

CEPAL

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Notes and explanation of symbols

The following symbols are used in tables in the *Review*:

Three dots (...) indicate that data are not available or are not separately reported.

A dash (—) indicates that the amount is nil or negligible.

A blank space in a table means that the item in question is not applicable.

A minus sign (-) indicates a deficit or decrease, unless otherwise specified.

A point (.) is used to indicate decimals.

A slash (/) indicates a crop year or fiscal year, e.g., 1970/1971.

Use of a hyphen (-) between years, e.g., 1971-1973, indicates reference to the complete number of calendar years involved, including the beginning and end years.

Reference to "tons" mean metric tons, and to "dollars", United States dollars, unless otherwise stated.

Unless otherwise stated, references to annual rates of growth or variation signify compound annual rates.

Individual figures and percentages in tables do not necessarily add up to corresponding totals, because of rounding.

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A new integration strategy

*Carlos Massad**

The Great Depression of the 1930s and the Second World War engendered an inward-directed growth process in Latin America, the continuance of which was later spurred by the important interests that grew up in connection with the region's industrial production. The exhaustion of the import substitution process at the national level triggered a new intellectual effort to seek appropriate development strategies; thence arose the interest in economic integration which acquired great imperus from 1960 onwards. Integration enjoyed considerable success in terms of the expansion of trade among the countries participating in the various schemes, and mechanisms were soon added which helped to save foreign exchange in the financing of regional trade payments.

The change in external circumstances, however, led countries to reconsider their production strategy and to embark upon a phase of opening up their trade to the rest of the world. In this setting, integration, conceived as a means of strengthening import substitution, became an obstacle to the new strategy. Integration is going through a crisis.

Curiously enough, this crisis is occurring in Latin America just when current trends are showing that the world of the future will be a world of huge economic and financial conglomerates. The countries of Latin America cannot subsist if they confront this situation as separate units.

It is indispensable to begin giving careful consideration to a new integration strategy: outward-directed integration. This consists in making the whole process of intra-regional liberalization negotiations, of approximations to a common external tariff and of co-ordination of economic policies functional to the objective of facing up to external markets.

*Principal Expert, Joint UNDP/ECLAC/RLA/87/003 Project Module II: "Finance for Development". Lecture given by the author at the Institute for Latin American Integration.

As part of a development strategy based on industrialization and on the strengthening of their home markets, in the 1960s the Latin American countries began to put economic integration devices into practice. Their efforts stemmed from the traumatic experiences of the Great Depression in the 1930s and of the Second World War.

In consequence of the Depression, the Latin American countries found themselves short of resources to pay for their imports, much less repay their debt. The Latin American countries' debt paper came to be negotiable in London at about 16 cents per dollar, on an average, and the countries' repurchases of it around 1936 and 1937 were made at similar prices.

I

Inward-directed development

The world had not fully recovered from the Great Depression when the Second World War paralysed supplies of machinery, spare parts, durable consumer goods and other products coming from the United States, Europe and Japan.

It is not to be wondered at, therefore, that the Latin American countries turned their gaze inward to look for supplies of all the types of goods needful for their development. Moreover, in order to keep the existing stock of capital in operation, in some way or other the indispensable spare parts and replacements had to be produced, a necessity which prompted production efforts in that direction. There are always some who mistakenly regard these efforts as irrational and inefficient behaviour, instead of as a real requisite for survival.

These inward-directed development trends, imposed by circumstances rather than by desire, were strengthened by the fact that as from the second decade of the present century, for long stretches of time the movements of Latin America's terms of trade were unfavourable. Observation of this fact, together with recognition that demand for services grew faster than demand for products, led to the formulation of the theory

that the terms of trade would tend to deteriorate for Latin America unless and until the countries of the region managed to incorporate services in their raw materials, or, in other words, unless and until they reached more advanced stages of industrial processing of their basic products.

Thus, while analytical thinking pointed towards industrial processing of raw materials, external conditions compelled the Latin American countries to look within themselves for supplies of a wide range of producer and consumer goods. These two factors in conjunction meant that development efforts in respect of the structure of production were focussed on satisfying the requirements of the domestic market, often in replacement of imports which in any case could not have been obtained from outside the region, either for want of resources or because of the limitations set to supplies by the war.

