage that comes from increased trade. Both sides of the trade prosper. The President made clear that "the primary responsibility for achieving growth lies with each individual country." He also made clear that U.S. interaction with the region would increasingly be based on trade rather than aid.

President Bush's speech and subsequent directives were a clear blueprint from which the rest of the government could work. Latin America's positive response cemented this new economic partnership. Our goal is to see people in Latin America and the U.S. doing better economically, through increased trade and improved investment relationships.

Free Trade Mechanisms

I would like to identify for the Committee four mechanisms at work in moving us toward the long-term goal of hemispheric free trade.

First, as the President said when he launched the Enterprise for the Americas Initiative, the Uruguay Round of GATT negotiations is our most important trade goal. It will create a more advanced starting point for hemispheric trade liberalization and provides the most "bang for the buck" in opening global markets to the entrepreneurs of the Americas.

Second, a sound NAFTA agreement, now under negotiation, will yield increases in trade and jobs in our three countries, pointing us toward the broader hemispheric goal and helping to set standards for future efforts.

The third mechanism, arguably the most important one, is Latin America's own liberalization effort. To reach the goal of hemispheric free trade, sweeping changes have to occur in Latin America. I am pleased to observe that the process is in full swing and will comment on this in detail in later sections.

The Enterprise for the Americas Initiative (EAI), or the Bush initiative as it is known in Latin America, itself created a fourth mechanism for moving toward the goal. We now have 16 agreements with 31 countries in the hemisphere for the explicit purpose of working toward a more liberal trading environment. Under these agreements, we regularly hold Trade and Investment Councils with each of the countries to look for concrete ways to speed the liberalization process.

Let me emphasize that this approach will not establish an exclusionary trading bloc. The U.S. remains committed to the multilateral trading system and to the GATT (General Agreement on Tariffs and Trade). As I noted above, we have placed our first priority on the Uruguay Round of GATT negotiations. We have made clear that any agreements under the EAI must be fully consistent with the principles and disciplines of the GATT, particularly GATT Article XXIV which governs free trade areas. A hemispheric system of free trade can complement but not take the place of a strong multilateral system.

Thus, we see the EAI and the GATT as complementary, with both pushing toward more openness in trade. Indeed, we have encouraged Latin American countries to open their markets not only to the U.S. but across the board, according to the MFN principle, consistent with long-standing U.S. policy. We believe maximum trade liberalization will enhance the development of the Latin American countries. It also means that the EAI will ultimately serve the interests of all trading countries, not just those in the hemisphere. Similarly, we are not interested in tying Latin America exclusively to our market.

Creating a free trade system in the hemisphere is likely to be a process taking some years. We will, of course, consult closely with the Congress throughout this process.

In moving toward free trade with any particular country or group of countries, we will take into account a variety of economic and political factors. A major issue facing any country realistically contemplating free trade with the U.S. will be its institutional capacity to fulfill the long-term and serious commitments involved. A stable macro-economic environment and market-oriented policies are crucial indicators of the readiness of countries to enter into those commitments. The degree to which countries have opened their markets to international trade and their commitment to the GATT will also be important in demonstrating their ability to fulfill the obligations of free trade agreements.

In this respect, I am encouraged by the considerable progress which countries in Latin America have already achieved in both stabilizing and re-orienting their economies.

Trade Liberalization

Latin America began working toward more liberal trade as early as 1982 with Mexico's declaration of an end to its import substitution policy. Chile worked steadily through the decade to bring its tariffs down to a uniform level of 11%. Other countries laid the foundation in the late 1980s, and accelerated their market liberalization soon after President Bush's Enterprise for the Americas Initiative speech. Today, virtually all countries of the hemisphere have opened up their economies in unprecedented ways, slashing both tariffs and non-tariff barriers.

- Five countries in Latin America now have average tariffs in the 9-12% range: Argentina, Bolivia, Chile, Mexico and Venezuela.
- Four more countries have average tariffs below 20%: Colombia, Costa Rica, El Salvador and Peru.
- Maximum tariffs used to be substantially above 100%. Today, they are a fraction of that. With very few exceptions, Argentina, Bolivia, Colombia, Chile, Mexico and Peru all have top rates at 25% or below.
- Ecuador and Brazil have been called laggards in this process of trade liberalization. And it is true that their progress has been slower than that of their neighbors. But even they have reduced their barriers substantially and continue to move in that direction.
  - Brazil's and Ecuador's average tariffs were around 50% just a few years ago. Their average rates today are around 25% for Ecuador and 21% for Brazil.
  - Their maximum rates were 105% (Brazil, in 1988) and 29% (Ecuador, as late as 1990). Today, Ecuador's maximum rate is 40%, and Brazil's maximum is scheduled to be around 40% by mid-1993.
- Another extremely important development is the dramatic reduction in import licensing requirements and similar non-tariff barriers.
  - Chile radically liberalized its system in the 1970's. There are no import restrictions now in place, except for second-hand automobiles, and sanitation controls on agricultural products.
  - In Argentina, five years ago, the value of industrial output subject to restrictions was 62%. The deregulation decree at the end of 1991 reduced non-tariff requirements to only security and sanitation controls and removed the "Buy Argentinean" restrictions.
  - In Bolivia, all prohibitions and license requirements on imports have been abolished, with two product exceptions (sugar and wheat), and two general exceptions maintaining controls on products which might endanger health and State security.
  - In Colombia, prior licensing restrictions were almost completely eliminated at the end of 1990, except for certain products produced by State monopolies (arms) or covered by international treaties (inputs related to drug traffic) and certain agricultural products.
  - Honduras said in late March it was abolishing all import licensing requirements.
  - In Mexico, coverage of import licenses was reduced from 92% of production in June 1985 to 18% by December 1990, and liberalization is continuing. Government- mandated minimum import prices have been eliminated.
  - In Peru, licenses, controls, import permits, quotas and prohibitions were swept away in March 1991.
  - In Venezuela, the number of headings subject to restriction was reduced from 2,204 in 1988 to 200 at present.

<u>Liberalization With Neighbors</u>

In addition to MFN-type liberalization, Latin America is reducing barriers between neighbors, creating early prospects for increased competition and efficiency. In the past, Latin America's integration groupings were characterized by high trade barriers protecting their markets. Today, regional economic groupings give hope that they will be liberalizing and outward-looking.

The debates within these groupings in setting the level of the common external tariff (CET) demonstrate this. Two regional groups–the Andean Pact and the Central American Common Market (CACM)–have committed to adopt maximum tariffs of twenty percent, in general. A third–MERCOSUR, comprising Argentina, Brazil, Paraguay and Uruguay–anticipates a similar change. Although questions remain about the application of the CET in each of these groups, and strong pressures exist to keep protection high for vulnerable industries or sectors, the trend is clearly toward liberalization.

The Andean Pact is moving steadily to liberalize its markets.

- In the Declaration of Barahona in December, 1991 the five member nations (Bolivia, Colombia, Ecuador, Peru and Venezuela) agreed to implement the essential elements of a customs union: a free trade area among the five, with a common external tariff ranging from 5% to 20%.
- The agreement for a free trade area among Venezuela, Colombia, and Bolivia took effect on Jan 1, 1992. Ecuador and Peru are to join the free trade system by July 1, 1992.
  - There is a one-year transition period. Each country may exempt up to 100 products in the petrochemicals, iron and steel, leather, automotive, and textile sectors. Exemptions are to be eliminated by Jan. 1, 1993.
  - In a separate bilateral agreement, Venezuela and Colombia have agreed to free trade in automobiles. Trading patterns have already begun to adjust.
- The Declaration of Barahona also calls for the establishment of a common external tariff (CET) by Jan 1, 1992. However, no agreement has yet been reached on the specifics of an Andean Pact tariff schedule (i.e. which products are dutiable at which rates) and thus implementation of the CET has been delayed.
  - There remains agreement on the principle that tariff rates should be 5% for raw materials; 10% for semi-finished goods; 15% for intermediate goods, and 20% for finished products and consumer goods. The top rate would come down to 15% on January 1, 1994.
  - However, the CET applies only to those imports which compete with goods produced within the countries of the Andean Pact. Separate tariffs for non-competing imports remain to be determined.
  - Exceptions to the four-level CET are automobiles, iron and steel, and agriculture. Automobiles are dutiable at 40% to be reduced to 25% by January 1, 1994.
  - Bolivia has a substantially lower tariff regime than its neighbors. It will continue to apply its national tariff rates of 5% and 10%, rather than the higher CET rates.
  - Ecuador is in the opposite situation, with rates that are generally higher than its neighbors. It is seeking to maintain its national tariffs for about 1000 tariff categories, some at lower and some at higher levels than its neighbors.

The five countries of the Central American Common Market (CACM)--Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua--have also agreed to revitalize their customs union, and to move quickly toward free trade within Central America behind a common external tariff.

- In June 1990, the CACM members agreed to form an "economic community".
- At the Puntarenas Summit (Dec. 1990), the Presidents instructed their ministers to design a new customs and tariff policy taking into account the importance of efficient participation in international trade.
- In July, 1991, the Presidents met at San Salvador and agreed in principle to a common external tariff analogous to that of the Andean Pact described above. The countries committed themselves to a CET of four levels (5%-10%-15%-20%), to be implemented by Dec. 31, 1992.
  - Exceptions are permitted but must be phased out by Dec. 31, 1994.
  - There will be CET rates higher than 20% for certain luxury goods.
  - Raw materials and other essential inputs may enter duty-free.
- The agreed timetable calls for the establishment of free trade in agricultural products by mid-1992.
  - Agricultural imports will be subject to a variable levy system, which will be phased out over a period of several years.
- The Presidents, in the Declaration of Tegucigalpa (Dec. 1991), urge their ministers to complete CET reform by early 1992.
  - Lack of agreement on exceptions to both the CET and to duty-free intra-regional trade may delay implementation of both the free trade and CET decisions.

Because of this lack of agreement, three of the CACM countries (El Salvador, Guatemala and Honduras--the northern tier of the CACM) are moving toward their own customs union goal, leaving Costa Rica and Nicaragua behind.

- Guatemala and El Salvador last month agreed to bilateral duty free trade between them, with the exception of unroasted coffee, wheat flour, raw and refined sugar, and products derived from petroleum.
  - It is assumed that Honduras will adhere to this agreement in the near future.
- The Guatemala/El Salvador agreement also calls for the establishment of a common customs administration and the harmonization of macro-economic policies.

MERCOSUR (the Southern Common Market) has also agreed on the principle of free trade among its members (Argentina, Brazil, Paraguay and Uruguay), as well as a common external tariff, macro-economic coordination and appropriate institutional reforms. But implementation is some years away, and critical details remain to be resolved.

- In March 1991, the four countries agreed to establish a common market by January 1, 1995.
- Although the rates of the common external tariff are not yet determined, unilateral liberalization measures already undertaken by some MERCOSUR members, especially Argentina, will diminish the likelihood of adoption of high, protective tariffs.
  - According to the terms of the MERCOSUR treaty, Paraguay and Uruguay may delay implementing the CET by one year.
- In anticipation of the establishment of a common market, intra-MERCOSUR tariffs are being reduced automatically and transparently by seven percent every six months.
  - Signatories may maintain exemptions from intra-regional liberalization, but these must be phased out by year-end 1994 (year-end 1995 for Paraguay and Uruguay).
- The MERCOSUR countries plan to coordinate economic, trade and sectoral policies in the future, but there is evidence of this already beginning. For example, they are making efforts to coordinate their positions on certain issues in the Uruguay Round.

The countries of the Caribbean Common Market (CARICOM) are also committed to strengthening their economic integration. We are, however, concerned that CARICOM's progress toward trade liberalization lags substantially behind that of other groups in Latin America.

- CARICOM agreed that they would implement a CET on January 1, 1992. However, we understand that not all members have put it into effect.
- Other regional groups in the hemisphere--the CACM and the Andean Pact--have committed to adopt a common external tariff with a maximum level of 20%, in general. CARICOM's 45% maximum CET is significantly higher.
- The CET is relatively low for agricultural and industrial inputs (5-10%), and rises to as much as 45% for finished products.
- We are concerned that some CARICOM members are raising some of their applied tariffs to meet the CARICOM common external tariff rates.
  - We support CARICOM's activities only in so far as they are trade liberalizing.
  - It is difficult to say definitively whether CARICOM's CET is liberalizing or restrictive on balance. Reporting from our embassies in the area indicate that tariff rates of some members have increased. However, during 1991, CARICOM granted numerous exemptions for members states wishing to maintain their own, and generally lower, tariff rates on products of special interest to them.
- Many intra-regional trade barriers remain, despite the agreement on a CET.
  - Under Art. 56 of the Treaty of Chaguaramas which established the community, member states may adopt quantitative restrictions to protect infant industry.
  - Member states are permitted to impose quantitative restrictions, import bans or import licensing schemes in the event of external payments instability.

Exchange Rate Liberalization

A great obstacle to Latin America's commerce in the 1980s was unpredictable exchange rates and controls on foreign exchange. The numerous mechanisms set up to compensate for this–clearing houses, offsets, etc.–failed when imbalances between countries arose.

In addition to progress on trade liberalization, Latin America's exchange rate systems are moving in a positive direction, facilitating the expansion of trade.

- Inflation is down dramatically. Per the IMF, it fell from 770% in 1990 to 154% in 1991, and may fall to 55% in 1992 depending on Brazil's progress.
- Whether cause or effect, the value of Latin currencies fell much more slowly in 1991. By our calculation, currency depreciation fell from a GNP-weighted rate of nearly 963% in 1990 to a rate of 223% in 1991.
  - Excluding Brazil, Latin currencies depreciated 372% in 1990 but only 18% in 1991.
  - Argentina, Dominican Republic and Nicaragua joined Bolivia, Chile, Mexico and Panama with relatively stable currencies.
- The official reserves of Latin governments increased sharply during the year ending in September 1991, bringing increased credibility to exchange rate systems and increased confidence to potential investors and traders. Per IMF data, reserves in the region increased from $29 billion to $40 billion. Reserves were up sharply in Argentina, Costa Rica, Guatemala, Mexico, Peru and Venezuela. Economist David Hale points out in a March paper that Latin America's share of world foreign exchange reserves is once again approaching 5%, its share of world GNP, after falling dramatically in the 1980s.
- Exchange rate systems were liberalized in several countries, and currencies made convertible. Argentina, Mexico and Venezuela virtually abandoned exchange controls. Chile, Colombia, the Dominican Republic, El Salvador, Guatemala, Nicaragua, Peru and now Jamaica all have substantially convertible currencies.

Next Steps

Looking forward, the calendar of Latin American trade events is full. As I noted before, in our Trade and Investment Councils under the EAI we are working closely and cooperatively with Latin American countries to keep the momentum going in trade liberalization.

1992 is a critical year for trade in many respects. We, of course, are working toward and expect major progress toward global liberalization of trade in the Uruguay Round of trade negotiations under the GATT, and toward achievement of a North American Free Trade Agreement. This will also be a critical year for Latin America's regional groupings, particularly for the commitments undertaken in the Andean Pact and in CACM.

In the Andean Pact: Peru and Ecuador need to prepare now to meet their commitment to implement regional free trade by mid-year. Implementation of the Andean CET has been delayed. Some difficult decisions need to be made to reach agreements on the specifics and to allow implementation soon.

In the CACM, intra-regional free trade should be fairly complete, including agriculture, by mid-year, and the CET is scheduled to be implemented by the end of this year. Honduras and Costa Rica are rapidly liberalizing their foreign exchange systems.

For MERCOSUR, the target date is still some years away–1994. But liberalization needs to keep pace with the agreed schedule in order to meet that target. That is particularly the case for Brazil, whose economy dominates the region and whose barriers are generally higher than its neighbors.

I believe CARICOM still has some fundamental issues to address. I am concerned that the current structure of the CET could keep the region from achieving the competitiveness and growth which it so badly needs and wants. The real crunch is the obvious tension between trying to protect vulnerable industries and sectors, and the need to liberalize to make these economies more efficient. We strongly believe that the only viable option for these economies is to push for the greatest possible openness, and hence the greatest possible competitiveness. We are so encouraging these countries. We expect to hold our first meeting of the Trade and Investment Council with the CARICOM on April 3.

I encourage the Committee to follow these developments over the coming years. If they are successful, economic activity in Latin America will increase, creating jobs and improved living standards there and building markets for U.S. exports. Our progress should be measured by this increase, not by the number and complexity of the agreements signed.

Based on this yardstick, we already see some progress. Trade between neighboring countries is expanding (albeit from a low base), even as countries develop new markets world-wide. For example, in 1990, Mexico's two-way trade with Guatemala ($260 million) was more than triple its level five years before (1986 trade was $77 million). As Argentina and Chile build roads, and reform and liberalize their economies, their two-way trade has doubled (from $285 million in 1986 to $574 million in 1990).

Some serious challenges remain, of course. While we applaud the progress toward free trade which we have seen over the past two years, this should not lead to a new sort of self-satisfied stagnation.

- The common external tariffs (generally with maximum rates of 20%) to which most Latin American countries are committed are wonderful progress when compared to the past, but are still too high when compared to the needs of the future. A number of countries apply additional import surcharges and luxury taxes that substantially increase the total charges on imports. In addition, the large number of exceptions to the common external tariff and to regional free trade agreements demonstrates how far countries still have to go. A significant number of the industries of the region will still enjoy substantial protection from international competition under existing arrangements.
- The long tradition of protected and directed industrial development in many Latin American countries has developed economies which lack competition and which tend toward corporatism and cartels. It will take vigorous deregulation and anti-monopoly efforts to build really healthy market economies.
- An open trading environment means more than low tariffs and sound macro-economic policies. It also requires an effective legal and regulatory framework that makes conducting business a transparent and predictable process. For example, a particular interest to a number of U.S. exporters and investors is adequate and effective protection for intellectual property rights. A strong intellectual property regime serves as a necessary component in a country's economic infrastructure. We are seeing signs of significant progress in this vital area, and we will encourage more.
- We have repeatedly made clear that our efforts to promote free trade in the Western Hemisphere is part of and complementary to our long-standing drive for free trade on global basis. Increasingly our Latin American neighbors are coming to share this vision. Indeed, this is a critical part of the EAI philosophy. We will continue to emphasize that we must minimize trade diversion by maintaining the liberalizing nature of all free trade agreements, whether among Latin Americans themselves or with the U.S.
- We need to keep the trade liberalization process as non-partisan as possible both in the U.S. and in Latin countries. Obviously, subjecting industries to new foreign competition can be painful to those involved and can lead to political controversies. Nevertheless, there is a broad consensus in the region in favor of trade liberalization.

<u>Conclusion</u>

The exciting changes going on in Latin America and the Caribbean are all based on the sound economic fundamentals of expanding the economic pie. That gives me confidence that these changes are leading to a sustainable revival of growth. Another cause for confidence is that both we and the Latin Americans are working from a clear and shared vision of a hemisphere governed democratically and prospering in a framework of market-oriented policies. The mechanisms to reach that vision are in place and operating. There are, of course, no guarantees of success, but we have in place the means and the will to reach this vision. As we work cooperatively with Latin America toward this goal, we also want to keep in close consultation with the Congress.

REPRESENTATIVE HAMILTON. Thank you very much, Mr. Malpass. We will begin with a few questions.

Put into perspective for me, if you would, how important Latin American economic relations are for the United States. We don't read about them very much, and don't see too much about it. Compare it with Japan and with the European Community.

MR. MALPASS. Latin America has 400 million people, which is, of course, much more than the United States.

Its average per capita incomes are substantially lower than ours and so the level of economic activity in Latin America is less than in Japan and Europe. Mexico is already our third largest trading partner, with our exports to Mexico being $33 billion, compared to some $80 billion with Canada, our largest trading partner.

As a whole, our exports to Latin America run some $66 billion. That's a healthy figure. It's up substantially over the last couple of years. I think it still has a long way to grow as Latin America's economic growth moves faster.

REPRESENTATIVE HAMILTON. Why are those exports up so sharply?

MR. MALPASS. Part of it is rapid growth in our exports to Mexico. That has come, in large part, because of the liberalization that Mexico undertook and its rapid growth rate.

REPRESENTATIVE HAMILTON. What percentage of the increase would be due to Mexico, for example?

MR. MALPASS. A large part. Our exports to Mexico are half of our total exports to Latin America. And they have remained so. The exports to Mexico are still the single most important factor in the growth.

REPRESENTATIVE HAMILTON. Beyond the exports, why is this market important to us? The potential is very, very great. Is that right?

MR. MALPASS. The potential is great. During the 1980s, the average growth rate in Latin America was less than 1 percent per year, even though the population growth was above that.

If Latin America were growing rapidly, that would create market potential for us–it would have a synergistic effect. Growth creates growth within the economies of Latin America themselves.

And so we would see a booming market there, and that would help us. From a political standpoint, that creates stability.

REPRESENTATIVE HAMILTON. Now, I appreciate your speaking for the Administration, but getting a longer view on it and not commenting so much on this Administration's record, but isn't it true that the United States has neglected Latin America in our economic policy over a period of many years?

MR. MALPASS. I would not say that, no. Latin America has been very important to the United States because of its proximity, really, throughout our history. We have been intertwined with a lot of Latin American historical events.

If you look around Washington, D.C., the statues that you see of foreign liberation efforts are statues of famous Latin Americans.

From an economic standpoint, we have always recognized the market potential.

However, from a practical standpoint, the market hasn't been that large. Our foreign investment in Latin America was much more important to us in, say, 1900 than it is now. As a percentage of our total worldwide foreign investment, it has declined substantially, in my opinion because of the economic policies in Latin America.

They have been stagnant many years. We see them now coming out of it rather rapidly and that is the reason for our optimism, that in the 1990s our economic ties will be even more fundamental to our economic policy.

Representative Hamilton. When you talk about the great potential that is out there for us in economic relationships, can you measure that or quantify it in any way for us?

Mr. Malpass. One would be if their growth rate meets what the Inter-American Development Bank expects it to be in the 1990s. We could see the export market for the United States grow from the $60 billion level to $100 billion or more.

One important factor here is that Latin America has a propensity to import from the United States. We are close. We produce the types of products that they are very interested in. Things like capital equipment, which is important in their growing market.

Also, food itself. Mexico, for example, is a net food importer. That's one area where the United States has economic strength, in agricultural production, and Latin America is a potential market there.

So I would just say that there is economic complementary between the two regions. So, if Latin America were growing more rapidly, we would get a good share of the benefits.

Representative Hamilton. Should we be saying to American business and agriculture, start looking South a lot more aggressively than you have been? The potential is there? It's a tremendous market for us and——

Mr. Malpass. Yes. Very much so.

Representative Hamilton. That's the right message?

Mr. Malpass. Yes, sir. We have many active programs in doing that and encouraging U.S. businesses to look at the opportunities in Latin America.

Representative Hamilton. Do you think that's happening?

Mr. Malpass. That is happening, but it's part of the overall problem of U.S. businesses not looking outside our own market. The United States market is the biggest and the most transparent of markets, and so it is typically hard for businesses in looking at these other markets to afford the salesmen.

More and more companies, I think, are doing it right. They are sending people out, letting them spend time in the countries, find out what the market is, and then begin to make their competitive bids.

Representative Hamilton. You said the common external tariffs are 20 percent, on average.

Mr. Malpass. No. That is the goal for two of the common markets that have already been formed, in the Andean Pact and in the Central American Common Market.

Several countries do have tariff levels under 20 percent, though, and I identified some of them in my statement.

REPRESENTATIVE HAMILTON. I see. The common external tariffs generally, with maximum rates of 20 percent, to which most Latin American countries are committed.

MR. MALPASS. Are committed, yes.

REPRESENTATIVE HAMILTON. Wonderful progress when compared to the past.

MR. MALPASS. Yes.

REPRESENTATIVE HAMILTON. But they are still too high. What is the common external tariff, then?

MR. MALPASS. That's a trade term. It means that countries that have formed a customs union have all adopted the same tariff rate. Let's put it in practical terms.

If Argentina, Brazil, Paraguay and Uruguay form a common market, they all would be harmonizing their tariffs so that they all have the same common tariff.

REPRESENTATIVE HAMILTON. They have maximum rates of 20 percent.

MR. MALPASS. That's the commitment of two of the common markets, but it hasn't been realized yet. I'm sorry if that's unclear in the statement.

REPRESENTATIVE HAMILTON. Are they coming down to 20 percent?

MR. MALPASS. They are coming down to 20 percent.

REPRESENTATIVE HAMILTON. Well, they're awfully high then, aren't they?

MR. MALPASS. That's very true. Even a year or two ago, we commonly saw rates of 100 percent, 80 percent. Remember that–and this is where my testimony began–Latin America basically stopped trading with each other in the 1980s. They had each raised their barriers so high that they couldn't bring products in and they stopped trading.

That was part of the reason for their low economic growth rate. It grew out of a theory called import substitution that was popular in the 1960s, in which a country would erect a very high tariff barrier in the hopes that it would create domestic industries, and it simply didn't work. It was a miserable failure.

REPRESENTATIVE HAMILTON. And we come along and talk about free trade in that environment?

MR. MALPASS. Yes. You are right. A 20 percent tariff is a high tariff. On the other hand, it is a much better market situation than what has existed in the past in the region, and we have hopes that that common external tariff will be brought down progressively.

If we take Mexico as an example, its average trade weighted tariff now is on the order of 11 percent or below. And Chile is in the same situation. So we see this rapid progress.

REPRESENTATIVE HAMILTON. Our priority at the moment on trade is this North American Free Trade Agreement. Is that correct?

MR. MALPASS. The Uruguay Round and the North American Free Trade Agreement.

REPRESENTATIVE HAMILTON. What are all these framework trade agreements? Tell me about those. They've been signed with most countries. Is that right? All?

MR. MALPASS. All but Haiti, Cuba and Suriname.

REPRESENTATIVE HAMILTON. Most of the countries?

MR. MALPASS. Yes.

REPRESENTATIVE HAMILTON. Now, what are they?

MR. MALPASS. In his speech on the Enterprise for the Americas Initiative, President Bush set out a vision for hemispheric free trade, but he pointed out that some countries are not ready to step into that today because they don't have liberal markets.

REPRESENTATIVE HAMILTON. Well, they're not even close.

MR. MALPASS. Not even close. That's right.

So pursuant to that initiative, we have created a process for discussing with each of the countries their liberalization effort.

So we sit down with a group of six or eight technical people from each of the countries at various times during the year and review what they are doing to liberalize their trade. And they also ask us the same questions.

REPRESENTATIVE HAMILTON. So the framework agreement is really a process.

MR. MALPASS. It's a process.

REPRESENTATIVE HAMILTON. What results can you point to with respect to the framework agreements? What have we achieved at this point? Have we gotten any of those big tariffs down?

MR. MALPASS. First, it's achievement to simply have the agreement, because the agreement states right at the beginning that we are sitting down together to talk about trade liberalization. That locks in the vision that everyone wants to move together toward free trade. That really does help in this process.

REPRESENTATIVE HAMILTON. Let's stop there. Do you think the leaders of Latin America are committed to the idea of free trade?

MR. MALPASS. Totally.

REPRESENTATIVE HAMILTON. Totally committed?

MR. MALPASS. Yes, sir.

REPRESENTATIVE HAMILTON. They want to get there?

MR. MALPASS. That's right.

REPRESENTATIVE HAMILTON. How quickly?

MR. MALPASS. In varying degrees of quickness.

REPRESENTATIVE HAMILTON. Who wants to get there fastest?

MR. MALPASS. Guatemala, El Salvador and Honduras, for example, have said that in 1992 they want free trade among themselves. At least that gets three countries trading together openly. And then they want to be ready, as quickly as possible, to move into freer trade with Mexico and the United States, and also with their other neighbors in Central America, Nicaragua and Costa Rica.

But those three countries, for example, have made firm commitments among themselves to have free trade.

Also Venezuela——

REPRESENTATIVE HAMILTON. Let me ask you. Do you think we will have free trade with those countries next year?

MR. MALPASS. No. And I don't mean to imply that. It's going to be a long process of——

REPRESENTATIVE HAMILTON. But they will have free trade among themselves.

MR. MALPASS. Among themselves. Colombia and Venezuela—

REPRESENTATIVE HAMILTON. How long would it be before we would have free trade with those countries?

MR. MALPASS. I don't know the answer to that. We see it taking several years. Recall that Mexico, as an example, signed a framework agreement with us in 1987. We began negotiations with them on a free trade agreement in 1991.

I would hope that with some of the countries, we could move more quickly in NAFTA, though that depends completely on our progress in the Uruguay Round and their progress in liberalizing their markets.

REPRESENTATIVE HAMILTON. What do you say to people in this country who are so worried about trade with Mexico? Low wages, export of jobs, and all that business. You know, the regular complaints that we hear so frequently. At least those of us who are politicians hear very frequently. I'm sure you do, too.

What do you say to those people?

MR. MALPASS. Well, there are a couple of ways to approach it. One is the practical foreign policy standpoint that we have a long border with Mexico. It's a very important country to us. To the extent that it can grow faster, that benefits the United States from the standpoint of exports, but then also from the standpoint of having a neighbor that's doing better economically.

REPRESENTATIVE HAMILTON. So our exports will go up. If exports go up, we'll create more jobs here. Is that the argument?

MR. MALPASS. That's right. And very rapidly. Exports create jobs more rapidly than other types of commercial activity because it is a high-value-added-type activity.

REPRESENTATIVE HAMILTON. Okay. Then, what's the goal in NAFTA? Is that what you call it, NAFTA?

MR. MALPASS. North American Free Trade Agreement.

REPRESENTATIVE HAMILTON. Is that going to be a free trade agreement?

MR. MALPASS. Yes.

REPRESENTATIVE HAMILTON. Basically, free trade between the United States and Mexico.

MR. MALPASS. Yes.

REPRESENTATIVE HAMILTON. And there will be some exceptions, I presume.

MR. MALPASS. Substantially, all trade is the term that makes it acceptable within GATT. We will be notifying the agreement to GATT and making it available for all countries to review and see that it fits within the GATT norms under Article 24.

REPRESENTATIVE HAMILTON. Do we have a target for a hemisphere free trade agreement, in time? It is a target, correct?

MR. MALPASS. That's correct.

REPRESENTATIVE HAMILTON. But you don't have a timetable for it.

MR. MALPASS. Correct.

REPRESENTATIVE HAMILTON. Okay.

MR. MALPASS. If I may, coming back to the NAFTA question, the pure economic point is that freer trade brings an expanding economic pie. I think that's the key response that needs to be made to people who have concerns about free trade with Mexico.

Trade creates growth on both sides. So, while we see growth in Mexico and growth in the United States, that's a completely consistent concept for economists and for the practical world, as well.

When two people are trading, they both prosper from the trade. And I should bring Canada into that, as well. It benefits from the close relationship with the other two.

REPRESENTATIVE HAMILTON. How is NAFTA going to work in terms of the countries other than Mexico? NAFTA is an agreement between the United States and Mexico. Are you going to have a clause in that agreement that says that if Chile wants to come in or somebody else, they can come in?

MR. MALPASS. This is still under negotiation within the agreement itself. At this point, I would say we think that we will invite accession by other Western Hemisphere countries, that NAFTA will have some sort of invitation.

But from a practical standpoint, it will be mostly a political statement, a statement of the interest of the three countries in having others join into NAFTA at a later date.

REPRESENTATIVE HAMILTON. So you think there will be a clause in there that will permit other countries to come into the agreement.

MR. MALPASS. No, that will invite them to come in.

REPRESENTATIVE HAMILTON. Invite them to come. What do you call that, an accession clause?

MR. MALPASS. An accession clause. But I would emphasize that it is more of a political statement than a practical statement. It would have to work with Congress, as well, to bring it into the trade procedures that Congress prescribes.

REPRESENTATIVE HAMILTON. What countries would be most apt to join in Latin America?

MR. MALPASS. We have had interest expressed to us from Chile in joining in. Chile has a very good reason for being considered, because its markets are some of the most open in the hemisphere and even in the world. That would certainly be a prime candidate for consideration.

Whether that would come through this accession clause process or through a free trade agreement with the United States directly, I don't know at this point

REPRESENTATIVE HAMILTON. We have some highly protected sectors ourselves, don't we, like sugar, for example?

MR. MALPASS. We do.

REPRESENTATIVE HAMILTON. Now, we get into this agreement. What is going to happen to a highly protected sector in the American economy down the line here? Are we going to have to say to the sugar people, "Okay, life is changing out there and you are going to have to get accustomed to a free trade world?"

MR. MALPASS. That's part of economic history, I would suppose, for centuries and thousands of years, adapting to a changing economic world.

REPRESENTATIVE HAMILTON. Is the Administration's position that we ought to have free trade in sugar?

MR. MALPASS. I don't know. I don't want to state a specific position on sugar or on products, but I would make the point that there are a number of responses.

One is that significant changes will be made gradually within whatever free trade agreement.

REPRESENTATIVE HAMILTON. You would have an adjustment period.

MR. MALPASS. An adjustment period that might be very lengthy, so businesses and individuals will have a chance to adjust and be aware of what is coming and what is happening, and make allowances.

REPRESENTATIVE HAMILTON. So we say to the sugar people, "You have ten years." Is that right?

MR. MALPASS. I don't know how many years.

REPRESENTATIVE HAMILTON. I'm just trying to get a sense of it. Our position is free trade. Free trade means free trade. Right?

MR. MALPASS. In substantially all products.

REPRESENTATIVE HAMILTON. That means sugar is a highly protected business here, right? And so is the Administration's position, "We want to move toward a free trade market in sugar?"

MR. MALPASS. I'm not a negotiator within the NAFTA, and can't answer the question of the position or of the ultimate goal for sugar.

I would add that there are mechanisms for whichever product–and I don't want to single out sugar because I don't know the specifics on sugar. There is a transition period. There's also adjustment programs within the United States that operate and that help deal with changes as industries change.

And also, freer trade will bring expanded growth and job opportunities in both countries.

REPRESENTATIVE HAMILTON. How about a country like Brazil? They have a lot of very severe economic problems. Right?

MR. MALPASS. Yes.

REPRESENTATIVE HAMILTON. And are they going to come into this free trade arrangement, too?

MR. MALPASS. When you say "this free trade arrangement," we are talking about a long-term goal that will be at work for many years and that is dependent on changes in Latin America—more liberal market situations, more market-oriented policies in those countries.

With respect to Brazil, I should note that it recently reached agreement with the International Monetary Fund on its standby arrangement. It is making a lot of changes in its economic policies, which may lead it into stronger economic circumstances.

As far as timing of free trade with it, there is no way to predict or to project when that might be. They have to make a lot of changes in their trade policies.

REPRESENTATIVE HAMILTON. You have a framework agreement, a process going on with Brazil now, I presume. Right?

MR. MALPASS. Brazil is part of MERCOSUR, so we meet with them.

REPRESENTATIVE HAMILTON. Brazil and——

MR. MALPASS. Argentina, Paraguay and Uruguay. Those four.

REPRESENTATIVE HAMILTON. And you are meeting with them together and you are working towards a free-trade agreement.

MR. MALPASS. With the ultimate goal of a free-trade agreement. For example, you raised earlier in the common external tariff that within MERCOSUR, they haven't worked out the technical details of having such a tariff. So each country now has varying tariff levels, many of which are very high.

So the types of discussions at this point are to encourage them to liberalize their markets more rapidly.

REPRESENTATIVE HAMILTON. What happens if the NAFTA goes down the drain for whatever reason? What are the implications of that? Let's suppose you get an agreement. Suppose you submit it to the Congress, and the Congress says no. What are the implications of that?

MR. MALPASS. It would be a loud and clear signal from the U.S. Congress that it doesn't really want to participate with the rest of the world, in a reasonable way, to seek growth for all of us. It would be a very unfortunate statement of the direction of U.S. trade policy.

REPRESENTATIVE HAMILTON. What would be the economic implications, do you think?

MR. MALPASS. I don't want to overstate the negative effects on Mexico, because I think its economy is very healthy and can grow and prosper almost without regard to specific things that the United States does.

On the other hand, it would slow Mexico's growth. We are an important partner for Mexico, and it is looking to expand that relationship.

From the United States' standpoint, out markets are so much larger that the immediate economic detriment would not be all that perceptible.

However, by stating our direction of trade policy, that we don't want to liberalize more, it would be a statement about U.S. economic leadership that would be unfortunate.

REPRESENTATIVE HAMILTON. Why?

MR. MALPASS. It would say that we are not as interested in opening and expanding trade as we were following World War II. The engine of growth in the United States over 40, 50 years has been expanded exports reached through trade agreements, whether under the Generalized Agreement on Tariffs and Trade, or through the free-trade agreement that we have with Canada, which has been very beneficial to our trade and to theirs.

And it is a process that we have going to expand and liberalize world trade. We're the world's biggest exporter, the world's most productive country, and we benefit strongly from freer trade in the world.

So it would be backtracking——

REPRESENTATIVE HAMILTON. Put that in very specific terms for me. I mean benefit from world trade or not. If NAFTA is rejected, what happens? We lose jobs?

MR. MALPASS. Yes.

REPRESENTATIVE HAMILTON. We lose sales, growth? Right?

MR. MALPASS. Yes.

REPRESENTATIVE HAMILTON. We lose profits?

MR. MALPASS. We lose profits, certainly. Profits, jobs, sales growth, and our standard of living in the United States wouldn't rise as fast as it could if we had a free trade arrangement with Mexico.

Look at the benefits to us. We have complementary economies. Things that Mexico can produce that we need, things that they need that we can produce very efficiently. It is a complementary arrangement.

So, if we step aside from that and push it away, it would set a bad direction for the rest of our trade policy.

REPRESENTATIVE HAMILTON. In terms of the impact on the United States, can you identify for us sectors of the American economy that you think would be benefited by NAFTA? And sectors of the American economy which you think would be hurt by it?

Now, I understand where you come out overall, you think it is very beneficial. But these are complicated matters and they impact on different industries in different ways.

In your analysis of it, have you gotten far enough to identify sector impact?

