UNITED NATIONS

ECONOMIC
AND
SOCIAL COUNCIL

LIMITED
E/CN.12/C.1/WG.2/2
25 January 1958

ENGLISH
ORIGINAL: SPANISH

ECONOMIC COMMISSION FOR LATIN AMERICA
TRADE COMMITTEE
Working Group on the Latin American
Regional Market

Santiago, Chile, 1-10 February 1958

SOME PROBLEMS OF THE LATIN AMERICAN REGIONAL MARKET

Note: This text should be regarded as provisional and subject to revision as regards both presentation and content.

INDEX

/INTRODUCTION

INTRODUCTION

The purpose of the present report is to define the main problems to be faced in planning the structure of a regional market for Latin America and to suggest various alternative ways of solving them. This is a preliminary outline aimed at facilitating the fullest possible discussion of such problems rather than at passing final judgement on each of them.

Not all but only what are considered the most important aspects of the preparations for a regional market are dealt with here. First of all the arguments in favour of the formation of a regional market are examined in the conditions existing in Latin America, and then follows an analysis of the relationship of the regional market to the payments system, on the one hand, and, on the other, to the necessary liberalization of trade in those commodities traditionally involved in intra-regional commerce. The report next reviews the advantages and drawbacks of a series of devices for selecting the commodities to be included in the regional market and for the gradual elimination of internal tariffs. Then there is a discussion of the possibility of disequilibria in future industrial development which may entail integration of the markets of countries with different degrees of experience in this field. When the disparities between the industrialization processes of various countries become acute and are accompanied by wide discrepancies in over-all economic development, a difficult problem arises; what kind of role are the relatively under-developed countries to play in the Latin American regional market? The need for additional capital to promote industrial development is felt not only in these less developed countries of Latin America but also in those that have reached a more advanced stage and in the case of the latter it is related to the increased opportunities afforded by the regional market to external competition, which will have to be faced by the local entrepreneurs. Lastly comes a brief analysis of the possible repercussions of the payments situation in each of the various member countries on the competitive position of its exports in the regional market area.

The most important of the questions not covered by the present document relate to the procedures for establishing a common tariff for member countries *vis-a-vis* third countries,[1] the indispensable improvement and development of transport in the region, and the institutional structure of the regional market.

It is hoped that as an outcome of the discussion and criticism of this report, definite guiding lines will be laid down for the secretariat's future work in connexion with the Latin American regional market.

Chapter I

PAYMENTS, LIBERALIZATION AND A REGIONAL MARKET

1. Reasons for Latin American integration

1. It has become evident in the course of the last few years that the growth of trade between the countries of Latin America is virtually at a standstill. The weakness of this trade is all the more patent when its evolution is compared with the continued upward trend of income and industrial production in the region.[2]

Undoubtedly, a revival of intra-regional trade would be sufficiently justified - even without any more ambitious motives - by the desire to increase its relative share in Latin America's total trade, and to place it on a level with the region's economic development. But there are grounds for doubting the possibility of any very considerable expansion unless at the same time the Latin American economies undergo certain structural changes, which might be effected by virtue of some formula for

---

1/ However, this topic is touched upon briefly in connexion with a certain aspect of the problem of the relatively under-developed countries (see chapter IV).

2/ On the recent evolution of inter-Latin American trade, see especially the following ECLA documents: *Study of inter-Latin American trade* (E/CN.12/369/Rev.1), United Nations publication, Sales N° 1956.II.G.3; *Inter-Latin American trade: current problems* (E/CN.12/423), United Nations publication, Sales N° 1957.II.G.5; and the report of the Organization of American States (OAS), *Liberalization of inter-Latin American trade* (Washington, May 1957).

/the gradual

the gradual integration of the region. Besides, a trend towards economic integration in Latin America would bring other advantages transcending the mere expansion of trade because of their powerful influence on the economic development of the countries concerned.

For these reasons, the clearest and most cogent argument in favour of the economic integration of Latin America derives from the region's economic development requirements rather than from the need to increase intra-regional trade.

2. The term "integration" in respect of economies is taken to mean a gradual merger of the individual country markets for commodities and services in the different branches of activity, accompanied by such co-ordinating measures of domestic economic policy as are necessary to ensure that this merger is effective and is brought about without excessive friction.

In general terms, the benefits of the merger of country markets achieved by the elimination of tariffs and of various kinds of obstacles to reciprocal trade might be classified under three heads.

(a) It is hoped that in existing activities costs will be reduced by virtue of longer manufacturing series;[3]

(b) The national product is considered likely to increase along with the increment in trade, as a result of more intensive utilization of the factors of production in existing installations;

(c) The national product is also expected to increase on account of the redistribution of current factors of production and the rechannelling of future investment.

3/ Economies of scale are not always the result of an increase in the average size of enterprises; they are sometimes the outcome of a higher degree of specialization, achieved by a redistribution of production among existing enterprises, which does not necessarily mean that the total size of the market and the average size of enterprises become any bigger.

/Nevertheless, the

Nevertheless, the benefits of integration will be felt in varying degrees according to the nature of the activities under consideration.

The advantages of integration will not be the same for Latin America's traditional commodities, which have long had a place on the world market and in intra-regional trade, as for other goods hitherto destined chiefly for the domestic markets of the various countries. In the former category are primary commodities produced in the main by the agricultural or mining sectors, and in the latter, manufactured goods, including those which each country has been producing for a long time - such as textiles and other durable consumer goods - and those representing activities which are new in Latin America, such as capital goods and production equipment and certain durable consumer goods whose manufacture entails more complex processes.