Here it seems to me extremely important to distinguish between the thinking of Latin American economists around the middle of the century, and the effect of external circumstances on the region. The theories formulated at the time reached the conclusion that some degree of industrial processing of our basic products was essential. They did not conclude that inward-directed development was desirable. This latter feature of development strategy was enforced, first by circumstances, at least until the end of the 1950s, and secondly by the interests that grew up around the region's industrial production, an important source of employment and of generation of public and private income.

Protectionism and emphasis on import substitution were imposed, not by the Latin American thinking of the day, with Raúl Prebisch at its head, but rather by force of circumstances.

II

Inward-directed integration

The heavy cost of sustaining this process after the rest of the world economy had normalized its production and the transport problems created by the War had been resolved led to rapid exhaustion of the opportunities of growth by way of import substitution. This prompted a new intellectual effort directed towards a search for development strategies which, by taking maximum advantage of the existing structure of production, could create additional employment and growth opportunities. Thus came the dawn of interest in economic integration, which would make it possible to broaden the market for the region's manufactures, facilitating the exploitation of economies of scale. Import substitution would thus be carried out on a regional scale, whereby the national costs of substitution strategy would be drastically reduced.

The year 1960 saw the birth of the Latin American Free Trade Association (ALALC), restructured in 1980 as the Latin American Integration Association (ALADI), and the Central American Common Market came into being. In 1969 the Andean Integration System was

established, within ALALC, and then in 1973 the Caribbean Common Market (CARICOM) was created. Among the countries members of CARICOM the Organization of East Caribbean States was set up in 1981.

These integration efforts were extraordinarily successful in terms of the expansion of trade among the member countries. Between 1960 and 1980 the countries members of ALALC had raised the value of their reciprocal trade 20 times over, whereas their trade with the rest of the world had increased only tenfold. An even greater success was scored by the countries members of the Central American Common Market: trade among them had been multiplied by a factor of 40, but that with the rest of the world only by a factor of nine. In the case of the Caribbean Community, their reciprocal trade had reached a level 17 times higher, as compared with an increase in their total trade by a factor of 10. As for the countries of the Andean Group, representing probably the most impressive case of trade expansion, they had enlarged their reciprocal trade fiftyfold, as compared with an

increase only by a factor of eight in their exports to the rest of the world.

This rapid trade growth was encouraged by machinery which made it possible to save extraregional foreign exchange in regional trade payments. The establishment of the Central American Common Market Clearing House in 1960, of the ALALC Payments and Reciprocal Credit System in 1965 (in the conception and launching of which I had the honour to take part) and of the Caribbean Multilateral Clearing Facility in 1977, made it easier for reciprocal credits to be conceded by the participant countries, for clearance of reciprocal payments as long as these were kept within the credit limits agreed upon.

The most important of these payments agreements, that of ALALC/ALADI, showed an increase in clearing balances from US\$31 million in 1986 to US\$1 648 million in 1981. Total operations transacted through the Agreements rose from US\$106 million in 1966 to US\$9 331 million in 1981, a sum which represented 83% of total inter-member-country exports. To finance this export total, which amounted to US\$11 200 million in the latter year, it was necessary to transfer foreign exchange only to an amount of US\$2 500 million, equivalent to the clearing balance plus advance transfer payments on operations which exceeded the agreed credit limits.

III

The 1970s: a change in national strategies

This resounding triumph of integration, however, was not a lasting success, capable of withstanding adverse external conditions and even providing an adequate development dynamic. While external conditions were favourable, integration forged steadily ahead, although generating increasing imbalances within each system. In the case of ALALC/ALADI, for example, in 1981 the unfavourable balances of countries in deficit totalled a little more than US\$2 700 million, while Brazil recorded a surplus of some US\$2 500 million, representing 91% of the cumulative deficits.

Progress in the liberalization of intraregional trade operations, in its turn, became increasingly difficult, and the targets set up in the original ALALC agreement could not be met. Countries found that given the circumstances prevailing towards the end of the 1970s the time had come to reconsider their production strategy and to embark, more or less aggressively, upon a phase of opening up their trade to the rest of the world. The integration organizations reached a crisis; their institutions were weakened; some countries began to reconsider their membership of specific systems, and one country withdrew formally from a particular integration scheme in which it had participated.

