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OUTLINE OF THE PROBLEMS OF THE REGIONAL MARKET

(Preliminary report)

OUTLINE OF THE PROBLEMS OF THE REGIONAL MARKET

I. Advantages and disadvantages of the multi-national market.

Advantages

Productivity and hence the rate of economic development will grow more rapidly as a result of the considerable expansion of the market consequent upon multi-national integration as compared with the relative smallness of national markets. This expansion will have the following effects:

- (a) As specialization develops, it will be possible to extend the import substitution process to more complex sectors of industry under more favourable economic conditions than those obtaining at present in national markets, especially as regards the production of capital goods, certain durable consumer goods (for example, motor vehicles) and intermediate goods of industrial origin;
- (b) It will also facilitate specialization in existing industries with a consequent reduction in costs;
- (c) It will create favourable conditions for the export of industrial commodities to the rest of the world as a result of the increased productivity deriving from the improvements described in sub-paragraphs (a) and (b);
- (d) It will give free access to the raw materials of the whole region and facilitate the more effective utilization of common resources;
- (e) It will promote trade in agricultural commodities and remove the obstacles now impeding such trade;
- (f) It will stimulate foreign investment;
- (g) It will increase the bargaining power of the Latin American countries in their trade relations with other areas.

Disadvantages

The following disadvantages of the common market have been pointed out:

- (a) The common market might cause excessive industrial concentration in one or several of the industrially more advanced countries to the detriment of industries which already exist in the others or which offer the best prospects of future development, and hence may prejudice their economic growth.

(b) The above disadvantage may well be felt among countries at present at a similar stage of industrialization (Brazil, Argentina, Mexico, for example) but it would have a particularly bad effect on the less developed countries of Latin America; at the same time, the old dispute over the international division of labour would tend to recur between the less developed and the more advanced countries and slow down the rate of development in the weaker countries.

(c) Similarly, the less developed countries might be compelled to acquire their capital, intermediate or consumer goods from the more advanced countries of the common market at prices higher than those obtaining in the rest of the world, although they would sell their raw materials to them at international prices.

(d) Countries, like Venezuela, which are not faced with the persistent problem of adverse foreign trade balances, might also suffer from the above disadvantage by having to pay dollars for goods acquired from the common market when they might get them more cheaply from the rest of the world.

(e) Certain countries, like Argentina, where agricultural production predominates, might suffer serious setbacks in the agricultural sector as the result of competition from countries with greater productivity.

II. The scope of the common market

There are various ideas concerning the scope of the common market both as regards the number of countries and the range of commodities to be included.

(a) Countries

(1) Should the common market be restricted to neighbouring countries or to those closely linked by geographical or economic ties or should it be extended to all or most countries of Latin America?

(2) If it is extended to all or most of them, should the process be immediate or should a start be made with groups of countries leaving membership open to others?

As regards point (1), it might be argued that the southern countries of Latin America which already trade relatively actively among themselves might be keener to integrate with their neighbours rather than with Mexico, for example, in whose case distance has constituted an unsurmountable obstacle.

On the other hand, if there were a common market, countries like Mexico which have achieved a high degree of industrialization, might prefer to exchange industrial products - not to speak of others - under the established preferential system. Such a system might overcome the obstacle of distance and facilitate industrial diversification and specialization.

(3) Is this in fact likely to happen in the case of Mexico and other distant countries?

From another point of view, it might be maintained that the participation of such industrially advanced but distant countries might have a beneficial effect on the trade of the less developed countries which, otherwise, might tend to depend too much on their more powerful neighbours.

As regards point (2); while the principle of expanding the common market gradually might make it easier to enter into negotiations forthwith, the temporary exclusion of certain countries might make it harder for them to join the market later because of the identity of interests that might meanwhile have developed in one group or the other and because of the possibility that existing inequalities might be accentuated.

(b) Commodities

The idea of a gradual and progressive common market seems to have taken root, but there is basic disagreement as to how to put it into practice.

(4) Is it advisable to begin with a limited group of commodities and, in the light of results achieved, to extend the market to other commodities by means of successive negotiations between Governments? or

(5) Would it be preferable to include all commodities from the outset and to determine immediately the form in which tariffs and restrictions are to be reduced in the course of time, without recourse to fresh negotiations?