MR. MALPASS. Some of your succeeding panelist are world experts on this question.

REPRESENTATIVE HAMILTON. I have some questions for them, too.

MR. MALPASS. Good. I will attempt an answer. I can give you some sense of this.

I think it's hard to make sectoral analysis, though. But some areas that you might see hurt if we don't get an agreement would be areas where the United States is most competitive—in agriculture and automobiles—where Mexico is a big potential market. If we can rationalize trade, we can both do better. It will help to have efficient production in both countries in the automobile area.

In energy, where Mexico has a lot of potential for energy production, where the United States could be helping participate in some of the services, some aspects of that industry.

REPRESENTATIVE HAMILTON. Is Mexican oil going to be included in this agreement?

MR. MALPASS. Again, I'm not a negotiator of the agreement.

REPRESENTATIVE HAMILTON. The only reason I ask is that I saw somewhere that Mexico is trying to exclude it. Is that correct or not? Do you know?

MR. MALPASS. Mexico has some very real constitutional constraints in this sector, and it is an area within the negotiation where we are working.

One area where we can make substantial gains within a free trade agreement is in investment rules. Mexico has in the past had limits on the amount of investment by people outside Mexico. Some of those rules can be changed within the context of the negotiation.

Another prospect–and I don't want to raise it as a real concern, though it is something that we ought to think about–Mexico has made immense progress over the last ten years in its liberalization efforts, but there is no guarantee that that won't turn backward.

We certainly hope not, and I don't have any expectation that it would. But one of the benefits of having a free trade agreement is to lock in the progress that Mexico has already made in its liberalization effort.

REPRESENTATIVE HAMILTON. Can you explain to me the relationship between GATT and NAFTA? You say EAI and GATT are comple- mentary.

MR. MALPASS. So are NAFTA and GATT.

REPRESENTATIVE HAMILTON. They are complementary?

MR. MALPASS. Yes.

REPRESENTATIVE HAMILTON. Spell that out for me a little bit, would you?

MR. MALPASS. Yes. GATT–the Uruguay Round negotiations–are working to set a common foundation for world trade that is more liberal than our present foundation. So the NAFTA negotiation, purely from a negotiating standpoint, can build on agreements and conclusions reached in the GATT negotiation.

So there is a direct negotiating linkage between the two.

Then, from a sense of direction standpoint, of course, the two are identical in their ultimate goals, to liberalize trade so that the economic pie grows.

So those are linkages that I would point out.

REPRESENTATIVE HAMILTON. Now, if GATT is approved, what does that do in terms of impact on NAFTA? Does that accelerate it or deter it?

MR. MALPASS. It accelerates it. It sets the platform higher for the next negotiation.

Some of the things that are under negotiation in GATT, if they are agreed to, don't have to be negotiated again in NAFTA.

The same is true, looking prospectively over the next 10 or 15 years, as we try to expand free trade in the Western Hemisphere. It sets a higher standard and starting point for the negotiation.

REPRESENTATIVE HAMILTON. I guess one of the difficulties I have just thinking about the free-trade agreement with Latin America, the differences in the economies of Latin America are so striking, so different.

I mean, can we have one agreement that is going to encompass all of these countries with enormous diversity?

There are only two or three countries there, that represents two thirds or three fourths of all of our trade. I mean, you talk about Mexico, Brazil, I suppose Venezuela, maybe one or two. But that really is the bulk of our economic trade, isn't it? Those three countries? Four?

MR. MALPASS. At present, that may be true that a few countries supply the bulk of trade. But as other countries within the region grow, they will have growing markets, as well.

Even a market of 5 million people is worthy of sales attention of U.S. companies getting involved and looking at the market potential.

I hope we can expand that type of trade.

As far as the diversity of the economies, that's very true. Trade agreements would, of course, have to be tailored. They could all start from the same level of high standards that we hold for the NAFTA negotiation and for any subsequent negotiation, ones of creating truly open trade within our economies. It would then be tailored.

However, I'm more cognizant of the similarities. All of the economies in Latin America are relatively market oriented when you compare them to Eastern Europe, let's say. They already have the basis for sound commercial development. So they are working on deepening that, on structural adjustments that will make it work better.

We are talking about countries that are used to the profit motive being a force within their economic development, to the concept of sales, of market price mechanisms, and so on.

So I think there's actually a lot of similarities, and that's what a free trade negotiation could leverage on.

REPRESENTATIVE HAMILTON. Tell me, what is the Enterprise for Americas Initiative? It's been well-received in Latin America, hasn't it? What is the core of it?

MR. MALPASS. President Bush looked at Latin America in early 1990. He was coming back from a very important counternarcotics summit in Colombia. He asked the Executive branch to do a full review of our trade and economic policy with Latin America.

EAI is the outcome of that. It has the vision of free trade in the Western Hemisphere over a period of years—a long-term goal. It also had a number of very specific tools and mechanisms within it to improve the investment climate in Latin America.

For example, the Inter-American Development Bank is now making investment-sector loans in the region. They are conditioned on changes in investment climate that make a country more accessible to foreign investment and growth.

REPRESENTATIVE HAMILTON. Okay. I think we are about through here. I appreciate very much your testimony. I certainly get the impression from you that you are quite upbeat about the economic prospects for both the United States and the Latin American countries in the near future. Is that right?

MR. MALPASS. Yes, sir. The changes that are going on in the region give every indication that they will be successful in increasing the growth rate, the living standard for all the people in the region, and also the market potential that the United States would look at in looking south.

REPRESENTATIVE HAMILTON. These countries are all–with one or two exceptions–dedicated to market oriented policies, right?

MR. MALPASS. Yes. Actually, one year ago I wouldn't have answered that in the affirmative. I can say pretty confidently today that that's true with the one or two exceptions. A standout exception is Cuba, of course.

REPRESENTATIVE HAMILTON. Mr. Malpass, thank you very, very much. We have appreciated your contribution. We will have our other witnesses come forward.

MR. MALPASS. Thank you, Mr. Chairman.

[Material submitted for the record in response to Representative Hamilton's questions to the Honorable Carla Hill, the United States Trade Representative, follows;]

THE UNITED STATES TRADE REPRESENTATIVE
Executive Office of the President
Washington, D.C. 20506

MAY 6 1992

The Honorable Lee H. Hamilton
Vice Chairman
Joint Economic Committee
Congress of the United States
Washington, D.C. 20510-6602

Dear Representative Hamilton:

I am pleased to know of your Committee's interest in the President's Enterprise for the Americas Initiative (EAI). Since President Bush announced his initiative on June 27, 1990, the Administration has been hard at work to ensure that his vision of hemispheric free trade is one day realized. My answers to each of the questions you posed in your recent letter will provide our strategy for moving the EAI forward (see Attachment A) .

I hope you and the Joint Economic Committee will find my explanation of the Administration's implementation of the EAI to be helpful in your deliberations. Please feel free to contact me if you have any questions or if I can be of further assistance.

Sincerely,

Carla

Carla A. Hills

Attachments

BS:lvs

ATTACHMENT A

RESPONSES TO REPRESENTATIVE HAMILTON'S QUESTIONS OF MARCH 27, 1992 REGARDING THE ENTERPRISE FOR THE AMERICAS INITIATIVE

Summary Of Steps Taken Since The Announcement Of The Eai To Liberalize U.S. Trade With Countries Other Than Mexico:

The President's June 27, 1990 speech laid out an ambitious long-term program for trade liberalization in the hemisphere, with its vision of a "system of free trade" stretching from Alaska to Patagonia. Since the speech, we have been consulting with members of Congress, business, labor and other interested groups in the United States, and with the hemispheric nations concerned, in the process of implementing the initiative. We have reached some conclusions as to our basic approach and developed criteria for implementing the policy on a country-specific basis.

As to the general approach, we have five main tenets. First, the United States remains committed to the multilateral trading system and to achieving liberalized trade through the Uruguay Round. We believe that the success of the Uruguay Round is of the utmost importance to our free trade initiatives in the hemisphere in that it will help clear away difficult issues requiring resolution in any free trade arrangement.

Our second tenet is that the proposed negotiations on a free trade agreement with Mexico and Canada will come first.

In the meantime, we are proceeding to conclude framework agreements on trade and investment with those countries and groups of countries that wish to work toward freer trade in the hemisphere. This is the third tenet.

Trade and investment framework agreements, in and of themselves, do not bind the signatories to carry out specific trade liberalization commitments. They do constitute an agreed declaration of trade and investment principles, an agreement to consult on a regular basis for the purpose of achieving expanded trade and investment, and an initial agenda for consultation.

We have made remarkable progress on framework agreements. Since President Bush launched the EAI, Bolivia, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Panama, Peru, Nicaragua and Venezuela have signed framework agreements with us. We have also signed framework agreements with two groups of countries, the Southern Common Market (Mercosur) composed of Argentina, Brazil, Uruguay and Paraguay, and also with the 13 nations which make up the Caribbean Community (Caricom). Only three countries in Latin America and the Caribbean--Haiti, Surinam and Cuba--have not signed framework agreements with the United States.

To date, we have held 22 meetings of the Trade and Investment Councils established by the framework agreements and have a full schedule of meetings over the next year. We will have had at least one meeting with every signatory by May of this year. A number of countries have had a second Council meeting.

These meetings have been extremely useful in reaching greater understanding of our trading partners' progress in liberalizing their economies, and in providing them with a comprehensive overview of U.S. trade and investment concerns, including but not limited to the areas of intellectual property rights, services, market access, and investment liberalization.

Throughout this time period, remarkable economic reforms have taken place in Latin America and the Caribbean. Tariffs and non-tariff barriers have been significantly reduced in Brazil, Colombia, Venezuela, Peru, Bolivia and Central America, to name a few. Significant investment regime liberalization in a number of countries has provided the opportunity for the U.S. to engage a number of them in discussions concerning bilateral investment treaties. The U.S. recently signed a bilateral investment treaty with Argentina and we are currently discussing similar treaties with other countries. Improvements to intellectual property regimes are under discussion in a broad range of countries including Brazil, Argentina and Venezuela, and recent improvements did occur in Chile. U.S. exports to Latin America and the Caribbean have increased sharply in recent years to nearly $63 billion.

This progress is primarily the result of the commitment that governments in the region, in their own self interest, have made to economic reform. The EAI has undoubtedly played a strong role in supporting this positive environment.

As for the fourth tenet of our approach, we see the process of creating a free trade area for the hemisphere as taking many years and stretching into the next decade. The commitment to open markets completely and on a reciprocal basis is a difficult one for any government to make. It takes time to carry out the required economic reforms and to build the necessary political consensus. As we proceed to explore possible opportunities and as we consider approaches to our goal, we will of course consult closely with Congress.

Fifth, we believe that we should be prepared to negotiate with individual countries and in particular with groups of Latin American or Caribbean countries associated to remove trade barriers among themselves. President Bush made this point in his 1990 speech "... the U.S. stands ready to enter into free trade agreements with other markets in Latin America and the Caribbean--particularly with groups of countries that have associated for purposes of trade liberalization."

From the U.S. perspective, negotiating with an integrated, fully open market created by a number of contiguous countries is attractive because it will provide us with access to a larger market and move us towards regional integration. This does not rule out concluding bilateral agreements where these are appropriate. Bilateral agreements can be a model and incentive for other countries to undertake needed reforms. Our overall objective remains to encourage countries in this hemisphere to increase trade among ourselves and reduce barriers to sub-regional trade as part of the overall process of promoting free trade throughout the hemisphere.

Current Or Planned Trade Talks With Brazil:

We are in regular contact with officials from the Government of Brazil. As noted above, we also meet with the countries comprising the Mercosur in the U.S.-Southern Common Market Trade and Investment Council established under our framework agreement. We held the first meeting of that Council on November 12, 1991 in Washington.

The second meeting of the Council is planned for May 28, 1992 in Buenos Aires. Although we are now in the preparatory stage, our plan at this time is to review with Mercosur (1) the emerging Southern Common market and its trade and investment implications for the U.S. and (2) the Uruguay Round with emphasis on the importance of increased market access for goods and services.

The Route To Hemispheric Free Trade:

Expanding on the explanation provided above, I would add that we contemplate that the NAFTA will invite accession by other western hemisphere nations. As a practical matter, however, the provision may not be more than a political statement. Accession pursuant to any such procedure would necessarily be considered a subsequent trade agreement which would require congressional notification of initiation of negotiations, careful negotiation of the terms of accession, and congressional approval of the resulting agreement. As the United States looks beyond the NAFTA to subsequent agreements, we have two basic goals:

1) We want any future agreements to secure open markets for U.S. producers of goods and services. This means we will be seeking comprehensive agreements that set high standards.

2) Any future agreements should support and strengthen the multilateral trading system. Here we will want agreements that are consistent with procedures established and being negotiated by the parties to the GATT.

Qualifying Criteria For Free Trade Negotiations:

The United States has informed its Latin American and Caribbean trading partners of the elements we see as central to a free trade agreement. We have made it clear that FTAs must be reciprocal in nature, with a balance of rights and obligations on both sides.

The elements we see as central to an FTA are the following:.

- An elimination of tariffs over an agreed phase-out schedule.
- An analogous phase-out of non-tariff barriers.
- Provisions to permit the distribution of goods and for expanded access to government procurement.
- Effective market access for services on a broad scale.
- Agreed rules for the application of standards and rules of origin.

–An investment chapter, containing the substantive equivalent of a "bilateral investment treaty" (BIT).

–A chapter establishing the obligation to recognize and protect intellectual property rights, which are so much involved in trade and investment decisions. As with the BIT, an agreement on IPR also could precede completion of an FTA.

– Special provisions to handle natural resources and natural resource-based products.

– A variety of other operational, technical or security provisions also will be needed in FTAs. These would include: public health and safety exceptions, essential security interests exclusions, safeguards, "docking" provisions for adding-on future FTAs, consultative and dispute settlement procedures.

– Finally, FTAs should discipline specific categories of government actions which could undermine the basis of the agreement. Of this nature would be provisions covering subsidies, state trading, trade restraints justified on balance of payments grounds, and the use of foreign exchange restrictions and controls.

Timetable For Achieving A Hemispheric Free Trade Area:

See response to first question above.

Hemispheric Free Trade And The Gatt:

We will seek FTAs only with countries that are members of the GATT. The U.S. will follow GATT rules regarding the formation of Comprehensive Free Trade Areas, or Customs Unions. GATT's Article XXIV procedures are designed to address these specific exceptions to most favored nation treatment.

We are also urging the other countries of the hemisphere to embrace this public approach to their agreements. We have asked that the agreements now in place or being negotiated by Chile and Mexico, Chile and Venezuela, in Central America, the Andean Pact, and the Mercosur also be presented to the GATT for review under Article XXIV.

The Caribbean And Andean Initiatives Vs. Hemispheric Free Trade

The President sought congressional approval for tariff preferences for the Andean region to fulfill his commitment to help the countries battling the drug scourge to expand economic alternatives. We view the trade preferences as a means of providing quick relief for a transitional period that will foster the conditions for freer mutual trade down the road as the Enterprise for the Americas envisions. Similarly, the CBI is intended to foster conditions for economic reform and freer trade down the road.

Both initiatives, inasmuch as they provide unilateral U.S. preferences, differ in concept from the EAI–which envisions comprehensive, reciprocal, negotiated free trade arrangements–but supports the EAI by encouraging the countries in their economic reform efforts. As highlighted above, such efforts are essential if the countries of the region are to see their own self-interest served in one day entering into a reciprocal and binding FTA. In short, these initiatives serve as bridges toward realizing the ultimate hemispheric free trade objective.

Bilateral Trade Data:

See Attachment B.

Projected Impact On Bilateral Trade Of A Free Trade Agreement:

The U.S. International Trade Commission is currently undertaking a study which aims to measure the potential impact of free trade agreements with our hemispheric trading partners. This study will be shared with the U.S. Congress when it is completed. We have no doubt, however, that dynamic economic growth in Latin American countries will continue to provide an important base for increased U.S. exports and jobs at home.

ATTACHMENT B

04/22/92

Table 1.--U.S. trade data
Flow: Total exports
Type: F.a.s. value
HS commodity: TOTAL
(Thousands of dollars)

Partner / Time period	1989	1990	1991
Anguilla	17,004	15,297	11,405
Antigua	73,299	69,146	74,699
Argentina	1,036,744	1,179,126	2,048,894
Aruba	126,709	202,180	234,532
Bahamas	773,303	800,729	720,938
Barbados	179,326	161,853	166,547
Belize	101,062	105,728	114,248
Bermuda	354,082	254,634	232,553
Bolivia	144,261	138,556	189,699
Brazil	4,799,438	5,061,877	6,154,097
British Virgin Islands	49,241	60,073	45,238
Cayman Islands	201,881	185,014	116,442
Chile	1,410,753	1,672,267	1,839,617
Colombia	1,915,884	2,038,393	1,946,862
Costa Rica	880,457	991,552	1,033,861
Cuba	2,901	1,298	1,380
Dominica	33,165	30,722	42,471
Dominican Republic	1,646,371	1,658,245	1,742,732
Ecuador	640,982	680,096	947,503
El Salvador	520,900	555,814	533,989
French Guiana	270,263	271,154	149,682
Grenada	27,921	34,587	31,552
Guadeloupe	32,634	54,160	83,425
Guatemala	661,791	758,966	950,629
Guyana	78,253	75,979	86,128
Haiti	471,148	477,563	392,096
Honduras	514,751	563,032	626,666
Jamaica	1,009,469	943,738	962,911
Martinique	24,611	33,769	36,597
Mexico	24,968,823	28,375,468	33,275,780
Montserrat	10,732	10,673	8,105
Neth Antilles	412,329	541,567	628,839
Nicaragua	1,884	68,104	146,974
Panama	728,780	866,710	981,250
Paraguay	166,704	307,104	375,116
Peru	689,606	778,078	840,298
St Christopher-Nevis	43,500	52,018	34,960
St Lucia	76,157	82,532	88,587
St Vincent and Grenadines	40,682	35,065	43,490
Suriname	138,462	156,817	134,545

Source: Compiled from official statistics of the U.S. Department of Commerce.

04/22/92

Table 1.--U.S. trade data
Flow: Total exports
Type: F.a.s. value
HS commodity: TOTAL
(Thousands of dollars)

Partner / Time period	1989	1990	1991
Trinidad and Tobago	561,981	429,621	468,893
Turks and Caicos Islands	45,967	39,396	39,772
Uruguay	133,188	145,337	216,444
Venezuela	3,035,703	3,107,198	4,668,376
Central/South Amer & Carib	49,053,105	54,071,234	63,468,821

Source: Compiled from official statistics of the U.S. Department of Commerce.

04/22/92

Table 2.--U.S. trade data
Flow: General imports
Type: Customs value
HS commodity: TOTAL
(Thousands of dollars)

Partner / Time period	1989	1990	1991
Anguilla	348	227	1,407
Antigua	12,274	4,120	3,901
Argentina	1,398,356	1,508,949	1,291,081
Aruba	933	1,171	100,231
Bahamas	462,194	508,990	470,432
Barbados	46,064	31,561	31,475
Belize	42,958	46,557	45,568
Bermuda	10,438	12,365	8,295
Bolivia	119,982	203,256	208,697
Brazil	8,379,033	7,976,467	6,726,803
British Virgin Islands	1,252	2,218	2,260
Cayman Islands	48,015	21,432	17,615
Chile	1,307,727	1,320,851	1,303,545
Colombia	2,548,028	3,174,662	2,733,699
Costa Rica	961,771	1,008,306	1,154,077
Cuba	0	77	0
Dominica	7,664	8,349	5,715
Dominican Republic	1,645,130	1,747,013	2,017,051
Ecuador	1,483,872	1,377,497	1,327,501
El Salvador	244,901	237,507	302,654
French Guiana	5,357	2,518	543
Grenada	7,758	7,780	8,086
Guadeloupe	1,612	1,428	1,674
Guatemala	609,212	794,728	899,976
Guyana	55,880	52,109	83,625
Haiti	374,973	342,617	284,653
Honduras	459,371	491,967	556,943
Jamaica	531,663	568,818	575,983
Martinique	9,963	937	815
Mexico	27,186,258	30,172,293	31,194,292
Montserrat	2,266	1,121	2,193
Neth Antilles	383,551	420,667	656,272
Nicaragua	31	15,301	59,531
Panama	268,099	233,001	270,176
Paraguay	44,982	50,799	43,119
Peru	815,350	803,265	777,504
St Christopher-Nevis	21,447	16,094	15,460
St Lucia	23,997	26,933	21,778
St Vincent and Grenadines	10,979	8,932	7,507
Suriname	73,892	50,039	51,689

Source: Compiled from official statistics of the U.S. Department of Commerce.

04/22/92

Table 2.--U.S. trade data
Flow: General imports
Type: Customs value
HS commodity: TOTAL
(Thousands of dollars)

Partner / Time period	1989	1990	1991
Trinidad and Tobago	768,007	1,015,961	856,095
Turks and Caicos Islands	2,507	3,547	4,212
Uruguay	218,290	207,882	237,621
Venezuela	6,786,009	9,446,523	8,228,548
Central/South Amer & Carib	57,382,394	63,926,838	62,590,302

Source: Compiled from official statistics of the U.S. Department of Commerce.

04/22/92

Table 3.--U.S. trade data
Flow: Trade balance
Type: Value
HS commodity: TOTAL
(Thousands of dollars)

Partner / Time period	1989	1990	1991
Anguilla	16,657	15,070	9,998
Antigua	61,025	65,026	70,798
Argentina	-361,612	-329,823	757,813
Aruba	125,777	201,010	134,301
Bahamas	311,109	291,739	250,506
Barbados	133,262	130,292	135,072
Belize	58,103	59,171	68,680
Bermuda	343,644	242,269	224,259
Bolivia	24,279	-64,700	-18,998
Brazil	-3,579,595	-2,914,590	-572,706
British Virgin Islands	47,989	57,855	42,978
Cayman Islands	153,866	163,581	98,827
Chile	103,026	351,416	536,072
Colombia	-632,145	-1,136,269	-786,836
Costa Rica	-81,314	-16,754	-120,216
Cuba	2,901	1,221	1,380
Dominica	25,501	22,373	36,757
Dominican Republic	1,241	-88,768	-274,318
Ecuador	-842,890	-697,401	-379,998
El Salvador	275,999	318,307	231,335
French Guiana	264,906	268,636	149,140
Grenada	20,163	26,807	23,466
Guadeloupe	31,022	52,732	81,751
Guatemala	52,579	-35,762	50,653
Guyana	22,373	23,871	2,503
Haiti	96,175	134,946	107,443
Honduras	55,381	71,064	69,722
Jamaica	477,806	374,920	386,928
Martinique	14,648	32,832	35,782
Mexico	-2,217,434	-1,796,826	2,081,488
Montserrat	8,466	9,551	5,912
Neth Antilles	28,778	120,900	-27,433
Nicaragua	1,853	52,803	87,443
Panama	460,681	633,709	711,073
Paraguay	121,721	256,305	331,997
Peru	-125,744	-25,187	62,794
St Christopher-Nevis	22,053	35,924	19,501
St Lucia	52,161	55,599	66,810
St Vincent and Grenadines	29,703	26,133	35,983
Suriname	64,570	106,778	82,855

Source: Compiled from official statistics of the U.S. Department of Commerce.

04/22/92

Table 3.--U.S. trade data
Flow: Trade balance
Type: Value
HS commodity: TOTAL
(Thousands of dollars)

Partner / Time period	1989	1990	1991
Trinidad and Tobago	-206,026	-586,340	-387,202
Turks and Caicos Islands	43,460	35,849	35,560
Uruguay	-85,101	-62,545	-21,177
Venezuela	-3,750,306	-6,339,325	-3,560,172
Central/South Amer & Carib	-8,329,290	-9,855,604	878,519

Source: Compiled from official statistics of the U.S. Department of Commerce.

REPRESENTATIVE HAMILTON. The other witnesses are Rudiger Dornbusch, Professor of Economics at the Massachusetts Institute of Technology; Sylvia Saborio, Director of the Program on International Trade at the Overseas Development Council, Former Minister Counselor of Finance for Costa Rica; and Sidney Weintraub, Dean Rusk Professor at the University of Texas, Lyndon Johnson School of Public Affairs.

We welcome each of you. We are delighted to have you, and I suppose the way to begin is to have each of you summarize your statements for me and for the Committee. Your statements, of course, will be entered into the record in full.

I am especially interested in your comments, with regard to the testimony you have just heard, so maybe you could weave some of those comments into your opening comments, if you would.

Does it make any difference to you who proceeds? Professor Weintraub, you have to leave——

MR. WEINTRAUB. I have to leave. That is my only reason for——

REPRESENTATIVE HAMILTON. At what time?

MR. WEINTRAUB. I have until about 11:30.

REPRESENTATIVE HAMILTON. Alright, sir. Why don't you begin? We'll move across the table quickly—from my right to left—and please keep your statements fairly brief so that we can get to questions, if you would.

STATEMENT OF SIDNEY WEINTRAUB, DEAN RUSK CHAIR, LYNDON B. JOHNSON SCHOOL OF PUBLIC AFFAIRS, UNIVERSITY OF TEXAS AT AUSTIN

MR. WEINTRAUB. Thank you very much. I'll be quite brief. You have the statement for the record. I'll try to weave in my responses to some of the points that you made in your questioning.

I guess you ought to know where I am coming from, in any event. I do favor free trade with Mexico. I do favor the process that is happening in the Western Hemisphere.

I am not a protectionist and therefore I'm very nervous about some of the tendencies that we are seeing in the country. The protectionists haven't dominated yet, but they are there. This is the economic nationalism tendency, the idea that we should manage our trade.

I think we would suffer grievously if, in fact, any of those policies were followed.

I can get into this in the questions. I won't elaborate on the point.

The previous witness made a point about changes in the trade and development policy in Latin America, and I think it is worth emphasizing.

I think we have had a watershed during the 1980s. The old policies of protection–and these typified Latin America–you built industries, you put them behind high walls. If you wanted to get the area of protection a little bigger, then you made agreements among several countries, all of whom could trade this behind those high walls in Latin America.

This development from within philosophy dominated for about 50 years, really from the Great Depression until the 1980s. And the 1980s were tragic in Latin America in terms of growth rates.

The tragedy forced Latin America to take a look at its development policies.

And, consequently, just about without exception, countries are now beginning to look outward, look outward in the sense of reducing their barriers, trying to stimulate competition in their markets and then build export markets. And it's that last point that I want to stress.

You are absolutely right. The countries are moving at different speeds and have different paths. I can get into which countries I think are doing what.

Let me make the broader point first, that the new policies can succeed only if the United States keeps its market open. This is particularly important to Mexico because Mexico sends 60 to 70 percent of its exports to the United States. If you look just at manufactured goods, about 85 percent of Mexico's exports come to the United States.

Central America has a high proportion of shipments to the United States. The proportion gets a lot lower as you get down into Brazil and the southern cone of Latin America.

But the position the Latin American countries have taken is that they now want to compete in world markets. They want the stimulus to their economy to come not just from the inside but from the outside. And that stimulus will come only if they can export, and they can only export if we permit them to by keeping our market open. If we don't, they will have problems and won't succeed in what they are trying to accomplish.

You asked earlier, what is at stake for the United States. Let me give some numbers that are in my prepared statement.

In the 1970s, when Latin America had fairly high growth rates, our exports to the region increased five times. These were high rates of growth.

During the 1980s, when the Latin economies did badly, our exports, after you take away inflation, didn't grow at all. They were the same as they were before.

In other words, the critical aspect in our exports to Latin America, I submit, is not only trade barriers, but it is their growth rates. That's the critical element. If their growth rates are high, they will buy from us. If they are low, they can't afford to buy from us.

And they buy from us. Mr. Malpass made this point. Mexico takes 60 or 70 percent of its products from us. When they sell to us, most of it comes back to us again in what they buy from us.

That's not true in Asia. It's not true in Europe. This is another one of the advantages we have in our hemisphere. This is our hemisphere. We have certain natural markets and certain links that have been built up over the years.

In my statement, I make the point that U.S. exports to all of Latin America in 1990 were $54 billion. They went up again beyond that in 1991.

Had the Latin growth rates of the 1970s prevailed in the 1980s, the figure would have been God knows how many times bigger.

It's not fair, though, to take the same figures, only because a lot of those imports were stimulated by debt, and that couldn't have been continued. But if our exports had only been double what they were in 1990—$100 billion instead of $50 billion—that would have, I think, changed all of the agonizing we're going through in the United States today, that you are going through in the Congress, about our poor trade performance. It wouldn't be there.

Our trade would have shown fairly good performance.

As it was, in fact, during the 1980s, the one place where our exports fell off was to Latin America. It grew by about half the rate in the 1980s than it grew to the rest of the world.

I guess what I am concerned about is that we not convert a Latin American tragedy of the 1980s into a U.S. debacle of a protectionist trade policy.

We have already seen what happened in Mexico when they started to grow again, as well as liberalize. After Mexico started to grow again in about 1986, at roughly 4-plus-percent a year, our exports since 1986 have more than doubled.

And if you want to talk about creation of jobs, if you look at the exact numbers, I think you can trace 400,000 to 500,000 U.S. jobs to the increased exports to Mexico. If Mexico keeps growing, our exports will grow.

Each Mexican today buys about $350 from us. It's a poor country. Each Canadian buys $3,200 from us. It's a rich country.

I guess I'm saying that if your choice is between a richer neighbor and a poorer neighbor, I don't think there is any disagreement. As Fannie Brice once said, or somebody, rich is better. And it's better for us as well as being better for them.

One or two comments and then I will quit and leave time for the other panelists.

I believe that hemispheric free trade is a good idea, but it is a process. It is not going to happen tomorrow.

Chile has already made known that it wants to be part of North American free trade. And I see no reason not to go ahead with Chile. I would finish the process first with Mexico so as not to muddy the waters too much. Chile is then ready to go.

The countries behind that are Venezuela and Colombia. They are not quite ready yet, they may be in four or five years. The others may be further away.

My own view is that except for Chile, we shouldn't take them one by one. I think that would be a horrible, horrible morass, negotiating country by country by country.

I think we ought to insist that Latin American countries get together first in their own regional arrangements with low barriers to the outside. A 20-percent tariff won't work. It must be a lot lower than that.

And then if NAFTA is in place, the other groupings can come to us and we will negotiate as NAFTA, not as the United States.

The reason I say this, the idea of having what the Canadians call hub and spoke–the United States being the hub that has free trade with everybody and everybody else being a spoke–will break down.

I say with the exception of Chile, because Chile is so far ahead of the rest that it really has no way of joining the MERCOSUR group or the Andean group at the moment. Maybe in a few years it can, but at the moment that is not the case.

Let me make one comment and then I will quit. You asked the question several times, "What would happen if the Congress turned down the North American Free Trade Agreement?"

I think it would be a terrible, terrible missed opportunity in political terms. Because here is a country that has held out a hand in friendship and anybody who knows much of U.S.-Mexican history knows this is really quite a radical change, saying, "Let's cooperate with the United States" instead of bashing them." And the United States responds by saying, "No, let's not cooperate, let's bash."

What I think is that in economic terms, we would lose the chance for a growing market in Mexico. Not lose it, but out trade would suffer because Mexico would have to then begin to consider its options.

I don't know what Mexico's options are. The status quo ante is not an option anymore. But some changes in policy are options. Some deliberate shifting away from the United States would be an option. Some souring of relations would undoubtedly occur, and that would come across in business relationships.

I think the economic consequences to the United States would be quite severe, and for the rest of Latin America, as Mr. Malpass said, I think it would be a signal that we really don't give a damn about you. And I think this would be tragic.

Now, one final comment on jobs. I won't get into sectors until the question period. I can, if you wish, because we have now done studies of just about every single sector.

There has not been a single quantitative study of which I am aware, made by a Mexican or Canadian or an American, by a qualified economist, that shows anything but job gain for the United States from the NAFTA. Not a one. All of those that show job loss are impressionistic studies. They are not quantitative studies.

Thank you.

[The prepared statement of Mr. Weintraub follows:]

PREPARED STATEMENT OF WEINTRAUB

Even as the United States is engaged in two major endeavors to liberalize trade--the Uruguay round of the General Agreement on Tariffs and Trade and the North American free-trade negotiations.--the future direction of trade policy is uncertain. Three tendencies, I believe, are vying for dominance. These are, first, to look inward, a form of economic nationalism; second, to manage our trade, an attempt to determine outcomes in advance rather than compete for markets; and, third, to seek further market opening on a reciprocal basis. The GATT negotiations represent the third option. So do the negotiations for free trade among the three countries in North America. So that you know where I am coming from, I favor the third option.

Future trade relations in the Western Hemisphere depend on the policy choice that is made in this country. I stress the U.S. choice because the Latin American and Caribbean countries (the LAC countries) have made their preference known, but their preferred option can be carried out only with the cooperation of the United States. Trade philosophy in the LAC countries is going through a transformation. I don't want to overstate, but I am convinced that the LAC countries are in a watershed period that will point the direction of their trade and development policy for years to come.

Starting as early as the Great Depression of the 1930s, and then intensifying during the decades following World War II, the LAC countries looked inward for the stimulus for their economic development. The policy of practically all the countries of the region was to establish national industries behind high trade barriers. This approach had its merits in establishing an industrial base, but it also fostered noncompetitive industries and contributed to the economic debacle of the LAC countries during the 1980s. This approach of looking inward as the engine of growth, and neglecting the potential of outside markets, dominated development policy in the LAC region for more than half a century. Once in place, fundamental approaches to trade and development policy are durable--the old policy was durable and so too can the new policy be durable.

The current LAC policy is to look outward, to exports, as an important engine of recovery and growth. The approach now being followed is to stimulate competition, both inside the LAC countries by reducing import barriers, and in their search for external markets. And the foreign market to which most LAC countries must look is predominantly the United States. They have a good chance of succeeding in their new development strategy if our market remains open. They cannot succeed if our policy is either of the first two options--if we look inward just as they have decided to look outward, or if we seek to constrain the region's exports through some form of management of trade balances.

There is much is at stake for the United States in the success of the LAC countries. This is our hemisphere. We are the major exporter to the LAC countries. During the 1970s, when the gross domestic product, the GDP, of the LAC countries grew at an average annual rate of 4.5 percent, our exports to them over the decade increased by 400 percent. By contrast, during the 1980s, when the LAC economies stagnated, U.S. exports to them rose by only 50 percent. After correcting for inflation, this means that real U.S. exports to the LAC countries did not grow during the 1980s. U.S. exports to all destinations during the 1980s increased by 7 percent a year and to the LAC countries by only 4 percent a year, that is, by about the same rate as prices increased. The export percentages I have given are calculated from official U.S. data.

The contrast between the two decades has contributed to the trade policy uncertainty that exists today in the United States. Actual U.S. exports to the LAC countries in 1990 were $54 billion. They would have been many times greater had they grown during the 1980s at a rate comparable to that of the 1970s. Even had they been only double the $54 billion figure in 1990, our total trade picture would look radically different today. Had U.S. exports to the LAC countries flourished during the past decade, the despair that now prevails about U.S. export competitiveness would not exist. One price we are paying for the tragic decade of the LAC countries during the 1980s is questioning our fundamental interest in an open, global trading system. We may end up transforming an LAC tragedy into a U.S. debacle.

It is worth contrasting U.S. export performance in the Western Hemisphere, which is the natural U.S. market, with Japanese experience in its hemisphere. The high Asian economic growth of the 1970s continued into the 1980s. So too did Japanese exports to its natural market region. It is much better to have rich hemispheric neighbors than poor ones.

I do not think that the United States has fully learned this lesson as yet, as witness the opposition to free trade with Mexico. As the Mexican economy has recovered since 1986, so too have U.S. exports to Mexico. U.S. exports to Mexico in 1986 had dropped to the low level of $12 billion. In 1990, they had recovered to $28 billion. They exceeded $31 billion in 1991. This increase in exports over five years of Mexican recovery contributed to the creation of some 400,000 U.S. jobs. Of the two competing positions--poor neighbors and low competition from them in the United States, or rich neighbors who both compete vigorously but also are able to afford growing imports--the latter is a far more exciting prospect for the U.S. economy. This evident from our trade with Canada, a high-income country, to which U.S. exports in 1990 were $84 billion. For each Canadian, U.S. exports in 1990 were $3,200. For each Mexican, U.S. exports in 1990 were only $350. This represents the difference between the market in a rich neighbor and in a poor one.

I give these data as backdrop to the policy positions toward the LAC countries I advocate for the United States. These are, first, that North American free trade, the NAFTA, will benefit the U.S. economy and create high-paying jobs; second, that it is in our national economic interest to support the new development philosophy emerging in the LAC countries because I believe this will stimulate their economic growth; and, third, in the course of the 1990s, we should support movement toward free trade in the hemisphere. Some hemispheric countries are ready to move to free trade today. Mexico and Chile fit this description. Others are only now embarking on the path of an open economy but should be ready to embrace free trade in a few years. Venezuela and Colombia fit this description, and perhaps others will soon. Still other LAC countries are many more years away from the possibility of free trade.

I do not wish to dwell here on the Mexican situation, but a few words are necessary. This is because the outcome of the free trade negotiations with Mexico will provide a signal to the rest of the LAC countries of what they can expect from U.S. policy. Mexico is by far the largest U.S. export market in the LAC countries. Indeed, U.S. exports to Mexico in 1990 exceeded those to the rest of the LAC countries taken together.

Mexico has become a stalking horse for other countries of the hemisphere. It led the way in debt restructuring. The shift in development philosophy in Mexico, from looking inward to joining the world trading system, was quite dramatic. Chile preceded Mexico in this respect, but the Chilean shift took place under a harsh dictatorship. Mexico unilaterally reduced its import barriers. Mexico has shown more courage in dealing with its public sector deficit than we have in the United States. It has sold off many government-owned enterprises, from airlines to banks to steel mills to the telephone company. And perhaps most dramatic of all for persons familiar with Mexican history, it shifted from maintaining a deliberately cool relationship with the United States to seeking cooperation. If free trade with Mexico is rejected, it is hard to see other countries taking such an initiative with us.