It looked as though the external financing bottleneck had been relieved, so that it had become possible to run risks in respect of economic openness, relying upon the cheap and easy financing provided by the expansion of the Euromarkets.

By the end of the 1970s the strategic approach had undergone a change: it was now a matter of each individual country's seeking integration with the outside world rather than with its neighbours, and financing the process with external indebtedness.

In response to the new situation, integration commitments were made more flexible or simply allowed to lapse. ALALC became ALADI, with commitments much more in keeping with the real circumstances prevailing at the end of the 1970s. In some Central American countries discussion began to see around their own development strategy: a discussion in which the integration commitments assumed figured as a constraint on development rather than as a basis on which to sustain it. Efforts to create a common currency which should be more than a mere accounting unit of little economic importance failed or were shelved.

IV

The 1980s: the crisis

It is in the context of a review of objectives and strategies such as this that the devastating effect of the debt crisis on integration efforts can best be understood. With the emergence of the debt problem, the causes of which have been analysed at length, intra-regional trade suffered far more than world trade, since many countries immobilized the payment of their trade balances under clearing agreements. By 1987, the operations transacted through the ALADI Payments and Reciprocal Credit System had dropped to practically one third of those recorded in 1981. In the case of the Central American Clearing House, the total value of operations transacted by it sank from US\$780 million in 1981 to barely US\$30 million in 1987.

Trade among the ALADI countries declined from US\$11 300 million in 1981 to US\$7 600 million in 1986; while that of the Andean Group decreased from US\$1 260 million to US\$690 million. That of the Central American Common Market was reduced to half in the same period, and by 1986 that of the Caribbean Community countries had shrunk to little more than 40% of what it had been in 1981. For the Latin American and Caribbean countries as a whole, the percentage of intra-regional trade in total trade dwindled from nearly 17% in 1980 to a little over 10% in 1985, a figure comparable only with the proportion of intra-regional trade in total trade recorded in the first half of the 1960s, more than 20 years before.

The trade financing machinery of the subregional integration organizations had a limited degree of support in secondary subregional financial mechanisms. The Santo Domingo Agreement, the Andean Reserve Fund, the Central American Common Market Fund, while they did play some sort of role, were quite insufficient to allow of normality in trade payments. The Latin American Bank Acceptances (ABLA), perfected in 1976, failed to gain a footing in the external financial markets, in face of the abundance of other forms of financing. The external trade financing programmes of the Inter-American Development Bank and the credits

issued by the Latin American Export Bank (BLADEX), by reason both of their characteristics and of the amounts they represented, produced no perceptible effect. Nor have the renewed efforts to establish currencies of subregional or even bilateral or trilateral acceptance prospered hitherto. The general climate is far from benign for integration.

The member countries of the various integration groups are seeking bilateral arrangements and global exclusions from operations under payment agreements, or, in other words, are trying to get out of the latter with a view to keeping up some level of reciprocal trade and ensuring trade payments by other means. Bilateral arrangements under ALADI between 1982 and 1987 amounted to almost US\$2 000 million and their global exclusions to some US\$700 million. Since 1983 the Santo Domingo Agreement has been usable only for possible renewals of loans extant in 1983. In that same year the Caribbean Multilateral Clearing Facility reached the available credit ceilings, and it has completely ceased to operate up to the present. Only the Andean Reserve Fund has succeeded in significantly enlarging its resources, both through increases in capital and through deposits by the central banks of the member countries, and is planning further steps to extend its range beyond the limits of the Andean Pact.

I must lay stress on my conviction that the problems generated by the debt crisis did no more than aggravate the difficulties of the integration process, which had already been making themselves felt towards the end of the 1970s. When the countries of the region as a whole have to hand over to the rest of the world, in little more than six years, net financial resources totalling US\$150 000 dollars, it is not surprising that payments difficulties among them should arise. What is more remarkable is that apparently the Latin American countries have been more prepared to default in the case of intra-regional trade payments than in that of trade with the rest of the world. This is merely

an additional indication of the difficulties by which the integration process was already beset even before the debt crisis.

To grow costs, foreign exchange, and intra-regional trade, while saving it, does not provide it. Every percentage point of growth of the gross domestic product costs, on an average,

US\$1 800 million in imports. The open-trade policies pursued in the recent past by many Latin American countries have made the region increasingly vulnerable to fluctuations in world markets. The burden of this vulnerability tends to be borne by trade with the neighbours, as the available figures show.

