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INTRODUCTION

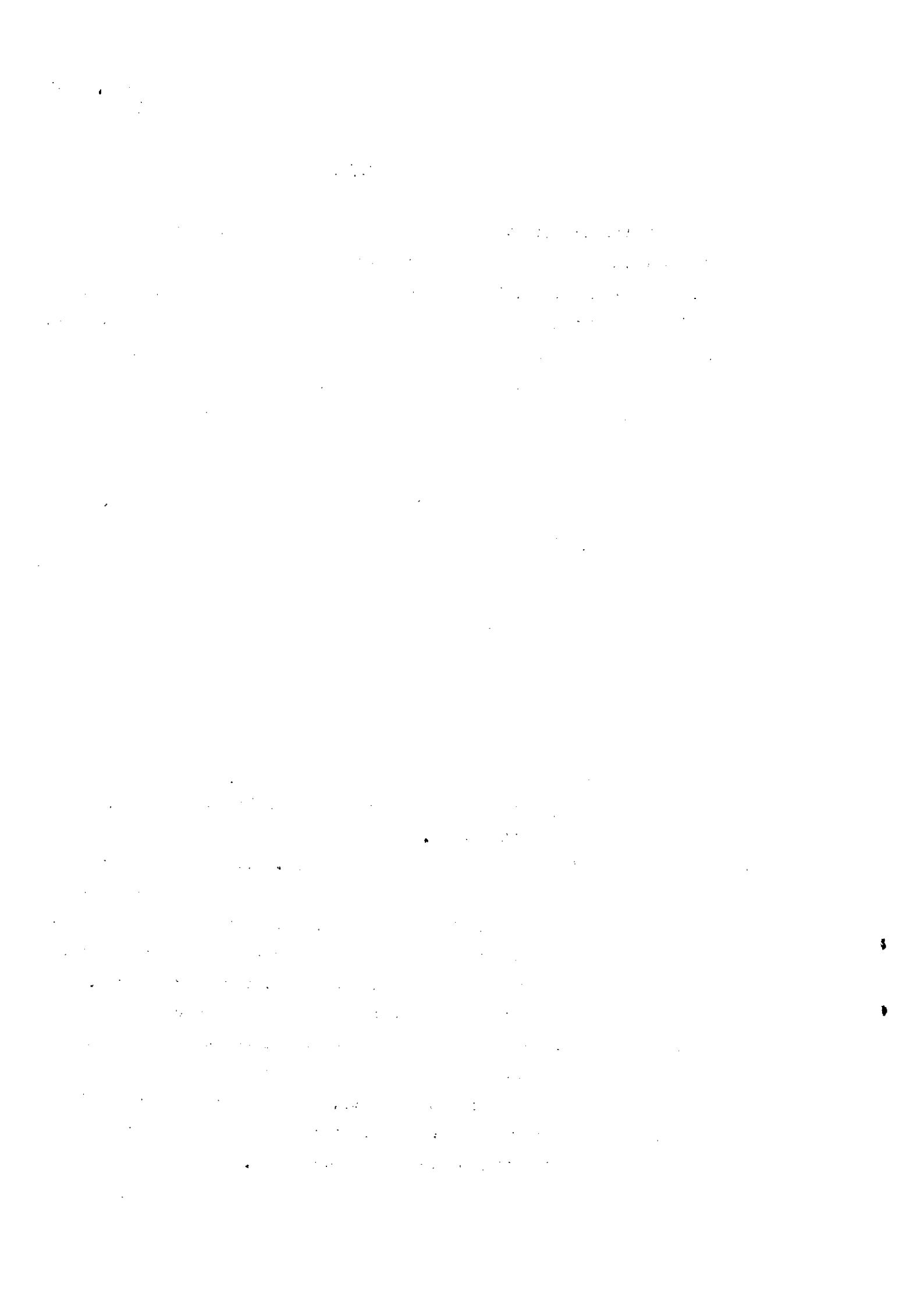
For over fifteen years, ECLA has been contributing to the creation of the two regional movements currently represented by the Central American common market and the Latin American Free-Trade Association. It has at all time followed up the programmes of both institutions with interest, has noted their admirable efforts and has co-operated with them to the full extent of its abilities and resources.

Today, awareness of the urgent need to accelerate the region's economic integration process is spreading throughout all sectors in Latin America; and with that end in view, new decisions will obviously have to be adopted, to supplement what has already been achieved. If these are to crystallize, the first prerequisite is a full conviction on the part of the Governments that to press onward is an imperative necessity.

The purpose of this document is to elucidate some of the problems at present constituting obstacles on the road to the common market, and to put forward a few suggestions as to how the region might more vigorously forge ahead. The ECLA secretariat had begun to analyse these difficulties some years ago. In the light of the experience acquired in the course of Latin America's economic integration movements, which has pointed up the limitations attaching to a mere free-trade area, it has been possible to consider new measures that might quite reasonably and feasibly be adopted in the immediate future.

The subject is complex and controversial. It is ECLA's hope, however, that the ideas and suggestions propounded here may serve to promote a discussion at the technical level which will help Latin America to translate into terms of practical action its anxiety to devise an economic integration formula, as an indispensable requisite for its future development.

The ideas in question reflect the motives of concern expressed during recent years in various circles, including the integration institutions themselves. Many of them will need further elaboration before they can be recast in the form of actual commitments. The aim of this document is precisely to offer a systematic presentation of the material that might provide a basis for such studies and negotiations.



Chapter I

ECONOMIC INTEGRATION IN RELATION TO THE DEVELOPMENT
OF LATIN AMERICA1. The tardiness of Latin America's development

In the twenty years that will shortly have elapsed since the end of the Second World War, Latin America's rate of development has been slow and fluctuating, and in vast areas of the region has so greatly slackened that average per capita income has increased only by 50 per cent in that length of time, rising from a minimal figure of 280 dollars to its present modest level of 430 dollars. Unless the trends that have thus evolved in the first half of the sixties are modified, the average per capita income of the 600 million inhabitants that Latin America will have at the end of the present century will be only about 650 dollars, and even if the growth rate registered in the last fifteen years were outstripped in the future, would not exceed 850 dollars.^{1/}

This slow rate of development, which entails such unsatisfactory material and cultural living conditions for the broad masses of the Latin American population, is thrown into sharp relief when it is borne in mind that such an average income - which, in default of radical reforms, could be expected to materialize only by the end of the century - represents no more than one-fifth of that currently enjoyed in the United States and little more than half the corresponding levels in Western Europe and in the USSR, while it is also lower than the figure registered in many other private-enterprise countries and centrally-planned economies. These gaps are bound to widen considerably, for while the Latin American countries in the aggregate have attained an annual growth rate of barely one per cent, the other regions mentioned are developing two or three times as dynamically,

^{1/} Data expressed in terms of 1960 prices. During the first four years of the present decade, average per capita income in the region as a whole increased at a cumulative annual rate of one per cent. In the interval between 1950 and 1964 the corresponding growth rate was 1.5 per cent.

/quite apart

quite apart from such examples of exceptionally rapid expansion as are afforded by Japan and some of the centrally-planned economies. Thus, while Latin America took twenty years to raise its average per capita income by 50 per cent, the members of the European Economic Community achieved the same relative increase in under ten years, while the other areas referred to did so in less time still, after having already completed an arduous phase of post-war reconstruction.

Moreover, in its cultural and material living conditions Latin America will go on lagging still farther behind on account of the wide disparities currently existing between its income levels and those of other areas. A 4 per cent increase in income in the United States enables its 192 million inhabitants to expand their consumption, on an average, by 55 dollars per capita; in Latin America, when income rises by 5 per cent, the per capita increment in the consumption of the region's 230 million inhabitants averages only 5 dollars.

These various data testify to the slowness and inadequacy of Latin America's development, and to the region's failure to participate in the economic expansion that is taking place in vast geographical areas of the world.

While it is true that particular characteristics, such as the high rate of population growth, help to retard per capita development, and that special circumstances, which have arisen in the past and still persist in some countries, at times permit more rapid spurts, it is equally undeniable that the experience of the past twenty years affords plenty of evidence of the difficulties attending Latin America's development, and that the foregoing comparisons of national income indexes reflect the truth of this picture of the region's backwardness in relation to the world at large, which becomes yet more marked when future development prospects are considered.

The contemplation of these problems, and the comparison of Latin America's experience with that of other countries, makes it very clear that the region has not succeeded in establishing the economic and social conditions required for the development of a mode of economic growth whose

sources of dynamic energy are permanent and powerful enough for the desired objectives to be attained. A great deal is being done of late at both the national and the international level; but, at the same time, the limitations imposed upon Latin America's development by the policy of the industrial countries with which the region has trade and financial links have been and still are stringent. Nevertheless, the question may well be asked whether it does not lie with the Latin American countries themselves to adopt the strategic decisions that may help, again at both the national and the international level, to prevent a delay of thirty or thirty-five years before the region can attain that modest per capita income of 650 dollars, which will still be accompanied by its train of unemployment, under-productive jobs, and minimal levels of living for fifty per cent of the Latin American population.

In secretariat documents and at the sessions of the Commission, ECLA has repeatedly discussed the problems of Latin America's economic development and the essential features of the policies that should be pursued. But it will not be superfluous to analyse a few points in the present document, which once again signposts regional economic integration as the only possible path for Latin America to take at this stage of its development.

2. The present stage of development and the need for regional economic integration

The problem of Latin America's development could be summed up by compressing the reciprocal economic and social relationships involved in its mechanics into the following terms. The low average income in Latin America is determined by the failure of the national economies to develop as dynamically as is needed not only for full utilization of their available manpower and material resources, but also for the assimilation of technical progress, which is an indispensable requisite for the improvement of productivity. Many obstacles which the region has not had the skill or the power to circumvent have hitherto prevented the establishment of the conditions required for such a process.

/The world

The world depression of the thirties and the policy applied by the industrialized countries disrupted the pattern of development that the Latin American economies had been following. Some countries were severely affected, while others were able to cushion the depressive impact by measures which later came to shape a new economic policy. Provisions which to begin with were primarily directed towards correcting the balance-of-payments deficits, and mitigating the effects of the fall in world market prices and the contraction in exports of primary commodities, spurred on an import substitution process which acquired major importance as time went by, and in many countries became one of the objectives of a deliberate industrialization policy. In practice, this process constituted the dynamic factor in a new growth pattern, and its repercussions made themselves felt in the economic and social changes that characterized one phase of Latin America's development.

The economic variables representative of this growth pattern are well-known: a long-term downward trend in the ratios between foreign trade and the domestic product, and expansion of the industrial sector's share in the formation of that product, and a striking change in the composition of imports. If the existing situation is compared with that prevailing in 1928-29, the statistics for the region as a whole show that the import coefficient has rocketed down from 30 to 9 per cent and the export coefficient from 31 to 14 per cent, while industry's contribution to the domestic product has risen from 13 to 23 per cent. Furthermore, the proportion of imports represented by consumer goods has dwindled from 46 to 18 per cent, while the share of intermediate products, fuels and capital goods has climbed from 54 to 82 per cent.

The industrialization process has not taken place in all the Latin American countries simultaneously, or at the same pace. The geographically or economically smaller countries - i.e., the majority - were slower to decide upon adopting this policy, and in many of them exports have continued to play the leading dynamic role in the growth process and in determining the economic situation. At the present stage of the region's development, the various countries display such marked disparities that they can be graduated in accordance with those economic ratios that indicate differences of structure, income levels and degrees of industrialization.

At one extreme, a relatively advanced stage of industrial development and low import coefficients are found in Argentina, Brazil and Mexico, especially in the first two. Close to them, although with special characteristics of their own, come Chile and Colombia. At the other extreme are the less developed countries such as Bolivia, Ecuador, Paraguay and most of those of Central America, where as a rule export and import coefficients are still high. Venezuela exemplifies a different type of economy, which developed quickly on the basis of petroleum exports and has been undergoing a rapid metamorphosis in recent years.

Despite these differences, all the countries have pursued a very similar policy as regards the conduct of the import substitution process, and all have continued to export primary products. In effect, the Latin American countries that are smaller in size or relatively less developed are embarking upon industrialization or proceeding from one stage to another through the same channels that were used by the more developed countries some time ago. Only recently have certain changes begun to creep in, with the initial integration efforts of the ALALC countries and the more trenchant decisions that are being adopted in the integration movement of the five Central American countries.

The purpose of the present chapter is to discuss some essential aspects of over-all development policy, especially those relating to the evolution of the external sector, in order to see how far it is contributing to the establishment of the basic requisites for an acceleration of the Latin American countries' economic growth rates which will enable them to make up their leeway. It is a matter of evaluating the possible alternatives that may present themselves, given existing conditions in respect of the national economies and of international policy, with the aim of defining the role that integration will have to play as an instrument of Latin America's development.

While it is no easy matter to make such an evaluation for the region as a whole, because of the marked differences among the Latin American countries, the experience of recent years unquestionably provides adequate grounds for certain basic inferences in the light of which Latin America's current development problem can be stated in reasonably accurate terms.

/The countries

The countries that made most progress in import substitution, reducing their import and export coefficients, witnessed a slackening of their growth rate as time went by, and have found themselves faced with serious difficulties as they approach later stages of development. This state of affairs has arisen in Argentina, Brazil, Chile and Colombia, although in different circumstances and periods. Mexico is the only one of this more advanced group of countries in which industrialization has continued intensively in recent years, thanks to peculiarly favourable conditions, but here too potential limiting factors exist, of the same type as those hindering the continuance of the process in the other countries.

The decline in the growth rate also affected the group of countries at less advanced stages of industrial development, whose economic development patterns were still comparatively open to the outside world. In their case, the fluctuations of external demand or purchasing power were reflected in the marked instability of the rate of development, which decreased from the mid-fifties onwards. The improvement registered in the economic situation of many Latin American countries in the last two years is attributable to the rise in export prices for primary products - which in turn must be largely ascribed to factors that may alter over the very short term or are, already undergoing modification - rather than to changes in the basic conditions upon which development traditionally depends.

Within the complex of factors and events that have been particularly influential in weakening and slowing down the rate of economic growth, attention must be drawn in the present over-all analysis and in the context of the topic under discussion, to those relating to the conduct of the import substitution process and those which have maintained and aggravated the external bottleneck in the Latin American economies.

Although the import substitution process was a fundamental dynamic factor in the development of what are now the most advanced countries, and is playing a similar role, in conjunction with external demand, in those that are relatively less developed, it has had virtually no influence on the diversification of Latin American exports. The countries of the region have continued to rely on their exports of primary products, while the industrialization process, under the aegis of a strongly protectionist régime, has been confined within the narrow bounds of domestic markets.

/In these

In these circumstances, the Latin American countries have been unable to solve the problem of their balance-of-payments deficits. On the one hand, exports have suffered considerable losses through the deterioration of the terms of trade and external purchasing power has remained stationary or increased very slowly. On the other, the substitution process has altered the composition of imports, but has not reduced the aggregate volume of external supply requirements, which, on the contrary, has tended to expand with the growth of income and of demand for the items not replaced by domestic production. External financing has covered balance-of-payments disequilibria, for given periods, and played an active part in the import substitution process, but the terms have tightened increasingly, so that the rate of economic growth and the further continuance of the substitution process itself have become unduly vulnerable to the vicissitudes of the balance of payments.

Two other features of this policy are of great significance for the region's development problem. They concern the economic productivity of the substitution process and the implications of dependence upon exports of primary products.

The economic yields of import substitution activities have fallen short of the levels they might have reached had a rational industrialization policy been applied. The process has been carried on at relatively high costs, partly imputable to excessive and indiscriminate tariff protection, and through an industrial organization which has failed to attain normal standards of efficiency, partly because the markets are too small for advantage to be taken of economies of scale and specialization in important branches of industry. At the same time, as exports have continued to depend upon primary commodities, foreign trade has not transmitted to the Latin American countries all the dynamic impetus that might have been expected of the intensive economic expansion registered in the industrialized countries. In short, the assimilation of technical progress has been held up and the improvement of over-all productivity impeded.

Obviously, if the region is to regain this lost ground, some means of rapidly expanding domestic production and increasing the efficiency of Latin America's economic organization must be devised. To that end, institutional reforms must be introduced, and the technical progress and high /productivity indexes

productivity indexes of contemporary industry must be assimilated. This is impracticable, as events are demonstrating, if the policy of industrialization within the narrow confines of individual country markets is persistently adhered to, and if foreign trade is circumscribed to primary products. It is indispensable, therefore, to expand trade flows and gradually to establish a diversified structure of production, demand for which will transcend the bounds of the national markets and, in addition, will mean that imports can be increased.

A solution of this kind is hardly conceivable if each individual Latin American country - including the most advanced within the region - makes a defenceless stand against the powerful industrialized countries and the still more powerful regional and political groupings they have formed. The developing countries have neither the resources nor the technical ability to compete with others even in the developing areas themselves, much less in the industrialized regions. And in so far as they might be able to do so, experience is showing that they would encounter very strong opposition.

The only way, therefore, is to establish a gradual integration process conducive to the economic union of the Latin American countries. By this means, the national economies would be enabled to take advantage of the region's resources and potential, and organize their activities, at much higher levels of productivity than at present, on the basis of a market of 230 million inhabitants, increasing at one of the highest population growth rates in the world. They would thus have found the means of remedying their present cramped foreign trade situation, in which their development possibilities are tied to the fluctuations and poor sales prospects encountered by their primary production on the industrialized countries' markets.

Given the existing position in respect of production techniques and international economic policy, regional integration appears to be the only efficacious formula for the creation of new dynamic stimuli and a new national growth structure, more flexible and more productive than that afforded by the substitution process. This thesis must not be interpreted as the expression of an alternative policy or of a policy sufficient in
/itself, since

itself, since the integration process cannot be put into effect unless at the same time national development programmes are carried out, trade with other regions reaches specific levels, and adequate technical and financial co-operation is forthcoming from abroad.

It will be useful, therefore, to analyse the arguments in favour of integration more thoroughly, and demarcate more precisely its place within the framework of integrated national development policies.

3. Development problems and the role of foreign trade

It has been shown that the bottleneck in the external sector has been a very important cause of the low productivity and the lack of dynamic force, displayed by the Latin American economies. It must not be inferred, however, that policy has only to concentrate upon surmounting this obstacle. Latin America's development problem is much more complex, since other economic and social factors and conditions, which have not yet been tackled, or at any rate not thoroughly enough, have combined with external difficulties to keep the Latin American countries in the rearguard of the world economy. Although these factors are all too well-known, it is worth while to restate them here in order to show the reciprocal relationships that link them with foreign trade and with the approaches to regional integration that are formulated in the present document.

In the first place, attention may be drawn to the general limiting factors relating to the efficiency of economic and social organization, and still subsisting because of the slowness with which the structural and institutional reforms required by an up-to-date and progressive society are being introduced. Immediate manifestations of this state of affairs are the lack of social mobility and the extreme inequity of property and income distribution; these factors in turn determine the stagnation of the social structure in many countries, low levels of living, deficient training and organization of human resources, and the constant frustration of economic growth incentives.

Secondly, there are other limiting factors more closely linked to economic policy and market size. Thus, the want of internal and external competition in national economic activities has led to monopolies and
/restrictive practices,

restrictive practices, which in turn have had repercussions in the shape of the concentration of ownership, ill-advised allocation of resources, under-utilization of production capacity and higher costs. At the same time, the small size of the individual country markets, which may not have been a serious obstacle in the early phases of industrialization, has made it impossible to reap the benefits of economies of scale and of particular degrees of specialization, and affords no incentives to the continuance of a dynamic investment process, especially in the relatively less developed countries of the region. Furthermore, the slow progress made in the organization of planning systems precludes sufficiently rapid implementation of efficacious policies, execution of plans and formation of investment absorption capacity.

Thirdly, something must be said of the more specifically economic factors. These are very numerous, but the following may be singled out as severely retarding the development of the Latin American countries: the under-development and stagnation of the rural economy, especially in the sectors producing for domestic consumption; and the public sector's lack of funds - resulting from inefficient tax systems and, in most countries, from the absence of proper financial machinery and institutions -, which hinders the execution of the infrastructure investment projects needed to encourage private investment in productive activities. In this context, allusion must also be made to the financial and monetary disequilibria manifested in the dizzy speed of inflationary processes whose harmful effects on the allocation of resources and the formation of savings finally culminate in the disruption of the conditions required for economic growth.

Fourthly and lastly, mention must be made of the limiting factors connected with the external sector. They derive from the inadequacy of external purchasing power, the deterioration of the terms of trade, the heavy burden represented by service payments on external loans and investment, the low levels of gold and foreign exchange reserves, the non-existence of a genuine policy of international financial co-operation, and the Latin American countries' insufficient bargaining power for the purposes of obtaining satisfactory trade and financial terms from the industrialized countries.

/The various

The various socio-economic conditions cited here as obstacles to development, and the limiting factors of a more specifically economic character, combine with the external bottleneck to weaken the rate of economic growth.

In several important respects, it would be difficult to draw a line between the facts that represent primary causes and the phenomena that might be regarded as their manifestations or effects. The operation of all these obstacles and limiting factors is inter-related. Thus, a policy which succeeded in removing internal obstacles would make for the improvement of external conditions, but a more flexible and easier balance-of-payments position would be needed to facilitate the implementation of reforms and the execution of over-all development programmes.

In these reciprocal relationships, the influence of the external sector is far-reaching and its operation, up to a point, autonomous, since its movements depend upon international market forces and on the policy of the industrialized countries, fields in which the Latin American Governments can exercise little control and take little action.

Moreover, the situation is unfortunate in that as long as the external obstacles subsist, it is very difficult to make a clean sweep of the limiting factors of an internal nature. The reason is that the development of Latin America is largely dependent on imports of essential goods, on the application of the technical progress that originates in the industrialized countries, and on financial co-operation from abroad.

It is worth while to cite a few aspects of development which will illustrate the strategic importance of the external sector. For example, even if the countries carried out the necessary reforms to promote an increase in domestic savings with the aim of augmenting real investment, these reforms could not be put into effect unless at the same time enough external purchasing power were acquired to cover the imports entailed by such investment. Progress in planning will unquestionably increase investment absorption capacity, but again, investment projects could not be executed without the corresponding imports of capital goods that some

/countries are

countries are not and may never be in a position to produce, because of the small size of their market or for want of technical know-how. In short, the implementation of a policy designed to improve the living conditions of the lower income sectors will encounter serious obstacles, if it proves impossible to expand imports, even in the case of actual consumer goods whose domestic production cannot immediately be developed.

To sum up, when the restrictive effects of the various factors are more thoroughly analysed, there will be no reasons for surprise if in many countries the obstacles deriving from the external sector should prove to be as serious as others, or even more formidable, in the sense that unless they are removed it will be impossible to surmount the rest.

Finally, this study leaves no room for doubt on one point. Development policy must attack on several internal and external fronts at the same time. Everything need not be done at once, for that will often be physically impossible. What is wanted is a strategy that will immediately tackle the more vulnerable points, among which the external bottleneck, alongside the need for internal basic reforms, has been plainly shown to constitute one of the most significant.

4. Long-term limitations of a policy of import substitution and external borrowing

(a) Chronic balance-of-payments deficits

The countries of the region have tried to get rid of the external bottleneck and stimulate economic growth by resorting more or less intensively to three basic measures: import controls and import substitution, external financing and the promotion of traditional exports or of new export lines.

For a number of reasons, both external and internal - among which a lack of planned policies or an excess of caution have been common -, little has been achieved in respect of the diversification of exports, and the Latin American countries have continued to depend in this respect

/on their

on their primary products. Policy has concentrated mainly on the restriction of imports and their replacement by domestic production, and on the utilization of external financing. It is in these sources that the larger countries have found the dynamic growth factors for which they had previously relied on exports. In the smaller countries, these factors have been combined, to a greater or lesser extent, with export movements, and as a result more stable development conditions have been promoted.

As time goes by, however, such a policy tends to lose its efficacy. Once the import substitution process and external borrowing reach a certain saturation point, extremely inflexible conditions are created that ultimately bring about a decline in the rate of growth. In the following pages the mechanics of this phenomenon will be analysed. The first step will be to study import substitution policy, with particular reference to the experience of the countries that have advanced farthest in their industrialization process, in order to draw generally applicable conclusions.

(b) Import substitution, economic growth and balance-of-payments equilibrium

The evolution of the import substitution process may conveniently be mapped out in several stages, although some rather arbitrary divisions are involved. An analysis of this kind is useful to clarify the effect of the process on the rate of growth and on balance-of-payments trends.

In an initial phase, import substitution develops in the sector producing non-durable consumer goods, where the production techniques employed are relatively simple and capital-intensity is low. It is comparatively easy to make the necessary investment and launch these activities. By their means, the growth of the domestic product and of internal income is directly and indirectly promoted, and employment levels are raised. External resources may help to finance investment. And the foreign exchange released or transferred by the restriction of imports of non-essential goods, and often of capital goods for other sectors,

/makes it

makes it possible for this phase of the substitution process to develop. The import coefficient decreases, and the dynamic effects on the domestic product and internal income are stepped up in so far as substitution activities are based on the use of domestic raw materials. It was precisely because a high proportion of their direct raw material inputs was available that this stage was facilitated in many Latin American countries.

The process continues in what may be demarcated as a second phase, when it extends to import substitution in respect of other consumer goods, including even certain types of consumer durables, branches of intermediate products and specific capital goods. The most highly industrialized countries of the region have completed this second phase, and several of the others are embarking upon it.

These new industrial activities use more complex techniques and require higher levels of technical know-how and more efficient organizing capacity. The ratio of fixed capital to output and the amount of investment per plant are higher, and economies of scale, or cost reductions in accordance with production levels, also acquire considerable importance.

The dynamic impetus of these activities is so considerable that they come to dominate the economic and financial process - as has been shown by the experience of Argentina and Brazil in recent years -, especially when the stage of installing the motor-vehicle industry is reached. Alongside these quantitative effects, there are others, no less significant, which influence development. This phase of industrialization involves the absorption of technical know-how and production techniques which raise the general level of training, organization and modernization in national economic structures.

But serious difficulties set limits to the economic soundness and hamper the advance of this process in the conditions attending it in Latin America. In the first place, their effects on the balance of payments must be considered.

/This phase

This phase is characterized by a marked substitution effort in respect of intermediate products, although there is an initial increase in requirements of imports of parts or spares which are not manufactured in the country, but are later gradually replaced by domestic production. In any event, as the volume of production in import substitution activities is usually greater than that of the former external purchases concerned, demand for imported parts and spares may very soon exceed the value of the goods that used to be imported. If the high import content of industrial plant is also taken into consideration, together with the additional demand for imported goods that is generated by the increase in the product and in income, it will be seen that in the upshot the volume of imports tends to surpass the original import substitution output.

Consequently, if there has not been an expansion of exports, the balance of payments will tend to become unfavourable or deficits previously registered will increase. Efforts to restrict imports of other items are then redoubled, but little is gained in terms of foreign exchange, since the restrictions that have long been in operation have gradually limited imports to essential goods. In all likelihood, these new import substitution investments may affect investment plans in other public or private activities through the shortage of external resources.

If in Latin America's experience these effects did not immediately make themselves felt, it was because the countries concerned resorted to external financing or because an important part was played in the substitution process by foreign direct investment, as was the case in Argentina, Brazil and Mexico. But the foreign exchange commitments under the heads of service payments and remittances of profits to which this external financing gave rise soon began to aggravate the balance-of-payments deficits.

In a third phase - upon which the most advanced countries of the region are now venturing - the import substitution process would have to cover basic intermediate products and various types of capital goods. The activities concerned are mainly of the type needing large-scale plant and heavy investment, and operating on the basis of complex technologies and high degrees of specialization, especially in the capital goods industries.

Table 1

TREND OF ALALC CONCESSIONS

Countries	First round	Second round	Third round	Fourth round	Total
Argentina	414	658	208	113	1 393
Brazil	619	631	62	52	1 364
Chile	268 <u>a/</u>	351	85	18	722
Colombia	343	490	31	8	872
Ecuador	-	1 714	<u>b/</u>	3	1 680
Mexico	288	319	120	82	809
Paraguay	520	69	76	19	684
Peru	227	72	56	12	367
Uruguay	567	43	54	<u>c/</u>	664
<u>Total</u>	<u>3 246</u>	<u>4 347</u>	<u>655</u>	<u>307</u>	<u>8 555</u>

Sources: National Schedules of the member countries of ALALC.

a/ Negotiated at the Special Conference held in February 1962.

b/ In the third round Ecuador withdrew certain concessions, thereby reducing the total to 1,677.

c/ Uruguay granted no new concessions in the fourth round.

/Development of

Development of these activities under adequate productivity and cost conditions and in line with up-to-date techniques will be difficult unless the policy of producing solely for the domestic market is drastically changed. A certain level of specialization and plant size is essential, which can only be achieved through expansion of trade. Moreover, the bottleneck in the external sector creates serious obstacles to the channelling of the real resources needed for these investments. There are no non-essential imports that can be restricted in order to divert foreign exchange into the new activities, the critical financial situation does nothing to encourage direct foreign investment, and new loans are increasingly spent on servicing the debts that have built up.

To sum up, the following conclusions may be drawn from experience gained in Latin America's import substitution process:

(a) Import substitution, at each separate stage, generated a strong dynamic impetus which has raised the national income and has decisively influenced economic and social development;

(b) The productivity and general efficiency of import substitution have fallen below the levels that might have been expected because import substitution was carried out indiscriminately under conditions of widespread de facto monopoly aimed only at a relatively small and unduly protected domestic market;

(c) In spite of the advances made in import substitution, the external imbalance was aggravated and the economies became more vulnerable to the vicissitudes of the balance of payments; and

(d) The rigidity to which the process has led explains the present decline in the rate of development and the frequent economic recessions suffered by the more industrialized countries of the region, particularly Argentina and Brazil. By contrast, industrialization has been able to forge ahead in those countries that have contrived to raise their current foreign exchange earnings, as in the case of Mexico, during the last few years.

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However, many of the Latin American countries are still in the early stages of industrialization and have fairly high import coefficients. There are practical possibilities open to them of reducing those coefficients and making some headway in import substitution, just as they are doing now. But it must be borne in mind that, in general, their domestic markets are far smaller in absolute terms and the obstacles to import substitution will arise at an earlier stage of industrial development. That is, even at different levels of industrialization these countries are now finding, or will soon find that the dynamic potential of import substitution has been exhausted. In other words, the economicity of import substitution activities, the obstacles to their subsequent development and the decline in their dynamic impetus are determined in these countries by conditions far more restrictive than those obtaining in the more advanced countries, because their domestic markets are much smaller and other impediments to development are more serious.

(c) External financing, rate of growth and balance-of-payments equilibrium

Foreign capital, in its various forms, is the additional source of funds to which the developing countries have access in order to finance the increase in investment needed to step up their rate of growth.

These external resources fulfil their dynamic role in the growth process if the conditions governing foreign investment, the movement of funds and the development of the economy making use of them, are clearly defined. Inflows should be sufficiently flexible and, in principle, should follow a given steadily upward trend. They should suffice to cover the mounting debt service and return on foreign investment, and possibly to provide a balance over a given period to finance the excess of imports over exports, which the country needs in order to increase the real resources upon which it can draw.

Moreover, there must be a rise in domestic income and savings as well as exports, so that, after a certain stage has been reached, the external accounts produce a surplus with which to cover, in some measure, the transfer payments deriving from debt servicing and returns on investments.

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While it is true that, in practice, economic and financial factors cannot act as freely as might be required, there is no doubt that this must be the pattern if external financing is to operate satisfactorily. In this respect, Latin America's experience in the last few years is very enlightening, since the critical financial situation affecting many countries of the region has been due precisely to the fact that those essential conditions were not met.

External sources of funds often lack the flexibility needed to feed a flow of capital that will meet the aforementioned aims. In practice, capital flows tend to dry up when a country's borrowing increases, and much more so should the outlook for the balance-of-payments position be bleak. The short amortization periods and high interest payable on a large volume of external financing to which the Latin American countries have recourse merely aggravate the position. In addition, the decisions adopted by financing centres may be affected by political factors, while at the same time national policy imposes limits on foreign participation in production activities.

In brief, if capital inflow fails to increase because of one of these factors, the time will inevitably come when transfer payments in respect of servicing and returns will tend to exceed new inflows. The higher the rates of amortization, interest and returns, the sooner this will come about. If capital flows are reduced and export earnings fail to increase sufficiently, the rate of economic growth will decline to the point of an actual recession, unless refinancing is secured on suitable terms.

This, broadly speaking, describes Latin America's experience in recent years. The increase in its foreign exchange liabilities under the head of service payments and returns gradually absorbed increasing proportions of the new capital inflows, and current foreign exchange earnings from exports either remained at a standstill or went up all too slowly. In other words, the necessary financial and economic conditions were lacking for a sustained dynamic evolution of the process of absorbing external loans and investment. This is obviously what happened, for example, in Argentina, Brazil and Chile.

/Two factors

Two factors added to the rigidity of the process: the restriction of imports to essential items, leaving no room for further retrenchment, and the effect of the deterioration in the terms of trade for primary products. The impact of the latter was so heavy that Latin America's losses exceeded the whole of the net external financing used by the region since the mid-fifties.

It may be inferred, therefore, that a policy which lays emphasis on external financing and import substitution but fails to expand exports tend to lose its efficacy, often within a relatively brief period. Nothing can be done to put matters right after they have reached a certain point, except at the expense of the growth rate.

