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LATIN AMERICAN DEVELOPMENT AND WESTERN HEMISPHERE TRADE

HEARINGS

BEFORE THE

SUBCOMMITTEE ON INTER-AMERICAN ECONOMIC RELATIONSHIPS

OF THE

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

EIGHTY-NINTH CONGRESS

FIRST SESSION

SEPTEMBER 8, 9, AND 10, 1965

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LATIN AMERICAN DEVELOPMENT AND WESTERN HEMISPHERE TRADE

WEDNESDAY, SEPTEMBER 8, 1965

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON INTER-AMERICAN ECONOMIC
RELATIONSHIPS OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met at 10 a.m., pursuant to call, in room AE-1, the Capitol, Senator John Sparkman (chairman of the subcommittee) presiding.

Present: Senators Sparkman and Javits; and Representative Reuss.

Also present: William H. Moore, economist; Donald A. Webster, minority economist; and Hamilton D. Gewehr, administrative clerk.

Senator SPARKMAN. The committee will come to order, please.

First of all I would like to place the subcommittee's announcement of these hearings in the record to suggest the area of our interest and the framework of our inquiry.

(The announcement referred to is as follows:)

AUGUST 26, 1965.

SENATOR SPARKMAN ANNOUNCES HEARINGS ON LATIN AMERICAN DEVELOPMENT AND WESTERN HEMISPHERE TRADE

Senator John Sparkman (Democrat, Alabama), chairman of the Subcommittee on Inter-American Economic Relationships of the Joint Economic Committee, today announced hearings on "Latin American Development and Western Hemisphere Trade." The hearings will be held on September 8, 9, and 10, at 10 a.m. in room AE-1 of the Capitol. The schedule of the planned hearings is attached.

In making the announcement, Senator Sparkman commented:

"Our subcommittee last year touched upon the relationship of U.S. trade arrangements with the developing countries of Latin America but was not able to explore the subject in any depth. In recent weeks the President has offered U.S. support of a continentwide program for production and trade of certain products needed to increase Latin American production, and a group of four prominent inter-American leaders have presented their views regarding methods of speeding up the economic integration of Latin America.

"The subcommittee is interested in a better understanding of the progress, trials, and hopes of the two regional economic groupings in Latin America which have been underway for several years; the role of the United States either as a supporter of, or a party to, regional groupings in the Western Hemisphere; the closely related problem of traditional U.S. most-favored-nation policy; the implications of trade integration to private investment; and the contribution which trade integration may make to the development process."

Members of the subcommittee are:

Senator John Sparkman (Democrat, Alabama), chairman.
Senator Jacob K. Javits (Republican, New York).
Senator Len B. Jordan (Republican, Idaho).
Representative Richard Bolling (Democrat, Missouri).
Representative Hale Boggs (Democrat, Louisiana).
Representative Henry S. Reuss (Democrat, Wisconsin).
Representative Martha W. Griffiths (Democrat, Michigan).
Representative Thomas B. Curtis (Republican, Missouri).

SCHEDULE

SUBCOMMITTEE ON INTER-AMERICAN ECONOMIC RELATIONSHIPS

LATIN AMERICAN DEVELOPMENT AND WESTERN HEMISPHERE TRADE

Wednesday, September 8, 10 a.m.

I. Regional trade groupings versus nondiscrimination as a choice for economic policy:
  Panel:
    Regional economic integration and development assistance in general:
      Isaiah Frank, Clayton professor of international economic relations, School of Advanced International Studies, Johns Hopkins University.
    Regional economic integration and development assistance as applied to Latin America:
      Joseph Grunwald, director of economic and social development studies, the Brookings Institution.

II. Private investment and economic integration:
  Emilio G. Collado, vice president and director, Standard Oil Co. (New Jersey).

Thursday, September 9, 10:30 a.m.

III. Regional economic integration groupings in Latin America:
  Latin American economic integration: Status and problems:
    George S. Moore, president, First National City Bank, New York; president, Inter-American Council of Commerce and Production.
  Progress report on Latin American economic integration and proposals for the creation of a Latin American common market:
    Felipe Herrera, President, Inter-American Development Bank.[1]
  Raw materials in relation to Latin American economic integration:
    Carlos Sanz de Santamaría, chairman, Inter-American Committee on the Alliance for Progress.[2]

Friday, September 10, 10 a.m.

IV. U.S. trade arrangements in the Western Hemisphere: Policies and aims:
  With special reference to Latin America:
    Jack Hood Vaughn, Assistant Secretary of State for Inter-American Affairs.
  With special reference to the general economic policy of the United States:
    Anthony M. Solomon, Assistant Secretary of State for Economic Affairs.

Senator SPARKMAN. The Alliance for Progress, which finds its expression in the Charter of Punta del Este, has just noted its fourth anniversary. This historic charter envisions a cooperative and mutual program aimed at the worthy goals of reducing illiteracy, bringing about a steady increase in average incomes, and accelerating economic and social development generally.

Last year this subcommittee held hearings and issued a report focusing on the role of private investment in the advancement of these objectives. We concentrated our study at that time on the mutual commitment which the signatory countries undertook through the charter with respect to private investment in these words:

> To stimulate private enterprise in order to encourage the development of Latin American countries at a rate which will help them to provide jobs for their growing populations, to eliminate unemployment, and to take their place among the modern industrialized nations of the world.

[1] See p. 84.
[2] See p. 117.

In the course of those hearings, we touched upon the importance of trade arrangements and economic integration movements among the developing countries of Latin America, but did not have an opportunity to explore the subject in depth.

In this present set of hearings, our chief focus on this matter of trade and development explores another area of the expressed provisions of the Charter of Punta del Este which declares as a goal the desirability and urgency of economic integration in these words:

> To accelerate the integration of Latin America so as to stimulate the economic and social development of the continent. This process has already begun through the General Treaty of Economic Integration of Central America and, in other countries, through the Latin American Free Trade Association.

I think it is worth while to remind ourselves of the undertakings in the Declaration of the Peoples of America at Punta del Este, and I ask inclusion of the full text of title III of the charter at this point.

(The text of title III follows:)

TITLE III

ECONOMIC INTEGRATION OF LATIN AMERICA

The American Republics consider that the broadening of present national markets in Latin America is essential to accelerate the process of economic development in the hemisphere. It is also an appropriate means for obtaining greater productivity through specialized and complementary industrial production which will, in turn, facilitate the attainment of greater social benefits for the inhabitants of the various regions of Latin America. The broadening of markets will also make possible the better use of resources under the Alliance for Progress. Consequently, the American Republics recognize that:

1. The Montevideo Treaty (because of its flexibility and because it is open to the adherence of all of the Latin American nations) and the Central American Treaty on Economic Integration are appropriate instruments for the attainment of these objectives, as was recognized in Resolution No. 11 (III) of the Ninth Session of the Economic Commission for Latin America.

2. The integration process can be intensified and accelerated not only by the specialization resulting from the broadening of markets through the liberalization of trade but also through the use of such instruments as the agreements for complementary production within economic sectors provided for in the Montevideo Treaty.

3. In order to insure the balanced and complementary economic expansion of all of the countries involved, the integration process should take into account, on a flexible basis, the condition of countries at a relatively less advanced stage of economic development, permitting them to be granted special, fair, and equitable treatment.

4. In order to facilitate economic integration in Latin America, it is advisable to establish effective relationships between the Latin American Free Trade Association and the group of countries adhering to the Central American Economic Integration Treaty, as well as between either of these groups and other Latin American countries. These arrangements should be established within the limits determined by these instruments.

5. The Latin American countries should coordinate their actions to meet the unfavorable treatment accorded to their foreign trade in world markets, particularly that resulting from certain restrictive and discriminatory policies of extracontinental countries and economic groups.

6. In the application of resources under the Alliance for Progress, special attention should be given not only to investments for multinational projects that will contribute to strengthening the integration process in all its aspects, but also to the necessary financing of industrial production, and to the growing expansion of trade in industrial products within Latin America.

7. In order to facilitate the participation of countries at a relatively low stage of economic development in multinational Latin American economic cooperation programs, and in order to promote the balanced and harmonious development of

the Latin American integration process, special attention should be given to the needs of these countries in the administration of financial resources provided under the Alliance for Progress, particularly in connection with infrastructure programs and the promotion of new lines of production.

8. The economic integration process implies a need for additional investment in various fields of economic activity and funds provided under the Alliance for Progress should cover these needs as well as those required for the financing of national development programs

9. When groups of Latin American countries have their own institutions for financing economic integration, the financing referred to in the preceding paragraph should preferably be channeled through these institutions. With respect to regional financing designed to further the purposes of existing regional integration instruments, the cooperation of the Inter-American Development Bank should be sought in channeling extraregional contributions which may be granted for these purposes.

10. One of the possible means for making effective a policy for the financing of Latin American integration would be to approach the International Monetary Fund and other financial sources with a view to providing a means for solving temporary balance-of-payments problems that may occur in countries participating in economic integration arrangements.

11. The promotion and coordination of transportation and communications systems is an effective way to accelerate the integration process. In order to counteract abusive practices in relation to freight rates and tariffs, it is advisable to encourage the establishment of multinational transport and communication enterprises in the Latin American countries, or to find other appropriate solutions.

12. In working toward economic integration and complementary economies, efforts should be made to achieve an appropriate coordination of national plans, or to engage in joint planning for various economies through the existing regional integration organizations. Efforts should also be made to promote an investment policy directed to the progressive elimination of unequal growth rates in the different geographic areas, particularly in the case of countries which are relatively less developed.

13. It is necessary to promote the development of national Latin American enterprises, in order that they may compete on an equal footing with foreign enterprises.

14. The active participation of the private sector is essential to economic integration and development, and except in those countries in which free enterprise does not exist, development planning by the pertinent national public agencies, far from hindering such participation, can facilitate and guide it, thus opening new perspectives for the benefit of the community.

15. As the countries of the hemisphere still under colonial domination achieve their independence, they should be invited to participate in Latin American economic integration programs.

Senator SPARKMAN. On August 17, 1965, President Johnson, at the ceremony commemorating the fourth anniversary of the Alliance for Progress, spoke of the accomplishments thus far and new directions for the future. I ask that the complete text of the President's remarks at the White House on that occasion be included as an appendix to these hearings. (See app. I, p. 207.)

In order, however, to have before us the specific comments of the President on matters which are the subject of these hearings, I would like to include at this point an excerpt of the President's speech listing three points. These comments were prompted by a letter which President Johnson and the other American Presidents had received from the Inter-American Committee on the Alliance for Progress, known commonly as CIAP. The text of the letter appears in this hearing as appendix IV, page 220.

(The particular excerpt from the President's remarks follows:)

Recently, I received—as did the other American Presidents—a letter from CIAP suggesting changes and new departures. The leadership of this organization is itself one of our very healthiest developments. And I pledge that my Government will review this letter with great care and sympathy.

But from this letter—and from our own experience—we can already see the shape of future emphasis.

First, we must step up our efforts to prevent disastrous changes in the prices of those basic commodities which are the lifeblood of so many of our economies. We will continue—as we did this week in London—to strengthen the operation of the coffee agreement and to search for ways to stabilize the price of cocoa.

We will try to maintain a regularly expanding market for the sugar that is produced by Latin America. And consistent with the CIAP recommendations, I will propose this afternoon that Congress eliminate the special import fee on sugar so that the full price will go to the Latin American producers.

Second, we must try to draw the economies of Latin America much closer together. The experience of Central America reaffirms that of Europe. Widened markets—the breakdown of tariff barriers—leads to increased trade and leads to more efficient production and to greater prosperity.

The United States will, as CIAP suggests, contribute from its Alliance resources to the creation of a new fund for preparing multinational projects. By building areawide road systems, by developing river basins which cross boundaries, by improving communications, we can help dissolve the barriers which have divided the nations.

In addition, I hope the American nations will consider the establishment of a program—patterned after the European Coal and Steel Community—for the production and trade, on a continental basis, of fertilizer, pesticides, and other products that are needed to increase agricultural production. My country stands willing to help in such a venture.

And thus, in ways that he never imagined, we can move much closer to the dream of Bolivar.

Third, we must emphasize the needs of rural Latin America. Here is the scene of the most abject poverty and despair. Here half the people of Latin America live. And it is here, in the countryside, that the foundation of a modern economy will finally be built. Through the diversification of crops, we can decrease dependence on a few export products. Through increasing production, the countries of Latin America can feed their own people. Through increasing farm income, we can provide growing markets for new industry.

Senator SPARKMAN. Senator Javits, you have a word to say before we start?

Senator JAVITS. Yes, Mr. Chairman; I would like to make a preliminary statement.

Mr. Chairman, these hearings on Latin American development and Western Hemisphere trade are of crucial importance. They come at the right time, when political leaders and experts both in Latin America and the United States are, at last, beginning to wrestle with the economic realities involved in the relationship between the nations of the Western Hemisphere.

The central question now before the Americas is how the promises of a true economic partnership between Latin America, the United States, and Canada can be realized. These hearings should lead to a thorough examination of this question as well as to a full exposition of the Administration's economic policies concerning Latin America—an exposition which will be of inestimable value to the economic policymakers of Latin America.

It is now widely accepted that without greater economic integration it will be extremely difficult, if not impossible, to attain the accelerated economic growth necessary for Latin America. It is also true that without greater export opportunities for Latin America's traditional primary commodity—exports as well as its manufactured products—Latin America will be unable to finance the imports that are vitally important to the development of its new industrial base.

The Latin American Free Trade Association and the Central American Common Market represent important advances in economic integration. The fact remains, however, that intra-LAFTA trade still constitutes only 9 percent of the total trade of LAFTA countries, while trade even between members of the Central American Common Market—which has done much better than LAFTA—accounts for only 13 percent of their total trade.

I believe that only a Latin American Common Market would permit the establishment of a rational, regional transportation and communication system, provide the necessary stimulus to rapid industrial development in a competitive atmosphere, and bring about the necessary diversification of Latin America's economy that would reduce its dependence on the exportation of primary commodities which still represent 75 percent of its income from exports. Such a common market would also greatly increase Latin America's leverage with the industrial nations of Europe and North America. I also believe that the United States should assist this process of economic integration, and I am pleased that the President has come out so strongly in support of this idea and its application in a number of fields.

I have said that these hearings come at the right time because they immediately follow several important developments from the viewpoint of Latin American integration and U.S. trade policy toward Latin America. These include the proposal for the creation of a Latin American Common Market prepared by Drs. Herrera, Mayobre, Sanz, and Prebisch in April, in response to the initiative of President Frei, of Chile; the proposals of President Illia, of Argentina; the letter of Dr. Sanz de Santamaría, Chairman of the Inter-American Committee on the Alliance for Progress, to the presidents of the hemisphere on August 10 and President Johnson's response on the fourth anniversary of the Alliance for Progress; and the start of full-scale operations by the multinational, multimillion-dollar ADELA Investment Co. The spiritual father of this investment company is here today, Dr. Collado. I had the honor to be chairman of the operative organization and of the conference that brought it into being.

These developments represent, in part, the growing support at the highest levels in Latin America for economic integration; in part, the increasing responsiveness of the U.S. Government to Latin American views on economic integration and for improved treatment of Latin American exports in the U.S. market and, in part, greater international confidence in the future of the private sector in Latin America. I credit these developments I have named with these results.

What we learn here may also have immediate application at two important inter-American conferences which are scheduled for November: the Rio Conference of Foreign Ministers, and the meetings of the Inter-American Economic and Social Council. While the Rio Conference will be concerned principally with political questions, it is clear that economic problems have now reached the stage where they require political decisions at the highest levels for a solution.

These hearings will provide an opportunity to get a clearer understanding of the meaning of President Johnson's proposals. They will also give Congress and the American people an opportunity to obtain the views of prominent Latin American personalities on the progress of Latin American integration and how Latin Americans view their economic relationship with the United States.

We will be fortunate to have before us the principal Administration official concerned with Latin American policy, Assistant Secretary Jack Vaughn, as well as the principal State Department foreign economic policy spokesman, Assistant Secretary Anthony Solomon. The views they express concerning new U.S. trade relationships with the hemisphere will be very closely watched by Latin American leaders who want to know specifically what positions the United States has taken to several recently expressed Latin American proposals in the field of economic integration.

The hearing will also cast light on how Latin American economic integration will affect the private sector. George S. Moore, president of the First National City Bank of New York as well as of the Inter-American Council of Commerce and Production, and Emilio G. Collado, vice chairman of the Executive Committee of the ADELA Investment Co. and vice president and director of the Standard Oil Co. of New Jersey, are both distinguished leaders and eminently qualified to testify on these problems.

Finally, may I pay my tribute to our chairman, Senator Sparkman, of Alabama, in whose debt I am so very often in this field as well as housing and other fields, for the foresight and initiative which have brought about these hearings. I know the chairman understands only too well how deeply involved in this matter I am and in all of the work of this subcommittee. I would like to assure the chairman that I see every indication that this year may very well mark a historic turn in the road for the United States toward a new relationship with Latin America which will really signalize the age of partnership succeeding the age of the good neighbor. Should we take advantage of new opportunities the Dominican situation will be a bad dream, happily behind us, attributable only to the fact that the inter-American system is not yet abreast of the grave exigencies which from time to time face us.

I should like to have the record include also the text of the remarks which I made on two occasions in Latin America last year. First, my remarks on March 6, 1964, at the 10th Plenary Assembly of Businessmen of the Americas, sponsored by the Inter-American Council of Commerce and Production in Santiago, Chile. (See app. II, p. 211.)

Second, the text of remarks which I delivered before the American Chamber of Commerce of Mexico, University Club, Mexico City, on April 5, 1965, on the subject of "Political Action Vital for Latin American Integration." (See app. III, p. 216.)

I think it highly desirable also that our record include the letter from CIAP to which President Johnson referred in his speech. This is the letter that was sent to the Presidents of all of the American Republics, and is signed by Roberto de Oliveira Campos, Luis Escobar Cerda, Rodrigo Gomez, Jorge Sol Castellanos, Roque A. Carranza, Ezequiel Gonzales Alsina, Walt Whitman Rostow, and Carlos Sanz de Santamaría. (See app. IV, p. 220.)

No doubt Felipe Herrera in connection with his presentation to the subcommittee will make reference to the so-called Proposals for the Creation of a Latin American Common Market which the four prominent inter-American economic leaders submitted last spring. This document should likewise be in the record of our hearings. (See app. V, p. 229.)

We should also include: "Toward a Latin American Economic Community: Problems and Progress," an address by Felipe Herrera, President of the Inter-American Development Bank, at the inauguration of the Institute for Latin American Integration in Buenos Aires, August 24, 1965. (See app. VI, p. 245.)

Senator SPARKMAN. Thank you, Senator Javits. We appreciate the very fine statement that you made; and the documents you mention are made part of the record.

Mr. Reuss, do you have a preliminary statement to offer?

Mr. REUSS. None other than to express my gratitude, Mr. Chairman, that you are holding these hearings—they are most timely—and to agree with what Senator Javits has just said.

Senator SPARKMAN. At this point in the proceedings we will include a statement by Senator Jordan of Idaho, a member of this subcommittee, and additional materials pertinent to these hearings.

STATEMENT BY SENATOR LEN B. JORDAN OF IDAHO

Senator JORDAN. Enthusiasm for the idea of regional economic development has been riding high in recent years. Both within our own country as well as overseas, powerful support has been mustered behind the drive for regional integration that exists today in several areas of the world. I welcome these hearings since they offer a unique opportunity to focus critical attention on the potentialities for regional integration in Latin America as well as throughout the Western Hemisphere.

While economic integration has much to offer the developing countries, I feel that some of the implications of integration have not yet been explored thoroughly by supporters of the integration movement. The question which should be in our minds is the degree to which economic integration may work against economic development and the goal of a more open, expanding, and nondiscriminatory world economy. Each of these regional groupings discriminates against the United States as well as against all nonmembers.

The issue is not really whether we support or do not support economic integration; the important question is the nature and spirit of these regional groupings that are actually evolving. We should be concerned whether the world economy in the future is going to be characterized by healthy competition and the allocation of resources largely through market mechanisms, or whether regulation, planning, and government operation will become the order of the day.

While I have not yet taken a position for or against integration in Latin America, I do think we should guard against discriminatory arrangements anywhere in the world that fall short of satisfying the GATT rules for a free trade area or customs union. The welfare of the developing countries and of the entire free world economy will be better served in the long run if we prevent economic integration from developing into a protectionist device. I hope that the subcommittee will direct some of its efforts at examining the dangers as well as the benefits that may arise from the integration movement in Latin America and elsewhere.

With your consent, Mr. Chairman, I would like to have several items touching on this problem included in the record of these hearings at this point. One is an excerpt from an article by Lincoln Gordon, formerly professor of economics at Harvard University and now U.S. Ambassador to Brazil. Another is an excerpt from a report written by Representative Martha W. Griffiths, a distinguished member of this subcommittee. Finally, there is an excerpt from a report on Latin America by the Committee for Economic Development which favors economic integration but which candidly recognizes some of the problems which may arise from it.

(The items referred to follow:)

FREE TRADE, TARIFF LEGISLATION, AND COMMON MARKETS FOR THE WESTERN HEMISPHERE: A COLLECTION OF EXCERPTS AND SELECTED REFERENCES[3]

* * * * * * *

C. EXCERPT IN OPPOSITION TO A WESTERN HEMISPHERE COMMON MARKET

(From Lincoln, Gordon, "Economic Regionalism Reconsidered," World Politics, vol. 13, January 1961: pp. 250–253)

IV. Interregional relations

The general shape of the world's economic structure to be aimed at in the 1960's, then, aside from the Communist bloc, would include an all-European grouping with internal free trade, the United States as a kind of economic region in itself, and various degrees of development regionalism in various groupings of underdeveloped countries.

With respect to the industrialized groups, it is of great importance that external tariffs be low, and that the aim of global free trade for industrial products among the advanced countries be kept steadily in view and be progressively achieved. This is significant not only for the prosperity and growth rates of the two large regions, but also for the accommodation within the system of a number of important countries, such as Canada, Australia, and Japan, which do not readily fit into one of the free-trading areas. Hopefully, some of the semi-industrialized nations will be gradually moving into this category as time passes. To achieve this objective, a new type of tariff-bargaining authority will probably be required for the United States, but this is a topic which lies outside the scope of the present article.

As between the advanced and the underdeveloped regions, the critical question is whether there should be preferential interbloc arrangements. The British system of imperial preference at one time was of great significance. Commonwealth preference for United Kingdom exports has been steadily decreasing over the postwar period, but almost all Commonwealth goods continue to enjoy free entry into Britain and this fact certainly influences the direction of trade. A major new addition to interregional preferences results from part IV of the Treaty of Rome, which provides for the association with the European Common Market of the oversea territories of France, Belgium, the Netherlands, and Italy. Most of these territories have become or are becoming sovereign much sooner than foreseen when the Rome Treaty was negotiated. The new nations will, of course, be free to decide whether they want to maintain association with the Common Market grouping, but they will undoubtedly be under heavy pressure to do so. Here again the American attitude toward these arrangements may be decisive in determining the actual outcome.

If the special economic relationships between European countries and their former colonies (e.g., between France and both west and equatorial Africa) were to be regarded as permanent, there might be some logic in broadening the European side of these relationships from individual countries to the new economic Community of Six. In the typical contemporary pattern, the relationship is two-sided, involving special responsibilities of the metropolitan area for technical assistance and public investment, as well as sheltered (and inherently discriminatory) arrangements for private investment and for trade in both directions. As a long-term system, however, it raises very serious problems, both economic and political. It is of questionable value for the underdeveloped areas concerned; it contains vestiges of the colonial relationship which are natural targets for nationalist attack and Soviet exploitation; and its durability is therefore highly uncertain.

[3] Prepared by the Economics Division, Legislative Reference Service of the Library of Congress, 1962, 87th Cong., 2d sess., H. Doc. No. 598, p. 66.

The United States would be well advised to use its influence against such arrangements, avoiding their expansion and working toward the dismantling of those now in being. This does not imply any effort to disrupt existing trade connections or to discourage the greatest possible contribution in technical assistance and other forms of aid from former metropolitan countries to the newly sovereign nations who welcome such aid. On the contrary, the assets of experience and understanding developed during the more enlightened phase of colonialism may be indispensable to the success of early developmental efforts. What is objectionable, however, is exclusivity and special privilege in such arrangements. The indicated course of action, therefore, is not to erect new barriers in the advanced countries to imports from developing ones, but to universalize the free (or low-tariff) entry now given to the favored colonial or ex-colonial areas. The alternative is another line of economic cleavage and source of friction in the free world.

A portent of this danger can be found in the legitimate concern already expressed by both Latin American and Asian tropical producers at the prospect of preferential access for African coffee, cocoa, cotton, bananas, and other such commodities into the European Common Market. It is difficult to see any justification for the resulting new discrimination by Germany in favor of Africa and against Latin America and Asia. Such action indirectly damages American interests and has no visible relevance to the objective of European political cohesion.

By the same token, the United States should be disturbed at the prospect of new discrimination in Africa against its own capital goods exports, not merely in bilateral relationships between former colonies and metropolitan countries but now also in favor of supplies from the whole Common Market, notably including Germany. In order to accelerate economic development, African regionalism to encourage its own industrialization should be fostered along the lines already suggested here. But this is an entirely different matter from inducing the African nations to discriminate against certain free world sources of capital goods, thereby losing the advantages of free competition among suppliers.

Politically, the whole idea of "Eurafrica" threatens to create new frictions and antagonisms within the free world. Consider the case of coffee, which is one of several primary products of the underdeveloped world faced with the prospect of very severe long-term surpluses. If Africa and Latin America become embroiled in a major coffee war, and if Europe develops a permanent preferential system to support the African side in such a war, there will be strong pressure on the United States to give similar preferences in the Western Hemisphere.[20] Apart from the direct disadvantages of this sort of economic warfare, it would create an intolerable situation for other countries who happen not to be proteges of either of the big regional blocs. Such unattached underdeveloped countries are much less able to take care of themselves than Canada and Australia among the more advanced countries.

It follows that the United States should press for general adherence to a policy of interregional nondiscrimination, under which the industrially advanced groups would give equal access to food, raw material, and manufactured goods from all underdeveloped areas, and the underdeveloped regions would, to the extent that they were protecting infant industries, protect them on a uniform basis from all comers and offer to all outsiders equal facilities for sales of capital goods and for investment. Where primary product market instability requires some sort of internationally organized intervention in the markets (as I believe it does through buffer stocks in the case of certain minerals and through production and export limitations in such cases as coffee), the advanced countries should cooperate in these arrangements on a free worldwide basis, again without discriminating in their treatment of individual underdeveloped countries.

V. American participation in regional blocs

It remains only to recapitulate briefly what has already been suggested above concerning direct American participation in regional economic arrangements. As among the industrially advanced nations (the "Atlantic community" idea), such participation would be economically desirable, but it appears politically out of the question for the present decade. It is not at all clear that Europe would now accept free trade with the United States, and it is virtually certain

[20] In this connection, the situation would be even more difficult if arrangements for merging the European trading blocs included the type of suggestion published in the Economist on July 2, 1960, calling for "perhaps a new joint policy toward Africa giving both ex-French and ex-British territories free access to the whole European market for their cocoa and coffee."

that the United States would now refuse free trade with Europe. If tariffs on industrial products of both of these large economic areas can be progressively reduced, we might hope to reach a situation toward the end of the decade in which they both approach external free trade on a worldwide basis. The issue of special trading blocs would then, of course, no longer arise. And this would avoid, among other difficulties, the charge that the United States was discriminating in favor of the already quite rich against the very poor, in those cases where underdeveloped countries are direct competitors of Europe.

The other suggestion in this field which is advanced from time to time is a Western Hemisphere common market or free trade area, including the United States (and presumably Canada) as well as all 20 Latin American Republics.[21] In my view, this proposal is neither desirable nor feasible. It would cut across the developmental aspirations of the industrializing nations of Latin America, nations whose governments differ in many economic policies but agree on the importance of protecting their infant industries from being throttled at birth by massive American competition. The very proposal would raise charges of a new form of economic imperialism from the "Yankee colossus of the north." It would also be open to the same kinds of objections with respect to this hemisphere that the Treaty of Rome raises for the Eastern Hemisphere.

A Western Hemisphere common market would imply discrimination by the United States against supplying countries of Africa and Asia, many of whom are even poorer and politically more vulnerable than the countries of Latin America. We do indeed face a major task of demonstrating our economic brotherhood with Latin America, but there are better ways to do this than engaging in systematic commercial discrimination against our friends elsewhere in the world.

Excerpt

ECONOMIC POLICIES AND PROGRAMS IN MIDDLE AMERICA, JOINT ECONOMIC COMMITTEE, 1963: A REPORT BY REPRESENTATIVE MARTHA W. GRIFFITHS

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It is, of course, debatable just how far the allocation of various industries among the countries can and should be carried out. Already far along are production plans designated as "integrated": tires for Guatemala, copper extrusions for El Salvador, sulfuric acid for Honduras, and insecticides for Nicaragua. Integration of this sort runs two risks: one of these is that the economic benefits of the price mechanism in assuring the most efficient use of resources may be lessened by the injections of political considerations into the allocation of plants to areas of relatively high cost in order that every area may share in the progress. The efforts to overcome the fragmentation of markets which now prevails may well tend, moreover, to encourage monopolistic elements by permitting, with official blessing, one producer to dominate the enlarged market. At the time of our visit there was already talk of an instance of logrolling in progress and of a politically high-level international understanding, or "deal," in the negotiations for allocation of a privileged monopolistic plant.

Excerpt

COOPERATION FOR PROGRESS IN LATIN AMERICA, COMMITTEE FOR ECONOMIC DEVELOPMENT, APRIL 1961

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REGIONAL ECONOMIC COOPERATION

Two agreements among Latin American countries have moved the area toward regional economic cooperation. One signed by the Central American Republics is part of a much wider effort to integrate their economies; the other, negotiated by six South American countries, plus Mexico, is limited almost wholly to trade.

[21] See, for example, Rockefeller Brothers Fund, "Foreign Economic Policy for the 20th Century," New York, 1958.

The rationale behind the movement toward regional economic integration in Latin America is essentially as follows: Many of the countries of Latin America are too small to be economically efficient in isolation. Their industries can reach efficient scale only if they can export freely. But they would be unwilling to enter into mutual free trading relations with the industrialized countries even if these countries should offer them, for fear that their infant industries would be snuffed out by competition from the advanced countries. Their response, therefore, is freer trade among themselves and protection against the outside world.

The danger in regional arrangements is that they may go too far in suppressing competition from the outside world and not far enough in opening up competition within the region. The result would be a self-sufficient but inefficient and low-income economy. The provisions of the two Latin American arrangements that have been negotiated make such an outcome conceivable, but by no means necessary. Everything will depend on the spirit in which the two regional systems are operated.

The United States should encourage the movements toward economic integration in Latin America. At the same time, we should urge two points. First, the reduction of internal trade barriers should be as comprehensive and uniform as possible, in order to achieve the benefit of intraregional competition. Second, in setting their external tariffs the groups should recognize that not all industries are equally capable of reaching world levels of efficiency, and that protection should be reserved for those industries that have a reasonable prospect of doing so.

Many of the Latin American countries do not subscribe to the General Agreement on Tariffs and Trade and we should not expect their regional arrangements to conform to the provisions of the GATT governing free trade areas and customs unions. But we believe that the basic principle of the GATT provisions is valid, that an enlargement of discrimination by a region against the rest of the world can only be justified by a real, substantial opening up of competition within the region.

The movement towards economic integration in Latin America should be accompanied by a movement toward greater freedom of payments, which in turn will require a greater degree of monetary stability. Without greater freedom in the use of currencies for international payments, the intent to form a common market or free trade area cannot achieve its purposes of promoting international specialization, wider makets, and extension of regional trade on a sound basis.

Senator SPARKMAN. We are beginning our inquiry by hearing this morning from two economists who, as experts, have had an opportunity to think systematically upon the economic and political problems of developmental policy, as well as international trade policy. I am sure that their informed opinions will greatly assist the subcommittee in understanding and arriving at its own informed opinion as to what should be the policy of the United States with respect to the regional trade groupings in Latin America, and as a supporter of, or party to, proposed regional groupings in the Western Hemisphere.

I am sure that members of the subcommittee will be much interested in the comments of these gentlemen on the relationship between the obvious needs of the developing countries and the traditional U.S. policy of the most-favored-nation treatment.

Our first witness this morning is Dr. Isaiah Frank, Clayton Professor of International Economic Relations at the School of Advanced International Studies of The Johns Hopkins University. He will be followed by Dr. Joseph Grunwald, director of economic and social development studies at the Brookings Institution. We have asked them as a panel and I hope that they will feel free to raise questions and discuss problems with each other for the enlightenment of the members who, of course, will want to ask questions in due course.

Following the discussion by these two gentlemen, we will hear from Emilio G. Collado, vice president and director of Standard Oil Co. of New Jersey. Mr. Collado, who incidentally has the privilege of also being called doctor like our previous witnesses, was formerly with the Treasury Department and with the Department of State for an extended period. We are very fortunate to have this opportunity to hear from him on the general subject of "Latin American Integration and Private Investment."

Dr. Frank, let me say we are delighted to have you with us and you may proceed in your own way.

Senator JAVITS. Mr. Chairman, may I just say I have four committee meetings this morning and I promise the witnesses I will most carefully review the testimony. I may have to come and go this morning.

Thank you, Mr. Chairman.

Senator SPARKMAN. Thank you for being here at the start and I am sure that you will be in as much of the time as you can.

May I say I have two committee meetings this morning myself and as it happens I am called upon to preside at both. I have divided the time and set the other committee meeting at 11. That is the Foreign Relations Committee.

Dr. Frank, you may proceed.

STATEMENT OF DR. ISAIAH FRANK, CLAYTON PROFESSOR OF INTERNATIONAL ECONOMIC RELATIONS, SCHOOL OF ADVANCED INTERNATIONAL STUDIES, THE JOHNS HOPKINS UNIVERSITY

Dr. FRANK. Mr. Chairman, after all these admonitions from the table, I don't see how I can adhere to my wife's admonition. She said, "When you read your statement remember one thing, read slowly."

I think I had better read fast. [Laughter.]

My remarks are addressed to the relationship between the traditional U.S. policy of nondiscrimination in trade and the emergence in the last decade of regional groupings whose common feature is discrimination against outsiders including the United States.

Can the new arrangements be squared with our basic policy? And, in particular, how should we view the recent efforts of less developed countries, especially those in Latin America, to achieve a greater measure of regional integration through free trade areas or common markets?

These are large subjects and I shall not be able to do more than touch on them in my brief comments this morning.

Traditional U.S. commercial policy is reflected in the articles of the GATT and the International Monetary Fund, the fundamental agreements governing our economic relations with the rest of the world.

Basic to the GATT and Fund approach to trade and payments are several principles:

1. The outlawing of discrimination.
2. The avoidance of the use of quantitative restrictions or exchange controls on current transactions.
3. Acceptance of the desirability of a policy of progressive tariff reduction.

Underlying these principles is the tacit assumption that countries will remain in overall payments equilibrium; otherwise, recourse to quantitative and exchange restrictions may be unavoidable, bringing with it the discrimination inherent in a system of controls.

The crux of the multilateral system that the United States has sought to foster, therefore, is not the elimination of moderate protection whereby a country favors domestic producers; rather it is the elimination of discrimination as among foreign markets.

This is the essence of the most-favored-nation clause which, in its unconditional form, has governed our trade relations with most countries for over 40 years and which has been endorsed by the principal trading nations of the world.

At the time that GATT was formulated in 1947, it was permitted two major exceptions from the most-favored-nation rule. Certain existing preferences, such as those of the British Commonwealth, were allowed to continue, provided the margins of preference were not increased; and a specific exception was incorporated to permit the formation of customs unions or free trade areas. In order to qualify for the GATT customs-union exception, conditions are stipulated to insure both that the potential benefits of the arrangement will in fact be realized and that the interests of outsiders would be protected.

The first requirement is that duties and other restrictions must be eliminated in respect to substantially all the trade between members. By insisting on a comprehensive and nonselective removal of internal barriers, customs unions and free trade areas are believed to offer advantages that are unlikely to flow from mere partial preferential arrangements: a greater likelihood that the beneficial trade-creating effects will take place leading to a more economic distribution of resources and output within the area; greater security against the reimposition of internal restraints; and a greater probability that the arrangement will lead to desirable longrun political developments because of the need for the partners to coordinate more closely their domestic economic and financial policies and their external commercial policies.

The second GATT requirement is that duties or other restrictions applying to outside countries shall not on the whole be greater than the general incidence of the restrictions obtaining prior to the formation of the customs union or free trade area.

Whereas the first provision is designed to maximize the trade-creating effects of the arrangement, this one is intended to minimize the undesirable trade-diverting effects by insuring that whatever discrimination results from the establishment of a regional arrangement comes about through the elimination of internal barriers rather than through the raising of barriers against outsiders. Moreover, the external tariffs are subject to reduction through negotiation with outsiders, as in the current Kennedy Round, so that the trade-diverting effects can be reduced over time. In short, a customs union or free trade area conforming to the GATT criteria can be viewed as a contribution toward freer trade worldwide rather than simply as a discriminatory arrangement.

What I have said thus far makes it apparent that the principal focus of orthodox commercial policy toward common markets has been on the balance between the trade-creating and trade-diverting effects of the tariff changes incident to the establishment of the arrangement. It is now widely recognized, however, that this approach is much too simplistic for judging the effects of a customs union either on its members or on the world as a whole. The main benefits from the creation of the European Common Market, for example, flow not from the static reallocation of the existing resources of the Six in accordance with comparative advantage but rather from the profound changes in method, scale and organization of production and distribution that have occurred in response to the enlarged market opportunities and more intensified competition. The principal gains have been in the form of new entrepreneurial decisions embodying innovations, an increased flow of investments, a greater scope for specialization and a larger scale of operations. All this adds up to more rapid growth. Even if one of the immediate effects of a customs union, therefore, is to divert trade from third countries, the longer run income effects may spill over into increased imports from third countries which more than offset the initial trade diversion.

Since the main benefit of regional integration is its stimulation of growth, it is not surprising that the common market approach offers a special appeal to countries in the earlier stages of development. The establishment of efficient, modern industries in these countries is hampered by small internal markets, often a consequence of both small populations and low per capita incomes. In order to realize the economies of scale underlying advances in productivity, developing countries must look to export markets. But rarely will investors risk their capital on manufacturing facilities geared primarily to exports since foreign markets are considered unstable and liable to be closed off at any time, as illustrated by the current restrictions on world textile trade.

While this example may be regarded by some as exceptional, it is viewed by many in the developing countries as a straw in the wind. Common markets are looked to, therefore, as an escape from narrow internal markets, but with freer and more assured access than is afforded by conventional export markets. They provide an inducement to domestic and foreign investors to modernize existing industries and to establish new industries where economies of scale are important.

Extension of the market can also be a potent force for breaking up monopoly, a condition widespread in developing countries. In their drives to industrialize and to save foreign exchange, developing countries have encouraged the substitution of domestic production for imports in a wide range of manufactured products, especially consumer goods. The main instrument for accomplishing import substitution has been the high degree of protection from foreign competition granted to local manufacturers.

In addition, however, the local manufacturer often enjoys substantial insulation from domestic competition since the limited home market offers little inducement for more than one firm to enter the field. Even where there are several firms, close family and social ties commonly lead to collusive practices. The result is inefficient, high-cost production geared to the small upper class market at prices completely ruling out the possibility of exports. Widening the market through customs unions or free trade areas could shake up this situation by making it profitable for more firms to enter the field and by making it more difficult to maintain collusive arrangements across national boundaries.

Although the potential growth-inducing effects of regional integration are great, it is now apparent, particularly as a result of LAFTA's experience, that the special problems involved in establishing common markets in less developed countries are formidable indeed. I shall mention only a few.

Because of the alinement of political forces, particularly the close personal relations between business and Government, it is especially difficult in developing countries to override specific vested interests in favor of a long-run national goal, the benefits of which would be diffused throughout the economy. The requirement in the Montevideo treaty that tariff dismantlement be negotiated item-by-item—this is a point that has been widely criticized here and abroad—is not a reflection of the ignorance of the drafters as to the advantages of automatic across-the-board reductions of restrictions. Nor do the numerous escape clauses reflect a lack of understanding as to the importance for successful integration of certainty of market access. Without these compromises, there would have been no treaty at all. I doubt the value of ringing statements from political leaders in Latin America or, indeed, the United States, exhorting the members of LAFTA to remedy the deficiencies of the treaty, so long as the underlying structure of political forces within Latin America remains substantially unchanged.

Another obstacle to customs unions or free trade areas among less developed countries is the common tendency toward inflation and balance-of-payments difficulties characterizing the efforts to force the pace of economic development. If members must periodically resort to import restrictions to defend their reserves, a comprehensive regional arrangement cannot work successfully. Nor is it likely that this problem can be sidestepped through regional payments arrangements, as some have proposed, designed to preserve freedom of trade, and payments internally while permitting balance-of-payments restrictions against the outside world.

A third difficulty is the well-known polarization effect of integration. Capital, entrepreneurs, and skilled technicians from within the preference area and from outside will tend to gravitate toward the more advanced partners of the preferential region. As a result, growth may be accelerated in the advanced members and retarded in the more backward countries. Southern Italy and the American South are classic examples of economic retardation stemming from the integration of these areas with the more dynamic North. In order to insure some measure of equality in the distribution of the benefits of integration, it is essential for the arrangement to include more than the freeing of trade. Institutions must be consciously created to stimulate and to finance a flow of resources to the lagging regions. Even in the European Economic Community where this problem was far less serious, its existence was acknowledged in the creation of the European Investment Bank.

Perhaps most important are the implications of the more active role assumed by governments of less developed countries in planning and shaping the course of economic growth. The architects of the European Economic Community recognized that government interventions in the economic process might lead to distortions of competition that could be highly disruptive to the smooth functioning of the Common Market. Hence provisions were included in the Rome

Treaty designed to harmonize such policies or to correct the distortions. This problem is apt to be much more serious among a group of developing countries where, as part of the planning process, a diversity of national aids and incentives to industry are applied through taxes, subsidies, credits, and other instruments. It is unlikely that the resultant conflicts between national development policies and regional integration goals can be successfully resolved without the active participation and initiative of a body comparable in status and function to that of the Commission of the European Economic Community.

I do not want to leave the impression, however, that the Treaty of Rome and the institutions it created can serve as a neat blueprint for regional arrangements in Latin America or anywhere else in the less developed world.

While there are lessons to be learned from the European experience, the obstacles to regional integration in Latin America, Africa, and Asia are far greater, and they can only be tackled within the context of the political realities of those areas. The Treaty of Rome was not simply a concoction by technicians designed to improve the economic situation in Western Europe; it was an expression of a profound conviction in favor of the political idea of European unity. The thrust of this idea came as a reaction to the horrors of a divisive nationalism contributing to two World Wars in one generation and to the mounting threat of Soviet expansionism in the early fifties. De Gaulle or no De Gaulle, I doubt very much that anything as comprehensive as the Treaty of Rome could be negotiated today.

Perhaps one of the lessons to be drawn is that regional groupings among less developed countries should be conceived, at least initially, in less ambitious terms than comprehensive customs unions or free trade areas embracing all of industry and the greater part of whole continents. After all, the European Economic Community was preceded by a variety of lesser steps including Benelux, the intra-European trade liberalization program and the Coal and Steel Community. It is not entirely irrelevant that the recent free trade agreement in automotive products between the United States and Canada was negotiated with relatively little opposition at a time when the notion of a United States-Canadian free trade area remained a subject strictly for academic discussion.

By and large, the roadblocks to integration in Latin America have been thrown up by the older industrial firms in the consumer-goods field which have benefited most from high protection. Pending the time when their opposition can be overcome, an effort should be made to outflank it by initially concentrating really effective integration measures in a selected group of key industrial sectors where the returns to scale are great and where vested interests are less entrenched. Perhaps this is the larger implication of the statement in President Johnson's recent speech commemorating the fourth anniversary of the Alliance for Progress in which he said:

> I hope the American nations will consider the establishment of a program—patterned after the European Coal and Steel Community—for the production and trade, on a continental basis, of fertilizer, pesticides, and other products that are needed to increase agricultural production.

The precise content of sectoral agreements, over and above the elimination of all internal restrictions, would have to be a matter for negotiation. And as time goes on, the approach could be extended to additional industries. While the GATT customs-union principle calling for the removal of internal restrictions on substantially all trade is a sound goal toward which to strive, as a practical matter it may be attainable sooner on the basis of more rapid moves covering more limited fields.

Mr. Chairman, the United States has been pursuing, in my view, the right course in its support of common markets as an instrument of development. In any case, the alternative today to desirable forms of regional integration among the developing countries is not a multilateral regime free of discrimination, but rather a more fragmented world trading system in which individual developing countries maintain a high degree of national protection and seek whatever advantage they can in special preferential deals such as the Nigerian association with the European Economic Community.

The real question now is how best to give a new impetus toward the kind of regional trade groupings we would like to see develop. Sectoral integration may provide a practical way station on the road to broader customs unions and free trade areas.

Thank you, Mr. Chairman.

Senator SPARKMAN. Thank you very much, Dr. Frank.

And now Dr. Grunwald. I have your paper; we will be very glad to hear from you, sir.

STATEMENT OF DR. JOSEPH GRUNWALD, DIRECTOR, ECONOMIC AND SOCIAL DEVELOPMENT STUDIES, THE BROOKINGS INSTITUTION

Dr. GRUNWALD. Mr. Chairman, my remarks are intended to give some background and perspective to the whole problem of integration in Latin America.

Latin Americans look to economic integration as an important cornerstone in the development of the region. Economists in Latin America are now viewing many of their economies as being in a state of "impasse". Most of the larger countries in the hemisphere have industrialized through replacing consumer goods imports with domestic production. This process has come to an end in the more advanced nations, and, in the absence of a significant rise in the purchasing power of low income groups, expansion in the consumer goods industries is limited to population growth.

This kind of industrialization while diminishing the need for imports of consumer goods, has increased dependency on the imports of machinery, equipment, fuels, supplies, and replacement parts; in other words, capital and intermediate goods necessary to keep the domestic consumer goods industries in operation. It has contributed considerably to the already serious balance-of-payments problem. If anything, industrialization has made these problems more acute because it is much harder to reduce producer goods imports during a balance-of-payments crisis than it is to reduce consumer goods imports. On the other hand, this industrialization has not been of much help to the balance of payments because production based on consumer goods import substitution almost by definition has been for local consumption and therefore has not contributed to raising export earnings to any appreciable extent. The second stage of the industrialization process, the substitution of domestically produced capital goods for imported capital goods, is much more difficult in markets which are limited in size.

Thus there are several aspects in the economic argument for integration. First, an increase in the size of the market will set the stage for the second phase of the import-substitution process: the establishment of efficient producer goods industries. These would include both capital goods to provide the machinery and equipment and intermediate goods such as chemicals to supply the raw materials for the industrial plant. The implication is that there are economies of scale in these industries and that unit costs can be minimized only at high levels of production. Second, larger markets will make it possible to expand existing consumer goods industries and, perhaps, to establish new ones in which economies of scale may exist. Hence, manufacturing would not only supply national markets but would be increasingly geared toward exports.

There are other aspects, as well which are more difficult to fit within an economic scheme. A common market arrangement will give the region greater bargaining power vis-a-vis other great trading countries and blocs. In particular, it is hoped that a Latin American economic community would be in a position to exact better terms for its exports, 90 percent of which, it should be remembered, still consists of raw materials, despite the industrialization of the past few decades.

Then there are noneconomic factors in the argument for economic integration which are rarely stated explicitly. They range from the belief that social unrest and political instability would be alleviated to sentiments of supranationalism as expressed in the hope that political union might emerge from economic integration.

It is therefore difficult, Mr. Chairman, if not impossible, to evaluate the repercussions of integration from a strictly economic point of view. Even if there were no political objectives, noneconomic forces are inexorably intertwined with economic ones in a massive and complex policy such as a common market. Put in different terms, the long-run effects of such a policy may differ radically from the short-run impact. Economic analysis is primarily geared toward the short run. For us this is certainly the more interesting time perspective because, as Keynes said, in the long run we are all dead. Economic integration, however, is not a simple measure to correct temporary economic ills, but it is a fundamental arrangement, the full results of which will probably not be felt until some of us will be gone.

In the short run, discrimination in trade seldom has beneficial economic effects. The creation of a trade area signifies the reductions of tariffs among a given bloc of countries and in analyzing its repercussions, economic theory distinguishes between "trade diversion" and "trade creation." Trade diversion or the shifting of trade with countries outside the bloc to countries within the bloc is generally not considered as adding to welfare, but any effects which result in the transfer of resources from high-cost to low-cost activities would increase both output and trade and thus raise welfare. This distinction is useful analytically but it cannot be made with great neatness when applied to specific cases. First of all, there is the problem of measurement and of adequately drawing the lines between the two concepts; then there is the more important conceptual question of weighing short-run versus long-run consequences. It is most likely that the establishment of a free trade area will have primarily diversionary effects on trade in the short run, but it is not all clear that these may not be welfare-producing in the long run.

There is little question that Latin American producers will not be able to compete with United States and European exports in the short run and that protection for domestic industries through tariff walls against third countries will be necessary. The resulting higher prices will obviously signify a loss in present welfare. The problem is one of weighing the benefits of industrialization with tariff protection against the costs to the economy that such industrialization would involve.

Many Latin Americans compare their integration aspirations to the common market constituted by the United States. Because the region is still so far from realizing such a union, this comparison may seem to have no practical purpose. One is able, however, to point out that some States probably experienced a loss in their economic welfare by joining the U.S. customs union and that even now a given State could, without the existence of tariffs, buy certain goods cheaper abroad than from another State. Yet the U.S. common market has been the greatest success story in history. It may appear that this argument is carried almost ad absurdum, but it shows three things clearly:

1. Longrun benefits can enormously outweigh shortrun losses.
2. As long as any tariffs or other trade barriers exist, it will always be possible to buy some things cheaper abroad than at home; and
3. Political union is necessary for an efficient and sustained functioning of economic union.

In Latin America there are tremendous differences between the individual countries and levels of income from one country to another vary much more than in the European Economic Community, not to speak of the individual States within our own country. The advanced countries within the region surely don't want to be lumped together with the more backward nations unless they can see a longrun advantage. The poorer countries, on the other hand, are suspicious of integration with the wealthier ones, because they are afraid of exploitation. This is a picture not too dissimilar from that of our country's own early history. Nevertheless, there is a growing sentiment in the region for a supranationalism, for feeling "Latin American," and many leaders are now pushing hard toward overcoming the obstacles to unification. History, language, other cultural factors, and the common economic problems which these countries face as raw material exporters, also help to move their interests closer together.

There are, of course, Mr. Chairman, great risks involved in the economic integration of the region. First of all, there is the classic trap surrounding the infant industry argument. The case for protection of new industries rests on the assumption that, with time, efficiency of production will rise and unit costs decrease so that the new industry will become competitive with producers abroad and the need for tariffs will fall away. However, there is the danger that protection may be given to industries not suited to the region and where the possibilities for raising productivity are small. Also, if producers are not convinced that there is a definite time limit on protection, they may have little incentive to lower costs and profit margins. In these cases the infant industry argument may be used to establish inefficient or monopolized industries on a permanent basis.

Then there is the possibility that economic integration may give the region a sense of a false panacea. A disproportionate effort may be put on industrialization, with the consequent neglect of the natural resource sectors, upon which the region undoubtedly will have to continue to depend for a long time to come.

In short, Mr. Chairman, there is always the chance that economic integration would provide nothing more than the facade behind which would be pursued some of the same short-sighted policies which have contributed to holding back economic growth in several countries in the past. I do not think that this will be the case.

Latin American leadership generally is new, more sophisticated and more perceptive; it has learned from past experience. If optional economic policies are not followed, we should assume that the economic optimum has been circumscribed by valid political constraints and that there are noneconomic objectives which are also desired by the community. If, instead of the "best" economic policy, the second or third best is chosen, we should not immediately jump to the conclusion that these policies are wrong but we should take the cost of deviating from the economic optimum as indication of the price the community is willing to pay for attaining noneconomic ends.

There can be little doubt but that regional development requires a large amount of foreign capital. Economic integration does not diminish this need. It is also clear that not all of this capital can come from public sources. Private foreign investment necessarily must be an important part of the industrialization effort. But Latin Americans are very sensitive to the possibility of U.S. industries gaining a foothold in a regional market. Latin American businessmen have little hope of being able to compete with large foreign corporations in the foreseeable future. Therefore, it is unlikely that the region will be open to foreign private investment without restrictions.

Compromise arrangements will be necessary. Some countries have already reached a modus vivendi by which they can take advantage of private foreign investment while at the same time satisfying their own national aspirations. Partnership arrangements, such as the "Mexicanization" rule used by Mexico, have not discouraged foreign investors but, on the contrary, Mexico has received the greatest amount of foreign private capital of any other country in the region within the last few years. The proposed Chilean arrangement with the U.S. copper companies also demonstrates the ingenuity on both sides through which the foreign private investment question can be handled satisfactorily also within a regional market.

As with so many fundamental social innovations, Mr. Chairman, it is much easier to find fault with economic integration than to give constructive support. There have not been many precedents of cases where integration has been very successful. It is sometimes said that a common market arrangement should be easier in a developing region where the level of industrialization is still low than it is in an economically advanced region such as Western Europe. The problem is, however, that countries with incipient industrialization are jealously guarding the few industries which have been established. Most manufacturing industries in Latin American countries are "infant industries" in the classical sense and therefore candidates for protection. Even if the countries agree to accept the rule of comparative advantage in production, they will have difficulty following it because comparative advantage does not obviously manifest itself on an *a priori* basis in most industries.

A certain amount of production and investment planning on a regionwide scale therefore seems inevitable. From an economic point of view, the aim of planning would be to locate new investments in places with comparative advantages for them, so that the unit costs in the industry would fall for the region as a whole. The hope is that ultimately Latin America could compete with U.S. and European producers. A planning mechanism may also aid to pinpoint investment priorities. From a political point of view, the planning objective would be to keep some balance in the industrialization of the region so that a high concentration of development in one or two countries could be avoided and all countries would obtain some gains from integration.

What should be the U.S. approach to the Latin American effort toward integration? It is clearly in the best interests of the United States to promote vigorous economic growth and political development in this hemisphere. In my opinion, some form of economic integration is a necessary, although not sufficient, condition for reaching a stage of accelerated and sustained development in Latin America.

Mr. Chairman, the United States is in a delicate and frustrating position in this respect. If we now become too enthusiastic about regional integration, our Latin American friends may question our motives and suspect us of wanting to participate directly in a hemispheric common market arrangement. In my view this is the last thing they wish. Yet they need and want our assistance in helping them to move closer to economic and, perhaps eventually, political union.

I recommend that we give careful consideration to any serious proposal which may be advanced by Latin American authorities. Such a proposal should provide firm safeguards that monopoly positions which might arise initially, would not become entrenched and that the barriers around a regional bloc would be opened within a reasonable time.

Thank you, Mr. Chairman.

Senator SPARKMAN. Thank you very much, Dr. Grunwald.

Now, as I stated in the beginning, my hope is that the two of you might comment on each other's statement. I suppose the best way to start off would be, Dr. Frank, to ask you if you have any comments to offer or any questions to ask Dr. Grunwald regarding his remarks.

Dr. FRANK. I think, Mr. Chairman, it is an excellent statement and basically I believe he and I are in agreement. I have not seen the statement before. Though we work across the street from each other we really have not compared notes on this.

I see he feels we should, if necessary, deviate from the theoretically best or optimum policy in order to attain our ultimate goal.

This was my purpose in suggesting that one such deviation which I think may well pay off is that we initially encourage these sectoral integrations such as the President suggested in fertilizer; I conceive of it being done in a variety of other fields.

I would very much like to get Mr. Grunwald's reaction to the notion of beginning the way the Europeans began.

The traditional argument against sectoral integration is that it sets up all kinds of imbalances within the economy. But the more I looked into this problem in connection with my own study of the European Common Market, Mr. Chairman, the more I realized there was no way short of literally establishing a complete political and economic union, of eliminating the kinds of imbalances that economists and theoreticians speak about.

People still talk about how, even in the United States, investment tends to move not in accordance with the highest rate of return but in reaction to the tax policies of individual States.

My feeling is that one can start within several broad sectors. There will be imbalances, but when we confront those problems we can move in and try to deal with them.

The Commission of the European Common Market is confronted with those problems every day and the process of coping with them results in a strengthening of that institution.

Even the European Economic Community is a case of partial integration. There are fields in which the Treaty of Rome sets down various objectives but no specific rules as to what should be done to achieve them.

I would very much like to get Mr. Grunwald's view on the desirability of moving along this pattern of beginning with perhaps half a dozen key sectors of the economy and having a thoroughgoing integration within those sectors in which attention is also given to the need for equity as among different parts of the region.

Senator SPARKMAN. Do you accept his challenge, Dr. Grunwald?

Dr. GRUNWALD. Yes, I do, Mr. Chairman; but since we are in basic accord I think it is not a challenge. I completely agree that integration cannot come all at once, at full blast. I think that sectoral integration means almost by definition that investment planning on a regionwide scale will be inevitable. It is important to have in the region some sort of mechanism, some organization which could coordinate some of these important policies. At the moment such an organization does not exist. There has been some talk that the Inter-American Development Bank should assume the functions of an investment promoting agency.

If this can be done then by all means I think the first emphasis should be given to what are called the strategic sectors of the economy, some of which Mr. Frank has mentioned.

Perhaps because of the difficulties of getting some development corporation going on a regionwide basis it has been suggested that, first, greater attention should be given to the trading mechanism in order to eliminate some of the very cumbersome commodity negotiations and to introduce some automation into the integration process. This does not involve any supranational organization, or any kind of mechanism to which perhaps individual countries might hesitate to surrender some sovereignty. Therefore, streamlining the tariff negotiations procedures may be an easier first step.

But I have absolutely no quarrel with Mr. Frank's statement on giving emphasis to sectoral integration, and I think Latin Americans will have no quarrel with that. The statement by the four Latin American leaders, Messrs. Prebisch, Mayobre, Herrera, and Sanz, also recommended that priority be given to key industries.

Senator SPARKMAN. By the way, I am going to have to leave but before I go let me ask just a very brief question that I am sure either one or both of you can answer right off.

I have noticed through your discussions you made frequent references to the European Common Market. Of course, it has been under development now for quite a long time.

Are you pleased with the progress that has been made by the Common Market to date?

Dr. FRANK. Mr. Chairman, I am afraid I cannot answer that yes or no.

Senator SPARKMAN. I realize that, because there are good spots and bad spots, are there not?

Dr. FRANK. Exactly, there are; and in general I would say the good overwhelmingly outweigh the bad.

There is no question in my mind that the Common Market, though by no means the only factor, has contributed to more rapid growth in Europe and a sense of confidence, a dynamism. Europe is a stronger partner in the very real sense of the term.

When considering the strength of Europe as a partner I am less concerned with the formal commitments in some military treaty than I am with Europe's own economic and political strength and her confidence and determination that she can continue independent, and I think the Common Market has accomplished that.

It has had an economic effect, a political effect, and a psychological effect, all of which have been to the good.

On the other hand, there is no question but that along with the growth and strengthening of Europe has come a feeling of confidence and a desire for more independence from the United States than we bargained for when we encouraged this movement.

I do not think this feeling is exclusively De Gaulle; I do not think it is exclusively French. I think anyone who travels in Europe will find, despite its absence from official statements, that many people and political figures in Europe have a great deal of sympathy with a desire for more independence, an independence which is really rooted in Europe's economic strength.

Europe's rate of economic growth, as we know, has exceeded that of the United States, and apparently Americans and Europeans have great confidence in Europe's economic future as shown by the rate of investment in that area.

On the other hand, I think quite seriously that the countries of Europe still have to measure up to the responsibilities that this new strength has given them.

My own feeling is that the European Commission, which is the supranational body, is far out ahead of the individual governments in this respect.

In general, it has been plumping for the right things. It has run up against difficulties with the national governments, particularly the French, but I think we ought to look at this with a certain measure of tolerance, Mr. Chairman. The very process of integration is a kind of counterpoint between the national government representatives in the Council of the European Economic Community and the European Commission which is a new creation in international politics.

All of this, I think, has tended, despite our concerns about NATO, to relax relationships between Europe and the United States and to be a force for the good. As time goes on—I am optimistic on these things—we will see Europe making a much larger contribution to its own defense and I think militarily and in other ways some of the tensions that have existed in the Atlantic alliance, as represented in the slow progress of the Kennedy Round, will diminish.

So I feel that the Common Market has been a good thing, Mr. Chairman, looking at it from the longrun point of view and abstracting from such things as chicken wars and the little hurdles we have had to overcome en route.

Senator SPARKMAN. Thank you very much, Mr. Grunwald. I would like to stay and hear your discussion but I must go. I apologize for having to leave. Mr. Reuss will assume the chair.

Thank you.

Mr. REUSS (presiding). I am afraid that with my assumption of the chair will come a diminution of the harmony that has so far prevailed, but I am concerned, gentlemen, at the fact that the subject we are discussing, particularly the form in which you two gentlemen have discussed it, indicated that we are crossing a great watershed in our economic foreign policy and I want to examine with you some of the assumptions that are implicit in that crossing of the watershed.

Certainly it was for a long time the policy of the United States that the world, or at least the free world, should move toward multilateral free trade, with a minimum of tariffs. That was the successive thrust of the various trade agreements acts from 1935 on, and for a brief shining moment in the Kennedy Administration, we reached out toward what seemed to me the culmination of that. That is to say, when the Kennedy Trade Act of 1962 was first proposed it was accompanied by a bargain-down-to-zero proposal which was aimed at buffing the rough edges of the Common Market and in at least 28 major groupings of goods that move in world trade, at attempting to eliminate tariffs, accompanied, of course, by exceptions for developing countries so that they might maintain their outside tariffs during the period when their infant industries were developing, and accompanied also by some special entries for their goods into the more developed countries.

That glorious attempt, in my judgment at least, got bogged down in some political considerations and we threw in the sponge on it rather quickly, and today, while one's view of the Common Market may differ, and mine obviously does from yours, we are faced with the fact that by our excessive preoccupation with regionalism, particularly in Europe which is the place where it has been tried, we have set in motion a power bloc which in my view is not engaged in such splendid cooperation toward the best interests of the free world.

For example, our efforts at monetary reform today are being retarded because one country of the Common Market—France—seems to be opposed to it and can use its political suasion on the other members of the Common Market to throw further monkey wrenches into our endeavor.

In foreign aid, instead of the multilateral consortia that we would like to have, we find an increasing regionalism. France wants to help its former colonies in Africa, and Britain is again engaged in what used to be portions of the British Empire, and we find ourselves today discussing an American initiative toward a grouping in Latin America.

In trade, we find that the Common Market is really not being very helpful at Geneva. It is, if I read the signs aright, the principal stumbling block on the realization of some of the things that President Kennedy had in his mind when he proposed the Kennedy Trade Act.

So, I wonder whether we really should be quite as blithe as we all seem to be in dividing the world up into power blocs and segments.

I wonder if we are considering sufficiently the fact that when you create power blocs less than the whole, if you are successful in doing it they may transfer to the supranational field some of the old distressing symptoms of nationalism.

Now, I know there is a tremendous difference between, let us say, the six highly industrialized countries of Europe, and the countries of Latin America, and that the case for permitting discrimination against the rest of the world is much greater with respect to underdeveloped or developing countries such as we have in Latin America.

But I am wondering if we should not spend a little more time on the fundamental watershed question, and ask ourselves whether it really has been historical post World War II policy to divide the free world into fragments, and whether we should not always have before us some of the lessons we should have learned from our Common Market flirtation of the last 8 or 9 years.

When both you gentlemen come down to brass tacks in your papers, you encourage me a great deal more, because there you talk about sectoral integration and Mr. Grunwald particularly talked about the necessity of avoiding overselling the Common Market at the expense of foreign aid and private investment and planning, and I think this is all to the good.

But I am wondering if you gentlemen would comment on the point I am raising and ask ourselves—because Congress is certainly going to have to debate this one of these days—whether there are not some negative things to be learned from fragmentation of the free world which is inherent in setting up a Common Market in Europe and then one in Latin America, and then one in Africa, and one in parts of the southeast Asia.

I would like to hear either or both of you on that.

Dr. GRUNWALD. Well, let me state briefly, Mr. Congressman.

I think the question of economic integration should be viewed not so much in the light of do we want to fragmentize the world economy and create trade blocs for their own sake, but it should be viewed with the basic question in mind, do they or do they not contribute to the economic development of the countries which join in a trading bloc?

Let me address myself specifically to the case of the developing countries such as the countries in Latin America. As I tried to point out very briefly in my statement before, these countries find themselves in a sort of impasse. Their industrialization cannot proceed at the same pace as it did in the past. Furthermore, their industrialization of the past was primarily of the import substituting kind which has not given them viability. It was production for their own local consumption and it did not diminish dependency on foreign markets and on imports.

Latin American countries want to get out of what they consider a straitjacket and be able to commence a second push and second stage of industrialization.

Now, it is very doubtful to me whether this can be achieved only on the basis of multilateralism without any kind of discriminatory arrangement for the region.

I believe that just as the United States for a long time had to depend on tariff protection for our industries in order to bring them to a state of efficiency and competitiveness, Latin American countries are now seeking to achieve the same.

All developing countries are trying to bring their level of industrialization to the point where they can actually compete in world markets. Not letting them enter into any sort of protective arrangement will jeopardize, in my view, the possibility of their industries ever reaching levels of efficiency where they can reach economies of scale, and can substantially lower their unit costs.

What I am trying to say, Mr. Chairman, is let us look at economic integration as a device to development: Is it an appropriate device within the scheme of things, or is it not? I feel that in the absence of any other arrangements that might be feasible, economic integration would be a particularly useful device for achieving development in Latin America.

Mr. REUSS. You have made a good argument, with which I thoroughly agree, for the developed world's doing something about the pitiful state of the developing world, but where I have difficulty is in this fragmentation approach—Latin America needs development, surely, but so does Africa, Asia, much of middle Europe, the Middle East, and all the rest of the developing countries.

Does not our experience of the last few years in getting away from the multilateral framework of GATT, which I think was a good framework, show that once you start, you set the world on a course of making special bilateral agreements, and these things go on and on?

Greece has an association with the Common Market now which is supposed to take about 20 years, and the EFTA is going merrily on failing to cover many, many, aspects of trade, including, for example, agriculture.

So are we not building a bilateral world here which it is likely to be very difficult to live with as these power groups grow stronger and as their nationalistic or autarkic tendencies are merely transferred from an individual national state to a grouping?

We have been against nationalism for many years, but are we not simply giving it a great pat on the back and a chance to exert its features on a wider scale?

It seems to me this is the question we have to discuss.

Dr. FRANK. It is the question very much, Mr. Chairman. But I think what we have to remember is that the doctrines which underlie the kind of approach you are putting forward were doctrines that held sway in the early years of this century. They were the backdrop of the 19th-century world in which we expected that everybody would be happiest if only government interventions in economic life were reduced.

But we have come, as we know, a very long way from that kind of world. We in this country have accepted a whole variety of government interventions in the economic systems, and the less developed world is convinced that the pattern for growth is not simply through minimizing or eliminating the role of government internally nor through free trade externally.

The thrust of the historic United Nations Conference on Trade and Development was as an effort to deal with the question of how foreign trade policy could become an instrument of development. If you speak to the leaders of developing countries, they will tell you that they do not think foreign trade can become an instrument of development by a mere process of all countries dismantling their trade barriers.

The United States grew following two policies over its history—one was integration of a vast continental area, and the second was a policy of protection throughout the 19th century.

We followed a policy of protection because there were stronger, more industrialized countries in Europe from whom we were protecting ourselves.

They will say it comes with ill grace for Americans now to preach that small countries with per capita incomes of $100 should confine themselves to their own markets, or take their chances with everyone else on exporting to neighboring countries.

We have to do something about this.

A variety of proposals for doing something emerged from the United Nations Conference—commodity agreements of various types, preferential access to other areas, regional arrangements—and of all of them, Mr. Chairman, I think the one that is most consistent with our traditional view of the world is that these countries should get together among themselves and widen the area of free trade.

You inject competition in that way, you shake up, you disrupt the kinds of cozy little practices in which these countries have traditionally engaged.

There is a man in the audience, Harry Conover, who used to be in the State Department and reported very effectively how this was going on in less developed countries. One of the reasons Jean Monnet wanted the European Common Market for France was because he saw the restrictive practices his country was engaged in during the immediate postwar period and felt it was impossible to do anything about the situation simply through domestic French legislation. Something more was needed.

The leaders of the developing world are aware of all this, and in my view, from all of the proposals they have put forth, we should encourage especially what I think is the most constructive move—to widen the area of free trade among themselves.

I remember very well, being in the State Department at the time Mr. Chairman, when there was proposed a European Payments Union and an intra-European liberalization program. There was a big argument between Treasury and State as to whether these arrangements were consistent with our long-run view of the world.

The State Department argued that they would get us to multilateral world trade more quickly while the Treasury said they were a violation of our traditional policy and would result in an entrenchment of discrimination by the Europeans against the dollar area. Looking back, I think it fair to say that the arrangements did permit the interim strengthening of Europe and its ultimate participation in moves toward worldwide convertibility and freer trade.

Mr. REUSS. Just for the record—and I favored it, too—wasn't that multilateralization of payments not among narrow groupings of sixes or sevens, but among all of the countries of Western Europe, which is the crucial virtue of that one?

Dr. FRANK. It was; that is correct. To the extent that you can get free trade areas or customs unions broad in geographic coverage, I think it is best to do so. Ultimately the goal should be a customs union that would exclude only the moon.

Mr. REUSS. I would not go that far. Let us have it make a difference between the developed and the developing countries, but my difficulty with the position of you two gentlemen, and with the position of our Government and everybody else, except for a few sentimentalists like myself, Jacob Viner, and others, is that you are carving things up more than I like to see them carved.

I am all for letting the developing countries keep or increase tariffs on their consumer and producer goods; they have to do that.

It would be hypocritical of this country to deny them that opportunity.

I would also like them all to have preferential access to the markets of the developed world, but the question I am putting to you two gentlemen is, is it wise to carve up the developing world?

If our position is aimed so that we look upon these regional groupings as a mere short-term means to this larger end, very well, but I do not find any one going around saying that.

Everybody is talking about the Latin American Common Market, and soon they will be talking about the former French-African colonial market, and the this-and-that group, and I wonder whether we are not fragmenting the free world too much by this excessively regional approach, because I am afraid you are never going to untangle it, once you get it so fragmented.

Dr. GRUNWALD. Well, Mr. Chairman, if you are willing to concede, in analyzing integration policies, a distinction between the developing and the developed world——

Mr. REUSS. You're absolutely right there.

Dr. GRUNWALD. And if it is in our interest to see the developing countries accelerate their economic growth, then we have to look for means of achieving this.

As Mr. Frank so convincingly pointed out, it is better to achieve a liberalization of trade and of economic practice, at least within a limited area, than it is to avoid it altogether and to continue on a very fragmentized basis.

I think that the integration question is not one of fragmentizing the world, but whether we have many little fragments or shall we try to agglomerate some of the small pieces so that they become more viable from an economic as well as from a political point of view.

Mr. REUSS. If it comes down to just the two alternatives, I would be in difficulty here. If the only alternatives were—

1. To do nothing about the trade position of the developing countries, and to say they have to sink or swim in the world with the developed countries.
2. Erect little regional power groups with walls against everybody else.

If there were one only alternative, I would perhaps be inclined to say, "All right, let us have the second." But I am wondering if this Nation's emphasis should not be on the real distinction between the developed and the developing world, and if we should not make that our goal, and view these regional groupings as permissible only if they are clear means to that broader end, because it seems to me our experience with the Common Market shows that if we benignly pat on the back every consortium that people put together, they sometimes acquire an independent existence and momentum of their own, and then that may lead to some consequences that we did not envisage at all.

Therefore, and specifically, would we not be better off if we adopted as our national policy a policy looking toward the trade relations of the developing countries of the world generally, and conditioned our approval of these regional groupings on a real timetable looking toward their broadening? But if we simply set up power blocs, I would be careful lest we would run in an intensified fashion into the same troubles that we are having with the Common Market.

Dr. FRANK. I have a great deal of sympathy with your unwillingness to swallow whole the Administration policy. I just returned this summer from a trip to Asia and the Far East, and there are very real problems when you compartmentalize the world into regional groups, especially when certain developing countries are linked to particular advanced countries.

The Thais, for example, want to know of what regional group will they be a member. They are not in the British Commonwealth, nor in Latin America and tied to the American market, nor in Africa and tied to the EEC.

Korea is similarly worried.

There is no question that you run into very real problems, but Mr. Chairman, I am afraid you paint an alternative which is not at hand.

The alternative you seem to be painting is that the advanced countries of the world should get together and open up the markets for the less-developed countries, while presumably permitting the less-developed countries, individually, to engage in protection.

The advanced countries are not prepared to go that far from every sign I have been able to see. You know better than any of us, being in the Congress, what the pressures are any time an industry gets into difficulty and how hard it is to withstand those pressures and how tenuous is every advance toward the goal of more liberalized trade.

So I am not sure that this vision you have—which I would share as a highly desirable objective—is realistic nor one we can convince the Latins and others is an alternative to their getting together among themselves and broadening their own markets.

Mr. REUSS. To this I would simply say I do not think we have tried. We constantly surprise ourselves, as recently in the United Nations, by doing something that everybody said could not be done. I am talking about article 19, yet our present position seems to work, and the world is better for it.

So, I do not think that what has been suggested here is any bit bolder than what President Kennedy first suggested in his Trade Agreement Act, and while that did not succeed, I think one of the main reasons it did not succeed was that we got cold feet along the way.

But anyway, I think we have exposed the point a bit.

Is Mr. Collado in the audience? I would like—if you are able to—for you gentlemen to stay here for Mr. Collado's presentation.

Thank you for your presentations.

You are again very welcome Mr. Collado, and your paper will be made a part of the record. You may proceed in any way you like.

STATEMENT OF EMILIO G. COLLADO, VICE PRESIDENT AND DIRECTOR, STANDARD OIL CO. (NEW JERSEY)

Mr. COLLADO. I am grateful for this opportunity to discuss with your committee some aspects of the important subject of economic integration in Latin America. It is to me a hopeful sign that the countries of Latin America increasingly are looking upon themselves as partners in a joint development effort, and to this end are attempting to make a concerted effort to reduce many of the impediments to trade and other transactions within the region. I believe that the spread of this atmosphere favoring greater economic freedom holds considerable promise for increasing the rate of growth and the prospects for fruitful capital investment in Latin America.

I have observed with great interest the steps which the countries of Latin America have already taken toward regional economic integration, most particularly, of course, in Central America. Naturally there has been greater opportunity to observe the course of integration in Europe and to work and cooperate with it.

While there are vast differences in circumstances in Europe and in Latin America, I feel that it may be possible to learn from the European experience in considering future steps toward integration in Latin America.

I do not wish to deny that at times there were some uncertainties whether integration in Europe would finally end up on balance with positive or negative results, but today, even despite current difficulties, it seems clear that the results already achieved in Europe have been positive. With that experience in mind, there are grounds to hope that integration in Latin America can proceed in such a way as to provide a strong impetus to economic development.

Yet we must not close our minds to the fact that there will be some real dangers and that it is not inconceivable that further steps toward regional integration in Latin America might take a form which would both be harmful to the U.S. economy and prejudicial to economic growth in Latin America.

Regional integration could be either destructive or constructive depending upon its orientation and implementation. If it is simply a matter of changing the form but at the same time increasing the effectiveness of economic isolation, it will be destructive; but if it is a dynamic attempt to unleash the forces of growth, it will be constructive. This fact has been widely recognized in relation to integration and the potential gains from international trade. Today I should like to present a similar view in relation to the vast benefits possible for Latin America from a greatly enlarged flow of private investment.

Perhaps it would be helpful for me to mention the dangers first. One danger is that any new integration agreements, whatever their specific provisions regarding commodity trade, might be strongly protectionist in their treatment of investment from abroad.

This fear is even called to mind by some sentences in the recent "Proposals for the Creation of the Latin American Common Market" advanced by Drs. Mayobre, Herrera, Sanz de Santamaría and Prebisch. (See app. V, p. 229, for full text.) Their study is a thoughtful and far-seeing document with many of whose points I am in full accord. Nonetheless, I regret to report that some of their words cause concern.

They state, for example, that—

> the rules for foreign investment will have to be founded on the principle that the regional market must be an instrument to strengthen the position of our entrepreneurs and confirm their paramount role in the development of Latin America—

and that—

> foreign investment must bring with it modern techniques of production and it must serve increasingly as an efficient vehicle for the transfer of such techniques to our technicians and entrepreneurs.

They also speak of forestalling "any substantial difficulties which might arise from competition." These statements, and others in the same document, could be subject to a considerable range in interpretation and implementation, but they clearly raise the danger that regional integration could take a course which would deter or prevent investors from outside Latin America from competing in service to the producers and consumers of the area. The result could be to raise prices and encourage inefficiency by "protecting" local firms from the spur of competition.

A specific instance of this danger has already arisen in one field which, in view of the geography of the region, would be particularly crucial to the outcome of any integration in Latin America. That field is transportation. Last May in a meeting on water transportation held in Montevideo under the auspices of the LAFTA, approval was given to a declaration which was not only very restrictive as to the flag of the ships that would be permitted to engage in intrazonal trade, but also restrictive of the nationality of the capital controlling them, of their crews and of the shipyards of origin.

I am, of course, aware that in these matters none of us is perfect, and I am particularly aware that all too many of the individual governments in Latin America already have erected high barriers to prevent foreign investors from competing with favored local entities, especially those owned by the state. Yet the danger remains that in the course of regional integration these barriers could be raised even higher; they could be made more general; and they could be subjected to an institutional rigidity which could hamper economic progress for years to come.

The fear has been expressed that if economic integration creates larger market areas, foreign investors with—

> technical and financial superiority * * * may well acquire a predominant position, to the decided detriment of Latin American entrepreneurs.

I can appreciate this concern, but I believe it is largely unfounded.

A regional market that made scale economies possible and significantly increased economic growth would make investment in basic industries more attractive than it is now. But the way to get broad-based investments in an economy is surely not to restrict entry into the investment market, but to make it as free and open as possible.

Latin America's great need is for a higher savings rate and efficient mobilization of the capital generated in the economy. Both of these will be fostered by faster growth and more equitable treatment of private investment, whether foreign or domestic.

Local entrepreneurs need the stimulus of opportunities to invest both in basic industries and to create ancillary industries. And while there is no doubt that many foreign investors now have a technological lead over many local producers, this is a situation that is much more likely to be changed by competition than by restrictions. In any industrial country, many of today's big companies are the energetic small companies of yesterday. It is this hope for Latin America that would be frustrated by narrow economic provincialism in respect of capital movements.

Another danger is that the trade rules adopted in the process of regional integration might prove so discriminatory against some commodity import categories as actually to provide too much incentive for investment in the production of those goods within the area, whatever may be the level of discrimination in favor of the local versus the foreign investor. It is generally recognized that regional integration will normally increase the effective protection of local production in competition with imports from abroad, even if—and this is a big "if"—the average level of import duties on goods from other areas is reduced.

After integration there may be the incentive for investment in new or expanded facilities for items which can be produced only on a high-cost and essentially uneconomic basis within the region. Purchasers in a country which had been importing an item from the United States or from Europe or Japan may find that, on the basis of the new low, or nonexistent, import tariff applicable to that item only when it is produced in Latin America, it is cheaper to import the item from a high-cost plant in another country in the area.

What appears cheaper to the private purchaser could, however, cost considerably more to the importing nation when account is taken of the fact that on the earlier purchases the amount of the duty was kept in the country and only the net amount excluding the duty was remitted abroad.

Integration efforts involve the possibility that "protection" for the high-cost local producer could be carried to the extreme not only of excluding competitive goods from outside the area, but even of eliminating all competition within the area as well. This possibility was provided for in the agreement establishing the Central American Common Market and virtual monopoly status was given to some industries in the region.

The recognition of these dangers inherent in further economic integration in Latin America is not the same as concluding that they are inevitable. Both dangers were also present in Europe and neither has been entirely avoided, but I would not say that either has been a predominant characteristic of the integration measures in Europe.

It is probably true to say, on the basis of experience with existing restrictive national economic policies in Latin America, that the dangers are greater in Latin America than in Europe that integration will lead to uneconomic governmental distortions in the pattern of of investment. Yet there are strong grounds for hope that in any further moves toward integration in the area there will be recognition of the importance of enhancing the flow into truly productive ventures of investment, both from within and from abroad.

To date, the policies of the two existing integration organizations in the area have probably been much more understanding of the role of international investment than have the policies of some of the individual governments in the area. Both the LAFTA and the Central American Common Market have stated clearly that they welcome foreign capital and they have shown a willingness to consult and cooperate with private investors.

The Central American Common Market authorities seem to have recognized the monopoly dangers inherent in the "integrated industry" approach and do not appear disposed to expand the list of such favored firms. The highest levels within the free trade area have not, or at least not yet, endorsed the restrictive recommendations of the special transportation groups, and the area authorities have thus far worked harmoniously with private investors on the so-called complementation agreements, which provide that in the case of specific industries various member countries shall specialize in certain products or stages of production while opening their markets for the other products of those industries from the other member countries. These agreements may have practical value in moving toward economic integration sector by sector.

The European Coal and Steel Community, using a sectoral approach, probably made a contribution to industrial development in Europe during the 1950's. Another proposal for a sectoral approach, this time in fertilizers, pesticides, and other similar products, was contained in President Johnson's speech to the Latin American Ambassadors last month. Measures of this kind may be useful steps in the process of integration and we should know more about them.

With agreements of this sort there will always be the danger that uneconomic national locations for particular kinds of production will result from the political pressures or the preconceived ideas of government planners, and there will be the danger that the governmental representatives negotiating such agreements will seek to promote the activities of particular uneconomic state-owned enterprises. But experience to date with the Latin American regional organizations encourages the hope that recognition will be given to those ways in which economic integration might truly result in economic advance.

Such a beneficial result could follow if further integration efforts stir up a fresh wind of freedom in economic affairs in Latin America. It may not be much of an exaggeration to say that something of this sort did happen in Europe in the industrial field, if not in agricultural matters. As experience was gained with the ease of adjustment to the removal of barriers to imports within the European regions, some of the fears also faded away regarding lowering the barriers to trade with other areas as well.

If in Latin America the lowering of internal trade barriers were accompanied by a significant lowering also of the "protection" from outside competition of local industries which should have passed long ago from their supposed "infancy," then integration could provide a spurt to economic growth in the area. In the process some changes in rates of currency exchange would undoubtedly be needed, but then the residents of much of the area are already familiar with such changes and could probably expect fewer currency changes with a productive integration effort than without it.

Drs. Mayobre, Herrera, Sanz de Santamaría and Prebisch have noted that—

> in our countries, the scale of competition is usually small or nonexistent owing to the high barrier of tariffs and restrictions behind which industrialization has developed. This situation conspires against technical progress and greater productivity. And even in those plants that could attain an adequate scale, especially in the larger countries of Latin America, the small extent of competition—or the lack of it—frequently leads to inadequate utilization of capital.

But if Latin America should adopt an outward-looking approach to integration, with a dedication to increasing the role of competition in the area, then it could be that scope would have been created for truly economic large-scale plants in the area. Such plants, faced with a market large enough to justify mass production and operating under the pressure of competition, could lower costs in the area, attract beneficial foreign investment and put Latin America as a whole on the way to the dramatic rates of growth achieved in recent years by some individual less developed nations around the world.

In such an open economy within Latin America there would be no place for the restraint on growth which has resulted, for example, from the pressure during the last decade for the installation of small-scale and relatively inefficient oil refineries in each of the separate nations of the Caribbean and Central America, and despite the existence of the Central American Common Market. Such refineries have in many cases raised the costs of basic petroleum products for economies not in a good position to support expensive monuments to national pride.

An integrated Latin American economy which established a low external tariff, which provided for the relatively free movement of capital within the region and from without, and which swept away the network of discriminatory measures which now protect favored local firms and government entities through market allocation, tax exemptions, preferential exchange regulations, et cetera, would still involve some degree of trade discrimination against the United States, but on the other hand the breath of fresh air which such integration could provide should more than overcome the drawbacks of discrimination and so enhance the rate of economic growth as to result in more rather than less opportunities for beneficial trade and investment flows between the United States and the area.

Realistically we should ask ourselves what direction will be taken in practice by further integration efforts in Latin America. Will the movement be in the direction of the dangers I have described, with an increase in the effective isolation of the economies of the area, or will the movement be toward an open economy in which the forces of competition and efficiency are given scope to bring productive innovation to the area? On balance I believe the latter course is probable. I suggest that a good indicator to watch for predicting the direction will be the proposals of those at work on the integration efforts in relation to the future role of private investment in the area.

Despite the severe limitations placed on private investment in some of the Latin American nations in recent years, it is still true that the bulk of the economic output in the area is being produced in the private sector. And, it is significant that wherever the private sector has been able to count on stable ground rules—as recently in Venezuela, Mexico, and Central America—the rates of economic growth have tended to be highest.

As the Latin American nations attempt to draw closer together in their trading relationships and joint economic planning, it is important that they do their utmost to marshall private decisionmaking and private initiative to build on this base and to encourage the dynamic growth fostered by both domestic and foreign capital investment.

An expression of interest by Latin American governments in the Draft Convention for the Protection of Foreign Property put forward for discussion by the OECD would be an encouraging sign. Another would be the ratification by some of the Latin American Republics of the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, which is sponsored by the World Bank. Jamaica and several Eastern Hemisphere states have already signed. I am pleased that Secretary Fowler signed for the United States 2 weeks ago, and I hope that the Senate will ratify this action shortly.

The contributory role of foreign private enterprise in stimulating economic growth in the host country is often underestimated. The contribution is not measurable merely by the increase in production directly associated with such investment.

Many other tangible benefits accrue—first in the rising incomes and increased training and education of the local populations employed in the new plants. Local businessmen receive incentive to undertake complementary economic pursuits putting additional persons in the ranks of the employed. The new ventures and the ancillary enterprises increase the tax revenues and often provide new sources of foreign exchange.

The less tangible benefits stemming from direct personal exchanges between local and foreign businessmen are not readily measured, but to me they may be the most important. They can demonstrate that business can be conducted on a responsible basis, and reasonable profits earned, even when the profit per unit of sales appears to be small. The economies of scale and the rewards of efficiency can still provide an adequate return on total capital invested.

Not only is there a tendency to underestimate in what measure foreign investment stimulates the local economies through these side effects, but there is also, I fear, a general misunderstanding of the quantitative significance of the operations of U.S. companies within Latin America.

More often than not, we tend to measure private investment activity by the net capital outflow reflected in the U.S. balance-of-payments statistics. On this basis U.S. direct investment in Latin America amounted to $290 million last year which represented a rebound from the lower levels of the previous several years.

The OECD and the U.N. tend rather to measure in terms of what they call the "transfer of resources," which adds to the net capital outflow figure the sum representing earnings reinvested by the American companies in their affiliates abroad. Earnings reinvested in Latin America have averaged over $200 million in recent years.

As some of you already know, I feel strongly that a more appropriate measure is "gross investment activity" which includes in addition to the items already mentioned, the new investment of funds arising out of depreciation and depletion of earlier investments. It is the gross number, estimated at well over $1 billion last year, that most nearly measures the opportunity gained for the introduction of productive innovations.

These statistics which I have given so far relate specifically to U.S. direct investment activity in Latin America. I do not wish to overlook the fact that portfolio and other long-term investments amounted to over $300 million last year and that U.S. banking institutions built up their short-term loans to the area by about $600 million.

These sums are important particularly in aiding Latin American countries to finance their imports, but their impact in terms of innovations in business enterprise may not be as lasting as the impact of funds invested directly in affiliated companies and accompanied by technical knowledge and management skills, and often foreign markets.

Beyond reinvesting and building on their own operations in places abroad, American firms have encouraged their affiliates to promote development through the financing of local investments outside their own direct sphere of influence.

For example, affiliates of my own company in Venezuela and Colombia have created new local companies for the purpose of investing in—and lending managerial and technical skills to—a variety of local enterprises in agricultural as well as manufacturing enterprises outside of the petroleum industry. American companies and financial institutions have also participated in local development banks and financieras for the promotion of new enterprises in Latin America.

These investments were the forerunners of the new, and to me, most exciting international experiment in private enterprise in Latin America—the ADELA Investment Co., which, as you know, was inspired by Senator Javits and developed with the support of the then Senator Hubert Humphrey. Formed at the end of last year, ADELA has a subscribed capital in excess of $32 million contributed by over 120 private business firms and financial institutions in Europe, Japan, Canada, and the United States. ADELA is in business. Already it has given approval to 14 investments for which the ADELA participation will be $8.5 million out of a total investment of $90 million. These investments are spread over seven countries in the area. As a matter of fact, since I have written this, they have approved a few more. It is going faster than I can keep up with.

Dr. Marcus Wallenberg, chairman of ADELA, has said that "ADELA is a vote of confidence in the future of private investment in Latin America." I believe current Latin American interest in economic integration is a further justification for that confidence.

It is my understanding that your committee is essentially asking the question whether the United States should support the development within Latin America of arrangements which will inevitably involve discrimination against U.S. exports to the countries of the area. In considering this question, I am sure that you will wish to take into account the legitimate interests of U.S. producers, traders, and investors as well as our more general national interest in the advance of economic well-being and political maturity in the area.

My own conclusion is that we can and should support a regional market in Latin America designed to break down the existing maze of high tariffs and other restrictions and to infuse a competitive spirit into the area, but in our further cooperative efforts in the Alliance for Progress we must seek to assure that there is a recognition that a reasonable external tariff and fair treatment for all investors will be essential to the success of any integration effort.

The goal is worth the effort. Latin America has the capacity for rapid growth, for significant industrial advance, and for important economic collaboration with the other areas of the free world.

Mr. REUSS. Thank you, Mr. Collado. We are approaching the noon hour, but I would like to ask each of you three gentlemen a question based on your presentation here this morning.

Would you each agree that in approaching this question of the Latin American Common Market we should do two things:

1. We should avoid uncritical acceptance of just any common market notion, bearing in mind that the discrimination inherent in a common market is something that departs from our long-term goal for world trade and investment.

2. We should recognize, in our consideration of the Latin American Common Market, that regional trading blocs can frustrate growth elsewhere, particularly in the developing world, by fragmenting markets, and in order to minimize that frustration, we should not require either a timetable or a philosophical framework for any Latin American Common Market which work against our goal of multilateral investment and free trade throughout the free world, not only for U.S. traders and investors but for traders and investors from the rest of the free world.

Is there a dissent on the part of any of you from the proposition I have just stated?

Dr. FRANK. It is certainly a valid proposition that the United States should not endorse anything that has the label "regional" attached to it; that we should take a close look at any proposals that the Latin Americans put forward insofar as our cooperation is required.

At the same time your statement apparently implies that we should look with a sympathetic eye at efforts on the part of the Latin Americans to achieve some of the benefits of larger markets through regional arrangements; and to the extent that those can, from the outset, be viewed as transitional toward the broader goal we seek, that, of course, is all to the good.

How firmly you can nail down such commitments at the outset, I think one has to recognize, is open to question. You may find that advances in a liberal direction can best be made when the parties to the regional arrangements themselves feel strong and believe that the lowering of the outside tariffs would be in their interest.

It is unlikely that they will do anything they do not feel is in their interest, but the appreciation of what is in their interest may not come on some of these points until the process is already underway.

Mr. REUSS. Of course, a departure from GATT's multilateralization philosophy can only come with the consent of the majority of the GATT members.

Dr. FRANK. As a legal matter——

Mr. REUSS. A fanciful group within GATT cannot just set itself up as a discriminatory trading arrangement and start in business the next day.

It has to ask GATT, pursuant to article 24; does it not?

So, we are not without powers, nor is the rest of the developed and underdeveloped world without powers, to constructively assist in shaping this preferential tariff area; is that not so?

Dr. FRANK. That is quite right.

The legal point is that the regional arrangement either conforms to article 24 of GATT, or else goes forward on the basis of a waiver given by two-thirds of the GATT members. But, despite the law, achieving the kind of objective you want, as illustrated in our relations with the EEC, requires a feeling of consensus, a conviction on the part of the Latin Americans that what we are asking them to do is in their interest.

Mr. REUSS. Mr. Collado, would you want to comment?

Mr. COLLADO. I think I would generally agree with your statement and more particularly with Professor Frank's additional description of it.

I think that, first of all, it is quite clear, and I think I devoted most of my own statement to the idea, that the form of the integration is important.

I think myself, and I agree with some of your earlier remarks before I was up here, that in many respects perhaps we could have been a little bit more careful in reserving positions in respect to the European Common Market; whether it would have done us any good in practice is another matter.

But at least I think we would have had at least a sounder position, and I think it is very important that we not willy-nilly encourage a common market in Latin America that is based on excessively high levels of protection, and we have plenty of cases to demonstrate that it is not impossible for them to do things that do not seem very economic.

I am not so worried about a Latin American Common Market harming the development of other undeveloped areas so long as we are talking about the kind of a market integration that I think all three of us have been talking about this morning, if only for transportation and other considerations that I do not think make the inherent protection or discrimination against, for example, products of Africa or Asia in real terms terribly important.

I think the much more important question on regional areas and discrimination between them is the preferences that may or may not be accorded by some groups of the developed nations to one or another of the undeveloped groups.

I think this is an area where the United States ought to be just as strong as it can be—I think it has been—and I think it is our Latin American friends that are in the greatest danger of suffering from this sort of thing, and I think here we should do everything possible to prevent that.

Now, I am very enthusiastic about the possibilities of developing industry in Latin America primarily through indigenous efforts in these countries, but also through foreign investment.

In our recent little ADELA experiment which I probably should not talk too much about, but which I am very pleased with, we have discovered that there are a very large number of possible industrial developments in each of these countries only waiting for a certain degree of synthesis.

There are people who know what to do, but they need technical help, they need some kind of financial encouragement, they need something or other.

Actually, finance is not the most important of the requirements.

There are now 70-odd financieras in Latin America, and they can provide a lot of finance. This is not the main problem—the main problem is what we would call in this country good investment analysis, good market analysis.

With this kind of aid I am convinced that we can have a very large further expansion of this kind of investment. ADELA is running about 10 to 1 in terms of the total enterprise investment versus what ADELA puts into it, and I would say that within 3 or 4 years ADELA will have contributed to about half a billion dollars' worth of investment.

This is a substantial number.

Investment in Latin America is moving forward, more particularly as I say in those countries that have been stable. I think this is important, so I am not worried about the future, but I think we must prevent the development of the common market from having stifling effects.

Geography is not very helpful to the development of a Latin American Common Market. It was very helpful in, say, Central America, but in South America geography makes the countries look outward rather than inward.

As Senator Javits mentioned, I think that only 9 percent of the trade of the LAFTA countries is with one another, and if you look at the map this is very easy to understand.

There are some big mountains and some swamps and other difficult areas in the middle, and trade does not follow across that very easily.

Mr. REUSS. Thank you.

Mr. Grunwald, do you have a comment?

Mr. GRUNWALD. I, too, basically agree with your statement, Mr. Chairman.

I also share your concern that we should try to open up any integration arrangement as much as possible and as soon as possible.