V

External financing prospects

Yet another factor creates new uncertainties. The economy of the industrialized countries is now in the sixth year of a steady process of recovery, probably the longest spell of uninterrupted economic growth since the end of the Second World War. Flows of capital or credit into Latin America, however, have not recovered. There seems to have been a structural change in the direction of capital flows in the world, brought about by the United States' great fiscal and balance-of-payments current account disequilibria. These imbalances are financed with external borrowing or foreign investment from Europe, Japan and even the Latin American countries themselves.

World economic growth beneath the influence of such large-scale disequilibria is ultimately bound to undergo an adjustment process which will be more or less traumatic according to its pace. In the course of this adjustment, unfortunately, the peripheral countries will once again see their foreign trade affected, since the imbalances on the deficit side will probably tend to be corrected faster than those on the surplus side in the industrial countries, so that part of the adjustment will be forced on to the less developed countries. This is only another way of representing the fact that the process of world economic adjustment is subject to significant asymmetries, materialized either through the influence of the multilateral credit agencies or through the force of circumstances themselves.

The change in the structure of capital and credit movements is most directly reflected in the immobilization of flows of financing into the

Latin American countries. The international financial system, both private and multilateral, has followed a procyclical line of conduct, in exactly the same way as it has done in every major economic crisis since the beginning of the last century.

It is perfectly understandable that the private international financial system should take this procyclical line. It is perfectly true that banks, by their very nature, have to protect the interests of their depositors and shareholders, and in their view they protect those interests best by withdrawing their loans when their clientele as a whole is exposed to an increase in risks.

On the other hand, it is neither understandable nor admissible that the multilateral financing agencies, whose duty it is to watch over the smooth functioning of the world economy and world trade, should behave in the same fashion. Both the World Bank and the International Monetary Fund are withdrawing net resources from our region, with the consequent aggravation of the external financing problems that are afflicting our countries. Both agencies seem to be making efforts to avert this negative effect, but hitherto those efforts do not appear to have been successful. If an increase in the resources available to these institutions is hampered in its use by the very constraints prevailing today, such an increase is of no interest, in my view, for the purposes of promoting growth and resolving current problems.

The object of these remarks is only to stress that in present circumstances it does not seem

that any substantial relief of the region's financial difficulties can be hoped for by way of a larger supply of fresh resources from the outside world. In contrast, increasing emphasis must be

placed on the need to seek a more drastic solution to the debt problem, while intensifying the exercise of all our bargaining capacity to broaden our external trade prospects.

VI

Latin America and the rest of the world

Curiously enough, the crisis in our integration schemes is occurring at the very time when the rest of the world is substantially strengthening its own. The European Economic Community is advancing towards a common market to be perfected in 1992. The United States has concluded a comprehensive trade agreement with Canada. The Soviet Union and the countries of Eastern Europe are making rapid headway in a process of decentralizing economic decisions, introducing direct incentives at the enterprise level and reducing central control and State planning. This means that the Soviet Union and the COMECON countries are establishing a reform of their economic system which will enormously facilitate their trade with the West. It would not be surprising if in the fairly near future these countries were to seek formulas for closer co-operation with the European Common Market.

Albeit integration is gaining strength in the more developed areas of the world, the methods and strategies there pursued are not necessarily the most appropriate for our countries. There are profound differences which will compel us to seek our own paths.

As early as 1938 about 30% of Western Europe's total trade was intra-regional. This figure, which had somewhat decreased in the years immediately following the Second World War, had been completely regained by 1955.

The United States are in themselves a vast common market, and trade among the States of the Union greatly exceeds United States trade with the outside world.

In both instances, the currencies of the countries themselves constitute foreign exchange which is more or less readily acceptable on the world market. This facilitates the creation of common currencies, since their backing is sufficient for them to command, should it be so desired, a broad international market for their circulation and use in transactions.

In Latin America's case, intra-regional trade is a small fraction of total trade, and our countries' currencies, often affected by rates of inflation that spiral up *ad absurdum*, have no hope whatever of constituting the basis for a common currency in international use.