There are two reasons for this: in the first place, import substitution in the Latin American countries has failed to reduce the over-all demand for imports; secondly, debt servicing follows a rigid pattern, being only partly dependent on the evolution of export earnings. Amortization and interest payments constitute fixed-term outflows while returns on foreign investment in local production or import substitution activities are comparatively high and depend upon domestic market trends. Export trends can only affect returns on investment in export activities.

Thus, the balance of payments of those countries which have made most headway in import substitution and in the use of external financing acquired a highly rigid real and financial structure. It was only when export earnings increased to some extent that the process could develop along fairly satisfactory lines.

5. Latin America's foreign trade deficit

In the present analysis of general development problems and the shortcomings of the policies applied in Latin America, the expansion and diversification of exports emerges as one of the most important aims. Accordingly, it would be useful to examine the practical possibilities open to the Latin American countries, taken individually, of achieving the aims for expanding their foreign trade, under existing conditions and based on the expected trends in the world economy.^{2/}

² This point was studied by the ECLA secretariat in Latin America and the United Nations Conference on Trade and Development (E/CN.12/693) and The United Nations Conference on Trade and Development: Analysis of the results and prospects for Latin America (E/CN.12/712).

From the technical projections made in relation to exports of primary products over the long term it does not appear that the Latin American countries can achieve the external purchasing capacity needed to meet the cost of imports and the servicing of the external financing required by a faster economic growth than at present. It is useful to remember that only in the early post-war years has Latin America attained a growth of 3 per cent per capita, thanks to highly favourable export conditions which in some degree recurred during the hostilities in Korea. On the other hand, notwithstanding the exceptional economic growth of the industrialized countries to which the region is linked, the last ten years have marked a gradual decline in Latin America's foreign trade, either because of the deterioration of the terms of trade or the slow growth of the volume of sales.

The improvement noted in the last two years has been due mainly to the higher prices caused by supply restrictions, which are now being largely adjusted, and not to an expansion in the volume of regional sales. Only a few Latin American exports - such as minerals - are expected to do better. Be that as it may, it is to be hoped that the concerted action adopted by the Latin American countries can bring about a change in the attitude of the industrialized countries which will prevent the existing conditions from worsening and might result in brighter prospects.

It is obvious, however, that not even under the most favourable conditions can the Latin American countries proceed with industrialization and ensure their future growth if they continue to be dependent on exports of primary products. If they propose to speed up their growth rate, the size of the deficit between their export earnings and their liabilities in respect of imports and service payments will be such that the gap will be hard to fill by means of additional external borrowing.

The Latin American countries will therefore have to find a way of pressing on with the process of economic and social change by creating an up-to-date industry which will produce for both the home and the export market. The question might be asked whether the Latin American countries would be capable, individually, of making the necessary investments and of competing with the industrialized countries on their home grounds and in the other parts of the world. While some encouraging samples exist in

/this respect

this respect, it is difficult to imagine that it can be done on the scale and within the span required by the acceleration of development. There are two implications illustrating the difficulty and, in certain respects, the physical impossibility of rapidly attaining such a target. First, the high production costs prevailing in Latin America and, secondly, the industrialized countries' reluctance to import manufactures from the developing countries.

It does not seem reasonable, therefore, to expect the Latin American countries to achieve those new forms of growth if they have to rely only on what the industrialized countries are prepared to grant them, either in respect of trade or financing.

On the other hand, if the Latin American countries formed an economic union they will have created the economic and political conditions required for them to achieve their objective of industrialization and trade expansion and would represent a powerful instrument for securing better terms from the industrialized countries.

6. Regional economic integration as an instrument of national development

(a) The contribution of integration towards eliminating the foreign trade deficit

Regional economic integration will contribute directly, and in two ways, towards eliminating the foreign trade deficit which is preventing the faster growth of the Latin American countries. On the one hand, it will expand intra-regional trade through new flows of manufactured products and increased trade in traditional products, and, on the other hand, it will facilitate the continuation of import substitution in respect of purchases from third countries.

During the course of this evolution, the coefficient of imports from the rest of the world can be reduced as required by the balances of payments, while that of imports from the integrated countries will soar. In fact, as the national economies forge ahead in the integration process, trade is stimulated by the co-ordination of policies, the reduction of customs duties and the elimination of other stumbling blocks or obstacles, and the preferences or agreements, entered into with a view to reserving the domestic market to investment from the integrated area tend to displace trade with third countries.

/It should

It should be borne in mind, however, that under existing conditions in Latin America the benefits deriving from integration will, particularly in the early stages, depend primarily on the extent to which it enables each country to expand its trade over and above the level it could attain without the help of integration. This must, of course, be an over-all evaluation, since many items now imported from third countries will gradually be imported from other Latin American countries. But integration should, at the same time, generate additional exports from those countries which have changed the source of their supplies. Obviously, however, a unilateral shift in imports would not be harmful if the Latin American countries could secure equal or better terms in the integrated area than those obtainable from third countries. Be that as it may, the important fact is that Latin American integration must bring about the expansion and diversification of trade in every country of the region.

While in all probability a conspicuous change will take place in the composition of extra-regional imports, their volume will tend to increase and, indeed, there are good grounds for desiring this, especially in the early stages of integration. The experience of the European Common Market is highly illustrative in this respect. Extra-area imports by the countries of the Community went up by over 50 per cent between 1958 and 1963, that is, in the same proportion as the product. In spite of this, area imports increased at a still faster pace, i.e., by 130 per cent over the same period, according to the values expressed in current dollars. In other words, these highly industrialized countries, in spite of having increased their reciprocal trade to a level representing 40 per cent of their total trade, nevertheless continued to import from the rest of the world without reducing the product-growth coefficient, which reached an annual average of 6.5 per cent.^{3/}

(b) Market size, productivity and efficient use of regional resources

Most of the Latin American countries have extremely small markets. This is clear from a few comparisons using population and average per capita income as approximate indexes of market size, which is tantamount to considering the product or total income of each country. On this basis,

^{3/} The domestic product is expressed in constant prices, and imports in current dollars.

Brazil, Argentina and Mexico, in that order, possess the largest domestic markets in the region. Brazil's market, for instance, is five times the size of Colombia's, and eight times larger than that of all the members of the Central American integration scheme as a whole. The ratios of Mexico's market to the same areas is apparently three to one and nearly five to one, respectively. Argentina occupies a middle place between Brazil and Mexico. Some thought should be given to the huge disparities there must be with respect to other countries of the region with smaller populations and income.

The Brazilian, Argentine and Mexican markets, large though they may be when compared with the rest of Latin America, also seem small when measured against the markets of the industrialized countries. Thus, for example, the comparative indexes reveal that France, with its 47 million inhabitants, has a market which might be anywhere from three to five times larger than those of each of the three leading Latin American countries. The gap would be even greater if they are compared with the Federal Republic of Germany. In these rough comparisons, the Netherlands and Sweden appear to have the same production volume as Mexico.

In actual fact, Latin America's domestic markets are even smaller, relatively speaking, than would appear from the indexes, particularly in regard to manufactured products. A more accurate analysis should take into account such additional factors as the integration of the national economies, income distribution, the structure of demand and the level of industrial development, which adversely affect the position of the Latin American countries.

The small size of the domestic markets prevents the Latin American countries from going ahead with industrialization on the basis of productivity levels and production costs similar to those in the industrialized countries since they cannot establish industrial plants of a size and degree of specialization required in order to take advantage of the economies of scale. Investments in certain key industrial development activities can only be made if strong protection is received from the State, and only at the expense of productivity and of efficiency in the utilization of resources.

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In most Latin American countries the domestic market is so small that there are a great many industrial activities in which investment is not justified on technical grounds, and consequently, it is practically impossible for import substitution to proceed any further. Major countries like Argentina, Brazil and Mexico present more favourable prospects, and their market potential, combined with ample resources, largely explains their faster and more advanced stage of development.

The economies of scale which cannot be turned to account because of market limitations are of significant proportions in important industries producing durable consumer goods, capital goods and basic intermediate products. Such economies depend on a number of factors, such as the indivisible nature of investment, the disproportion between the increase in a plant's production capacity and the cost of equipment, and the possibility of introducing up-to-date techniques and a certain degree of specialization when operating on an extensive scale of production.

Regional integration will play a direct part in solving all these development problems deriving from the size of the market. As the integration process advances, production activities in each country will be able to count on the potential demand of the whole integrated area. It will therefore be possible to establish up-to-date plants of optimum size, with an adequate level of specialization, and to carry on with industrialization in other sectors where nothing can be done today within the limitations of the domestic markets.

Concurrently with broadening the market, integration will provide the enormous advantages deriving from the optimum location of new investment, in terms of the cheapest sources of raw materials, energy, fuels and other inputs with an important influence on production costs. Some highly illustrative examples of economies in investment and reductions in costs to be achieved through optimum regional location and through the establishment of up-to-date plants as to specialization, techniques and size are to be found in the chapter dealing with regional investment policy.

The potential expansion of the market will assume exceptional proportions in those countries of the region of small or medium geographic or economic size. For example, on the basis of the aforementioned approximate indexes,

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it can be stated that the five countries of the Central American economic community would have a potential additional market twenty-five times larger than that of their integration area itself; as regards Colombia, the rest of Latin America would represent a market fourteen times larger, and Chile, twenty-two times larger.

The broader market will also play a very important part in the major countries of the region. Thus, it may be estimated that compared with Brazil the rest of Latin America represents a population of 150 million, and a market two and a half times larger than the local market; compared with Argentina, the population is 205 million, and the market four times larger; and in the case of Mexico, 190 million inhabitants and a market five times the size of the Mexican market. It is not out of place to stress that these comparisons give only an approximate idea of the potential market expansion. In practice, it cannot be taken for granted that a given industry of a country, can count on the whole economic space of the region as a market, since the advantages inherent in location, transport costs and other general factors will tend to limit the scope of the market within the integrated area, a limitation which is all the more important because of the geographical size of the region. That is why this document plays such stress on the need for embarking forthwith on a study of transport facilities with a view to the adoption of a co-ordinated policy for promoting integration. Whatever the difficulties, however, the huge disparities noted between the size of the domestic markets and the potential size of the regional market convey some idea of the force that would be gathered by the incentives to trade expansion. As progress is made in the establishment of a regional transport network and in the reduction of transport costs, the geographical size of Latin America will become an advantage, since, concurrently with enlarging the real market, advantage can be taken of the region's resources in the interests of the most suitable location and the diversification and specialization of economic activities.

A matter of some concern, and rightly so, is that the reduction in customs duties and the removal of obstacles to trade might give rise to an investment race aimed at the expansion of existing activities and the replacement of equipment. Such action might well have adverse repercussions

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were it to deflect resources from other higher-priority investments and undermine the economic activity of the less industrialized countries or those which cannot at once promote a process of modernization. These and other problems which will have to be provided for in establishing the instruments for an integration policy are dealt with later on this document. In the meantime, it should be stated here that integration will have to come about gradually so that the countries concerned will have time to introduce the necessary adjustments and reforms, as and when domestic output and income increase. In the first few years, action would be focused primarily on the integration of dynamic industries which have a strategic part to play in development, and in which, moreover, the economies of scale are usually considerable.

(c) Recourse to technical progress

Technical progress has been the basic factor of economic growth in the industrialized countries. Much research on the subject ascribes to it an equal or greater dynamic influence than to the human effort and the physical volume of capital applied to the production process.

Nevertheless, the Latin American countries are not taking advantage of the potential offered by technical advances in order to step up their development. A set of factors prevents them from so doing, pre-eminent among them, because of their bearing on integration being the narrowness of the market, the lack of dynamism in foreign trade and the limited resources allocated to manpower training and to scientific and technical research.

As mentioned previously, the limitations of the market and the slow income growth preclude the establishment of industrial plants with up-to-date production techniques in a broad range of activities. Even if this were feasible, the Latin American countries feel obliged to adopt a cautious policy, because employment indexes cannot be increased. Regional integration will break this vicious circle since, in facilitating a faster increase in production and income, the two objectives - i.e., the raising of productivity and employment levels -, which today are incompatible, can be pursued.

In the analyses of production in specific activities and of the economy as a whole, an effort is made to explain the part played in the expansion of production by each of the above-mentioned factors, i.e., technical progress,

/human effort

human effort and capital. But in actual fact technical progress does not act entirely on its own, but through better training and organization of the human factor and a more efficient use of the new capital goods applied to new production techniques. Therefore, as long as the Latin American countries continue to rely on exports of primary products and fail to increase their external purchasing power, owing to the deterioration of the terms of trade or the lack of external demand, they will be unable to take full advantage of this powerful factor of development.

In removing the external bottleneck, integration will permit the countries of the region to use their export earnings more efficiently for the acquisition of capital goods and for the establishment of up-to-date plants which will promote the necessary conditions for autonomous forces of scientific and technical progress to come into being in Latin America. Clearly foreign scientific and technical co-operation and co-ordinated action in regional education, training and research programmes will be needed in this connexion.

(d) Regional integration and international policy aims

As shown above, regional integration is essential if the Latin American countries are to speed up their economic and social development and emerge from the stagnation in which they find themselves at present. However, integration does not represent an alternative to the aims of expansion and diversification of trade with other regions, particularly with the industrialized countries.

The Latin American countries must take decisive steps towards integration and at the same time press on with their international economic policy aims. No other course is open to them since 90 per cent of their present trade is with areas outside the region; they rely on the industrialized countries for supplies of essential goods and require foreign financial and technical co-operation if they are to make any headway in integration itself. Furthermore, it should be made plain right from the start that in the early stages of integration, requirements in respect of imports from other areas will increase considerably, and at a later stage their structure will change, though they will not diminish in absolute terms. On the contrary, it would be more logical for them to continue expanding, although on a lesser scale than the domestic product.

Two experiences which occurred under very dissimilar conditions in the Central American countries and in the European Economic Community illustrate these relationships between the evolution of trade and economic growth in an integrated area. The five Central American countries which are making steady progress in integration increased their reciprocal trade by a total of 150 per cent between 1961 and 1964. At the same time, their extra-area imports grew by 40 per cent. Undoubtedly the integration process has been helped in the last two or three years by the improvement in the export sector of the countries concerned, which enabled external supplies to be increased on the scale indicated above. The countries of the European Common Market, with a combined population of 175 million inhabitants a market probably three times the size of Latin America's, and a level of industrial development which is above comparison with the average for Latin America, increased their imports from third countries, as previously indicated, by over 50 per cent between 1958 and 1963, notwithstanding the tremendous growth of their reciprocal trade.

All these considerations point to the need to co-ordinate on an over-all plane integration aims with trade policy and international financing objectives. The Latin American countries will have to pool their efforts and work out a common policy vis-à-vis the industrialized countries; their economic union would give them the negotiating power they lack individually and place them on a better competitive footing. Co-ordinated action with respect to the industrialized countries and international financing agencies is at once urgent and imperative, because radical changes must be wrought in the present situation so that the industrialized countries will facilitate the expansion of trade in primary products on the basis of adequate terms of trade, permit the entry of exports of manufactures from the developing countries, and increase their technical and financial co-operation in line with new systems that would be less onerous for the recipient countries.

Chapter II

PROGRESS AND LIMITATIONS OF THE LATIN AMERICAN INTEGRATION MOVEMENTS

Any proposal for increasing the dynamism of the integration process in Latin America and of ensuring that it fulfils the requirements of a developing region should be viewed first and foremost as the development of the two movements that are already taking place in the form of the Central American Common Market and ALALC. Both were begun with the intention of creating more favourable conditions for the trade and development of their member countries and both have successfully accomplished the first stages of their work.

The present chapter will review the history of the two experiments and examine their structure in the light of the conditions required of an integration process in a developing region.

1. Economic integration in Central America

Although covering a much smaller area than ALALC, the integration programme of the five Central American countries has some useful practical lessons to offer. Beginning in 1950 as a network of bilateral free trade agreements, by 1958 it had crystallized into a multilateral free-trade area. In 1960 the bases for integrated regional development were laid down with the creation of the common market and of a number of institutions and mechanisms designed to co-ordinate the activities of the five member countries.

Some of the results obtained in the course of these events merit special attention, particularly for their bearing on integration problems in the rest of Latin America.

(a) The Central American countries have already lifted restrictions on intra-regional trade in 82 per cent of the tariff items and have undertaken to free all products by 1966, except for a few agricultural exports such as coffee, coffee extracts, cotton and cane sugar. During its first few years the integration process was focussed entirely on liberalizing the staple items of traditional commodity trade (the stage currently reached by ALALC). After 1960, however, the programme was
/extended to

extended to all primary commodities and to new industrial products as well. The selective method employed was thus a means of setting the programme in motion and thereafter gave way to an automatic mechanism of tariff reduction and abolition.

The adaptation of existing industries to the rapid tempo of intra-regional trade liberalization has been fairly smooth, thus dispelling the fears aroused in some sectors of private enterprise during the period of negotiation. No serious disruptions of either employment or production have been recorded in the established plants. On the contrary, automatic trade liberalization assured entrepreneurs of an open regional market for their products within not more than five years, a prospect which, combined with the common external tariff, acted as a powerful stimulus to the expansion and modernization of industry. During the initial period, the increase in regional trade was largely due to plant expansion and to fuller utilization of capacity in such industries as textiles, food processing and building materials. Moreover, enterprises that had to adapt their production processes to meet the new competitive requirements were able to obtain local financial assistance through the Central American Bank for Economic Integration.

(b) It is recognized that special rules and conditions for liberalization should be established in respect of a number of agricultural commodities in the Central American Common Market. For instance, such staple items of diet as rice, beans and maize should be made the subject of special protocols for regulating trade, co-ordinating production and supply policies and ensuring the fullest possible freedom of movement. However, the Central American countries have not instituted special rules for their agricultural commodities as a whole, having found it possible to give certain items such as meat, butter, milk, cheese and fruit juices exactly the same treatment as industrial products.

(c) The five countries have standardized import charges for third parties in respect of 98 per cent of the items in the Central American tariff nomenclature. Their task was made easier by the fact that they, unlike the rest of the Latin American countries, had all reached more or less the same stage of industrialization. Consequently, when negotiating rational tariff /levels, the

levels, the bulk of their industrial products could be classified in the same categories throughout the area. But notwithstanding these favourable conditions, the tariff negotiations lasted for nearly three years and another three years will be needed to complete the process of ratification and bring the tariff into full force.^{1/}

(d) Both the liberalization of intra-regional trade and the establishment of a common external tariff have been made easier by the fact that stable exchange rates have been maintained in the Central American countries for many years thanks to the particular structure of their economies. It has thus been possible to avoid the use of multiple exchange rates and similar types of exchange controls which, by affecting relative prices, would have tended to distort the competitive position of the regional industries, both between individual countries and between Central America as a whole and the rest of the world.

Before the establishment of the Common Market, the Central American countries had already taken steps towards monetary co-operation through informal annual meetings of Central Banks and bilateral compensatory arrangements. These arrangements were formalized in 1961 with the establishment of the Central American Clearing House and, more recently, of the Central American Monetary Council, which provides permanent machinery for regular consultations among Central Banks, joint studies of the region's monetary problems and the exchange of information through the medium of its sub-committees and Executive Secretariat.

(e) The Central American countries have unified fiscal incentives to industrial development. Their object in doing so has been to prevent competition for new investment from becoming over-intensive with the establishment of free trade, and thus giving rise to unnecessary income losses and an uneven and uneconomic pattern of industrial development in the area. The uniform system of incentives improves on the previous national régimes in being selective, and extending the greatest benefits

^{1/} By September 1963, the five member countries had ratified the special protocols bringing standard duties into force on approximately half the products included in the Central American common tariff. It was hoped that the process would be concluded at the end of 1964 or beginning of 1965 with the formal ratification of the remaining protocols by the two countries that had not yet taken that step.

to industries that are of key importance for the industrial development of Central America (e.g. producing capital goods, intermediate goods and raw materials). By helping this kind of industry, the new system also tends to give greater advantages to the countries that are at a relatively less advanced stage of industrialization and have only just begun to tap their natural resources. In this way the benefits of integration would be spread fairly among the participating countries.

(f) The balanced distribution of such benefits has been one of the prime objectives of the integration programme. The first step taken was the conclusion of an agreement on a régime for Central American integration industries. In this it was stipulated that no country should be allocated a second integration industry until each of the five countries had been assigned their first plant. This rule was later made more flexible so that more benefits could be granted to the less advanced Central American countries, and now permits the allocation of additional plants to a country irrespective of whether each of the others has received one, provided that the additions do not belong to the same branch of industry as the original plant.

The Central American Bank for Economic Integration is another instrument that is required by its statutes to promote the balanced economic development of the member countries. Through its loan policy, the Bank is able to provide an effective answer to the needs of the less advanced countries. It is specially concerned with assisting infrastructural projects designed to correct serious imbalances between the member countries.

(g) The special instruments that have been created to ensure the balanced development of the member countries also supply the necessary institutional incentive for taking full advantage of the Common Market potential. The régime for integration industries was planned as a body of conditions and incentives aimed at opening up the Market to certain dynamic sectors in particular, more rapidly than would be possible by means of general tariff reductions.

/The main

The main purpose of the Central American Integration Bank is to provide financial assistance in a region where capital and the spirit of enterprise are in short supply. The founding agreement stipulated that the Central American countries may not receive loans or guarantees until they have ratified the treaties liberalizing trade and setting up the common external tariff, thereby ensuring that the Bank's resources are lent to projects directly connected with the economic integration programme.

A prerequisite for obtaining financial assistance from the Bank is the preparation and technical study of the project in question by such organizations as the Central American Research Institute for Industry (ICAITI) and other technical assistance agencies.

(h) Central America's experience with these mechanisms to promote balanced regional development is still so recent that it would be difficult and perhaps premature to try and assess their effectiveness. One instrument the Agreement on Fiscal Incentives, has not even entered into force, as ratification by two of the five countries is still pending. Some comments can however, be made which will help to determine the type of problem that is likely to arise during the early period of regional co-operation.

The instrument that has so far proved itself to be most flexible in practice is the Bank, since it can act without waiting for the different countries to negotiate an agreement. As indicated above, its loans have mainly been given for the expansion and modernization of existing industries. It has also taken part in prior investment studies designed to explore the prospects for industrial development in Central America and ascertain the corresponding investment requirements in transport, telecommunications and electric energy. In relation to new regional industries, the work of the Bank has been limited by the small number of projects that have reached the financing stage.

This has also been one of the main reasons for the relatively slow application of the régime for integration industries. Few projects have been submitted and those sent in have differed considerably as regards thoroughness of preparation and economic importance. It has thus proved a thorny problem to decide on their merits and to allocate them among the

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different Central American countries. So far the Governments have approved only two projects for integration industries, and three others have been assigned in principle pending submission of more detailed plans.

It is to be hoped that this problem will gradually disappear as Central American entrepreneurs become more familiar with the new industrial opportunities offered by the growth of the Market, with the aid of the different financial and technical organizations that co-operate closely in the preparation and execution of regional industrial development policy. This policy would be made more effective if it were made part of a development plan for the area as a whole, which would provide objective criteria for guiding negotiations on the location and distribution of industry among the different countries. A plan of this kind would also play a vital part in determining the efficient use of the Bank's funds, the application of the system of fiscal incentives, the co-ordination of public investment among the member countries and the proper channelling of private investment.

As a first step towards the establishment of a regional development plan, the Central American countries have instituted joint programming activities on the basis of an expert mission sponsored by several international organizations. In order to circumvent the difficulty of co-ordinating national plans that already exist, new plans are being prepared while the targets and regional guidelines to be used as a frame of reference for those plans are being worked out. The fact that the Joint Programming Mission is working at both the national and regional level is an additional guarantee that the necessary co-ordination will be achieved.

(i) The Central American countries have always been conscious of the fact that their economies were divided in the past not merely by tariff barriers but by the lack of a regional infrastructure. Plans were therefore made for a regional highway network to serve the needs of the Common Market which is now in process of construction. Joint electrification projects are being prepared which will lead to huge savings in comparison with national electrification plans. A regional telecommunications system is also to be set up, since it is an essential condition for active trade.

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(j) The principle of unanimity is normally applied in the organs of the Central American Common Market, but for some technical questions the Governments have introduced the practice of decisions by majority vote. In the course of integration, an impartial evaluation of the facts is often required. The responsibility for this devolves on the Permanent Secretariat of the General Treaty on Central American Economic Integration or on ICAITI. The Central American integration programme owes its dynamic spirit to the fact that institutions exist whose work is inspired by regional rather than national considerations. The Central American Economic Co-operation Committee, assisted by its sub-committees and the ECLA secretariat, has been the driving force behind integration and the forum in which solutions are found for the problems presented by the creation of a Common Market.

(k) The results so far obtained by the integration programme reveal the existence of an untapped potential for expanding reciprocal trade in the developing countries. Intra-Central American trade has increased from less than 3 per cent of the area's total trade in 1955 (13 million dollars) to 12 per cent in 1963 (66 million dollars). The share of industrial products is expanding rapidly and is already nearly 75 per cent. As has been mentioned before, the main results of the new trade vistas opened up during the first few years of integration were the utilization of idle capacity and the improvement and expansion of existing industries. The extent to which integration furthers the development of the region will largely depend on efficient use of the machinery that has been set up to complement and strengthen the impact of free trade and the common external tariff.

(l) The concept of reciprocity as expressed in the Central American integration programme has come to acquire a broad significance. It is no longer a matter of distributing trade benefits on an arithmetically equal basis, but of awareness that the capacity of economic integration to step up the process of growth for all the member countries is more important to their common interests than the short-term trading results achieved.

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The Central American Common Market has already taken the decisions and entered into the commitments needed to push ahead with economic integration as far as it can within the possibilities offered by the region as a whole. From now on work must be concentrated on the application of investment and production plans to take full advantage of the joint economic and trade structure. The real benefits of integration for Central American development will, in the last analysis, depend on the efforts made by the countries acting severally and in unison to introduce the requisite changes in the fabric of their economic and social life.

There is, however, a new task to be undertaken: that of linking up this sub-regional market with a broader market for Latin America as a whole. The Central American market itself is limited in the variety of its resources and its capacity to use economies of scale, even more so than are some of the ALALC countries. Although much can be done through the Central American Common Market to introduce the structural changes needed for industrialization and development, there is no doubt that the general and systematic linking up of this market with the sort of integration process that it is hoped to bring about in Latin America would open up new avenues for attaining the levels of industrialization and general productivity that are necessary for self-sufficient development.

2. The history of ALALC

The Montevideo Treaty is the most serious attempt made in the history of Latin America to unify the region's economic resources.^{2/} It is essential to strengthen this endeavour, as expressed in the Latin American Free-trade Association, and to ensure the progressive achievement of its ultimate aim: the establishment of a Latin American common market.

To do this, it is necessary to take stock of the progress that has already been made by ALALC, become acquainted with the main problems that have arisen and weigh the suitability of the present agreements as a basis for the more rapid progress that will be demanded by the region in future. Only then will it be possible to appreciate the complexity of the task that lies ahead.

^{2/} Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru and Uruguay have ratified the Treaty of Montevideo.

(a) The scope of the undertakings embodied in the Montevideo Treaty

Although the specific undertakings contained in the Treaty of Montevideo were appropriate for the unhurried and sober fashion in which the countries embarked upon their economic integration in 1960, the spirit of the Treaty is one of resolute determination to advance towards certain goals that, however unattainable at first, could be reached with the passage of time.

Swifter progress was out of the question in view of the difficulties inevitably encountered by a developing region in abandoning its restrictive trade practices and intensifying reciprocal trade. The fact that the method chosen was to establish a free trade area through the gradual liberalization of traditional exports and imports on the basis of selective negotiation offered the advantage of reconciling the region's inexperience in intra-Latin American trade with the varied nature of its economies and the need to move towards a common market with the maximum stability and smoothness.

Selective negotiations also offered the advantage of enabling items that presented no competitive problems to be liberalized from the outset with much greater speed than by the method of uniform linear reduction. Moreover, the fact that the countries as a whole were allowed twelve years in which to lift all restrictions on their primary commodity trade gave them a breathing-space in which to modify their national production in such a way as to ward off the adverse effects of an immediate or very rapid opening of the markets.

ALALC fulfils five essential functions for Latin America:

1. It is the framework for negotiations on the establishment of preferential treatment for numerous regional commodities and the reduction of trade protection and controls among the member countries.

2. It is an institutional mechanism for proposing solutions to such problems as the lack of adequate transport facilities and of uniform trade instruments that are acting as barriers to trade.

3. By acting in a liaison capacity between the entrepreneurs of the region it has made for greater mutual understanding and knowledge, thereby helping them to take their proper part in the formation of the free-trade area.

/4. It

4. It has had a far-reaching catalytic effect on public opinion in a number of different sectors, thereby making a valuable contribution to the study and general understanding of the concept and problems of economic integration in Latin America.

5. It is the forum in which the future stages of integration have been mapped out.

Since the entry into force of the Montevideo Treaty, ALALC has notable achievements of every kind to its credit. An outline of these is given below.

(b) Application of the Treaty

(i) Specific achievements in trade liberalization and expansion. The trade liberalization commitments have been completely fulfilled. In the course of the various rounds of negotiations, nearly 8,600 tariff reductions were granted representing the sum of the concessions made by each country to the other countries as a whole. Of these concessions, a fifth consisted in the total abolition of duties and other restrictions.

The countries have already included on their National Schedules virtually all traditional import items, and have therefore given preferential treatment to such products from within the Area. Five of the nine countries have completely freed more than 30 per cent of the items on their respective schedules. A large proportion of the concessions agreed upon concern items that were not traded in the Area before the Treaty entered into force and for which no agreements had previously been negotiated. Over 50 per cent of the concessions in question are for industrial products, mainly chemicals, machinery, electrical appliances and equipment and common metals and metal products.

Intra-ALALC trade has taken on a fresh lease of life between 1961 - the year that preceded the enforcement of the reductions - and 1963, it expanded by 44.5 per cent.^{3/} Its share in the total trade of the ALALC countries rose from 6 per cent in 1961 to 8.4 per cent in 1963. With the exception of Brazil and Colombia, the member countries have intensified their exports to the Area, in some cases doubling their previous

^{3/} Figures for 1964 are not available, but aggregate data indicate that there was a further and fairly sizable increment.

figure between the two years in question. No less than 75 per cent of over-all trade in 1963 (valued at 950.7 million dollars) consisted of products that were on the National Schedules.

The liberalization programme has also been instrumental in fulfilling the Treaty's pledge to increase the part played by the relatively less economically advanced countries in the trade of the Area. For example, the ALALC countries have granted Ecuador and Paraguay a total of about 1,200 and 4,800 tariff concessions respectively, to which the most-favoured-nation clause is not applicable within the Area. The importance of this treatment is that, by giving the two countries sole rights to a market, it enables them to step up their exports considerably and also affords extensive opportunities for developing investment in the industrial processing of their primary and resources and thus changing the traditional composition of their exports to ALALC.

The establishment of ALALC has acted as a spur to trade among the countries of the Area. The preferential system that has been set up is an incentive to such activities and strengthens traditional commodity channels while opening up new paths to explore.^{4/}

Despite the difficulties encountered, it was clear from the first negotiations at which a start was made on the Common Schedule that the countries intended, by 1973, to free completely and simultaneously those products which constitute the bulk of intra-Area trade. The first section of the Schedule, as approved at Bogota, exceeded the minimum prescribed by the Treaty. Together with a variety of traditional commodities there were also new trade products, the entire number totalling 175 of which about 25 per cent consisted of articles that had not hitherto been traded in the Area. Some of the industrial products included may shortly become very important in view of their present incidence in the Area's total imports. Examples of these are chemical wood pulp, semi-manufactured copper products, machine-tools and some synthetic raw materials. The Common Schedule has an impressive dynamic potential whose full implications are

^{4/} See Evaluación de las negociaciones de la Asociación Latinoamericana de Libre Comercio (E/CN.12/717), which reviews the results of the first two rounds of negotiations.

hard to gauge because the products it includes will bring a great deal of diversity into intra-area trade and because of the very significance attaching to the total liberalization of so many traditional commodity items.

(ii) Other parallel achievements. ALALC's achievements in the field of tariff reductions have been matched by important advances in other operational aspects that facilitate liberalization and stimulate intra-Area trade while paving the way for further progress. They include the following:

1. Pursuant to the provisions of the Treaty, ALALC has drawn up and approved a standard tariff nomenclature for the presentation of trade statistics and as a basis for the negotiations. This nomenclature is now being revised and modified with a view to its adoption by the member countries as a common tariff nomenclature. Progress has also been made in formulating the bases for standardizing customs procedures in the different countries. The work done on these lines, together with the determination of comparable levels of customs duties and charges of equivalent effect imposed on imports by ALALC member countries, is laying the foundation for the future preparation and adoption of a common external tariff.

2. ALALC has established a body of criteria for determining and certifying the origin of goods traded within the Area, and thus enabling the products on which concessions are granted to be properly identified. The criteria are designed to give the greatest possible encouragement to the use of inputs from within the Area, with due regard to the nature of the production processes there.

3. As regards the infrastructure, attention should be drawn to the work carried out on shipping questions. Although the Treaty does not contain any provisions on transport, the importance of such facilities for intra-Area trade has led ALALC to pay special attention to such questions as the development of merchant marines, maritime transport conditions, costs and services and port deficiencies. In addition, a draft general agreement on maritime, river and lake transport has been drawn up and is under consideration by the member Governments. Studies have also been undertaken on air, road and rail transport.