Mexico must come first. The rest follows from that. It was unthinkable to students of Mexican affairs as recently as 10 years ago that Mexico would seek free trade. It was equally improbable 10 years ago that the LAC development philosophy would shift as dramatically as it has. The reasons for the LAC change are not hard to find. The main reason was the tragic failure of the old policy during the 1980s. At the same time, the evidence was clear that the Asian countries, which consciously promoted exports, continued to progress economically. Not only were their growth rates higher than in the LAC region, but the distribution of income among their populations was less unequal. South Korea's per capita income was well behind that of LAC countries, including the more developed ones such as Brazil, Mexico, Argentina, Colombia, `and Venezuela, in the period following World War II and certainly after the Korean War. South Korea's per capita income now exceeds those of all these countries. The same is true of the other Asian tigers. Thailand may soon overtake the LAC countries.

It has been eye opening to students of hemispheric affairs how warmly the LAC countries embraced President Bush's Enterprise for the Americas, particularly its idea of free trade from Alaska to Tierra del Fuego. Had this proposal been made 10 years ago, it would have been rejected as just another manifestation of U.S. economic colonialism, as it was when proposed in the last century. It was not dismissed this time. Indeed, the proposal for movement toward hemispheric free trade has been the most warmly received U.S. initiative in the hemisphere since the Alliance for Progress.

Here again, the reason is not hard to find. As LAC countries open their economies, as successful exporting becomes crucial to achieving their fundamental development goals, assurance of access to their main market is needed. A free trade agreement is one way to accomplish this, as Canada decided earlier and Mexico after that. The LAC countries need access to our market to accomplish their development goals. And in turn, growing LAC incomes will foster growing U.S. exports. We learned during the 1980s that we can't have one, growing U.S. exports, without the other, growing incomes in our markets.

My formation in trade policy was in the multilateral arena. I believe there is no substitute for the GATT, or an organization like it that deals with trade issues on a global basis. In a world of regions--Europe, Asia, the Western Hemisphere--we undoubtedly give less than full attention to the multilateral system. The reality, however, is that a world of regions exists. The European Community is in place and expanding. There is a regional emphasis in trade patterns in Asia as well. Almost 30 percent of U.S. exports go to our two neighbors, Canada and Mexico.

This only solution to this inherent conflict between the reality of regionalism and a viable global structure is to fashion regional agreements that have low barriers against nonmember countries. A Fortress Western Hemisphere would be no more in the world's interest, or our interest, than a Fortress Europe or a Fortress Asia. We have too many economic and political interests in all regions. We are also a Pacific and a European nation in our overseas interests. What I urge, therefore, is to reject agreements that do no more than establish protected, preferential groups.

The LAC countries did just that for several decades. In the period following World War II, they set up sub-regional customs unions and free trade areas whose purpose was to widen the scope for protected import substitution. Every one of the earlier LAC regional integration groupings failed. They raised import costs and they contributed little to promoting export competitiveness.

Now the effort in the LAC region is to reconstruct these earlier integration efforts, but this time based on low barriers against outside countries. These have a chance of succeeding. Negotiations for sub-regional free trade areas or customs unions are now taking place in the Southern Cone of South America, among the Andean countries, in Central America, and in the Caribbean. Not all LAC countries have opened their markets as extensively as either Chile or Mexico have--but make no mistake, the effort at economic opening in the LAC region has gone very far. But its consummation requires U.S. cooperation. This is why the President's free trade proposal received such a hearty endorsement from the LAC countries.

Reaching free trade in this hemisphere will not be easy nor need it be a quick process. Most of the countries are not yet ready to make this leap. As we are learning from the Mexican free trade negotiations, even when other countries are ready for free trade with the United States, there are sensitive issues on both sides of the table. We wish to ease the transition for U.S. workers who might suffer. Mexico wishes to ease the transition for its millions of impoverished campesinos.

However, the free trade process has started, both in North America and in the rest of the hemisphere. I do not believe we should contemplate negotiating free trade agreements in the LAC region country by country. This would be a harrowing process. Instead, I believe that each LAC sub-region, when it has completed its own free trade arrangement and is ready to take up President Bush's free trade offer, should come to us as a group of countries. This would permit group-to-group negotiations between NAFTA and the LAC grouping. This, in my judgment, puts first things first. The LAC countries must first encourage their trade with each other. As they put this sub-regional free trade framework into place, there is time enough to enter into free trade negotiations with us.

Chile is an exception to this recommendation. Chile is ready now to negotiate a free trade agreement with the United States. This is not true of other LAC countries, other than Mexico. In addition, Chile does not belong to any of the sub-regional groupings now negotiating economic integration arrangements. This is because Chile moved so much faster than the others to open its market. My belief is that we should be ready to negotiate a free trade agreement with Chile once the NAFTA negotiations are completed. Chile could then become part of NAFTA, although a new name might be needed.

I will summarize my main points.

1. Growth in our exports to LAC countries depends primarily on their healthy economic growth. If this occurs, much of the agonizing now taking place about inadequate U.S. export performance is likely to disappear.
2. The LAC countries cannot reach their growth targets if our market does not remain open to them.
3. Just as we are the main market for most LAC countries, so are we the main supplier of their imports. More than for any other region, what they earn from selling to us comes back to us from what we sell to them.
4. The dramatic change in development philosophy in Latin America, from looking inward to joining the world, has made this a most propitious time for considering free trade arrangements in the hemisphere. Such negotiations are taking place among groups of countries throughout the hemisphere as well as in North America.
5. This move toward import openness should permit free trade agreements and customs union in the hemisphere that are not closed to imports from other countries, as was the case earlier in the LAC region under the import substitution philosophy.
6. If the global trading structure is not to be damaged irreparably, then regional arrangements must not become closed blocs. Trade diversion of imports from nonmember countries is not a healthy scenario because all regions can do this.
7. Finally, with the exception of Chile, the United States should not enter into free trade negotiations in the LAC region country by country, but instead follow a procedure of negotiations between groupings of countries, between NAFTA and those LAC groupings ready to negotiate with it.

REPRESENTATIVE HAMILTON. Thank you very much, Professor Weintraub. Ms. Saborio, please proceed.

STATEMENT OF SYLVIA SABORIO, DIRECTOR, PROGRAM ON INTERNATIONAL TRADE, OVERSEAS DEVELOPMENT COUNCIL; FORMER MINISTER COUNSELOR OF FINANCE, COSTA RICA

Ms. SABORIO. Thank you, Mr. Chairman. It is a pleasure to be here today discussing U.S.-Latin American trade relations in the 1990s.

I would like to speak to three issues, essentially. First, the stakes that both the United States and Latin America have in increased growth and trade in the Hemisphere, and whether or not the best way to attain those objectives is through a series of regional trade arrangements. I will then refer to the incentives that both sides would have to participate in such a Western Hemisphere free-trade area. And finally, I will highlight some of the issues on which progress is needed if the process is to move forward smoothly.

The launching of the EAI in June of 1990 unleashed a revolution of expectations in Latin America. Therein lies the initiative's main success, but therein also lies its main danger.

Both the launching of the initiative and the region's enthusiastic response belie a dramatic shift by both sides regarding the possibility and desirability of closer hemispheric cooperation.

For Latin America, as Mr. Weintraub pointed out, the 1980s were a costly but sobering experience that dispelled many myths about the relative merits of alternative development strategies. The crisis exposed the limits as well as the inconsistencies of the import substitution model, and it also exposed the failings of pervasive but weak and ineffectual state intervention. From it sprang a vigorous and pragmatic reform movement which is market based and export oriented.

But Latin America's debacle was also costly for the United States in terms of jobs and income foregone. Between 1981 and 1983, exports to Latin America declined by 43 percent. Since then they have recovered, but only in 1988 did they recoup their 1980 level.

According to some ODC estimates, had previous trends been maintained, an additional $280 billion in exports would have occurred. Since about 21,000 jobs are created per each additional billion dollars in external sales, this shortfall in exports to Latin America translates into a loss of approximately 600,000 job opportunities per year in the United States.

Thus, both the U.S. and Latin America stand to gain a great deal from rekindling growth and increasing trade in the Hemisphere. The question is then whether the best way to attain that goal is through preferential trade arrangements.

Clearly, both the United States and Latin America have big stakes in the well-being of the GATT and the multi-lateral trading system. The United States, because it is a global trader for whom Latin America represents only a small fraction of its total trade interests worldwide, about 13 percent.

Latin America, likewise, has a stake in the GATT, partly because it also trades with countries outside the hemisphere, but mainly because a strong GATT is the only protection that smaller players have against harassment and abuse by larger trading partners. Indeed, a fair, transparent, predictable and disciplined international trading environment is a must if these countries are to succeed in their export drive.

If both sides have such a strong incentive to preserve the GATT, then why bother with regional arrangements?

The answer lies in two premises. First, that regional arrangements complement rather than compromise the GATT. And second, that trade can be liberalized farther, faster in the context of regional trade arrangements than in the GATT.

For the first premise to hold, as Mr. Malpass mentioned, regional FTAs should comply with Article 24 of the GATT, which requires the elimination of virtually all trade barriers among members, and that barriers against non-FTA members not be raised as the result of the FTA.

The second premise implies that the sub-set of prospective regional partners will be less susceptible to the "convoy problem," either because they are more like-minded than full GATT membership or because they have higher incentives to cooperate.

Now, is this premise likely to hold in the case of a Western Hemisphere Free Trade Area?

The question of like-mindedness would have been preposterous just a few years ago. It is far less so today in light of the amazing convergence of views on a basic package of economic policy matters–the so-called Washington consensus. Still, beneath the surface, there lurk many differences that need to be resolved before an FTA can be hammered out.

Really, the WHFTA is the first attempt to link developed and developing countries in a reciprocal free trade arrangement. Vast differences among prospective members in terms of economic size, stage of development, and mutual importance as trading partners are bound to raise very thorny questions regarding the meaning of reciprocity in the context of such asymmetry.

Such disparities will also affect the distribution of costs and benefits from WHFTA, posing vexing questions regarding, for instance, the use of compensatory mechanisms, both domestic and WHFTA-wide, to deal with the dislocations and possible polarization effects induced by the WHFTA.

This brings us to the incentives.

The United States portrays the idea of a hemispheric free trade area as a matter of enlightened self-interest. Quite apart from geopolitics, the argument is that in an increasingly competitive world and for a country that is increasingly dependent on trade, it makes sense to strengthen ties with its fastest growing export market.

Indeed, opening up the previously highly protected markets of Latin America, provided that these countries have the wherewithal to increase foreign purchases, should translate into a boon for U.S. exports. In addition, a more receptive investment climate and better intellectual property protection, two *sine qua non* conditions for WHFTA membership, should also favor U.S. business interests in the region.

In exchange, of course, the United States would be expected to remove its own trade restrictions and to exercise more discipline in its trade remedies.

On balance, though, the adjustment required of the United States, in relation to both its potential gain and corresponding adjustment burden for Latin America, seems quite low, although it is likely to be highly concentrated in certain sectors.

In fact, Latin America has a great interest in the United States retaining or gaining increased international competitiveness in high-skill, high-wage jobs, because otherwise the countries in the region and in the United States will be engaged in battle over the sharing of low- waged jobs.

For Latin America, the main attraction of a U.S.-centric FTA would be to gain enhanced, assured, predictable and preferential access to the largest market in the world, in the expectation that this would improve allocation efficiency, increase investment—both domestic and foreign—and spur growth.

But, of course, an FTA would not have the same allure for all countries in the region. Those that rely on the United States for a large share of their exports–for instance, Mexico–would have the greatest incentive to secure access to the U.S. market contractually. Since export dependence on the United States is largely a function of proximity, as is shown in Table 1 of my prepared statement, such incentives would tend to diminish as one moves south down the Hemisphere.

Countries whose exports face high or unpredictable barriers in the U.S. market would also have an incentive to join an FTA, provided that the removal of such barriers were part of the agreement.

On the whole, though, access barriers for Latin American exports to the U.S. markets are not very high, especially compared to those faced, for instance, by some of the Asian countries, as you can see in Table 2.

But there are certain sectors where there are high tariffs and nontariff barriers in the United States—apparel and textile, for instance—and the removal of those barriers would be of great interest to Latin America.

Moreover, access to the U.S. market has become increasingly unpredictable in view of the proliferation of antidumping, countervailing, Section 301 and Super 301 cases in recent years. This is a drag not only on trade but also on investment in trade related activities.

Finally, Mexico's entry to the NAFTA creates an additional incentive for other countries in the region to follow suit: to avoid the costs of exclusion in terms of both trade and investment diversion that they would otherwise incur.

Countries that stay out of the FTA face a double jeopardy–in the U.S. market vis-a-vis FTA members and in FTA members' markets vis-a-vis the United States.

The risk of future market closure, coupled with concern that these presumably temporary competitive disadvantages may lead to permanent investment losses, provides a powerful incentive to join the FTA, even though, in fact, the direct first-round impact of eliminating U.S. trade barriers on Latin America's exports appears to be only modest.

Some economists from the World Bank have determined that a step increase of the order of only 8 or 9 percent in Latin America's exports to the United States would occur if tariffs in the U.S. were removed and "hard core" measures were liberalized, and that the increase would only be about 6.6 percent if only tariffs were eliminated.

The bandwagon effect towards regional integration in North America, however, is being derailed, partly by Mexico's understandable resistance to dilute the benefits it expects to gain from NAFTA membership, which depend to some extent on exclusivity. But mostly by lack of U.S. leadership.

Indeed, countries in the region are increasingly frustrated at Washington's lack of a "beyond-NAFTA" agenda, and concerned about the contours of a NAFTA-plus-Mexico-hub structure that is emerging instead. Such a pattern, which makes no economic sense, except for Mexico, is evolving largely by default as countries seek to be where the action is, and Mexico is the closest that they can get to it. Foot-dragging in this regard is clouding the positive expectations created by the EAI and deflating somewhat the momentum for reform in the region.

I conclude with the following observations.

First, it is of the utmost importance that the NAFTA include an accession clause for the sake of good economics as well as good politics. While one may question the wisdom of a piecemeal approach to regional integration, now that it is underway, it would be best if NAFTA were to become the basic nucleus of the hemispheric system of free trade. That would impart consistency to the process and prevent the development of a crazy quilt pattern of minilateral accords that would distort trade and divide rather than unite the hemisphere.

I have some ideas about how the accession clause should be, but in the interest of time, I will skip over that, though we might come back to it in the discussion. It is important, however, to have a clause that contains eligibility conditions and provisions so that essentially countries can self-select rather than have the United States decide in each case who is next in line. Such a clause would also prevent the need to reopen the negotiation of the basic agreement every time a new member joins.

For Latin America, of course, entering into a free trade arrangement with the United States will entail much more than the removal of trade barriers, difficult as that may be. Before goods can move freely from place to place, even in the absence of tariffs and quotas, a certain amount of harmonization of standards must take place. Moreover, the removal of border controls will only be sustainable if countries exercise great discipline in their macroeconomic policies.

And last but not least, the removal of border barriers will exert enormous competitive pressure on domestic industries in Latin America, particularly since opening up to the United States for most of these countries is tantamount to opening up worldwide.

While the purpose of the exercise if, of course, to make industries in Latin America more efficient, the process will be difficult and painful. The question is whether it will be possible for these countries to pull it off without additional support mechanisms that explicitly take into account their lower level of development and the disproportionate share of the adjustment burden that they will have to bear.

Investment will be critical for these countries to be able to benefit from enhanced market access in the United States., Most of them suffer from supply rigidities and bottlenecks, worsened by disinvestment and massive resource transfers in the last decade, which are projected to continue well into the

1990s. Such resource drain will severely constrain their ability to meet competitive challenges.

The "investment pillar" of the EAI is inadequate to meet the investment needs of the region. Thus, it behooves policymakers in Washington and in Latin America to come up with some creative solutions.

Finally, adequate or not, little progress has been made in the implementation of the debt and investment components of the EAI. The pace should be speeded up. This would not only support ongoing reforms, but also signal a U.S. commitment to the process.

Progress in this area would benefit particularly the smaller countries in the region. They badly need this support for they face the greatest burden of adjustment, are likely to bear the brunt of the unintended fallout in terms of trade and investment diversion from Mexico's entry into NAFTA, and they also stand to gain the least at the margin from additional access to the U.S. market. They truly could use a pick-me-up.

Thank you, Mr. Chairman.

[The prepared statement of Ms. Saborio follows:]

PREPARED STATEMENT OF SYLVIA SABORIO, SENIOR FELLOW[1]

Mr. Chairman and members of the committee, it is a pleasure to be here today to discuss US-Latin American trade relations in the 1990s.

The EAI: A New Beginning?

The Enterprise for the Americas Initiative (EAI) is arguably the single most important U.S. foreign policy initiative towards Latin America since the Alliance for Progress. Since its announcement in June 1990, a veritable revolution of expectations has taken place throughout the region. Therein lies the EAI's main success to date. Therein also lies its main danger.

The timing of the EAI was superb. It came at a critical juncture when--after a decade of crisis and decline--Latin America verged on despair that both its plight and its progress towards political and economic reform would be overshadowed by dramatic events in Eastern Europe and the (former) Soviet Union. Furthermore, to its credit, the EAI spoke to issues right at the heart of Latin America's dilemma--debt, investment, trade--and did so in terms broadly consistent with trends already gathering strength in the region.

Both the launching of the EAI and the region's enthusiastic response belie a dramatic shift by both sides regarding the possibility and desirability of closer hemispheric cooperation. For Latin America, the 1980s were a costly but sobering experience that dispelled many myths about the relative merits of alternative development strategies. The crisis exposed both the limits (and inconsistencies) of the import substitution model and the failings of pervasive but weak and ineffectual state intervention. From this realization, plus the example of the far more successful East Asian NICs, sprang a vigorous and pragmatic reform movement which is market-based and export-oriented.

Latin America's debacle of the 1980s was also costly for the United States in terms of jobs and income foregone: between 1981 and 1983 exports to Latin America dropped by 43%. Even though they have increased somewhat since then, only in 1988 did they recoup their 1980 level. Had previous trends been maintained, additional exports of $283.5 billion would have occurred during the decade. Since some 21,700 jobs are created for each additional billion dollars in external sales, this shortfall in exports to Latin America translates into an overall loss of approximately 6 million job opportunities in the U.S. equivalent to 500,000 permanent new jobs per year.[2]

Thus, both the U.S. and Latin America stand to gain a great deal from rekindling growth and increasing trade in the hemisphere. The question is whether the best way to attain that goal is through preferential free trade arrangements in the region.

Whfta: Friend Or Foe To Gatt?

Clearly, both the U.S. and Latin America have a big stake in the well-being of the GATT and the multilateral trading system. The U.S., because it is a global trader for whom trade with Latin America and the Caribbean represents only a small fraction (13.3%) of its trade interests worldwide. Latin American countries do so, partly because they also trade with countries outside the hemisphere, but mainly because a strong GATT is the only protection smaller players have against harassment and abuse by larger trading partners. Indeed, a fair, transparent, predictable and disciplined international trading environment is a must if these countries are to succeed in their export drive.

If both sides have such a strong incentive to preserve and strengthen the GATT, why bother with regional arrangements? The answer lies in two premises: 1) that regional arrangements complement rather than compromise the GATT and 2) that trade can be liberalized farther, faster in the context of regional trade arrangements than in the GATT.

For the first premise to hold, regional FTAs should comply with Article XXIV of the GATT, which requires that virtually all trade barriers among FTA-members be eliminated within a reasonable time-frame, and that barriers against non-members not be raised as a result of the FTA.

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[1] The views of Ms. Saborio do not necessarily represent those of the Overseas Development Council as an organization or of its individual officers or Board, Council, Program Advisory Committee, and staff members.

[2] See, Tucker, Stuart K. "U.S. Exports to Developing Countries: Analysis and Projections", Overseas Development Council, Feb. 1992, mimeo.

These conditions would help to ensure that the FTA will be on balance trade-creating rather than trade-diverting, thereby contributing to global welfare.

The second premise implies that the sub-set of prospective regional partners will be less susceptible to the "convoy problem", either because they are more like-minded (than full GATT membership) or because they have higher incentives to cooperate. Is this premise likely to hold in the context of a Western Hemisphere Free Trade Area (WHFTA)?

Forging A New Partnership

The question of like-mindedness between the U.S. and Latin America would have been preposterous just a few years ago. It is less so today, in light of the amazing convergence of views throughout the region on a basic package of economic policy matters –the so-called "Washington consensus."[3] Still, underneath the surface harmony there lurk a myriad differences that will need to be resolved before an FTA can be hammered out.

After all, the WHFTA is the first attempt to link developed and developing countries in a reciprocal free trade agreement. Vast differences among prospective FTA-members in terms of economic size, stage of development and mutual importance as trade partners are bound to raise thorny questions regarding the meaning of reciprocity in the context of such asymmetry. Such disparities will also affect the distribution of costs and benefits from the WHFTA, posing vexing questions regarding the use of compensatory mechanisms (both domestic and WHFTA-wide) to deal with the dislocations and the possible polarization effects induced by the WHFTA.

Whfta: The Privilege Of Membership

This brings us to the incentives for a WHFTA. The U.S. portrays the idea of a hemispheric free trade area as a matter of enlightened self interest. Quite apart from geo-politics, the argument is that in an increasingly competitive world, and for a country that is increasingly dependent on trade–in recent years over 40% of GDP growth was due to increased exports–it makes sense to strengthen ties with its fastest growing export market. Indeed, opening up the previously highly protected markets of Latin America–provided these countries have the wherewithal to increase foreign purchases–should translate into a boon for U.S. exports. In addition, a more receptive investment climate and better intellectual property protection–two sine qua non conditions for WHFTA membership–should also favor U.S. business interests in the region. In exchange, the U.S. would be expected to remove its own trade restrictions and to exercise more discipline in its trade

remedies. On balance, the adjustment required of the U.S.–in relation both to its potential gains and to the corresponding adjustment burden for Latin America–seems quite low, although it is likely to be highly concentrated in certain sectors and/or regions.

For Latin America, the main attraction of a U.S.-centric FTA would be to gain enhanced, assured, predictable and preferential access to the largest market in the world, in the expectation that this would improve allocative efficiency, increase investment (domestic and foreign) and spur growth. An FTA would not have the same allure for all countries in the region, though.[4] Countries that already rely on the U.S. for a large share of their exports (Mexico being the prime example) would obviously have a strong incentive to secure access to the U.S. market contractually. Since export dependence on the U.S. is largely a function of proximity (see Table 1), such incentives would tend to diminish as one moves South along the hemisphere.

Countries whose exports face high or unpredictable entry barriers in the U.S. market would also have an incentive to join an FTA, provided the removal of such barriers were part of the agreement. On the whole, access barriers for Latin American exports to the U.S. market are not very high (see Table 2). However, there are sectors protected by high tariffs and non-tariff barriers–notably textiles and clothing and certain agricultural products (see Table 3). Moreover, unencumbered access to the U.S. market has become increasingly unpredictable, in view of the

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[3] The term was coined by John Williamson. See Williamson, John (Ed.): Policy Reform in Latin America: How Much has Happened?, Institute for International Economics, Washington, D.C., April 1990.

[4] The same is true for the U.S., of course, with incentives varying largely according to market size. Indeed, the lack of such incentives in the case of the smaller countries in the region may become a stumbling block for the completion of the hemispheric vision.

proliferation of antidumping, countervailing, section 301 and Super 301 cases in recent years (see Table 4). This is a drag not only on trade, but on investment as well.

Finally, Mexico's entry to the NAFTA creates an additional incentive for other countries in the region to follow suit: to avoid the costs of exclusion in terms of trade and investment diversion that they would otherwise incur. Countries that stay out of the FTA face a double jeopardy: competitive disadvantages in the U.S. market vis-a-vis FTA members, as well as in FTA-members' markets vis-a-vis the U.S.[5] The risk of future market closure coupled with concern that these presumably temporary competitive disadvantages may lead to permanent investment losses provide a powerful incentive to join the FTA, even though the direct first round impact of eliminating U.S. trade barriers on Latin America's exports appears to be only modest: a step increase of the order of 8% if tariffs are removed and "hard core" NTBs are liberalized, 6.6% if only tariffs are eliminated.[6]

The bandwagon effect towards regional integration to North America is being derailed, partly by Mexico's understandable resistance to dilute the benefits it expects to gain from NAFTA membership (which depend to some extent on exclusivity), but mostly by lack of U.S. leadership. Indeed, countries in the region are increasingly frustrated at Washington's lack of a post-NAFTA agenda and progressively concerned about the contours of the "NAFTA + Mexico Hub-and-Spoke" that is emerging instead.[7] Such a pattern, which makes no economic sense (except for Mexico), is evolving largely by default as countries seek to be where the action is, and Mexico is the closest they can get to it, for lack of a mechanism of accession to the NAFTA. Footdragging in this regard is clouding the positive expectations initially created by the EAI and deflating somewhat the momentum for economic reform in the region.

Concluding Remarks

1. It is of the utmost importance that the NAFTA include an accession clause, for the sake of good economics as well as good politics. While one may question the wisdom of a piecemeal approach to regional integration, now that it is underway, it would be best if NAFTA were to become the basic nucleus of the hemispheric system of free trade. That would impart consistency to the process and prevent the development of a crazy-quilt pattern of minilateral regional accords that may end up distorting and constraining rather than freeing trade.

The accession clause should consist of three parts. The first would lay out the eligibility criteria for prospective FTA members. The requirements should be those essential to the well-functioning of an FTA, e.g. macroeconomic stability, the removal of gross distortions in the economy, the rationalization of incentives and barriers to trade and the elimination of foreign exchange controls. The second part would contain the core principles, disciplines and procedures by which all FTA members must abide. These two parts would be common to all. Part three would contain the specific provisions of a particular negotiation, e.g. the calendar for complying with commitments under the FTA and the (ideally, timebound) exceptions to the disciplines of the agreement.

Such an accession clause would have several advantages. It would make the accession process fair, objective and transparent, allowing countries that would like to join the FTA to self-select, as opposed to having the U.S. decide in each case who is next in line. It would not reopen the negotiation of the basic agreement every time a new member joins. Congress would only need to concur with the calendar and the exceptions contained in part three. This would greatly reduce the profile and controversy of the process, especially since the amounts of trade involved will be small compared to Mexico's.

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[5] The same is true for non-members outside the region, an issue of great concern to Asia. In fact, a recent study shows that over 90% of the trade diverted as a result of Mexico's entry into NAFTA would affect extra-regional exports. See Erzan, Refik and Alexander Yeats: Free Trade Agreements with the United States: What's in it for Latin America?, World Bank, Working Papers Series 827, January 1992, Box 7.

[6] Erzan & Yeats, Op. cit, Table 8.

[7] Mexico has already signed an FTA with Chile and is negotiating additional ones with the Andean countries, CARICOM, the countries of Central America; Mercosur can not be far behind. In addition, Mexico has signed special trade treaties with extra-regional partners in Europe and the Far East.

2. For Latin America, entering into a free trade arrangement with the United States will entail much more than the mere removal of trade barriers, difficult as that may be. Before goods can move freely from place to place, even in the absence of tariffs and quotas, a certain amount of harmonization of standards must take place. Moreover, the removal of border controls will only be sustainable if countries exercise great discipline in their macroeconomic policies. Last, but not least, the removal of border barriers will exert enormous competitive pressures on domestic industries, particularly since opening up to the U.S. for most of these countries is tantamount to doing so worldwide. While the purpose of the exercise is to make industries more efficient, the process will be difficult and it will be painful. The question is whether it will be possible for these countries to pull it off, without additional support mechanisms that explicitly take into account their lower level of development and the disproportionate share of the adjustment burden they will have to bear.

Investment will be critical for these countries to reap the benefits of enhanced market access. Most of them suffer from supply rigidities and bottlenecks, worsened by a decade of disinvestment and massive resource transfers to the rest of the world. Recent projections indicate that Latin America will continue to effect significant net financial transfers at least until the year 2000.[8] Such resource drain will severely constrain these countries' ability to meet the competitive challenges that they are likely to face. The "investment pillar" of the EAI--a $1.5 billion Multilateral Investment Fund plus sectoral investment loans out of existing IDB resources--is clearly inadequate to meet the investment needs of the region. It thus behooves policy-makers both in Washington and Latin America to come up with creative solutions to this conundrum.

3. Adequate or not, little progress has been made in the implementation of the debt and investment components of the EAI. The pace should be speeded up. This would not only support on-going reforms, but also signal that the U.S. is committed to moving the process along. Progress in this area would benefit particularly the smaller countries in the region. They badly need this support for they face the greatest burden of adjustment, are likely to bear the brunt of the unintended fallout in terms of trade and investment diversion from Mexico's entry into NAFTA and, stand to gain the least, at the margin, from additional access to the U.S. market. They truly could use a pick-me-up.

Thank you, Mr. Chairman, for the opportunity to testify before the committee today.

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[8] See Feinberg, Richard, Eduardo Fernandez-Arias & Frank Sader, Debt Reductions and North-South Resource Transfers to the Year 2000, Overseas Development Council, Washington D.C., Policy Essay No. 3, 1992, Figure 5a.

Table 1

U.S. Latin American Trade Flows

	% of exp. to U.S.	% of exp. within group	% of exp. from U.S. to group
Canada	72.6	73.0	21.1
Mexico	73.1	75.5	7.2
NAFTA		41.4	28.3
ANDEAN	48.3	3.7	1.7
CARICOM	43.9	6.9	0.7
CACM	42.1	15.7	1.0
MERCOSUR	20.0	8.6	1.7
Chile	16.8	N/A	0.4

SOURCE: Direction of Trade Statistics, 1991.

Table 4

U.S. Trade Remedies, 1980-1988

Number of Cases

	Total	Western Hemisphere
Section 301	43	11
Countervailing	338	96
Antidumping	415	54

Source: Bayard, Thomas O. "Latin America in the Context of US Trade Policy Since 1980", Institute for International Economics, Dec. 1991, mimeo.

Profiles of Latin American Countries' Exports to the U.S. Affected by Tariffs and Nontariff Trade Barriers

Exporting Country or group	IMPORTANT TARIFF & NTB AFFECTED Exports ≥ $50,000; import tariffs ≥ 5%; NTBs applied			IMPORTANT TARIFF AFFECTED Exports ≥ $50,000 and import tariffs ≥ 5%			ALL DUTIABLE TRADE Exports > $0 and import tariffs > 0%			ALL 1986 EXPORTS[3]	
	No. of lines[2]	Value ($000)	% of total exports	No. of lines	Value ($000)	% of total exports	No. of lines	Value ($000)	% of total exports	No. of lines	Value ($000)
Argentina	55 (35)	89,610	10.7	83	211,319	25.1	256	479,859	57.0	771	840,810
Bolivia	10 (0)	2,679	2.2	11	2,906	2.4	62	6,302	5.1	140	123,204
Brazil	168 (148)	835,128	12.5	259	2,021,710	30.2	591	3,701,454	55.4	1,927	6,681,211
CACM[3]	7	57,741	2.6	52	196,927	8.7	33	223,459	9.9	81	2,255,792
CARICOM[3]	1	239	0.0	3	3,653	0.1	5	933,760	32.3	79	2,887,260
Chile	36 (6)	11,220	1.4	90	41,616	5.1	452	455,970	55.6	586	818,632
Colombia	76 (70)	195,267	10.4	92	209,913	11.2	236	705,184	37.8	682	1,865,117
Ecuador	13 (3)	4,767	0.3	18	7,466	0.5	109	581,947	39.6	300	1,466,776
Mexico	214 (191)	1,447,020	8.5	345	3,629,835	21.3	787	11,766,950	68.9	2,350	17,071,611
Paraguay	3 (1)	4,718	15.5	7	8,541	28.1	38	9,213	30.3	61	30,390
Peru	53 (52)	41,127	5.4	55	41,861	5.5	217	328,613	43.4	590	757,806
Uruguay	44 (20)	56,888	12.0	54	68,008	14.3	120	76,028	16.1	249	472,509
Venezuela	22 (11)	34,050	0.7	32	44,047	0.9	178	4,232,090	85.0	654	4,978,021
ALL ABOVE COUNTRIES	694 (537)	2,722,474	6.8	1,046	6,287,222	15.6	3,046	22,343,610	55.5	8,310	40,249,139
Excluding Mexico	480 (346)	1,275,454	5.5	701	2,657,387	11.4	2,259	10,576,660	45.6	5,960	23,177,528
Memo item:											
Korea, Rep. of	512 (279)	6,985,160	55.1	814	7,225,100	57.0	2,044	11,684,970	92.1	2,331	12,681,860
Hong Kong	608 (264)	4,990,221	56.4	764	5,877,398	66.4	2,099	8,273,618	93.5	2,439	8,848,030
Singapore	491 (154)	1,008,119	21.4	510	1,177,200	25.0	860	3,664,222	77.7	1,041	4,712,991

Note: In the above the NTB data pertain to 1990 while the covered trade is computed from 1986 imports.

1/ The U.S. customs schedule distinguishes between some 5,861 individual tariff line products.

2/ Figures in parentheses show the actual number of tariff lines where NTBs directly cover the specific Latin American countries' exports. The other figure shows the number of tariff lines where the country has exports and an NTB occurs. For example, if the Latin American country exported a product where there was a VER (say) against Japan, the tariff line would be included in these totals. These items are said to be "affected" by NTBs in that other exporters often will restrict their trade to prevent the spread of the measure.

3/ No. of lines is the average for the number of countries in the group.

Source: Erzan, Refik and Alexander Yeats. "Free Trade Agreements with the United States: What's in it for Latin America," in Saborio, Sylvia (ed.) US-Latin American Trade Relations in the 1990s, Overseas Development Council, forthcoming

Table 3

The Share of Latin-American Exports Subject to "Hard Core" and Other Forms of United States Nontariff Barriers: Statistics by Major Product Groups

	Share of Exports Covered by NTBs - Hard Core Coverage Ratios in Parentheses[1]							
					Manufactured Goods			
Exporter	Food and Feeds	Agricultural Materials	Coal and Petroleum	Ores and Metals	All Items	Textiles and Clothing	Nonelectric Machinery	All Items
Argentina	24(11)	12	99		12	55[2]	39	29(4)
Bolivia	32(32)		100					4(2)
Brazil	25(5)		99	2	24(13)[3]	81(81)	38	26(9)
CACM	2	3			8(6)	38(38)		16(7)
CARICOM	38(22)	2	100		9(6)	40(39)		22(8)
Chile	64		1	3				24
Colombia	3(3)	100	95		26(26)	82	6	39(5)
Ecuador	1(1)	4	100				2	40(1)
Mexico	43(1)	8(2)	98	11	13(7)	91(88)	7	34(4)
Paraguay	18(18)							14(4)
Peru	10(10)	28(5)	100		36(36)	95(94)		34(9)
Uruguay	13(13)				27(26)	39(37)	9	7(7)
Venezuela	7		96	24	17(16)		49	85(1)
All countries listed above	26(3)	32	97	7	16(9)	81(77)	14	39(5)

1/ See the notes to Table 4 for the SITC numbers corresponding to each of the product groups listed below.
2/ Fifty-five percent of Argentina's textile and clothing exports to the U.S. are subject to anti-dumping duties.
3/ Two percent of Brazil's exports of electrical machinery face (non-hard core) NTBs.

Note. Hard core NTBs consist of quantitative restrictions (QRs) and flexible import fees (i.e. the counterpart of EC's variable levies). QRs which were effective include the following: Quotas, Global Quotas, Quota by Country, VER, MFA Quota Agreement, Textile Restraint Agreement and Prohibitions.

Source: Erzan, Refik and Alexander Yeats "Free Trade Agreements with the United States: What's in it for Latin America," in Saborio, Sylvia (ed.) US-Latin American Trade Relations in the 1990s. Overseas Development Council, forthcoming.

REPRESENTATIVE HAMILTON. Thank you, Ms. Saborio.

We will turn to Mr. Dornbusch.

STATEMENT OF RUDIGER DORNBUSCH, PROFESSOR OF ECONOMICS, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

MR. DORNBUSCH. Thank you, Mr. Chairman.

I would like to argue that free trade with Mexico and beyond with Latin America should be a focus of U.S. trade policy for three reasons.

One, it is good to have extra markets, that that will inevitably create more jobs and good jobs.

Second, from a national security point of view, it is important to sustain the modernization of Latin America. With the end of the Cold War, we certainly have not won the war on instability and poverty in Latin America.

And lastly, with the new agenda, and one that is certainly appropriate, of social standards and environmental standards, we would be far better off in our discussions with Latin America if we engaged them in a process of opening and modernization than if we let them try and find their own way.

Why Latin America?

The first argument is that it is a very large market in which the United States has exceptionally privileged access, but that market still continues to be extremely protected, so the lowering of barriers would be in our interest differentially because we are very open and they are still very closed, so we stand to gain.

And second, in the swing of the pendulum, this is a very good time to advance the proposition because modernization now is fashionable, but of course will not remain so unless the movement actually has progress to show.

How should we proceed in our negotiations?

The first step ought to be an unrestricted, wide agreement with Mexico without exceptions. Wherever there are sensitive issues, a long phase-in period ought to be the means, but not exceptions.

And that should have a most-favored-nation clause for the region so that countries can adhere without amendment but with adjustment periods for them as they come on.

Lastly, and differing with earlier statements, I do not believe that the United States ought to encourage Chile with the prospect of an early special treatment. Chile is boycotting the MERCOSUR on the argument that they are way ahead and therefore eligible for special treatment. But they are shunning free trade with Argentina and Brazil. They are not making their contribution to freer trade in the region.

If Chile is totally open, we really don't have a special interest in them, and we certainly should not encourage the destabilization of the free trade movement that Chile is practicing in Latin America.

When we ask, are countries ready or not for free trade, that is really a very, very silly question.

We trade with totally unstable economies. We have traded with Italy in the middle of chaos and with Spain under an unstable democracy. And we have traded with France at 50 percent inflation.