The first solution might appear more prudent; the effect of abolishing customs duties and restrictions in respect of groups of articles, where the advantages clearly outweigh the disadvantages, should be examined before arrangements are made in successive negotiations to include other commodities.

On the other hand, the prudence of such successive negotiations is open to question because, if the preliminary arrangements to create the common market are carried out in a piecemeal and dilatory manner, there is the risk that new interests may come to the fore which will make the establishment of the market very difficult, if not impossible.

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Moreover, the wider the range of the common market, both as regards countries and commodities, the more likely it is that its advantages will be equally distributed among all participants.

To question (5) there are several answers, which may be summed up as follows:

(a) A complete list of commodities might be drawn up and specifications made in respect of each regarding the manner in which the customs duties levied upon it will be gradually reduced;

(b) Groups of commodities might be agreed upon and the annual percentage of the decrease in the duties to be levied on each group might be determined;

(c) Instead of individual or group decreases, a total average decrease in customs duties or other restrictions might be worked out in such a way that each contracting State is free to eliminate gradually such duties and restrictions in the form which disrupt its economy least; in order to avoid an arbitrary choice, the average should be calculated by weighing each duty with the total consumption of the relevant commodity.

It is felt that this formula, besides obviating the difficulty of classifying and grouping commodities, has the merit of flexibility. In addition to the direct advantages accruing therefrom, it would facilitate bilateral negotiations designed to establish reciprocal reductions of interest to two countries, independently of their automatic extension to other contracting members.

While suggestion (b) may not offer these advantages of flexibility, it has others, particularly that of enabling tariff reductions to be extended progressively within a previously determined and accepted programme. The first reductions would apply to that group of commodities where there are no or only incipient interests involved, while those relating to fully established industries which need time to adapt themselves to the new competitive conditions of the regional market would come last. The first group would include those capital and other durable goods, as well as intermediate products, the production of which the more advanced countries of Latin America should undertake or encourage in the next few years, in order to accelerate development and offset the persistent trend towards disequilibrium in their balance of payments.

In this connexion, a very important point arises: so far, no information is available - and this matter should certainly be clarified - on the actual or potential significance of the tariff as a factor affecting the pattern and volume of inter-Latin American trade. Nor is it clear, in the case of certain commodities to which tariffs cannot be applied, whether trade liberalization should rather be based on quantitative or other non-customs procedures.

III. The common tariff vis-à-vis the rest of the world

The common market also presupposes a common customs tariff vis-à-vis the rest of the world. In certain Latin American countries, inflation has led to the virtual disappearance of tariffs, and the task of reintroducing them is extremely urgent. The tariff in a developing country is a dynamic instrument. Commodities on which no tariffs are levied at present because it is politic to stimulate the activities using them (for example, the capital and intermediate goods previously referred to) might have to be classified as dutiable in the course of time in order to encourage their replacement by domestically produced goods.

(6) On what principle should the common tariff be based? Should protection be restricted to commodities which are at present essential, leaving future problems to be settled by subsequent negotiations, or should such problems be tackled now by levying the appropriate duties?

This question does not relate to the future alone; it also has bearing on the different stages of economic development attained by the Latin American countries. Indeed, it has just been seen that the more advanced countries are starting to replace imports of complex durable goods (both capital and consumer) and of intermediate products by domestically-produced goods, while other countries have to continue importing them. The common market would compel these latter countries to import such goods from other contracting countries under the established tariff preference. A relative rise in the price of these goods will result, since the Latin American countries cannot match the lower costs obtaining in the rest of the world, which is the very reason for recommending the preferential system.

In a common market this drawback is more than offset by the marked advantages involved. It is essential for the financing of the market that such advantages should be reciprocal. However, a country, particularly a less developed one, might import goods from the other Latin American countries instead of from the rest of the world without being able to pay for such imports with exports of similar magnitude to those countries. This is a particularly important case which is dealt with in section V.

IV. Detrimental effects of the common market on certain activities

The common market is an essentially dynamic project. When any industry or activity has to readjust its production while demand is constantly growing and there is room for new competitors, the process of readjustment is much less difficult than when demand is stationary. In this sense, the Latin American common market will be dynamic. Nevertheless, cases may arise where the readjustment made necessary by external competition becomes difficult and where the displaced manpower is not easily absorbed in other activities. Again, for different reasons or in order to increase future demand, certain activities may require special encouragement. These cases may occur both in industry and agriculture but the difficulties are likely to be acute in the latter sector particularly.