4. As regards intra-Area trade statistics, ALALC has already set up a uniform system which will facilitate negotiations and the study of other problems stemming from the increased share of intra-Area trade in the total trade transactions of the member countries as a whole.

5. It is proposed to strengthen the executive powers of the ALALC organs through the establishment of technical committees for specific sectors. An endeavour is also being made to set up technical, political and administrative machinery to be administered by the persons who are responsible in the different countries for policy decisions in each of the economic sectors connected with integration.

(c) The development of criteria and the search for new avenues of progress

(i) Action taken on specific problems. The ALALC organs have been engaged in seeking solutions to the problems that have cropped up during the implementation of the Treaty and in charting the future course of the integration movement. A valuable contribution has been made in this respect by the body of resolutions adopted at the various conferences and the work of the Standing Executive Committee and its secretariat. Some of the more recent resolutions, in particular, reflect the desire to forge ahead with the process of integration and to make every effort to fill the lacunae apparent in the Treaty undertakings. A case in point is afforded by complementarity agreements, whose conclusions has been blocked by the unlimited application of the most-favoured-nation clause. An attempt has been made to remedy this situation in resolution 99 (IV), which stipulates that the benefits of a complementarity agreement shall not be extended to countries that have not adhered to it unless they have previously granted satisfactory compensation.

The new regulation has certain advantages over its predecessor, because the automatic extension of benefits acted as a deterrent to countries

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that were interested in entering into such agreements.^{5/} However, care should be taken that the more flexible attitude adopted to the conclusion of agreements between groups of countries does not lead to an undue and perhaps irrevocable fragmentation of the integration of the industrial sector.

Another step forward is the recognition by ALALC that integration presents special problems for the medium-size countries, and that they must be helped to play a satisfactory part in the process, particularly through the medium of complementarity agreements.

The difficulties that would be caused for some countries by the complete liberalization of agricultural commodities led ALALC to extend the application of the agricultural saving clause beyond the time-limit set for the formation of the Area in the hope that the development policies of the agricultural sector would be co-ordinated and regional markets organized.

In order to foster the economic growth of countries at a relatively less advanced stage of development and to provide additional help to their exports over and above the benefits extended by the Treaty, a plan of

^{5/} Little attempt has been made to conclude complementarity agreements. Up to the present only two have been signed. One, in force since July 1962, deals with calculating and other punch-card machines and has been acceded to by Argentina, Brazil, Chile and Uruguay. The second, concerning electronic valves, came into force in April 1964, and has been signed by the same four countries and Mexico.

The first agreement has already begun to have an effect on trade in the goods in question. Argentina has exported 354,000 dollars' worth of calculating machines to Brazil and Uruguay. In addition, more investment has been made to develop new market opportunities.

A number of explanations are forthcoming for the scant use made of these agreements, including the unlimited application of the most-favoured-nation clause; the difficulties and inevitably slow tempo of any negotiations of this kind; the lack of specific multi-national projects in particular sectors; the want of an agency to study and promote such agreements; the incompatibility of industrialists' interests those of their respective Governments; and lastly, the preference of these concerned for Common Schedules as a means of liberalizing trade in certain products.

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financial, technical and other assistance was approved and it was decided to give them the exclusive advantage of being able to dispose of their exportable surpluses of manufactured goods within the Area. It was also agreed to set up special credit machinery for financing the exports of such countries.

(ii) Resolution 100 (IV). This resolution is the most serious attempt made by ALALC to establish a general work programme for the immediate future, including a definition of the basic economic policy principles that should complement commitments dealing exclusively with questions of trade. It deals in a fairly comprehensive way with the main aspects of a general integration policy: the characteristics of trade policy, industrial development and agricultural development, financial and monetary aspects, and fiscal, labour and infrastructural questions.

With respect to foreign trade, the resolution states that the object is to create conditions favourable to the establishment of a common market. With this in mind, it sets forth possible guidelines and instruments for the adoption of a common trade policy. It requests the countries and secretariat to carry out specific work on tariff questions with a view to achieving the greatest possible equalization of duties and restrictions on imports from third countries, and sets a deadline for the completion of the secretariat's work on a draft common tariff nomenclature.

It outlines an industrial development policy for the Area, with special reference to the problems that stem from the different stages of industrialization reached by the members of ALALC, the nature of their respective industrial structures and each country's special capacity to initiate or expand certain productive activities. More specifically, the industrial programme endorses the work of the study groups set up and recommends that their sphere of action be enlarged. Furthermore, it requests the secretariat to classify industrial activities in the Area with a view to determining suitable sectors for complementarity agreements and those in which industrial reorganization would have to be stimulated by a judicious amount of competition in addition to complementarity arrangements.

/Resolution 100

Resolution 100 further declares that national agricultural policies should be co-ordinated and reconciled as soon as possible and regulations laid down for the organization of commodity markets. For this purpose the ALALC countries should compare their respective programmes and decide on the sectors that offer the greatest relative advantages. The resolution also lays down guidelines for raising productivity and improving the use made of the Area as a market for regional production, including regulations to systematize such trade once the period allowed for the formation of the Area has expired.

As regards financial and monetary affairs, the resolution recommends the study of ways and means of setting up a credit system for financing intra-Area trade, the intensification of relations between banks, an analysis of the effects of exchange policy on trade movements and the adoption of criteria for foreign investment and capital movements within the Area.

Other studies recommended by the resolution deal with the establishment of a common policy for production and trade in raw materials; an analysis of fiscal régimes with a view to ascertaining their effects on the programme for co-ordinating economic policies; labour conditions in the Area and co-operation with inter-American organizations in examining infrastructural projects designed to further integration. Similarly, the resolution stipulates that ALALC shall consider other infrastructural questions, such as transport, the adoption of technical and quality standards; regulations for industrial and other copyrights and patents; and the interconnexion of electricity services and traffic.

Lastly, in respect of development programming and with the aim of establishing bases for co-ordinating national programmes, the resolution proposes that close co-operation be maintained between the planning agencies and offices of the ALALC countries so that the respective national policies can be compared and eventually co-ordinated in the light of regional integration aims.

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(d) The main limitations of ALALC

If ALALC is to attain completely its aim of achieving a common market, and play its full part in the region's development, two basic conditions must be met: (a) the system of tariff liberalization must lead gradually but effectively to a sufficiently free circulation of goods within the area to permit a real specialization of production, an adequate measure of competition, and full exploitation of the opportunities for import substitution on a regional scale; and (b) a regional investment policy must be formulated and effectively applied, that will make possible a joint effort to meet regional production and investment targets, an orderly solution of infrastructure problems, and a decision on the part of all member countries to benefit fully from the advantages offered by the integration process.

Then again, the aims should be governed by certain basic conditions. Firstly, trade liberalization should cover all the present and potential lines of production in the region since, as already pointed out, the object is to establish in the region the maximum opportunities for the full play of the factors of competition, rational use of resources, and specialization. Secondly, liberalization must respect the right of all countries to attain higher levels of industrialization, which means that each country should be able to count on its fair share of the benefits deriving from the larger market. Thirdly, liberalization must be such as to permit the gradual adaptation of existing production to the new competitive conditions.

It must be considered whether or not these aims can be achieved, in the context of existing agreements, with the speed and on the scale that the region needs. The first step is to examine the ability of the existing negotiation machinery to achieve a general and systematic liberalization of regional trade.

It has already been stated that the adoption of this machinery had initial advantages that were made clear during the first years after the signing of the Treaty. In fact, as a result of the first two annual rounds of negotiation, rapid progress was made in the reduction

/of barriers

of barriers to intra-ALALC trade. Subsequently there was a substantial decline in the number of products for which tariff concessions were made within the Area. In the first round 3,246 concessions were granted, and in the second 4,347, but the number fell to 655 in the third round and 307 in the fourth. For certain countries the decline was even more marked. In the fourth round, one of the members of ALALC granted no concessions, and many granted very few; thus it can be asserted that this round provided no prospects of increasing trade (see table 1).

Thus it is obvious that the liberalization process taking place through the annual ALALC negotiations is slowing down, and there is a danger that the problem will persist and become more serious as time goes on. Although in future negotiations countries may decide to save the situation by offering such substantial reductions that there will be a new stimulus to reciprocal concessions, this hardly seems probable at present, and the more realistic view is that the difficulties that have arisen are likely to continue in the future.

The present procedure of selective negotiation has certain drawbacks that make it difficult to achieve free trade within the Area by this means. Above all, it is far too flexible. The present system is based on a minimum average annual reduction of the tariffs applied in the Area, and consequently countries are free to choose the moment, the form and the amount of the reduction for each individual product.

This flexibility entails two further problems. It is essential that the liberalization process should offer the potential exporters in the Area sufficient certainty as to when and to what extent restrictions on trade will be reduced or abolished, together with a formal guarantee that the reductions will be maintained. The lack of certainty is a factor that prevents full advantage being taken of the opportunities opened up by tariff reduction for the expansion and diversification of trade, and delays or limits the possible investments that could result from the process.

The fact that each country is able, under the system of selective negotiation, to reserve the granting of tariff reductions on any given product until it considers it opportune to do so reduces the possibility that national production can prepare itself gradually for the foreseeable reduction of competition to a minimum.

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Since the traditional commodity items are mainly outside the field of negotiation, being largely the subject of previous special treaties in the form of bilateral agreements, and possibilities of reductions are further reduced in respect of products already produced or to be produced in the near future in the country granting the concession, and which may be imported from other countries in the region at world prices, it should be recognized that under the present system the vast majority of the tariff items in which really active trade is to be expected, and for which the competitive factor is particularly relevant, are being excluded from the negotiations.

Furthermore, during the transition period the present undertaking does not ensure uniform treatment for all products, or guarantee a standard margin of preference. The difference in the structure of the imports of each country from within the Area, and its right to choose what products are to be the subject of negotiation, and what reductions are to be accorded, means that not all countries undertake commitments for the same items, and moreover, the tariff reduction and preferential treatment granted are usually different. Thus, for example, if a given country wishes to export an item to the Area, it will find that different tariffs will apply according to the concessions granted by the different ALALC countries. Until the Common Schedule that is to enter into force in 1973 is applied, there is no guarantee that the products covered by the liberalization programme will receive a standard tariff treatment. This means that in fact there is as yet a regional market for hardly any of the products already included in the liberalization programme. The most that can be said is that certain opportunities, varying in effectiveness, have been opened up in one or two of the presumed importer countries.

The difficulties in calculating the weighted averages for the reductions in customs duties and other charges of similar effect, and consequently in establishing whether the countries have met their minimum annual obligations, means that the negotiations are based essentially on the prior establishment of some balance of advantages. If a country considers that it has met its minimum obligations, and that in addition, whatever concessions

/it has

it has granted are, in its own view, sufficient to maintain this balance, it may be that the country concerned will either refrain from negotiating in a particular round, or will grant very few concessions. This is in fact what has happened in ALALC, although it cannot be asserted that it is due solely to the defects of the negotiation system.

To judge by the course taken by the last round, progress along this path seems to have reached a stage where the possibility of new concessions being granted comes into conflict with the general tendency of the member countries to refrain from granting concessions on those products that are produced internally on any considerable scale, or which imports are controlled or prohibited for balance-of-payments reasons. All these limitations of the present selected negotiation undertakings are so serious that it can be foreseen that the aims of the common market cannot be achieved if the necessary progressive liberalization of intra-Area trade is entrusted solely to a system whose tendency to come to a standstill may lead to future discouragement and frustration.

Resolution 100 (IV) constitutes the formal recognition of the limitations of ALALC, and of the need that the Treaty of Montevideo should be amended as soon as possible to permit more far-reaching and ambitious agreements.

Moreover experience in ALALC has shown that the aims of economic integration cannot be achieved through the mere liberalization of trade, which must be accompanied by other agreements that constitute a real regional programme for the achievement of a series of major common objectives.

It cannot be said that the search for new principles undertaken by ALALC is a sufficient answer to the main problems of integration and to the weaknesses of the present system. This is because ALALC is essentially limited by the narrow scope of the specific agreements contained in the Treaty of Montevideo, in terms of their ability to give impetus and significance to the integration process. It is generally agreed in Latin America that the region needs new undertakings that will provide the basis for compulsory action. It is true that ALALC has

made an effort to escape the limitations imposed by the system within which it must now operate, but it is equally true that the programme of action drawn up for this purpose in resolution 100 (IV) has not succeeded in going beyond a mere listing of basic directives for an economic policy for the area that the countries could perhaps adopt on the basis of the studies undertaken by ALALC. This programme does not represent the decision by the member countries that is so urgently required if the integration process is to make effective progress.

As regards the substance of the principles adopted, it is clear that they are so closely linked with the fulfilment of the whole body of agreements that no progress can be made in one area unless it is made at the same time in all the others. The result is a vicious circle which is very difficult to break, as the past working of ALALC has shown. Thus, for example, if progress in tariff reduction is linked with the reconciliation of the various trade policies and instruments, the point may be reached where the process of liberalization is weakened or paralysed because that reconciliation has not been achieved.

The declarative nature of the basic directives and the general aims and principles contained in ALALC's programme of action deprives it of any real power to stimulate integration. There is at present no guarantee, for instance, that in the forthcoming negotiations of ALALC the member countries will bring their actions into line with the principles laid down in that programme, and they can hardly be expected to do so, since the basic directives have been conceived and formulated within the narrow margin of a system which in itself is inadequate for the purpose of encouraging the real process of integration that Latin America needs to solve its general economic difficulties. Thus a new stage must be embarked on, and for this purpose the region needs to adopt forthwith a body of new agreements at a high political level that will permit effective action in the various fields covered by the integration process. However great the desire to take such action, it cannot be done through the machinery of a free-trade area.

/(e) The

(e) The potentialities of the present institutional structure

In an integration process it is to be expected that national interests will not necessarily always coincide with the interests of the community of nations. Progress in integration cannot depend solely on negotiations in which the temporary interests of the individual countries are the only factors taken into account. Integration requires permanent contact between national interests and the bodies that represent the interests of the community of nations, all the more so if integration is taking place in a developing region. The formulation of common policies implies the existence of institutions that are responsible to the community. Furthermore, the application and control of the rules of competition must be based on standards that, although with an eye to the decisions and interests of individual countries, take account of the community interests. These considerations lead to the conclusion that integration needs, in addition to bodies that directly represent the Governments, others that represent the community, with the necessary powers of action and with sufficient independence and financial resources to promote the region's development, propose guarantees for the proper fulfilment of agreements, assess the facts on which requests for exceptions are made, and make recommendations on methods for dealing with them.

In ALAIC the responsibility for carrying out the functions involved in the existing agreements has been entrusted to the system's political organs. The Conference, in addition to supervising the carrying out of the Treaty, is also responsible for formulating the Association's policy and adopting decisions for putting it into effect; the Standing Executive Committee, composed of government representatives and answerable directly to the Governments, carries out studies, suggests measures and submits to the Conference the recommendations it deems necessary for the proper fulfilment of the Treaty.

This system of functions does not appear the most suitable for the effective carrying out of the broader functions required for a new stage of integration. This is mainly because of the nature of the two organs. Their task is above all to represent, and defend the interests of, the individual countries, and consequently it is unlikely that they will be able to carry due regard, on a continuous basis, to the aim of progressing towards integration.

/The fulfilment

The fulfilment of other integration aims, such as the co-ordination of sectoral or infrastructure policies and the formulation of a regional development policy, is also a function that should be entrusted to bodies answerable to the community, with suitable powers and machinery to permit them to work effectively towards those aims.

Here again, the ALALC organs have certain problems. The adoption of policies aimed at the promotion of regional integration calls for the reconciliation of national interests with the over-all aims of development of the Area, and this may sometimes be difficult for bodies that by their very nature do not represent the interests of the community as a whole, and do not have real powers of practical action.

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1. The first part of the text discusses the importance of the environment and the need to protect it. It mentions that the environment is a natural resource that we all depend on, and it is essential for our survival. The text also talks about the impact of human activities on the environment, such as deforestation, pollution, and climate change. It emphasizes that we need to take action now to prevent further damage to the planet.

2. The second part of the text focuses on the role of education in environmental protection. It states that education is a key tool for raising awareness and promoting sustainable practices. Through education, we can teach children and young people about the importance of the environment and how they can contribute to its protection. The text also mentions that education can help to change attitudes and behaviors, leading to a more sustainable future.

3. The third part of the text discusses the role of government and industry in environmental protection. It notes that governments have a responsibility to regulate and enforce environmental laws, and to support research and development in sustainable technologies. Industry also has a role to play, as it is a major source of pollution and resource consumption. The text suggests that governments and industry should work together to find solutions to environmental problems.

4. The final part of the text concludes by emphasizing the need for collective action. It states that environmental protection is a global issue that requires the cooperation of all countries and people. We need to work together to address the challenges we face and to create a more sustainable future for ourselves and for the planet.

Chapter III

THE BODY OF NEW AGREEMENTS

As explained, AIALC's present activities in the field of regional integration are of unquestionable importance, and may be expected to lead to real progress, although, as has been shown, in future this progress will be too slow and limited in scope.

Because of the urgent nature of Latin America's development problems, and the likelihood that these will increase progressively in the short run, it appears unreasonable in view of the task facing the peoples of the region, and the hopes pinned to integration as a powerful driving force of the region's economic and social growth, to wait while the present agreements of the Treaty of Montevideo gradually come to fruition. Without prejudice to the care that will be needed in deciding on the necessary programme of action, certain additional agreements of a more promising nature can even now be undertaken, agreements broader in scope and more effective than those now in force, and which would also make it possible for production in individual countries to adapt gradually to an increasingly competitive situation in the region.

The circumstances that permitted the establishment of the European Common Market do not exist in the same form in Latin America. There is no such large-scale trade as that which took place in Western Europe before the Treaty of Rome, nor the same experience with foreign competition, nor the ability to respond rapidly to the stimulus of a broader market. But it is the very absence of such positive factors that makes it more urgently necessary, even though it is more difficult, to aim at the outset at a full-scale integration in Latin America.

AIALC's activities in recent months in seeking new formulas to broaden the tariff reduction agreement, and adopt work programmes aimed at providing the basis for co-ordinating policies in various fields, is clear proof that the Association is also convinced that more rapid progress towards integration is essential. It is a matter of urgency to speed up progress through a more decisive approach, which will inevitably call for new political decisions to make it effective.

/To speed

To speed up the pace of integration a first stage must be envisaged, involving the carrying out of agreements more far-reaching than those that now exist, and during which the final stage will be prepared. There is ample room for immediate progress at a much more rapid pace, and on a broader scale, than what could be achieved through the present system of selective negotiation, while in the meantime studies can be prepared and the proper conditions established both to solve the problems of a common external tariff and to establish means of co-ordinating monetary and exchange policies, and national development programmes in general.

Firstly, an automatic tariff reduction system, broader in scope than the present system, would be established. There can be no progress towards integration if the products on which tariffs are lowered are those that would be traded in even without any tariff reduction. Furthermore, as mere reduction of tariffs cannot automatically bring about certain basic aims and objectives of the Latin American economy, it should go hand in hand with a regional investment policy, which constitutes the second element in the programme of action. Thirdly, the expansion of trade will make it essential to put into operation certain special machinery of a financial and monetary character. Lastly, the new tariff reduction agreements, the formulation and execution of a regional investment policy, and the monetary and financial problems, all require institutions capable of making studies, promoting action, and taking decisions.

1. The new trade policy commitments

The new commitments would be as follows:

First. A progressive and automatic system of tariff reduction for intra-Area trade would be adopted, covering all products and based on an annual linear reduction, whose practical and technical details are examined later in the present document. At the end of ten years the participating countries would not be able to apply any customs duties to items of reciprocal trade, including other charges of equivalent effect, exceeding 20 per cent of the c.i.f. value of each item, except for the relatively less developed countries, for which the time-limit could be extended to fifteen years.

/To give

To give greater impetus to the process of tariff reduction within a fairly short period, and to promote the gradual increase of regional competition, it is proposed to reduce tariff barriers to intra-regional trade fairly rapidly, so that by the end of the first five years the maximum tariff level that countries can apply to reciprocal trade shall not exceed 50 per cent of the c.i.f. value of each item. In this case, too, the relatively less developed country would benefit from a special treatment.

Selective negotiation would continue to be used to effect more extensive reductions in customs charges, when the countries so agree. In addition sectoral complementarity agreements would also make a valuable contribution to this more rapid reduction of tariffs.

Second. During the ten-year period there would be a gradual abolition of the quantitative and other restrictions not equivalent to customs duties now in force, so that at the end of this period the restrictions on reciprocal trade would consist solely of customs duties within the maximum limit indicated above.

Third. Within five years a common external tariff would be drawn up and approved, and would be gradually put into effect in the subsequent years. However, every effort should be made to arrive at standard tariffs in a shorter period for raw materials and intermediate products, in order to eliminate a major source of difficulty in relation to the competitive footing of the individual countries. The sectoral agreements on industrial complementarity could provide an effective means of achieving this aim.

Fourth. Until the common external tariff is negotiated, minimum preference margins would be negotiated and established for the products of the member countries where those resulting from the tariff reduction process prove inadequate.

The new tariff reduction formula would also make it possible to achieve other basic aims, such as the introduction of a considerable element of competition between the countries of the region that, in addition to offering new trade prospects and contributing to the adoption of more effective criteria in the industrialization of the individual

/countries, would

countries, would prepare the ground for more advanced stages of integration. In addition, there would be from the outset a general preference in favour of area production, that would act as an effective stimulus to the substitution of imports from third countries.

These various undertakings would be supplemented by escape clauses to permit countries to take emergency measures in cases where the fulfilment of such agreements would result in serious harm to national production or in major balance-of-payments difficulties. Furthermore, countries could establish domestic taxes for the purpose of restricting the consumption of certain articles, especially luxury goods, when such action was considered necessary to offset certain adverse effects of trade liberalization or the adoption of the common external tariff. These taxes would be of equal effect for domestic and imported goods.

2. A regional investment policy

More particularly when a developing region is concerned, an agreement to reduce tariffs automatically and across the board is not in itself sufficient to achieve certain economic and social aims. Just as in the field of national economic policy, the free play of market forces does not suffice to fill the structural gaps, and there must also be planned action if the desired aims are to be achieved. Consequently the second major element of the new stage for ALALC would consist of the defining of a specific series of regional production and investment aims in the basic sectors. Such aims should be co-ordinated with national plans so that in the sectors in question the most rapid progress possible can be made towards complete tariff abolition and the full use of the opportunities provided by a regional market. At the same time an immediate action programme should be adopted to solve infrastructure problems on a regional basis.

Regional action can also be taken to activate the forces that will help to achieve a progressive rise in exports to third countries, especially in the form of manufactures and semi-manufactured goods.

Consequently it will be necessary to adopt well-founded criteria for the achievement of regional investment aims, mainly on the basis of sectoral and sub-sectoral agreements, and to agree on the general bases for a regional investment policy.

/3. Financial

3. Financial and monetary action

The region urgently needs payments systems to facilitate transactions between individual countries and to increase the supply of credit for the encouragement of exports and to help solve the unexpected problems that may arise. In addition there will have to be studies of problems of exchange and of monetary policies, with a view to proposing specific measures and machinery in relation to integration.

4. The new institutions

The fourth pillar of a new and more dynamic stage for ALALC is the establishment of institutions that can promote and supervise the fulfilment of the new agreements and that will be capable of playing an active part in furthering progress towards integration.

An automatic system of tariff reduction and a regional investment policy directed towards a really dynamic integration process calls for institutions different from those of a system in which tariff reductions are achieved through negotiations between the countries. The character of the community organs is completely different: the new agreements require an institutional framework that is more complete, has more power of decision and more freedom of action to analyse problems and embark on an organized effort to find solutions that will be of benefit both to individual countries and to the whole community of nations.

Consequently a Council of Ministers should be established, as the highest authority on integration. In addition there should be a Board to lay down the lines of progress for the integration programme and to supervise the fulfilment and smooth working of the new agreements. There should also be a body that will co-operate in the promotion of regional investment. In addition, there should be ad hoc arbitration tribunals.

Integration should not be based only on the participation of Governments and experts, but should also have the active co-operation of the whole population and all the economic forces in every country. Consequently, there should be a Latin American Assembly, and a committee representing entrepreneurs and workers.

Chapter IV

TRADE POLICY

1. Requirements, scope and limitations of trade policy measures

In essence the establishment of the Latin American common market consists of merging the individual markets of the participating countries into one large regional market. From the trade policy standpoint this integration inevitably requires the reciprocal abolition of trade barriers, together with the adoption of a common external tariff and the standardization of other aspects of the region's trade policy towards the rest of the world.

The free circulation of goods within a common market, while it permits the integration of national industries and provides them with a broader market, at the same time exposes them to the competition of similar lines of production. The creation of this competitive situation, and in general the merging of the markets, gives rise to the two main problems that a Latin American common market will involve: firstly, the adjustments that such industries and even perhaps an appreciable proportion of the economy in every country, will have to face in adapting to the new situation; and secondly; the danger that the integration of several national economies in a single market may have harmful effects for some of them, particularly those at a lower stage of development, whose development prospects may be adversely affected by the integration. More broadly speaking, this second problem is a question of reciprocity, that is, the need for a proper correspondence between what each country grants to the others and what it receives from them in the integration process, and for the benefits deriving from the process to be fairly distributed among all the participating countries.

In the process of establishing a common market, adjustments to the competitive situation are inevitable, and are necessary if some of the most important benefits are to materialize, such as increased specialization and more economic scales of production; expansion of the most

/efficient enterprises

efficient enterprises and higher productivity in those that are less efficient, or their conversion to other lines of production in which they would be more competitive; the chance for industries to obtain raw materials, intermediate products and other inputs at lower costs, etc. Although it is to be hoped that the common market will provide an effective stimulus to the expansion of the Latin American economies, there is no doubt that such benefits will only be obtained to the extent that the serious distortions in those economies are corrected and there is consequently a more efficient use of resources. For the very reason that these distortions are so serious, the adjustments needed to correct them and to adapt to a competitive situation will eventually, but inevitably, mean the elimination or conversion to other lines of certain marginal production operations, with the resultant consequences not only for the industries concerned but also for the economy as a whole.

The magnitude of these consequences will probably be much less than is generally expected. There is a tendency to exaggerate them on the part of those who, rightly or wrongly, fear that they may suffer from regional competition. Furthermore, it is to be expected that these consequences will be mitigated by the expansionist effect of the formation of the common market on the Latin American economies.

For the economy of the individual countries as a whole, the consequences will be more than offset by the benefits resulting from the merging of the markets. However, it is desirable to reduce the adverse effects to a minimum, and as far as possible to facilitate adjustments by allowing them to take place gradually over a transition period.

But the aim of the transition period, in addition to permitting these gradual adjustments, is to ensure that they do take place gradually. In other words, it should not be possible for countries to avoid making the adjustments or to delay them to the last minute, since that would go against the whole purpose of the transition period.

The securing of these aims requires a formula or procedure providing for specific and detailed agreements for the gradual reduction of tariffs and other restrictions on intra-area trade, and the progressive adoption

of a common external tariff applied automatically. Consequently tariff reduction, in addition to being gradual, should be linear and automatic, and cover all products.

Similar considerations apply to the saving clauses. These clauses should be limited to what is essential for the temporary reliefs, in cases that are fully documented and justified, of a critical balance-of-payments situation or serious harm to a given industry or sector as a result of the fulfilment of the tariff reduction agreements or any others that may be adopted. In any case, any delays or exceptions to measures provided for in the liberalization agreements should have a time-limit, since the adjustments that will be needed both on the part of the enterprises and in government policies will be made only if there is certainty that there will be no interruption or change in the process of merging the markets and establishing conditions of full competition.

Furthermore, there must be sufficient certainty with respect to when and how fast the trade restrictions will be removed or reduced for products of interest to potential exporters, together with a guarantee that, save in exceptional cases, the reductions made will be maintained. Without such certainty there will not be the necessary incentive to exploit the opportunities offered by the liberalization process and to effect investment to establish or expand enterprises, etc.

Unless Latin America resigns itself to the idea that regional integration of industries can never be achieved, no attempt should be made to solve the problems of adjustment to the competitive situation resulting from the process of the gradual liberalization of reciprocal trade by excepting from liberalization the industries that are, or fear to be, threatened by the new competition.

These adjustments can and should be facilitated and stimulated by other means that will effectively help industry and labour to adapt themselves to the new conditions resulting from the merging of markets and the integration of the separate economies. Possibly the most important and effective of these measures would be the financing of projects for the modernization or conversion of enterprises, and the

/compensation of

compensation of workers unemployed or displaced as a result of the adjustments, together with arrangements to retrain them. The accent should be not on measures that have the negative effect of permitting the continuance of an inefficient use of resources, but on positive measures that will further the adjustments, encourage those concerned to take advantages of the new opportunities, and expand trade.

Although it is not particularly difficult to find a suitable formula for the gradual and automatic reduction of customs duties and other charges of similar effect, the same does not apply to quantitative and other restrictions whose nature precludes the recommendation of any procedure for their gradual reduction in all cases.

In order to achieve the gradual abolition of quantitative restrictions, the best procedure would therefore be to reduce their total number year by year. This procedure offers the advantages of being practical, simple, and easy to apply and control. In addition it allows each country to choose the products or tariff items that will be liberated from these restrictions each year.

Such a system has the drawback that the restriction would be completely abolished for those products that the country concerned selects, and in some cases this might be too abrupt a measure. This shortcoming might be overcome by resorting to escape clauses when the question is one of serious harm, or relates to a major economic activity. Furthermore, authorization could be granted to replace quantitative restrictions by customs duties in circumstances, forms and conditions to be laid down by the community organs.

Another procedure would be to reduce gradually all the restrictions, but its application might give rise to serious practical problems. In fact such a procedure would require that for each product subject to quantitative restrictions there must be an initial quota free of restrictions for imports from within the area. This quota would have to be increased annually by a given percentage. Apart from the problem that would be involved in agreeing on criteria for establishing the initial quota, the rate of its expansion and its distribution among the /various countries,

various countries, it would be extremely difficult and arduous to apply such criteria to a vast range of products, and even more so to administer the resulting quotas.

The second of the basic problems presented by the formation of a common market is the danger that the benefits of integrating the national economies in a single market might not be distributed equitably among the participating countries.

The integration process should take place in such a way that there is reciprocity in terms of what each participating country grants to and receives from the others. Although this reciprocity should be understood in the broadest terms, it is usually taken to refer in particular, and sometimes solely, to reciprocity of the trade type, that is, that there should be reciprocity with respect to the prospects of each country's trade with the others that can be expected to result from the liberalization process, the granting of minimum preference margins, and eventually the standardization of the treatment of imports from third countries.

Reciprocity must, of course, be taken in a much broader sense than strictly trade reciprocity. The volume, and in particular the composition, of the trade flows will constitute a most important criterion in determining whether or not adequate reciprocity has been achieved. However, this should also be assessed in the light of other factors such as the form in which the individual economy has evolved, with particular emphasis on differentiating between the effects imputable to the integration process itself and those due to the action of lack of action of the country concerned.

Both the liberalization formula and the other trade policy measures that are adopted in order to achieve a common market must be drawn up in the light of the need to ensure a minimum degree of reciprocity for the participating countries. But it must be borne in mind that the effectiveness of these measures is rather limited, and that in any case the most they can achieve is to ensure some equality of opportunity.

The difficulty or practical impossibility of finding satisfactory solutions to the reciprocity problem by means of the formula of tariff

/reduction and

reduction and other trade policy measures is due not only to the real limitations of such measures, but also, perhaps to a greater degree, to the variety of factors that enter into the problem and the complexity of each of them, as well as the difficulty of predicting with any accuracy the effect of any automatic system of tariff reduction on specific economies or industries, and on the trade flows within the area.

The problem of reciprocity in Latin America is particularly important because of the substantial differences in the level of economic development of the various countries of the region. This problem is more serious in relation to the relatively less developed countries which, precisely because they belong to that category, do not have sufficient means and resources to take full advantage of the opportunities opened up by the integration process. The same problem may also affect other countries in relation to particular activities or industries.

There are also other factors that may enter into the effectiveness or value of the concessions that a country grants or receives under the liberalization programme, and affect the possibility of exploiting the opportunities offered, or the impact on the individual economies. These factors include the distortions in the structure of the Latin American economies and the consequent marked differences in costs, and hence in the competitive footing, of many industries; the great differences in customs duties and other charges on imports into Latin America, and the lack of relation between these charges and the actual need for protection; and the distortions in the competitive situation resulting from unrealistic exchange rates and from the difference in the internal and external devaluation of national currencies.

The differences in the levels and types of charges applied to imports by the Latin American countries gives rise to three main problems: (a) they lead to marked differences in the costs of many raw materials and other inputs used by industry, and consequently in the final cost of manufactured products, thus introducing a strong element of distortion into the competitive position of the industries concerned; (b) they also give rise to marked differences between the

/preference margins

preference margins in each country, for imports from within the area, that result from the process of internal tariff reduction; (c) they considerably increase the risk of the diversion of trade from the countries of the area, through the importing of a given product from outside the area by the country with the lowest tariff, which then re-exports it to another country in the area under the cover of the liberalization of intra-area trade.