I believe from a practical point of view it might not be feasible to put a time limit on such an opening now because the present concern is with putting time limits on the reduction of internal tariffs, and even this timetable has not yet been definitely established for a common market in Latin America.

I do not think that the discrimination against third countries will be any greater under an economic integration arrangement in Latin America than it is now. After all, each country has very high tariff walls now. I do not think that the tariff walls around a regional bloc will be higher, on an average, and if anything, I think they may even be lower.

I think the crucial question is, Do we, by encouraging economic integration, make it possible for countries which are at present not viable economically, which have little chance for rapid and sustained development, to become more viable within a larger regional arrangement?

I feel that in Latin America we have an opportunity that we may not have in other developing areas. Latin America is much closer to moving toward integration than any other developing region in the world and I think that we have an opportunity for an experiment for development that is within our interest to support.

Mr. REUSS. Thank you very much, gentlemen; the subcommittee stands very much in your debt. You have made a tremendous contribution this morning.

There is a particularly interesting and excellent article in the April 1965 issue of Lloyds Bank Review, the very title of which suggests the problems which we have been studying. It is called "Would Tariff Preferences Help Economic Development?" by Prof. Gardner Patterson of Princeton University. We will include it in the record at this point.

(The document referred to follows:)

WOULD TARIFF PREFERENCES HELP ECONOMIC DEVELOPMENT?†

(By Gardner Patterson*)

The proposal that the "developed" nations grant tariff preferences to imports of manufactured goods from the "developing" nations was one of the major issues before last spring's U.N. Conference on Trade and Development [1] and during recent GATT sessions. The idea behind the proposal was that if producers in the less developed countries faced lower tariffs in the developed areas than their rivals from the highly industrialized nations, then the markets for the former's exports would be enlarged and economic development of their countries would be facilitated.

Following weeks of discussion and debate, the U.N. conference's 120-nation Second Committee recommended that the rules of international trade be so amended as to provide for preferential entry into the developed countries of manufactures and semi-manufactures originating in developing countries. The United Kingdom was in the forefront of the highly industrialized nations holding that, while they did not like many of the details of the actual proposals on the table, they believed some system of preferences was feasible and desirable. Only Canada, Norway, Sweden, Switzerland, and the United States were determined in their dissent from the principle of such preferences. Of these, the United States was the most unyielding and was often charged with being a slave to outmoded doctrine.

This particular resolution, however, contained some conflicting provisions and many vaguely-worded and sweeping obligations, which led most developed countries to abstain. In the end, therefore, and as a part of the intense efforts in

†Reprinted from Lloyds Bank Review, J. C. Winton, editor, April 1965, p. 18.
*The author is Professor of Economics at Princeton University. He spent the academic year 1963–64 in Geneva, with financial help from the Ford Foundation and the Social Science Research Council; and followed much of the public discussion of the subject of this article in the meetings of the GATT and the U.N. Trade and Development Conference.
[1] The question of less developed countries granting preferences to each other has also been on the agenda, but received little attention and is ignored here.

the final days to get a form of words to which all, or nearly all, participants could agree, the Final Act limits itself on the operative provisions of this item to stating that the great majority of countries agree with the principle. Mr. U Thant is also asked to make appropriate arrangements for the establishment of a committee to consider the matter "with a view to working out the best method of implementing such preferences . . . as well as to discuss further" differences in view as to the principle itself. Efforts in November to incorporate the policy into the new GATT chapter on trade and development failed—for the moment.

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The subject will continue to have a high place on the agenda of all manner of international gatherings. Its discussion will give rise to all sorts of questions, as it already has in Geneva. How is a "developing" country defined for these purposes? What should be the margin of preferences? Should all manufactured goods be treated the same? How long should preferences last? What criterion should be accepted for ending preferences? What account should be taken of the fact that, as regards stages of industrialization, the differences among the developing countries themselves are greater than between some of these countries and some of those commonly regarded as developed? What arrangements should be made for incorporating existing preferential arrangements into any new scheme? Should preferences be negotiated and selective (strongly favoured by Belgium and France) or automatic and general (insisted upon by the developing nations)?

These complex matters will warrant the necessary study by busy and harassed officials only: if there is a defensible case for offsetting the high money costs of producing many manufactured goods in the developing countries, if preferences can do this, if the amount of assistance that can be so extended is more than trivial, and if the probable costs do not outweigh the benefits. The object of this essay is to offer preliminary answers to these questions, which have so far received scant attention. To do this, it is necessary, first, to sketch the events which have fostered this new interest in discriminatory practices.

BACKGROUND TO PREFERENCE PROPOSALS

The belief that tariff (and quota) preferences could be an effective device for encouraging economic development has been growing for some time. It has been an element justifying preferences in various trade arrangements between a metropolitan country and its overseas territories. The Latin American States have often been convinced that the preferential systems of the British Commonwealth and of the France zone have been costly to their exports; and so, it was reasoned, to obtain preferences would probably be beneficial. On several occasions during the post-war years the Contracting Parties to the GATT have granted waivers to individual countries of their most-favoured-nation obligations [2] on the specific grounds that this was an effective way for a rich country to help a poor one to develop. Examples of such arrangements have been those between Italy and Libya and between Australia and Papua/New Guinea. There is little concrete evidence that these were successful, but it was often said they were.

Precedents such as these, however, are only part of the story. Of fundamental importance has been the adoption by all the less developed countries of a more rapid rate of economic growth as a major national goal. Their efforts have been spurred on by the evidence that the gap in *per capita* incomes between the rich and the poor nations seemed to be increasing. But, for well-known reasons, a persistent tendency for serious balance-of-payments deficits to develop has been characteristic of nearly all the poorer countries in which rapid economic development is a major objective. Many nations attempted initially to meet this problem by increasing the domestic production of import substitutes. This was soon found to provide only a partial answer: there were physical and technological difficulties, the smallness of the domestic market often meant intolerably high unit costs, often little foreign exchange was in fact saved because the import-substitute industries relied so heavily on imported components. It was, in short, soon recognized that import substitution could easily result in an uneconomic use of existing resources. And, although private investment and traditional foreign

[2] If one country reduces a tariff in favour of another, it is accordingly obliged to reduce that tariff in favour of other countries which enjoy "most-favoured-nation" treatment.

aid could also help to cover balance-of-payments deficits, most nations found them inadequate, given the growth goals they had set for themselves.

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Many, in developed and less developed areas alike, soon concluded that one of the major tasks confronting the world trading community was to find ways for expanding the export earnings of the less developed countries so as to permit them to increase their imports. This, in turn, would facilitate the "development and diversification of their economies," in the words of the 1958 GATT Programme of Action. For the first few years, attention was centered on traditional measures for increasing traditional exports: general lowering of tariffs on a most-favoured-nation basis, removal of quantitative restrictions, and reduction of internal duties, taxes and other charges which had often borne heavily on the established exports of the poorer countries. In fact, however, relatively little was actually done in these years to reduce import barriers. This was also the time when the theory of the second-best and the European regional arrangements were giving new respectability to discriminatory practices. Many of those responsible for policy in the less developed countries became deeply concerned that one effect of the association of the former French overseas territories with the Common Market might be seriously to prejudice their own established exports.

The gloom all this caused was deepened by the growing belief that, while earnings from traditional exports of less developed countries might increase, these could not be expected to match the growth of imports which would be associated with the desired or planned rates of economic growth. Demand for raw materials, in general, was thought to be little affected by price changes or by rising incomes in the major markets. The growth in demand for some of the agricultural exports of the less developed countries was further dampened by the great increases in productivity, combined with protective policies, in the advanced nations, and many feared their goods would also be subject to ruinous competition from synthetics. It was widely believed that such sluggish demand conditions were often accompanied by relatively inelastic supplies of many natural raw materials. Although the evidence, theoretical and factual, did not satisfy the sceptics, most spokesmen for the less developed countries became convinced that the long-run tendency would be for a serious worsening of the terms of trade for primary-goods producers.

The conclusion drawn was that a necessary element in the process of development for most less developed countries was a great expansion in the production and export of new manufactured and processed goods. In early 1961, the Secretariat of the U.N. Economic Commission for Europe, in their *Economic Survey of Europe in 1960,* set the framework for much of what has followed. They estimated in this report that, for the less developed countries to achieve a 3 per cent per year increase in *per capita* income, they would have to expand their total exports to the developed economies by some 2½ times by 1980. The burden of their analysis was that this could be done only if the less developed countries together were able by that time to export manufactured goods to an amount *at least seven times* that recorded in 1960. Since the lion's share of the manufactured goods exported by these countries in that year had come from only a few among them—notably Hong Kong, India and Mexico—the problem for most was even greater than these over-all figures suggested.

SHORTCOMINGS OF ESTABLISHED COMMERCIAL POLICIES

As closer examination was given to the many-sided problem of expanding production and export of manufactured goods, a widespread conclusion emerged that ranking high in the list of obstacles were certain old-established rules of commercial policy. These were: that negotiations for tariff reductions were held only with the "principal supplier," that reciprocity was required in bargaining concessions, and that most-favoured-nation treatment was accorded to all reductions in import barriers.

It was argued, first, that since, by definition, the less developed countries could not be the "principal supplier" for the new products they believed it both necessary and desirable to produce for export, tariffs on these would be lowered only when others decided to negotiate and were able to reach agreement. This meant that the less developed countries would be mere bystanders. However, the linear (or "across the board") approach to tariff reductions, which is being followed in the Kennedy Round, greatly reduces the importance to the less developed countries of the principal supplier rule. [3]

Secondly, as to the reciprocity requirement, the developing countries said they had little to give and so could have little to expect if this rule remained. They "could not afford" to lower duties on many consumer goods, because this would deprive them of a needed source of internal revenue and might also prejudice their economic development plans by using foreign exchange for what they regarded as unessential purposes. Duties on industrial and manufactured goods and related raw materials were already often low, or needed to be retained either as a source of revenue or as a protection for infant industries. In any case, their trade in such products was not big enough to constitute much of a bargaining counter. Finally, they argued, at least in the beginning the benefits they would get from the lower tariffs on their new exports would not be worth much in the way of concessions by them, because their exports would be small. In fact, for several years the reciprocity rule has not been rigorously applied to the less developed nations, and in May, 1963, the Contracting Parties to the GATT formally agreed that in the Kennedy Round full reciprocity would not be expected.

It was, finally, the most-favoured-nation rule—"the cornerstone of the GATT"—that came under the strongest attack. The mere reduction of import barriers on a most-favoured-nation basis on the new goods the less developed countries hoped to produce for export would be of little help, it was alleged, because the new industries in the less developed countries would often be unable to meet the competition in third markets from exporters in the already industrially-advanced countries. What was needed, it was concluded, was preferential access: lower duties against their exports than had to be paid on competing exports from the already efficient industrialized countries.

THE CASE FOR PREFERENCES

Assuming no *general* inflationary problems, the inability of one country to export a particular good at competitive prices may be a more or less permanent state of affairs, reflecting the basic economic fact that it costs more to produce than in other countries or than other goods. This is true for every nation with respect to some products; but one can easily imagine instances where a nation might still wish—for political, or military, or sentimental reasons—to use some of its resources in this uneconomic way. Other countries might even be willing to facilitate such uneconomic activity by subsidies of one kind or another. But this is not what is at issue today. Rather, the contention is that this inability to produce at competitive prices is frequently a temporary state of affairs and that preferences are an effective and desirable way to prevent its becoming permanent.

Costs per unit during the early stages of growth may be high for a firm or plant or industry, because it is still inexperienced or has not yet reached a size to take advantage of the known economies of large-scale production. Once this level of output is reached lower costs may permit competitive prices. It has been argued that, if this be true, entrepreneurs (private or public) in the developing countries should themselves be willing to bear the costs either of absorbing the losses during the period of growth or of building to optimal size right away. But it is claimed, in reply, that this over-estimates the entrepreneurial initiative available in many of these areas, and assumes the availability of a volume of capital which is simply beyond the reach of the local entrepreneurs. It is the need to help to offset the high costs of infant industries, so as to permit them to grow into lower-cost mature industries, that has usually been put forward as justifying special help.

A more important factor than this straightforward question of economies of scale is that of so-called "external economies." These may be very great at the "learning" stage of economic development and they may be present whether a firm is on the downward or upward part of its cost curve. In the present context, it means that the costs borne by the producer of new manufactured goods, and reflected in his prices, may be much greater than the *real costs* to the community of producing the goods. This deviation may be due in part to the fact that the first enterprises in the less developed countries, just because they are the first, sometimes have to bear a disproportionate share of infra-structure costs, such as

[3] Unless covered by the "exceptions list", or made the subject of a disparity rule, goods of interest to the less developed countries will automatically be included in the tariff reductions, even though the major negotiations are between the developed countries. The extent of reductions on goods of particular interest to them will, under the linear approach, not be dependent on the bargaining power, or lack of it, of the less developed countries. It is therefore surprising that the less developed countries apparently have taken so little interest in the question of disparities and the exceptions list.

those for roads, public utilities, etc. Probably more significant is that frequently these first enterprises have to shoulder the considerable expense of educating and training both labourers and managers in the basic practices and techniques of industrial work. These men then leave, taking their newly-acquired skills to another enterprise, forcing the original firms to bear these high costs once more. The nation may lose nothing, or even gain, by this shift, but the process can add greatly to the money costs of the early enterprises. Moreover, in the middle of the 20th century, some of the less developed countries may have assumed social-welfare obligations and adopted wage policies which, during the early stages of industrialization, result in money costs exceeding productivity, valued at world market prices. This can be true even though the workers' productivity in real terms in the new industrial establishments exceeds that in the rural areas from which they were drawn.

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It is easy to overstate their extent, but there can be no doubt that there are many instances in the less developed countries where important economies of scale are possible and where there are divergences between social and private costs. Although no studies seem to have been made to determine their magnitude, it has become a virtual article of faith among many of those responsible for determining policy that such phenomena are widespread.

Economic welfare could be increased in the less developed countries by government action designed to offset the "excess" of present private costs, permitting production—and exports—on the basis of the (lower) real and the long-run costs. It is possible for the less developed countries to do this by internal tax and subsidy measures, in which case the "excess" costs are shifted from the producers of the goods in question to others within the country. This, after all, is the way an import duty helps a domestic producer to overcome non-competitive prices in the home market. Some have deplored such a solution, on the grounds that it would involve a transfer of real wealth from the poorer nations to the richer ones. If the goods could in fact be exported at the higher price, there would be merit in this concern. Otherwise, the measures should be seen merely as an adjustment of prices within the producing country to reflect the real costs of producing goods, and then charging the latter. There is, however, a serious practical problem: an effort by the less developed countries to offset by means of subsidies the difference between the money cost to the producer and the real social cost might result in the imposition of countervailing duties by importing countries.

But it is also possible that these "excess" costs in the less developed countries might be borne by other countries. Such help might take a variety of forms. There are many ways in which the traditional foreign aid programmes can be and have been used for such purposes. Foreigners could also bear such costs directly by paying higher prices for the goods produced than they would have to pay for comparable goods bought from someone else. This is, of course, what the preference proposals come down to. Preferences are a form of foreign aid. The costs are shouldered by the nation granting the preferences and by those losing markets as a consequence.

HOW MUCH AID CAN BE PROVIDED VIA PREFERENCES?

Assuming there is a compelling case for the richer nations helping the poorer to meet this problem, one must still ask: Is it in fact possible today to extend much aid via tariff preferences? Is it an efficient way of helping?

Two major conditions must prevail with respect to any product if tariff preferences are to permit a less developed country to export where it otherwise could not. First, the price charged by the less developed country must still be *below* those of the domestic producers in the developed country being asked to give preferences. It is only in this circumstance that a tariff removal has a direct influence on trade. Second, the price charged by the developing country can *exceed* those of other producers among the developed exporting countries only by an amount which is *less* than the tariff. If its price disadvantage is more than this margin, exporters from other countries will still be able to keep the market, even though the less developed country has no tariff at all to hurdle. If the latter's price is below those of developed countries, then in most cases a preferential tariff cut has few if any advantages over a nonpreferential one: *i.e.* a most-favoured-nation reduction. To the extent the price charged by the less developed country falls within the range set by these two conditions the nation granting the preference presumably will purchase its goods. Prices at the port of entry (prior to duty collection) for imports from the less developed country will be higher than for imports from developed countries. However, the total price, *including duty*, will be lower for the former than for the latter and so such goods will be preferred, to the benefit of the less developed country.

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It seems often to have been forgotten by those urging preferences that the creation of the EEC and EFTA has dramatically increased the significance of the first condition: that prices charged by producers of a commodity in the less developed country must be below those of producers in the preference-giving country. It will be only a few years until "domestic producers" in each of these areas include the most efficient in any of the respective member countries. The importance of this can perhaps be seen by imagining the reaction of the spokesmen for the less developed nations had they proposed five years ago that, say, Denmark, grant tariff preferences to their manufactured exports and the Danes had replied, "All right, but you should know that we are going to grant even larger preferences on competing goods to producers in the United Kingdom, Switzerland, and Austria." The EEC and EFTA greatly reduce the scope of the preferential advantages that can in fact be given to the developing countries by the major industrial nations.

The second condition noted above means that the higher the tariffs in the preference-granting countries, the greater is the number of goods produced in preference-receiving countries that may enjoy larger export markets, and the larger the price differential that may be provided to those enjoying preferences. Together, these measure the total amount of aid that may be provided through this device. It is notoriously difficult to measure the heights of tariffs and I have neither made, nor found, a detailed, commodity-by-commodity and country-by-country study. But it seems doubtful that the heights of the tariffs that might be reduced preferentially are now great enough to permit a large amount of help. The present average tariff level in the major developed countries amounts to only about 15 per cent. *ad valorem*, calculated as a simple arithmetic average of the tariffs on all manufactured items. The tariffs on some items in some countries are, of course, a great deal higher than this, but a quick survey of the detailed schedules shows that there is a heavy clustering around this average. Such an average also does not take account of the important fact that a seemingly low tariff on a processed good, when combined with a much lower duty on the incorporated imported raw materials, may yield a very high duty on the value added by the processing. Nonetheless, the possibilities here are of a different order of magnitude from the aid which countries in the past have often forced their own consumers to provide to their own infant industries by means of high tariffs, and which is often cited as demonstrating the effectiveness of this method in encouraging industrial growth.

TARIFF LEVELS AFTER KENNEDY ROUND

Assuming that the Kennedy Round of tariff negotiations is moderately successful, and that the level of tariffs on most manufactured goods is reduced by something in the neighbourhood of 35 per cent., the resulting simple arithmetic average level of *ad valorem* tariffs on all manufactured goods may turn out to be no more than 10 per cent. Account must also be taken of the fact that there will be great reluctance to give preferences that result in no tariffs at all or "zero duties." The less developed countries during the recent World Trade Conference, where bargaining positions were being taken, spoke of zero duties, but frequently proposed that for most goods preferences initially should be equal to "at least 50 per cent. of the most-favoured-nation rate." Applying a 50 per cent. rate to the assumed post-Kennedy-Round tariff yields an average preference in the neighbourhood of 5 per cent. One must also remember the strong probability that any general system of preferences would have some exceptions: cotton textiles are one of the obvious examples, but there are others.

These calculations are, at best, only rough orders of magnitude. Still, the question must be asked: How many cases are there where a 5–7 percent price advantage would be a decisive factor in making it possible for less developed countries to take markets in developed nations away from both domestic producers in those countries (including all members of any regional group) *and* from producers of comparable manufactured goods in other industrial countries? I believe there are some, but not many. Excluding those goods for which most-favoured-nation reductions would probably be as effective as preferential ones (leather and wood manufactures, some textiles, rugs, some drugs, etc., come to mind), the most likely candidates would seem to be in such products as pottery, toys, sporting goods, footwear and rubber manufactures. These are goods in which the most industrialized of the less developed countries have demonstrated a modest, but not impressive, ability to compete with domestic producers and exporters from the developed countries. They seem likely, also, to be goods for which supply is probably very responsive to small changes in price, a necessary condition if substantial benefits are to be gained. But the important thing is that there does not seem to be a long list of such goods. Of course, preference-receivers *already* exporting affected goods, especially if they supply only a part of the imports, would benefit in the form of "windfall" increases in prices on the existing level of their exports.

Would whatever aid that was provided by preferences be in addition to that which would otherwise be available? A confident answer is not possible, but the fact that "preference aid" would be hidden might permit its being additional and more long-lasting. Moreover, it can be argued that more important than the actual price advantage that preferences would bestow would be the side effect of this kind of action. Such evidence of a willingness on the part of developed countries to try and help less developed countries via commercial policy measures might encourage investors and entrepreneurs in the less developed countries to press their export programmes more vigorously. This could have long-run effects far greater than might be expected from looking only at the effect of present cost differences on demand and supply. There is also the possibility that such aid might be especially well-placed, because it could help only those activities of the greatest relative efficiency and which were on the threshold of becoming competitive in world markets. On the other hand, across-the-board preferences, demanded by the less developed countries, might encourage indiscriminate investment, with resulting waste of scarce resources and so reduced supply capability in the areas able to compete.

THE COST OF PREFERENCES TODAY

Accepting that some help can be provided by a system of tariff preferences, it remains to be asked whether whatever aid that can be extended is likely to have important costs *over and above* those associated with the more traditional forms of foreign aid.

History, including that of the European Economic Community, has often shown that preferential or discriminatory arrangements create much political friction. This cost was demonstrated again last spring in Geneva. At the UNCTAD conference the preference issue set the African States which wanted to continue to enjoy their present preferences in the Common Market against the other less developed countries which wished to see preferences extended uniformly by all developed countries to all developing ones. Some members of the Common Market conflicted with others on the question of selective and individually-negotiated preferences versus a generalized system. Those less developed countries at the lower end of the industrialization scale opposed those at the higher end which, the former feared, might pre-empt any preferential advantages. Some members of the industrialized nations who wanted no new preferences clashed with others who saw the cost to themselves of such measures as small and the political advantage in supporting them as high. In the end, some of these differences were resolved, others were only covered up, still others remained. The risk is not negligible that any new preference system will create new divisive elements in the international community.

Aid via preferences seems almost certain to carry especially large costs for administration. The Geneva discussions made it seem likely that any acceptable system would have some exceptions, always difficult to administer. It would also have to attempt to give something called "equality of advantage" to each of the less developed countries, which are in very different relative stages of development and so differ in their ability to take advantage of any preferences. The arrangements so far suggested to take account of these considerations (country quotas, differential preferences, etc.) could easily result in an administrative nightmare.

A potentially much more important cost—and one that seemed to worry the U.K. delegation at Geneva—is that a new system of preferences would be likely to reduce the incentives for a lowering of tariff barriers on a most-favoured-nation basis, thus depriving the developed nations of the benefits of more liberal trade policies. Not only would a new preferential system result in the less developed countries ceasing to press for most-favoured-nation reductions, but it would create a vast new interest in preventing such reductions. After all, the only way preferences can be honoured is by not reducing barriers to imports from all sources. Moreover, there is the risk that those granting preferences will find that, in opening up their markets by preferential reductions, they will have done about as much as it is judged politically possible to do in the way of trade liberalization.

* * *

The greatest potential cost arises from the fact that such a system of preferences is probably not feasible unless the United States participates. Other industrial nations seem to be agreed that they would not grant preferences to all the less developed countries unless the United States market was also similarly opened. Otherwise, they fear, the affected exports would be so concentrated on them as to create an unacceptable burden or "disproportionate dislocation." In addition, those less developed countries already enjoying preferences in some of the developed States have indicated they would share these with other less developed nations only if, among other things, in return they were given a chance to share preferences in other major markets, including the United States.

United States participation would require Congressional action, for existing legislation provides no authority to grant such preferences. One can only guess the response of Congress to a request that the law be so changed as to permit the granting of preferential treatment to imports from the less developed countries. A reading of the recent legislative history of U.S. trade laws convinces me that Congress would probably agree to a strong plea from the Executive for such a change. But would it stop there, or would it grasp this as the occasion for swapping the policies embodied in the present Trade Expansion Act for a new wide-ranging protectionist policy?

Once such a major departure from most-favoured-nation treatment and traditional liberal trade doctrine had been sanctioned, must we not anticipate that Congress would insist on granting "preferential" treatment, probably in the form of non-tariff safeguards, to many domestic producers who also are not competitive with foreign producers? The irony would be that often these would likely be in those industries which the less developed countries are most anxious to encourage. There seem to be many cases where the best manufacturing prospects of the less developed nations are in those older, labour-intensive industries which are often the relatively weak or stagnant, and so sensitive, sectors of the more industrialized countries: textiles, footwear, pottery quickly come to mind. Once a wide-ranging system of preferences was authorized, could Congress resist the temptation to try and increase American bargaining power by denying most-favoured-nation treatment to imports from the Common Market, as well as from other nations with which it seems to be somewhat disenchanted these days? Such moves could quickly incite retaliation and result in a substantial increase of the trade barriers around the world, to the great cost of all.[4]

CONCLUSION

My conclusions are apparent and can be briefly summarized. There is a case for government action to offset some of the high money costs of producing some manufactured goods in some of the less developed countries. A case can be made for the more highly developed nations giving aid for this purpose. Tariff preferences are properly seen as a form of such aid. But at this particular time the amount of aid that could be provided in this way is probably small and the various costs, as compared with those of more traditional forms of assistance, seem likely to prove very large indeed.

Mr. REUSS. Because of the several references to it during the proceedings today, I believe it will be helpful if we include the text of article XXVI of the official text of GATT in the printed record of these hearings. (See app. VI, p. 245.)

We will now stand adjourned until 10 o'clock tomorrow morning.

(Whereupon, at 12:12 p.m., the subcommittee was recessed to reconvene at 10 a.m. on Thursday, September 9, 1965).

[4] In the July, 1964, issue of this *Review*, Michael Hoffman wrote that the failure of the Kennedy Round might well bring an end to U.S. adherence to the principle of non-discrimination.

LATIN AMERICAN DEVELOPMENT AND WESTERN HEMISPHERE TRADE

THURSDAY, SEPTEMBER 9, 1965

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON INTER-AMERICAN ECONOMIC
RELATIONSHIPS OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met at 10:30 a.m., pursuant to recess, in room AE-1, the Capitol, Senator John Sparkman (chairman of the subcommittee) presiding.

Present: Senators Sparkman and Javits; and Representative Curtis.

Also present: William H. Moore, economist; Donald A. Webster, minority economist; and Hamilton D. Gewehr, administrative clerk.

Senator SPARKMAN. The committee will come to order, please.

We continue our hearings this morning with particular reference to regional economic integration groupings in Latin America. We are pleased to have an expert witness on that subject this morning, Mr. George S. Moore, president of the First National Bank of New York and president of the Inter-American Council of Commerce and Production.

Mr. Moore, we are pleased to have you with us. We have a copy of your statement that will be printed in full in our record. You handle it as you see fit.

Senator JAVITS. May I just say that we welcome Mr. Moore as one of our most distinguished citizens of New York, president of what is now our largest bank, with an enormous number of branches in Latin America—I think the American bank with the most branches in Latin America—and not only the distinguished president of what is equivalent of our U.S. Chamber of Commerce for Latin America, the CICYP to which the Chair has referred, but also a banker in Latin America for 30 years of his own business life.

Mr. Chairman, I also ask unanimous consent as part of Mr. Moore's testimony to include a memorandum which has been prepared by Mr. Moore, entitled "Economic Integration in Latin America: A Progress Report," which I think is an excellent factual analysis of the situation.

Senator SPARKMAN. Without objection that will be done. It will appear in the record following Mr. Moore's testimony.

(See p. 57, for publication referred to.)

Senator SPARKMAN. All right, Mr. Moore, you may proceed.

TESTIMONY OF GEORGE S. MOORE, PRESIDENT, FIRST NATIONAL CITY BANK

Mr. MOORE. Thank you, Mr. Chairman and Senator Javits. I appreciate your words, and I especially appreciate very much this opportunity to appear before your committee on the subject of Latin American economic integration because it is a subject of the greatest importance to the entire free world as well as to our country.

With its rapidly increasing population, Latin America will need to create between 30 and 35 million jobs in the next decade. It is estimated that agriculture will not be able to absorb more than 5 million of those entering the labor force. Industrial development is necessary, but on the scale needed will not be forthcoming or economic if done in watertight compartments of narrow national markets. Economic integration, on the other hand, uniting more than 200 million consumers with a gross national product currently estimated in excess of $75 billion, would open up vast possibilities for new industries and greatly accelerate economic growth.

But economic integration of itself will not be enough, in my opinion. While it would open up vast new investment possibilities, these will be realized only if Latin America also succeeds in creating an environment conducive to private initiative and investment, both local and foreign.

This subcommittee has made significant contributions to discussions of this subject. In its report, "Private Investment in Latin America," the subcommittee pointed out the importance of private enterprise and investment as an effective instrument making for political stability and providing a bulwark in support of individual freedom.

While the role of private enterprise was neglected in the early years of the Alliance for Progress, in fact, barely mentioned, I am pleased with the growing awareness of its vital role in the last few years. CIAP in a recent report noted that—

> Countries must intensify their present efforts toward the design of strategies for the expansion of the private sector within national plans and for working out the guidelines which would permit private foreign enterprise to make an enlarged contribution to Latin American development * * *.

This increased awareness in Latin America of the vibrant, democratic role of private enterprise stems from a variety of circumstances. Prime among these, I think, is the fact that there has been an acceleration in the rates of growth of countries relying upon the energies of free private initiative. Meanwhile, economic stagnation, even retrogression, have characterized countries of the Soviet bloc. We now read and hear they are admitting the need to overhaul their bureaucracy and themselves adopt a greater reliance on decentralization and greater play of market forces.

Businessmen of the Americas have today an increasing awareness of their social responsibilities and contributions which private enterprise and investment make in assuring greater employment opportunities and higher living standards. This awareness has been promoted by such organizations as the Inter-American Council for Commerce and Production, commonly known by its Spanish initials as "CICYP," of which I am President. In this country the Council for Latin America, headed by Mr. David Rockefeller, the President of the Chase

Manhattan Bank, has been particularly active in this effort. In fact, we had a meeting only yesterday afternoon on these subjects. It is the primary objective of both organizations to create a better understanding and appreciation of the private enterprise system and to emphasize the social obligations of businessmen themselves.

The enlargement and activation of CICYP is, in fact, a historic breakthrough. The views of this group will now be heard and I am satisfied it will add a new and unifying force in the evolution of Latin American policies. We are going to have a meeting in Caracas in October where these matters will be thrown on the table and we will consider ways and means to accelerate these programs for economic integration and, obviously, give consideration to the theme which has developed in these hearings this week.

CICYP is prepared increasingly to contribute on the national and international scale to the economic planning process. We fully agree with CIAP's recent observation that all sectors of the community must participate in formulating economic development plans. Too often these have been done without the participation of private entrepreneurs and the established targets for the private sector have proven unrealistic. Now I think that the deck is clear for this cooperation and through CICYP we are prepared to cooperate. We emphasize in CICYP that the economic planning must include governmental measures and policies to activate and provide incentives for private capital resources and human skills and encourage private foreign investments. It must also, therefore, be thought of in terms of more responsible fiscal management of government budgets and of State enterprises so as to reduce and ultimately eliminate inflationary deficit financing. Above all, properly conceived, national planning should include formulation of consistent tax policies and fair and adequate guarantees of property. In the balance hangs encouragement for private capital, savings and economic growth—and without this we will have discouragement and economic stagnation.

The allotted time, 20 minutes, does not permit a detailed study, and for that reason a detailed report on the progress toward Latin American economic integration has been prepared by myself and by my staff and Senator Javits has just submitted this and you have put it into the record.

I will point out from the substance of this statement what is becoming increasingly apparent to all of us: (1) While encouraging progress has been made in the Central American market, the market area involved is relatively small; and (2) In contrast, progress under LAFTA, although encompassing a larger population and geographical area, has been impeded because of deficiencies in provisions of the Montevideo Treaty which brought it into being and in some countries the inflationary policies discouraging private investment.

Recognition of the slow pace of economic integration prompted more than 200 businessmen of the hemisphere in a CICYP meeting in Buenos Aires last March to adopt a resolution calling for—

1. Greater consideration of the views of private enterprise in LAFTA Councils.
2. Closer coordination of economic policies of LAFTA countries and adoption of a system of automatic reduction of tariffs.

3. Termination of subsidies, price and exchange controls, and a rigorous attack on the root causes of inflation, and

4. Creation of a Council of Ministers empowered to make decisions along the lines of the authority accorded the Permanent Council of Ministers of the European Common Market.

Many of these recommendations are paralleled in the report which your subcommittee is examining which was simultaneously, but independently, prepared by the distinguished Latin American economists: Carlos Sanz de Santamaría, Felipe Herrera, Raoul Prebisch and José Mayobre. This is an excellent report and many of its recommendations deserve immediate adoption, especially the following:

1. That public opinion must be galvanized into support for Latin American economic integration through organized educational efforts, drawing upon the Western European experience in creating such public understanding and support of the European Common Market. Senator Javits has pointed to this need and proposed creation of an Action Committee for Economic Union of the Americas to be comprised of businessmen, trade union, university, and public opinion leaders. CICYP has endeavored to contribute to this effort and is continuing to do so.

2. Automatic reductions of tariffs—and other restrictions of equivalent effect, such as quotas—on a prescribed schedule be adopted as the only method to move with certainty toward complete elimination of trade barriers. This is essential to facilitate calculation by investors and traders who must know what each successive year will bring. Your subcommittee, as early as 1962, pointed to the deficiency of LAFTA's mechanism in this respect in comparison with the European Common Market and the Central American Common Market.

3. Immediate reduction of existing excessively protective tariffs, some of which are as much as 300 percent on individual products. The report proposes an absolute ceiling on tariff levels.

4. Curbing of inflation in order to maintain stable, realistic exchange rates.

I would be less than frank, however, if I did not record some reservations with respect to other aspects of these recommendations:

1. The concept of reciprocity advanced in the report appears to imply an effort should be made to balance trade among members of the proposed Latin American Common Market. In my view, such a concept not only is economically unsound and constricting, but unrealistic. The purpose of economic integration is to free trade, not to balance it. Real and adequate reciprocity, as the distinguished Peruvian economist, Romulo Ferrero, has remarked, lies in the equal opportunity for competitive growth accorded all participants.

2. The report proposes establishment of a payments union offering compensatory credit facilities to each member to cover trade deficits. Only excess balances periodically would be liquidated in convertible currencies. The report draws upon the European Payments Union for inspiration. We must recall, however, that the EPU was designed as an interim step toward convertibility and away from the bilateralism prevalent in 1948. Such a union in Latin America today would signify retrogression for those numerous countries whose currencies

are now convertible and which are following multilateral payments procedures. It would imply reimposition of exchange controls at the very time when it is imperative to eliminate the monetary and fiscal practices which give rise to them. The basic solution lies in combating inflation and in maintaining external convertibility and multilateralism. This may, of course, be supplemented by IMF assistance for those members faced with a temporary payments disequilibrium of a global, not just a regional, character.

These are my initial reactions to a highly significant document which I am sure will be subject to careful and objective assessment by LAFTA's Council of Foreign Ministers when they meet in November.

I turn now to the role of the United States in advancing Latin American economic integration. This is a subject both delicate and complex for which I pretend no ready solutions. I think the broad aspects of indicated policies are pretty clear. It is when you get down to detail you come to the problems, because there is nothing you can do that will please everybody.

I think the problem is of a twofold character:

The first is the matter of our attitude toward moves by the Latin Americans. I agree with the conclusions voiced yesterday by Mr. Collado, who said:

> We can and should support a regional market in Latin America designed to break down the existing maze of high tariffs and other restrictions and to infuse a competitive spirit into the area, but in our further cooperative efforts in the Alliance for Progress we must seek to assure that there is a recognition that a reasonable external tariff and fair treatment for all investors will be essential to the success of any integration effort.

We must urge that this instrumentality not be discriminatory against anyone.

The precise form the Latin American regional market should take and the pace with which it is organized are matters for our Latin American friends to decide. They have the ultimate re ponsibility for resolving their problems and reconciling their divergent viewpoints. The sectoral approach suggested yesterday by Professor Frank, drawing upon President Johnson's inspiring proposal for a continental program for production and trade of fertilizers, pesticides, and other products needed to increase agricultural production, is imaginative. A variety of other suggestions have been made. It is now up to the Latin American political leaders and people to choose among them.

Our interest in the nature and outcome of their deliberations is of course, substantial. The problems are deep rooted and extensive. The terrain itself constitutes a formidable barrier to transport and communications. Centuries of mistrust and national political rivalries and conflicts have impeded political stability, retarded the development of managerial and administrative competence and weakened confidence in the security of persons, savings, and investments. Even under ideal institutional arrangements, therefore, economic integration there must realistically be expected to be a slow and difficult process.

A second and more urgent aspect of the U.S. role in advancing Latin American economic progress is the need to moderate or eliminate regional preferential trade arrangements existing in other areas to the detriment of Latin American trade expansion. Some of those responsible for drafting LAFTA conceived it primarily as a defensive regional mechanism on which to rely for bargaining purposes to this end. They had particularly in mind the preferential treatment accorded by the European Common Market to products from the former French colonial territories in Africa. Unfortunately, such tariff preference arrangements in other areas have in the interim increased rather than diminished. Indeed, the prospects are that in the near future there will be an even greater array of non-European countries and countries and products benefiting from preferential treatment within the European Common Market. This gives cause for continuing preoccupation and the need to search for alternatives. As CIAP on August 10, 1965, in its report to the Presidents of the American Republics observed:

> It is inequitable for the products of some of the developing countries to enjoy preferences outside the hemisphere plus nondiscriminatory access to the U.S. market.

While compensation for this inequity imposed by others on Latin America should not be construed as an obligation of the United States, the matter is of urgent concern to the United States in view of its special interest in and relationships with Latin America. CIAP itself in the report to which I have just referred appears to be urging that the United States take steps to accord Latin American tropical products preferential tariff treatment. Almost all of such tropical products and all the important ones such as bananas, coffee, and cocoa now enter the U.S. market duty free. Hence it would appear that CIAP proposes to have the United States impose customs duties where none now exist and to apply lower rates to or exempt imports of these products from Latin America. Depending upon the flexibility of demand and the reaction of the American housewives to such an action, this might provide Latin America with a higher income from its exports to the United States and reduce the necessity for official U.S. Government financial assistance to Latin America. I recognize the desirability of such an objective and the advantages in terms of greater self-esteem from substituting trade for aid. It does, however, raise questions as to how such higher trade income might effectively be channeled into Latin American economic development, including diversification of its economies and reduction of excessive dependence on single export crops. Above all, I would fear that adoption of such a recommendation would harm other underdeveloped countries, provoke disturbances and retaliations and be a step backward from the path of progressively reducing and eliminating trade barriers on a multilateral basis. In particular, it might well reinforce intensification of world "spheres of influence" to which CIAP itself so rightly is opposed.

The preferences accorded by the European Common Market to imports from certain African countries were urged and defended initially on grounds that these former dependencies had special historical and cultural ties with its members, notably France. But as these preferential arrangements have become more extensive and are likely to encompass not only Turkey and Nigeria but much of east Africa, never part of the territories or culture of members of the ECM, this rationale becomes more specious. Fortunately, some in the ECM are becoming self-conscious of that fact and appreciate their vulnerability to the justifiable complaints of the Latin Americans. Self-consciousness may not, however, be a sufficient inducement to change.

I therefore believe the United States must, with all the instruments of persuasion at its command, intensify its pressures on Western Europe to rectify its present trade discriminations against Latin America. This would not only be a move to restore observance in practice of the principles of GATT—it is, as CIAP has said, a matter of equity. Preferences now accorded by the Europeans to certain limited numbers of underdeveloped countries would, thus, be more generalized. Such action would offer concrete and persuasive evidence of the interest in Latin American welfare which the Europeans have so often professed. It would also reflect awareness of the self-interest and obligations which they have in an area whose culture and origins, as ours, largely derive from Western Europe itself.

If, having made such an intensified effort to persuade its European friends to broaden their trade policy horizons to take account of the legitimate interests of Latin America should fail, the United States will be reluctantly but decisively constrained to pursue other tactics. It is conceivable, for example, that the Europeans may be unmoved by any unilateral actions by the United States to accord preferential treatment to its imports from Latin America. It is not they, but the other developing countries who would be affected. The concern of the Europeans might be aroused only were the United States to enjoy some preferences on a reciprocal basis in Latin America which they did not. This may be the unfortunate reality.

Here, in the field of trade strategy, the proposals of Senator Javits and Mr. Clayton, made before this subcommittee last year, have special pertinence.[1] They visualize possibilities of a Western Hemisphere free trade area for Latin America, the United States, and Canada. At the outset, this might be confined to trade in raw materials, the barriers to trade in which within the hemisphere would be progressively reduced and eliminated. The precise identification of these raw materials and the readjustments each member country would have to make in its current domestic policies would, of course, require careful study. But it would be a first step in adjusting to a world not of our or Latin America's making.

The initial emphasis on raw materials would reflect the fact that Latin America for many years to come will not be, generally speaking, in a position to compete effectively with our or Canada's mass production industries. An essential condition for building up such industries is acceleration by the Latin Americans themselves of the process of economic integration in a competitive atmosphere along the lines I and previous witnesses have already endorsed.

During this interim period consideration should also be given to unilateral extension by the United States of tariff preferences to all Latin American countries for manufactured and semimanufactured products which they have the potential to sell competitively in the U.S. market. In turn, the more industrialized countries of Latin America, such as Mexico, Argentina, and Brazil, might extend similar preferences to the lesser-developed ones. This is in line with the pattern developed by the European Common Market with Greece.

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[1] See p. 170.

It is also in harmony with the suggestions set forth by the four distinguished Latin American economists in the report to which I referred earlier.

The ultimate emergence of a competitively strong, industrialized Latin America should itself facilitate agreements between existing world regional commercial groupings, including the European Common Market and the European free trade area, to extend the benefits of competition on a global scale. But if it does not, and systems of regional preference elsewhere tending to fragment and compartmentalize the free world persist, then the Western Hemisphere free trade area, in line with the suggestions of Senator Javits and Mr. Clayton, might move toward progressive reduction of barriers to trade among its members in manufactured and semimanufactured goods.

Long before that stage might be reached, I think it extremely likely that attitudes in the Eastern Hemisphere drastically would change. But if they did not, then this is the direction realism appears to me to dictate.

In summary (1) we should manifest a patient, sympathetic interest in and support for soundly conceived moves in Latin America to promote regional integration on sound bases; and (2) the United States should begin considering alternatives to its present commercial policy unless this soon becomes more fruitful in terms of effecting greater equality of opportunity for Latin America to sell its products in world markets.

To sum it up, Latin America is not moving fast enough, Mr. Chairman, to meet the minimum economic needs of humanity and of political stability. The steps needed are to overhaul LAFTA, to adopt automaticity of tariff reductions and to take necessary steps to provide the proper environment for private enterprise. They must include private enterprise in their planning, and along with this the United States must adopt flexible attitudes on tariffs.

As to U.S. attitudes, I have said, our primary objective must be to work with GATT, hope for success in the Kennedy Round, hope for Latin America to achieve access to the European markets, but if this is not achievable, we must seek Western Hemisphere unity.

This means greater access to our markets for their raw materials, assistance to help them through commodity agreements to stabilize their balance of payments, and reciprocal and nonreciprocal access to our markets for manufactured and semimanufactured products.

I think these tariff and trade arrangements will only do a small part of the job, but if they can provide a catalyst to encourage their economic integration and the development of the necessary scale markets, I think the greatest rewards will come from that.

I have spent many, many months in Latin America over the last 30 years, as has been suggested, and I know for a fact that the majority of the industries developed there have been developed on a compartmentalized basis and most of them have been uneconomic, basically, due to the protection from competition they enjoyed.

I do not think this can change until they get scale markets encompassing the whole area, and if we can encourage and aid them in developing this, the greatest rewards and greatest progress will result.

Above all, I urge, Mr. Chairman, that we be respectful of other countries' policies and views on this, but that we not be inhibited by it. Whatever we do, we are going to be criticized, but I think the whole world has had enough evidence of our postwar part in European progress to accept the good intentions of this country in Latin America. I think the deliberations of your committee can make a contribution to this progress, and we in private industry want to contribute all we can.

Thank you.

(The memorandum referred to on p. 49 follows:)

Economic Integration in Latin America: A Progress Report

(By George S. Moore, president, First National City Bank, New York, N.Y.)

The past decade has witnessed an accelerating trend toward the formation of regional economic organizations aimed at achieving a common solution to common problems. Two such combinations have taken root in Latin America: the Latin American Free Trade Association and the Central American Common Market. Both were fashioned in response to the problems of rapidly growing populations, overdependence upon the production of primary products for employment opportunities and foreign exchange earnings, poor transportation systems, and inadequate marketing facilities. Both aim at breaking down the national economic barriers that impede areawide growth of trade and investment. Basic to both is the realization that maximum efficiency in a modern industrialized world requires a volume of output and sales that exceeds the potential demand of any single domestic market.

This statement outlines the framework of the two regional groupings and examines progress to date in an attempt to assess their prospects for accomplishing the urgent task of integration and achieving rapid growth within the organizational structures as they are presently constituted.

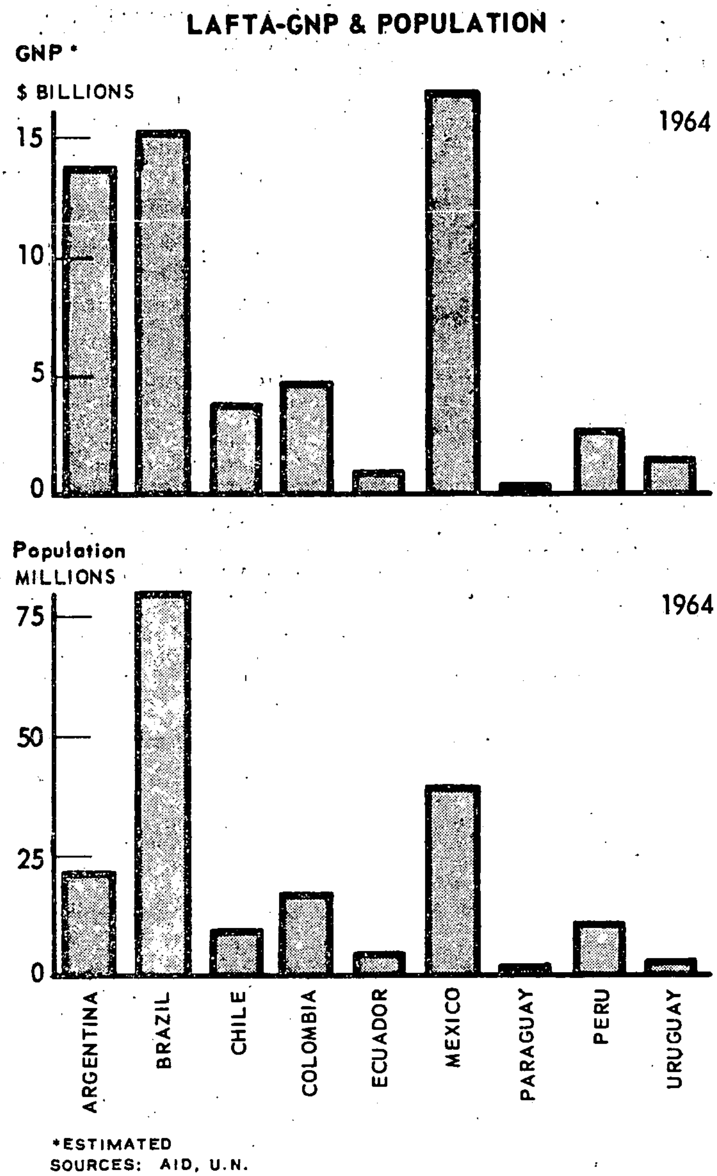
I. THE LATIN AMERICAN FREE TRADE ASSOCIATION

In 1960, seven Latin American countries agreed to work toward the creation of a free trade area as a means of speeding their economic development. With the signing of the Treaty of Montevideo they linked their domestic markets within the framework of a new organization, the Latin American Free Trade Association (LAFTA). Its goal is the creation of a broad, multinational market which would encourage investment in new industry, provide jobs for their rapidly expanding populations and introduce the benefits of industrial specialization and mass production. The treaty, ratified in June 1961 by Argentina, Brazil, Chile, Mexico, Paraguay, Peru, and Uruguay, was adhered to later in the year by Colombia and Ecuador. As a result, a regional market essentially free from trade restraints and encompassing nine nations is now being brought into existence through a series of tariff reductions to be negotiated over a 12-year period.

The nine LAFTA countries, with 185 million people, account for almost 85 percent of Latin America's total population. The area's gross product—about $60 billion in 1964—is over four-fifths that of all Latin America. LAFTA's total exports and imports, amounting to some $12 billion, constitute more than 65 percent of overall Latin American trade. Venezuela and Bolivia are reportedly considering membership in the association and there is hope that the Central American Common Market may eventually also join forces with LAFTA.

LAFTA members can already point to some accomplishments brought about through this association. Four rounds of negotiations completed since 1961 have produced tariff and other concessions on over 5,000 products and trade within the area is rising. Government-level conferences inspired by LAFTA's formation have produced significant discussions of many of the area's problems. Representatives of the area's business communities have also been meeting together to improve contacts at the private level.

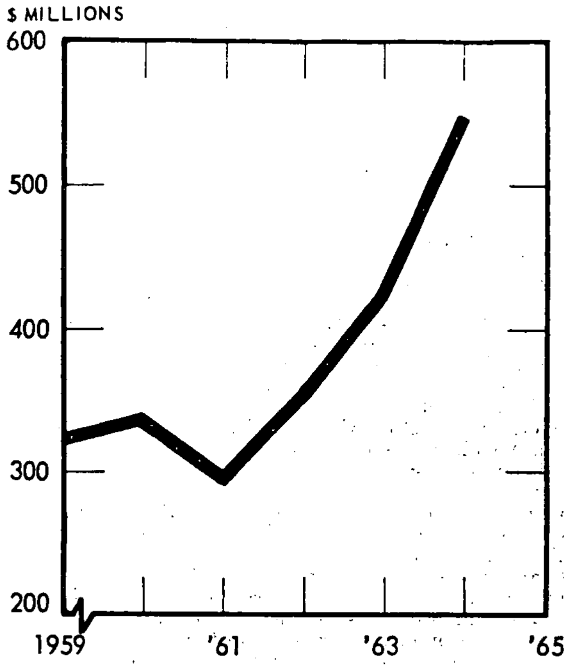
With this increased activity, however, there has come a greater awareness of the magnitude and complexity of the economic problems facing the area. Historically, the volume of intra-area trade has been small; in 1961, before tariff cutting began, it totaled less than 10 percent of the members' overall trade. Thus,



despite the substantial percentage growth in intra-LAFTA trade—roughly 85 percent between 1961 and 1964—the increase in absolute terms has been relatively modest and appears to have benefited most those countries already possessing industrial advantages. It is becoming increasingly evident that, to accelerate regional development and to reduce disparities in the levels of economic activity among members, the scope of the treaty must be widened to include, in addition to limited cooperation in trade matters, the coordination of domestic economic policies.

The need for broadening the Association from a free trade area to a common market with a unified external tariff and coordinated monetary and fiscal policies is acknowledged both by economists and the business community. Political

GROWING INTRA-LAFTA TRADE



SOURCE: IMF

inertia, however, must first be overcome. Recognizing this, delegates attending the most recent round of tariff-cutting negotiations, late in 1964, called upon the foreign ministers of the member countries to meet this year.

This conference, now slated for late fall, will examine the need to establish a system of automatic tariff cuts, a common external tariff and a permanent ministerial council (similar to the European Economic Community's Council of Ministers) which could make binding political decisions. The speed and vigor with which the integration movement can be expected to move forward will be revealed more clearly by the decisions reached at this meeting.

Mechanics of trade liberalization

LAFTA members have agreed that, within a 12-year period, they will "gradually eliminate, in respect of substantially all of their reciprocal trade, such duties, charges, and restrictions as may be applied to imports of goods originating in the territory of any contracting party." Tariff reductions are to be arranged through periodic negotiations which will set up two sets of interrelated tariff lists. National schedules itemize the annual reductions in duties, charges, and other restrictions which each country agrees to extend to the other member countries. The common schedule lists products on which member countries collectively agree to completely eliminate duties and charges by 1973.

Tariff cuts itemized on the national schedules are effective immediately but may be withdrawn and replaced by an equivalent concession at a later date. Listing on the common schedule is final, although reductions may be phased over the entire 12-year period. This permits countries facing hardship as the result of a more liberalized trade policy to adjust to the removal of protection. The treaty allows members whose producers suffer competitive hardships to adopt temporary, nondiscriminatory restrictions. It also stipulates that less developed members may be granted special concessions to induce more rapid economic growth.

Negotiating sessions produce concessions and reveal problems

Concessions granted at four annual rounds of tariff negotiations have reduced by about 40 percent the weighted average of duties and charges previously existing within the area. With each successive conference, however, bargaining has grown more labored, and the number of concessions placed upon the national schedules has diminished. Negotiations on the first items to be placed on the common schedule were particularly strained, and at times it was feared they might be broken off entirely.

This growing difficulty in dismantling tariff barriers is due to the nature of intra-LAFTA trade. Existing trade consists chiefly of an exchange of temperate for tropical agricultural commodities and of certain minerals. Most of this movement is between the nations in the southern portion of the continent—Argentina, Brazil, Chile, and Peru—where regional transport links are better developed. Restrictions on this type of trade have been the easiest to reduce. But expansion of trade in manufactured goods is the real problem.

Prior to the formation of LAFTA, industrial products rarely entered into intraarea trade. Such goods are produced by industries nurtured under national programs of import substitution, which are heavily protected, primarily in Argentina and Brazil, and to some extent in Mexico. There is a reluctance to modify restrictions on trade in manufactured products since many of these items are produced in limited volume and at high cost and thus are not competitively priced. However, since LAFTA's economic growth is dependent upon the creation of an areawide industrial base, which requires a flourishing trade in manufactures, future tariff-cutting sessions must deal also with new categories of industrial goods.

Another problem is the permissive nature of LAFTA's present system of tariff reduction. By allowing member countries to select the products that they wish to submit to liberalization at any given time, the LAFTA mechanism permits a considerable degree of freedom to protect indefinitely the most sensitive areas of the members' economies. This gives rise to the real danger that, as 1973 approaches and internal trade is scheduled to be substantially freed, there may be only token liberalization of trade in the most significant fields. Drastic action would then be required of the member countries—action which may not be politically feasible—in order to fulfill the goals of the treaty. The progressive shrinking of the annual addition of items to the national schedules and the lengthy and strained negotiation preceding agreement on the first items to be placed on the common schedule suggest that the basis for such criticism is valid.

Recommendations for strengthening the present system have been debated extensively. Those most frequently cited propose modification, either by the inclusion of definite intermediate objectives in addition to the final target of substantially free trade or by the adoption of an annual 8-percent across-the-board reduction on all products.

Benefits of trade liberalization are uneven

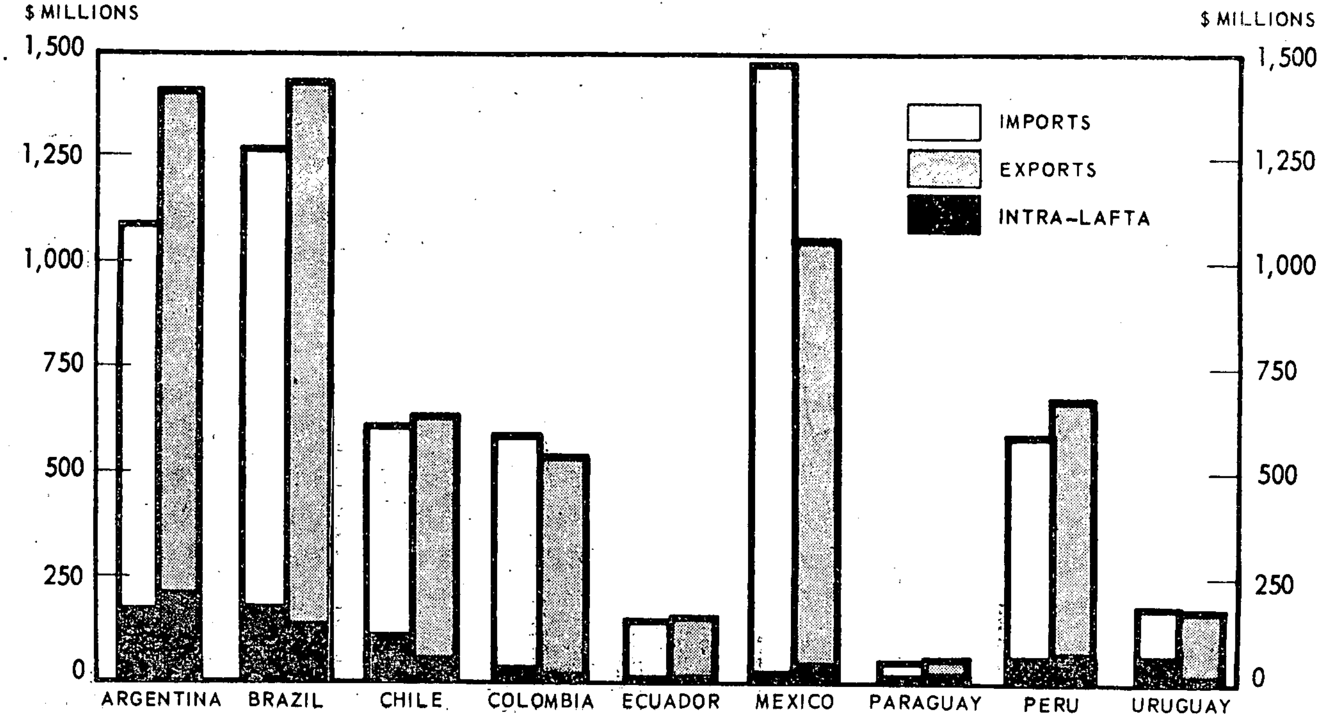
Total intra-LAFTA trade increased about 19 percent during 1962, 20 percent in 1963 and over 28 percent in 1964. Argentina, Brazil, and Mexico, because they already possess substantial industry, stand to reap the greatest benefits from the creation of a free trade area. Argentina and Mexico are currently running sizable surpluses with the rest of LAFTA, while Brazil shows a deficit only because of the high volume of its wheat imports, mainly from Argentina. Ecuador and Paraguay maintain favorable trade balances primarily because they receive special tariff concessions from other LAFTA members. The other nations sustain consistent deficits.

Attempts are being made to insure the benefits of trade liberalization will be equally distributed. Soon after the treaty's ratification, Ecuador and Paraguay were designated "less developed countries" and thus entitled to special tariff concessions. These countries have also received financial and technical assistance from other LAFTA members. During the 1963 negotiating session, Chile, Colombia, Peru, and Uruguay, whose economic development places them in an intermediate position, were reclassified as "countries with insufficient markets" and therefore entitled to similar benefits.

Greater coordination of economic policies is needed

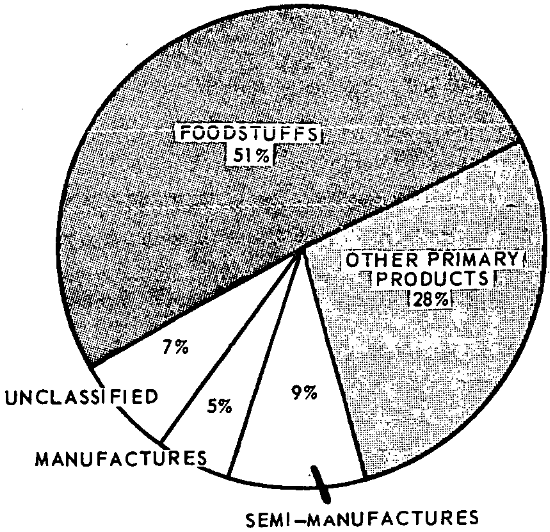
LAFTA was formed on the assumption that the breaking down of trade restrictions among its members would provide a market large enough to foster substantial industrial growth. Trade liberalization alone, however, cannot accomplish this task. It is becoming increasingly evident that balanced growth within LAFTA will also depend on the degree to which domestic monetary, fiscal, and exchange rate policies can be successfully coordinated.

LAFTA – DIRECTION OF TRADE – 1964



SOURCE: IMF, U.N.

PRIMARY PRODUCTS DOMINATE INTRA-AREA TRADE



SOURCE: FNCB

Difficult problems were created for Latin America by the decline in export prices for primary products in the mid-1950's. Seriously diminished export earnings resulted in widening trade deficits. Foreign exchange reserves were rapidly depleted to pay for needed imports.

This led many countries to step up programs of industrialization aimed at import substitution. But these subsidized industries operating within small, heavily protected markets have often been uneconomic, and when combined with deficit spending by governments have created serious inflationary pressures. The resultant distortion of price levels and currency instability have warped normal trade patterns. Differences in tax and wage levels which produce disparities in production and marketing costs have also hindered trade.

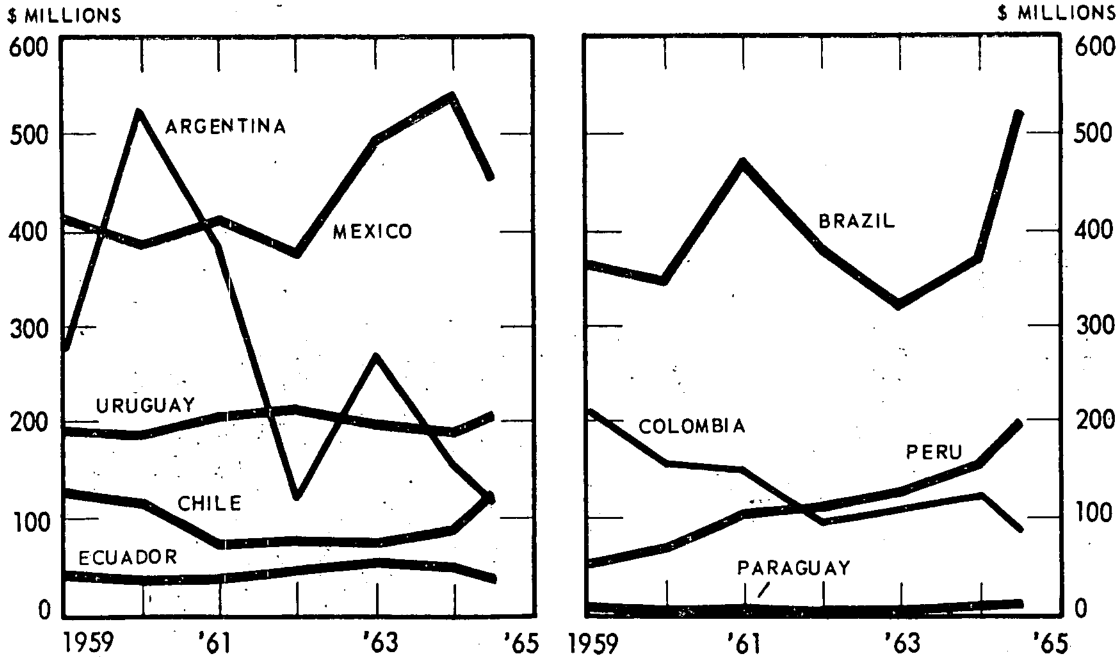
Conferences called by the Inter-American Development Bank and the Center for Latin American Monetary Studies (CEMLA) have brought together representatives of Latin American central banks and other specialists to discuss the financial aspects of integration and economic development. Among topics under study are the formation of a Latin American clearinghouse or payments union, ways of improving the regional banking structure and means of developing closer ties among the commercial banks operating in the region.

At the 1964 negotiating conference, a major resolution was adopted calling for a new system of financing intrazonal credits, as well as for a study of the effects of the various foreign exchange policies on the flow of trade. The resolution also initiated studies of methods of encouraging local capital to participate in the establishment of multinational companies. A permanent council composed of representatives of the central banks of the member countries was set up to oversee the harmonization of monetary policy.

U.S. stake in LAFTA

As its chief customer and principal supplier, the United States has a large stake in LAFTA's future. The present LAFTA countries absorb two-thirds of all U.S. shipments to Latin America and provide about 60 percent of total Latin American exports to this country. The value of U.S. sales to LAFTA countries dropped immediately after the establishment of the organization—from nearly \$2.5 billion in 1961 to about \$2.1 billion in 1963. But most of this decline was attributed to stringent import controls imposed because of foreign exchange shortages. In 1964, despite these restrictions, U.S. exports surpassed their 1961 level.

LAFTA – INTERNATIONAL RESERVES



SOURCE: IMF

As the tempo of intra-LAFTA trade accelerates, reflecting internal tariff cutting and the removal of other barriers such as prior deposits on imports, some U.S. producers may find it more difficult to compete in this market. In the long run, however, as LAFTA members become more industrialized, export opportunities for advanced U.S. industrial products should increase.

U.S. investment in the LAFTA countries has climbed steadily throughout the postwar period. However, because of political disturbances in a number of these countries, the rate of capital flow slackened during the early 1960's and has not yet recovered. The bulk of U.S. private investment has gone into Argentina, Brazil, and Mexico—countries which already possess considerable industrial capacity—and has been directed mainly into manufacturing facilities. Mexico has already achieved fiscal, economic, and political stability and thus is attracting ever-larger amounts of U.S. equity capital. As other LAFTA members stabilize their economies they too should become increasingly attractive to U.S. investors.

Conclusion

Not long after it was organized, many observers cautioned that the formidable nature of LAFTA's long-range task might discourage progress on intermediate objectives. These warnings have proven to be well founded. During the past few years, while Latin America's need for a full-scale, viable program of economic integration has become increasingly evident, LAFTA's rate of progress has steadily slowed. Tariff negotiations have become labored. Industrial integration has moved only slightly beyond the talking stage. The coordination of economic policies is still being debated at the working-party level. And most serious of all, monetary and fiscal stability, without which an integration program cannot be effectively pursued, is still lacking in many of the member countries.

Three major groups—the economists, the political leaders, and the businessmen—share the responsibility for formulating the ideas, making the decisions and implementing the policies that will ultimately bring economic integration. The economic technicians, who prepared the background studies and set up the groundwork for negotiation, nudged LAFTA into existence and helped it to reach the present level of activity. Government leaders, however, have not yet made the basic political decisions needed to insure that the integration process is carried out.

Private enterprise can play a vital role in strengthening LAFTA by taking full advantage of the trading opportunities it now offers and by calling for the broadening and acceleration of the integration program. Industrial interests are just awakening to the commercial possibilities inherent in an integrated Latin American market. The scarcity of marketing information, unwieldy export procedures, and loss of inititative following long years of operating in small and protected markets have all contributed to the failure of local businessmen to respond wholeheartedly to LAFTA's formation.

Now, however, the increasing participation of business leaders in conferences, advisory groups and other regional meetings signals a new awareness of LAFTA's potential and of the twofold role the private sector must play if economic integration is to succeed. The skeletal structure of LAFTA must be given body by the vigorous expansion of intra-area trade based on an acceptable pattern of regional specialization. In the political realm, business leaders must communicate their concern for LAFTA's success to their governments, upon whom the responsibility for the advancement of regional integration ultimately rests.

The foreign ministers' meeting called by the annual conference last year will convene within the next few months. Its prime task will be to define the most formidable political barriers to integration and to determine the first steps for overcoming them. However, until monetary and fiscal restraint are more widely practiced and the idea of competition more readily accepted, no amount of joint planning can realistically be expected to promote regional integration or yield a satisfactory rate of economic growth.

II. THE CENTRAL AMERICAN COMMON MARKET

With the Central American Common Market approaching many of its goals, a century-old dream of union is moving toward realization. Years of complicated negotiations among Guatemala, El Salvador, Honduras, Nicaragua, and Costa Rica have culminated in the formulation of regional ties providing for free trade within the market, a common external tariff and harmonization of a wide range of economic, financial, and social policies. These developments have stimulated local and regional trade and commerce and have laid the groundwork for growth in manufacturing. Handicraft industries are being supplemented by enterprises utilizing modern technology. As a result, foreign investors are increasingly responding to the opportunities presented by an expanding, unified Central American economy.

A major reason for promoting economic integration in Central America is the knowledge that only through industrialization can these countries lessen their vulnerability to fluctuating prices for coffee, cotton, and bananas, the area's dominant commercial commodities, and raise the income level of their people. Although the member countries are still dependent upon agriculture, each is making an effort to industrialize. Today, only 40 percent of the gross domestic product of Central America is derived from agriculture, compared with 45 to 60 percent a decade ago.

Advocates of integration regard the individual economies as too small to support an efficient manufacturing industry. But combined, these countries comprise an economic unit of respectable size. In area about the size of France, the Common Market countries support a population of 12 million. The area's gross product totaled $3.5 billion in 1964. On a per capita basis, the gross national products of the individual countries range from nearly $225 a year in Honduras to almost $370 in Costa Rica. The region's average is about $290.

Obstacles to integration, however, are plentiful. The similarity of their economies makes it difficult for these nations to achieve a meaningful regional integration. Domestic capital is scarce and nonagricultural resources are scanty and inaccessible. Skilled technicians are also in short supply, as are semiskilled and partly trained workers; surprisingly, even migratory harvest laborers are hard to find. Physical isolation caused by the forbidding terrain and inadequate road system was for many years the fundamental barrier to administrative and economic integration. With the overland flow of goods, and people kept to a trickle, only limited geographic diversification of economic activity was possible. However, roadbuilding on a regional basis has been underway for several decades. Good highways now link the principal cities, and connections between ports on the Caribbean and Pacific coasts are being expanded.

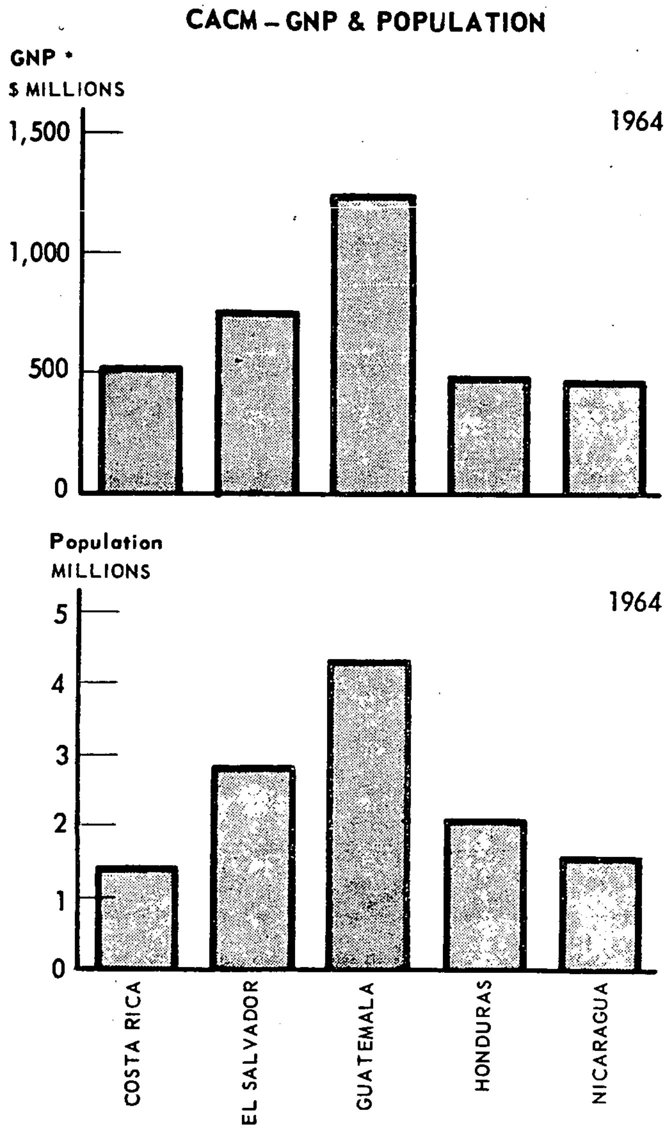
Instruments and institutions of integration

The Central American Common Market is being fashioned through the implementation of a series of agreements designed to draw the five economies together and weld them into a single, rapidly growing, industrialized market.

The organization's master document is the General Treaty on Central American Integration. Signed in 1960, the treaty superseded the various earlier conventions entered into during the 1950's except for provisions in earlier agreements not covered in the general treaty, which remain operative. Designed to accelerate the integration process, it provided for immediate free trade for over 50 percent of goods entering into intraregional trade and set forth a 5-year reduction schedule for most of the remaining items. A common external tariff was also stipulated, with a common customs administration to become effective by 1970. The general treaty also provided for free movement of labor and capital; harmonization of investment policies, taxation and the financing of integration; and the establishment of certain Central American institutions.

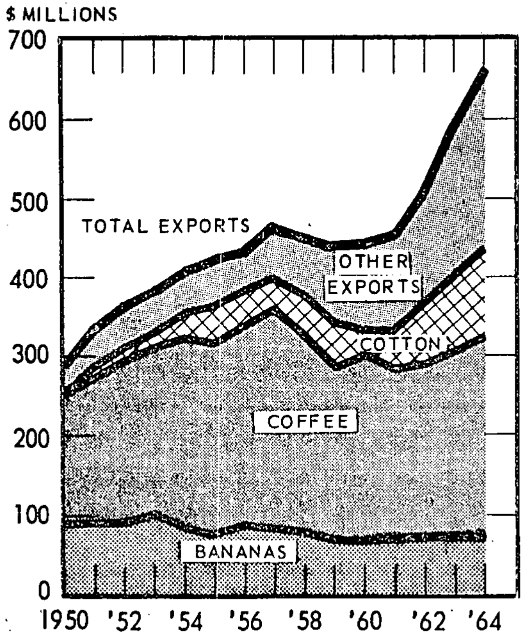
The general treaty reinforced the Central American Agreement on Equalization of Import Tariffs, the key instrument for reducing intraregional tariffs and creating a common external customs code. Additional protocols to this agreement, effective in September 1960, June 1961, and July 1962, have enlarged its scope and accelerated the timetable for creating a Central American Common Market. These agreements have already abolished 95 percent of all tariffs on items originating and traded in the market, and have placed a common external tariff on 98 percent of items in the regional customs classification.

Provided for in the general treaty, the Central American Bank for Economic Integration (CABEI), inaugurated in July 1961, spurs regional integration by extending loans chiefly for regional projects. The bank has become the main channel through which domestic and foreign capital are directed into regional projects with growth potential. With paid-in capital of $20 million from the Common Market countries and an additional $30 million from external sources, the Bank had made 91 loans totaling approximately $34 million through the first quarter of 1965. These funds have been used mostly to provide private firms with plant equipment and working capital. The recent establishment of a $42 million Bank-administered Fund for Economic Integration, authorized to make

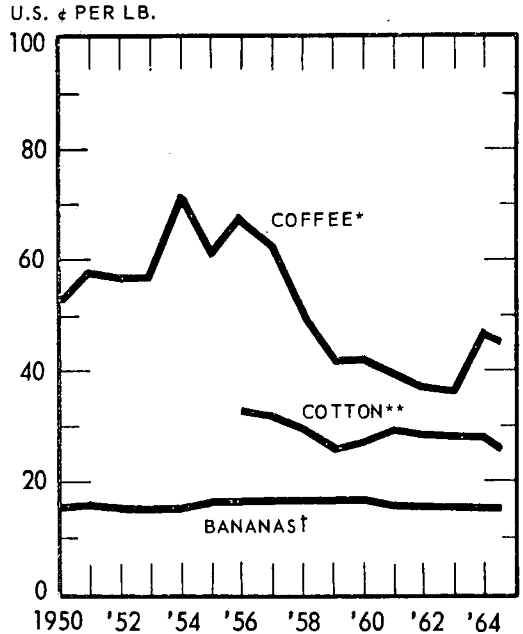


*ESTIMATED
SOURCES: AID, U.N.

GROWING DIVERSITY OF EXPORTS



- - - BUT WEAK COFFEE PRICES CUT EXPORT EARNINGS



* EL SALVADOR WASHED HIGH GROWN, IN N.Y.

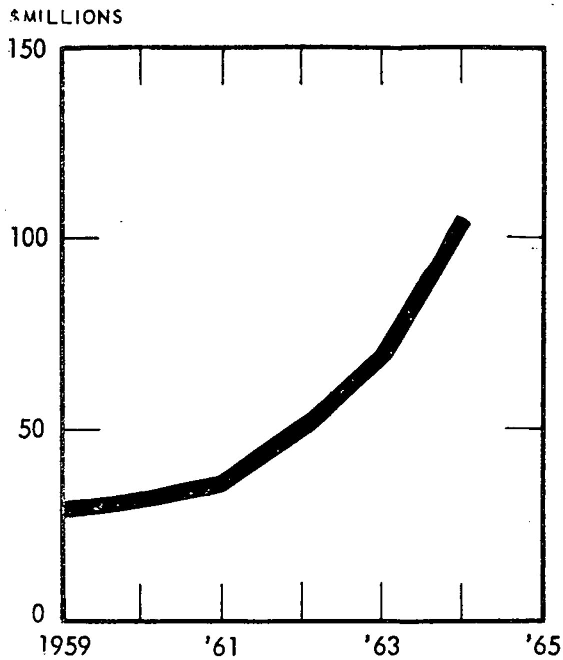
** NICARAGUAN M 1 - 1/32'', C.I.F. LIVERPOOL

† RETAIL PRICE IN N.Y.

infrastructure investments for regional development, should enhance significantly the ability of the Bank to expand its public sector activity.

Also incorporated into the general treaty framework is the Agreement on the Regime of Central American Integration Industries, through which preferential status may be assigned to specific new or existing firms requiring access to the entire Central American market to assure sufficiently low-cost, volume operation. Benefits include tax advantages and preferential import duties on equipment and raw materials. A commission of the Secretariat studies proposals and makes decisions on eligible firms, subject to ratification by the member governments.

GROWING INTRA-CACM EXPORTS



SOURCE: IMF

The economic integration program is advancing on other fronts. The goal of the Central American clearinghouse, which began operations in October 1961, is the eventual establishment of an integrated monetary system for the region. Use is being made of a "Central American peso"—a unit of account equivalent to the U.S. dollar—to settle accounts. Capitalization is equivalent to $1.5 million; temporary credit of up to $500,000 is available to any member central bank. The clearinghouse facilitates contact among the member central banks, thereby improving the prospects for monetary and foreign exchange stability within the region. Reinforcing the mechanisms of the clearinghouse are a formal statement by the five member states in 1963 that regional development would require a monetary union and common fiscal, monetary, and social policies and the adoption in 1964 of the Agreement for the Establishment of a Central American Monetary Union, under which studies and draft agreements are being formulated in pursuance of this goal.

Another important step toward fuller integration has been taken with the drafting of a uniform code of tax incentives for stimulating industrial development and expansion. The new code applies both to the establishment of new industries and the expansion of existing facilities.

Panama is observing Central America's efforts to create an integrated regional economy with mounting interest. A first step toward possible affiliation was taken early in 1963 with ratification of the Treaty on Preferential Exchanges and Free Trade, a trade agreement among Panama, Costa Rica, and Nicaragua. Panama has not acceded to the general treaty, but it has been singled out for special treatment in the provisions of this and other Central American treaties. For Panama some sort of "associate membership" in the integration program would probably be the most acceptable status. Not all of the other Central American countries, however, are presently prepared to accept this arrangement.

Development activity is accelerating.

The effects of the Central American countries' efforts to spur development activity are becoming increasingly apparent. Through the Central American Bank for Economic Integration, the Inter-American Development Bank, the World Bank, the various central banks of the region and the national development banks, a broad program of coordinated resource development is underway. To facilitate industrial development, plans for a regional electric power grid have been drawn up. Seaports, such as Acajutla on El Salvador's Pacific coast and Guatemala's Puerto Matias de Balvez, have been enlarged and are assuming increased importance in Central American regional trade. Jet airports are being constructed or enlarged in the principal cities of the region and are handling the growing passenger and freight traffic.

This massive integration effort, combined with abundant natural resources, presents many profitable opportunities for both foreign and local investors. Cottage industries operating within self-sufficient economies are gradually being replaced by modern manufacturing plants serving regional markets. Expanded cotton output has sparked new spinning, weaving, and apparel industries to fill Central American needs. Dacron and rayon are being produced in Nicaragua, and El Salvador is manufacturing nylon stockings and underwear. Cotton-ginning mills are mushrooming, particularly in El Salvador.

Edible-oil mills have been installed to process the expanding volume of cottonseed. These have given rise to a margarine industry and to the production of animal feeds from cottonseed residue, supplying markets both within the region and abroad.

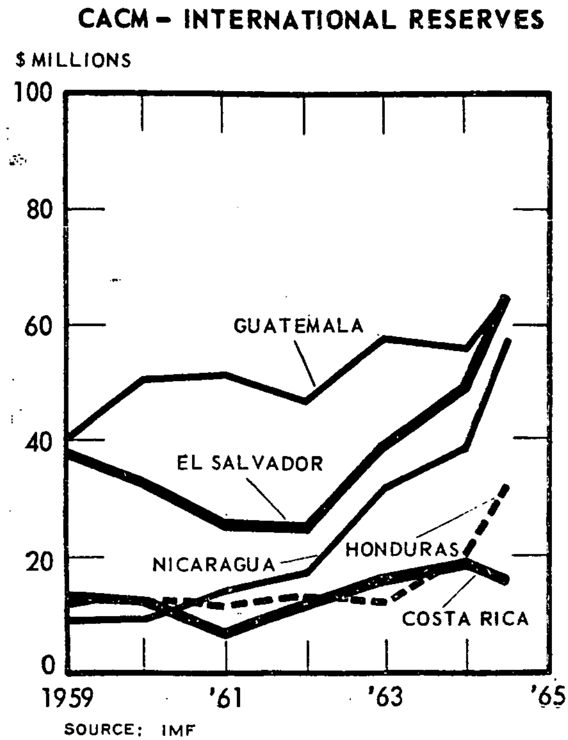
Marine resources are being developed. Meat and seafood are frozen for export with modern methods of food handling, refrigeration and packaging. The entire food industry is undergoing a vigorous expansion. Specialized farming and livestock raising is being developed, while irrigated farming is becoming more widespread. Canned fruits and vegetables, fruit juices, meats, soups, and juice concentrates are being prepared on a mounting scale. New corn and wheat flour mills are operating throughout the region, and there is a large powdered milk processing plant going up in Nicaragua. New demand for packaging materials is being increasingly supplied from within the region. The need for commercial and industrial refrigeration is attracting U.S. capital. An industrial refrigerator plant has been built in Guatemala and a refrigerator assembly plant is planned for Nicaragua.

The chemical industry is broadening product lines in the entire region. Sulphuric acid, insecticides, fertilizers, caustic soda, paints, detergents, and soap are among the items now produced. The construction industry is being stimulated by international development agencies and the supply of construction materials from local sources is increasing.

Several more complex industries are being established as well. Tools, light machinery and metal furniture are produced in a number of countries. It is expected that a wire and cable plant in El Salvador will provide copper and aluminum cables and wires for the region's expanding electric power and communications system. Guatemala has a tire and rubber plant supplying all Central America. Local manufacture of aluminum extrusions, sheeting, and corrugated roofing is being initiated. Bicycles and motorcycles are being manufactured locally and an automobile assembly plant is scheduled for El Salvador. The first pressed and blown glass factory in Central America is also in the planning stage in El Salvador. New petroleum refineries have gone into production in all the Central American countries in the last few years.

Changing patterns of trade

Central American intraregional trade is expanding rapidly. Exports have grown almost 300 percent since 1959, rising to $106 million in 1964. El Salvador exports more to its neighbors than do any of the other four countries. Its exports—$37 million in 1964—have increased over threefold since 1959. Although the internal trade of Central America has traditionally accounted for only a



small part of its total trade, it has increased from 6 percent of the total in 1959 to 16 percent in 1964 and is expected to continue to accelerate as industrialization proceeds. Food products currently constitute about half of the intraregional exchange. Manufactured products—chiefly textiles, clothing, shoes, paper, and cardboard—make up some 35 percent of the total. Raw materials—mainly wood and lumber, tobacco, leather, and seeds—account for the remainder.

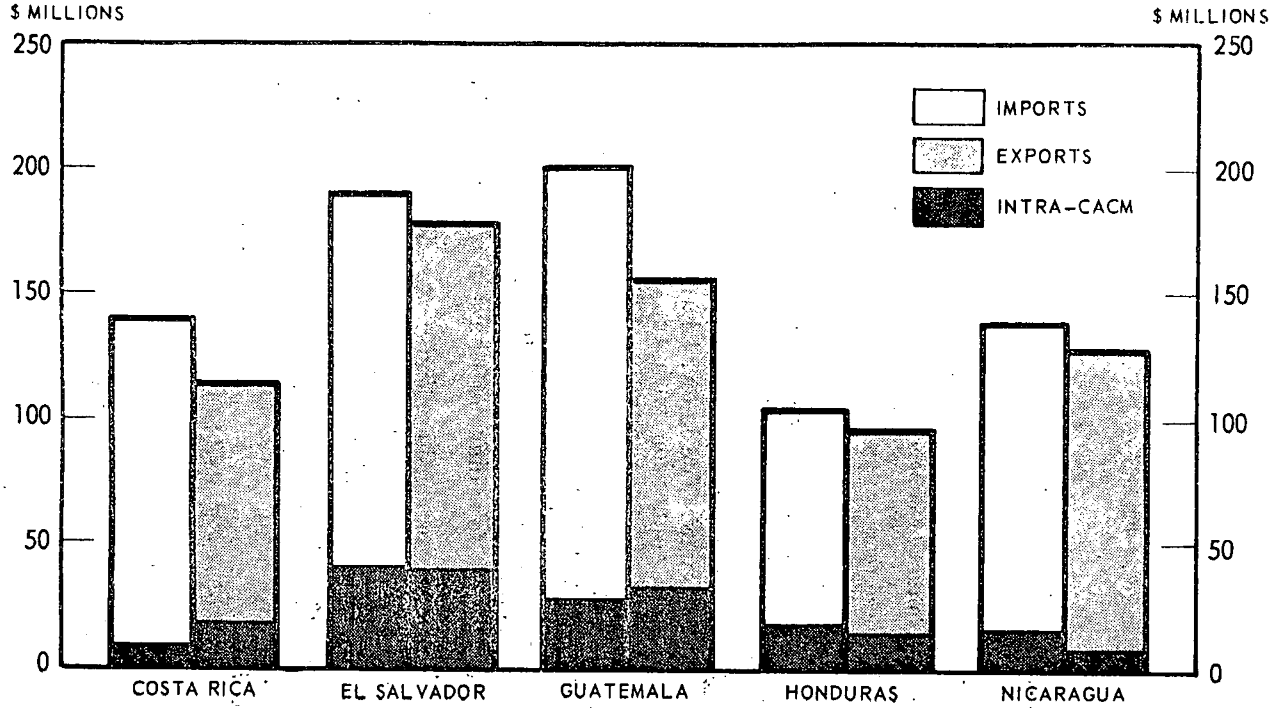
Global trade has also expanded appreciably. Total exports from the CACM countries rose from $285 million in 1950 to a record $668 million in 1964. Following a steady gain through 1957, declining coffee prices and falling banana sales kept the annual value of exports almost stationary until 1962, when increased cotton and sugar sales resulted in a renewed, substantial rise in export earnings.

U.S. stake in CACM

The United States has played a dominant role in Central America's development. U.S. direct private investments, which exceeded $400 million by 1965, are of major importance to the area. Central America's most successful banana plantations were pioneered, financed, and expanded with U.S. capital, which has also gone into such public services as railroads, electric power, and telecommunications. Improvement of transportation facilities has long interested U.S. investors, who were active in promoting various transisthmus railroads. The Inter-American Highway development program has so far involved the expenditure of well over $200 million of U.S. public funds.

Although the United States has traditionally been Central America's best customer, its share of the region's exports has been falling. From a peak of $218 million in 1953, U.S. imports from Central America gradually dropped off to $175 million in 1959. Their subsequent recovery, to $236 million by 1964, resulted mainly from increased sugar purchases following the disappearance of Cuba as a U.S. supplier. As Central America's chief supplier, the United States exports a wide variety of merchandise to the region. In 1964, U.S. exports to the area totaled a record $315 million, up almost 20 percent from the previous year.

CACM – DIRECTION OF TRADE – 1964



SOURCE: IMF

Western Europe's share in CACM's trade, now about 33 percent, has risen slightly over the past decade. West Germany is the major purchaser in this group of countries. Exports going to Japan have quadrupled in the past 10 years and now account for some 12 percent of the total. Japanese purchases have been limited almost exclusively to cotton, which now constitute more than one-sixth of all Japanese cotton imports.

Central America looks ahead

With acceptance of a formula for establishing a common market by mid-1966, the Central American integration movement has now advanced beyond the difficult early stages. The movement has stimulated a rapid expansion of intra-regional trade and some acceleration of investment in industries capable of taking advantage of the larger, regional market. New industries and new crops are diversifying output, thereby lessening dependence on the shifting world demand for a few commodities.

Central America is also looking beyond its own borders. The central bank of Mexico has been accepted into the Central American Clearing House. British Honduras and the Dominican Republic are showing growing intere t in the emerging, integrated Central America. The terms of Panama's po.sible formal association are under negotiation. Most important, the Central American countries have initiated contacts with the Latin American Free Trade Association intended to achieve an eventual merger of the two groups. The success of these talks would indeed represent an historic climax to long years of endeavor on the part of Latin American nations to stimulate economic development through regional cooperation.

Senator SPARKMAN. Thank you very much, Mr. Moore.

I suppose I could summarize this quite quickly by saying there is a lot of work yet to be done; is there not?

Mr. MOORE. Yes, sir.

Senator SPARKMAN. You know, I have been in hearings since 9:15 this morning in connection with the European Economic Market talking to some of our negotiators there and I am amazed at the amount of work yet to be done. I take it from your paper the same thing is true in Latin America.

Mr. MOORE. That is correct.

Senator SPARKMAN. And a great deal of work is going to have to be done, in your opinion, in order to make it work out in its final shape.

I notice you list four different things in which CIAP has indicated a great concern.

The first is greater consideration of the views of private enterprise. Second is the closer coordination of economic policies of LAFTA countries and adoption of a system of automatic reduction of tariffs. Third, termination of subsidies, price and exchange controls, and a vigorous attack—rigorous, I do not know whether you make much distinction between the two or not—a rigorous attack on the root causes of inflation; and fourth, the creation of a Council of Ministers empowered to make decisions somewhat along the lines of that given to the President of the United States under our trade accounts.

I was interested in noticing that inflation was No. 3. Do you really intend to put them in that order? Inflation stands just about at the top?

Mr. MOORE. Well, it just destroys economic progress.

Senator SPARKMAN. And it is actually one of the great threats or realities in most of the South American countries, is it not?

Mr. MOORE. Yes, sir.

Senator SPARKMAN. Do you see a conflict between sectoral integration approaches which look toward a limited number of reductions and our national objective of having substantially all trade free, including that within regional groups?

Mr. MOORE. Yes, sir. But I do not think it is destructive of the process. There are so many problems that must be phased out that I think if we get automaticity over a period of, say, 10 years, for the basic barriers we can start making interim and special arrangements without destroying the long-range objective.

But as it is now, the whole matter is subject to negotiation without any element of automaticity. As you know, the agreement provides that certain tariffs will be eliminated by 1973, but they may wait and do it on midnight of December 31, 1973. Obviously, when they get to that date, it will be impractical to achieve it the last night. I do not see the theoretical conflict as significant in practice.

Senator SPARKMAN. Are you not afraid that there may be some risk of a Common Market arrangement tending to encourage monopoly and favor "chosen instrument" producers?

Mr. MOORE. No, sir; on the contrary, I think it will increase competition because the scale markets will provide, will enable manufacturing industries to achieve optimum costs of production and prices which should lead to the industries within the market being able to survive competitively with exterior producers, which is not the case today because of the narrow compartmentalized markets they are serving and which require protection.

Senator SPARKMAN. You bring out a very significant point that over the next decade, I believe you said, there would have to be 30 to 35 million additional jobs created in South America.

Mr. MOORE. In Latin America.

Senator SPARKMAN. All of Latin America?

Mr. MOORE. That is right.

Senator SPARKMAN. You seem to be rather pessimistic as to the ability to create sufficient jobs to take care of the increasing population.

Now, you point to the creation of the Common Market as being a factor in that it would stimulate trade and trade, in turn, stimulates investment. Have you taken into account there the expenditures, the investments that are contemplated under the Alliance for Progress program?

Mr. MOORE. Yes, sir. I am not, Mr. Chairman, pessimistic. I just say the problem is enormous and it will not be dealt within traditional laissez-faire programs.

Senator SPARKMAN. In other words, it is going to take careful attention:

Mr. MOORE. Yes, because in the past century the increases in population normally were on the soil and found a living in the agricultural field primarily. As I say, our estimates are that only 5 million of this group can find economic employment in agriculture.

Senator SPARKMAN. That will be the normal?

Mr. MOORE. Right, sir. But industrial development does not happen as easily as farm development. It has to thrive in an environment that is conducive to savings, and most of this will be done domestically. I do not believe foreign investment has provided more than 15 or 20 percent of the growth or jobs of any country at any time, but the same environmental conditions that produce domestic investments and savings induce foreign investments.

Inflation is one of those basic factors. And if this environment is created, I am optimistic as to the possibilities. I have seen this process develop, especially in Mexico in the last 10 years, and I have seen jobs created, industries created. I have been a visitor there two or three times a year for the last 25 years, and I have seen a gradual absorption of the population growth as the industrial process proceeds. It has not hurt the U.S. markets in Mexico, because as they made one product that they formerly bought from us, they bought the machinery to build the factory and the workers in that factory bought something else. Now they are buying water skis, taking trips to the World's Fair, and they are buying style merchandise. It is only by making the lower cost goods that can be made by less skilled labor that they can afford to buy the luxury products which support the wage levels that we enjoy in this country.

So I consider the prospects are excellent for this development, but it requires coordinated and constructive, flexible policies on our part and, most importantly, policies within the Latin American area.

But as I say, the complications are that we cannot deal with this problem until we know how the European buyers of their raw materials are going to act. Therefore, I think we have to keep the jury out and be guided by European attitudes toward their raw materials, because they already have access to our markets for most of their raw materials, but they are being discriminated against in Europe.

Senator SPARKMAN. Did you say that an increase in the economic growth of 10 to 15 percent—what was it you said about that?

Mr. MOORE. I do not believe I mentioned any figure.

Senator SPARKMAN. I thought you used 15 percent.

Mr. MOORE. I mentioned that the foreign investment in any one of these countries does not contribute to more than 10 or 15 percent of the jobs, although the private sector in its entirety is called upon pretty generally in these country programs to supply 80 to 85 percent of the GNP. That is why private enterprise should be at the table. If the national development plan for X country says we need *x* private investment this year, in the next 10 years, and 85 percent must come from the private sector, I think private entrepreneurs should be invited to answer, "Is this a feasible figure?" "What conditions will prevent this happening?" And then consider the answers in the light of the national interest.

I am not saying governments necessarily should adopt every recommendation that is made, but private businessmen should be at the table when they pass resolutions assigning quotas and roles and jobs to them.

I believe this is recognized by Latin American planners themselves, Mr. Chairman. In fact, Mr. Santamaría has told me of his desire to broaden the planning process and have private enterprise included.

Senator SPARKMAN. Thank you, Mr. Moore, there are lots of questions I could ask you, but I should pass the questioning around. Mr. Javits? Senator Javits do you have questions?