What we are interested in is lots of trade that gives us good jobs and a good influence of an open trading environment on how a country evolves and adjusts. Countries that are less "ready" are probably the better targets for us to bring into the process, saying, "Start modernizing because free trade is coming."

It is obvious in Mexico, where the prospect of free trade is now forcing agricultural reforms that are a major and positive change in the economy, and there would have been no natural timetable to initiate those without the coming of a free trade agreement.

Lastly, regional agreements versus GATT. Is there a conflict?

I think the European experience of a wide regional preferential trading arrangement, which created prosperity there and hence a good market for us, is also a precedent for us to use. Under GATT, regional arrangements, if they are pervasive, widespread, are totally allowed, and we should use the European precedent. The European precedent now encompasses the merging of the Common Market and EFTA and accession agreements for Eastern Europe already under way because of the recognition that if Eastern Europe can't join the market, then they will come by foot.

For the United States, too, the recognition that the alternative to trade is immigration should become stronger and stronger, because we are witnessing it as countries like Haiti in Central America fall into destitution and as unstable Brazil adds more and more immigration to the United States.

Lastly, Mr. Chairman, you mentioned sugar and the sugar people. I think that when we look at free trade with Latin America in any industry, we will find winners and losers.

First, I want to give the example of garments and textiles. It was widely believed that free trade would be a disaster for the United States in textiles. But it is clear that it has been a major boon to the textile industry, running a textile surplus with Mexico. Our textiles are very good in quality and are being used in the production of garments in Mexico for Mexicans and for export to the United States.

In the sugar business, if there were free trade, sugar processors would be far more competitive worldwide and would become exporters. Of course, producers of raw sugar would suffer. So we cannot really say that there are whole industries that are winners or losers. But what we can say, what every study has shown, that there is major net job creation, that the jobs that will be created are high-value-added jobs, that the jobs that will be suffering are low-value-added jobs, in many, many cases performed today by immigrants, illegal or otherwise. So, on the job side, and again on the wage side, without question, there are benefits.

And lastly, sugar. We have to think about it because Cuba will arrive on our doorsteps, and while we will not do what West Germany has done for East Germany, we have the choice of doing something which includes sugar, or else face the most massive immigration because of the very small distance.

So, even in that context, we have to think about freer trade as a means of stabilizing the region.

Thank you.

[The prepared statement of Mr. Dornbush follows:]

PREPARED STATEMENT OF RUDIGER DORNBUSCH

SUMMARY

• Free trade with Latin America and the Caribbean is in the national interest. Trade policy should create good jobs rather than focusing primarily on the protection of bad jobs. Free trade with Mexico represents a step in the direction of enlarging US export markets. Because the US is already wide open to world competition, and especially to Mexico, further bilateral trade liberalization cannot have dramatic dislocation effects but will on balance create more and better jobs in the US.

• By fostering confidence in Latin America, an FTA will help mobilize the return of flight capital as has already occurred in the case of Mexico and increase the access of these developing countries to the world capital market. Availability of financing will facilitate the return to growth and to imports. Every extra billion of US exports creates 30,000 jobs in the US. If Latin America moved to a trade deficit of 2 percent of GNP in the mid-90s that means an extra 500,000 jobs in the US.

• Democracy, workers' rights, safety and environmental standards are obvious issues on the political agenda of modern, open economies. A Free Trade Agreement supports modernization in the region and thus nurtures these objectives. It will also help raise wage levels, back to their 1980 level and beyond. By contrast, trade restriction here must mean even more poverty there; and with more poverty there will be fewer rights and the risk of political radicalism, neither of which is in the American interest.

• The Administration should use the negotiations with Mexico to create a model free trade agreement that can serve as the vehicle for accession by other countries in the region. As such, the agreement should be comprehensive and foreshadow a complete opening for trade in goods, services and investment. Transition periods rather than exceptions should deal with sensitive issues. There should be a firm completion date for the phasing out of any transition periods, say 2005.

• Regional integration represents a parallel track strategy to the GATT process. GATT has served us well in the postwar period, especially in the North Atlantic trade relations. It can yield extra benefits in the ambitious targets set in the Uruguay Round liberalization for agriculture, and trade in services and dispute settlement. GATT explicitly recognizes regional free trade agreements as an exception to the MFN rule; Europe has taken advantage of that exception throughout the postwar period and has derived peace and prosperity from that strategy. The United States can only gain from emulating the European precedent.

• The focus on some countries being "ready" for an FTA and others not yet is largely misdirected. The United States trades today with many countries who have not achieved financial stability of significant modernization. There is no plausible reason why we should want to maintain tariffs and quotas on their trade, or should want them to restrict our access to their market just because they have not yet reached an advanced level of stability. The guiding principle should be much more our interest in market access and the real possibility that the prospect of a free trade agreement can help exert important pressure to stabilize.

• The United States needs to prepare a strategy for handling Cuba. It will not take long before the communist regime falls. At that point, just as in the case of East Germany, from one day to the next there will be a need for concrete answers: if the United States does not offer a program of stabilization and open trade, mass migration is bound to be the result. A far reaching trade opening, including sugar, will be necessary to avoid that Cuba suffers the extent of economic decline experienced in Haiti or Nicaragua.

• An Americas' will involve the possibility and even the likelihood of some trade diversion. Trade partners in Europe, Africa and Asia will not enjoy the same preferential access that insiders share. The resulting trade diversion is the down side of regional liberalization. But it hardly can be a reason for not going ahead. Moreover since the United States is already a very open economy, actual trade diversion will be minor. Increased prosperity and stability of the entire region, and increased opening of Latin America creates prosperity and hence opportunities for outside countries that might not otherwise come about.

• Today the United States faces an unusual opportunity to implenent an outward looking trade policy with Latin America. Looking for modernization as the way out of a difficult economic situation, Latin America today is open to far reaching trade reform. If we miss this opportunity, we are bound to fail building an important Western Hemisphere trade and investment block in the 1990s. Turning our back on trade opening means inviting a slowdown if not failure of the reform movement and a resurgence of protectionism throughout Latin America and beyond.

WHY FREE TRADE WITH LATIN AMERICA?

Several important trends in the world make pursuit of an Free Trade Agreements with Latin America an important, productive trade strategy. First, all of Latin America is reforming and modernizing in a way we have not seen since early in this century. The momentum, direction and success of these reforms must be strengthened by a partnership that makes it difficult for Latin American to move back and delivers tangible benefits to offset the immediately visible costs of opening up. Having encouraged the modernization, it would be unwise for the United States to walk away from participation and partnership in the process.

Second, regionalism has been a successful strategy in Europe throughout the postwar period and it is now being driven there at a far more ambitions pace. The merging of EFTA and the EC and the creation of a "European space" are projects that are already off the drawing board and way into realization. The creation of an Asian co-prosperity sphere around Japan is also in the making. Economic modernization demands a wider scope for economic activity and the regional level offers the most concrete setting in which to visualize the benefits and hence find the willingness to make the concessions. These regional developments are not a threat to multilateralism; rather, they are a means to break down barriers on a limited regional scale which create precedents, blueprints and competitive forces that help drive a broader liberalization effort.

Third, Latin America represents a national security issue and as such deserves attention. If freer access to the U.S. market, and less restriction on trade, at least from the United States, can help reduce the economic problems of Latin America then a useful purpose is immediately served. One only needs to contemplate the risks of a Latin America turning in the direction of poverty and destitution experienced in Haiti to recognize that there would be serious risks, certainly in terms of migration, for the rich North. With the spreading of democracy in Latin America, U.S. concerns have focused on deepening democracy and broadening the focus of trade policy to economic and special objectives including in particular labor standards and the environment. Opening and modernization of Latin America through trade and investment links is a certain way to encourage the process and help shape the agenda.[1] Limiting trade opportunities could not oily set back modernization, but it would certainly force lower standards for workers and for the environment.

Fourth, Latin American is our fastest growing market. Of course, free trade with Latin America cannot be a panacea for economic U.S. problems; but even if Latin America is not most of the solution of our problems, it still is an important market and our trade posture has important implications for their prosperity and hence our security. It would be a mistake to write off Latin America as an important partner.

One must also explore a favorable longer run perspective of Latin American markets. Latin America's population is almost twice that of the United States and economic growth in the years to come will be substantial. If Latin America recovers economically, and the United States can certainly invest in that prospect, there is ultimately a very significant market for U.S. exports. A clear demonstration is given by the (unilateral) Mexican trade liberalization in 1988. Within a single year Mexican imports from the United States increased by $6 billion. That represents a larger increase than the entire prospective gain from the U.S.-Canadian free trade agreement.

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[1] On this view see Luis Rubio "Democracy and Economic Reform in Mexico" in Democratic Institutions Vol. 1, 1992.

Table I Comparative Data: 1989

	Population (Mill.)	GDP (Bill $Us)	GDP Per Capita ($US)
U.S.	248.8	5,202.4	20,910
Canada	26.2	498.6	19,031
W. Hemisphere	436.0	837.0	1,918
Brazil	147.3	374.1	2,540
Mexico	84.6	170.0	2,010

Source: World Bank

The Mexican trade liberalization is of interest because it highlights two features. First, LDCs' markets are extraordinarily closed and hence, in a situation of trade liberalization, offer a potential for very major increases in U.S. exports. The second point is that the first round it Mexican liberalization was multilateral and hence, even though it benefited overwhelmingly the United States, also allowed other countries to participate. A free trade agreement with Latin America would yield for the United States a more privileged status, at least for a while until a move toward multilateralism comes about.

It might be argued that the Mexican gains are already in place and that Mexico is one of the larger countries so that there is little left. Of course, there is Brazil which is far larger and offers a very striking opportunity in the perspective of the next 20 years. Brazil does have a strong interest in unimpeded access to the U.S. market and it offers an important market for U.S. exports in return. The current level of trade with Brazil is far below the potential of the country as a market. This point is quite apparent from Table 2. Brazil ought to be opened up.

Table 2 U.S. Trade: 1990

	Exports	Imports
World	393.6	517.0
Canada	83.0	93.8
Japan	48.6	93.1
W. Hemisphere	54.0	67.2
Mexico	28.4	30.8
Brazil	5.1	8.6
Chile	1.7	1.6

Source: IMF

Another argument might be that Mexico was getting ready for an agreement after years or successful reform (much as Chile), but that the same cannot be said of most of the region. The response surely must be that we are interested in export markets and we are interested in regional stability. We are now trading with these countries and nobody can possibly argue that existing trade restrictions, here or there, help make their economies or their societies function better. It can be argued, however, that more intensive trade and investment links will. Hence, particularly for economies where much is to be accomplished--notably Brazil--the perspective of an FTA raise the ante and will enhance and speed up the need for reform. Nobody is thinking of political union or EC-style deep integration for which a very high level of community is essential. What is at stake is the removal of impediments to trade and investment.

TRADE AND EMPLOYMENT EFFECTS

The controversy surrounding the proposed FTA with Mexico, and surely an FTA with all of Latin America, is misplaced. Free trade with Mexico will not bring about "an economic and social disaster for U.S. workers and their communities" as argued by the AFL-CIO.[2] Any job losses are bad news at a time where real wages are depressed and employment at best stagnant. But these issues must not become an argument for stopping a good move in trade policy, which creates good jobs at home.

Even if trade liberalization inevitably causes some dislocation, that must not mesmerize us into maintaining the status quo for poor jobs. It is bad trade policy, to keep workers and their children in poor jobs and even pervert protection to the point where we attract immigrants to perform this work. We should not let go of competition. But, equally important, displaced workers should get adjustment programs, skill building and education to help them get into good jobs. We do not at all do an adequate job in this area. The scope for worker training and adjustment assistance should be enhanced and broadened to include both trade and productivity-caused losses in jobs.

Concerns about the effect of free trade on U.S. jobs focus on the low level of Mexican labor cost. True, Mexican labor costs far less than U.S. labor but that is true with and without free trade. Short of closing our economy we will be unable to escape from the increasing ability of developing countries to produce manufactures at a highly competitive prices. But we can turn to our advantage the situation by gaining access to their markets with our goods. The dramatic effect of opening measures in Mexico on our exports is already amply demonstrated by the experience of the past four years.

Table 3 U.S. Nonoil Trade With Mexico and U.S. Job Creation (Billion $US)

	U.S. Exports	U.S. Nonoil Imports	Net Nonoil Trade Balance
1986	12,391	14,040	-1,649
1990	28,375	25,206	3,169

Net U.S. Job Creation: 1986-90

30 Jobs per $ Million	25 Jobs per $1 Million
144,531	120,450

Note: 30 jobs per $1 million exports is the number used by the Economic Policy Institute.

Several factors support the assertion that an FTA with Mexico cannot bring major harm and is very likely to be beneficial. First, Mexico is very small relative to the United States. Any significant increase in Mexican exports (measured on the U.S. scale) would increase labor requirements and wages in Mexico dramatically and thereby squash competitiveness.

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[2] Thomas R. Donahue, Secretary-Treasurer, AFL-CIO, before the Senate Finance Committee on February 6th, 1991: "The enactment of a free trade agreement with Mexico, as proposed by President Bush, would be an economic and social disaster for U.S. workers and their communities, and do little to help the vast majority of Mexican workers."

Second, although Mexican labor costs are low relative to those in the United States, these labor costs also reflect in many cases a low level of productivity and in some areas such as textiles the very low quality of output. The quality factor especially is a major obstacle to a dramatic development of Mexican exports.

Third, the United States is a very open economy. Competition from abroad is not a threat but a complete reality. Protection continues only in a few sectors, not across the board in all lines of activity. Moreover, Mexico enjoys already a privileged position both as a result of the GSP and more importantly as a consequence of the maquila program which exempts reimports from U.S. duties except for the Mexican value added component. The combination of factors reduces the extra impact of U.S. trade liberalization to a few sectors and to a total effect that have simply no chance of amounting to much in terms or aggregate employment or output. And what goes for Mexico also goes for countries in Latin America.

In the 1980s a vastly overvalued dollar brought about abnormal import competition and hence joblosses and a reduction in real wages in the U.S. labor market. No doubt, some of the competition came from Latin America and hence helps explain the 0.5 to 1 percent decline in real wages attributable to import competition.[3] But the remedy is not closing down, but rather to seek markets and thus create extra opportunities in manufacturing which have a demonstrable positive effect on earnings. With Mexico that has now already happened and more is to come as Mexico prospers in the 1990s; much more is to be gained from access to Brazil and the other protected markets of Latin America. Aggressive pursuit of market access is the only sensible strategy for a country like the United States which is already open and does not wish to close.

NEGOTIATIONS

A useful approach to Latin America would be to target Mexico and the Southern Cone group (Brazil, Argentina, Uruguay) for a free trade area, including if possible Canada. Once the principle is accepted and the outline of an agreement is in place other Latin American countries could join.

The dynamics of concluding an FTA are important because of the trade diversion aspect. It would be a mistake to have a long drawn out process with much uncertainty about who can or cannot join in the end. Trade diversion in the interim and a halt to investment pending clarification could create unnecessary problems for countries who ultimately may be members but are not in the early rounds at the negotiating table. This argument enhances the case for a blueprint negotiation with Mexico and for an early and short window of time during which other countries can adhere. Anything more than a 2 year period would be unnecessarily and unproductively long.

The fast track approach is clearly the right way of proceeding. Negotiations in any other setting are an invitation to cannibalize the agreements with exemptions and loopholes so that what is left in the end may not be worth having, or worse. The Caribbean with its exception of sugar, textiles and more is a case in point. In a setting other than fast track it is virtually foregone conclusion that politicians will have to seek "relief" for their customers and special advantages; they will be judged not by the total result but by the deviation from the norm that they can secure. The result, unfailingly is a worthless agreement.

Even as an FTA with Mexico is being negotiated, it must be made clear that Latin America should practice opening and clearing the trade field of the myriad of obstacles in place today. Countries like Brazil have a lot of work to do in removing the extensive controls on trade and the tariffs. Other countries like Chile or even Argentina are already far ahead. But it would be a mistake to rush in an agreement with say Chile because the country is already open but proceed slowly with a country like Brazil. Chile has boycotted the Mercosur on the grounds that it was in an express lane for an FTA with the United States and that its neighbors were too unstable. The United States should maintain an environment where only good neighbor practice collects rewards.

The focus on some countries being "ready" for an FTA and others not yet is largely misdirected. The United States trades today with many countries who have not achieved financial stability of significant modernization. There is no plausible reason why we should want to maintain

[3] See Brauer,D. "The Effects of Imports on U.S. Manufacturing Wages. Federal Reserve Bank of New York Quarterly Review Spring 1991.

tariffs and quotas on their trade, or should want them to restrict our access to their market just because they have not yet reached an advanced level of stability. The guiding principle should be much more our interest in market access and the real possibility that the prospect of a free trade agreement can help exert important pressure to stabilize.

REGIONAL TRADE ARRANGEMENTS AND GATT

Concerns about pursuing a regional trade liberalization stem to some extent from fears about the dynamics of the world trade game. If the United States were to pursue a bilateral route and set up a preferential trade blocks, would not there be a risk of the formation of other, competing blocks? And if that were to happen, could one be certain that there would not be a 1930s style decline in world trade?

The opposition to plurilateral approaches is thus more than anything a reaction to the untried. But it also seems that the principle of bilateralism is far more offensive and readily challenged than any particular implementation, and more so when it is suggested for the case of the United States than anywhere else. The principle of multlateralism and the liberal trading system are so sacred because the United States sees itself as the custodian of a policy tradition that it helped create in the 1930s. The system has served us well and still does, but it certainly does not represent a unique track strategy toward freer trade.

The policy debate in the United States has been until quite recently hostile to regional trade arrangements or bilateralism. The status quo position of those who favor an open trading system is the Gatt-based multilateral approach. Few among the protagonists of the status quo ask of the GATT process where the gains will be and when they come, if at all--negotiations take a decade or more. The beneficial effects of the status quo are taken for granted and the only counterfactual is a world without trade.

Violations of the open trading system by Japan are played down by arguing that Japan is "already" opening up. Bilateralism practiced abroad, as in Europe's postwar experience or the joining of EFTA and the EC, is welcomed, even if the same policy used by the United States is seen as a threat to the system and the process. Any bilateral proposition is presumed subversive and argued to death on grounds of impracticality, political unfeasibility, here or abroad, insignificance of effects or on principle. After free trade with Mexico came on the agenda, the special aspects of the relation were played up to justify the exception. Free trade with all of Latin America is certainly not an accepted strategy.

Regionalism (and even more so, bilateralism) has an unnecessarily bad name. The gains from the multilateral approach in the past have been significant and are not in question; but the pace at which the process delivers extra gains is slowing down and the liberal trading system is eroding. Moreover, trade policy initiatives in Europe and in Asia, are working quite possibly to the detriment of US-located production. In such an environment a search for more effective U.S. trade policy assumes special importance. To reap the real income gains that freer trade can offer the United States must not be blocked by limiting negotiations to a potentially unproductive GATT process.

Moreover, if the system is open in the sense of allowing conditional MFN access, a bilateral initiative can become a vehicle for freer trade on a regional basis. Regional initiatives are a policy option that pushes the world economy toward freer trade, complementing the GATT process where it heads in that direction or filling a vacuum in the quest for freer trade in those areas where GATT has tacitly accepted the status quo or even a slide into protectionism.

Supporters of a multilateral approach--GATT, the Uruguay round, unconditional MFN--argue two points. One is that the approach has served us well in the past. Second, that alternative approaches, including a dual track strategy, implicitly weaken if not outright undermine the multilateral approach. Faced with this choice they would throw their undivided support to the multilateral approach.

Crediting on an exclusive basis the multilateral trading system with reconstruct on of world trade after the breakdown of the 1930s, and with the growth of world trade far higher than world real income, would certainly be overdoing it. The reconstruction of world trade started on a bilateral basis, in Europe a dual track strategy has been followed all along. Japan and many if not most LDCs never opened up in the first place.

In the past thirty years, GATT notwithstanding, Europe has used regional approaches over and over again, from the European Payments Union to the Common Market and EFTA, and to the Europe 92 initiative. Few questions have been raised about the wisdom of that strategy, whether it amounted to deepening the extent of integration or widening the scope to include Greece and Portugal, North Africa and Turkey. Developments in Eastern Europe offer the prospect that this region will soon enjoy a preferred trade status with the Common Market just as all of EFTA already does.

The major regional effort in which Europe is involved removes any conceivable argument that a U.S. free trade block policy would undermine an otherwise intact multilateral system. The Europe 92 project so clearly foreshadows trade discrimination that the EFTA partners are scrambling to get inside the deal for fear of being left out in the cold. A U.S. policy of building a trade block is certainly not the first or even a decisive trespass on a system of more open trade. On the contrary, it is giving energetic support to the idea of trade liberalization. In fact, it is the best idea in free trade thinking for a long time.

If there is any threat to the multilateral, open system it is posed by the continuing closedness of the Japanese market, not by the pursuit or freer trade on the part of the United States.

REPRESENTATIVE HAMILTON. Thank you all.

The first question I have for you is what did you hear from Mr. Malpass that concerned you? Did you agree with everything he said? Disagree? Where did you disagree?

MR. WEINTRAUB. He didn't answer some of your questions directly. I guess he wasn't in a position to do so.

I would have turned the sugar question back to you. I also think our sugar policy has been a travesty.

REPRESENTATIVE HAMILTON. We have a rule around here, though. We ask the questions.

MR. WEINTRAUB. Well, I was going to answer that.

I agree with what Rudy Dornbusch said. There are some winners now in our sugar policy, but there are a good many losers. And our policy affects so many other products that use sugar, and we get ourselves into all kinds of contortions to deal with the chocolate industry, the growth of cornstarches. It's endless.

In other words, I would agree, I would like no exceptions to free trade. There will be exceptions only because the political process brings exceptions about. I hope they can be minimized.

REPRESENTATIVE HAMILTON. Are you as optimistic as Mr. Malpass was, generally, about the economic future of Latin America?

MR. WEINTRAUB. Yes, I am. I am optimistic.

REPRESENTATIVE HAMILTON. Are all of you optimistic about it? Quite optimistic. All of you think the direction to go is free trade.

MR. DORNBUSCH. Certainly.

REPRESENTATIVE HAMILTON. And how quickly?

MR. DORNBUSCH. Fast.

REPRESENTATIVE HAMILTON. As fast as you can?

MR. DORNBUSCH. Even faster.

[Laughter.]

MR. WEINTRAUB. There is absolutely no reason not to have the agreements at this time, and then do the phasing in over ten years. Common market——

REPRESENTATIVE HAMILTON. You emphasized, as you should, of course, here, the advantages to the United States. Are there advantages to the countries of Latin America, too? Do you see advantages from their standpoint to free trade?

MR. WEINTRAUB. They won't ask for it if they don't see an advantage for it.

REPRESENTATIVE HAMILTON. And they are asking for it?

MS. SABORIO. Yes.

MR. WEINTRAUB. Chile is asking and the others say they want to move in that direction.

MS. SABORIO. I think that there is a great deal of concern about the process issue, that a process be set up so that they can move to bat when they feel that they have done the internal adjustments that would enable them to do so.

But because there is such a heterogeneity in the region and because the United States does not have the same economic interest in different countries, especially the smaller countries want to make sure that they have a chance of joining the process, even though there will probably never be a groundswell of support here for them to do so.

REPRESENTATIVE HAMILTON. You heard Mr. Malpass talk about our objectives—free trade and all the rest of it. It is a little mushy, isn't it? I mean, how much of a priority is it for the Administration to get the free trade in Latin America?

I'm sitting here in the United States Congress. I don't have any sense that they are pushing hard on free trade in Latin America. I usually have some sense of priorities of the Administration. How big a priority?

MR. WEINTRAUB. Let me answer that. Maybe I can answer and run, or something like that.

I don't think they put a big priority on it either. I agree with what Ms. Saborio said.

However, I think the process should be as fast as the Latin Americans are willing to go. And, therefore, when countries are willing to act, I would put a good deal of priority on it.

But I wouldn't put so much priority on it that I would push countries and say that you must do it or else.

In other words, I would let the pace be determined by the readiness of the Latin American countries to enter into a process.

REPRESENTATIVE HAMILTON. What is a reasonable timetable for free trade?

MR. WEINTRAUB. Mexico?

REPRESENTATIVE HAMILTON. Mr. Malpass was very reluctant to commit himself to any kind of a timetable. What's a reasonable timetable?

MR. WEINTRAUB. Let me answer. Then, if I may, leave.

Mexico, this year, next year, whenever you get to it, whenever the Administration gets to it. I think Chile ought to come right after that. We obviously have some disagreement.

And then for the rest, I would assume they would proceed over about a decade.

REPRESENTATIVE HAMILTON. About a decade?

Before you leave, the Enterprise for Americas Initiative. What do you think of it?

MR. WEINTRAUB. I think it was a good initiative. I don't think it was fully thought through at the beginning. I think they have added to it.

It was good in the sense that the area that most pleased me was the trade area. As you know, there is some debt reduction and some investment arrangements in there which are important, but——

REPRESENTATIVE HAMILTON. Have we made any progress on those?

MR. WEINTRAUB. Yes, we have. We have forgiven some debt in a few places. There have been some investment sector loans from the Inter-American Development Bank. That is the technique that we are using over there.

But the reception in Latin America, I think, was far more enthusiastic than any American sitting up here would have guessed. They suddenly decided the

United States was speaking a language that was meaningful to them, the language of development rather than of the Cold War.

I have been knocking around Latin America for 30, 40 years now, and other than the Alliance for Progress, I really don't remember a reception as warm as this one.

Now, expectations may be too high, but nevertheless, there it is.

REPRESENTATIVE HAMILTON. Thank you very much, Mr. Weintraub. We appreciate your coming today very much and you are certainly excused. We understand that.

Let me direct the same questions to the other two witnesses.

Mr. Weintraub said a decade. Is that a reasonable target for free trade?

MS. SABORIO. I guess it depends a little bit on what you mean by free trade. I would find it very difficult to imagine the total elimination of all barriers on all sectors in ten years.

REPRESENTATIVE HAMILTON. It's a worthy target. It's a reasonable kind of a target—ten years.

MS. SABORIO. It is.

MR. DORNBUSCH. I said in my statement that 2005 would be a good year. The European Common Market took ten years to phase out tariffs and quotas. Absolutely no merit in the eleventh year. So why not just set a deadline and be done by that time?

REPRESENTATIVE HAMILTON. Why is the Administration reluctant to set a deadline?

MR. DORNBUSCH. I take it they are in the middle of the negotiation and will use the deadline as one of the chips. So poor Mr. Malpass couldn't really give you an answer to that question.

But it would be deplorable if they said 20.

REPRESENTATIVE HAMILTON. I'd like to get your general reaction to the Enterprise for the Americas Initiative, too. Are you as upbeat about it as Mr. Weintraub is?

MS. SABORIO. I think it did wonders to change the dynamics and atmospherics in U.S.-Latin American relations. It came at a very critical time for Latin Americans when, after a decade of decline and despair, they were concerned about being overshadowed by events taking place in Eastern Europe and in the former Soviet Union, just as they were getting serious about their economic reform.

And it also was cast in a language that Latin Americans thought was appropriate because it addressed the issues at the heart of their dilemma.

REPRESENTATIVE HAMILTON. You said not much progress with regard to implementation of debt and investment components.

MS. SABORIO. That's right. The legislation has not been approved. Only the PL480 component of the debt reduction package was approved in the Farm Bill of 1990. The multilateral investment fund has, in fact, been created, but it is not operational until such time as the Congress appropriates the U.S. contribution.

REPRESENTATIVE HAMILTON. What do you think, Mr. Dornbusch, about the Enterprise?

MR. DORNBUSCH. I don't think it is a particularly interesting initiative other than to give Latin America the sense that they weren't left out of negotiations under way with Mexico.

It is not sufficiently energetic in pressing the free trade agenda with a country like Brazil, where we have an overriding interest in getting in, where it has taken an age to get, even in the area of computers, a little bit of progress.

So it isn't ambitious enough.

REPRESENTATIVE HAMILTON. It is not ambitious?

MR. DORNBUSCH. No, certainly not. And the wholesale offer——

REPRESENTATIVE HAMILTON. What do you mean, not ambitious enough?

MR. DORNBUSCH. Can I just add. The wholesale offer of debt relief is totally unwarranted. Brazil does not need debt relief. They need serious government.

It isn't ambitious enough because it really tells countries, "Come one day and we will talk about a framework agreement," which is an agreement to talk every year.

We ought to say that modernization is the source for growth and not aid, and that countries like Mexico, like Chile, have done well with it. Why don't you come with a proposal?

REPRESENTATIVE HAMILTON. What do you think of the framework agreements?

MR. DORNBUSCH. The framework agreements are a good institution to introduce the discussion of trade obstacles that used to be taken as a normal part of the landscape, and are now coming under scrutiny and attack.

That is a good process to start.

REPRESENTATIVE HAMILTON. Can you point to specific results that have come out of the framework agreements?

MR. DORNBUSCH. I would think that in Argentina the negotiation of the most liberal investment agreement that we have with any country is immediately a by-product.

Of course, the Argentines would be happy to do a lot more. They also want a free-trade access to the United States, and would be happy to negotiate it tomorrow morning. They are happy to accede unconditionally to what we do with Mexico.

I think we ought to be aware that there are more countries than Chile ready and willing and, from our point of view, interesting. Argentina, certainly.

REPRESENTATIVE HAMILTON. From the standpoint of U.S. policy, are there risks to moving ahead with a free trade agreement in the Western Hemisphere, with respect to Europe, Japan and diversion of trade?

MS. SABORIO. I think that would be the main systemic concern that the United States should be worried about. In fact, the quality of the agreement itself should prevent that kind of fallout. To the extent that it is based on good economics, that it doesn't openly discriminate in terms of trade or investment against nonregional partners, the systemic risk and the negative externalities of this agreement would diminish.

MR. DORNBUSCH. I would say that 90 percent of the trade that emerges as a result is trade that didn't take place with anyone before because the economies were very closed.

Second, all models of trade have this gravity factor. You trade most with the people closest. And that means the natural trading partner for Latin America is the United States.

Between the two, the trade diversion issue is really not a substantial point, certainly not anything that warrants not harvesting all the gains from the extra trade that are there.

We would have to undo the European Common Market if we really thought that we had a serious problem here.

REPRESENTATIVE HAMILTON. There has been a lot of emphasis in our discussion, particularly on Mexico with Mr. Malpass.

Mexico is a special case now, aren't they? I mean, the country has shown financial discipline. Other countries not so much financial discipline. You mentioned Brazil a moment ago, didn't you, where their real problem was government, I think you said.

MR. DORNBUSCH. Yes.

REPRESENTATIVE HAMILTON. Does it make sense to be talking about free trade agreements with a government that is not disciplined?

MR. DORNBUSCH. General Motors sells most of its cars to people who aren't financially disciplined. If they took the view that they will only sell to people who are upper income and stable, it would be very bad for business.

REPRESENTATIVE HAMILTON. We might not sell to ourselves, mightn't we?

MR. DORNBUSCH. We might exclude us.

Beyond that, I do believe that the Mexican example shows very clearly that the prospect of a free trade agreement imposes enormous discipline on the reforms at home, makes the impossible suddenly necessary.

REPRESENTATIVE HAMILTON. So it becomes very beneficial, in terms of providing an incentive to these countries, to get their own fiscal house straightened up, right?

MR. DORNBUSCH. It strengthens the hands of the people who say normality should now start because soon we will have to compete internationally, and we cannot do that.

REPRESENTATIVE HAMILTON. All of you are very enthusiastic about free trade agreement. You point out some benefits of it. What is the downside to these agreements? Who is going to be hurt?

MR. DORNBUSCH. In the United States, there will be sectors where people will lose their jobs as a result of free trade. Certainly in the garment industry. There will be problems because garments are labor intensive. We will send the textiles to Mexico, and they will produce garments there, and the same would be true with the Caribbean or Central America.

The same will be true in the cheap glassware industry. There would be problems. In particular, agricultural commodities.

But for every one of them, there is, of course, the other half.

Expensive glassware, we will have fantastic exports. In textiles, we are having them. In agriculture, the entire Mexican agricultural reform is to prepare for the fact that American agriculture is arriving on an extraordinary scale.

So we will, without question, have job losses, but——

REPRESENTATIVE HAMILTON. The net will be a plus.

MR. DORNBUSCH. The net is a large plus, yes.

REPRESENTATIVE HAMILTON. Jobs.

MR. DORNBUSCH. Yes, for jobs. In my statement, I say we have had 150,000 net extra in the last five years just from Mexico.

I would like to add that a lot of the emphasis on job losses is really a reflection of the extraordinary high rate of productivity growth in manufacturing in America in the 1980s, and not of import competition.

The studies that have been done say yes, import competition has cost some jobs, but trade opening net has gained them.

But very, very little of the fall in wages that has occurred can be traced to import competition. Half a percent.

REPRESENTATIVE HAMILTON. Ms. Saborio, how do you answer this question about the impact on sectors of the American economy?

MS. SABORIO. Well, the first, mapping would have to be related to the mapping of protection, because in those sectors where protection is highest today, the greatest costs of adjustment will occur. That would single out sectors such as clothing, some of the agricultural sectors, and steel to some extent.

But I just wanted to point out, if I may, that the adjustment on the Latin American side is probably going to be far more extensive.

REPRESENTATIVE HAMILTON. I wanted to get into that a little bit.

What is the adjustment there? Who is going to be hurt down there? Who is going to win and who is going to lose in Latin America? If you can generalize to that extent.

MS. SABORIO. The same sectors that, in a way, are going to be affected negatively here are going to be the ones that stand to benefit in the case of Latin America.

But new opportunities will open up. Things that are not currently being produced in Latin America will suddenly have a potential that they did not have in the past. So one would have to be looking at potential exports rather than the expansion of current exports because, of course, the latter reflects the structure of protection in both countries. I mean, the import substitution policies that have been followed in Latin America, as well as the barriers of protection in the U.S. market.

REPRESENTATIVE HAMILTON. I've been thinking more about jobs, but what about the question of direct foreign investment by the United States in Latin America? Is that going to jump forward under free trade substantially? Will it?

MS. SABORIO. That is the hope. First of all, the environment for investment is improving very substantially, partly because the general macroeconomic environment in these countries has improved significantly. But also, the attitudes, the receptiveness to foreign investment has changed quite dramatically.

At this point, the fear is that there will not be enough investment forthcoming in order to ready the supply for these countries to be able to take advantage of the enhanced market opportunities.

REPRESENTATIVE HAMILTON. What do you say to the working person, the labor person, in the United States whose obvious main concern is jobs, points out that the Mexican wage level is whatever it is, a fourth, fifth, sixth of what it is here?

Why wouldn't American industry just move on down there, create the jobs there, and not create jobs in the United States?

When they make that argument, they can always point to a plant somewhere in Indiana, or in some state, that has already made the move down there.

What do you say to that person?

MR. DORNBUSCH. I think you have to say that all the evidence we have says that there are more jobs and better paying jobs any time there is an opening of trade. Czechoslovakia is a fantastic opportunity for Germany. The people there earn one dollar an hour; in Germany, $22 an hour. And there is no indication of the German industry packing up and leaving to produce in Czechoslovakia.

Most of them are selling from Germany, and Germany has full employment like never before.

REPRESENTATIVE HAMILTON. But there is a lot of evidence of American corporations going across the border and putting plants up right across the border in Mexico.

MR. DORNBUSCH. And that is good news because——

REPRESENTATIVE HAMILTON. That is good news?

MR. DORNBUSCH. That is good news because components that are extremely labor intensive ought to be produced in low-wage countries so that the total product is more competitive in the home market against foreigners who produce at low cost and sell here, and on the export side.

We cannot produce everything in this country, including the most labor intensive things.

What we have to tell them is that we have done a terrible, terrible job in retraining and adjustment assistance, and that people who lose a job in a low wage industry have a right to the training that will develop the skills they need to get into those jobs about which we are talking. And that they aren't stuck and unemployed and will never make the transit.

That has to be the focus of the attention.

MS. SABORIO. In fact, one of the main benefits of creating this free trade area is precisely to have a larger pool of resources that can be combined in more appropriate ways to gain competitiveness, not just within the free trade area, but in the rest of the world.

REPRESENTATIVE HAMILTON. Mr. Weintraub, I think, was speaking about the hub-and-spoke route to free trade. What does he mean by that? Is that a term of art, an economist's term; what is it?

MS. SABORIO. I think it was a concept developed by Wanacott in Canada, which originally surfaced when Canada was deciding whether or not it was in its best interest to join trilateral negotiations towards the NAFTA, or whether it should sit it out.

The argument actually boils down to the fact that it would not be in the interest in the case of Canada, but the argument can be extended to the Hemisphere not to have a bunch of bilateral agreements to which the United

States—as the hub—would be one of the parties with individual countries, or small groups of countries, at the other end—as spokes. This would concentrate the advantages as an investment site, and also in terms of trade preferences, in the hub country, but would do nothing to increase trade among the countries at the other end, among the spokes.

REPRESENTATIVE HAMILTON. You said something in your statement. I'm looking for it here.

MS. SABORIO. About a Mexico-hub?

REPRESENTATIVE HAMILTON. No, about the accession clause. I want to get into that a minute.

You talk about the three main parts of it, that it has several advantages.

Go into that a little bit. What are the advantages of the accession clause now? You think NAFTA ought to have an accession clause?

MS. SABORIO. I do.

REPRESENTATIVE HAMILTON. You think it will have?

MS. SABORIO. I hope so.

REPRESENTATIVE HAMILTON. You think so.

MS. SABORIO. I think the United States should worry about process, and if it does, then it should insist that the NAFTA have an accession.

REPRESENTATIVE HAMILTON. That's a means of getting other countries into the agreement, right?

MS. SABORIO. That's right.

REPRESENTATIVE HAMILTON. That's basically what it says.

MS. SABORIO. On a conditional basis. Provided that they agree to the principles and the procedures contained in the agreement, there would be no reason to keep them out.