These problems will be more sharply felt as further progress is made with trade liberalization. Consequently, when liberalization has reached a significant level, it will be advisable gradually to eliminate the differences in the duties on imports from third countries by the progressive adoption of a common external tariff. It will also be necessary for any accelerated tariff reduction -- for example, by means of sectoral agreements on industrial complementarity -- to be accompanied by a more rapid standardization of the treatment of imports from outside the area of products included in the agreements, and particularly of inputs for those products.

If it proved impossible to standardize tariffs for third countries with the necessary speed, other measures could be adopted -- such as permitting the application of compensatory charges within the area -- in order to effect a temporary improvement in the cost distortions resulting from the differences in the external tariff, when these have a major effect on the competitive situation in a given industry.

Until a common external tariff is adopted, the other two problems referred to above can be dealt with by the fixing of minimum preference margins, when those resulting from tariff reduction prove insufficient, and the establishment of conditions that must be met by products before they can be considered as originating within the area.

The various factors referred to in the preceding paragraphs mean that there are appreciable differences in the ability of the various national industries to adapt to a competitive situation, and in the capacity of the whole economy of each individual country to take advantage of the opportunities provided by a larger market. Moreover

/the progressive

the progressive establishment of regional competition and the formation of a common market will modify the conditions in which national economies and individual industries are developing.

Hence in most cases a knowledge of the tariff structure of the Latin American countries, and of the comparative cost position of a given industry, will not provide a sufficient basis for correctly predicting the effect of trade liberalization. The differences in the levels of protection enjoyed by a single industry in different Latin American countries do not usually correspond to differences in production costs. Furthermore, the fact that the industry may produce in one country at costs considerably higher than in the others does not mean that the industry will necessarily continue to be at a competitive disadvantage when tariff charges are gradually reduced. The reverse may be true, since under the stimulus of increasing competition and the opportunity to export to foreign markets, together with the reduction of the cost of inputs resulting from tariff reductions, the industry may succeed in achieving a favourable competitive footing, especially if its high costs are due to factors that are easily remedied, such as obsolete machinery, inefficient organization, or costly raw materials.

The difficulty in arriving at a tariff reduction system that will guarantee in advance an adequate measure of reciprocity between concessions and benefits has been made very clear by the diametrically opposed positions adopted in ALALC by the countries with the highest tariffs and those with the lowest. Whereas the first emphasize the considerable preference margin that they will be granting by reducing charges on imports from within the area, and minimize the value of concessions resulting from the reduction of tariffs that are very low, by asserting that the resulting preference margin will be insufficient, the second group stresses the fact that their concessions will open access to their markets, which is not the case when there is a partial reduction of charges that remain extremely high even after the reduction. This conflict shows the impossibility that any tariff reduction procedure can ever fully satisfy both groups. The differences in the treatment

/accorded by

accorded by the various countries to their imports will persist during the transition period; the most that any tariff reduction system can hope to achieve is gradually to reduce these differences, until they disappear through the full liberalization of reciprocal trade and the complete adoption of a common external tariff.

These considerations also underline the fact that it is difficult to define or explain the actual concept of reciprocity, and that in any case it is impossible to know in advance what degree of reciprocity will be achieved by given trade policy measures. Although it would be possible, within certain limits, and with the avoidance of over-complicated formulas, to take such measures with a view to promoting reciprocity, with due regard to the differences in economic development, tariff levels, etc., of the participating countries, it is only after they have been taken, and a reasonable period has elapsed, that it can be ascertained whether reciprocity has in fact been achieved. If it has not, it will be necessary to identify the factors responsible or partly responsible for the imbalance, in order to decide on the most suitable corrective measures.

Furthermore, the effectiveness of trade policy measures in helping to achieve an adequate measure of reciprocity will depend almost entirely, as already shown, on how far they are supplemented by measures of other kinds, such as financial and technical assistance, promotion and guidance of production, a regional investment policy, etc.

As regards the relatively less developed countries, the tariff reduction formula and any other trade policy measures adopted should provide for their preferential treatment in tariff reduction agreements, saving clauses, the granting of unilateral concessions, etc. But such measures, although important, will not suffice in themselves to ensure a satisfactory situation with regard to reciprocity. Reciprocity should be essentially based less on trade policy measures than on those of the type referred to in the preceding paragraph, in order to establish in the relatively less developed countries the conditions needed for a more rapid development of their economies and to ensure that full advantage is taken of the opportunities provided by the expanded market.

/Consequently the

Consequently the application of reciprocity must be clearly defined and must have an institutional framework. The functions of the community organs must include that of ensuring a balance of advantages. Similarly, special treatment and measures in favour of the relatively less developed countries will ensure greater equality of opportunity for all the countries participating in the integration process.

All the foregoing considerations should be borne in mind in any attempt to evaluate and remedy the trade imbalances that are produced during the application of the new agreements. There must in any case be more clearly defined and expeditious procedures to deal, through the community institutions, with the problem of reciprocity during the transition period.

The bases of such procedure might be the following. During the first stage a country whose trade deficit with the area had increased considerably, or one whose trade surplus had changed to an appreciable deficit in relation to its total volume of trade, could approach the Board with a request for an enquiry into the reasons for the imbalance. When the Board examined the case, it would take into consideration, inter alia, the following factors:

(a) Whether the imbalance is due to special circumstances of a temporary nature such as poor harvests, etc.

(b) Whether or not sufficient time has elapsed for the effects of the tariff reductions to have been produced and taken advantage of, since it is very difficult to establish new export flows, especially in a region where there are few trade contacts and trade channels between countries. Consequently it is not easy to see how reciprocity has operated until a reasonable period, such as two years, has elapsed since the entry into force of the new agreements.

(c) Whether or not the country concerned has made the proper efforts to promote possible exports and abolish any unnecessary formalities or other difficulties that there may be. No country should expect the others to take special measures on its behalf if it has made no real effort of its own.

/(d) Whether

(d) Whether or not the insufficient volume of exports is due to an over-valuation of the national currency.

(e) Whether or not the preference granted to the products of a given country in the markets of the area is sufficient to stimulate exports of those products.

Once the Board has studied the situation it could recommend, where appropriate, that the country concerned should adopt any necessary internal measures, indicate the desirability that the countries trading with the country concerned should provide additional stimuli (such as a greater margin of preference for its exports), or suggest special measures of promotion and encouragement to benefit the applicant country.

The second stage of the procedure would relate to cases where the recommendations had not had the desired effect, or had not been applied by the other countries. In such a case the applicant country might be exempted from certain of the agreements it had signed, but only to the extent necessary to correct the imbalance. In any case, the selection and application of the measures authorized to correct situations of considerable and persistent imbalance in one country's trade with the rest of the area should be such as to ensure that there is no unnecessary disturbance of trade flows or introduction of elements of instability that might affect the growth of intra-regional trade and the process of integration.

2. Specific agreements in the field of trade policy

The tariff reduction agreements adopted in the Treaty of Montevideo are limited in scope, and the procedure of annual selective negotiation, apart from its tedious nature, does not ensure that tariff reduction takes place gradually for all products and all types of restriction. In general the system results in concessions of a limited and piecemeal nature.

In order to give a new impetus to integration and make effective progress towards the formation of a common market between the Latin American countries, it is therefore essential that those countries should adopt new agreements that will accelerate, broaden and make automatic the process of tariff reduction, so as to ensure that the reduction will in fact take place gradually for all products. These agreements should be formulated in the light of the problems of achieving reciprocity, the differences in levels of economic development, and in the levels of imports duties, etc.

In addition to these agreements for the progressive abolition of barriers to intra-area trade, the countries will also have to adopt others relating to the progressive reconciliation of their trade policies towards the rest of the world, and in particular to the adoption of a common external tariff and the establishment and effective application of adequate margins of area preference.

In particular, the first agreement suggested is that the member countries of ALALC should consolidate their present levels of customs duties, and other charges and restrictions on their reciprocal trade. This is an essential requirement for any type of automatic tariff reduction.

Secondly, it is suggested that the countries should adopt the following agreements as targets that should be attained within a ten-year period:

(a) Gradual and automatic reduction of customs duties and charges of equivalent effect now applied to intra-area trade. At the end of the ten-year period these charges should not exceed, for any product, 20 per cent of the c.i.f. value. For the relatively less developed countries

/the period

the period of gradual reduction could be longer, for example fifteen years. At the proper time agreement would have to be reached on the procedure and time-limits for advancing from this intermediate goal to the final abolition of all duties involved in the formation of a common market.

(b) Gradual and automatic reduction, within ten years, of the quantitative and other restrictions not equivalent in effect to customs tariffs that apply to intra-area trade, so that at the end of the ten years they would be completely abolished, and the only remaining restrictions on intra-area trade would be the customs duties within the limits indicated above.

(c) The drawing up, during the first five years, of a common external tariff, which would begin to be gradually put into effect at the end of the fifth year by means of annual percentage reductions made by each country in the difference between the level of its national tariff for each product and the level fixed in the common tariff. These annual reductions should amount to at least 10 per cent of the difference, so that at the end of the ten-year period the difference between the two levels would be reduced by at least 50 per cent.

The process of standardizing the tariff in relation to the rest of the world should be speedier for raw materials and intermediate products, which are important inputs for regional industries, in order to eliminate or minimize a serious element of distortion in the competitive footing of those industries. The sectoral complementarity agreements will be an effective means of determining the cases where more speedy standardization of the treatment of imports from third countries is called for.

The automatic reduction of charges and quantitative restrictions to be undertaken by the countries in respect of their reciprocal trade would have the aim and effect of liberalizing that trade and, in addition, establishing margins of preference and thus of protection for area production, which would stimulate substitution of imports from outside the area and the development of new trade flows.

The preference margins would eventually be consolidated at standard levels for all the countries, when the common external tariff is adopted in full. But in the meantime these preferences may be insufficient for certain products for the purpose of achieving the aims set forth in the preceding paragraph. Consequently it is desirable that in those cases the countries should agree to establish minimum preference margins, by means either of sectoral complementarity agreements, or of decisions relating to specific products.

It will also be necessary to ensure that the preference margin is not changed unilaterally if this would affect intra-area trade prospects. For this purpose it is advisable to maintain and amplify the provisions set forth in ALALC resolution 53, that is, that countries undertake not to reduce their customs charges on imports from outside the area without prior consultation with the community organs as to when this is to be done. Similarly, countries will undertake not to reduce or abolish such charges, nor to make purchases from third countries through State or semi-public bodies, when the items in question can be obtained within the area on satisfactory terms with respect to price, quality, delivery dates, etc. Moreover it will be necessary to adopt provisions to ensure that the prices of products are not unjustifiably high for the area, as a result of the preference protection.

A procedure to ensure the gradual and automatic fulfilment of the agreement to reduce tariffs, as proposed above, will have to be found so that every country can make an annual reduction of 10 per cent in the difference between the total level of customs and other charges now applied to every product within the area, and the 20 per cent established as the target level. Thus an initial duty of 50 per cent (including charges of equivalent effect) would be reduced by 3 percentage points a year, and a duty of 130 per cent would be reduced by 11 percentage points.

This procedure will require, however, that all customs duties and other charges be expressed in ad valorem terms, since there is no other form that will permit the percentage difference to be established between such duties and the target 20 per cent, or ensure that the reductions are proportional. Since all the Latin American countries,

/with the

with the exception of Brazil, have mixed tariffs, and some have duties that are almost entirely of the specific type, it will be necessary, before the tariff reduction procedure can be applied, for the countries to adopt exclusively ad valorem duties, or else for them to draw up a special customs tariff for the area, in which the treatment of imports from within the area is consolidated in ad valorem terms, and on the basis of which the annual reductions can be made. The conversion of the duties would naturally be such as not to result in any less favourable treatment for the area than that existing at present.

Even in the least difficult cases this task would take a considerable time, and only when it had been completed could a beginning be made in applying the procedure for the annual automatic reduction of tariffs. Moreover, such a method would have the drawback that the charges would be initially very high, and during much of the ten-year period they would be at such high levels that access to the market would be difficult. For example, an initial duty of 200 per cent (fairly common in many Latin American countries) would by the end of five years be reduced only to 110 per cent, and by eight years only to 56 per cent.

In order to avoid these disadvantages another procedure might be adopted, whereby the ten-year period would be divided into two five-year periods, and countries would undertake to make, during the first five years, annual percentage linear reductions in their customs duties and other charges of equivalent effect. These reductions could be begun immediately, since they can be applied equally to specific and ad valorem charges. Before coming to the end of the first stage, the countries would agree on how the tariff reduction process would be conducted during the second stage, with a view to attaining the general goal proposed above by the end of the second five years.

Such a procedure would have other significant advantages, since it would make it possible to adopt, during the first stage, a fairly rapid tariff reduction that could be put into effect immediately. Thus one essential condition would be met for giving the integration process the necessary dynamic force. It would also be possible to obtain during

/this first

this first stage most valuable experience in the application of the system, as well as regarding the effects of automatic tariff reduction and the speed with which it had taken place. In addition information would be gained as to the practicability and effectiveness of the other measures suggested to assist in attaining the aims pursued through tariff reduction, and any possible adverse effects could be counteracted. At the same time this first stage would permit the preparation of the right conditions and the necessary basis for further progress during the second stage with a view to achieving the goal set for the ten-year period.

In essence, what is suggested is that the countries undertake, during the first five years, to make annual linear reductions of 12 per cent in their customs duties and other charges of similar effect that are now in effect for intra-regional trade. The annual reduction would be only 6 per cent for the relatively less developed countries. Consequently, save for exceptions granted by virtue of escape clauses, by the end of the first stage the level of such duties and charges would be below the present levels by 60 and 30 per cent, respectively. These reductions would be the minimum that could be made during this stage, although for some products they could be higher if the fulfilment of other agreements (which are suggested later in this paper) so required, or when there had been such an undertaking in sectoral complementarity agreements or other multilateral or bilateral negotiations.

In addition to this agreement to undertake linear and automatic tariff reduction, it is suggested that countries also commit themselves to ensuring that in no case, at the end of the five-year period, will any duties or other charges be applied to reciprocal trade that exceed 50 per cent of the c.i.f. value of any product. For the relatively less developed countries the ceiling would be 75 per cent. The ceiling has the aim of eliminating, during the first stage, all excessively high barriers, and thus making it possible within a relatively short period to arrive at a minimum degree of regional competition for all products to permit the take-off of Latin American integration.

The obligation to reduce charges to this ceiling obviously means that countries will reduce tariffs more rapidly in cases where a linear reduction in the form of the percentages proposed would not result after five years in a level equal to or below the ceiling. This increased pace can be established in an approximate and tentative form for each product, with a view to an adjustment at the end of the period. The fulfilment of this obligation would naturally be subject to the saving clauses proposed later in this paper.

With respect to the quantitative and other restrictions not equivalent to customs duties, it is suggested that the countries undertake to abolish each year at least 10 per cent of the items in the Brussels Tariff Nomenclature (BTN) that are subject to such restrictions on a total or partial basis, in accordance with a list in line with the BTN that each country will submit. Thus the number of these restrictions will be reduced by 50 per cent at the end of the first five years, and abolished completely at the end of the ten-year period. At that point, in accordance with what was proposed earlier, no barriers to intra-area trade would remain apart from the customs duties, except for any restrictions whose maintenance, restoration or introduction was authorized by virtue of saving clauses. In order to reduce the possibility that in the first years liberalization would be concentrated excessively on items of no great interest to the other countries, or of interest to only a few of them, the 10 per cent annual reduction in the number of restrictions should be applied separately for each and every one of the chapters of the BTN. Furthermore, the desirability should be studied of authorizing countries, either on a general basis or in certain individual cases, and in accordance with the procedure and conditions to be established by the community organs, to replace such restrictions by customs duties.

In the case of State monopolies for the importing or marketing of goods, and of any other State or semi-public bodies through which a country directly or indirectly controls, or exerts an appreciable influence, on the imports of particular products or groups of products, it is

/suggested that

suggested that the countries should undertake gradually to abolish all discrimination against suppliers within the area in respect of purchases or marketing undertaken by such bodies.

These tariff reduction agreements will be supplemented by saving clauses whereby a country can be authorized to adopt exceptional measures or be temporarily exempted from the fulfilment of one or more of the said agreements, in cases of emergency and where there are good grounds for such action. If the fulfilment of the agreements for the liberalization of intra-area trade lead to serious harm to certain productive activities that are important to the economy of a given country, or to serious balance-of-payments difficulties, the country concerned may be authorized to impose or restore duties or quantitative restrictions on imports, but as a temporary emergency measure. It may also be authorized temporarily to postpone the reduction of the import charges on one or more products from third countries, when the gradual adoption of the external tariff gives rise to serious problems. In addition, the relatively less developed countries may be authorized to maintain or increase for certain products and for a given period, the customs duties on imports from within the area, in order to provide sufficient protection for new industries for which there are reasonable expectations that they will be economically viable.

With respect to certain products such as luxury items, for which the liberalization process may have adverse effects on the balance of payments or the allocation of resources, countries may establish internal taxes on such products. These taxes will have the aim of restricting the consumption of such items, or preventing their expansion, while at the same time they will not afford protection, since they will apply equally to the domestically produced and imported articles. That is, they will not affect the competitive situation within the area or encourage anti-economic or otherwise undesirable forms of production, such as may result if action is confined to import restriction.

The countries will also be empowered to replace by internal taxes any customs duties and other revenue charges on imports, but in line with the provisions of chapter V of the Treaty of Montevideo.

/Without prejudice

Without prejudice to the right to invoke, in exceptional and well-grounded cases, saving clauses aimed at the temporary alleviation of a critical situation, the permanent solution of the problems posed by trade liberalization must be sought in positive measures which facilitate adjustment, open markets for countries that are not obtaining a sufficient measure of reciprocity, and in general stimulate the expansion of trade and the development of industries.

There is, of course, no reason why countries should not reduce tariffs and other restrictions more rapidly than is established in the agreements, either in general or for particular sectors or products. In fact countries should expressly state their intention of doing so as soon as the general economic situation in the country, or in its industrial sector, makes this possible. This action could be taken either on a unilateral basis or through periodic negotiations, or, most probably, through complementarity agreements.

If after the minimum percentages of automatic tariff reduction had been in effect for a reasonable time it was found that there was not an adequate degree of reciprocity, the countries obtaining the greatest benefits should increase the rate of reduction of their tariffs, either in a general form or for specific products, in line with decisions or recommendations of the community organs, without prejudice to other non-trade measures that can be taken at the same time to correct the imbalance.

In addition to the general agreement, there will have to be other more specific agreements aimed at compensating for the disadvantage at which countries with small markets may find themselves, and, even more, those whose economic development is not sufficiently advanced to enable them to take full advantage of the opportunities provided by the integration process.

For the countries with small markets such measures should concentrate on ensuring conditions that will enable them to establish or expand particular productive activities. The sectoral agreements will no doubt be the most appropriate means of attaining this aim, as proposed in chapter VII of this document.

/In addition

In addition to maintaining the ALALC provisions in favour of the relatively less developed countries, and to adopting the tariff reduction agreements proposed for those countries, other measures will be needed to encourage their participation in the process of integration. With this aim it is suggested that the most advanced countries of the region should remove any restrictions on their imports of industrial products from the relatively less developed countries.

This preferential treatment would have the essential aim of stimulating the incipient industries in the less developed countries. Hence the period of duration of such preferences should be determined with this aim in view. Unlike the present ALALC procedure, the period of the preference should be calculated from the moment when the first exports from the benefitting country are made. Nevertheless, the abolition of this treatment at the end of the period concerned should not take place at once, but gradually, without prejudice to the possibility that in some cases, when circumstances seem to justify such a decision, the preference may be extended.

With respect to the exclusive concessions that have been granted, or may be granted in the future, to the relatively less developed countries under the terms of article 32 of the Treaty of Montevideo, the level of tariffs established in the concessions should be subject to the same annual automatic percentage reduction in tariffs proposed above for all countries.

These and other measures relating to trade applied in favour of the relatively less developed country should, in any case, be supplemented by financial and technical measures that will help and encourage those countries to make full use of the opportunities afforded by the integration process.

Chapter V

THE SPECIAL TREATMENT OF AGRICULTURAL PRODUCTS

1. Introduction

The situation in the agricultural sector has special features that deserve separate treatment. The main object of integration in relation to agricultural products must be to make use of the resources available in the region by means of a higher level of specialization that can be reflected both in output that increases in line with the growth of demand, and in lower prices for food products and agricultural raw materials, to the benefit of all Latin American consumers.

Because of the many economic, political, social and technical problems posed by Latin American agriculture, the liberalization of the trade in agricultural products calls for a special approach.

Among these problems are the great differences in productivity and cost levels in the various Latin American countries. Because of natural conditions and technical factors, yield per hectare varies widely from country to country, and in addition, as a result of other variables (wage systems, prices of inputs, tax treatment, exchange rates, etc.) the competitive situation of certain basic commodities varies to an extraordinary degree. Thus, for example, there are six-fold differences in the price of rice, and three-fold differences in the prices of wheat and maize. The changes in the exchange rates mean that the price ratios between countries fluctuate sharply from year to year, which is a major cause of instability and uncertainty.

It should also be noted that the great bulk of the population work in agriculture, mainly at the mere subsistence level. Either for structural or for other reasons, a large part of the agricultural population cultivate poor soils and use primitive techniques, and this situation is reflected in the region's low agricultural yields.

The fact that such a large proportion of the population work in agriculture gives the sector an inherent rigidity, which in many countries is further aggravated by the lack of widespread knowledge of alternative

types of cultivation. Agricultural research, both scientific and economic, is still very limited. A more detailed study of existing and potential resources would undoubtedly point the way to changes that could be made in the cultivation of the land, and a study of future Latin American demand for agricultural products would indicate just what changes would be advisable.

In addition there are technical reasons why a given crop should not be eliminated altogether, even though from an economic standpoint it might be better to produce it elsewhere. For example, there are areas where for climatic reasons the agricultural production possibilities are very limited, and production might even be regarded as anti-economic from a regional standpoint; nevertheless, it does not appear advisable to break the continuity of cultivation the type in question because over the long term it may be necessary to call on all the resources available for the production of food and agricultural raw materials in order to meet the region's future needs.

The same principle applies to the opening up of virgin lands. If, for example, it proves necessary to take over new lands for crops or livestock, in remote areas with a low yield, the output will have to be treated in a special way, since it will hardly be able to compete on the open market from the outset. A case in point is land reform. In the first stages of modification of the agrarian structure it will be essential to ensure that the new farmers and beneficiaries of land reform are able to compete with the more experienced and better organized farmers of other countries. The foregoing observations indicate that the process of trade liberalization for agricultural products must be so managed as not to result in a severe disruption for the existing groups, in some countries of what might appear to be marginal farmers in comparison with other cultivators.

From the long-term standpoint it is essential that all the land available in Latin America should be used to meet the demand for food, in order to avoid inroads into the capacity to import other goods. In fact, estimates by ECLA and FAO show that the regional demand for wheat, for example, will by 1980 be 12 million tons above its present level,

/and amount

and amount to about 24 million tons. For maize the increase is expected to be even greater. If these higher levels of output are to be attained, a technological revolution in the countryside will be essential, in order to achieve a significant increase in yield per hectare, since the area under cultivation cannot expand indefinitely.

Moreover it should be noted that there is a substantial margin for the substitution of imports from outside the region. It is estimated that agricultural exports from the rest of the world now amount to about 600 million dollars a year, although a considerable proportion represent imports made under the special conditions of United States Public Law 480. The great range of climates in Latin America justifies the assumption that the greater part, if not all, of agricultural imports from outside the region could well be obtained from within Latin America.

2. Trade policy for agricultural products

The agreements to reduce tariffs and quantitative restrictions referred to in chapter IV will apply to agricultural products, but in view of their special nature and their importance, there will have to be a special system governing trade in these products, which will supplement, and in some cases modify, the general system of tariff reduction.

The establishment of such a special treatment is in accordance with the provisions of chapter VII of the Treaty of Montevideo and ALALC resolutions 91 and 97. The special system will have the basic aim of regulating trade in agricultural products through the organization of markets, and promoting an advance in line with the co-ordination of agricultural development policies. This means that the system in question must stress, not so much the reduction and gradual elimination of tariff barriers to intra-regional trade in agricultural products, as the adoption of measures aimed at a rapid increase in agricultural output and in the substitution of imports from outside the region.

Countries should undertake to adopt such a special system within a period of five years, together with an effective organization of markets and a co-ordination of their production policies, at least for the main agricultural products. For this purpose studies should begin at once to determine the bases for the agreements in question.

/Thus, for

Thus, for example, there should be a detailed study of the present and potential use of available agricultural resources in the Latin American countries, with a view to settling upon a more rational distribution of production within the framework of future estimated demand. Similarly, there should be an analysis of the factors underlying the present discrepancies in productivity and costs, and an estimate of the displacement of population groups that would result from any proposed changes. In this connexion an estimate will be needed of the type and volume of investment required to absorb the surplus agricultural population.

At the same time there should also be, during the five-year period, studies to establish the bases for an effective co-ordination of policies on the production of and trade in agricultural products. The institutional machinery proposed might well include special committees to consider and agree on specific programmes for the production of and trade in certain products or groups of products, that would cover matters relating to general and specific policies, as well as technical, trade, financial and legal questions. Such committees would have the task of reconciling national development programmes for each product or group of products. On the basis of the specific agreements the committees could establish a common agricultural programme that could, inter alia, aim at avoiding possible imbalances in the agricultural sector for the region as a whole.

Until this special system is drawn up and adopted, agricultural products would be governed by the general system of linear and automatic tariff reduction and progressive abolition of quantitative restrictions. However, in order to avoid any abrupt changes or serious ill effects that such a system might lead to for certain major items, it is suggested that a saving clause should be adopted, similar to that in article 28 of the Treaty of Montevideo, supplemented by AIALC resolution 97. This saving clause would permit countries to apply quotas to regulate imports of the agricultural products concerned. The clause could be applied by a unilateral decision of the country affected, but the intention to adopt it should be communicated in advance to the community

organs, which

organs, which in case of any protests on the part of other member countries, would have to decide whether or not the application of the clause was justified, and if so, what the amount and period of duration of the quotas should be, the procedure to be adopted for their distribution and progressive increase, etc.

For the same purpose and on the same conditions, such quotas could be used to replace import permits, import prohibitions or existing quotas in the Latin American countries in respect of imports of agricultural products. The replacement could be regarded as part of the fulfilment of the agreement to abolish quantitative restrictions, as proposed in chapter IV.

Another point is that in some Latin American countries there are State agencies or enterprises that have the exclusive right to import or market agricultural products. As it is possible through such agencies to control and regulate imports of these products, the community organs should study the possible effects of their existence in relation to the promotion of regional trade, and to the designing of the system to be finally adopted in the field of agricultural integration.

3. Programme of financial assistance

In addition to the integration programme for agriculture there will have to be a regional programme of financial assistance to provide the funds needed to: (a) raise productivity, especially in the more backward areas, by the introduction of new techniques, new direct investment, agricultural research and extension work, mechanization, improved facilities, increased irrigation, etc.; (b) the study of alternative land use and the preparation and execution of the projects involved; (c) the absorption in other employment of the population displaced from agriculture, when no alternative economic use of the land is possible. In relation to the last point it should be noted that there are a number of areas of low fertility (either because of natural conditions or as a result of erosion) that could be reforested; this would create new sources of wealth and employment, but only over the long term.

1. The first part of the document discusses the importance of maintaining accurate records in a business setting.

2. It highlights the various methods used to collect and analyze data, including surveys, interviews, and focus groups.

3. The second section focuses on the challenges faced by researchers in the field, such as limited resources and time constraints.

4. It provides a detailed overview of the research process, from the initial problem identification to the final report writing.

5. The third part of the document explores the ethical considerations that must be taken into account during the research process.

6. It discusses the role of the researcher as a facilitator of learning and the importance of fostering a supportive environment for participants.

7. The fourth section addresses the practical aspects of data collection and analysis, including the use of statistical software and the interpretation of results.

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Chapter VI

REGIONAL INVESTMENT POLICY

1. Aim of a regional investment policy

(a) Trade and investment policy

In order to speed up the rate of Latin America's integration, it is essential for trade and investment policies to dovetail. Trade liberalization alone cannot achieve integration, since it would make the regional inflow of investments dependent upon the more or less free play of the market forces. In such circumstances it would be difficult to ensure that sufficient resources were mobilized for the activities which are of major importance for regional development and integration.

A regional investment policy would consist of a body of planned measures for the allocation and mobilization of resources to ensure a sufficiently rapid growth in sectors considered essential to the region's development and integration, and an increasing measure of specialization that would open the way to the benefits of economies of scale and a more rational use of resources. In this way a more vigorous development could be achieved for the whole region, and every country could be assured of a share in this more dynamic growth. The formulation and execution of such an investment policy would be the task of the community organs, in close co-operation with the public and private agencies in every country.

Essentially, a regional investment policy provides an operational formula that permits reconciliation of national investment policies with regional aims. Furthermore, it permits the integration process to develop at a level of major decisions which can help to determine in advance what advantages and obligations are involved for each country.

A regional investment policy is also a key instrument in solving a major difficulty in Latin American integration, namely, the problem that some of the Latin American countries are relatively less developed than others, and the need to eliminate these differences by promoting a joint development of all the countries in the Latin American system. A mere preferential tariff reduction on the lines laid down in the Treaty of

/Montevideo has

Montevideo has little meaning for the relatively less developed countries, because of their limited capacity to promote investment, and increased production and exports, for the items in question. The removal of regional imbalances is therefore basically dependent on a regional investment policy which aims on a planned basis at achieving a more rapid growth in the relatively less developed countries.

Lastly, a regional investment policy will encourage the formation of a Latin American common market because, without prejudice to the liberalization of all trade, the integration of key sectors of the region's economy will permit this goal to be attained more rapidly in those sectors.

However, the possibility that countries will in fact support the regional solution depends on the speed with which the community system operates in terms of offering immediate response to national ambitions. The countries that have already reached a more advanced level of industrial development and import substitution cannot be expected to delay their plans in the hope of a future regional solution.

The reconciliation of national aspirations with regional integration cannot be based merely on a theoretical definition of the advantages of an integrated regional development as compared with a development conceived on national lines. There must also be specific and immediate proposals in terms of the national plans, especially in the basic industrial sectors. Hence the formulation of a regional investment policy, particularly in those sectors, is the key to the reconciliation of national aims with those of the region as a whole. If Latin America accepts this approach, the many advantages of an integrated development will persuade every country from the outset to participate actively in the integration process.

(b) Maintenance and stimulation of competition

The formulation and execution of a regional investment policy entails the adoption of protectionist measures at the regional level for the integrated industries. In the case of large industrial investments, producers might reach an understanding likely to hamper the competition that, for many reasons, it is important to maintain. The public interest can be protected by a policy of vigilance aimed at preventing monopoly agreements. Effective competition between the producers of the regional market would stimulate industrial efficiency, and a common external tariff will have the same effect.

/The aim

The aim should not be for sectoral investment agreements to establish rules that will bar the way to other individual attempts to operate in those sectors. The purpose will be to channel investments towards the activities proposed in the regional investment policy. In so far as this policy is in line with the region's real situation, and with its aspirations for economic growth, those activities will offer the best opportunities for the establishment and expansion of industries. The body of incentives adopted should be sufficient to channel capital towards the sectors that are the subject of the agreements in question.

(c) Foreign capital and a regional investment policy

Foreign capital represents another problem that needs examination. Given the region's present conditions of under-development, the formation of a broad regional market in itself may give rise, especially in the technically complex industries, to an inflow of foreign capital in conditions and forms that may weaken the control that the region must necessarily maintain over the basic sectors of its economy. The essence of a balanced Latin American nationalism lies not only in the vigorous promotion of the region's development and of the living standards of its peoples, but also in encouraging regional capital to play a decisive role and in establishing the conditions for a self-sustained and independent development.

A regional investment policy must ensure that foreign capital is absorbed on terms compatible with the region's capacity for external borrowing, and with the independence of its development process. The policy of trade liberalization is not in itself the ideal instrument for achieving this aim, but a regional investment policy is.

This is another fundamental advantage which makes a regional investment policy the key to the process of regional integration.

2. The fields to be covered by an investment policy

A regional investment policy must concentrate on those activities which will accelerate Latin American integration and at the same time strengthen the region's economic structure. At present, as a result of the lack of capital in the region, the shortage of technical and

/administrative staff,

administrative staff, and the high proportion of investment that goes to meet domestic demand, it would be impossible to put into practice a policy that would cover the formation of capital in Latin America as a whole. Hence at this stage the first priority would not be the formulation of a regional policy of investment in activities directly strictly to the domestic market in each country, or in such social activities as housing and health services, or in infrastructure projects aimed at integrating the national markets.

On the other hand some activities are of particular importance to the process of regional integration, and if these activities were undertaken within the framework of integration, every country could speed up its development. These activities cover mainly certain manufacturing branches, agriculture, and transport and communications, together with other activities that relate particularly trans-frontier areas in the region.

(a) Industrial investment

This includes investment in various branches of basic industry or in traditional industries that lend themselves to regional complementarity, or are connected with certain specific integration aims such as the balanced development of the region as between the different countries.

(i) Basic industries. The industries that produce industrial raw materials and capital goods and can be encouraged within the framework of a regional investment policy appear to be steel, aluminium metallurgy, the heavy chemical industry (fertilizers, sodium alkalis and the basic petro-chemical industry), pulp and paper, the manufacture of basic industrial equipment (for the production of steel and petroleum, the generation of electric power and the manufacture of pulp and paper), transport material (for road, rail and water transport), machine tools, textile machinery and road-building equipment.