(7) In the cases just referred to, should imports from other countries of the common market merely cover the increment in consumption (or a part of it) so as not to interfere with domestic agricultural production?

V. The situation of the less developed countries

In discussions on economic integration misgivings have often been expressed that the less developed countries might find themselves at a disadvantage as compared with the more developed countries of Latin America if a common market is established. Of course, it will offer them ample outlets for their export industries and other productive activities, but, if they are to take full advantage of these opportunities, such industries and activities should be able to compete with those of the more advanced countries, which will naturally take time. This raises a further question.

(g) Priority might be given to such industries in the financing of investments or the granting of credits, should it prove desirable to establish special financial machinery for the development of the common market.

(9) At the same time, could consideration be given also to the particular situation of the landlocked Latin American countries so that the regional market might encourage their development?

The position of these countries is becoming increasingly difficult because their economies are based on one or only a few lines of production. Would it be possible within the framework of the common market, to devise methods of facilitating, the absorption of their exportable production and the diversification of their economies?

VI. Payments disequilibrium within the regional market

Two types of disequilibrium must be distinguished among the countries of the common market in their financial dealings with one another: temporary disequilibrium, whose causes are short-lived; and persistent disequilibrium deriving from structural defects which retard development.

The problem of payments machinery in the common market and the possible use of credits as a first line of defence against temporary disequilibrium are dealt with later. However, if the disequilibrium is not overcome by the use of these credits,

(10) Could the country in question apply direct measures to restrict imports from other participating countries? What conditions and safeguards should apply to such measures? This raises another question:

(11) Should the disequilibrium arise only vis-à-vis other participating countries and not vis-à-vis the rest of the world, could the country in question apply restrictions on imports originating from them and not on those from the rest of the world?

(12) Should the concerted reduction of tariffs be postponed in an effort to restore equilibrium or should special duties or charges be levied on imports?

The case of persistent disequilibrium is more complex. For very different reasons (economic, social and political), one country might lag behind others in its industrial progress. In such circumstances, its industrial exports to the common market would not have grown at a rate

/comparable with

(8) For the common market to work smoothly, must special measures be taken to encourage the active participation of the less developed countries in the intra-regional trade in industrial commodities? Will tariff measures alone be enough, or will consideration have to be given to additional incentives or direct measures to promote industrial activity?

As regards the tariff measures to be adopted, the following suggestions may be considered, as well as others which may arise later.

(a) The less developed countries might be given a longer time in which to reduce their customs duties so that, in their own markets, growing industries will receive greater protection than the competing industries of the more advanced countries.

(b) At the same time, the application of the common tariff vis-à-vis the rest of the world might be postponed; thus, while in the more developed countries the production of certain capital and intermediate goods would be protected immediately, the less developed countries might refrain from levying duties on such goods for a reasonable period and continue importing them from their normal sources of supply instead of from the common market. This process might continue until they can develop their own industrial exports to the more advanced countries. The problem described at the end of the previous section could be solved in this manner.

(c) Pending the development of their own industrial exports, the less developed countries might grant the more advanced ones a temporary subsidy designed to compensate the former for the increased cost of capital and intermediate goods exported by the latter.

(d) Also on a temporary basis, the more advanced countries might levy tariffs on imports from the less developed countries which would be more favourable to certain manufactured goods than to raw materials.

(e) For a given period, the more advanced countries might be prohibited from establishing industries which could be developed in the less advanced countries.

As regards incentives or direct measures of promotion, there is a wide variety of possibilities among which the following might be mentioned:

(f) The authorization of tax exemptions in the less developed countries for the purpose of facilitating the establishment of industries there, or special measures to attract foreign capital.

//(g) Priority might

comparable with that of the other countries and its tempo of development will consequently suffer. In some cases, a cautious revaluation of its currency abroad might encourage exports while discouraging imports and bring about structural changes which, together with other measures, might accelerate its economic growth. However, such a readjustment may not be desirable for other reasons. In this case,

(13) Could the country concerned employ direct measures of protection, such as the re-imposition of tariffs which had already been reduced or eliminated, or subsidies, in order to bring about these structural changes? This question leads to another:

(14) Could the country in question take these and other special measures by itself or would it have to consult or seek the approval of an international authority appointed by common consent?