Senator JAVITS. Thank you, Mr. Chairman. Mr. Moore, first, let me congratulate you on a very able statement given both in your capacity as a leading banker and as a leader of private enterprise in the Americas. I think that it is very significant that an American was chosen by the Latin Americans to be the president of CICYP, although I understand the tradition of CICYP has been up to now to have a Latin American as president. Is that not correct?

Mr. MOORE. Yes, sir; with the exception of a former Ambassador.

Senator JAVITS. So this did represent a recognition in the private enterprise field?

Mr. MOORE. Ambassador Kemper from Chicago was president about 25 years ago when he came back from being Ambassador to Brazil.

Senator JAVITS. But in a quarter of a century this has not taken place and is this not a recognition of the unity of interest of the private enterprise of the Americas?

Mr. MOORE. Yes, sir.

Senator JAVITS. You really offer us two different sets of policies. You believe that the United States should support a regional market in Latin America designed to break down existing restrictions in the area leaving the precise form of such a market to agreement among our Latin American friends. You suggest, at the same time, the United States should take the lead in persuading Western Europe to rectify its present trade discriminations against Latin America.

Should we fail to persuade the EEC to give Latin America greater equality of opportunity for Latin America in its growing market, you would then have the United States reconsider its trade policies and look toward alternatives.

And the other policy is in the absence of that, yet confident that it will occur if not right away, an interim policy for the Americas?

Mr. MOORE. Yes, sir.

Senator JAVITS. Now, does this presuppose that the development of Latin America is not proceeding as rapidly as it should in order to maintain political stability?

Mr. MOORE. It is not, sir. You see evidence of this in the paper every day.

Senator JAVITS. Well, I do not quite get your answer.

Do you feel we must accelerate the economic development of Latin America in order to maintain political stability?

Mr. MOORE. Yes, sir. It is clear, as I said in my final summary, that economic progress in Latin America is not proceeding at a rate sufficient to meet the minimum human needs of the people, nor provide economic stability, which is essential to peace—world peace and hemispheric peace.

Senator JAVITS. Of course we see the penalties in Asia and in the Dominican Republic of situations in which the economy will not support political stability, is that right?

Mr. MOORE. Yes, sir. In fact, I would predict if we do not succeed in accelerating economic growth in Latin America the problems we have had in the past 10 years are fractional compared to those we will have in the coming 10 years.

Senator JAVITS. In terms of security of freedom, in practically all of Latin America outside of Cuba?

Mr. MOORE. The problems we have been having in the last 10 years will be increased manyfold, in my opinion.

Senator JAVITS. So we are not talking about the musing of economists and bankers, we are talking about the hard realities of order and freedom in the Western Hemisphere.

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Mr. MOORE. Yes, sir.

Senator JAVITS. And unless we get back of a policy which will accelerate development, we are in for trouble?

Mr. MOORE. Yes, sir.

Senator JAVITS. Real trouble?

Mr. MOORE. But I still think, Senator, that we must not seemingly grab the ball. We must continue to emphasize to them that this is their job, we are their friends, we will give them support, but we should not take the ball and run with it.

Senator JAVITS. Now, as a matter of fact, everything you have said would lead to the fact that they can help themselves far more than we can help them; is that not correct?

Mr. MOORE. Yes, sir.

Senator JAVITS. In other words, the regionalization of their markets—do you believe—will produce for them in Latin America as relatively sensational a result as it has produced for Europe in the European economic rank—relatively speaking?

Mr. MOORE. Yes, from the low level from which they start, the relative progress could be equivalent. The problems are different, as you know, but I think the relative progress could be even more remarkable.

I think it is in process, too, sir.

Senator JAVITS. To the limited extent they have gone?

Mr. MOORE. Yes, sir.

Senator JAVITS. And a good deal of this depends upon the consciousness of Latin America that it is an economic unity?

Mr. MOORE. Yes, sir.

Senator JAVITS. Now, do the rules of the GATT accommodate the policies that you have described? In other words, under the rules of GATT is it not a fact that we can contemplate a hemispheric free trade area or common market as the case may be without violating the rules of GATT?

Mr. MOORE. I am not a parliamentary expert on GATT, but I have been told we can. I think the more important conflict involved is the fact that it would constitute a deviation from our traditional most-favored-nations policy, which is our own rule, not GATT's rule.

Senator JAVITS. But we could fully comply with GATT?

Mr. MOORE. I think so.

Senator JAVITS. But within the regional concept we would have to waive the most-favored-nations clause?

Mr. MOORE. Yes, sir.

Senator JAVITS. On the other hand, we would, under your proposals, be advertising to the whole world that we do not wish to do that, but we are being compelled to do it because of the fact Europe is invoking precisely that privilege? It is a fact that Europe is invoking precisely that privilege.

Mr. MOORE. Yes, sir.

Senator JAVITS. In the very commodities with which the Latin American countries compete toward which Europe is waiving?

Mr. MOORE. They are making a drive to increase their exports to Latin America.

Senator JAVITS. And that increase of the effort for trade with Latin America on the part of Europe is not accompanied by Europe contributing something to Latin American development, which is material?

Mr. MOORE. Yes, sir.

Senator JAVITS. Is it a fact that the major contribution from Europe to Latin American development has come recently through private enterprise in the ADELA Investment Co. in which you are a very prominent factor?

Mr. MOORE. Yes, sir, and of which you were the original godfather. I think the overwhelming European support of ADELA reflected increasing interest in Latin America and a heartening prospect that the proper policies will develop. Of course, this came from the businessmen, not from the political leaders of Europe, and there is somewhat of a difference.

Senator JAVITS. And also to influence Latin American policies into these fields by offering the carrot of private investment. That was the whole concept I had for ADELA, and you and Dr. Collado and the spiritual fathers with me had for it. And that is the concept Senator, now Vice President, Humphrey had when he joined us.

Mr. MOORE. Yes.

Senator JAVITS. I have one or two other questions, if I may.

Is it true there is a new and developing importance to the business community of Latin America?

Mr. MOORE. Yes, sir; I do not believe until the last several years that the business community was organized to speak for themselves and to participate in councils in the manner that I have suggested and which I now feel is essential to achieve its role.

Senator JAVITS. Congressman Curtis reminds me we better make clear I am talking about the Latin American business community, as you are now president of an organization which includes them, that is correct?

Mr. MOORE. Yes, sir.

Senator JAVITS. That is relatively new.

Mr. MOORE. That is new.

Senator JAVITS. Now, do you feel that laying aside dynamics within your organization—I am sure, like every other group, there are a lot of brilliant businessmen who think that little private satrapies in their own countries will do the the most good—the dominant characteristics of the new business community of Latin America will be more along your line or more along the old line of the oligarchy?

Mr. MOORE. I believe they will be along the lines I have indicated. In fact, this rebirth of the business community in Latin America was sparked from Latin America not from the United States.

A group came to the United States, you will recall, Senator. You met with them two and a half years ago. They said, "The Alliance for Progress is falling on its face; we are falling apart; you have to do something about it. The private sector has been ignored, you are promoting policies within our area that are destroying progress instead of achieving it. You have got to do something about it. And among other things, the business group must get organized." "We are going to wake up CICYP, we want you to be head of it," they said to me, and they promised to back me up, and they have. As you know, we have accelerated the programs and we are increasing our staff and we are preparing to play this role.

I am not saying there are not businessmen in every country as there are here that enjoy their comfortable little status quo, that are not looking for change or for investment, or for economic integration, but I think the overwhelming majority of them realize that the scale markets ahead and the political and social problems ahead demand this program be successful and that the common good and their own good is inevitable and inexorably tied to it, Senator.

Senator JAVITS. Mr. Moore, do you find any substantial political support for the economic integration of the Americas?

Mr. MOORE. Yes, sir; I do.

Senator JAVITS. You find a growing political support?

Mr. MOORE. I do.

Senator JAVITS. And finally, as a banker with so much experience and with such authority, surveying the regions of development in the world, that is Latin America, Africa, the Near and Middle East, and Asia, would you say that the Latin American countries are the furthest on the road toward development?

Mr. MOORE. Yes, I would, sir.

Senator JAVITS. So that it is a tremendously good bet as well as being essential to American security, prosperity, and the American future?

Mr. MOORE. I believe they have a better structural basis to achieve progress than many of the other areas you have mentioned. They have a population problem, but not as great a population problem. They have a lesser educational problem and more cultural and religious foundation for their social structure.

Senator JAVITS. I certainly thank you very much, Mr. Chairman, for this opportunity.

Senator SPARKMAN. Mr. Curtis?

Mr. CURTIS. Thank you.

Mr. Chairman, I want to personally thank you for having these hearings. I think that a great deal can be accomplished, and I am sorry I was not able to be here yesterday. Already from the testimony and interrogations here, the reasons for and the importance of these hearings, I think, are very clear and obvious.

As you said, there are so many areas to explore that it is hard simply to begin the discussion.

Let me pick up what might seem to be some details. Each one is very important, but I could not help but think when you were discussing this problem of preferences between Europe and African countries, that this is in my opinion such a very important aspect of the Kennedy Round, that we should even set aside a special GATT study group on tropical products. Putting it in different semantics, instead of European discrimination against Latin America, we are seeing preference for African countries, the former colonial dependencies of Western Europe.

In that sense, the Latin American countries, in asking us to set up a preference in the United States for them, are at the same time asking that we set up discrimination against other countries that compete with Latin countries in tropical products and other things. In this context it is a lot more difficult to come up with answers.

I share your expression of hope that we do not just compartmentalize the world and further bind trade patterns.

Mr. MOORE. Yes, sir. I am from Missouri, and we realize that a straight line is not always the shortest distance between two points. I think we know where we are going. But I think we may have to deviate en route. I share your feeling that, necessary as it may be, a regional development is a retrogressive step on the road we would all like to follow.

Senator JAVITS. If the gentleman would yield, when he says "we", I assume he means himself and Congressman Curtis, both from Missouri?

Mr. CURTIS. Maybe we have the same approach to things. We take hold of them and turn them around several times to see them from all sides before we are convinced of anything.

One other "detail" worries me very much. You referred to it indirectly rather than to bring it in as a very important aspect. This is the role of international commodity agreements as a method of stabilizing prices.

I have been very, very concerned about the international coffee agreement and our international sugar agreement. I am concerned about using the techniques we now employ as precedent for new agreements.

Existing agreements are contrary to our trade policy, in my judgment. The arguments for them have always been to stabilize prices and, of course, I know that there is a commercial advantage in stabilizing prices. But the term "stabilizing prices" can be used as the argument in behalf of trusts or cartels or anything else.

Would you comment a little more on the part that you see these international commodity agreements playing here? Would you agree that they ought to be geared to our overall trade policies and the policies we are discussing here as to how countries in Latin America might develop?

Mr. MOORE. I think that is a subject that you probably ought to delve into with people that are more qualified than I am, Mr. Curtis. I know there are different schools of thought among economists in this field and there are some of my own staff that have misgivings about these commodity agreements, particularly when they inhibit consumption and restrict free flow of these products.

On the other hand, unrestrained increases in production create problems, particularly when we have varying costs of production and low-wage areas and low-cost producing areas which threaten to completely destroy the economy of other producers unless there is some reasonable restraint developed. Therefore, as a large consuming nation, I think that some happy middle path needs to be developed. It is a very interesting subject, and, as I say, my own economics department that prepares our economic bulletin has criticized many of these agreements and has supported others, and I think they look upon them with mixed blessings, but I do not personally feel qualified to speak on them.

Mr. CURTIS. The reason I raised the question is because these agreements become so important to the underdeveloped countries and particularly some of the Latin American economies which are almost one-crop economies producing such things as sugar and coffee.

It seems to me rather difficult to discuss basic economic and trade policies of Latin America without agreeing what part these kinds of commodity agreements play. I raise this point because increasingly we seem to be moving toward these techniques.

The international textile agreement becomes of significance particularly to underdeveloped countries, not just because of the raw materials involved, but because textiles is one of the first industries underdeveloped countries can move into.

I want to get away from what to me is sort of a schizophrenic policy which deals with these important aspects of economics almost apart from the discussions that have taken place in the Joint Economic Committee.

Let me move on to the area that I am most concerned about and on which you have touched in almost everything you have said, yet we have not picked it out and zeroed in on it itself. This is the relationship of private and public investment capital.

For a number of years I have been trying to find out from the Administration, or anybody, where in the principles and founding documents of the Alliance for Progress is stipulated the mix of public and private, internal and external, investment under the Alliance.

When Secretary Dillon was Secretary of the Treasury, he referred to a goal of about $2 billion private investment.

Well, I frankly am a little bit shocked that is the goal of $18 billion public money and only $2 billion private.

Now, the question is, first, has there been any firm decision or even any public discussion of what the mix should be, as far as you know?

Mr. MOORE. Well, I would think the percentage would be more likely the other way, sir—$18 billion private and $2 billion public.

Mr. CURTIS. I would certainly hope so.

Mr. MOORE. In fact, the root of the deficit problem of most countries in Latin America goes back to uneconomic public enterprises. In Argentina it is the railroads; in Brazil it is Petrobras and some other public companies. And I think these countries recognize this, and I think they are endeavoring to unravel or find social solutions to these problems of their budgetary deficits. It would be impossible, in my opinion, to achieve the mix with those figures you mentioned suggested.

Mr. CURTIS. And yet if this is the information given to the American public, to the extent, that there is any information given, and if this is the Administration policy, and my last inquiry about this was this year, and again this kind of a ratio was set forth, then I conclude that nobody is really zeroing in on this issue at all. In fact, as near as I can determine, there was not any real agreement at Punta del Este of what the ratio might be, but this was only Secretary Dillon's own judgment and did not seem to have been the result of any understanding or discussion at the Punta del Este meeting.

Could you throw further light on what our government policy is, if it is not this 90 to 10 ratio? Do you not think it is important that there ought to be a public statement somewhere by the Administration or the Latin American countries as to what is their concept of the mix of this $20 billion capital investment period of 10 years?

Mr. MOORE. Well, I have not seen the study to which you refer, sir, nor the statement of policy as to the allocation of it, but I would say that our CICYP group and the Council for Latin America have been in extremely close contact with Under Secretary Mann for economic affairs, and when he was Assistant Secretary for Latin American Affairs, and I found his views in complete accord with those I have expressed today, generally speaking, not on these trade matters but on the role of private enterprise, on the needs to achieve the basic environmental goals that I have described and on the obligation and role that the private sector has to play.

I have not had it expressed numerically.

Mr. CURTIS. This is very interesting, because I think it was Secretary Mann himself who reiterated Secretary Dillon's ratios. From my public discussions with Secretary Mann, I do share with you the feeling that he supports the private sector philosophy that you have advanced here, but then reiterates a ratio of this nature. The two are so inconsistent that something must be done.

Now, in our foreign aid programs, we had the appropriation bill on the floor of the House just yesterday, there has been very little attempt to determine the relationship of private and public capital. I have made this observation. I say it is almost an economic law—I call it Curtis' corollary to Gresham's law—that Government money drives out private money. It does not have to. But if we are not careful in the way we spend Government money, far from being a pump primer, which we hope it would be as a basis for a healthy economy, this money can have and does often have the opposite effect. Particularly in South America it seems to me this has occurred.

There was one year, 1963, in which for special reasons, perhaps, there actually was a negative amount of private investment.

Mr. MOORE. From abroad, sir?

Mr. CURTIS. That is right, from abroad. We are dealing now with the $20 billion investment from abroad, talking about the mix of private versus public money. I did want to ask a final question about the private investment in Latin America itself, but the $20 billion is from abroad. It is United States policy to assist.

Mr. MOORE. Yes, sir; roughly it takes $5 of capital investment to provide $1 of GNP, and in Latin America we have a $75 billion economy growing, say, 3 percent populationwise a year. You have to have a $2 billion-plus a year increase in GNP. That means you have to invest $10 billion, roughly, a year.

Well, there is not that kind of money for this in government, either here or there, and it has to come from the private sector. I would estimate that 80 to 90 percent of the investment to provide this necessary GNP has to come from reinvestment of earnings and from the private sector and that for the most part from local investment.

Mr. CURTIS. I wish we could get this dialog on this basis instead of what I have regarded as almost ignorant replies of the Administration when I have inquired, What is your ratio?

To get an answer, I used to say, well, I think it is a 10 to 10 ratio—10 private, 10 public, just to get the dialog going.

I happen to agree with you. It has to be more the other way, but I have been contradicated by the Administration. I think we can probably find out where there is agreement or disagreement on basic U.S. policy if the Administration would forthrightly state what is contemplated here.

Is this really to be $18 billion additional public investment and only $2 to $3 billion private?

Now, could I also direct your attention to the flight of domestic investment. This committee was very concerned about hearings a couple of years ago indicating that actually Latin American domestic capital investments were not being reinvested in their own countries, but were actually being invested in, say, the U.S. stock market, Europe, and elsewhere.

What is the picture now?

Mr. MOORE. I think it has been turning back, sir.

Mr. CURTIS. First: Was this true? Do you think there was need for a concern?

Mr. MOORE. Well, let us say, there was a large local investment within Latin America, even at the low ebb of domestic confidence. But there was, on the other hand, a flight of capital, you might say, to the United States and to Europe from Latin America. I think the tide has turned and I think some of that capital is returning to some of the countries. I think domestic internal confidence in some areas—you cannot generalize on Latin America—but on balance I would say it is more inclined to stay at home than it has been for some time past. Local investors are usually wiser than foreign investors, and that is why environmental conditions that attract foreign investors encourage local capital to stay home and take courageous investment steps.

I think the trend is favorable. There are some trouble areas at the moment, as you well know, but I think Brazil made the important turnaround in the past year.

Mr. CURTIS. In your statement you have made it so clear that the basis of this is the climate for investment. Whether it is local investment or foreign investment or even Government investment, if we are intelligent, all should relate to the climate of investment. So much of the legislation we have relates to providing a climate—the Hickenlooper amendment to the foreign aid bill relates to the climate.

One other thing, and this leads away from your paper, but I am trying to pull together various aspects of our foreign policy as they relate to this question.

One of the great Administration claims is we tie AID programs to purchases in the United States. I have raised the point that, while from the viewpoint of balance of payments this sound good, is this "tied AID" policy good policy as far as Latin America is concerned?

Some figures that were just given to me in regard to our "tied AID" program in Pakistan showed that Pakistan had to pay about 50 percent more for its imports because of the fact that we required purchases to be made in the United States.

If we were trying to assist these economies, it seems to me to be very contrary economics—it may be necessary, domestic politics, to get these programs through—but it certainly is erroneous economic policy to have and insist on the tie-in. Would you comment?

Mr. MOORE. Well, the necessities of our balance-of-payments problem dictate this policy to a large extent today because we just must bring our payments in equilibrium. With that problem on the table it is not unreasonable to ask the recipient of a cash award or grant to spend it in our country to the extent it can economically be done.

It should not be necessary, if we were in equilibrium, as I hope will be the case before long.

Mr. CURTIS. I am trying to turn it around somewhat the other way. The whole purpose of spending the money is to assist the country.

Now, what happens to that money if there is this artificial requirement inserted to meet one of our problems?

Mr. MOORE. If the money is to be spent to build an electric light plant or steel plant or an industrial enterprise, if they buy the motor in the United States instead of West Germany, it does not adversely affect the economy of the recipient to have it tied. It may cost them a little more, I do not know.

It is a retrogressive step, but it is one of the steps we have to take until we bring out payments into balance. I would criticize it on general grounds, but I would acknowledge the need to pursue it under present conditions.

Mr. CURTIS. All I would like to say is, I would like to have our policymakers sit down and recognize that this is inconsistent policy, which they are not willing to do. I would ask, Do we have to do this?

I could not agree more. We have a balance-of-payments problem, but in my judgment this is not the way we are going to solve the balance-of-payments problem. We have other, correct ways to move, and this leads to the other question. The Administration along with this policy also imposes the interest-equalization tax, which is a bar or rather an attempt to interfere with the flow of private investment, and yet—and their argument again is the need to aid our balance of payments—and yet they will continue to ask Congress, and the Congress had complied, to give them more money for public, Government investment in these areas.

Now, again, what I am seeking to do here is to bring together in one forum a series of important areas where policy decisions are made, and to seek to relate those policy decisions to each other, when it seems to me we have one policy going one way, another going another, with apparently no thought being given to relating these various programs—whether they are commodity agreements, whether it is public versus private investment policy of the Alliance for Progress, or whether it is the policy we have adopted to private foreign investment.

Do you see any inconsistency in the U.S. policies I have enunciated here?

Mr. MOORE. Well, the interest equalization deals directly with our balance-of-payments problem again. When it was announced, I was opposed to the interest-equalization tax. I hoped it would not be necessary. I will acknowledge its present need as an interim step and short-term step, as a result of the problem facing us balance of paymentswise. I frankly—this is another whole subject we could open up—I would hope it would be temporary. Frankly, I feel if we adopted the monetary and fiscal policies necessary to bring our payments in balance, this interest-equalization tax would not have been necessary and would not be necessary today, but that is another ball game.

Mr. CURTIS. That is another question and I think we might end on that happy note of where we certainly do agree. I would end with this observation: We are again talking about investment climate.

If we want investment money to stay here and not go abroad on balance-of-payments reasons, I think it behooves us not just to be giving advice to these countries in South America and elsewhere about the need for proper investment climate, we had better start directing our attention toward home.

Thank you very much.

Senator SPARKMAN. Well, thank you very much, Mr. Moore.

We have enjoyed your paper this morning and the discussion with you thoroughly, and we certainly appreciate it.

Mr. MOORE. Thank you.

Senator SPARKMAN. We were hopeful when we set this schedule that we might have with us today Mr. Felipe Herrera, president of the Inter-American Development Bank, and also Mr. Carlos Sanz de Santamaría, chairman of the Inter-American Committee of the Alliance for Progress.

I have a telegram from each of the gentlemen.

From Mr. Herrera's message I read just the following: "I take the liberty of responding to your request"—that is the request to appear and give us the benefit of his information and suggestions—"by means of material which I prepared in my own personal capacity and which I have asked my office in Washington to transmit to you. This material contains everything I would have said, had it been possible for me to personally appear before your committee."

Mr. Herrera's telegram and statement in their entirety are placed in the record at this point.

(Document referred to follows:)

SANTIAGO, CHILE.

Senator SPARKMAN,
Chairman, Subcommittee on Latin American Economic Relationships,
U.S. Senate,
Washington, D.C.:

Thank you for your very kind letter of August 26, 1965, informing of the subcommittee's hearings on Latin American development and Western Hemisphere trade. I am glad to learn of your interest and that of the other distinguished Members of the U.S. Congress in the Latin American integration movement and their desire to receive a report on its progress. I feel deeply honored that you wish me to present my own views in light of the report which my colleagues, Messrs. Sanz de Santamaría, Mayobre, Prebisch, and I, put forward on April 1965 for the creation of a Latin American Common Market. I take the liberty of responding to your request by means of material which I prepared in my own personal capacity and which I have asked my office in Washington to transmit to you. This material contains everything I would have said had it been possible for me to personally appear before your committee.

Respectfully yours,

FELIPE HERRERA,
President, Inter-American Development Bank.

STATEMENT BY FELIPE HERRERA, PRESIDENT, INTER-AMERICAN DEVELOPMENT BANK

OBSERVATIONS ON THE SUBJECT OF LATIN AMERICAN ECONOMIC INTEGRATION [1]

I. INTEGRATION AND DEVELOPMENT

The economic integration of Latin America must be understood as a joint attempt to accelerate the collective development of the region as one of the main instruments to advance the welfare of each

[1] These observations have been prepared by Mr. Felipe Herrera in his personal capacity.

country. Although the common historical-cultural background of the Latin American nations is helpful, this does not inexorably lead to integration; it is rather the vital necessity of accelerating development which lends urgency to the process.

The long-range objectives

In Latin America, the production of goods and services must expand faster in order to absorb, at higher levels of productivity, a rapidly growing population which tends to concentrate in urban centers.

This implies the application of modern technology requiring large plants, division of labor, and a degree of specialization which often cannot be achieved within the narrow confines of national markets. This modernization process, in turn, requires large investments of capital which is scarce, but continues to be invested in sectors which are oriented primarily to the domestic rather than the more dynamic regional market.

In addition, limited competition, or its absence, leads to inefficient utilization of capital and other productive resources. It is indispensable, therefore, to achieve an integration of markets so that industrial production, continuously stimulated by reciprocal competition among the Latin American countries, will be forced to increase efficiency, improve quality, and lower costs.

The lowering of industrial costs will contribute at the same time to the achievement of another fundamental objective: increase and diversify exports of manufactured products to the great markets of the industrialized countries of the world. The development of the Latin American countries will require ever increasing imports of capital goods, intermediate goods, and new consumer goods. These requirements cannot be met while Latin America continues to be mainly an exporter of basic products whose demand increases slowly and whose prices fluctuate erratically.

Economic integration also is one of the basic instruments in the intense effort to reform and modernize the socioeconomic structure of Latin American countries. As such, it is not an alternative but rather a complement to the urgent necessity of undertaking, in each country, the internal reforms which will effectively permit the great masses of the region to enjoy the benefits of economic and social development.

This is the concept reflected in the Charter of Punta del Este, which states:

> The American Republics consider that the broadening of present national markets in Latin America is essential to accelerate the process of economic development in the hemisphere. It is also an appropriate means for obtaining greater productivity through specialized and complementary industrial production, which will, in turn, facilitate the attainment of greater social benefits for the inhabitants of the various regions of Latin America. The broadening of markets also will make possible the better use of resources under the Alliance for Progress.

The need for political decisions

The last 5 years have seen in Latin America rapid advances in the commercial and financial spheres as well as progress toward the coordination of basic investment. However, much as we may have advanced, experience indicated that the integration process has completed its first stage and that new decisions are required in order to assure that the movement gathers new dynamism.

The process of Latin American integration must include not only a series of measures in the commercial sphere, but also must involve coordination of regional investments, and of monetary, fiscal, exchange, and foreign trade policies.

It was the recognition of the need for an accelerated action in this field that led President Frei of Chile to request, from three of the leading economists of Latin America and the undersigned, specific recommendations to enable the Latin American governments to adopt the decisions which would intensify the drive for integration.

The reply of the four economists was contained in a document which urged the creation of a Latin American Economic Community as an institutional expression of the need for a common market in which the nations of the region could, at the end of the process, exchange goods and services without internal barriers and with a single external tariff.

That document also sets forth the objectives of the community, the appropriate accompanying policies, the general criteria which should determine action in various fields, and the institutional mechanisms necessary for orienting the whole process to assure the achievement of its objectives.

Recommendations for immediate action

We well know, nevertheless, that the creation of this institutional machinery is not a simple task and that it will not be achieved automatically. It must be the result of an evolutionary process culminated by a political decision by the Latin American governments to accept the economic community as the expression of the will of the collective majority. Meanwhile, however, it is possible to advance toward this ultimate objective by complementing the freeing of Latin American trade with the promotion of regional investments, especially in the fields of infrastructure and basic industries suffering within the straitjacket of limited national markets.

The Charter of Punta del Este recognizes that—

> The economic integration process implies a need for additional investment in various fields of economic activity, and funds provided under the Alliance for Progress should cover these needs * * *

and it adds that—

> the cooperation of the Inter-American Development Bank should be sought in channeling extraregional contributions which may be granted for these purposes.

These antecedents lend special importance to the recent declaration of President Johnson stating that the Government of the United States will contribute to the creation of a fund, within the Alliance for Progress, for the study of projects and programs of a regional nature. It is especially significant that this declaration was made on the fourth anniversary of the signing of the Charter of Punta del Este because it reflects the clear understanding by the U.S. Government of the interrelationship between the processes of Latin American national development and regional integration. The use of resources to meet the high cost of studies leading to the execution of multinational projects, constitutes a positive step toward achieving the goals established in the Charter of Punta del Este.

It seems useful to offer some suggestions with respect to the form and administration of the fund to finance the study of multinational projects. In this field, major obstacles will present themselves if an attempt is made to utilize the traditional system of tying external financing to the availability of borrowers who will offer a significant local contribution. The multinational nature of the projects and the need to undertake the extensive preparatory work required for the negotiation of specific agreements among the participating countries, make indispensable the participation of technical institutions to promote the undertaking of these studies. These institutions will need to have sufficient resources to be able to finance the necessary expenses without dependence on reimbursement. Later, as these studies lead to specific projects and to the agreements among the countries involved, it will be possible to include the cost of the studies in the financing as part of the respective final investments. In this manner, it will be possible to recover the original cost of the studies so that the funds may be used again in the preparation of new projects.

Taking these operational problems into consideration, as well as the pertinent dispositions of the Charter of Punta del Este, the report to the Latin American Presidents, referred to above, recommends that the Inter-American Development Bank channel—

> a considerable part of its resources into these investment programs without thereby giving any less attention to the financing of national development—

And that—

> as the integration policy gathers momentum more extensive resources will have to be forthcoming, either from additional contributions made to the Bank for this purpose, or from funds from other sources.

The same report adds:

> The Inter-American Committee on the Alliance for Progress (CIAP) is destined to play a leading role in coordinating these various kinds of financing.

This means, therefore, that the Inter-American Bank and the CIAP, with the cooperation of other institutions which presently participate in the studies of regional investment, should assume a major responsibility in promoting and directing these initiatives. In order to achieve this, additional funds will be necessary to complement those which the Bank can utilize for these purposes. For the reasons indicated these additional funds should not be reimbursable.

We have said that the advances already made in the march of Latin American integration are significant. Although they have not been sufficiently publicized even in Latin America, anyone who visits these countries today and reads the press, listens to political figures and intellectuals, meets with leading businessmen or leaders of its labor unions, will quickly realize that integration is no longer a concept discussed only by experts but has become a preoccupation of all sectors.

Here is a potentially great force which can be released to give new impulse to the process of development within an environment of much broader perspectives. In addition, the Latin American integration will improve the present system of inter-American relations by strengthening the ties between the two Americas, by accelerating the achievement of the general objectives of the Alliance for Progress, and by bringing about a genuine and significant Latin American role in the field of international relations, as an important part of the Western World.

While recognizing the positive steps which have been taken toward Latin American integration, we should not forget the obstacles and limitations which are still to be confronted. For this reason, it is desirable to point out the obstacles and advances which determine the road which must be followed in assuring the closer association of the Latin American nations.

II. PROBLEMS AND OBSTACLES TO INTEGRATION

In order to undertake an objective analysis of the difficulties and prospects of the process of integration we have to recognize the limitations that derive from the socioeconomic structure of Latin America.

The economic growth of the region as a whole has been slow and unsatisfactory. During the past 15 years per capita incomes have grown at about 1 percent per year, an extremely modest rate of increase when compared with the other developing regions and with the industrialized countries. The Alliance for Progress program has tended to better the situation, and so, in spite of negative factors in certain areas and of a steadily increasing population, per capita income increased by over 2.5 percent in 1964, meeting the goals set forth in the Charter of Punta del Este; the prospects for 1965 appear equally favorable.

The external sector

Nevertheless, the fundamental structural problems remain unsolved. Foremost among these is the weakness displayed by the external trade sector. With a few exceptions, short- and long-term prospects for the basic commodities produced by the region are rather uncertain, and industrialization has failed to compensate for the extreme fluctuations in external demand because of the reduced size of the domestic markets and the lack of competitiveness in foreign markets.

This weakness of the external sector has had repercussions on the increasing level of long-term external public debt which has increased from $5.7 billion in 1958 to $11.1 billion in 1964. The service on this debt has increased during the same period from $780 million in 1958 to $1.6 billion in 1964.

It is true that external public assistance has increased significantly, especially from the United States and international and regional financial institutions. Thus, the amount of public development loans from these sources to Latin America increased from $400 million annually in the 1957–60 period to close to $1 billion annually in the 1961–64 period.

In spite of this significant improvement, external assistance has been insufficient to undertake the vast amount of investment that is needed to overcome the gap created by the external sector.

As a matter of fact, only a month ago the President of the World Bank stated before the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD) that "the present level of financing is wholly inadequate" and that "the whole order of magnitude of external capital flows to the developing countries wants changing." He pointed out that the total net long-term public capital received by the developing areas from DAC member countries has held at approximately the same level since 1961. This has happened despite the increases recorded in the gross national products of the industrialized countries during the same period at a rate equivalent to 4 to 5 percent per annum. Consequently, the constant total of net official assistance represents a declining percentage of national income for the countries providing such aid. From the standpoint of the developing countries this constant level of aid has represented a decreasing amount in per capita terms owing to the expansion of their population.

Integration and national development

The positive efforts undertaken internally by the Latin American countries, especially since the establishment of the Alliance for Progress, to accelerate development and to achieve the necessary reforms in their economic and social structures have not yet substantially altered the current situation in Latin America. Two out of three inhabitants of the region still suffer from chronic malnutrition, per capita agricultural output is lower today than it was 30 years ago, and two out of every five adults are illiterate.

It is not surprising therefore that tensions of every sort are rising as a product of the interacting processes of inflation, substandard social conditions, urban pressures created by the mass movement of the rural population to the cities, frustration in the middle class, and unrest in the countryside. This inevitably has forced governments to take emergency action on a stopgap basis and has made it difficult to undertake long-term programs on a regional level.

However, there are other factors which presently conspire against the acceleration of a common Latin American effort. The most outstanding are the political compartmentalization into 20 separate nations, the preponderant orientation of the economies toward world markets, and the consequent lack of a regional infrastructure required for the interconnection of the isolated domestic markets. Even today the most felt need in Latin America lies in two basic fields; transportation and communications. It is noteworthy, for example, that Latin America has only 8 percent of the world's railroad network and 3.2 percent of the all-weather road system. Maritime transportation is no better; in addition to the lack of adequate port facilities in most countries, the fleet is not suited to carry the actual needs of intraregional trade. Scarcely 6 percent of the cargo which enters or leaves the region is transported in Latin American flagships, which receive only 11 percent of the area's freight charges. That is why, during the last few years, the annual balance-of-payments deficit of the 19 Latin American Republics on account of freight, insurance, and other similar items, has amounted to about $700 million.

The regional action is not an alternative to the national action, but rather complements it. Internal development and reform will be facilitated and invigorated by a generalized approach of all the countries of the region. The Inter-American Bank, for example, has found that the geographic factors make it difficult, at times, to overcome the isolation of particular regions, unless a joint coordinated development is undertaken with a neighboring country. This explains why the Bank has participated with such keen interest, by invitation of the respective countries, in studies of frontier integration. The same comment can be made about industrialization since the process of development of light manufactures, oriented toward an internal market, is in many cases reaching the limits of possible expansion, because of small national markets. Consequently, the prospects of its future growth will depend heavily upon the potential exports to other countries in the region. Also, the limitations imposed by international markets for basic commodities, make it necessary for Latin America to establish its own capital goods and other basic industries which, due to necessary large-scale operations, cannot be created on the basis of the demand from only domestic markets.

The experience of Central America is most interesting in its social, cultural and human aspects. This area, based on economic development promoted by integration has within a few years evolved new groups of entrepreneurs, technicians and skilled workers whose prospects have greatly improved now that they are no longer constrained by the small dimensions and limited opportunities of each single country.

Just as national development is stimulated by the integration process, the latter must be based on accelerated national development. An accelerated national development will stimulate the growth of widening markets and improve the opportunities offered by regional integration. This process of interaction requires that the countries of Latin America pass from the stage of national programing to regional coordination of their respective efforts, always seeking opportunities for complementarity and reciprocal specialization. Even now, it is essential to undertake sectoral integration in basic industries, transportation, communications, and in other fundamental areas.

A second major group of limitations, hampering accelerated integration, are of an institutional and cultural nature. Just as Latin America became divided into 20 different economies lacking sufficient intercoordination, so, over the course of 150 years, it has tended to develop diverging institutional and cultural experiences.

Largely as a reflection of the foregoing factors, Latin America has a limited absorptive capacity for technological and scientific knowledge. It is almost axiomatic that the great nations, with their broad markets, large populations, and vigorously expanding national incomes are those best able to create, develop, and adopt contemporary technology.

It is impossible for a disintegrated Latin America, with rudimentary or backward educational systems, with only a few research institutions comparable to those found in the more advanced regions of the world, to receive massive benefits from modern technologies. The establishment of a Latin American Common Market would create the conditions and requisites for such development; but at the same time the region requires joint scientific and technical activities to share the inherently high cost which these types of processes imply.

Furthermore, an exclusive "economic development" approach is inadequate as a formula for providing the Latin American countries with the status they aspire to reach in the contemporary world. The strength derived from economic growth alone will not lead to a larger and more responsible role in the international affairs, unless Latin America organizes itself as a creative community, bound together by a common cultural heritage and definite political-historical objectives.

The sluggishness of the integration process can also be traced directly to the hesitancy or refusal of the Latin American countries to adopt effective formulas for multinational action.

Perhaps economic, sociological, and technical conditions were not previously sufficiently mature to produce this result. Nevertheless, it is our firm belief that, in Latin America, the moment has been reached for fashioning the institutions required to carry on an accelerated Latin American integration process.

It is for these reasons, that we have advocated the creation of communitywide or multinational mechanisms, designed to promote the process of integration and to insure its continued regular progress. We believe that just as institutions have been established in our individual countries to bear the primary responsibility for satisfying community needs, it is equally urgent to develop an institutional approach in the overall sphere of Latin American activities.

III. ADVANCES AND PERSPECTIVES OF LATIN AMERICAN INTEGRATION

Regional trade

Since 1960 the Latin American countries have undertaken two significant and distinct approaches to integration. While the five Central American republics will perfect a common market in 1966, the nine LAFTA countries have undertaken, under the Treaty of Montevideo, to form a free trade zone within 12 years; i.e., in 1973.

These differences are easily explained if one takes into account that in Central America the integration movement began in the 1950's, greatly assisted by the traditional unionist tendencies of these countries, by the similarity of their economies and level of development, which facilitated the signing of a series of bilateral agreements creating free trade areas. The General Treaty of Economic Integration signed in 1960, not only provides for the free movement of almost all goods and for the establishment of a unified external tariff, but also undertakes to create the institutions charged with promoting the integration process such as the Central American Economic Council, the Executive Council of the General Treaty, the Permanent Secretariat (SIECA) and the Central American Bank for Economic Integration (CABEI).

On the other hand, in the rest of Latin America, the integration movement had to face a series of obstacles and circumstances which permitted only the more limited approach of establishing a free trade zone. The objective of achieving a free trade zone in 12 years is to be accomplished through two mechanisms: the negotiations of national lists of products whose tariffs are to be reduced at the rate of 8 percent a year; and the adoption of a common list of goods which is to completely free 25 percent of total intraregional trade every 3 years. The implementation of these measures has increasingly encountered difficulties as the obvious possibilities for conceding tariff reductions without touching traditional protected activities become fewer. Nevertheless, the Treaty of Montevideo has given its member countries an opportunity to achieve an increased appreciation of the benefits of intraregional trade and above all has gradually prepared the ground for a completely free movement of goods.

The advances which have been achieved in increasing regional trade have been encouraging. In Central America intraregional trade has

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tripled in 4 years and its share of the total trade of the region has increased from 7 to 15 percent. In the LAFTA countries, while trade with the outside world increased by only 4 percent from 1960 to 1964, intrazonal trade rose by 83 percent, thus increasing its participation in the total trade of the region from 7 to 10 percent. It is expected that in 1965 additional significant increases in intraregional trade will be achieved.

Regional financial institutions

The advances in the financial field also are different in the two areas undertaking integration.

The Central Americans have a specialized financial institution, the Central American Bank for Economic Integration, which promotes, through loans and technical assistance, projects in the fields of highways, electrification, housing, and regional industries. Its financing capacity has just been increased as a result of being named the administrator of an integration fund of $42 million, $35 million of which has been provided by a 40-year loan from the Government of the United States.

For its part, the Inter-American Development Bank, acting under its basic agreement which gives the Bank the responsibility of accelerating the individual and *collective* development of its member countries, is playing a significant role in promoting the integration of the region as a whole. It has made two loans to the Central American Integration Bank and has assisted it with technical assistance especially during the organizing period; with SIECA it has collaborated in studies respecting such factors of production as capital and labor in Central America; it is financing infrastructural projects in the fields of transport and power which have a strong integration flavor, in Central America, Argentina, Chile, Paraguay, and Uraguay; it is participating with entities such as the Latin American Iron and Steel Institute (ILAFA), the Economic Commission for Latin America (ECLA), the Food and Agricultural Organization of the United Nations (FAO), the Latin American Institute for Economic and Social Planning (ILAPES), in the realization of sectoral studies in the fields of basic industries and agriculture which will promote integration.

Thus, for example, under the auspices of the Brookings Institution, it is participating in coordinated studies with 10 Latin American institutions in the fields of preinvestment and identification of possible investments for the purpose of orienting its regional financing policies to serve the future needs of integration and complementarity; it collaborates with LAFTA in the search for projects which will permit the relatively less developed countries (Ecuador and Paraguay) to take advantage of the concessions which they have already received under the Treaty of Montevideo or to form the basis for new requests for concessions; it organized and put into operation a system for providing medium-term financing for capital goods exports within the region, providing for this purpose a total of $30 million of which $12 million has already been loaned to five countries; it has undertaken studies to facilitate integration in the frontier zones between Colombia and Venezuela and between Colombia and Ecuador; it has prepared, at the request of the Inter-American Committee on the Alliance for Progress, the first inventory of multinational projects in the fields of roads, communications, power, and river basins; it convokes periodic meetings of institutions interested in Latin American integration for the purpose of coordinating their efforts and studies and to serve as a clearinghouse for the exchange of information and consultation in this field; it organized, with the collaboration of the Latin American Center for Monetary Studies (CEMLA), a library on integration, which will be given without charge to planning institutions and universities in Latin America. As a culmination of all these efforts, it has recently created within its organization the Institute for Latin American Integration with headquarters in Buenos Aires for the purpose of undertaking studies, consultations, and training of personnel in the field of integration for the benefit of the Latin American countries.

Monetary policies and payments arrangements

A common market implies not only facilities permitting the expansion of trade and for financing new infrastructure and basic or strategic industries, but also arrangements which will permit the coordination of monetary policy. Inflation, monetary instability, and exchange restrictions are serious impediments to the realization of the opportunities created by the reduction of customs barriers. Fortunately, there is a clear understanding in Latin America of the need to achieve further progress with respect to these problems, and their possible solutions are being sought by various international and regional institutions. One of the possibilities which has been mentioned involves the coordinated use of monetary reserves through a common regional fund.

In Central America, in view of the large degree of prevailing monetary stability, significant advances have already been achieved, such as the adoption of a common monetary unit, the creation of a clearinghouse for intraregional trade transactions at the level of the central banks, and the first outlines of a monetary union.

In the rest of Latin America various initiatives have been undertaken to overcome the enormous difficulties and obstacles which are faced in the monetary sphere. Among the institutions which have been most active in the study of this matter is the Center for Latin American Monetary Studies, and LAFTA, through a Consultative Committee on Monetary Matters. This Committee has proposed the creation of an organ of consultation and coordination among the monetary authorities of the member countries, and the adoption of a payments system based on guaranteeing exchange convertibility and transferability through multilateral clearing of balances among central banks.

For its part, the private banking community of the Latin American countries is organizing a Latin American Banking Federation, which will undertake to establish a system of uniform documents for banking operations and is considering to participate in other formulas for cooperation, such as a Latin American clearinghouse and a Latin American bank for payments and acceptances.

Basic industries

In the process of industrialization, the Latin American countries have generally followed a deliberate policy of import substitution based on relatively high tariff protections or import quotas, thus creating a cost and price structure which is not competitive. Nevertheless, certain initiatives are being undertaken to overcome this situation, which seriously limits the possibilities of industrial expansion. Under the auspices of ECLA and with the financial support of the Inter-American Development Bank, a series of studies are underway to evaluate the ability of Latin American industry so as to take advantage of the benefits of a regional market, of the economies of scale, and of technological progress.

Attention has been concentrated on a limited number of basic industries such as iron and steel, fertilizers and other chemical products, heavy industrial equipment, machine tools, and the production of automobiles.

The coordinated efforts of the Latin American Iron and Steel Institute, which was founded in 1959 by the principal steel producing enterprises of Latin America, has had significant repercussions, and a preliminary study is already available on the integration possibilities in this important branch of industry, prepared with the cooperation of ECLA and financed by the IDB.

In the chemical field, interest has been concentrated on fertilizers because of their importance in increasing agricultural productivity in Latin America. A complete study has been undertaken through the unified efforts of FAO, ECLA, and IDB with the recent collaboration of CIAP and AID. The conclusion has been reached that a solution at the regional level of the problems of producing and marketing these products would be much more economical than solutions adopted by individual countries. It is notable in this respect that President Johnson recently suggested the creation of a common market for fertilizers in Latin America.

Agriculture

As in Europe, agricultural production is the activity which offers the greatest difficulties for integration schemes. Nevertheless, given the fundamental importance of this sector in Latin America, it is evident that a major effort must be undertaken to assure that this sector is a significant contributor and beneficiary of the integration process. In order to achieve this goal, it will be necessary that the agricultural sector overcome its well-known rigidities and structural deficiencies in order to be able to enter into the general scheme of a common market. It is desirable to achieve, gradually, a degree of specialization which will permit each country to enjoy the benefits of the comparative advantages which it may have in the production of foodstuffs and industrial raw materials. As a regional development plan will take time to prepare and negotiate, in the short run, it would appear best to agree on a regional policy of agricultural investment which, on the one hand, would stimulate specialization, and, on the other, would meet the financial necessities arising from the required readjustment and diversification of crops which must be promoted in marginal areas of traditional production.

The time has come for Latin American agricultural experts to investigate and formulate the programs, techniques, institutions, and procedures which will permit integrated agricultural development at the regional level.

Within this spirit, the Inter-American Development Bank recently signed a working agreement with FAO to cooperate in the study of certain activities designed to promote agricultural development in Latin America. The agreement formalizes the collaboration of IDB and FAO in all agricultural fields broadly speaking, but especially in those areas closely related to Latin American economic integration, through a closer coordination between national and regional development programs.

Transportation

The critical situation in the field of Latin American transport is the principal argument justifying the necessity of adopting multinational criteria and concepts in undertaking this task. In the field of land transport, the initiatives undertaken to complete and improve the Pan-American Highway are well known. A preliminary study financed by the IDB, evaluating the joint project of Bolivia, Colombia, Ecuador, and Peru to construct the "marginal highway of the jungle," has been placed before the interested governments.

Other important projects are being undertaken or studied to complete the system of roads which will open the access to isolated areas and between countries; for example, in Chile and Argentina, a first-class highway to unite Valparaiso and Mendoza; in Uruguay, interconnecting routes with Brazil and Argentina; in Brazil and Paraguay, a highway which will unite the port of Paranaguá with Asunción. All these projects are being considered by the IDB for financing.

Insofar as maritime transport is concerned, it is worthwhile to mention the creation of the Latin American Association of Ship Owners (ALAMAR) in which 60 port steamship companies, public and private, have united their efforts. LAFTA is undertaking initiatives to coordinate the port, maritime, and river transport policies of the countries of the area.

In the air transport field, international air transport agreements impede, at this time, the use of concessions made to one country or company by others, even though they may be associated. This has postponed the process of merging existing airlines. It is not necessary to underscore the gains in transporting capacity and operating efficiency which would result from a coordinated policy of investment and operation of the Latin American air transport, especially in view of the imminent entrance into service of the supersonic planes.

Communications

There is still no Latin American system of telecommunications, but efforts are being made to interconnect a number of existing fragmented systems into a regional system, which could adapt itself to the requirements of integration and of modern technology.

In Central America studies have been made to organize a regional telecommunications enterprise which would administer an integrated system from Mexico to Panama. The World Bank had directed this study and has indicated its interest in the financing of the project.

The problem of achieving a similar interconnection in South America is more difficult, but recent technological advances offer possibilities for solving the problem on a regional scale. In this connection, various South American countries have taken initial steps with respect to the satellite communications system, which Comsat has agreed to put into operation on a worldwide basis in 1968.

Power

The countries of the southern part of Latin America have been the first to become interested in the interconnection of their electric systems. The public enterprises of Argentina, Bolivia, Brazil, Chile, Paraguay, and Uruguay are considering a proposal to interchange electric energy by interconnecting the national networks, and to coordinate the expansion of existing plants or the erection of new plants.

In Central America various projects are being studied which would interconnect the electric systems of Costa Rica and Nicaragua, Panama and Costa Rica, El Salvador and Honduras, and even a more ambitious undertaking which would cover three countries, El Salvador, Guatemala, and Honduras, taking joint advantage of available hydroelectric potential.

The IDB has financed projects for expanding the production of electric energy involving the interconnection of the systems of two or more countries. The projects of North Santander (Colombia) and of Acaray (Paraguay) are of this type, the first connecting with the Venezuelan system and the second contemplating the supply of energy to neighboring regions in Argentina and Brazil.

River basins and frontier regions

Within the ultimate objective of forming an economic community which will include all of Latin America, there is still room for some undertakings of a subregional character. In the first place, there is a possibility of developing river basins which would benefit two or more countries in terms of agriculture, navigation, energy, exploitation of forest resources, fishing, etc. These systems must be developed cooperatively due to limitations of the international law and because no single country could afford to provide the necessary financial and technical resources. Among this type of multinational projects are the Amazon Basin, which interests a large number of countries in the central part of South America, and the river basin system of the Parana-Paraguay and Plata Rivers. Of course, it will take a long time before these projects will materialize, but meanwhile, the preparation of surveys and studies constitutes an activity which could well be assumed by the fund for integration, as President Johnson indicated in his address on the occasion of the fourth anniversary of the Alliance for Progress.

Immediate possibilities are offered by the studies of frontier integration which the IDB has undertaken, at the request of interested governments, for Colombia and Venezuela, in 1964, and, more recently, for Colombia and Ecuador. These studies make evident the integration possibilities to be achieved through increases in trade, complementary agricultural and industrial development, social and cultural contacts, and improved communications and transportation.

Institute for Latin American Integration

The Institute for Latin American Integration, which has just been inaugurated in Buenos Aires, reflects the great importance which the IDB confers on integration.

This Institute will undertake the training of technical personnel and of business and labor leaders, the advancement of research work, as well as serving as a regional forum, at a technical and academic level, for those who are struggling to achieve the consolidation of the Latin American Republics into an economic community.

(The annexes I and II which follow are part of Mr. Herrera's presentation:)

ANNEX I

(Submitted for the record with statement of Mr. Herrera)

PRINCIPAL ASPECTS OF THE REPORT SUBMITTED BY RAÚL PREBISCH, JOSÉ A. MAYOBRE, FELIPE HERRERA AND CARLOS SANZ DE SANTAMARÍA TO THE PRESIDENTS OF THE LATIN AMERICAN REPUBLICS

On April 12, 1965, Raúl Prebisch, José Antonio Mayobre, Felipe Herrera and Carlos Sanz de Santamaría forwarded to the Latin American Presidents the document entitled "Proposals for the Creation of the Latin American Common Market."

This report was prepared at the request of Eduardo Frei, President of Chile, and represents the personal and joint opinion of its authors concerning the most urgent decisions required to speed up the economic integration of Latin America.

The most important aspects of that document are outlined below.

I. THE PURPOSES OF INTEGRATION

Economic integration is one of the basic instruments in the extensive effort to reform and modernize the production methods and socioeconomic structure of the Latin American countries. We must state at the very beginning that this process is not an alternative but a supplement to the urgent need for domestic reforms on the national level that will effectively extend the benefits of economic and social development to the masses in each country.

Industry and services must play a major role in absorbing, at higher levels of productivity, a rapidly expanding population tending to concentrate in the urban centers. All of this requires heavy investments in sharp contrast to the scant resources available. This is the true crux of the problem, for Latin America continues to squander capital by setting up industries without thought to their economizing effects.

Modern techniques demand large-scale plants and a division of work and specialization that is often not feasible within the narrow confines of national markets. Furthermore, the restriction of competition, or its absence, frequently leads to poor utilization of capital and productive resources. Consequently, it is essential to achieve a close interplay of markets within a single economic area so that industrial production, continually spurred by reciprocal competition among the Latin American countries, will be obliged to increase its efficiency by improving quality and cutting costs.

A reduction of industrial costs will help to achieve another fundamental objective: the expansion and diversification of exports of manufactured products to the great markets of the industrialized countries. Development of the Latin American countries calls for an increasingly larger importation of capital goods, intermediate goods, and new consumer items. Importations of these commodities in the necessary volume will not be possible as long as Latin America continues to export almost exclusively primary products for which demand, in general, rises more slowly. It will only secure the industrial goods needed for its development by supplementing traditional exports with other manufactures.

II. INTEGRATION POLICY

The process of Latin American integration should incorporate a series of measures covering commercial policy, regional investments, monetary and payments policy, and foreign trade planning.

Trade policy

The Latin American countries must undertake four closely inter-related commitments, to be fulfilled within a period of 10 years. These are as follows:

1. Gradual and automatic reduction of customs duties applicable to intra-regional trade so that, at the end of the period, no duty will exceed 20 percent of the c.i.f. value of each product. In the case of customs duties now higher

than 100 percent, reduction would be intensified in such a way that, at the end of 5 years, none would exceed 60 percent.

Although total elimination of customs duties is an essential condition for establishment of the Common Market, it is not considered advisable to regulate the means of reaching this goal at the present time. It is preferable to utilize experience of the initial stage, in which a very substantial decrease in tariffs would be attained.

As explained later on, the fulfillment of this commitment would be subject to application of the principle of reciprocity and of the safeguard and readjustment measures, and adapted to the case of the relatively less developed countries.

2. Gradual and automatic reduction of the quantitative and other nontariff restrictions on intraregional trade with a view to their elimination at the end of the period. These formulas would make it possible to convert these restrictions into customs duties which would be subject to the commitments outlined in the preceding paragraph. Exceptions would be acceptable, on a transitory basis, with reference to application of the safeguard clause.

3. Establishment of a common external tariff providing reasonable protection for regional production. Major efforts in this aspect should be aimed at securing, as promptly as possible, uniform tariffs for raw materials and intermediate products, in order not to dislocate competition among countries of this system, and to establish common external tariffs in the sectoral agreement of industrial supplementation and integration, in order to obtain a reasonable degree of protection against external competition.

4. Establishment of preferential customs treatment to provide reasonable benefits for regional production, until the common external tariff enters into force, provided the tariff reduction process is unable to achieve satisfactory results.

Regional investment policy

The economic forces stimulated by tariff reduction cannot be expected to suffice to maintain integration. It will also be necessary to work deliberately through a policy of investments within the framework of the Common Market. In this connection, activities should cover the following areas:

1. Regional infrastructure projects, particularly with reference to transportation facilities and services (international highways, ports, and airports, air and maritime transport services, etc.), communications (telecommunications and microwave and satellite communications) and generation and distribution of electric power.

2. Programed development of a limited number of large industries offering substantial economies of scale through projection on the level of the regional market. This would be the case, for example, of the steel industry, certain nonferrous metals, fertilizers and some chemical products, and the manufacture of automobiles, ships, and heavy industrial equipment.

In programing the development of these activities, a series of incentives, particularly fiscal, technical, and financial, should be offered to guide the flow of investment in such a way as to fulfill the purposes of each plan, but without preventing the development of new initiatives beyond the scope of these incentives. Furthermore, in order to provide for limited competitive agreements, it would be advisable to reduce gradually the tariff barrier vis-a-vis the rest of the world to a point offering reasonable protection that will insure productive efficiency, once regional industry has evolved beyond the formative period.

3. With reference to the agricultural sector, it must be acknowledged that the lack of information and systematic study makes it impossible for the time being to develop a regional policy fulfilling the three main objectives: an increase in production to improve the diet of the people and supply of raw materials for industry; a reduction in imports that can be economically replaced; and, finally, expansion and diversification of agricultural exports to help eliminate the foreign trade deficit. It is obvious that the solution of this problem cannot be left entirely to the corrective action of a free trade policy and that it requires a program of agricultural development and modernization which would give preferential attention to price and marketing policy for farm commodities.

4. Promotion of the development of basins contained in the principal river systems and of the regions whose economic unity has been artificially divided by political boundaries.

The Inter-American Development Bank should channel a considerable part of its resources into the implementation of a regional investment policy, without prejudice to its continued financing of national development. However, as the integration process develops momentum, it will be necessary to secure a larger volume of resources, whether through additional contributions made by the Bank for this purpose or through funds derived from other sources. The CIAP is destined to play a significant role in coordinating such financing.

Monetary, payments, and foreign trade financing policy

It is obvious that the inflation prevailing in certain Latin American countries and the inadequate means of payment available to most of those countries pose very serious obstacles to the process of regional integration, in addition to disrupting their economic and social development.

In order to deal with these problems in depth, it would be highly advisable for the Latin American central banks to coordinate their monetary policies within the context of regional integration and, particularly, to examine the phenomena of temporary or permanent imbalance in intraregional payments, as well as in trade relations with the rest of the world. Such joint efforts by the central banks would help to strengthen the sense of collective and mutual responsibility, both in examining the domestic measures adopted by one country which may affect the rest and in jointly supporting the efforts to be made by the Latin American countries in order to solve their balance-of-payments problems.

The need for establishing a system of reciprocal and multilateral payments and credits among the Latin American countries is an acknowledged fact. In this connection, the formation of a payments union to provide for the periodic liquidation in convertible currencies of balances exceeding the established limits should be encouraged, together with the adoption of substantive measures designed to eliminate the causes of continuing imbalances. The idea—discussed again recently—of forming a joint reserve fund of the Latin American central banks would help in mobilizing the external resources required for proper operation of the payments union.

With regard to the need for establishing regional machinery for medium-term financing of exports of certain goods, the Inter-American Development Bank has already taken a very important step in organizing a system to finance intraregional exports of capital goods. This system must be expanded to cover other goods usually traded on the basis of deferred payments and to supplement it by regional machinery for insurance and reinsurance.

III. OTHER RECOMMENDATIONS

The integration policy measures outlined above should be supplemented by the application of certain essential principles for sound functioning of the Latin American Common Market.

The principle of reciprocity

Reciprocity of advantage within the Common Market is an essential principle for its smooth functioning.

It is impossible to lay down specific, general rules for achieving such balance. It would be necessary to examine carefully specific cases as they arise in order to determine whether the problem derives from the conduct of the country in question; for example, through shortcomings in its exchange system, or whether it results from the fact that the other countries have not accorded it sufficient advantages. In the latter case, it will be the responsibility of all the countries to insure that it obtains due reciprocity; in this aspect, investment policy plays a role of the utmost importance.

Countries which persistently gain greater advantages from the Common Market than others should speed up the reduction of customs duties and the elimination of restrictions on imports, insofar as the imbalance is not due to the policies of the less-favored countries. Such countries will also have to offer a greater margin of preferences in order to promote their imports from the region, in cases where the reduction of customs duties or preferences already granted are not sufficient.

The relatively less-developed countries

The success of integration requires that the relatively less-developed countries receive preferential attention and special treatment, particularly with reference to trade policy, technical and financial assistance, and regional investment policy.

With regard to the application of trade policy, the less-developed countries should have longer periods in which to achieve the quantitative goals set for the reduction of customs duties and elimination of other trade restrictions and to establish the corresponding preferential margins for intraregional imports. In other words, these countries should fulfill the general obligations only insofar as they gain specific advantages from the Common Market.

Incorporation of the less-developed countries in the regional integration process will require a special effort of technical and financial assistance. As far as technical assistance is concerned, the more-developed countries of the region, the industrialized countries, and the international agencies should coordinate their efforts in programs with well-defined objectives that will make it possible to prepare the respective projects opportunely. Moreover, external financial assistance should be supplied on more flexible conditions and more favorable terms.

The regional investment programs should also give preferential attention to the less developed countries, especially in connection with power supply and their link-up with the rest of the region in terms of transportation facilities and communications systems. Similarly, the economic integration programs of the less developed countries, as in the case of the Central American countries, and the border programs between such countries or between them and the relatively more developed countries should be given special impetus. Lastly, particular attention should be given to solution of problems arising in the less-developed countries as regional competition becomes stronger, assisting them to readapt established industries that are not sufficiently efficient.

Measures of protection and readjustment

The liberalization of intraregional trade will lead to inevitable readjustments in the productive structure of the Latin American countries. Various measures that would be implemented to assist the affected countries have already been outlined. During the readjustment period, it is essential that the countries should have defensive measures at their disposal in order to avoid seriously jeopardizing activities of obvious importance to their national economy and substantial imbalances in balance of payments or in the employment situation. Such measures might consist, for example, of provisional imposition of import quotas or customs duties higher than those agreed upon. The application of such measures should be authorized by the competent organs of the Common Market indicated below.

Similar cases may arise as the result of the disturbing effects of overvaluated or undervaluated exchange rates. In these cases, the competent authorities of the community could also authorize temporary measures until such time as the corresponding readjustments are made. A similar procedure would be followed to overcome the upsetting effect of differential tariff treatment given by the countries to imports of raw materials and intermediate products, until such time as a common tariff is applied.

The stimulation of Latin American initiative

The common market should serve as an instrument that will strengthen effective and equitable participation by the regional entrepreneur in Latin American economic development. Attainment of this objective requires the adoption of measures on two levels: The formulation of a statute providing a clear and uniform definition of the terms offered by Latin American countries and the Common Market to extraregional investors, and the adoption of a policy providing regional entrepreneurs with solid technical and financial support.

Foreign capital undoubtedly has an important part to play in the economic development of Latin America, particularly when it operates in association with local entrepreneurs in industries which are so technically complex or so capital intensive that access to them is difficult for regional entrepreneurs alone. Consequently, foreign capital would fulfill the primary purposes of introducing modern techniques of production and of serving as an efficient vehicle for the transfer of such techniques to local entrepreneurs, effectively incorporating them into business management.

The Latin American countries, the international financing agencies and the industrialized countries should share the responsibility of providing adequate technical and financial assistance to the regional entrepreneur. The former should organize and sell with a view to mobilizing their own technical personnel—frequently dispersed among secondary activities or absent abroad—and setting up credit instruments and capital markets which will contribute to project preparation.

While tremendous progress has been made in the last decade in the volume and caliber of international financial cooperation to development of the region, particularly in the financing of public investments, much remains to be done to establish credit instruments through which similar financing can be rapidly channeled to the private sector.

IV. INSTITUTIONAL ARRANGEMENTS FOR THE COMMON MARKET

In order to achieve a systematic integration policy, it is necessary to set up institutional arrangements which will make use of the various agencies and facilities already in operation to coordinate all action taken in connection with the objectives and general criteria stated above.

Council of Ministers

The supreme power of decisions should be vested in a Council composed of a Minister of State and an alternate delegate representing each member country. It would be desirable to have the right to veto the Council's decisions restricted from the outset.

It would also be desirable for the Council to have the help of advisory committees composed of high-level technical officials from the member countries and that of a committee composed of representatives of the workers, entrepreneurs, university and technical and professional organizations.

Executive Board

The executive authority of the Common Market would be vested in a board composed of a chairman and a limited number of members, preferably four and no more than six, appointed by the Council. The Chairman and members of the Board should be nationals of the member countries, would be eligible for reappointment and should be selected mainly on the basis of their technical qualifications.

The members of the Board would represent not the governments appointing them, but the community itself. Consequently, they would be forbidden to receive orders or instructions from countries individually and would be required to exercise complete independence of judgment in the performance of their duties.

The principal functions of the Board would be: to insure that the objectives, policies, and general criteria of the Common Market were attained; to propose to the Council measures designed to accelerate the integration process; to promote the negotiation of sectoral integration agreements; to promote, or to have carried out under its direction, the studies required for application of the general integration policy; to decide on the application of safeguards and readjustments as required; to act as a court of first instance in disputes on interpretation, and, in short, to coordinate activities relating to commercial and investment policies, monetary and payments policy, and foreign trade financing policy.

In addition, the Board should promote or carry out studies designed to coordinate the activities of the Latin American countries in negotiations for the expansion or diversification of exports, protect the prices of products exported to the rest of the world, and play an effective part in devising other measures of international cooperation.

Latin American Parliament

The Latin American Parliament would be the regional forum in which the major currents of public opinion would converge to elucidate the most important problems of integration. A climate of opinion would thus be created which would be favorable to the political decisions needed to initiate and to maintain steady progress toward regional integration.

The Latin American Parliament would be composed of representatives of the region's parliaments. At recent meetings in Lima, Peru, Latin American parliamentarians gave their unanimous support to this fundamental decision.

Instruments for the promotion of regional investments

To implement the regional investment policy, the Board should reach agreement with the Inter-American Development Bank on the establishment of an instrument which would actively promote the preparation of studies and projects in connection with the regional market, taking advantage of the work already being done in this direction by various organizations and drawing upon their experience. This instrument should form part of the IDB system and be under the joint direction of representatives of the IDB and of the Board.

Its main function would be to carry out preinvestment studies and to prepare programs and projects, chiefly in the field already indicated in the regional investment policy.

With these studies and projects available, the Board would be able to promote the sectoral supplementation agreements required to negotiate financing of the corresponding investments. It should be pointed out that the functions assigned to the Board do not exclude the important contribution currently being made in this field by agencies of the inter-American system and by international organizations. On the contrary, closer collaboration among all concerned should be encouraged so that their efforts may be put to optimum use.

Conciliation procedure

Disputes on interpretation not solved by direct negotiation between the parties should be referred, in the first stage of the conciliation procedure, to the Board. If no agreement should be reached, the problem would be solved by an ad hoc conciliation committee acting as a supreme court; its members would be drawn by lot from a list of persons previously designated for the purpose by the member countries. This experiment might lead to the establishment of a regional court of justice.

Annex II

(Submitted for the record with statement of Mr. Herrera)

Progress Toward Integration in Latin America

I. IN TRADE

Since 1960, two integration schemes have been underway in the Latin American countries. The first, encompassing the five Central American Republics, is designed to set up a common market in its essential features. The second, though of greater geographic scope, having been launched by nine of the largest countries in Latin America, makes a less ambitious contribution in the integration field since it aims only at the establishment of a free-trade zone within a period of 12 years. Thus, there are, as in Europe, two types of pacts or arrangements: one patterned on the European Economic Community (EEC) and the other on the European Free Trade Association (EFTA). Nevertheless, the long-term goal in Latin America is doubtlessly to arrive at an economic community with all its attributes and institutions.

Therefore, the following paragraphs will endeavor to describe the progress that has been made in that process and the specific steps taken in that direction.

1. In Central America, the integration movement begun in the fifties was encouraged by the traditional unionist inclination of those countries and by the similarity of their economies and level of development. The first approach in the commercial sphere was made in a series of bilateral treaties setting up free-trade zones.[1] In June 1958, the five republics signed the Multilateral Treaty on Free Trade and Economic Integration under which they abolished their mutual duties on trade in natural and manufactured products originating in all of them, as itemized in an appended list. Along with this treaty, two agreements were signed, one on integration industries and the other on standardization of import tariffs, which extended well beyond the free-trade area concept. The next step was the signing, in February 1960, of the Economic Association Treaty by Guatemala, El Salvador, and Honduras, guaranteeing the free circulation of goods, capital, and persons and shortening to 5 years the period for completion of the free-trade zone, scheduled for 10 years in the earlier treaty. The system was completed in December 1960 with the signing of the General Treaty on Economic Integration which, in addition to providing for free trade in all goods except for a list of products accounting for 5 percent of the tariff schedule, also established institutions to advance the integrationist process, such as the Central American Economic Council, the Executive Council of the General Treaty, the Permanent Secretariat (SIECA), and the Central American Bank for Economic Integration (BCIE). The consolidation of tariffs and customs procedures as called for under the treaty has brought the Common Market closer to fulfillment.

2. The situation is quite different in the rest of Latin America. Integrating attempts have had to contend with a series of obstacles and circumstances that have only permitted the adoption of the free-trade zone formula as a precursor to more highly evolved arrangements. The Treaty of Montevideo, originally signed by seven countries[2] on February 18, 1960, aims at the establishment of a free-trade zone in 12 years by means of two devices, the first affecting the scale of tariff barriers and the second the volume of trade liberalized. The first device consists of the national lists negotiated in conference once a year, which must allow a minimum tariff reduction of 8 percent as a weighted average relative to the level in force for third countries; the second mechanism calls for the compulsory and irreversible liberalization of up to an additional 25 percent of the volume of traded goods every 3 years. Consequently, at the end of 12 years, tariffs will have been reduced 96 percent and free trade will have been extended to all products. Difficulties have been encountered in the application of these pro-

[1] El Salvador and Honduras had a free-trade agreement in force from 1918 to 1957. The other agreements refer to the 1953–58 period.

[2] The original signatories were Argentina, Brazil, Chile, Mexico, Paraguay, Peru, and Uruguay. Ecuador and Colombia signed in the following year.

visions. Although the first round of negotiations easily exceeded the agreed average reduction, the following ones became increasingly strained as the possibilities of granting cuts without affecting traditionally protected products were exhausted. The drafting of the first common list was an even more laborious affair, requiring two conferences (Montevideo in May 1964 and Bogotá in November 1964) to arrive at the agreed 25 percent.

However, the Treaty of Montevideo has awakened the participating countries to a fuller awareness of their reciprocal trade potential, and chiefly to a climate of acceptance for, and gearing of production structures to, a commerce without barriers.

3. The stimulus to Central American reciprocal trade provided by existing treaties has been particularly powerful. From $33 million and a mere 7 percent of total trade in 1960, intrazonal traffic spiraled to $105 million in 1964, thus tripling in value and doubling its share in the total. Although the impact of the reciprocal trade concessions granted by the LAFTA member countries has not been as great, some noteworthy progress has been made. Firstly, it may be noted that establishment of the free-trade zone arrested the downward trend observable in intrazonal trade, which had shrunk to less than 7 percent of the total in 1960. Secondly, and more significant, while extrazonal commerce increased by only 4 percent between 1960 and 1964, intrazonal trade expanded by 83 percent to a total value of $1.2 billion and to more than 10 percent of the total.

It is clear that there has not been time for the benefits of the treaty to make themselves fully felt, owing to a certain inertia besetting commercial flow and to the inadequacy of the infrastructure, particularly in transport and banking services, available for the conduct of relations among countries traditionally geared to extrazonal commerce. Yet a country such as Mexico, which used to have almost no commercial dealings with the other LAFTA countries, has in 3 years generated trade with that bloc aggregating more than $50 million.

4. One undertaking that will powerfully expand trade, while at the same time diversifying it considerably, is the launching of production activities geared to the expanded market. In Central America this will be brought about by the so-called integration industries, which enjoy preferential treatment in the market of the five countries. In the LAFTA zone, the same aim is pursued by the signing of supplementation agreements. This line of approach has only recently been adopted: only three industrial firms have acquired this status in Central America, and only two supplementation agreements, one on statistical machinery and another on radio tubes, are in force in the LAFTA countries.

II. IN FINANCE

1. The first multinational financing institution specifically designed to finance integration projects in Latin America is the Central American Bank for Integration established by an agreement provided for in the general treaty and signed in Managua on December 13, 1960. Its organization is quite similar to that of the Inter-American Development Bank, which, moreover, furnished the BCIE with technical assistance before it opened its doors and has provided financial aid on several occasions.

Its most important organ is the Board of Governors, which consists of the Ministers of Economy and the presidents and managers of the central banks of the member countries, who lay down the general policy guidelines for the agency. The Board of Governors appoints five Directors, one for each member country; the Chairman of the Board of Directors is also the President of the Bank.

With an authorized capital of $40 million, the BCIE makes loans and furnishes technical assistance to promote the following activities: Highways, electrification, housing, and regional industry. By May 31, 1965, it had granted 95 loans totaling 35.8 million Central American pesos, equivalent to the same amount of dollars.[3] Financing by the Central American Bank has been used to establish or expand 59 industries and 3 service enterprises and to underwrite 20 feasibility studies, 2 infrastructure loans, and 5 housing construction credits.

2. As the financing agency of the integrationist movement, the BCIE has been selected to channel part of the Alliance for Progress resources into the region. This role has been given a more concrete and institutional character with the signing of the agreement placing the resources of a new fund at the disposal of the BCIE.

[3] The BCIE adopted the Central American peso as the unit of account for all its operations.

At the meeting of the Central American Presidents held in March 1963 in San José, Costa Rica, and attended by President Kennedy, the latter proposed the formation of a Central American Fund for Economic Integration to which the U.S. Government would make a sizable contribution. The negotiations between that Government and the members of the BCIE culminated in July 1965 in the signature of a contract under which the U.S. Government will loan the BCIE the equivalent of $35 million for a term of 40 years, including a 10-year grace period, at 1 percent during that period and 2½ percent during the remaining 30 years, reimbursable in the currencies lent. To complete the resources of the Fund, the BCIE member countries will make available to it $7 million drawn from the callable capital.[4]

The Fund will be administered as part of the general assets and within the institutional structure of the BCIE, but its operations and accounts will be handled separately from the other business of the institution.

Credits extended from the Fund may be large enough to cover the entire cost of a project and will be granted at terms and interest similar to those applicable to the resources of the Fund itself, plus a small surcharge to defray administrative costs and provide a small margin for capitalization.

As the first phase of its activity, the Fund will finance projects in the fields of telecommunications, highways, grain silos, cadasters, electric power interconnections, and industrial parks.

3. The Inter-American Development Bank is also playing a significant role in the financing aspect of integration. It bases this action on one of the basic provisions of its establishing agreement, which gives it the mandate to contribute to the economic development of its member countries, individually and collectively. It has made a highly varied contribution. Its financial and technical assistance to the BCIE has already been mentioned. We may add its financing of heavily integrationist infrastructure, transport, and power projects in Central America, Paraguay, and Uruguay. On several occasions, its readiness to grant certain loans to production enterprises was based on the opportunity they afforded of contributing to the formation of a regionally expanded market.

4. This same purpose of assisting in the creation of a regional market led the IDB to establish and put into operation a system for the medium-term financing of intraregional exports of capital goods, for which it allocated a sum of $30 million out of its own resources. This will place producers of capital goods in Latin America on a better competitive footing with producers outside the region who have access to medium-term credit and export insurance systems.

Five credit lines totaling $12 million have to date been granted to Argentina, Brazil, Chile, Mexico, and Peru.

5. One of the most important tasks of the IDB as the "bank of integration" is to seek out, study, and finance multinational projects. To this end, the Bank, at the invitation of the CIAP, prepared the first inventory of multinational projects existing in Latin America in the fields of highways, communications, power, the development of hydrographic basins, etc. These are generally works of extensive scope which, in view of their prospective impact, cost-benefits ratio, and geographic location, will require careful analysis.

6. As recognized in the Charter of Punta del Este, it is clear that, while special attention should indeed be given to multinational projects, as well as to the financing needed for industrial production and the expansion of trade in Latin America, as proper objects of financing with Alliance for Progress funds, this process entails additional investment needs beyond those covered in the financing of national plans.[5]

Since then, their different circles have discussed the advisability of setting up a fund for the promotion of integration, and its eventual administration by the IDB, which is also mentioned in the Charter of Punta del Este.[6]

This hope of a financial mechanism for integration was expressed in the letter sent by the Chairman and members of the CIAP to the Presidents of the 20 member countries of the Organization of American States, dated August 10, 1965, and asking the governments in the hemisphere and external financing institutions to support the establishment of a revolving fund to finance the preparation of projects and feasibility studies bearing on regional integration.

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[4] The BCIE's authorized capital was increased in April 1965 to $40 million to handle its increased credit activities and the flow of other resources to the Fund.

[5] Charter of Punta del Este, title III, pars. 6 and 8.

[6] Ibid., title III, par. 9.

This appeal was answered with singular celerity and clear vision by the President of the United States in his speech commemorating the fourth anniversary of the signing of the Charter of Punta del Este. President Johnson stated that his Government was prepared to contribute Alliance for Progress funds to the establishment of a new fund for the preparation of multinational projects. He noted that the construction of highway systems, the development of hydrographic basins that straddle national frontiers, and the improvement of communications will help to break down the barriers separating the nations of Latin America.

For his part, in citing this proposal during the inauguration of courses of the Institute for Integration in Buenos Aires, the President of the IDB pointed out that, although more work is required on this proposal, it will effectively promote initiatives to lay the regional infrastructure that Latin America so urgently needs, and that, if this fund is to accomplish its purposes successfully, it will not only have to grant loans, but should also be able to extend financing on contingent recoveries and nonreimbursable bases for the vital and often costly work of preinvestment.

III. IN MONETARY POLICY

1. The achievement of a Common Market requires not only facilities for trade expansion and a supply of capital for the financing of infrastructure works, basic industry, etc., but formulas for the coordination of monetary policies as well. It is precisely at this point that the integration effort in Latin America encounters one of its most serious obstacles. Inflation, monetary instability, and exchange restrictions hamper extraction of the full benefits from the common area being created by the lowering of customs barriers.

These are problems of which there is clear awareness in Latin America, and their solution is the object of constant studies by experts in various regional and international institutions. It is acknowledged that the coordinated use of monetary reserves could facilitate the solution of the short-term payments problems that so heavily burden most Latin American countries and, while the possibility of setting up a "regional central banking" system is already in sight, it is obvious to all concerned that this will be difficult to achieve so long as inflation, and the consequent distortion of prices and purchasing power, continues to prevail in some countries.

2. As in the commercial sphere, so also in the monetary sphere, it is in Central America where the most significant advances are being made, as indicated by the higher degree of monetary stability boasted by the countries in that region.

In July 1961 the central banks of the five Central American Common Market countries signed an agreement establishing a mutual Central American Clearing House under the BCIE, located in Tegucigalpa, Honduras. The purpose of the Central American Clearing House is to promote the use of Central American currencies in transactions among the member countries as a means of accelerating their economic integration.

Each central bank puts up the equivalent of $300,000, 25 percent in U.S. currency and 75 percent in its own currency. The dollar contribution goes into the guarantee fund and the contribution in the local currency into the fund for current operations. The Clearing House adopted the Central American peso, equivalent to the dollar, as its unit of account. The central banks guarantee the convertibility of their respective currencies and have undertaken to clear balances in local currency in the event of parity changes in respect of the dollar.

During its first year of operations, the Clearing House cleared transactions representing 60 percent of intrazonal trade, and, in the second year, up to 80 percent of that trade. Today it handles virtually all reciprocal payments in visible trade.

In 1963, the Banco de México joined the Central American Clearing House under a clearing and reciprocal credit agreement with the five Clearing House member banks. The overall credit extended by the Banco de México to the Clearing House amounts to 2 million dollars.

3. The other step taken by the Central American countries is the "Agreement on Establishment of the Central American Monetary Union," signed in February 1964, in San Salvador. Under this agreement, an Executive Secretariat was organized to undertake a comparative analysis of the monetary policy guidelines followed by each country, including policies on foreign credit and financing of the public sector, and to study the legal and operative aspects of the Central American banking system in relation to the demand for economic development of the region. In addition, four committees, on monetary policy, financing operations, legal studies, and exchange policy and compensation, will be engaged in laying the

groundwork for broad coordination among all aspects of unification of monetary and financial policies.

Formation of the Central American Monetary Union is proceeding gradually and it is soon expected to be an accomplished fact.

4. Although less ambitious and effective, the efforts being made in the rest of Latin America to coordinate banking and monetary policy are also commendable, particularly in view of the vast difficulties and disparities that must be overcome. A number of measures have been adopted, some organized by the central banks and ECLA; others by CEMLA, the regional institution for monetary studies, and others by LAFTA. In this connection, it is advisable to review some of the historical background.

In the meeting on trade policy and central banks of the LAFTA countries, held in Bogotá in April 1963, the principal operational and banking policy problems in the region were examined with a view to initiating their solution and a simplification of the encumbrances and restrictions governing the free transmittal of funds. It was agreed to convoke a meeting of representatives of the central banks to study and propose formulas for regional banking supplementation.

In May 1963, the Permanent Executive Committee of LAFTA created the Advisory Commission on Monetary Affairs, composed of one representative of each country, with a view to following closely the problems in this field and to devising solutions.

In November 1964, a report issued by a working group convened by LAFTA to study the monetary problems of the region proposed the establishment of an agency of consultation, collaboration, and coordination among the monetary authorities of member countries as a means of attaining maximum liaison among the central banks.

In December of that same year, during the fourth period of sessions of the conference of LAFTA contracting parties, the establishment of this agency on a permanent basis was approved.

Furthermore, the Advisory Commission on Monetary Affairs, in its second meeting in March 1965, recommended adoption of an operative system of payments based on guarantee of convertibility and transferability of foreign exchange through a multilateral compensation agency established in one of the central banks of the region.

Now under consideration by the Permanent Executive Committee of LAFTA is a proposed agreement between the central banks prepared by a group of experts and recommending the establishment of machinery for multilateral compensation and reciprocal credit in convertible currencies, which might develop into a clearinghouse.

5. Private banking, in turn, has been seeking out formulas for rapprochement and coordination. The latest in a series of events inside and outside of LAFTA was the first regional meeting of Latin American bankers held in Mar del Plata (Argentina) in April of this year. This was attended by over 300 participants representing the banks of Argentina, Brazil, Bolivia, Colombia, Costa Rica, Chile, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Paraguay, Peru, Uruguay, and Venezuela; also present were observers from the banking systems of the United States, France, Italy, the United Kingdom, Switzerland, Sweden, and a number of international agencies such as the International Monetary Fund, the OAS, the IDB, and LAFTA.

The bylaws and agreement establishing the Latin American Banking Federation were approved, documents were signed conditional upon their approval by banking associations and bankers of the 14 countries which in due course ratified their adherence, and the city of Bogotá was chosen as the headquarters site.

Important progress was made toward the standardization of documents for international operations in Latin American banking. It was decided to follow the recommendations approved in the first meeting of commercial banks of the LAFTA countries and suggested that a Latin American clearinghouse and a Latin American bank for payments and acceptances be established.

IV. IN INDUSTRY

1. The industrial evolution of Latin America is well known. The process of industrialization was stimulated by the conditions created by the two World Wars and the crisis of the thirties, when the demand for goods could not be satisfied by foreign sources. Subsequently, a deliberate effort was made to replace imports, which, in a number of countries, has reached a point where

economies of scale, specialization, and technological capacity have become powerful factors.

In this industrialization process, to date, the countries have followed a policy characterized by a relatively high degree of protection and a market limited by national boundaries, which has generally resulted in high cost and price structures, owing to the dearth of effective competitive conditions.

However, efforts are being made to resolve this situation, which tends toward marginalism and limits industrial expansion. Primarily under the auspices of ECLA, a series of studies has been conducted to gage the aptitude of Latin American industry to enter into supplementation agreements or to create conditions for the establishment of regional markets.

2. It is in the heavy iron and steel industry, considered basic to economic development, that the greatest strides have been made, under the aegis of the Latin American Iron and Steel Institute (ILAFA), which was set up prior to signature of the Treaty of Montevideo.

ILAFA has the following objectives:

(*a*) To undertake studies and research on Latin American markets to achieve a coordination allowing better development of the steel industry in this region;

(*b*) To foster the standardization of iron and steel products;

(*c*) To promote the exchange of information, experience, and techniques for improved productivity;

(*d*) To prepare and maintain a system of statistics on steel products in the Latin American area;

(*e*) To encourage and strengthen ties among Latin American iron and steel companies;

(*f*) To participate in moves designed to facilitate the production and technical personnel training.

As an entity, ILAFA includes, as active members, the Latin American iron and steel companies, individually, or the official agencies whose membership is composed of a maximum of two producers per country; ILAFA also includes as affiliated members those entities, institutes, universities, and other corporations which, because of their character or activities, can contribute to attainment of the Institute's objectives.

ILAFA holds its general meeting annually in one of the Latin American capitals, simultaneously with the Latin American Iron and Steel Congresses. The last joint meeting was held in Santiago, Chile, in July 1965 (sixth meeting and fifth congress).

With the IDB's financial assistance, ILAFA has prepared a series of monographs on the aptitudes of each of the Latin American countries for iron and steel industrial development, and with the collaboration of ECLA recently completed a regional study suggesting broad possibilities for integration through an investment program aimed at better utilization of economies of scale and specialization of production systems.

3. Between 1952 and 1963, the apparent consumption of laminated steel products in Latin America doubled, rising from 4.5 million tons to 9.2 million (expressed in terms of steel ingots), which represents a cumulative annual growth of 7.2 percent. In this consumption, the contribution of local production has increased from less than 50 percent to more than 75 percent.

Per capita consumption is indicative of the degree of industrialization and development attained. The average for Latin America is 44 kilos, less than the world level of 113 kilos, which is the result of averaging very high consumption (more than 300 kilos in the United States, Canada, and Western Europe) and very low figures in Africa, Asia, and Latin America itself.

Three projections of steel demand in Latin America for 1975, computed by ECLA, ILAFA, and the European Economic Community, are comparatively similar. The ECLA estimates are lowest, at 27.3 million tons, which is exactly three times the consumption in 1963.

ECLA considers that in order to reach this level of consumption another goal must be attained, namely, a regional output of 23 million tons, since the limited supply of foreign exchange makes it impossible to envisage the importation of more than 5 million tons.

In order to meet the demand in quantitative and qualitative terms within 10 years it will be necessary to expand steel production and especially lamination considerably, restricting importation to those products which, because of their very special quality or limited consumption, cannot be economically produced in the region.

The fundamental problem posed by future investments concerns economies of scale. If the present policy of installing plants with small and intermediate capacities is continued in Latin America, investments could entail three times the volume required for large-scale plants.

According to ECLA calculations, in a plant with a capacity of 100,000 tons per annum, the investment necessary to produce laminated steel from iron ore would be $700 a ton, while in a plant of 1,500,000 tons per annum, the unit investment would drop to approximately $300, representing a 60-percent difference.

In the steel sector, as in other branches of production, economies of scale operate on two levels: in terms of plant size and in terms of distance between raw material and final product.

These figures from ECLA are based on application of an "intermediate" technology, which would be more easily assimilated by the Latin American companies, thus still reserving a margin of economies that could be obtained through the application of more advanced modern technology. The substitution of modern for intermediate technology would mean a 5-percent saving in the production of iron ingots and 18 percent in rolled sheets.

The introduction of improvements in present plants is another aspect to be considered vis-a-vis the alternative of constructing new plants to replace technically obsolete ones. In a plant with a capacity of 1.5 million tons employing the oxygen converter in place of the open-hearth furnace, $33 million would be invested, but the saving in costs from the changeover would be $10 million a year; in other words, the investment would be paid off in slightly over 3 years.

ECLA suggests that integration of the steel sector be carried out in two 5-year stages. The first would allow the companies time to systematize their output and reduce their cost to levels comparable with international ones, while the second would be used to construct efficient, modern, low-cost plants to satisfy increased demand.

Integration by stages offers the further advantage of permitting correction of present imbalances in the production cycles vis-a-vis the structure and dynamics of demand. Assuming immediate implementation of all the expansion required to utilize the full capacity of rolling mills, regional output of rolled products would increase by over 6 million tons; within the region, the only markets for such surpluses would be Central America; Uruguay, Venezuela, Ecuador, and Paraguay, which could absorb only 7.5 percent of that surplus.

4. The chemical industry is another basic activity of great importance for the integration of Latin America, owing to its dynamic nature and multiplier effect. A series of studies have been prepared, principally by ECLA,[7] which indicate, on the one hand, a vast range of possibilities for supplementation and specialization agreements, and, on the other, a lack of uniformity and a strong tendency toward duplication.

It may be estimated that the total value of the present output of the region's chemical industries is more than US$2.5 billion per year; of this value, about 40 percent corresponds to Brazil, slightly more than 20 percent to Mexico, and another 20 percent to Argentina.

Another characteristic of this field of activity is that the basic products, both organic and inorganic, represent only a little more than 10 percent of the total while the bulk of the industry is geared to the processing of pharmaceuticals, soaps, and detergents.

It is important to note that the unquestionable progress achieved by regional production has not been sufficient to meet the expanded amounts for chemicals in the area, so that imports have continued to be high in absolute terms. In 1962, imports of chemicals for the countries of the region as a whole (except Cuba) amounted to US$1,050 million, or almost 13 percent of total imports of all goods and services. In 1962, imports of raw materials for synthetic fibers, including processed fibers, amounted to approximately US$60 million. In the same year, imports of synthetic rubber and pharmaceutical products resulted in a foreign exchange expenditure of almost US$210 million, or approximately 20 percent of the total cost of chemicals imports. This industry generally requires heavy investments which can only be justified if ample markets are available. This explains the importance of programing the sector in such a way as to supply the demands of the entire region.

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[7] These studies were submitted to the first seminar on chemical industries, held in Caracas late in 1964.

5. The importance and complexity of the chemical industry has led the Permanent Executive Committee of LAFTA to establish two study groups for this sector:

(1) A study group of petrochemical industry; and

(2) A study group on the chemical industries of greatest importance to the region which are not included in the terms of reference of other existing groups.

The petrochemical group, which started its activities in 1964, is currently making a survey of the member countries with respect to 103 products, and is expected to present a report next December on the results of its work.

To complete the study of this sector, the second group on the chemical industry was established in March of this year. The group held its inaugural meeting recently and prepared a report on the first stage of its work.

In order to carry out its objectives it will perform the following activities:

(1) Determine what chemical products are to be studied, in order to define the scope of its work.

(2) Owing to the number and complexity of products included within this sector, it will be necessary to conduct the study in successive stages and for selected products as part of its predetermined program with fixed time limits.

(3) In determining the products to be studied within each branch of the industry the following procedure will preferably be followed:

(*a*) Final selection of those products which are most significant, representative, and characteristic of the industries in the region.

(*b*) Determination of intermediate, basic, and primary products and natural raw materials that will be needed to manufacture the final product. In this determination, the following will be considered:

(1) Manufacturing methods used in the area;

(2) Manufacturing methods considered most economical for the future;

(3) Industrial groupings appropriate for regional integration.

(*c*) In determining these products, their relative importance and principal use in the industry selected will be taken into account.

(4) The products included in each selected branch of the industry should be related to one another and to those considered by the study group on the petrochemical industry.

6. It is interesting to note that in the second sectoral meeting of the basic chemical industry organized by LAFTA, the Mexican delegation presented a statement of principle indicating the manner in which it considered that this important activity should be integrated. The statement includes the following concepts: it is not feasible to consider a partial integration of the Latin American chemical industry; the chemical industry represents a single process from raw materials to final product.

Consequently its integration should preferably be vertical and for this purpose the following items should be considered:

(I) A common external tariff for—

(*a*) The basic chemical industry;

(*b*) Raw materials and intermediate products;

(*c*) Final products.

(II) Free trade and access to the raw materials and intermediate products of the area.

(III) Automatic elimination, general or by stages, of levies and other restrictions on chemical products.

(IV) Creation of a Latin American organization to promote the integration of the chemical industry and foster the establishment of financial institutions to favor its development.

(V) A unified regional policy of industrial development and investment in the chemical industry, for the purpose of encouraging—

(*a*) Establishment of integration industries, planned at the regional level, with special facilities for locating them, other things being equal, in countries of lesser economic development or those lacking adequate markets;

(*b*) The free transfer of capital within the area;

(*c*) Financial mechanisms to facilitate free trade in chemical products;

(*d*) The establishment of a common policy with respect to external investment.

7. A sector of great importance for integration is the production of fertilizers and pesticides, owing to the need to raise the productivity of Latin America's agriculture by introducing advanced inputs and technology, and owing to the fact that there is a large potential of unsatisfied demands that could be supplied by the region itself, which currently has a shortage of production capacity.

This interest has been expressed in a number of studies and at meetings in which the Inter-American Bank has actively participated. An FAO–ECLA–IDB working group is currently analyzing the demand in the LAFTA countries and Venezuela in order to evaluate the present and potential size of the fertilizer market and to solve this problem on a regional level. On the other hand, the joint ECLA–ILAPES–IDB industrial development program will attempt to project the supply needed to meet this demand in the region. This study is in its initial stage of country-by-country analysis. The partial reports for Chile, Argentina, and Colombia have been completed and the one for Mexico is well advanced.

At the request of the IDB, the joint ECLA–FAO Agriculture Division drew up a memorandum on the supply position of Latin America for nitrogen, potassium, and phosphate fertilizer. This document, prepared for the fertilizer meeting convoked by the CIAP last June, contains the following conclusions:

(*a*) Most of the fertilizers used in the countries considered in the study are of foreign origin. Local industries supplied only 35 percent of the total fertilizer consumption, even if the manufacture of phosphate fertilizer from imported phosphate rock is regarded as domestic production;

(*b*) In 1963, only four countries (Chile because of its nitrates, Colombia, Mexico, and Peru) supplied more than 50 percent of their total consumption of nitrogen;

(*c*) As far as *phosphate* fertilizers are concerned, only Mexico has a domestic industry, which supplies 90 percent of consumption. In the remaining countries, domestic production covers only 25 percent on the average;

(*d*) For *potassium* fertilizers, reliance on imports is almost total;

(*e*) The aggregate value of these imports is about US$80 million, the principal suppliers being the United States and Germany (65 percent). Only Chile exports nitrogen fertilizers in their natural state.

The use of fertilizers is very limited in Latin America, which is one of the reasons for inadequate productivity. This limited consumption is not attributable to meager dosage where fertilizers are used, but rather to the small number of farmers who use this technique and the extremely limited acreage fertilized. In Latin America, fertilizers are used principally for intensive crops of high unit value and for some export products. Even countries like Chile, Colombia, and Peru, which are the largest users of fertilizers, need to triple or quadruple their consumption to reach acceptable levels; in other countries, such as Brazil and Argentina, the increase should be 20-fold. For the nine countries considered, the overall ratio of actual to "ideal" consumption is as follows:

	Percent
Nitrogen	9.7
Phosphorus	10.5
Potassium	6.7
Average	9.2

The consumption per hectare under cultivation is only 13 kilograms, compared to more than 300 kilograms per hectare in countries such as Belgium, the Netherlands, and Japan.

The reasons for this low level of consumption are—

(*a*) The relatively high cost of fertilizers in proportion to the value of the product (unfavorable price relationship);

(*b*) The agrarian structure and system of land tenure;

(*c*) The lack of extension agents;

(*d*) The commercial practice of disseminating formulas unsuitable for the various types of soils.

To summarize, there are ample opportunities for integration in this sector. A study is needed of the reserves of phosphate rock and the possibilities of orienting the petrochemical industry toward the production of nitrogen fertilizers. In potassium, the requirements of Latin America are smaller and the sources of production more accessible. This was discussed at the recent fertilizer meeting called by the CIAP, in which the AID participated on behalf of the U.S. Government.

V. IN AGRICULTURE

1. In Latin America, as in Europe, agricultural production is the sector posing the greatest problems in the application of integration schemes. Even in Central America, where more progress has been made, the principal agricultural products have had to be omitted from the uniform external tariff and also from the provisions for automatic elimination of custom duties and intraregional trade.

However, in view of the great importance of agriculture in Latin America as an activity that provides employment for approximately one-half of the active population and accounts for 55 percent of all foreign trade earnings, it is evident that an effort should be made so that this sector may contribute to the process of integration, of which it will ultimately be the principal beneficiary.

It is imperative that the region's agriculture eliminate its well-known rigidity and structural shortcomings to become a part of the general Common Market system. It will be necessary, of course, to proceed with caution. An an intial objective, it will be well to achieve a greater degree of specialization that will make it possible to utilize the comparative advantages offered by each country for the production of certain items. But this cannot be achieved by simply establishing preferential treatment as part of the gradual process of tariff removal. It requires a genuine regional development plan in which the problem can be examined in its overall aspect and regional solutions found. Since it will not be easy to arrive immediately at the development of the plan of this nature, agreements can be reached at this time on a regional policy of agricultural investment to enable that sector to eliminate its present structural and economic rigidity. This regional investment policy would encourage and guide specialization and, at the same time, attend to the financial requirements for adjustment and diversification and for the introduction of crops in the marginal areas of traditional production.