For many reasons the industries referred to are of great importance to the integration process. Latin America as a whole, and the relatively more developed countries in particular, are already far advanced in the import substitution of relatively simple industrial goods. Moreover

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projections of the trends of the region's capacity to import on the basis of its traditional exports show that it will be insufficient to meet the demand for the imports of capital goods and industrial raw materials essential to the expansion of Latin America's production capacity. When the region is forced to extend the process of import substitution to the capital goods industries, the smallness of the national markets will raise serious problems.

The strategic nature of the basic industries and the need to encourage their development is underlined by their valuable role in both assimilating and disseminating modern technology. The external economies generated by these industries has been one of the main pillars of the development of the more advanced countries. In addition their expansion is an essential condition for the diversification of Latin American production, which will enable the region to diversify its exports and gradually to compete on the world market in respect of the most dynamic items

Lastly, the expansion of various branches of the basic industries such as metal-transforming and the petro-chemical industry is an essential requirement if the region is to go beyond the present stage of exporting raw materials (tin, copper, iron ore and petroleum) and process them in the region for both the Latin American and world markets.

Hence the key to the integration of the basic industries is a regional investment policy aimed at achieving within given periods certain production and trade targets, and for this purpose not only must national investment programmes be co-ordinated, but the necessary specific projects must be prepared.

(ii) Traditional industries. In certain traditional industries such as the textile industry the formulation of a regional investment policy could contribute effectively to increased modernization, greater efficiency, more regional specialization, and easier access to world markets for Latin American production. The direction of this policy, and the vigour with which it is pursued, must be closely linked to the process of trade liberalization.

/(iii) Special

(iii) Special purpose industrial projects. The balanced growth of the region and the promotion of a more rapid growth for the relatively less developed countries provides a third field of operation for a regional investment policy, to the extent that the projects relating to the basic and traditional industries, based on principles of efficiency and appropriate location, may not suffice to allow those countries to develop sufficiently.

The exploitation in those countries of the resources that can be processed for sale in the region, or to the rest of the world, may provide the opportunity for specific industrial programmes and projects that will supplement this aspect of a regional investment policy.

(b) Investment in agriculture

The need to make up the existing deficit, and to meet future increases in demand, both in food products and raw materials for industrial use, calls for the adoption of measures at the national level aimed at a marked increase in agricultural output and productivity. Specially important are investments in irrigation works, experimental stations, and facilities for the storing, processing and packing of agricultural products, to name only the most important.

The achievement of the over-all aims of integration and economic development should be based on the firm and steady growth of agriculture, enabling it to overcome the structural and other obstacles that have hindered its progress. A regional investment policy may encourage the execution of projects in the particular fields that will contribute to the region's supply. The reaching of the agreements on agricultural products referred to in chapter V will undoubtedly help to determine the most important subjects for a co-ordinated investment policy in this sector.

(c) Investment in infrastructure

As regional trade increases as a result of the investment policy and the liberalization of trade, the difficulties of communication and transport between the various countries will make themselves more felt. Hence there will have to be improvements in the systems of road, rail, air, maritime

/and inland

and inland waterway transport, which means that investments on a regional basis must be made in each of these fields.

The main aspects of a transport policy for the Latin American common market are dealt with more fully in chapter VIII.

The growth of the flow of goods and services within the region will make it more and more necessary to expand and interconnect the national communications systems. The region should incorporate into its systems the latest technological advances. An enterprise of this magnitude can only be conceived within the framework of a policy co-ordinating services and investment in this field.

An infrastructure investment policy should also cover the expansion of installed capacity for the generation of electric power to meet the region's needs. From this standpoint it is of the utmost importance to carry out joint projects for the exploitation of multinational resources, such as certain hydroelectric resources, and for the increasing inter-connexion of national electricity systems.

(d) Investment in trans-frontier areas

There are in Latin America many frontier zones that constitute a real economic entity, and where the policies of the countries involved should be co-ordinated in order to meet the specific development problems of the whole area. This is the case, for example, with respect to the areas bordering on the frontiers between Colombia and Venezuela, Colombia and Ecuador, and Argentina, Brazil and Paraguay. The formulation of development programmes for the whole of these and other areas that go beyond national frontiers, and of a common investment policy to promote their development, is a prerequisite of their economic and social progress.

The main responsibility for the development of these border areas lies with the countries directly concerned. Nevertheless the community organs should lend their assistance in the formulation of development programmes and specific projects for the development of such areas. In particular the Board should bear in mind that encouraging the development of the border areas of concern to the relatively less developed countries may be an effective way of increasing the economic growth rates of those countries to levels closer to those for the region as a whole.

A number of international agencies have shown special interest in co-operating in the promotion of the development of the border areas.

Chapter VII

AGREEMENTS ON BRANCHES OF INDUSTRY

1. The benefits of integration in the industrial sector

The main barriers to the quicker and more rational development of manufacturing industry in Latin America are the small size of the national markets, the shortage of capital, the limited technical knowledge and the lack of a spirit of competition that would put a premium on the achievement of operational efficiency in industry.

The establishment of a common market in this sector would make for the necessary changes in industrial structure and methods of operation, and thus pave the way for Latin American industry to compete on world markets.

The immediate benefits would be a reduction in production costs per unit of output and an appreciable saving in the investment needed to reach a specific over-all rate of growth in the manufacturing sector. The cost and investment savings would result from the following factors:

- (a) Advantages of selecting the location of productive activities in terms of the most economical sources of raw materials, fuel and energy as well as other inputs with a heavy incidence on production costs;
- (b) Economies of scale derived from the decreasing ratio of plant size to unit cost in many branches of industry;
- (c) Better utilization of production capacity; and
- (d) Greater operational efficiency.

The proportion of benefits obtained would vary according to the branch of industry concerned. Other benefits of equal importance would come at a later stage; these would take the form of cumulative external economies or more rapid import substitution at the regional level, and derive from the more intensive growth of industry under the influence of the former group of factors.

/This chapter

This chapter does not propose to make a systematic analysis of all the effects of market integration on industrial development. Instead it will confine itself to examining some of the advantages that may be derived in the particular conditions obtaining in Latin America.

There are wide differences in the availability and price of the main industrial inputs - raw materials, fuels, energy and labour - in Latin America. These variations are a source of sharp disparities between the cost of the same product manufactured on the same scale and with the same operational efficiency in different places, and thus indicate the benefits to be obtained from regional specialization in accordance with the comparative advantages afforded by each place. So far no attempt has been made to turn these to account, because of the tendency for the whole range of industrial products to be manufactured indiscriminately in every country.

In a common market, advantages of location would be particularly marked for products whose cost is heavily influenced by raw materials or energy since the unit cost of such inputs varies widely in Latin America. The chemical industries are a good example of the cost reductions that could be achieved through progressive regional specialization.

The uneven distribution of natural and other resources required for the chemical industry in Latin America would determine the most suitable location for each product. Once this had been settled the process of integration would enable production lines to be divided up in a more balanced way so that each country could specialize in the particular branches for which it was best qualified. Some countries, for instance, have better natural conditions for the production of natural gas derivatives, nitrogen fertilizers, carbon black from gas, methanol and so on, others have an abundant supply of sulphurous gases as a by-product of copper mining and could take advantage of this cheap input to specialize in products using large amounts of sulphuric acid (triple superphosphates), while those possessing phosphorite are well-equipped to produce phosphate fertilizers (phosphate bicalcium and sodium phosphates).

The aluminium industry, on the other hand, illustrates the vital importance of regional specialization for reducing electric energy costs. These vary extensively in Latin America, and nearly all the middle-sized

/or larger

or larger countries plan to produce aluminium metal if not alumina. In fact their incidence is so great that in two countries where the cost per kWh is 3 and 10 dollar mills respectively, plants of the same size and similar technical characteristics would have unit costs per ton of 240 and of 360 dollars. The advantage to be obtained from optimum location in this case would thus be nearly 50 per cent. In a region that hopes to produce the bulk of the 200,000 tons of aluminium needed for its estimated apparent consumption in 1970, the extra cost incurred through a poor choice of site is a factor to be reckoned with, quite apart from the added drawback of the inadequate scale on which national aluminium industries would operate.

Location also has a notable effect on costs when the principal input consists of raw materials, since these, being a natural resource and therefore closely dependent on local conditions, vary widely from country to country. Non-ferrous metals and pulp and paper manufacture are cases in point. In the steel industry, on the other hand, and particularly the processing industries in which capital charges have a substantial incidence on costs, it is economies of scale that tip the balance.

2. The steel industry

(a) Location, economies of scale and costs

A number of Latin American countries have very favourable conditions for steel making. The differences between these countries as regards advantages of location are not marked enough to prevail over all the other factors.

For a hypothetical plant of the same size (producing 1.5 million tons of ingot), technical structure and operational efficiency in the principal steel-making locations, Venezuela (Orinoco) would probably offer certain advantages thanks to lower inventory costs for raw materials. Next in order of preference would come Mexico (Monclova), Brasil (Victoria), Peru (Chimbote) and Chile (Huachipato), although the differences would not be large enough to offset the higher transport charges.

Orinoco's margin of advantage as regards the estimated cost of pig iron production would be 7 to 8 dollars over Huachipato and Chimbote and even more in comparison with Monclova and Victoria. In view of the high cost of transport in Latin America (notwithstanding the hope of some improvement in this respect) which is 10 to 20 dollars per ton, Venezuela's advantage is probably too narrow to attract the bulk of steel production to that country, although large enough to rule out competition from such steel firms as San Nicolás (Argentina).

This conclusion is not applicable to the analysis of existing industry, for which the factor of location is overshadowed by those of plant size, economies of scale, specialization and operational efficiency, which play a much greater part in determining the final cost of production.

In the rolling of flat products, scales varying from 300,000 to 1 million tons are enough to change the cost by 44 dollars, or nearly 40 per cent in relation to the level for the most economic plant size (it drops from 156 to 112 dollars per ton).^{1/} Differences in operational efficiency (including the internal distribution of capacity) are liable to have an almost equally marked effect on prices.

Given the variety of scales and levels of efficiency, etc. that are displayed by the Latin American steel industries, complete liberalization of trade might have, on several of them, an adverse and much more powerful impact than advantages of location, as demonstrated by the theoretical costs estimated for the conditions in which the Latin American industries are currently operating. If opened in the immediate future, a common steel market would place the San Nicolás, Paz del Río, Chimbote and Huachipato steel mills at a disadvantage, since all four are inadequate in size, one suffers from serious imbalances in its internal capacity (San Nicolás), two produce an excessively large wide range of flats (Huachipato and Chimbote) and, in addition, Chimbote's technical structure is unsuited to the natural resources available.

^{1/} These figures are for plants using modern techniques and therefore apply to a few only. Where less advanced techniques are employed, economies of scale lead to more pronounced disparities.

(b) A sectoral development programme

The estimated differences in cost for existing industries are too high for transport charges to offset them, and thus prevent competition by the bigger or more efficient mills from having an adverse effect on San Nicolás or the steel industries along the Pacific coast. The formation of a common steel market should therefore be planned on a sectoral basis, side by side with a programme for trade liberalization. In other words, the regional integration of the steel industry should be conceived as the outcome of a consistent and rational development programme, methodically prepared and applied over a certain number of years, during which the adverse factors that leave certain countries (particularly Chile, Peru and Argentina) ^{2/} ill-equipped to compete in a free regional market would be reduced or removed. The programme would provide for the necessary investment to balance the internal capacity of some firms, improve the operational efficiency of others, change the technical structure of certain plants and increase the operational scale of those producing less than one million tons of flats or 500,000 tons of non-flat products to the requisite economic minimum. Not until the whole programme has been carried out will the Latin American industry be in a position to play its full part in a system of regional competition.

This programme could be applied in two successive stages, each probably lasting for five years. The first would be mainly concentrated on improving established industry. Plants would be enlarged, advantage would be taken of the lower investment costs that would result from industrial complementarity and internal equilibrium as regards existing plants, and recent technical improvements would be introduced (the use of oxygen, etc.) to raise output substantially at very little capital cost; no attempt would be made, however, to set up new plants. By the second stage, the possibility of continued expansion of existing industry will have been seriously reduced, while the increase in demand would

^{2/} Paz del Río (Colombia) is something of a special case, since the natural barrier set up by high domestic transport costs protects the industry from regional competition.

entail the construction of new plants. These should from the very beginning be built of minimum economic size and with all possible technical improvements. In short, the stages for gradually setting up a common steel market, in conjunction with a programme for modernizing existing industry, would be as follows:

I. 1965-70 ^{3/}

Introduction of technical improvements in the operation of existing mills

Expansion in scale

Elimination of internal imbalances in plant capacity

II. 1970-75

Establishment of new integrated industries with a minimum capacity of 1.5 million tons for flats and of 900,000 to 1 million tons for non-flat products, equipped for a fair amount of specialization in final rolled products and with all possible technical improvements (particularly those implying a lower capital coefficient, such as LD, continuous casting, etc.).

The first stage would be aimed at economizing on investment and lowering production costs through the reorganization of the industry, which would give it by 1970 an economic scale and level of operational efficiency comparable with those of Western Europe.

The purpose of the second stage will also be capital savings and cost reductions, but from 1970 onwards economic expansion will not be feasible except in one or two cases. New installations will be required, and these should be given the right economic dimensions from the outset instead of being built on a small scale to be expanded later, as is the current practice in Latin America.

Market integration would play an important part in putting a programme of this kind into practice. During the modernization stage (1965-70), integration would supply the necessary element of competition (potential rather than real at that stage) and emulation, in default of

^{3/} The dates are arbitrary, serving merely to give an idea of the time that it will probably take to introduce the necessary changes.

which there is little hope of modifying the actual state of relative technical stagnation and serious imbalances in capacity. A contributory factor would be the tariff reduction proposed in this document, particularly in chapter IV. Wherever expedient for enabling certain industries to operate at full capacity, the reductions might be carried further than the general limit. During the stage of establishing new plants, bigger tariff reductions combined with other measures of harmonization, would make it possible for them to be built to meet the requirements of regional specialization, economic size and specialized production programmes.

In principle, it would not be necessary to conclude an agreement for regional integration during the first stage, since the rationalization of established industry could be largely accomplished through national programming. However, no country has yet embarked upon a radical reorganization of its steel industry, and the creation of a common market may well provide the stimulus needed to rouse them from their inertia. During the second stage, a common market would be absolutely essential since the large-scale specialized plants to be set up would cut into purely national markets, particularly in the smaller countries.

A scheme of the kind proposed would be the solution for countries such as Chile and Peru which, while possessing advantages of location because of the low cost of basic inputs, do not have a large enough domestic market to warrant the scale of operations and specialization that would make their costs comparable with those of Orinoco, Monclova and Volta Redonda. Under the programme outlined, Huachipato should expand its capacity to one million tons of flat products (more than the additions it has just made) and change its rolling mill so as to specialize in certain rolled products. Chimbote would benefit from the recent change in its technical structure which involves the use of a blast furnace for reduction instead of an electric furnace, an oxygen converter in the steel mill and continuous casting. It should also enlarge the scale of its operations and specialize in a few products. It is estimated that with this structure and a capacity of slightly over 400,000 tons of ingot, a specialized steel mill at Chimbote could produce

/non-flat products

non-flat products for about 90 dollars which compares favourably with the estimated theoretical cost for Volta Redonda and would make it possible to export to world markets. It is essential for Peru to export, whether to the regional or world markets, since its own outlets cannot absorb more than 60 per cent of such specialized production. These examples show that a ten-year programme for steel modernization and development can make it possible for each of the Latin American countries to compete freely in a regional market.

(c) Investment savings and costs

An endeavour was made to determine the effects of the programme as regards investment savings and the reduction in aggregate steel costs. The results of the estimates, which are provisional and considerably simplified, are given in tables 2, 3 and 4.^{4/}

Table 2 shows the volume of production envisaged for 1965, 1970 and 1975. The figures derive from a projection of demand based on the probable growth of the gross domestic product in the different countries and of the industries that use steel.^{5/} It was assumed that annual imports of steel products would decrease to 2 or 3 million tons less than the current figure. The increase in output in 1965-70 would be achieved entirely by means of additions and better operation of existing industry. In 1970-75 further additions would be made if justified by an expansion in the market (which is not expected to take place before 1970), but the bulk of the increase in production would come from new plants.

Table 3 indicates the amount of investment represented by the industry in 1965, and estimates the volume needed for expanding and improving existing plant and establishing new facilities. The aggregate figures show the saving that would be obtained through the implementation of the programme, as a result of the drop in investment per unit of product.

^{4/} A general study on the Latin American steel industry, prepared by ECLA in co-operation with ILAFA, IDB and ILPES, is shortly to be issued.

^{5/} The future rate of growth for apparent steel consumption is estimated at 7.86 per cent annually.

Table 2
ANNUAL PRODUCTION CAPACITY ENVISAGED, 1963-75
(Thousands of tons of ingots)

	1963	1965	1970	1975
Projected consumption or demand	9 356		18 148	27 259
Real or programmed production	7 211	9 971	16 235	25 202
Deficit to be covered by imports	2 145		1 913	2 057
Production in 1963	7 211	7 211	7 211	7 211
Additions and entry into operation of new installations before 1965		2 760	2 760	2 760
Additions and entry into operation of new installations between 1965 and 1970			6 264	6 264
Expansion by 1975 of the industry as it exists in 1970				3 167
One new mill for flat products to enter into operation between 1970 and 1975 (with a capacity of 1.5 million tons)				1 500
Four or five new mills for non-flat products to enter into operation between 1970 and 1975 (with a capacity of 900 000 to 1 million tons each)				4 300
	<u>7 211</u>	<u>9 971</u>	<u>16 235</u>	<u>25 202</u>

Source: ECLA.

Table 3

INVESTMENT REQUIRED TO DEVELOP THE STEEL INDUSTRY AS ENVISAGED
IN THE PROGRAMME a/
(Millions of dollars, and in brackets dollars per ton of ingot
production capacity)

	1965	1970	1975
Investment in total installed capacity in 1965	4 076 (408.78)	4 076 (408.78)	4 076 (408.78)
Additions and entry into operation of new installations between 1965 and 1970		757 (121.63)	757 (121.63)
Additions in 1970 to enter into operation before 1975			243 (76.73)
One new plant for flat products (with a capacity of 1.5 million tons)			318 (212.00)
Four to five new plants for non-flat products (with a capacity of 900 000 to 1 million tons each)			835 (194.19)
	<u>4 076</u> (408.78)	<u>4 833</u> (297.69)	<u>6 229</u> (247.16)

Source: ECLA.

a/ The figures for 1963 have not been included since four of the most important plants (San Nicolás, USIMINAS, COSIPA and Orinoco) had only just entered into operation.

Table 4

TOTAL DIRECT COST OF LATIN AMERICAN STEEL PRODUCTION AS ENVISAGED
IN THE DEVELOPMENT PROGRAMME, AND AVERAGE COST PER TON a/

(Millions of dollars, and in brackets average cost in dollars per ton)

	1965	1970	1975
Direct cost of total steel production in 1965	1 313 <u>b/</u> (131.68)	1 313 <u>b/</u> (131.68)	1 313 <u>b/</u> (131.68)
Direct cost of additional production resulting from expansions and establishment of new plants between 1965 and 1970		629 <u>b/</u> (100.42)	629 <u>b/</u> (100.42)
Direct cost of additional production resulting from expansions between 1970 and 1975			243 <u>b/</u> (76.73)
Direct cost of producing 1.5 million tons of flat products in the new mill of that capacity to be set up between 1970 and 1975			144 <u>c/</u> (96.00)
Direct cost of producing 4.3 million tons of non-flat products in four or five new mills with a capacity of 900 000 to 1 million tons			405 <u>c/</u> (94.20)
	<u>1 313</u> (131.68)	<u>1 942</u> (119.62)	<u>2 734</u> (108.48)

Source: ECLA.

- a/ Including 6 per cent of the value of the equipment for amortization and 9 per cent of fixed assets for debt servicing and repayment of share capital.
- b/ Calculated from average input costs, on the assumption that all possible technical improvements have been made to increase capacity and reduce costs and that the industry is efficiently run.
- c/ For modern structures with a coke blast furnace, steel mill with oxygen converter (L.D. or similar), continuous casting and rolling.

Table 4 presents an estimate of what has been termed theoretical total direct cost,^{6/} in other words, direct cost per ton in the plant (including the cost of raw materials, fuel, energy, manpower and capital charges) multiplied by the volume of production (or capacity) for each year. It is clear from the table that the reduction in the unit cost of steel under the programme will be substantial.

The programme will lead to a saving of investment in steel plant and a reduction in the cost of steel. The relevant figures, which should be taken as approximate estimates only, are contained in table 5 and are based directly on the data quoted above.

To sum up, the annual savings in the total cost of steel production in Latin America will be as follows:

	<u>1975</u>
In steel investment	375 million dollars
In steel costs	416 million dollars

Very considerable investment will be needed to produce the 15.2 million tons of steel represented by the expansion of the steel industry between 1965 and 1975 if the industry's structure remains the same and its capacity continues to be under-utilized to the same degree as at present. On such circumstances the amount required would be 5,906 million dollars (see again table 5). The same expansion would be more economical if the integration programme were carried out in two stages, since investment would then be reduced to 2,153 million dollars. The saving effected (3,753 million over the decade) is equivalent to slightly over 60 per cent of total investment requirements "without integration". This testifies to the inefficient way in which capital is now being used in the Latin American steel industry and the extent of the benefits that would be obtained through regional co-ordination of its future development.

^{6/} This has been calculated on the basis of the average cost of inputs in Latin America, with the addition of 15 per cent for capital charges on investment in sections that are currently in operation.

Table 5

INVESTMENT SAVING AND COST REDUCTION UNDER THE DEVELOPMENT
PROGRAMME, 1965-75

(Thousands of tons and millions of dollars)

	1965	1975
Production capacity	9 971	25 202
Total investment required	4 076	6 229
Investment requirements for the same structure of industry as in 1965	-	9 982 a/
Investment saving		
During the ten-year period	-	3 753
Annually	-	375
Total direct cost of annual production	1 309	2 734
Total direct cost of annual production based on the same structure of industry as in 1965	-	3 150 b/
Investment of annual cost	-	416

Source: ECLA.

a/ The investment indicated is 320 million dollars (3.2 per cent) less than the product of projected production capacity for 1975 multiplied by actual average investment per ton, because allowance has been made for the substantial investment represented by existing plant that is either not worked at all or else on a very small scale, particularly in Argentina, Brazil and Mexico, a situation that is assumed to be the same in 1975.

b/ Production costs in 1975 have been estimated as 6 per cent less than the product of actual costs multiplied by the tonnage envisaged, on the assumption that the upward trend of productivity in recent years will continue.

/The savings

The savings that would accrue in production costs are estimated at about 416 million dollars annually, or 13.2 per cent of the total primary ex-plant cost of the steel produced up to 1975 (25.2 million tons).

Production costs would be cut much less than investment because full use will be made of plant capacity, which is currently under-utilized. Moreover, the estimate made of the direct cost of a total output of 25.2 million tons in 1975 has been strongly influenced by the fact that 10 million tons are already being produced in 1965. The direct cost per ton (131 dollars) for this proportion is expected to be just as high in 1975 as in 1965. The reductions in cost would be greater if the expansions and new plant to be set up during the period covered by the programme at a unit cost of 77 to 102 dollars per ton were to be compared solely with the new volume of production envisaged for the same period, i.e. 15 million tons, at the present unit cost of 131 dollars per ton. Total direct cost is postulated in the two hypotheses as follows:

Total direct cost of producing an additional 15 million tons of steel between 1965 and 1975

- | | |
|---|-----------------------|
| 1. Calculated at the estimated average cost in 1965 | 1,965 million dollars |
| 2. Calculated on the basis of the unit cost resulting from additions and improvement to the capacity of existing plants and the establishment of new units of economic size | 1,431 million dollars |

The resulting savings would amount to 534 million dollars, which is slightly over 25 per cent of the highest estimate of total cost.

3. Other industries

(a) Aluminium metallurgy

This industry exists in only two Latin American countries - Brazil and Mexico - and is about to be established in Venezuela. Current production is very small in comparison with the region's total demand, which increases at an average annual rate of over 10 per cent. It is

/estimated that

estimated that by 1970 and 1975 total demand (apparent consumption) in Latin America will be 200,000 and 270,000 tons respectively.^{7/} In contrast to these figures, Brazil's two plants are turning out about 30,000 tons a year, Mexico's recently-installed plant has a capacity of 20,000 tons and projected production in Venezuela will begin at 10,000 tons a year. Hence, there is ample justification for establishing new plants in the next few years, and the possibility is being studied both in the producer countries and in Argentina, Chile, Colombia and Peru. Aluminium metallurgy is distinguished by marked economies of scale in costs and investment, and if the industry continues to develop on the same lines as at present, with small units in different countries, Latin America would lose the benefits that it could obtain from the establishment of a few large plants located in the best position for supplying the requirements of the region as a whole.^{8/}

The investment required for primary aluminium is provisionally estimated to vary from 1,250 dollars per ton in plants with a capacity of 10,000 tons to less than half (600 dollars) in plants of 180,000 tons. The unit cost declines in the same proportion because of the peculiarly heavy incidence of capital charges. As has been pointed out, the cost of electric energy has a marked influence on the unit cost of aluminium. As a result, the need for optimum location in terms of raw materials and energy supplies makes it additionally important for the industry to be developed with an eye to the interests of the region as a whole.

In order to underline the practical importance of such factors, the total investment needed to cover Latin American demand for primary aluminium in 1975 has been estimated on the basis of two hypotheses:

1. That each country with a market larger than the absolute minimum capacity of the plant sets up its own plants during the next decade to cover domestic demand;

^{7/} At an annual rate of increase of 2.5 per cent for the per capita product.

^{8/} See Los principales sectores de la industria latinoamericana: problemas y perspectivas (E/CN.12/718), Chapter II.

2. That three large regional plants are established, one in the area formed by Mexico, Central America and the Caribbean, a second on the Pacific coast and a third on the Atlantic seaboard.

In order not to enlarge upon and complicate these examples, unnecessarily, it has been assumed that the alumina would be imported from outside Latin America, although one country is already processing it in the region, and other countries are likely to follow in its footsteps despite the large economies of scale that characterize this stage of the industry as well.

Investment requirements are compared below on the basis of national production and regional production:

Investment requirements for supplying
demand in 1975

National production

Six plants (Argentina, Brazil, Colombia, Mexico, Venezuela and other countries) 9/

235 million dollars

Regional production

Three regional plants (North of Latin America, and Pacific and Atlantic coasts)

178 million dollars

Saving in investment represented by regional production

57 million dollars

The estimated saving is 57 million dollars, or 32 per cent of the investment required for national production. In practice, the balance will be tipped even more sharply in favour of regional production. To begin with, the first solution assumes that each plant will construct one plant of a larger size than is warranted by the local market, but experience has shown that the Latin American countries prefer to set up several plants, even if their respective markets are smaller than the minimum economic plant capacity, one of their reasons being to prevent

9/ The "other countries" group corresponds to the sum of the capacities of countries with an apparent annual consumption of less than 10,000 tons each.

the formation of monopolies. Secondly, the location of domestic plants would necessarily be less favourable than that of the three regional plants, and, as indicated earlier, location (as regards raw materials and electric energy) is a factor of prime importance in determining production cost. Lastly, the adoption of a regional approach at the earlier stage of alumina production would result in a saving of 25 per cent in the large additional investment that would otherwise be needed.

(b) Pulp and paper manufacture

Size has an equally marked effect on unit cost and investment in the manufacture of pulp and different kinds of paper. If a capacity scale ranging from 50 to 200 tons a day is taken as corresponding to market sizes in Latin America, integrated paper and unbleached sulphate pulp production would cut investment per ton of daily capacity from 180,000 to 92,500 dollars (i.e. by slightly under 50 per cent) and direct production costs from 256 to 145 dollars per ton (44 per cent).^{10/}

The possibility of reducing the investment required is of vital importance for Latin America because of the large shortage of capacity foreseen for 1975 which will entail extensive additions to existing industry. One solution is to continue to build plants with a very small capacity (either because of the small size of many of the domestic markets or the wish to have more than one plant), while the other is to pave the way for the construction of regional plants of economic size through the facilities afforded by a common market. The future development of the industry on rational lines would also be vital, since a high cost structure prevails in nearly all the Latin American countries. If the sales prices for the major paper products are compared with world market prices (import averages c.i.f.), the differences will be seen to vary from 50 to 150 per cent to Latin America's disadvantage.

The additional capacity needed to satisfy the predicted increase in demand in 1970-75 has been calculated on the basis of two hypotheses, one for a plant of the minimum size (200 tons/day) and another for a plant of the average size current in Latin America. These figures will give some

^{10/} See E/CN.12/718, op.cit., Chapter 13.

idea of the extent to which the future development of the industry in the context of a common market will make for reductions in investment and costs. If the theoretical unit cost is also set against the total volume of capacity to be installed, it will be possible to determine the cost reductions to be obtained through the establishment of regional plants.

	Total pulp	Total paper and paperboard
Capacity shortage expected in 1970-75 (thousand tons/year)	1,893	2,114
Average capacity of existing plants (tons/day)	56	36
Investment/ton day corresponding to average capacity of existing plants (thousands of dollars)	127	226
Total investment needed for establishing additional capacity in plants of average existing capacity (thousands of dollars)	729,000	1,448,000
Unit cost of production in plants of average existing capacity (dollars)	163	215
Total cost of additional production in plants of average existing capacity (thousands of dollars)	309,000	455,000
Investment/ton day in plants of 200 tons/day (thousands of dollars)	85	133
Total investment needed for making capacity additions to plants of 200 tons/day (thousands of dollars)	487,000	852,000
Unit cost of production in plants of 200 tons/day (dollars)	119	133
Total cost of additional production in plants of 200 tons/day (thousands of dollars)	225,000	281,000
Savings: in investment (thousands of dollars)	242,000	596,000
in annual production costs (thousands of dollars)	84,000	174,000

/These are

These are theoretical calculations that involve a number of simplifications. In some cases it is inevitable that plants should be small, while in others the cost of transport to local markets may enable a small plant to compete successfully with others of more economic size. However, the basic argument remains valid, and the resulting savings in investment and costs, which are about a third less than they would be with national production, whether of pulp or of paper and paper-board, are an eloquent indication of the potential offered by a Latin American common market for this branch of industry.

(c) Chemical industries

Normal production scales in the Latin American chemical industry are very far from the optimum, and are often below the economic minimum as regards market prices that are unprotected by high tariff barriers.

The data provided in earlier ECLA studies on the expected lack of sufficient capacity to meet demand for the major chemical products in 1965-70, and the theoretical costs and unit investment with different production scales gives an idea of the savings to be obtained in expenditure and total investment requirements through the adoption of a regional integration plan in ideal conditions for the chemical industry.

The reductions that would result in both production and investment costs from the elimination of the deficit foreseen for 1965-70 have been estimated as nearly as possible, on the basis of two alternative solutions. The first is domestic production, whereby each country would try to meet domestic demand through its own efforts, and the second regional production, which would make for the establishment of plants of economic size. The method of estimation and the simplifications that had to be made have been described in an ECLA report.^{11/}

^{11/} Las industrias químicas y la integración económica regional
(ST/ECLA/CONF.15/L.8/Rev.1).

Millions of dollars

Annual savings in production costs in respect of the expansion envisaged for 1965-70	290
Annual savings in investment in respect of the expansion envisaged for 1965-70	200
Annual investment with national production	442
Gross value of estimated production (basic and intermediate chemical products) in 1970	2,945

The findings relate solely to basic and intermediate chemical products, which constitute 50 per cent of total production in the chemical industry, since the very nature of the manufacturing processes rule out the possibility of large economies of scale in parache^{12/}mical products and end goods. The annual savings will thus be 10 per cent in production costs and 45 per cent in investment.

4. The reorganization of industry

The increased competition offered to local industry by the imports flowing in from other parts of the region as a result of tariff liberalization causes enterprises to react in a number of ways. The premises on which integration is based assume that such reactions will lead to an increase in the average productivity and efficiency of the industrial sector and a simultaneous drop in costs. However, the process of enhancing its efficiency will inevitably be accompanied by a series of changes in the industrial enterprises. In extreme cases, these changes may compel such firms to close down, or to shift to other lines of activity thereby losing much of their capital. It is vital to take the possibility of such disruptions into account so as to determine the pace at which tariffs and other barriers to trade can safely be removed.

^{12/} The name given by ECLA to chemical products whose processing does not involve any change in molecular structure, such as cosmetic and toilet preparations, paints, detergents, etc.

The nature and intensity of the impact on local industry depends, first, on the degree of the competition from imports and, secondly, on the conditions in which the enterprise operates, the kind of entrepreneur who administers it and the state of the local market. With due allowance made for variations in conditions, inefficient enterprises can be classified into certain categories in accordance with the way they react to stronger intra-regional competition:

- (i) Inefficient enterprises that circumvent competition by producing for local markets or supplying a highly irregular volume of demand that holds no attraction for the more efficient concerns;
- (ii) Inefficient enterprises which, prodded by competition, overhaul their methods or change their products on the basis of their own efforts and resources;
- (iii) Inefficient enterprises that are unable to react to the spur of competition but can be set on their feet through soundly-directed technical and financial assistance programmes;
- (iv) Inefficient and economically unsalvageable enterprises that, for reasons of national policy, have to be kept in existence through temporary - if sometimes prolonged - protection;
- (v) Inefficient and unsalvageable enterprises that should be eliminated, and partly replaced by efficient enterprises and those falling into categories (ii) and (iii), and partly by an increase in trade.