In spite of these safeguards to meet extreme cases, countries would almost certainly be reluctant to give a firm promise to eliminate completely tariffs between participants, however long the period of time allowed. It might therefore be desirable to consider a compromise system which, without having all the advantages of absolute economic integration, would lead to a considerable increase in trade but at the same time would give each country some latitude to apply special measures in cases such as those just described.

(15) Could the essential aims of the common market be achieved if the reduction of tariffs does not lead to their complete elimination but stops at a relatively low average level?

In other words, tariff reductions would be based on an average and would cease once this average had reached a determined level. Each country would be free to remove individual tariffs provided that the weighted average of all the tariffs in no case fell below the agreed figure.

Of course, the level reached need not be final. Further reduction to the point of complete elimination might be the subject of new negotiations, which would have the obvious advantage of being based on the experience derived from the gradual application of tariff reductions within the framework of the common market.

It should also be remembered that systematic co-operation between Governments could do much to solve these problems. In order to increase trade, they should keep a constant watch on trade developments and encourage those additional exchanges of goods which will be necessary to remove or mitigate disequilibria.

VII. Multilateral clearing within the regional market

The Governments of the southern part of the continent have agreed upon measures for the gradual replacement of the bilateral system by an automatic system of multilateral payments. Of course, the increase in trade brought about by the progressive reduction of customs duties and by other liberalization measures will considerably facilitate the operation of a multilateral system. However, the development of the common market depends basically on the tariff preferences which the member countries grant to each other and the common tariff which they establish vis-à-vis the rest of the world. The following question then arises:

(15) Is it necessary or desirable to maintain the multilateral payments system and to extend it to all countries of the common market? Or rather, has the time come for the countries which have abandoned bilateralism to make a decisive move towards the free convertibility of balances deriving from trade within the common market, once the period of transition is over?

In fact, once bilateralism has been eliminated, favourable conditions might be created for the reintroduction of complete convertibility. What would then be the significance of a Latin American system of multilateral payments?

In order to answer this question, the very important matter of credit must be considered. Trade within the common market would have to be developed with great flexibility, and credit is essential for this purpose. Such credit could be granted by existing banks. However, besides other difficulties, once convertibility has been re-established, credits granted to liquidate trade balances within the common market may finally be converted into hard currencies to the detriment of the requirements of trade with the rest of the world. The following question therefore arises:

(17) Would it be enough for the countries to undertake to use only these credits for trade amongst themselves or should they grant each other

/reciprocal credits

reciprocal credits in units of account for the liquidation, within certain limits, of trade balances within the common market, and should the debtor country be required to make payment in convertible currencies only when such credits become exhausted?

If the answer to the second question is in the affirmative, a system of multilateral payments would become an integral part of the common market. But however simple the system might be, certain special problems would undoubtedly arise. The most important of them might be expressed in the form of the following question:

(18) In a multilateral payments system in Latin America, what would be the position of countries which now have no difficulty in selling their exports on the world market for convertible currencies? Should these countries include such exports, when they are shipped to Latin America, in the multilateral clearing accounts or should they exclude them completely? Or might the solution lie midway between these two extremes?

VIII. Financial aspects of the common market

There may be reasonable doubts as to whether the measures described in section IV will be sufficient to encourage the establishment of new industries in the less developed countries so that they may enjoy the benefits that the common market may have to offer. To a certain extent, foreign private enterprises might be interested in this question. However, even though such industries may develop satisfactorily, consideration must also be given to the position of entrepreneurs in these and other Latin American countries, who may wish to participate in this process of industrialization. The problem of resources must therefore be tackled, and the following question arises:

(19) Should the common market have as an adjunct a financial agency designed to promote the industrial development of the less advanced countries? Should such an agency restrict its activities to these countries or should it extend them to the other countries as well so as to encourage all the efforts made to ensure the more effective operation of the common market and a better regional distribution of industries?

As always happens when the establishment of bodies of this kind is mooted consideration must be given to the danger of duplicating existing international credit institutions. The following additional questions therefore arise:

(a) Would the special character of this agency be enough to justify its establishment and allow it to receive financial help from existing bodies in order to fulfil its particular purposes?

(b) Is it likely that participating Governments would contribute to a fund of units of account designed to finance the operations, or part of the operations, entailing expenditures within the same countries of the area, so that external financial aid would be extended only in respect of that part of the expenditure which was incurred outside the common market?