The narrowness of our markets means that import substitution, even at the regional level, quickly reaches its limits. Furthermore, the nature of the negotiations which have to be conducted in order to obtain tariff reductions in inter-Latin American trade, as well as to forestall other forms of protection, leads to the laying of emphasis on counterpoised rather than on common interests. Negotiation itself thus becomes an obstacle to integration.

Nor is that all. In the struggle to gain external markets for our exports, with the aim of obtaining foreign exchange, integration commitments become a handicap. Thus, the commitments assumed are often evaded by means of ingenious formulas; or at least, new commitments are avoided that might place at risk a country's capacity to employ all its instruments in the conquest of external markets.

VII

The "super blocs"

Does this mean that we should abandon all interest in Latin American integration? Must the present difficulties really make us throw overboard the political idea that inspired the Liberators 180 years ago?

These are questions of such importance for the future of Latin America that they must be studied with the utmost care and objectivity. I cannot claim to make such a study here, but I should like to establish certain facts which in my view constitute a clear pointer to the nature of the reply.

The first fact I have already mentioned. European economic integration is making giant strides, and relations between the resulting systems and the COMECON countries may well become increasingly close. China and India, in their turn, are growing fast. The total population of these two countries numbers 1 800 million persons, whose per capita income today averages some US\$300 at 1984 prices. At the growth rates they are currently attaining, their per capita income will rise six times higher in 25 years, forming a total gross product on the same scale as that of the United States and Canada together at the present time. In 1984 the two last-named countries, with almost 280 million inhabitants, had a total product of US\$3.8 thousand billion. The market economy industrial countries of Europe and the countries of Eastern Europe form a conglomerate of 750 million persons, with a total product of US\$4.5 thousand billion. Japan, which is also growing at a very rapid pace, has 120 million inhabitants, with a gross product of over US\$1.5 thousand billion.

Such are our probable trading counterparts in the world of the future. Latin America, with a population of some 400 million inhabitants, will be unable, disunited, to face up to next century's super-blocs. If it tries to do so, it runs the risk of being, at least commercially and culturally, absorbed.

Nevertheless, our integration strategy seems to have reached a crisis. We do not cooperate with one another, often not even to the extent of giving information. The efforts made by our integration organizations often encounter limited interest on the part of governments, which is absolutely understandable in view of the external circumstances that undoubtedly will continue to prevail for several years more.

At this point, I should like to revert to the brief historical review appearing a few pages back in connection with the emergence of Latin American thinking and action in the field of integration.

Integration was originally conceived as a way of promoting inter-Latin American trade in order to permit the broadening of the market for production and sale of import-substituting goods. In other words, it was "inward-directed integration", just as development strategy had in its day been "inward-directed". The integration style outlived the development style, and this probably explains why the integration crisis began even before the debt crisis. For progress to be made in integration, as Gert Rosenthal, Executive Secretary of ECLAC, has pointed out, integration commitments must be seen by the formulators of national economic policy as functional to development objectives.

VIII

A new integration strategy: outward-directed integration

If we look into the future, I do not doubt that the economic frontier of Latin America will be found outside rather than within the region. Much yet remains to be done within our countries: vast masses of their population are still right outside the market fringe. Perhaps 40% of the Latin American population is poor or extremely poor. In many countries the debt crisis has caused a reduction of per capita income, which has especially affected the more defenceless population groups. Development with justice, an imperative requisite for peace, will be imposed by reason or by the force of circumstances. The continent's democratic governments are seeking it by the light of reason; dictatorships are defeated by hard facts.

Development with justice will not be enough, however, if our countries attempt to face the super-blocs of the future alone, as separate entities.

Hence my belief that it is indispensable to begin giving careful consideration to a new integration strategy: outward-directed integration.

The idea is not a new one. Many have already posited the need to co-operate in some respects: the management of the debt, certain Latin American multinational enterprises. My own proposition is more ambitious. It comprises a systematic search for all possible forms of co-operation with a view to penetrating external markets, resolving financial problems, progressing in the technological field, taking advantage of economies of scale, joining up our external purchase and sales capacities, and thus confronting, united, the huge economic blocs whose formation is already under way. It consists in making the whole process of intra-regional liberalization negotiations, of approximations to a common external tariff, of co-ordination of economic policies, functional to the objective of gaining a foothold in external markets.