It emerges from an analysis of this kind that the number of enterprises liable to become bankrupt is very small - although varying from one sector to another - and that certain steps should be taken either before or concurrently with tariff liberalization to facilitate the reorganization of local industry at higher levels of productivity and efficiency.

Labour productivity and operational efficiency is apt to show very marked differences within a single industrial sector. For instance the productivity of the cotton textile industry in Brazil displays a range of from one to twelve and that of the woollen goods industry in Uruguay from one to eight. The same margins of variation characterize the textile industry in other countries and tend to be reproduced in other branches

/of industry,

of industry, such as those that undertake processing and, above all, those in which the worker-machine adaptation and internal organization are of particular importance (metal-transforming industries in general).

The first factor to be taken into account is that many of the lowest-productivity enterprises do not really enter into competition with the more productive and efficient concerns, whether domestic or foreign, since they manufacture special products for which demand is limited or sporadic, or depend on typical characteristics of the local market. This frequently large group of inefficient factories has nothing to fear from stronger competition. Although it has no direct bearing on integration, the question may accordingly be asked how the efficiency of that extensive group of plants could be enhanced if competition is not an effective instrument in their case. Their efficiency is dependent, above all, on the industrial conditions prevailing in the country in general and in the sector in particular, and will increase as and when the average level of education and training in the labour force is raised and the principles of industrial administration and management become more widely current and extend to the inefficient enterprises. This is a slow process, in the course of which the frequently large group of entrepreneurs concerned (operating primarily in the traditional and consumer goods industries, but in a great many metal-transforming and other manufacturing activities as well) will lag behind the rest of the sector.

Other enterprises, which are forced to meet competition because of the types of products they manufacture, react chiefly in two ways. Some adapt themselves to the new market conditions, reorganizing their working methods, modernizing their equipment and thereby reducing their costs, while others achieve the same end by changing their production lines and specializing in one product or a very few, whereas their efforts were formerly dispersed over too wide an assortment.

It is hard to estimate what proportion of enterprises in a given sector have this capacity to adapt themselves, which depends, in essence, on able and flexible entrepreneurial management, but also, in no small measure, on whether the right conditions for such changes exist in the

/country concerned,

country concerned, especially as regards credit facilities during the transition period. An analysis of the data on the efficiency and productivity of enterprises assembled in ECLA studies suggests that the bulk of traditional industry in nearly all countries of the region lacks the entrepreneurial capacity to effect such changes. At first sight, traditional industry presents a picture of absolute technical stagnation in which the possibilities of recovery through its own efforts are practically nil, but a more thorough examination casts some doubt on that diagnosis. There is no denying the low levels of operational efficiency, but there is nothing to prove that they have existed for a long time and will persist in the future. The detailed studies which present the data in question, relate to a specific period and shed no light on past or future trends. Accordingly, the hypothesis cannot be entirely rejected that some enterprises with low operational efficiency indexes may, at a given moment, be in the throes of a progressive decline, which will bring them to the point where their operation is no longer remunerative, and the firm is declared bankrupt and either closes down or passes into other more capable hands, and thence starts to climb the scale of productivity and operational efficiency; while others may be pursuing an upward trend ensuing upon a process of internal reorganization or renovation of their equipment. This dual movement of enterprises would represent a dynamic situation in which the average level of efficiency was rising steadily throughout the sector. There are not enough data to give a reliable idea of what is really happening in Latin American industry, as the searching sectoral studies available were not carried out until very recently. But a dynamic process of that nature might well be found to exist in various sectors and countries, at the level of the individual enterprise, in which case the adjustments entailed by the expansion of regional trade could be effected with less risk of distortion in the existing enterprises.^{13/}

^{13/} See another recent ECLA study, El proceso de industrialización en América Latina (E/CN.12/716), for an over-all analysis of the subject.

Subject to the foregoing reservation, it can be asserted that a fairly large segment of traditional industry will be incapable of adapting itself to the new market conditions through its own efforts and resources, either for want of the necessary entrepreneurial capacity to analyse the new situation and on that basis to determine the changes that must be introduced in the enterprise, or because those changes would entail additional investment for which the necessary funds are lacking. These concerns, which may be called salvageable, could attain higher levels of productivity and efficiency, provided they were backed by sufficiently large-scale and flexible programmes of technical and financial assistance, organized with due regard for the sector's special characteristics and the keener competition envisaged. The textile industry is the best example in this category.^{14/}

But a similar situation exists in other branches of industry, including the manufacture of capital goods. The machine-tools industry, which is concentrated almost exclusively in Brazil and Argentina, presents a disparate structure, consisting in a few largish or very large establishments with satisfactory technical standards and high levels of efficiency, side by side with a considerable number of small and even tiny workshops operating less efficiently at a lower technical level. Some of these are clearly faced with the possibility of disappearing as industry expands and intra-regional and national competition grows stronger, or at best of continuing in their present rut, as producers of simple, roughly-constructed, low-cost machines for which there will always be some demand, however much it shrinks in relative terms. Recent ECLA studies on this industry have shown that a number of these establishments will be unable to adapt themselves easily to the future requirements of the metal-transforming industry, involving as they do a growing proportion of machines or more complex

^{14/} See another ECLA document, Los principales sectores de la industria latinoamericana: problemas y perspectivas (E/CN.12/718), chapter VI, for a fairly detailed study of the nature and mode of application of an assistance programme to facilitate the reorganization of the textile industry when its markets are integrated.

design and delicate structure for the precision work and the longer series that are typical of the more advanced stages of the metal-transforming industries in general. On the other hand, there are certain establishments possessing skilled manpower and satisfactory production equipment which will rise to the occasion, provided that some technical assistance agency, besides guiding them in the evaluation of future market needs, furnishes them with the designs of heavier and more complex models of machines and helps them to prepare the necessary prototypes and, in the early stages, to introduce stricter standards of quality and performance. In this as in other similar cases, which are fairly numerous even in the more industrialized countries, a technical assistance and investment programme for the reorganization and improvement of factories will not only make it possible to reap the benefits of an increase in trade and specialization among the countries members of the common market without causing serious maladjustments in the existing industries, but will also contribute decisively to industrial progress and the improvement of productivity and efficiency, by making a drive for better use of important factors of production already applied in the manufacturing sector.

The remaining enterprises are completely unsalvageable, and the whole technical assistance programme and investment effort would be useless in their case. Some of them represent substantial investment, and both on this account and for such motives as "national security" and "industrial equilibrium", based on other than strictly economic considerations whose existence must nevertheless be recognized and respected, they cannot be abandoned to their fate. In the case of these enterprises, the sectoral agreements would have to include a temporary saving clause, based probably on a system of import quotas, which would enable them to subsist during such time as the above-mentioned motives remained operative. The rest of the unsalvageable enterprises, to which the same arguments do not apply, would represent a minor sacrifice - since they would clearly be few in number - for the sake of the benefits that would derive from the transformation of the whole structure which, at the end of an admittedly long transition period, will enable Latin American industry to eradicate its present depressive characteristic of systematically high costs.

/The assets,

The assets, even in this extreme case, would not be wholly lost. In the first place, tariff liberalization and the consequent strengthening of competition would be a deliberately slow process, which means that for many enterprises the expiry of the period of grace might coincide with the end of the useful life of their production equipment. Failure to replace that equipment would really be the net result of the process. Secondly, in the still fewer cases of a rapid collapse under the pressure of competition, the equipment that was still serviceable would be sold to other concerns operating in the same branch of industry, as occurs in any normal process of internal competition.

5. Sectoral integration within ALALC

ALALC has two instruments at its disposal to promote the integration of markets for manufactured products: the yearly negotiations to reduce customs duties and the complementarity agreements in respect of specific products or groups of products.

Although the yearly negotiations have resulted in the inclusion in the National Schedules of a not insignificant number of manufactures, trade in those products has not increased greatly as a result, nor for various reasons, could it logically be expected to do so in the future. The system of negotiation product by product, by pairs of countries, the concessions agreed upon being extended to other countries, tends to be centred on new products which are not yet produced in the region, or are produced only in small quantities, and to by-pass those already being manufactured, where regional competition might cause maladjustments in the existing industries. But new investment is required before reductions in customs duties on items that are not yet produced can be turned to account; and this in turn necessitates the assurance that tariff reductions will not be withdrawn or altered in the next negotiations, but will actually be extended to the point where all obstacles to trade are eliminated. This requirement would be met by the inclusion of products in the Common Schedule. However, the limited number of really important manufactured products hitherto included in the Common Schedule shows that there are serious impediments which preclude trusting to the yearly negotiations as a means of furthering industrial integration.

The Montevideo Treaty provides for another instrument specifically intended to promote industrial integration, namely, complementarity agreements.

(a) Complementarity agreements

These agreements are dealt with in articles 15, 16 and 17 of the Montevideo Treaty. Each agreement should include a specific liberalization programme and rules for maintaining the preference margins agreed on vis-à-vis third countries, as well as provisions designed to reconcile the treatments accorded to imports from third countries, to co-ordinate government programmes and incentives (including those relating to the treatment accorded to capital and services from inside and outside the Area) and to establish regulations for the prevention of unfair trade practices.

Only two complementarity agreements have been negotiated and ratified to date, in connexion with certain types of calculating-machines and with electronic valves. Although the results obtained seem encouraging, it is clear from the limited field thus far covered and the obstacles to the conclusion of other such agreements that as regards speeding up liberalization for manufactured products, this is not the solution either.

The difficulties probably stem from the fact that complementarity agreements, as applied in practice, are not very different from a normal negotiation which culminates in the inclusion of specific tariff reductions in the National Schedules. Although the Treaty concedes that the agreements may contain provisions over and above the mere reduction of duties, connected with the establishment, wholly or in part, of a single external customs tariff and the harmonizing of other competitive conditions, such as foreign capital régimes, etc., such a procedure is not practicable for the following reasons:

(i) The Treaty fails to establish rules and procedures for defining such additional commitments;

(ii) Nor does it lay down procedures or rules, even of a general character, for the inclusion of promotional provisions, although the spirit and the letter of the Treaty clearly admit them;

(iii) If

(iii) If a complementarity agreement were so formulated as to include specific provisions for the promotion of a given industry, ALALC's present institutional structure would make it difficult to implement them, particularly in regard to supervision of the fulfilment of commitments and to the execution of investment and technical assistance programmes designed to promote new production activities or to facilitate the adaptation of those already existing;

(iv) Lastly, there would be no agency in a position to prepare complementarity agreements of the required complexity, and it would be unrealistic to expect the interested parties to draw them up on their own account.

This situation has long been realized by ALALC itself, which in the last few months has adopted certain measures to remedy it. The first important step in that direction has consisted in the establishment of the Advisory Committee on Industrial Development (Comisión Asesora de Desarrollo Industrial - CADI) and the work it has done thus far.

(b) CADI and the sectoral study groups

The Advisory Committee on Industrial Development (CADI) was established by virtue of resolution 31 of the Standing Executive Committee of ALALC, pursuant to a recommendation made by the First Meeting on Planning, Promotion and Orientation of Industrial Development, held at Lima. Resolution 75 of the Conference of the Contracting Parties of ALALC, adopted at the Conference's third session, stipulated that the Standing Executive Committee should direct CADI to make a study of the Contracting Parties' industrial policies and to define the problems affecting the integration of industry. CADI's first meeting, held in May 1964, had two particularly important results: it approved a number of bases for the formulation of the Area's industrial development policy, and recommended to the Standing Executive Committee that four study groups should be set up, three of which would be concerned with the elucidation of integration problems in specific branches of industry.

The bases for the formulation of an industrial development policy applicable in the Area represent a conceptual advance with respect to those on which complementarity agreements have thus far been established,

/and constitute

and constitute the first enunciation of an industrial integration policy. This advance is manifested in three principal ways:

(i) The concept of "the programmed location of industries of importance for the Area" is accepted, "in view of the different structures and levels of development in the ALALC countries", and it is recognized that this objective requires "the adoption of a common policy in the production sector under consideration";

(ii) The bases explicitly state that the aim of such programming should be "an equitable distribution of the benefits deriving from integration"; and

(iii) They establish that the devices and incentives to be used in the programming of integration should include not only trade policy instruments, but "all others capable of influencing a process of industrial integration by sectors".

Thus CADI would appear to be upholding a genuinely region-wide form of sectoral programming, which is a far broader concept than that of the complementarity agreements. However, one important point remains to be clearly defined. Complementarity agreements have been conceived for new production lines and as a means of reconciling the advance of integration with protection of the position reached by each country's existing industries. This characteristic of the approach to complementarity agreements constitutes a serious limitation, to which, it would seem, the new bases formulated by CADI, ambitious as they are in many respects, will also be subject. Indeed, though they mention the aim of securing "the fullest and most efficient use of regional resources" and recognize that "competition between producers in the Area will stimulate the reorganization of industry in ALALC countries", the bases still harp on industrial complementarity and place special emphasis on the "study, installation and development of industries of importance to the Area", thus clearly envisaging the development of new and as yet non-existent industries, rather than the real integration of industry which would make no distinction between new and established branches, except as regards the type of measures adopted in the case of each category.

The study groups were to be composed of technical experts from the ALALC secretariat and from inter-American economic co-operation agencies (ECLA, IA-ECOSOC and IDB), in addition to experts designated by the Governments members of ALALC by way of technical co-operation rather than official participation. Three of these groups were to be concerned with problems affecting steel-making, the petro-chemical industries, and the pulp and paper industry, respectively.

The three study groups met several times towards the end of 1964 to devise a method of work for compiling the data considered essential for an analysis of integration prospects and difficulties in their respective fields. Recently, at its second meeting, CADI examined the methodologies proposed by the groups, set the targets for the ensuing stage of their work and suggested ways and means of attaining them.

In their reports the groups have recognized the full magnitude of the task assigned to them and the need for ample and specialized resources with which to accomplish it. As pointed out by the ALALC secretariat in a report presented at the second meeting of CADI, the experience of the international agencies engaged in making descriptive studies of sectors of industry in ALALC countries shows that, given several experts working exclusively on one sector, and the funds required for visits to the countries concerned, the work takes about three years.

CADI is to comment on this at its second meeting. The lines along which the ALALC sectoral groups will ultimately work are not yet known, but the decisions taken will perforce be influenced by the fact that, since the date of its first meeting, the Conference of the Contracting Parties has adopted two important resolutions which will have a decisive impact on the course of industrial integration activities. At the same time, one of them in particular throws even more clearly into relief the disequilibrium existing between the targets accepted by the member countries and the institutional machinery available to further their attainment.

(c) The industrial integration policy embodied in Conference resolution 100 (IV)

The more frequent use of complementarity agreements has been hampered, inter alia, by the fact that they have had to conform to the general

/provisions of

provisions of the Treaty relating to the multilateral extension of the concessions agreed on. Only two countries (Paraguay and Ecuador), considered as being at a relatively less advanced stage of economic development, would be entitled to benefit by exemption from the most-favoured-nation clause. In other words, the Montevideo Treaty did not afford scope for sub-regional agreements, and precisely the likeliest possibilities of complementarity, in a restricted sense, seemed to exist in smaller groups of countries, often being of interest to a single concern established in the countries in question.

Resolution 99 (IV) of the Conference of the Contracting Parties of ALALC opened up fresh possibilities for such sub-regional arrangements, by admitting exceptions to the application of the most-favoured-nation clause. Under the terms of article XXI of this resolution, the Contracting Parties expressly agree that those of them which are not parties to a complementarity agreement shall only benefit by the reciprocal concessions agreed on between its signatories, subject to the granting of fair compensation. This compensation will have to be negotiated with the interested parties, while it will be incumbent upon the Standing Executive Committee to declare the agreement compatible with the general principles and aims of the Treaty. It is also for the Committee to settle any differences of opinion likely to arise in the course of negotiation as to what is meant by "fair compensation".

A more liberal attitude in regard to the formation of sub-regional groups is undoubtedly necessary if agreements by sectors of industry are to be more flexibly adapted to the real conditions of a region where there are notable disparities between the development levels and aptitudes of the various countries. But at the same time, it would entail a risk of undue and perhaps irrevocable fragmentation in the industrial integration process. To prevent this, the application of exemptions from the most-favoured-nation clause would have to be strictly regulated.

The purpose of resolution 100 (IV) of the Conference is to formulate, in broad terms and in the light of past experience, the basic guidelines for economic policy in relation to customs, monetary, agricultural and industrial development questions, as well as to draw up a programme of action for the implementation of such policies.

/The guidelines

The guidelines for industrial development policy embody all the criteria proposed by CADI, but also lay down the following bases for the studies and work connected with industrial development in the Area:

(i) Particular stress should be laid on sectoral integration as a means of furthering Latin America's economic development, and it should be made clear that this presupposes the development of the branch of industry concerned, in line with the joint programming schemes established to that end;

(ii) Recourse should be had to all possible ways of achieving complementarity, in the sphere of industrial production, not solely to the agreements provided for in article 16 of the Treaty;

(iii) Special attention should be paid to production activities as yet undeveloped or at an incipient stage of development;

(iv) In the case of industries offering limited complementarity possibilities on the basis of joint programming, fair competitive conditions should be established to ensure that they can take an systematic advantage as possible of the expanded market.

It should be noted that such criteria place strong emphasis on industrial integration through the joint programming of sectors of industry and the use of instruments other than complementarity agreements; but at the same time a distinction is still drawn between new and existing activities, joint programming being regarded as acceptable only for the new branches of industry. The two concepts would appear to hamper the formulation of a policy for industrial integration by sectors which would promise complete success.

The programme of action drawn up for the implementation of industrial policy also seems inadequate, despite the emphasis laid on the quest for new procedures. It comprises the following features:

- (i) Sectoral study groups, including those already established and those to be set up by the Standing Executive Committee with the advisory assistance of CADI;
- (ii) A study by the ALALC secretariat to classify the industrial activities of the Area according to their level of development and the complementarity possibilities they offer; and

/(iii) Establishment

(iii) Establishment of the bases for securing fair competitive conditions for existing industries.

(d) The need for new instruments to promote industrial integration

The aims of industrial integration policy are set forth boldly in resolution 100 (IV) and reflect a clear realization of the importance of the undertaking. But there are also evident weaknesses in the proposed programme of action, which is clearly inadequate in the face of such a herculean task. These weaknesses would appear to be, briefly, of three kinds. First, there is the insistence on differentiating between new or incipient activities and those already in existence, and the effort to establish completely distinct and separate means of action in each case - complementarity agreements or not too clearly defined joint programming agreements for the former rules of competition for the latter. Such a distinction seems very hard to put into practice in a region where two or three highly industrialized countries have nearly every conceivable type of industry in operation at some stage or another, unless the definition of such industries is reduced to the level of the individual product or specific model of manufacture, which would be incompatible with the joint sectoral programming approach.

Moreover, the advisability of reserving the sectoral programming approach to the new and dynamic sectors is open to question. Such a step might result in a tendency to sanction the unprogressiveness and virtual technological stagnation now prevalent in many of Latin America's traditional industries. Instead of respecting and even accentuating the disparities in productivity and operational efficiency between the new and the traditional sectors, industrial integration ought to aim expressly at eliminating them little by little, extending to the whole of the manufacturing sector the benefits of competition as an instrument for promoting efficiency and technological progress, and using sectoral programming as an effective means of gradually and systematically modernizing the traditional industries, as well as of promoting substitution of the new sectors' production for imports from outside the region.

/Secondly, the

Secondly, the type of instrument to be used for establishing tariff and non-tariff commitments with a view to sectoral integration has not yet been determined, although ALALC itself recognizes that complementarity agreements as defined in the Treaty are unsatisfactory.

Thirdly, once the best instrument for furthering sectoral integration is chosen, a method of preparing it would have to be established, with all that involves in the way of processing and analysing technical and economic data. The procedure of setting up study groups attempted by ALALC through CADI has proved ineffectual so far, and perhaps, given the nature of the groups, could be successful only in the case of very short-term objectives.

Lastly, it remains to ascertain whether an agreement relating to a sector of industry and representing a genuine sectoral and regional development programme, in which recourse would be had to the whole range of indispensable non-tariff instruments, could be implemented and supervised through the existing institutional machinery.

6. The nature of sectoral agreements

The proposed sectoral agreements aimed at meeting the aforementioned requirements constitute legal instruments designed to adapt the general economic integration formulas and instruments to the particular conditions of specific branches of manufacturing industry, with a view to speeding up integration in the markets concerned.

(a) Possible lines of approach

The purpose of sectoral agreements is both to harmonize competitive conditions and to promote development of the sector of industry concerned. It would seem that all sectoral agreements should contain provisions relating to the two objectives, but in what proportion will depend a good deal on the approach adopted to the question, which may lay greater emphasis on one or the other. To take the two opposite extremes, for the sake of simplicity, two typical models of sectoral agreements might be described as follows:

- (i) Harmonization agreements, which represent a set of rules designed to harmonize competitive conditions, institute free trade and establish the principle that comparative advantages should be the main consideration determining such trade flows;

/(ii) Promotion

- (ii) Promotion agreements, which relate primarily to the final results desired as regards investment distribution and the furthering of production and trade, with a view to "indicative programming" for the sector.

In the first case, the prime objective of the provisions included in the agreements is to permit the free play of competition, without there necessarily being an express consensus of opinion among the signatories as to what are the desired results in respect of trade and of the regional distribution of investment. This is apparently the type of sectoral agreement which culminated in the establishment of the European Coal and Steel Community. Although it included technical assistance and financing provisions in favour of enterprises which were expected to suffer from competition, they were in the nature of saving clauses designed to facilitate the transition to completely free competition, and did not reflect an active policy for investment and orientation of trade flows dictated by development considerations. In the European Coal and Steel Community treaty, attention is focused exclusively on the question of eliminating factors of distortion in price formation, with a view to establishing free and fair competition. And this gave rise to the obligation to observe a great many "rules of competition", designed to prevent discriminatory treatment in regard to transport rates, price fixing, etc.

The second type of agreement is concerned with harmonization only as regards salient disparity or discrimination problems, and devotes special attention to the establishment of criteria and rules for consultation with a view to correcting, a posteriori, such unfavourable trends as may appear in the sector's development. These agreements include, as an essential factor, a set of technical and financial assistance provisions in favour of countries that are harmed by competition, owing to insufficient basic resources, limited markets or some other initial shortcoming which can be mended by such provisions and a region-wide co-operative effort.

The aims of these two types of sectoral agreement entail very different requirements as regards commitments and institutions. A

/harmonization agreement

harmonization agreement must establish not only formulas for the reduction of duties, but also detailed rules of competition and provisions for harmonizing structural features. The supervision of compliance with all those rules and provisions calls for burdensome institutional machinery. Furthermore, it is difficult to ensure that the increase in investment and trade due to market integration, even if all the rules of competition and harmonization provisions are fully and efficiently applied, will result in the well-balanced development of the whole region. Considerations bound up with external economies, with the lesser risk of investing in large markets that are not so dependent on exports, and with other factors, might give rise to some concern as to the results of an integration process based entirely on automatically operating machinery.

Conversely, an agreement aimed at programming the development of a sector on the basis of specific commitments with respect to results (in the fields of investment and trade flows) within periods of five and ten years, could dispense with rigid rules and provisions, at least in the early stages, establishing ad hoc consultation machinery for the solution of difficulties and the adoption of any remedial measures that might prove necessary. This seems to be the best type of sectoral agreement under present conditions in Latin America.

These agreements stand out because of their pragmatic character and the way in which they subordinate trade policy formulas to certain development criteria.

(b) The pragmatic element in sectoral agreements

Sectoral agreements are a method of obtaining the advantages and solving the difficulties described in the foregoing paragraphs on the basis of commitments over and above those generally applicable, which are negotiated pragmatically in accordance with the specific circumstances of each sector. The reduction of internal customs tariffs is carried beyond the targets (particularly the ceiling) which form part of the formula applied in general. The pertinent objectives are established in line with regional cost conditions for the products of the sector concerned - especially the disparities between one country and another, and in some cases between enterprises - and also with the possibilities

/of salvaging

of salvaging the inefficient segment of the industry, its size, and the period within which the inevitable changes would have to be introduced. The common external tariff is also established in terms of the minimum required to prevent the deflection of intra-regional trade flows and to eliminate any disequilibria in basic competitive conditions that might result from marked differences in the import duties levied on raw materials and parts and spares from third countries. The margin of difference between external and internal tariffs, which is compatible with an increase in intra-regional trade on a normal competitive footing, varies in each case, and is closely related to the internal tariff levels maintained. The more headway it is desired to make in the reduction of internal tariffs, the more necessary it will be to establish a single external tariff. Moreover, this whole question is greatly influenced by the expected intensity of intra-regional trade, the unit value of the typical products of the sector and the effect of existing and foreseeable transport costs on such products.

However, competitive conditions are not exclusively the result of the tariff framework within which trade is conducted. The sometimes widely differing practices that prevail in each country in respect of foreign capital have a strong impact on the pattern of investment and, therefore, on the generation of new trade flows. The same applies to tax systems, policies for subsidizing and promoting new activities, and so forth. The reconciliation of policies connected therewith, which would be very difficult on a general plane, over the short or medium term, becomes feasible when action is taken within narrow limits, care being taken to avoid very specific problems which can be identified or foreseen in each sector. This effort to interpret the minimum essential requisites for the advance of integration in a given sector constitutes the pragmatic element in sectoral agreements.

Another of their salient features is that trade policy measures and action designed to promote development are adopted simultaneously. Or rather, the implementation of provisions for the liberalization of trade is, in fact, subordinate to certain criteria and commitments bound up with the development and structure of the sector concerned. This question is dealt with more fully elsewhere in the present chapter.

(c) Limitations of the sectoral approach

There now arises the problem of standardizing the criteria applied to the different branches of industry in a sectoral approach. Uniform bases for competition are gradually established for each separate sector of industry, and formulas, instruments and commitments are adapted pragmatically to the conditions prevailing therein, while some account is also taken of the varying entrepreneurial attitudes to integration. The tax systems of the various member countries, their policies, and the treatments they accorded to capital and enterprises owned by third countries, would be standardized or reconciled -- within certain limits -- for each separate sector of industry, in line with different criteria in each case. If this pragmatic system is followed of seeking the minimum commitments required for the integration of each sector, the nature and degree of harmonization attained might be very different between one sector and another.

Such a procedure would entail the risk of splitting up the regional economy into other watertight compartments and replacing the distortions between countries by sectoral distortions. That would be tantamount to replacing one problem by another, and at the end of a long and difficult process of sectoral integration a real Latin American economic community would still be far away.

Certain precautions will have to be taken to avert this danger. In the first place, sectoral agreements should be prepared for a fairly large number of sectors representing a considerable proportion of total manufacturing industry. In addition, they should be drawn up and negotiated simultaneously or within a fairly short span. This will permit an over-all view of the situation and enable relatively uniform criteria to be applied to each sector in relation to the essential degree of harmonization and the method of attaining it.

Secondly, sectoral agreements should fit into an over-all framework of customs tariff commitments and harmonization of policies relating to the economy as a whole. These general commitments cannot progress far in the early stages, during which the specifically sectoral commitments will be the ones to speed up integration. But in the ensuing stages

/the general

the general commitments will have to become gradually heavier and more specific, which will progressively reduce the margin for variation and disparity of the sectoral commitments. To accomplish this aim, the final objectives of integration will have to be established right from the start; in other words, it will be necessary to ensure that the particular measures devised in subsequent stages will converge towards a final specific target.

7. Structure and characteristics of a model sectoral agreement

The salient points regarding the definition of a sectoral agreement are described above, the next step being to analyse more thoroughly the modes of applying such agreements and the characteristics they show in operation. The study will cover the following questions: definition of the sector and its geographical sphere of application; the structure in outline of a model sectoral agreement; a salient feature of its structure relating to investment and technical assistance programmes; and the application of the most-favoured-nation clause.

(a) Definition of the sector and its geographical scope

It would be advisable, in principle, for sectoral agreements to be drawn up and signed by all countries members of the common market and to apply to broad sectors of industry rather than to individual products or groups of products. In this way there would be more assurance that the agreements would be conducive to the general harmonization of conditions of competition, without distinctions as to countries or branches of industry, which is the final aim of integration. However, to adhere rigidly to this procedure would mean limiting the scope of the practical liberalization and harmonization provisions which might be included in those agreements. De facto circumstances relating to the unequal development levels of the Latin American countries also counsel that consideration be given to agreements of more limited scope, both in the geographical sense and as regards the products covered.

The first problem that arises concerns the relatively less developed countries. There is no denying that there is a definite tendency to

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concentrate certain important industries in the larger Latin American countries and that this might render integration in some sectors less attractive to the countries concerned. Accordingly, a determined effort should be made to ascertain the feasibility of sub-regional agreements between the small and medium-sized countries, followed by their integration with the major countries.

Sub-regional integration projects, based on an ad hoc, product by product approach (or in relation to sub-branches within each main branch of industry), would constitute a method of achieving faster progress in some directions and, provided they were subject to far-sighted regulations, they could be compatible with final integration aims. Such sub-regional integration projects should be accompanied by a gradual, reciprocal opening up of the markets of country groups so established, with a view to establishing free competition throughout the region.

Secondly, there are many cases where the capacity of existing industries is not fully utilized, which might make it advisable to provide for the complete abolition of customs duties for short periods. Concessions of that kind could play a major part in ensuring that capacity is used to the full, without requiring the country according them to adopt any final decision regarding its future structure of production. Such agreements, however, should be advocated only when there are major obstacles to more permanent concessions between countries, and once they have lapsed, customs tariffs and other trade restrictions should be restored at a level not higher than that determined by the application of the general system for reducing tariffs.

Lastly, account should be taken of the interest displayed by many of the Latin American countries in developing a broad range of basic production lines, even in some extreme cases of small-scale operation and high costs, with the object of attaining a well-balanced structure of industry or of accumulating external savings in favour of other activities, thereby creating exceptional situations within the broad schemes of regional specialization.

The foregoing considerations appear to show that it would not be an easy matter to apply the same concept or the same integration procedures

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to the whole range of products of each individual branch of industry. On the contrary, some thought might be given to defining different integration procedures for given groups of products in each branch of industry, according to their specific characteristics as to magnitude of economic scale of operation in relation to the size of the domestic markets, the incidence of raw materials in production costs, the geographical distribution of resources, etc. There would be no reason for such procedures to give rise to a great many integration agreements by products and by groups of countries, since the same sectoral agreement with respect to a complete branch of industry, and to all the countries members of the integration area, could specify the different rules to be applied in each case, that is, to specific products and groups of products and to the sub-regional groupings concerned.

It seems essential to establish all sectoral agreements in two stages: the period of transition during which industry would be reorganized and would prepare to operate on a competitive footing, and integration proper when competition would be full-fledged. The duration of the transition stage and the procedures used therein would in some respects depend on the rules established in the general formula adopted by the Latin American countries to strengthen the economic integration process; during this phase the countries concerned should be provided with the technical and financial assistance they need to be able to introduce the necessary adjustments in their industries with a view to making them more efficient and competitive. To that effect, an agency specialized in the study and application of such assistance measures should be in operation by the time agreements for the regional integration of industries begin to be implemented.

In short, it might be said that:

(i) The member countries, in adopting the provisions concerning the new stage in the process of forming a common market, would undertake to negotiate with one another and to conclude, in the course of the ensuing five years, integration agreements relating to a limited number of major branches of industry; the branches specifically listed would represent a minimal commitment, it being desirable to prepare and negotiate agreements for other sectors of industry as well;

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(ii) The minimum list of industries could consist of the following: steel, aluminium, copper, pulp and paper, fertilizers, alkalis, petrochemicals, heavy industrial equipment (for the aforementioned sectors and other basic industries), transport material (for road, railway and water-borne transport), machine-tools, textile machinery, energy generating equipment, mining equipment, tractors and agricultural machinery, road-making equipment, and textiles.

(iii) Sectoral agreements would cover major branches of industry instead of individual products or limited groups of products; nevertheless, such agreements could establish different rules for separate products or groups of products;

(iv) The agreements would be approved by the member countries and would be binding upon all of them, although there might be special rules for sub-regional groups with respect to a certain product or groups of products, or even the whole industry;

(v) The provisions of sub-regional scope might or might not require exceptions to the most-favoured-nation clause; regulations covering such exceptions will be dealt with later;

(vi) Sub-regional agreements, or agreements relating to products or limited groups of products, could be concluded over and above a general sectoral agreement, even if the parties had not undertaken to prepare a sectoral agreement within the initial five-year period of the new phase of integration.