It should be borne in mind, moreover, that since agriculture provides employment for so high a percentage of the population, the adjustment stemming from integration may be reflected in a further increase of the already considerable exodus from the countryside to the cities. A regional investment policy, coupled with proper attention to the economic aspects of the process, would also give rise to important social benefits, since the diversification of production would result in greater income for the farmers by introducing higher yield crops.

A projection of agricultural problems and solutions from a national to a hemispherewide dimension brings us face to face with the hard-core problems of development, more so that would be the case of a similar transition in any other sector of the economy.

In effect, there are problems of production, yield, domestic and foreign marketing, infrastructure, priorities, and coordination of investments; problems of markets, prices, quotas, transportation, inputs, specialization, diversification, irrigation, drainage, shortage of land, and crop rotation; technical problems and problems of research, aid, and agricultural expansion; socioeconomic problems involving the agrarian property structure, the equitable distribution of the benefits of production and working conditions; and, finally, problems of credit, supervision, technical and sanitary controls, and social problems of housing, health, and education. The interplay of these problems and the relation of agricultural development to the entire economic process, particularly to industrial development, could multiply the list many times over. Finally, consideration should be given to ways and means of explaining to the 110 million Latin Americans who live in the rural areas and derive their living from agricultural activities—whether engaged directly in agriculture or in related occupations—how the new geoeconomic conception of Latin America will insure them a future with higher income, more equitable prices, and more justly distributed social benefits, notwithstanding the adjustments they will have to make in some cases.

Therefore, the time has come for the agriculture experts of our continent to prepare or examine programs, means, institutions, and procedures to make possible the integration of agricultural development at the regional level.

2. The Inter-American Bank recently [8] signed a working agreement with the FAO which lays the groundwork for mutual cooperation of the two institutions in certain agricultural and livestock development activities in Latin America. This agreement will make it possible to extend and systematize a series of activities that the two institutions have been carrying out, including the question of agricultural inputs mentioned above.

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[8] On July 23, 1965.

The agreement provides for the formal coordination of IDB and FAO activities in the fields of agriculture, cattle raising, forestry, fisheries, and in relation to methods of conservation, processing, and marketing of and trade in the products derived from those fields, as well as the agricultural aspects of Latin American economic integration. The agreement has a duration of 3 years and can be extended for similar periods.

Coordination of activities with the FAO will help to make this work of the Bank even more effective by establishing better correlation between technical assistance, training, and financing.

The agreement will also help to establish a closer relationship between national and regional development programs, and will facilitate optimum utilization of available financial resources by contributing to prompter and more efficient identification of projects that can be carried out with external aid.

VI. IN INFRASTRUCTURE

1. A common market without the underlying infrastructure is impossible to conceive. Along these lines, Latin America, a region whose pattern of communication was traditionally determined by the orientation of its extraregional trade, is faced with a need to establish an infrastructure that will bring the components of the regional market into closer relationship.

2. Mention should be made of the efforts now being exerted to overcome this basic problem that results in higher transportation costs, delays and losses in shipping, and, in some cases, makes it impossible to trade.

It is often mentioned, as an argument against the practical possibilities of regional integration, that Latin America has only 8 percent of the world's railway mileage and only about 4 percent of the all-weather highways. It is also pointed but that Latin America lacks a port infrastructure adequate to the needs of intraregional trade, that its merchant fleets are small and incapable of carrying the volume of freight that would be required, and that its ships are now carrying only 6 percent of the ocean cargo entering or leaving the region. As a consequence of all this, Latin America's payments for freight, insurance, and other transportation items are increasing the general balance-of-payments deficit by more than US$700 million a year.

Moreover, this critical situation of Latin America's transportation facilities is the best justification of the need to approach improvement of these conditions from a multinational standpoint and on a multinational basis.

3. In the field of *surface transportation*, this approach is exemplified by the projects designed to complete and improve the Pan American Highway. Another example is the joint project of Peru, Colombia, Ecuador, and Bolivia for the Bolivarian Highway, whose preliminary study, financed by the IDB, shows that of the 5,600 kilometers this highway would cover from the Colombian-Venezuelan border to Santa Cruz, Bolivia, approximately one-third already exists or is programed for construction. Another 2,400 kilometers are regarded as economically feasible; in other words, 75 percent of the total length of this highway serving an area of 5 million hectares would appear to be justified.

The same integration criterion gives special importance to other projects now being studied or carried out in Central America to complete its regional intercommunication or to provide access by some of those countries to "new frontiers" on the Atlantic coast; to those in Chile and Argentina for joining Valparaiso and Mendoza by a first-class highway; to the interconnection routes planned in Brazil and Argentina; and to the project in Brazil that woul establish communications between the port of Paranaguá and the city of Asunción, Paraguay.

There are various other communications projects which, once concluded, would change the face of the region and provide a new infrastructure. The same may also be said on a number of international bridges that would establish contact between national highway networks now lacking direct connection.

4. With respect to *marine transportation*, it should be noted that 90 percent of the trade between countries of the LAFTA area is carried in ships.

This has led to the establishment of the Latin American Shipbuilders Association (ALAMAR) in which 60 public and private shipping companies of Latin America are joining their efforts and studies. The initiatives of LAFTA, in sponsoring meetings and conferences and mechanisms, are aimed at coordinating the port. marine transportation, and river transportation policies of the countries in the area.

5. With regard to *air transportation*, it has been necessary to postpone the search for ways of consolidating the Latin American companies. Unfortunately,

various problems arising from the rigidity of international air traffic agreements. have made it impossible, for the time being, for concessions or authorizations assigned to a given country or company to be used by others, even if these are closely interrelated, as would be the case if existing services were coordinated. Paradoxically, the tremendous investment effort each country is making to operate its own service and the right of each country to require that its air traffic be given access to other countries in reciprocity for the permits it issues to foreign companies for overflying its territory, are leading to a proliferation of small public or private companies in the Latin American countries.

A recent study of freight traffic in Latin America, published by the International Civil Aviation Organization, emphasizes the growth of air freight traffic in the region since 1945 as a result of industrial development and the domestic transportation requirements of each country. Despite this growth, the study shows that the average operating costs of the Latin American countries in 1963 was 15 percent higher than the world average. This is not surprising, considering that of the 127 scheduled and 164 nonscheduled Latin American airlines in operation that year, only 20 were operating more than 10 DC–3's or planes with greater load capacity. Of the 950 aircraft registered in the region, 90 percent were piston-type planes, 50 percent had been manufactured in the 1930's, and there were only 38 jets and 68 turboprops.

There is no need to emphasize the gains in transportation capacity and efficiency and in reduced operating costs that could be achieved if the investment and administration represented by this multiplicity of airlines could be coordinated and used to modernize the Latin American air transport system. The problem will assume more serious and urgent proportions when supersonic aircraft appear on the international competitive scene. Unfortunately, the cost of such planes is far beyond the economic capacity of the great majority of the airlines in our countries.

6. Bringing the Latin American *telecommunications* system into line with the requirements of integration and with the scope of the latest technical advances is another problem that should be faced and which is actually being approached in a resolute manner. There is no real system at the present time, but only a series of inadequately connected fragments which generally require the facilities of a third country to establish the necessary communications.

7. In Central America, preinvestment studies have already been made to establish a regional telecommunication company that will administer the integrated systems of the five countries in the area. The World Bank has shown interest in financing this highly significant project, which, at an estimated cost of approximately US$7,000,000, would establish direct intercommunication among the five Central American capitals through a single system extending northward to Mexico and southward to Panama.

8. The problem of establishing similar intercommunication in South America is more complex; however, technological advances in this field open up the possibility of finding a solution on an integrated scale. At the beginning of this year, a regional group (GRATEL) was established under the auspices of the International Telecommunications Union for the purpose of preparing and carrying out a regional communications plan. This group has already started its preliminary work and has informally requested technical and financial assistance from the IDB to accomplish its purpose. Moreover, various South American countries have taken the initial steps to adhere to the international agreement signed in August 1964 in order to utilize the worldwide satellite communication system to be placed in operation by the Communications Satellite Corp. (Comsat) in 1968.

The Inter-American Telecommunications Commission (Citel), established in 1964, resolved at its first meeting, held in January of this year in Washington, to petition the Inter-American Economic and Social Council to recommend to the Latin American member governments of the International Telecommunications Union that they adopt the necessary measures so that the ITU can consider the establishment of ground stations to be connected with the satellite communications system.

It is interesting to note that the multinational scope of this project refers not only to the utilization of the same system of satellites but also to the agreements to be concluded for establishing and financing the respective ground stations. For the time being it appears that only Argentina and Brazil would have sufficient traffic to justify the cost of a satellite communication system, including the related ground stations. However, since the operating cost would be 58 percent less than for the system of submarine cables now in use, it might be feasible to consider the possibility of having various countries pool their efforts to construct a single ground installation and to use the microwave system, not only to expand and perfect their present telephone and cable communications, but also to provide for integration of their television broadcasts.

9. Another item of basic infrastructure for integration is the system of *electrical interconnection*. In this field, the countries of the southern part of South America have been the first to concern themselves with establishing such a system, which will result in better utilization of power generation and transmission facilities. In various specialized meetings, technicians from the official agencies of Argentina, Bolivia, Brazil, Chile, Paraguay, and Uruguay have examined the problems that will have to be solved to establish a system for exchanging electrical power by connecting the national networks and coordinating on a subregional level the expansion of existing plants or the construction of new stations, principally those utilizing hydroelectric power.

10. In Central America several projects are being studied to interconnect the electrical systems of Costa Rica and Nicaragua, Panama and Costa Rica, Salvador and Honduras, as well as a more ambitious project that would connect three countries, El Salvador, Guatemala, and Honduras, and provide joint utilization of the available hydroelectric potential.

11. The IDB has been alert to the possibility of considering on a priority basis any projects for the production of electricity that are designed to supply two or more countries. The projects already financed in the department of Norte del Santander, Colombia, and at Acaray Falls, in Paraguay, fall into this category, since the former is combined with a connection with the Venezuelan network and the latter will supply power to the neighboring regions of Argentina and Brazil.

12. There are other projects of a purely multinational nature which should be studied eventually to determine the best possible use of available power resources. These include the hydroelectric project at Salto Grande, between Argentina and Uruguay, and the development of Salto das Sete Quedas on the Brana River between Brazil and Paraguay.

VII. SUBREGIONAL DEVELOPMENT

1. Although the final objective of the integration process is to establish an economic community embracing all of Latin America, this does not preclude the carrying out of subregional programs. Such programs, far from being incompatible with the objectives of regional integration, will actually help to attain them. The enlightening experience of the Central American Common Market shows the advisability of continuing to favor those groupings which, while small in geographical scope, will eventually serve as nuclei for a hemispherewide scheme.

2. Another important aspect of subregional integration is the development of river basins extending over two or more countries and whose resources for navigation, power, forestry, fishing, etc., can be utilized only on a cooperative basis either because the rules of international law would inhibit strictly national utilization or because the financial and technical resources needed to develop them are beyond the capacity of a single country.

3. This category of multinational projects includes the development of the Amazon basin, which is of interest to an entire group of countries in central South America, and of the Parana-Paraguay-River Plate Waterway. These are ideas which admittedly will take some time to assume concrete shape and even longer to carry out, but they are of far-reaching importance to the integration of those regions of the South American Continent. Meanwhile as President Johnson stated in his speech commemorating the fourth anniversary of the Alliance for Progress, the preparation of surveys and preinvestment studies is a proper activity for the Integration Fund.

4. More modest in scope but closer at hand are the border integration studies carried out by the IDB for Colombia and Venezuela, in 1964, and more recently for Colombia and Ecuador, at the request of the governments concerned. These studies have shown the possibilities of integration based on existing trade movements, social and cultural contacts and infrastructure connections that can be improved. They have led to the identification of a number of investment projects which are being submitted to the IDB and, possibly, other international financial institutions for consideration.

VIII. THE INSTITUTE FOR LATIN AMERICAN INTEGRATION

1. The Institute for Latin American Integration, established by the IDB with additional support from all the member countries, has just inaugurated its activities in Buenos Aires.

Its principal purpose is to study the integration process in Latin America and train the necessary personnel for this movement.

In so doing, the Institute will conduct research into the various aspects of integration; distribute documents and studies on that process in Latin America and other regions of the world; cooperate with regional and international technical and teaching institutions, whether public or private, that conduct activities related to integration; and provide training through courses, seminars, and lectures.

2. Thus, the Institute will be a research, advisory, exchange, dissemination, and teaching center devoted to analyzing and making known the various aspects of the process of integration.

3. The Institute is a permanent unit of the IDB but its budget is financed by special quota contributions of the member countries. It is assisted by an Advisory Board composed of seven outstanding persons from the public or private circles of the Americas.

Senator JAVITS. Mr. Chairman, I would just like to state that I have had the privilege of examining Dr. Herrera's statement. In the first place, he is one of the most distinguished Latin Americans on the international economic scene and I find, Mr. Chairman, that he recognizes that essentially what is needed here is a political decision on the part of Latin America itself, and in that regard bears out our witnesses to date.

Dr. Herrera argues persuasively for accelerated Latin American economic integration, including the coordination of regional investments, and of monetary, fiscal, exchange, and foreign trade policies, not only as one of the basic instruments to reform and modernize the social and economic structure of Latin America, but also to improve the present system of inter-American relations.

Dr. Herrera is not unaware of the complexities of creating a Latin American Common Market and he recognizes that it must be the result of an evolutionary process, culminated by a political decision by Latin American governments to accept the economic community as the expression of the will of the collective majority. During this evolutionary process, he believes that it is possible to advance toward this ultimate objective by complementing the freeing of Latin American trade with the promotion of regional investments.

Dr. Herrera also agrees with the positions of Dr. Frank, Dr. Grunwald, and Dr. Collado as to the sectoral approach and he thinks that even now it is essential to undertake sectoral integration in the basic industries of transportation, communications, and other fundamental areas, and he says that studies are already taking place in the area of iron and steel production, fertilizers, transportation, and communications.

An examination of his statement leads to the conclusion that just as in the case of the advocates of the European Common Market, Latin American leaders view a Latin America common market as a means to achieve political unity as well as more rapid economic growth and Dr. Herrera believes that the achievement of unity will strengthen greatly relations between North and South America as well as enormously raise the position of Latin America in the contemporary world.

I wish to pay my tribute, Mr. Chairman, to Dr. Herrera for the obvious painstaking care and study which went into the preparation of what members will find to be a most comprehensive and important contribution to our consideration of this critically important subject.

Senator SPARKMAN. Thank you, Senator Javits.

May I say that we also have a communication from Mr. Sanz, explaining his inability to appear at our hearing but promising a subsequent statement.

Senator JAVITS. I ask unanimous consent we include the statement of Dr. Sanz de Santamaría in the record in its entirety.

Senator SPARKMAN. That will be done.

(The material referred to follows:)

[Cable from Dr. Sanz, Sept. 8, 1965]

Hon. JOHN SPARKMAN,
Chairman, Joint Economic Committee:

Owing to my absence from Washington, I have just learned of your kind invitation to appear before your committee. As it is impossible for me to attend, personally, tomorrow's session, and because of my desire to lend you my fullest cooperation, I shall transmit to you within the next few days some observations that might be useful to your committee concerning the important items mentioned in your letter. May I express to you my satisfaction at the importance the U.S. Congress and your committee are giving to the urgent problems of the hemisphere.

With best wishes.

Respectfully yours,

CARLOS SANZ DE SANTAMARÍA,
Chairman of CIAP.

ORGANIZATION OF AMERICAN STATES,
PAN AMERICAN UNION,
Washington, D.C., September 16, 1965.

Hon. JOHN SPARKMAN,
Chairman, Subcommittee on Inter-American Economic Relations,
U.S. Senate, Washington, D.C.

MR. CHAIRMAN: I have the honor of submitting for your consideration and that of the Subcommittee on Inter-American Economic Relationships which you chair, the enclosed statement comprising some observations on the subject of raw materials and Latin American economic integration.

I deeply regret that I was unable to appear personally before your subcommittee, but as I indicated in my telegram of September 8, my absence from Washington made this impossible. May I express my hope that this statement will aid in a better understanding of the issues being considered by the subcommittee, and that it can be included in the official record of the hearings.

Sincerely yours,

CARLOS SANZ DE SANTAMARÍA,
Chairman, Inter-American Committee on the Alliance for Progress.

STATEMENT BY DR. CARLOS SANZ DE SANTAMARIA, CHAIRMAN, INTER-AMERICAN COMMITTEE ON THE ALLIANCE FOR PROGRESS

Mr. Chairman, I welcome the opportunity to come before this committee and to present, as Chairman of the CIAP—the Inter-American Committee on the Alliance for Progress—some observations on the role that primary products exports can play in promoting Latin American economic integration. It is, of course, within the context of the Alliance for Progress that I believe this subject must be considered.

The Alliance is by now well rooted in the hemisphere and has to its credit several significant accomplishments in various of its fields of activity. Though the goals established in the Charter of Punta del Este are far from having been met, we may point with some satisfaction to the initial advances being recorded at the national level in intensifying and rationalizing economic effort through planning, and in introducing structural reforms aimed at modernizing rural life, raising production, and stimulating savings, investment, and national income redistribution. Notable progress has also been achieved in the area of international financial cooperation, mainly with the United States.

It is in the area of regional economic integration, however, where certain weaknesses still exist. Dr. Felipe Herrera has very ably described to you the nature of the economic integration movement in Latin America, so that I shall be very brief in this respect. I should like, however, to call attention to particular progress that has been made and some of the problems that have been confronted.

The panorama in Central America is encouraging. The area is advancing rapidly and in an orderly way toward integration, and has passed from the purely commercial phase to that of taking the first steps toward planning investment and harmonizing economic and social policies, with all this implies with regard to the future transfers of productive factors. On the other hand, it can be said that most of the rest of the Latin American region, which is directing its integration under the treaty instituting the Latin American Free Trade Association (LAFTA), although it has made significant headway, still remains in an initial stage of the process. Thus, in spite of there having been negotiated some 8,600 tariff reductions, of which one-fifth involve the total elimination of duties and other restrictions, intra-LAFTA trade still accounts for only about 10 percent of those countries' total foreign trade.

There is no doubt that LAFTA has been developing with timidity as regards tariff reductions, and for it to move faster basic decisions must be made at the highest political level; decisions which must substantially change the structure and scope of the agreements thus far reached. To promote a suitable atmosphere for such decisions, in the spring of this year, Drs. Felipe Herrera, José Antonio Mayobre, Raúl Prebisch, and myself, in our personal capacities, formulated several proposals, addressed to the Latin American heads of state, with regard to the basic decisions it will be necessary to make in order to hasten and consolidate the movement toward integration.

Also, the letter addressed by CIAP to the Presidents of Latin America and the United States expressed the committee's support for the general position taken in the proposals referred to. Bearing in mind that the intraregional trade aspects of the integration movement come under the purview of other agencies, an urgent program of action was outlined with regard to investment and financing related to the integration process.

The U.S. Government has, as recently as August 17, in a speech by President Johnson, indicated repeatedly its support of effective Latin American economic integration. In addition to reaffirming the cooperation of your Government in the integration process, President Johnson announced the U.S. intention of contributing, as suggested by CIAP, through its resources pledged to the Alliance for Progress, to the establishment of a new fund for the preparation of multinational projects.

These initiatives, warmly welcomed throughout the Americas, serve to reemphasize your country's firm purpose of contributing to the cause of the Alliance for Progress.

In spite of the attempt to build the firm basis for making new and great decisions on economic integration, their adoption and, what is more important, their prompt implementation, will depend to a great degree on the general atmosphere of economic expansion in Latin America. The European experience is quite illustrative in this context. The economic dynamism that prevailed in Europe and was the vehicle on which integration advanced so speedily has been lacking in Latin America throughout the course of this decade. Integration is indispensable for the speeding up of development, but a certain degree of sustained growth must take place in order for integration to move ahead.

Consequently, it is not entirely appropriate to consider the problem of economic integration as separate from that of Latin American foreign trade, one of the prime determinants of internal economic performance. The wider accessibility by the Latin American countries to the markets of the industrialized countries is therefore a sine qua non for creating an environment within which intraregional concessions can be made. It might thus be said that it is precisely in the field of international trade in which the cooperation of the United States could be most useful for the promotion of the economic integration of the region.

But it is in the field of international trade cooperation, unfortunately, that the Alliance for Progress has shown few advances. In analyzing the main causes of the lag in the region's growth and of the sense of frustration there seems to be in several countries, CIAP, in the above-mentioned letter of August 10 to the Presidents, identified the following as one determinant:

> The sharp deterioration of trade prospects, caused by weakened prices or markets for some products—cocoa, sugar, and bananas—has tended to reduce or cancel the positive effects of aid measures, rendering more difficult stabilization efforts, reducing the rate of development, and creating hardships for certain population groups or regions.

President Johnson is fully aware of this fact, and he clearly indicated so in his speech of August 17:

> First, we must step up our efforts to prevent disastrous changes in the prices of those basic commodities which are the lifeblood of so many of our economies. We will continue * * * to strengthen the operation of the coffee agreement and to search for ways to stabilize the price of cocoa.
>
> We will try to maintain a regularly expanding market for the sugar that is produced by Latin America. And consistent with the CIAP recommendation, I will propose * * * that Congress eliminate the special import fee on sugar so that the full price will go to the Latin American producers.

These words reflect the deep concern felt by all the Latin American governments with respect to current international market trends and the pessimistic outlook for the future.

Following a brief period of expansion in Latin American exports, covering the latter part of 1963 and all of 1964, resulting primarily from climatic conditions affecting agricultural production in many countries outside the area, international markets are again characterized by excess stocks and sharp, sustained price declines. The price index for basic commodities prepared by the World Bank, which includes certain of the principal Latin American products, is highly illustrative. The general price index for the first quarter of 1965 was 93.5, while for 1964 it amounted to 100.3, based on 1955–57 equals 100.

If we consider the price index for agricultural food commodities, including, among others, cocoa, coffee, corn, wheat, rice, meat, and sugar, all of which are highly important for Latin America, in terms of the same base period it will be noted that the index declined from 115.4 for the first quarter of 1964 to 83.4 for the same period of 1965.

Such price developments will reduce considerably Latin America's export receipts in 1965, bringing them to levels nearer to those prevailing in 1963. Besides having the effect of reducing the dynamic impact of exports on the growth of the region, these current reductions in receipts from abroad intensify the critical bottlenecks that exist in the external sectors of the economies of most of the countries in the region. Several of them have reached such levels of foreign indebtedness as to be forced either to considerably expand their exports or reduce their rates of growth in the coming years. Furthermore, it is quite clear that the pace at which exports should expand can be attained only if larger and better outlets are assured for the traditional exports of the area. Export diversification is of the utmost importance and has to be tackled more vigorously, with the help of the importing countries. But this is a highly complex and time-consuming process that can only have a long-term effect. In the short— and medium—term it is only the expansion of traditional exports that can have a significant uplifting effect. It is, therefore, of the greatest importance to try to identify a group of such products whose supply can be swiftly expanded in Latin America and absorbed by existing world demand.

I do not intend on this occasion to begin to identify such products, but I will refer myself, very briefly, to a few of those items in which the region enjoys a good supply position; and on which the United States is apt to take action in a direction that might help to redress the adverse market expectations referred to above.

Cocoa

Prices for this commodity, which in 1964 ranked as the 11th most important Latin American export item, are the lowest recorded since the end of 1946, for a number of reasons. The accelerated expansion of African production, motivated to some extent by the possibility of assured markets in their former European metropolises, has been an important factor in the increase of total world output. Production in the 1964–65 agricultural year exceeded output in the preceding cycle by 25 percent and the 1.3 million tons of consumer demand projected for this year by over 230,000 tons. Latin American production has remained virtually stable over the past 5 years.

The cocoa market has been undergoing one of the most serious crises of any of the basic commodities, with no favorable prospects apparent in the immediate future. The most recent attempts—in 1963—to establish an international agreement on the regulation of trade and production failed when no accord could be reached on prices.

Sugar

Very recently, in my address to the Agricultural Committee of the House of Representatives on August 18,[1] I treated in some depth my

[1] U.S. Congress, House of Representatives, Committee on Agriculture, "Hearings: Amend and Extend the Sugar Act of 1948, H.R. 10496," 89th Cong., 1st sess., 1965, pp. 346–361.

points of views and the position of Latin America vis-a-vis the problems confronted by its sugar exports. Here I will just highlight some of the points I made at that time.

Sugar stood fifth in order of importance among Latin American exports in 1963 and eight in 1964, with a possible further drop during the present year. Latin America is one of the world's regions best suited to sugar production. It is, in fact, one of the oldest industries in the area, and was the first agricultural commodity to benefit from large-scale industrialization in Latin America. However, despite its status as an efficient producer, Latin America has been unable to develop its exports of this product in keeping with its potential. For one thing, in contrast to other exporting areas, Latin America does not have access to any preferential market. For another, the existence of a protected market representing 70 percent of world trade in that item, and of protectionist policies penalizing or restricting imports in certain markets of the developed countries, has posed obstacles to the expansion of Latin American sugar exports. Furthermore, increased world sugar production, resulting largely from increases in subsidized output by some of the developed countries, is running ahead of world demand. As a result of this situation, prices have rapidly and steadily deteriorated. Consequently, free market prices at the midpoint of this year were lower than the levels recorded 30 years ago.

This indicates the importance of the U.S. market for Latin American sugar and fully justifies the anxiety with which the Latin American governments are following the development of sugar legislation in the Congress.

Elimination of the import fee from the bill sent to Congress by the executive branch has been a source of great satisfaction to Latin America. It now eagerly awaits its participation in the supply of this market with imported sugars to recover the regional position it occupied early in this decade when the Latin American product represented 90 percent of total imports, excluding Philippine sugar.

Coffee

This is the most important of the Latin American export commodities, excluding petroleum, and is included in the export list of 16 countries.

Recent trends in the international coffee market, while not fully satisfactory, indicate that the situation for this product is less critical than for sugar and cocoa; largely as a result of the International Coffee Agreement, which has made considerable progress in regulating most of the world supply of this commodity.

Nevertheless, there are serious causes for concern with respect to the long-range outlook. The vast reserve stocks which continue to exert pressure on the market and the prospect of new production increases pose serious problems for the world coffee economy.

CIAP assigns great importance to the potential influence of the coffee agreement and realizes that its strengthening is a matter of enormous interest for both the member countries of the Alliance for Progress in particular, and the community of nations in general. Accordingly, CIAP has submitted for consideration to the signatory countries of the agreement the possibility of establishing a special fund designed to facilitate production control and to advance immediately those aspects of the International Coffee Agreement aimed at promoting diversified production.

Cotton

This product is also of great importance for Latin America's economy. Excluding petroleum, it occupies third position, on a dollar-value basis, on the list of basic export products (with $540 million in 1963–64). Cotton is exported in varying quantities by 11 of the Latin American countries, supplying 25 percent of the cotton traded on the world market.

During the last 3 years world production has exceeded consumption, thereby raising stocks to more than 28 million bales, or the equivalent of about 7 months' average supply.

Up to now, cotton prices have not been subject to the violent fluctuations of other basic export products in Latin America; this relative stability, however, has managed to sustain what could only be considered as a minimum price level from the point of view of producing countries: the prevailing average price during the last year for 1-inch Middling type has been 24.07 cents per pound.

Since the United States is the main exporting country, with almost one-third of the world market and one-half of total world stocks, U.S. cotton policy is the major factor in world price movements. Consequently, the Latin American countries are deeply concerned about the new legislation now being considered, which would bring about important changes in the cotton marketing system and result in a significant drop in world prices.

If the measures now contemplated were put into effect, world prices could fall to as low as 21 cents per pound, an event which would mean for the Latin American countries an earnings reduction of up to $65 million yearly. In terms of the limited economies of the various countries involved, such losses would have considerable impact.

The Latin American countries recognize the recent efforts made by the U.S. Government in its cotton marketing policy, directed toward the greatest possible stabilization of the world cotton market. However, these efforts have not been sufficient to mount an all-out attack against the basic problem of overproduction which characterizes this market.

In this regard, it might be appropriate to mention once again that a number of the basic principles of the Alliance for Progress refer to the policies which should be followed by industrialized countries in order to help expand and stabilize the world export markets of underdeveloped countries. Also, reference might be made to similar recommendations adopted by the recent United Nations Conference on Trade and Development. Undoubtedly, it would be preferable to solve the problem of maladjustment of the world cotton market by means of an international agreement. However, as long as joint action of this type is not taken, the Government of the United States ought to make every effort to maintain the present price level of 24.07 cents per pound, and measures should be intensified to limit production to levels that are more in harmony with world consumption.

Other commodities

Up to this point, I have referred solely to a few commodities whose outlook is extremely critical. There are others, however, which, though less important from the standpoint of the region as a whole, are basic to the economies of certain countries, such as bananas and wool, whose position is also very delicate.

In contrast, for certain other lines the status of international markets is more favorable, as for example, for certain nonferrous ores and metals. Nevertheless, it must be kept in mind that these markets are strongly influenced by factors wholly beyond the control of the Latin American countries and at any moment present market prospects may be reversed. In the case of nonferrous metals and ores, current demand is derived from the economic prosperity of the developed countries. Any modest decline in the rate of their economic development or any intensification of consumers' efforts to achieve a higher degree of self-sufficiency through subsidized domestic production or the use of substitute materials, can rapidly introduce elements of instability with disastrous consequences to the economies of the Latin American countries.

This illustrates once again the high degree of vulnerability of the Latin American economies derived from their heavy dependence on export trade. The countries themselves have realized this fact and have been making efforts to diversify their exportable production. But as I said before, at the current stage of the development process, the main resources available to Latin America are supplied by the traditional export commodities whose market prospects are, as already noted, so discouraging.

These factors are one of CIAP's major concerns and have for this reason received special attention.

Furthermore, the Charter of Punta del Este spells out this situation, and in chapter IV stresses the need for seeking solutions to the problems of Latin America's export trade.

In the letter addressed by CIAP to the Presidents of the member countries of the Alliance for Progress, on August 10, the point referring to trade policy is aimed specifically at calling attention to the need for immediate action in this field. The letter proposes certain specific measures designed to correct the present situation. I will refer to some of them.

Commodity agreements

As stated previously, the present disorganization of world markets for basic commodities offers discouraging prospects with no indication of spontaneous solutions in the foreseeable future. The unstable factors are so diverse in type, so numerous and influenced by such varied forces and policies that it is unrealistic to assume that the classic laws of economics can resolve the current situation.

The only truly positive solution is to establish world commodity agreements covering the largest possible number of exporters and importers. However, at the current stage of international relations based on the principle of solidarity among nations, it is no longer possible to speak of classic agreements, whose sole objectives have been to stabilize prices and insure a supply that would consistently satisfy demand.

The present concept of an international commodity agreement incorporates as a fundamental principle the economic development needs of the exporters, the social welfare of their peoples and the diversification of their production.

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The market situation I have described demonstrates the urgent need for undertaking the disciplined and effective negotiation of stabilization agreements to promote the economic development of the less advanced countries through mutual obligations of exporters and importers alike. If the organization of markets on the world level could prevent short-term price fluctuations and insure more favorable prices, it would help to solve some of the most serious problems affecting the economic development of Latin America.

Coffee and cocoa offer two clear-cut examples. The International Coffee Agreement illustrates what can be achieved when producers and consumers are willing to collaborate. In contrast, the sharp drops in cocoa prices, with their serious economic and social repercussions, exemplify the dangers of a disorganized market.

Transitory, compensatory measures against preferences outside the hemisphere

The existence of preferential markets established by certain industrialized countries in favor of specific developing countries has been one of the significant factors handicapping the normal expansion of export trade by the Latin American countries.

Latin America maintains the principle of nondiscriminatory preferential treatment for the developing countries in their trade relations with the industrialized nations. This principle is in accord with the position adopted by Latin America in requesting the generalization of preferences for the developing countries at the United Nations Conference on Trade and Development, and is consistent with the premises of the Charter of Alta Gracia, signed in April 1964.

CIAP feels that this principle is extremely important and constitutes a long-range objective. The difficulties encountered in its application within the agencies of the Trade and Development Board support this long-term view.

Meanwhile, since the Geneva Conference, the trend outside of the American Hemisphere has been to broaden trade preferences selectively and discriminatorily, particularly with reference to tropical products.

It is unfair that exports by certain developing countries which benefit from preferential treatment by their former metropolises or associated industrialized countries should enjoy indiscriminate access to the U.S. market in competition with Latin American exports, which have no preferential markets in any developed country.

This state of affairs endangers the prospects of the Alliance for Progress. For this reason, CIAP, although opposed to the creation of preferential trading blocs, has proposed for urgent consideration by the governments of the member states of the Alliance the adoption of a transitory hemispheric policy of protection designed to offset the harmful effects of discriminatory measures against Latin American exports. Such a policy could be based on commodity-by-commodity concessions on conditions aimed at attaining the Latin American goals in connection with preferences. This policy of hemispheric preferences would cease upon termination of the discriminatory practices cited above.

I do not wish to close without repeating my initial statement: the Alliance for Progress is a going concern, and its achievements to date permit us to hope that the goals proposed in the Charter of Punta del Este are within our grasp. However, we have taken only the first steps in this direction. New and more intensive efforts must still be made to consolidate our gains and to insure the realization of our goals.

The contribution of the United States to Latin American development has been positive, and not in vain. There are still areas, however, especially trade policy, which have not yet received proper attention. Much of the success of this undertaking will depend upon the resolve with which your country implements its cooperation in those areas.

Senator SPARKMAN. Tomorrow, we are going to be discussing U.S. trade arrangements in the Western Hemisphere.

First with special reference to Latin America, we will have Mr. Jack H. Vaughn, Assistant Secretary of State for Inter-American Affairs, and with special reference to the general economic policy of the United States, we have Mr. Anthony M. Solomon, Assistant Secretary of State for Economic Affairs.

That completes the work for today and the committee stands in recess until 10 o'clock tomorrow morning.

(Whereupon, at 11:53 a.m., the subcommittee was recessed, to reconvene at 10 a.m., Friday, September 10, 1965.)

LATIN AMERICAN DEVELOPMENT AND WESTERN HEMISPHERE TRADE

FRIDAY, SEPTEMBER 10, 1965

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON INTER-AMERICAN ECONOMIC
RELATIONSHIPS OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met at 10 a.m., pursuant to recess, in room AE-1, the Capitol, Representative Henry S. Reuss presiding.

Present: Senators Sparkman and Javits; Representatives Reuss and Curtis.

Also present: William H. Moore, economist; Donald A. Webster, minority economist; and Hamilton D. Gewehr, administrative clerk.

Representative REUSS. Good morning. The subcommittee of the Joint Economic Committee will be in order.

Senator Sparkman, our chairman, is on his way, but so as not to keep our witnesses waiting I would like to convene the session.

Our first witness this morning is Jack Hood Vaughn, Assistant Secretary of State for Inter-American Affairs and U.S. Coordinator of the Alliance for Progress.

Mr. Vaughn has just returned this week from what has been widely reported as a successful trip to Latin America. He was appointed to his present office in March of this year. He was previously U.S. Ambassador to Panama and Regional Director of Latin American Programs for the Peace Corps.

Our other witness is Assistant Secretary of State for Economic Affairs, Anthony M. Solomon, who has also had a special opportunity to understand Latin America. His previous positions have been Deputy Assistant Secretary for Inter-American Affairs, and Deputy Assistant Administrator for Economic Coordination in the Bureau for Latin America of AID, and he was president of the Rosa Blanc Corp. in Mexico City from 1954 to 1961.

Both of you gentleman have prepared statements and in accordance with our practice these will be admitted to the record, and we now would like to ask you, Mr. Vaughn, to proceed in any way you care to, either by reading your paper, going beyond it, or summarizing it.

STATEMENT OF JACK HOOD VAUGHN, ASSISTANT SECRETARY OF STATE FOR INTER-AMERICAN AFFAIRS

Mr. VAUGHN. I thank you very kindly. I would like to preface my remarks with a comment on what I have just seen in Central America.

I, of course, had discussed developments in this area over the years with our technicians involved in the Central American common market effort, the officials of ROCAP.[1] Yet I really didn't understand what was going on and what had been established in the Central American common market.

All of the stories that I heard are obviously true and they are even better than that. I was struck, also, by the side benefits and the byproducts that come from an effort and success in a common market effort.

In the areas of education, and communication, and health, you find tremendous strides have been made among and between the five Central American countries.

I also feel that one of the substantial benefits to be derived from economic integration and Common Market arrangements is a greater political-social stability and responsibility.

I think this is one of the things that has been accomplished in the Central American grouping and I am very much encouraged as we look forward to further moves in the Central American group and possible moves in the Caribbean and South America along similar lines.

What I want to say, Mr. Reuss, is I think we have a good model. I am not suggesting that mistakes haven't been made or that there are things that won't have to be corrected, but on balance I am much impressed with what these countries have done with some modest help from us.

It is a big plus on balance and I think that the countries individually, and the hemisphere in general, are much better off for their having made this great effort.

I welcome this opportunity to testify before you and to exchange thoughts with you about ways that we in the United States might work to strengthen the Alliance for Progress.

Tony Solomon and I have been preceded to this witness stand by distinguished men. I know from the brief opportunity I have had to study their testimony that each has used the occasion of these hearings to make still another contribution to what might be called the continuing dialog of responsibility about the future of Latin America.

I think it is appropriate, also, to note the record of achievement established by this subcommittee and its individual members. I shall not prolong this testimony by recounting the many ways our perception of inter-American relationships has been enriched by the activities of this subcommittee and its members—your hearings and subsequent report on "Private Investment in Latin America" are a good example of this—but I cannot let this opportunity pass without expressing a special word of thanks for the balanced, yet provocative and always challenging, views and actions in the field of Latin American relations that you, Mr. Chairman, and the ranking minority member of this committee, Senator Javits, have contributed to our thinking.

All who would understand Latin America better and who would work for a hemisphere where relationships between men and nations are marked by mutual respect are indebted to the members of this subcommittee for your leadership.

[1] Regional Office, Central America and Panama.

(Senator Sparkman enters.)

Mr. VAUGHN. Good morning, Mr. Chairman.

Senator SPARKMAN. Good morning.

Mr. VAUGHN. From my point of view, the timing of this hearing is particularly fortuitous. I have just returned from a series of conversations and observations in seven Latin American nations, and I should like to begin this morning by sharing with you a few impressions of what I saw and heard.

Everywhere I went I saw people seeking change. The new leadership in Latin America is determined that the old order must change and that the people must find a path to freedom, to justice, to opportunity.

Your own report on "Private Investment in Latin America" stated most succinctly:

> The worst enemy of freedom on all fronts is the concentration of power.

All enlightened leaders in Latin America agree with that proposition, whether the concentration of power be in the hands of government, of the military, of a religious body, or of private individuals or corporations.

Everywhere I went I saw progress. Ultimately, everything done under the banner of the Alliance for Progress—our statistics, our macroeconometrics, our schools built, teachers trained, dwelling units completed, roads paved, taxes collected—come to a single goal: people benefited.

I might add here that I was more struck in these seven countries I visited by the acceptance and the understanding of the people, the slum dweller, and the peasant, of what the Alliance was and meant than in certain other groups around the capital.

People are living in homes today in Peru for whom home financing was never before available; technicians provided by the Alliance for Progress helped Peruvians create a system of private savings and loan institutions through which savings were collected to build those homes.

Small farmers in El Salvador are building new herds of higher breed stock, an innovation inspired by a Salvadoran extension service trained by U.S. Department of Agriculture specialists and financed by long-term loans made available from an AID loan for supervised agricultural credit.

In Mexico, my colleague, Mr. Solomon, and Mr. Mann and others were instrumental in getting a system devised whereby small farmers who never before in the history of Mexico had been able to qualify for agricultural loans, are now getting loans through the participation of private banks.

The story is repeated again and again. Everywhere I went I saw evidence that the benefits of the Alliance are reaching the people of Latin America.

The aggregate of the Alliance accomplishments is also impressive. President Johnson gave these totals in his address August 17 commemorating the fourth anniversary of the Alliance:

> In 1964 Latin America exceeded the 2½-percent per capita growth rate that is the target of the Alliance;
>
> In 4 years, the United States has made available $4½ billion in grants, loans, goods, and technical assistance; the Latin American nations have matched this with the investment of more than $22 billion in development;

Ten nations have development programs;
Most nations have enacted tax administration reforms;
Fourteen nations have land reform programs underway;
Twenty-five million people, including 13 million children, are receiving food through the Alliance;
More than 1½ million Latin Americans live in new homes;
A million children attend school in new classrooms and 10 million textbooks have been distributed;
Many hundreds of thousands are served by 850 hospitals, health centers, and health units;
More than half the people of Latin America are protected from malaria.

The President summarized the progress of the Alliance in this manner:

* * * * * * *

> This 4 years has been the greatest period of forward movement, progress, and fruitful change in the history of the hemisphere. And the pace is increasing.

I observed in these last weeks that in the overall sense, the Alliance has made two contributions of great importance. First, the reform measures that have been taken—in land, education, public administration—have laid the groundwork for progress and social justice.

And, second, the real efforts that the nations of Latin America are making to halt inflation and achieve sound economic planning are creating the environment for even greater progress.

One evidence that the Alliance is paramount in the minds of the leaders of the hemisphere is the growing amount of comment about it.

The Alliance is not an unmixed blessing in the minds of many, but on balance, the enlightened leaders of our hemisphere are firmly committed to the economic, political, and social goals of the Alliance.

I have given this brief summary of what has been achieved by the Alliance for Progress because I thought it might help you, as it helps me, to consider the matter of Latin American integration within the context of the Alliance experience.

I have given this brief summary of what has been achieved by the Alliance for Progress because I thought it might help you—as it helps me—to consider the matter of Latin American integration within the context of the Alliance experience. I am certain the members of this subcommittee fully understand the long-range nature of our commitment to Latin America and the importance to our Nation that the rest of the hemisphere enjoy at the earliest possible moment the material affluence and political freedom that we in this Nation have been so privileged to possess. So long as any nation in the hemisphere is without freedom, and any men are without hope, our own freedom and aspirations are jeopardized, and must ultimately be undermined.

Now, I should like to discuss some other specific topics concerning Latin America's economic problems and involving special U.S. relationships with the area.

Too often, perhaps, the Alliance has been characterized as an effort concentrating on increasing investment in Latin America to improve economic growth and social improvement.

The range of activities and multitudinous areas of interest which are related because they also bear importantly on development, are treated improperly as if they were apart from our common effort.

One of these areas is international trade. The success of the Alliance is not only closely bound to the building of infrastructure and industry, to the betterment of housing, health, and education, and to reform and modernization of the economic and social structures, but it is heavily dependent upon a satisfactory growth and development of Latin America's foreign trade.

Export earnings are vital to the viability of the development plans and the United States is acutely aware that it must lend strong support to Latin American efforts to diversify, stabilize, and increase its trade.

Allow me, therefore, to review recent developments in this field and to make a few comments on prospects for the near future.

Latin America's export trade has grown markedly in recent years and is now nearing the $10 billion mark—1964 was a good year for most Latin American countries.

A prolonged industrial boom in the United States and Western Europe brought a sharp increase in the price of industrial raw materials—especially metals—and the prices of agricultural products held at relatively high levels throughout most of the year, sugar and cocoa being notable exceptions.

Total exports of the 19 American Republics rose by some $700 million or 7.5 percent last year. Figures for the first quarter of 1965—the latest available—indicate that trade is off about $300 million this year and that final figures for 1965 may stand about halfway between 1963 and 1964—but still roughly a billion dollars above 1962.

Improved export earnings were reflected, as is usual, in a higher rate of imports. Imports from all sources rose to almost $8.5 billion in 1964.

In the early part of this year, however, they were down by some 10 percent as a number of countries were forced to introduce or tighten import control measures to meet serious balance-of-payments problems which arose for a variety of reasons, in most cases unassociated with trade problems, which I shall discuss later.

TABLE I.—*Exports and imports of 19 Latin American Republics, 1960–64*

[In millions of dollars]

	Exports (f.o.b.)					Imports (c.i.f.)				
	1960	1961	1962	1963	1964	1960	1961	1962	1963	1964
Latin America	7,950	8,090	8,640	9,190	9,890	7,690	7,950	8,040	7,860	8,490
Argentina	1,079	964	1,216	1,365	1,410	1,249	1,460	1,357	981	1,077
Bolivia	51	58	59	66	86	69	73	92	98	97
Brazil	1,269	1,403	1,214	1,406	1,433	1,462	1,460	1,475	1,487	1,263
Chile	488	506	530	540	623	500	585	518	637	609
Colombia	466	435	463	446	548	519	557	540	506	586
Costa Rica	86	84	93	95	133	110	107	113	124	139
Dominican Republic	174	143	172	174	180	100	80	148	184	220
Ecuador	144	127	143	149	154	114	106	97	129	169
El Salvador	117	119	136	154	178	122	109	125	152	191
Guatemala	117	113	117	154	158	138	134	133	166	202
Haiti	33	32	42	41	40	36	42	46	39	41
Honduras	63	73	81	83	95	72	72	80	95	102
Mexico	764	826	930	985	1,055	1,186	1,139	1,143	1,240	1,493
Nicaragua	56	61	82	100	118	72	74	97	111	137
Panama	27	30	48	60	68	128	146	171	192	198
Paraguay	27	31	33	40	50	38	41	40	38	40
Peru	430	494	538	540	666	373	468	534	552	571
Uruguay	129	175	153	165	179	218	209	230	177	198
Venezuela	2,432	2,413	2,594	2,629	2,740	1,118	1,092	1,096	950	1,155

NOTE.—Figures do not add to totals because of rounding.

Source: International Financial Statistics, August 1965.

Much of this trade (nearly 40 percent) was with our country; U.S. exports to Latin America during 1964 reached a level of $3.8 billion, some 16 percent above the 1963 level. The year 1964 marked a reversal of both the downward movement of the U.S. share in the Latin American market of the past few years and of the negative U.S. trade balance with the area experienced in 1963 (table II). U.S. imports from Latin America increased by $173 million in 1964 to an alltime high of $3,524 million.

TABLE II.—*Total imports and U.S. share of the market, 1961–64, for 19 Latin American Republics*

	Imports from world (c.i.f.) [1] (in millions of dollars)				Imports from United States (c.i.f.) [1] (in millions of dollars)				U.S. share of market (in percent)			
	1961	1962	1963	1964	1961	1962	1963	1964	1961	1962	1963	1964
Argentina	1,460	1,357	981	1,077	383	396	242	255	26.2	29.2	24.7	23.7
Bolivia	78	93	104	103	33	39	50	53	42.3	41.9	48.1	51.4
Brazil	1,460	1,475	1,487	1,263	515	457	457	436	35.3	31.0	30.7	34.5
Chile	591	518	638	607	238	200	224	257	40.3	38.6	35.1	42.3
Colombia	539	540	506	586	279	283	263	284	51.8	52.4	52.0	48.4
Costa Rica	106	112	124	143	50	53	59	63	47.2	47.3	47.6	44.1
Dominican Republic	78	129	160	[2] 160	30	63	81	[2] 81	42.9	48.8	50.0	[2] 50.0
Ecuador	101	97	129	169	48	44	50	76	47.5	45.4	38.7	44.9
El Salvador	108	125	152	191	43	46	51	67	39.8	36.8	33.6	34.9
Guatemala	134	133	166	202	64	65	80	90	47.7	48.9	48.2	44.5
Haiti	25	45	36	36	[3] 26	[3] 24	[3] 21	[3] 24	74.3	53.3	58.3	66.6
Honduras	73	80	95	102	38	41	46	50	52.1	51.3	48.4	48.5
Mexico	1,139	1,143	1,240	1,493	798	783	850	1,023	70.1	68.5	68.5	68.5
Nicaragua	74	98	111	137	36	50	54	65	48.6	51.0	48.6	47.4
Panama	123	148	163	168	64	67	74	73	52.0	45.3	45.4	43.4
Uruguay	35	34	33	34	5	11	10	7	14.3	32.3	30.3	20.6
Peru	469	538	557	580	207	213	208	236	44.1	39.6	37.3	40.7
Paraguay	206	231	177	198	47	44	27	31	22.8	19.0	15.3	15.7
Venezuela	992	985	871	55	536	518	470	634	54.0	52.6	53.9	54.9
Total	7,794	7,880	7,727	8,405	3,439	3,397	3,313	3,768	44.1	43.1	42.9	44.8

[1] Except Venezuela, which reports on f.o.b. basis.
[2] Data for 1964 not available. 1963 totals carried forward.
[3] U.S. export statistics used.

Source: Importing country data compiled from foreign statistics by Irene Johnson, Bureau of International Commerce, American Republics Division, U.S. Department of Commerce.

Other important markets are Western Europe and Japan. The EEC nations regularly run a deficit in trade with Latin America. In 1964 the negative balance had reached $728 million. The outlook for 1965, based on the first quarter, is for a slight narrowing of the gap to about $660 million. EEC imports from the Latin American Republics in 1964 totaled about $2.4 billion and their exports to the area about $1.6 billion. This was an increase in exports of about 5 percent and of imports of about 9 percent as compared with 1963 (table III). Trade with the European free trade area in 1964 was at approximately the 1963 level, exports to Latin America amounting to about $900 million and imports from Latin America up 4 percent to about $1,440 million. Japan's exports to Latin America in 1964 totaled $436 million and imports were about $600 million. Trade in the first quarter of 1965 showed a slight decline, but was still well above the 1963 level for both imports and exports.

TABLE III

(a) *Monthly average trade with the 19 Latin American Republics*

[In millions of dollars]

	Exports to Latin America				Imports from Latin America			
	1962	1963	1964	1st quarter 1965	1962	1963	1964	1st quarter 1965
EEC	137	126	132	140	163	184	201	195
Japan	23	23	28	26	35	43	50	48
EFTA	71	76	75	80	104	115	120	122
United States and Canada	281	291	345	346	306	317	330	354

(b) *Indicated annual trade (constructed from monthly rates)*

[In millions of dollars]

	Exports to Latin America				Imports from Latin America			
	1962	1963	1964	1st quarter 1965	1962	1963	1964	1st quarter 1965
EEC	1,644	1,512	1,584	1,680	1,956	2,208	2,412	2,340
Japan	276	276	436	312	420	516	600	576
EFTA	852	912	900	960	1,248	1,380	1,440	1,464
United States and Canada	3,372	3,492	4,140	4,152	3,672	3,804	3,960	4,248

Source: Compiled from OECD publication "Foreign Trade—Series A," July 1965, by eliminating from trade with "America" the following: Canada, United States, Cuba, Jamaica, French Antilles, Trinidad and Tobago, Netherland Antilles, Surinam.

Since the Guianas and British Honduras are included in "Other countries" they could not be eliminated without also eliminating Central America, Bolivia, and Paraguay, which are not separately listed.

Senator SPARKMAN (presiding). May I interrupt just to clarify something in my mind. You referred to 19 American Republics. That is all of them except the United States and Canada, is that right?

Mr. VAUGHN. And that is excluding Cuba.

Senator SPARKMAN. And excluding Cuba.

Mr. VAUGHN. Yes, sir.

Senator SPARKMAN. So it would be Canada, United States, and Cuba—the 19, excluding those 3.

Mr. VAUGHN. "Latin American Republics," I think, is the correct term.

Senator SPARKMAN. You said "American Republics" and I just wanted to be sure we had it straight.

Thank you.

Mr. VAUGHN. In the early part of this year, however, they were down by some 10 percent as a number of countries were forced to introduce or tighten import control measures to meet serious balance-of-payments problems which arose for a variety of reasons, in most cases unassociated with trade problems, which I shall discuss later.

Prediction is always dangerous, but we must attempt some forward analysis of Latin America's export prospects in order to assess the area's ability to carry forward its plans for economic development on the basis of its own resources and to gage the assistance which may be needed from the industrial countries.

In large measure the trade prospects of Latin America, as of other countries which depend heavily on exports of food and industrial raw materials, are associated with the outlook for industrial expansion in the more developed countries.

The OECD, which includes the major industrial countries of Western Europe, Japan, Canada, and the United States, reported at midyear that there is indication of a slowing down in the rate of growth of industrial activity which is already affecting both the volume and the price of imports of raw materials.

In volume terms, imports into OECD countries were rising at the rate of 8 percent per year from the beginning of 1962 to the middle of 1964. The recent slowdown of growth, especially in Europe and Japan, has so far had a rather limited effect on the volume of imports.

But, this somewhat slower growth, combined with developments on the supply side, was enough to reverse the rise in commodity prices beginning late in 1964.

The big question is whether this falling trend in the prices of primary commodities is likely to continue. The general price index reached a peak in the early months of 1964 under the influence of the sharp rise in sugar prices.

The subsequent fall in sugar quotations more than offset the rise in the prices of nonferrous metals which continued through most of the year. Prices of other agricultural products were stable at a relatively high level until the fourth quarter, when they fell sharply.

Food prices were affected by good crops of both tropical foodstuffs and grain; the decline in wool prices reflected slackening demand in European textile industries.

Since the beginning of 1965, agricultural prices have moved little either way, but nonferrous metal prices, which declined at the end of 1964 and in the early months of 1965, had recovered much of their loss by midyear.

For the second half of the year, OECD analysts anticipate a slowing down in growth of industrial production from 3 percent a year to 2 to 2½ percent, and continued downward pressure on commodity prices, but not to the same extent as in 1964, and not for all products.

Turning from the general problem of the primary producers to the outlook for those specific commodities which figure heavily in Latin America's export trade, we can narrow the field to nine commodities, which account for some 70 percent of total Latin American exports.

They are, in order of importance in value terms, petroleum, coffee, cotton, copper, meat, sugar, wool, iron, and bananas (table IV).

TABLE IV.—*Relation between the values of 9 export products and the value of total Latin American exports (in percentages of the total)*

	1960	1961	1962	1963	Average, 1960–63
Petroleum	28.5	29.3	28.5	27.2	28.4
Coffee	18.2	17.0	15.9	15.6	16.7
Cotton	4.1	5.0	6.1	5.7	5.2
Copper	5.3	5.0	5.0	4.9	5.1
Meat	3.8	3.8	4.0	4.8	4.1
Sugar	3.2	3.5	3.0	3.7	3.4
Wool	2.7	3.1	2.6	2.7	2.8
Iron	2.9	2.5	2.3	2.0	2.4
Bananas	2.4	2.3	2.1	2.2	2.2
Total, 9 products	71.1	71.5	69.5	68.8	70.3

NOTE.—In estimating these percentages account has not been taken of the exports of these products by those countries where their importance is relatively small.

Sources: Minutes and working documents of the subcommittees of the CIAP: "International Financial Statistics," published in the Alliance for Progress, 1963–64, p. 68.

Some are important to many countries; some to only a few. Meat accounts for over 20 percent of Argentina and Paraguay's total exports. Three countries, Panama, Honduras, and Ecuador, derive one-half or more of their foreign exchange from bananas. Six countries depend on coffee for 40 percent or more of their export receipts. Venezuela is almost totally dependent on petroleum—over 90 percent; almost two-thirds of Chile's earnings are from copper and a fourth of Peru's; 80 percent of Bolivia's are from tin; cotton has become increasingly important to Mexico and Central America in recent years, and now accounts for one-fifth of Mexico's exports and 37 percent of Nicaragua's. We should add to the list fishmeal, which is now a major export of Peru (24 percent of total exports) and a growing industry in Chile (table V).

TABLE V.—*Relation between the value of exports of the principal export product of each country and the value of total exports*

[In percentages of the total]

	Products	1960	1961	1962	1963	Average 1960–63
Argentina	Meat	20.3	22.5	18.8	24.5	21.6
Bolivia	Tin	78.7	83.9	87.1	79.7	82.4
Brazil	Coffee	56.0	50.5	52.9	52.8	53.0
Colombia	do	67.0	66.7	69.5	65.4	67.1
Costa Rica	do	53.2	51.2	51.6	47.5	50.8
Chile	Copper	62.8	63.6	64.7	62.7	63.5
Ecuador	Bananas	53.9	61.1	55.7	62.6	60.0
El Salvador	Coffee	79.0	60.9	54.8	48.8	59.2
Guatemala	do	65.6	62.8	62.4	53.0	60.5
Haiti	do	44.6	40.1	52.1	37.1	43.5
Honduras	Bananas	44.2	58.2	45.7	40.9	47.1
Mexico	Cotton	20.1	18.9	23.1	19.5	20.5
Nicaragua	do	23.0	26.2	34.6	37.3	31.5
Panama [1]	Bananas	60.3	62.0	43.5	43.0	52.2
Paraguay	Meat	19.3	19.6	22.3	26.8	21.9
Peru [2]	Copper	21.3	20.5	16.5	16.0	18.4
Dominican Republic	Sugar	55.9	48.2	57.1	57.9	55.1
Uruguay	Wool	51.6	62.9	53.2	51.5	55.1
Venezuela	Petroleum	90.9	92.8	93.5	93.6	92.7

[1] Excludes exports of goods to the Canal Zone.
[2] In 1963 the principal export product of Peru was fishmeal (23.7 percent of the total) and the 2d ranking was cotton (17.5 percent). The average participation of these products in the total value of exports during 1960–63 was 14.2 percent for the fishmeal and 16.9 percent for cotton.

Source: Minutes and working documents of the subcommittees of the CIAP: "International Financial Statistics," published in the Alliance for Progress, 1963-64, p. 69.

What is the outlook for these commodities? I am including, for the record, two tables based on data published by the International Monetary Fund. One shows the annual average price for selected years for these products and latest quotations (table VI).

TABLE VI.—*Comparative prices of principal Latin American exports, 1958, 1963, 1964, and latest available*

[In U.S. cents per pound except as noted]

Commodity		1958	1962	1963	1964	1965
Metals:						
Copper:						
June	United States	26.3	31.0	31.0	32.30	36.0
Do	United Kingdom	24.7	29.3	29.3	43.84	59.2
Lead:						
June	United States	12.2	9.6	11.2	16.00	16.0
Do	United Kingdom	9.1	7.0	8.0	17.40	12.6
Silver (ounce): August	United States	89.0	$1.27	$1.29	$1.29	$1.29
Tin: August	do	95.0	$1.145	$1.167	$1.58	$1.86
Zinc:						
June	do	10.8	12.0	12.5	14.04	15.0
Do	United Kingdom	8.3	8.4	9.7	14.88	14.26
Foods:						
Beef:						
June	United States	29.9	29.2	27.3	28.70	32.0
Do	United Kingdom	29.9	29.2	27.3	34.8	39.08
Cocoa: June	United States	43.9	20.8	25.3	23.4	13.3
Coffee:						
June	Colombia	52.3	40.8	39.6	48.8	47.5
March	Brazil	40.3	29.7	29.0	38.4	41.9
Sugar:						
June	United States	6.3	6.4	8.1	7.00	6.80
Do	Caribbean	3.5	3.0	8.5	5.89	1.97
Wheat (bushels):						
March	Argentina	$1.62	$1.67	$1.77	[1] $1.78	$1.57
June	United States	$2.03	$2.14	$2.18	$1.88	$1.45
Raw materials:						
Cotton: June	United Kingdom	28.2	27.6	26.6	26.3	27.4
Nitrates (tons): June	Chile	$48.9	$48.0	$48.0	$48.0	$48.0
Petroleum (barrels): June.	Venezuela	$3.05	$2.8	$2.8	$2.8	$2.8
Wool:						
March	Argentina	39.2	37.7	48.0	53.8	39.9
Do	Uruguay	47.5	56.6	63.2	70.4	55.6
Do	United States	48.0	57.7	62.4	68.2	60.5

[1] November.

The other is a country table showing the index of export prices for each Latin American country through 1963 and for the latest quarter of 1964 or 1965 for which data are available (table VII).

TABLE VII.—*Indexes of Latin American export prices compared with those of all industrial countries and the United States* [1]

[1958=100]

Latin America	1960	1961	1962	1963	1964	1964: 1st quarter	1964: 2d quarter	1964: 3d quarter	1964: 4th quarter	1965, 1st quarter
Argentina	108	107	99	108	-------	120	123	116	-------	-------
Bolivia	107	113	116	118	152	136	138	164	180	161
Brazil	83	85	80	81	96	94	97	95	98	-------
Chile	115	108	110	110	117	110	119	118	126	-------
Colombia	87	84	80	78	92	88	93	95	93	-------
Costa Rica	86	83	84	83	89	86	89	88	91	-------
Dominican Republic	86	80	99	114	117	133	115	117	102	95
Ecuador	91	81	84	84	82	78	82	83	83	81
El Salvador	81	78	71	74	-------	77	81	-------	-------	-------
Guatemala	86	82	82	77	-------	-------	-------	-------	-------	-------
Haiti	88	84	79	83	-------	99	106	-------	-------	-------
Honduras	90	89	109	117	119	118	119	119	119	-------
Nicaragua	91	88	88	91	-------	99	105	101	-------	-------
Panama	95	83	97	98	97	95	97	97	96	98
Peru	103	100	103	108	-------	-------	-------	-------	-------	-------
Uruguay	118	111	116	124	138	139	146	131	131	117
Venezuela	92	92	92	92	92	92	92	92	92	92
17 Latin American Republics: [2]										
Including petroleum	94	93	91	93	102	99	102	100	102	-------
Excluding petroleum [3]	97	96	95	104	113	118	114	112	109	107
Industrial countries	100	101	100	101	103	103	103	104	105	-------
United States	101	103	102	102	103	103	102	103	105	-------

[1] Weighted index of export prices to all areas.
[2] Not including Paraguay and Mexico.
[3] Compiled by National Institute for Economic and Social Research (a United Kingdom organization) with 1957 weights. IFS index uses 1957–59 weights.

Source: "International Financial Statistics," August 1965.

Since so many countries are heavily dependent on a single commodity, the table provides a rough index of the trend of prices of commodities important in the export trade of individual countries.

PETROLEUM

The index of export prices for Venezuela, which is made up of 90 percent petroleum, has remained unchanged for the past 5 years, and the outlook is for continued stability in the receipts from this first-ranking Latin American export product.

COFFEE

Coffee prices have remained relatively stable for the past 6 months, and we are hopeful that with the International Coffee Agreement now in full effect there will be no sharp downward fluctuation in coffee prices. This year's coffee crop is very large in relation to normal world requirements, and the producing countries will have to exercise discipline in their seasonal marketing and some will have to diversify out of coffee and into other products over the long term to maintain price stability. Production control is a major item on the agenda for the next meeting of the Coffee Council. I am confident that with the assured cooperation of the consuming countries the producing countries will be able to work out satisfactory measures of control and maintain their income from this product at a satisfactory level.

COTTON

Cotton prices have been among the most stable, and should remain relatively so. With the rapid growth in production in countries outside the United States there is likely to be downward pressure on world prices. However, the United States is a large factor in the world market, and has customarily utilized its position as residual supplier to avoid market instability. Any decline in cotton prices will probably be small, and should help the cotton-producing countries hold their markets against the growing competition of synthetic fibers. Increases in volume can compensate, incomewise, for a decline in price, although sharp price fluctuations are undesirable.

COPPER

Copper prices are well above the levels of recent years, and show little sign of weakening. The long-term outlook for copper is good. The prices of other nonferrous metals such as lead and zinc are also being well maintained and there appears to be no immediate threat to Latin American earnings from this source.

MEAT

Beef prices are at a very satisfactory level. The average price in June in the United Kingdom market was 39 cents, compared with 27 cents in 1963 and 35 cents in 1964. Latin America's problem here is to rebuild its herds to be able to take advantage of the relatively high prices. The volume of exports from the areas's major meat-exporting countries has been declining in recent years.

SUGAR

Sugar presents a different picture. The world market price is currently at the lowest figure in 25 years—1.6 cents per pound. However, Latin America in 1964 sold only about 923,000 tons out of total exports of 2.5 million tons, or 36 percent of its exportable supply on the world market. Under existing U.S. sugar legislation the Latin American countries are marketing about 1.7 million tons in the United States at an average price of about 5.6 cents per pound, and under the administration's proposals for new sugar legislation they would have an assured market for at least this quantity for the next 5 years, with some increase as U.S. consumption grows. Their income from sugar will not be subject to the sharp fluctuations which affect producers who depend entirely on the world market.

This is not to indicate a lack of concern with the world market problem. We expect to make every effort to help bring to a successful conclusion the Conference which has been called by the United Nations for September 20 to try to work out a new international sugar agreement, with a price objective which would give producing countries a fair return for sugar sold in the world market as well as for that shipped under quota to the United States.

WOOL

Wool is of major importance to Argentina and Uruguay. Both are experiencing problems in marketing their crop, but these appear more related to their financial policies rather than to any surplus of wool in world markets. Prices are off from the very high levels of 1964, but have been improving recently, with estimates of world production off about 2 percent. Argentina has a good crop, but Uruguay's production will be substantially reduced as a result of drought. If there should be a serious problem affecting the wool trade, international cooperation is assured through the Wool Study Group, of which the United States is a member, as well as the major producing countries. Here, as in meat, Latin America's problem is to increase its volume of sales, which has shown little change in the last decade.

IRON ORE

Iron ore, which scarcely figured in Latin America's export trade a few years ago, is becoming increasingly important and now accounts for about 2.5 percent of total exports, ranking with bananas. There has been some softening in prices of high-grade ores, as a result of new techniques which improve the usability of low-grade ores. However, the market for iron ore is an expanding one, and as new resources are developed there is no doubt that there will be a satisfactory market for them which will contribute increasingly to the income of Brazil, Venezuela, and other countries.

BANANAS

The outlook for bananas varies from country to country. Consumption shows little change, as the United States accords free entry to bananas and demand increases at about the rate of our population growth. We are working with the producing countries to try to obtain more liberal entry for their bananas in European markets, where there are duties, and where the market might be expanded if restrictions were abolished. The problem, at the moment, is to adjust production to match a slowly growing demand. One country runs into a disease problem, and another country increases its production to fill the gap. As disease control measures become effective, production returns to normal in the first country and the second is faced with a problem of oversupply. The problems facing banana producers are recurrent, and the United States has urged the establishment of a Banana Study Group, under the Food and Agriculture Organization, which will help producing countries to cooperate in developing a clearinghouse of information and studying the market outlook. as is now done for other major commodities.

OTHER

Two other commodities should be mentioned—fishmeal, because the outlook is so favorable—and cocoa, because the outlook is so unfavorable. The fishmeal industry which has grown up on the west coast of South America during the past 10 years is a resource, formerly unrecognized, which will contribute greatly to Latin Amer-

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ica's income. There is a great demand for the product, and prices remain high despite a constantly growing production.

Cocoa is relatively unimportant in the total trade picture of Latin America. Exports of cocoa and cocoa butter amount to only about $90 million in a total export trade of almost $10 billion. Nevertheless, it is important to the development of certain areas in a number of countries, and the recent decline in prices to a 24-year low is a matter of concern. Here, too, we are working intensively with international organizations in a search for ways to prevent the very sharp price fluctuations which have been typical of cocoa.

From the foregoing, you will conclude with me that while there appears little reason to fear any serious widespread fall in export earnings, there is good cause for the concern which has been expressed concerning prospects for the needed substantial growth in export trade. We share that concern and, as I have stated, we are stepping up our efforts to take those actions which offer the best prospects for stabilizing and improving the market prospects of commodities on which Latin America will be heavily dependent for some time to come.

Our concern for the improvement of the area's export earnings has increased the urgency with which we view efforts to speed the establishment of export-oriented industries in Latin America, to promote exports of the area's manufactured and semimanufactured goods and to reduce trade barriers generally for both commodities and industrial products. Therefore, in our assistance efforts in the hemisphere, we give high priority to projects which will increase the export potential of the various countries. We have stimulated and are cooperating with inter-American groups planning and organizing export promotion activities and intend to assist them in executing their programs when these are formulated and approved. Mr. Solomon is prepared, I believe, to discuss U.S. efforts seeking reduced world trade barriers and I will leave that subject for him, adding only that we are convinced that Latin America will benefit substantially if our efforts in this direction succeed.

Turning now from the vital topic of export earnings I would like to comment on a related factor, the external indebtedness of Latin American countries and on U.S. action to assist in resolving the problems which have arisen from it.

We have all been aware that debt servicing requirements are a serious burden on the balance of payments of many of our partners in the Alliance, limiting their freedom to use current export earnings for development programs and thus endangering the continuance of the drive toward economic advance.

During the past decade the rapid growth of external indebtedness of the Latin American Republics has caused amortization payment obligations of a number of countries to approach or even exceed their capacity to pay, as measured by their foreign exchange earnings and reserves. As a result, some of the Latin American governments in recent years have had to request creditor nations to refinance their debts. Not only political considerations, but also the economic interest of the creditor countries have impelled them on these occasions to agree to a debt refinancing in order to avoid possible defaults.

In most of these cases, the debt burden was caused by an excessive recourse by the debtor country to short- and medium-term suppliers' credits.

A large proportion of this type of credit has been extended by the European nations; nevertheless, the Latin American debtor government when it found itself in difficulties has approached the U.S. Government for debt relief as well as the Europeans. Prior to 1964, the Eximbank had provided debt relief to Argentina and Brazil on a bilateral basis, albeit concurrently with negotiations by these two countries with European governments for similar refinancings. The Europeans, since the mid-1950's have negotiated debt refinancings with Latin American and other governments as a bloc, working through ad hoc conferences which were convened as required. These informal groupings of creditor governments, which after the locale of the meetings have come to be known as the Paris or Hague Clubs, negotiate with the debtor government uniform terms and conditions to be followed in the debt refinancings. The terms and conditions are later embodied in bilateral agreements between each of the creditor governments and the Latin American government concerned.

In 1964, when the Brazilian Government broached the need for debt relief to major creditor governments, the United States decided to participate as a full member of the Hague Club, which was convened to work out a multilateral creditor position and to negotiate an agreement with Brazil. Subsequently, the United States took part as a full member in two Paris Club meetings, one in February of this year which negotiated a debt refinancing agreement with Chile, and the second this past June which performed a similar function in the case of Argentina. The United States has obtained substantial benefits by becoming a full member of the creditor "clubs":

1. U.S. participation has permitted us to take part in the formation of the body of precedent which has grown up out of these recent refinancing operations, and thereby to influence the terms and conditions of these and future debt refinancing agreements;

2. The United States has been able to safeguard its interest as a creditor by insuring that it will not accord more generous debt relief than the Europeans. Previously, when the Eximbank negotiated solely on a bilateral basis, it ran the risk that it would give more generous relief and thereby indirectly help pay off European suppliers;

3. By our participation we have been able to encourage the Europeans to accord reasonable refinancing terms and this has had the effect of lengthening the maturities of European credits to Latin America;

4. We have been able to insure that self-help measures consistent with the Alliance for Progress are an important consideration in the creditors' decision whether to extend debt relief and how much to extend.

GENERAL PRINCIPLES

The body of precedent which has emerged from the refinancing agreements of the past year and a half include the following terms and conditions:

1. The agreements cover not more than 2 years' repayments, although the creditors usually undertake to have another look at the problem at the end of that period. This permits the creditors

to exert some continuing influence on the debtor government to follow satisfactory economic policies, since the debtor knows that performance will influence the creditors' willingness to refinance in the future.

2. Only government-guaranteed suppliers' credits, or direct government credits are included in the refinancings. This prevents the creditor government from bailing out private suppliers who have not availed themselves of the protection of their governments' guarantee and insurance programs. Long-term development assistance, such as AID's Alliance for Progress loans, are excluded on the grounds that the terms of such loans are already so generous that they cannot be said to be contributing to the debt burden problem.

3. The refinancing or rescheduling is for a percentage of principal payments and does not cover interest. This protects the U.S. position, inasmuch as the Eximbank's credits are usually on longer terms than those of the Europeans and therefore have a higher proportion of interest.

4. The debtor must undertake to follow sound financial policies in an attempt to prevent a recurrence of the balance-of-payments difficulties. If the country has an IMF standby agreement, the performance conditions embodied therein are considered sufficient; otherwise, the creditors may define specific commitments which they believe are necessary to strengthen the balance of payments. In addition, the agreements invariably require specific limitations on future acquisitions of supplier credit debt, and if commercial or financial arrears exist, the debtor government must undertake to reduce them over a reasonable period of time.

BRAZIL

Under the Hague Club agreement of July 1, 1964, the United States, Japan, and six Western European Governments agreed to reschedule or refinance the equivalent of 70 percent of payments falling due in 1964 and 1965 on official or officially guaranteed project loans and suppliers' credits.

In accordance with the multilateral agreement, a bilateral agreement was signed in September 1964 between Eximbank and the Government of Brazil by which $66 million of principal payments due in 1964 and 1965 were rescheduled. In addition to its obligations under the Hague Club, the United States also agreed to reschedule $51 million in principal payments due in 1964 and 1965 on certain nonproject and short-term stabilization credits of the Eximbank and the U.S. Treasury.

In October 1964, Brazil concluded an agreement with a group of major U.S. private suppliers for the rescheduling of about $70 million in payments due in 1964 and 1965 on terms similar to those agreed in the official Hague Club rescheduling agreement.

CHILE

At a Paris Club meeting in February 1965, 11 creditors, including the United States, agreed to reschedule or refinance the equivalent of 70 percent of principal payments due in 1965 and 1966 on certain government project credits and government-guaranteed suppliers' credits to Chile. After a 2-year grace period, the rescheduled 1965 maturities are repayable between 1968 and 1972 and the 1966 maturities between 1969 and 1973. Chile undertook to limit the acquisition of new suppliers' credits during 1965 and 1966 to an amount not greater than net repayments, and to reduce commercial arrears over time. Under this agreement, the Eximbank has rescheduled approximately $40 million in principal payments; in addition, AID rescheduled repayments of $2.6 million on an old ICA loan which had been made for balance-of-payments support and which was repayable in 10 years.

ARGENTINA

In 1962 and 1963 the Paris Club and the United States, acting separately, refinanced certain Argentine debts. Government and Government-guaranteed debt repayments scheduled for 1964–66 were at record levels, however ($519 million in 1964, $489 million in 1965, and $369 million in 1966). Although a large trade surplus helped Argentina to get through 1964, the Government in the spring of 1965 sought another debt rescheduling from the Paris Club to cover 1965 and 1966 debts. In June 1965, the representatives of the Paris Club, including the United States, agreed to reschedule or refinance 60 percent of principal payments due in 1965 only, and to consider the 1966 situation later in the year in the light of prevailing circumstances. The absence of a standby agreement between the IMF and Argentina was a major reason for the creditor's reluctance to reschedule over a longer period or in greater amounts. The refinanced amounts are to be repaid over a 5-year period beginning in 1968. Argentina agreed to maintain a flexible exchange rate (to be tested by the maintenance of foreign exchange reserves at the level as of the end of 1964), not to increase the level of suppliers' credits during 1965 and 1966, and to eliminate the backlog of exchange applications for remittances by April 1966.

I turn now to the subject which is being given primary attention during this series of hearings and in which the subcommittee so often has shown a keen interest. As you know, the United States has long supported integration of the developing economies of Latin America. This support was first formally and most prominently expressed in our signing of the Charter of Punta del Este in 1961, and has been an integral part of the common effort to accelerate economic development in Latin America throughout the history of the Alliance for Progress. We have since reiterated in official statements, and through the concrete assistance we have rendered, the importance which the United States gives to the need to move forward with the integration of Latin America.

Thus, U.S. support for effective movement toward integration was again clearly indicated by Vice President Humphrey on the occasion of Pan American Week commemorative ceremonies in April 1965 when he identified integration as essential to economic and political development in the area and looked forward to increased, mutually advantageous, trade and financial relations between the United States and an integrated Latin American region. In May 1965, U.S. delegates to the annual meeting of the Economic Commission for Latin America, expressed our view that Latin America must pursue progress toward economic cooperation as rapidly as possible; this was again made explicit by President Johnson only a few weeks ago, on the anniversary of the Alliance, when he told Latin American ambassadors to the United States:

> * * * we must try to draw the economies of Latin America much closer together. The experience of Central America reaffirms that of Europe. Widened markets—the breakdown of tariff barriers—leads to increased trade and leads to more efficient production and to greater prosperity.

U.S. readiness to extend support and encouragement in this field arises from our conviction that real and effective economic integration can, through broadening the markets available to Latin American producers, hasten the growth and diversification of industry that will lead to greater employment opportunities and increased incomes. Industries limited by the inadequacies of prospective markets cannot avail themselves fully of new technology and rational organization which make possible economies of scale and which enhance the productivity of both labor and invested capital.

In Latin America today industry exists in every country. In some, however, the industrial sector consists largely of small units using easily mastered processes to produce simple types of consumer goods in limited volume. Small national markets discourage the investment required to improve existing industries or to establish plants of increased size and complexity. In the larger Republics industrialization has proceeded much further, where private enterprise, supported by official incentive programs and widespread, often excessive, tariff protection, is producing goods previously imported. Some countries now have the capacity to produce a large proportion of the consumer goods in common use as well as considerable quantities of iron and steel, automobiles, and even many types of machinery, equipment, and machine tools. But to progress rapidly to a more advanced stage involving more complex modern industries would, for the most part, require mass markets able to consume a high volume of output. Without a large home market, tariff protection, even at excessive rates, cannot create conditions attractive to the large capital investments required.

It is this barrier to more advanced industrialization that we, along with many Latin Americans, hope to see broken through the removal of the import barriers which now surround the limited national markets. Industries free to serve several or all of the Latin American countries would be encouraged to select optimum locations and produce quality goods for sale at competitive prices. There would follow, too, construction of useful additions to infrastructure and the establishment of related secondary production and service facilities. In this way, it would be possible to provide the increased incomes and expanding employment opportunities so acutely needed in a region where population is growing at a very rapid rate. Such industries could also make more economical and efficient use of the natural resources of the area than is the case at present when facilities are unnecessarily duplicated in uneconomic scale in several countries, while, on the other hand, potentially productive resources lie idle for lack of opportunities.

There is good reason to believe that some industries which an integration of regional markets would make possible could, within a short period, compete on world markets and help to provide a badly needed diversification of export earnings. This would speed the day when more Latin American countries are freed from overdependence on too few primary commodities produced for export.

As the ever increasingly integrated industrial sectors of the region grow, providing expanding markets for agricultural foodstuffs and raw materials, and enhance their capacity to provide the supplies and equipment used on ranches and farms, effective economic integration should be used to bring about increased specialization in agriculture production. Higher productivity resulting from better use of available land would raise incomes, increase consumer goods markets, and additionally spur economic growth.

Effective integration would gradually but surely change the economic structure of Latin America and alter the character of U.S. trade with the area. Traditional markets for some U.S. exports would become foreclosed as production of these items grows within the region. Just as surely, the area would become a more promising market for the increasingly sophisticated products of U.S. industry. The area would both have a greater need to import than if it were less developed and be better able to purchase what we have to offer. Our economy overall is one that is accustomed to change and able to make the adjustments that may be required as trade patterns change while trade grows. I am sure the members of the subcommittee will agree that rapid economic development in other areas of the world, in Europe and Japan, for example, has proved advantageous to the United States in terms of increased trade flow, and in other ways also.

I have not intended to repeat testimony which this committee has heard from others who have appeared here to speak of the theory or practical aspects of economic integration. I have enumerated only a few of the positive results which it seems clear to me should follow upon the realization of effective integration in Latin America. My purpose is to emphasize that we in the executive branch are convinced that this integration is one of the changes which must take place if the growing aspirations of the Latin American peoples for vastly improved economic and social conditions are to be satisfactorily met. We wish to see stable democratic governments the rule rather than the exception in the area; obviously the emergence and preservation of such desirable political traditions are in large part dependent upon rapid economic improvement.

This is why the United States has so often and so clearly expressed its support for economic integration in Latin America; nor have we only paid lipservice to the principle while remaining otherwise aloof or hostile toward efforts to accomplish this admittedly difficult task. The United States has given concrete evidence that its support is real.

Most strikingly and most effectively, the United States has directly supported the formation and development of the Central American Common Market. To date, we have committed funds in excess of $60 million to be used, along with contributions of the five member states, in financing regional projects for infrastructure and industry. Through AID we have provided extensive technical assistance and cooperation which we feel sure have been of value in developing the institutions, policies, plans and projects of that quite successful regional group; we continue to search for new ways in which we can be of assistance.

From its inception, the Inter-American Development Bank was given a mandate not only to assist national projects but also to contribute to collective and complementary economic development in the area. Recently as the operational and technical capacity of the Bank has grown, it has been increasingly accepted that IDB can and will become a powerful adjunct to integration movements in Latin America. Some time ago it began cooperating with other Inter-American institutions in the search for new measures to promote integration and decided to give a high priority to acceptable projects which would advance the integration of two or more countries in the area. It now aids in financing intra-Latin American trade in capital goods. The United States has participated actively in these decisions and, meanwhile, has increased its contributions and commitments to the Bank's operating funds to above the billion dollar mark (in addition to $525 million in SPTF) and agreed to subscribe over $600 million in callable capital, which enables the Bank to borrow substantial sums. It is therefore clear that the United States has given substantial concrete evidence of its willingness to support true integration.

This subcommittee has expressed particular interest in considering what the role of the United States should be as a supporter of Latin American integration efforts. I want to assure you that this question receives much attention in the Department of State; our related policies and the possibilities for assisting integration in new ways are under constant review.

We appreciate that forward movement toward integration signifies important changes within the economic and political structure of each country directly involved. Difficult decisions relating to the exchange of what are regarded as gains or sacrifices in established or potential interests must be made. We recognize that it is the peoples and governments of Latin American countries who have the responsibility for taking these decisions which determine the goals, the substance and the form of their integration efforts, and we find it natural that they should wish to arrive at their decisions without interference.

I would really like to underline that last sentence.

It is our policy to encourage the Latin American countries to seek the advantages of integration in their own way, with due regard for the interests of other trading nations and with all the urgency which the need for accelerating development demands. We have been generous and reasonably prompt in offering financial assistance both through specialized institutions in Central America and through the Inter-American Bank. Considerable sums are at the disposition of these organizations for use in projects connected with economic integration, and I feel confident the United States will be forthcoming in augmenting these resources whenever suitable projects appear to be exhausting those now available. We stand ready to consider requests for technical assistance which could facilitate the advance of the integration movement.

Within the larger of Latin America's organizations for integration, the Latin American Free Trade Area (LAFTA), there is a growing consensus that regional cooperation in the planning and promotion of industrial expansion in selected industries must be undertaken to augment the gradual trade liberalization efforts now underway. The development of such ideas is not complete, nor have the methods for planning and executing regional industrial projects been chosen. Much work remains to be done in this field. However, we believe that this approach holds promise for more rapid fruitful progress. If the member countries of LAFTA agree upon such programs, provide for reasonable flexibility in the location of an industry, expand prospective markets and stimulate a desirable degree of competition through encouraging progress toward free intraregional trade in its products, we are convinced the stimulation given to private investors, both Latin American and others, will give great impetus to the creation of needed new industries. And, as President Johnson stated on August 17, the United States is willing to help in a venture of this type for the production and trade, on a continental basis, of fertilizer, pesticides and products needed to meet the urgent need for increased agricultural production in the area which is of evident priority.

As I have outlined it here, our actual and prospective role in support of Latin American integration is large and growing. However, I am aware that there is a respectable body of opinion which holds that because the general economic integration movement in Latin America is progressing only slowly and cautiously, the United States should seek to stimulate it through offering to establish special trading relationships with regional groups in the area under certain conditions, either immediately or eventually.

In this connection, I would call to your attention that many Latin American leaders feel strongly that their countries must avoid a high degree of dependence upon the United States. Also, the view is widespread that much time must pass before the economies of the area can deal on equal terms with that of the United States. Only last week, the President of Mexico, among statements indicating his strong desire to see Latin American economic integration proceed rapidly, made it quite clear that his country will not now consider arrangements on a larger scale which might include the United States and Canada.

Because this topic is a part of the broader subject of the position and policies of the United States within the context of its worldwide economic relationships and responsibilities, I have agreed with my colleague, Mr. Solomon, that he should discuss it during his remarks this morning.

Thank you very kindly, Mr. Chairman.

Senator SPARKMAN. Thank you, Mr. Vaughn.

Mr. Solomon, we are glad to have you with us and we shall be glad to hear from you at this time.

STATEMENT OF ANTHONY M. SOLOMON, ASSISTANT SECRETARY OF STATE FOR ECONOMIC AFFAIRS

Mr. SOLOMON. Thank you, Mr. Chairman.

I welcome the opportunity to discuss with the Joint committee the administration's position on Latin American economic integration and to consider the possibilities for wider hemispheric trade cooperation.

My point of departure is the general economic and trade policy of the United States.

Our worldwide trade policy can be stated briefly. We favor a free and open world trading system, based on the principle of nondiscrimination, with minimum restrictions on the flow of goods and services across national boundaries.

Such a system is, in our view, truly growth-promoting. It enables participants to benefit from the specialization, the development and exchange of technology, and the spur to productivity that competition provides.

It serves United States commercial interests directly. It serves the interests of other trading nations, of whom we are the largest by far.

We learned from the disastrous experience of the interwar period that attempts by nations to solve their problems at each other's expense throttled the economic growth of all.

Experience has amply shown that the wider the area of trade freedom, the larger the possibilities for fruitful exchange and growth.

We have, therefore, directed our efforts in the postwar period to the progressive reduction of barriers to world trade on a multilateral basis, and we are now engaged in negotiations for the most ambitious reduction of trade barriers in history, the Kennedy Round.

The principle underlying our trade policy has been equality of treatment. This principle has been endorsed by the Congress in successive trade agreement legislation, most recently in the Trade Expansion Act of 1962.

The same philosophy is embodied in the General Agreement on Tariffs and Trade (GATT)—the instrumentality through which more than 60 countries, including 8 of the 19 Latin American Republics, have carried out multilateral negotiations for the reduction of tariff barriers, subject to automatic extension to all contracting parties under the most-favored-nation principle.

The GATT, however, is not a rigid instrument. It condones three major derogations from the MFN principle:

(*a*) Preferential arrangements which were in existence prior to the coming into force of the GATT in 1947—a clause which covers British Commonwealth preferences and United States-Philippine preferences:

(*b*) Customs unions; and

(*c*) Free trade areas.

The exceptions for preexisting arrangements was accepted at the time as a political fact of life. It is worth noting that United States-Phillippine preferences are now being phased out under a fixed schedule and will terminate in 1974.

British Commonwealth preferences are now a much less significant factor in world trade than was once the case and will continue to decline in importance as a result of multilateral tariff reductions and declining preference margins.

The exceptions for customs unions and free trade areas reflected the widespread view that the trade-creating effect of regional groupings would offset the disadvantages to third countries of the commercial discrimination they would suffer.

In other words, a successful regional economic grouping would benefit the trade of nonmembers as well as members, although in different degree. Moreover, regional economic groupings can have a politically unifying force of significance.

In this connection, it may be noted that Latin America's exports to the EEC increased by 40 percent during the 5-year period 1959–63, a higher rate of increase than to any other major market, including the United States.

I would like to interject as well certain additional data that I asked for which indicate that U.S. exports to the EEC increased by 43 percent during the same period, 1957 through 1964, that its exports to the world as a whole were increased by only 27 percent, and U.S. exports to the Central American Common Market increased by 48 percent during the 1960–64 period—the CACM was established in 1960—at the same time that our exports to the world were only 28 percent, so I think this shows that the trade-creating effects where a regional grouping has been properly constructed and is not inward looking have outweighed the trade-diverting effects.

The hearings in the past 2 days have amply exposed the rationale for economic groupings among developing countries.

Senator SPARKMAN. Before you leave that page, Mr. Solomon, I wonder if I might ask you to give me those figures again. Our exports to EEC increased by 40 percent during the 5-year period?

Mr. SOLOMON. Forty-three percent.

Senator SPARKMAN. Forty-three percent?

Mr. SOLOMON. Yes, from 1957 through 1964 at the same time that our exports to the world increased by 27 percent.

Senator SPARKMAN. Now, the Latin America.

Mr. SOLOMON. In the Central American Common Market——

Senator SPARKMAN. You have them broken down separately?

Mr. SOLOMON. I have not done it for the LAFTA area because I don't consider this as a very significant kind of regional grouping so far.

Senator SPARKMAN. All right. Give us that Central America.

Mr. SOLOMON. In the Central American Common Market our exports increased from 1960 to 1964 by 48 percent, while during that same period of time our exports to the world increased by 28 percent.

Senator SPARKMAN. Thank you very much. I think those are significant figures and I noted that they were not in your printed text.

Mr. REUSS. On this point, I think they are significant, too, but I am not sure I agree with the inuendo of the State Department. Is it your suggestion that this rate of increase to the European Common Market of Latin American exports is attributable to the fact that there was a common market?

Mr. SOLOMON. Those figures I gave, Mr. Reuss, refer to the U.S. exports to the Common Market and to the Central American Common Market.

Mr. REUSS. You have referred to the increase in Latin American exports to the Common Market.

Mr. SOLOMON. Right.

Mr. REUSS. And you also referred to our increase.

Mr. SOLOMON. Right.

Mr. REUSS. Don't you think that the vigorous fiscal policies of the European countries and their full employment economies and the resultingly generated demand was the important factor there?

Mr. SOLOMON. I don't think it was due to their fiscal policies, Mr. Reuss, but I think you are right that it was a high rate of economic activity and employment generated by the very heavy investments due to the fact that the trade barriers among the six countries of the EEC were reduced and this created a whole ferment of activity where the trade-creating effects, even as far as the external world went, outweighed these trade diversions.

Mr. REUSS. You have more confidence than I in your ability to sort out investment that was made because of the Common Market, and an investment that would have been made anyway because of the expansionary fiscal policies of those countries, so let me just note a doubt about the cause and effect, a mild dissent, as the chairman says.

Mr. SOLOMON. I think, sir, that that is a very valid point. We certainly have no way of analyzing this very clearly. I think the presumption is fairly strongly in favor of our analysis, but I would like to say that there is no doubt in my mind that this is true in the Central American Common Market.

There is no question in my mind that in the Central American Common Market you would not have had this differential, this much higher rate of increase of this external trade without the reduction of the barriers among these four or five tiny Central American countries.

Mr. REUSS. We had testimony the other day from Mr. Collado that, despite all the big talk about the Central American Common Market having rationalized industry and prevented duplication of industry, each one of the Central American countries has quite recently set up its own petroleum refining industry.

I am wondering if maybe our exports haven't jumped up to satisfy this petty nationalistic autarchy, let's-everybody-have-our-own-petroleum-industry notion that is floating around.

Mr. SOLOMON. I can supply you later, Mr. Reuss, with a list of investments that have been made in the Central American Common Market which services the entire market which are not small, petty, autarchically oriented.

Mr. REUSS. I wish you would and include your comment on the point I just put, that there has been a distressing example of everybody wanting to set up their own basic refining industry.

Mr. SOLOMON. This is one of the basic problems.

Mr. REUSS. If it is untrue, let us have the record so indicate.

Mr. SOLOMON. Certainly. The very narrowly national interests of each country entering a common market do tend to get in the way of the movement toward the reduction, the elimination, of the barriers, and this has been the problem in LAFTA.

This is why I think LAFTA has made relatively little progress. I will supply you, sir, with all this.

Mr. REUSS. Thank you.

(For information subsequently supplied, see p. 184.)

Senator JAVITS. There is one figure, Mr. Secretary, that I think you need to add, and that is to this 40-percent figure; what is the correlative figure for the world, the one that is in your text?

Mr. SOLOMON. Yes, sir; I will.

Senator JAVITS. Do you have that?

Mr. SOLOMON. No; I do not have that at this time.

(Information furnished follows:)

In the 5-year period 1959–63, Latin America's exports to the EEC increased by 40 percent, while her exports to the world as a whole increased by 17.6 percent.

Senator SPARKMAN. It seems to me that even though you cannot draw an accurate conclusion affirmatively, certainly we are safe in the negative conclusion that it hasn't done damage.

Mr. SOLOMON. Oh, I think this is definitely an understatement, Mr. Chairman; yes.

Senator SPARKMAN. Yes. All right. Thank you.

Mr. SOLOMON. In the postwar period, when the trade of the advanced countries increased dramatically in volume and value, the trade of the low-income countries lagged.

Trade has not, as a general matter, been an engine of growth for the developing countries. The reasons for the less favorable trend in the export trade of the low-income countries are rooted in the basic structure of this trade itself. The low-income countries depend for 85 to 90 percent of their export earnings on raw materials, in major part on agricultural raw materials.

Demand for these traditional export commodities is not dynamic. Saturation in the main consuming centers, competition from synthetics, economies in the use of materials, and the increasing agricultural self-sufficiency of some industrial countries have contributed to the slow growth in export earnings, as have deteriorating prices of certain key commodities.

If the low-income countries are to make more satisfactory progress in economic development, they must diversify their agriculture and expand their industry.

In many countries, however, internal markets are too small to support efficient modern industrial plants. It is not the size of the population but their effective purchasing power that determines the size of a market, and in the developing countries per capita income is, of course, low.

Thus, these countries must not only seek ways of expanding their domestic markets through greater internal trade but they also require larger external markets to enable their enterprises to benefit from the economies of scale and the intraindustry specialization on which growth and efficiency depend.

That Latin American industry would benefit from a market of continental size is self-evident. While shielded for a time from export competition from the advanced countries, enterprises would be exposed to more tolerable competition within the broader regional market, and would reach a competitive position in international markets much earlier and more effectively.

Recognizing that the low-income countries may be able to move ahead more readily by forms of partial integration, we suggested in the GATT in November 1963 that consideration be given to amending the GATT so as to permit developing countries to undertake regional economic integration on a broad sectoral basis.

That is, to sanction the establishment of free trade in a few selected products by groupings of less-developed countries. The sectors chosen should be those that would clearly benefit by large-scale operations for a broad market.

This proposal and related ones submitted by other contracting parties are currently under consideration and although no agreed draft has yet emerged, the basic principle of partial economic integration among developing countries is widely accepted, in addition to the option of forming customs unions and free trade areas.

For the benefit of the committee, although you probably know, the difference between a customs union and a free trade area is simply that a customs union has a common external tariff, whereas in a free trade area the countries may have varying external tariffs.

That remark is probably unnecessary, but I notice that there is confusion from time to time.

In his remarks commemorating the fourth anniversary of the Alliance for Progress, the President urged the Latin American countries to consider the development on a continental basis of fertilizer, pesticides, and other products needed to increase agricultural production.

This would be a form of sectoral integration, free trade in certain chemical products needed for agriculture. The President made it clear that we are willing to help in such a venture, and Secretary Vaughn has referred to that.

Let me summarize at this point. We continue to favor a nondiscriminatory world trade regime. We recognize at the same time that common markets and free trade areas can have significant salutary effects on member countries' economic growth and thus contribute to the expansion of world trade and world income generally.

We particularly support Latin American economic integration for these reasons. We see our role as one of encouragement and support. We shall continue to assist in every appropriate way.

The President has offered to contribute from Alliance resources to a fund for multinational projects to link the countries of the region together, and to help in the development of continentwide industries needed to increase agricultural production.

I know the committee is interested in exploring the possibilities for new and closer trade relations between the United States and Latin America, and indeed embracing the entire Western Hemisphere, relations that go beyond encouragement and financial support for Latin American integration.