REPRESENTATIVE HAMILTON. Your preference, if I understand it correctly, is for an accession clause rather than the hub and spoke approach. Is that right?

MS. SABORIO. That's right.

REPRESENTATIVE HAMILTON. Do you agree with that, Mr. Dornbusch?

MR. DORNBUSCH. Yes, we will not be able to govern how trade emerges between Argentina and Brazil. If we have a good, wide open free trade agreement, if they join each, then they will have free trade with each other and that's the best we can do for it. And it ought to have an accession clause.

REPRESENTATIVE HAMILTON. I wanted to ask about Brazil, specifically. Is it possible that the United States and Brazil could have a free trade agreement any time soon?

MR. DORNBUSCH. In Brazil, there is very little of an obstacle, because radical change is demanded by the population. Modernization is the only winning strategy.

People are tired of corruption, tired of instability, and they are tired of protection.

So it is a wonderful opportunity to give the government a little bit more for discipline by saying, why don't we do free trade.

REPRESENTATIVE HAMILTON. What does Brazil have to do before the United States would enter into a free trade agreement?

MR. DORNBUSCH. Nothing.

REPRESENTATIVE HAMILTON. It doesn't have to do anything. You think it would be advantageous——

MR. DORNBUSCH. The inflation rate does not make a difference because the exchange rate offsets it. We have trade with countries that have 20 percent inflation per year and we have vigorous trade with countries that have 400. That is just not an issue for a free trade agreement.

REPRESENTATIVE HAMILTON. It does not matter what the economic conditions are.

MR. DORNBUSCH. It does not make the slightest difference. And if they are foolish enough to overvalue their currency, as we did in 1985, then we will have even more exports.

REPRESENTATIVE HAMILTON. Do you agree with that, Ms. Saborio?

MS. SABORIO. Yes and no. While, in principle——

MR. DORNBUSCH. Say yes.

MS. SABORIO.——it might true. I would doubt that countries that do not get their macroeconomic house in order would be able to live by the commitments that they would need to make under a free-trade agreement.

It may well turn out to be that the FTA itself will create the discipline necessary to put that house in order. I would not necessarily say that it has to be a precondition that Brazil come down to zero inflation before it can contemplate a free-trade agreement.

But unless macroeconomic discipline is achieved somehow, it would be very difficult to live up to the FTA.

REPRESENTATIVE HAMILTON. Mr. Dornbusch, do you think we ought to have a free trade agreement with Cuba?

MR. DORNBUSCH. I do think that we should start thinking of how to manage the transition of Cuba after communism falls. It will come at a time that is inconvenient, and we have to have a quick answer because in East Germany we had a million people migrate within a month when the system broke.

In the case of Cuba, we ought to think a little bit about what room we have on the trade side, because I cannot imagine that we would pour in billions of dollars.

Free trade with Cuba, after communism is gone, is the right strategy because that way we avoid a Haiti situation. That country now has below African standards of living, and the only way ahead for people is to get out of there and come here.

REPRESENTATIVE HAMILTON. Do you think we ought to have a free trade agreement with Japan, too?

MR. DORNBUSCH. No. Certainly not.

REPRESENTATIVE HAMILTON. No.

MR. DORNBUSCH. By no means. No. We should have a very, very strong approach to Japan, to say that 800 negotiations in the past have gotten us absolutely nothing.

REPRESENTATIVE HAMILTON. What negotiations?

MR. DORNBUSCH. Eight hundred trade negotiations. It is a scandal that Japan is closed still, even though it is a member of GATT, and we should set a target that by 2000, they should look like all the other industrialized countries, and they should choose how they get there.

But if not, then Europe and us together should have a tariff of 50 percent or so on Japanese goods.

I think Japan is a scandal in the world trade system, and the last thing we should do is abolish our 301 and get nothing on the other side.

REPRESENTATIVE HAMILTON. Should we be tougher than 301?

MR. DORNBUSCH. Certainly. We should say–quiet but tough—by 2000 you look like everybody else, or we have a significant tariff on Japanese goods.

REPRESENTATIVE HAMILTON. Are you suggesting managed trade with Japan?

MR. DORNBUSCH. I would never use a word like that. Neither industrial policy nor managed trade, but we should have trade results, yes. And we have not——

REPRESENTATIVE HAMILTON. What is the difference, if you are talking about——

MR. DORNBUSCH. I think managed trade is what we do now in our negotiations with Japan. We got a little bit opening here, a little bit opening there. We are actually managing them with a discussion that they thoroughly enjoy, because they are feeding us a candy at a time. And we haven't had any significant progress.

Japanese import penetration is 3.5 percent of GNP. Germany, which is a country that exactly looks like Japan in all its characteristics, has 20 percent of GNP.

The Japanese ratio of nonoil imports to GNP has fallen, on average, every year since the 1950s, and the German ratio has gone from the same 11 percent at which they started to 28 percent.

Japan is now 7 percent less than in the 1950s, with all the trade opening that the world has seen. So Japan is a scandal.

REPRESENTATIVE HAMILTON. Haven't we had a number of 301 investigations with Brazil?

MR. DORNBUSCH. Certainly. And we ought to sit on Japan's back until they say they want an opening.

REPRESENTATIVE HAMILTON. And likewise with Brazil.

MR. DORNBUSCH. With Brazil, yes. They will say that there are a few areas where we have concerns, and the natural way, because they are a market economy like ours and very much with our culture of doing business, to say let's have free trade.

REPRESENTATIVE HAMILTON. Is there any risk that a free-trade agreement would exclude in the Hemisphere other countries outside the Hemisphere, would become a fortress America?

MS. SABORIO. I suppose there is a risk, but it is up to the various participants to make sure that it doesn't happen.

REPRESENTATIVE HAMILTON. When Mr. Malpass says that he sees this effort as complementary to GATT, you agree with that.

MS. SABORIO. Yes.

REPRESENTATIVE HAMILTON. Okay.

MR. DORNBUSCH. Can I add a remark to this question about fortress America?

Rules of origin are the way of solving a problem, and not raising external tariffs is the other half. I think on both they are a firm part of the agenda, and there is no prospect that other than for the attraction of the economic zone that is created, we should interfere in any way with the rest of the world.

We should not have to make our economic zone particularly unattractive, as a favor to the rest of the world, by parceling it up into little uncompetitive pieces.

REPRESENTATIVE HAMILTON. We are ready to conclude. We thank you very, very much for your participation this morning. We have had a good session, and the Joint Economic Committee stands adjourned.

[Whereupon, at 11:55 a.m., the Committee adjourned, subject to the call of the Chair.]

U.S.–LATIN AMERICAN ECONOMIC RELATIONS

WEDNESDAY, APRIL 29, 1992

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The Committee met, pursuant to notice, at 10:30 a.m., in room 2359, Rayburn House Office Building, Honorable Lee H. Hamilton (vice chairman of the Committee) presiding.

Present: Representative Hamilton.

Also present: Richard F Kaufman, general counsel.

OPENING STATEMENT OF REPRESENTATIVE HAMILTON VICE CHAIRMAN

REPRESENTATIVE HAMILTON. This meeting of the Joint Economic Committee will come to order.

We meet today for the second in a series of Joint Economic Committee hearings on U.S.—Latin American economic relations in the 1990s.

Our focus today will be on the prospects for continued economic growth in Latin America. Major economic reforms have accompanied the tenuous but widespread democratization movement in Latin America. It is important for U.S. policymakers to assess the status of these economic changes so that we may take them into account in formulating U.S. policy towards Latin America.

Testifying today will be four private specialists. We are very pleased to have each one of you here.

I apologize for being a few minutes late. We have, as you perhaps know, Governor Clinton at the Democratic Caucus, and I understand there is a Republican Caucus going on this morning. There is a lot of activity on Capital Hill, which is not unusual these days.

I apologize to you for being late. I am looking forward to your testimony.

We have Dr. Hernando de Soto, President of the Liberty and Democracy Institute; Richard Feinberg is President of the Inter-American Dialogue and former Vice President, Overseas Development Council; Riordan Roett, Director, Latin American Studies Program, Paul H. Nitze School of Advanced International Studies at the Johns Hopkins University; and Norman Bailey, President of Norman Bailey, Inc., a former staff member of the National Security Council.

I would like to have each of you submit your statements for the record in full. In order to maximize our time for discussion, I would ask that you make your opening statements reasonably brief, hitting upon the central points that you want to make in your testimony.

Then after we have heard from each of you, we will turn to questions.

Dr. Roett, why don't I begin with you and move across the table from right to left, if that is all right, and Dr. de Soto would be the last to speak.

Dr. Roett, please proceed.

STATEMENT OF RIORDAN ROETT, DIRECTOR, LATIN AMERICAN STUDIES PROGRAM, PAUL H. NITZE SCHOOL OF ADVANCED INTERNATIONAL STUDIES, THE JOHNS HOPKINS UNIVERSITY

MR. ROETT. Thank you, Mr. Chairman.

I state in my testimony that the issue of sustained economic recovery in Latin America and in the Caribbean is linked to two parallel developments in the region.

The first is the transition and consolidation of democratic regimes and the need to address the very long, overdue social agenda in the region. That is obvious from the social data that the international organizations have provided.

Quite clearly there is now an historic opportunity in the 1990s to address a number of these issues.

Latin American leadership appears willing and able to take on many of the fundamental economic and financial reforms that are required before you move on to the more complicated social and political agenda items.

The need for a social net, though, in the region is important—as the reform process is—and we learned that recently, of course, in Venezuela, and recently in Peru. Social equity is an issue that was overlooked in the 1980s; it is an issue that we cannot fail to address in the 1990s.

The general economic outlook which the Committee asked us to address is relatively optimistic about the growth aspects for Latin America in 1992 and 1993.

If the reforms take hold and the external environment is favorable, the rest of the decade could see sustainable growth and per-capita gross domestic product.

On the other hand, if reforms are not sustained and the stabilization policies are relaxed prematurely, growth is likely to remain elusive.

Therefore, we are at the very important cutting edge of whether or not we move forward with dramatic new changes in the region, or whether or not we indeed remain dead in the water, as the case of Brazil might illustrate.

There are two critical components of the IMF's evaluation: internal and external.

Internally we are moving well.

Externally we are moving in some areas very well—foreign direct investment, in terms of renegotiating the foreign debt; and in terms of increasing exports.

The critical issue for Latin America, since it must be looked at in the context of the global economy, is that there is indeed worsening consumer confidence in the industrial world, increased taxation and high interest rates in Europe, reduced spending on business investment in Japan, and relatively sluggish growth in the industrial countries.

These factors cast doubt about the prospects for recovery in the industrial world. That is a critical issue for Latin America in terms of its foreign exchange earnings and its capacity to trade.

The foreign exchange conundrum for the Latin American and Caribbean countries is central to their revival economically and their capacity to invest socially.

It is clear that the Uruguay Round of GATT, which is now in deep trouble, would be a very significant contribution for the Latin American countries.

If the GATT negotiations do not end satisfactorily, the probability of heightened protectionism and a move toward regional trade groupings will increase. That is the bad news for Latin America, Mr. Chairman.

The debt crisis, which the Committee is interested in, is clearly over if we define it in 1980s terms; but the issue of debt remains very much alive in Latin America.

The IADB recently reported that the ration of debt service payments to exports rose from 26 percent in 1990 to 30 percent in 1991.

This was due in part to extra debt payments made by Brazil. It also reflects a slowing demand for Latin America's exports because of the slowdown in the industrial economies, a decline in commodity prices, and a general deterioration in terms of trade.

Therefore, once again the trade issue becomes central to Latin America's prosperity. The capacity of the countries to find markets in order to earn the foreign exchange needed to service their debt and to make social investments at home remains very important.

The foreign direct investment and the flows of private capital have been impressive for Latin America during the last 18 months.

In 1991, Latin America attracted more than $40 billion of private capital, of which $15.7 billion was in borrowing, $14 billion in FDI and privatization flows, and a further $6.4 billion in portfolio investment. That is a very favorable number compared to 1990 when the figure was $13.4 billion.

Latin America is opening to new investment. There is new foreign direct investment. Life capital is returning, and there quite clearly is a marginal increase in interest in terms of investors.

An important issue that the Committee is interested in is the equity issue and economic liberalization.

There is no question that the international organizations and the Latin American governments are beginning to be very concerned about the sustainability of democratic governments and of the economic reform process if, as the IADB referred to them, severe social problems that stem directly from high unemployment, depressed incomes, and the poor provision of social services are not taken care of by the governments.

As I pointed out, the informal economy in Latin America has played a very important role in terms of absorbing the work force. In some countries, the informal economy may go as high as 40 percent of urban employment and, some economists have argued, up to 70 percent in Peru.

The informal economy is temporary. It is not a permanent answer to the issue of economic development and social justice, but it does provide an important bridge during which the United States and the industrial countries should support the efforts of the new democratic governments in Latin America to introduce and consolidate social and economic modernization programs.

The role of nongovernmental organizations can be, has been and should be supported since grass-roots development is what the informal economy is all about. And at the margins, governments need to be much more attentive, as the Mexican government has been, to putting in a social floor.

Mexico's so-called "Solidarity Program" has been a very important and very political program with a great deal of success.

There is no question that the very difficult moment in Latin America at the present time reflects a lack of decision as to what the next and most appropriate steps are.

How quickly must you move on the social equity side?

How much do you deepen the economic and financial reforms?

How dangerous would that be to political stability?

All of these are the kinds of things that the Latin America Governments are now trying to struggle with.

The general numbers, I think, are very good in terms of capital flows, in terms of investment opportunities, in terms of the privatization and the repatriation of foreign capital.

What we need now to look at, it seems to me, is the integration effort underway in Latin America.

For the first time in the history of the region, we now have a number of important integration efforts ranging from what we hope will be a revival of the Central American Common Market, the MERCOSUR in the southern part of the Continent, the NAFTA negotiations with Mexico, a revision of CARICO in the Caribbean, and a number of other bilateral and subregional efforts which, for the first time, make it possible to think about real free trade opportunities and their integration and the opening of new markets in Latin America.

That too deserves to be very strongly supported, but that too is linked to the successful conclusion of the current GATT Round.

If the Uruguay Round succeeds and is concluded before the end of the NAFTA, that will facilitate the negotiation and, I hope, the ratification by the Congress of the NAFTA.

But there are real sticky points—textiles, agriculture, steel—and the GATT results would relieve the NAFTA negotiators of the burden of negotiating and defending reforms in these sensitive sectors where entrenched political groups oppose liberalization of standing trade barriers.

A positive conclusion to the Uruguay Round helps Latin America; it helps the Enterprise for the Americas Initiative; and it helps regional integration.

A failure of GATT means that we need to go back to the drawing boards and begin to look at very important short-term changes in development strategies.

Is there an appropriate role for the United States, Mr. Chairman?

Quite clearly—as I travel through the region frequently—it is impressive how much good will exists for the Enterprise for the Americas Initiative. It is a symbol, but it also offers substance.

I would urge the Congress to act on the important components of the Enterprise Program that now stand before them.

The reduction of debt, for example, needs to be addressed. The muti-lateral investment fund is indeed important, but it is stalled.

My first recommendation, then, is that the Congress revive and rescue the Enterprise for the Americas Initiative.

Do not see it as a partisan program, but very much as the United States' response to what are important changes in Latin America.

Second, we clearly want to come out very strongly in favor of a successful conclusion to the Uruguay Round. That will have dramatic impacts on Latin America.

Third, channeling assistance to nongovernmental organizations. Increasing the flows for those organizations is important.

Fourth, let's look again, Mr. Chairman, at the U.S. program to fight narcotics.

There is a relationship between sustainable development and the elimination of the narcotics industry in the region.

Narcotics cultivation and processing damage the environment in the Andean region.

Tropical deforestation, watershed pollution, and many other ills accompany this.

We need to look at the overall framework within which countries like Peru and Colombia and Bolivia are going to make sustainable developmental decisions in the coming years, and I think that we need to look at the way in which the drug program is being administered by the United States, the way our monies are being allocated, and the increasing militarization of the program which does not have a very large social component, as indeed it should. That was made clear at the San Antonio Drug Summit just a few months ago by the Latin Americans.

Fifth, the United States can be very supportive of Latin America at the "Earth Summit" in June in Brazil.

We need to look at sustainable development—the key theme of that meeting—as an important bilateral position by the United States.

The United States should lead, and not drag its heels, on the environmental questions. So far, our image in Latin America and elsewhere is indeed of being recalcitrant to take a strong stand on the environment. That is critical to the future development of Latin America and, as Hernando Fajnzylber, an economist writing late last year, argued that:

> Latin America's ... competitiveness will be inextricably linked to environmental sustainability and that the determining factor in making the two aims (competitiveness and sustainability) compatible will be the incorporation and dissemination of technical progress.

Latin Americans understand that the competitiveness in the world markets, as well as their own development, is linked to the environment, and the United States should be very, very sensitive to that.

Sixth, we should encourage and provide support for the region's efforts to increase competitiveness through investment in education and the increase of social equity. Both strengthen democracy.

Seventh, the United States should encourage our industrial allies in the G-7 and elsewhere to indeed be more supportive of developmental efforts in the region.

Finally, Mr. Chairman, the role of the United States in the modernization of Latin America and the Caribbean will be modest, given our own domestic constraints. But, as I argue, a modest contribution can be positive and salutary. Leadership need not represent domination.

We can encourage through the Enterprise for the Americas Initiative. We can encourage by taking a positive stand at the Rio Summit in June.

We can encourage by revisiting and relooking at our drug program, and making sure there is a very important social component to what we do in the Americas.

We need to support these very positive trends underway in the economic and financial area in Latin America with a clear endorsement of the democratic process, and of the need to address and sustain social development, and to provide a social net for a majority of the people in the region.

These are not easy goals. They are difficult, but they are now overdue for attention. The success of the agenda will determine our relations with Latin America and the Caribbean for years to come.

Congress has a very important role to play, and I would hope that this Committee, indeed, would provide the opportunity for furthering and deepening U.S. support for the important changes that are underway in the hemisphere.

Thank you.

[The prepared statement of Mr. Roett follows.]

PREPARED STATEMENT OF RIORDAN ROETT

Mr. Chairman, I appreciate the opportunity to discuss the important issue of "Prospects for Economic Recovery in Latin America" with the members of the Joint Economic Committee.

INTRODUCTION

The issue of sustained economic recovery in Latin America and the Caribbean is inextricably linked to two parallel developments. The first is the transition to and the consolidation of representative democratic regimes and the second is the need to address a long overdue social agenda in the region. There is an historic opportunity to address these multiple tasks in the 1990s. The leaders of Latin America's most important states have undertaken fundamental economic and financial reforms with a great deal of success. But there have been warning signals, also, that the burden of economic reform, in the short term, falls disproportionately on the poorest sectors of society. The need for a "social net" is important as the reform process moves forward to preclude a repetition of the events of February 4 in Venezuela. And the issue of the social agenda—or social equity as some term it—is now seen as part and parcel of the development process. Poorly educated and trained Latin Americans are not good workers or good citizens. These considerations have been overlooked in the past; the region cannot afford to do so, again, in the future.

THE GENERAL ECONOMIC OUTLOOK

The recently published World Economic Outlook of the International Monetary Fund is relatively optimistic about the growth prospects for Latin America, projecting real GDP output in 1992 of 2.7 percent and, in 1993, 4.2 percent. The outlook states that

> if reforms take hold, and the external environment is favorable, the rest of the decade could see sustainable growth in per-capita gross domestic product; on the other hand, if reforms are not sustained, and if stabilization policies are relaxed prematurely, growth is likely to remain elusive.

There are two critical components to the Fund's evaluation—internal and external. On the internal reform process, all of the major countries, with the exception of Brazil, have made impressive strides in recent years. Inflation levels are falling, fiscal deficits are being downsized, privatization has moved forward quickly, tariffs are down, and Foreign Direct Investment (FDI) is openly encouraged. We now see evidence that flight capital, one of the points of friction in the 1980s, has begun to return to the region.

But the external side remains more problematical. Industrial countries real GDP output in 1992 is estimated at 1.8 percent and at 3.3 percent in 1993. The Fund reports that growth has been held back by worsening consumer confidence in the industrial world; increased taxation and high interest rates elsewhere in Europe; and reduced spending on business investment in Japan. These negative factors continue to cast doubt over the prospects for recovery in the industrial world.

Latin America has learned that the combination of internal reform and structural change is critical to positioning itself in the global economy. The countries clearly understand that aid will not be forthcoming in large amounts in the 1990s. And they understand that the "name of the game" today is trade. But at the moment in which they are undertaking the most far reaching structural changes in their history, they confront a prolonged slow down in consumption in the industrial countries, rising protectionism, and a growing concern over fiscal deficits in the industrial economies.

Foreign exchange is crucial to the continued reform efforts in Latin America. An open and fair global trade regime is essential. The recent conversations in Washington, DC, between President Bush and leaders of the other G-7 countries are not encouraging that a successful conclusion to the Uruguay Round of GATT is in the making. If the GATT negotiations end unsatisfactorily, or end in failure, the probability of heightened protectionism and a move towards regional trade groupings will increase. That will be bad news for Latin America and the Caribbean.

THE DEBT CRISIS

The debt crisis, as we knew it in the 1980s, has ended. But the issue of debt is very much alive for Latin America. The Inter- American Development Bank reported recently that the ratio of debt service payments to exports—an important measure, as you are well aware, of the burden of debt servicing—rose from 26 percent in 1990 to 30 percent in 1991. This was due in part to extra debt payments, for example by Brazil to its creditors, to clear arrears with the commercial banks. But it also reflected a slowing in demand for the region's exports because of the slowdown in the economies of the industrial countries and declining commodity prices and deteriorating terms of trade.

Since demands for imports also rose in 1991 as investment and output increased, the region's trade surplus shrank and its current account deficit expanded substantially. The stock of the debt of Latin America and the Caribbean fell slightly in 1991 from the end-of-year level in 1990 of $431.8 billion as debt conversions roughly offset an increase in debt associated with new lending and exchange rate changes.

But, on a positive note, FDI and portfolio investment continued to rise last year. This continued a trend that began in 1987: a rise in the proportion of the region's resource inflows which do not create debt. These inflows more than covered the region's rising current account deficit and allowed for a rise in its international reserves. For some countries in the region, increased imports were the consequence of high real exchange rates associates with the large capital inflows.

Latin America attracted more than $40 billion of private capital in 1991 of which $15.7 billion was in the form of borrowing, $14 billion in FDI and privatization flows, and a further $6.4 billion in portfolio investment. That compares very favorably with $13.4 billion in 1990.

But there are notes of caution that need to be mentioned. Are Latin American financial instruments likely to be mispriced? Over the past year, for example, Brazil's public sector institutions have borrowed in the Eurobond market at up to 6 percentage points over U.S. government bonds of equivalent maturity. International investors have been rushing into short-term money market instruments in domestic currencies at yields equivalent to up to 20 percent. This means that regulators need to be on their guard in the 1990s. We do not want to create a new Latin American debt crisis in this decade. We do not want to see a repetition in Latin America of the U.S. junk bond market of the 1980s.

Finally, Latin America and the Caribbean have been helped by the substantial reduction of short-term interest rates in the United States, the United Kingdom and Japan.

At this moment, therefore, the debt burden appears to be manageable. Argentina has reached agreement for a Brady Plan with its commercial bank creditors. Brazil should be able to do the same this year, also. That will end the 1980s phase of the debt issue. The question before us is to preclude the makings of a new crisis. That will depend both on good management in Latin America and continued investor confidence worldwide.

THE EQUITY ISSUE AND ECONOMIC LIBERALIZATION

At its recent annual meeting in Santo Domingo, The Inter-American Development Bank released its annual report. That document confirms the positive gains of the last few years but offers a note of caution when it indicates that average per capita outcome in the region is still only at the level of a decade and a half ago. This fact has contributed, the report continues, to "severe social problems" that stem directly from high unemployment, depressed incomes and poor provision of social services. As the *New York Times* (March 21, 1992) recently reported on the vitality of what we call the "informal economy:"

> many Latin governments are in the delicate and lengthy process of reordering their economies, laying off tens thousands of workers and cutting back on social programs. But that is not resulting in long lines of the unemployed because the informal economy is creating millions of jobs, feeding families and generating some of the most vibrant economic growth on the continent.

The articles report that if the informal economy did not exist in a country such as Bolivia, the country's unemployment rate of 7 percent would jump to 35 percent. A recent study by the United Nations Regional Program for Employment in Latin America found that employment in the informal sector had risen to almost 35 percent of total urban employment, from 20 percent at the end of the 1970s. At the same time, urban unemployment fell to about 5 percent, from a peak of nearly 10 percent in 1983. The informal economy represents up to 40 percent of urban employment in many countries and in Peru economists say the figure is closer to 70 percent. This implies total employment at about 40 million. Exact calculations are impossible given the nature of the informal sector, of course.

Is the informal economy the answer to Latin American economic development? Certainly not. Is it a reasonable transitional mechanism to contribute to social and political stability? Obviously it is. The challenge for the governments of Latin America is to incorporate, slowly, the informal sectors into the mainstream of their economies, reducing tax evasion and enabling governments to crack down on illegal activities.

That issue raises the important role that the Non-Governmental Organizations (NGOs) often play in working with the workers and families in the informal economy. Just as the concept that "small is good" in the informal economy, it may well be that NGO involvement—small but good—is a very appropriate way to direct aid monies and assistance for the poor. Government bureaucracies generally do not work very well. And in a region where governance—read "honesty" remains an issue—informal sector-NGO linkages may serve as an important component of the transition from the old models to those of a new era.

It is also clear that governments can do more than work at the margin. The so-called Solidarity Program in Mexico has been successful in achieving two goals. The first is establishing a "social floor" under the poor with self-help and direct aid projects. The result of the honest implementation of Solidarity has been the reestablishment of political stability in Mexico if the elections results of mid-1991 are any indication, and I believe that they are.

Governments are not hopeless in the face of the dangerous combination of social unrest and economic restructuring. Solidarity is one example. NGO-informal sector synergies is another. The Inter-American Development Bank Annual Report points out that many countries plan new initiatives to alleviate poverty in the 1990s, increasing the cost effectiveness of the delivery of social services and improving the targeting of such services. That is a critical component of recovery and sustainable modernization. Social equity must be understood in terms of increasing support for democratic institutions and increasing the competitiveness—and the opportunities for economic participation—of the majority of Latin American citizens. To be competitive in the 1990s, Latin America will need a better educated, healthier and better housed working force. This is a right of the people of Latin America. But it is also a sine qua non of the rapid insertion of the region in the global market place.

The region will not be able to absorb and apply new and appropriate technologies if its work force lacks the capacity of "problem-solving." Continued social inequity will have negative political consequences. Democratic institutions, formally defined by election results, are sustainable for shorter or longer periods of time. But, as we now know from the history of the region over the last decades, sustainable political development will required sustained investment in people and in the appropriate institutions that will represent their interests and provide the needed social infrastructure to allow them a larger stake in their societies.

REGIONAL TRADE INTEGRATION AND FDI IN LATIN AMERICA

FDI figures for 1991 for Latin America are impressive. After decades of ambivalence in the region regarding the advantages of FDI, the vast majority welcome, and actively encourage, FDI. The decisions regarding the scope nature of FDI is a sovereign decision. It is also a calculation about the availability of alternatives sources of investment. As I have stated, the Latin American governments are realistic. They know there will not be a Marshall Plan for the region. They also know that competitiveness is the name of the 1990s game. New and appropriate technologies, improved marketing techniques, new product lines—these are strategic components of the region's insertion in an increasingly competitive world economy.

The North American Free Trade Agreement is a good example. As you know, the tariffs between the U.S. and Mexico stand at an all time low. The NAFTA is really about investment, not trade. It is one part of a complex mosaic of North American relations that offer a unique opportunity to reorient and redirect trade and investment flows among the three states of North America. The approval of NAFTA is a signal for continued and increased investment flows—as well as a continuation of current, and increasing, trade flows. Hopefully, the successful completion of the NAFTA will then result in a series of succeeding bilateral trade agreements and eventually broader arrangements within the Western Hemisphere.

Economic integration offers new markets. It provides a creative stimulus for new investments. It opens opportunities never before available in the Western Hemisphere. For example, the petroleum industry. As a result of the increased confidence in integration efforts and economic reform, Latin America will double its annual investment in the petroleum industry over the next four years, it has been recently reported by the Association of Latin American State Petroleum companies. The investment plans are built on the new flows of foreign capital into the region.

The Association reports that new investments in exploration and production between 1992 and 1996 are likely to total $75 billion, an annual average of $18.75 billion, not including the petrochemical sector. This compares with $8 billion invested in 1990 and $9 billion in 1991. The major part of the program will come from Venezuela, the region's biggest producer, which is embarking on a series of joint ventures, followed by Mexico and Brazil, which has an ambitious program to become self sufficient by 1994-95. As you know, Latin America has the world's second largest oil reserves after the Middle East and is at present responsible for 12 percent of global production. The new investment drive will increase the region's production from 7.4 million barrels per day to 10 million by the end of the decade. Latin American reserves have increased 600 percent over the last 25 years—more than any other region in the world.

The Association believes that the petroleum sector will be a key engine of growth in the 1990s. It will benefit greatly from the region's re-entry into the international financial community and will serve as an essential tool for integration in the region. It offers the possibility, finally, of a Western Hemisphere energy program and reserve strategy. It holds out the possibility of an increase in the sort of commitment to the smaller and poorer countries that the San Jose arrangement represents in which Venezuela and Mexico provide petroleum to Central America at subsidized prices. And its offers the hope of important spin-offs which will create jobs and open opportunities for new investments downstream.

As you know, Mr. Chairman, there is a vitality in the integration efforts in Latin America that has never been present before. The Andean Group, composed of Bolivia, Colombia, Ecuador, Peru and Venezuela, has announced plans to define common external tariff rates during 1991 and to implement those rates by the end of 1995, which an Andean customs union will be established (for Colombia, Peru and Venezuela the customs union will come into force in 1993). Colombia and Venezuela are taking unilateral steps towards liberation by slashing tariffs. The Central American Common Market (CACM) is in the process of being revised after the devastating wars of the 1980s. CACM has entered into free trade arrangements with Mexico and Venezuela. In January 1991, Mexico and the six Central American countries agreed to reduce gradually their trade barriers, with a view to eliminate them by December 1996. Venezuela has agreed to reduce immediately all non-tariff barriers and to eliminate most tariffs on imports from the six countries of Central America.

The CARICOM—Caribbean Economic Community—opened its first common stock exchange in January 1992 and, by 1994, they hope to have achieved currency alignment among member states. They also agreed on a Common External Tariff. The Southern Cone Common Market (MERCOSUR) plan a Common Market by December 1994. The treaty commits the member countries to eliminate tariffs and NTBs, to avoid recourse to safeguard measures, to coordinate macroeconomic policies, and to establish a common external tariff of 15 percent after 1995. This target will probably not be reachable given the slow progress in macroeconomic adjustment in Brazil. That country represents 78 percent of the region's population and 82 percent of its combined GDP. Progress is being made in Brazil but the pace is slow and the MERCOSUR will need to wait for its full implementation for the "catch-up" in policy changes that is now underway.

Critical to the success or failure of these efforts, Mr. Chairman, is a common dependence by the Latin countries on a well functioning multilateral trading system. Unlike Europe, where intraregional trade comprises a large share of total trade (60 percent in the case of the European Community), most countries in the Western Hemisphere depend heavily either on access to the U.S. market or markets outside the region. For example, Chile and the MERCOSUR countries ship 71 and 67 percent of their exports outside the hemisphere; the Andean Group, CARICOM, and the CACM rely on the U.S. market for 50, 44 and 37 percent of their exports, respectively. Latin American states share a strong interest in strengthening the multilateral trading system. Effective GATT rules and procedures provide the best safeguard for continued access to the U.S. and overseas markets; while multilateral liberalization will open new export opportunities in European and Asian markets.

A successful conclusion to GATT is essential. If the Uruguay Round succeeds, and concludes before the end of the NAFTA negotiations, the GATT results could facilitate the negotiation and the ratification of the NAFTA. Current sticking points such as textiles and apparel, agriculture and steel could be dealt with by GATT accords. The GATT results would relieve NAFTA negotiators of the burden of negotiating and defending reforms in sensitive sectors, where entrenched political groups oppose liberalization of standing trade barriers. A positive conclusion of the Uruguay Round would provide impetus for the Enterprise for the Americas Initiative, also. A new trade regime will create new export opportunities and promote economic growth throughout Latin America and reinforce current reform efforts. It would inhibit growing protectionist pressures. A failure at GATT will have negative implications for the region. Growth prospects will suffer. FX earnings will drop. Incentives for new investments, joint ventures and other opportunities will be less attractive. Other world areas may become more attractive to North American investors such as Asia. Regional trade arrangements would suddenly be seen as "blocs."

Latin America is committed to regional integration and to a global free trade regime. It is in the region's best interests and it is in the best interests of the US. The commonalities of interest are obvious. Th failure to achieve a new trade regime is one that could undo much of the good work of the last ye rs in Latin America and the Caribbean.

AN APPROPRIATE ROLE FOR THE UNITED STATES

As I travel through the region, Mr. Chairman, it is impressive how much good will exists for the Enterprise for the Americas Initiative. It is a symbol—but it also offers substance. But the Congress has yet to act on important components of the program. Debt relief for the region's public debt is stalled. The Multilateral Investment Fund, planned to function within the Inter- American Development Bank, is stalled. My FIRST recommendation is that the Congress revive and rescue the Enterprise for the Americas Initiative. We are not discussing large amounts of money but the requests are reasonable and significant. And in an era in which it is known that the U.S. deficits preclude any increase in foreign aid funding or other gestures that would be welcome in the region, the broad outlines of the Initiative are important.

SECOND, whatever can be done to rescue the Uruguay Round of the GATT should be done immediately. GATT and free trade are critical to the region's continued progress.

THIRD, channeling available development assistance through NGOs to support the informal sector in Latin America during this critical transition period of structural reform can play a very useful role.

FOURTH, the Congress should revisit the issue of the U.S. program to fight narcotics. Why? Because there is a direct relationship between sustainable development and the elimination of the narcotics industry in the region. Narcotics cultivation and processing damage the environment in the Andean region. Severe tropical deforestation and watershed pollution clearly occur. Short-sighted farming practices and widespread use of toxic chemicals are proportionally more destructive than the environmental impact of legitimate agricultural and industrial activities. The local consequences on the soil are often devastating and may delay the introduction of substitute crops for years.

The drug trade needs to be stopped. But is the U.S. going about it the right way? Will current policies accomplish the twin goals of dramatically reducing the flow of drugs and offer a reasonable economic alternative for the peasants of the Andean countries? I think not. As you know, Mr. Chairman, the administration has requested $1.2 billion in anti-drug spending in its FY 1993 defense budget. Since 1989, DOD anti-drug spending has jumped by 190 percent. That money will concentrate on detection and monitoring; interdiction and enforcement; research and development; and developing the National Guard's role in the United States. The thrust is interdiction and eradication in Latin America. It seeks to support the activities of the local armed forces and police. It implicitly states that the problem is supply—not demand.

Our Latin American colleagues disagree. That was made clear earlier this year at the San Antonio Drug Summit. The refusal of the American public and responsible political leaders to correct the emphasis does have an impact on sustainable development in Latin America. The reduction, or virtual elimination, of the drug trade will not be accomplished by military means. Cutting demand in the United States will do so over time. And U.S. efforts in Latin America should be devoted not to military escalation by the DoD but to working with friendly governments in strengthening their systems of justice, exploring rural development alternatives, seeking to raise the levels of education, and therefore employability, of the local population; and related policy initiatives. As long as the U.S. continues to argue the supply side, and not recognize the demand side, we contribute to the degradation of the environment in Latin America.

FIFTH, the US should be supportive of the "Earth Summit" to be convened in Rio de Janeiro in June of this year. Sustainable development is the key theme of the meeting. The United States is viewed in Latin America as antagonistic to movement on a series of environmental initiatives that will be critical to the region's productivity and competitiveness in the future. The United States should lead, not drag its heels, on the most potent policy issue of the 1990s—the environment. It has implications for Latin American exports, for its overall development, for FDI flows, and for its integration into the new global economic order.

Latin Americans have begun to link export strategies, environmental standards and social equity as they explore new models for the region. As Fernando Fajnzylber wrote in a paper prepared for a November 1991 conference entitled "International Forum on Latin American Perspectives," sponsored by the Inter-American Development Bank and the OECD Development Centre, that

> in the future, Latin America's international competitiveness will be inextricably linked to environmental sustainability and that the determining factor in making the two aims (competitiveness and sustainability) compatible will be the incorporation and dissemination of technical progress.

SIXTH, as a reflection of Fajnzylber's argument, the United States should encourage and provide support for the region's efforts to increase competitiveness through investment in education and the increase of social equity. Both strengthen democracy. And both support the evolution of a new, outward-looking, economic development model of which free trade is a key component.

SEVENTH, the US should encourage our industrial allies, Japan and Europe, to examine opportunities for investment in Latin America. Both Japan and Europe are perceived to be more supportive of Latin America's environmental concerns. There are other areas in which they can play a useful role. The Western Hemisphere is no longer a closed box. The Cold War and post-1945 security considerations have changed. The US should welcome in the hemisphere as partners our allies in other parts of the globe.

In conclusion, Mr. Chairman, the role of the United States in the modernization of Latin America and the Caribbean will be modest given our domestic constraints. But a modest contribution can be a positive and salutary contribution. Leadership need not represent domination. Encouragement and partnership are as important in the 1990s as attempting to tell the countries of the region what to do and how to do it.

There are very positive trends underway. There are obvious pitfalls as the recent events in Venezuela and Peru clearly indicate. Our common goal is the stabilization of representative, democratic regimes. To accomplish that goal will require continued economic adjustment, with all of the obvious social consequences, and the creation of a "social net" to provide support and hope for the people of the region.