(b) Structure of a model sectoral agreement

The main feature of a sectoral agreement would be its adaptation to the specific conditions and difficulties of a particular branch of industry and, in this respect, there could not be two identical sectoral agreements. None the less, they must all have the same structure. The principal characteristics of a model sectoral agreement would be:

(i) A development programme for the sector throughout the region, designed to indicate the framework for the evaluation of trade development and industry location trends, investment needs, etc., in successive years, and to constitute a diagnosis of the outstandingly weak points of the industry considered;

/(ii) An

(ii) An investment programme, i.e., an estimate of the investment needed if the branch of industry is to grow in line with the assumptions of the above-mentioned sample programme, and also of that required to eradicate or correct the weaknesses of certain countries or enterprises as regards intra-regional competition, according to the diagnosis of the industry prepared and included in the development programme;

(iii) A technical assistance programme parallel with the investment programme, aimed at helping the competitors that are likely to suffer most when intra-regional competition is intensified, describing the procedures, areas of application and manpower and financial resources needed;

(iv) A programme for the reduction of internal customs duties over and above the targets established in the general formula, as consistent with the specific conditions obtaining in the industry itself; and procedures for applying the safeguard clause in case of maladjustments in existing concerns, adapted to the particular conditions of the industry in question (for example, liberalization by means of quotas as applied to a growing proportion of the market);

(v) A programme aimed pragmatically at standardizing the external tariff in so far as it is strictly necessary to prevent distortions in competitive conditions and shifts in trade flows, in the light of the particular conditions ruling in the branch of industry concerned;

(vi) A set of commitments for the reconciliation of certain aspects of economic policy which carry most weight in the branch of industry considered (systems of incentives to industry or regulations governing foreign capital and enterprises, tax provisions, etc.), representing the indispensable minimum to avoid obvious distortions; and consultation machinery to mitigate the difficulties that might arise in this connexion in future, since it is deemed very difficult to establish rulings, a priori, for all the action called for without the risk of carrying the arduous task of reconciliation beyond the limits of future practical requirements;

(vii) A set of provisions concerning the use of exceptions to the most-favoured-nation clause admitted in the general formula, favouring the aims with respect to a well-balanced regional development set forth in

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the sample plan prepared for the sector; that is, provisions relating specifically to countries at a relatively less advanced (and medium) stage of economic development.

(viii) Measures for the practical implementation of the provisions and programmes included in the sectoral agreement, use being made of the institutional mechanisms of the common market (the Board and the Promotion Agency) and other instruments which might be created especially for the sector concerned (producers' counsels or advisory boards for consultation regarding the harmonization of conditions for inflows of foreign capital, etc.); as a matter of general policy, it might be as well in the early stages to have recourse exclusively to the general organs of the Treaty in the way of permanent bodies, and to accept new sectoral agencies or mechanisms only on a consultation or advisory basis.

(c) Investment and technical assistance programmes

A sectoral agreement should comprise, as an integral part of the commitments and provisions relating to the sector, an investment programme in which the capital needed to expand the industry's capacity during the period covered by the agreement would be estimated in accordance with the growth targets and projections of demand. These estimates would cover the whole of the industry and all the countries members of the common market, and would discriminate in favour of investments designed to improve the competitive position of particular countries or groups of enterprises.

The investment required for the sector's growth would be decided by the countries concerned and financed essentially by the national and international resources which each country and the region as a whole are able to mobilize. It would be as well, however, if a proportion of the investment were the joint responsibility of all parties to the agreement. This proportion would be earmarked directly for eliminating the outstanding weaknesses in the structure of the industry concerned, in one or more countries, which would constitute an obstacle to increasing competition or might bring about serious disruptions in existing industry. In other words, it would be advisable that the investment designed to remedy shortcomings in the structure of the industry concerned - the rapid enlargement of installations that are too small to compete, the conversion
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of means of production to other manufacturing lines, the modernization of installations and equipment or the introduction of more advanced techniques - should constitute a joint responsibility, in the sense that the relevant international financing should be negotiated with the support of all parties to the agreement, and that the application of the commitments to reduce customs tariffs in those countries whose position had been recognized in the sectoral agreement as being disadvantageous and meriting technical and financial assistance should be conditional upon the prior or simultaneous investment envisaged.

This point may be illustrated through the broad outline of a possible investment programme for the steel industry, as discussed at the beginning of this chapter. Given the preliminary and illustrative character of this description, no discrimination was made between investment for promoting the industry's normal growth and that needed to improve the competitive position of certain countries. However, attention has been drawn to the likely problems that would need to be solved by means of additional investment and technical assistance in order to reach the stage of complete tariff liberalization in the steel industry. The investment programme predominates over the technical assistance programme in this sector, although a large proportion of the funds envisaged are earmarked for improving the industry's techniques and operational efficiency.

In other industries, including textiles, technical assistance for improving their internal organization and operational efficiency would be at least as important as the remedial investment. The latter would be used for replacing obsolete machinery, which exists in very high proportions in several countries of the region, but if proper use is to be made of the new machinery, far-reaching and lasting action will be required for the complete modernization of working methods in regard to the organization of production, control of productivity and operation of the equipment, etc. On the other hand, the need to obviate a mass shift of manpower as a result of the replacement of machinery, if carried out on a large scale and with a high level of automation, urges that its renovation be programmed with the utmost caution and by gradual stages.

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For all the above reasons, the technical assistance programme aimed at raising the industry's standards of operational efficiency should be the main instrument used to place the textile industry on a sound footing with regard to regional competition. In other sectors which, like textiles, have a high level of manpower absorption and low levels of internal organization, more attention could justifiably be paid to technical assistance than to additional investment.

Lastly, mention should be made of the important role which the joint financing of regional factories by several countries could play in sectoral agreements. One of the conclusions of the Latin American Seminar on the Integrated Development of the Chemical Industry (Caracas, December 1964), convened by ECLA and the United Nations Bureau of Technical Assistance Operations (BTAO), is that the removal of obstacles to trade in the main chemical products should be accompanied by schemes for the expansion of production in the best possible locations, through large regional factories whose capital was financed jointly by the principal consumer countries. To sum up, it would be a question of opening up the markets to imports from other countries of the region, while at the same time establishing multi-national enterprises backed by intra-regional financing, to cope with the new large-scale manufacturing output for export. In principle, the contribution of capital from each country would consist of its own public or private resources. In practice, however, given the shortage of capital in nearly all the countries concerned, in all probability the contribution of importing countries would have to be financed by international credit. This conclusion seems to be equally applicable to other branches of industry, and is perfectly in keeping with the investment programme of a sectoral agreement.

(d) Exceptions to the most-favoured-nation clause

The rules governing the non-extension to third countries of the concessions agreed upon in sectoral agreements between groups of countries might be summed up briefly as follows:

(i) In the case of products manufactured by industries not included in the list of sectors for which the Latin American countries had undertaken to negotiate sectoral agreements proper in the first five years, the said /countries would

countries would be free to conclude between one another any sub-regional agreement that might be in their interests, without application of the most-favoured-nation clause to the countries members of the common market but no parties to the agreement, and without the need for the approval of those countries through the organs of integration; the establishment of such sub-regional commitments would require only the observance of certain rules calculated to make the commitments in question converge towards the final target of a common market;

(ii) As regards products manufactured by industries classified as being subject to the negotiation of sectoral agreements of regional scope, countries would also be free to enter into sub-regional agreements, provided they agreed to the extension of the concessions arranged between them to third countries of the region; the opinion of the Board would be required if sub-regional commitments should in any way conflict with the sectoral agreement in course of preparation for the same branch of industry; however, its opinion would not be essential to the entry into force of sub-regional agreements of this kind;

(iii) For the products of basic industries, for which sectoral agreements were being prepared, the approval of the competent community institutions would be required wherever the countries parties to the sub-regional agreement wished to be absolved from extending the most-favoured-nation clause to other member countries.

A set of rules of this type would apparently reconcile the possibility of sub-regional agreements with sufficient incentive for countries preferably to negotiate and enter into region-wide sectoral agreements in relation to the most important branches of industry.

In the case of sub-paragraphs (ii) and (iii), once the region-wide sectoral agreements were concluded and approved, the sub-regional commitments that had entered into force for the products or groups of products of the same branch of industry would be embodied in those agreements in the form of special rules or provisions of more limited scope. In other words, the sub-regional agreements relating to products would retain their individuality only until such time as the agreements for the whole region and branch of industry entered into effect. Once the
/general agreements

general agreements were signed, the sub-regional agreements would be incorporated in them. The compatibility between them would be assured from the start by the rules referred to above.

Lastly, it would be useful to establish certain conditions for the compulsory implementation of sub-regional agreements, in order to ensure their ultimate reconciliation with the general integration targets and commitments and to prevent them from becoming merely provisions for the reciprocal reservation of markets in small groups of countries, or even understandings confined to products of exclusive concern to a single enterprise or consortium of enterprises, with no real integration aims.

8. Preparation and implementation of sectoral agreements

Programmes for the regionally integrated development of major branches of industry, like the sectoral agreements described above, require careful and necessarily slow preparation on the basis of a considerable quantity of technical and economic data concerning the position of the industry concerned in each country, its growth prospects and each country's capacity for developing it. The preparation of such technical data would require the establishment of a specialized body, such as an investment development agency.

The preparation of sectoral agreements for each of the industries agreed on, to be submitted for negotiation by Governments, represents a gigantic task, given the complex nature of the agreements, the need to accumulate and analyse a huge quantity of data, and the geographical area covered by the work. A very comprehensive study would have to be made of the existing situation and the factors conditioning the future development and geographical location of each industry, and the necessary technical and economic data - usually not easily available - would have to be collected and processed before such draft agreements could take shape. Because of the need for the negotiation to be carried out on such lines as to cover several sectors of industry at once, so as to facilitate a well-balanced distribution of the advantages among the participating countries, the task of preparing the relevant data would have to be accomplished on a large scale and within a relatively brief period, possibly five years.

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The many studies ECLA has carried out on industry in the last few years, and the recent intensification of those studies through the establishment of the Joint ECLA/INST/IDB Programme on Integration of Industrial Development, sponsored by ECLA, the Latin American Institute for Economic and Social Planning and the Inter-American Development Bank (IDB), have resulted in the accumulation of valuable data and diagnoses on the steel, aluminium, chemical, pulp and paper, basic industry equipment, machine-tools, textile machinery and textile industries. These studies, most of them well advanced, provide a useful point of departure for the action required.^{15/}

Once the provisional versions of the sectoral agreements relating to a certain number of industries were ready, the Board would consider them in the light of general integration mechanisms and commitments. After introducing the amendments or additions it thought fit, it would submit them for the consideration of the member countries.

^{15/} The report Los principales sectores de la industria latinoamericana: problemas y perspectivas, op.cit., contains a summary of those studies from the standpoint of regional integration.

The first part of the document discusses the importance of maintaining accurate records of all transactions. It emphasizes that every entry, no matter how small, should be documented to ensure the integrity of the financial data. This includes recording dates, amounts, and the nature of the transactions. Consistent record-keeping is essential for identifying trends and anomalies in the data.

Secondly, the document highlights the need for regular audits and reconciliations. By comparing internal records with external statements and bank statements, discrepancies can be identified and corrected promptly. This process helps to prevent errors from accumulating and ensures that the financial statements are accurate and reliable.

Thirdly, the document stresses the importance of transparency and accountability. All financial activities should be clearly documented and accessible to relevant stakeholders. This not only helps in building trust but also allows for better decision-making based on accurate and complete information.

Finally, the document concludes by stating that maintaining good financial practices is not just a legal requirement but also a key to long-term success. By adhering to these principles, organizations can ensure their financial health and sustainability.

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Chapter VIII

TRANSPORT IN RELATION TO REGIONAL ECONOMIC INTEGRATION

Introduction

Transport and communications constitute an essential basis for economic integration, since their function is to overcome the obstacle of distance and enable goods, people and knowledge to circulate freely. Every market presupposes a transport and communications system, and this requisite is all the more indispensable in the case of a common market.

In several of the Latin American countries the transport networks are so deficient in many respects that they represent a serious obstacle to economic development. From the regional standpoint, the situation is still more unsatisfactory. With the exception of the Central American area, where international overland transport enjoys a measure of relative importance, Latin America's transport system is virtually confined to shipping. By sea, and by international inland waterways, whose relative importance is slight, the Latin American countries carry on almost the whole of their reciprocal trade, the volume of which accounts for barely one-fifth of the region's total foreign trade. Of this proportion, 70 per cent corresponds to liquid fuels. The predominance of maritime transport in intra-regional traffic is symptomatic of the way in which economic activities are concentrated in isolated centres along the seaboard of the continent.

The structure of the national networks also reflects this characteristic of the Latin American economies, inasmuch as roads and railways converge on the coastal centres, and such few international overland routes as exist make no major contribution to the geographical integration of the region, as they often cross areas that are marginal to the economic activity of some of the more developed countries, or link these with the countries at less advanced stages of development.

A basic requisite for the economic integration of Latin America, especially if the long view is taken, is the gradual establishment of a continental transport and communications network that will join up all the countries of the region. For various reasons, however, including the long distances involved, a leading role will still devolve on maritime transport, which means that it is essential to improve port facilities and supplement

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them with an adequate network of international overland routes. Despite the progress made in recent years, there are still not enough international highways; and inter-country rail connexions, too, are few and far between, or even, over vast areas, non-existent. Furthermore, advantage should be taken of Latin America's inland waterway traffic potential, and optimum air transport, postal and telecommunications services should be established.

The availability of a satisfactory transport network, with low costs and good-quality infrastructure and services, would improve existing conditions with respect to economies of scale, especially for the new industries that will have to be established during the next few years at the multinational level; it would facilitate access to raw materials and to markets, and would influence all the factors that determine the location of industries. It would also be equally important for the more rational distribution of agricultural production in the region.

Concurrently with the gradual establishment of a regional transport and communications network, Governments would have to adopt decisions aimed at ensuring optimum joint utilization of international routes, including arrangements to eliminate possible discrimination in respect of transport rates and conditions, as well as transport cost and tariff practices that might introduce artificial distortions in competition among producers in the various countries of the region.

1. Transport in the Latin American Free-Trade Area and in the Central American common market area

The experience of ALALC in the field of transport may usefully be reviewed in broad outline, as well as the progress made in this respect under the Central American economic integration movement.

The Montevideo Treaty contains no provisions relating to transport. Nevertheless, because of the vital importance of shipping routes in regional trade, the Conference of the Contracting Parties and the Standing Executive Committee of ALALC have been interesting themselves during the last few years in the development of the mercantile marines of the member countries, maritime transport costs and conditions, measures making for

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greater flexibility, and the shortcomings of the region's seaports. In compliance with a resolution adopted by the Conference of the Contracting Parties, the Advisory Committee on Transport of ALALC prepared, for consideration by the Governments, a preliminary draft of a general agreement on maritime, river and lake transport.

Certain reservations and objections with respect to this preliminary draft have been formulated by several of the signatories of the Montevideo Treaty, and it is at present being discussed by the Governments of the ALALC countries. At the Fourth Conference of the Contracting Parties of ALALC (Bogotá, 1964), it was agreed that a meeting at the governmental level should be held in order to analyse the various aspects of the Association's waterborne-transport policy, on which occasion the final text of the proposed agreement is expected to be drawn up. This meeting is to take place early in May 1965.

Under the terms of the draft agreement, 80 per cent of intra-ALALC trade cargo is reserved on a bilateral basis, for the two countries between which the trade flow is generated; of the remaining 20 per cent, 10 per cent would be distributed on a multilateral basis among the regular shipping lines of all the countries members of ALALC, and the other 10 per cent among the regular shipping lines of ALALC countries and of third (including extra-regional) countries.

Despite the initial concession, limited to the application of the multilateral principle in relation to the mercantile marines of all the ALALC countries, the essentially bilateral character of the draft agreement is hard to reconcile with the multilateralism that should prevail in a free-trade area and still more in a common market. De facto, the draft text tends to crystallize the existing situation. Apart from the fact that for various technical reasons its provisions would be difficult to apply in practice, the principal disadvantages of bilateralism in this field consist in the excessive splitting-up of a volume of cargo which is already tiny enough, and the consequent under-utilization of available hold space, which has an adverse effect on costs and freight charges, and might mean that the tariff

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rates on certain routes would rise too high. Moreover, the essentially bilateral character referred to may lead to discrimination in intra-Area transport among the ALALC countries and their merchant shipping.

As regards the Central American common market, attention may be drawn to article XV of the General Treaty on Central American Economic Integration, under the terms of which the signatories undertake to ensure full freedom of transit through their territory, subject to no discrimination or quantitative restrictions, for goods proceeding to or from the other signatory States, as well as for the vehicles transporting these goods.

In view of the vital importance of a regional infrastructure, the Central American countries adopted, in September 1963, for the purposes of the integration and development of the area, an over-all plan for the improvement and construction of a regional network of 13 international highways, linking up all the countries, and representing a total investment of 73 million dollars. This network will be nearly 5,200 kilometres long in all; more than half is already paved, and all-weather roads constitute a substantial proportion of the remainder.

In respect of air transport, a Central American corporation has been set up to improve traffic conditions, and plans are afoot for the creation of a Central American airline consortium, which will involve a considerable saving on equipment and administrative overhead.

In May 1964, the Governments concerted a draft agreement for the establishment of a regional telecommunications system, which will necessitate investment amounting to about 7 million dollars. Study is at present being devoted to the possibility of adapting the network as proposed in the draft to a system with broader specifications that will permit of inter-connexion with the rest of the Americas.

2. Other undertakings relating to regional transport problems

Of great significance for the future is the growing interest that is being displayed in Government and other circles in transport problems and their importance for the economic integration of the region.

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The chief manifestations of this interest include the establishment of the Latin American Association of Shipowners (ALAMAR), in July 1963, and the creation, in March 1964, of a Latin American Association of Railways. Other of recent date and worthy of mention are the conclusions of a meeting of the Argentine-Chilean Commission on Economic Integration, held in Santiago early in 1965, the report of an Inter-American Development Bank mission on the integration of Colombia and Venezuela; and the stepping-up of efforts and the progress of the studies in connexion with the construction of the Carretera Marginal Bolivariana de la Selva. The Governments of Argentina, Brazil and Uruguay have also signed agreements at the ministerial level granting reciprocal facilities to simplify frontier formalities for loaded lorries from the signatory countries.

3. Transport in relation to the acceleration of the economic integration of the region

The acceleration of the region's economic integration process calls for the adoption and execution - by the Governments and by the competent regional agencies - of a whole body of measures and commitments in the field of transport. The transport measures which should be studied and applied to this end are sketched out below. The measures and commitments that could be adopted by Governments, and the studies that could be carried out by the appropriate agencies, are analysed separately and in succession.

(a) Measures and commitments for a new phase

The primary objective of such measures would be to minimize transport obstacles to the full implementation of the set of commitments assumed in other fields and sectors, and to establish sounder bases for more complete economic integration in the next phase. The measures outlined are dictated by a spirit of flexible progressiveness, and would also be of special importance in relation to sectoral agreements in specific basic industries and to the situation of the countries at less advanced stages of development, whose position is particularly unfavourable in respect of transport. Where maritime transport is concerned, the measures proposed have already been the subject of lengthy discussion in ALAIC, the outcome of which has been the formulation of a preliminary draft agreement on maritime, river and lake transport. The measures relating to rail and road transport would include

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some that have already been introduced in other parts of the world, particularly in Europe, where they were adopted even before the formation of the Common Market.

(i) Maritime transport. A regional pact or agreement on maritime transport should be adopted in the near future to which all the Latin American countries could accede. It should be based, as was suggested à propos of what is happening in ALALC's case, on the multilateral principle of the free, although organized, participation of all the Latin American mercantile marines in intra-regional traffic. However, the rapid and unconditional application of this principle might give rise to difficult problems in connexion with the competitive position and the relative operational cost levels of the various national merchant fleets, and with the assistance, subsidies, and other concessions which these are accorded in some countries. In such circumstances, provision should be made, by virtue of the principle of progressiveness, for the gradual enlargement of the proportion of intra-regional cargo reserved on a multilateral basis for all the Latin American mercantile marines, until by the end of the intermediate phase a very high percentage had been reached. This would give plenty of opportunity to adopt the measures of adaptation and co-ordination that in the course of time would be needed in this field.

Another problem calling for long-term studies - although they would not cover the whole of the intermediate period - is that of fixing the aggregate proportion of intra-regional traffic which should be reserved for the Latin American mercantile marines, and, correlatively, the proportion that should be left open to the merchant shipping of third countries not belonging to the region. This raises the complex problem of the degree of protection that the mercantile marines would need in order to ensure their optimum development. The allocation of too small a share to the merchant shipping of third countries might - as has already been objected in connexion with ALALC's existing draft agreement - produce adverse effects on freight levels in Latin America's trade relations with other parts of the world. It would be impossible to deal with this problem, however, without more thorough research; in any case, its solution would not affect the

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adoption of the multilateral principle that all the Latin American mercantile marines should participate in intra-regional traffic.

In addition, the agreement should include certain other provisions, notably those bearing on questions which were discussed at length during the United Nations Conference on Trade and Development. They would relate, in particular, to the organization of consultation machinery whereby close co-operation could be established at the regional level between shippers and the liner conferences and shipping companies. Such a system, besides giving shippers complaints a hearing would be an essential instrument for extensive co-operation and consultation on all matters connected with shipping services and freight, especially in so far as they affected the development of intra-regional trade and the contribution of maritime transport in this field.

The ECLA Trade Committee, at its fourth session (November, 1964) endorsed the recommendations of the United Nations Conference on Trade and Development and recommended to the Governments of the Latin American countries that, as a first step, they should adopt forthwith the measures needed to establish the system of consultation referred to above. The Committee also recommended that the Governments should establish, at the Government level, with the participation of shippers and associations of national shippers, "units to study problems of maritime transport" and freight, which would meet regularly to report on the progress of their work, exchange information and co-ordinate their activities, and would be able to call on the advice and assistance of the secretariat of the Economic Commission for Latin America.

Although these measures cover maritime transport as a whole, both intra-regional and extra-regional, they are of particular importance in relation to the former.

The relevant resolution of the Conference on Trade and Development also laid considerable emphasis on the incidence of cargo handling costs (including the cost of ship's time spent in port) on the total cost of maritime transport. The shortcomings of many Latin American ports are well known, and all the countries of the region should therefore pledge themselves to make in the next few years, a resolute and co-ordinated effort to

/modernize ports

modernize ports and rationalize port operations, with the requisite international aid and financing, as well as the technical assistance, envisaged in the resolution referred to. The matter had already been taken up, on the same lines, in a resolution adopted at Punta del Este.

Lastly, the Governments of the region should undertake to expedite the execution of a series of measures, already recommended in broad outline by ALALC, to facilitate regional maritime transport and endow it with greater flexibility. These measures would include some relating to the simplification and standardization of clearance papers for inbound and outbound ships.

(ii) International railways. The progressive implementation of the various regional trade commitments may lead to a considerable expansion of international rail transport, especially in the southern tip of South America, where such few international railway connexions as Latin America possesses are concentrated. The present almost negligible volume of traffic on these lines means that they are really under-utilized, and could carry a good deal more without its entailing much investment, although in several cases they might have to be modernized or reconditioned to some extent. Projects might be formulated for the financing of these requirements through IDB or under the programmes of the Alliance for Progress. Moreover, an increase in the traffic on the lines in question would itself improve the economic situation of the railways and therefore facilitate their technical and physical reconditioning. Thus great interest would attach, and in several instances high priority should be assigned, to a specific study on the state of the existing international railways and their needs in respect of reconditioning and modernization, with a view to their adaptation to the requirements of an accelerated regional integration process.

In the railway sector, a number of problems also arise in relation to government promotion of technical, administrative and commercial co-operation among the railway companies possessing international lines, with the aim of improving the quality of the services provided, facilitating the expansion of international traffic through greater flexibility in every respect - including administrative and customs formalities -, and reducing

/operational costs

operational costs and rail fares. Particular attention should be devoted to rail tariffs for basic industries covered by sectoral and complementarity agreements.

It would therefore be an excellent thing for Governments to push co-operation in this field during the intermediate phase. Such action could be channelled through the newly-created Latin American Association of Railways (Asociación Latinoamericana de Ferrocarriles - ALAF). This may be regarded as the embryo of a Latin American organization similar to the International Union of Railways (Union International des Chemins de fer - UIC), which has its headquarters in Paris, and even before the time of the Common Market played a considerable part in the work of developing and facilitating international rail traffic in Europe.

Furthermore, in conformity with the principles of progressiveness governing the advance towards a Latin American common market, provision should be made, even in the intermediate phase, for the elimination of discriminatory practices that might interfere with the application of the projected trade measures. Discrimination of the kind referred to would result, for instance, from differential tariff rates depending on the country of origin or destination of the goods transported. A similar difficulty would be created by special development or support rates which might perhaps hamper the implementation of sectoral agreements in respect of basic industries. But for the less developed countries, recourse to such rates - in order, for instance, to encourage their intra-regional exports - might constitute a wise and equitable measure. It seems desirable, in any event, that provision should be made for such discriminatory practices and special tariffs to be submitted to the consideration of the institutional agencies of the common market, which would be empowered to make recommendations to Governments with respect to their compatibility with the requirements of the Free-Trade Area and of the prospective common market.

(iii) International highways and motor-vehicle transport. Similar considerations apply to the potential expansion and the possible means of encouraging and facilitating international highway traffic, of which there is at present very little in Latin America, except among the Central American countries. Although several countries are already concerning themselves with

/this problem

this problem or have adopted measures to improve the operation of international services, elsewhere international traffic is still carried on in distinctly unfavourable conditions, since the compulsory trans-shipment of cargo at the frontier swells the costs of international transport and burdens it with a number of other disadvantages.

Among the feasible commitments in this field that should be envisaged for the intermediate phase, the following deserve special mention:

The conclusion of the pacts or agreements, at the regional level, needed to facilitate and increase the flexibility of the customs, administrative and other traffic formalities to which motor-vehicle transport is subject at frontiers;

The establishment of uniform standards and regulations applicable to vehicles in transit (covering, inter alia, technical requisites, weight, and dimensions) and to the drivers of international-service motor vehicles;^{1/}

The adoption of measures to improve operating conditions in international services and ensure that a fair share in intra-regional traffic is available to the transport enterprises of the countries concerned.

In this connexion, it would be as well to bear in mind the relevant provisions adopted by the European countries, on the basis of resolutions, pacts and agreements concerted within the Economic Commission for Europe and the European Economic Community. The special conditions prevailing in Latin America would of course have to be carefully taken into account, including the fact that because of the vast distances to be covered, international traffic would be circumscribed for a considerable length of time to groups of neighbouring countries and frontier areas, especially in South America. Hence several aspects of international motor-vehicle transport might be the subject of agreements and arrangements concerted on a bilateral or area basis, but in conformity with principles that would

^{1/} These matters were dealt with in the Convention on Road Traffic signed by the United Nations Conference on Road and Motor Transport at Geneva in 1949. It was ratified by only nine Latin American countries: Argentina, Chile, Cuba, Dominican Republic, Ecuador, Guatemala, Haiti, Perú and Venezuela.

be the same for the whole of Latin America.^{2/} Progressiveness and flexibility would be particularly to the point in this field, as it often happens that only experience can reveal the possible stumbling-blocks and lay down guidelines for progressive liberalization agreements.

At the same time, high priority would have to be given to a firm commitment by virtue of which the Governments of the region would intensify their technical and financial co-operation, within the institutional framework contemplated in the present document, in the tasks of improving the existing international highways, where necessary, and speeding up the construction of new international routes of common interest, for which carefully studied projects are or very soon may be available, and which could open up substantial regional traffic flows or break through the total or relative isolation of regions and areas with considerable development potential.

Apart from the Pan American Highways several inter-governmental agreements have already been concluded - especially between adjacent countries - for the construction of international highways that are of vital importance for the economic integration of the countries concerned.

Reference was previously made to the projected Carretera Marginal Bolivariana de la Selva. In the same context, attention should be drawn to the importance of the prospective construction of a stretch of the Pan American Highway, over 800 kilometres long, on the frontiers of Colombia and Panama, to cover the so-called Darien Gap, which at present interrupts road communication between Central and South America. The engineering studies relating to the selection of the route and the actual road-building are under way. Other projects of great potential significance for integration, which have lately been discussed by the Pan American Highway Congress - with reference, inter alia, to financing possibilities - are a proposed road from Rio Branco, Cruzeiro do Sul and Boqueirão in Brazil to Pucallpa in Peru,

^{2/} A resolution on this question was also recently adopted by the Permanent Executive Committee of the Pan American Highway Congress, in relation to a draft agreement on international transit of motor vehicles over the Pan American Highway system.

/which would

which would form part of the Brasilia-Lima highway, and the Pan American Transverse Highway (Carretera Transversal Panamericana) in South America (Lima-La Paz, Asunción-Paranaguá).

As in the case of railways, high priority should be assigned to a specific and systematic study of the state of all the existing and projected international highways in the region, with particular reference to their importance and priority for the acceleration of Latin America's economic integration process. Several national road transport programmes envisage the improvement or construction of international highways, but as a rule the execution of the projects is held up for want of funds. At all events, from the suggested study might emanate a co-ordinated set of projects that could be financed through IDB, the programmes of the Alliance for Progress and the international credit institutions.

(iv) International inland waterway transport. In large under-developed areas, Latin America has a vast river network hitherto under-utilized, especially by international traffic, with the exception of the Rivers Paraná and Paraguay in the River Plate basin. Fuller use of this network would be of particular interest and importance for several of the less-developed countries. During the intermediate phase, it would be highly desirable for the Governments to assume a firm commitment to co-operate more closely in the adoption of measures whereby navigability conditions could be immediately improved, river fleets developed, regional inland waterway transport facilitated and better river port facilities provided, especially on those reaches that might open up the way for rapidly expanding intra-regional traffic flows. Projects with high regional priority in this field might be financed through IDB or the programmes of the Alliance for Progress. In view of its great advantages for the development of basic industries, inland waterway transport would also merit special attention in sectoral agreements relating to industries in that category that might be located in river basins.

(b) Preparation of long-term commitments: formulation of a common transport policy

Stress has already been laid, in the introduction to the present chapter, on the high priority that in a long-term approach must be assigned to the gradual establishment of a regional transport and communications

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network, as a basic requisite for economic integration and for doing away with the present partition of Latin America into what are practically closed cells.

The preparation of government commitments with this end in view should also be supplemented by the study and formulation of those to be assumed in two complementary fields. They would be directed, on the one hand, towards the elimination of such obstacles to the establishment of the general common market and to the smoothly co-ordinated development of the whole region as are represented by the operational conditions of transport services; and, on the other, towards the progressive formation of a common market for the transport services themselves. International transport transactions are no different, in reality, from those relating to other activities in a common market, which implies the free circulation of services as well as of goods; the common market for transport services themselves would also constitute an indispensable requisite for the optimum utilization of the international network.

A common transport policy, as an integral part of over-all economic integration policy, and the commitments deriving therefrom, which should be studied and formulated within the institutional framework outlined elsewhere in the present report, would therefore cover the basic questions mentioned, and embrace all means of transport - maritime, inland waterway, overland (roads and railways) and air transport media - as well as communications, i.e., postal and telecommunications services. The transport and communications system in fact constitutes an organism, rather than the mere sum of its component parts.

The great complexity of the problem is obvious, from the fact that a plan for a future integrated transport and communications network can only be drawn up in close relationship with a forward-looking and dynamic view of the geographico-economic structure of the whole region. Clearly, an optimum Latin American transport system would be one of the most important determinants of a more rational division of economic activities and of more balanced and harmonious development throughout the region.

In any event, another top-priority study would be one whose purpose was to map out in broad outline, with possible alternatives, a future

/regional transport

regional transport network for Latin America. There would be no question of arriving at firm conclusions or recommendations which might in the near future give rise to commitments that could be assumed by the Governments. This would be over-ambitious, in view of the complexity of the problem and the conjectural nature of the conclusions that could be drawn from an initial study. It would be a matter, in essence, of drawing up a frame of reference, indicating the main lines along which an integrated regional network might possibly be developed, and serving to guide the policy and decisions of common market institutions in other fields, especially that of the development of regional industries.

The situation in this respect is not at all the same in Latin America as in the continent of Europe, where an international network had already been developed in the past and only needed expanding and improving. But a point of interest in relation to the task that has to be tackled in Latin America is that as early as 1950 sixteen States members of the Economic Commission for Europe signed a declaration relating to the construction or reconstruction of a European road network, comprising 22 arterial highways and 50 secondary or approach roads, which the signatories undertook to build as part of their own national programmes. In subsequent years, the European Conference of Ministers of Transport approved several roads, rail and inland waterway infrastructure programmes of regional importance. In 1960 and 1961, the Commission of the European Economic Community submitted recommendations to Governments bearing on a plan for major railways, highways and navigable waterways of interest to the Community.^{3/}

^{3/} One of the Commission's general recommendations contained a statement to the effect that the networks had been constructed in terms of the particular economic requirements of each individual State and of various extra-economic factors. Hence the national networks constituted more or less watertight compartments, with defective inter-connexions, heterogeneous infrastructure characteristics in frontier areas, deficiencies in the links between the major seaports and the industrial areas, and a tendency for the means of communication to converge upon the capital cities or certain industrial centres, which did not take sufficient account of the requirements of a sound regional policy. In the light of these observations, which may seem surprising at a first glance, the problems confronting the Latin American countries loom larger still.

It should be pointed out in this connexion that in Latin America the determination of the location of industries in terms of existing factors and conditions might consolidate the present structure of the Latin American economies and make it difficult to reorient them in the future, since location decisions relate to the long term and are largely irrevocable. Hence there would be an imperative need for close co-ordination of industrial development and transport policies through the common market agencies.