I would like, therefore, to examine some of these possibilities. We do, after all, have a special interest in Latin America.

The facts of geography and the ties of history bind us. The Alliance for Progress testifies to our deep and special interest in Latin American economic and social progress.

It would seem reasonable to begin our consideration by examination of the proposals that the countries of Latin America have themselves advanced.

But the fact is that there is no clear-cut Latin American position on this matter.

Some Latin American spokesmen have from time to time suggested the possibility of special trade relations with the United States, but it is not clear from their remarks whether what is desired is general tariff preferences or preferential quotas on primary products, or other arrangements.

We might, therefore, examine objectively the various forms of special trading relations between the United States and Latin America that are theoretically possible, and consider their implications.

We might examine four possibilities which overlap to some extent—

1. A full-fledged customs union or free trade area in this hemisphere.

2. A modified free trade arrangement in which Latin America would have unrestricted access to the U.S. market but would be free to retain or impose barriers to protect her infant industry.

3. A hemisphere free trade area in raw materials alone.

4. Tariff preferences on manufactured goods, generalized to all developing countries as requested by UNCTAD, or restricted to Latin America alone.

As to the first possibility, it is unmistakably clear that the time is not at hand for a full-fledged Western Hemisphere Common Market or free trade area embracing manufactures as well as raw materials.

The disparity in levels of development between the North and South is so great that Latin America would be overwhelmed. Our exports would swamp them. Such an arrangement would be seriously considered only in the future when Latin America is an economically mature and developed society.

In an address to the Mexican Congress on September 1, President Diaz Ordaz paid special attention to the desirability of economic integration of Latin America, but made it explicit that such integration should be confined to Latin America and not include the United States, Canada, or other industrial countries.

As to the second possibility, that is, a modified free trade area, Latin America would be free to retain or impose revenue duties and protective barriers for her infant industry but would enjoy free entry in the U.S. market.

An arrangement of this kind would correspond to that between the European Common Market and the Associated African States. It would be essentially a preferential arrangement in which Latin America would enjoy advantages in the U.S. market denied to countries outside the hemisphere and the United States might enjoy special access in Latin American markets.

Such an arrangement would be a significant departure from established U.S. trade policy and practice. A forbidding array of imponderables stand in the way of the easy answer to the question whether a United States-Latin American preferential arrangement of this kind would make economic and political sense for the United States and Latin America.

In strictly economic terms, Latin America would need to weigh the possible benefits of preferential access to the large U.S. market against the possible losses in other markets if a hemisphere free trade area spurred industrial countries outside the hemisphere to develop new preferential arrangements with developing countries in Africa and Asia and to broaden and deepen those now in effect.

Latin American desires to encourage a larger flow of aid and investment from industrial countries outside the hemisphere both to increase the amounts available to her and to diversify the sources of assistance.

Would she suffer a diminution of aid and investment from other sources rather than the expansion she desires?

And would she be in a position to take advantage of free entry into the U.S. market, given the high cost and modest scope of her industry today?

Her manufactures would still have to compete in the U.S. market with large and efficient U.S. firms.

Indeed, the rationale for a continental Latin American Common Market is precisely to enable her to develop the efficiency and scale of operations she would need to meet this competition.

Very careful thought would need to be given to the impact on the U.S. trading position in other markets. The United States is truly a world trading nation.

Latin America accounts for about 15 percent of our exports and 23 percent of our imports. Our exports to the European Economic Community account for about 17 percent, to EFTA countries about 9 percent, to Canada 18 percent, to Japan 7 percent of our total exports.

Were a preferential American trading area to spark similar arrangements in other parts of the world where trade now moves on a nondiscriminatory basis, U.S. trading interests outside this hemisphere could be substantially injured.

Whatever the balance of direct economic losses and gains within the hemisphere might be, countries outside the hemisphere in whose peaceful progress we have a deep interest could lose and the loss could be significant.

One can mention India, Pakistan, the Philippines, Thailand, Israel, Iran, Ethiopia, Kenya, Taiwan—the list is obviously illustrative, not exhaustive.

The United States is, after all, a country with worldwide interests and responsibilities.

Turning to the third possibility, a free-trade area in raw materials alone, this was proposed to this committee by private parties at its hearings last year.

It was proposed that barriers to trade in raw materials within the hemisphere be eliminated over a 10-year period; and further that this hemisphere arrangement proceed concurrently with the development within Latin America alone of a full continental common market in all goods, raw materials, and manufactures alike.

We would, of course, look with favor, as I have said earlier, on the development of a Latin American continental common market. The question is whether the proposed hemisphere arrangement in raw materials would be mutually beneficial and what its effects might be on countries outside the hemisphere.

As the committee is aware, many key Latin American export commodities, such as coffee, cocoa, bananas, tin enter the U.S. market duty free.

The proposed new arrangement would not increase Latin America's earnings from the sale of these products. To enable Latin America to obtain special benefits from the sale of these commodities, it would be necessary to give her special quotas in these products or to impose tariffs against nonhemisphere suppliers.

If we were to do this, we would need to consider the effects of such action on developing countries outside the hemisphere whose trade would be injured to the extent Latin America was helped.

There are other important Latin American raw material exports—copper is illustrative—which are subject to duty but the duties are quite modest and the benefit to Latin America that would flow from their removal, while real, would be correspondingly modest.

A few important Latin American exports are subject to quota in the U.S. market, most notably petroleum, sugar, lead, and zinc.

But is it realistic to contemplate unrestricted entry in these products given the considerations of national policy that have led to imposition of these quotas?

Nor can we ignore the effect on developing countries outside the hemisphere if the quotas they now enjoy were withdrawn in favor of hemisphere suppliers.

We must also consider the effects in Latin American markets of free entry there for U.S. raw material exports. Rice, cotton, and wheat are illustrative. Would Latin American producers of these commodities be disturbed at the prospect of unrestricted entry in their markets of competing U.S. commodities?

I would like to add here, sir, that I have a specific list of the contributions of these various commodities to Latin America's foreign exchange earnings and exactly which ones are duty free and which ones are subject to quota, and if there is time afterward it might be useful for me to read that, because when we look at this picture, 90 percent of Latin America's foreign exchange earnings are from raw materials and when we look at the raw materials we find that virtually everything is either duty free or is subject to quota, like sugar and petroleum, and therefore we find ourselves in the quandary of how to give real practical content to a Western Hemisphere market in raw materials.

The only way would be to erect new tariff barriers to the rest of the world or to set up a system of quotas which would confine the commodity markets, import commodity markets, in the United States to Latin America. It is very, very difficult to see, even though it is attractive and challenging as a concept, what the actual content of this proposal would be. I could go into this in detail item by item later if you wish.

Senator SPARKMAN. I think it would be well if you would just read them off. Then in the questioning if anyone wishes to go into detail he may do so.

Mr. SOLOMON. On petroleum, there is a duty of 2½ percent, but this is insignificant compared to the fact that petroleum is subject to restrictive import quotas.

You are familiar with the oil import program. Coffee is free. Upland cotton is duty free but subject to a quota under section 22 of the Agricultural Adjustment Act.

On copper, there is a modest duty, 1.7 cents per pound on the metal content. On carcass meat, principal suppliers have agreed to voluntary restraint and formal quotas must be imposed by the President if imports surpass a given level. On sugar we have quota arrangements. There is also a tiny duty on sugar, just six-tenths of a cent per pound.

Iron ore is free. Bananas are free. Fishmeal is free. Cocoa is free. Lead and zinc we have quotas on.

These are the leading products, sir, and tin is free, as I mentioned earlier. These are the leading export raw material items for Latin America and therefore we are confronted with this problem that I mentioned earlier.

Senator SPARKMAN. All right.

Mr. SOLOMON. Turning to the fourth possibility——

Senator JAVITS. Before you leave the third possibility, I notice that you said nothing about any selected preferential entry of a modest quantity of manufactures from Latin America into the United States and Canadian markets, which was part of the Clayton proposal as well as my own.

Mr. SOLOMON. Yes, Senator Javits. That is the fourth possibility which I would like to take up now.

For conceptual reasons, even though there could be some slight overlapping of different schemes, I divided it into, first, full customs-union or free-trade area; secondly, modified with Latin Americans having the right to restrict to protect their infant industry; thirdly, the Western Hemisphere free-trade area in raw materials, which I think has been explored by this committee to some extent; and, fourthly, the question of preferential access for manufactured goods,

Senator JAVITS. Yes, I understand you and I read your whole statement through, but you didn't relate 4 to 3 and the fact is that, though it may have no mileage particularly to have free trade and commodities for the reasons you stated, it may have a considerable mileage if you combine 3 and 4, and even if you didn't go so very far with 4, but it does make a much more attractive picture if they are combined. I didn't wish the point to be made that they live in separate compartments.

There is no reason in the world why items 3 and 4 as modified, that is, in moderation, could not be combined and they might be very useful.

Mr. SOLOMON. I think you are right, Senator.

In the sense of a psychological impact, you are absolutely right. I think, though, that the economic content could still be the same whether you combined them or not, of course.

The fourth possibility we might examine is preferential access for manufactured goods.

Latin America has urged the introduction of preferential arrangements for manufactures. But the striking fact is that she has not thought in hemisphere terms. Instead she has alined herself with the developing countries of Asia and Africa at the U.N. Conference on Trade and Development in urging a system of generalized preferences from all advanced countries in favor of all developing countries.

A variety of preference schemes has been proposed, but one-way free trade for developing countries' manufactures is illustrative of what is being urged.

I think I should, however, insert here that over recent months many of the developing countries have made it clear that they do not simply want free trade, zero duty entry into the advanced countries, but they would want gradations of preferences in inverse relationship to their own development among the less developed countries.

So, for example, Nigeria and some of the smaller countries who feel that they cannot compete as well as, let us say, India, Brazil, or Mexico, would want to have a higher degree of preferential treatment, let us say zero entry for them, but still retain some intermediate degree of preference for more advanced but still less developed countries. So, the thing gets quite complicated.

The rationale for the proposal is that low-income countries cannot meet the competition, in developed country markets, of the manufactured exports of other developed countries whose greater efficiency enables them to quote lower prices.

Given preferential access, goods offered by low-income countries would be less expensive to importers—depending, of course, on the tariff rate importers must pay on the same type of goods coming from developed countries. Importers attracted by the price advantage would place orders, volume would increase, and overtime costs would be reduced so that when preferences were phased out these low-income manufactures could compete on a most-favored-nation basis. This is the rationale.

We have been studying the many preference proposals advanced by the low-income countries and by some of the industrial countries—there are substantial variations—but we have not been convinced that any of them would produce significant trade benefits for the developing countries as a group, while their adoption could do injury to specific countries and to the trading system as a whole.

I want to interject here again that we have not approached this in a doctrinaire spirit. I have attempted, and I have given this a good deal of time in recent weeks, to analyze this as pragmatically as I could and not accept just automatically the fact that for 40 years we have had a historic unconditional, most-favored-nation doctrine, and I do urge the committee to believe that the Department is not approaching this in a doctrinaire spirit.

In a system of generalized preferences, the trade possibilities for the low-income countries would depend on the level of tariffs on goods offered by them. While import duties in advanced countries vary, rates on goods of export interest to the developing countries average about 15 percent ad valorem, some more, some less.

Following even a moderately successful Kennedy Round, it is reasonable to foresee a reduction to less than 10 percent on the average.

The questions we have asked ourselves are these: Are there many manufacturing enterprises in the developing countries, excluding those like textiles which are quite competitive already and need no preferential advantage, that could break into industrial markets against established developed country suppliers on the basis of a 10-percent margin on the average?

We should bear in mind that infant industries in the developing countries, certainly in Latin America, are in many cases protected by tariffs of 100 percent ad valorem and more. It is likely that private foreign investors would be stimulated to locate in developing countries in order to enjoy the advantage of a 10-percent margin in the markets of the developed countries. This advantage would be diluted for any one country because all low-income countries would be eligible.

It is difficult to believe that the trade and investment effect of a 10-percent preferential margin would be more than marginal. If so, the breach in the most-favored-nation principle would add little to economic growth in the underdeveloped world but it might at the same time create resistance to further multilateral tariff reductions because such reductions would narrow the scope for preference margins for the low-income countries. This is a real consideration.

This examination of possible special hemisphere trade relations would be incomplete if I failed to note the recommendation in the CIAP report of August 10 to the Presidents of all American Republics. The CIAP report urged consideration of a policy of "temporary, defensive measures" to compensate Latin America for discrimination arising from arrangements in other parts of the world. The present impact of these discriminatory arrangements is on trade in primary products, including several of major export interests to Latin America.

Although the magnitude of the discrimination Latin America faces has been overstated frequently in the press, it is a problem. But our analysis—which again I could supply for the record later—indicates the share of Latin America in different key commodities and exports to the EEC has not declined. In most cases it has increased, with the exception of cocoa. I think you could also argue that in some cases, such as bananas, even though Latin America exports to EEC haven't declined, preferences hurt exports from Latin America by limiting their share in the growth of trade. I think there is a valid charge there.

However, we do view with alarm this increasing tendency to proliferate EEC preferential arrangements with more and more African countries.

Senator JAVITS. That is beyond the former French countries, is that right?

Mr. SOLOMON. Yes.

Senator JAVITS. Would you address yourself also in your testimony to what the Kennedy Round negotiations will do with respect to the EEC-African preferences now being, I won't say proliferated—probably the choice of the word is inaccurate—rather, extended to countries which it was not originally designed to cover. Is that correct?

Mr. SOLOMON. Yes.

Right now, the EEC has virtually concluded, and, in fact, it has concluded although not formally, its negotiation with Nigeria, which was not a member of the Yaounde Convention, the 18 African Associated States.

I understand that there are negotiations continuing or about to continue with the east African countries. There are negotiations going on between the EEC and the Mahgreb countries—Tunisia, Algeria, and Morocco.

I think that possibly the word "proliferation" may be strong, Senator Javits, but there are so many of these that it comes close to being the correct word.

Senator JAVITS. I hope you will comment on this. I do not want to do the questioning now. I think the chairman is right about that. I hope you will comment on what the Kennedy Round is going to do about that.

Mr. SOLOMON. All right.

Do you want me to answer that question now, Mr. Chairman?

Senator SPARKMAN. Yes. Go ahead.

Mr. SOLOMON. The Kennedy Round, as such, does not have built into it a set of guidelines which would permit us in any formal way to insist on the phasing out or the elimination of these preferential arrangements, although progress in this direction may be possible through the negotiations on tropical agricultural products which are being planned. We are urging the EEC countries to phase out these arrangements by the time the Yaounde Convention, which establishes present preferences, expires in mid-1969. We are increasingly making our concern known to the European countries and to the African countries, depending upon the situation.

Senator JAVITS. As usual, we are the good guys living a church-going life while looting and stealing goes on all around us.

Mr. SOLOMON. I think, Senator Javits, that there is a good deal of validity in this concern of yours and, of course, with the fact that increasingly closed trading systems are being generated in Europe and in Africa. It is true, we should point out in all fairness, that the actual trade impact of these prospective new preferences on third countries like Latin America, Asia, and the United States to the extent that there are reverse preferences, will be reduced by the setting up of elaborate systems which give this preference only up to certain levels that reflect historic shares.

It becomes a rather complicated system of preferences but even though you cannot prove significant injury by reference to the trade figures, except possibly in one or two commodities, I think certainly any possible new production that might in the future develop in third countries would suffer a competitive disadvantage as against similar industries that could be created in countries that enjoy preferences in the European market.

Senator JAVITS. You understand, I don't say that we should join the practices that we condemn. I only point out whereas we might be able to sit still and afford it, the Latin Americans can't, and that we are their strong ally, their strong trading partner, and I think we have to exercise some of our strength, not just to preach good doctrine, but to see that they get a fair break. That is all.

Mr. SOLOMON. The CIAP recommendation is a manifestation of the same concern the United States has felt about departures from the principle of nondiscrimination. There have been some disconcerting recent developments suggesting a further proliferation of such discriminatory arrangements.

The course we should follow seems to me reasonably clear. We should seek ways by which existing discriminatory arrangements can be phased out or their injurious effects neutralized; and we should continue to counsel others against the institution of new preferential arrangements.

It may be, however, that our efforts in this direction—and we intend to pursue them vigorously—will be unsuccessful. In that event, we may want to reconsider our own historic trade policy of nondiscrimination. We must retain sufficient flexibility in our policies to adjust to the evolution of the world economy and policies adopted by other major countries of the world.

I have tried to be responsive to the committee's inquiry, its interest in Latin American regional integration, the most-favored-nation principle, and the possibilities for new hemispheric trade relations. But I would not want to conclude this statement without noting two points.

First, the advanced countries are committed in the Kennedy Round of trade negotiations now underway to make a special effort to reduce barriers on trade items of interest to the developing countries without asking full reciprocity from them.

Second, here and now, and for years to come, the trade of Latin America, as of all the developing countries, is trade in primary products. These are indeed the lifeblood of their economies and the source of 85 to 90 percent of their export earnings.

The economic diversification and industrialization that successful integration can promote will necessarily be a long, slow process, and its salutary effects will be realized only gradually. If we want to help Latin America and the developing countries in other regions with the major trade problem that confronts them today, we must take steps to improve commodity market conditions, to help stabilize prices at equitable and remunerative levels and improve conditions of access.

Where the root problem of instability and depressed prices is oversupply, we should work in concert with other consumer countries and the international development agencies to help producing countries curb overproduction and find more rewarding uses for the resources now wasted in harvesting surplus supplies.

The International Coffee Agreement is an example of our efforts in this direction. Coffee accounts for more than 16 percent of Latin America's export earnings. By helping to improve Latin America's coffee economy, within the framework of the coffee agreement, we can make a real contribution to Latin America's trade and growth.

Where the root problem in commodity trade is competition with synthetics, we can give appropriate assistance to producing countries in improving their efficiency so as to enable them to meet synthetics on a price and quality basis and hold their share of the market.

These are positive, practical measures to cope with the major trade problem of Latin America and of the developing countries generally and to do so in ways that are nondiscriminatory and beneficial to all participants.

Senator SPARKMAN. Mr. Solomon, all of us are going to have to leave here by 12 o'clock. Mr. Reuss and Mr. Curtis must leave at 11:45, and Senator Javits and I have to leave by 12 because there is a rollcall.

We will start with Mr. Reuss.

Representative CURTIS. Mr. Chairman, these are good papers. May I ask for the usual permission that we could submit written questions?

Senator SPARKMAN. Yes. I hope that will be agreeable with both of you gentlemen, that, if there are specific matters that we are interested in, we can ask you to give us the answers. I want to say this, and I shall not indulge in questions myself so as to give the time to these three gentlemen.

I have thoroughly enjoyed these two statements and I want to say that they make me feel good.

It seems to me there is room in here for considerable optimism with reference to the progress that is being made, particularly when we consider that the Alliance for Progress program is no older than it is and when we consider the difficulties that it had to incur during that time.

I want to thank both of you for presenting us these very thoughtful and thought-provoking statements.

Mr. VAUGHN. Thank you, Mr. Chairman.

Senator SPARKMAN. Mr. Reuss, we will give you 9 minutes.

Representative REUSS. Thank you, Mr. Chairman. That is more than generous, and I hope I can have my say in a small fraction of that.

Let me once again express my gratitude to you for calling these hearings and to reaffirm my position of vigorous support of the Alliance for Progress.

Senator SPARKMAN. I beg your pardon.

Will you take 7 minutes? I forget that both of you have to leave at 11:45.

Representative REUSS. Yes. I will take less than that.

He will get at least equal time or better, and I think you would be interested in the question I am going to ask.

Representative CURTIS. Yes.

Representative REUSS. I am, however, disturbed by the apparent position of the U.S. State Department.

I refer to Secretary Solomon's statement:

> We would, of course, look with favor on the development of a Latin America continental common market.

Since a "common market" is a term capable of precise definition, that means a preferential discriminatory trade area on the Latin American Continent in which duties on substantially all products, industrial and agricultural, would be eliminated within the area, and a tariff wall maintained against the rest of the world.

I would hope that Congress would be given the opportunity, in view of the revolutionary nature of this change in our American foreign economic policy, to debate and vote on whether this change should, indeed, be made.

I have jotted down some of the questions I would like to ask in such a debate and I will ask them of you now, not for answers now, but for answers at your convenience, so that they can be in the record. (See p. 173.)

If we do what the State Department favors—

(1) What would be its effect upon exports from the United States to Latin America over the years? What would we lose, and particularly how would that be divided among the various sectors of the American economy? Who would bear the cost of this?

(2) What about the exports from the rest of the world, developed and developing, to Latin America? Who would bear the cost of that? How much displacement would there be, and have those countries which would feel this displacement been consulted about this and what do they have to say about it?

(3) What is the effect of the State Department's espousal of a discriminatory tariff area in Latin America likely to be in causing other areas of the world to want to set up discriminatory trading blocs, such as in Africa and various portions of Africa, the Middle East, Asia, middle Europe, and elsewhere?

(4) What will be the effect upon the American outlook and temper as regards reciprocal trade—an outlook and temper which for the last 30 years has been in the direction of multilateral, most favored nation, freer trade—when American producers in fragile industries like pottery, or glassware, or footwear, observe that manufacturers of those commodities in Latin America are being given a discriminatory protective preference, whereas an American shoe manufacturer has to hurdle the tariff wall? Will not these elements of American society then demand similar protection? And when that happens, what

happens to the Cordell Hull; to the Harry Truman; to the Eisenhower; to the Kennedy; and to the LBJ multilateral trade programs?

(5) Will the State Department's proposed Latin American Continental Common Market tend to take the eyes of the Latin American countries off of what they really ought to be doing: which is to build up, at least in the larger countries, domestic markets for their own people? If a Latin American common market is attempted, and fails because the countries don't have very much to sell to each other, what will be the political cost to the United States of having supported the Common Market?

(6) Who made the decision that political union for Latin America was such a great thing? It is implicit in the State Department's thinking that we should urge an economic union because then they will all get together and be a United States of Latin America. Do they want it? Is their historical development such that this is inevitable, and is it necessarily a good thing for them and for the rest of the world?

(7) What has been the reaction of the Latin Americans themselves to the proposal for a Latin American common market? I have some information that it hasn't been greeted with hosannas everywhere, but I would like to hear about this.

(8) To what extent is this concentration on a Latin American common market a substitute for facing up to what seems to me the real problem: getting development aid and investment, public and private, into Latin America in sufficient amounts to enable those countries to make an economic takeoff? To the extent that a common market is thought to be a panacea for the troubles of Latin America, I would be afraid that it would give encouragement to those in this country who look with disfavor upon an adequate program of aid, public and private, for Latin America.

Those aren't all the questions that I think Congressmen and Senators have a right to ask, but they surely have a right to ask them and we haven't the slightest unveiling of the mind of the State Department on this. I would appreciate, as my seventh minute rolls around, if you could give me an answer to those, and, finally, tell us whether you are going to let Congress in on this great American policy decision? I think you should.

I think there should be a congressional resolution so we can debate it before we go over this watershed, and I feel badly that we didn't do this back in 1957 and 1958 when we were going over the European Common Market waterfall.

Mr. SOLOMON. If you had the time so that Mr. Vaughn and I could answer you, I would be delighted to answer you now.

Representative REUSS. I want you to take full time and answer me for the record.

(See p. 174 for questions and answers referred to.)

Mr. SOLOMON. I think there is just one point that should be said for the record so that there won't be any mishandling of this in the press. This is not a State Department-initiated proposal. This is a Latin American proposal.

Senator SPARKMAN. CIAP, wasn't it?

Mr. SOLOMON. The CIAP proposal, in which only one of the seven members is a U.S. citizen—the other six are Latin Americans—was a push for integration; you are right, sir; and we feel that we are supporting this because we consider this as appropriate to the objectives of the Alliance; but I do want to stress, however, that any implication that the initiative in this is within the United States——

Representative REUSS. I made no such implication.

What I objected to was the State Department's position that it looks with favor on a Latin American Continental Common Market. You have a Congress in this country and I think it would be nice to ask Congress whether it looks with favor. I think I might in the end look with favor, but I want to ask some questions about it.

Senator SPARKMAN. Thank you very much. Mr. Curtis?

Representative CURTIS. Thank you, Mr. Chairman.

Let me say again that I appreciate the chairman's courtesy here, and, of course, the best way to proceed would be to have the exchange right here on the record. The only reason I have suggested that we follow the technique of submitting written questions is because of the time involved.

I would like to get copies of the replies to Congressman Reuss sent to me, just as I will send copies of the questions that I submit to you gentlemen to the panel. It will be in the committee record, of course, when it is printed, but if this looks like a good exchange, I will put it in the Congressional Record so that this dialog can move forward.

I think you are right in pointing out that in a way it is a little unfair for us to ask these questions and make these statements without your giving a response here, because, hopefully, the press is concerned about this.

Senator SPARKMAN. May I just offer this thought?

I am of the opinion it can be satisfactorily handled in the way that you suggest, but if for any reason that needs further exploration, there is no reason why we couldn't find a day sometime that would be convenient to all of us to explore it further.

Representative CURTIS. That would be preferable. Of course, there is nothing like a live exchange.

I have a prepared statement I would like to have placed in the record, but I would like to just go through it very briefly just to make several points.

(See p. 165 for statement in full.)

Again, I am complimenting both Senator Javits and the chairman for zeroing in on this most important question. These hearings are also the first to look into the proposals for preferential trading arrangements which have been demanded of the United States and other developed countries at the U.N. Conference on Trade and Development.

I was a little disappointed as I ran through the statements here not to see reference to UNCTAD; reference to GATT, yes, but we have a real problem with UNCTAD.

I wanted to emphasize the particular concern that I bring to these discussions; while these hearings center on the problems of the hemisphere, the policies that we have discussed here have worldwide application, and this has been noted.

We must examine how to overcome the problem of inadequate growth of Latin American economies. But in debating these questions we must keep in mind the relationship of our trade policies in

Latin America to those we adopt toward the rest of the world. I want, therefore, to relate proposals for a Latin American common market and regional integration to the General Agreement on Tariffs and Trade and to other regional trading blocs.

I have expressed my concern in my report to the House of Representatives just about 2 months ago, after returning from the Kennedy Round negotiations last spring, at which I am one of the four congressional negotiators.

The claims of less-developed countries for preferential arrangements and sheltered entry into the markets of industrialized countries should not lead us to create new spheres of interest in which one industrialized country or group of countries looks after a particular group of developing countries. The division of the world into economic spheres of interest would represent a very serious backward step politically. We should certainly not abandon lightly the most-favored-nation principle, and I would relate to what happened just recently in the Canadian auto treaty agreement which was debated on the floor of the House. As I responded to one question from the floor as to what we were doing, I said we are diagnosing schizophrenia in the administration's foreign economic trade policy.

I want to emphasize another thing. The Latin American free trade area is not an instance of real success. Your report here notes the success of the Alliance for Progress. That is fine propaganda, but I am afraid that the Alliance for Progress has to be related to what was going on and how the Alliance changed it. Maybe it stopped progress that was going on.

I don't regard this as a very scholarly dissertation on what has happened there.

Serious economic, political, and geophysical dissimilarities exist among Latin countries. Too often do we removed northerners tend to talk about and think of Latin America as a homogeneous area.

Also, we must examine here the interrelationship of trade and aid. I think it can be demonstrated from static per capita growth rates and increasing debt burdens and the lack of real increase in export trade that we have not created wealth through our economic aid efforts in Latin America under government-to-government aid programs.

The countries in which real growth has been shown, notably Mexico, have been those that, in spite of socialist tendencies and strong central government planning, have established a happy modus vivendi with private enterprise, both domestic and foreign. And, so, we should consider today exactly what relationship exists between public aid and private investment in the planning U.S. officials are undertaking in the Alliance for Progress.

One of the key questions I still haven't received a clear answer to is, What is the mix of the $20 billion of capital investment that goes into Latin America under the Alliance for Progress? I have always said 10 to 10, just to get the dialog going. Secretary Dillon contradicts me saying, "No; it is more like $2 billion to $18 billion."

There has just been called to my attention a United States Chamber of Commerce publication on the Alliance for Progress, "A Hemispherical Response to Global Threat." On page 18, it discusses this 10 to 10 myth, but I don't know whether anybody really knows what the mix is, and one of the questions I will be directing to you will try to help spell out what it is.

(Excerpt referred to follows:)

* * * * * * *

The United States is expected to contribute about $10 billion in public funds to the Alliance over the projected 10 years of the program, with the other $10 billion divided in roughly equal amounts, from three sources: (*a*) U.S. private capital; (*b*) private capital from Western Europe and Japan; (*c*) funds from such international institutions as the Inter-American Development Bank, the World Bank, the International Finance Corporation, the International Development Association, and the United Nations Special Fund.

* * * * * * *

Then, if I may, Mr. Chairman, I would just like to comment on the reason for my tardiness today. I was attending a conference on the interest equalization tax. One of the problems there that has intrigued me—speaking of schizophrenia—is that here we have put private investment abroad in a straitjacket, and, yet, we discussed in conference just a few minutes ago, the Byrd amendment, which was accepted, which attempted even in a mild way to put some sort of discipline into the governmental expenditure program, the administration was just hollering bloody murder.

I think we have to have an understanding of the relationship between private and public investment and understand that if we don't pay attention, I think the Curtis corollary goes into effect, and to restate it, it is a corollary to Gresham's law, that Government money drives out private. It doesn't have to. You can spend Government money intelligently so it really does stimulate, and pump prime, but if unattended, and I think to date it has been unattended, the Curtis corollary goes into effect and it does drive out private investment rather than increase it.

Thank you very much, Mr. Chairman. I will be able to make my plane.

(Representative Curtis' prepared statement follows:)

A Time for Study and Sound Innovation in Trade With Developing Nations

Today, the third day of these ground-breaking hearings of the Inter-American Subcommittee, we have set aside to examine with two U.S. officials the tremendously important subject: "U.S. Trade Arrangements in the Western Hemisphere, Policies and Aims." As my distinguished colleague, Senator Javits, said earlier, these hearings come at the right time. They are more than ever needed now, when the foundation principles of the policy on which international trade and free world economic growth has flourished as in no other period of history are being questioned on all sides.

Thus, I wish again to thank Senator Sparkman for holding these hearings. They are the first congressional examinations of the meaning of the theories of Latin American integration, and so the record we are establishing here is especially important. And these hearings are also the first to look into the proposals for preferential trading arrangements which have been demanded of the United States and other developed countries at the United Nations Conference on Trade and Development (UNCTAD).

I wish to emphasize the particular concern that I bring to these discussions. While these hearings center on the problems of this hemisphere, the policies we discuss here have worldwide application. True, we must examine how to overcome the problem of inadequate growth of Latin American economies. But in debating these questions we must keep in mind the relationship of our trade policies in Latin America to those we adopt toward the rest of the world. I want therefore to relate proposals for a Latin American common market and regional integration to the General Agreement on Tariffs and Trade and to other regional trading blocs.

I have expressed my concern in my report to the House of Representatives after returning from the Kennedy Round negotiations last spring. The claims of less developed countries for preferential arrangements and sheltered entry into the markets of industrialized countries should not lead us to create new spheres of interest in which one industrialized country or group of countries looks after a group of developing countries. The division of the world into economic spheres of interest would represent a very serious backward step politically. We should certainly not abandon lightly the most-favored-nation principle. Certainly the case for an alternative policy must be very carefully weighed.

In debate in the House on Canada-United States automotive products agreement, I expressed my concern that the erosion-of-trade principle by special industry-by-industry agreements and bilateral arrangements could only be harmful to our longrun objectives. Similarly I have expressed my concern that commodity agreements lightly undertaken will make it even more difficult to establish a consistent trade policy.

I recognize that economic integration brings very great reward to those countries capable of benefiting from it. The U.S. experience and that of the EEC are ample proof.

But I want to determine here whether economic integration in Latin America will be truly beneficial and whether it is truly possible. The Latin American free trade area is not an instance of real success. Serious economic, political, and geophysical dissimilarities exist among Latin countries. Too often do we removed northerners tend to talk about and think of Latin America as a homogeneous area.

Also, we must examine here the interrelationship of trade and aid. I think it can be demonstrated from static per capita growth rates and increasing debt burdens and the lack of real increase in export trade that we have not created wealth through our economic aid efforts in Latin America under government-to-government aid programs. The countries in which real growth has been shown, notably Mexico, have been those that, in spite of socialist tendencies and strong central government planning, have established a happy modus vivendi with private enterprise, both domestic and foreign. And so we should also consider today exactly what relationship exists between public aid and private investment in the planning U.S. officials are undertaking in the Alliance for Progress.

As you see, I have great hopes for these, and succeeding hearings. They can prove very beneficial, and I look forward to the testimony and cross-examination of this morning's witnesses, Mr. Jack Vaughn and Mr. Anthony Solomon.

Senator Sparkman. Thank you. Senator Javits, you may have the rest of the time.

Mr. Solomon. I have the answer to your question, Senator Javits, if you would like it.

Senator Javits. I would say that in the Senate 11 minutes is but a wink of the eye.

Mr. Solomon. You asked how in the Central American Common Market that 40-percent increase in exports to the EEC compared with total exports.

Senator Javits. No: it wasn't Central America. Your testimony was all of Latin America.

Mr. Solomon. Latin America's exports to the EEC increased by 40 percent and at the same time Latin American exports to the world as a whole during the same period of time increased by 17.6 percent.

Senator Javits. Now, I have just a couple of questions. We have had an extraordinary and uncharacteristic silence from Secretary Vaughn so I would like to ask him a question or two.

Do you believe that the present rate of development in Latin America must be materially accelerated and can you give us any order of magnitude in order to prevent widespread dislocation of democratic governments in Latin America in the next decade upon, perhaps, even the model of southeast Asia?

Mr. VAUGHN. I believe, Senator Javits, that there is a very tenuous relationship between any percentage figure of growth and political stability in democratic governments.

I think this is more of a myth than almost any concept that we fly under. I think that instead what is important is the integration of societies and economies. You are aware of the history of Latin economies, where you have had two sharply segregated sectors in most countries. You have had a small industrialized sector, usually in the capital city, with a different standard of living, many modern manifestations, and then you have had the rest of the country, with people who don't participate in the society, who don't vote, who often are not literate, who have a sharply lower standard of living. To me the objective is to bring all the people of Latin America within their societies, so that they will actively participate in the civic, social, economic, and political affairs of their countries.

The first part of your question, I think, is a crucial one because I think we do have to have an accelerated rate to provide hope, and to provide the necessary savings to do the infrastructural things.

I really don't know where the magic 2.5 per capita growth target that is included in the Alliance, in the Charter of Punta del Este, came from. Something like what is happening in Central America, to me, is much more hopeful. There we have a growth rate approaching 7 percent, which gives us something closer to 4 percent a year per capita growth. In countries like Nicaragua and El Salvador you have an even larger rate of growth.

What I am trying to say is that I don't think there is any direct connection between rates of growth and political stability and maturity and development.

Senator JAVITS. But you do see, I gather, a direct connection between a failure to accelerate growth materially from where it is now——

Mr. VAUGHN. Yes, sir.

Senator JAVITS. And major social upheaval in Latin America in the next decade.

Mr. VAUGHN. Yes, sir.

Senator JAVITS. Are we likely to face it unless we get something more done that is being done now?

Mr. VAUGHN. Yes, sir.

Senator JAVITS. You feel that?

Mr. VAUGHN. I feel that way and I feel that way especially with regard to the rural sector because we have this very unfortunate coincidence of a roughly 3-percent-per-year increase in population and the constant migration of the peasants to the urban slums, and this results in problems of every kind—housing, health, education—political problems.

Senator JAVITS. And revolution.

Mr. VAUGHN. Yes, sir.

Senator JAVITS. Or wars of liberation.

Mr. VAUGHN. Yes, sir.

Senator JAVITS. Do you see any connection between our policy in Latin America—you have just come back from there?

Mr. VAUGHN. Yes, sir.

Senator JAVITS. And this sudden move to broaden trade relations with Eastern Europe and the common ties, Far Eastern countries in Latin America.

For example, Campos is going to Moscow. What is going on there?

Mr. VAUGHN. My assessment of this move is that Latin America, certainly countries in Latin America, have reached the point of desperation with regard to unloading some of their chronic surpluses.

They look at our markets and then Western European markets and see that the growth of their sales in tropical export commodities is limited.

The increase brought about by population increase is minimal and they are stuck with these overlays, surpluses, warehouse stocks of their tropical export commodities and they are trying to get rid of them. It is the same thing we saw in Canada, with regard to wheat, and in other Western countries who have done business in the past 5 or 6 years with the Soviet bloc countries.

They see this, I think, as their only out in terms of disposing of certain very troublesome surpluses.

Senator JAVITS. Does this or should it worry the United States?

Mr. VAUGHN. I think we have twinges, but I don't think it is a serious concern.

Senator JAVITS. Now may I turn to Secretary Solomon and ask him this?

Is it now considered policy of the United States to bring about an acceleration of Latin American development through Common Market techniques?

Mr. SOLOMON. Encouraging the Latin American Common Market?

Senator JAVITS. Right.

Mr. SOLOMON. Or regional integration, whatever form it may take. I think that is very much the policy of the United States, but we envision this support being in the form of financial and technical assistance, for the reasons I have mentioned earlier.

We do not feel, partially because the Latin Americans have not taken any concerted initiative on this, but partially because of the considerations I have outlined here, that the creation of any special trading relationships between the United States and this proposed regional economic integration in Latin America would be appropriate economic support.

Senator JAVITS. As a practical matter are we preparing proposals to be laid before the Foreign Ministers' Conference in Rio de Janeiro, and the Inter-American Economic and Social Council with respect to the President's August 17 proposal on fertilizers, pesticides, et cetera, for sectoral development, as you recall it?

Mr. SOLOMON. I think that this comes in Secretary Vaughn's area.

Mr. VAUGHN. Senator Javits, this was a proposal made by CIAP and we view this as something that should be very much in the area of CIAP's activities as an agency that stimulates, provides ideas, coordinates, and evaluates what is happening in the Alliance.

Our response to this has been very favorable. We are hoping now that this Conference will take place beginning in mid-November and that at that time we will be ready with some specific recommendations as to how this general recommendation can be initiated.

Senator JAVITS. Including the mix between public and private?

The President didn't specify that.

Mr. VAUGHN. Yes, sir.

Senator JAVITS. This would then be something like the European Coal and Steel Community, a kind of a trial run on integration; is that right?

Mr. VAUGHN. Yes, sir; perhaps two or three sectors to begin with. We are engaged intensively in preparations for the Conference. The Conference was postponed twice, and much has happened since it was originally scheduled. We are going to have to review all we have done here for it.

Senator JAVITS. As a practical matter you have a pretty good base to build on in the Latin American Free Trade Association and Central American Common Market which take in 14 of the 19 countries of the Americas.

Mr. VAUGHN. Yes.

Senator JAVITS. And the door is open certainly in LAFTA for other countries; is it not?

Mr. VAUGHN. Yes, sir.

Senator JAVITS. So that really when we talk about a Latin American Common Market you don't have to dream one up. There is one. The only point is that it is not adequately revved up to do the job?

Mr. VAUGHN. Correct.

Senator JAVITS. That is right.

Mr. VAUGHN. Yes, sir. There is a third movement that has come on fast in just the past 2 or 3 months in the Caribbean area where the Puerto Ricans have taken the initiative in proposing a number of regional, sectoral-type projects in trade, and tourism, and other areas.

Senator JAVITS. Would the concept of these three regional organizations be a satisfactory implementation in the eyes of the United States to the American policy favoring a Latin American Common Market?

Mr. VAUGHN. Since that has been our policy for many years and since these are arrangements that are already at various stages of development, I see no reason why we would change our policy at this point.

Senator JAVITS. And there always can be interrelationships between them?

Mr. VAUGHN. Yes, sir.

Senator JAVITS. I think, like my colleagues, that there is a great deal more of course that needs to be asked, and personally I feel that we need to move into this far more vigorously. Latin Americans will not resent economic initiatives on our part nearly as much as they will resent political initiatives or more Dominican Republics, and I feel we need to be, and I speak only as one Senator, much less diffident and much less circumspect about economic initiatives, especially if we work closely with the business community which is less developing in Latin America.

I think the hour is so late and the need so urgent that we have to lay the diplomatic striped pants and niceties aside in the economic field and move in and do things.

I think you two gentlemen feel that way. You don't have to say so, but I know you do. And I hope very much that will be the temper of our country, and I believe—our chairman is really much more expert at that even than I because he has been here longer and knows the situation better—the Congress is ready for it on this field, far more than on the political field.

Mr. Chairman, if I may, I would like to insert in the record the actual plan of Will Clayton as proposed to us on January 16, 1964, because it is so pertinent.[1]

Senator SPARKMAN. That may be done.

Without objection it will be inserted.

(Material referred to follows:)

WILLIAM L. CLAYTON—ANDERSON, CLAYTON & CO.; FORMER UNDER SECRETARY, OF STATE FOR ECONOMIC AFFAIRS, PROPOSAL TO JOINT ECONOMIC COMMITTEE, JANUARY 16, 1964, "HEARINGS" PAGE 408

* * * * * * *

I suggest that a Western Hemisphere free trade area should be established, as a beginning, on the following limited basis:

1. The United States, Canada, and Latin American countries would reduce their tariffs on imports of raw materials originating in other Western Hemisphere countries at the rate of 10 percent per annum for 10 years, until such tariffs are at zero. Where import quotas are employed on such trade, such quotas are to be modified annually, so that at the end of 10 years they will have completely disappeared.

2. Latin American countries will reduce tariffs at the rate of 10 percent per annum on all imports (both raw materials and industrial products) originating in Latin American countries so that at the end of 10 years such tariffs will be at zero. And then the same condition applies to import quotas as mentioned in 1.

This second step must be taken if the Latin American area is ever to be developed industrially. In 10 years' time, a common market or free trade area of 200 to 300 million people (larger even than the U.S. Common Market) will be created, justifying the establishment of highly efficient, giant industries in Latin America.

3. It is expected that the Western Hemisphere free trade area will further multilateralize the above plan by negotiating arrangements with other free trade areas, or common markets.

4. At the end of 10 years, the foreign ministers of Western Hemisphere countries will meet to discuss their future problems in respect of trade and to advise their respective governments on the course that should be pursued for the future.

A Western Hemisphere free trade area on the above basis would accomplish the following:

(*a*) Raw materials originating in the Western Hemisphere would circulate freely throughout the whole of the Western Hemisphere.

(*b*) All goods—raw materials and industrial products—originating in Latin America would circulate freely throughout Latin American. * * *

Senator SPARKMAN. Thank you very much, gentlemen. This is quite timely. There is the rollcall now. Thank you very much.

The committee stands adjourned.

Mr. VAUGHN. Thank you.

(Whereupon, at 12 noon, the hearing was adjourned.)

[1] "Private Investment in Latin America." Hearings before the Subcommittee on Inter-American Economic Relationships of the Joint Economic Committee, Jan. 14, 15, and 16, 1964; p. 408.

SUPPLEMENT TO ORAL PORTION OF TESTIMONY

Further Questioning of Department of State Representatives With Submitted Answers

53-372—65——12

DEPARTMENT OF STATE,
Washington, October 12, 1965.

HON. JOHN W. SPARKMAN,
Chairman, Subcommittee on Inter-American Economic Relationships, Joint Economic Committee.

DEAR SENATOR SPARKMAN: At the completion of testimony by Assistant Secretaries Solomon and Vaughn before your subcommittee on September 10, a number of questions were asked by Congressmen Reuss and Curtis. As you know, the members of the subcommittee were immediately thereafter called to the floor for a rollcall and written replies for inclusion in the record were requested.

I am pleased to forward these replies as an enclosure to this letter. I am also enclosing material requested by Representative Reuss during my testimony for incorporation in the record.

The Department would like to comment for the record on a point raised by Congressman Reuss both at the beginning and the end of his specific questions, namely that the State Department's favorable attitude toward a Latin American Common Market represented a new departure in our policy. We wish to note that American support of Latin American integration has been clearly expressed by both of President Johnson's two predecessors.

Early in 1960, three Central American countries agreed to establish a customs union and seven Latin American countries in the Treaty of Montevideo set up a Latin American Free Trade Area (LAFTA). It was at this very time that President Eisenhower made a 2-week trip to Latin America. Speaking to the Chilean Congress on March 1 the President said:

"The United States, as the largest common market in the world, could not but look with favor on the efforts of other free nations—in Europe, Latin America, or elsewhere—to enhance their prosperity through the reduction of barriers to trade and the maximum use of their resources. We feel that a common market must be designed not only to increase trade within the region but to raise the level of world trade generally."

Upon his return from Latin America President Eisenhower reported to the Nation on March 8 that the real solution to Latin America's economic woes was in agricultural and industrial diversification:

"Here we are encouraged by the progress being made toward the creation of common markets. Large areas, relatively free of trade restrictions, will make for greater efficiency in production and distribution and will attract new capital to speed development."

President Kennedy enunciated his administration's support of Latin American integration at a White House reception on March 13, 1961, for Latin American diplomats and Members of the Congress. The President stated:

"We must support all economic integration which is a genuine step toward larger markets and greater competitive opportunity. The fragmentation of Latin American economies is a serious barrier to industrial growth. Projects such as the Central American Common Market and free trade areas in South America can help to remove these obstacles."

Testimony before the House Committee on Foreign Affairs on the foreign aid bill, H.R. 7372, in June 1961, also clearly points to our underlying support of Latin American economic integration. Speaking for the economic aid program, Acting Assistant Secretary De Coerr characterized the Central American Common Market and LAFTA as self-help measures "essential to the success both of social and economic development." Further, in testifying before the House Committee on Foreign Affairs in support of the Foreign Assistance Act of 1963, Alliance for Progress Coordinator Moscoso in May 1963, spoke of the success already achieved by the Central American Common Market and added that progress had been made toward the goal of economic integration and the eventual creation of a Latin American common market. He pointed out that the "United States continues to support LAFTA in its efforts to accelerate the integration efforts which will lead to diversification and expanded trade."

Although the U.S. policy of encouraging Latin American economic integration is therefore not new, we wish to emphasize our wholehearted agreement with Congressman Reuss as to the value of continuing congressional interest in and discussion of such questions. We wish particularly to express our appreciation for the opportunity afforded Mr. Solomon and Mr. Vaughn to appear before your subcommittee in furtherance of that purpose.

Sincerely yours,

DOUGLAS MACARTHUR II,
Assistant Secretary for Congressional Relations.

QUESTIONS ASKED BY CONGRESSMAN REUSS

Question 1.—What would be * * * [the] effect [of a Latin American Common Market] upon exports from the United States to Latin America over the years? What would we lose, and particularly how would that be divided among the various sectors of the American economy? Who would bear the cost of this?

Answer.—In order to assess the likely effects of the formation of a continental Latin American Common Market on U.S. exports, we must take into account the nature of the development effort which the Latin American countries have been pursuing for many years. That is, we need to consider whether a Latin American Common Market is more likely to promote or impede U.S. trade with the area in comparison with our trade prospects if current Latin American policies—short of meaningful integration on a continental scale—are continued.

The Latin American countries have sought to change their domestic economic structure, diversify production into new areas and radically alter cost conditions through investment, training, incentives, etc., but all, essentially, on a national scale. As a general matter the course of structural change has been pursued by a conscious policy of import substitution; i.e., conservation of scarce foreign exchange by inducing and protecting domestic production of goods previously imported. The limitations of a policy of concentrating on import substitution have become increasingly apparent to the Latin Americans. A policy of export expansion, however, requires diversification of production beyond the few primary commodities traditionally exported. A large proportion of such diversification must also inevitably be in items which are also exported by the United States and other developed countries.

Thus whether or not a Latin American Common Market is instituted, the countries of the area are determined to break away from their traditional dependence on production of a limited range of primary commodities. The choice they face is essentially whether diversification and growth should continue to proceed on the basis of narrow national markets protected by high tariff barriers, or on the broader scale of a continental common market. In either case the very nature of the vast technological change involved makes necessary a continued reliance on the developed countries of the world for more advanced techniques and equipment. Moreover, the fact that the area cannot properly develop in isolation from the rest of the world is recognized by Latin America both in theory and in practice: the major constraint on the total volume of Latin American imports is, and will continue to be, the foreign exchange the area can earn from its exports.

The bulk of U.S. exports to Latin America already take the form of intermediate and producer goods for Latin America's own industry rather than relatively simple consumer goods. The characteristic mode of operations of the American firms supplying producer goods—machinery, transport equipment, chemical products, etc.—is one of constant development of new and improved products in response to the changing technical needs of their markets, both domestic and foreign. Thus these industries have every reason to expect to be able to remain on the crest of the innovational wave moving through the Latin American economy.

The significance of a Latin American Common Market should be judged, therefore, not by the fact that goods will be produced in Latin America which were previously imported, for this process is already well underway, but primarily in terms of the increases in efficiency, income and foreign exchange earnings which are likely to be brought about by a development effort pursued on a more economical scale. If genuine integration takes place such that Latin American industry competes throughout the entire common market, the resulting increases in productivity should contribute heavily to Latin American ability to compete also in world markets. Increased export earnings would, in turn, permit her to import a greater volume, especially of the sophisticated goods needed to support the development effort, and even some new or specialized consumer items. In addition, the climate of more rapid growth and expansion, and the prospect of an area-wide market, can be expected to enhance the attractiveness of Latin America for U.S. investment, itself an added stimulus to U.S. exports of manufacturing equipment.

Although it is impossible to predict the precise areas of U.S. exports which might undergo contraction or expansion as a result of a Latin American Common Market, the general trend of our exports to the area is clear with or without Latin American integration: it will continue to be a movement away from simpler manufactured items, particularly traditional consumer goods, and toward the more technically complicated items necessary to modern industrial production. It is also likely that many industries, and indeed firms, which lose markets because of Latin American industrialization will frequently also be the ones that gain new markets; this pattern of interdependence and shifting specialization characteristic of modern industry becomes clearer perhaps by recalling that many multiproduct firms within a given industry find their best customers within the same industry. Thus the growth of the Latin American machinery and chemicals industries, for instance, should mean more rather than fewer sales of U.S. machinery and chemicals to Latin America.

The fundamental consideration, however, is the likelihood that more rapid growth of production and exports fostered by a common market will bring about a greater rather than a lesser volume of imports into the area. This has indeed been the case with respect to U.S. exports to the European Economic Community (EEC) and the Central American Common Market (CACM).

Question 2.—What about the exports from the rest of the world, developed and developing, to Latin America? Who would bear the cost of that? How much displacement would there be, and have those countries which would feel this displacement been consulted about this and what do they have to say about it?

Answer.—We would expect the development of a Latin American common market to affect imports from the rest of the world in much the same fashion as it will affect the United States; namely, a continuing change in composition and an increase in the volume of imports as Latin American productivity rises, foreign exchange earnings increase, and Latin America is thereby enabled to take better advantage of the gains from trade.

As to the impact of changes on the underdeveloped countries, the striking fact is the extent to which less-developed countries trade primarily with the developed countries rather than each other. Latin American imports from all other less-developed areas amount to less than 5 percent of total imports, and this, in turn, amounts to less than 2 percent of the total exports of these less-developed areas. It is likely that, for the medium term at least, the impact of any changes will significantly affect only the developed countries.

With regard to consultation, other countries have had ample opportunity over the past 4 years to take a position on Latin American economic integration and the consensus has been one of approval rather than opposition. In particular this attitude is reflected in the results of a multilateral examination of the Treaty of Montevideo creating the Latin American Free Trade Association (LAFTA) in 1960. The Montevideo Treaty was examined by the contracting parties to the General Agreement on Tariffs and Trade (GATT); no recommendations for modification were made and the treaty signatories were free to implement their free trade area under the terms of GATT article XXIV.

Although the LAFTA arrangements do not involve a common customs tariff, which is normally implied by the term "common market," the essential feature of an integrated Latin American market, namely the elimination of internal barriers to trade, has clearly been the major element of LAFTA from the beginning. The current recommendations for a Latin American Common Market, therefore, in particular the "proposals" of the four eminent Latin American economists (Messrs. Herrera, Mayobre, Prebisch, and Sanz), should be regarded as a reflection of dissatisfaction with the speed with which the goal of free trade within the area is being achieved rather than as a new departure in principle.

Question 3.—What is the effect of the State Department's espousal of a discriminatory tariff area in Latin America likely to be in causing other areas of the world to want to set up discriminatory trading blocks, such as in Africa and various portions of Africa, the Middle East, Asia, Middle Europe, and elsewhere?

Answer.—The interest of the less-developed countries in regional economic integration is largely attributable to their having observed the spectacular success of the EEC in speeding the growth of income, intra-Common Market trade and trade with the rest of the world, rather than to the attitudes toward integration adopted by the United States or any other country. There already exist two full-fledged customs unions in Africa: the Equatorial Customs Union/Cameroon arrangement (Central African Republic, Chad, Republic of the Congo Brazzaville, Gabon, and Cameroon) and the East African Common Services Organization (Kenya, Tanzania, and Uganda). Both of these, however, are primarily the result of the carryover by the newly independent states of trade arrangements prevailing during the colonial period.

There is active discussion, under the auspices of the U.N. Economic Commission for Africa, of a West African free trade area in iron and steel products. Possibilities for other manufactured items and other African regions are also receiving tentative consideration.

In the Middle East, Turkey, Iran, and Pakistan have formed an organization for regional cooperation and development which is seeking means to integrate their markets for basic industrial products. A number of Arab countries have reached the point of submitting a plan for an Arab Common Market which will be examined by the GATT in the near future.

And in the Far East, too, there is considerable sentiment in favor of integrating the relatively isolated national markets. Perhaps because of the greater political heterogeneity of the area and the turbulence of events in the recent past, plans for regional trading groups in the Far East appear to be at an earlier stage than elsewhere in the developing world.

Meaningful steps toward integration require profound domestic political undertakings, especially for developing countries acutely conscious of newly acquired sovereign status. Progress is likely in any event to be slow and arduous, as has been the case even in Latin America which to a considerable degree shares a common language and customs. It remains to be seen whether the various less-developed countries contemplating regional economic integration have the political will necessary to achieve it.

We believe, however, that the benefits to be derived from regional economic integration among developing countries are worth the continuing effort. This attitude is based not only on the view that regional integration can, per se, provide advantages to the developing countries, but also on the conviction that the discipline necessitated by serious integration commitments, in terms of responsible monetary and fiscal policy and realistic exchange rates, will also be conducive to increased participation in world trade on a multilateral basis.

Question 4.—What will be the effect upon the American outlook and temper as regards reciprocal trade, an outlook and temper which for the last 30 years has been in the direction of multilateral, most-favored-nation, freer trade, when American producers in fragile industries like pottery, or glassware, or footwear, observe that manufacturers of those commodities in Latin America are being given a discriminatory protective preference, whereas an American shoe manufacturer has to hurdle the tariff wall?

Answer.—The formation of customs unions and free trade areas, in the interests of more rapidly freeing trade among the members, has long been recognized by nations as consistent with the aims of most-favored-nation treatment. Further it is reasonable to expect the American outlook and temper favoring freer trade to continue and even to be strengthened by a successful Latin American Common Market leading to more rapid growth in income, exports, and imports. Certainly, the growth of our exports to the European Economic Community, for instance, has had that effect.

It is undoubtedly true, however, that there will be cases where U.S. exporters to Latin America may find their markets reduced by Latin American suppliers enjoying the benefit of location within the Common Market. It may be, in any given case, that in the absence of the Common Market the U.S. supplier would nonetheless find his product excluded, either by virtue of protection afforded domestic infant industry or balance-of-payments restrictions necessitated by shortage of foreign exchange. Nevertheless, particular U.S. exporters may indeed be negatively disposed toward U.S. support of a Common Market which affects, or appears to affect, their marketing opportunities adversely. But if the development and growth objectives remain paramount in the implementation of a Common Market, opportunities for increased trade by U.S. business should far outweigh those of loss.

The effect of Latin American economic integration on such sensitive industries as pottery, glassware, and footwear is likely to be minimal. Each of these industries is oriented overwhelmingly to the domestic U.S. market rather than to exports; nearly 99 percent of U.S. pottery production, slightly more than 97 percent of U.S. glassware production, and over 99½ percent of U.S. footwear production is consumed domestically.[1] This concentration on domestic rather than oversea markets is, of course, not unrelated to their competitive position in international trade. The existence of protection for Latin American industry per se does not seem likely to provoke a marked change in U.S. business attitudes toward freer trade, since this has long been a fact of life and it is generally conceded that industries in developing countries often do need such protection.

Question 5.—Will the State Department's proposed Latin American Continental Common Market tend to take the eyes of the Latin

[1] Percentages calculated from 1962 U.S. Bureau of Census and U.S. Tariff Commission data.

American countries off of what they really ought to be doing, which is to build up, at least in the larger countries, domestic markets for their own people?

If the Latin American Common Market is accepted and fails because the members do not have very much to sell to each other, what will be the political cost to the United States of having supported a Common Market?

Answer.—There would seem to be little danger that any of the Latin American countries is likely to consider the prospective benefits or gains from integration so substantial as to permit a relaxation in internal efforts to promote development. Each is under great pressures to provide improved economic conditions for its rapidly growing population. From experience, each is already aware that the others are willing to proceed toward integration only slowly, carefully, and in stages that require years to bring the full fruits of integration to those domestic industries which can derive a direct benefit from new opportunities to export. Governments and business leaders alike recognize that inadequate transportation and communications, arbitrary and unstable exchange rates and faulty knowledge of markets raise serious obstacles to integration, and that their removal will require much time and effort. Nevertheless, many are convinced that economic integration, while not an alternative to national efforts, can provide a useful and badly needed additional impetus to the modernization and growth of their economies.

The foregoing does not deny that there may be individual firms or businessmen in Latin American countries who hope for and will seek to achieve positions of special privilege in regional markets such as some enjoy today in domestic markets. Some may work to enlarge their protected markets and seek to maintain artificially inflated prices and exorbitant profits instead of striving for increased efficiency and lower costs which can be passed on, in part, to an increased number of domestic and regional consumers.

To the extent that competition among producers within the region is artificially kept limited or regional industries receive excessive and prolonged protection from extra-zonal competition, the countries concerned will fail to receive the full possible benefits in terms of increased output, best use of resources, growth of internal markets. If these conditions were widespread they would seriously limit the possible effectiveness of the integration effort, and this would have to be taken into account in considering how and to what degree the United States could support such an effort. Fortunately there is a widespread awareness concerning the need for competitive markets. Recent proposals for more advanced integration in Latin America lay stress upon the need for intrazonal competition.

Success in initiating further integration in Latin America is also unlikely to deflect other efforts by individual governments to build up domestic markets. While much remains to be done, and faster progress is desirable, recent reviews of the Alliance reveal many examples of tax reforms designed both to mobilize funds for developmental investments and to promote social justice, of programs to build industry and create employment, to assist small farmers expand production and income, and of projects to improve inadequate distribution and marketing arrangements. These are intended to increase or have the effect of building domestic markets. Integration movements, far from detracting from such efforts, will give them more meaning and, perhaps, a better chance of success.

It is improbable that a Latin American Common Market, once organized, would fail because the members do not have much to sell to each other. In 1964, the intrazonal exports of LAFTA countries exceeded $550 million, and preliminary data show the value of such trade in 1965 to be 30 percent above last year's level. Trade within the Central American Common Market has more than tripled in the past 4 years, and in 1964 exceeded $100 million. In both cases intrazonal trade has grown more rapidly than the trade of member countries with the rest of the world. For Latin America as a whole, and including the countries of the area which are still not members of any regional trade grouping, intra-area exports in 1963 (the latest period for which complete data are available) totaled about $735 million. The data on existing trade indicates the Latin American countries already have a great deal to sell to each other. In the two existing regional groupings, 14 countries have entered serious commitments to continue reduction of trade barriers which can be expected to increase the number of items which enter the zonal trading patterns.

It is conceivable, of course, that in the future, vested interests in the various countries of Latin America might seriously hamper efforts to continue trade liberalization, that the rate of growth in intrazonal trade could be substantially reduced, and that critics would term the integration effort a failure. Unforeseen political developments conceivably also could disrupt progress within a Common Market effort.

Economic integration in Latin America is a voluntary effort undertaken by the Latin Americans on their own initiative. Should the movement fail for any reason, it can be expected that individuals and groups generally critical of the United States would attempt to shift the blame for the failure upon our country. The charge, however, is most likely to be that the United States failed to support the Latin American effort to help itself. To the degree that we are able to show extensive support and assistance for effective integration measures, we will avoid such an accusation.

Neither does the Department believe that there is a potential political cost outside Latin America attached to U.S. support for Latin American efforts to achieve integration. The major part of the measures which have been undertaken by the Latin Americans to form a regional grouping, and also most of the measures contained in existing proposals for accelerating integration have been approved, in principle, by the large majority of countries.

Question 6.—What is—has been—the reaction of Latin American countries to the idea of a continental Common Market?

Answer.—Leaders of most Latin American republics have spoken in favor of a Latin American Common Market, and the principle of economic integration was approved at the July 1965 meeting of the Latin American parliamentary representatives in Lima. This group is comprised of members from nearly all the political groupings included in the legislatures of the 19 republics. Approaches to achievement of closer economic ties and expanded trade vary widely as to form, and the timing of steps toward such matters as tariff reduction, construction of a common external tariff, and industrial integration. There are also various points of view as to the eventual membership of a regional common market and the institutions needed to achieve the general goal. These divergencies relate, however, to the means of attaining objectives, not to the goal of economic integration itself.

A meeting of the Economic Commission for Latin America (ECLA) in Mexico City during May 1965 provided a recent opportunity for an open exchange of views among the countries concerned. The larger countries spoke in favor of integration, but showed a preference for achieving it within an improved LAFTA framework. The Central American countries indicated their willingness to cooperate in gradual progress toward continental integration, but made clear that they wish to preserve the gains already achieved in the Central American Common Market. The least economically advanced countries in South America were interested primarily in obtaining special treatment from any organization for integration that will help them close the gap between their stage of development and that of their larger and stronger neighbors.

Chile has been a strong proponent for making a completely fresh start toward a full-scale Common Market. President Frei, in July, stated that "early and rapid progress toward Latin American economic integration is an absolute necessity." Chile's Foreign Minister, speaking in Washington on integration, September 28, 1965, reiterated Chile's support for a Common Market and declared this as important as any internal policy of his government.

Argentina's Foreign Minister outlined his country's position in support of economic integration efforts in a letter handed to LAFTA ambassadors in April 1965. The letter contains proposals to modify and improve LAFTA institutions and programs without going so far as to specifically endorse automatic tariff reductions or establishment of a common external tariff.

In his annual message to the Mexican Congress, President Díaz Ordaz on September 1 this year emphasized his country's support for economic integration limited to the underdeveloped countries of our hemisphere. Colombia's Finance Minister stated in mid-September that the way should be paved for eventual conversion of LAFTA to a Common Market, including a common external tariff and a payments system.

Venezuela and Bolivia are both seriously considering joining the Latin American Free Trade Area, and judging from the statements of various officials, they will not long remain outside the organization which will then include all the countries of South America.

The Foreign Ministers of the LAFTA members are scheduled to meet in November 1965 for the purpose of considering measures which can be taken to accelerate integration. This may also be taken as evidence of the keen interest which Latin American countries have in improving cooperation in the economic field.

Question 7.—Who decided political union in Latin American is good? Do Latin American countries want this? Is it inevitable? Is it good for them and for the rest of the world?

Answer.—U.S. support for economic integration in Latin America is not based upon a presumption that it will lead to political union in the area. Such a union is not necessary for the efficient operation of a free trade area or Common Market. We would hope and expect that the greatly increased contacts among government officials and businessmen, which cooperation in a regional economic effort would require, will also vastly improve their understanding of each other's political and social problems and the area of agreement on all types of mutual or common problems. This result cannot fail to be of benefit to them and to all other nations.

The political union of Latin America has often been discussed, but more in theoretical than practical or realistic terms. The new Latin American Parliament (an association of Latin American legislators), meeting in Lima in December 1964, and again this past July, has indicated that "political integration" of Latin America is one of its objectives. The Christian Democratic parties tend to favor economic integration to be followed by some measure of political unification.

Few political leaders, however, believe that under existing conditions any real political integration can be attained in the next few years, nor would it seem a likely event over a period of several decades. In our opinion, few Latin Americans consider it "good" except in very abstract terms. Notwithstanding much in common, the Latin American countries have many differences—cultural, economic, and political; they are strongly nationalistic. Certainly not until major advances are made economically and culturally would they be willing on any large scale to move towards political union. As of now Latin Americans have the advantage of a score of votes in the United Nations. Such representation would not readily be given up. Still somewhat remote, the most likely step in the direction of political integration would be the federation of the Central American countries.

Over a period of years many Latin Americans might come to see political union as desirable, since it would—under favorable circumstances—provide for a strong and stable central government, maximum economic cooperation, and an opportunity possibly, to assume the role of a major world power. Whether or not such a union at some distant time in the future would be good for the United States and the rest of the world is a question that could be answered only on the basis of extremely speculative assumptions.

Question 8.—To what extent is this concentration on a Latin American Common Market a substitute for facing up to what seems to me the real problem, getting development aid and investment, public and private, into Latin America in sufficient amounts to enable those countries to make an economic takeoff?

Answer.—Those who support measures promoting effective economic integration in Latin America, either a full-scale Common Market or less ambitious goals, do not view them as substitutes for economic assistance but as means for creating conditions under which the assistance would become more fruitful and effective, conditions which would attract more, not less, assistance, especially in the form of private investment. If the expectations of those favoring integration were realized, the results should be that a given amount of public assistance would result in a greater amount of development in an economically integrated Latin America. Private investment would not only be greatly stimulated but each unit invested would be better used and result in a greater product. Hopefully, under such conditions the period required to achieve economic takeoff for Latin Amerca and an end to concessional U.S. public assistance to the area would be shortened.

The Alliance for Progress and the present institutions for integration in Latin America, the Central American Common Market and the Latin American Free Trade Association, are of about the same age. Neither the U.S. Government, nor the Latin American governments, has relied upon the integration movements to produce a miraculous economic transformation or to carry the main burden of development within the area. These organizations were new, weak, unsure, and untried. Instead we worked with national and local governments, business firms, cooperatives and labor groups to seek out, develop and formulate projects through which our assistance could make a maximum contribution toward the Alliance objectives of economic development and social betterment.

It is the same today. Our various programs are well known. They range from the fields of education and health through building needed publicly administered infrastructure, and giving technical assistance to boost agricultural productivity, to extending guarantees to private U.S. funds invested in Latin America. They are concentrated in individual countries.

Of late, we have been able to add still another promising type of activity to the many developed in the early years of the Alliance. With the rapid maturing of the Central American Common Market, and the formation of its Bank for Economic Integration (CABEI) and its integration fund for infrastructure, there is now available more adequate and appropriate machinery for finding, evaluating and developing projects that can have a multinational effect. We can and do assist in projects which are designed from their origins to improve the infrastructure of several countries. Industrial credits are available to businessmen who seek to exploit opportunities offered by the widened markets in Central America.

As integration movements grow stronger, in other subregions or in all Latin America, the opportunities to use U.S. official assistance or new private investments more effectively should grow. A modern road linking capitals or industrial centers in two neighboring Latin American countries might, if it were built, slowly create a demand for reduced trade barriers, but, today, potential traffic would not justify its cost. With effective integration, traders' demands will quickly demonstrate the need for such a road and the priority it should be given.

In the more important field of private investment, the opportunities to improve the effective use of scarce capital have been called spectacular. Latin American countries seeking to conserve exchange, increase employment and diversify their economies have promoted industrialization primarily to supply their domestic markets. Investment costs per unit of output could be greatly reduced if fewer plants of more nearly optimum size could serve combined integrated markets. Such conditions would also be more attractive to the investor and should act to involve the private sector more rapidly and more heavily in the economic development of Latin America.

(The following information was supplied subsequently by Assistant Secretary Solomon in response to Representative Reuss' request. See p. 150.)

The lowering of internal barriers to trade following the formation of the Central American Common Market led to a spectacular growth in trade among the Common Market members and spurred a rising tide of investment, both local and foreign, in a wide range of light industries to serve the entire area.

Between 1960 and 1964, trade among the member states increased from \$32.7 to \$105.4 million. The fastest-growing component of this regional trade was industrial goods, which increased more than fourfold, from \$13 to \$69 million. These industrial goods are predominantly finished consumer goods, such as textiles, footwear, cosmetics, detergents, furniture, and paper products, as well as fertilizer and cement. The growth in trade in products of this character was made possible both by increased output of existing plants and by the establishment of new plants in the region.

Illustrative of the investments that have been made in the Central American Common Market to serve the entire area are those financed with the help of the Central American Bank for Economic Integration (CABEI). From 1961 when it was chartered through June 30, 1965, CABEI made 67 loans totaling \$25 million for the establishment and expansion of 61 private industrial plants. The industries in which these investments were made and the amounts lent by CABEI are given below:

Investments	Number	Amount
Food processing	9	\$2,461,000.00
Tobacco processing	1	300,000.00
Textile factories	12	9,190,290.00
Shoes and clothing	5	781,409.86
Lumber industry	2	325,000.00
Books and stationery	1	140,000.00
Leather processing	1	65,000.00
Plastic industry	1	40,000.00
Chemicals and chemical products	16	4,837,734.28
Nonmetallic minerals	4	3,220,000.00
Basic metallic industries	2	1,025,604.00
Metallic products	6	1,363,335.00
Electrical appliances and accessories	1	600,000.00
Transportation material	1	211,500.00
Various manufactures	5	376,000.00
Total	67	24,936,873.14

It should be noted that CABEI will not, by the terms of its charter, "invest in industries of essentially local character." Its purpose is to "encourage economic integration" and each loan application is judged not only from the standpoint of its technical and economic soundness but also the degree to which it contributes to regional integration.

Private foreign investment has been actively stimulated by the formation of the Common Market. In the last few years, U.S. private companies have made investments in the Central American region in fertilizers, paints, paper products, batteries, a wide range of processed foods, phonograph records, shirts, cotton sheeting, vaccines, soaps, detergents, bleaches, camelback rubber, and pesticides. These investments were made in response to the opportunities opened up by the reduction of barriers to regional trade. Between 1960 and 1963, when foreign investments in the field of agriculture—the traditional field of foreign investment in Central America—fell, investments in manufacturing rose from $12 to $20 million, and in commerce from $16 to $19 million. Complete statistics on foreign investment in 1964 are not yet available but one can anticipate that they will continue to show a rising trend.

The number of inquiries handled by the Guatemalan office of the Department of Investment Promotion of CABEI is evidence of the degree of foreign investor interest stimulated by the Central American Common Market. In the last 6 months of 1964, the office handled 41 inquiries. In the first 6 months of 1965, it handled 103 inquiries. The bulk of these inquiries was made by U.S. businesses, but there were inquiries by European investors as well.

It is also of interest to note that at the First Central American Conference on Investment Opportunities, held under the auspices of CABEI in May 1965 to inform local businessmen of investment possibilities in industry and tourism, CABEI announced 50 offers of foreign investors who are planning to associate themselves with local investors in joint projects to service the Central American Common Market.

Petroleum has been treated differently from other products in the Common Market. There have been no reductions made in the tariffs on refined petroleum products, and the tariffs in each country apply equally to products from abroad or of Central American origin. At a time when Central America is giving great attention to the development of an integrated regional market, nationalism seems to be setting the pattern for petroleum fuels. At the present time, Guatemala, El Salvador, and Nicaragua have their own refineries and Guatemalan refining capacity is being expanded. Costa Rica is arranging for the establishment of a refinery and Honduras has invited proposals for one. None of these refineries is as large as is generally considered economically desirable. The treatment of petroleum is untypical of developments in the Common Markets.

QUESTIONS SUBMITTED BY CONGRESSMAN CURTIS

Question 1.—Timing—

(*a*) To what degree is planning toward a Latin American common market premature in light of the uncompleted Kennedy Round? Brazil, Chile, Nicaragua, Uruguay, and Argentina, as members of GATT, must first find out the degree to which their needs are met in the Kennedy Round before wishing to join a Latin American economic union.

Should the United States first see what it comes up with from the Kennedy Round before engaging itself in a Latin American economic union?

(*b*) What is being done by the United States to adopt the new GATT chapter on trade and development, which lays ground rules for less-developed country participation in GATT, to LDC needs?

Is the U.S. Government attempting to convince LDC's that they have a stake in GATT? How specifically?

Answer.—1.*a*. We are confident that a successful Kennedy Round will be a significant contribution to improving access to the markets of the developed countries for the products of the developing countries, including those of Latin America. It is noteworthy that in accordance with the ministerial decision of 1963 and the new GATT chapter, full reciprocity will not be required of the less-developed countries for the trade concessions extended by the developed countries.

Nevertheless many Latin American industries must experience further growth and development before they are able to compete with other producers in the markets of developed countries and a Latin American Common Market would provide the necessary scope for that further growth. Moreover, and we believe this is of particular importance, such a market would subject the industries in each of the individual country members to greater competition on the domestic scene. In our view, the countries of Latin America would benefit by pursuing two different but complementary goals simultaneously; namely, improved access to developed country markets through reductions of trade barriers (the Kennedy Round) and more rational development of industry through economies of scale on a regional basis (a Latin American Common Market).

1.*b*. The United States has accepted the new GATT chapter on "Trade and Development" which becomes effective upon acceptance by two-thirds of the contracting parties. (The protocol incorporating the new chapter remains open for signature until December 31, 1965, but may be extended beyond that date; thus far 13 governments including the United States have signed the protocol without reservation, and 15 governments have accepted ad referendum or subject to domestic ratification procedures.) The new chapter represents, in essence, a formal codification of practices and procedures which have gradually developed over the past several years in the GATT with respect to developing countries' trade problems. The United States considers that it has for some time been acting in accordance with the objectives and commitments contained in the new part IV. For example, the inclusion in part IV of the statement that developed countries "do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less-developed contracting parties" simply lends greater formal status to an agreement reached earlier among the countries participating in the Kennedy Round negotiations.

The United States is seeking to convince developing countries that they have a stake in the GATT. We do so by encouraging the widest possible participation by developing contracting parties in the Kennedy Round negotiations; this "encouragement" takes the form of urging these countries (in their respective capitals and through our negotiating teams in Geneva) to come forward with offers consistent with their own development needs so that the United States and other developed contracting parties will be able to offer maximum concessions of benefit to them. In some cases, the developing countries have been uncertain what kinds of offers they might be in a position to make; we have responded with specific suggestions as to trade barrier reductions which we feel they could offer without adverse effect on their own development efforts.

We also seek to convince developing countries of their stake in GATT by supporting other new activities under GATT auspices primarily of benefit to them. For example, the GATT established a Trade Information Center in 1964 as a central point where developing countries (whether contracting parties or not) can obtain accurate, up-to-date information on market opportunities for their exports. In addition, a separate Committee on Trade and Development was established by GATT early this year to deal with all aspects of developing contracting parties' trade problems (other than the Kennedy Round negotiations) and to oversee the implementation of the new part IV. This committee has established many specialized working parties so that in practice a very substantial proportion of all GATT meetings is now devoted to one or another aspect of developing countries' trade problems.

Question 2.a.—How is it reasonable to assume enough stability in Latin America to build economic union? The European Common Market has succeeded in large part because it was built by stable nations with political systems capable of handling change in an orderly manner.

b. Much of the inspiration for the report submitted by Raúl Prebisch, Jose A. Mayobre, Felipe Herrera, and Carlos Sanz de Santamaría, to the Presidents of the Latin American Republics comes from the successful Common Market in Western Europe.

However, there is a vast difference in the economic bases of the European Common Market and the potential base of the Latin American Common Market. In Western Europe the agricultural "feeder" for the market has been France and the principal industrial supplier has been Western Germany. In Latin America the main components of its economic pattern are a backward agricultural plant and raw materials. How can Latin America then claim an effective base for a Common Market without an internal industrial supplier?

c. With Latin America in effect two geopolitical blocks how can unity in a Common Market be hoped for? Wouldn't the great transportation and communication lacks hamper an integrated market?

Answer.—*2.a.* It is true that some parts of Latin America have suffered from political instability. In most of the Latin American countries, however, the past century and a half of independence has permitted the evolution of an organized administration capable of handling matters dealing with the countries' trade and foreign relations. In several, the administration contains units more recently developed to promote and protect the growing industrial interests. Changes of government cause considerable turnover in personnel at the policy formation levels, but the increasingly expert trained groups at the working level are necessary to any new government, and are normally retained.

Stability in basic political policies and the existence of highly trained expert staffs are undoubtedly helpful in any effort to proceed with economic integration. There is evidence, however, that multinational cooperation seeking to integrate the economies of a region can proceed if the various influential political and social sectors of the population are convinced it is desirable. In Central America, for example, where the efforts to form a Common Market have been crowned with significant success, this was achieved despite abrupt and unscheduled changes of government in two of the five countries involved during the first 3 years of the integration attempt. There was, of course, in each instance, a hiatus during which new governments were temporarily handicapped in meeting their commitments or cooperating in the making of plans or taking of decisions. However, in each instance the leaders of the new government, the business community, and vocal sectors of labor were all convinced of the desirability of furthering integration so that the setback was reduced to a minimum. It is reasonable to expect that these developments could be repeated in Latin America as a whole once the countries of the area, and the influential sectors of society which are involved, reach a consensus on the goals and the form of the integration they wish to undertake.

It is not to be denied that frequent and unexpected changes of government would hamper the work of institutions developed to administer and promote integration. Unless they were of extraordinary severity and frequency, however, they should not prove to be a factor dooming integration efforts to failure. To the extent that economic integration accelerates economic growth, dissatisfaction with economic conditions will be reduced as an element tending to cause abrupt changes in governments.

2.*b*. Though some of the Latin American countries, principally Mexico, Argentina, and Brazil, have a larger and more extensive industrial sector than do the smaller countries of the area, the proposals for a common market on the continent do not rest upon the basis that it is an effort to draw together economies which already complement each other.

The proponents of integration in Latin America see the rise of a common market as a development which would prevent all of the countries of the area from attempting to build an excessive number of small uneconomic industries. They hope that deliberate trade liberalization can encourage regional markets of sufficient size to support modern industries requiring a large output or a high degree of specialization for maximum efficiency. By maintaining a measure of protection against the rest of the world, they will increase the incentive for the establishment of such industries within the countries of the zone. If successful, they will insure the industrialization and diversification of their economies without paying the high economic cost in excessive investment, high unit costs of production, and high prices to consumers which have accompanied their efforts in the past, as each nation sought to promote "import substitution" industries.

Latin America lacks adequate and efficient transportation and communications. It lacks developed intrazonal trading patterns and the mentality and expertise for promoting exports developed in Europe over centuries. It lacks capital and financial markets for mobilizing savings. In a word, it is relatively undeveloped. By seeking to carry this development forward on a regional basis rather than in small national compartments, the proponents of integration believe it can be done at less cost and produce a more competitive and dynamic unit which will be better prepared to keep pace with the growth of the world economy.

2.*c*. Latin America is in effect divided by natural barriers of geography and distance which, added to historical developments, have resulted in the political and economic fragmentation which exists today. There is no doubt that the inadequacies of present transportation and communications facilities act to hamper integration efforts. Not only the poor physical facilities available, but also the trading patterns which have developed as a result of poor intra-area connections, are factors which must be overcome before integration can proceed far. This is clearly seen by most proponents of integration and all serious proposals for proceeding with integration give a high priority to joint efforts for elimination of this type of obstacle.

For a century or more the economies of the Latin American Republics were externally oriented to an extraordinary degree. The opportunities for trade were largely with the more advanced economies of North America and Europe, with the world markets of New York and London. Transportation and communication facilities were built along the same routes. Since the First World War this situation has been modified only slightly. As the Latin American countries have begun to industrialize, concentrating on production for domestic markets, internal transportation and communications have been improved, but externally little change has taken place.

It is to be expected that as the Latin American countries proceed with integration, the obstacles posed by transportation and communication shortages will be gradually overcome in two ways. As they lower tariff barriers among themselves, producers and traders will discover new opportunities for profitable commerce, and stand ready to pay for services which, previously, they did not need and could not use. Entrepreneurs will seek to provide this service with or without the active direct assistance of the governments involved.

There will undoubtedly be cases where the current or short-term demand for transportation and communications facilities will not justify their cost, although they hold the promise of great economic and social benefits over the long term. We hope that in such instances the vision of political and economic leaders on the continent will cause the governments to cooperate in direct action to provide such facilities in the interests of their several countries. Private investors and governments in the developed countries can, in appropriate cases, assist greatly in the process of building the transportation and communication network required by the growing economies of Latin America. This type of cooperation is already in progress as plans go forward to link and improve the highway systems of Central America, and to study the possible advantages and feasibility of building a new highway joining Colombia, Peru, and Bolivia east of the Andes.

Question 3.—Objective. In the Prebisch report (see above) the final objective of the integration process is stated as the establishment of "an economic community embracing all of Latin America" (p. 43, "Latin American Economic Integration," documents prepared by Felipe Herrera).

Ought not the final objective to be hemispheric rather than regionally limited to Latin America? A Latin trade bloc without U.S. participation would produce unfavorable terms of trade vis-a-vis the United States, so shouldn't the United States push for some involvement within the trade bloc giving it preferences, e.g., in exchange for giving the Latin trade bloc preferences?

Answer.—We are convinced that effective Latin American regional economic integration can make a major contribution to increases in productivity and foreign exchange earnings of the area, and that the trade of third countries with Latin America, including that of the United States, will increase, although shifts in the composition of that trade will take place. The basis for this conviction is elaborated in the answer to Congressman Reuss' first question.

As for the problems and possibilities of a special hemisphere relation of a preferential kind, reference is made to the opening statement of Assistant Secretary Solomon which explored the implications of various United States-Latin American trade arrangements.

Question 4.—Again and again in Mr. Prebisch's report (see above) mention is given to the necessity for a greater market in order to increase demand, which in turn would lead to economies of scale and greater production.

In the example of fertilizers, however, often cited as a logical place to use the "sectoral" industry-by-industry approach to integration, the problem is in large part the lack of use of fertilizers by farmers who (1) don't know how to use it; and (2) are inhibited from using it by "the agrarian structure and system of land tenure" (p. 31, Herrera documents). Doesn't the answer then lie, in this area as in many others, in educating the people and effecting internal reforms rather than simply the creation of a larger market?

Answer.—As the Congressman has noted, there are a number of reasons why the use of fertilizers in Latin America has remained at a low level. Clearly, the effect of encouraging a regional industry in agricultural chemicals, through reducing trade barriers and assisting in the necessary investment, would be limited if the geographical market area were simply expanded without action being taken to increase the demand for the industry's product. A rational organization of the industry could result in the availability of more adequate supplies at more reasonable costs. We agree that alone, however, this would be insufficient to encourage the rapid increase of demand and use which the deteriorating agricultural situation demands.

Necessarily, development of large fertilizer industries must be preceded or accompanied by educational programs which will teach farmers how to use such products successfully and demonstrate their utility for increasing producers' incomes. In some cases changes in the land tenure system must take place before farmers will find it profitable to make added investments in fertilizer. In many instances, increased use of fertilizer will be highly dependent upon the availability of agricultural credit to the users. Distribution systems may require adaptation so that supplies will reach the farmer who desires them. However, efforts to deal with the factors which now limit the use of fertilizers must be coordinated with programs to promote an efficient industry for its production. They are interdependent. Benefits derived from normally costly programs to provide educational services and agricultural credit programs or from improving land tenure systems would be reduced unless facilities were also created to supply the fertilizer at reasonable costs.

Preliminary studies of the possibilities and advantages of fostering zonal free trade in fertilizers and related chemicals and a regional industry to supply such a market indicate this would be a more rational course of action than is the one being followed by a number of Latin American countries which are now seeking to promote such industries based on national markets. A regional approach in this industry and in others with proper attention paid to the use of local natural resources could act to make the economies of the area more complementary and enhance their mutual trade.

DEPARTMENT OF STATE,
Washington, October 22, 1965.

Hon. JACOB K. JAVITS,
U.S. Senate.

DEAR SENATOR JAVITS: In your letter of September 18, 1965, to Assistant Secretary Vaughn you asked that the Department supply answers to a number of questions for inclusion in the record of hearings of the Subcommittee on Inter-American Economic Relationships of the Joint Economic Committee. As was the case with the questions submitted by Mr. Reuss and Mr. Curtis, several offices of the Department have cooperated in formulating the enclosed responses.

If the Department can be of further assistance, please let me know.

Sincerely yours,

ROBERT M. SAYRE,
Acting Assistant Secretary.

QUESTIONS ASKED BY SENATOR JAVITS

Question 1.—A reading of your testimony regarding the Latin American commodity price situation gives the impression of a relative lack of commodity problems in Latin America. Yet the recurrent theme of Latin Americans is that world markets for Latin American commodities are unstable, limited, and that the industrial countries should put into existence a variety of stabilization or compensation plans. How do you explain this discrepancy?

Answer.—It was not my intention, in commenting on the immediate outlook for Latin America's principal export products, to suggest that Latin America has no problems in the commodity field, but only to indicate that the efforts we have been making to solve individual commodity problems on an individual commodity basis are bearing some fruit, and that at the present time there is not quite the same urgent basis for Latin American requests for stabilization and compensation plans as there was a short time back.

The United States has established a good record of cooperation in these matters, especially in recent years. Privately, representatives of Latin American governments would probably concede this. However, it can only be said that a start has been made toward alleviating their problems; much more remains to be done, and the success of efforts that have been launched is not assured. Moreover, the behavior of prices and demand for individual commodities is notoriously unpredictable, and there is no assurance that we will not face a critical situation with respect to one or another product which now appears in reasonably good position. Therefore, if only for tactical reasons, these countries maintain their pressure for more attention to their problems.

The testimony presented showed that the countries which depend primarily on exports of primary commodities did benefit during 1963–64 from rising prices and volume of trade, and that the outlook for many commodities important in Latin American trade is good, at least through the current year.

The outlook for the principal minerals—copper, lead, zinc, and tin, should be good not only for this year, but well into next. The continuance of high industrial activity in the United States is a major supporting factor. Tensions in producing countries of the Far East and Africa are also buoying up metals prices, to the benefit of the Latin American producers.

Although coffee prices have declined moderately, as was to be expected with the return to normal production after a short crop year, the new international agreement has certainly helped to stabilize prices over the past 2 years through its export control program, and they are far above the prices prevailing when the agreement was signed. However, it has not yet made adequate progress with the production control program on which future success must hinge, and we are making every effort, through our representatives on the Council and the Executive Board, to get the producing countries to face up to this problem realistically. Unless they do so, coffee may again become a problem commodity.

Cocoa prices have risen in the past 2 months from 12.5 cents a pound to 17 cents. While this is not a satisfactory price from a producer standpoint, if consumption grows so that this price can be maintained in the face of the rapid increase in production which we have witnessed recently, returns to producers might exceed what they formerly received from smaller crops at higher prices. Although the situation is somewhat improved, we are proceeding, through appropriate international organizations, to develop a solid factual basis for further consideration of the various stabilization measures which the producing countries have proposed.

Latin American countries market about two-thirds of their sugar in the United States at prices well above the world price. Nevertheless, sales on the world market, where prices are fluctuating at about 2 cents per pound, are an important source of revenue. We, therefore, regret that the recent conference in Geneva failed to negotiate a new international sugar agreement, with export quota provisions of the type needed to stabilize world market prices at a remunerative level.

Latin American cotton producers have expressed grave concern, since I appeared before the committee, that the cotton provisions of the new farm bill will lead to a sharp drop in the world price of cotton. This is a very important crop, especially in Central America, and their concern is understandable. We are endeavoring to reassure them, through consultations both in Washington and through our Embassies abroad, that the legislation, by restricting output, should lead to an improvement in the world market for cotton. The trend in world prices has been downward for over a decade and will continue so until there is a better balance between supply and demand. If others will adjust production to market demand through acreage control measures, as our farmers are obliged to do, prices need not drop abruptly or to unremunerative levels.

While commodity problems are certainly not a thing of the past, we encounter new ones daily, I believe that real progress is being made in developing the basis for collaboration between producing and consuming countries. We now have international study groups or international agreements which follow market developments for almost every problem commodity and which, in an emergency situation, can recommend appropriate action. The field is fairly well covered.

There is not always a ready solution, but increasingly the groundwork is being laid, through collection of basic statistics on production, consumption, stocks, and through market analysis, for weeding out proposals which have little promise and developing alternatives which do.

Question 2.—Do you believe a Latin American Common Market would be detrimental to U.S. interests? We seem to favor Latin American economic integration yet we do not seem to be very enthusiastic about specific proposals advanced in regard to the Latin American Common Market. Why? How would a Latin American Common Market affect traditional trade and investment patterns between North and Latin America and between Latin America and the rest of the world?

Answer.—We believe that an effective and thoroughgoing Latin American Common Market, far from being detrimental to U.S. interests, would further them by promoting greater economic and political stability of the area, and by fostering expanded trade relations with the United States through more rapid economic growth.

As was noted in other testimony before the subcommittee, U.S. support for Latin American economic integration is of long-standing duration. Vice President Humphrey's April 14 remarks to the OAS Council and President Johnson's August 17 address on the occasion of the fourth anniversary of the Alliance for Progress are both expressions of support for recent efforts to further a Latin American Common Market.

The absence of detailed U.S. comment on various specific proposals is best understood as a corollary of U.S. recognition that no one set of procedures is necessarily best suited to reach integration; that any specific set of means chosen to hasten the achievement of a Latin American Common Market must have widespread Latin American support; and that this process of achieving consensus and undertaking additional fundamental commitments is of its nature primarily a Latin task.

In answers to questions by Congressmen Curtis and Reuss we have set forth the reasons for believing that a successful Latin American integration effort will result in expanded trade between Latin America and the United States and other third countries. With regard to investment, it seems most likely that a more rapidly expanding Latin American economy, based on a continental market, would mean greater power to attract capital from the United States and other industrial countries, as well as providing an added inducement for indigenous capital to be invested within the area.

Question 3.—What indications do you see that there is top level political support today for a Latin American Common Market?

Answer.—Leaders of most Latin American republics have spoken in favor of a Latin American Common Market, and the principle of economic integration was approved at the July 1965 meeting of Latin American parliamentarians in Lima, Peru. Nevertheless, the suggested approaches to achievement of closer economic ties and expanded trade vary widely as to form, and the timing of steps toward such matters as tariff reductions, construction of a common external tariff, and industrial integration. There are also various points of view as to the eventual membership of a regional common market and the institutions needed to achieve the general goal. These divergencies relate, however, to the means of attaining targets, not to the objective of economic integration, itself.

The Latin American Parliament group passed a resolution providing for holding of a special committee meeting in December in Brazil to discuss economic integration. The Parliament is comprised of representatives of member nation parliaments, and reflects the sentiments of legislatures in 19 republics. Despite lively interest in the subject, the Parliament lacked time for an orderly meaningful discussion of the complicated subject of common markets, and remanded it until the end of the year.

In a letter handed to LAFTA Ambassadors in April 1965, Argentine Foreign Minister Zavala Ortiz outlined his country's position in support of economic integration efforts. He also presented an agenda of topics for discussion at the 1965 meeting of LAFTA Foreign Ministers. His proposals are tailored specifically to deal with the LAFTA area, not the entire Latin American region. Minister Zavala Ortiz suggested:

1. Creation of a Council of Ministers (possessing decision-making powers far greater than those of present LAFTA Ministers);
2. Creation of a Parliament of the member nations of the Association (intended to study, coordinate, and introduce in respective national legislatures, changes and actions needed to fulfill the objectives of the LAFTA Treaty);
3. Creation of a council of delegates of businessmen and workers (essentially an advisory body);
4. Coordination of national development plans and economic policies;
5. Establishment of an intrazonal clearinghouse and bank or financial fund; and
6. Coordination of the Association's policies with the Central American Common Market and contacts with the European Common Market.

Speaking at the inaugural meeting of the Sixth General Assembly of Latin American Iron and Steel Institute in Santiago, Chile, in late July, President Frei reiterated his belief "that early and rapid progress toward Latin American economic integration is an absolute necessity." He observed that some progress had been made through the establishment of the Central American Common Market and of LAFTA, but said that the achievements of the latter have been much less that originally expected.

Mexico's President Díaz Ordaz, in his annual message delivered September 1 this year, stated that the "theme of economic integration is, without doubt, the most important of the questions being debated in our hemisphere." President Díaz Ordaz viewed economic integration as a solely Latin American effort, but "without hostility toward either the United States, Canada, or the more industrialized areas of the world."

The Colombian Finance Minister, Joaquin Vallejo, stated in mid-September 1965 that the LAFTA foreign ministers' meeting should pave the way for the eventual conversion of LAFTA into a common market. Any common market plan, he said, should include a common external tariff and a payments system.

The foreign ministers of the countries members of LAFTA have agreed to meet on November 3, 1965, to appraise the progress of the free trade association, and consider proposals for accelerating efforts toward further integration. Their meeting itself suggests considerable high level political interest in and support for improving the economic integration movement. The decisions and statements which result from this special meeting will give a current guide to readiness of the member governments to move toward a common market arrangement.

Question 4.—What efforts are we undertaking in the GATT negotiations to assure equal treatment for Latin American exports in the EEC? Specify?

Answer.—The purpose of the Kennedy Round is to achieve significant reduction, on an MFN basis, of world trade barriers, particularly those of the developed countries including the EEC. In answering Congressman Curtis' first question, it was noted that the United States has employed various means to encourage less-developed countries to participate actively in the Kennedy Round. We are happy to say that most of the Latin American countries which are contracting parties to the general agreement are represented in the current negotiations. By their participation they are helping to insure the widest possible inclusion of items of interest to Latin America in the round of tariff cuts. To the extent that the EEC reduces its tariffs as a result of the Kennedy Round, Latin America will be on a more nearly equal footing in the EEC market with the members of the Community and countries associated with it.

Latin American countries have expressed a considerable interest in reductions in the EEC Common external tariff, because this tariff imposes duties on considerably higher precentage of Latin American products than does the U.S. tariff schedule and, also, because the EEC grants a preference to certain African countries. The EEC has suspended or reduced for all non-African suppliers the duties on an important group of tropical products including tropical hardwoods, tea, coffee, cocoa, and certain spices. We hope these duty suspensions and reductions can be consolidated and made permanent in the Kennedy Round. The United States, EEC, and other participants accepted an obligation in the Kennedy Round to make a special effort to reduce trade barriers to LDC's. While the EEC did not table its agricultural offers on September 16, we hope that it will do so soon and, pursuant to this commitment, will include a number of products of interest to Latin American countries.

The Kennedy Round, as a multilateral tariff negotiation, does not address itself directly to the special trade relationship existing between the EEC and its associated African countries, a factor which is perhaps the primary concern implicit in the above question. Trade and aid relations between the EEC and the associated African countries is presently governed by the Yaounde Convention which expires in 1969. It provides for duty-free entry into the EEC of certain major commodities imported from the African signatory states, such as coffee and cocoa, and for the early elimination of duties on other imports into the EEC from these countries.

The industrial development of the African countries associated with the EEC is generally not as advanced as is the case in much of Latin America. Hence, the relevance for the Africans of preferential entry into the EEC is at present largely restricted to approximately nine major tropical commodities. In many of these commodities the African countries taken together are major suppliers not only for the EEC, but also for the rest of the world, and the degree of direct competition between Africa and Latin America is limited for all but one or two of these products. Thus, there is good reason to doubt that preferential entry into the EEC for these products now constitutes any significant advantage for the Africans, and conversely any significant disadvantage to the Latin American countries. Moreover, as mentioned in Assistant Secretary Solomon's earlier statement, trade figures indicate that Latin American exports to the EEC have been expanding rather than suffering.