Those are goals easily stated; they are difficult, but not impossible, to achieve. The suggestions I have made are general but they attempt to address what I see to be the emerging agenda of Inter-American relations in the 1990s. The success of that agenda will determine the relations of the United States with the countries of Latin America and the Caribbean for years to come. It is a challenge that we cannot fail to meet and win. Since 1945, the Us has had few opportunities to reorient its agenda with the region. Internal changes, regional integration efforts, and meaningful structural reforms now provide that opportunity. I hope that the Committee, Mr. Chairman, and the Congress will openly participate in defining that agenda and playing a meaningful role in accomplishing it.

REPRESENTATIVE HAMILTON. Thank you, Dr. Roett.

Mr. Feinberg, please proceed.

STATEMENT OF RICHARD FEINBERG, PRESIDENT, INTER-AMERICAN DIALOGUE; AND FORMER VICE PRESIDENT, OVERSEAS DEVELOPMENT COUNCIL

MR. FEINBERG. Thank you, Mr. Chairman.

I am very pleased to follow Riordan Roett with whom, as you will see, I am in substantial agreement. I think this agreement is indicative, Mr. Chairman, of the fact that among Latin Americans and Latin Americaness in the Hemisphere, there is a growing convergence with regard to what needs to be done in the economic area and, to a significant degree, in the political area.

In Washington, at least, there is a growing awareness that Latin America offers major markets for U.S. traders and investors; that the United States already sells in fact more to Latin America than it sells to Japan.

The export sector is our major engine of growth these days, given the recessed domestic economy, and so therefore a growing Latin America can absorb a rising share of our expanding exports and a rising share of our domestic production.

Allow me to suggest that we are in the early stages of the creation of a hemisphere where the freer flow of goods, capital, and people will raise the living standards throughout the United States and Latin America.

In the broad sweep of history, I would argue that technological change in the globalization of markets make hemispheric integration inevitable.

Good policy, however—the work of good men and women—can accelerate this process and reduce the potential political disruptions and social costs involved in rapid change. Good policy can also spread the benefits more equally.

Looking to the situation within Latin America, in sharp contrast to the very depressed mood of the debt-ridden 1980s, today, there is a mood increasingly of buoyancy and optimism in the Latin American capitals under the tutelage of economic teams that possess impressive technical talent, and in a number of countries, a clear strategic vision of where they want to take their countries.

In Mexico and Chile, for example, there is a restructuring process underway to make their economies more competitive in global markets. It is a strenuous and difficult process, but it is being emulated in other countries throughout the region.

It is true that recovery has just begun in some countries. Per capita income remains well below earlier peaks, but the vital signs—lowering inflation, declining real interest rates, rising exports and imports—these vital signs are positive.

The bases are being laid for a resumption of steady growth in the hemisphere. To its credit, in response to these revolutionary changes in Latin America, the Bush Administration has offered a vision of the Hemisphere of free trade and open capital markets, unburdened by old debts and protective of its endangered environment.

This vision of the Enterprise for the Americas Initiative has, as Mr. Roett suggested, captured the imagination and the praise of leaders around the

Hemisphere. In broad terms, I would suggest that the EAI is, in fact, a proper complement and a proper response to the reforms already underway in Latin America.

This is not to say there are not important obstacles to success in our path. The vision of a free-trade area is endangered by stagnation in the GATT on the one hand, the NAFTA whose fate is also uncertain, and particularly the design of a broader Western Hemisphere Free-Trade Area remains very sketchy indeed.

On the debt issue: While less critical than in past years, old debts continue to exert a drag on Latin American growth. Within Latin American Nations, critical economic reforms are endangered by legitimate popular discontent over the inequitable distribution of the costs of adjustment.

So allow me, Mr. Chairman, to address these issues in trade, finance, and development strategy.

The GATT, first of all, remains the first, best instrument to the liberalization of global trade and for the healthy expansion of Latin American exports.

For example, the World Bank recently estimated that a 50 percent reduction in trade barriers, roughly—as is being considered in the GATT—would permit Latin America to increase its exports by about 20 percent, or nearly $10 billion a year—a significant amount for Latin America.

So the costs of a GATT failure would be grave for Latin America as well as for the United States.

With regard to trade negotiations on the NAFTA, tri-lateral freer trade—and we are not talking of course about "free trade" but "freer" trade—between the United States, Canada, and Mexico is in the common interest.

It is important to note that the proposed NAFTA is less about trade than it is about Mexican macroeconomic policy and the future flows of investment capital into Mexico.

This is because when a smaller nation enters into the free trade area with a much larger partner, the smaller nation will confront strong pressures to bind its exchange rates, and hence its macroeconomic policies, to those of the senior associate.

Moreover, microeconomic reforms in such areas as capital markets and other services, agricultural industry and industrial policy, when these are codified in international agreements, these reforms will become more durable than the reforms that are only backed by domestic decrees.

So for Mexico, therefore, a Free Trade Area Agreement is a voluntary, self-denial of economic sovereignty in exchange for enhanced economic welfare. It is a purposeful locking in of future generations of policymakers in Mexico by the incumbent economic team of Carlos Salinas.

Mexico also hopes to lock in current U.S. trade policy, and to forestall the future erection of new trade barriers against the anticipated surge in Mexican-manufactured exports into the U.S. market.

The Mexicans are seeking an insurance policy against the protectionist pressures that the more advanced Asian exporters have been confronting. Therefore, this double "lock-in" of Mexican economic reform, on the one hand, and liberal U.S. trade policy, on the other, is intended to impress investors that Mexico will offer a predictable and attractive location.

The U.S. Congress wisely persuaded the Bush Administration to address environmental and social issues in the context of the NAFTA talks. Mexico should not become a safe haven for U.S. firms seeking to avoid national environmental and labor standards.

It is also essential that agreements on those issues establish adequate monitoring mechanisms as well as enforceable sanctions to gain compliance.

Looking more broadly, to be consistent with the promise of a broader Enterprise for the Americas Initiative, the NAFTA should contain provisions which permit other Latin American and Caribbean nations to join the emerging Hemisphere Free Trade Area.

In particular, Chile is worthy of early consideration. Here, there is possible conflict between U.S. and Mexican interests. It may be in the Mexican interest to delay the accession of South American competitors—particularly Brazil and Argentina—in order to lengthen the period between which Mexico has preferential access to the U.S. market. But that is not our interest. It is in our interest to accelerate a genuine Hemisphere-wide integration effort.

The creation of the Western Hemisphere Free Trade Area will be a very complex process involving a widening array of difficult issues and an expanding number of nations.

New mechanisms, therefore, will have to be created to undertake studies and collect information, to check agreements for consistency with other agreements in the region and with global norms, such as the GATT.

We will need mechanisms to monitor compliance with those agreements and to settle disputes, and perhaps to negotiate on behalf of the entire Hemisphere in global fora.

It is not too early to begin to consider the institutional architecture that will be needed to guide an economically integrated Hemisphere.

Moving on, Mr. Chairman, to the issues of finance and debt, the Third World debt crisis is over for the financial markets, as the commercial banks have reduced their exposure, set aside reserves, and are now watching the value of their remaining Third World debt rise on secondary markets.

For Latin American countries, however, service on old debt continues to drain significant portions of their export receipts and investable funds, and therefore exerts a drag on their economic recovery.

Since the debt crisis struck way back in 1982, a decade ago—we are about to celebrate ten years of the debt crisis—Latin America, during this ten years, has paid out tens of billions of dollars in debt service.

This net transfer of resources on long-term debt is, unfortunately, likely to remain negative throughout the 1990s. This picture does not improve even when direct investment and grants are included, because projected profit remittances cancel the cash-flow contribution of new investment, while grants to the large and middle-income countries of Latin America will remain small.

So there will continue to be a negative net transfer.

On the bright side, however, the burden of these negative transfers will decrease, hopefully, in proportion to rising Latin American exports and rising GDP. That is because the absolute level of the transfers will remain roughly level, while we have reason to hope that regional exports and GDP will gradually increase over time.

Hence, if all goes well under a set of reasonably optimistic, but I think reasonable, assumptions, by the end of the decade most countries of the region should be able to manage their debt-service burdens without undue strain.

It will then—but only then—be possible to fully conclude that the Third World debt crisis will have passed not only for the commercial banks but also for the debtor nations.

In order to accomplish this more rapidly, however, application of the Brady Debt Reduction Formula to Brazil—currently being negotiated—and other eligible Latin American nations should proceed to reduce their debt burdens.

Experience in Mexico and elsewhere suggest that the major advance to the Brady-debt deals, however, lies less in cash-flow relief, which is modest although positive, but the real advantage is in the enhanced predictability, and hence investor confidence, that has developed as a result of the Brady-debt deals.

A potentially greater cash-flow relief for Latin America—and this is of interest now to the U.S. Congress—a potentially greater cash-flow relief would be a comprehensive application by all bilateral debtors, including the Japanese and the Europeans, of the debt reduction proposals in President Bush's Enterprise for the Americas Initiative.

If that were done, the region would save about $10 billion over ten years. If we pull together both the Brady debt reductions and the Bush debt reductions and apply them comprehensively and multilaterally, then Latin America could save about $17 billion by the year 2000.

So both of these initiatives are worth pursuing and worthy of Congressional support.

Finally, let me look at the issue of the politics of economic reform and development strategies. There is growing statistical evidence to buttress what any visitor to Latin America can readily see. That is to say that poverty has deepened and inequalities have widened during the 1980s.

The association, in the popular minds, of economic reform, which proceeded during this period with poverty and inequality, threatens the durability of these economic reforms.

Just as alarming, widespread popular discontent and distrust of now-democratic governments jeopardizes the durability also of democracy and the rule of law.

Thus, for reasons of ethics, efficiency and democratic values, Latin American governments should now directly address the social agenda.

Tax structures need to be made fairer and more enforceable.

Government expenditures should be directed to helping the poor and the middle class develop their human capital, particularly through quality education and adequate health care.

In addition, special programs should be carefully targeted to assisting the very poor.

This may seem obvious, but the problem is that the poor in many Latin American countries today are politically powerless. They have less power today in fact than they had, perhaps, 10 or 15 years ago in many countries.

Therefore, it will fall to the international agents—IMF, World Bank, Inter-American Development Bank, USAID—to try to correct this domestic asymmetry, to tilt the balance in favor of the underprivileged and underrepresented.

The good news is that there are already signs that the multilateral agencies are beginning to understand the importance of that mission. The agency should be encouraged to pursue that mission with zeal.

Mr. Chairman, just to briefly summarize my major recommendations then:

Yes, to a Regional Free Trade Area.

The NAFTA Accords should include adequate monitoring mechanisms to enforcement agreements and environmental standards and social rights, and should contain an accession clause that would facilitate the entrance of interested Latin American and Caribbean nations.

The time has also come to construct the institutional architecture that will be needed to oversee Hemispheric integration.

"Yes" to debt reduction. Debt reduction via the Brady Initiative for commercial loans, and via the Bush Initiative for bilateral debts, should be pursued and with vigor.

And finally, "yes" to equitable growth. The United States should encourage the multilateral lending agencies, as well as AID, to seek to improve income distribution in Latin America by tilting resource allocation toward the poor.

Thank you, very much.

[The prepared statement of Mr. Feinberg follows:]

PREPARED STATEMENT OF FEINBERG[1]

U.S.-Latin American Economic Relations In The L990S

Mr. Chairman, thank you for inviting me to testify on economic conditions in the Western Hemisphere. Having recently assumed the presidency of the Inter-American Dialogue, I am pleased to have the opportunity to address matters which are central to the concerns of my new institution.

There is a growing awareness in Washington that Latin America offers major markets for U.S. traders and investors; that the U.S. already sells more to Latin America than it does to Japan; that the export sector has become our strongest engine of growth; and that a growing Latin America can absorb a rising share of our expanding exports.

Indeed, we are in the early stages of the creation of a hemisphere where the freer flow of goods, capital, and peoples raises living standards throughout the United States and much of Latin America. In the broad sweep of history, I believe that technological change and the globalization of markets make hemispheric integration inevitable. Good policy, however, can accelerate the process, and reduce the potential political disruptions and social costs. Good policy can also spread the benefits more equally.

Regional Economic Renaissance

In sharp contrast to the depressed mood of the debt-ridden 1980s, today many of the best informed Latin Americans are upbeat and optimistic. Under the tutelage of economic teams possessing impressive technical talent and clear strategic vision, Mexico and Chile are restructuring their economies to compete in the global economy—strenuous but rewarding processes that the region's other major nations, including Argentina and Brazil, Colombia and Venezuela, are seeking to emulate. Recovery has just begun in many countries, some economies are still trapped in recessions, and per capita incomes remain well below earlier peaks, but the vital signs—lower inflation, sounder fiscal positions, declining real interest rates, renewal of investor confidence, rising exports and imports, healthier levels of foreign exchange reserves—are positive. The bases are being laid for a resumption of steady growth.

In response to these revolutionary changes in Latin America (and consistent with the imperative in the post-Cold War period to place economics at the top of our national security agenda), the Bush administration has offered the vision of a hemisphere of free trade and open capital markets, unburdened by old debts and protective of its endangered environment. The vision of the Enterprise for the Americas Initiative has captured the imagination and the praise of leaders around the hemisphere. In broad terms, the EAI is a proper complement to the reforms under way in Latin America.

Obstacles To Success

Thus, there are good reasons for optimism as we envision an increasingly integrated and prosperous New World. But there are many obstacles in the path toward a more affluent Americas:

— Industrial country growth rates are slipping, making it harder for both the U.S. and Latin America to export commodities and import capital;

— Trade negotiations in the GATT have seemingly stagnated, the fate of the North American Free Trade Area (NAFTA) is uncertain, and the design of the broader Western Hemisphere Free Trade Area (WHFTA) remains very sketchy;

— While less critical than in past years, old debts continue to exert a drag on Latin American growth;

— Within Latin American nations, critical economic reforms are endangered by legitimate popular discontent over the inequitable distribution of the costs of adjustment, and widespread distrust of incompetent and corrupt governmental leaders and institutions.

Allow me to discuss these problems in turn, and to suggest answers to each of them.

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[1] The views presented here are solely the responsibility of the author, and should not be attributed to the members, staff, or Executive Committee of the Inter-American Dialogue.

The Breakdown Of Global Macroeconomic Management

A lackluster recovery in the United States, high interest rates and slow growth in Europe, and a capital implosion in Japan will make 1992 the third year in a row of disappointing performance in the industrial world. The entire world, including the Western Hemisphere, suffers from this failure of global macroeconomic management.

In light of our own persistent budget deficits, we are ill placed to press the Germans to allow for lower interest rates by altering their fiscal and monetary mix—i.e., tightening fiscal discipline in order to relax monetary policy. But it is clear that the processes of global macroeconomic management have been allowed to wither. Rather than building on the success of the 1985 Plaza Accords, the Group of Seven industrial countries seems to have retreated toward unilateralism in macroeconomic policy. This withdrawal runs counter to the imperatives of increasing economic interdependence, and is costly to all countries. Renewed energy should be devoted to fortifying the procedures that could make global macroeconomic policy coordination more effective.

The Western Hemisphere And The Group Of Seven

Even as a more integrated economic unit, the Western Hemisphere will remain very much imbedded in the larger global economy, and therefore cannot be indifferent to G-7 coordination exercises. Indeed, in presenting its views within the counsels of the G-7, the United States should take into account the interests of the hemisphere we lead and whose health is vital to our own. Such a self-conscious representation of hemispheric needs would be both in the diplomatic and economic interests of the United States, and would be consistent with the farsighted vision of an integrated hemisphere actively engaged in the global economy.

Multi-Tiered Trade Liberalization

The GATT remains the first-best instrument for the liberalization of global trade, and for the healthy expansion of Latin American exports. The World Bank recently estimated that a 50 percent reduction in trade barriers (including cuts in tariffs and non-tariff barriers) would permit Latin America to increase its exports by 19 percent, or nearly $10 billion per year.[2]

The United States is correct to criticize the European Community's Common Agricultural Policy, which is as harmful to the farmers of Latin America as it is to our own. More questionable, however, is the tactic of holding the entire Uruguay Round hostage to European concessions in a sector whose coddled constituents are known to be politically powerful. However wrong French farmers may be, we should not place the fate of the world trading system in their hands. Of course we do not want a bad treaty, but nor should we allow the perfect to drive out the good. The costs of a GATT failure could be grave for all.

North-American Free Trade

Within our hemisphere, trilateral freer trade among the U.S., Mexico, and Canada is in the common interest. It is important to note that the proposed NAFTA is less about trade as such than it is about Mexican macroeconomic policy and the future flows of investment capital. When a smaller nation enters into a free trade area with a much larger partner, it will confront strong pressures to bind its exchange rate and interest rates—hence its macroeconomic policies—to those of its senior associate.

Moreover, microeconomic reforms in such areas as capital markets and other services, as well as in agriculture, energy, and industrial policy, which are codified in international agreements, will be more durable than reforms backed only by domestic decrees. For Mexico, an FTA is a voluntary self-denial of economic sovereignty in exchange for enhanced economic welfare, a purposeful "locking in" of future generations of policymakers by the incumbent economic team.

The Mexicans also hope to "lock in" current U.S. trade policy—to forestall the erection of new trade barriers against the anticipated surge in Mexican manufactures. The Mexicans are seeking an insurance policy against the protectionist pressures that the more advanced Asian exporters have been confronting. This double "lock in"—of Mexican economic reform and liberal U.S. trade policy—is intended to impress investors that Mexico offers a predictable and attractive location. For Mexico, the strategic target of the NAFTA are investors with a long-term horizon

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[2] World Bank, Global Economic Prospects and the Developing Countries. 1992 (World Bank: Washington, D.C., April, 1992), p.23.

and the capacity to export to the U.S. and to the other highly competitive markets around the world.

The U.S. Congress wisely persuaded the Bush administration to address environmental and social issues in the context of the NAFTA talks. It is in the U.S. interest for its southern neighbor to protect its environment, and to raise the living standards of its workers. Mexico should not be a safe haven for U.S. firms seeking to avoid national environmental and labor standards. Moreover, more prosperous Mexican workers will be able to purchase more U.S.-made products, and be less likely to emigrate into our already overcrowded and overburdened cities. It is essential that agreements on these issues establish adequate monitoring mechanisms, as well as enforceable sanctions to gain compliance.

More broadly, the NAFTA should be seen as an important step on the road toward the creation of a hemispheric community of economically integrated and prosperous nations governed by increasingly democratic and responsive political institutions. In such a community, wealth must not only be created. Development must be sustainable and equitable.

Hemisphere-Wide Freer Trade

To be consistent with the promise of the broader Enterprise for the Americas Initiative, the NAFTA should contain provisions which permit other Latin American and Caribbean nations, whether singularly or in groups, to join the emerging hemispheric free trade area. Here U.S. and Mexican interests may temporarily diverge: it may be in the Mexican interest to delay the accession of South American competitors, to lengthen the period during which Mexico has preferential access to the U.S. market. Conversely, it is in the U.S. interest to accelerate a genuine hemisphere-wide integration effort.

The creation of a Western Hemisphere Free Trade Area will be a complex process involving a widening array of difficult issues and an expanding number of nations. New mechanisms will have to be created to undertake studies and collect information, to check agreements for consistency with other WHFTA accords and with global norms, to monitor compliance with agreements and to settle disputes, and perhaps to negotiate on behalf of the hemisphere with other trading partners. Initially, it may be possible for existing institutions, such as the Inter-American Development Bank, the Organization of American States, and the United Nations Commission on Latin America and the Caribbean, to perform some of these functions. But further thought should be given to the institutional architecture that will be needed to guide an economically integrated hemisphere.[3]

Finance And Debt

The Third World debt crisis is over for the financial markets, as the commercial banks have reduced their exposures, set aside reserves, and are now watching the value of their remaining Third World portfolio rise on secondary markets. For Latin American countries, however, service on old debts continues to drain significant proportions of their export receipts and investible funds, thereby exerting a drag on recovery.

Since the debt crisis struck in 1982, Latin America has paid tens of billions more in debt service than it has received in new loans from the international financial system. This net financial transfer on long-term debt is likely to remain negative throughout the 1990s.[4] The picture does not improve greatly even when direct investment and grants are included, because projected profit remittances cancel the cash flow contribution of new investment, while grants to this largely middle-income region remain small.

On the bright side, however, the burden of these negative transfers will decrease in proportion to Latin American exports and GDP. This is because the absolute value of the transfers is

[3] For an elaboration on this point, see "The Americas Commission: A Proposal," in Richard E. Feinberg and Peter Hakim, New Directions in U.S.-Latin American Economic Relations (Overseas Development Council and Inter-American Dialogue: Washington, D.C., 1991).

[4] See Richard E. Feinberg, Eduardo Fernandez-Arias, and Frank Sader, Debt Reductions and North-South Resource Transfers to the Year 2000 (Overseas Development Council: Washington, D.C., 1992). Calculations are for long-term debt from official bilateral and multilateral sources and from private creditors. Net financial transfers for Latin America are projected at negative $186 billion over the decade of the 1990s for the baseline case, and at negative $154 billion when direct investment and grants are included (pp.24-25). Not captured in either measure are short-term flows and portfolio equity investment.

expected to remain roughly level while regional exports and GDP are assumed to increase gradually over time.[5] Hence, by the end of the 1990s, most countries of the region should be able to manage their debt service burdens without undue strain. It will then be possible to conclude that the Third World debt crisis will have passed not only for the commercial banks but also for the debtor nations.

Completing Debt Reduction

More immediately, application of the Brady debt reduction formula to Brazil and the other eligible Latin American nations would reduce their debt service burdens, but only modestly. Experience in Mexico and elsewhere suggests that the major advantage of Brady deals lies less in cash flow relief than in enhanced financial predictability and hence investor confidence. Of potentially greater cash flow relief for Latin America would be a comprehensive application, by all bilateral creditors, of the debt reduction proposed in President Bush's EAI. The region would save about $10 billion over ten years. Comprehensive, multilateral application of both the Brady and Bush initiatives would save Latin America about $17 billion by the year 2000.[6] These are initiatives worth pursuing, and worthy of Congressional support.

Multilateral Finance

The region's financial picture could also improve if it can attract portfolio equity investment and portions of the interest earned on capital held abroad by nationals ("flight capital"), as began to occur in volume in 1991. But these flows are generally short term and volatile. The proposed Multilateral Investment Facility (MIF) would focus on long-term direct investment. Unfortunately, this initiative was announced without adequate consultations with governments who were expected to contribute, and without adequate development of program design. More recently, however, the Inter-American Development Bank, which hopes to house the MIF, has fashioned promising programs for the Facility which would focus on education and training and on technology transfer, and, it is to be hoped, avoid direct subsidies to businesses that should have ready access to private capital markets.

Finally, the proposed 50 percent quota increase will enable the International Monetary Fund to help finance stabilization programs in Eastern Europe and the former Soviet Union without diverting funds from Latin America. While the IMF has made mistakes in Latin America, on balance it has made the inevitable austerity less austere, and has helped initiate economic reform processes upon which everything else—private investment flows, trade liberalization, resumed growth—depends. The U.S. is the only major industrial country that has not yet approved its share of the IMF quota increase, an omission that the Congress should move swiftly to rectify.

The Politics Of Economic Reform

There is growing statistical evidence to support what any visitor to Latin America can readily see—that poverty deepened and inequalities widened during the 1980s. In many countries the top income brackets improved their relative and in several cases their absolute positions.[7] Association, in the popular mind, of economic reform with poverty and inequality threatens the reform's political durability. Just as alarming, widespread popular discontent and distrust of government jeopardize democratic institutions and the rule of law.

Thus, for reasons of ethics, efficiency, and democratic values, Latin American governments must now directly address the social agenda. Tax structures should be made fairer and more enforceable. Government expenditures should cease to be wasted on production subsidies, and be directed instead to helping the poor and the middle class develop their human capital—particularly through quality education and adequate health care. Human capital development will be critical not only for obtaining social objectives but also for upgrading productivity and international competitiveness. In addition, special programs should be carefully targeted to assisting the very poor, e.g., nutrition programs for poor mothers and young children. These services can be delivered through creative combinations of public, private, and non-profit channels. Government must be seen to care—and to be competent in its humanity.

[5] Ibid., pp. 32-34.

[6] Ibid., p.25.

[7] Nora Lustig, "Poverty and Inequality in Latin America: Facts, Issues and Dilemmas," paper prepared for the Inter-American Dialogue, April, 1992.

Equitable Growth

The problem is that the poor in many Latin American countries are politically powerless. The parties and trade unions that formerly attempted to represent their interests have become weaker while the wealthier can translate their newly amassed financial fortunes into dominant political influence. In some countries, therefore, it will fall to international agents—the IMF, World Bank, IDB, and USAID—to correct this domestic asymmetry, to tilt the balance in favor of the under-privileged and underrepresented. Happily, there are already signs that the multilateral agencies are beginning to understand this mission. They should be encouraged to pursue it with zeal.

In the 1990s, equitable growth in Latin America can consolidate the liberalizing economic reforms of recent years, and help legitimate democratic institutions. It can also provide the United States with expanding markets for our export products, and compatible, more stable partners in our efforts to compete in global markets. The pursuit of equitable growth can be the common foundation undergirding the hemispheric free trade area and the deeper hemispheric economic community to follow.

The concept of equitable growth is not new in this hemisphere. What would be new is a commitment to pursue it seriously. What is also new—and provides grounds for hope—is that the United States now has the economic and political interests for doing so.

Summary of Recommendations

In short, Mr. Chairman, I believe that Latin America could be on the verge of an historic economic revival, and that the Western Hemisphere could become a single, healthy economic organism. To achieve these goals, I suggest the following actions:

— The industrialized countries should strengthen global macroeconomic policy coordination. In its representations in these fora, the United States should take into account the interests of Latin America.

— The NAFTA accords should include adequate monitoring mechanisms to enforce agreements on environmental standards and social rights, and contain an accession clause that would facilitate the entrance of interested Latin American and Caribbean nations.

— The time has come to begin to construct the institutional architecture that will be needed to oversee hemispheric integration.

— Debt reduction, via the Brady initiative for commercial loans and via the Bush initiative for bilateral debts, should be pursued with vigor.

— The Bush administration and the Congress should work to secure passage of the U.S. contribution to the IMF quota increase.

— The U.S. should encourage the multilateral lending agencies as well as AID to seek to improve income distribution by tilting resource allocation toward the poor.

This is not an easy agenda. But the end of the Cold War has freed the United States to focus on its economic interests, and to recognize the economic potential of its own hemisphere. For their part, most Latin American governments are embracing closer economic ties with the industrial giant in their neighborhood. The historical moment awaits us; it remains for us to seize it.

REPRESENTATIVE HAMILTON. Mr. Feinberg, thank you very much.

Dr. Bailey, please proceed.

STATEMENT OF NORMAN A. BAILEY, PRESIDENT NORMAN A. BAILEY, INC., WASHINGTON, D.C.; AND FORMER STAFF MEMBER, THE NATIONAL SECURITY COUNCIL

MR. BAILEY. Thank you, Mr. Chairman.

The most important, nonreactive foreign policy initiative of the Bush Administration is the one entitled Enterprise for the Americas, and announced by the President on June 27, 1990.

The EAI includes important debt, investment, and environmental aspects, as well as the vision of a free trading zone spanning the Hemisphere.

The importance of the EAI lies in the counterweight such a zone would represent to other blocks in a world increasingly divided into great regional economic groupings.

The EAI has awakened great interest and enthusiasm in Latin America where growth is commencing again after a decade of depression, in an atmosphere of ever-increasing economic liberalization and political democratization.

Almost every country of the Hemisphere has now joined, or is negotiating entry into, one or more subregional free-trade agreements, and looking forward to doing the same with the United States, under the terms of the EAI.

Although the North American Free Trade Area negotiations among the United States, Canada, and Mexico are formally separate from the EAI and predated as an initiative, no one is in any doubt that its successful conclusion and ratification by Congress is an essential precondition of the eventual fulfillment of the EAI vision.

The NAFTA and the EAI are vital elements of a future of economic strength for the United States based on its political and economic dominance in its own hemisphere, peopled by our first and third most important economic partners, an inexhaustible store of natural resources, and accessible and increasingly open markets.

The current trends which are transforming the global environment and ushering a whole new era of international affairs will greatly heighten the importance of inter-American relations.

The substantial changes within and beyond the confines of this Hemisphere create both the conditions and the need for a fresh look at reviving, or considerably revising, the current network of inter-American institutions.

This necessary effort cannot be undertaken on the basis of wishful thinking or the invocation of traditional Hemispheric shibboleths.

Rather, it must proceed from careful analysis of the interests and perspectives of the quite varied countries that comprise this Hemisphere, the universe of significant issues that they are likely to face in the future, and the real options that can be identified for reforging and sustaining a truly effective and mutually beneficial pattern of inter-American cooperation.

It should not be forgotten that until World War I, Washington's foreign relations were primarily concerned with the Western Hemisphere, and that only for the past 50 years, since the outbreak of World War II, has the United States been a consistent player in events across the oceans.

Interestingly, the most recent reordering of U.S. foreign policy is occurring between the centennial of the establishment of the Inter-American system in 1889—that is, the founding of the Pan American Union; later, the Organization of American States—and the 500th anniversary of the discovery of the New World in 1992.

The coming decade will also be the time when leadership is passed from the generation that was formed by World War II to new leaders who will take the United States into the 21st century.

It is obvious that a very substantial change of attitudes and policies is also underway in Latin America. Diminution of the kind of divisive ideological conflicts that characterize the Cold War era is also evident within the Hemisphere. At the same time, the practice of democratic government has prevailed almost throughout Latin America and the Caribbean.

Regional chancellors are abandoning overly sensitive and often self-serving advocacy of "ideological pluralism" and concentrating on the defense of democracy, often in open partnership with the United States.

The principal risk that Latin America runs now is that of marginalization from political and economic currents that are currently transforming the international environment. Japan and the Asian tigers are speeding forward economically.

The United States and Canada are creating a powerful new free trade area, and the EC countries are well on their way to becoming a truly integrated economic unit.

It is to be hoped that these groupings will resist tendencies to protectionism. However, enhanced economic competition among them is a certainty, and the specter of block-based protectionism cannot be ignored.

Any such trend would be particularly unfortunate for countries that depend heavily on trade with these three blocks, but do not belong to any of them, which is certainly the case of Latin America.

Likewise, investment from capital rich countries may increasingly stay at home or be directed either to other developed areas, or toward Eastern Europe and the former Soviet Union.

Such eventualities will also have a deleterious impact for the transfer of necessary skills and new technologies to Latin American countries attempting to modernize and re-ignite their economies.

The United States and most Latin American countries have come to general agreement on many political and economic issues that formerly divided them, while many contentious security questions have abated.

In the economic area, the basis for closer collaboration has already been laid by the Enterprise for the Americas Initiative and the free-market reform process currently underway in many countries of the region.

A true FTA covering the entire hemisphere would be a natural economic and geopolitical grouping. That it would greatly enhance regional growth cannot be doubted. That it will meet with serious opposition from vested interests on all sides also cannot be doubted.

Nevertheless, a more balanced and peaceful international order in which countries move in their natural spheres is the ideal which we may perceive through the fog of the current situation.

Realization of this goal, however, will require both restraint and vision in both the United States and Latin America. Long after the Byzantine conspiracies of the Middle East are regulated and put into the footnotes of history where they belong, and it has become obvious that the role of the United States and the former Soviet bloc will be secondary to that of Europe and Japan, whether NAFTA and the EAI become realities or memories, will condition the future economic prosperity and power of the United States.

Unfortunately, much of the enabling legislation to implement the debt and investment elements of the EAI have fallen victim to various legislative vagaries, and more especially to the controversy over the Israeli Housing Fund Guarantee request.

I strongly urge that the authorization and funding of the U.S. portion of the Multilateral Investment Fund and Public Debt Relief be attached to a piece of legislation apart from foreign aid authorization or appropriations' measures.

Organization of the Western Hemisphere under U.S. economic leadership and the support of fragile democracies is simply too important and too urgent to brook further delays. Before ending, Mr. Chairman, I would like to make two additional points.

One is as a result of my colleague Riordan Roett's testimony. I differ very slightly with him in the emphasis that he put on the successful conclusion of the Uruguay Round. As an economist, I can only devoutly hope that the Uruguay Round is a success.

The only thing I would say is: Whether or not the Uruguay Round concludes successfully, it is extremely important for the United States to implement the NAFTA and the Enterprise for the Americas Initiative.

Certainly, the Far East and Europe are going to go on with economic integration whether or not the Uruguay Round is successful, and we can only hope that they will not become protectionist blocks, but unfortunately the record of history is not terribly optimistic in this regard.

The second thing that I would mention, which came to my attention only after the testimony was completed is that one of the things that has been lacking with reference to what has been going on in Latin America over the last couple of years has been an intellectual framework for the kind of liberalization that has been taking place.

Intellectuals are very powerful in Latin America, and an intellectual framework is important. On March 6, the President of Mexico—Carlos Salinas de Gortari—made a speech in which he outlined such an ideology, if you like, or such an intellectual framework, which he referred to as "social liberalism."

He contrasted that with what he called the new reactionaries, who are the Marxists and the Statists, and who, he said, are simply wrong in their prescriptions, and what he referred to as the "neo-liberals."

It is interesting. His criticism of the neo-liberals is different from his criticism of the new reactionaries. He doesn't say that the neo-liberals are wrong; he says that they are "incomplete;" that they have not given sufficient attention to the human factor in economic restructuring. Then, he goes on to discuss what he understands as social liberalism in many various areas of economic and political liberalization in Latin America.

I would strongly urge everyone to read the speech, which is I think very significant.

Thank you very much, Mr. Chairman.

[The prepared statement Mr. Bailey follows:]

PREPARED STATEMENT OF NORMAN A. BAILEY

Mr. Chairman, members of the Joint Economic Committee. I am Norman A. Bailey, consulting economist and former Special Assistant to President Reagan for International Economic Affairs on the staff of the National Security Council.

The most important, non-reactive, foreign policy initiative of the Bush Administration is the one entitled Enterprise for the Americas (EAI) and announced by the President on June 27, 1990. The EAI includes important debt, investment and environmental aspects, as well as the vision of a free trading zone spanning the Hemisphere. The importance of the EAI lies in the counterweight such a zone would represent to other blocs in a world increasingly divided into great regional economic groupings.

The EAI has awakened great interest and enthusiasm in Latin America, where growth is commencing again after a decade of depression, in an atmosphere of ever-increasing economic liberalization and political democratization. Almost every country of the Hemisphere has now joined or is negotiating entry into one or more subregional free trade agreements and looking forward to doing the same with the United States under the terms of the EAI.

Although the North American Free Trade Area (NAFTA) negotiations among the U.S., Canada and Mexico are formally separate from the EAI and predate it as an initiative, no one is in any doubt that its successful conclusion and ratification by Congress is an essential precondition of the eventual fulfillment of the EAI vision.

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The current trends which are transforming the global environment and ushering a whole new era of international affairs will greatly heighten the importance of inter-American relations. The substantial changes within and beyond theconfines of this Hemisphere create both the conditions and theneed for a fresh look at reviving, or considerably revising, the current network of inter-American institutions. This necessary effort cannot be undertaken on the basis of wishful thinking or the invocation of traditional hemispheric shibboleths. Rather, it must proceed from careful analysis ofthe interests and perspectives of the quite varied countries that comprise this Hemisphere, the universe of significant issues that they are likely to face in the future and the realoptions that can be identified for reforging and sustaining a truly effective and mutually beneficial pattern of inter-American cooperation.

It should not be forgotten that, until the First World War, Washington's foreign relations were primarily concerned with the western hemisphere and that only for the 50 years in a since the outbreak of World War II has the United States been a consistent player in events across the oceans. Interestingly, the most recent reordering of U.S. foreign policy is occurring between the centennial of the establishment of the Inter-American system (is., the founding of the Pan-American Union, later the Organization of American States) in 1889 and the 500th anniversary of the discovery of the New World in 1992. The coming decade will also be the time when leadership is passed from the generation that was formed by World War II to new leaders who will take the U.S. into the twenty-first century.

Evolution In The Interests Of Latin America

It obvious that a very substantial change of attitudes and policies is also under way in Latin America. Diminution of the kind of divisive ideological conflicts that characterized the Cold War era is also evident within the Hemisphere. At the same time, the practice of democratic government has prevailed almost throughout Latin America and the Caribbean. Regional chancellories are abandoning overly sensitive and often self-serving advocacy of "ideological pluralism" and concentrating on the defense of democracy, often in open partnership with the United States.

The principal risk that Latin America now runs is that of marginalization from political and economic currents that are currently transforming the international environment. Japan and the Asian Tigers are speeding forward economically; the United States and Canada are creating a powerful new free-trade area, and the EC countries are well on their way to becoming a truly integrated economic unit. It is to be hoped that these groupings will resist tendencies to protection.

However, enhanced economic competition among them is a certainty and the specter of bloc-based protectionism cannot be ignored. Any such trend would be particularly unfortunate for countries that depend heavily on trade with these three blocs but do not belong to any of them—which is certainly the case of Latin America.

Likewise, investment from capital-rich countries may increasingly stay at homs or be directed either to other developed areas or toward Eastern Europe and the former SovietUnion. Such eventualities would also have a deleterious impact for the transfer of necessary skills and new technologies to Latin American countries attempting to modernize and reignite their economies.

Conclusion

The United States and most Latin American countries have to general agreement on many political and economic issues which formerly divided them (while many contentious security question have abated). In the economic area, the basis for closer collaboration has already been laid by the Enterprise for the Americas Initiative and the free-market reform process currently under way in many countries of the region.

A true FTA covering the entire hemisphere would be a natural economic and geopolitical grouping. That it would greatly enhance regional growth cannot be doubted. That it will meet with serious opposition from vested interests on all sides also cannot be doubted. Nevertheless, a more balanced and peaceful international order in which countries move in their natural spheres is tho ideal which we may perceive through the fog of the current situation. Realization of this goal, however, will require both restraint and vision, both in the U.S. and in Latin America.