As an economist I cannot allow my own ideals to stand in the light of objective thinking. I cannot pretend that this will be easy. But I do

believe that it will be much simpler to find common interests in respect of tackling external markets, and to make them the springboard for our integration efforts, than to go on wearing ourselves out in exhausting and unproductive discussion of how to reconcile our desire for openness to the rest of the world with the constraints that seem to be imposed upon us by the strategy that has prevailed in the past.

Neither can I say that such a change of strategy will be painless. The common effort to penetrate into external markets may often mean renouncing the frequently fallacious belief that any one of our countries can obtain better terms from our financial and commercial partners in the exterior by itself than through any form of co-operation. The reorganization of production will necessitate giving up some items and raising the production standards of quality and regularity required.

The recent Meeting of Presidents at Punta del Este is a clear indication that it is possible not only to meet at the highest level, but also to devise mechanisms whereby concrete proposals can be formulated to pave the way for the necessary political decisions. The difficulties which we are facing in the fields of trade and financing, and which show no sign of easing up, are a spur to the adoption of such decisions. Our crisis of today may be turned to account in constructing our strategies for tomorrow.

In the field of integration, "outward-directed integration" strategy implies strengthening our productive efficiency, our technological capacity, our financial machinery and our bargaining power.

Where productive efficiency is concerned, domestic policies play a decisive role. The tax system must be overhauled in order to prevent the generation of incentives or disincentives which careful social valuation does not warrant. The financial system must be modernized so as to tap and efficiently utilize the savings that must be the basis of development financing in

the future. There must be implacable insistence on efficiency in State activities, to prevent transmission to the rest of the community of excessive costs representing simply waste. Workers must feel themselves participants in the social and economic development process, to avert unsustainable social tensions. Care must be devoted to macroeconomic equilibria, to forestall the need for violent adjustments which distort the whole process. In this last respect, outward directed integration strategy implies close co-operation among the developing countries to secure indispensable changes in the international monetary system which may limit the negative effect on our economies of the economic policies pursued by the industrial countries. Otherwise, in so far as this proves impossible, we shall once again suffer new debt and external financing crises in the future. But by then patience will have been exhausted.

Strengthening our technological capacity entails special concern for education at all levels, for research in enterprise and university alike, for information as to what is going on in other centres. It may often happen that the scale of work required for making headway in technology exceeds the potential of some of our countries individually considered. Here, multinational laboratories in the region might make a contribution of great importance to technological progress, while at the same time generating common interests to galvanize the integration process and make it irreversible.

A first requisite for strengthening our financial machinery is to strengthen institutions. It is highly probable that we need to concentrate talent in a few institutions to plan their operations and means of increasing their resources. The Inter-American Bank covers the area of public and private investment projects financing and, to a very limited extent, includes commercial financing for exports. But the field of the Latin American commercial banks is completely open. Perhaps the commercial banks of the region, both public and private, might co-operate in establishing an entity to cover matters relating to the region's commerce, perhaps using as a

basis the Latin American Export Bank (BLADDEX). A regional banking institution in the field of trade might attract more external resources than we are obtaining today or, at least, internalize some of the commissions which we have to pay at present on operations of this kind.

The idea is not to displace the traditional commercial banking system, but simply to supplement it with a regional co-operation effort designed to seek additional resources that any single one of our countries will have difficulty in attracting by itself.

Lastly, strengthening our bargaining capacity means looking for ways of producing and bargaining jointly, for the purposes of buying and selling whatever we need. Here too multinational corporations in the region may play a very important role, and governments should encourage the formation of enterprises of this kind. An initial field of regional collaboration, however, lies in the current Uruguay Round, where close co-operation among our countries may obtain much better results than could isolated action.

These ideas call for very careful analysis. I should not discharge my responsibility as an academic and an international civil servant if I did not attempt to call attention to the changes that are taking place in the world economy and to the need of not giving up our integration efforts and seeking new strategies which may improve our chances of success in the next century. Failing these, history may well show us once again that frontiers afford much weaker protection than we suppose today. I do not know whether there is a single frontier in the world that has not undergone some change in the last 100 years. Empires have been dismembered; countries have disappeared and others have been created; important territories have changed hands. In the world of the future, face to face with the super-blocs that are already beginning to take shape, Latin American integration may be not only an instrument of economic growth, but also the basis of collective survival. This and nothing less is the challenge which in my opinion lies ahead of us today.