A regional transport network that is satisfactory in respect of its structure, density and quality may do much to ensure that the less developed countries obtain their fair share of the benefits of integration. Their position at the present time is particularly unfavourable from the standpoint of transport. Consequently, in the formulation of a transport policy directed towards the creation of such a network, the possibilities of doing harm to these less developed countries must also be borne in mind. The improvement or construction of international routes linking such countries or areas only with others at more advanced stages of development might in fact expose the former to keener competition from the producer centres already located in the more highly developed areas or countries. To obviate this risk, an essential requisite is that the internal transport networks of the less developed countries should be improved at the same time, in order to strengthen their potential comparative advantages and their ability to offer inducements for the location of industries and to establish new focal points of development. This goes to show once more that in the field of transport, too, regional integration is only a single element - although an important one - in the indissoluble whole formed by national and regional development problems.

The foregoing remarks are likewise applicable, mutatis mutandis, to the region's postal and telecommunications services, since any considerable intensification of intra-regional trade would be inconceivable without an optimum network of postal, telephone and telegraph services at the continental level.

As regards the need to eliminate the obstacles that the transport system may place in the way of the establishment of the general common market - particularly practices in the transport sector which might be

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capable of distorting over-all competitive conditions -- and the necessity of forming a common market for the transport services themselves, the first steps that it would be advisable to take in this direction have already been outlined in the context of commitments for the intermediate phase.

The commitments that should be studied and prepared in these interdependent fields with a view to the longer term, and with the requisite degree of progressiveness and flexibility, would relate to the following requirements:

- (i) The progressive readjustment, co-ordination and orientation of national transport systems and policies in the light of regional economic integration needs and objectives;
- (ii) The establishment of rules and principles -- as far as possible standardized, with due regard to the differing characteristics of the various transport media -- for the operation of services, as well as for tariff rates and transport conditions in regional services;
- (iii) Unrestricted freedom of participation in regional transport for the enterprises and services of the various countries. This liberalization would be effected in progressive stages until the final objective was attained, i.e., the constitution of a single regional territory within which Latin American transport services would operate freely but in conformity with appropriate regulations; and
- (iv) Development of the mercantile marines of the Latin American countries in the framework of a promotion policy based on special agreements, in the same way as was suggested for industries of regional importance.

Such objectives are indubitably ambitious, but as final targets they seem indispensable for the purposes of a common market, although it is true that the gradual and staggered implementation of the corresponding measures and commitments calls for long-term studies. From all points of view, the introduction of such measures even by degrees would raise a number of extremely delicate problems in relation to the progressive harmonization

/of the

of the social, fiscal and technical factors that might affect competition in regional services among the several means of transport and among the various countries' enterprises. There are wide disparities between the Latin American countries in this respect; for example, differences - sometimes considerable - in the relative levels of operational costs are determined not only by the factors indicated but also by economic distortions that influence transport just as they affect the other sectors of economic activity.

The immense complexity of these problems is clearly evidenced by the fact that the formulators of the Rome Treaty were also unable to reach complete agreement on the subject; the provisions of the Treaty do not precisely determine the content and underlying principles of a common transport policy.^{4/}

Separate mention must be made of air transport, which is perhaps one of the fields of greatest importance for regional integration, since the over-dispersion of national efforts and the bilateralism that still prevails in this means of transport are particularly self-defeating and anti-economic. Nor has reference been made, in the review of possible commitments for the intermediate phase, to those that might be viable or appropriate in this particular sphere, since from the existing studies no reliable idea can be formed as to the precise scope of the joint integration and operational measures, at the regional or area level, that might be put into practice in the immediate future. In any event, it would be worth while to make a careful evaluation of the progressive integration possibilities in respect of regional civil aviation, even during the intermediate phase.

Lastly, a basic feature of a common Latin American transport policy would be the formulation of its possible principles and commitments as regards the region's relations with other areas. This is of special importance

^{4/} The programme of action drawn up by the European Economic Community Commission in 1962 in relation to a common transport policy is still under discussion.

/with respect

with respect to maritime and air transport, since, apart from communications proper, these media would constitute the continent's links with the outside world. As regards maritime transport, at all events, it should be pointed out that the report of the meeting of government experts held at Brasilia in January 1964, and the Charter of Alta Gracia, together with the discussions and conclusions of the United Nations Conference on Trade and Development, have laid the foundations and established the guidelines for a common Latin American policy within the world framework.

Chapter IX

MONETARY AND FINANCIAL POLICY

The integration process calls for a policy and instruments by means of which each country's monetary and financial situation can be adapted to the requirements of intensive trade and keener competition, and which will meet the special needs that are bound to arise in respect of trade and investment payments and financing.

The pressing necessity of a monetary and financial policy is thrown into relief by the variety of situations found in Latin America. While some of the countries of the region enjoy a healthy balance-of-payments position and internal monetary stability, others are afflicted by chronic foreign exchange deficits, and have to cope with high rates of inflation. All this creates distortions as between the exchange rates in force and domestic price levels, which are reflected in varying degrees of over-valuation or under-valuation of national currencies.

Some apprehension is felt lest these exchange rates, which are artificially high in relation to those of other Latin American countries, may in many cases constitute a factor even more unfavourable to the progress of the integration movement than the disparities caused by the differential tariff treatments applied to third countries in respect of raw materials. As the tariff barriers between the countries of the region are gradually lowered, a country which persists in over-valuating its currency will have difficulty in keeping up its intra-regional exports, while at the same time it will tend to increase its imports. Conversely, an under-valuated currency implies a subsidy for exports and a disincentive for imports. Corrective measures are not easily brought into play, since the country concerned may be unwilling to revise an exchange rate which is usually adjusted to serve its interests in relation to the bulk of its world trade; and the regional imbalance will therefore be likely to persist.

This state of affairs is almost inevitable as long as the inflationary processes affecting various Latin American countries remain in operation. In face of exchange rates which are apt to be rigid, the increases in costs and prices that inflation brings in its train cause radical changes in
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the international competitive relationships previously existing within the framework of intra-regional trade.

Furthermore, a discrepancy between a country's exchange rate and its theoretical parity rate with other countries of the region may also emerge in the case of countries with a high level of internal monetary stability and a sound aggregate balance-of-payments position. In these latter, the exchange rate is essentially determined by their transactions with the rest of the world economy, and is the one calculated to maintain over-all balance-of-payments equilibrium. Where export earnings create a very high capacity to import, it almost naturally follows that the value of the national currency, in international terms, tends to be high in relation to the currencies of countries with balance-of-payments difficulties. Thus a gap opens - sometimes widely - between the exchange rate required for the maintenance of over-all equilibrium, and the one which would correspond to the other Latin American countries' different price levels. The difference between the two rates of exchange will be proportional to the disparities in productivity between export activities and the other economic sectors in the country concerned. The result will be an artificially high exchange rate with respect to the rest of Latin America, which will minimize intra-regional sales opportunities for products other than the traditional export lines. Presumably there will be some danger that, owing to this artificially high rate, countries where productivity is much higher in the traditional export activities than in the rest of the economy may find their balance of payments with the region invariably showing a deficit, unless other corrective factors come into play or continue to operate.

This chain of disequilibria unquestionably distorts what ought to be a steady and growing trade, and may handicap some countries in the movement towards a common market. The region must therefore take this situation into account, and expedite the preparation of measures or systems to counteract it.

Nevertheless, recognition of the danger, and of the need to devise ways and means of lessening it, should not mean that its implications are over-estimated or that the integration process is halted or retarded until the problem has been fully solved. It would be a serious mistake, for

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example, to contend that only when stability has been achieved, and realistic exchange rates, consistent with a break-even level for all the countries of the region, have been established, can progress be made in implementing liberalization commitments. Such an attitude might vitiate and inhibit the integration movement, which is just what could, through competition and the solution of balance-of-payments problems at the regional level, effectively help to overcome the difficulties deriving from inflation and external disequilibria.

Hitherto, it has not really been possible to verify the scope of the distortions in practice; nor has a reliable method yet been established for defining or measuring the extent to which the currency is over-priced or under-valuated, or the ratios between exchange distortions and rates of inflation. First and foremost, the problem calls for much more carefully prepared and systematic studies and investigations than have been carried out so far.

It is safe to say that while the studies in question are being undertaken, and until permanent and specific solutions are discovered, the commitments suggested in the present document as means of furthering the integration process tacitly imply sufficient correctives to prevent serious trade disequilibria from arising in the course of the next few years as the result of exchange distortion. In the first place, there are the margins of protection which will still remain in force after five years, and even after the ten years corresponding to the next phase. Secondly, one of the essential aims of the principle of reciprocity will be to avert or remedy marked imbalances in trade flows. Thirdly, the proposed regional institutions will be responsible for ensuring that countries which have to cope with specially difficult situations (and a serious distortion would be a case in point) can state their problem and secure appropriate solutions.

Again, the fact that the distortion problem can be partly solved by means of indirect measures during the forthcoming phase makes no difference to the above-mentioned necessity of devising direct and permanent basic solutions. The most decisive and constructive of these consists in the

/gradual approach

gradual approach to internal financial and monetary equilibrium in all the countries of the region. This objective is unlikely to be attainable over the short term, in view of the formidable difficulties which some of the Latin American countries are at present encountering in the financial field. But, at all events, the endeavour to adopt and implement stabilization policies will lead, little by little, to a more hopeful situation in this respect.

An essential requisite for the purpose is the establishment of contacts among leading Latin American financiers, and, in particular, the Presidents and other senior officials of the central banks. Such contacts, besides helping to elucidate and define the real characteristics and scope of the distortions, may be conducive to the adoption of realistic exchange rates calculated to prevent them, while at the same time an effort can be made to contribute to the studies, attitudes and decisions likely to promote the attainment of integration objectives.

The proposals now being broached, to the effect that Directors of central banks should meet at regular and frequent intervals, with a view to the study and solution of distortion problems, constitute a decisive step forward.

Consideration might also be given to other expedients. There has been some discussion, for example, of the possibility of establishing a system of compensatory rates, which could be applied by a country whose exchange rate was artificially high, subject to given conditions and characteristics. Such a system might help to stabilize intra-regional trade balances, inasmuch as it would discourage imports. Another formula that some experts have outlined consists in the establishments of ad hoc exchange rates among Latin American currencies, which might differ from those in force for the rest of the world, and would be determined in the light of the corresponding internal terms of trade.

Both these procedures, however, call for very detailed analyses which have not yet been carried out, so that for the moment it is difficult to put them forward in concrete terms.

In addition to the problem of exchange distortions, another and more universal difficulty is the shortage of foreign exchange under which almost all the Latin American countries labour. An instrument that would facilitate

/intra-regional trade

intra-regional trade payments and would thereby encourage transactions would be one means of mitigating the effects of this shortage and spurring on the integration process.

One of the possibilities that has been discussed of late, with steadily increasing regional unanimity and international approval, consists in a number of variants of the compensatory payments system, based on multilateral credits, and aimed at reducing the need for the direct and invariable use of hard currencies in all intra-regional trade transactions.

The characteristics of a satisfactory system to facilitate inter-Latin American payments have been considered in specialized studies carried out by the central banks and by such institutions as IDB and CEMLA, apart from the efforts made in the same direction by ALALC and ECLA. It seems unnecessary, in a general document like this, to set out the various technical alternatives in detail. But what is important is to stress the desirability of a decision on the part of financial authorities in Latin America to form, at the earliest possible date, a regional payments union, understood as a system of compensatory payments, combined with credit margins, for intra-regional trade. Naturally, balances not covered by the credits would have to be settled in gold or convertible currencies. By means of such a payments union proper attention to each individual country's exchange problems could be ensured, and the need to co-ordinate exchange policies and systems could be met.

Another very interesting prospect relates to the creation of a common reserves fund, which has already been the subject of preliminary discussion among representatives of the central banks of several Latin American countries. The constitution of such a fund would permit much more rational utilization of the reserves maintained by all the countries at the present time. The effects of the seasonal nature of each individual country's exports would be minimized, and the fund might constitute a special source of short-term credit to relieve the temporary difficulties of particular central banks, besides serving to guarantee loans from other sources. This idea, which may have far-reaching repercussions, is being actively elaborated.

To sum up, Latin America should consider the following possible lines of action in relation to its regional monetary and financial policy:

/ (1) Stress

(1) Stress must be laid on the importance of continued study of the problem of monetary distortions, in search of specific solutions applicable in those phases of the integration process when the levels of protection still maintained will not be enough to compensate the effects of the distortions in question. The assumption of the commitments proposed for the new phase, however, must not be conditional upon the disappearance of these distortions, so long as provision is made for the tariff levels to be kept high enough to offset the risks which the distortions entail, and inasmuch as in any case the application of the principle of reciprocity would also operate as a corrective;

(2) Not only in order to further the attainment of equilibrium in intra-regional trade, but also to enable due advantage to be taken of the opportunities opened up by the over-all tariff reduction process and specific requirements of regional investment policy to be met, permanent instruments will have to be established which, at the highest level, will be responsible for co-ordinating the monetary and exchange policies of the Latin American countries. To procure this co-ordination will be one of the principal functions of the new institutional system;

(3) It is also a matter of urgency for the common agencies to expedite the adoption of the following regional measures, which, among others, will be indispensable if the opportunities offered by the integration process are to be intensively exploited:

- (a) Establishment of a regional payments system to facilitate transactions, reduce the need to use hard currencies and bring down the cost of strictly financial operations in inter-Latin American trade, at the same time providing such reciprocal credit as may be appropriate and necessary;
- (b) Study of the possibility of creating a common reserves fund, to be drawn upon in accordance with regional criteria;
- (c) Expansion of the export financing systems that IDB has already launched for some products;
- (d) Organization and intensification of suitable liaison arrangements among commercial banks in Latin America, so that trade operations can be facilitated to the utmost possible extent;
- (e) Organization of a regional system of insurance and reinsurance, as a means of avoiding the heavy disbursements of hard currencies at present made under these heads; and
- (f) Study of the organization of a Latin American stock exchange, with a view to channelling the capital market on regional lines.

Chapter X

THE INSTITUTIONAL STRUCTURE

The establishment of community institutions that are effective and adequate to the task is an important condition of the integration process. The obligations entailed by integration cannot all be foreseen and fixed in advance in final form. The search for a common trade policy, the formulation and putting into practice of a regional investment policy, and the co-ordination of financial and monetary policies, all call for a great capacity to adapt to changing circumstances. Hence there must be community institutions empowered to deal effectively with such circumstances, since otherwise the process will be in serious danger of coming to a halt, despite apparent activity that is, however, not translated into deeds or positive achievements.

Latin American integration cannot make any satisfactory progress unless it has strong institutions appropriate to a new stage at which efforts must be made not only in the field of trade, but also in such other areas as sectoral industrial complementarity agreements, which are the warp and woof of real integration. In a region like Latin America economic development cannot be expected to result from automatic economic forces. The institutional basis of integration must be as well organized, if not more so, as in the developed areas, which also need an institutional structure capable of providing the essential political impetus, within the framework of a great regional concept formulated by an organ which meets the needs of the community.

Although national Governments will, of course, reserve the right to formulate their own economic policies, participation in a common market will oblige them to bring these policies into line with the interests, of the region and to consider the views of the other countries. In addition the freedom of the market needs to be supplemented by a planned development policy, both at the regional level and within each country, since freedom of trade can and should go hand in hand with the pursuit of economic and social aims. Some of those aims will form part of the common purpose of integrated development, while others will continue to be the responsibility

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of the individual countries, since all will continue to make their own efforts, decide on the social policies that suit them and encourage the sectors of production that they consider most promising. All this involves the co-ordination of national development policies, and the establishment of community institutions responsible for this task.

The institutional structure should reflect a balance between the national interests of the individual countries and the common interests of Latin America. It would not work, for example, if it consisted only of an organ at a high political level without a technical body to voice the interests of the community. Such a lack of institutional balance could hamper, weaken and even bring to a halt the whole process of integration.

What is proposed is not a political integration but the establishment of community institutions that are more independent, and have more freedom and scope for action, than the existing ALALC organs, but would at the same time have the same Latin American character as those organs, without prejudice to any co-operation that might be received from inter-American or international institutions.

At the first stage of integration the community institutions should fulfil specific practical purposes, including the following:

(a) In many cases, before establishing how the new agreements would be applied, or proposing solutions for particular problems for the countries to decide on, it would be necessary to make evaluations based on an objective study of the facts. This objective evaluation could not be submitted to an agency concerned mainly with negotiations based on reciprocal concessions.

(b) As integration progresses the need will arise for new obligations to be assumed in fields or respects not covered in the initial agreements. If the continuity of the integration process is to be preserved, there must be an institution that can formulate and study new agreements from the standpoint of the interests of the community, and subsequently submit them to the Governments. Such an institution could make specific recommendations on the basis of which the Governments could negotiate.

/(c) In

(c) In addition, it is essential to have agencies to promote and encourage actively, and on a continuing basis, the full and prompt exploitation of the new trade and development opportunities provided by the agreements signed.

(d) Lastly, there must be a high-level organ than can adopt decisions relating to the execution of the agreements concluded, and propose amendments to the Governments.

To fulfil these functions, the community organs should be:

1. The Council
2. The Board
3. An agency to promote investment
4. A committee of entrepreneurs and workers
5. The parliamentary assembly
6. Ad hoc arbitration tribunals.

1. The Council.

The Latin American community should have a high-level political organ, the Council, which would be responsible for taking the decisions required for the progress of integration. It would not only supervise the satisfactory fulfilment of the agreements signed, but above all it would decide on the new agreements that would be needed to promote integration. With an organ of this nature the integration process would be under the immediate and continued supervision of the Governments concerned, through their Ministers for Foreign Affairs or other Ministers who would take their place when certain special subjects were considered. The Ministers, by virtue of their posts, would have direct access to the head of State, Congress and the parliamentary committees. This would make government action in support of integration much more rapid and effective.

The Council would consist of representatives of the various countries, and consequently, although it would be a community organ, it would also provide expression for national interests, within the context of the aims of Latin American solidarity. It would be a Ministerial organ, consisting of the Ministers for Foreign Affairs of all the member countries, who could be accompanied, and in some cases replaced, by other Ministers with

/jurisdiction over

jurisdiction over any special questions that might come up. The Council would be the highest organ of the community, and would meet at least twice a year, or more often if necessary. In any case the Ministers for Foreign Affairs would be represented by alternates to deal with the day-to-day problems of the Association. If the Council's operational requirements made it necessary, each country could appoint a special Minister in charge of integration affairs.

The Council would have the following basic powers in relation to the integration process:

(a) To decide on any formulas for advancing the process of tariff reduction submitted to it by the Board that would require the adoption of new agreements.

(b) To take a decision on the regional investment policy formulated by the Board.

(c) To take decisions on the financial, monetary and payments policy.

(d) To take decisions on a policy covering cultural matters and questions of scientific and technical development.

(e) To rule on all questions submitted to it for decision by the Board.

(f) To adopt all the decisions and provisions necessary for the fulfilment of the agreements concluded.

(g) To decide on programmes of future action.

(h) To represent the Association in dealings with third countries, and international agencies or bodies, on questions of community interest. The Council would also represent the community in signing contracts and other documents of public and private law.

(i) To elect, for a period of one year, a President and two Vice-Presidents.

(j) To elect the members of the Board.

(k) To approve the Association's annual budget.

The decisions and resolutions of the Council should be adopted unanimously, but could be reached by a simple majority in the following cases:

(a) In deciding on requests for exception to the rules in force, in the light of the Board's recommendations. If the Council does not take a decision within a certain period, the applicant country may act in accordance with the Board's recommendation until the next meeting of the Council, when the Council would have to take a final decision.

(b) In dealing with disputes between Contracting Parties arising out of the application of the agreements. The Council would have a specific time-limit for deciding on any question submitted to it, and if this period expires before a decision is taken, the Parties can apply to the arbitration tribunal for a decision on the question. Similarly, the parties can appeal to the tribunal against decisions of the Council.

The Council would be empowered to establish technical committees composed of government officials to advise the Board in particular fields in order to facilitate its work and expedite its decisions.

2. The Board

Experience in Latin America and in other countries shows that it is essential to have an organ that represents the interests of the community and encourages the integration process, with powers to make studies and propose action with complete freedom from any kind of limitation. This organ, that could be known as the Board, would be the prime mover of integration. The interests of the community can only find expression in a collegiate body on which all members have the same standing. The same purpose cannot be fully achieved by means of a secretariat, however broad its powers, since it would necessarily consist of a subordinate technical body and a single chief who would be finally responsible for establishing the ruling principles. In the Board, on the contrary, the exchange of views would take place between members with absolutely equal rights and powers. If agreement could not be reached, the divergent views should be reconciled in a form that genuinely reflects the interests of the community.

The Board would essentially represent the interests of the community, but it would not be a supranational authority, since it would not impose any new obligations on the Parties. However, in expressing the interests of the community, it would adopt a supranational approach. The Board would consist of a few persons appointed by the Council on the basis of their general suitability. The members would be elected for specific periods, and they could be reappointed for one or more additional periods. They would elect a Chairman for the same number of years as their own period of office. The Board would have its own technical services and secretariat.

The Board should include representatives of the various groups of countries that can be distinguished from the standpoint of level of development, and only nationals of members states could be appointed. The members of the Board would act with complete independence, without seeking or accepting instructions from any Government or from any national or international organization. The members of the Board should refrain from any attitude incompatible with their position as representatives of the community. The Contracting Parties, for their part, would refrain from seeking to influence the members in the discharge of their responsibilities. The Board would take decisions by a simple majority.

It is believed that only a body composed of persons of high reputation in Latin America would have the necessary authority to fulfil the basic function of representing the community interest, both present and future, of the Parties.

The Board would have the following functions:

(a) A supervisory function, in watching over the faithful and strict fulfilment of the agreements concluded and of decisions adopted by the Council and the tribunal.

(b) The dynamic function of proposing projects, programmes or provisions to the Council, and formulating any recommendations it deems desirable for the better fulfilment of the agreements and for the conclusion of new agreements. In this connexion, in the light of the general aims of integration, the Board would undertake to carry out certain specific activities such as the following:

- (i) Formulating and submitting for the approval of the Council a regional investment policy, and promoting its implementation. This function would include seeking to achieve a suitable balance of the advantages resulting from integration, as between all member countries, and hence special attention to the needs of the relatively less developed countries.
- (ii) Submitting to the Council, for its approval, programmes, measures and provisions in the field of trade policy aimed at facilitating and accelerating integration.

/(iii) Submitting

- (iii) Submitting programmes and measures to reconcile the trade and tariff policies of the member countries with respect to third countries.
- (iv) Proposing to the Council the bases for a common agricultural policy.
- (v) Formulating and proposing to the Council a cultural and educational policy, and promoting its implementation.
- (vi) Studying how far the discrepancies in other national policies (for example, in the monetary, social and tax fields) are important factors in distorting the competitive situation, and proposing measures to deal with them.
- (vii) Proposing to the Council projects aimed at avoiding the harmful effects of the lack of uniformity in national legislation, for example, those relating to the treatment of foreign investment.
- (viii) Submitting an annual report on the progress of integration, and on the measures that should be adopted to encourage and support integration.

(c) A promotional function in furthering economic development within the framework of the regional investment policy. For this purpose the Board would undertake:

- (i) To encourage sectoral complementarity agreements and projects for the establishment of new industries as a joint operation by several countries. Such projects would cover not only manufacturing, but also infrastructure, especially transport and the supply of electric power between countries. For the less advanced countries the Board should work out and support development projects in the strict sense.
- (ii) To encourage programmes for the reconversion of industrial and agricultural activities, or for the modernization and renewal of machinery in undertakings or sectors adversely affected by the removal of barriers to imports.
- (iii) To study specific projects prepared by the investment promotion agency.

(d) A co-ordinating function, by virtue of which the Board would act as a link between national agencies for the planning and promotion of development, and would facilitate and encourage the consideration, and promote the complementarity, of projects of common interest to several countries.

(e) An evaluating function, in determining and considering the facts on which are based requests for exemption from the general rules in force, and in making recommendations on how such requests shall be dealt with.

(f) A conciliatory function, in relation to disputes that may arise from the application of the agreements, through the recommendation of solutions.

The Board would be empowered to establish committees to deal with specific subjects, such as trade questions. The Board should encourage meetings between the Central Banks of the member countries with a view to establishing the principle of co-ordination between monetary, credit and exchange policies.

The Board could play an important part in solving the many problems that arise from the participation of foreign capital in the integration process. In general foreign enterprises would have more funds and easier access to sources of finance. Hence they would be at an advantage in participating in multinational projects. The fear of the financial, technical and administrative superiority of such enterprises might lead to resistance and hamper the conclusion of certain agreements. Consequently the basic activities of the Board should include the promotion of the right conditions to enable Latin American enterprise to take full advantage of the benefits of integration, and in particular of sectoral complementarity agreements, and to compete with foreign enterprises, or associate with them on terms of real equality. This kind of support may take various forms. When deciding on formulas for sectoral integration or multinational projects the Board should take into account the position of the existing Latin American enterprises and the interests of Latin American investors, in order to ensure that they can make full use of the new opportunities.

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For this purpose the Board could take part in joint efforts to convince Governments of the need to co-operate in establishing a given system of tax or tariff incentives.

The safeguarding and promotion of Latin American interests in an enterprise would be considerably facilitated if a Latin American community agency could acquire shares and hold them temporarily. The agency could acquire temporarily whatever shares reserved for private subscription were not subscribed and paid for, and could later make them available to the public again. The national development agencies could acquire part of whatever shares the community agency could retain. Some proportion would have to be established between the shares to be sold in the country where the industry would have its headquarters, and the volume of shares to be offered to the other Latin American countries, as well as the total that could be subscribed by investors outside the region. By empowering the community agency to acquire shares, the danger would be avoided that, because of the fear of private investors of running certain risks, Latin America would be unable to establish the enterprises or undertake the activities needed for integration. A system that would thus safeguard the integration process would effectively protect the real interests of Latin America.

A balance and harmony between strictly national interests and the interests of the Latin American community could be achieved through an exchange of views and through the functional relation between the Council and the Board. The existence of the Board, with its dynamic and promotional functions, will permit the systematic and serious study of long-term problems and the establishment from the outset of the bases that would allow an extension of the agreements concerned at the subsequent stages.

3. The investment promotion agency

Integration does not automatically achieve the reduction or abolition of obstacles to trade between nations, but is the fruit of a great collective effort in the field of investment and of production in general, with a view to taking full advantage of the new opportunities offered by a broader

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market. Hence there must be a promotional machinery to provide an active stimulus to investment through the preparation of specific projects, which should be conceived within the general frame of reference afforded by the regional investment policy formulated by the Board and approved by the Council.

The agency in question should be established by an agreement between the Board and the Inter-American Development Bank (IDB). This agreement would lay down the Agency's terms of reference, which should include serving the interests of the Latin American community in accordance with the general principles and directives established by the Board. IDB would provide the Agency with the funds needed to begin and continue its activities and to meet, inter alia, preinvestment costs. The Agency would be directed and administered by a governing council on which the Board and IDB would be represented, and to which only nationals of member countries of the Latin American economic community could be appointed. The Agency would carry out the regional investment policy by translating it into specific projects. Although the initiative in preparing such projects could come from the Board, the member countries or the Agency, the latter would be responsible for making the necessary studies and conducting the discussions and consultations with the authorities and entrepreneurs of the countries concerned until the technical and economic aspects of the project took final shape. In discharging its functions the Agency would have the assistance of technical advisers and the co-operation of other institutions such as ECLA, the Latin American Institute for Economic and Social Planning, etc. The Board would examine all the projects prepared by the Agency, whatever their prior origin, and would verify that they were in line with integration aims, the regional investment policy, and trade policy, and the directives laid down by the Board itself and by the Council. The Board would then proceed with the promotion and negotiation of the projects.

The Agency would act specifically in relation to the following:

- (a) The preparation of draft projects of sectoral agreements;
- (b) The advising of countries and of the Board in the negotiation of such agreements;

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- (c) The execution of particular aspects of sectoral agreements, when the Board so requests, in particular those relating to technical assistance;
- (d) Advice to the Board to ensure the correct functioning of the sectoral agreements and the fulfilment of the obligations they involve.

With respect to the special support that should be given to Latin American enterprise, the functions of the Agency may be of particular importance. Thus, for example, it could provide Latin American investors with technical assistance to enable them to take advantage of the opportunities opened up by the process of integration, and could co-operate with existing Latin American industry in improving its production conditions and competitive footing.

4. The committee of entrepreneurs and workers

This organ would provide expression for national economic forces, in particular entrepreneurs and workers. In co-operation with the Board, the Committee would assist in clarifying and defining the region's problems and interests. It would consist of a given number of representatives of the entrepreneurs and workers of each of the Contracting Parties, and its members would be appointed by the various Governments for a given period, and could be re-elected.

The Committee would be of an advisory nature, and would meet in plenary session twice a year, although at the request of the Board it could appoint advisory committees on a temporary basis for special problems.

5. The parliamentary assembly

The Latin American parliamentary assembly would consist of representatives of the Congresses of each of the member countries. This body could perform a valuable task in that it would permit the establishment of a group of persons who would act in their respective national parliaments on the basis of a direct and detailed knowledge of integration problems.

/Its functions

Its functions would include submitting to the Board projects for the unifying of national legislation in fields where the existence of provisions that conflict, or are not sufficiently consistent, hampers trade and integration. The Assembly would receive the Board's annual report.

The legislators of the various countries have already given evidence of their desire for such a development by meeting in Lima in December 1964 and establishing the Latin American Parliament. If it were thought advisable, this Parliament could be incorporated into the proposed new institutional structure.

6. The ad hoc arbitration tribunals

No tribunal would exist as a permanent organ, but one would be established every time it proved necessary.

In each case the tribunal would consist of members of different nations appointed by lot from a five-member panel submitted by each country. It would be competent to deal, in the first instance or on appeal, with complaints relating to non-compliance by one of the Parties with agreements or obligations entered into under the Treaty, or other instruments deriving from the Treaty. If the country affected by the verdict does not comply with it, the complainant would be able to adopt whatever compensatory measures the tribunal considers appropriate for restoring the balance of advantage.

The tribunal could serve as the legal advisory body to the other community institutions.

Chapter XI

ALALC AND THE NEW COMMITMENTS

The new commitments herald the beginning of another stage in the evolution of the Montevideo Treaty. Consequently they represent a necessary improvement upon the existing system rather than the creation of a different system.

In the preamble to the Treaty, the Contracting Parties state their determination "to persevere in their efforts to establish, gradually and progressively, a Latin American common market". In other words, they recognize that a common market has to be reached by successive stages, at each of which certain work is done, the accomplishments of the preceding stage are consolidated and Latin America is brought a step nearer to a common market and the integration of its economies.

As indicated in chapter II, ALALC's activities have had far-reaching results in terms of the number of concessions granted, the reversal of the downward movement that had brought intra-trade to very low levels and the more than satisfactory fulfilment of its basic tariff reduction commitments. Moreover, ALALC has made Latin America generally aware of the vital role that integration can play in developing the economy and raising the levels of material and cultural welfare. This awareness, which has become equally widespread among entrepreneurs, Government circles and the public in general, provides the social and political background to the new commitments in default of which it would hardly be possible even to visualize the fulfilment of other stages of improvement and progress in the integration movement.

When new obligations and procedures are evolved for satisfying the aim of the Contracting Parties to advance progressively towards the establishment of a Latin American common market, the criteria and methods adopted should be those indicated in the Treaty itself. At the same time the new commitments should be a true and faithful reflection of the demands of the new stage in so far as they should expedite, invigorate and strengthen the process of integration while creating more favourable conditions for a common market. In Article 54 of the Treaty, the Contracting Parties undertake

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to make every effort to direct their policies with a view to the creation of such conditions. Article 61 provides that on the expiry of the twelve-year term starting on the date of entry into force of the Treaty, the Contracting Parties shall study the results of its implementation and initiate negotiations with a view to fulfilling the purposes of the Treaty more effectively and, if desirable, adapting it to a new stage of economic integration. The fact that this examination must be carried out without fail at that time does not prevent the Contracting Parties from proceeding to do so earlier, if they deem it expedient.

This imperious need is the outcome of the different factors and circumstances that have been analysed in the course of the present document. The Montevideo Treaty expressly states the form in which amendments are to be couched. On Article 60 it is specified that such amendments should be set out in protocols that would enter into force upon ratification by all the Contracting Parties and after the corresponding instruments have been deposited with the Government of Uruguay. This procedure might also be adopted for the new commitments since this would comply with the spirit and letter of the Treaty and at the same time manifest the continuity of Latin America's efforts to bring about the establishment of a common market and integration.

This element of continuity should not be limited to the formal or legal aspects of the development of ALALC's present system; it must become part of its basic achievements and of the utilization of the abilities and experience which, at every level, have made such achievements possible.

The Montevideo Treaty not only provides for the gradual and progressive fulfilment of the commitments directed towards the establishment of a common market, but aims at the incorporation of all the Latin American countries into that market. There is also a practical reason for redoubling the efforts made to ensure that the new commitments form the basis for an understanding into which all the countries of the region can enter. In fact, the greater the progress made towards a common market, the greater the concessions agreed upon by the member countries of ALALC. This undoubtedly militates against the accession of new members which would probably be

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expected to reciprocate all previous concessions granted. For this reason, every effort should be made to bring into the Association those countries that have so far not joined. The way to accomplish this has been set forth in Article 58 of the Treaty. The Central American countries are in a different situation because they already form a separate system, and are bound by the Treaty of Managua not to accede unilaterally to new treaties that might affect the principles of Central American economic integration. Suitable conditions would have to be created to enable these countries to join the Association as a single unit. The coalition of the two systems would entail separate negotiations and formulas, but would in no way prejudice the past achievements of the Central American community or the future course of integration in that area.