Long after Byzantine conspiracies of the Middle East are regulated to the footnotes of history where they belong and it has become obvious that the role of the U.S. in the former Soviet bloc will be secondary to that of Europe and Japan, whether NAFTA and the EAI become realities or memories will condition the future economic prosperity and power of the United States.

Unfortunately, much of the enabling legislation to implement the debt and investment elements of the EAI have fallen victim to various legislative vagaries and more especially to the controversy over the Israeli housing fund guarantee request.

I strongly urge that the authorization and funding of the portion of the Multilateral Investment Fund (MIF) and public debt relief be attached to a piece of legislation apart frog foreign aid authorization or appropriations measures. Organization of the Western Hemisphere under U.S. economic leadership and the support of fragile democratic is simply too important and too urgent to brook further delays.

Thank you very much.

REPRESENTATIVE HAMILTON. Thank you, Mr. Bailey.

Mr. de Soto, please proceed.

STATEMENT OF HERNANDO DE SOTO, PRESIDENT INSTITUTO LIBERTAD Y DEMOCRACIA; AND FORMER ADVISER TO PERUVIAN PRESIDENT ALBERTO FUJIMORI

MR. DE SOTO. Thank you, Mr. Chairman.

I will probably look at the same problems that my friends on this table have addressed from a different viewpoint. Rather, the long-term than the short-term; rather, from the point of view of a citizen of a country that does not just want to be stable and survive, but wants to actually be developed.

In this sense, I will argue that, as my paper does, the problem in Latin America is not a "social agenda." The problem is that there is really no democracy, and there are no institutions for market economies, and that is the reason it does not work.

Therefore, that is why I think all the short-term good news of the vital signs pointed out by Mr. Feinberg—debt privatization, structural adjustment, the fight against inflation—will be short-lived if one does not address that popular discontent which he talked about, as well, but which is not a temporary discontent.

It is a long-term discontent. It is one that, precisely because it is politically powerless as Mr. Feinberg said, has only violent ways to express itself in my country through terrorist groups like "The Shining Path," or the growth of the coca leaf and the supply of drugs to the north.

Therefore, I think this issue is fundamental. It is not a new issue. It is an old issue.

We have been in Latin America since the 1820s trying to achieve democracy and market economics, and freedom and liberty in economic transactions. So that is 170 years of failures that we are addressing, and I see nothing on the horizon that says that we have now found the formula.

This issue, of course, should not be a surprise. Only 25 out of 175 countries in the world are stable democracies in prosperous market economics.

The fact that 150 of us want to become stable democracies in market economics now—and we are not managing—means that we have not yet found a formula of what may be successful.

It also means that it has been such a gradual and spontaneous process in places like the United States that you may have forgotten or never realized what really was at the bottom of your success, since you have not been able to teach it.

One of the proofs of this is that after the World War II in 1945, Latin America's GDC per capita was, as a matter of fact, not only much higher than the Southeast Asian Tigers, but they were also much higher than those of Eastern Europe, or what was then the Soviet Union.

And today, 40 years later, with your active assistance, we are failed capitalism in which none of our countries in Latin America grow over $2,000 GDP per capita per annum, while totalitarian socialism, which has also failed, has given Eastern Europe $5,000 GDP per capita.

So, obviously, not only has socialism proved a failure in Eastern Europe, but capitalism has also proved a failure in Latin America. It is a good idea to find out why it was a failure in Latin America, and dwell on it somewhat longer before you start spending resources on Eastern Europe, and we all make the same mistakes all over again, discredit the formula, and then give arguments again to all those people in Latin America that say that markets and democracy are not really in accord with our culture.

Now, what I think is basically missing in Latin America—and I will address the issues of democracy and market economics one at a time—is that we have imitated all your organizations.

We have a separate executive branch, a separate legislative branch, a separate judiciary, and political parties, which span the whole spectrum of ideologies, central reserve banks and treasuries, but we have none of the underpinning institutions.

In other words, it is something like, as I say in the paper, an institutional vacuum. It is like a tree which has been transplanted, but lacking a developed root system, it withers and dies after a brief period of boom.

You will, if you go back in Latin American history, see that we have been through all of these vital signs of macroeconomic prosperity in other times. We have adjusted in other times. We have stabilized in other times. We have privatized in other times.

That is the reason we passed our railroads over to the British, and we had to nationalize them all over again when those formulas did not work, and we are back at the same cycle all over again.

Now the question is: Why didn't it stick then? And why will it not stick now, unless we address the fundamental issues?

The fundamental issue is that we have, as I repeat, the organizations but not the institutions. In Latin America, in my country where I have the concrete facts, participation in rulemaking is not available. In the United States, elections are but the tip of the democratic iceberg. In Latin America, that is practically all that you have in terms of democracy.

There is no participation in rulemaking. There is no transparency in rulemaking. There are no elements to make public officials actually accountable. And there is no access to property rights.

Let me illustrate each of these issues.

In my country, every year the government produces something between 26,000 and 30,000 rules and decisions, 99 percent of which are produced by the executive branch.

As opposed to your country, there is no "case law." There is no jurisprudence. There is no Freedom of Information Act. We citizens have no access whatsoever to government information.

The people you talk to when you talk to Latin American officials are not only not accountable, but they do not provide information to their citizens, and they get no feedback from them.

There is no comment and notice periods. We do not publish our draft laws in the Federal Register so that citizens can be involved, so that interested parties can give the information that is necessary to correctly rule a country.

No cost/benefit analyses are made of the rules like the Office of Management and Budget provides.

There is no effective petition rights to go through courts. I know of only one case where somebody who was not in government has actually won a case in court against government.

There is no individual accountability of officers, *per se*. There is no real independent General Accounting Office. There are no referendums. There are no popular participation in codes, like when you make codes of the sort like the Unified Commercial Code.

Therefore, the law essentially in Latin America, and especially in Peru, reflects what the elite, the leadership wants—of which I am a part of as well. It is not a reflection of what the people need and want. As a result, it produces enormous obstacles to participation, which is not a social problem, it is a problem of democracy that does not work.

Let me give you a few concrete examples.

It takes nearly 300 days, working 6 hours a day, to register a firm in my country, if you happen to be of the poorer classes. That is why the majority work in the informal sector.

If you are not registered, you have no access to limited liability; you have no access to having shareholders, or the documents to have shareholders, and therefore bring in capital. And, of course, if you are not registered, you have no access to real credit unless you go to the shark market where interest rates are five or six times higher than they are in the formal market.

To get a home—if you want to go to the outskirts of Lima—red-tape measures require that the president of a housing association will take something like 6 years and 11 months, working 8 hours a day, to get a legal home—which is the reason why 80 percent of the origins of these Peruvian cities happen to be illegal—the result of squatters or invasions.

Let's address it now to the drug issue.

When we went to the Upper Aguja to also look at the institutional side of the problem, we found that we had 250,000 farmers—with their families, 1 million people—who actually live from the growing of the coca leaf.

When we found out that the average income per capita of each farmer that grows coca leaf in Peru—which is a supplier of 60 to 70 percent of the world's coca leaf—we found that they have an average income of something between $400 and $600 per capita per year, even below the average national income.

The question was: Why did they not grow other crops, some of which were, of course, obviously more profitable—like, for example, palm oil, which has four times the profit than coca leafs. The reply to that is, of course, that you need to start up with good property rights. Nobody grows a crop that only produces results after five or six years if you do not have secure property rights.

But more than that, we found out that for crop X, for example, they told us the laws—and we checked it—forbid you of exporting a certain crop—which is well known in Latin America, which I shall not mention, to get into trouble with the respective trade association—but the law says that before you can export crop X, to ensure the quality of Peruvian exports, you must have proven that you have had experience in doing so by demonstrating that you have exported that crop for three years before.

In other words, it is a little bit like saying, to get into Harvard you have to prove that you have already been there three years before.

[Laughter.]

These are legislations that lock out people.

Each one of these rules, which we call "the accordion," absolutely prohibit the entering of any other crop except coca, and we have 16-1/2 yards of rules which make it legally impossible for any farmer in Peru in the areas of Upper Aguja or Aparemak to actually grow anything else other than coca.

So, unless you start looking at the issue of democracy and how rules are made, and start drug wars without looking at the institutional issues, and finding out if these people have actually got the channels to express themselves and be able to tell you why they can't grow something else, even though it is more profitable, you are not going to be able to resolve the program with any amount of social net, or aid, or structural adjustment, or macro economic measures that stabilize the economy.

So, no democracy, no growth, plenty of poverty and plenty of drugs.

A second point about market institutions. Since we have a limited amount of time, let me tell you this: Informality is not a small deal. It is not temporary. It is a big deal, and it has been around for a long time.

Most Peruvians have always been "informal." That is to say that they operate outside the law.

What happened is, just after World War II, or up until World War II, the only way you saw them was when they were being photographed in *National Geographic* magazine.

Since then, they have moved into the cities and Upper Aguja Valleys to grow coca, and now they are part of the political spectrum. They are those people that Mr. Feinberg called the "popular discontent."

They are the majority of citizens, and they are not participating in much of the macroeconomic benefits because they have no access to them, and will not have access to them until the issues of democracy, market institutions, elitism, discrimination and economic apartheid are actually addressed.

Ninety-two percent of all agricultural land in Peru—and we have found no differences even in Asia and in other Latin American countries—is not registered or titled. You don't know who lives there, or who is growing what.

They are held or possessed through common law.

Now, the fact that there is no registration and titling means a lot of things. First of all, we have found that when people are registered and titled, and therefore have addresses, the very moment you title them, the value of their property goes up twice. And after ten years, it goes nine times.

In other words, a "proper property rights" definition itself produces growth. But not only that, it also produces credit. When we have studied the small businesses in the United States, with the help of the Small Business Administration, we have found that of all the new businesses that start in the United States and that require credit, 70 percent of them obtain their credit through real estate collateral or mortgages.

Now, in a country where 92 percent of all farmers are not titled and registered, it not only means that they do not have property, it not only mean that they need a social net, it not only means that there is no social equity, it also means that there is no credit.

When we sum up all the money, the United States Government gives—the World Bank, the Inter-American Development Bank, the Organization of American States, the Dutch Association of European Evangelist Churches—altogether, all the credit for microenterprises and small enterprises, it is equivalent to 0.7 percent of total Peruvian credit—that is to say, less than 1 percent.

The solution is obviously not how much more micro credit you are going to actually provide us with—you could double it, and that probably would not pass through your chambers—it is a question of who has access to credit in Latin America, and that is an issue of equitable markets, and it is an issue of democracy.

Also, when you do not have property registry and titling, and you cannot identify people, you cannot have environmental programs.

How can you give sanctions to people whose address you don't know?

How can you reach the Amazon, address people and tell them to stop putting in millions of tons of toluene, or kerosene, or sulfuric acid—replace it—if there are no property rights and you have no legal way to address yourself to them, either through the economic system or through the political system, because they simply do not participate?

So you cannot make them accountable for either environment or drugs. The issue of democracy and market economics goes much further than present stabilization, structural adjustment, and aid programs.

Now, this means, to sum up, Mr. Chairman, that I really do not have many recommendations for you. We have an idea of what we Latin Americans should do. How you look at it from the focus, or the vantage point, of the United States is another matter that we would have to reflect upon.

I have never looked at these issues as a North American. But generally speaking, I would say that they require that we actually look more towards transformational strategies to reform what are basically not democracies but electoral systems; what is basically not market economic institutions but mercantilistic institutions, like the ones you got rid of when you got rid of King George III of England. And stop looking so much towards growth, but realizing that the institutional infrastructure, which you actually take many times for granted in the United States, is not in place, and that has to come first if you are ever going to have sustainable growth over a long period of time.

[The prepared statement of Mr. de Soto follows:]

PREPARED STATEMENT OF HERNANDO DE DOTO

Mr. Chairmen:

I appreciate the opportunity to appear before the committee today to share some thoughts regarding policies toward Latin America which may be helpful.

The economic policies of Western Countries toward Latin America generally fall into 3 broad program areas:

1) macro-economic programs based on sound monetary, fiscal and credit policies;

2) structural adjustment programs, including privatization and deregulation; and,

3) bilateral and multilateral aid programs to provide for capital investment, suitable technology and social equity.

The underlying assumption is that these types of programs will create the conditions necessary for entrepreneurship to produce socially equitable economic growth.

You ask what U.S. policymakers can do to improve your economic policies toward Latin America, particularly in light of democratization in the region.

Based principally on my experience in Peru, I believe that Latin American nations lack the institutions required to establish equitable, prosperous, and sustainable democracies and market economic systems. Though your economic policies are necessary, I find no reason to believe that they will produce major changes in this respect.

This should not come as a surprise. Both history and the rate of success are pretty good evidence of the difficulty of making democracy and markets work. Since the 1820s, most Latin American countries have had constitutions that provide for democratic organizations, equity and economic freedom. Today, 170 years later, we are still unstable, inequitable and poor.

The fact is that fewer than 25 countries out of 175 worldwide have succeeded in establishing stable democracies and prosperous markets. We believe that Latin American attempts to imitate these systems have largely failed because they have adopted only the superficial, organizational elements of these systems. Beneath the surface is a total institutional vacuum. The problem is like that of a tree which is transplanted but, lacking a developed root system, it withers and dies after a brief period of bloom.

Latin American countries have all the hallmarks of developed democracies and market economies: elections, separate Executive, Legislative and Judicial Branches, political parties which span the ideological spectrum and Treasury Departments and Reserve Banks to carry out macroeconomic policies. If these organizations are failing, it is because they are missing the following institutional underpinnings:

* public participation in government decision and rulemaking;
* transparency in government decisionmaking;
* accountability of government; and,
* legally secure property rights accessible to all.

Let me give you some examples from Peru that are akin to many Latin American countries:

<u>Example No. 1: Democratic Decisionmaking</u>

Since 1980, Peru has been considered a democracy because it elects a president and a parliament. After elections there is no on-going relationship between those who make decisions and those who live under them. In the five years after elections, government typically proclaims some 134,000 rules and decisions—more than 99 percent by the Executive Branch—without benefit of any input from citizens and without being effectively accountable to anyone.

In the United States, elections are only the tip of the democratic iceberg. Rulemaking is also democratic. To begin with, Americans have access to most government information. Draft regulations are published. Citizens can comment on them in writing and in hearings, and officials must respond. If officials do not, people can overturn regulations by using administrative courts. Civil servants do cost-benefit analyses on proposed regulations and Congressmen receive and react to constituents' letters. At the state level, referenda are used to circumvent government when, in spite of all the aforementioned mechanisms, the government fails to respond.

In countries such as Peru, none of these—or equivalent—institutions exist. Regulations and legislation are not the product of a democratic process, but of bargaining between a few special interest groups, political party leaders, and government officials. The result is rules which are contradictory and unpredictable and a legal system which is incoherently complex, and riddled with privileges and tollgates for corruption. Citizens have no guarantee that government policies will not harm them, or that the government will even pursue worthwhile policies.

Good coordination requires transparency and good information. Just as price information in open markets generate better economic coordination than central planning, democratic rulemaking generates better political coordination. In the same manner that competitive prices inform buyers and sellers how to allocate their resources, democratic rulemaking permits all interested parties to become aware of one another's aspirations, successes and failures.

Democratic rulemaking is the messenger of democracy just as prices are the messengers of markets.

Non-democratic rulemaking creates uncertainty, elevates transaction costs and distorts prices. For entrepreneurs it matters little whether costs come in the form of non-competitive prices or arbitrary and unanticipated regulations; they will minimize exposure to long term risks where there is no transparency and predictability. It is difficult to obtain stability or growth under such conditions.

Worse still, non-accountable, non-transparent rulemaking creates regulations that keep the majority of Peruvians out of the legal economy and forces them into that gray area known as the "informal sector." Some examples of Peru's economic apartheid: An informal entrepreneur finds that it takes nearly 300 days, working 6 hours a day, to register his business legally. To obtain legal authorization to build his home he must spend 8 hours a day, for 6 years and 11 months, to fulfill 207 administrative steps in 52 different government offices. The fact that 278 of Lima's 331 markets have been built by informal street vendors is not surprising when one considers that to obtain the building license generally requires 13 years of red tape.

This explains why most Peruvians remain informal, that is, they operate outside the law. Without legal property rights, the informal home owner or businessman is prey to eviction and exploitation, and he lacks the collateral needed to obtain credit. In short, he is deprived of all the facilitative law needed to operate within a market economy, among them enforceable contracts, limited liability systems and the security required to achieve economies of scale.

Non-democratic rulemaking requires armies of bureaucrats and policemen to enforce the law which in turn propels underground economies (including coca cultivation) for the peaceful poor, violent resistance from the rest, and migration to the United States for those able to travel.

Without institutions to ensure participation, transparency and accountability in government decision- and rulemaking, Latin Americans quickly lose respect for "democracy". No amount of macro-economic, structural adjustment and foreign aid programs, as presently designed, will create a stimulating and sustainable environment for most potential entrepreneurs and investment. No amount of available aid will suffice to create sustainable and socially equitable development.

Example No. 2: Legally Secure Property Rights Accessible To All

In Peru, private property abounds, but it is not legally recognized. In fact, 92 percent of all rural, and 60 percent of all urban property is not legally titled and registered. The principal source of the problem is that the system takes an average of 48 months to award title and costs the equivalent of 70 times the monthly minimum wage. The Peruvian situation is similar to that in many other Third World countries.

In Peru, we found that whenever registered titles have been awarded property values double immediately and increase nine-fold in ten years. In some developed countries, close to 70 percent of new enterprises are financed by credit secured by real estate collateral. At a minimum, a legal address is required to get a loan. This demonstrates that legally secure property rights are essential for growth and investment.

Our research also reveals much about the role of property in social order. Terrorists generally offer protection for informal property rights, a protection which is totally unnecessary when registered titles exist. Precise property identification is essential to create incentives for, and to develop accountability in law enforcement and environmental protection, and to carry out comprehensive drug crop substitution.

In the United States, a market economy works, among other reasons, because property rights are grounded in unambiguous titles and registration. Transfer is easy, by sale or lease, and property is used frequently as collateral for bank loans. In particular, since North Americans enjoy full access to secure property rights which enable them to participate in the market economy, they can understand and accept the necessity for good macro-economic policies and structural adjustment measures such as privatization.

How can Latin Americans, the overwhelming majority of whom have no access to legal property rights, be expected to support the hardships, or understand and obtain the benefits of macroeeonomic and structural adjustment measures? No amount of available aid will compensate for the lack of property rights.

Example No. 3: Procurement And The Origin Of International Public Debt

The lack of underpinning institutions such as transparency and accountability are responsible in large measure for the debt problems of Latin America. Some governments are suspected of paying as much as double the true dollar value of the capital investment projects for which they contract. The reasons are complex but stem from the lack of controls on the officials in charge of the contracting process and on the inadequate bidding procedures which permit collusive behavior between government officials, project designers, and suppliers.

At a time when Peru's external debt amounted to $17 billion, $11 billion was the result of capital project expenditure. Consider the environment in which public contracts are awarded: Congress scarcely plays a role in determining whether the project is even necessary. When it does, lack of transparency in budget-committees give rise to shady back-room deals. Rarely are procurement notices published in the federal register. Project specifications are continually tied to particular suppliers. Government-to-government contracts, regulated in Peru by 8 different protocols, shut out competition. No price lists of readily available "off the shelf" products exists to provide comparisons, and there are no "sole source" contracts linked to procurement under $25,000. Finally, there is no Office of Federal Procurement Policy to oversee the management of capital projects from start to finish.

Without institutions to ensure transparency and accountability in procurement, there can be little hope that the tendency to incur excessive debt and foment corruption will be arrested when international credit is available.

Conclusions

These remarks should not be considered a criticism of U.S. or developed countries' economic policies toward Latin America. My point is not that macroeconomic, structural adjustment, and aid policies are mistaken, but rather, that they do not get to the heart of the most apparent causes of underdevelopment. They offer short term remedies for our ills, rather than sustainable solutions.

My assumption is that with the underpinning institutions of democracy and markets, Latin American citizens themselves would make sure that the right policies are set up and followed. No society with the appropriate institutions will tolerate absurd obstacles to wealth creation or let overspending degenerate into unbridled debt and inflation or permit obvious corruption and privilege, much less harm to a political system that responds to its mandate and its claims.

Any elected government can be "of the people", but to be "by the people" it must inform the governed so that they can choose effectively, and to be "for the people" it must involve the governed so that its actions will reflect their needs and interests. The more we are all informed and involved, the more our rules and private decisions will be rational and our actions will be socially compatible. This is what legitimizes democracies and markets.

The challenge faced by U.S. policy makers who want to help Latin America is, first, to understand what institutions in their own countries make government decisionmaking transparent and accountable and what guarantees exist to protect the property rights of all citizens; then, to help developing countries create their own institutional mechanisms to ensure that real democracy and market systems can take root.

This is not as easy as writing a check. The institutions which underlie the success of the American market system and the genuine participation of Americans in their governing system were constructed over 200 years. The process has gone so unnoticed that Americans have taken it for granted and they have lost the ability to recognize and teach the importance of these institutions. In fact, they seldom incorporate these institutions into their foreign policies.

Moreover, the institutional underpinnings of successful democracies are difficult to discern. Their forms vary from one developed country to another. There is no model that captures the essence of these complex institutions independent of the particular historical process from which they emerged. Their strength and legitimacy rest on culturally accepted rules. The attempt to directly transplant alien models to Third World countries fuels xenophobia and assists paternalistic and vested interests in the rejection of those institutions.

Nonetheless, in much of the Third World we can find in the informal sector distinct cultural varieties of the institutional underpinnings needed to build markets and democratic systems. In contrast to developed countries, these institutions are dispersed, legally unenforceable, and need further development if they are to supplant the prevailing system.

Our work in reforming institutions in Peru is demonstrating that when legislation and programs to introduce democratic and market reforms are rooted in these informal institutions and advocated in the language of the cultures, they obtain the widespread acceptance needed to overcome resistance.

The basic task that lies ahead is to develop the strategies necessary for the peaceful and purposeful transition to a market economy and a stable democratic society. Emphasis must be put less on growth and more on transformational strategies to develop those institutions that foster equitable growth and democracy. A peaceful yet subversive attitude may be in order. My colleagues and I at the Instituto Libertad y Democracia have some home-grown recipes that we can talk about.

In spite of all the attention and resources you are currently giving to Eastern Europe it may be important for you to dwell somewhat longer on Latin America before you give up on us. We have to talk. Consider this: After 170 years of attempts to imitate your organizations, including 40 years with your active assistance, our failed attempts at capitalism have been more dismal than Eastern Europe's failed attempts at socialism. While Eastern Europe's totalitarian socialism produced per capita GDP of some $5000 a year, Latin Americans have not raised ours over $2000.

REPRESENTATIVE HAMILTON. I am glad you came along, Mr. de Soto, because before you spoke, I thought that we had too much agreement. Now, it is pretty clear that we do not have full agreement on the panel, and we can have ourselves a pretty good discussion.

In the first place, I want to get the reaction of Dr. Bailey and Mr. Feinberg and Dr. Roett as to what you said, Mr. de Soto.

I was sitting here, wondering whether you folks are talking about the same continent. We have three Americans here who have a totally different view of things down there than you do, Mr. de Soto. It is hard for me to think that you are talking about the same place.

Let's go ahead.

Dr. Roett, how do you respond to what Mr. de Soto said?

MR. ROETT. Oh, I have heard Mr. de Soto before.

REPRESENTATIVE HAMILTON. I have not, so it came as a bit of a shock to me.

MR. ROETT. It is a delightful message, and it is the old issue of whether the bottle is half empty or half full.

REPRESENTATIVE HAMILTON. Yes.

MR. ROETT. Quite clearly, he comes from a very, I think, unique situation in Peru.

All of us understand, given the recent events in Peru, that that country is indeed comparable to Africa, in many ways, in terms of its level of development and institutional problems.

Latin America is not homogeneous, as you know, Mr. Chairman.

The problems of Peru are not those of Chile.

The problems of Peru are not those of Costa Rica, and they are not those of Mexico any longer, either.

REPRESENTATIVE HAMILTON. Is Peru much worse off?

MR. ROETT. Absolutely. I think we would have a consensus on this panel that of the problem countries, or the problems in Latin America, Peru represents the most dangerous and difficult set of those issues, and therefore Hernando is quite right to address them in the way he did. And the kinds of extremes of institutional, or lack of institutional structures, I think, are obvious and manifest in Peru, for they are moving very differently in other ways in different countries.

So, I think, it is very important to understand that there is an extreme on the Latin American landscape, which is Peru—and one or two of the very smaller countries—but that does not represent the trend that is moving in a very different kind of way—not in all—but in many of the countries.

As my colleagues have mentioned, new kinds of leadership— younger, more technocratic, better informed and better educated leadership.

Second, realism about economic development and growth, moving away from statist models of economic development. That is nonsense for most of the leaders of Latin America today.

Understanding that there is a real world outside in which they must compete, in which they must export, in which they must attract foreign direct investment, all these are very recent and new changes, and they are real changes.

That does not, again, exclude the fact that Peru is a very serious situation.

REPRESENTATIVE HAMILTON. Mr. Feinberg?

MR. FEINBERG. I think Mr. de Soto has done, not only in this forum but in the work he has done over the last decade, an important service for all of us in that he has pointed and emphasized a certain, particular problem which has to do with the repression of economic activity by small-scale business, etc., in Latin America, and it has been important to focus on that.

It is also the case that democracy in many Latin American countries is rather thin, that it is electoral. It is what we would call here a "civic culture" of popular participation in everything from a parent-teacher association to Boy Scouts, and so on.

Those sorts of organizations are typically absent in most Latin American countries.

REPRESENTATIVE HAMILTON. Let me just interrupt you.

If there is anything we have heard about Latin America in the last decade, it is the "move towards democracy." And yet, Mr. de Soto just made the blunt statement a moment ago that there is no democracy—if I understood you correctly, Mr. de Soto. He just flatly says there is no democracy, period.

MR. FEINBERG. I think, as he said, there are electoral systems which we have tended to identify as a very important element of democracy, and certainly it is in our own political systems here. We know how much we focus on elections.

But that is not a full-blown, mature, fully developed democracy as we would understand it.

If you define "democracy" as an ability to participate in the essential decisions that affect your life, certainly decisions that are made at the national level by elected officials is part of that, but it is certainly not all of it.

So it is a matter of elections being an important start. I do not think we should belittle it.

If you compare the Latin American political atmosphere today, compared to ten years ago, or fifteen years ago, Latin Americans know how preferable the current, albeit electoral democracy, is as compared to rule by authoritarian military. It is imminently preferable today than 15 years ago. Therefore, yes, there has been progress.

Is it a deep, full-blown, satisfactory democracy? No, it certainly is not.

REPRESENTATIVE HAMILTON. And very fragile?

MR. FEINBERG. This varies from country to country, and I think Riordan's point is correct. Peru has been in economic decline for 20 years.

One economic experiment after another has been a disaster. I would not generalize in the Peruvian case. But, yes, over a long period of time, if democracy is not deepened and economics is not successful, yes, it is fragile.

Let me just respond a little bit to some of his economic points, as well, if I might.

You need good macroeconomic policy. It is extremely important no matter what is going on at the lower political level.

Without good macroeconomic policy and growth, you are not going to solve the problems of the small entrepreneur.

You also need good micropolicy. A lot of what he is talking about really has to do with what is commonly referred to as microeconomic policy, or deregulation.

To suggest, however, that protectionism, or unequal access to credit, is a sign of mercantilism, is equivalent to saying that our own Food & Drug Administration, or our own Department of Agriculture, are signs of lack of democracy and mercantilism.

Well, maybe they are, but maybe they are also signs that interest groups can organize in a democracy and are able to arrive at certain forms of protection of their own immediate interests.

We certainly suffer from unequal access to credit in the United States, as well. The S&L scandals have pointed that out.

So I think to some extent, in Mr. de Soto's general analyses, there is a problem of identifying what are the key causal factors.

I would suggest that some of the problems that he points to in which certain interest groups have been able to implement state policies that favor themselves is, in fact, often the result of democracy rather than the absence of it, and it reflects the ability of certain groups to be more successful than others in fostering certain governmental policies.

So there is a question of identification of the nature of the problem.

REPRESENTATIVE HAMILTON. Dr. Bailey, did you want to get into this?

MR. BAILEY. Well, I think there are four reasons why our testimony differed from Mr. de Soto's testimony.

One is the question of definition, as pointed out by Richard: What do you mean by "democracy"?

I mean, that is one of those wonderful words that can be defined 512 different ways.

Second, he was referring primarily to the Peruvian situation, and we were referring to the regional situation. Much of what he said I agree with, in terms of Peru. I definitely disagree with him in terms of Latin America, as a whole.

An example of that is in recent years in Mexico there has been a flowering of a civil society.

There has been the formation of civic groups all over the place to do all kinds of different things, and this has not happened in Peru.

But that does not mean that one can apply the Peruvian example to other parts of the Hemisphere.

A third reason for the difference is, quite simply, that we were addressing primarily the question of U.S. policy, and he was not. As he himself pointed out, he really didn't have any suggestions for U.S. policy.

Finally, I would say that a number the statements that he made are factually wrong.

The per capita GDP of the Eastern European and former Soviet bloc countries is nowhere near $5,000 a year, unless he used totally artificial exchange rates, which of course is what they did, and what they still do to a large extent.

I, however, found the points he made about the drug traffic extremely interesting and very true, not only for Peru, but also for other countries, such as Colombia.

This points out a very serious problem, frankly.

In my personal view, the whole thrust of U.S. anti-narcotic drug efforts are completely and wrongly directed.

They don't take the time and the trouble to find out what the real situation is.

The superstructure, policy structure, in this can only be described as brain dead, and has been for many, many years.

REPRESENTATIVE HAMILTON. I want to come back to that, but let's give Mr. de Soto a comment on this.

Dr. Bailey says that your perspective is all skewed, that you are looking at the whole continent from the standpoint of Peru, and you have a very parochial point of view.

What have you got to say about that?

MR. DE SOTO. Well, I think that he is right. I have taken, as I pointed out in my paper, a Peruvian point of view.

It is the country that I know best. It also happens to be, in that sense, because it is actually deteriorating faster than any of the other countries in the region, an interesting country in terms of being able to see the faults and make a diagnosis more clearly.

But the fact that Latin America is not homogeneous does not mean that these things are not taking place elsewhere.

I mean, there would have been a time that, for example, even just five years, we would have been here looking at Salvadorians, or Nicaraguans, or Hondurans, and we would have said, well, the dilemmas of these three countries are very different from Peru.

Peru has a stable government. It does not have as much of a guerrilla problem, and it does not have as many drug problems.

As a matter of fact, we looked at Peru just 30 years ago. We had one of the highest growth rates in Latin America, and everybody looked pretty fragile next to us. Even talking about GDPs of Brazil—and we will come back to the factual stuff, in awhile—we were slightly lower 30 years ago than the one of Peru.

So, you know, every country——

REPRESENTATIVE HAMILTON. Your statement says that beneath the surface there is a total institutional vacuum. You do not confine that statement to Peru. You are talking about all of Latin America in that statement.

MR. DE SOTO. Yes.

REPRESENTATIVE HAMILTON. You are talking about the tree withering and dying after a brief period of bloom.

You are saying to us that democracy is going to go down the tubes in Latin America, and that the market economies are going to go down.

MR. DE SOTO. The first thing I am saying is that there are no real market economies in the sense that market economies are everyone being able to potentially participate. That does not really exist.

I am also saying that though they all may be different, you are talking about differences between $750 per capita GDP to $2,000. In other words, we are talking about all poor countries, some of which are slightly better off than the rest.

We are comparing countries with GDPs of $2,000 to countries with GDP of $20,000.

The fact that Peru is in a bad situation would have meant that maybe 200 years ago when there were a lot of people and there were a lot of other informals tossing tea into the harbors of Boston, calling themselves the Boston Tea Party, somebody could have said: Look at King George III. They're the more stable. It is a different cultural situation. Now, that is a government that is standing still.

If you compare Williamsburg, which was at that time your capital, to either Mexico City or Lima, you actually looked at that time like a shanty town in Peru.

What I am trying to say——

REPRESENTATIVE HAMILTON. May I——

MR. DE SOTO. Yes?

REPRESENTATIVE HAMILTON. May I ask you, is this institute that you head, is that a private institute?

MR. DE SOTO. Yes, sir.

REPRESENTATIVE HAMILTON. Okay.

I want to go back to a point where Mr. Feinberg was speaking about the relationship between democracy and economic reform. What is the relationship in Latin America between democracy and economic reform?

Chile has been the outstanding example—am I correct—of economic progress in Latin America? I do not know if that is a correct statement, and you can correct me if I am wrong, but it has been one country that has been a very authoritarian situation, has it not?

What is the linkage here between democracy and economic reform?

Anybody can speak up.

MR. FEINBERG. In the actual situation of Latin America today, we currently have, at least, electoral democracies everywhere. So the issue is——

REPRESENTATIVE HAMILTON. In Peru?

MR. FEINBERG. As of most recent, but by and large, those are the trends in the Hemisphere, without a doubt.

REPRESENTATIVE HAMILTON. Yes.

MR. FEINBERG. If you said, with the possible exception of Mexico, then I said we would have an interesting discussion as to the evolution of Mexico. But I think even—

REPRESENTATIVE HAMILTON. What do you mean by Mexico? Explain that a little bit.

MR. FEINBERG. Mexico, as you know, sir, is essentially a one-party state that had elections in 1988 of dubious fairness.

REPRESENTATIVE HAMILTON. Are you saying that they do not have a democracy there?

MR. FEINBERG. I think that they do not have what we would think of as a multiparty, fully competitive and open system.

Representative Hamilton. Mr. de Soto's comments, with regard to Latin America, apply to the political democracy side, with force, to Mexico?

Mr. de Soto. That goes more to his definition of "democracy" than to the formal definition of "democracy."

Representative Hamilton. The Mexican situation?

Mr. de Soto. Yes.

Representative Hamilton. Okay.

Mr. Feinberg. What I think we should keep our eyes on are trends.

In Mexico, however authoritarian the Mexican political system has been, it has been opening up. There are a lot more NGOs in Mexico today, for example, than there were—whether or not we are talking about human rights, democracy, environment—than there were 10 years ago.

The Enterprise for the Americas Initiative and the Free Trade Area have accelerated and fostered the development of nongovernmental organizations and a civic society in Mexico. That is what I think we need to emphasize.

Representative Hamilton. You have political stability in Peru. That is obviously true. You have political instability in Venezuela? Is that a correct statement?

Mr. Feinberg. I think things have calmed down somewhat in Venezuela recently, but, yes, there was a shock to the system.

Representative Hamilton. Is it true generally that where you have had successful economic reform; you have had democratic government? Is that a fair statement?

Dr. Bailey, go ahead.

Mr. Bailey. I would like to address that question.

It is something I have studied for a long time.

If you take economic growth, in and of itself, without relation to anything else—which I do not, myself—the perfect combination is an authoritarian political system with a highly liberal economic system.

I mean, that is what you had in Taiwan and Korea, and a lot of the other places that have had marvelous economic development.

In 1952, Korea was a total disaster area. Taiwan, after the Chinese Civil War, was an overgrown swamp, and so on.

Representative Hamilton. Do you agree with that statement, Mr. Feinberg? Dr. Roett?

Mr. Roett. Yes. I think that my own perspective on this issue is——

Representative Hamilton. I will come back to you, Dr. Bailey, in just a minute.

Mr. Roett. ——complementary.

Mr. Bailey. Thank you. I do not want to leave it there.

[Laughter.]

Mr. Feinberg. In the swamp.

[Laughter.]

Mr. Bailey. I really do not.

Representative Hamilton. No, no, we will come back to you. We will let you finish that statement.

MR. ROETT. Yes. It seems to me that the important issue that I tried to emphasize, and which I think complements this discussion, is the emphasis on people.

We have a new generation of decisionmakers in Latin America, whom the United States has never had the opportunity to work with before. They are younger, better educated, and committed to structural and institutional changes.

If we were back in 1945, 1955, 1965, the people who we would be dealing with would be absolutely impossible.

The new generation understand the linkage between economic modernization and stabilization.

REPRESENTATIVE HAMILTON. Yes, but Dr. Bailey was saying a moment ago that the perfect situation is to have a liberal authoritarian government with market economics. Do you agree with that?

MR. ROETT. That is a particular model out of a textbook that some countries have tried, and that has indeed been successful in Chile in terms of building certain kinds of market institutions, and indeed providing a mechanism for return to electoral democracy.

It certainly is not one that I would advocate being followed in Latin America.

REPRESENTATIVE HAMILTON. Let's go back to Dr. Bailey.

MR. BAILEY. Yes. Thank you very much.

REPRESENTATIVE HAMILTON. We do not want to leave him hanging there.

MR. BAILEY. To me, of course, freedom and democracy are goods in and of themselves, so I am not "advocating" that method of doing it.

REPRESENTATIVE HAMILTON. I understand.

MR. BAILEY. If you have market liberalization and democracy simultaneously, in terms of my overall system of beliefs, that is the ideal situation—although it will undoubtedly result in a somewhat slower pace of economic growth for the simple reason that democracy is a messy system of government.

If you do not know that, just look around.

REPRESENTATIVE HAMILTON. Easy there. We are talking about Latin America.

[Laughter.]

MR. BAILEY. It is like Winston Churchill said. Democracy is the worst system of government, except for all the others.

REPRESENTATIVE HAMILTON. Dr. Roett, you have spent a lot of time in Venezuela, as I understand it. You have looked at the upheaval there pretty carefully.

Mr. de Soto's references there to the institutional obstacles to democracy and market economy, do they apply in the Venezuelan case?

MR. ROETT. Not completely, but they certainly are relevant to it.

I would argue that probably institutionally, Venezuela—of the major countries in Latin America—is indeed the weakest at the present time.

Of course, the irony is that at one point in the 1950s and 1960s, it had a very strong, dynamic political-party system.

That party system has atrophied and is no longer in touch with grassroots Venezuela.