With the growth over time of African industrial capacity, the ramifications of duty-free entry into the EEC could become greater for the parties directly concerned and for third countries. The implications of this possibility, we feel, will necessarily receive serious consideration in the formulation of a trade relationship between the EEC and the associated African countries for the period subsequent to the expiration of the present Convention. U.S. policy is to continue our efforts, consistent with our general attitude, to influence this arrangement in the direction of fully multilateral and nondiscriminatory trade.

Question 5.—In your estimation, what has been the effect of the interest equalization tax and the "voluntary" program on the flow of U.S. private capital to Latin America? (Please provide this committee a table showing the net flow of private U.S. capital to Latin America by the type of flow and by calendar quarter since January 1963.)

Answer.—The interest equalization tax is not applicable to U.S. capital flows to the less developed countries of the world. All Latin American countries are defined as "less developed" for purposes of the tax. It has thus had no effect on security flotations of Latin American countries or term loans to them by U.S. banks. New security issues floated by Latin American countries in the U.S. capital market rose from $35 million in 1963 to $51 million in 1964, and totaled $16 million in the first half of 1965.

The less developed countries are also specifically exempted from the voluntary restraint program on direct investment abroad by U.S. corporations. Direct investment outflows to Latin American countries were, in fact, much higher during the first 6 months of 1965 than during the corresponding periods in the 2 previous years. (See attached table.) The small first quarter inflow seems to reflect merely a seasonal pattern.

The guidelines for the Federal Reserve voluntary restraint program affecting banks and nonbank financial institutions do cover credits to less developed countries. However, after an absolute priority for export credits, priority is to be given to credits to less developed countries. In the second quarter of this year, there was a reduction in the claims of U.S. banks on Latin American countries. Reductions of considerable magnitude have occurred in the past, however, as recently as the first quarter of 1963. There have been no complaints evidencing any substantial impact attributable to the voluntary restraint program.

While we do not have full information explaining the decline in the second quarter, several important factors are apparent. Bank credits to Latin America, especially on the short-term side, expanded rapidly in 1964 and in the first quarter of this year—far above historical levels. These receipts no doubt reduced the requirements of the Latin American countries for credits during the ensuing months. This conclusion is supported by a country-by-country analysis; two of the biggest borrowers in 1964 and early 1965, Mexico and Colombia, have been the biggest net repayers in 1965. No other countries—except for Uruguay, which has been having acute internal financial difficulties—have suffered significant reductions in flows of bank credit from the United States. Another element is the high demand for bank credit within the United States, and the resulting reduction in the availability of capital to lend abroad. Since outstanding bank claims on Latin American countries represent about 35 percent of all foreign claims of U.S. banks, such reduced availabilities would naturally have an impact on loans to them.

Net flow of private U.S. capital to the Latin American Republics, January 1963 through June 1965, by quarters

[Amounts in millions of dollars]

	Direct private, net	Portfolio, short-term, and other capital transactions, net	Net total
1963, total	−69	−96	−165
1st quarter	+6	+52	+58
2d quarter	−17	−35	−52
3d quarter	+57	−97	−40
4th quarter	−115	−16	−131
1964, total	−156	−871	−1,027
1st quarter	+3	−104	−101
2d quarter	−35	−121	−156
3d quarter	−51	−198	−249
4th quarter	−73	−448	−521
1965 (6 months' total)	−83	+90	+7
1st quarter	+2	−29	−27
2d quarter	−85	+119	+34

NOTE.—Minus sign (−) indicates an outflow of U.S. capital (i.e., an increase in U.S. assets abroad). A plus sign (+) indicates an inflow of capital to the United States (i.e., a decrease in U.S. assets abroad).

Source: U.S. Department of Commerce.

Question 6.—What would be the consequences in terms of increased trade and in terms of trade policy of preferential treatment by industrial nations of less developed country exports? Specify.

Answer.—Preferences are intended to provide a commercial policy incentive to import goods from preferred rather than from nonpreferred suppliers. In a system of generalized preferences in favor of all developing countries, designed to increase the export earnings of the latter, this increase would be at the expense of suppliers either in the importing country or in other developed countries.

The effectiveness of trade preferences in inducing a shift in the source of imports will depend primarily on their price effects; that is, whether the margin of preference is large enough to give an advantage to the preferred over the nonpreferred supplier—taking into account relative production costs. A starting point for any attempt to measure this is the height of tariffs in major industrialized countries on items of current (or near-term) export interest to LDC's. Our examination of this matter leads us to doubt that tariff preferences would be of significant benefit to developing countries because:

(*a*) If one excludes products for which the developing countries are already highly competitive and hence need no preferences (e.g., textiles), it appears that developed countries' tariffs on items of export interest to developing countries is on the order of 15 percent ad valorem (There are a number of technical difficulties in tariff averaging and any such average tends to minimize the importance of high rates where preferences might be of greater potential significance; the estimate of 15 percent ad valorem nonetheless gives a general frame of reference.)

(*b*) Most developed country tariffs on such items may be reduced substantially during the current Kennedy Round negotiations, hopefully by as much as 50 percent;

(*c*) Most developing countries consider it necessary to protect their own domestic industries from foreign competition by tariffs and other barriers whose composite effect is generally many times higher than tariffs in developed countries, sometimes over 100 percent ad valorem; if such countries heed this level of protection in their own markets, we see little reason to assume they could overcome the same foreign competition in individual developed country markets with much lower preference margins.

The foregoing paragraphs deal only with initial price effects. There are also other price effects with respect to individual products which are difficult to assess with any degree of precision; e.g., whether some competing developed country exporters would lower their export prices in order to meet competition from preferred developing country suppliers in order to maintain markets.

Quite apart from the question of whether a preference system is or is not adopted, we hope and expect fundamental structural improvements in the economies of many developing countries will continue to be made. This process of course contributes to a marked increase in export competitiveness in a number of manufactured products. A number of the more advanced developing countries have already reached this stage in the case of certain manufactured products. Against this background, adoption of any of the various preference systems proposed recently would, we believe, lead to pressure from domestic producers in industrialized countries for safeguards (e.g., tariff quotas) against the risk of dramatically increased imports from the developing countries. Such a safety mechanism would of course reduce the gains from preferences, complicate the nature of any preferential arrangement immensely, and would be susceptible of becoming an additional vehicle for domestic protectionist drives.

The developing countries have suggested that preference systems in their favor should be limited in duration but applied over different periods for different countries and commodities. The objective of this proposal is to insure that the benefits of preferences are distributed equitably among all the developing countries.

We question whether a workable administration of such a system can be devised or that, in the absence of an agreed formula, it is wise to assume that bilateral, ad hoc negotiations between developed and developing countries to decide when a particular country's preference on a certain product should be phased in or out can produce reasonably equitable and harmonious conclusions. Further, even if such problems could be overcome, it would entail tariff regimes in the developed countries which distinguish, product by product, among various categories of exporting countries, categories which themselves would be subject to continuous changes by addition or deletion. This would introduce a major new complication into the daily business of importing and exporting.

Another trade policy implication of preferences we wish to note is that the entire thrust of a worldwide preference system which sought to distribute benefits among LDC's equitably would be in the direction of central planning and control of that portion of world trade directly affected, tending to substitute bureaucratic decision for the function now performed by the market mechanism.

Finally, we wish to note that if a system of preferences were adopted, there would probably be an adverse impact on the prospects for further multilateral tariff reductions among developed countries. Tariff preferences depend on preference margins and such margins are reduced whenever there are multilateral reductions. There would be strong political pressures on developed countries to maintain preference margins, once established.

In summary, although it is readily conceded that some advantages could flow from preferential treatment by industrial countries in favor of less-developed countries' exports, we have not yet been persuaded that the advantages would outweigh the disadvantages.

Question 7.—What are the benefits of "nondiscriminatory trade policy" in terms of less-developed country requirements? What are its drawbacks? Aren't the benefits of regional versus national trade and development being demonstrated in the European Common Market and Central American Common Market?

Answer.—The advantages of conducting a nondiscriminatory trade policy are basically the same for less developed and developed countries—the operation of the free market under a nondiscriminatory regime results in the purchase of imports from the cheapest supplier; it is in a sense the price of obtaining equal access into the markets of others; and it avoids the creation of vested interests in the maintenance of margins of preference, thereby facilitating the move over time to more liberal world trade.

The promotion of trade on a regional basis by means of lowering barriers so as to form a free trade area or customs union has long been recognized as consistent with the aims of a generally nondiscriminatory trade policy and long-term trade liberalization, and we concur that the experience of the European Economic Community and the Central American Common Market have tended to confirm the benefits that can be expected from such arrangements. We believe this course holds much promise for Latin America and for other developing countries where it is found feasible. Areawide competition among Latin American industries, which are generally more nearly on an equal footing with one another than with industry in the developed countries, should contribute to their competitive strength and gradually enable fuller participation in worldwide multilateral trade.

Question 8.—If regional economic integration is beneficial in terms of rationalization of investments, how can development aid be utilized to consolidate and accelerate this process? How have we used the U.S. aid program and our membership in the IBRD, IDA, IFC, and the IADB to achieve this?

Answer.—President Johnson has made it clear that the United States encourages and is ready to assist Latin America in its economic integration efforts. This willingness to help was most recently reiterated in the President's remarks commemorating the fourth anniversary of the Alliance for Progress.

"The United States will * * * contribute from its Alliance resources to the creation of a new fund for preparing multinational projects. By building areawide road systems, developing river basins which cross boundaries, by improving communications we can help dissolve barriers which have divided the nations.

"In addition, I hope the American nations will consider the establishment of a program—patterned after the European Coal and Steel Community—for the production and trade, on a continental basis, of fertilizer, pesticides, and other products that are needed to increase agricultural production. My country stands willing to help in such a venture."

Past U.S. assistance to the ongoing integration process in Central America confirms that we are ready and willing to back such efforts. For example, the Central American Bank for Economic Integration (CABEI) was established with paid-in capital of $20 million provided by the five member countries and loans and grants from AID and the IDB. CABEI is undertaking the investment of (*a*) private investment projects, especially those projects in the field of manufacturing which will contribute to intraregional trade and (*b*) public investment projects, especially projects of a regional nature in the fields of transportation, communication, and power. More recently, AID has contributed an initial $35 million loan for the establishment of a fund for Central American economic integration. Administered by CABEI, the fund will be used for investment projects aimed at building regional infrastructure, such as roads, electrical interconnections, grain storage, and industrial parks.

The United States is contributing to other programs helpful to regional integration such as the Pan American Highway, and is ready to consider assistance to the marginal highway when the Andean countries reach full agreement concerning it.

The IDB, with its heavy U.S. participation, is increasingly active in its encouragement of regional economic integration. In addition to two loans to CABEI, the bank has also recently inaugurated its Institute for Latin American Integration in Buenos Aires. It is the first center in Latin America devoted exclusively to the systematic study of the process of regional integration in its economic, technical, legal, and institutional aspects, and to the training of technical personnel in the field. In addition, the IDB has made a contribution to a study now being conducted by the Brookings Institution which is attempting to identify industries that could serve an entire region and would therefore be multinational.

In cooperation with the planning organization of the governments involved, the bank has been studying how economic integration of the border areas of Colombia/Venezuela and Colombia/Ecuador, can be accomplished. The recommendations of the study propose the development of interconnecting roads, river valleys, and power systems as well as various irrigation and colonization projects. A first step in executing the program was an IDB loan of $3.2 million made in December 1964 to finance the enlargement of the Tibu powerplant in Colombia, which will make possible an interconnected system that could be linked up with the Venezuela system.

The IBRD has been the executing agent for a U.N. study for the purpose of unifying communications facilities in Central America and has an active interest in assisting efforts to establish a telecommunications system in Latin America.

The United States fully supports efforts to create an effective Common Market, however, and as the form and substance of regional integration are developed in greater detail by the Latin Americans, it will become clear how the United States can best assist. In Latin America it is widely recognized, in the abstract, that the diversification of industry, the building of competitive export industries, and regional integration can do much to speed the economic development of all the countries involved. However, every nation has its own timetable; its unique economic problems. Given these, economic nationalism does not readily give way to cooperation.

The United States is ready and willing to assist in other regional integration programs as countries collaborate on developing good projects. This is true in the case of power development along contiguous borders, of international highways, multinational industrial development projects, and of regional communication programs.

Question 9.—How many "complementation" agreements have been reached thus far? How many are under negotiation? What are the expected benefits of these agreements in terms of intra-LAFTA competition, on production, on employment, and on trade with the United States and Europe?

Answer.—Two complementation agreements have been signed, ratified, and entered into effect among LAFTA countries. The first, covering statistical business machines and machine cards, was signed by Argentina, Brazil, Chile, and Uruguay in mid-1962, and placed in effect later that same year. The second, involving a large number and variety of electronic tubes, was signed in February 1964 between Argentina, Brazil, Chile, Mexico, and Uruguay, but entered into force only recently, in June 1965.

At the present time, some 24 additional complementation agreements covering 9 groups of industrial products have been proposed for negotiation. The items involved include glass products, machine tools, milling and dairy machinery, electric household appliances, mining, and road-building equipment, electric and electronic communications equipment, chemicals, and rubber products. In most of these cases, draft agreements were drawn up by representatives of industrial groups or associations from various member countries during regional meetings held between March and August 1965, and the proposed agreements are now being examined by the governments of the LAFTA countries. The next step in the process involves negotiations among interested governments. Then before new complementation agreements can become effective, the Permanent Executive Committee of LAFTA must find them in accord with the Treaty of Montevideo, and member governments must sign and ratify them.

Complementation agreements of the type formally permitted under LAFTA arrangements are designed to foster an economic use of resources, encourage specialization in production, promote economies of scale, increase trade, and foment competition. Basic to all such agreements are provisions establishing a system through which the countries involved approach free trade (in a specified number of products, components, and materials connected with one industry) more rapidly than is provided for under the general trade liberalization goals of the Montevideo Treaty. A typical agreement would allow any signatory country only 3 to 5 years to remove, in stages, all import restrictions against enumerated products originating in other participating countries.

As free trade conditions are approached, plants producing now for protected national markets become exposed to competition from similar or competitive products originating in other participating countries. Plants producing efficiently, or enjoying natural cost advantages can expand their markets over national boundaries, forcing previously protected plants in other countries to seek greater efficiency. In some cases, plants previously making all components of their finished product would find it advantageous to import parts (duty free) for assembly rather than continue their production. Some firms would become regional in scope, concentrating production of components in locations dictated by economic considerations and, subsequently, bringing these together in one or more locations for assembly and to be distributed and sold throughout the region. In other instances, large firms, such as exist in the automobile industry, may use the new situation to concentrate production of various models in specialized plants located in different countries, shipping part of the production of each model to countries where it is not produced, in effect, creating cross trading in various models.

Complementation agreements can and should bring about significant increases in production and employment. To the extent they enter into force and cover important industries, they promote the establishment of larger and more economical plants for mass production, and the rise of related subsidiary and service industries which tend to increase employment. Not only do the agreements provide a greater geographical market, but economies of scale and competition should make possible lower prices and this, in turn, increased demand and greater production than is likely while plants are confined by import restrictions to narrow national markets.

Complementation agreements, while accelerating progress toward limited free trade within LAFTA, will normally provide for a continuance of protection against non-LAFTA products; and to the degree they are effective in stimulating industrialization and trade within the area, they will result in a closing of that market to some products now imported from the United States and Europe. However, as production and incomes rise within LAFTA, as the area's industry

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grows and increases its needs for more numerous and more sophisticated modern machinery, as the area's economic development progresses and its power, communications, and transportation systems need more new equipment, its trade with the United States and Europe should flourish as never before.

Question 10.—Dr. Herrera put forth a suggestion (see p. 93) in his statement that one way Latin American economic integration could be pushed forward would be to pool or coordinate monetary reserves through a common Latin American regional fund. What would be your reaction to this?

Answer.—Dr. Herrera's idea is an appealing one. Pooling of a portion of their monetary reserves by a group of countries could have the advantage that, unless most members of the group tend to experience concurrent improvement or deterioration in their balance-of-payments positions, a smaller quantity of total reserves would be required to serve emergency or temporary needs of the group. Stated in another way, through a pooling arrangement, each country could gain the right of temporary access to additional reserves. The International Monetary Fund, with its contribution quotas and drawing rights arrangements, provides an excellent example of the benefits of pooling reserves.

In the case of the IMF, however, because its initial membership was so large and so varied, there was reasonable certainty that the deficits of some countries would be offset by surpluses experienced by other member countries. Any limited group of countries, most of which are chronically or frequently short of reserves, will encounter obviously difficult problems in determining the appropriate contribution to be made by various members and the conditions and limits governing each member's possible use of the combined reserve.

The most appropriate policies for managing the relatively scarce exchange reserves of most Latin American countries can be decided only by those countries. We can, of course, discuss them in an academic manner only, as friendly interested observers. Some would argue that cooperation on monetary matters in Latin America should seek to harmonize basic monetary and exchange policies before moving into the field of exchange reserve management. Certainly, the Latin American countries should be giving constant attention to the advantages of increasing their quotas with the IMF and thus amplifying the facilities which they can seek there when there is need. However, should the Latin American countries decide to pool a portion of their reserves, thereby freeing an additional portion of the exchange resources, for use in financing development, we would hope that they can be successful making the best possible use of their exchange availabilities.

Question 11.—What has been the reaction among the Latin American countries, themselves, to the proposals by the four economists for the creation of a Latin American Common Market?

Answer.—Spokesmen of private and official groups in virtually all Latin American countries seem to believe firmly that regional economic integration is vital to the attainment of economic diversification and development. Attitudes toward specific lines of action vary considerably, however, and many leaders recognize that conditions in

Latin America are different from those which made a ready success of the European Common Market.

In early 1965, additional interest in integration was stirred by the presentation of the study "Proposals for a Latin American Common Market." The recommendations in the study were formulated by four Latin American economic experts—Messrs. Herrera, Mayobre, Sanz de Santamaría, and Prebisch—following an invitation last January from President Frei of Chile to meet in Santiago and explore ways to speed the course of regional economic integration in Latin America. The report of the four-man commission was formally presented in early April 1965 to representatives of 19 Latin American countries in Mexico City. It etched out an entirely new set of institutions for Latin America designed to establish and support a continental common market.

A meeting of the Economic Commission for Latin America (ECLA), in Mexico City, May 6 to 18 provided the first opportunity for an open exchange of views on the proposals of the four specialists. Chile appeared to be the strongest proponent for making a completely fresh start toward a common market along the lines recommended by the four-man team. The larger countries spoke in favor of integration but showed a preference for achieving it within an improved LAFTA framework. The Central American countries indicated their willingness to cooperate in gradual progress toward continental integration, but made clear that they wished to preserve the gains already achieved in the Central American Common Market. Small, less economically advanced countries in South America were interested primarily in obtaining special treatment from any common market organization in order to close the gap between their stage of development and that of their larger and stronger LAFTA members.

Since May, support for closer economic integration has continued and each of the two regional common market organizations—the CACM and the LAFTA—has worked to improve its operations. An upcoming meeting of LAFTA Ministers in early November will see a new review of LAFTA and probably some additional discussion of the sweeping integration program suggested by the four experts.

The response submitted to the Senator's question No. 3 is also pertinent here.

Question 12.—Would you comment on the proposal made to the committee last year by William L. Clayton, former Under Secretary of State for Economic Affairs, on the conditions for a Western Hemisphere free trade area? (Reprinted, p. 170, these hearings.)

Answer.—The portion of Assistant Secretary Solomon's statement dealing with a Western Hemisphere free trade area in raw materials is pertinent to Mr. Clayton's suggestion. A particularly relevant fact is that many key Latin American export commodities such as coffee, cocoa, bananas, and tin already enter the U.S. market duty free. Other important Latin American raw material exports such as copper are subject to duty but the duties are quiet modest and the benefit to Latin America that would flow from their removal, while real, would be correspondingly modest.

A few important Latin American exports are subject to quota in the U.S. market, most notably petroleum, sugar, lead, and zinc. The question arises, however, whether it is realistic to contemplate unrestricted entry in these products given the considerations of national policy that have led to imposition of these quotas. Also to be considered is the effect on developing countries outside the hemisphere if the quotas they now enjoy were withdrawn in favor of hemisphere suppliers.

Lastly, the effects in Latin American markets of free entry for U.S. raw material exports must be examined. Rice, cotton, and wheat are illustrative. It must be asked whether Latin American producers of these commodities would be disturbed at the prospect of unrestricted entry in their markets of competing U.S. commodities.

These and other considerations regarding preferences mentioned elsewhere in testimony before the subcommittee tend toward a conclusion that the promised benefits of such arrangements do not outweigh the problems they would generate.

APPENDIX I

Remarks of President Johnson at the Ceremony Commemorating the Fourth Anniversary of the Alliance for Progress

THE WHITE HOUSE, AUGUST 17, 1965

Mr. Vice President, Secretary Rusk, distinguished Ambassadors, members of the Cabinet, distinguished friends in the Congress, my fellow citizens of the Americas:

Four years ago, this hemisphere embarked upon a great adventure—the greatest perhaps since an unknown Italian mariner touched these shores almost five centuries ago.

It was nothing less than to transform the life of an entire continent.

It was to reach into the homes and the villages of more than 200 million people, touching each with great hope and expectation.

It was to replace privilege with social justice, and unchanging poverty with economic progress. Where there was disease we would bring health. Where there was ignorance we would bring learning. We would feed the hungry and we would shelter the homeless and we would do all of this as freemen making liberty the companion of progress.

The adventure began in a dozen scattered spots. In Colombia, the Act of Bogotá, was signed. In Caracas, Romulo Betancourt moved a nation from dictatorship to a living and hopeful democracy. In Costa Rica and Mexico, and in many other places, new standards were being shaped; old dreams were taking on fresh meaning. Across the hemisphere revolution was in the air, promising these three things: freedom, justice, and progress.

And then all of these growing, resistless forces converged on this room. A brilliant new President of the United States addressed himself to his fellow citizens of this hemisphere, and, with unmatched vision, John Fitzgerald Kennedy called for "a vast cooperative effort unparalleled in magnitude and nobility of purpose, to satisfy the basic needs of the American people * * *."

And 5 months later—4 years ago today—on the coast of Uruguay, 20 American Republics solemnly resolved to establish and to carry forward an Alliance for Progress.

That act was a turning point, not only in the history of the New World, but in the long history of freedom itself.

The goals were towering, almost beyond achievement. The hopes were soaring, almost beyond fulfillment. The tasks were immense, almost beyond capacity. But entire nations are not stirred to action by timid words or narrow visions. The faith and will of millions do not take firebrands that are muffled in reluctance and fear. And if the reality of progress was to be slow, the radiance of ultimate achievement must be bright enough to compel the efforts and the sacrifice of generations.

If our Alliance was suffused with compassion and idealism, it also responded to the most real and the most urgent necessities of our time. Our continent is in ferment. People long oppressed demanded their share of the blessings and the dignity which the modern world can offer to man. The peaceful democratic social revolution of the Alliance is not the alternative to tranquility and changelessness. It is the alternative, and the only alternative, to bloodshed and destruction and tyranny. For the past is gone. And those who struggle to preserve it enlist unawares in the ranks of their own destroyers.

We will shape the future through the principles of our Alliance or we will find it swallowed up in violence that is bred of desperation.

How fortunate we are to live in such a time when justice so mingles with necessity and faith with opportunity.

Almost from the moment of birth, the Alliance for Progress was beset by doubt. But men of rooted faith in every country held firm to the purpose. And if they have not really reached the farthest limit of expectation, we have done much; more, indeed, than many believed we could do.

This 4 years has been the greatest period of forward movement, progress, and fruitful change that we have ever made in the history of this hemisphere. And that pace is now increasing.

Last year Latin America as a whole exceeded the Alliance for Progress target of 2½ percent per capita growth rate. Our experts tell me that we will do the same this year. And in the Central American Common Market the growth is almost 7 percent.

A large and swelling flood of resources contributes to this progress. In 4 years the United States alone has contributed almost $4½ billion in grants, in loans, in goods, and in expert assistance. The nations of Latin America have channeled $22 to $24 billion into development. And more than an extra billion dollars has come from other countries and international agencies.

At the heart of Alliance are the twin urgencies of planning and reform. Ten nations have already submitted development programs, and others are on the way. Fourteen nations now have major tax reforms underway, and their rate of tax collection is steadily increasing. Fourteen nations have now instituted land reform programs. Others are confronting the growing importance of population control. One government after another is determined to reconcile reform and economic growth with the struggle against destructive inflation. And this morning I salute those—the people of Brazil—who have helped to lead the way.

In my own country we have constantly worked to improve the speed and the usefulness of our own participation in the Alliance, and we have made remarkable progress.

In the last year and a half we have loaned over $847 million—and that is almost $150 million more than was loaned in the entire 2 full preceding years combined. The number of loans is increasing. The amount of investment guarantee is on the rise. Housing guarantees have gone up 20 times in the last 2 years.

So you see in both the United States and Latin America we are moving more and more swiftly to meet the obligations and to reach the goals that we set in the Alliance for Progress.

And behind the statistics lie the countless stories of human needs that have been met, human suffering that has been relieved, and human hopes that have been fulfilled.

Twenty-five million people—13 million of them little children—are receiving food from the Alliance programs.

More than 1½ million people already have new homes. A million children now have new classrooms, and 10 million textbooks have already been produced.

Hundreds and hundreds of thousands now can find relief from suffering in more than 850 hospitals and health centers and health units that have been already placed into operation.

More than 100 million people today are protected from malaria. And all across the face of the hemisphere new roads are being constructed. Electric powerlines are going up. And institutions for savings and credit and development are already opening new doors.

These are important gains. But, perhaps more importantly, the banners of reform, of social justice, of economic progress have been seized by governments and by leaders and by parties throughout this hemisphere. Elections are fought and elections are won on the principles of the Alliance. And where once the light of hope flickered in very few places, today it burns in many nations. In the oppressed countryside and in the desperate slums, growing numbers of people know that far away in distant capitals—under different slogans and with varying success—their leaders are working to brighten their days and to ensure their dignity.

For the fact is, even though the forces of injustice and privilege and tyranny still hold many fortresses, they are on the defensive today. And we can say, far more surely than we once could, that their final day is coming.

But whatever we have accomplished, we all know that the road ahead is longer and it is more steep than the way behind. If many have been helped, then there are many more that are still untouched. If some are newly free, there are millions that are still shackled by poverty and disease and ignorance and malnutrition. If we have made more progress than before, as we have, we have made far less than we should and we must.

So, to this end, we must all increase the efforts that we are now making:

First, to build modern industry and the structures on which it rests; to attract a growing flow of private investment and technology to Latin America; to speed up the process of social reform.

But it is not just enough to continue doing what we are doing. From the experience and the achievement and the failures of the first 4 years, we can now shape new directions.

Recently I received—as did the other American Presidents—a letter from CIAP suggesting changes and new departures. The leadership of this organization is itself one of our very healthiest developments. And I pledge that my Government will review this letter with great care and sympathy.

But from this letter—and from our own experience—we can already see the shape of future emphasis.

First, we must step up our efforts to prevent disastrous changes in the prices of those basic commodities which are the lifeblood of so many of our economies. We will continue—as we did this week in London—to strengthen the operation of the coffee agreement and to search for ways to stabilize the price of cocoa.

We will try to maintain a regularly expanding market for the sugar that is produced by Latin America. And, consistent with the CIAP recommendations, I will propose this afternoon that Congress eliminate the special import fee on sugar so that the full price will go to the Latin American producers.

Second, we must try to draw the economies of Latin America much closer together. The experience of Central America reaffirms that of Europe. Widened markets—the breakdown of tariff barriers—leads to increased trade and leads to more efficient production and to greater prosperity.

The United States will, as CIAP suggests, contribute from its Alliance resources to the creation of a new fund for preparing multinational projects. By building areawide road systems, by developing river basins which cross boundaries, by improving communications, we can help dissolve the barriers which have divided the nations.

In addition, I hope the American nations will consider the establishment of a program—patterned after the European Coal and Steel Community—for the production and trade, on a continental basis, of fertilizer, pesticides, and other products that are needed to increase agricultural production. My country stands willing to help in such a venture.

And thus, in ways that he never imagined, we can move much closer to the dream of Bolivar.

Third, we must emphasize the needs of rural Latin America. Here is the scene of the most abject poverty and despair. Here, half the people of Latin America live. And it is here, in the countryside, that the foundation of a modern economy will finally be built. Through the diversification of crops, we can decrease dependence on a few export products. Through increasing production, the countries of Latin America can feed their own people. Through increasing farm income, we can provide growing markets for new industry.

And we must, as CIAP also suggests, direct more of our effort toward those things which directly touch the lives of individual human beings—housing, education, health, and food. And it is not enough simply to say that a growing economy will ultimately meet those needs. Misery and pain and despair exist in the present, and we must fight them in the present with all we have and the best way we can. This is not only the command of compassion. It is, as we all recognize, the counsel of wisdom. For factories and banks and dollars do not alone build a nation. People build a nation. And on those people, on their health and their knowledge and their faith, their participation and their sacrifice, rests the future of all of us and the future of all nations. This is the common thread which runs through the Great Society in my country and the Alliance for Progress in all countries.

These are a few—and only a few—of the many tasks which lie before us as we meet here this morning to labor to complete the second revolution of the Americas.

The task of development is a practical process. Development demands skilled leadership. It demands careful judgment. It demands initiative, ingenuity, and imagination that is firmly tempered by possibility. But it also demands something more. For our progress is not its own end. It is an instrument to enlarge the dignity of man. And so we must build on faith and on belief and on those values which are the resistant and enduring mark of our civilization.

This means that each man should have the chance to share in the affairs of his nation. Each should participate in that liberating process of self-rule that we know as democracy. It is fundamental to our Alliance that all of our nations should be free and that all of our people should be a part of that freedom. We have not yet achieved that for all of our countries, indeed for all the people of my own country. But that is our goal for this entire continent. And, however we build, the Alliance will not be a success until that is accomplished.

It is to protect that right of self-determination that the OAS today works in the Dominican Republic. I know that all of you share the wish that the future government, chosen by the Dominican Republic and by the Dominican people themselves, will be devoted to the principles of liberal democracy and social justice; and that you share as well the intention of my country to help them rebuild that memory and strife-scarred land.

This also means that each man's nation—whether it is great or small—must walk as an equal with all others—free to shape its society, free to select its institutions, and free to find its own way to the future so long as it respects the rights of its fellows. And, from this enriching diversity of custom and tradition—practice and the conduct of affairs—I think we will all draw strength and, perhaps, even wisdom.

This also means that each man must have a chance to share in present benefits and to share in future progress. God did not create any man to live in unseen chains, laboring through a life of pain to heap the table of a favored few. No farmer should be enslaved to land that he can never own. No worker should be stripped of reward for toil. No family should be compelled to sacrifice while others escape the obligations of their society. "Indeed," said Thomas Jefferson, "I tremble for my country when I reflect that God is just." We must surely tremble for our continent as long as any live and flourish protected by the walls of injustice.

If we follow these commands in all our lands, then progress will fulfill our dreams. But if we sacrifice them to weakness, or interest, or to false promise, then the hand that builds will become the hand of desolation.

I am, as best I can and best I know how, trying to follow them in my own country. This year new laws will help the old in my country to find health, will help families to supplement the cost of their homes, will help the Negroes to share in democracy, will help the poor to find an exit from poverty, and will help little children to seek learning. For in my nation, like yours we are still struggling to find justice for all of our people. And because we are fortunate in abundance, we feel that morality requires that we must also try to help others who seek it for their own people, too.

And there is also something more. The process of development is still an unknown process. Although we mask our uncertainty with charts and tables, calculations and intricate theories, we are still very uncertain. But one thing we do know. Development is not just a matter of resources, or trade, or production, or even crops. Rather, in some mysterious way, a people—because they have great leaders and because they have great hopes and because they themselves are great—an entire people begin to stir, and to sacrifice, and to work. And when they move, a nation begins to move.

And today in this country and, I believe, throughout this continent, this is really beginning to happen.

It is this—not the numbers or reports—which tell us these have been fruitful years. And with luck and with skill and with intransigent resolve we will clear away the thousand barriers that lie ahead, if enough hands grasp them, and all are allowed to make the journey.

To all that was pledged that momentous August day 4 years ago—and everything promised since then—I here. on this anniversary today, again pledge my administration and my personal life in office.

As for the future, leave that to the New World. It will be ours, as it was promised so many years ago.

Thank you.

APPENDIX II

The following are the remarks of Senator Jacob K. Javits, prepared for delivery at the 10th Plenary Assembly of Businessmen of the Americas, sponsored by the Inter-American Council of Commerce and Production in Santiago, Chile, Monday, March 16, 1964:

The Age of the Good Partner: A Program for the Americas

The questions that must be answered by the governments and responsible elements of the Western Hemisphere in the next few years are whether we are capable of understanding the social and political ferment which now pervades the hemisphere and whether we are ready to deal with this ferment by making the necessary and sustained adjustments to satisfy the just aspirations of its peoples. How can we, acting together, bring about economic and social change within a democratic framework? Not only the United States future relations to the hemisphere but the future of each nation of the hemisphere depends on the answers to these questions.

Accordingly, I propose that the policy of the good partner should succeed the policy of the good neighbor, in the relationships between the United States and the other American Republics. To implement this policy, I suggest for your consideration an economic program for the Americas consisting of two major parts: (1) A basic revision of the trade relations among the Latin American Republics on the one hand, and between the Latin American Republics and the United States and Canada on the other hand, leading to a Latin American Common Market and a Western Hemisphere Free Trade Area; and (2) a new role for the private enterprise system in the development of the Americas—a new social direction, with broader responsibilities and commensurately broader opportunities for success.

We all know that in developing countries the political framework within which economics and society operate tends to determine the success of even the most auspicious efforts. I suggest, therefore, that the program which I propose needs to be espoused by the democratic, progressive, and non-Communist parties of the American Republics.

Great and fundamental changes are taking place in every part of the world which critically affect the future plans of the hemisphere. The nuclear stalemate between the United States and the Soviet Union has lessened the chances of war but increased competition between the two systems in trade, aid, and culture. Long-standing tensions existing between China and the U.S.S.R. over the leadership of the Communist movement have come out into the open for all to see and have considerably weakened the effectiveness of Communist parties everywhere. Nationalism, a desire for self-determination, is causing many nations now undergoing the process of economic development to seek their own direction outside the shadows of the two power blocs. Western Europe is fully recovered, the European Common Market is a reality and France under General de Gaulle has embarked on an effort to create a "third force."

In the Western Hemisphere, the centuries-old lethargy toward social injustice, poverty, feudal land systems, hunger, and disease is giving way to an insistent demand for political and social reform and economic improvement.

The response of the inter-American system to this demand, although at first long delayed, has been by no means ineffective. Within the space of 4 short years, there has been brought into existence a new system of inter-American cooperation for economic and social development—the Act of Bogotá, the Central American Common Market, the Latin American Free Trade Association, the Inter-American Development Bank, and the Alliance for Progress.

Despite criticisms which may be leveled against some aspects of its implementation, the Alliance is already achieving one of its fundamental objectives—to create an awareness throughout the hemisphere that comprehensive and well-planned social policies and reforms are essential to achieve accelerated economic development in a democratic framework. The new atmosphere created by the Alliance appears also to be exercising a major influence on the internal politics of a number of Latin American countries.

Another encouraging step was the establishment, at the Second Annual Meeting of Ministers of the Inter-American Economic and Social Council last November, of an Inter-American Committee on the Alliance for Progress (CIAP) to coordinate and promote the multilateral implementation of the Alliance. The establishment of CIAP represents a development of historic importance to Latin America, similar to the OEEC, which played such an important role under the Marshall plan in the recovery and unification of Western Europe. Indeed, even today, as I speak here, the President of the United States and the Latin American diplomatic community are celebrating the installation of CIAP, and the third anniversary of President John F. Kennedy's first call for the Alliance for Progress at the White House in Washington, D.C.

The great unfulfilled tasks, however, do not permit a pause over what has been achieved. Gains, which have been made in Latin America in the formulation of development plans, in economic integration, and in increasing the economic well-being of millions of people, will now have to be followed by further progress in education, health, industrial development, housing, and institutional reforms of all kinds.

The hemisphere must now turn its attention to the future and take the next steps necessary to give new impetus to the gains already made in its economic development.

First, we must accelerate the process of regional economic integration.

The Latin American Free Trade Association and the Central American Common Market are clear evidence that the idea of continentwide economic integration can become a reality in the foreseeable future. In its brief period of existence, LAFTA, which includes 82 percent of Latin America's population and 78 percent of its income, has closely adhered to its schedule of tariff reductions, resulting in a significant increase in intraregional trade: up 37 percent from 1961 to 1962. The Central American Common Market is much smaller than LAFTA, with a population of 12 million as compared to 180 million for LAFTA, and an estimated total gross national product of $2.3 billion as compared with an estimated $55 billion for LAFTA. But during its as yet short life, the Central American Common Market has eliminated trade barriers on about half of the trade of member countries, standardized external tariffs on most commodities, launched a regional development bank, set up machinery for resolving disputes arising among its members, and just last month, established machinery for a Central American Monetary Union as a base for eventual monetary unification. As a result of the activities of the CACM the members' trade with each other has increased from 3 percent of their total trade in 1958 to 11 percent in 1962. The members still do well over 70 percent of their trade with Europe and the United States.

Undeniably, many problems remain before the broader aims of Latin American economic integration are fully realized. LAFTA faces important difficulties in negotiating further tariff concessions, in creating a common market in specific complementary industries within the region, in creating an adequate inland and ocean transportation system and in providing adequate financing for its foreign trade. The CACM, in turn, is faced by problems arising from the existing inequalities in the development levels of its member countries and their dependence on primary commodities for the bulk of their export earnings.

The resolution of these problems, in my view, can best be effected within the framework of a genuine Latin American Common Market, within which goods, persons, and capital can move more freely and which would comprise the nine countries of LAFTA, the five-nation CACM as a unit, plus Venezuela, Bolivia, Panama, and certain of the Caribbean countries. With the emergence of a common external tariff and a phased, across-the-board removal of tariffs on intraregional trade, there would emerge in such an arrangement a mass market of 220 million with a combined annual gross national product of between $70 and $80 billion, $18 billion in foreign trade, and $2.5 billion in gold and foreign exchange reserves. Such a common market with a unified commercial policy would greatly increase Latin America's leverage with the industrial countries of the West in the field of trade. It would also provide a powerful pull on private capital from the United States, Western Europe, and Japan which is essential for Latin America's rapid industrial development. It would permit the establishment of a rational regional transportation system, in coastal shipping as well as inland road and rail transportation. It could provide a great stimulus to economic growth through the strengthening of competition in the region, and the expansion of additional local manufacturing. Further diversification in production in domestic manufacture would help to reduce Latin America's dependence on the exportation of primary commodities.

The United States could provide a major impetus to the creation of a Latin American Common Market by offering to LAFTA and CACM a unilateral reduction in U.S. tariffs on simple manufactures and semimanufactures imported from Latin American in exchange for a speedup in the rate of the integration schedules of LAFTA and CACM, and effective safeguards for new foreign investment. The extension of unilateral tariff concessions to developing nations on this basis would be preferable to proposals now being advanced by developing nations which do not provide some reciprocity to the developed nations.

Once such a Latin American Common Market is a reality, the United States and Canada would have to establish a new relationship with it. Such a relationship could take the form of a Western Hemisphere Free Trade Area limited to raw materials. Under this arrangement, the United States, Canada, and the Latin American common market would reduce their trade restrictions—both tariffs and import quotas—on raw materials originating in the Western Hemisphere on a phased annual basis until such trade restrictions, say in 10 years, are at zero.

As the Latin American common market is more industrialized and is able to compete with the more efficient industries of Western Europe, Japan, and the United States, this limited Western Hemisphere Free Trade Area could be expanded to cover manufactured products; and could develop further by negotiating arrangements with other regional trading groups, such as the European Economic Community. Its existence would also insure that the Latin American common market would be outward looking and competitive.

In 10 years' time, a common market area of 200 to 300 million people (larger even than our own U.S. "common market" of 50 States) could be created, justifying the establishment of highly efficient, large-scale industries in Latin America.

In proposing the creation of a Western Hemisphere Free Trade Area on raw materials, I am not overlooking the fact that 55 percent of Latin America's exports to the United States already enter the United States duty free and that the forthcoming trade negotiations under the Trade Expansion Act of 1962 may bring additional benefits to Latin America.

For, while it is difficult to estimate with precision the amount of trade that would be generated by eliminating trade barriers on raw materials, a recent study conducted by the Inter-American Research Committee of the National Planning Association suggests that such a move could have a substantial impact on Latin American exports to the United States, which now total $3.4 billion. It was estimated that suspension of U.S. import restrictions on a selected category of Latin American raw materials would increase U.S. imports from Latin America by at least $850 million, and perhaps by as much as $1.7 billion.

Some will protest that such an arrangement would necessitate a departure by the United States from its traditional unconditional most-favored-nation policy. My answer is that GATT has already made a number of exceptions to this principle, notably in the case of the European Economic Community and the European Free Trade Area. I see no reason why GATT should object to a similar exception with respect to the countries of the Western Hemisphere. For the United States, it may be necessary to subordinate the value of continuing the practice of extending U.S. tariff concessions on a nondiscriminatory basis to all countries automatically, to perhaps the greater value of aiding the worldwide movement toward regional economic integration.

Nor am I unaware of the difficulties involved in creating such a Western Hemisphere Free Trade Area, especially in regard to such commodities as sugar, lead, and zinc. But with U.S. cooperation and hemispheric determination, I am confident these problems are not insoluble.

As we examine the future shape of our trade relations, there are problems which can and should be resolved now in our mutual interest.

The United States should utilize the forthcoming "Kennedy round" of trade negotiations to facilitate entry for Latin American exports—primary commodities as well as other products—to the European Common Market. There appears to be some disposition along this line by the EEC, notwithstanding its special relations with the associated African States. Also, together with other Americans, I am doing my utmost to minimize to the greatest extent possible the rigors of

U.S. import quotas on such products as lead, zinc, and residual fuel oil. I also believe that the United States should support measures like the International Coffee Agreement, designed to stabilize primary commodity prices.

At the same time, all of us must recognize the dangers of inflation—in some places galloping inflation—which nullifies economic gains. The flight of capital and the grave imbalance of the international balance of payments represent major threats to countries subject to these inflationary forces. To deal with this threat every effort ought to be made to modernize antiquated fiscal systems and monetary policies and to organize capital markets and other institutions to mobilize untapped national savings for productive uses. In short, self-help and mutual cooperation must be the rule, even as we develop Western Hemisphere institutions along the lines which I am charting here.

All of this leads me to the second part of the economic proposal I am here advancing—the role of private enterprise in Latin America.

The Latin American nations must find means for improving the climate for private initiative, while at the same time providing for social justice. These ends are not in the least incompatible. But we recognize that Latin America is trying to achieve in a decade what has taken a century in the United States and is even yet far from perfected there—the operation of private business in the public interest. What is needed is a new spirit both on the part of government and of private enterprise in the achievement of common goals of progress without sacrificing their own self-interest. In many Latin American countries, leadership in developing such a spirit has been demonstrated to a heartening degree.

Latin American development can be based on a strong foundation of successful private enterprise investment. It should be remembered that not only does some 70 percent of all Latin American economic activity originate in the private sector, but contrary to a widespread impression, 90 percent of this private sector is owned by Latin American investors themselves. A developing economic system so intimately tied to private ownership clearly cannot accelerate its forward movement in the face of the erosion of investor confidence—an erosion signaled by a substantial outflow of private Latin American capital over the past few years and the sharp reduction in net U.S. private investment. I am aware of the selective nature of the investment process and of certain bright spots in the picture. However, these positive currents are bucking a great outward tide caused by private decisions which range from expressions of indifference to acts of panic. To reverse the outward tide—and such a reversal is essential—the positive factors must be greatly augmented. Latin American governments can aid immeasurably in restoring investor confidence. The infusion of Western European private and public investment into these contrary streams can also be an important element in reversing the overall capital outflow and in accelerating the momentum of economic growth in Latin America.

The Atlantic Community Development Group for Latin America (Adela), under the sponsorship originally of the NATO Parliamentarians' Conference and in the United States, of myself and Senator Hubert Humphrey, of Minnesota, was established in order to formulate a means for focusing free world economic strength—i.e., the force of private sector activity—on this problem.

The multinational, multienterprise private investment company now being established to implement the Adela program, envisages a revitalization of the private enterprise forces in Latin America by enlisting the partnership of North American, European, and Japanese private enterprise strength. In the first instance, this investment company will focus on expanding the sector of medium-sized and smaller enterprises in Latin America so that they may serve as the essential base for the larger ventures of national and regional economic development. The talents and the capital of many enterprises of many nations will go into partnership with the Latin American enterpriser, in order to supply him with that measure of financial resources and technical assistance which he needs to participate more fully in the success of the social-economic revolution which is intended to carry Latin America toward a new era of freedom.

The implementation of the Adela program represents a unique experiment. It recognizes that the governments most directly involved in the Alliance—i.e., the governments of Latin America and the United States—cannot accomplish the job of Latin American economic development alone. It recognizes, above all, that even all of the governments of the free world together are not possessed of the combination of capital, skills, initiative, and knowledge needed for the successful economic development of Latin America and that the role of the private sector is indispensable.

In the Adela project the private sector of the free world has the opportunity to give concrete evidence of a fact which it has too long claimed to be self-evident. It can show that inherent in the processes of the system of private enterprise, which has brought historically unparalleled wealth to large areas of this globe, are qualities of statesmanship and discipline which can give Latin America an opportunity to attain equality of economic status. Indeed, private enterprise can show that it has the moral qualities needed for its own survival, in those areas now threatened from the outside by a system which cannot abide individual initiative, which cannot tolerate private ownership of anything and which affords no person credit. Above all, the leaders of private enterprise can display a political awareness of the shape of the future. Thus, the successful realization of this private enterprise action program in the Adela investment company can be a turning point in the history of Latin America.

In the Adela project private enterprises are seeking to turn their capital, manpower, and techniques to the creation of economic and social conditions which will assure the viability of the system upon which their own existence depends—not only today or tomorrow, but far into the future. If the peoples in this great Western Hemisphere can be shown that relative freedom from poverty can be achieved by means compatible with individual political freedom, they will decisively choose such means. This is the challenge which the private sector of our economies is uniquely fitted to meet.

I said earlier that the economic program I have outlined here should be espoused by the democratic, progressive, and non-Communist parties of the American Republics. I believe the economic and social development of Latin America can be enormously forwarded through the work of political parties which possess the will to express a real evangelism for freedom and free institutions—an evangelism which can be communicated directly to the people in meaningful terms. In short, the Western Hemisphere needs to develop a flaming morale conducive to values which freedom and private enterprise can foster. And this spirit can be created by an identification of the mutuality of interest in each country of all peoples in the Western Hemisphere who are fighting for these values on the basis of democratic political organization, our common Judeo-Christian ethic and progressive economic principles.

One way to do this has been suggested by your compatriot and scholar, Felipe Herrera, president of the Inter-American Bank, who has proposed a Latin American Assembly with functional participation by capital, labor, and the universities, with a cooperative working arrangement with delegates of the U.S. Congress. Call it, if you will, the "Parliament of the Hemisphere."

Whatever steps we take to develop greater hemispheric unity would advance in our time the dream of Simón Bolivar when he envisioned consolidating Latin America into a "single nation, united by pacts into a single bond."

"The time has now arrived," said Bolivar 140 years ago, "when the interests and associations which unite the American Republics should secure a firm foundation."

It is a fitting note on which to sum up and to dedicate ourselves to this high purpose—as valid today as it was then—and at least as urgent.

APPENDIX III

The following are the remarks of Senator Jacob K. Javits prepared for delivery before the American Chamber of Commerce of Mexico, University Club, Mexico City, April 5, 1965:

POLITICAL ACTION VITAL FOR LATIN AMERICAN INTEGRATION

It has been more than 3 years since the signatories of the Declaration of Punta del Este agreed to accelerate the integration of Latin America so as to stimulate economic and social development in the continent.

In these years we have witnessed substantial gains in the economic integration of Latin America. We have seen both the Latin American Free Trade Association (LAFTA) and the Central American Common Market (CACM) make substantial cuts in tariffs, and intraregional trade has increased.

Despite these accomplishments, despite these gains, true economic integration and the harmonization of economic policies has not been achieved, particularly in LAFTA. In short, reality has not been able to match the plan of Punta del Este; actions have not yet been able to fulfill the manifest destiny of Latin America—a continental economic union, cemented by mutual interest, and designed to allow the peoples of Latin America to realize the potential of their resources, natural and human.

It is evident that this destiny of true economic integration of the Americas can be realized only through full political commitment to it at the highest levels and with the strong support of democratic political parties, trade unions, men of influence in all walks of life, and the peoples concerned. Even though the Inter-American Committee on the Alliance for Progress (CIAP), ministerial groups, experts, and private enterprise hemispherewide organizations such as the Inter-American Council for Commerce and Production (CICYP) fully realize this need, such commitment has not been made evident today to any appreciable degree.

Unless widespread political support develops, the great gains of LAFTA, CACM, and the Alliance for Progress could be dissipated with the most damaging consequences to the future of freedom and well-being in the hemisphere.

I invite today, therefore, leaders of democratic political parties and trade unions of the Americas—which excludes the extremist right and the Communist left—and Latin American personalities devoted to the cause of democratic reform and unity to join me in the establishment of an Action Committee for an Economic Union of the Americas.

This Committee should dedicate its heart and soul and its influence to bringing about a true continental economic union by rallying strong political support behind the idea of a treaty for a Latin American Common Market, composed of all the nations of Latin America, to be followed, in due course, as the Latin American members agree, by a treaty for a Western Hemisphere Free Trade Area, including the United States and Canada.

To those who would dismiss this call as being unrealistic—or at least premature—let me refer you to the comment that was the fashion in the capitals of Europe on the future of Western European economic integration in the early 1950's: "A common market of all Europe is a wonderful idea, and it may even happen someday, but how can anybody expect it to succeed when the nations of Europe have been rivals for centuries?"

Who indeed, would have thought that in the next decade, a European Common Market would become one of the most powerful economic forces in the world? Who, indeed, but Jean Monnet and his Action Committee for the United States of Europe. The Committee I propose today, like Monnet's group, would derive its strength from a membership agreed on the necessity of achieving the goal of a continental economic union and committed to influence their respective parliaments, trade unions, and public opinion in general to realize that goal.

The problem of political leadership in Latin American economic and political unification is becoming clearer daily to the governments and people of the hemisphere. What is needed now is a final, well-organized drive to overcome that inertia and that provincial view of nationalism which separates the hemisphere from the realization of these goals.

The experience of the Monnet group in Europe can teach us much about how such goals can be realistically achieved.

Monnet's group came into existence in late 1955 following the Messina Conference of the Foreign Ministers of the six countries of the European Coal and Steel Community, which recommended the initiation of "a common European market, free from all customs duties and all quantitative restrictions" on the basis of "appropriate institutional means for the realization and operation" of enlarged economic organisms. The ministers created an intergovernmental committee under Paul Henri Spaak to draft the relevant treaties or arrangements.

As in the case of Latin America today, the European integration movement was well underway at this time and had succeeded in the creation of the European Coal and Steel Community. LAFTA, the Central American Common Market, CIAP, and the Inter-American Bank represent the victories so far of the economic integration movement in the hemisphere.

But the parallels between Europe in the early 1950's and Latin America today do not stop here. Monnet and his group realized that there was a lack of organized, Europe-wide political support to insure that governments would implement the recommendations of the Spaak Committee.

Similarly, more and more dissatisfaction is being heard today over the lack of political support for the meaningful economic integration of Latin America. There has not been an important inter-American conference during the past several months which did not recommend in one form or another a means to remedy this lack. What has been absent, however, is a focal point—a central group—that could give direction and purpose to the diverse groups working toward the same goal.

Similar ferment in Europe—a similar feeling that not enough was being done—brought about the creation of Monnet's Action Committee in late 1955. It brought together a coalition of divergent forces which were agreed on one point, the important one—the need for European unification. It created conditions which made certain that any draft treaty put together by the Spaak Committee would fall on the ears of receptive parliamentary and public opinion. Its members were party and union leaders of the democratic left who were agreed on the principle of economic integration and who were prepared to build up the necessary political support to make this goal realizable, without further delay. Largely through the work of this group, the Spaak Committee's draft treaty establishing the European Economic Community and the European Atomic Energy Community was approved in Rome by the foreign ministers of the six nations joined in the European Coal and Steel Community.

It is my belief that a similar action committee in Latin America in 1965 can have the same effect as Monnet's European group in 1955. Certainly there are many divergent forces in Latin America. But there is ample evidence that there is one central idea which is gaining credence in all sections of the hemisphere—the need for Latin American economic unity.

This is true, because many Latin American economic and political leaders are now becoming aware that the process of Latin American economic integration is not proceeding fast enough and many basic problems remain. For example:

1. 75 percent of Latin America's foreign exchange income is still generated through exports of oil, coffee, meat, cotton, copper, sugar, wool, iron ore, and bananas.

2. Developed countries, especially in Europe but including the United States, continue to impose restrictive measures on Latin American exports such as coffee, lead, zinc, and oil—a situation which has been condoned by Latin American exporters desiring the benefits of selling in protected, high-price markets.

3. Wide disparities remain between the development of economic sectors within individual countries as well as between the levels of development of individual countries of Latin America—per capita annual income ranges between $1,120 in Venezuela to less than $100 in Bolivia.

4. Development planning often takes place without the full participation of the private sector.

5. The heavy external debt burden of many Latin American countries impedes their economic development efforts.

6. Intra-LAFTA trade still constitutes only 8 or 9 percent of the LAFTA countries' total trade. Intra-CACM trade accounts for only 13 percent of that region's total trade.
7. Tariff-cutting procedure in LAFTA is permissive rather than automatic or across-the-board which allows member countries to protect indefinitely against effective competition the most sensitive areas of their economies.
8. Industrial integration among countries is still only in the talking stage.
9. Real monetary and fiscal stability is still lacking in many of the member countries of LAFTA.
10. Expansion of intra-LAFTA trade in manufactured goods has been quite limited due to the reluctance of the more advanced member countries to reduce their high tariffs on such goods because of a fear of exposing their heavily subsidized industries to competition from abroad.

It is becoming more evident each day that the resolution of Latin America's economic problems can best be effected within the framework of a genuine Latin American Common Market, within which goods, persons, and capital can move more freely. With the emergence of a common external tariff and a phased, across-the-board reduction of tariffs on intraregional trade, there would emerge in such an arrangement a mass market of 220 million people with a combined annual gross national product of between $70 and $80 billion, $18 billion of foreign trade, and $2.5 billion in gold and foreign exchange reserves.

Such a common market with a unified commercial policy would greatly increase Latin America's leverage with the industrial countries of Western Europe, North America, and Japan in the field of trade. It would also provide a powerful pull on private capital from the United States, Western Europe, and Japan which is essential for Latin America's more rapid industrial development. It would permit the establishment of a rational, regional transportation system, in coastal shipping as well as inland road and rail transportation. It could provide a great stimulus to economic growth through the strengthening of competition in the region, and the expansion of additional local manufactures. Further diversification in production of domestic manufactures would help to reduce Latin America's dependence on the exportation of primary commodities.

At the same time, the process of establishing a Latin American Common Market can receive great impetus from the industrially advanced nations of the world. These nations under the leadership of the United States, have already recognized the importance of trade to developing nations and the need to take urgent action to improve their terms of trade. In a statement of May 1963, the ministers of the contracting parties of GATT agreed that in the forthcoming GATT negotiations every effort would be made to reduce barriers to the exports of developing countries and that the more advanced industrialized countries would not expect to receive reciprocity from the developing nations.

I strongly believe that in line with the May 1963 GATT ministerial declaration the United States could now call on the industrialized nations of GATT to extend preferential treatment to specified American exports. The United States itself could take the lead by taking such a step, provided that the other GATT nations involved follow suit and that Latin American nations agree to accelerate the process of Latin American economic integration in a competitive atmosphere. Low-cost, efficient modern industries, established in regions which offer the best combination of accessibility to markets, resources, and trained manpower and ready to face competition from abroad, are the best assurance that competitive conditions would prevail during this process.

Once such a Latin American Common Market is a reality, and in agreement with its member countries, the United States and Canada could effectively establish a new economic relationship with it. Such a relationship could take the form of a Western Hemisphere Free Trade Area—but limited at first to raw materials. Under this arrangement, the United States, Canada, and the Latin American Common Market would reduce their trade restrictions—both tariffs and import quotas—on raw materials originating in the Western Hemisphere on a phased annual basis until such trade restrictions, say in 10 years, were at zero.

As the Latin American Common Market becomes more industrialized and is able to compete with the more efficient industries of Western Europe, Japan, and the United States, this limited Western Hemishpere Free Trade Area could be expanded to cover specified manufactures and semimanufactures and could develop further by negotiating arrangements with other regional trading groups, such as the European Economic Community. Its existence would also insure that the Latin American Common Market would be outward looking, and competitive.

If such an economic union is to succeed, however, Latin American nations must improve the climate for private initiative, while at the same time providing for social justice. These ends are not in the least incompatible. But we must realize that Latin America would be trying to achieve in a decade what we in the United States, after a century of trying, have not perfected—the operation of private business in the public interest. What is needed is a new spirit both on the part of government and of private enterprise in the achievement of common goals of progress without sacrificing their own self-interest. In many Latin American countries, leadership in developing such a spirit has been demonstrated to a heartening degree.

Proof that businessmen of the hemisphere are becoming more and more concious of their responsibility to play a major part in solving the profound problems facing Latin America was evidenced in the meeting last month of the Executive Committee of the Inter-American Council of Production and Commerce (CICYP). The Committee decided to form a committee to represent private enterprise before LAFTA and to send a delegation to the upcoming LAFTA foreign ministers' conference as well as to promote a miltilateral system of investment guarantees for private capital in Latin America and to undertake a number of measures to expand Latin American export possibilities in cooperation with the Inter-American Committee for the Alliance for Progress.

This proof is also provided in the formation of the multinational, multiprivate enterprise investment company last September to implement the Atlantic Community Development Group for Latin America (ADELA), which I had the honor to initiate. ADELA is designed to revitalize private enterprise in Latin America by bringing the capital and the talents of many enterprises in many nations into a partnership with Latin American business.

The implementation of Adela represents a unique experiment. It recognizes that even all the governments of the free world together are not possessed of the combination of capital, skills, initiative, and knowledge needed for the successful economic development of Latin America without the indispensable aid of the private sector.

Latin America has the resources and I believe many of its political and business and trade union leaders now have demonstrated their desire to bring about an economic union which will benefit all the peoples of the continent. It is my hope that an Action Committee for the Economic Union of the Americas will now be formed to translate these resources and these desires into organized action to make Latin America the great, independent free world economic force it has every right to be.

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APPENDIX IV

LETTER OF THE INTER-AMERICAN COMMITTEE ON THE ALLIANCE FOR PROGRESS (CIAP) TO THE PRESIDENTS OF THE AMERICAN REPUBLICS

AUGUST 10, 1965.

THE PRESIDENT OF THE UNITED STATES OF AMERICA,
The White House, Washington, D.C.

MR. PRESIDENT: Taking into account the present situation of Latin America and the concern arising from recent developments in some countries of the hemisphere, the Chairman of CIAP, on his own initiative, convoked a special meeting of the Inter-American Committee on the Alliance for Progress. Based on the experiences acquired in his visits to the countries of Latin America and on his contacts with the governments, he considered it appropriate that the Committee call attention to the most urgent problems that the hemisphere is currently facing and to the means of joint action that could be adopted to solve those problems. He was also moved to call this meeting to give consideration to the suggestion he made at the Inter-American Economic and Social Council meeting in Lima regarding the need to begin a systematic review of the results of the Alliance, since we are nearing the midpoint of the time period established in the Charter of Punta del Este, to carry out this continental effort.

The meeting took place in Washington, July 23–26, and we believe it appropriate, Mr. President, to inform you directly of its results.

The members of CIAP do not act as officials of governments, nor can they take decisions on those matters which, by means of this letter, we bring to your attention.. Consequently, in sending this letter to you and to the presidents of the other countries participating in the Alliance for Progress, we have no purpose other than to stimulate an interchange of views on these matters and to provide a starting point so that the governments can make the decisions which they consider necessary in the coming months.

The nature and importance of the concepts which we forward to you are the justification which moved CIAP to address you and your Government directly.

This letter summarizes the conclusions reached in our meeting, which have been approved (unanimously) by (the members of) CIAP. This letter refers to all of Latin America and for this reason characteristic situations referred to in some countries may not be applicable to others.

The Alliance for Progress is a going concern. There has been widespread forward movement on many fronts as the CIAP reports of October 1964 and May 1965 indicated. Although progress is by no means uniform among the nations of Latin America, it appears likely that for the second successive year the overall growth target of the Charter of Punta del Este will be achieved; that is, a 2½-percent per capita increase in gross national product.

The task of CIAP, however, is to help reinforce the efforts to solve problems that still await solution if the Charter of Punta del Este is to be accomplished. It is the judgment of CIAP that at this time a redoubled effort is required in the fields of economic and social action in order to avoid the spread of a sense of frustration which appears to exist in some parts of Latin America.

These pressures derive from various causes in different parts of the hemisphere. Among those causes are the following:

(*a*) The slowness of some countries in executing economic and social reforms designed to mobilize their internal resources and to bring about a sense of participation, social justice, and self-evident progress;

(*b*) The inadequate absorption of foreign assistance due, in part, to insufficient planning and project preparation, particularly in the field of social investment and, in part, due to cumbersome aid procedures;

(*c*) The sharp deterioration of trade prospects, caused by weakened prices or markets for some products—cocoa, sugar, bananas—has tended to reduce or cancel the positive effects of aid measures, rendering more difficult stabilization efforts, reducing the rate of development, and creating hardships for certain population groups or regions.

It was against the background of this mixed assessment of our situation that the present meeting of CIAP was devoted not merely to stocktaking but also to beginning to chart the course ahead. In this effort we had the advantage of a number of specific propositions laid before us by the Chairman.

We agree that it was appropriate to take counsel together and to set down our thoughts on two matters: first, on certain problems, mainly of an economic character, where action is both urgently needed and possible; second, on the wider economic and social problems we must seek to solve if, over the whole span of the Alliance for Progress, we are to fulfill the injunctions of the Charter of Punta del Este. These relate, in particular, to land reform and the modernization of rural life, housing, education, and public health.

This letter sets forth our present views on the implementation of the Charter of Punta del Este in its next phase, covering both sets of problems.

The agenda for action which emerged falls naturally, therefore, into two parts.

Our initial recommendations concerned possible next steps in fields with which we have all become familiar: planning, monetary stabilization, external trade, regional economic integration, and improvements in the scale and quality of external assistance.

CIAP has examined these fields at length in its three reports[1] over the past year; and it has made extensive observations and recommendations we would still hold to be valid. On this occasion we wish to call your attention only to certain specific and urgent items of action, where forward movement is possible but requires prompt political decision and initiative at the highest level, in order to fulfill better the commitment to the Charter of Punta del Este.

1. The acceleration of national planning

Our common vision of the Alliance for Progress calls for longrange national plans—commanding the full support not merely of governments but of the major sectors of each society, supported by long-term loans on a stable basis, including program loans.

These are the essential framework for bringing the nations to a position of self-sustaining growth, where progress can be supported wthout recourse to special external assistance.

Progress has been made in the planning process in Latin America; but we do not have enough stable, realistic, publicly understood and supported national plans, intimately related to the projects, institutions, and to the national budget. Only on the basis of such plans can the resources of Latin America be effectively mobilized and the full potentialities of external assistance brought to bear.

CIAP considers it quite important that the countries of Latin America examine the possibility of accelerating and strengthening the national planning process in its technical, institutional, and political dimensions. The flexibility afforded by program lending can be a powerful instrument for development and institution building; but it demands the prior existence of serious national programs (even if not necessarily fully elaborated plans) and the national consensus necessary to give them life.

In connection with planning, action should be taken to organize in Latin America working sessions which would regularly bring together for relatively short periods (4 to 6 weeks) politicians, industrialists, leaders of worker and farm organizations, and economists to consider the problems and possibilities of national and regional economic planning. The lack of a common understanding among these groups is a major weakness in the Alliance for Progress which such sessions might help to remedy.

2. Inflation and political leadership

Inflation remains an enemy of economic and social progress; a disrupter of national plans; and one major block to regional integration. In this connection, it should be noted that some countries are now in a delicate stage of their stabilization process requiring both a steady flow of external assistance and measures to prevent deterioration of their trade position. We have analyzed and made technical policy recommendations designed to prevent and halt inflation. We would call to your attention, in addition, the critical need to bring about, by political leadership at the highest level, a social compact among the major groups in the society which would relate wage policy as a whole to the average national increase in productivity, while correcting for inequitable aspects of the wage structure, which would commit industry and commerce to avoid anticipatory price

[1] CIAP/71, Rev. 2; CIAP/178; CIAP/219, Rev.

increases under the pretext of possible or even inevitable price increases; and provide the widespread political understanding necessary to permit governments to conduct effective counterinflationary policies. Without this political and social foundation it will be difficult to prevent and to end inflation in Latin America.

3. Trade policy

The Alliance for Progress remains seriously endangered by weak or precarious prices or markets for certain traditional Latin American exports. Remedy must be found by simultaneous action in various fronts.

(*a*) *Commodity agreements.*—The coffee agreement is emerging as a model of what may prove possible if producers and consumers are prepared to cooperate. It includes provision for realistic quotas, for built-in quota flexibility designed to assure the producer stable and remunerative prices while also being fair to the consumer, internal prices which do not encourage overproduction, strict production controls, effective measures by consuming countries to assist in enforcing marketing discipline, and commitments to diversification.

It is in the interest of the Alliance for Progress as a whole and, indeed, the whole world community, that the coffee agreement be reinforced. We commend for consideration by its members the development of a special fund designed to facilitate the production control and accelerate the diversification features of the coffee agreement.

The state of the prices and markets for sugar and cocoa make it urgent that effective, disciplined commodity agreements engaging producers and consumers, be sought in these fields. What is needed is international action to organize world commodity markets to reduce short-term price fluctuations and to achieve more favorable prices as a partial answer to some of the trade problems of Latin America.

(*b*) *Transitory, compensatory measures against preferences outside the hemisphere.*—Latin American countries and the United States are committed to the principle of nondiscriminatory treatment for developing countries in their trade relations with the industrial nations. This principle is consistent with the position taken by the Latin American countries in their request for generalized preferences at the UNCTAD Conference in Geneva and in the Declaration of the Charter of Alta Gracia of April 1964, and does not conflict with the traditional most-favored-nation policy of the United States. We believe this principle remains sound as a working, longrun objective. The fact is, however, that since the UNCTAD meeting the movement outside the hemisphere has been toward more rather than less preferences in trade, particularly in relation to tropical products. This tendency is damaging the prospects for the Alliance for Progress. Therefore, although we are opposed to the creation of spheres of influence, we commend for urgent consideration, a policy of transitory, defensive measures to compensate for such preferences. It is inequitable for the products of some of the developing countries to enjoy preferences outside the hemisphere plus nondiscriminatory access to the U.S. market. A policy to compensate for such discrimination against Latin America should be worked out pragmatically, on a commodity-by-commodity basis, with provisions which would facilitate return to nondiscriminatory trade as discriminating practices are removed elsewhere.

(*c*) *Compensatory financing.*—In the short run, it is urgent for the Executive Board of the International Monetary Fund to clarify the ambiguities surrounding the so-called floating tranche. Toward this end it is recommended that it be discussed at the forthcoming meeting of this organization. This "tranche" is designed to supply additional automatic assistance to developing nations suffering from a fall in export earnings for reasons beyond their control. It is our view that the claim on such compensatory short-term resources should be automatic, when the facts are established; and the assistance should be additional to that provided under other circumstances, by criteria which apply to normal quota drawings.

In the long run, we must look in two directions: First, to the system of compensation being studied by the IBRD; second, to the expansion of liquidity (means of payment) in the international monetary system to deal with such shortrun fluctuations in foreign exchange earnings. It is evidently time for the nations of Latin America to clarify and formulate their own interests and proposals in any reorganization of the international monetary system. As a result of proposals laid before the present CIAP meeting by the Chairman, it was agreed that he initiate studies, on the basis of expert opinion within and outside the hemisphere, to this end.

(*d*) *Agricultural diversification and export promotion.*—We would underline strongly that efforts to protect the foreign exchange earnings of traditional Latin American exports will fail unless production is guided by effective programs of agricultural diversification (which are, in any case, required to increase food supplies); and that Latin America will not be able to generate the foreign exchange it requires unless exports are effectively promoted in nontraditional fields, both industrial and agricultural. In both cases, attention to market expansion is of critical importance. We urge that the priority accorded these sectors be elevated in Latin American economic planning and policy and we would note that untapped project resources exist in the external financial agencies, notably in support of agricultural diversification and the promotion of exports of agricultural and manufactured products.

4. External debt

The problem of external debt in Latin America is not one of debt service beyond the financial capability of the region, but rather one of heavy amortization payments which a limited number of countries have to make in the next few years. This situation has already been reviewed at some length in Document CIAP/170, "CIAP Policy Statement on the State of the Alliance for Progress and Prospects for 1965." In part, the problem results from inadequate control, in the past, in contracting external debt. But equally important factors have been the tendency in certain lending countries to furnish supplier credits to increase their own exports, and their inability to adjust to loan policies which would have assured more appropriate terms for Latin America's development and its capacity for debt service.

To correct this situation, consolidation of existing debt under longer and easier terms than those originally established is essential; but this measure alone is not sufficient. The debtor countries must be prudent and restrain themselves, by means of an effective system of discipline, in contracting new short- and medium-term debt; they must also make the greatest effort to meet existing obligations; and to adopt monetary and development policies which will facilitate access to long-term international financing. These efforts must be complemented by the adoption, in the creditor countries, of a credit policy appropriate for development as well as for export promotion. Credit terms must be in harmony with the financial capability of the country and its ability to earn foreign exchange. Short-term loans should not be agreed to when it is obvious from the beginning that in time it will be necessary to renegotiate them. It is also opportune to request creditor countries to eliminate restrictive commercial policies which prevent debtor countries from earning the foreign exchange needed for external debt service.

5. Integration

In CIAP/219 of May 1965 we underlined the convergence and mutual reinforcement of policies of national development and internal market expansion, export diversification, and regional integration. Since that time Raul Prebisch, Felipe Herrer, José Antonio Mayobre, and Carlos Sanz de Santamaría have addressed themselves to the Latin American presidents in support of regional economic integration; and the Government of the United States has clearly reaffirmed its support for effective Latin American economic integration. We wish to express to you our collective support for the general position taken in that report by the four Latin Americans mentioned above.[2] The larger nations of Latin America, which might find in time a basis for mature industrialization through national development and conventional trading arrangements, nevertheless have a major stake in Latin American regional integration. But the fate of the smaller nations (and the pace of development throughout Latin America) depends vitally on a decision to go forward boldly together, in regional groupings such as the Central American Common Market or in other subregional groupings within the larger framework of regional economic integration. The trade aspects of the integration movement are dealt with mainly by other organizations which should be supported. CIAP has focused principally on certain investment and financial aspects of the integration movement. We believe this work should be carried forward urgently on the following fronts:

(*a*) Multinational projects to develop the region's infrastructure, notably in the fields of multinational highway construction, telecommunications, shipping, and port development.

[2] "Proposals for the Creation of a Latin American Common Market," Mexico, Apr. 12, 1965.

(b) Multinational development of river basins, irrigation works, and power projects.

(c) The development of more rational patterns of regional investment in industrial fields where economics of scale can be applied to advantage, such as chemical fertilizers.

(d) Acceleration in the development of Latin American regional financial arrangement, via the central banks, designed in particular to facilitate the movement of intraregional trade. We have requested our Chairman to explore the possibilities of support by governments of the hemisphere and the external financing agencies for a revolving fund which would finance project preparation and feasibility studies related to regional integration, the fund to be replenished from the loans flowing from these studies.

6. External assistance

(a) We believe the time has come for the Government of the United States carefully to review whether the tying of its assistance to Latin America under the Alliance for Progress is required on balance-of-payments grounds. The overall Latin American contribution to the U.S. balance-of-payments deficit was always small—if, indeed, it was a factor at all. Recent official statements indicate that the U.S. balance-of-payments position has improved; although it remains to be seen if this improvement can be sustained. On the other hand, the tying procedures are cumbersome and reduce the contribution U.S. assistance could otherwise make to the Alliance for Progress. One form of partial untying might be considered; that is, to free U.S. loans and grants for purchases either in the United States or elsewhere in Latin America. A provision of this kind, already incorporated in the operations of the Inter-American Bank and, for a narrower region, in the recent loan to the Central American Bank for Economic Integration, could contribute substantially to the development of intraregional trade and to the integration movement in general.

(b) The Chairman of the CIAP has been informed that the U.S. Government has agreed to review in detail, with members of the CIAP staff, current AID procedures with a view to seeing what changes in those procedures (including, for example, those related to advance procurement and the 50–50 shipping clause) and in action by recipient governments might make the flow of external assistance from the United States more prompt and efficient.

CIAP views with satisfaction the growing interest demonstrated by certain countries of Western Europe, Canada, Japan, and Israel, in the economic and social development of Latin America. These countries have begun to participate in the annual reviews conducted by CIAP and in the consultative groups organized by the IDB, as well as in a series of technical assistance and training projects. It is hoped that this tendency which strengthens the multilateral sense of the Alliance will be matched by a more liberal attitude on the part of the more developed countries of Latin America so that they may provide, in the future, financial or technical assistance to other countries of the region.

The second part of our deliberations focused on the problem of implementing those parts of the Charter of Punta del Este which promise to the peoples of Latin America more and better food, land reform and the modernization of rural life, more and better housing, more and better education, and more and better public health facilities. As we all know, the governments of Latin America and the external agencies committed to their assistance have undertaken many measures and projects in these fields since 1961.[3] And the fresh resources available to the IDB under the expanded fund for special operations assures the continuity of these efforts. But we are convinced that, as the Alliance for Progress unfolds, increased emphasis must be given to these dimensions of our common commitments under the Charter of Punta del Este. We must all do more. And we must do it better.

How can this be done? On the basis of our common experience thus far we must proceed in terms of three principles.

First, we should attempt to develop systematic programs as opposed to ad hoc projects in these fields. These are required to provide adequate benchmarks of performance and a better basis for allocating marginal resources as between social and more directly economic investments. Second, we should seek out, stimulate,

[3] Roughly $892 million have been lent or granted to Latin America in these fields in the period since 1961 by the Inter-American Bank (including grants under the Social Progress Trust Fund); and $750 million by the U.S. Government (including Public Law 480 grants and loans but excluding Export-Import Bank loans). The IBRD has also made an increasing contribution in these fields.

and expand local institutions capable of carrying forward these enterprises. Third, we should build these enterprises to the maximum possible, on the principle of individual participation and contribution, rather than solely on the receipt of benefits and assistance either from the local government or from foreign institutions.

Men do not feel the full impact of development unless they participate and contribute personally to the process.[4]

Within these broad principles, observations on each of these four fields of economic and social progress follow:

(1) *The modernization of rural life.*—In talking of the modernization of rural life we are considering the environment of about 50 percent of the people who live in Latin America. The working agenda under this heading, therefore, has many dimensions each, in itself, immensely complex. The major elements of an Alliance policy to accelerate the modernization of rural life appear to be the following:

(*a*) Changes in land tenure (both latifundia and minifundia) remain, in regions of many Latin American countries, an essential condition for fulfilling the Charter of Punta del Este. The whole machinery of the Alliance for Progress should be geared to helping governments achieve such structural reform with equity and efficiency and in ways which achieve an increase in agricultural productivity.

(*b*) The encouragement of agricultural policies by governments which afford the farmer a fair and reliable price for his product.

(*c*) The expansion of production and distribution at fair prices of chemical fertilizers, on a national and, if possible, on a regional basis, including an expansion of fertilizer loans to cover the interval until Latin American fertilizer resources are more fully developed.

(*d*) The expansion of agricultural extension and credit, especially to the small farmer, as well as credit for land reclamation and irrigation projects. Agricultural development banks have a particularly important role to play in carrying forward these policies.

(*e*) The modernization of urban-rural marketing, including feeder roads, transport, storage, food processing, etc.

(*f*) Support for and the development of institutions which combine elements which assure a fair price to the farmer, credit, fertilizer, seeds, etc., and modern marketing facilities. These institutions may take the form of producers' cooperatives, food-processing firms, large commercial farming ventures, etc.

(*g*) The linking of urban and rural life by programs of popular cooperation and community development of the type now being successfully pursued in some countries of the area.

2. *Housing.*—An expansion in housing construction in Latin America could serve two purposes: first, to help meet one of the region's most urgent social and human needs; second, to absorb in useful employment substantial numbers of those who are underemployed or without jobs, while exploiting the fact that building materials are mainly local, involving little requirement for foreign exchange.

Some of the most hopeful recent developments in housing in Latin America involve institutions which encourage local citizens to put up their own money to help finance the construction of housing. External resources are contributing and could do more to develop and strengthen such institutions. We require a systematic search in each Latin American country for such institutions, both rural and urban, that the Alliance for Progress might back.

But many Latin American families, urban and rural, cannot save enough to participate financially, on a substantial scale, in these programs. The Alliance for Progress encourages the allocation of additional public funds and external resources to provide housing for families of low income on terms which they can afford, even though the beneficiaries cannot through their own savings meet all of the costs of improved housing. Maximum encouragement should be given in such programs to self-help and mutual aid efforts, as a form of contribution by the ultimate beneficiaries.

In both approaches, much needs to be done to reduce the high cost of housing construction through research in new and less costly building materials which can

[4] The following wise passage in the encyclical letter of Pope John XXIII (Mater et Magistra) should, perhaps, be noted (151): "Special effort must * * * be made to see to it that workers in underdeveloped areas are conscious of playing a key role in the promotion of their personal socioeconomic and cultural betterment. For it is a mark of good citizenship to shoulder a major share of the burden connected with one's own development."

be found locally and which save foreign exchange, and through innovations in housing design and construction methods.

Housing is only one aspect of the problems created by the explosive growth of Latin America's cities. Inadequate social, economic, and administrative services threaten to prevent the major urban areas from fulfilling their function as the centers of growing industrialization. Improved planning for the orderly expansion of cities is indispensable, as well as the improvement of their financial and administrative institutions.

3. *Education.*—The educational institutions of Latin America have been created and are being developed not merely to fulfill certain functional purposes in their societies, but to carry forward the whole rich stream of national, regional, and universal culture. Nevertheless, as the process of modernization proceeds rapidly in Latin America, the educational institutions are being reshaped to meet the practical changing needs of Latin American society. It is our conviction in CIAP that under the Alliance for Progress this trend should be reinforeced.

As part of development planning, we must in the years ahead encourage more systematic programs of education; we should support key pathfinding educational institutions within Latin America which are likely to set patterns for the future; and, in this field above all, external resources must be woven into the fabric of local initiative, contribution, and participation. It is proper to continue to encourage and support the training of students in other Latin American countries, in the United States, and Europe, notably in critical fields related to modernization and development. But the primary objective should be the development of more first-rate Latin American educational institutions.

At the present time the Latin American universities could contribute even more to the development of their countries and to the achievement of Alliance for Progress goals than they already contribute. They could prepare more highly qualified planners, educators, economists, specialized industrial engineers, scientists and social scientists, and administrators. They could conduct more research projects bearing directly on the economic and social development of their countries and the region as a whole. To do this, the quality of research and instruction in the universities and the capability for dispassionate scientific inquiry will have to be improved as well as the physical facilities, particularly with respect to teaching aids, laboratories, and libraries.

Concerted efforts are required to develop projects in these fields to use available funds which are not fully tapped. The curriculum of at least one university in each of the countries of Latin America should be directly related to national planning efforts so that the country's needs for trained professional manpower can be met at both the graduate and undergraduate levels, with Latin American personnel.

Looking beyond the universities, education is the source of the manpower which will fulfill—or fail to fulfill—the requirements of national development plans. Traditionally there has been little communication between educational planners and economic development planners. The CIAP country review process should be used to encourage this essential communication and linkage. Therefore, we should seek, in the 1966 country reviews, a systematic examination of the mutual consistency of education and other manpower training programs and economic development plans.

4. *Health and population.*—Acting in terms of the Charter of Punta del Este, we in the Alliance for Progress must work on the principle that those born into the world deserve the fullest opportunity for their physical and mental development, bearing in mind that those ill fed up to the age of 6 are permanently limited as members of society. We must, therefore, look to the expansion of public health institutions of every kind, including programs of child feeding. As in other fields of social investment, much has been going forward in recent years out of resources generated within Latin America and through the assistance of external financial agencies. What is required here, as elsewhere, are systematic efforts geared to the national development plans themselves. Certain Latin American countries face problems due to the rate of population increase in relation to the increase in their economic and social infrastructure. CIAP is now engaged, as a result of decisions taken at its meeting of May 1965, in studies of the population problem in Latin America. It will make available its conclusions and recommendations to the governments when those studies are completed.

5. *A general problem: Local institutions to develop project preparation and feasibility studies.*—The simple fact is that we have more external project capital resources available for economic and social purposes than we are bringing to bear

in the Alliance for Progress; and feasibility studies remain a major bottleneck, even in the more advanced countries of Latin America. The weakness is particlarly pronounced in the four social and economic fields examined above. The use of foreign firms to do ad hoc project preparation and feasibility studies is often expensive, inadequate, and generates widespread local resentment. We should concentrate, therefore, on measures to expand public and private institutions in Latin America capable of turning out a flow of first-rate feasibility studies. This means strengthening the feasibility study capacity of government departments, including the provision inside those departments of foreign experts on a technical assistance basis when they are needed. It also means encouraging the development of local private feasibility study firms, including firms which combine foreign and local capital and talent. Investment in this kind of institutional development in Latin America should, in the next several years, be a major item of concern both to Latin American governments and to external financing agencies.

6. *The financing of social investment.*—The resources available for investments of the type discussed above depend critically on three factors: public savings, private savings (notably with respect to housing), and the scale and terms on which external resources are available.

The expansion of domestic resources, in turn, demands the fulfillment of the common commitment to tax reform and improved tax collection, against the background of regularly rising levels of gross national product. In addition, public resources should be freed for these investments by systematic programs to improve the efficiency of public corporations which, in many Latin American countries, now lay a heavy claim for subsidy on tax revenues.

With respect to the terms of external assistance, there is a prima facie case for flexibility in the proportion of local contribution required. The overall level of income and the potential level of tax revenues are relevant to a sound judgement, as well as the character of the particular project under examination. We commend to the external financing agencies, in the course of the reviews proposed in the following paragraph, a careful reexamination of the arrangements governing the proportion of local funds required to match external grants and loans in these fields of social investment.

In order better to come to grips in a practical way with these four fields of economic and social action, the Chairman of CIAP will seek the collaboration of the various financing and technical assistance agencies to set up immediately committees in each field to examine current policies and programs. Having assessed what is now going forward and what steps the external agencies might themselves take to accelerate these programs, CIAP will be prepared to organize multilateral teams, where they are desired, to work intensively with the authorities and experts in particular countries to generate new projects and to strengthen local planning agencies and institutions.

What is the relation between the two parts of the working agenda we propose?

First, without success in meeting urgent problems of planning, capital formation, price stabilization, trade, market integration, and external assistance, it seems unlikely that Latin America will command the capacity to fulfill on the requisite scale the promise of the Charter of Punta del Este to the peoples of Latin America in these crucial fields where we seek the welfare of man and the community.

Second, properly conducted, the social and economic dimensions of the Charter of Punta del Este can be made substantially to converge rather than to compete. More effective action under the headings of the second part of the agenda could contribute to the expansion and modernization of the Latin American economies as well as to meeting deep social and human needs.

The modernization of rural life promises, for example, not merely more and better food but industrial raw materials, expanded exports, and enlarged national and regional markets.

Expanded housing programs promise not merely to fulfill an essential human requirement but to achieve a reduction in unemployment and partial unemployment, as well as an enlargement of private savings and a favorable change in consumption habits.

Properly designed education programs not only enlarge the capacity of men and women to develop their talents and perceptions, they are the human foundation for modernization of every aspect of life.

Improved health measures not only prolong and protect the quality of life, they are the basis for an effective working force.

Third, we may be able to set in motion more effective action sooner in some aspects of the economic program outlined in the first part of this letter; but we are conscious that we must begin now to put renewed emphasis on the social part of the agenda, which was given prominence in the Act of Bogota, if we are to achieve in the later years of the Alliance the scale of effort required to meet the standards of the Charter of Punta del Este.

Specifically, CIAP recommends that at the Extraordinary Meeting of the Foreign Ministers, scheduled to take place in Rio de Janeiro before the end of 1965, there take place a meeting of the Inter-American Economic and Social Council, starting shortly before and running concurrently with the Foreign Ministers' session. By that time the governments will have had an opportunity to consider our present recommendations and to formulate their own ideas. As noted earlier, CIAP plans to conduct further intensive staff work on these problems between now and the Foreign Ministers' meeting, and to present those results to the Inter-American Economic and Social Council, should that concurrent meeting be convoked. We shall also have the benefit at that time of having completed and assessed the full round of CIAP country reviews which have just begun.

CIAP also suggests that the scheduled regular meeting of the Inter-American Economic and Social Council in Buenos Aires might begin on the fifth anniversary of the launching of the Alliance for Progress, March 13, 1966. That regular meeting, against the background of the earlier discussions and deliberations, should be in a position to lay out firmly and in detail the lines of policy we should all seek to follow in the next phase of the Alliance for Progress. CIAP will try to prepare for that regular meeting a detailed analysis of what has transpired in the Alliance in its first 5 years as well as concrete recommendations for consideration by the ministers, in the light of the discussions and resolutions at the Rio Conference.

In addition, we would recommend that, in preparation for the Buenos Aires meeting, each of the governments signatory to the Charter of Punta del Este review and assess its own performance and problems encountered over the first 5 years in seeking to fulfill its commitments, in order to provide a basis for policy recommendations covering the next phase of the Alliance for Progress.

We would wish, Mr. President, finally to express to you our deep confidence that, whatever the magnitude of current problems and the tasks ahead, the Charter of Punta del Este reflects the active will of the peoples of our hemisphere; that the Alliance for Progress can and will succeed; and that, as a result of this unique multilateral experience, the nations of Latin America shall emerge in the years ahead with the capacity to sustain economic growth, under conditions of increasing social justice, out of their own human and material resources, without the need for abnormal external assistance.

We can already begin to see within the hemisphere the more advanced Latin American nations helping the less advanced. A truly multilateral sense of responsibility and participation is spreading and must be encouraged. Our institutions for the multilateral examination and evaluation of national development plans must be strengthened as well. If we persist with courage and faith, we shall build a community among us, including a Latin America whose economy is increasingly integrated, that can meet the tests of progress and interdependence which life in this century demands.

Respectfully,

Roberto de Oliveira Campos,
Luis Escobar Cerda,
Rodrigo Gómez,
Jorge Sol Castellanos,
Roque A. Carranza,
Ezequiel González Alsina,
Walt Whitman Rostow,
Members.

Carlos Sanz de Santamaría,
Chairman.

APPENDIX V

Proposals for the Creation of the Latin American Common Market

INTRODUCTORY NOTE

On January 6, 1965, Eduardo Frei, President of the Republic of Chile, addressed a letter to four prominent inter-American leaders asking them to present their views regarding methods of speeding up the economic integration of Latin America.

As a result of this request, the four economists—Raúl Prebisch, Director General of the Latin American Institute for Economic and Social Planning José Antonio Mayobre, Executive Director of the United Nations Economic Commission for Latin America; Felipe Herrera, President of the Inter-American Development Bank, and Carlos Sanz de Santamaría, Chairman of the Inter-American Committee on the Alliance for Progress—drafted the following "Proposals for the Creation of a Latin American Common Market."

The recommendations appearing in this document represent the unanimous opinions of the authors and are their own and exclusive responsibility. They wish to point out that they had the cooperation of various persons, including the very valuable collaboration of Mr. Angel Alberto Solá, Executive Secretary of LAFTA.

I. THE NEED FOR A GREAT ECONOMIC BASE

Community of effort

Latin America is failing to face resolutely a course of events which is jeopardizing the pace and the very meaning of its economic and social development and shaking its political life to its foundations.

Never before have we seen such a population explosion; nor has the very legitimate desire of our peoples for a better life been so strikingly expressed. But neither have we witnessed, until recently, the enormous possibilities that modern technology can offer for the eradication of poverty and its accompanying evils.

We have understood these possibilities. We admire the stupendous rise in the living levels of the long-industrialized countries. And we have been impressed by the experience of others which have, within a short time, gathered great economic monentum in their recent development. From both these categories of countries, the technological revolution is striving to spread out to the rest of the world. We are awaiting impatiently what this revolution has to bring us in order to fulfill that desire for a better life, but perhaps we have not perceived the many and complex aspects of what this process inevitably requires.

If we remain disunited, we shall not be able, in our desire to reap the full benefits of contemporary technology, to meet such requirements, among them the need for great economic bases: 95 percent of the industrial output of the more advanced countries is produced within large markets which, even though each of them has immense and varied resources, reach out farther in a constant search for more trade.

Our countries, nevertheless, attempt to develop in an area arbitrarily divided into numerous watertight compartments with very little intercommunication. By thus dispersing their efforts in isolated action, these countries cannot carry the weight they should in a world where, in addition to the countries that were already large, vast economic blocs have emerged. The full advantages of industrialization will not be secured if the Latin American countries, thus thrown back on themselves, persist in trying to produce every type of goods and doing, within their own frontiers, everything that the others are doing within theirs.

This mutual isolation is not confined to the economy: it applies to a wide range of activities. Scientific and technological research, and the training of complex skills in these fields, are very haphazard because of the limited range and dispersal of effort. And so far as culture is concerned, creative activity suffers and languishes because of the same limitations of national horizons. Moreover, incapacity to combine resources has been partly responsible for these countries being so far unable to acquire those powerful technical media of expression and dissemination which are available to others. Accordingly there have prevailed in Latin America certain outside elements of dubious value which not only fail to contribute to the enrichment of the common cultural heritage but are also incompatible with the purpose of enhancing our native values and molding the true image of our personality.

Technology will be of ever greater influence in our time. We must adapt it to the realities of our own situation and resolutely master it, if we are not to subordinate the essence of our existence and our brotherly relationship to it. We shall not succeed in this if we continue to use up our strength in isolated effort.

We must learn to work together; we must form the community of Latin American peoples. Up to now we have been unable to undertake this great task to any meaningful extent, because we have not been able completely to escape from the pattern in which our development began in the 19th century. Thus separated one from another, without active relationships closely binding them together, each of our countries in those days was attracted, in isolation, toward the world's major economic, political, and cultural centers. We lived in the reflection of those centers, and this has had a far-reaching effect not only on Latin America's past but also on its present. Many features of this pattern continue to exist; we must rid ourselves of them, given the facts of the world's evolution and the growing tensions within our own process of development.

In order to overcome these and other obstacles which stand in the way of Latin America's development, we must combine our forces and harness them to the achievement of major common objectives. It is not enough for us merely to respond to the requirements of technology, or to work together to create a great economic base and widen our cultural, scientific, and technological horizon. Our action in this sense must also be for the purpose of securing greater political influence internationally.

In this context, a new historical dimension is emerging—the dimension of the developing world. Despite the striking differences that distinguish us from other regions, we have a series of common denominators which inevitably spur us to common endeavors, without detriment to the personality of each of us. We have already set out on this road, and must continue along it with tenacity of purpose. We should try, not to set ourselves up against the major centers in sterile and fruitless competition, but to secure better understanding with them, to strengthen our capacity for effective negotiation so as to place the policy of international cooperation on a new basis.

The extraordinary prosperity of the advanced countries and the opulence which some of them are attaining should open a broad path toward this new policy of international cooperation. This is a matter of urgency. Markets for the traditional export of our primary commodities are shrinking and closing, without new ones being offered for our manufactures. The trend toward imbalance in foreign trade is placing a serious brake on the economic development of many of our countries. And deterioration of the terms of trade is materially reducing the positive contribution of international financial resources to our development.

It is not enougn to identify the problems or to talk about the attitude of the major countries toward the lot of the smaller. We must organize our common action in order to secure a constructive response from the former in all fields—in trade, finance, and our primary commodities in regard to which a sound policy to uphold values and expand markets is urgently required.

A lesson for all this can be drawn from the United Nations Conference on Trade and Development, held at Geneva in 1964, and from the preparatory meetings of our countries, held at Brasília and Alta Gracia. Without joint action we can make no headway toward solving these grave problems at the international level. The more we coordinate our own efforts at this level, the better Latin America will be able to help this action to develop effectively and responsibly—a process that is not incompatible with, but on the contrary strengthens, the regional action defined in the Charter of Punta del Este.

The policy of Latin American integration, regional action, and, in general, international cooperation are not alternatives to reforms in our own economic and social structure. Such reforms are inevitable. They are already going forward and must acquire great scope in the vast movement to modernize our countries. But it will be much less difficult to cope with this herculean task in an economy that is growing at a faster pace, with all the inspiration of a bold and clear-sighted policy of integration and of continental and international cooperation. This policy must be applied concurrently with and not after such reforms if we are to avoid frustrations fraught with dangerous consequences.

The need for political decisions

All of these changes require major political decisions at different levels. Conscious of this pressing need, President Frei has urged the authors of this document to offer suggestions for accelerating Latin American economic integration.

We share the concern of the Chilean President. We also associate ourselves with his desire to further a process that has already begun. The Latin American Free Trade Association, established at Montevideo at the beginning of 1960, is a very important step toward the common endeavor, as is also—and from an earlier date—the happy initiative of the Central American countries.

The Central American nations are proceeding resolutely toward the formation of the common market, under favorable conditions of which their Governments took advantage with laudable determination.

The same is not true as regards the broader trend toward Latin American economic integration. What has been done until now, while important, is not enough. We are still far from achieving the goal that the same Latin American countries set themselves, in August 1961, in the Charter of Punta del Este. There our countries undertook to work during this decade, which is already so far advanced, in order "to strengthen existing agreements on economic integration, with a view to the ultimate fulfilment of aspirations for a Latin American common market that will expand and diversify trade among the Latin American countries and thus contribute to the economic growth of the region."

The integration objectives are not being fulfilled at the pace required by the magnitude of the problem. The practical obstacles are great but not insuperable.

The slow pace of integration is not, of course, due to the Montevideo Treaty itself, but to the fact that no general integration policy has yet been formulated that clearly and distinctly establishes the desired objectives, the methods to be used, or the time required to attain these objectives, and because not all of the countries of the area have acceded to the treaty.

The treaty has placed in the hands of governments the preferential instrument necessary for applying the trade measures required by this general integration policy. Hitherto it has only been used in limited commodity-by-commodity negotiations, and although this initial experience has been very useful and instructive, it is now becoming imperative to pass on to a new stage of commitments that will lead to a common market in the form described below.