(c) To what extent might the Chilean move to earmark part of the monetary reserves of the Latin American countries for a common fund be related to the problem of financing these operations? Would it be wise to use these resources for operations lasting several years, such as industrial investments, or should their use be limited to shorter-term credits designed to finance exports within the common market or imports of raw materials or intermediate goods from the rest of the world?

(d) Is it likely that participating Governments would agree to give firm guarantees for all operations, especially those financed with resources made available by international credit agencies or, in general, with allocations from the rest of the world?

However these problems are solved it should be borne in mind at all times that the lack of social overhead capital investment is one of the greatest obstacles to economic development, particularly in the less developed countries of Latin America, and will obviously be felt in the regional grouping of industries within the common market.

(20) Would the co-operation of existing international credit agencies be sufficient to solve this problem? Or should the more developed countries play their part in the provision of social overhead capital at least to the extent to which such expenditure is incurred within the common market itself?

A few figures suffice to give an idea of the effort which the more advanced countries might have to make. The incomes of Central American countries, plus Haiti and the Dominican Republic, in the north, and Ecuador, Bolivia and Paraguay, in the south, taken together amount to 8 per cent of that of the other Latin American countries. Thus for each 1 per cent increase in income by which the coefficient of capital formation might be raised in the former countries, the other countries would need to transfer the equivalent of only 0.08 per cent of their national incomes (38.5 million units of account).

IX. Co-ordination of monetary and fiscal policies in the common market countries

Among several others, the following are two important fields where the need for co-ordination might be examined:

(a) Monetary policy - to ensure that no participating country may compete unfairly with the exports of the others as a result of an external currency devaluation which is greater than its internal devaluation.

(b) Fiscal policy - in order to avoid tax exemptions which interfere with the smooth working of the common market.

(21) As regards the first point: is it likely that the participating countries, while they might agree on certain fundamental measures of co-ordination outside the common market, would subordinate certain decisions affecting monetary policy to such agreement? Or would it perhaps be preferable, in order to allow countries to retain their freedom of action, to adopt certain measures any to correct any deviation which was in fact tantamount to unfair competition?

In this connexion,

(a) Would it be an admissible procedure, for example, to allow the countries unfavourably affected to offset external over-devaluation by levying compensatory charges on imports from the countries whose currency is over-devalued? Or, alternatively, could the countries affected require that the countries whose currency is over-devalued abroad should levy similar compensatory charges on their exports?

(22) As regards fiscal policy, would it be possible to work out arrangements whereby tax exemptions would be limited to certain specific cases, as for example that of the less developed countries, or cases in which industrial development may have been slower or where it may have been necessary to encourage to a certain extent the regional distribution of particular industries?

X. The administration of the regional market

The basic structure of the regional market depends, of course, on the permanent agreement reached by the contracting parties. However, in implementing the agreement, instances may arise, such as those described in this memorandum, in which a country may adopt measures affecting the others. Furthermore, if it is found desirable to supplement the common market with a special financial organization, problems of policy will arise which cannot be solved merely by referring to the organization's statutes. Hence, a delicate problem arises:

(23) Will the administration of the common market require an executive body to approve the decisions which its members propose to take in these special cases? Or will it suffice to establish an advisory body, supplemented by a suitable arbitration procedure, to solve the problems which may arise?

XI. International undertakings

The general principle governing international trade in Latin America, with the exception of border traffic, is equality of treatment for all countries. In a very few cases, exceptions to this rule may be found in the exemptions or special treatment granted on the basis of reciprocity by neighbouring countries or those with special historical or geographical ties.

The features and characteristics of the regional market are exceptional in the sense that reciprocal exemptions or privileges granted by the contracting parties have to be extended to third countries.

An exception to the "most-favoured-nation clause" is allowed in the case of States members of GATT in conformity with certain provisions of the General Agreement on Tariffs and Trade (article XXIV). This raises the following questions:

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(24) Although only eight Latin American countries belong to GATT, should the regional market be established in accordance with those provisions of the General Agreement or should some other procedure be adopted? Would negotiations be necessary with every third country which benefits from the "most-favoured-nation clause"? And what action would subsequently be necessary to enable the Latin American countries to reach an agreement on joint negotiations with third countries?