REPRESENTATIVE HAMILTON. Do most of you think that ten years from now, democracy will be stronger in Latin America than it is today?

MR. ROETT. My own bet would be that in most of the countries, yes, if indeed they receive the kind of support they need for continued economic modernization and social development.

REPRESENTATIVE HAMILTON. Do you agree with that, Mr. Feinberg?

MR. FEINBERG. Yes.

REPRESENTATIVE HAMILTON. Do you agree with that, Dr. Bailey?

MR. BAILEY. Yes, I do.

REPRESENTATIVE HAMILTON. How about you, Mr. de Soto?

MR. DE SOTO. No, I do not necessarily agree with some of the things that have been said so far, if I may have——

REPRESENTATIVE HAMILTON. Do you agree with any of them?

MR. DE SOTO. I agree with some of them, but we are talking, I repeat, about a very crucial and unfathomable problem. We only have, I repeat, about 25 countries that have made it in the world.

The rest of the 150 have not. So, obviously, the fact that we should be able to produce a formula in two hours is going to be very difficult.

Nevertheless, to address your issues about authoritarian political systems working with liberal economic systems, in most of the world where this has occurred—which, for example, are the Asian Tigers —these happen to be countries that neighbored what is called a "Communist threat." Therefore, number one, they actually had incentives to do something very rapidly, in a contrary sense, and also to attract your attention.

Second, at least in talking about Hong Kong or Singapore, we are talking about relatively small countries with very special characteristics.

Next, what I would like to say in this case is that there is no way to elect a libertarian dictator. With our kind of luck, we would get a Mu'ammar Qadhafi. We get Fidel Castro. We get Valasco Averados. We get all sorts of different people.

There is no such thing as "electing" a dictator. So you cannot advocate that as a model.

Third, what I would like to say is that democracies are messy. They can be efficient or inefficient depending on whether they actually reflect popular opinion, popular will, and what the market wants.

What I am trying to say is that Latin America is not a democracy to be compared to yours.

Our governmental systems are not in touch with the people. The public officials get elected, for example, in the case of Peru—and I think it is absolutely no different in the rest of Latin America—they are elected, and when selections are over, governments are no longer in contact with the people.

None of the institutions that I mentioned before have feedback for accountability in place, and therefore they cannot produce the same results.

If they were in place——

REPRESENTATIVE HAMILTON. There are no exceptions to that in Latin America?

MR. BAILEY. I do not think there are any exceptions to that in Latin America; maybe, with the exception of Costa Rica.

REPRESENTATIVE HAMILTON. Let me ask you this.

Do any of you think that the democracies in Latin America will show the same kind of economic growth in the near future that the Asian Nations—the "Asian Tigers"—have shown?

MR. BAILEY. Absolutely. We have had cases in the past.

REPRESENTATIVE HAMILTON. Do you think that will occur?

MR. BAILEY. Oh, yes.

REPRESENTATIVE HAMILTON. Where?

MR. BAILEY. Well, if I had to point the finger, I would say Mexico, Chile, Argentina, and probably Venezuela and Colombia, although I am less sure of those two.

MR. FEINBERG. I would say, contrary to the idea, which is a very dangerous one, that economic reform is only possible under authoritarianism. In the last several years, wall-to-wall democracy has been undergoing, in country after country in Latin America, very radical economic reform in which vested economic interests are being pushed aside, defeated, ground under by the weight of very dramatic reforms implemented largely by technocrats, but with the political support of the top central leadership.

REPRESENTATIVE HAMILTON. Before we get too far, I want to say that Representative Armey wanted to be here today.

He would like to submit a statement for the record, and without objection that will be done. I think there is a Republican Caucus meeting now that prevents him from being here.

[The written opening statement of Representative Armey follows:]

WRITTEN OPENING STATEMENT OF REPRESENTATIVE ARMEY

Mr. Chairman, I commend you for holding this series of hearings on U.S.-Latin American economic relations. The first hearing on April 2, which focused on trade between the United States and our Southern neighbors, was helpful and enlightening. I trust that this morning's hearing will be equally infomative.

The United States and Latin America have the same interest in greater economic development and cooperation — increased economic interchange will create jobs, prosperity and social stability throughout the Western hemisphere.

There seems to be great deal of agreement among the exports about the general direction of future U.S.-Latin American relations — that President Busih's Enterprise for the Americas Initiative (EAI) has a lot of merit and that Congress should get off the dime and help the President implement it. I agree, and hope that at least some of the necessary enabling legislation can be approved this year.

I am worried, however, by the tendency for some well-credentialed "experts" in Latin American economics and/or sociology to use the region as a real-life laboratory for social engineering and economic planning experiments. These experiments have the laudatory expressed goals of greater democracy, incrased dispersion of wealth, and stengethened social services in "backward" Latin American nations. The experiments, of course, would be guided and directed by all-knowing American intellectuals, and funded by the American taxpayer either directly in new U.S. programs or indirectly through multilateral agencies funded heavily by these same American taxpayers.

While I agree that participatory democracy and economic prosperity are good goals for Latin America (as well as other nations), I think we should resist the temptation to give detailed instructions on domestic econoimc and social matters to our Latin American neighbors. WEll-intentioned American intellectual imperialism, especially that funded mostly by other persons' dollars, should have a high hurdle of credibility to meet before it is funded with scarce American money.

The better course seems to stick with a few basic principles about which we are sure, especially the primary insight that increased and freer trade between nations and/or regions increases the wealth of all trading partners. Expanding trade and wealth is the best and first step — we should be cautious about ambitious social plans we would like to impose on others.

REPRESENTATIVE HAMILTON. Let us go on.

I am interested, of course, in U.S. policy. I want to focus a few questions with respect to that, but I guess the beginning point may be to just describe for us the economic impact on the United States of what happens in Latin America.

Why is it important to us what happens down there, or what does not happen?

Give me a sense of how important Latin America is to the United States, not to Latin America.

MR. ROETT. Mr. Chairman, it is jobs. It is investment. It is exports. It is opening factories. It is producing more goods that, if Latin Americans grow, they are going to buy from us as they have traditionally, and there is no reason to believe those markets will not respond in the same kind of way.

We need to redefine our security relationship with Latin America in the 1990s. It is no longer based on Fidel Castro and the East/West conflict.

REPRESENTATIVE HAMILTON. Why is there such a gap between you folks who have studied this—you are all experts on this—and the ordinary working American who sees this jobs question totally different from the way you see it?

I mean, they look upon the situation as jobs going down to Mexico and Latin America, and we are losing jobs all over the place. Then, I ask you the question and you define it, in terms of jobs, as if to say that you are going to create more jobs in the United States if we have good relations with Latin America. Why the gap there? Do you understand that?

MR. FEINBERG. Well, I would make two points.

One is that there is not only vis-a-vis Latin America, but there is an asymmetry in the debate on trade, which is that the workers who are directly threatened with imports tend to mobilize. They are immediately aware of the threat that is presented to them.

Whereas, those who actually benefit from trade, or who might benefit from trade, tend not to be as well organized.

Therefore, it is largely a political matter of mobilizing the actual beneficiaries or potential beneficiaries of freer trade.

REPRESENTATIVE HAMILTON. Are the "beneficiaries" even aware that they are the beneficiaries?

MR. FEINBERG. There is also an educational and informational problem.

There is another policy problem, though, which is that in the United States, as opposed, for example, to a number of other countries, workers who lose their jobs—be it for trade reasons or for others—who do not have an adequate safety net.

There are not adequate retraining programs, relocation programs, etc., as the Congress has been debating, as you well know.

Without that, it is not surprising that workers very justifiably are frightened that if they lose their jobs, they will be out on the street, and that is a very depressing situation.

REPRESENTATIVE HAMILTON. All of you are persuaded that if NAFTA is adopted, that is going to benefit the United States, and it is going to benefit the United States in terms of jobs?

Right?

Do you agree with that, Mr. de Soto?

MR. DE SOTO. Yes. It should. That is the theory.

REPRESENTATIVE HAMILTON. You are all in agreement on that point?

[The panels voices agreement in unison.]

MR. FEINBERG. On a "net" basis.

REPRESENTATIVE HAMILTON. I understand. On a net basis. And a free- trade arrangement is going to be very beneficial to Latin America, as well?

MR. FEINBERG. [Nods in the affirmative.]

REPRESENTATIVE HAMILTON. So we have a very large stake, then, in what happens with respect to NAFTA. That is a very critical matter, as I understand your testimony.

Do you expect the NAFTA agreement to be expanded to include the other nations of Latin America?

Is that the natural course of things here?

MR. BAILEY. I would very much hope that there will be an accession clause of NAFTA.

REPRESENTATIVE HAMILTON. An accession clause will permit other countries to come in, if they want to?

MR. BAILEY. Yes.

REPRESENTATIVE HAMILTON. Is that basically correct?

MR. BAILEY. If they accept the terms of the agreement.

REPRESENTATIVE HAMILTON. And would you expect most countries to come in?

MR. BAILEY. Certainly, a majority of the countries of the Hemisphere, yes.

REPRESENTATIVE HAMILTON. Do you expect any of them to stay out?

MR. BAILEY. Peru?

MR. DE SOTO. I would like to make a comment on that.

REPRESENTATIVE HAMILTON. We will go to Mr. de Soto, and then MR. FEINBERG.

MR. DE SOTO. The restrictions that I pointed out regarding, for example, a subject like coca, or housing that would take 6 years and 11 months, were put in by the same type of vested interests in Peru and in the rest of Latin America as the restrictions toward foreign trade.

So I do think it will be very interesting when NAFTA works and it creates an example. It can have an exemplary and positive effect on the rest of Latin America, like the European Economic Community had effects on Greece, Spain and Portugal, because it will be an example of prosperity.

But it will take the beating down of the vested interests, which are the only ones who have access to making rules and decisions.

REPRESENTATIVE HAMILTON. Dr. Feinberg?

MR. FEINBERG. Yes. I do not think it is a foregone conclusion that the NAFTA will necessarily spread to the rest of the Hemisphere.

I think that there are in STR, for example, and elsewhere, a lot of questions as to whether or not that is a good thing.

REPRESENTATIVE HAMILTON. Do you agree with Dr. Bailey that it would be desirable?

MR. FEINBERG. I think it is desirable. In order to be certain that it happens, I think that the NAFTA negotiations have to be followed very closely to be sure that there is an adequate accession clause, which may not necessarily be what the Mexicans want, and I think we have to be aware that Mexican interests and U.S. interests are not necessarily convergent there.

MR. BAILEY. A very important point.

MR. FEINBERG. I also would urge that we begin to ask questions about the institutional structure that will be created as we think about this expanding free trade area, which is after all not just free trade but investment flows, flows of people, flows of services—it could actually be a deepening Hemispheric economic community, if you would allow the phrase.

REPRESENTATIVE HAMILTON. What were you talking about by "institutional structures"?

MR. FEINBERG. Well, the European Community, for example, has a very deep—perhaps too deep—but a very deep—

REPRESENTATIVE HAMILTON. Do we have to have a Brussels?

MR. FEINBERG. I think we need to think in terms of institutional structures that deal with everything from information collection to dispute settlements——

REPRESENTATIVE HAMILTON. It is one whale of a bureaucracy that they have over there.

MR. FEINBERG. Well, one does not have to go that far. It is too much of a bureaucracy, but if you ask yourself, despite all the vested interests in Europe, how come that process of European integration has moved forward so decisively? Who set the objective of 1992? Who pushed that and made that happen?

Political leaders come and go. George Bush is currently in favor of integration. We do not know what the next administration would necessarily think, what their emphasis would be.

What a bureaucracy does is that it keeps the mind focused. You have leaders who then have a vested interest in the expansion of Hemispheric integration, if you have such a bureaucracy with some good leaders like Jacques DeLeurs, for example.

That keeps the eye focused and keeps things moving, despite political vagaries of who happens to be chief executive at any moment in time.

So, yes, I think that despite all the failings, we do need to think in terms of an institutional structure to see to it that Hemispheric integration moves forward over time.

REPRESENTATIVE HAMILTON. I want to get at this Enterprise business, a little bit—the Enterprise for the Americas.

As I understand it, it is basically declarations of intent for future trade negotiations. That is what the Enterprise is about.

It has other components to it—debt reduction, and the MIF, the multilateral investment fund.

I am under the general impression that the latter two—the debt reduction and the multilateral investment fund—have not gotten very far.

I would like you to comment on that, if you would. I want to know your assessment of the Enterprise for the Americas Initiative. Most of you commented favorably on it in your statements, but give me a little sharper analysis of it; what is right with it, what is wrong with it at this point, and what needs to be done.

I must say, from the standpoint of a member of Congress, this Enterprise Initiative does not have very much visibility. It does not have very much push. Maybe it does not have enough, but I suspect if you ask most members of Congress about the Enterprise for the Americas Initiative, they would have a hard time telling you what it is all about. Yes?

MR. ROETT. Mr. Chairman, that is a serious failing on the part of the Administration that the Enterprise does not have a home in Washington.

Having said that, though, as I pointed out in my testimony, in Latin America, the resonance is very strong, and it continues to be so, that this is finally a new initiative by the United States.

So, therefore, the very strong steps that Congress can take in terms of supporting the Investment Fund, in terms of moving forward on modest but important debt reduction, would, again, be both symbolic and substantive to the Latin Americans, who we indeed are interested in revising our relationship with.

REPRESENTATIVE HAMILTON. Does this have a ring of the Alliance for Progress in Latin America?

MR. ROETT. I hope not. That was a different era, and a different epoch, and the Alliance turned out badly for a number of reasons that have been well proven.

REPRESENTATIVE HAMILTON. That left a sour note down there. But this one is very positive so far?

MR. BAILEY. It is a completely different kind of program.

MR. ROETT. It is a very different program, and it is coming at a very different moment of history in Latin America, as all of us have been pointing out.

REPRESENTATIVE HAMILTON. Let's spell that out a bit. What is different about it?

MR. BAILEY. The Alliance for Progress was basically an aid program, and was seen in Latin America as being highly paternalistic, which it was.

The Enterprise for the Americas Initiative is directed toward trade and investment, and there is an important environmental aspect that even people who know a lot about the Enterprise tend to overlook.

As Riordan said, it is coming at a very different time in the mentality of both the Latin Americans and the United States.

I would very strongly urge that, as I did in my paper, Congress put the investment and debt parts of the Enterprise into another bill and pass them, because it is my understanding that nobody was particular against them. They just got caught up in this whole foreign aid, and guarantee for housing in Israel stuff, and so on and so forth.

REPRESENTATIVE HAMILTON. That is right. Most of the Enterprise enabling legislation is stalled, not because it is the Enterprise, but because of other matters.

MR. BAILEY. Right.

REPRESENTATIVE HAMILTON. I did not mean to interrupt you, Mr. Roett. Did you want to comment on the Enterprise for the Americas Initiative? Please focus your comments, if you would, on the debt component and the MIF—the Multilateral Investment Fund. What needs to be done there?

MR. ROETT. Again, I think this is a modest but important initiative to indeed stress that the Enterprise for the Americas Initiative has three components: trade and investment, as well as debt reduction.

The Latin American countries look to us for cooperation, and indeed leadership, on all of these issues.

REPRESENTATIVE HAMILTON. Have we done enough with respect to debt reduction?

MR. ROETT. No. Not at all. As I pointed out in my testimony, we are now getting a slight increase in debt, and we need to keep whittling away at that.

REPRESENTATIVE HAMILTON. What does that mean, "debt reduction"? Does that mean we have got to appropriate some more money here for it? Or, we have to forgive debt? We have to reschedule it? What does "debt reduction" mean?

MR. ROETT. There are many forms of debt reduction. Very clearly what we are looking at here is public debt, which is held by the United States, and indeed the President has made——

REPRESENTATIVE HAMILTON. What do you want us to do?

MR. ROETT. Indeed, forgive some of the public debt.

REPRESENTATIVE HAMILTON. You think we ought to just forgive it?

MR. ROETT. I think, depending on economic performance——

REPRESENTATIVE HAMILTON. Do you agree with that, Dr. Bailey?

MR. BAILEY. I mean, it is not a question of forgiving the entire public debt. It is not a very large sum and is mostly important to the smaller Latin American countries, and it does not necessarily involve forgiveness, as such.

Some part of the Enterprise for the Americas Initiative talks about—and this part is forgotten by just about everybody—is to say that some part of this public debt can be paid back in local currencies and applied to environmental concerns that are of importance to us as well as to the rest of Latin America.

REPRESENTATIVE HAMILTON. Would you have us forgive any debt?

MR. BAILEY. Yes.

REPRESENTATIVE HAMILTON. We should forgive some?

MR. BAILEY. Yes. It is not being paid, anyway.

REPRESENTATIVE HAMILTON. What about the commercial banks? They are owned some money, too. Should we go to the commercial banks and say, write off some of this debt?

MR. BAILEY. They are doing that.

REPRESENTATIVE HAMILTON. Are they doing it?

MR. FEINBERG. The way to see the Bush Initiative is actually in response to the Brady Initiative, which is to say, there already was a debt reduction plan forcing the commercial banks to take some losses without the U.S. Government putting any money in directly, but with the IMF and the World Bank putting in money, and the IDB.

The commercial banks said, well, we are forgiving some money, why doesn't the U.S. Government also forgive some of its own credits?

And, hence, that is where this comes from.

REPRESENTATIVE HAMILTON. But if——

MR. FEINBERG. If I could make just one point here?

REPRESENTATIVE HAMILTON. Okay, but I want to get this. You are basically satisfied with the debt reduction effort now?

MR. FEINBERG. What I am not satisfied with is that it has not been multilateralized on the bilateral debt side.

REPRESENTATIVE HAMILTON. You lost me there—"multilateral," "bilateral"—what are you talking about?

[Laughter.]

MR. FEINBERG. The Bush Initiative says that the U.S. Government should forgive substantial portions under certain conditions of debts owned by Latin American Governments to the U.S. Government.

This is mainly AID money, PO-480, to some degree Export/Import Bank, ECC.

We have not required, or even discussed, really, that the debts owned by Latin American Governments to the Government of Japan, or to the Governments of Europe, should be part—

[The roll call bell rings.]

REPRESENTATIVE HAMILTON. Would you check and see what that is? We are not in session.

Go ahead. Excuse me.

MR. FEINBERG. Debts owned by Latin America to the other industrialized nations should also be part of this debt forgiveness process. That is the way bilateral debts have traditionally been handled in a multilateral framework in the context of the Powers Club. That is the way the Brady Debt Reduction Commercial Bank Forgiveness is being handled.

If we go ahead and forgive debts, the Latins can just take the money they save off of us and give it to the Europeans or to the Japanese. It should be multilateralized. Why has it not been?

The U.S. Treasury has not consulted adequately with our industrial country allies in putting together these programs initially.

REPRESENTATIVE HAMILTON. On the Multilateral Investment Fund, you all favor that, but it has not been fully funded. Is that correct?

MR. BAILEY. It has not been funded at all, in terms of the U.S. part.

REPRESENTATIVE HAMILTON. It is not funded at all.

Other countries have contributed, have they?

MR. FEINBERG. Yes.

REPRESENTATIVE HAMILTON. So we are lagging here.

MR. FEINBERG. We are lagging here.

MR. BAILEY. Yes.

REPRESENTATIVE HAMILTON. That is a request the President has made, and we have not provided in the Congress?

MR. BAILEY. That is correct.

REPRESENTATIVE HAMILTON. Is that correct?

MR. BAILEY. Incidentally, however, the Fund will not enter into operation until we have made our contribution.

MR. ROETT. The United States is holding this up.

REPRESENTATIVE HAMILTON. So that is a deficiency, a serious deficiency at this point. Right?

[The panelists nod affirmatively.]

REPRESENTATIVE HAMILTON. Okay, let us get back to the drug problem.

Dr. Bailey, I was interested in your comments a moment ago. You were very harshly critical, if I understood you correctly, with respect to the drug problem. Let's spell that out.

MR. BAILEY. Well, the U.S. policy on the drug problem has been just about equal parts meaningless rhetoric, beating up on foreign countries, and "enforcement"—"enforcement" meaning that every now and then you seize a few tons of cocaine, or something else on a boat, or on a plane, or something like that, and then you trumpet that to the skies and say that the operation is being successful.

It has not been successful at all. I mean, there has been no important, or even significant, reduction in the amount of drugs coming into the United States. There has been no price effect——

REPRESENTATIVE HAMILTON. Okay. What is the problem? What do we have to do?

MR. BAILEY. Because we are paying no attention to the conditions under which people produce and process these substances, the kinds of things that Hernando was talking about, and about which I absolutely agree with.

Our attitude to the entire problem is one of overbearing arrogance in which the "solutions" that we are in favor of are the ones that are being driven down everybody else's throat, and they do not work.

I would not be so unhappy about them being driven down other people's throats if they worked, but they do not.

REPRESENTATIVE HAMILTON. We talk about interdiction. We talk about eradication. What is wrong with that? And we talk about substitution. That makes sense.

MR. BAILEY. Interdiction will work about as well as it did during the period of prohibition, which means not at all, and it makes the situation worse.

REPRESENTATIVE HAMILTON. We are putting a lot of money into it.

MR. BAILEY. Oh, yes. We devote a lot of money to it. We would save money if we simply legalized it all and taxed it. Not only would we not spend the money that we spend now on interdiction, but we would also raise fund to which we could address the deficit problem and a few other things, and so forth.

However, I am not advocating legalization.

REPRESENTATIVE HAMILTON. It would be pretty tough for me to go out here and vote for legalization. I will tell you that.

[Laughter.]

REPRESENTATIVE HAMILTON. But in any event, you do not think the interdiction is working.

The eradication is not working, I gather?

MR. BAILEY. That is correct.

MR. ROETT. Mr. Chairman, most of the major studies indicate also that the emphasis on supply without any concern for demand and consumption is going nowhere. The issue is demand, and we are doing nothing, or relatively nothing, in this country about demand.

REPRESENTATIVE HAMILTON. That is basically the Latin American view, is it not?

MR. ROETT. It is my view, as well as the Latin American view, and many of the reports being written now about the narcotics' industry and trade emphasize the importance of our transferring some of our monies—70 percent now is being spent overseas for interdiction and eradication, and 30 percent at home. Of that 30 percent, 70 percent is going for domestic interdiction; only 30 percent is going for rehabilitation, education and retraining. That is the critical component missing.

REPRESENTATIVE HAMILTON. Do all of you agree with that?

MR. DE SOTO. No.

REPRESENTATIVE HAMILTON. You do not, Dr. de Soto?

MR. DE SOTO. But I do agree with something that has been said before by MR. BAILEY.

[Laughter.]

REPRESENTATIVE HAMILTON. We are making a little progress. Okay.

[Laughter.]

MR. DE SOTO. I think what Mr. Bailey said, if you will permit me, Mr. Chairman—and I think it is a very wise phrase—is that one of the problems regarding drugs is that no attention is being paid to conditions under which this war takes place elsewhere.

I would like to go back, if I may, just 10 seconds to another issue before coming back to drugs.

I addressed the issue of institutions that do not work. For example, you have addressed the debt question, again, in what I consider the short-term view, which is how are we going to get rid of the bad debt that we have now—is it going to be forgiven, or not—without addressing the conditions under which it was generated back home.

The Latin American debt—and I really do not think that the conditions are so different in Peru in quantitative terms as they are in Latin American countries—was generated under conditions of no competitive supplier bids, no tender procedures, no Office of Federal Procurement Policy to oversee.

Profit specifications were continually tied to specific suppliers.

Calculations in the World Bank by people like Mayma bol Hak indicate clearly that the costs of the projects bought with money of the foreign debt cost at least 100 percent more than it would have cost us if we had bought them in the United States, taking away all of the transaction costs.

In other words, it is also important to find out why this debt was generated, and why, when we get rid of this debt problem, we will not generate a second debt problem.

That has again to do with transparency, with accountability, and with participation decisions, because decisions do not only relate to rules of everyday life, they also relate to procurement and to the contracting of capital projects, which are a source of large corruption and a source of the foreign debt.

Now, regarding drugs——

REPRESENTATIVE HAMILTON. Let me just ask you, is corruption rampant in Latin America?

MR. DE SOTO. Yes. Of course.

REPRESENTATIVE HAMILTON. Everywhere?

MR. DE SOTO. Oh, yes.

REPRESENTATIVE HAMILTON. Do all of you agree with that?

MR. FEINBERG. I would not say everywhere.

REPRESENTATIVE HAMILTON. Where is it not?

MR. FEINBERG. I would say Chile, for example, has, through democracies and dictatorships, maintained a civic culture——

REPRESENTATIVE HAMILTON. Most of the governments of Latin America are very lax on prosecuting corruption. Is that a fair statement?

MR. BAILEY. Yes.

REPRESENTATIVE HAMILTON. Excuse me.

MR. DE SOTO. Yes. I would say that they have no instruments to prosecute corruption, because for that you need participation and transparency, and access to public information.

REPRESENTATIVE HAMILTON. Okay. I got that point. You have driven that home pretty hard.

MR. DE SOTO. Thank you.

Regarding the supply-side again, I would like to say something about what has been done in Peru that has been successful—and we could call it the supply-side of drugs—or it has a chance to be successful.

With the United States, an agreement was signed. Peru and the United States signed an agreement in which the Latin American point of view—which is that excessive repression by police on farmers can cause civil war, or accentuate civil war—was taken into account by United States authorities.

Therefore, there is an agreement whereby repression—that is to say interdiction—will take place against the drug traffickers, but making a distinction with the farmers who, to repeat, have no other alternatives.

What was proposed to the farmers were the following three things:

We have signed an agreement with the United States. Now, under that agreement, you are to eradicate and substitute against the following three conditions:

First of all, your property rights, your possessions, will be guaranteed by the State and legalized in such a way that you have an address, and you have collateral and can decide how you can associate to get economies of scale.

Second, we will respect your democratic organizations, and we will let you participate in any decisions that refer to you—you know, just like the United States, or Switzerland, or Germany, or any other messy democracy.

And third, we will try and find alternative markets for your products which fetch a total income for the coca farmers of Peru of about $100 to $150 million a year, which is half of 1 percent of what you spend federally to fight drugs.

Each one of the coca organizations—because they are all organized in the informal sector, and I would like to talk a little bit there about civic culture. All the informal sectors in Latin America are democratic; there is civic culture. The people who are not democratic are obviously the interlocutors of my neighbors at the stable, but below that surface people have democratic organizations.

There is not one coca organization that does not have a legislative assembly and an elected government. There is not one taxi drivers association. There is not one indigenous community. There is not one shantytown organization that does not have democratic elections, representation, feedback and open rulemaking.

When we asked the 182 coca organizations of the Upper Yuaga Valley, and the Aparemak Valley, where——

REPRESENTATIVE HAMILTON. What do you mean in your statement when you say: Beneath the surface, there is a total institutional vacuum?

MR. DE SOTO. Beneath the surface of the "formal" government, my paper says that in the informal sectors—where most Latin Americans actually live—there are all of the democratic institutions, which you find in the United States and elsewhere.

REPRESENTATIVE HAMILTON. The informal sector is democratic, and the formal sector is authoritarian? Is that what you are saying?

MR. DE SOTO. Yes. And you were the first ones to prove it when you started your revolution.

Now coming back to coca. There, we found that there were 182 coca-producing communities. That is to say, democratic organizations of the coca producers. They produce 60 percent of the world's coca. And all of the 182 legislative assemblies in this document, which I can leave with you, have signed and said that they would wish to substitute under the conditions offered them: property rights, democracy and respect of their organizations.

So there is a proof that you can do something on the supply-side.

Moreover, I repeat, half of 1 percent of your federal budget is what they require to substitute. They do not want subsidies necessarily. They need the infrastructure to export.

Second, as opposed to how you fight on the demand-side, you can control the crops because you can see them from the air. You can see them from a plane. You can see them from a satellite, which is something you cannot do with drug traffickers in the United States who work in cellars.

Third, they are cheap. Your direct traffickers make $40 to $50 billion a year. Our farmers make less than $100 or $150 million.

So something can be done on the supply-side. We just have not studied the issue sufficiently. Just like we have abandoned poverty to anthropologists, we have abandoned drugs to the police, and monopolization by any discipline of any problem leads to a distorted point of view.

REPRESENTATIVE HAMILTON. Now, the others of you, what is wrong with this substitution policy. Why is that not working?

MR. FEINBERG. I think, basically, despite some of the figures that Mr. de Soto threw out, there is a question of profit differentials that, at least in many regions——

REPRESENTATIVE HAMILTON. Have we had any success in getting them to substitute crops?

MR. FEINBERG. By and large, it has not succeeded because the underlying economics are such that, in fact, it is much more profitable to produce the coca than most of the substitute crops available.

Palm oil, by the way, with regard to cholesterol, is not the optimal oil to be used.

REPRESENTATIVE HAMILTON. What do we do on the substitution policy? Just forget it?

Dr. Bailey?

MR. BAILEY. I would point to the only example that I know of as a successful substitution policy, which is not in Latin America, it is in Turkey.

What the Turkish Government did was to tell the opium producers— because that is their problem, not coca—we will buy your crop because there is a legal opium market in the world.

We will also pay you what you make from the opium to gradually, not all at once, but gradually reduce—I think it was 20 percent per year of the area of production—the area devoted to poppies until that area reached the point where the legal market was supplied, and so on.

And they provided them with all kinds of technical assistance and credit, and help with pesticides and herbicides and fertilizer, and so on and so forth, in order to make their fields productive and profitable with alternative crops.

Now, Turkey has the advantage in the fact that much of their production is in the high-value per volume agricultural goods like fruits and vegetables. That program has been very successful.

REPRESENTATIVE HAMILTON. But not in Latin America?

MR. BAILEY. No. It has never been done that way in Latin America.

REPRESENTATIVE HAMILTON. Is it a program that is salvageable, or should we just forget it?

MR. ROETT. The broader question, Mr. Chairman, requires, for example, not just the introduction of new crops, but the production of roads, storage facilities, incentives to get to market; none of these things have been put into a coordinated package. Nor are we talking about a program that is going to work in six months or a year.

We must sit down and work out a five- to ten-year program that is going to produce——

REPRESENTATIVE HAMILTON. It is salvageable if we do it right? Is that it?

MR. ROETT. There is, at least, I think, an arguable case to be made that it is part of an overall solution.

MR. FEINBERG. I think one has to be very careful in jumping to that seeming conclusion. Because even if in one valley or in one country in Latin America, one were to succeed with a crop substitution program at considerable cost—putting in all the infrastructure, credits, etc.—the production moves to another valley, and another valley, and another country, and another valley.

We have seen that. In fact, to the extent to which there has been some success in putting pressure on the cartels in Colombia, in Medellin and Cali, what have we seen?

Five other countries in Latin America, or ten other countries in Latin America, now have a drug problem. So a micro success story in no way solves the problem in terms of U.S. consumption, or for Latin America.

REPRESENTATIVE HAMILTON. Dr. Roett, There is a sentence about "social equity" that I wanted to follow up on with you.

You say, "Social equity is now seen as part and parcel of the development process."

How are the countries doing with regard to this question of equity down there?

MR. ROETT. Well, that became a very important point——

REPRESENTATIVE HAMILTON. And I guess my interest is: Are the leaders of Latin America today, or are there leaders of Latin America today who are genuinely interested in the question of social equity?

MR. ROETT. I think there certainly are, and I think the issue became very clear at a recent meeting in Santa Domingo of the Inter-American Development Bank where the poverty issue/social equity question was addressed. The annual report of the Bank indicates that an increasing number of governments and leaders are beginning to address it.

In Brazil, for example, perhaps the most famous spokesman for social equity, Elude Jagobede, has just been taken into the government by President Calarde Giamello. Here is a man who spent a decade publishing books and studies, and pulling together the material to indicate how a social equity relates to Brazilian economic change.

That I think is a very important sign.

REPRESENTATIVE HAMILTON. Brazil has the worst inequality in the world, according to some studies; right?

MR. ROETT. That is right, in terms of income distribution, and so on.

REPRESENTATIVE HAMILTON. But the whole continent is characterized by enormous disparity. Right?

MR. FEINBERG. I am a little less confident with regard to the intentions of the current Latin American leadership and their real interest in addressing equity.

Here is an issue, it seems to me, not of democracy or lack of democracy, but the actual power structure in most Latin American countries where the wealthy are very powerful and have plenty of access, and poor people are not well organized in terms of political parties that successfully articulate their interests.

Hence, the governments of Latin America are not by and large, so far, primarily concerned with the equity issue, which is why I would emphasize that it has to be the international institutions that put a lot of pressure on the Latin American governments during this period and highlight the importance of the equity issue.

REPRESENTATIVE HAMILTON. Is social equity an issue in the presidential campaigns in Latin America? Does a candidate have to say certain things——

MR. FEINBERG. In Latin America, candidates run left and govern right. There is a long history of that.

MR. BAILEY. It is rhetorical.

MR. FEINBERG. But I think what is beginning to happen—and this is Riordan's point—is that the leadership is beginning to recognize that the economic reforms that they are in favor of and have recently instituted will not endure if they cannot address the social issue.

REPRESENTATIVE HAMILTON. They are beginning to see that?

MR. FEINBERG. They are beginning to see that.

Hence, they understand that both some of the political reforms that Mr. de Soto was talking about and the economic reforms are in their interest.

REPRESENTATIVE HAMILTON. Dr. Bailey?

MR. BAILEY. I agree, in general, with Richard. I think there is one shining exception, and that is Mexico.

I think the Mexican Government has addressed the social issue right along with the economic restructuring, and I think we are seeing the beneficial effects of that.

REPRESENTATIVE HAMILTON. Mr. de Soto wanted to comment.

MR. DE SOTO. Yes, please.

Regarding democracy, it has, I think, very much to do with the power structure.

If you compare how a Latin American political is elected, or a Latin American president is elected, as compared to, for example, a U.S. politician, they are two different things, even though they are elections.

You have to go through a whole process of primaries where you have to prove yourself in your state and in your political party.

You have to then compete with whoever has won the primary in the opposing political party. You then get to Congress. You get letters from you constituents because the system is that way. You follow your tracking stations. You have to go back and get re-elected all the time, on a personal basis.

In the case of Latin America—and I do not think it is very different in most places in Latin America—the candidates do not come from the bottom up. It is the political parties that have the money to actually get television and newspaper space that provide lists, and what people do is to choose between these lists in those countries——

REPRESENTATIVE HAMILTON. What are the voting participation rights in Latin America?

MR. DE SOTO. They are the same as elsewhere.

The problem is, how are candidates selected.

REPRESENTATIVE HAMILTON. I understand that, but I mean are they very high?

MR. DE SOTO. Yes, of course, because voting is obligatory.

REPRESENTATIVE HAMILTON. I see.

MR. BAILEY. Not everywhere.

MR. DE SOTO. Not everywhere, but in most places it is obligatory.

REPRESENTATIVE HAMILTON. In most, it is obligatory?

MR. DE SOTO. Yes.

As a result, of course, the fact is that the particular regime, even though they are all advocated to equity because there is no other way of being elected—because most people are poor—when it comes to actually taking the precise measures decision by decision—since none of the mechanisms to feed back are there—they cannot even address the issue, not because they do not want to, but because they are not even informed to begin with.

REPRESENTATIVE HAMILTON. We are running out of time here.

Go ahead, Dr. Bailey.

MR. BAILEY. I was just going to say on this point, what Hernando de Soto says about the democratic process in Latin America is true. It is also true of most democratic countries.

I mean, the primary election system, and so on and so forth, is fairly unique in the United States. Most democracies in the world operate the way he is describing.

MR. DE SOTO. This is not correct, of course.

There are other elements, even where there are lists, in the way those lists are selected in other countries. So there is a factual mistake there, too.

REPRESENTATIVE HAMILTON. I wanted to raise the question of flight capital.

One of you said in your statement—and I am not sure which one—about flight capital coming back.

Is that coming back into Latin America? Or just coming back into Mexico? Is it coming back all across the Continent?

MR. ROETT. There are indications it is coming back across the Continent, and as the stabilization programs work and institutional mechanisms are there.

REPRESENTATIVE HAMILTON. Does that mean that money is coming out of the United States and out of Europe into Latin America?

MR. FEINBERG. I think you have to be really careful here before we talk about flight capital returning.

The amount of money that has returned so far would not exceed the interest earned on the pool of flight capital. In other words, principal by and large is not yet returning. It is just the interest earned.

Because if we imagine something like $250 billion in flight capital out of Latin America, interest on that might be, say, $20 billion, not more than that has been returning on an annual basis. So we have not had a return of principal, yet.

REPRESENTATIVE HAMILTON. This return of flight capital is encouraging. Can it be sustained?

MR. FEINBERG. A lot of the money flowing in is in response to high real-interest rates in Latin America. That cannot, and in fact should not, be sustained.

But, yes, if Latin Americans should themselves decide that they want to invest a portion of their portfolio in Latin America, it should be sustained. And if the economic reforms continue, it will be sustained.

REPRESENTATIVE HAMILTON. Is Latin America open to foreign investment?

MR. BAILEY. No question about it.

MR. FEINBERG. Increasingly.

REPRESENTATIVE HAMILTON. Very clearly. There are no barriers?

MR. FEINBERG. They are coming down.

MR. BAILEY. There is much less than before.

REPRESENTATIVE HAMILTON. Mr. de Soto?

MR. DE SOTO. The reason why people flee the legal system and go into the informal sector is exactly the same reason why Latin Americans do not keep their capital back home, because the progress in democracy, transparent decisionmaking, and arbitrariness is not open to inspection. That is why capital flees, middle classes migrate to Miami, and the informal sector goes to the Upper Yuaga Valley. It is all the same reason. The political system does not work, and there is no guarantee of sustained policies.

REPRESENTATIVE HAMILTON. Thank you very much. I think we have had an excellent discussion. I appreciate your participation in both your testimony and your response to questions.

The Committee stands adjourned.

[Whereupon, at 12:35 p.m., the Committee adjourned, subject to the call of the Chair.]

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