Other instruments are also available: The Inter-American Development Bank, which has been defined as the "bank of integration," will have to participate on a major scale in the promotion and financing of sectoral integration agreements and other multinational or national programs that are in keeping with the needs of overall integration policy. The Inter-American Committee for the Alliance for Progress and the Panel of Nine, in view of their important functions as regards Latin American development and the coordination of its financing, must make a major contribution toward insuring that national plans, in their pertinent aspects, follow the lines just mentioned. In short, the machinery already available must be fully utilized.

Other important steps are also indispensable. Agreements to supplement the Montevideo Treaty are necessary: Instruments are required for the programing and promotion of investments at the regional level; a compensatory payments and reciprocal credit system is lacking; it is necessary to define more precisely, in the light of experience, the principle of reciprocity, special treatment for the relatively less developed countries, procedures to correct the dislocations that could emerge from the liberation of intraregional trade, and the fundamental role of the Latin American entrepreneur in the overall context of the common market.

This general integration policy cannot be carried out without an institutional system which has the powers and resources essential for its independent functioning.

While, for understandable reasons, the proposals presented here respond to the need for a general integration policy that will give a powerful impetus to the constructive work initiated in LAFTA, they are not limited to the geographical area of LAFTA. On the contrary, they are also based on the need to extend this policy to Latin America as a whole. It would therefore be advisable, in addition to seeking the incorporation of other nonmember countries, to negotiate the integration of the Central American Common Market in the whole system as a single economic entity. It would thus have to be granted the advantages advocated here in favor of the relatively less developed countries. The fact that Central America is moving more rapidly toward a common market is not an obstacle but rather an advantage as regards implementing the general policy of integration. It would likewise be an advantage if other Latin American countries were to decide on general or specific objectives in order to advance rapidly toward this goal within the framework of the Latin American Common Market.

In this great movement we need the fullest support of our peoples, the active and resolute participation of workers and entrepreneurs, of technicians and researchers, in short, of the Latin American people at all levels.

The idea of a Latin American Parliament is already becoming a reality. It could be an efficient means of giving integration the broad base of popular support that is so essential for its vigorous advance.

The common market that will take shape as integration policy proceeds does not imply that a country should neglect its own development efforts. These efforts remain the prerogative of each country, and to direct them properly will be its individual responsibility. Nevertheless, the common market will provide a favorable environment for national development efforts to be made with the maximum use of our productive resources, thanks to the direct or indirect effects of reciprocal trade and to the possibility of increasing exports to other countries within the system, always provided that imports from the others grow at the same time.

Hence there is no incompatibility between the common market and national development. On the contrary, the common market is one of the means—and certainly a very powerful one—of carrying out a design that is shared by us all, namely, the achievement of vigorous national development. It is a common design in that the national aspect harmoniously expands to cover the entire range of our countries. If our history and our feeling are not sufficient by themselves to demonstrate this, there are inescapable events creating a growing sense of community, of a genuine Latin American community, which, in addition to its vital intrinsic importance, will enable us to guide our relations with the other developing countries and the great industrial centers along the proper lines.

Industrialization, exports, and the common market

Even when conceived in its broadest terms, integration is only one aspect of a vast effort to reform and modernize methods of production and the economic and social structure of the Latin American countries.

This must be done in the face of the serious and growing social tensions in our countries, tensions which largely derive from the lack of internal integration, from rapid demographic growth, from the progressively more conspicuous and disturbing presence, in our countrysides and towns, of swarms of people in occasional employment with precarious incomes who are denied the opportunities for a progressively better life that are offered by modern technology. These problems tend to become worse before they are solved and offer clear proof of the present inadequate dynamism of the Latin American economy to absorb, at rising income levels, the steadily increasing human potential.

It is imperative to incorporate this impressive potential into economic activities of higher productivity. Within this process, industry must play a role of the utmost importance, together with services that grow with general economic development, because, the more technology penetrates into the backward agricultural sector and the outdated marketing of its products, and the more that primitive forms of production disappear, the greater must be the part played by modern industry—and services—in absorbing the surplus manpower which is no longer necessary in those activities where technology is making inroads.

All of this requires considerable capital, which stands in clear contrast to the scarcity of available resources. And here we really touch on the core of our problem, because we are wasting a considerable amount of capital which, if properly employed, would enable growth to be expedited and thereby greatly increase the volume of goods available for Latin American consumption and investment.

We are producing much less than we are capable of, because of the present fragmentation of what should be a large market. It is well known that a large market, the great economic base, is indispensable if production is to be efficient and low cost, even in the most densely populated countries of Latin America. This need is evident both for reasons deriving from productive technology and for other reasons connected with the process of competition.

Modern technology requires large-scale plant; it requires a division of labor, and a specialization that often is not feasible within the narrow limits of national markets. Latin American industrialization is far from having met this requirement. Within each country all kinds of industries have been, and continue to be, established regardless of their economic viability. Moreover, if we continue industrializing in watertight compartments, this evil will tend to grow worse instead of being remedied. But, since it is not possible to interrupt the establishment of new plants while awaiting a new integration policy that is slow in taking shape, the need to formulate such a policy becomes progressively more urgent.

To understand the importance of these considerations, it is sufficient to cite some figures which indicate the order of magnitude of the problem in the iron and steel industry. If a rational integration program were to be brought into existence, it has been calculated that, of the probable increase in output of some 15 million tons of iron and steel by 1975, savings of some $3,700 million could be made as regards the investments required if each producing country continued making, by itself, all the items for its own consumption. This would represent an annual saving in direct production costs of more than $400 million by 1975, i.e., a considerable proportion of the total steel cost by that date.[1]

The considerations regarding competition are also very important because it is closely related to the private enterprise system. In our countries, the scale of competition is usually small or nonexistent owing to the high barrier of tariffs and restrictions behind which industrialization has developed.

This situation conspires against technical progress and greater productivity. And even in those plants that could attain an adequate scale, especially in the larger countries of Latin America, the small extent of competition—or the lack of it—frequently leads to inadequate utilization of capital and the other productive resources. Moreover, the establishment of new plants, added to those already producing the same items, does not usually stimulate competition but frequently leads to tacit or explicit understandings that, far from lowering costs and prices, often raises them arbitrarily.

Close communication between markets in a single economic area is essential for industry to feel itself continuously spurred on by competition among the Latin American countries. From the point of view of economic viability, this process will have two main effects. First, it will lead to sectoral complementarity or integration agreements, especially in the major import-substitution industries. To a large extent, products that are now imported from the rest of the world would be replaced by others of Latin American origin in intraregional trade. Secondly, competition will give a powerful impetus to the modernization and readjustment of existing industries.

Of course, the great differences in productivity between our countries and the technically more advanced industrial centers make it necessary to continue protecting our industries. Nevertheless, it will be necessary gradually to reduce this protection, as productivity increases and as the persistent tendency to external disequilibrium prevailing in Latin America is gradually corrected. But, are there any reasons for not promoting active competition among our countries through tariff reductions and the elimination of restrictions?

The reduction of industrial costs, obtained through complementarity and integration agreements and by the effects of reciprocal competition, would further the other objective that must be achieved at the international level, in order to help, together with import substitution, to correct the phenomenon of disequilibrium just mentioned. This objective is an increase in our industrial exports to the major centers. Even if we can achieve rational import substitution—and it is not rational today—we shall still have to continue importing a growing quantity of goods, particularly all those that cannot be produced economically within the common market. Our imports, especially of capital goods, of intermediate products, and of new consumer items, will have to go on growing intensively even though there will be continuous changes in their composition.

We can only obtain these industrial goods in adequate quantities if we export other goods, also of industrial origin, to the major centers. It will not be possible to rely upon primary commodities, since exports of them generally tend to grow slowly whereas the demand for industrial imports tends to develop at a relatively faster pace.

But how are we to increase our exports of manufactures on a large scale if our costs continue to be high? At the above-mentioned Geneva Conference, we

[1] Estimates based on studies by the secretariats of ECLA, IDB, and the Latin American Institute of Economic and Social Planning.

strongly urged the major centers to change their trade policy toward the developing countries and we asked them to grant tariff preferences for our manufactured goods. Nevertheless this by itself will not be sufficient for our industrial exports to expand to the extent required. Inevitably we must cut our production costs in order to take advantage of these preferences and be capable of existing without them when the period for which they have been granted has expired. This brings us to another of the decisive reasons for creating a common market.

Imports of certain manufactures from developing countries will certainly require adjustments in the industrial structure of the major centers.

Similarly, as a result of reciprocal competition, adjustments will be required in Latin America, together with the safeguards later mentioned in this document. If we are not prepared to make these adjustments to expedite growth, how can we expect the major industrial centers to agree to do so? Will we have the authority to impress upon them the need to transform the traditional structure if we do not show our decision to do likewise in the reciprocal trade between our own countries?

II. INTEGRATION POLICY

As has been previously mentioned, this document conceives the general policy of Latin American integration to be a series of measures covering commercial policy, regional investments, monetary and payments policy, and certain basic principles required for the proper functioning of the common market. Each of these aspects will be dealt with separately in the following pages.

Trade policy

It was already stated that the Montevideo Treaty has put a very important trade policy instrument in the hands of the signatory Governments. It would not be fair to examine the best way of using that instrument for the gradual attainment of the common market without a frank and explicit recognition of the significance of everything that has been accomplished at Montevideo during the nearly 4 years of the treaty's existence.

A common list of products has been agreed upon with a firm commitment to eliminate completely, by 1973, the customs duties and other restrictions on zonal trade in these products. That common list is subsequently to be gradually enlarged every 3 years. In addition, the annual negotiations have resulted in the inclusion in the national lists of a much larger number of products for which lower duties of differing degrees have been established. All this has created favorable conditions for encouraging industrial investments in the next few years. And reciprocal trade has grown by 38 percent in the 3-year interval between 1959–61 and 1962–63, even though the $950 million recorded in 1963 still represents only a small proportion of the total trade of the LAFTA countries.

At the technical level, very useful work has been carried out, such as the adoption of basic criteria and the clarification of various problems regarding the definition of the origin of goods and others connected with customs technique, and progress is being made with the standard customs nomenclature, without which progress toward a common external tariff vis-a-vis the rest of the world is impossible.

Within LAFTA a group of technical advisers has been established, and private enterprise has been encouraged to establish representative bodies to collaborate in carrying out the treaty. Moreover—and this is particularly important for the future—a capable and efficient secretariat has been formed with a strong sense of its responsibilities.

Some very commendable results have therefore been achieved. But if these are evaluated in terms of the major objectives of a common market, as previously defined, the enormous field of action still to be covered can be clearly seen.

The Montevideo Treaty constitutes an important step toward the establishment of the Latin American Common Market, and member governments have declared their intention of doing their utmost to create favorable conditions for attaining that purpose. But the immediate objectives and the commitments assumed have so far been primarily those required in order to create the preferential instrument to which reference was previously made, within the juridical context of a free-trade area, by means of selective negotiations on a commodity-by-commodity basis.

This cumbersome procedure of miniature negotiations is showing itself to be incapable of bringing about a substantial liberalization or an important expansion of trade. As the stage of easy concessions comes to an end, it has become increasingly more difficult to include new products in the lists. Moreover, in each negotiation vested interests exert pressure on governments to exclude products that could be exposed to competition from the rest of the area. As a general rule, the selective procedure limits tariff reductions to a specific number of items and makes it almost impossible to achieve the general liberalization of reciprocal trade. This is even more important if account is taken of the high barrier of tariffs and restrictions on the area's trade. The tariff barrier is largely a result of the improvisation to which our countries have frequently been forced to resort in trade policy under critical pressure from outside. It is estimated that the average tariff level of the LAFTA countries exceeds 100 percent, and duties of 200 and 300 percent are frequent.

Perhaps it would not have been possible to choose any procedure other than these commodity-by-commodity negotiations during the initial stages of the treaty. Still, it was foreseeable, from the experience of the European Common Market, that the procedure would be inhibited by fear of the dislocations which might transpire when the market was gradually opened up to competition from other countries of the system. It might have been seen, in the light of the European experience, that this fear was without foundation, but nonetheless it has been impeding the advance toward the reduction and elimination of tariffs.

Today it is generally recognized that such a system of negotiations will have to be replaced by another, in which reductions take place automatically. Within LAFTA itself, the secretariat has been studying ways and means of achieving that purpose.

In order to strengthen the integration process, it is essential to determine clearly and distinctly the point to be reached within a given period of time. Accordingly, it is considered necessary for the Latin American countries to assume four closely interrelated commitments to be fulfilled within a period of 10 years: first, to establish quantitative targets for the desired maximum level of customs duties—including restrictions of equivalent effect—to be attained and to adopt a gradual and automatic mechanism for the application of such a system; second, to eliminate gradually the application of quantitative and other nontariff restrictions on intraregional trade; third, to establish a common tariff vis-a-vis the rest of the world; and, fourth, to establish a system of reciprocal preferences for member countries to enjoy in their intraregional trade pending the establishment of the definitive preferences in the common tariff.

As to the first commitment, it is proposed that, at the end of the specified period, participating countries should not be able to levy customs duties in their intraregional trade exceeding 20 percent of the c.i.f. value of each product, with the exceptions that are explained later, particularly with respect to the relatively less developed countries. For obvious reasons, those reductions should not be left until the end of the period, but should be introduced annually. Once this idea is accepted, the technicians should present appropriate formulas for bringing this quantitative target into effect within the established time limit.

Application of this gradual and automatic process would mean that, at the end of the first half of the period concerned, i.e., at the end of 5 years, all customs duties not now exceeding 100 percent would be reduced to levels equal to or lower than 50 percent, which is considered a reasonable minimum target for the first part of the period mentioned. The case of customs duties now higher than 100 percent is different, and it would therefore be advisable to intensify their reduction in such a way that, at the end of the first half of the period, none of them exceeds 50 percent.

In this way the differences in customs duties that now exist between countries and even within the same country for various products would be gradually eliminated until the target is reached; this is an indispensable requirement if a common market is to be attained. It should be borne in mind that the proposed system does not exclude the desirability of continuing those commodity-by-commodity negotiations that help to accelerate the tariff reduction process.

Furthermore, establishment of the common market implies the total elimination of customs duties, and not merely a quantitative target for reduction. It would not, however, be advisable to try to do this immediately. This should rather be left for the final stage, when decisions should be taken in the light of the experience gained during the initial stage when a substantial reduction of tariffs would be obtained.

Clearly it will be necessary to anticipate the difficulties that may arise in fulfilling these commitments. For this purpose, as is explained later, the system would also include adequate safeguard clauses that would make it possible effectively to deal with such situations or possibly to correct any trade disequilib-

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riums that might arise. Moreover, countries could introduce internal taxes affecting national production and imports alike for the purpose of restricting consumption of certain items, especially luxuries.

As for the second commitment, quantitative and other nontariff restrictions on intraregional trade—other than safeguard clauses—should also be gradually and automatically eliminated within the same period in accordance with formulas proposed by the technicians. These formulas should enable the above-mentioned restrictions to be converted into customs duties that would be subject to the other commitments proposed in this section.

As regards the third commitment, a common external tariff, which is an essential element for the creation of a common market, should be gradually worked out. Nevertheless, the greatest efforts should be made both to attain uniform tariffs as soon as possible for raw materials and intermediate products, in order not to dislocate competition among countries of the systems, and to establish common external tariffs in the sectoral complementarity or industrial integration agreements, in order to obtain a reasonable degree of protection against external competition.

With regard to the fourth commitment, until the common external tariff is achieved, a system of preferences should be introduced for products of member countries when the preferences resulting from the process of tariff reduction are insufficient to satisfy the principle of reciprocity.

Regional investment policy

It would be a mistake to assume that the efficient manipulation of the trade policy instruments described above is enough to put the integration policy suggested here into effect. The play of economic forces alone, stimulated by tariff reductions, would not by itself lead to this result. It would be imperative to exercise some control over those forces, in order to attain the objectives of that policy.

It is not merely a question of reducing or eliminating duties and restrictions, of creating preferences, of foresightedly introducing safeguard measures to ward off or remedy dislocations, or of having corrective expedients available. It is much more than that. Integration also requires constructive action. Trade policy measures could not be a substitute for it; their function is solely to establish an adequate framework in which integration can be attained.

This constructive action should be translated primarily into a stimulating common market investment policy. Within the broad context of development, this policy must include, in particular, a series of activities relating to integration—first and foremost, the large import-substitution industries which, in addition to their importance in the development process, must help to overcome the external imbalance which is a feature of the more advanced countries of Latin America and which will soon appear in the others if current external trade trends continue.

As is well known, the import substitution process is entering a new stage. Easy substitutions are wholly or nearly exhausted in the more advanced Latin American countries and technically complex industries are beginning to be set up requiring large investments and a sizable market. None of our countries, no matter how large or vigorous, could begin or continue this stage of industrialization on its own in economically viable conditions.

It is therefore necessary to plan the development of these industries on a regional scale. This planning refers principally to iron and steel, some nonferrous metals, some groups of heavy chemical and petrochemical industries, including the production of fertilizers, and the manufacture of motor vehicles, ships, and heavy industrial equipment. This involves a limited number of industries which, in addition to being import-substitution industries, cover fields of vital importance for strengthening the economic structure and accelerating the pace of our countries' development. It is precisely in such fields that economies of scale, the advantages of suitable siting, the utilization of productive capacity, and better operational efficiency will be most strikingly achieved. One of the paradoxical situations existing side by side with the Treaty of Montevideo has been that some of these industries have been established or expanded in various countries without regard to the objectives of an integration policy.

It would be appropriate for the governments to decide now to conclude these sectoral agreements in such industries so that a start can be made without delay on the studies needed for carrying out the relevant negotiations.

One result of the investment policy in all these industries might be the conclusion of a series of sectoral agreements within the next few years. Although these agreements are provided for in the Treaty of Montevideo, very few of them have so far been concluded, and those that exist do not relate to the industries that are of basic importance. One circumstance which may have contributed to this situation is the view originally taken that these agreements should conform to the most-favored-nation clause. This has just been corrected by a decision of LAFTA which provides that tariff reductions negotiated under an agreement will not automatically extend to the countries not parties to the agreement in the absence of the compensatory measure stipulated.

As a general rule, complementarity agreements would have to start from a more rapid and radical reduction in customs duties than would result from the gradual and automatic lowering of tariffs. In most cases, it might be possible for tariffs to be completely eliminated even before the end of the initial period of 10 years. This, of course, does not exclude the possibility of import quotas being established for limited periods so that the industries of some countries might be able to maintain a certain volume of production until such time as they became competitive within the common market.

In order to prevent combinations which, in the execution of the agreements, would restrict competition, it would be desirable to provide for a gradual and reasonable reduction of tariffs vis-a-vis the rest of the world as soon as the Latin American industries had been strengthened.

These sectoral agreements should be based on development plans for the various industries. Each plan should set out the production targets which would enable demand to be met and some or all of the relevant imports to be replaced. In addition, the necessary financing would have to be provided, and the broad lines of the policy to be adopted would have to be determined, especially to forestall any substantial difficulties which might arise from competition.

From another point of view, such agreements should not be exclusive or impede any other action that might be effective in the areas covered by the agreements. The scope of the agreements should, in this regard, be limited to providing incentives—particularly fiscal, technical, and financial incentives—that would direct the flow of investment in accordance with the aims of each plan but would not discourage new forms of action not benefiting from such incentives.

Apart from the sectoral agreements, the regional investment policy should concentrate on the countries that are relatively less developed and on any country in which the process of integration might give rise to substantial difficulties.

On the other hand, it must be recognized that in other branches of the consumer- or capital-goods industries, too, the progressive integration of markets may require special measures as regards promotional activities, reorganization, and both technical and financial assistance, which would differ in degree and kind according to the particular circumstances and be complementary to the action taken to reduce tariffs.

Agriculture presents its own very special problems. Generally speaking, agricultural production has not expanded fast enough to keep pace with a growing population and its needs. Latin America as a whole continues to import a large volume of agricultural products from the rest of the world, whereas its exports are expanding at a slow rate. Imports currently amount to $600 million, about $200 million of which is represented by U.S. agricultural surpluses.

There are thus three objectives to be achieved: an increase in production to improve the diet of the people and supply raw materials for industry; a reduction in the proportion of imported food and raw materials for internal consumption; and the encouragement of agricultural exports as a means of helping to eliminate the external bottleneck.

It is obvious that the solution of this problem cannot be left entirely to the corrective action of a trade policy. The problem is a complex one that has not yet been attacked in its full breadth and depth. What possibilities does Latin America have of achieving these objectives if it takes energetic action to increase productivity? In what form and to what extent will the various countries be able to take part in this action? In what way could the agricultural trade balance of each country be modified in relation to the rest of the common market? How far would it be possible to adjust whatever imbalance might arise from purely agricultural trade?

It must be confessed that the lack of systematic research in this matter makes it impossible to give any satisfactory reply to these questions. Nothing more can be done than to make certain very general statements of principle which may serve as a guide to the technicians. One paramount consideration in this regard is that the land of each country and the factors of production related to the land must be employed in the most economically efficient manner possible and that there can be no such thing as chronic unemployment, insofar as these factors are concerned, which cannot be corrected through their absorption in other sufficiently productive types of activity.

What is needed for the achievement of all these things is a program for developing Latin America's production and agricultural trade, a program in which special attention must be given to price policy. Such a program would also have to make provision for the investment necessary to put it into effect.

As to the infrastructural investment of the common market, special attention must be given to investment in transport and communications and, in some cases, to investment in power production and distribution. It is not intended that a single program should embrace the entire range of investments to be made in these fields by the countries belonging to the system; the aim is rather to coordinate this investment and to concentrate on carrying out those measures that require joint action.

With regard to air transport, the fragmentation and lack of coordination among the large number of Latin American airlines obviously impairs their efficiency and ability to compete with the airlines of the more advanced countries. This situation will become much more serious than it is now when supersonic aircraft come into use in the near future.

Joint action is also needed in the matter of shipping, which is affected by numerous complex problems ranging from the participation of Latin American fleets in traffic both inside and outside the area to the possible organizing of multinational shipping companies and the establishment of an adequate port regime.

Existing communications are generally poor and inefficient, and the need for improving, expanding, and linking the various systems is obvious. The technological revolution in communications resulting from the use of satellites makes it even more imperative to unite efforts that would otherwise continue to be weak and ineffectual.

Investment policy should likewise encourage efforts for the integration of frontiers so as gradually to eliminate the consequences of an artificial division in regions where development calls for a common approach.

The Inter-American Development Bank should channel a considerable part of its resources into these investment programs without thereby giving any less attention to the financing of national development. As the integration policy gathers momentum, however, more extensive resources will have to be forthcoming, either from additional contributions made to the Bank for this purpose, or from funds from other sources. The ICAP is destined to play a leading role in coordinating these various kinds of financing.

Monetary and financial policy

It must be recognized that the inflation prevailing in some Latin American countries is a serious obstacle to integration, besides disrupting their economic and social development.

The struggle against inflation is a long and difficult one and the policy that is being carried out in this connection should be pursued resolutely and persistently. It would not be possible to wait for it to bring about monetary stability before putting the integration policy that is advocated in this document into effect.

In addition to the measures which are mentioned later in this document for dealing in particular with the exchange discrepancies that inflation usually causes, it would be very useful if the Latin American central banks could coordinate their efforts in considering the problems of monetary policy in the context of integration and, more particularly, in examining the phenomena of temporary or permanent disequilibrium in intraregional payments and in trade relations with the rest of the world.

Such joint efforts on the part of the central banks would be important as an expression of the sense of collective responsibility inherent in the policy of integration. This same attitude should prevail in discussions of the domestic measures of one country which might affect other countries and it should also strengthen the joint support of the efforts made by the Latin American countries in the relevant international organizations with a view to solving their balance-of-payments problems.

These movements toward regional unity will be of undoubted importance in the approach that Latin America should take as regards the revision of the world monetary system that has been recently begun. The fact that we and other developing countries are not taking part in the study of problems of international liquidity that is being made by the group of 10 highly industrialized countries is further evidence of the urgent need to strengthen our capacity for international negotiation.

On the other hand, there is no doubt that the lack of an adequate system of reciprocal and multilateral payments and credits is a considerable drawback in the policy of reducing tariffs and eliminating trade restrictions among the Latin American countries. This effort, and, generally speaking, the whole policy of integration, would be largely frustrated if there was no payments union, i.e., no system under which the operations of each country can be compensated by those of the other member countries and reciprocal credits can be granted to cover the balances resulting from regional trade. It is therefore necessary to provide for the periodical liquidation in convertible currencies of the balances which exceed the limits of the established credits and for the adoption of substantive measures to eliminate the causes of the continuing disequilibriums.

In this connection, the idea that has been discussed again recently of forming a joint reserve fund of the central banks should be encouraged, for various reasons, one being that it would help in mobilizing the external resources needed for the proper operation of the payments union.

A general compensatory machinery, designed to simplify payments and to enable sizable economies to be made in currencies and operational costs, would not preclude the establishment of smaller compensatory boards of groups of countries that have close trade relations.

In this regional plan it would be necessary to use the services of the existing commercial banks and, with their close cooperation, to promote the development of a system of short-term commercial loans to encourage Latin American trade.

With regard to the need to establish machinery for the medium-term financing of exports of certain types of goods, the Inter-American Development Bank has already taken a very important step in organizing a regional system for the financing of intraregional exports of capital goods. This system should be made more flexible and should be supplemented by regional machinery for insurance and reinsurance.

III. OTHER RECOMMENDATIONS FOR THE SYSTEM OF INTEGRATION

In the foregoing pages we have considered the measures of trade policy, investment policy, and monetary policy that would have to be adopted in order to promote the establishment and smooth functioning of the common market. It would, however, be advisable also to establish clear criteria for other aspects which, if disregarded, might hamper progress toward this great objective. To this end, the following recommendations are put forward concerning the principle of reciprocity, the treatment to be accorded to the relatively less developed countries, the measures needed to deal with the internal dislocations that might arise in the process of liberalizing trade, and measures designed to stimulate Latin American private enterprise within the common market.

The principle of reciprocity

Reciprocity of advantage within the common market is an essential principle for its smooth functioning. No country will be able to go on deriving greater advantages than it grants to others.

It is impossible to lay down specific rules for maintaining this type of balance. Information on the additional trade which each country gains as a result of the reductions and elimination of tariffs and restrictions and of the specific integration agreements will, of course, be an important factor in assessing those advantages. Each specific case, however, will have to be examined carefully, for the disequilibrium working against one country will not always be due to the other countries not having granted it sufficient advantages. It might also have its source in the actual conduct of the country in question—its exchange system, for example, or the lack of adequate action to encourage exports, or other reasons. If that were not the case, however, it would be the responsibility of all to insure that it obtained due reciprocity. Investment policy is of the utmost importance in the fulfilment of this collective responsibility, which is vital for the proper functioning of the common market, but in order to insure reciprocity it will be necessary also to adjust tariffs.

In this sense, the countries which persistently gain greater advantages from the common market than do the others should speed up the reduction of customs duties and elimination of restrictions, insofar as the imbalance is not due to the attitude or policy of the less favored countries. Those countries will also have to offer a greater margin of preferences in order to promote their imports from the region in all cases where the reduction of customs duties and the preferences already granted are not sufficient.

This corrective action might prove necessary irrespective of the countries' level of development. The case of the less developed countries of Latin America, however, would have to be given preferential attention, in accordance with the following general criteria.

The relatively less developed countries

If integration is to succeed, all the countries must have in actual practice equal opportunities to profit from the establishment of the common market. For that reason, the relatively less developed countries require preferential attention and special treatment, particularly in three fundamental aspects: trade policy, technical and financial assistance, and regional investment policy.

With regard to the execution of trade policy, the less developed countries should have longer periods in which to reach the quantitative goals set for the reduction and elimination of customs duties and other trade restrictions and to establish the corresponding preferential margins for intraregional imports. This system would have to be applied in relation to the actual expansion in the volume that these countries manage to export to the common market, on the understanding that the less developed countries will continue to fulfill the obligations they have contracted only insofar as they go on gaining specific advantages from the common market.

There is no doubt that the incorporation of the less developed countries in the regional integration process will require a special effort of technical and financial assistance. As far as technical assistance is concerned, the international organizations, the industrialized countries, and the more developed countries of the region must coordinate their efforts in programs with well-defined objectives that will enable the respective projects to be prepared in good time. Moreover, for the financing of the necessary investments, consideration must be given to external financial assistance on flexible conditions and favorable terms.

The regional investment programs must also give preferential attention to the less developed countries, especially in connection with power supply and the linking of those countries with the rest of the region, with regard both to means of transport and to communications systems. Similarly, the economic integration programs of the less developed countries—as in the case of the Central American countries—and the border programs between those countries and between them and the relatively more developed countries must be given special impetus. Lastly, particular attention must be given to the problems that arise in the less developed countries as regional competition becomes stronger. In this aspect, the action to be taken in order to improve or adapt established industries that are not sufficiently efficient is of special importance.

Measures of protection and readjustment

It is understandable that countries should be reluctant to enter into agreements providing for substantial reductions in tariffs and other trade restrictions until they have a clear picture of what protective measures they will be entitled to take if their imports should involve them in serious and persistent economic difficulties. Reference has already been made to the fact that technical and financial cooperation is needed for the readjustment of any activities which may be affected. While this process of readjustment is going on, it is essential that member countries should have at their disposal defensive measures which they can take in cases where their compliance with the agreements entered into jeopardizes activities of obvious importance to their national economy, or seriously affects their balance of payments or level of employment. Such measures could consist, for example, in the provisional imposition of import quotas or tariff rates higher than those agreed upon.

These measures could not be left to the sole discretion of the importing countries; they would have to be authorized by the competent organs of the common market, indicated above, so that the exporting countries would have some guarantee that measures of this kind would not be arbitrary, or be continued beyond the reasonable period necessary to bring about the required readjustment.

In this connection, the disturbing effects on trade resulting from inflation give rise to justified concern.

Until monetary stability is achieved throughout the region, any marked disparities between internal price levels and the external value of currencies will have to be avoided. Such disparities, whether they take the form of monetary overvaluation or of undervaluation, affect the entire process of trade and the entire payments system, not only our intraregional trade.

Where a country's currency is overvalued, the harmful effects are felt by the country itself, which can rectify them by altering its rate of exchange. However, it is conceivable that the country in question could be authorized to take certain transitional measures to correct the effects of the overvaluation of its currency on its trade with the other Latin American countries.

Where a country's currency is undervalued, the harmful effects are felt by the other countries members of the system. Accordingly, these countries should have at their disposal measures to protect their internal production and their exports until the exchange discrepancy is rectified. These measures, of course, would have to be expressly authorized whenever the country whose currency was undervalued failed itself to take measures of readjustment or compensation, as would be highly desirable.

In any event, the governments concerned will have to avoid or correct these disparities until such time as success has been achieved in removing their causes, whether these are to be found in inflation or in any other phenomenon.

Difficulties may also be caused by the varying tariff treatment given by different countries to imports of raw materials and intermediate products, since this gives rise to cost and price differences which interfere with normal conditions of competition. Until a common tariff—the fundamental solution to this problem—has been achieved, authorization could be given for transitional measures of a compensatory character.

The problem of stimulating Latin American initiative

The signatories to this document share a concern which is extremely widespread in Latin America: that in the most complex and investment-attracting sectors of the common market—i.e., in basic industry—private initiative in the great industrial centers enjoys so great a technical and financial superiority that it may well acquire a predominant position, to the decided detriment of Latin American entrepreneurs. This serious problem, while not the sole problem of the common market, may prove an obstacle to its progress.

Accordingly, solutions must be sought which will effectively dispel this concern. Two types of solutions may be conceived: the formulation of a statute providing a clear and uniform definition of the terms offered by Latin American countries and the common market to extraregional investors; and the adoption of a policy providing regional entrepreneurs with solid technical and financial support.

Proposals were recently made for the establishment of an international system to do away with the conflicts of interest which face foreign investors. In refusing to support these proposals, the Latin American countries have implicitly assumed responsibility for creating a system of their own offering practical and stable safeguards, within a code of principles rooted in an entire tradition of independent life.

Foreign capital undoubtedly has an important part to play in the development of our economies, particularly when it operates in association with local entrepreneurs in industries which are so technically complex or so capital-intensive that access to them is difficult for Latin American entrepreneurs alone at their present stage of development. Foreign firms generally have considerable exporting experience, and this experience, in conjunction with the efforts of our own entrepreneurs, could be of great use in insuring better exploitation of the opportunities offered by the common market, and, particularly, in promoting the export of industrial goods to the rest of the world. There are already a number of highly positive examples of these forms of association in various Latin American countries.

If the Latin American entrepreneur is to be enabled to take an efficient and equitable part in this type of association, the rules for foreign investment will have to be founded on the principle that the regional market must be an instrument to strengthen the position of our entrepreneurs and confirm their paramount role in the development of Latin America.

Thus foreign investment must be brought into line with the fundamental objectives; that is, it must bring with it modern techniques of production and it must serve increasingly as an efficient vehicle for the transfer of such techniques to our technicians and entrepreneurs and their genuine incorporation in the processes of business management.

But if the Latin American entrepreneur is to be able fully to fulfill his function, this is not enough; he must also be given solid technical and financial assistance. This is a responsibility which will have to be shared by the actual countries concerned and by the international organs and industrialized countries which are participating in the development of Latin America. The former will have to organize themselves with a view to mobilizing their own technical personnel—frequently dispersed among a variety of secondary activities—and setting up credit instruments and capital markets which will be of help in the preparation of projects and will contribute to financing the local costs of the resulting investments.

External financial assistance is a fundamental element in our development process. While the tremendous progress made in the last decade in the volume and quality of internationl financial cooperation—particularly in the financing of public investment—must be recognized, much remains to be done to create credit instruments by means of which similar finance can be rapidly channeled into the private sector. This is a problem demanding urgent attention, for until it is solved the very high proportion of total investment in Latin America represented by private investment will for the most part go to financing suppliers frequently in respect of purchases of capital equipment at prices higher than the market prices and on amortization and interest terms incompatible with the capacity to pay of the lending countries. To solve this fundamental problem, concerted and tenacious efforts on the part of all international financial organs and the active cooperation of the competent authorities of the capital-exporting countries will be essential.

IV. THE INSTITUTIONAL MACHINERY OF THE COMMON MARKET

In order to pursue systematic integration policy culminating in the establishment of a Latin American common market, it is necessary to set up institutional machinery which will make use of the various agencies and facilities already in operation and will thus make it possible to coordinate all action taken in connection with the objectives and general criteria stated above.

Council of Ministers

The supreme power of decision should vest in a Council composed of a Minister of State and an alternate representing each member country. The Council would hold regular meetings at least twice a year and special meetings when circumstances so required. When specialized subjects were under examination, the competent Secretaries of State should be present. Without prejudice to the foregoing, the alternates would meet more frequently in order to keep one another informed and to facilitate the work of the Executive Board and specialized bodies referred to below.

It would be desirable that the right to veto the Council's decisions should be restricted from the outset.

It would also be desirable for the Council to have the help of advisory committees composed of high-level technical officials from the member countries, and that of a committee composed of representatives of the workers, entrepreneurs, universities, and technical and professional organizations.

Executive Board

The executive authority of the common market would vest in a Board composed of a Chairman and a limited number of members—preferably four and in any case no more than six—appointed by the Council. The Chairman and members of the Board should be nationals of member countries, would be eligible for reappointment and should be selected mainly on their technical qualifications.

The members of the Board would represent, not the Governments appointing them in the Council, but the community itself. They would accordingly be forbidden to receive orders or instructions from countries individually and would be required to exercise complete independence of judgment in the performance of their duties.

The principal functions of the Board would be: to insure that the objectives of the integration policy were attained and that the general criteria of that policy, including the principle of reciprocity and the necessary tariff-adjustment and preferential measures, were applied; to propose to the Council measures designed to accelerate that process; to promote the negotiation of sectoral complementarity agreements; to promote, or to have carried out under its direction, the studies required for the application of the general policy of integration; to decide on the application of safeguards and readjustments when required; to act as a court of first instance in disputes on interpretation; and, last, to coordinate activities relating to commercial and investment policy, monetary and payments policy, and foreign trade financing policy.

In addition, the Board should promote or carry out studies designed to coordinate the action of the Latin American countries in negotiations for the expansion or diversification of exports, should protect the prices of products exported to the rest of the world, and should play an effective part in devising other measures of international cooperation.

Latin American Parliament

The establishment of a Latin American Parliament, composed of representatives of the region's Parliaments, would give great impetus to the integration process. At the recent meeting at Lima, Latin American parliamentarians gave this fundamental decision their unanimous support. The Latin American Parliament would be a regional forum in which the major currents of public opinion would converge to elucidate the most important problems of integration. A climate of opinion would thus be created which would be favorable to the political decisions needed to set the process in train and to maintain steady progress toward regional integration.

Instrument for the promotion of regional investment

In the matter of regional investment policy, the Board should reach agreement with the Inter-American Development Bank on the establishment of an instrument which would actively promote the preparation of studies and projects in connection with the regional market, taking advantage of the work already being done in this direction by various organizations and drawing upon the experience they have gained. This instrument should form part of the IDB system and be under the joint direction of representatives of IDB and of the Board.

Its main function would be to carry out preinvestment studies and to prepare programs and projects in the following fields: basic industry, border programs, regional infrastructural investment, and investment in relatively less developed countries, or investment designed to correct maladjustments.

With these studies and projects in its possession, the Board would be able to promote the sectoral complementarity agreements required to negotiate the financing for the required investment. It should be made clear that the choice of functions for this body implies no disregard of the important contribution currently being made in this field by organizations of the inter-American system and by international agencies. On the contrary, the aim should be to encourage closer collaboration among all concerned, so that their efforts may be put to better use.

Conciliation procedure

Disputes on interpretation may arise in the course of the integration process. Problems not solved by direct negotiation between the parties should be referred, in the first stage of the conciliation procedure, to the Board. If no agreement were to be reached, the problem would be solved by an *ad hoc* conciliation committee acting as a supreme court; its members would be drawn by lot from a list of persons designated for the purpose by the member countries beforehand. This experiment might lead to the establishment of a regional court of justice.

V. FINAL OBSERVATIONS

These are the proposals which are being submitted to the Latin American governments for their consideration. What is needed, more than technical studies, is a definition of major objectives and the adoption of political decisions at the highest level. However, once these decisions are taken by governments, there will have to be technical discussions on the best means of translating them into specific agreements and commitments which will insure their implementation. Without these prior political decisions, there is a danger that the technicians will unduly prolong their deliberations for want of a complete picture of the aims and objectives to be achieved.

These proposals call for a vast program of work. Our countries must set about this program without delay, however much effort this may require of them, and resolutely mark out the path of Latin American integration. It would be useless to seek another solution. None exists, nor will one appear with the passage of time; indeed, time will make the task more difficult.

Integration is not something that can equally well be done or left undone. It is of fundamental importance for expediting Latin America's economic and social development, which is so gravely threatened by internal and external factors which may be dealt with most decisively.

We must realize, however, that the solutions which will lead us to that goal are not simple or easy ones. Ever since the great world depression, we have been seeking such simple and easy solutions, but we have not found them. Nor shall we find them, for our ills do not respond to contingent or transitory factors. They are basic ills, and they require basic remedies. In those earlier times, we lacked the experience to undertake this task on a regional scale. To fail to try now, after a long succession of frustrations, would be unpardonable.

Nevertheless, we must not underestimate the serious obstacles barring the way to these solutions. A multitude of immediate problems urgently demand the attention of our governments, leaving little time or energy to attack their fundamental causes. Thus, we are caught in a vicious circle. The immediate problems are becoming more serious and more acute because no basic decisions have been taken, while such decisions are not being taken because of the constant pressure of the immediate problems.

An extraordinary effort is required in order to break this vicious circle, and it is an effort which can no longer be postponed.

There is no doubt that the course of action advocated here—action leading to a common market—is fraught with dangers. However, there are also risks in inaction, and they are far greater. It would be the height of folly to run the risks of inaction in a Latin America which is in the throes of such profound social upheaval.

Moreover, the risks of action should not be exaggerated. There is no risk in the advance toward economic integration which cannot be averted or overcome, nor is there any dislocation which cannot be corrected. Why should the emphasis be placed on all these things rather than on the positive aspects of this great policy? Will it not offer our countries the most promising opportunities for action? Indeed, confined within the narrow limits of a national market, that action lacks broad horizons. Its frontier must be extended so that it can develop as effectively as possible until it reaches the 230 million inhabitants of Latin America.

We must also extend the frontier at the higher levels of Latin American educational and technical and scientific development as an essential part of the vast integration process.

This represents a tremendous challenge. It is a challenge to Latin American statesmen. It is a challenge to entrepreneurs with a spirit of determination and pioneering. And it is also a challenge to the Latin American workers, to technicians, and to the new generations which will find a great vital stimulus in the eager effort to create a Latin American community.

All this must be done now, without delay and with broad vision and constructive boldness. For a great deal is at stake. It is not simply a question of markets and competition. What is threatened in Latin America, given the imperious social demands of development, is the dynamic effectiveness of the system under which we live and the survival of our own values. What is at stake is our ability to step up the pace of development in order to achieve, on an impressive scale, a better life for the entire community through the vast potentialities of technology, within the broad and promising framework of an integrated Latin America which is conscious of its destiny and of the weight it carries in the modern world.

APPENDIX VI

Toward a Latin American Economic Community: Problems and Progress

Address of Felipe Herrera, President of the Inter-American Development Bank, at the inauguration of the Institute for Latin American Integration in Buenos Aires, August 24, 1965

As the year 1817 opened, all arrangements had been completed in Mendoza for the departure of the Army of Liberation. The instructions obtained by San Martin from the Buenos Aires government contained the broad guidelines of the Argentine Revolution's emancipation program for the other countries of the Americas, and solicited his influence in persuading the Chilean patriots to send their representatives to the Congress of the United Provinces "for the purpose of constituting a form of general government for all Latin America, fused into one nation."

A century and a half later, we, the heirs of those who forged and shaped our Republics, are meeting here under the same banner of "hemispheric nationalism" that inspired those instructions from the Plata revolutionaries to the Great Captain at a time when Bolivar was engaged in a mortal struggle for a free, united, and politically stable fatherland in northern Latin America.

Today the circumstances have changed, but the essence of the message of unity is the same. In the words of Alberdi, referring to the breaking off of our ties with the metropolis: "Once the crisis has been solved, we loosen the bonds of solidarity." With a clear vision of the need for integrated development, he added: "Prior to 1825, the American cause was represented by the principle of territorial independence; following the achievement of this aim, we find its main interests today to be vested in trade and material prosperity. The current cause of America is the cause of its population, its wealth, its civilization and communications, its merchant marine, its industry and commerce. In the union of tariffs, in the union of customs lies the true source of American strength. I shall forever admire the noble purpose of those States which turn from the narrow confines of their own borders to fix their sights upon a higher sphere of general, hemispheric life in the Americas, for this is to choose the path of progress. Under a great political system, the parts draw upon the whole and the whole upon its parts. The work of reform should alternate between the framework of the inner core and its outer shell. Any other course would lead only to half measures and abortive results."

These same political and economic concerns, inspired now by problems and needs then unknown, bring us together today for the inauguration of this Institute. The banner of integration now connotates full economic and social development. In this era of "hemisphere nations," of vast economic areas, and of common markets, we can no longer trust our isolated efforts to achieve the international stature and development we desire and which we have promised to the clamoring masses within our own borders.

In the recent report submitted by Mr. Prebisch, Mr. Mayobre, Mr. Sanz de Santamaría, and myself to the Latin American Presidents, we suggested the formation of a Latin American Economic Community as a legal and institutional expression of a regional common market in which our national economies could freely trade goods and services unhampered by internal barriers and subject only to a single, common external tax. Such a Community requires an institutional framework equipped with mechanisms that can harmonize the legitimate interests of the member countries, not through a supergovernment compromising national sovereignty, but through common institutions in which such sovereignties join on a higher plane to direct matters of mutual interest.

This document embodies not only the experiences but also the concerns and anxieties of four Latin American public servants, whose contact with actual conditions and aspirations in the hemisphere led them to outline systematically what might become a program of action designed to accelerate the integration process.

These proposals have been widely circulated and have been the subject of much political and technical discussion. We have appreciated both the support and the critical objections offered in response to our views for we believe that both will help to orient a vital process and a dynamic give-and-take.

To this end, on the first day of activities of the Institute, our best approach is to continue this dialog, concentrating specifically on the problems and progress resulting from our endeavor to consolidate the association of Latin American nations.

PROBLEMS

The general problem

There are some who feel that the difficulties confronting the Latin American integration movement today are insurmountable. It is pointed out, not without reason, that we are witnessing an intensification of nationalistic approaches, a rebirth of trends toward strictly bilateral relationships, and a loss of faith in the promise that closer ties among our nations will be the best means of achieving the economic growth and social justice to which the governments and peoples of the hemisphere aspire.

If we examine this statement further, we will see that it is largely determined, not by defects in the integrationist movement itself, but by the very problems inherent in our economic and political development process. Let us not forget, however, that progress toward higher forms of rapport are, historically, very often followed by periods of stagnation and reversal.

For behind the undeniable improvement and trends to better production and distribution of our wealth and income, the far-reaching, structural, and endemic, limitations of our Latin America continue to exist. Over the past 20 years, these limitations have been repeatedly outlined and defined in international and regional meetings, and they have been the object of concentrated efforts during the last 5 years, following signature of the Charter of Punta del Este, through concerted action by the inter-American system.

Beginning in 1950, the discontinuity of growth rates is highly significant, in that they fail to record a vigorous and sustained upward trend. Figures for 1964 show that Latin America as a whole has increased its real income by an estimated 5 to 6 percent, which, translated into per capita terms, complies with the 2.5 percent annual goals set by the Charter of Punta del Este. The 1965 trends also appear favorable. However, during the first part of the 1950's, the average growth rate was less than 4 percent, declining still further during the second part of that decade. All of this indicates that in the last 14 years Latin America's gross national product has tended to expand in real terms at an annual rate of 3.6 percent, a figure which, considering the demographic expansion, leaves a per capita margin for improvement of only about 1 percent. Obviously, in an international comparison with other parts of the industrialized or developing world, this margin is extremely modest.

The general external trade outlook in our raw materials continues to be uncertain, despite transitory improvements and the apparent broader acceptance on the international level of possible consideration of formulas designed to provide more equitable terms of trade for countries exporting basic products. Suffice it to recall that at present most of the food commodities exported by the Latin American countries, with the exception of meat and, temporarily, coffee, are involved in a crisis of oversupply that has led to a drastic price drop. The best examples of this situation are cacao and sugar, whose prices declined from mid-1964 to the midpoint of this year by 54 and 41 percent, respectively.

The weakness of the external sector in meeting regional development needs in recent years is also illustrated by the recorded levels for long-term external public debt. Between the end of 1958 and the close of 1964, this item rose from $5.7 million to $11.1 million. Service on this debt has increased correspondingly, from $780 million in 1958 to about $1.6 billion in 1964. In the case of certain countries in the region, this service represents between 20 and 30 percent of their earnings from visible and invisible trade.

In recent years, a broader approach has been adopted by certain capital-exporting countries which seek, through the systematic transfer of funds in the form of international public assistance or private capital investment, to achieve higher investment rates for the developing world with a view to narrowing what has been called the gap between rich and poor countries.

It would seem that at present this transfer of funds is more positive for Latin America than for the rest of the developing world, if we consider that the volume of public development loans authorized by the United States and the regional and international financing institutions for this area has risen from an annual average of slightly more than $400 million in 1957–60 to close to $1 billion in 1961–64. The Inter-American Bank has been operating at an average level of $300 million a year, and this figure is expected to increase to $400 million. Nevertheless, it would seem that this experience has not yet provided the final answer to underdevelopment.

At the recent meeting of the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD), Mr. Woods, President of the World Bank, said:

"* * * [it] is my deep conviction that the present level of finance is wholly inadequate, whether measured by the growth rate which the advanced countries say they are willing to facilitate or in terms of the amount of external capital which the developing countries have demonstrated they can use effectively. The whole order of magnitude of external capital flows to the developing countries wants changing."

He pointed out that the net total long-term public capital received by the developing areas from DAC member countries has held at approximately the same level since 1961, despite the increase recorded in the gross national product of the industrialized countries over the same period, at a rate equivalent to 4 to 5 percent per annum (probably about $40 billion a year). Consequently, the constant total of net official assistance represents a declining percentage of national income for the countries providing such aid. From the standpoint of the developing countries, the constant level of aid received has represented a decreasing amount in per capita terms, owing to the expansion of their population.

On the domestic level, many important steps have been taken by Latin America to accelerate its development, to modernize its agriculture, to reform its institutions and adapt them to community needs, to overcome its structural economic and social shortcomings, to provide broader social services, and, in general, to promote maximum efficiency in the utilization of its investment potential from both local and foreign sources.

These positive achievements have not yet substantially altered the current situation in Latin America, which is characterized by unresolved structural problems with respect to international trade, limited action by the capital-exporting countries on behalf of the developing nations and slow domestic progress, contrasts with a spiraling population, an accelerated trend to urbanization under poor social conditions unaccompanied by public services or education, and a sustained pressure by the low-income sectors, which historically receive the smallest share of the total product, to secure broader participation in contemporary Latin American society. If to this we add the high index of population less than 15 years of age, we find a difficult basic situation confronting the weak productive structures of our economies, which are thus exposed to unprecedented pressures. In Latin America, two out of every three inhabitants still suffer from chronic malnutrition, whole per capita agricultural output is lower today than it was 30 years ago; in Latin America, even now, two out of every five adults are illiterate.

Therefore, it is not surprising that the conjoined processes of inflation, substandard social conditions, unrest in the middle classes, turmoil in the farms, and tensions of every sort are worsening. This has inevitably forced our governments to take emergency action, on a stopgap basis, in order to solve difficulties and ease tensions.

On this basis, it is difficult for political leaders to undertake long-term programing for the hemisphere as a whole. For this reason, when we have on other occasions advocated the establishment of common or multinational technical mechanisms designed to promote the integration process, we have taken into account the need for institutionalizing regional action and for insuring its continuing, regular progress and scope. We believe that, just as the consolidated institutions in our individual countries bear the primary responsibility for satisfying community needs, so it is urgent to develop an institutional approach in the overall Latin American sphere of activities.

In my opinion, we are not facing a crisis in the integration process but we are facing a permanent manifestation of a Latin America undergoing profound political and social changes based on 20 weak, unintegrated economies. I have maintained that one, though certainly not the only, solution to these national difficulties is to open our doors to the outside world, and to begin by developing closer communication and association among ourselves. It is apparent that the Latin American countries represent varying rates of development, and that their historical experiences and their ethnic evolution differ. However, we do not know of a single case in which a rapid strengthening of the ties between our nations would not benefit, in one way or another, the essential processes of change in the various Republics of the hemisphere.

Special factors

There are also, of course, special factors and circumstances conspiring against any acceleration of a common Latin American movement. These are not new factors; they have been present throughout our entire history. They are the very geographic, political, technical, and cultural barriers that prevented us, upon becoming independent Republics, from constituting a confederation of nations as a prerequisite for sustained progress and stability. There are those who view these factors as new elements arising to disprove the arguments of integration partisans. But if we have rallied more supporters to our cause and if we have garnered greater experience and wisdom, it is precisely because we have begun not only to explore and define these limitations, but also, in many cases, to overcome them.

Therefore, I believe it is useful to give a panoramic view of the most serious restrictions confronting Latin American integration today.

1. In the first place, the major obstacle to a process of economic complementation on the regional level can be traced to the historical organization of the economic structure of Latin America. We must remember that our economic systems were, from colonial times, "peripheral." They were, indeed, doubly peripheral: for the economic centers that have traditionally drawn their supplies from Latin America and for our own countries, insofar as their most intensive economic activity was based solely on export trade, generally located in the coastal areas and lacking coordination with the provinces. It is rightly said that our countries need to integrate in a national geographic direction as well, since the distinctive features of a national market have not been developed within their own borders.

These peripheral economies have been traditionally projected abroad, with no regular mutual interrelationship, separated by geographic factors and lacking a transportation and communication infrastructure to draw them closer together.

When, in the last few decades, our countries became aware of the need for industrialization, they limited their efforts in this direction to narrow confines and were often unable to direct them toward their own national markets for the same reasons of geography and infrastructure and for an even more serious reason, the lack of sufficient consumers resulting from underpopulation, low income, or poor income distribution. In this connection, a further effective criticism leveled at the current state of affairs has been that Latin America, on a national plane, still needs to establish its domestic markets, which will also require social adjustments as a basis for better income distribution and for elimination of drawbacks in its economic structures.

Much remains to be achieved by Latin America on the national level in order to form, develop, and consolidate its domestic economies. I do not believe that anyone who justifiably maintains the premise of regional economic integration offers it as an alternative for national integration, either geographic or social. Occasionally we have heard our views interpreted to imply that we who are striving to establish a Latin American Economic Community propose to ignore the basic problem of the domestic development of our own countries in its political, economic, and, particularly, in its social apsects.

In this respect, I consider it timely to recall today my statement at the First Plenary Session of the Latin American Parliament, held in Lima in December of last year: "Regional integration will permit active coordination of the progressive forces, of the dynamic sectors, and of those individuals in every country currently striving to benefit their peoples. It is the responsibility of the leaders of regional integration, and of the leaders of each national community, to coordinate the process of regional cohesion with that of socioeconomic reform, so that the benefits and prosperity inherent in integration can flow through every artery of the great national structure to reach the vast rural and urban masses."

Although it is true that the regional action we seek is not an alternative to national action, it is equally true that such national activity can be made more flexible and more dynamic through external stimulation and cooperation. We have learned in the Inter-American Bank that on a geographic level it is practically impossible to break through the isolation of many regions unless their development is coordinated with that of a neighboring country.

In connection with industrialization, the inner-directed expansion of light manufacturing has in many cases come to a standstill because costs can no longer be covered or because the limited markets have already been supplied. The domestic growth prospects of many industries have made their future heavily dependent upon potential exports to other countries in the region.

The experience of Central America is most interesting in its social, cultural, and human context. This area, based on economic development promoted by integration, has within a few years evolved new groups of entrepreneurs, technicians, and skilled workers, whose prospects are no longer exclusively limited to a small special dimension but are pegged to a broader market in which the flexibility of trade relations stimulates and encourages the awakening and utilization of potential or latent individual and community aptitudes.

Therefore, integrated regional development must be based on accelerated national development; both factors interact in a process which very often involves not only the economic sphere but the entire field of social sciences as well.

How can we, at this moment, coordinate pragmatically these two aspects which, in the opinion of some, appear to be antithetical? We believe that an answer is possible and logical at this present stage of history in which the prospects of organizing collective efforts are becoming increasingly feasible. To this end, we need to prepare ourselves so that the stage of national programing will bring us closer to regional schemes. It is not a question of a simple juxtaposition of national programs, but rather of seeking common fronts where supplementation and coordination are possible. The solution may be sectoral integration, to which we will refer elsewhere, based on certain fundamental industries, transportation and communication systems, and other basic areas.

2. A second major group of limitations hampering accelerated integration might be termed institutional and cultural. Just as Latin America became divided into 20 different economies lacking sufficient intercoordination, so over the course of 150 years, conspiring against our common origins, we have tended to develop divergent institutional and cultural categories.

One part of this process is explained by geographic factors. Only a very few years ago, the Latin America composed of the Caribbean area, Mexico, and Central America, was a world far removed, in many respects, from southern Latin America. Its monetary systems, its external cultural influences, social classes, and commercial expansion were alien to its neighbors to the south.

These sociological aspects were obviously strengthened through an inevitable process of differentiation as our various countries underwent their own historical experiences. And even though today we are witnessing the effective shrinking of our world through the technological revolution in transportation and communication systems, these differences have not disappeared.

It is interesting, nevertheless, to point out how Latin America's reaffirmation of its proper image—this reawakening of awareness by nations of their role as part of a single historical and cultural community—has in recent years reached a peak unprecedented since the time of independence. Today, more than ever before, the proposal to remake our "great dismembered nation" is no longer the romantic concept entertained at the end of the last century or early in this one.

We have often suggested that, in planning our strategy for integration, we should utilize this common awakening as a basis for action toward an economic community. Political and cultural integration in Latin America does not represent a utopia, but rather a projection and, at the same time, an efficient tool for a regional economic association.

No matter how far the Latin American nations may progress toward more advanced status, given their backward starting point vis-a-vis the more industrialized countries, it is impossible for them to achieve comparable levels by themselves. Furthermore, assuming a hypothetical and rapid economic integration of our hemisphere, this will not insure a standard of living equal to that of societies that have progressed far beyond our own. We will inevitably repeat the experience of the thirsty traveler in the desert who, struggling to reach an oasis, sees the mirage receding even further beyond his horizon.

For this reason, an exclusively "economic development" approach to Latin America, as a formula for providing us with the rank or status to which we aspire in the contemporary world, is inadequate. We need economic development to insure the well-being of our countries and our peoples; but the strength derived from our economic growth alone will not broaden our influence in the world of the future, except insofar as we can create a community bound together by a policy of common purpose in its relations with other blocs or regions.

I have consistently assigned great importance to the coordinated action which our countries resolved to undertake at the Alta Gracia meeting to protect our raw materials. Never before had the Latin American bloc played a major role in an international economic forum, as it did in Geneva at the United Nations Conference on Trade and Development. For our countries renounced their separate, disjointed identities to form a dynamic nucleus which exerted considerable influence on that meeting.

3. In the third place, concomitantly with and largely as a reflection of the foregoing factors, we should point out our limited capacity for technological and scientific absorption. It is almost axiomatic that the great nations, with their broad markets, vast populations and vigorously expanding national incomes, are those best able to create, develop, and adapt contemporary technology. At present, the future of nations depends not only on their natural and human resources, but also on their scientific and technical resources and on their capacity to apply these factors to economic and cultural processes.

It is impossible for an unintegrated Latin America, with rudimentary or backward educational systems and only a few research centers comparable with those to be found in other parts of the world, to receive mass benefits from modern technology. Establishment of a Latin American Common Market would create the conditions and requisites fundamental for such development; but, at the same time, we would require joint scientific and technical activities in which we would share the inherent high costs.

4. The sluggishness of the integration process can also be traced directly to the hesitancy or refusal of our countries to adopt effective formulas for multinational action.

The history of this hemisphere records many earlier experiments designed to promote greater exchange, greater rapport and greater economic and political cooperation. Nevertheless, only in the past 5 years have these initiatives become truly dynamic, adopting more permanent institutional mechanisms better suited to our situation.

Economic and sociological and technical conditions may not previously have been sufficiently mature to permit this possibility. History is sometimes curiously punctual. If certain national processes are speeded up, they may not reach fruition; yet, if they are slowed down, they may relegate their countries to the sidelines of progress and to a future without promise.

I hope that we have still time to fashion the institutional tools of integration which, if they are improved and adopted, can be the effective lever which Latin America has intuitively sought for many decades. Allow me to outline briefly these initiatives and their proper place in the general contemporary panorama.

PROGRESS

Trade relations

Among the steps taken in the last 5 years, mention should first be made of trade mechanisms. The characteristics of the Central American Common Market and the Latin American Free Trade Association are well known; both have led to a substantial increase in the regional flow of trade.

The experience of the Central American Common Market is particularly dynamic. In 1964, intrazonal trade (about $95 million) was triple the 1960 figure ($30 million), which in relative terms signified an increase in the total value of intraregional foreign trade from 7 percent to nearly 15 percent. Trade in manufactures has risen steadily, effectively encouraging industrial expansion. Investment in new industries multiplied from 1960 to 1963; this process was intensified in 1964, helping to raise private investment in the region as a whole by 18 percent as compared to the preceding year.

LAFTA, the Latin American Free Trade Association which aims at establishing a free trade area within a period of 12 years, also shows a notable upward trend. Intrazonal exports in 1964 were valued at $560 million, representing an increase of more than 80 percent as compared to the 1961 level, while total exports for the area increased by only 20 percent in the same period. Consequently, the value of intrazonal exports expanded from 6.1 to 9.4 percent of total trade. In the last 3 years, the ratio of commodities traded through intrazonal imports increased in all LAFTA countries, except Paraguay and Uruguay. The largest relative increase was in manufactures, which include not only consumer goods and intermediate products but capital goods as well.

These steps were perhaps the only ones that could be taken to initiate our trade integration. However, just as Central America and the countries of the Free Trade Association prepared in advance for adoption of these mechanisms, especially based on the technical work of the Economic Commission for Latin America, so should we now coordinate our preparations for new stages. This is the basic premise of the report prepared by Mr. Prebisch, Mr. Mayobre, Mr. Sanz de Santamaría, and myself: In the light of the results achieved by LAFTA and the Central American Common Market, the next logical step should apparently be framed not only in terms of subregional schemes but also of a regional common market, in which these experiences could be coordinated and to which those countries not yet incorporated in either of the two systems would belong.

A common market requires both mechanisms designed to facilitate trade expansion and formulas for the coordination of financial and monetary policies, as well as promotion and investment policies, which should be harmonized with an institutional organization capable of directing this process. It is not a matter of copying or mechanically adapting the experiences of the European Common Market, but rather of utilizing the lessons to be learned from that scheme and, expecially, of trying to avoid some of the limitations that periodically handicap its progress.

In the report submitted to the Latin American Presidents, we stated that: "It would be a mistake to assume that the efficient manipulation of the trade policy instruments * * * is enough to put the integration policy * * * into effect. The play of economic forces alone, stimulated by tariff reductions, would not by itself lead to this result. It would be imperative to exercise some control over those forces, in order to attain the objectives of that policy."

Financial aspects

In this connection, it is in the area of long-term investment financing that the most important substantial incentives can be offered for integral action. The Inter-American Development Bank, through its activities to accelerate material progress at both the national and regional levels, represents one of the dynamic tools that has emerged in the last 5 years and has become, in fact, one of the pillars of what may evolve in the future into a Latin American economic community. This mission of our regional financing institution, in its role as the "Bank of Integration," was stressed in a special resolution adopted at our last Board of Governors meeting, held in Asunción.

By its very nature, the Bank, in contrast to the Central American Common Market and the Latin American Free Trade Association, goes beyond the exclusive association of Latin American countries, serving to channel contributions received from the United States in this multilateral undertaking and, in recent years, to absorb resources from nonmember countries, particularly Western Europe and Canada.

The recent establishment of the African Development Bank and the forthcoming formation of a regional bank for Asia indicate the technical benefits of this approach, initiated in Latin America, and the opportunities offered for joint undertakings between developing regions and the capital-exporting countries. Let me recall that only 5 years ago, in making my first official visit to this city as the newly elected President of the Bank, our available resources did not exceed $800,000, while today they total more than $2.6 billion in overall availabilities, formed by both public contributions from the United States and Latin America and the resources we have been able to attract on the U.S. market itself and in Italy, Germany, the United Kingdom, Spain, and Canada. This has enabled us to finance 287 projects for $1.3 billion, whose total cost is about $4 billion.

Our financial assistance for regional expansion includes a program of specific cooperation in integration efforts such as the financing of exports of capital goods for intraregional trade, the study and financing of border development operations and multinational projects, and participation in the development of industries and in enterprises aimed at serving more than one national market.

Central America has evolved a special financing agency, the Central American Bank for Economic Integration, which, with the support of the U.S. Government and the Inter-American Bank, is supplying the needed financing for projects of regional scope. That bank was recently augmented by the addition of a Central American Economic Integration Fund of $42 million to give preferential attention to regional and multinational infrastructure projects.

It is interesting to recall that, even though there are no serious financing problems within the European Common Market owing to the nature of its component economic structures, the Treaty of Rome nevertheless provided for the establishment of a European Investment Bank for the chief purpose of furnishing financing wherever needed to promote the more harmonious development of the region as a whole. This is why it has been so greatly concerned with financing the growth of southern Italy, the most backward area in the European Community.

The Inter-American Bank observes the same bias by giving preference in its financing operations to the relatively less developed countries in Latin America, according special and more flexible treatment to those which are, for a variety of circumstances, unable to absorb external funds, rather than to countries that lead a more stable economic life. Thus, as we review the history of our credit activities, it is not surprising that Central America, Paraguay, Bolivia, and Ecuador have received, relatively speaking, the largest benefits under our lending and technical assistance programs.

The financing of studies and implementation of multinational projects demanded by our integration process will be strongly reinforced by the announcement of the President of the United States only a few days ago that resources newly appropriated for the Alliance for Progress would be channeled to those purposes. President Johnson said: "* * * we must try to draw the economies of Latin America much closer together. The experience of Central America reaffirms that of Europe. Widened markets—the breakdown of tariff barriers—leads to increased trade and leads to more efficient production and to greater prosperity."

He then stated that the United States would contribute to the establishment of a fund for the preparation of multinational highways, communications, and river development projects benefiting two or more countries.

Although more work is required on this proposal, it will effectively promote initiatives which help to lay the regional infrastructure that Latin American so urgently needs. If this fund is to accomplish its purposes successfully, it will not only have to grant loans for the necessary and costly preinvestment work but should also extend financing on contingent recovery and nonreimbursable bases.

For harmonious development within a single common economic area, experts study the coordination of monetary policies, of payments, and of interbank and financial relations as well as capital markets. Coordinated use of international monetary reserves could help to solve the shortrun payment problems that so often plague many of our countries. This also points the way to the prospect of a regional central banking system.

In Central America, currency coordination has already advanced to the creation of a common unit of account, and institutional machinery has been established whose newest additions, paralleling the Central American Clearing House, are the Central American Monetary Union and the Central American Monetary Council, composed of the presidents of the Central Banks and aimed at unifying monetary and exchange policies. This process has been facilitated by the traditional currency stability of the area.

In the case of LAFTA—or, in more general terms, for the general economic integration of Latin America—we must face the problem posed today by inflationary trends and the distorted or unrealistic exchange rates they engender. We are aware that without stable parities, that is, without sound monetary policies, trade and the mobilization and placement of investments in the area will be undermined by a multitude of difficulties.

We believe that the efforts being made by several of our countries toward financial stability will be strengthened if, along parallel lines, we can hit upon devices for financial coordination and cooperation on the regional scale.

Thus, we see that the process of evolving a Latin American Economic Community must be carried forward on several fronts. An indispensable element is political leadership that will clarify its goals and regulate its pace. The foundations must be laid for internal and external customs schedules, a monetary accord, and financial machinery. We must build, on existing agencies, institutions designed to make the process a continuing and regular one and to insulate it from the shifting tides of politics. Coordination is essential among legislative and educational systems and among our health and welfare policies.

Latin America has already launched this manysided endeavor and is exploring fields in which cornerstones are gradually being laid. Many of them, such as some I have already mentioned, are widely known. Others have not yet emerged from the stage of discussion by technical groups. Yet others have been considered and proposed by experts, entrepreneurs, and professionals who realize that a regional approach will afford a solution to their national problems. An example of this is provided by the aspects of sectoral integration and supplementation to which I will now refer.

The steel industry

Latin American steel production climbed from 500,000 tons in 1940 to 8 million today. Growth has been progressing at a rate of 15 percent per annum during the last 5 years, which, on the regional level, outstrips the expansion of any other industrial sector during the same period. Plans for expansion underway in practically every country with a steel industry suggest that current production will double before 1970. In spite of this, steel consumption is still at a very low level in Latin America: the regional average is 44 kilograms per inhabitant against a world average of 113.

Estimates of Latin American demand for steel in 1975 indicate a consumption of about 27 million tons in that year, that is, triple the 1963 figure. It is calculated that, in view of the region's limited import capacity, the regional output would have to be increased to 23 million tons to supply that level of consumption. Fortunately, we have iron ore reserves in sufficient quantity and quality to satisfy that demand while continuing our ore exports to the regions we currently supply. But the great investment effort involved in steelmaking compels us to a more vigorous application of the principle of economies of scale since, as we all know, the proliferation of small or intermediate plants within the framework of restricted national markets demands an investment computed at two or three times the requirements of large-capacity plants that could be built to meet the needs of a broader market.

For the last few years the steel producers of Latin America have been associated with the Latin American Iron and Steel Institute (ILAFA). The Inter-American Bank is a member of this organization and has helped to pay for studies which for the first time afford an overall view of the steel industry in Latin America. At the last annual meeting of that Institute, the President of the European Coal and Steel Community gave our businessmen the following message:

"We all know what steelmaking signifies, not only economically, but also politically and, we might add, from the standpoint of national prestige and dignity. I wish only to stress that the steel industry calls for a maximum of investment and unceasing technological progress; consequently, steel production, especially today, cannot be splintered into a great many small units, each identified with a national sector. This integration comes at a very opportune time."

Electric power development

In the electric power sector, we are also greatly concerned with coordinating plans for better utilization of hydraulic resources between neighboring countries, for increasing installed generating capacities and for interconnecting generation and distribution systems. It should be remembered that, in July 1964, the First Congress on Regional Electric Power Integration set up a standing committee, which is now functioning, and that the Second Congress, held recently in Santiago, has made progress in considering the implementation of multinational hydroelectric development projects. This work has gone forward more actively in the "Southern Cone" countries, where specific possibilities are emerging for the integration of several electric power networks.

The Bank has had two interesting experiences with regional electric power projects. The first, for development of the Paraguayan economy, is the Acaray hydroelectric project, costing about $30 million, to which we are contributing a loan of $14 million; in addition, suppliers in the European Common Market are also contributing under a parallel-financing system sponsored by the Bank. The purpose of this project is to harness the falls of that Paraguayan river on the country's border with Brazil and Argentina by installing a hydroelectric power station with an initial capacity of 45,000 kilowatts, later to be increased to 180,000 kilowatts, which could supply part of its power output to the Province of Misiones. At the same time, under an agreement with Paragruay signed in 1956, Brazil is entitled to acquire up to 20 percent of that power for a period of 20 years.

The second project, to which the Bank is contributing a loan of $3.2 million, calls for expansion of the Tibu hydroelectric power station in Colombia to connect it with the Ocaña and Pamplona power stations in the border zone of that country with Venezuela, and with the Venezuelan power station across the border at La Fría, thereby making the electric power systems of both countries mutually supplementary along their common boundary.

Along similar lines, I might mention the agreement between Bolivia and Peru for joint study of the prospective tapping of the waters of Lake Titicaca for electric power and irrigation purposes; the feasibility study by the Paraguayan and Brazilian Governments for the project to harness the Sete Quedas falls on the Paraná River, and the joint prospects for Uruguay and Argentina offered by the Salto Grande project.

Within the Central American integration effort, research into potential electric power interconnections and joint development of hydraulic resources have, of course, received special consideration. Three studies of this type have been made during the last 2 years and another will be completed in 1965. One project refers to interconnection of the high tension systems of Honduras and El Salvador. Another calls for interconnection of the border systems of Panama and Costa Rica; the corresponding feasibility and financing studies are being conducted with the cooperation of the United Nations Special Fund. A third project, for interconnection of the primary systems of Nicaragua and Costa Rica, could result in a reduction in planned investments by $21 million. Lastly, there is another project for interconnection of the systems of Guatemala, El Salvador, and Honduras.

Telecommunications

In speaking of Latin American infrastructure as limiting our development, the difficulties of communications come to mind as constituting a problem not only at the regional level, but also within the territory of each country. But in this field, too, the trend is toward overcoming these disintegrational factors.

In Central America, preinvestment studies have already been completed to implement the agreement concluded among the five countries in that area for the establishment of a regional telecommunications enterprise. The World Bank has evinced interest in financing this important project, which, at an estimated cost of about $7 million, would unify the five Central American capitals in a single direct intercommunication system extending from Mexico in the north to Panama in the south.

The problem of achieving a similar intercommunication in South America is more complex, but modern technological progress is devising the means of solving the problem on a truly integral scale. Several South American countries have already taken the first steps by joining the international agreement signed in August 1964 to exploit the possibilities of the worldwide satellite communications system which the Communication Satellite Corp. (COMSAT) proposes to place in service by 1968.

At its first meeting held last January in Washington, the Inter-American Telecommunications Commission (CITEL), set up in 1963, agreed to ask the Inter-American Economic and Social Commission (IA-ECOSOC) to recommend that the Latin American member governments of the International Telecommunications Union take the steps required to enable the agency to study the establishment of ground stations for connection with the satellite communications system.

It is interesting to point out that the multinational scope of this project deals not only with the utilization of the satellite system itself, but also signifies that this regional cooperation will have to be included in the agreements to be drawn up for establishment and financing of the respective ground stations. It appears that, for the time being, only Argentina and Brazil will have enough traffic to pay for the satellite communication system, including their own ground stations. However, when it is considered that the operating cost would be 58 percent less than that for the submarine cable system in use today, it appears possible that several countries might unite to construct and operate a single common microwave ground installation both to expand and perfect their present telephone and telegraph communications and to integrate their television broadcasting.

Transportation

One argument against the practicality of regional integration is the fact that, Latin America possesses only 8 percent of the world's railway trackage and only 3.2 percent of its all-weather highways. It is also pointed out that there is no port infrastructure suited to the needs of intraregional commerce, that Latin American merchant fleets are small and in no condition to carry the requisite volumes of cargo (more than 90 percent of the trade among LAFTA countries is by ship), and that our bottoms today carry scarcely 6 percent of all marine freight entering or leaving the region. As a consequence of these factors, the deficit on regional balance of payments increases by over $700 million annually in freight charges, insurance, and other transport costs. Yet, this critical situation in Latin American transport is unquestionably the strongest argument for the need for a solution on a multinational basis.

In the field of land transportation, this approach is expressed in the steps that have been taken to complete and improve the Pan American Highway and the joint project of Peru, Colombia, Ecuador, and Bolivia to build the "Bolivarian" Highway. The preliminary study for this latter project, financed by the Bank, demonstrates that, of the roughly 5,600 kilometers it would run from the Colombian-Venezuelan border to Santa Cruz in Bolivia, close to one-third is either under construction or scheduled for construction by each of those countries, while another 2,400 kilometers are rated as economically feasible. In other words, there is economic justification for 75 percent of the overall length of the highway, with a zone of immediate influence of 5 million hectares.

This same integration approach is representative of other projects now under study or in execution in Central America for completion of its regional intercommunication or access for several of those countries to their "new frontiers" on the Atlantic; in Chile and Argentina for linking Valparaiso and Mendoza by a first-class highway; in Uruguay for its projected highway connections with Brazil and Argentina; in Brazil for communication with Paraguay through the project that will ultimately link the Atlantic port of Paranaguá with Asunción.

In the field of maritime transport, a forward step has been taken in the establishment of the Latin American Shipowners Association (ALAMAR), through which 60 public and private shipping companies of Latin America are pooling their efforts and studies. The initiatives of LAFTA and the meetings, conferences and mechanisms sponsored by that organization are aimed at coordinating the port and maritime and river shipping policies of its member countries.

In the air transport sector, the proposed formation of a Latin American Airline was, unfortunately, postponed, owing to difficulties stemming from the inflexibility of international air traffic agreements, which for the time being prevent the concessions or authorizations granted to any given country or company from being used by others, even though they were mutually associated, as would be possible if existing concessions and authorizations were coordinated. Paradoxically, the heavy investment being made by each country to establish its own air fleets to carry its flag to other skies, and the right of each country to request air traffic access from others in reciprocity for overflight authorizations granted to foreign companies, are causing a proliferation of small public or private airlines in the Latin American countries.

A recent study on freight traffic in Latin America published by the International Civil Aviation Organization stresses the expansion of air cargo in the region since 1945 as a result of industrial development and of the internal transportation requirements of each country. Despite that growth, the study reveals that the average operating costs of Latin American companies were 15 percent higher than the world average in 1963. This is not surprising when it is considered that, of the 127 registered and 164 unregistered Latin American airlines operating in that year, only 20 use more than 10 DC-3 or larger capacity aircraft and that, of the 950 planes registered in the region 90 percent were powered by conventional engines, 50 percent had been built between 1930 and 1940, and only 38 jets and 68 turboprop planes were listed. There is no need to stress the potential gains in transport capacity and efficiency and in reduced operating costs to be derived from a pooling of investment efforts to modernize the Latin American air transport system. The problem will become more acute and more urgent with the appearance in international competition of supersonic aircraft, whose cost is out of all practical proportion to the economic capacity of the great majority of our countries. It is interesting to note that, even though they possess very large air fleets, the several countries of the European Market are exploring the possibility of associating these airlines for the purpose of providing supersonic service.

Agriculture and stockraising

A glance at the Europe of the Common Market is sufficient to indicate the extent to which rigid agrarian productive structures can pose major obstacles to an integration process, since the present slowdown in the once rapid pace of integration on that continent is the result of difficulties in regional adjustment of the diverse national levels of agricultural productivity.

A few months ago, when I discussed these matters at the FAO regional conference in Viña del Mar, however, I pointed out that, despite the difficulties confronting our agriculture and livestock sectors, a comparison with Western Europe reveals two aspects of that sector in Latin America favorable to integration. Viewing the region as a whole, there is a greater degree of supplementation owing to a diversity of production determined by the range of climate from tropical to temperate. Furthermore, the marginal potential demand for foodstuffs in comparison to current supply is wider and, under proper conditions, could generate dynamic agricultural economy, if each of our countries would pursue a policy aimed at improving existing nutritional levels.

We are all aware of the sharp differentials in costs, productivity, and material fields, and of the fact that these and other variables determine drastic disparities in the competitive positions of certain basic agricultural commodities. Consequently, it is advisable to seek greater specialization in order to exploit the comparative advantage enjoyed by each country in the production of certain goods.

Central America is endeavoring to adopt a common agrarian policy with regard to free trade in agricultural products (now almost fully implemented), without detriment to the relative position of each country or to the stability of prices and markets; joint exploration and exploitation of national resources; coordination and harmonization of policies for the exportation of principal agricultural and livestock commodities and for diversification of exports; regional programing of agricultural and livestock development; productivity gains through technological progress and planning; and the study of projects of regional scope and effect as well as of their prospects for adequate financing.

Greater difficulties are being encountered within the LAFTA system. This is why the treatment to be accorded to trade in agricultural and livestock goods was one of the questions most actively debated prior to approval of the agreement and in subsequent negotiations on the common list. However, favorable results have already been observed in increased trade which indicates the real possibilities of supplementation among the various lines of agricultural output. Suffice it to note that, of the total value of $450 million in liberalized trade among the member countries in 1963, 74 percent corresponded to agricultural products or to products of agricultural origin, and that the value of extrazonal imports of agricultural and livestock origin is estimated at about $500 million. There is now a clear and certain prospect of success for a program promoting the progressive replacement of agricultural imports from third countries as an incentive to the specialization and supplementation of agricultural and livestock production.

The Bank has joined with other international agencies in considering the significance of a coordinated agricultural investment policy. This study particularly stresses fertilizers. The early conclusions are revealing: most of the fertilizers used in our countries are of foreign origin. Although the total value of such imports amounts to more than $80 million a year, the level of fertilizer use is very low in Latin America. In the 10 countries studied, real consumption amounts to less than 10 percent of the ideal level. Only 3 kilograms are used per hectare, while countries like Belgium, the Netherlands, and Japan use more than 300; these figures amply illustrate the agricultural productivity gaps between our area and other regions.

These conclusions show that there is a wide field for regional production of fertilizers, which could easily be undertaken as a multinational investment in view of our limited installed capacity and of the advantages of projecting output toward a general Latin American market.

We might also mention the program for the eradication of foot-and-mouth disease. The losses suffered by Latin American countries from this livestock disease aggregate about $450 million yearly. This serious damage is caused not only by declining livestock production but also by an equally or even more serious consequence: embargo on shipments to the largest meat-consumer markets in the world.

Accordingly, consideration has been given to a multinational program that could be launched in the Southern Cone region, including southern Brazil, Uruguay, Paraguay, Argentina, and Chile, where studies are already underway on collaboration designed to integrate their respective national campaigns.

Gentlemen, a great Peruvian historian, Jorge Bosadre, has said that the progress of his country has evolved between two poles: Problem and possibility. The panoramic view I have tried to convey of the Latin American situation today from the standpoint of integration also presents problems that will not be easy to solve, but at the same time it holds out genuine promise for the accomplishment of such integration. In this counterpoint of obstacles emerging from the past and opportunities projecting into the future, there is no reason for skepticism to magnify the former and belittle the latter.

The construction of a Latin American Economic Community requires action of societies imbued with a vital sense, which can turn obstacles into accomplishments.

There are some who, having confined their mental existence within the bounds of narrow interests or hermetic ideologies, find it difficult to understand this enterprise and to answer the summons of San Martin and Bolivar, of Bello and Ingenieros, of Gabriela Mistral and Rodó, of Juarez and Morazán, to raise Latin America to its rightful stature.

Knowledge of the tremendous progress our countries have made in these last 5 years toward fulfilling their destiny and confirming the unity of their task, has not been spread as widely as could be wished. We should bear in mind that, up to 1960, there was no Central American Common Market and no Latin American Free Trade Association; nor was there an Inter-American Bank. Our aspirations to an economic association or to political reunification were either reverent memories of the past or the theme of ideologists unable to win a hearing for their views at the decisive levels of public opinion in our countries. How encouraging it is now to look back along the path of the ideas and activities we have so rapidly charted and traversed.

We can take pride not only in our shared technical and economic progress, but also in our repeated accomplishments in the political and sociological fields. The Latin American Parliament is already a tangible reality as a tribunal for expression of the forces that animate our democracy, drawing the widespread interest of the citizenry of our continent in all its diversity of sectors and strata. Associations or groups have emerged today in each of our countries to promote the ideas of economic and political integration just as the new ideas that inspired the Emancipation message were evolved within the study circles that gave expression to the yearnings of our peoples in different parts of Spanish America.

The Institute for Latin American Integration is also a product of these new forces, and thus its task is a dual one. Born of the experience and preoccupations of a financial and technical agency, it is charged with an objective study of the problems of integration and with an investigation of the ways and means of their solution. At the same time, however, its function will be to serve as a point of contact for Latin Americans in diverse spheres of activity who are participating in the search for policies and answers in order to move rapidly toward the building of our community of nations.

Although the Institute is a technical agency, its work will be one of commitment, for its academic and technical activities are bound to the service of a cause: the cause of Latin America.

That task was defined by Ingenieros in the following terms: "No historical convergence seems more natural than a federation of the Latin American peoples. Disjoined a century ago by isolation and feudalism, they can once again approach the problem of their future national unity, from the Rio Grande to the Strait of Magellan, in order to undertake our great task of the future; the achievement of social justice within our continent nation."

APPENDIX VII

Excerpt from "The General Agreement on Tariffs and Trade":

*   *   *   *   *   *   *

PART III

ARTICLE XXIV

TERRITORIAL APPLICATION—FRONTIER TRAFFIC—CUSTOMS UNIONS AND FREE-TRADE AREAS

1. The provisions of this Agreement shall apply to the metropolitan customs territories of the contracting parties and to any other customs territories in respect of which this Agreement has been accepted under Article XXVI or is being applied under Article XXXIII or pursuant to the Protocol of Provisional Application. Each such customs territory shall, exclusively for the purposes of the territorial application of this Agreement, be treated as though it were a contracting party; *Provided*, That the provisions of this paragraph shall not be construed to create any rights or obligations as between two or more customs territories in respect of which this Agreement has been accepted under Article XXVI or is being applied under Article XXXIII or pursuant to the Protocol of Provisional Application by a single contracting party.

2. For the purposes of this Agreement a customs territory shall be understood to mean any territory with respect to which separate tariffs or other regulations of commerce are maintained for a substantial part of the trade of such territory with other territories.

3. The provisions of this Agreement shall not be construed to prevent:

(a) advantages accorded by any contracting party to adjacent countries in order to facilitate frontier traffic;

(b) advantages accorded to the trade with the Free Territory of Trieste by countries contiguous to that territory, provided that such advantages are not in conflict with the Treaties of Peace arising out of the Second World War.

4. The contracting parties recognize the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements. They also recognize that the purpose of a customs union or of a free-trade area should be to facilitate trade between the constitutent territories and not raise barriers to the trade of other contracting parties with such territories.

5. Accordingly, the provisions of this Agreement shall not prevent, as between the territories of contracting parties, the formation of a customs union or of a free-trade area or the adoption of an interim agreement necessary for the formation of a customs union or of a free-trade area; *Provided* that:

(a) with respect to a customs union, or an interim agreement leading to the formation of a customs union, the duties and other regulations of commerce imposed at the institution of any such union or interim agreement in respect of trade with contracting parties not parties to such union or agreement shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union or the adoption of such interim agreement, as the case may be;

(b) with respect to a free-trade area, or an interim agreement leading to the formation of a free-trade area, the duties and other regulations of commerce maintained in each of the constituent territories and applicable at the formation of such free-trade area or the adoption of such interim agreement to the trade of contracting parties not included in such area or not parties to such agreement shall not be higher or more restrictive than the corresponding duties and other regulations of commerce existing in the same constituent territories prior to the formation of the free-trade area, or interim agreement, as the case may be; and

(c) any interim agreement referred to in sub-paragraphs (a) and (b) shall include a plan and schedule for the formation of such a customs union or of such a free-trade area within a reasonable length of time.

6. If, in fulfilling the requirements of sub-paragraph 5(a), a contracting party proposes to increase any rate of duty inconsistently with the provisions of Article II, the procedure set forth in Article XXVIII shall apply. In providing for compensatory adjustment, due account shall be taken of the compensation already afforded by the reductions brought about in the corresponding duty of the other constituents of the union.

7. (a) Any contracting party deciding to enter into a customs union or free-trade area, or an interim agreement leading to the formation of such a union or area, shall promptly notify the Contracting Parties and shall make available to them such information regarding the proposed union or area as will enable them to make such reports and recommendations to contracting parties as they may deem appropriate.

(b) If, after having studied the plan and schedule included in an interim agreement referred to in paragraph 5 in consultation with the parties to that agreement and taking due account of the information made available in accordance with the provisions of sub-paragraph (a), the Contracting Parties find that such agreement is not likely to result in the formation of a customs union or of a free-trade area within the period contemplated by the parties to the agreement or that such period is not a reasonable one, the Contracting Parties shall make recommendations to the parties to the agreement. The parties shall not maintain or put into force, as the case may be, such agreement if they are not prepared to modify it in accordance with these recommendations.

(c) Any substantial change in the plan or schedule referred to in paragraph 5(c) shall be communicated to the Contracting Parties, which may request the contracting parties concerned to consult with them if the change seems likely to jeopardize or delay unduly the formation of the customs union or of the free-trade area.

8. For the purposes of this Agreement:

(a) A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that

(i) duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories, and,

(ii) subject to the provisions of paragraph 9, substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union;

(b) A free-trade area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated on substantially all the trade between the constituent territories in products originating in such territories.

9. The preferences referred to in paragraph 2 of Article I shall not be affected by the formation of a customs union or of a free-trade area but may be eliminated or adjusted by means of negotiations with contracting parties affected. This procedure of negotiations with affected contracting parties shall, in particular, apply to the elimination of preferences required to conform with the provisions of paragraph 8 (a)(i) and paragraph 8 (b).

10. The Contracting Parties may by a two-thirds majority approve proposals which do not fully comply with the requirements of paragraphs 5 to 9 inclusive, provided that such proposals lead to the formation of a customs union or a free-trade area in the sense of this Article.

11. Taking into account the exceptional circumstances arising out of the establishment of India and Pakistan as independent States and recognizing the fact that they have long constituted an economic unit, the contracting parties agree that the provisions of this Agreement shall not prevent the two countries from entering into special arrangements with respect to the trade between them, pending the establishment of their mutual trade relations on a definitive basis.

12. Each contracting party shall take such reasonable measures as may be available to it to ensure observance of the provisions of this Agreement by the regional and local governments and authorities within its territory.

APPENDIX VIII

THE UNITED STATES PRIVATE INVESTOR AND THE CENTRAL AMERICAN COMMON MARKET *

By SHELDON L. SCHREIBERG, Woodrow Wilson School

INTRODUCTION

The objective of this paper is twofold. First, to evaluate mostly through interviews, the Common Market as perceived by the U.S. businessman and his response to its creation—what is actually happening rather than what theoretically should be happening. I sought to learn who is coming in and why—to discuss the factors important in investors' decisions, the merits of different countries and the form of organization that business takes. I have chosen the U.S. investor as an example of the foreign both because he was most accessible and information therefore most readily available and because he is by far the largest foreign investor in Central America. I have eliminated from my discussion investment in the traditional export crops, bananas, coffee, sugar, and cotton, because it has been affected only negligibly by the creation of a common market. The paper deals, too, only with equity investments, not loans. My second objective was to identify and analyze some of the efforts made by Central American and the United States Governments to create a climate more attractive to the U.S. investor. Naturally many impediments to investment result simply from a sense of insecurity stemming from differences and uncertainties in international economic, political, and social conditions which are beyond the control of individual governments. Still, the actions and attitudes of governments are of crucial importance to the investor and some governments are clearly more interested in attracting U.S. capital than others. These governments have acted aggressively and successfully to improve their investment climates. It is hoped that my discussion of these efforts can contribute to further efforts in this area and help bridge the gap between the legitimate claims of U.S. investors and the legitimate aspirations of the Central American people.

PATTERN OF U.S. INVESTMENT BY SECTOR

Central America was of the first areas of the world to attract U.S. investors at an important level. Early investors were involved in mining and railroads. Later, large investments were made in agriculture, especially bananas, and after World War I investments in utilities, aviation, trade, insurance, banking, and manufacturing were added. According to estimates made by the Department of Commerce, the total accumulated value of direct U.S. private investment in Central America at the end of 1963 was $375 million with a market value slightly over $1 billion. Of this total, 120 million or 34.4 percent in public services (railroads, telephones, electric power) and 102 million or some 27.2 percent was in agriculture. Investments in petroleum exploration totaled 94 million or 25.1 percent.[1]

Investments in railroads and utilities, although high, are becoming less important with the increase in other means of transportation and the increasing tendency to transfer the responsibility for providing utility service to the state.

The largest percentage of investment in agriculture is located in Honduras, Guatemala, and Costa Rica. In the first country, there was a disinvestment of over $23 million in the period 1958–61 which coincided with the decline of the

*Submitted for the subcommittee's information and, at the suggestion of Representative Thomas B. Curtis, included in the record because of its special relevance to the subcommittee's inquiry. Mr. Schreiberg spent some months in Central America during the summer of 1965, interviewing businessmen, financial and governmental trade experts, gathering material for this study as a part of the graduate program of the Woodrow Wilson School of Public and International Affairs, Princeton University.

[1] Arthur D. Little, Inc., "Background Material—Conference on Industrial Investment Development" (Tegucigalpa: CABEI, June 7, 1965), app. A, p. 8.

banana industry. There has been some incidental positive effect from this since with the loss of importance of bananas, exports have been diversified, efforts to attract industry stimulated, and in influence of the fruit companies in the area has been decreased.

In the industrial sector, the largest investments have been made in petroleum refineries with slight, but increasing, attention paid to other industrial activities. In relation to total investment in all sectors, investment in manufacturing represented only 5.3 percent or $20 million at the end of 1963, an increase of ouly $8 million since 1960 when Common Market related activity began in earnest.[2] Relating this distribution of investment to all of Latin America and to Western Europe, while here manufacturing represented only 5.3 percent of all investment, in all of Latin America the percentage of all U.S. private investment that was made in the manufacturing sector was 18.5 percent while in Europe the percentage was 10 times greater—54.2 percent.[3] Quite plainly, we see the close correlation between the degree of economic development of a region and the direction in which investment flows. More investment is made in manufacturing as an area develops to the point where manufacturers can take advantage of scale economies.

Many American and Central American officials believe that the figure of 5.3 percent which I have cited is misleadingly low and that the past 2 years have seen a decided shift in emphasis out of agriculture and into light manufacturing. It is true that substantial outlays have been made recently especially in food processing and pharmaceuticals and the level of new investment in agriculture has fallen considerably. Traveling through Central America, one gains the distinct impression that changes in the nature of our investment are most definitely taking place—almost all the new investments cited to me were in manufacturing. My efforts to secure statistics post-1963 in order to confirm this hypothesis were almost totally fruitless however. Only in Guatemala was I at all successful.

From the Banco Central de Guatemala, I was able to obtain an unpublished list of foreign investments registered in Guatemala in 1964. From this list I extracted U.S. investments and classified them by sectors. These investments totaled a surprisingly high $44.1 million (surprising because the cumulative regional total at the end of 1963 was just $375 million), of which slightly over $7.2 million or 16.3 percent were in manufacturing. One can assume further that the percentage of investment now going into manufacturing, at least in Guatemala, is even higher for the 1964 figure of $44.1 million includes three investments totaling $11 million by major petroleum firms and a $13.5 million expansion by an electric power company—none of which are likely to be repeated in the near future. Interesting too, investment in agriculture reached only $3.7 million, slightly over one-half of the total for manufacturing.

While North American investment remains concentrated in the traditional agricultural export and public service sectors, it is safe to say that a shift in emphasis is now taking place. This is happening simply because every company in evaluating its opportunities in a particular area asks, "What does it have to offer?" And in the case of Central America, the creation of a Common Market has meant a change in the answer it receives.

CREATION OF THE COMMON MARKET

In recent years, we have witnessed a marked increase in the formation of regional economic organizations among nations seeking a better understanding of the common problems they face and willing to make a collective and concerted effort to solve them. Basic to all of these unions is the recognition that maximum efficiency and successful operation of certain desired enterprises in a modern, industrialized, and interrelated world economy requires a volume of output and sales that exceeds the capacity of any single domestic market. In Central America, Guatemala, El Salvador, Honduras, Nicaragua, and Costa Rica have established a set of regional institutions and programs for finance, research, trade, investment and other functions that together form perhaps the most advanced movement toward economic integration found anywhere in the less developed world. It is not a particularly happy commentary on U.S. businessmen, but for many of them, especially the smaller ones, the first thing they knew about Central America was that a common market was being organized there.

The general treaty on Central American economic integration signed by the first four nations in December 1960 and by Costa Rica in November 1962 is the

[2] Ibid.
[3] Ibid., app. A, p. 9.

major document defining the Common Market. The general treaty provided for immediate free trade within the area for all but 56 products, mostly agricultural or produced by traditional light industry. These excepted items are to be brought into free trade by June 1966. Some negotiations are proceeding to this end, but agreements on corn, rice, beans, sugar, wheat, flour, and petroleum byproducts did not go into effect as scheduled earlier this year and it is doubtful, because of some strong protectionist feelings which remain, if the total liberalization of trade within the area will be achieved as anticipated. In fact large U.S. investments now being made in a series of national oil refineries are predicated on the feeling that political, not economic considerations, will define market areas for some time to come. Other comments regarding artificial restraints put on businessmen seeking to sell across national borders were widespread. For example, Costa Rican refrigerators move freely only to Nicaragua while Guatemalan shirts move freely to all countries except Nicaragua. Nevertheless, this liberalization has given a tremendous boost to interregional trade, the impact of which is discussed below.

The second major treaty important to the Common Market's creation was the 1959 Central American Agreement on Equalization of Import Duties and Charges which provided the basis for an eventual customs union and initially unified 10 percent of tariff classifications. Since that time, unification of about 98 percent of the classifications has been achieved. However, in practice the classifications are not uniformly applied, many of the common rates have not been ratified by individual countries, and the hard core 2 percent nonunified classifications include such items as autos, refrigerators, and some clothing which represent approximately 30 percent of the value of the region's imports.

Still, the point remains. Not on all items, but on imports totaling, in terms of value, 70 percent of the regions' total, customs union has been achieved. How do the new tariffs compare with the previous? A significant increase has been made. A glance through the Arancel de Aduanas Centro Americano (customs rate book) shows that where prior differences existed between the five nations, the new tariff usually approximates that of the second highest earlier. Whether this was done by design is not certain, but it is borne out empirically.

Since integration envisages an intensive effort by the countries to substitute outside imports with goods manufactured within the area, it was expected that imports from the United States and other industralized areas would be curtailed. Indeed, U.S. exporters have experienced adverse effects on their sales to Central America as a result of the more favored customs treatment enjoyed by competing products produced in the contracting countries. Figures released by the Department of Commerce indicate that in spite of an increase in absolute terms, the U.S. share of Common Market imports declined from 55 percent in 1960 to 44.7 percent in 1963.[4] In Guatemala our share has declined steadily from 59.3 percent in 1958 to a low of 44.5 percent in 1964.[5] In Honduras the decline from 1960 to 1964 was from 55.9 to 48.8 percent;[6] in Nicaragua from 54.9 to 46 percent during 1958–64.[7] At the same time these declines have taken place, interregional trade has grown from $8 million in 1950 to $105.4 million in 1964[8] and will rise to an estimated $135 million in 1965. Percentage figures show that intra-Central American commerce varied from 2.8 to 4 percent of the region's total foreign trade from 1950 to 1957 and then rose continually to 15 percent in 1964.[9] Between 1961 and 1964 imports from the rest of the world grew from 459 to 654 millions—an average annual increase of 11 percent whereas imports from other Central American nations increased at an annual rate of 42 percent.[10]

It has been determined that most of the loss in the U.S. share of imports has been absorbed by this increased intraregional trade. The area's next largest trading partners are West Germany, Japan, and the United Kingdom. Since 1960, Germany's share has held constant, Japan's risen a percentage point from 5 to 6 percent, and the United Kingdom's has also declined. Local industries

[4] U.S., Department of Commerce, International Commerce (Sept. 6, 1965), p. 7.
[5] U.S., Embassy, Guatemala City, Economic Section, Guatemala Economic Indicators, May 1965, p. 1.
[6] Airgram No. 47 from the U.S. Embassy, Tegucigalpa, Sept. 2, 1965. (In the files of the Department of Commerce, Bureau of International Commerce, Office of Regional Economics).
[7] U.S. Export Projections for Nicaragua and Costa Rica, June 7, 1965. (In the files of the Department of Commerce, Bureau of International Commerce, Office of Regional Economics.)
[8] "The Interregional Trade of Central America," CAPTO Circular No. A-16, July 1965. (In the files of the Department of State, Agency for International Development, regional office for Central America and Panama.)
[9] Ibid.
[10] U.S., Department of Commerce, International Commerce (Sept. 6, 1965), p. 7.

such as tires, shoes, insecticides, soaps and detergents, cotton textiles, construction materials, and processed foods have expanded sufficiently to export within the entire region.

Quite simply, these two agreements, the general treaty and the Agreement on the Equalization of Import Duties have made Central American goods move easier and U.S. imports more expensive.

A trip through any food store in the region shows quite clearly the situation which the U.S. food packer, for one, now faces. In a large supermarket in San Jose one finds a well-known U.S. brand of tomato paste selling for 2 colones (1 colone equals about 15 cents); one Guatemalan brand selling for 1.10 colones; and another for 0.90 colones. The same U.S. brand of ketchup sells for 4.40 colones; three produced in Guatemala sell for 2.25; one Costa Rican brand at 2.35 and another at just 2.20. A small tin of American peas cost 2.90 while Costa Rican peas sell for 1.55. A can of beer brewed in Texas sells for 4.50, but several local beers range in price from 1 to 1½ colones. Higher transportation costs from the United States account for only a small fraction of these differentials.

The long-term outlook for U.S. industry taken as whole, of course, is more favorable for development will heighten demand for machinery of all types, transportation and heavy construction equipment, chemical products, electrical gas and refrigeration equipment and other products needed for industrialization as well as for more sophisticated U.S. consumer goods. The region's small, but growing, middle class prefers high quality, branded items and U.S. products of this type are generally considered superior to other foreign products. Development is all well and good, then, for U.S. industry per se, but it creates obvious tensions and requires immediate adjustments by individual exporters who witness rapid declines in their sale.

What we have seen in Central America, really, is a shift in purpose for the tariff—from income to protection. The approach being used is the traditional approach to industrialization—building a sufficiently high tariff barrier to prevent imports from entering the area. Once this is done opportunities are automatically created for small and medium sized industries. Quite simply, this approach has worked. I am not discussing whether this policy is in the best long-range interest of Central America but it is contributing to the achievement of their shortrun objective of industrialization and diversification. To survive, U.S. manufacturers have found it expedient to move inside the barrier themselves and produce or negotiate licensing arrangements for production of their goods in Central America. The firms which are making new investments are, by and large, those which already operated commercially in the area through branches or distributors, and, who, seeing their profits diminished conclude that they can keep their markets and maintain and increase their profits only by manufacturing locally the articles which had previously been imported. Most often their plants are basically simple light assembly operations utilizing large percentages of imported components.

Like most generalizations which explain causes, this one needs to be tempered for another factor of almost equal importance is working, too, to attract the U.S. investor. In economic union, there is strength. Although the five capitals, Guatemala, San Salvador, Tegucigalpa, Managua, and San Jose are each important and growing markets, individually none of the nations has a market large enough to attract large-scale industrial investment. Factories supplying one alone are simply not economically feasible. For instance, one manufacturer believes that with his smallest plant he can produce the annual requirements for Honduras in 6 weeks, but his plant would be idle for the rest of the year. On this basis his investment and others like it would not be made. For the Common Market, however, the picture brightens. As one manufacturer of bakery goods put it, "The markets were insignificant. We couldn't get enough units to divide our fixed costs. The growing market possible with intraregional trade makes our operation profitable." The president of a firm operating two Central American fertilizer plants said they came "only with the promise of an area wide market." Finally a pharmaceutical manufacturer suggested that it is not tariffs for there are few protective tariffs in his field, but the fear of local competitors now having the markets to lower their unit costs substantially that brings Americans in.

For many firms, it is the combination of these two factors—tariff increases and a regional market—that is required to make their entry feasible. Neither alone would have provided enough incentive. Again some examples are worthwhile: In the late fifties a California foodpacker saw the whole price of his product double from $14 to $30 a carton. Of the original price, roughly one-half was duty, but now three-quarters of his price was so constituted and his sales fell rapidly. Still, it was not until the signing of the general treaty late in 1960 that he believed he could operate a plant efficiently in Central America. Presently he is packing his product in Guatemala and selling this same carton profitably for $6.20. The regional manager for a large toiletries and detergent firm explained that in 1959–60 sales fell, then prices and then profits as the company tried to hold its market in the face of an 80-percent increase in tariffs. Still, he added, without 5 markets and 12 million people his company would simply have written off the area.

There are other factors, at work, too, bringing investors into the region. One of these—the desire to be "first in" is as much psychological as economic.

Many exporters were late in comprehending the impact that the creation of a European Common Market would have on their sales. They responded there only after they had lost their market to more alert American, Japanese, and European competitors who established facilities inside the Market. They found, too, that effort exerted at a later date was not only extremely costly but often unsuccessful. Their markets, once lost, remained lost. These men are anxious to avoid making this mistake a second time and others have witnessed their experience and do not wish to share it. The very phrase "Common Market" thus has a certain appeal which transcends cold economic data. Many firms are quickly constructing plants in the belief that they will have a marked advantage in winning and holding consumers if they can beat their competitors into Central America.

The Central Americans are also granting tax incentives to attract new industry. A large number of the firms anxious to be "first in" believe that they will be granted these incentives along with tariff protection more readily than those who will come later. Generally speaking, these men are correct. While incentives are made available to all manufacturers in a given industry the first investor receives a warmer reception on the grounds that he is more essential. By the time second and third firms enter, the first may have filled the market's demand governments become more critical in granting benefits. It is also true that there have been instances in which latecomers have received benefits which expired at the same time as those of earlier entrants. This means that they enjoy only 7 or 8 years of incentives while their competitor usually enjoys 10. Protection promised by a single government, however, can prove to be a very weak crutch to lean upon. For instance, in 1963 a firm in the highly competitive cosmetics field began manufacturing in Guatemala with that government's promise that no other foreign firm would be given similar benefits. In 1964 a competitor moved into Nicaragua and another into Salvador, but in 1965, two more were granted incentives by the Guatemalan Government and opened plants in Guatemala City. The explanation the first firm received was that the latter two firms had made definite decisions to begin operations in Central America and that if they would not receive benefits, they, like the second and third firms would locate elsewhere. Rather than lose their plants, the Guatemalans decided to reverse themselves. I should add that this firm is not greatly concerned, however, since it believes that its 2-year headstart has given it a grip on the market that the later firms will not be able to loosen soon.

A few investors are entering early with the hope of entering into long-range contracts with governments and private parties and tying up the supplies of raw materials which are essential to their industry.

Several Americans have invested to provide services and supplies to the manufacturers who have begun operations for the reasons cited above. Branch offices of U.S. banks, insurance, and advertising agencies have opened or are opening in all five countries. Smaller firms are now supplying aluminum tubing and plastic packaging materials to the cosmetics, pharmaceutical, and food industries. This type of investment is helping to create the "industrial infrastructure" necessary for sustained economic growth.

One further point should be made before leaving the subject of motives for entering. As I stated at the outset I do not intend to discuss the wisdom of Central America's industrialization goal at any length. Still, it is useful to look just a bit deeper at the economics of the industry the new policies are attracting.

Higher duties have been of prime importance in attracting investors. The prices paid by the Central American consumer for goods formerly imported but now produced locally, however, have not always fallen and have often risen since manufacturing costs are not usually lower than in the United States. Surprising as this seems in a period in which we hear so much about cheap foreign labor, it is a fact that U.S. manufacturers are not moving into Central America as they are moving into other areas—Japan, Formosa, and Hong Kong—to take advantage of lower labor costs. Labor does cost less in Central America but its productivity is also lower and volume, even with a regional market, is so small compared to the level it reaches in the United States that total cost per unit incurred in manufacturing only for the Common Market reach or exceed their U.S. level. It is only the higher tariffs and generous incentives, not lower costs, that make production in Central America necessary and profitable.

IMPORTANT CONSIDERATIONS IN LOCATIONAL DECISIONS

The increase in private investment in industry is related to diverse factors. I have mentioned in general terms the forces at work in bringing the U.S. investor to the area. These are the growing tariff walls and the loss of markets which accompanies them, the growing regional market, the chance to build larger, economically feasible plants, and the desire to share in the fruits of economic development and union. I now wish to examine some of the more specific considerations involved in each decision and the manner in which a specific site within the Common Market countries comes to be chosen. Later I will look briefly at how a specific form of business organization is chosen.

The investor is concerned principally with the earning potential of his investment. He considers locations with respect to proposed markets and population—its age and educational level—natural resources, and climate. He considers government—its form, stability, financial condition, and attitude toward foreigners. He considers the requirements for setting up business—questions of capitalization, control, governmental supervision, and intervention. He considers the tax structure, conditions surrounding remittance of profits, incentive laws, import and tariff policies, patents, and trademarks. He considers labor—attitudes, skills, and costs. He considers transportation and communication facilities and utilities—power, fuel, and water supplies. He considers, too, interest rates and the availability and quality of local goods, services, and plant sites.

While he is concerned principally with these considerations as they bear directly on earning potential, he is also concerned about living conditions and social relationships and the attitude of the community toward him and his employees recognizing that these factors may be of decisive importance in the attainment of profits. He therefore analyzes shopping facilities, housing, educational institutions and programs, medical services and hospitals, recreational and cultural centers, and the number and types of civic, fraternal, religious, and professional societies in each community as well. Finally, he must consider the policies and programs of his own government as they relate to his proposed investment.

Certainly I am unable to look at all these considerations as they affect individual investments. They are not of equal importance nor are all of them important to all investors. I wish to examine only some major factors which proved most influential and a few that proved surprisingly unimportant.

Market

When the U.S. businessman looks to the Central American Common Market (hereafter CACM), he sees a population of some 12 to 13 million, slightly greater that than of the New England States. In terms of buying power, however, a truer comparison would be to the State of New Hampshire, not the entire New England region.[11] Of these 12 to 13 million people, only some 30 percent have any real degree of market power; 65 percent of the region's economically active population are engaged in agriculture, forestry, hunting, or fishing [12] and available statistics show that per capita incomes in these sectors are only one-fourth (US$131) as large as those of the remaining population. In the course of my interviews the CACM was often equated with a medium-sized American city. Memphis, Denver, and Portland, Oreg. were cited.

The U.S. manufacturer, on the other hand, is accustomed and equipped to serve a mass market and Central America certainly presents problems in this respect. With the possible exception of Costa Rica the national wealth is not proportionately distributed and wide gaps exist between the rich and poor with only a small middle class. In Guatemala, for example, 27 percent of the population receive 78 percent of the national income.[13] Figures available for the United States, in contrast, show that in 1961 20 percent of our population received 43.6

[11] Committee for Economic Development, Economic Development of Central America (New York: by the author, November 1964), p. 8.

[12] Lawrence C. Lockley, A Guide to Market Data in Central America (Tegucigalpa: CABEI, 1964), p. 13.

[13] R. W. Rosenhouse, "Guatemala Goes on Buying Binge," New York Times, Jan. 22, 1965.

percent and that 40 percent of the population received 66.6 percent of our after tax incomes.[14]

In Guatemala, a large U.S. dairy is producing milk, butter, cheese, and ice cream of a quality comparable to American tastes. The company's products are sold almost entirely within Guatemala City and reach only the top 13 percent of the population. The dairy's regional manager explained that all attempts to expand the market to other parts of the country and lower income groups have failed. The bulk of Guatemala's people are either satisfied with lower quality, less sanitary products, unaware of any real qualitative difference, or unable to pay the higher price that his products must command. His case is far from unique.

In a speech delivered in Tegucigalpa on June 9, 1965, Murray Bryce told a gathering of Central American business and financial leaders that—

"While it is wonderful to have a Common Market, it is still a very small market and Central America has not escaped from the problems of smallness just by developing a Common Market. You have escaped from the disasters of having very small markets. Now you have a market substantially larger, but * * * still so small as to have great problems."

It is easy to overstate the attractiveness of the Common Market. Incomes are so low and unevenly distributed and consumers so "uneducated" that unit costs often become so high that in spite of tariffs, firms can compete very effectively from the outside. Only a very small percentage of all U.S. manufacturers and exporters have shown an interest in investing in the area.

When a businessman does decide, however, to manufacture within the CACM, the size of particular markets becomes an important factor in determining which country or countries he will select. He seeks to locate near his largest markets thereby reducing transportation costs and facilitating promotion and servicing of customers.

Central America's people, like its natural resources, are not evenly distributed throughout the five nations. Nicaragua is the largest country but its population constitutes only 12 percent of the region's total. El Salvador, by far the smallest country in land area, has a density more than 10 times that of Nicaragua and 5 times the regional average. It contains 23 percent of the people. Costa Rica has the smallest population, just 1.3 million, but per capita incomes there are by far the Market's highest. Guatemala, with 4.3 million persons, 35 percent of the area's total is the largest country in terms of population. One would expect that this would make it the largest single market for most items, but businessmen do not necessarily find this so since roughly one-half its people are of pure Indian extration and unassimilated into the money economy.

A general feeling does exist, nevertheless, and can be supported statistically, that in spite of a low per capita income, Guatemala, by sheer virtue of the size of its population, is the largest single market. In 1962, its gross national product totaled $700 million, followed by El Salvador's $556 million, Costa Rica's $435 million, Honduras' $418 million, and Nicaragua's $340 million.[15] For most articles Guatemala and El Salvador represent the most important national markets and their joint market is by far the region's most attractive.

How do these markets explain investor behavior? Simply, they explain why many companies entering the CACM pick these two countries for no other apparent reason. Almost all the U.S. pharmaceutical firms entering in the past 5 years have located in Guatemala. Although the Indians are largely unassimilated into the country's economic life, for some products there are exceptions. Pharmaceuticals are one. Indians are acutely conscious of disease because of a long history of epidemics, malnutrition, and high infant mortality. Government programs which have dispensed medical and vitamin compounds have left as an aftereffect an acceptance among the Indians of both ethical and proprietary medicines. Because they purchase these articles, Guatemala's market assumes the importance that is expected of a country with 35 percent of the region's population. For other products this does not hold true. For climatic reasons, the largest market for air conditioners and refrigeration equipment in is Nicaragua. Because of the higher living standards in Costa Rica, it becomes the attractive area for manufacturing electric water heaters, household appliances, and paint. Sears, Roebuck opened its first Central American outlet in Costa Rica because it most closely approximated the U.S. markets it was used to serving.

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[14] National Industrial Conference Board, the Economical Almanac (New York: Newsweek 1964), p. 399.

[15] Committee for Economic Development, p. 11.

I do not wish to dwell on this point of markets. It is enough to say that in looking for factors that explain the location of facilities within the CACM, one must remember that there is not only a regional market, but also five separate national markets to be served. Because the two largest are contiguous, there is a strong tendency to center regional operations in one of them.

Political and monetary stability

The fact that the government of a Central American country can make or break any enterprise is grudgingly, but definitely, accepted by U.S. investors. The wise ones recognize that they must evaluate the likely political direction of a country before investing—a factor which would be trivial in a domestic situation. It is as important to evaluate a country's past experience with foreign economic and political interests, its internal stability, national pride, and attitude and policies of government toward Americans as it is to evaluate market, technical, and financial data. Until there is some degree of political and economic stability in any area, an investor is not going to be interested in it.

Taken as a whole, Central America has a history of political instability involving frequent changes in personnel and policies which creates an atmosphere of uncertainty and insecurity. Certainly investment by nationals is severely limited by this history and although actual damage to property and loss of life have been minor, this history has prejudiced the foreigner as well. Differences between the five nations in this regard are both wide and significant. The impressive record of political stability and democracy in Costa Rica is certainly the greatest advantage it has in competing with its neighbors for new industry. A well-known American publisher will soon locate its Latin American facility in that country for that reason. A fertilizer manufacturer opened a second regional plant in Costa Rica after a coup in El Salvador caused it to doubt the likelihood that operations could continue uninterrupted if it maintained only a Salvadorean plant. Indeed, the area lost an artificial fiber manufacturer a year ago because Costa Rica was the only country in which he felt secure and that country refused to grant him fiscal incentives. To this day, that investment has not been made elsewhere.

Political stability, not democracy, I should stress, is the important criteria. The U.S. investor is not concerned with abstract political theory. Any government approximating or to the right of our own politically is acceptable. The impressive record of 35 years of political and economic stability in Nicaragua under Somoza family rule proves a definite asset to its industrial promoters. In the last year, Guatemala has experienced a slowdown in the number of investments it is attracting relative to the other market partners and much of this decline is attributable to widely publicized government instability and Castroite guerrilla activity.

The majority of U.S. businessmen in the area believe that the region is now entering a more mature era in this respect. One representative firm believes that—

"* * * gradual evolution is * * * taking place principally because of the tremendous concentration and increasing importance which the economic sphere * * * has recently taken in terms of the total scheme of things. It has recently been said that businessmen in Central American will no longer put up with wild political gyrations. * * * There is no question that the economic and business element is beginning to exert more * * * of a stabilizing influence on the political and social life of Central America." [16]

The orderly development of regional institutions, of course, exercises a further dampering effect on disruptive political or economic actions by individual governments.

Monetary stability is also important to the investor, but Central America apparently has no great problems in this matter. All of the countries banking structures have been characterized by conservative policies which have made internal price levels quite constant and currencies very stable. There exists some feeling that Guatemala's quetzal which has remained at par with the U.S. dollar since 1924 is the strongest currency but this difference was not important in individual decisions.

Governmental policy

A proposed investment's potential is initially evaluated in terms of present and future markets. The political climate then becomes crucial—the investor

[16] Robert Shepherd and Richard M. Kinne, Central American Common Market: Opportunities Plus (Atlanta: Conway Research, Inc., July 1964), p. 92.

is leery in the face of what he regards as excessive nationalistic or socialistic tendencies. When the market seems sound and the political climate acceptable, legal factors become important. Are there restrictions on the segments that foreigners may enter or requirements of local participation on an equity or operational basis or specific approvals, licenses, or consents to be obtained? Do laws or administrators discriminate between domestic and foreign entities?

There are few restrictions on the areas of activity that foreigners may enter. Legally speaking, American firms can, with one exception, enter the same geographic and economic sectors that are open to nationals. Typical of the exception is the Honduran law which prohibits ownership of land or real property within 40 kilometers of beaches or frontiers. However, long-term leases of 99 years are common in Honduras and in the other countries similar arrangements are available. In practice, if not in law, majority control of internal aviation, trucking, and bus operations is reserved for Central Americans. Central American property laws, which have Spanish rather than English antecedents, provide that all underground resources belong to the state rather than the party that holds title to the property. Governments are required, therefore, to grant concessions and exploration rights to investors. Owing to the relatively low returns on such investments and the large amounts of capital they require, local investors are seldom interested. These privileges are granted, then, quite freely to foreigners and nearly all investment in petroleum, minerals, and forestry is made by them.

Each country grants incentives in order to stimulate new investment. The Guatemalan, Honduran, Nicaraguan, and Costa Rican laws establishing these benefits provide that no distinction is to be made between foreign or local firms and require no proportion of stock to be held by nationals. Costa Rica's law does provide, however, that in the event that a local and a foreign concern have applied for benefits to manufacture identical items, "preference will be given to those applications for operation with full or partial local capital * * *."[17] In Costa Rica and Guatemala investors indicated that one was at a distinct advantage in gaining benefits in any field whenever he was able to identify with local investors. In the case of El Salvador, article 16 of its law for industrial promotion provides that in order to obtain the privileges of the law "the enterprise shall have no less than 50 percent of Salvadoran capital." The article's next paragraph adds that the "percentage mentioned in this clause may be reduced by the executive power * * * taking into account the special circumstances of each case." Apparently, this restrictive clause, inserted in 1962, was merely a political gesture by the new military government for the percentage has been regularly reduced to accommodate foreigners. The only ownership requirements in the other countries are for "integrated industries" where minimum Central American ownership has been stipulated at between 30 and 60 percent. (The reader is referred to J. Allen Brewster's study of "Integrated Industries" in this same set of papers by the Woodrow Wilson School students.)

Change and progress always have their enemies. Therefore, the story of the Central American governments' attitudes toward foreign investment cannot end here. Manufacturer after manufacturer has found himself threatened by the growth of the Common Market and the new competition it has brought from plants controlled in the United States, Europe, or Japan. Commercial segments, of course, have a vested interest in maintaining traditional import-export relationships. Large numbers of merchants have, therefore, joined with manufacturers in urging their governments to restrict foreign participation in the CACM. Their efforts have received considerable reinforcement from the small, but vocal, intellectual and academic communities.

Each government is committed, however, to maximizing its economic growth and intense competition has developed among the countries in attracting industry. Thus, if a government were to commit itself to a unilateral policy of restricting foreign participation in new ventures it would find itself at a serious handicap. For this reason, development of common policy toward foreigners has become a matter of prime concern within the area. In November 1964 the subject was discussed by planning officers in San Jose. The question became increasingly controversial in late May and early June of this year as a result of plans announced by Japanese textile and American tire manufacturers; policies toward foreign investment were clarified somewhat at a meeting of the finance ministers on June 19 through 21 at which time a broad spectrum of monetary, fiscal, and credit matters were discussed. U.S. officials had feared that the ministers would reverse their earlier position and exhibit a disproportionate concern

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[17] Costa Rica, Ministry of Industries, "Investor's Guide to Costa Rica," 1965, p. 22.

for protecting Central American capital. The language of the statement issued, however, which now constitutes official Central American policy on foreign investment, was both mild and vague.

"The ministers believe that, to achieve the development goals that Central America has set for itself, the formation of internal savings that can be channeled toward productive investment is insufficient and, therefore, it is desirable to complement those savings with a flow of foreign investment that will contribute to the growth of the Central American economy within the legal and institutional framework of the Central American countries * * *. Fundamental to the economic development of the region are the stimulation and support of Central American capital and the development of a capable and vigorous management class * * *. It is considered essential that foreign investment be channeled * * * primarily toward new fields of activity, without, on the other hand, establishing for it prohibitions or restrictions. The formation of firms with mixed * * * capital is considered desirable particularly in those industrial activities which, by their size, technical complexity, and channels of distribution and necessary markets cannot be carried out satisfactorily exclusively with local capital * * *. Foreign investment, when made, will be required to contribute * * * technology, organization, and management as well as the marketing practices needed * * *. It is considered necessary that foreign investors allow Central Americans to take part in the management of the enterprise and be required to train local personnel at all levels * * * that foreigners give an option for a reasonable length of time to Central American investors to subscribe to and buy capital stock in order to establish joint ventures." In conclusion, the ministers made known "their desire to put into effect concrete measures, based on studies that SIECA will make, to perfect the mechanism, proceedures, and regulations that will facilitate * * * investment on a fair and proper basis * * *."[18]

Little is asked in this statement which is not already standard practice. U.S. firms are contributing technology, organization, and management and as I shall point out later, training local personnel for all positions. Joint ventures, too, are becoming increasingly popular. SIECA is charged with formulating more exact limitations, but my impression is that this meeting has taken a good deal of the steam from critics and has issued as strong a statement as will be forthcoming in the near future. The majority of Central American leaders realize that they cannot think of themselves as isolated, but as part of a world economy in which anyone can participate if he recognizes that industrial development is largely a transfer process and takes advantage of the international financing and know-how that is now available at an unprecedented level. It is unlikely that the U.S. investor will be subjected to requirements to which he cannot readily accommodate himself.

Incentive legislation

Economic change in the CACM has been accompanied by an increased awareness of the role that tax legislation plays in guiding the direction of development. Central Americans have recognized the necessity of restructuring their tax systems and the past 3 years have seen major changes made in the direction of creating more equity in distribution of tax burden, raising more revenue, and improving administration. Examples include Guatemala's new income tax and increased property appraisals and property tax rates, Honduras' surcharge on high incomes, Nicaragua's increased tax on gifts and inheritances, and Costa Rica's higher levy on idle lands.

However, as I shall point out below, changes such as these have exercised no reportable effect on the U.S. investor. Another mechanism, the industrial incentive or encouragement law is used throughout the area and enjoys great respect among Central American governments and promotional officers, is more important. These laws which are being used throughout the world and in States and localities within this country reduce taxes for firms, foreign or national, whose activities are believed beneficial to the country. At the same time, they introduce new burdens and problems in administration and reduce government revenues—at the same time, incidentally, when governmental services and expenditures are rising sharply. Critics argue that instead of inducing investors the laws simply bestow windfall benefits upon firms that would have made substantially the same moves and provided the same benefit to the country in their absence. Proponents, who include every Central American and United

[18] Declaration on Foreign Investment by Meeting of Central American Ministers of Economy, June 1965 (translated by ROCAP in CAPTO Circular No. 251).

States official to whom I spoke believe that the eventual economic and social benefits accruing from the incentives far outweigh any temporary advantages in terms of revenue or equity costs.

Certainly when incentives stimulate investment that would otherwise not have occurred or would have been made elsewhere, there can be little criticism on revenue grounds. Since these benefits are only temporary, upon termination, they will result in net additions to national tax bases and revenues. The question I shall ask is whether or not they really do attract new industry.

The most common incentives provide partial or complete exemption for some 5 to 10 years from several taxes—import duties on the importation of machinery and raw materials, equipment, fuel, and packaging materials; taxes on income, assets, and net worth. They strive to raise the return on new or expanded investments in industry to a level closer to that common in more purely speculative ventures. Secondary goals include fuller utilization of national human and physical resources and substitution of locally produced for imported manufactured goods. Laws vary only slightly within the area. The laws, however, only set up maximum benefits that may be granted and each conferral results from bargaining and negotiation between the prospective investor and individual governments and naturally exemptions offered vary with the importance that governments attach to different enterprises. Thus a small assembly plant might be offered 3 years exoneration from duties on imported components while a large fertilizer plant could receive a 10-year exoneration on this tax and all other taxes as well.

Similarly, different countries see different value in identical enterprises. In the absence of a common policy, business firms hold great bargaining advantages over individual governments and have been able to drive Central Americans to incentive races which unnecessarily transfer some of the benefits of integration outside the region. For instance, imagine that country A offered a manufacturer 5 years of exemptions. He could then travel to country B, less developed and more eager for any investment and demand, say, 8 years. Finally, could return to A or move on to C, exhibit B's offer and induce the other countries to match or better it. These countries, then, rather than get nothing would, despite their better judgment as to the enterprise's real contribution, usually up their offers. By this process, potential investors, Central American as well, could receive the maximum amount of benefits.

An important step was taken toward ending this situation with the signing of the Agreement on Uniform Fiscal Incentives to Industrial Development on June 31, 1962, at which time the countries agreed to equalize and unify their industrial encouragement laws and coordinate their application. The aim of the agreement is not only to end wasteful intercountry competition but also to eliminate any misallocation of resources or locational decisions made on the basis of such artificial criteria.

The new plan is also significant because it offers the first fairly firm method of classifying investments according to their contribution to the market's goals. Enterprises will be classified in one of three groups. Group A, which receives the largest benefits, includes firms that produce industrial raw materials or consumer goods, packaging material, or semifinished products with at least 50 percent of the value of the materials used in these products being of Central American origin. Group B includes firms producing consumer items, packaging, or semifinished goods that obtain a major portion of their materials outside the area. In addition the value added to materials through processing or transformation should be substantial and the total operation should have a positive effect on the balance of payments. Group C firms are those which simply assemble, pack, cut, or dilute products. Specifically included here are manufacturers of beverages, perfume and cosmetics, and tobacco products. Excluded from benefits are firms engaged in mining and extracting, forestry, fishing, agriculture, or the provision of services. Generally, the uniform incentives are somewhat more generous than those granted under existing national legislation. However, they will prove more difficult to obtain since an executive council of the CACM will be responsible for resolving difficulties that arise between nations. This implies that approval of incentives may be required not only from the country in which a project will be established but from other countries that may well feel that the benefits granted by their partner are too generous.

The agreement, too, awaits ratification by the Congress of Honduras before taking effect. Hondurans believe—and rightfully so—that because their nation is behind the others, they must grant additional incentives if they are to attract industry in the face of poor infrastucture and other handicaps. It is anticipated that the other countries will agree by the end of the year to allow Honduras to grant 2 extra years of exemptions in order to secure her signature.

The Central American governments have made considerable usage of investment incentives prompted, I believe, by three assumptions. First, they believe that tax considerations are important factors in decisionmaking and that minimization of taxes will permit a higher return on capital, and that there exists a clear inverse relationship between taxes and the attractiveness of investments. Incentives mean that investments will be made which otherwise appear unpromising. Second, each country is faced by competition from its neighbors in Central and South America and in Asia, Africa, in fact, the entire free world. They believe that they must offer at least the same incentives as others if they are to attract foreign capital. Finally, they believe that this type of legislation is valuable in that it publicizes the country's investment climate—indicating to business the favorable disposition of government toward private foreign investment.

Certainly these assumptions, the legislation they have produced, have strong commonsense appeal—appearing to offer a rapid and straightforward means of hastening industrialization. So strong is the appeal that the laws have come to represent the major legislative effort yet made by individual countries to foster development and attract the foreigner. Briefly, I wish to examine these assumptions and the attitude of the U.S. investor to the incentives. Does he see them as significant factors? Are they perhaps unnecessary in that they attract investments which would have been made without further stimulus? Do they serve to advertise and enhance investment climates?

Incentive laws do not operate in isolation. Investment decisions as I stated earlier encompass a great range of rational and irrational calculations making it impossible to assign a correct weight to all variables or isolate a single one. In any specific case, even in the case of an investor who cites incentives as a prime factor, it is impossible to say accurately what amount of investment can be attributed to a specific benefit. Still, there is some evidence available to aid in making this analysis.

Practically every firm surveyed mentioned the availability of tax relief as a factor in his locational decision. Only the obvious consideration—existence of a market—was cited more often. Quite predictably, each firm was interested only in particular benefits. A cigarette manufacturer wanted assurance that his filters, cellophane, and aluminum foil would be brought in free of duty. Income and other taxes were unimportant. A toiletries firm wanted exoneration from duties on glass containers adding that this would cut costs some 30 percent and insure a profitable operation. Again, relief from other taxes was of minor importance. The greater the value of imported items in relation to a product's total cost, the greater the urgency attached to exoneration. Thus a firm importing all its raw materials except water and alcohol was more adamant than one which purchased 80 percent of its supplies locally.

The real significance of this legislation, however, cannot be known until the number of firms that would have made investments without it is determined. When pushed on this point, that is "Would you have made the investment even if the incentive was not available," roughly two-thirds of the interviewees responded positively.

Incentives are of more importance to smaller firms—to sole proprietors, partners, and small corporations. With one exception the companies that insisted on the critical role of incentives were in this category. One told me that "we couldn't have come in without them because all our material is imported and our volume is so small, we would have been wiped out otherwise." Small firms simply do not have the resources to incur losses for lengthy periods. The flow of cash made available to them by lightened tax burdens was essential to their continuing as going concerns. Generally speaking, the big corporations did not wish to stand on these incentives either because they felt that they cost more in the long run in terms of interference and paperwork or did not attach great weight to them because they presented very small cost savings and they were willing and able to sustain losses for several years whenever they began new operations. A great many firms, too, fail to show profits in the period that the incentives cover—the starting up years. This is another explanation of why exoneration from income taxes is even less significant than the other incentives.

It is interesting to note that in response to a similar question asked by Ross and Christensen in Mexico, 58 percent of the firms said their investment would have definitely have been made even without exemptions; 38 percent would probably have been made anyhow; 4 percent later, and no one replied "definitely not" or "uncertain." [19] Dr. Thomas Bergin found some years ago in discussing the various factors that influence plant locations that financial aid is almost at the bottom of the list.[20]

Tariff protection is much more important than incentives, "We were importing tin cans and when we expanded we received exemption from duties. Only when duties went from 50 to over 200 percent on imported finished stuff, however, were we able to knock the others out of the market." From Costa Rica, "It wasn't incentives but the increase of tariffs from 20 to 80 percent of value on competitive items from outside the area that permitted us to survive." Or, "We got 99 percent customs exemption, all right, but our decision was pretty obvious anyhow."

Although incentives are of secondary importance to most investors, they are nevertheless welcomed and sought almost without exception. What becomes important to men who have neither the time nor the money to wait indefinitely is not the amount of exemption since these differences are slight and being eliminated, but the speed and ease with which applications for them are processed by governments.

Costa Rica has had a law for industrial development since 1959 that appears very attractive and comprehensive. Its commendable aims are expressed in the first article which states that it will contribute to the development of industry, the strengthening and diversification of economic activity, the channeling of savings into efforts to provide more employment at higher wages—all things which will improve the welfare of the populace. A national banking system was set up and 99 percent exemption from duties was provided for most imported materials and equipment. Certainly this constitutes a "nice" law; yet it has failed to generate a rush of investors to Costa Rica. Why is this?

The intent of the most favorable law will be frustrated when administration is inefficient, slow or unsympathetic to its aims. The effects of inadequate or hostile personnel manning the agencies that administer the incentive program can be seen not only by examining Costa Rica but by contrasting the efforts of that country and Guatemala with those of Nicaragua and El Salvador.

The first countries have complicated application forms and reputations for very slow processing. It has not been uncommon for investors to wait a year and one-half in Costa Rica. Guatemala requires that its form be filled in with the help of a registered national professional or ICAITI. The form asks for a 5-year market analysis, minimum and maximum annual capacity, break-even costs, and anticipated profits. Excerpts from the application must be published three times at the applicant's expense to permit opponents to be informed and heard. [21] Honduras, incidentally asks one to explain how much could be produced in the plant if it were operated 365 days a year by three 8-hour shifts—a ridiculous question since no plant will be operated in this manner. In Nicaragua, by contrast, one must submit an estimate of profit and loss but no cost breakdown is required.

As I mentioned, there are several ways in which approval of applications can become a discouragingly slow process.

1. In the CACM where incentives are determined on a case-by-case basis, considerable leeway is given to personnel who may not be anxious to grant them. Outspoken opposition to benefits is not feasible for fear of frightening off investors or of losing one's job, but dilatory tactics can easily be practiced. Many businessmen believe that Costa Rica is damaged in this way by Socialist-oriented personnel who tend to regard all private enterprise as somewhat reactionary and therefore create obstacles in excess of their legitimate functions. In Guatemala, the criticism is not of leftism but of excessive nationalism. The Ydigoras government is accused of indiscriminate granting of benefits in exchange for certain personal considerations. In contrast, the present government is held up as scrupulously honest and cautious. The Minister of Economy complains of losing revenue unnecessarily and is reportedly unhappy with several U.S. advisers who have worked in the country. He also feels a genuine concern for Guatemalans who have suffered from foreign competition.

2. Complications are introduced by the number of persons who must handle applications. In Costa Rica an industrial commission consisting of representa-

[19] Jack Heller, "Tax Incentives for Industry in Less-Developed Countries" (Cambridge: The Law School of Harvard University, 1963), p. 125.

[20] Edward J. Alofs, speech on the occasion of the First Central American Conference on Investment Opportunities, in Managua, June 1965, p. 6.

[21] Amerconsult Corp., "Observations on Industrial Development Programs in Central America" (New York: By the author, October 1964), p. S-9.

tives of six public and three private groups must approve applications. In the case of large projects, entailing loans or special benefits (such as the new oil refinery), the Legislative Assembly is also consulted. Guatemala consults seven institutions, including the Chamber of Industry, and each holds a virtual veto. Approval is more difficult when so many interests must come to a consensus.

3. Thorough, intelligent, skeptical, and honest examinations of applicants can also handicap a government. The difficulty in getting Costa Rican approval is partially attributable to the fact that they have not felt the urgency of the others and have been more critical and less interested in attracting transformation operations which provide a few jobs, but still cost much foreign currency and seriously deplete the national treasury. The present Governments of Costa Rica and Guatemala enjoy reputations of honesty—the well-placed bribe does not work as well as it used to. Also the number of parties that must be reached are too many to permit the traditional practice to continue on a profitable basis.

4. There is also the simple problem of staffing. Delays branded above as deliberate may in fact be brought about simply by a shortage of adequate personnel. A high degree of competence and experience is necessary to administer these laws effectively—a higher degree than is widely available in Central America. In Guatemala, for one, there is no regular civil service system, merit promotions, or job security. Government employees get their jobs through political patronage or family ties. An AID-sponsored survey found clerks who were illiterate.[22]

Businessmen do not look as deeply as I have just done. For all the reasons listed above, there exists a questioning of the will and purpose of Guatemala and Costa Rica. It is doubted whether enthusiasm for development extends far beyond the Ministry of Industries in Costa Rica and if it even extends that far in Guatemala.

The attitude of business toward Nicaragua and El Salvador, in contrast, is one of genuine enthusiasm. As I shall point out in the following section, it is the efforts made by these two countries to interest and satisfy businessmen, rather than any natural factor, that have been most responsible for their attraction of new investment.

In Nicaragua, El Instituto de Fomento Nacional (INFONAC), an autonomous development agency of the government, takes responsibility for aiding investors with their applications. The Nicaraguans believe that there is no reason why a decision should require more than 3 weeks and by law they must produce one in 30 days. Since September 1964, INFONAC has followed up applications and obtained positive conferrals in as little as 2 weeks. Salvador welcomes assembly and other plants, recognizing the need for jobs in a country with the highest population density in Latin America. A commission representing the Ministers of Economy, Finance and the National Planning Office makes decisions and does so in 2 weeks if need be. Significantly there is no representative of the private sector on this commission; thus the pressures and conflicts created by having manufacturers with strong interests in the status quo ruling on potential competitors is reduced substantially. Two examples were cited of firms who had initially sought to locate elsewhere, but shifted to El Salvador after losing patience with the other governments.

Certainly exemptions, especially when linked with increased tariffs, raise the potential return on investments, but it is a rare situation when they contribute substantially to attracting a plant to the area. They can, however, play a larger role in affecting the site selected within the market. Incentive laws, it must be remembered, are not unique. There are many investors in the world, but there are also many investment alternatives. For this reason Central American countries must offer them but only to remian competitive. Their presence does not give the region any competitive advantage and represents a poor and costly substitute for direct advertising or other promotional efforts. They have only marginal significance and will not "compensate for such negative factors as administrative corruption, arbitrariness or ineptitude in the implementation of * * * laws pertaining to individual activity." [23] They will not improve a climate already made unattractive by political or economic conditions.

As stated above, the firms granted these incentives are often of questionable economic justification. They are generally light and uncomplicated transformation operations utilizing substantial percentages of duty-free imports. Industry which makes extensive use of imported components to sell the local market, even

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[22] Harvard University Graduate School of Business Administration, "Management Problems and Opportunities for Management Training in Central America" (Cambridge: By the author, 1963), p. 141.
[23] Heller, p. 63.

if it reduces finished goods imports and adds local labor contributes little to the economy. In exchange for the loss of duties and frequently higher costs to consumers, the Central Americans are obtaining moderate increases in manufacturing skill, purchases of local goods and services, some additional purchasing power, and prestige. The percentage of local value added to total product value cited in a Harvard study was just 5 to 10 percent. The remaining 90 or 95 percent of the income continued to flow out of the country in the form of payment for basic inputs and equipment.[24] Similar testimonies were offered by manager after manager. These industries have value only in the long term if some backward integration can be achieved. U.S. investors are seeking in most instances, to grow or purchase their materials locally and several successful examples of these efforts could be cited.

I believe that Central America does not need to offer great additional incentives to attract investors. Rather the task is to exploit the inducement created by the CACM and insure that incentives are not wasted on uneconomic or low priority enterprises. To this end, three concluding recommendations are made:

1. There are useful parts of the incentive laws which are now unenforced which could be helpful to governments. Operating data, quality checks, and a general followup of projects to assure that host countries are getting the maximum return possible would be valuable. Governments should also be ready to up-or downgrade one's classification. For example, if a packer of a product buying cans locally decides for no sound reason to begin importing them, his exoneration from import duties should be lifted.

2. The Central Americans must act, as they have begun to act, together to create a situation where competition is between potential investors rather than amongst potential hosts. A regional administration of some type is needed to grant incentives—one that avoids the excess of regulations and procedures that have retarded the development of Costa Rica and Guatemala. Administrators must be experienced and sympathetic to regional programs before they can be entrusted with the broad discretionary powers they now have. Further, the administration must be adequately staffed to perform the tasks of conferral and surveillance. The primary benefit of selective incentive laws, of course, is the flexibility they offer in selecting investors for benefits according to development priorities and changing economic conditions. However, where the capability for making technically difficult discriminations is lacking or no guidelines exist, a more rigid statutory pattern such as that proposed by the uniform agreement is advisable.

3. Jack Heller has written that it is necessary "balance the substantive to advantages and disadvantages of a tax incentive statute against the possible gain that would accrue * * * if these administrative resources were devoted to endeavors outside the tax field."[25] Incentives are definitely of secondary importance in creating conditions attractive to the prospective investor. More important obstacles are the underdeveloped state of the economy, in terms of physical infrastructure, the scarcity of local capital and entrepreneurs and the restricted effective demand. As new human or monetary resources become available, concentration on these problems would prove more important to the progress of Central America.

Promotion

"Ignorance of opportunities is one of the principal reasons for failure to invest in foreign countries. This ignorance is a result primarily of a lack of interest * * * on the part of the top executives of the company."[26]

"A point which is common to almost all the development areas is the belief that foreign investors are anxiously waiting outside the borders * * * to rush in the moment the doors open. This is not so. It is true there are many investors in the world, but * * * nobody is begging for permission to enter Central America or any underdeveloped area * * *.

"You should not overestimate what the world knows about Central America. Most people in the world do not know anything about Central America, perhaps with the exception of knowing that bananas are produced here * * *. There must be a significant number of potential investors who could become good industrialists * * * who do not have any idea about even the countries which

[24] Harvard University Graduate School of Business Administration, p. 51.
[25] Heller, p. 56.
[26] E. R. Barlow and J. T. Wender, "Foreign Investment and Taxation" (Cambridge: The Law School of Harvard University, 1955), p. 221.

form Central America, and for whom Guatemala and Nicaragua constitute as far away places as Nepal or Ethiopia. Do not overestimate the knowledge of the people you are trying to attract." [27]

An important impediment to investment in the CACM is that U.S. firms have simply not investigated the opportunities existing. Many firms do not act overseas until some problem arises and if a firm has had no contact with the area through exports, opportunities are unnoticed. Conservative managements tell themselves, too, that the problems of the area are greater than they actually are. It is futile to hope to encourage investment in Central America unless the countries take steps that are necessary to provide a suitable investment climate—to expedite the modification of laws and procedures whose major function is to create obstacles to development and do something to start private enterprise moving—to point out new opportunities and prepare brief feasibility and marketing studies—to state something in writing so that the investor will be aware of the area.

Significant steps have been taken in this regard, that the same time strikingly sharp and important national differences exist with respect to the organization responsible for promotion, the degree of coordination exercised, information and services available to prospective investors, and representation abroad. These differences are clearly reflected in the accomplishments of developmental and promotional programs.

Briefly, Nicaragua and El Salvador, with outstanding programs, are far ahead of the other countries. Honduras and Costa Rica have done little in the past but are aware of their error and working hard to correct it. Promotional efforts in Guatemala are practically nonexistent.

Nicaragua's INFONAC should serve as a model for the region. Responsibility for promotion has been centered in this autonomous office since 1954 and in 11 years it has made substantial contributions to the economic growth of that country by channeling technical and financial resources into the improvement, diversification, and stimulation of activities which contribute constructively to the development of Nicaragua. Through careful selection of key personnel, contracting of foreign technicians and consulting firms, and adherence to rigid standards, INFONAC has filled to a very high degree the needs described two paragraphs above. The institute has achieved international respect as a strong parter of private enterprise. Although it has consistently oriented its action toward stimulating the local business community, it has also been the most important factor in enticing U.S. Common Market investors to locate specifically in Nicaragua. Although no statistics are available, a strong consensus exists in both foreign and indigenous business and governmental circles that Nicaragua and El Salvador are now attracting the most important elements of foreign investment. In both instances, the promotional offices of the countries are given credit for this phenomenon.

The most important functions of INFONAC can be classified as follows:

1. INFONAC has issued several excellent, up-to-date, well-organized compilations of economic data and legislation and rules relating to commercial activities. It formulates programs, investigating industries where outlook appears favorable, and carries out feasibility studies of specific projects, agricultural or industrial. While these studies do not satisfy an investor's complete informational needs, they go a long way toward answering his most obvious questions.

2. It has among its personnel economists, chemists, engineers, agronomists, veterinarians, lawyers, administrators, and accountants and also draws upon the technical services of international organizations as FAO, ICAITI, and AID. They have assisted managers in working out plans and problems in new operations and train Nicaraguan personnel for all levels of industry and business. This effort, especially in training skilled laborers, is heartily welcomed by the U.S. investor.

3. INFONAC also performs a financing function. It makes medium- and long-term loans for the acquisition of fixed assets in either industrial or agricultural enterprises. It can also promote new projects on its own volition by taking an active participation even involving risk capital—in projects which local interests normally would not consider. At the end of 1964, it had made loans and investments in excess of $38 million. Central American banks rarely grant either medium- or long-term industrial loans and these efforts by INFONAC are impor-

[27] Murray D. Bryce, "Industrial Promotion for Central America," speech delivered in Tegucigalpa, June 9, 1965, p. 2 (mimeographed).

tant to the investor, seeking local partners, who often finds them lacking sufficient capital.

4. With the support of Nicaragua's four leading public and private banking institutions, a branch promotional office was opened in New York City in 1963. The office, headed by an American, publicizes the facts of the CACM's growth, seeks out and establishes contact with the management of desirable U.S. firms, assists in the preparation of preliminary survey questionnaires and arranges travel and accommodations. Further, it offers important follow-up assistance to executives who have just returned from Nicaragua and are preparing reports for company directors.

INFONAC is not hidden away in bureaucratic isolation, but instead is located on a main intersection with the central plaza. Its staff is bilingual.

El Salvador, the smallest country in Latin America has the highest population density. Because agricultural expansion is limited by the amount of arable land, every expert who has analyzed the nation has concluded that industrialization is the obvious answer to the nation's unemployment and development problems. For this reason and because Salvadorean businessmen are the most aggressive in the region, the country has long been one of the prime supporters of the integration movement. Salvadorean leaders, who are fond of comparing their country to the Netherlands, Belgium, or Japan, view Salvador as the major manufacturer for the Common Market.

Promotional responsibility is centered in INSAFI which is similar in purpose and operation to INFONAC. It works in close contact with AID and the Ministry of Industries. (The AID industry officer maintains a desk in INSAFI's headquarters and spends over half of each day there.) Its staff of 100 occupies a downtown building with an impressive English library. Descriptive folders packed with laws, opportunity listings, steps in applying for benefits and so on, are found in hotels throughout the capital. A copper-wire facility was recently opened as a joint venture between INSAFI and an American firm. The U.S. firm was alerted to this plant's potential by INSAFI representatives.

The main obstacles to promotion in Costa Rica have been (1) a lack of vision—a failure to see how other countries were moving ahead more rapidly, stemming from, (2) a high degree of smugness. Costa Rica is the most politically stable and democratic country in the region and has the highest per capita national product. The populace, as a whole, have been very satisfied with social improvements made by government, their high level of education, homogeneous European-descended character, and a relatively high standard of living. Its business leaders are not aggressive manufacturers but rather men who depend on coffee, real estate, and commerce for their incomes. Costa Ricans really have become somewhat proud and complacent. While the country exhibits no evidence of resentment toward foreigners there has been little evidence of a basic determination to accelerate development by actively seeking their know-how and capital.

Costa Rica has had a small promotional effort conducted through the Ministry of Industries. A New York office was opened in November 1963 but its representative was forced to withdraw because of a lack of preparation and financial support. Manufacturers chose Costa Rica for factors other than its efforts to attract them, largely the charm of the country. The population is highly literate—over 20 percent of the government's budget is spent for education. The country is orderly with a very low incidence of crime—the author met and spoke with the President as he and his family walked unguarded in a public recreational area outside San Jose. The extremes of wealth and poverty that mark Central America are less noticeable in Costa Rica. Modern supermarkets, appliance stores, dependable laundries and cleaners, and the widest variety and highest quality consumer goods in the region are found in San Jose. The city is clean—hospitals, doctors, schools, opera, and a symphony are well regarded. It is therefore sought out, especially by small and retired businessmen and expatriates who operate such nonregional enterprises as drive-ins, skating rinks, and contracting. Big firms seeking the regional market do feel, however, that its location makes it a poor spot from which to sell the regional market although its appeal does grow as Panama's entry into the CACM becomes more probable.

In the past year, Costa Rican leaders have seen the effects of regional competition and the progress being made especially in Nicaragua and El Salvador in attracting new industry and closing the gap between their incomes and Costa Rica's. They admit that their country's traditional appeal is no longer enough and colder, harder examinations are made by regional investors than by individuals merely seeking a comfortable life. The Ministry was reorganized in

January 1965 and to emphasize the change a new Vice Minister was placed in charge of development and promotion. With the help of AID, the most complete publication available in Central America describing the investment climate down to rates for radio and TV time was issued.[28] Further a bill, with excellent chances of passage is being discussed in the legislative assembly, which will establish a government corporation modeled after those of Nicaragua, Salvador, and Puerto Rico. The New York office will reopen soon.

The promotional aspects of development in Honduras and Guatemala are scattered among government, semiautonomous, and private organizations.

In June 1964, the Honduran Government designated the Division de Desarrollo Industrial of the Banco de Fomento to coordinate promotional efforts, but today five organizations work in the area. The Banco de Fomento does broad statistical work, makes loans and selects plant sites; the Banco Central and the National Economic Council both do specialized industry studies; the Ministry of Economy handles Common Market related activities; and the National Productivity Center makes productivity studies.

The lack of a civil service, too, with the replacement of government employees at all levels following governmental changes presents a serious handicap to administrative efficiency and the correction of blatant problems. If this system were replaced by one employing trained employees who might expect a reasonable degree of tenure in their jobs, improvement could be expected. Honduras, more than any other nation, needs promotion.

Promotional responsibility in Guatemala is shared by the Ministry of Economy, the National Planning Office, the National Development Institute (INFOP), and the National Productivity Center. In a month's interviews in Guatemala, not one businessman or official suggested that I might obtain any useful information from these sources. Only one descriptive bulletin issued by any of them was found in Guatemala, the Productivity Center's Guia de Inversionista, published in Spanish and sold for $1.

Guatemalans do not appear to have learned that a government policy of noninterference with the foreign investor is not enough. Substantial growth is taking place, really in spite of the government. Guatemala is the largest single market for most items; it has the most varied resources; it is closest to to the United States; it has a wonderful climate, and with the possible exception of San Jose, has the most cosmopolitan city in Central America.

The efforts of Nicaragua and Salvador, then, have been well organized and successful. INFONAC has been the factor in attracting to Nicaragua a larger share of new investment than one would expect given the country's location, resources, and market. Costa Rica and Honduras are newer, but increasingly active in this area. One would expect that, in time, Guatemala will learn its lesson as well.

Some investors argue that five competing agencies are wasteful and ought to be discouraged. In most respects, this is true. The countries would gain by pooling their efforts into a well-equipped regional office—an expansion of the functions of CABEI or ICAITI perhaps would suffice—and presenting a unified front to the outside world. The investor is ignorant enough about Central America without five separate New York offices. To corporate leaders, time is a very precious consideration and wherever the opportunity for success is most positively demonstrated and vacilitated, the investment is likely to be made. It is easier to induce a man to visit Central America for discussions of regional rather than solely national possibilities. When a potential investor is in Central America and has been oriented in a regional office as CABEI's in Guatemala, he can then decide which country is most suitable and the national offices can attempt the final "sale" and assist in beginning operations.

The regional office should identify projects and supply the basic data. It is unnecessary to imitate INFONAC or INSAFI by preparing lengthy and costly feasibility studies unless they are undertaken for a specific client. It should promote regular visits and appearances utilizing this material, encourage the organization of enterprise on a regional basis and serve as a focal point for investors, foreign or Central American, seeking joint participation. The office should also be prepared to receive complaints from businessmen, incentives, seek finanacing, and begin construction and operation. A source of information would thus be provided to analyze for modifications in rules and other obstacles to investment.

[28] See footnote 17.

Transportation

The lack of adequate inland transportation facilities has long retarded industrial growth by limiting access to raw materials and markets. Land transportation has been costly, reflecting both terrain and the traditional overseas orientation of economic activity. Commerce has been centered at the five capitals with little interregional exchange other than exiles and intellectuals.

In the past there have also been difficulties in connection with imports of equipment and raw materials and the shipment of finished goods across national frontiers. Customs officers were given a share of the fines levied for violations of regulations and therefore had a strong personal interest in discovering technical oversights and typographical errors. In numerous instances, the time consumed at borders discussing and rectifying these matters when added to the amount of time necessary for transportation alone. made intraregional trade unfeasible.

A U.S. firm manufacturing in Costa Rica explained that 20 to 30 days were required to ship his product north to Guatemala, with stops in each capital for unloading and at each border for customs examination. Customs procedures have now been somewhat unified and exporters are able to use a common form and file it at each border. Examinations have become much more perfunctory.

More important, the Inter-American highway system begun in the 1930's when only a Guatemala-El Salvador road link existed was officially opened from Guatemala to Costa Rica in early 1963. It is supported by a growing network of paved and gravel feeder roads. Although some additional work is needed in southern Guatemala and Costa Rica, the highway must be given nearly as much credit as the customs union in explaining the phenomenal growth of intraregional trade and molding the regional market that attracts foreign investors.

The same manufacturer cited above is now able to ship his goods from San Jose to Guatemala in a maximum of 4 days. An appliance maker estimates that his transportation time and costs have been halved.

El Salvador is widely credited with having the best transportation facilities and is thus able to exploit its central location. Its port at Acajutla is the region's largest. Several businessmen mentioned the highway network which allows easy export to regional markets to the north and south as a crucial factor in decisions to locate in that country.

Transportation deficiencies, particularly roads to the south were mentioned as unnecessarily impeding Guatemala. Top priority should be given to this project if manufacturers not satisfied only with its internal market, but interested in serving the region, are not to be lost to neighbors.

With the still high cost of moving products, the supply of basic low cost or bulk manufactured products from a central factory is not practical in most instances. Naturally this is important in explaining a good many of the locations in industries where two or more firms are competing or a single firm is engaged in multiplant operations. In cigarettes, batteries, detergents, toothpaste, and flour, for examples, one U.S. firm is moving into Guatemala while another (or a second plant of the first) is opening in Costa Rica or Nicaragua. A Guatemala-based flour manufacturer cannot ship profitably beyond San Salvador. His transportation costs to Costa Rica are six times greater than to Salvador. This was a basic consideration in his decision to open a second mill in Nicaragua.

Labor

Labor is not an important factor affecting decisions within the CACM. Only one study of comparative labor costs has been completed and it indicates that labor costs are slightly higher in Guatemala and Nicaragua and lowest in Costa Rica.[29] Business reaction does not support these findings. They believe that labor costs slightly more in Costa Rica but that its higher productivity and trainability offsets this cost. In spite of the fact that extensive legislation covering hours of work, overtime, vacations, profit sharing, severance, age, and employment restrictions, and training requirements no businessman mentioned labor as a serious problem or as the reason for his locating in a specific country.

As mentioned earlier, there is practically no firm entering Central America to take advantage of lower wage rates (about $1 a day) and to reship goods to other parts of the world.

There is little evidence of unreasonable attitudes toward management on the part of labor unions or employees. Unions of consequence exist in older and larger industries as bananas, railroads, and radio, but are not important in the

[29] Central American Bank for Economic Integration, Resultados de La Investigacion Sobre Prestaciones Sociales, Sueldos y Salarias en Centroamerica (Tegucigalpa: By the author, undated), table 5.

newer industries. Paternalism in varying forms is well established. Managerial dominance of significant portions of the lives of workers is traditional to the area and large by U.S. standards. Workers are financially weak and vulnerable. In many cases they are recently uprooted and in need of some stabilizing point in their daily life. They therefore approach employers with a predisposition to accept a dependent relationship. Management complains that this is troublesome and time consuming, that it spends more time with workers and makes more personal loans that it would prefer to. However, they know that if they refuse, problems of partial commitment and discipline set in. It is easy to overestimate the problem of paternalism, though, for workers are conceded to identify more with the firm and take more pride in their work than many of their American counterparts.

Each country has a requirement that between 75 to 90 percent of personnel employed be nationals except in the special cases of directors and technical personnel whose positions are impossible to fill with nationals. Requirements to train local personnel are written into contracts at the time of classification for benefits, but seldom if ever, mentioned again.

U.S. firms follow policies of hiring and training nationals to replace foreigners as rapidly as possible at all levels anyway. This is not only done for public relations but also because nationals are far less expensive than U.S. employees who must be transferred long distances with their families and belongings. In the firms interviewed, where U.S. citizens were employed at all, their number was 1 to 4 and decreasing. Because exemptions from this restriction are freely granted and because firms choose to use nationals, the percentage requirements are not demanding.

U.S. firms pay the highest wages, follow labor laws most closely, and provide the best working facilities. A combination of factors explain this situation. Americans imitate their home operations and facilities which are superior to Central American. They are willing to accept lower profit margins and usually have better technology and managerial skills. Finally, they are foreign and know that they are therefore more subject to criticism from inspectors, academics, and politicians.

Taxes

Taxes, too, are not important factors in selecting a country within the Common Market. Comparison of corporate tax rates and discussions with bankers and accountants indicates that Costa Rica's are highest and Nicaragua's and El Salvador's lowest. There are disparities, too, in the treatment of depreciation, bad debts, loss carryover and other features, but, in sum, tax differences are slight. No firm mentioned taxes as a force differentiating countries in the market. Differences were variously described as "negligible," "unimportant," and "not enough to matter." The continuation of this situation is advisable, for like the Agreement on Common Fiscal Incentives, it eliminates artificial distortions of investment patterns. It would be wise to permanize the present situation through a complete regional harmonization of tax laws. The OAS has discussed such a possibility on a Latin American basis, but it would certainly be proper and advisable for the Central Americans to take action on their own. Such action would be a logical extension of the agreement on incentives.

Some other factors

The impact of a dozen or so other considerations commonly weighed in decisions has not been evaluated. The location of raw materials is an obvious factor in decisions—so obvious that I have not devoted a special section to it. It is enough to say that traditional investment in export items—agricultural and mineral—is of course determined largely by natural endowments and has been unaffected by the creation of a Common Market. In the case of new manufacturers utilizing large percentages of imported inputs, the location of materials in Central America is obviously of little significance. I have, then, discussed only factors which I found most critical or surprisingly insignificant (Labor and taxes). By way of concluding this section I wish to list other forces which are determinant in individual cases, but which are often overlooked in analyses of this sort.

Personal contracts are a most important element in locational decisions. Many exporters have located their new facilities in the home country of the man who had proven to be their most capable distributor in Central America so that he could take part in the new venture as partner, manager, or both. The most common form of international joint venture in the Common Market takes this form.

Many firms including detergent, battery, and ink manufacturers, have located in a particular country because of the availability of talented local partners. This differs from the distributor-determined location in that in this second type of cases, no previous business arrangement existed between the parties. Salvador benefits considerably from this sort of thinking because of its small, but active and aggressive local entrepreneurial group with whom Americans are anxious to associate. In this regard, one investor made the point that the reestablishment of Costa Rica's National University in the late forties was most detrimental to its development. There is, I think, some validity to this statement. The other four countries are not particularly proud of their national schools and whomever can afford to goes to school in the United States or Europe where he mingles with students and is exposed to technological, scientific, and business skills from the more advanced nations. Costa Ricans, on the other hand, are proud of their university and a greater percentage of the students remain in Costa Rica to complete their education and a large proportion enroll in humanities, fine arts, and law. These are not the students who are going to lead the economic development of a country and introduce new dynamism. This "inbreeding" has contributed to the smugness and lethargy of Costa Rica.

Local initiative has been the reason several firms have chosen particular sites. In El Salvador and Nicaragua, the national development agencies have begun projects and offered partnerships to Americans. Individual businessmen, again especially in these two countries, have also sought out U.S. firms for financial and technical aid. AID and the commercial sections of our embassies have regularly served as intermediaries in bringing firms together, but in most instances, it was efforts made by the Central Americans that made Americans aware of opportunities and join with them. This pattern is not one generally followed by the exporter with considerable experience in the area, but instead explains a good deal of the investment made by firms who had had little or no contact with the region.

Just as there have been these cases in which a local firm had received industrial incentives, begun operation, and then sought assistance from the United States, there are examples where the U.S. investor was anxious to acquire a going concern or avoiding some of the difficulties and delays encountered in obtaining their own benefits, beginning operations. In the cigarette industry, for instance, only two independent firms of consequence remained in operation, one in Guatemala and one in Costa Rica, when a U.S. firm became interested in the area some 4 years ago. It acquired the Guatemalan plant because it could better serve the two largest markets—Guatemala and Salvador and because there was some suitable local tobacco available. In July 1965, another firm entered through a licensing and technical assistance agreement with the Costa Rican firm.

U.S. firms complain of almost primitive warehousing and distributing facilities and methods. Central warehouses for redistribution are nearly totally lacking. Truckers must dispose of their loads in small quantities thereby significantly raising distribution costs and consumer prices. U.S. firms are also accustomed to finding in communities a "package" which incudes a modern building, utilities, and arranged financing. Such "packages" were a big factor in Puerto Rico's development as they are in communities throughout the United States. The first country to offer these warehouse facilities and industrial package will have a decided advantage in attracting new investment. (There exists only one complete industrial park in all of Central America.) It appears that with AID prodding, INSAFI in El Salvador is moving quickly in this direction.

FORMS OF ORGANIZATION: THE JOINT VENTURE

American investors can elect any of several forms of organization when doing business in Central America. They may enter alone—as branches of U.S. corporations or their subsidiaries or as local subsidiaries incorporated under the laws of the host country. Alternatively they may enter into a "joint venture"—an enterprise undertaken with local capital participating on an equity basis. In its widest sense, a joint venture "comprises any form of association which implies collaboration for more than a very transitory period." [30] My references to joint ventures, however, are limited to those investments which are made on a permanent basis—not simply construction projects, for instance. The legal differences between these types of organization relate principally to registration

[30] Wolfgang G. Friedmann and George Kalmanoff, "Joint International Business Ventures" (New York: Columbia University Press, 1961), p. 6.

procedures and the financial liabilities of the participants. As a general rule in the Common Market countries, every entity, foreign-owned, mixed, or national receives the same rights and tax treatment.

Although close relations between Central American and United States businessmen have existed for decades, the joint venture—in which our capital, skill, and experience are combined directly with theirs—has played a very minor role in total U.S. investment in the area. Business relations have largely been limited to dealings between local agents and distributors and the U.S. manufacturers. Detailed and recent statistics, unfortunately, are not available, but the most recently published study indicates that in the period 1951–57, in 90 percent of all direct U.S. investments in Latin America, the U.S. interest was 95 percent or greater. In 6 percent of these investments the U.S. partner held between 50 and 95 percent, and in just 4 percent were U.S. interests willing to accept a minority position.[31] It appears, however, that as Central American industrialization has proceeded at an increasing pace, a great many new and closer arrangements have been sought and consummated.

Joint ventures are becoming more common because they are offering more advantages to both parties concerned. The Central American investor gains, first, the technical assistance in the form of technicians, management and/or reports on new processes and developments. He gains, also, financial support not only in cash, but in the form of equipment, supplies, and services. He may gain the important right to produce well-known products on an exclusive and regional basis. Joint ventures also provide them with a form of insurance against destruction by large outside or Central American firms which are entering their market areas on an ever-increasing basis. By obtaining a strong U.S. partner he both discourages other companies from competing with him and secures an eager supporter with a vested interest in his survival.

Although there are no real requirements for local participation in enterprises receiving concessions or doing business in Central America, partnership also offers several advantages to the U.S. firm.

The prospect of making an investment strictly on one's own terms is rapidly disappearing. Many firms seek to become "national," worried not so much about expropriation or consumer boycott, but by the substantial risks of bureaucratic harassment and delay especially if the United States is out of favor with the host government. Friendship has greater utility than protective legislation. Local participation, it is argued, both dissipates the dangers of this type of reaction and favorably influences governmental treatment during private negotiations including the disposition of contracts.

Close personal relations with key suppliers, customers, bankers, and government officers are useful to entrepreneurs the world over, but even more so in Central America where business circles are quite limited and where individual acquaintances are of tremendous import. Central American families are big and when one has a good friend or partner who is well related in social and business circles, it is very possible that he has a relative or a friend who holds an important position in the government or business who can be a great help in smoothing the way to better business operations.[32] Loans, reductions of duties on components, residence and work permits are all processed more rapidly. No matter how talented a U.S. owner or manager is, he can never overcome all national barriers.

By using local lawyers and intermediaries one can achieve a degree of "national" status, but many feel that influence is made more effective when the local representative has a strong financial stake in the outcome of his negotiations. When a national's interest is put on this basis, conflicts of loyalty between country and company disappear quickly. Naturally, this assumes that no business decision will represent any sort of treasonous action—a thoroughly reasonable and legitimate assumption.

Local partners also provide capital—important to both the small and the cautious investor—to the small because he needs financial assistance and to the cautious who wishes to gain profits, but minimize his own investment in the area.

Generalizations in this area are particularly unwise since the experiences, problems, and prospects for joint ventures in mass-consumed items are very different from those in highly complex heavy goods industries. Nevertheless I will offer several observations on the nature of joint ventures in the CACM.

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[31] Leland L. Johnson, "U.S. Private Investment in Latin America: Some Questions of National Policy" (Santa Monica, Calif.: The Rand Corp., 1964), p. 65, citing a Department of Commerce survey.

[32] Frank J. Thomas, "Successful American Entrepreneurship in Central America" (San Jose, Costa Rica: Latin American Business Publications Co., Ltd., 1964), p. 156.

First, although a small group have a high degree of business sophistication and a keen interest in learning and adopting new production and managerial techniques, the vast majority of Central American businessmen have a different business philosophy than their American counterpart which stems naturally from different traditions, technical, legal, social, and commercial standards. This creates a serious impediment to successful partnerships. The Central American seeks the fastest possible return on his investment, demanding its recovery in 2 to 5 years (which is possible in real estate) and has very little interest in long-range planning. Thus, a new venture involving substantial capital outlays and a deferred break-even point is unattractive to the average Central American investor. In the early years of an enterprise, before the company is able to generate a large profit or cash flow, the Central American's need or desire for large payouts conflicts with the American's willingness and ability to withhold and reinvest earnings. Americans, then, find local capital hard to find and unrealistic in its demands.

Second, joint ventures are rare in the heavy technical industries which are new to the area. Because these projects are unlikely to show profits for several years and also because investors generally seek ventures in fields they know best and these are new areas, Central Americans are not very interested in them. Failure is always a possibility and while it can be sustained by the larger worldwide firm, it is difficult, if not impossible, for the Central American with his more limited assets to take the chance of concentrating them in a single venture. Governments and development agencies are likely to be the partner if and when the U.S. investor in this sector has a local partner.

Third, large American firms are less likely to be involved in joint ventures than their smaller counterparts. The requirements of an internationally integrated operation do not allow for the potential conflicts between individual joint ventures and worldwide policy. Individual participation by Central Americans can seriously handicap a firm's freedom to define transfer prices, market areas, and so on. These firms believe that participation by locals should take place by acquisition of stock in the parent corporation and that the acquisition of interest in a particular country facility is no more justified than is the acquisition of stock in a separate operating division in the United States.

Fourth, decisions are often made on the basis of established relationships with businessmen in a given area—the combination of exporter and distributor to establish a manufacturing plant in the latter's home country being most common. In the heavy industries such relationships are rare since the product is newer to the area and because larger firms have relied more heavily on their own sales organizations.

Fifth, big companies see little benefit in the capital saving aspect of a joint venture and are more concerned with the profit potential. They also complain that the only contribution a national can make is intangible since their own patents, brand names, experience, et cetera are so valuable that no amount of Central American financial or managerial contribution can match them. The indigenous partner's contribution of political, cultural, and social influence, plus some knowledge of local markets, they believe, becomes less valuable as they themselves become more acclimated to and accepted within the area. At the same time the value of the American's contribution grows with the expansion of his product line.

The internationally integrated firm does find it useful to acquire a local partner when it is entering into a new phase of operations. A large petroleum firm sought Central American participation when it initiated a fertilizer plant. A chemical firm has entered into a joint venture for its first overseas oil refinery.

Sixth, U.S. firms tend to follow worldwide policies regarding joint ventures—either yes or no. Where legal or practical requirements are made of them they will accept local equity participation. They are prone to accept local partners when they buy into a going concern. Such purchases are more common in the light goods industries traditional to the area—cigarettes, food processing, and baked goods for examples—for they are most likely to arouse local criticism of takeover by foreigners.

Seventh, the American firm is hesitant to accept a minority position in an investment. When he does, he often is granted a management contract. Alternatively, if he wants only a small interest, licensing arrangements are commonly used in which he obtains a royalty from a Central American firm and markets for his supplies and equipment.

Finally, the value of a local partner in reducing political risks is often overrated. In Cuba, for instance, Cuban participation in many enterprises did not provide an effective guarantee against expropriation by Castro. Personal relationships, too, cut both ways. One's local partner may move easily in government circles with one regime, but he is likely to be out of favor with the next.

The U.S. investor sees clearly two sides to the joint venture issue. It is quite possible that he cannot find a local partner who is able to make an effective contribution to the enterprise's success. Although a joint venture means less capital is required it also means a smaller share of potential profits. It provides additional managerial resources, but introduces problems of cooperation. It provides useful governmental connections, but governments change. Generally, they are still distrusted by conservative management although extremely hostile attitudes are rare. The totally negative comments on joint ventures came from firms who had no experience with them. Acceptance of them is found in direct proportion to the confidence one has in his Central American partner.

THE ROLE OF THE U.S. GOVERNMENT

The U.S. Government is concerned with the creation of stable, reasonably democratic governments friendly to the United States. Economic development, besides its humanitarian appeal, is therefore important to us because we believe that it provides necessary, though certainly not sufficient, conditions for the emergence of such regimes. Our Government recognizes that private investment is an indispensable tool in our foreign aid program and also that the presence and behavior of American-owned firms has been and continues to be a major factor in shaping not only economic, but also political and social environments and attitudes toward this country.

The Government takes the general position that it supports U.S. investors in underdeveloped areas as long as they recognize the legitimate conviction of foreign governments that U.S. investment is to be made primarily for the benefit of their countries and only incidentally to benefit the entrepreneur. Within this framework and because we realize that a richer world and a richer Central America is in our own best interest, the Departments of State and Commerce and their field staffs are working to channel and promote the flow of U.S. private investment into activities that foster efficient growth for Central America. Even President Johnson's recent request for voluntary curtailment of foreign investment as a balance-of-payments measure excluded Central America and other less developed regions.

A variety of means—grants and loans to governments and private parties for high priority projects, reduced taxation on certain foreign investments, and clarification of our antitrust legislation—are employed to this end. In addition, Commerce and AID offer a broad array of informational services to guide potential investors—data on trade, financial and industrial structure, labor, transportation and commercial regulations, and detailed catalogs of specific opportunities are published regularly. Finally AID shares the cost of feasibility surveys undertaken by private parties to explore possible investments and provides protection against political risks which have prevented or discouraged American investment in the past.

Space limitations do not permit an analysis of all these factors so instead I wish to examine only one—the guarantee program—and then offer some general findings as to the role played by the U.S. Government in promoting private direct investment in the area.

The investment guarantee program

The protection of merchants, industrialists, and investors operating overseas has traditionally been a keystone of U.S. foreign policy. Lately this policy has received a new and special type of emphasis in the form of AID's specific risk investment guarantee program. The program which has been operating since 1948 insures investors against the inability to convert foreign currencies received as earnings and against losses attributable to expropriation or confiscation, war, or revolution. It does not offer a guarantee against failure to make profits, devaluation, losses on commercial loans, or any other normal business risk.

To obtain this insurance a firm must be "substantially beneficially" owned by U.S. citizens (ordinarily this means 50 percent or more) and both AID and the government of the nation in which the investment is being made must give their approval. Because the program's goal is to facilitate and increase private participation in the development of less developed lands, guarantees are not available for existing investments but only for new enterprises or additions, expansions, or major changes in existing facilities. Both new and used materials may be eligible and patents, processes, techniques, and services are often calculated as part of one's contribution. There is no restriction upon the size of investments which might be guaranteed and investors are under no obligation other than to submit information surrounding the nature of their projects to both governments and pay an annual premium. This premium is the same for each type of guarantee and each country—currently one-half of 1 percent annually for each type of coverage desired initially and one-quarter of 1 percent for coverage taken on a standby basis. The standby amount is the difference between the current investment and some maximum investment which may be covered in the future. An investor may not increase the maximum amount of coverage after the contract is executed—he may only increase the amount of current coverage at the start of any contract year up to his maximum level.

In the 5 countries, 29 firms had been issued 99 separate guarantees totalling $54.6 million at the end of March 1965.[33] This amount of course, exceeds the face value of the investments covered for there is in the system double and triple counting. For instance, if a firm has invested $100,000 and insured it against inconvertibility, expropriation, and war risk, its guarantees total $300,000. In El Salvador four firms had taken just nine guarantees. In Guatemala, where AID had counted 107 firms (exclusive of individuals engaged in agriculture) with direct investments as of April 1, 1964, only 4 firms had taken 7 guarantees totaling just over $3 million. A year later, March 31, 1965, when presumably the number of firms investing in the country had risen somewhat, there were still just the four firms with their seven guarantees. More than $41 million of the $54.6 million total were concentrated in Honduras and Costa Rica and over two-thirds of these guarantees were in bananas and banana-related activity. Quite simply, then, I was interested in learning why, in a period of significant investor activity and political instability, especially in Guatemala, was the program largely being ignored by U.S. investors? Does this mean that the program lacks applicability to the area?

Investors in underdeveloped countries are concerned that a shortage of foreign exchange may develop and preclude them from obtaining dollars for dividends, principal, or other payments from investments. A questionnaire asking participants at a recent Columbia University conference to list specific impediments to U.S. investment abroad is most interesting. The most frequent reply was "lack of assurance of free convertibility of capital and profits into dollars"—mentioned by 79 percent of the respondents. The next reply, "general political, social, and economic stability" was received in only 44 percent of the questionnaires.[34] AID's convertibility guarantee assures that an investor can secure U.S. dollars for local currency at 95 percent of the rate at which exchange transactions would have been effected at the time the investor attempted to convert.

The problem appears to be real and the guarantee formidable. It is, in fact, true that convertibility is a prime concern to the investor, yet it does not pose a problem in Central America. The investor makes sparse use of this guarantee because he is not hindered by Central American exchange controls. From time to time, the countries have introduced controls as a method of restricting the importation of nonessentials and permitting the importation of capital and intermediate goods without creating severe balance of payments problems. They have caused concern, but have not posed any serious obstacle to normal business operation.

In Costa Rica, Nicaragua, and Honduras there are no restrictions. In El Salvador and Guatemala all currency acquired from outside and that which is remitted must be registered with exchange authorities, but only in Salvador is a limit imposed. This limit, 10 percent per annum on investments, does not hinder the new investor for rarely is he remitting at that level and even if he is exceptions can be authorized.

Under international law, if a government takes one's property or repudiates its contracts with a businessman so that his operation is materially damaged, compensation is due. International lawsuits can, however, be both lengthy and inconclusive. The second major type of insurance available from AID is against

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[33] U.S. Department of State, Agency for International Development, "A Cumulative Report of All Specific Risk Investment Guarantees Issued Since the Beginning of the Program in 1948 Through March 31, 1965."

[34] Columbia Society of International Law of Columbia University School of Law, Conference on U.S. Trade and Investment in Latin America, Proceedings (New York, June 1963), p. 284.

loss due to expropriation or confiscation. After the investor has taken "all reasonable measures" to preserve his claim, our Government compensates him. In turn, the insuree transfers the claim to the U.S. Government and the United States sues the foreign government in the World Court.

The fact of the matter is that substantial numbers of investors in the CACM do not fear expropriation or confiscation just as they do not fear inconvertibility and for a variety of other reasons do not make use of guarantees even when they do acknowledge that insurable risks do exist.

The first reason that explains the nonuse of the program, then, is that investors simply do not see the risks. In Cuba, not a single guarantee had been issued at the time of Castro's takeover. A vice president of Pan American Airways has expressed a common view:

"The major problem is that of defining the risk * * *. Creeping expropriation is the difficult thing. It is fairly, although not always, easy to identify when you are unable to convert your currency, and it is ususally easy to identify when somebody has just taken property. But when discriminatory measures are applied, identification of legal rights is harder, and the insurance schemes * * * do not provide very much protection in that area * * * .. The best protection against the most difficult problem of foreign investors, creeping expropriation, is not legal * * * . It is more a practical problem of knowing the temper of the people who are trying to impose these restrictions and keeping abreast of them."[35]

The general feeling of businessmen in Central America is that the role played by this program—in fact, the role played by all our Government's programs for investment promotion—is slight. The obstacles and impediments they encounter rarely have reference to factors over which our Government has control. Some did mention tax laws and inconvertibility as areas in which the U.S. Government might have some influence, but its importance is seen as minuscule when contrasted with that exercised by the national governments of the area.

Closely related to nonrecognition of risks and uninsurability of recognized risks as limiting considerations is the widespread feeling that if a country is subject to these dangers, it is not a favorable place for investment anyway. Central America does not constitute a large enough market for major firms to justify their entrance in the face of severe uncertainty. The general feeling among these firms and their smaller counterparts is that "if you need the insurance, do not bother investing."

A common complaint is that coverage is too limited. For equity investments the maximum amount of the guarantee generally cannot exceed 200 percent of the dollar value of the original investment. Businessmen argue that this cannot adequately compensate for the loss of time, effort, or markets. The worth of a going concern will, in fact, usually exceed the original investment by a greater percentage than this. Investigations completed by Prof. Jack N. Behrman support this claim, for he found that the market value of direct U.S. investments abroad is, on the average, three times the book value.[36]

The prohibitive cost of the program was a fifth factor mentioned, but exclusively by small investors. They believed that the premium was too high in view of the good record of the area. Several large corporations mentioned that they were able to get cheaper, more comprehensive insurance privately when their home office insured on a worldwide basis. As I mentioned above, the cost of each guarantee is the same in each country. This is an unusual way of computing premiums and criticism of it should be expected. Our brief experience with Government insurance, however, gives no clue as to what ultimate losses might be as a guide for evaluating probable risks. Varying fees will have to await their justification before implementation.

Although many persons feel that fees should be reduced in order to popularize the program, never were fees alone mentioned as the reason for nonuse. A much greater number of interviewees opposed the idea of lowering the cost on the grounds that unsound operations would be encouraged. These answers reflect a mistaken conception of the extent of the insurance that is granted, but, also, a strong conviction that it is the responsibility of foreign, not the U.S. Government or taxpayers, to create a suitable investment climate.

Here, then, is a sixth limiting factor—one of principle. Businessmen do not want Government help or control. A more precise phrasing would be that businessmen do not want Government help when they feel it might invite some

[35] Ibid., pp. 97-98.
[36] Little, app. A, p. 8.

governmental control over their business. An investment guarantee application requires approval and at least superficial oversight by not only one, but two governments. This only makes the situation worse. A good deal of sophistication is found among U.S. businessmen in the area. Rather than urging stronger Government support in the protection of contractual obligations, protection against discrimination, and protection of property rights as is traditional with investors overseas, they are realistic in acknowledging changes that have occurred in the international situation. Businessmen know that the area has passed beyond the "big stick" period and when problems arise, they prefer to deal independently with host governments. A few complained that AID personnel overidentify with local interests and possess a negative attitude toward serving U.S. business, being interested only with "using" them without proportionate concern for their welfare but most accept this as AID's legitimate function.

Part of the desire to avoid contact with the Government of the United States stems from a general agreement that the commercial and economic sections of our Embassies are staffed with pleasant, slow-moving, nonexceptional, or even particularly knowledgeable gentlemen enjoying their stay in Central America. Their regard for AID personnel was higher but not very great. Contact between these groups was almost completely social.

Another consideration is time. Processing of the applications is slow and cumbersome. Entrance into the market ahead of competition is a prime motivation and investors do not wish to wait until they have secured a guarantee before proceeding. An investor will very often begin construction and perhaps apply for insurance just as he will often begin construction and apply for incentives, but in either case he regards these items as "gravy," not necessary inducements. After decisions are made, based on other factors, one might make use of insurance as a useful convenience. More often he will ignore it.

An eighth limiting factor is ignorance. Roughly one-quarter of the businessmen interviewed were either unaware of the program or had only heard of the program and were just vaguely familiar with it. Still others failed to understand its scope and applicability.

The final explanation might be the attitude of the host governments. The present Government of Guatemala has issued a ruling—and that a negative one—on only one application which it has received in 2½ years. All the guarantees in effect in that country were issued prior to August 1962. Nationalism, as mentioned earlier, is a stronger force in the Guatemalan case than elsewhere. The Government is concerned with protecting Guatemalans [37] and believes that by assuming an obligation to repay foreign firms for losses from expropriation, and so forth, it is doing more for them than it can do for its own citizens. Guatemalans are not covered by such a scheme and, therefore, would face greater risks than would foreigners. Greater risks mean higher returns demanded and higher prices necessitated. However, at higher prices, Guatemalans could not be competitive and the benefits of industrialization and integration would tend to flow out of the country. The Government, too, it has been suggested is extremely honest and sincere and, consequently, unwilling to undertake an obligation that it feels it may not be able to fulfill; it admits the instability of its control and the possibility of takeover by a government that may, in fact, expropriate and ignore the guarantee treaty. There may be some plausibility to this argument, but the author prefers the other explanation.

One might expect that this policy of doubt and inactivity would lessen Guatemala's appeal in a period of Castro, the Dominican crisis, and active terrorist activity. Especially one would contend that firms making substantial investments in petroleum refineries would demand guarantees against expropriation. It is difficult to imagine a more likely target for a revolutionary government. Yet one U.S.-owned petroleum company just began operating a new refinery whose cost is estimated at $10 million and another is engaged in an expansion involving an outlay of $4 to $5 million. Both of these investments are being made without guarantees. The regional manager for the first explained that they applied for the guarantees, but they were neither concerned nor expectant of Guatemalan approval. If these firms and their counterparts in El Salvador, Nicaragua, and Costa Rica (Honduras has no refinery) do not need guarantees, who does?

It is true that I did not interview any firms that may have stayed out of the CACM because they could not secure guarantees. Perhaps such firms do exist,

[37] Another example of Guatemala's emphasis on protection of nationals is a law, unique to the area, that requires that all advertising material, written or spoken, be produced in the country.

but in 3 months of research I was never referred to one. The firms whose applications were still pending had apparently gone ahead with their plans in any event. Neither did I learn of a firm that had made its Common Market investment outside of Guatemala because of that Government's policy.

For a variety of reasons AID's specific risk investment guarantee program was ignored by companies of all sizes and types. What does this mean?

It means that action taken by our Government is only one of the many elements affecting the character of a country's or the region's investment climate. The central consideration affecting this climate is the prospect of profits. In most instances someone who has decided to make an investment because its prospects seem good, learns during his preliminary negotiations that some protection is available. In many cases, though in far fewer than with tax incentives, he seeks this insurance. The guarantees may provide an additional incentive in an area where political instability is traditional, but they alone will not induce an American to invest irregardless of how badly a government might wish this investment to be made.

The signing of a bilateral investment treaty, like the enactment of a development law, does not automatically increase the amount of capital attracted because other considerations—the desire to preserve a market, faith in Central America's long-term prospects, and personal inclinations—are more important. Still, legal means are useful in effecting some improvement in investment climates. By investing in Central America, one subjects his capital to future alterations in local political and economic conditions. Therefore, even though a change in legal conditions will not be sufficient to attract U.S. investors, it can make a given situation more attractive. The more certain the investor can be of his future, the less reason he has to believe that an unfavorable political situation will seriously undermine his investment, the more likely he will be to initiate or expand operations in an area. Thus, legal guarantees given by the United States and Central American Governments cannot fail to have some favorable results in stimulating investment. Their influence, however, must be of far less importance than one would first believe.

CONCLUSIONS

The principal finding evident from this paper is that all investments are individual cases which vary with the type of industry, experience in the area, company size, individual inclinations and desires, and a large number of commercial and legal factors. Certainly, most important is the reaction to each factor by the man or men who possess the ultimate power of decision. Each potential investor may weigh differently each factor in any decision and any single factor can be the one that eventually sways a decision. While any factor can alter a decision, generally speaking, some factors are considerably more crucial than others.

The most important single factor is the discovery, maintenance, or expansion of a profitable market. A negative finding here will negate any other inclination toward investment. For most investors, this market is a small, proven, and growing one.

Economic and political conditions must permit development of this market. Currency should be stable and convertible. A system, too, under which entry into the potential market is blocked or whereunder the advantages granted an entrepreneur might be nullified by future legislation is most discouraging. Faith in the continuity of governmental policy of the sort exhibited in Costa Rica is another important consideration which is weighed heavily when evaluating alternative locations. Attitudes toward Americans significantly affect profit potential. Do a country's past or present policies indicate that it really wants American know-how and capital?

Capitalism with its emphasis on profits is often placed on the defensive in academic discussions. Many Americans and Central Americans expect international business to be of a nonprofit nature, assuming a vast responsibility for social welfare in the areas in which it operates. We must recognize that the businessman's first obligation is to keep his enterprise strong and growing. Of course, the profit motive is capable of misuse, but it does offer tremendous potential for the furtherance of economic development in the CACM and the investor must not be unnecessarily handicapped in his work. In this same vein Leland Johnson has written:

"To leave the level and allocation of private investment to the dictates of market forces carries the danger that some business will not operate in a manner consistent with United States or Latin American interests, but the greater the level of government imposition and direction, the greater the danger that the valuable characteristics of private decisionmaking will be lost." [38]

Instead of being restricted excessively, the businessman should only be reminded that a business' growth depends upon raising the standard of living in the area which it serves. It is as wise for him to devote considerable attention to this objective as to the pursuit of greater efficiency in production and distribution.

The U.S. investor in Central America is not greatly concerned with abstract political and social theories. In most cases, democracy is not as important as a reasonable degree of political stability and a promising market. He fears socialistic trends and programs and looks for higher profits for he believes that the risks of doing business in Central America are greater than those at home.

He worries occasionally about fluctuations in exchange rates and currency problems for he wants to be able to transfer the profits he does not reinvest and repatriate capital when he chooses. He understands the historical image of the U.S. investor—the fruit companies are always cited—and realizes that he is doing business in the face of rising nationalism. This means that he is more willing to reinvest and less concerned with merely withdrawing dividends. It means, too, that he is more concerned with his image, that he is beginning in a small way to take a responsible part in the social and cultural as well as the business life of his host community and assume the same community service function that he performs in the United States: to sponsor magazines, symphonies, baseball teams, scholarships, and nurses' training programs. He knows his Government is not defending overseas assets from expropriation or confiscation and that these functions constitute a sounder form of insurance.

He seeks a feeling that he is welcome and will be accorded treatment equal to that received by nationals. Increasingly, he prefers joint ventures as a means of avoiding being singled out as somehow different from other businessmen. Often he follows a policy of restrained competition—the practice traditional to the area. He does not push every advantage because his competitors are strong politically and to ruin them is bad politics. Fortunately this policy is disappearing as Central Americans themselves adopt more aggressive techniques and attitudes.

He wants his enterprise to be rooted in the local community and as a manufacturer he obtains locally as many of the components that he profitably can. If the means of producing them are not developed, he occasionally encourages them financially and technically. He observes national laws more closely, pays taxes more honestly, pays higher wages, and provides better working facilities than his Central American counterpart because he is used to doing so and because he recognizes that he is a political target. He is anxious to use a local work force, supervisors, and managers to the greatest extent possible for economic as well as community relations motives. He accepts incentive benefits but believes that his business should be based on the economics involved rather than such artificial inducements.

The role of the U.S. Government in promoting and channeling private direct investment is only slight. The businessman prefers to work alone—if he is small he is likely to make considerable use of Government-provided information; if he is large, he will have and prefer his own sources.

I have not considered statistically the influence of private foreign capital on various aspects of Central American life such as conditions of employment, increases in income, improvement in the standard of living, and so on. It is true, however, that traditional investment which has contributed substantially to the improvement of the region's payment situation and the level of employment has not exercised a catalytic effect of great importance to the economy. In contrast, investment stimulated by the creation of the Common Market can be used in this manner.

Foreign capital should be used as a magnet to attract and supplement indigenous private capital. The former must not become a substitute for the latter. It must only supplement, encourage, and strengthen private indigenous investment. Therefore, as a policy, private U.S. capital should be discouraged in those sectors where its participation is becoming less necessary, such as public services, and encouraged in such fields as manufacturing and tourism, always judging its importance principally in terms of the mobilization of internal resources into productive activities and increasing self-sufficiency.

The scale of operations required in the CACM is suited to small- and medium-sized investments. Although many of our largest firms will remain uninterested because the market is too small to support efficient units of the size they nor-

[38] Johnson, p. 71.

mally operate, many firms are likely to acknowledge the potential of the regional market in contrast to five small separate markets and consider establishing plants in the area. In particular, Central America is well suited to the investor interested in beginning international operations on a small scale and in an area close to the United States. This type of newcomer, too, will be better suited to and more interested in joint ventures which lessen the danger of foreign domination and allow nationals to participate more freely in the benefits of development than is his larger American counterpart.

Presently, receptiveness to foreign investment is greater within governments than amongst businessmen and the populance as a whole,, We should expect that in some 10 to 15 years, when a sensitive period of transition is further along, these attitudes of the latter groups will liberalize and foreigners will find it even easier to enter and to displace inefficient local manufacturers. At the same time, Central Americans will demand larger roles in basic, complex, and technical industries from which they are now largely excluded. American businessmen will find it wise, even now, to give up a few percentage points of control to satisfy these claims.

Throughout this paper many suggestions have been made as to what might be done to induce Americans to enter into and expand operations in the area. In final summary, I merely wish to outline in general terms what further steps Central Americans might take if they wish to capitalize fully on American resources and interest in the market:

1. Development and acceptance of foreigners must be established as clear-cut national policies in fact as well as in word. Governments must work to create widespread public understanding and acceptance of these policies.

2. They should adopt liberal domestic fiscal and monetary policies and programs which will tend to generate more even distributions of income and widen markets. Included would be more strongly graduated income tax structures and greater expenditures on education, especially in the rural areas.

3. They should strive to develop the economic and industrial infrastructure—basic service and communications networks to unite the area, industrial banks and capital markets, improved warehouse, distribution, and credit facilities, a more highly qualified labor, managerial, and entrepreneurial force. Especially important are improved port handling facilities and feeder roads into undeveloped agricultural and forest areas.

4. At the same time, governments must strive to control their debt burdens and inflation which can upset monetary stability and necessitate undesirable exchange controls.

5. They should make laws' primary goal the stimulation of domestic investment. If laws are good for indigenous businessmen, they will be accepted by foreigners.

6. They should recognize that an attractive investment climate cannot be created by law alone. In fact, it is possible that excessive laws and regulations may have a serious countereffect.

7. They should simplify procedures under which industrial classifications are made and take measures to insure that benefited firms began to integrate backward by using increasing percentages of local goods and resources.

8. On a regional level they should develop an autonomous promotional agency along the lines of INFONAC and INSAFI. Special emphasis should be placed on attracting the smaller firm which is likely to be less familiar but more suitable to the area.

9. Full support should be given to the more than 40 regional institutions and agreements and all future efforts to reduce fragmentation for it is the progress made towards integration that has attracted new investors to the area and is beginning to shift the balance in the type of American investment found in Central America.

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APPENDIX IX

List of Organizations Referred to

ADELA	Atlantic Community Development Group for Latin America
AID	Agency for International Development
ALAMAR	Latin American Association of Ship Owners
CABEI	Central American Bank for Economic Integration
CACM	Central American Common Market
CEMLA	Center for Latin American Monetary Studies
CIAP	Inter-American Committee on the Alliance for Progress
CICYP	Inter-American Council for Commerce and Production
CITEL	Inter-American Telecommunications Commission
DAC	Development Assistance Committee
ECLA	Economic Commission for Latin America
EEC	European Economic Community
EFTA	European Free Trade Association
EPU	European Payments Union
FAO	Food and Agricultural Organization of the United Nations
GATT	General Agreement on Tariffs and Trade
GRATEL	International Telecommunication Union, Planning Committee for Latin America, Permanent Telecommunications Working Group
IA-ECOSOC	Inter-American Economic and Social Commission
IBRD	International Bank for Reconstruction and Development
ICA	International Cooperation Administration
ICAITI	Central American Institute of Research and Industrial Technology
IDB	Inter-American Development Bank
ILAFA	Latin American Iron and Steel Institute
ILAPES	Latin American Institute for Economic and Social Planning
IMF	International Monetary Fund
INFONAC	National Development Institute (Nicaragua)
INSAFI	National Institute for Industrial Development (El Salvador)
ITU	International Telecommunications Union
LAFTA	Latin American Free Trade Association
OAS	Organization of American States
OECD	Organization for Economic Cooperation and Development
OEEC	Organization for European Economic Cooperation
ROCAP	Regional Office, Central America and Panama
SIECA	Central American Economic Council, the Executive Council of the General Treaty, Permanent Secretariat
SPTF	Social Progress Trust Fund
UNCTAD	United Nations Conference on Trade and Development