3. What would be the situation with respect to primary commodities were a merger of the Latin American markets to be achieved? In the first place, the position varies according to the degree of competition faced by such commodities in the region. It is idle to expect that economies of scale will emerge as a result of the broadening of the markets for those commodities - such as coffee, copper, tin, cacao, sugar, etc. - which are produced in any one Latin American country, because these traditional lines of production are not usually at the stage of declining costs, and furthermore they are well organized on an international price basis. Moreover, there is no need to fear that readjustments of the means of production will take place, as a marked degree of specialization exists in these branches in Latin America. The main outlet for such commodities will still be the world market, since within the predictable future there is no likelihood of an increase in Latin America's own consumption large enough to absorb high proportions of the region's output. Neither does Latin America display any tendency to develop the production of these traditional commodities in less favoured areas where costs are high, but if such a trend were to emerge it might be checked by the merger of the individual markets. From the point of view of the commodities in question, the chief advantage attaching to the formation of a Latin American regional

/market would

market would be the strengthening of Latin America's power to negotiate in the field of tariffs and trade in general, since negotiations would be conducted by an organization which represented the countries as a whole instead of by each individual country. Furthermore, it should be mentioned that, in so far as the merger of the markets is accompanied by the integration of the economies concerned, Latin America will become less vulnerable to fluctuations in external demand and prices for its primary commodities.

4. The situation differs as regards those other primary commodities in whose case no such marked specialization exists in Latin America. The advantages offered by integration seem to be most substantial for such commodities as wheat and meat, although the difficulties deriving from the inevitable readjustments may also be more serious. While it is true that these Latin American commodities have so far found their main market outside the region, external markets are unlikely to be able to absorb them in increasing quantities in the future. Not only has demand for wheat and meat a low income-elasticity, but in the consumer countries there seems to be a decided trend towards self-sufficiency with respect to these commodities. On the other hand, Latin America's consumption of wheat and meat is growing very rapidly, both as a result of the accelerated growth of the population and in consequence of the higher income-elasticity of demand registered at the lower levels of <u>per capita</u> income. Future increments in the output of these foodstuffs could therefore, be channelled towards a Latin American regional market, with the advantage that producer countries would find compensation for the relative stagnation of the world market and consumer countries would be able to obtain supplies within Latin America at international prices, with the possibility of large compensatory exports to the other countries of the region. The difficulty is that, in the case of commodities like wheat and livestock, similar lines of production exist, although on a higher cost basis, in several Latin American countries. As the expansion of this autarkic production would be able to keep pace with the rapid rise in consumption only with a vastly increasing outlay, the natural solution might consist in some arrangement designed to maintain its current level and limit its subsequent growth, leaving future increases in

/consumption to

consumption to be met by the regional market's specialized suppliers.

These, in broad outline, are the prospects which the formation of a regional market can offer to Latin America's traditional primary commodities.

5. For regional manufactures of long standing, such as textiles and certain durable consumer goods, the advantages of market integration lie in the economies of scale resulting from specialization on the part of industrial enterprises, and the improvement in productivity deriving from keener competition and the heavier investment which this entails. Such an increase in investment is rendered possible in its turn by the manufacture of the appropriate production equipment within the region itself. In most cases economies of scale may be achieved by a reduction in the number of products and models of the same product manufactured by the same enterprise, expansion being unnecessary. Thanks to increased competition, a significant rise in productivity may take place without the need for additional investment. It will be possible to replace the obsolete production equipment which is still in constant use, when as a result of the combined requirements of the various markets a single broader market is created which makes manufacturing within the area an attractive proposition. This may prove particularly true of the textile industry and the many small engineering industries which have found difficulty in renewing their equipment because of the limitations of the capacity to import and the obstacles to small-scale domestic manufacture of a vast range of different types, varieties and sizes of the same machine. On the other hand, the risk of readjustments in the means of production as a result of the increase in the size of markets seems more serious here.4/

6. Lastly, among manufactured goods consideration must be given to an important sector - that of capital goods - which in many cases are not yet or are only just beginning to be manufactured in the region. Their inclusion in a Latin American regional market might enable striking

---

4/ This is a delicate problem, which will be discussed in detail in chapter II.

/economies of

economies of scale to be achieved, both through increased specialization and by virtue of the larger size of the producer enterprises. Within the framework of regional specialization, the balance of industrial development might be better maintained in the future with the gradual elimination of the tendency to lag behind at present displayed by the basic sectors - those of industrial raw materials and heavy capital goods. Installations could be utilized at full capacity from the outset, and there would be no need to await the development of each country's market. As new capital goods manufactures evolved, the region's future development would not be so dependent on the external sector. Conversely, as the lines of production concerned have scarcely begun or have not been started yet in Latin America, the necessary readjustments of the production media could be reduced to a minimum.

7. The position of the capital goods industry in a Latin American regional market deserves more careful analysis.

The crux of the argument in favour of a regional market for Latin America seems to be the need - in order to accelerate the rate of growth - to make domestic production for the replacement of imports more economic in the phase of medium and heavy capital goods industries upon which Latin America is now entering. Various circumstances render it probable that the movement towards substitution of Latin American production for imports may have to be stimulated in the near future.

In the first place, as certain systematic secretariat studies reveal, the growth of the capacity to import is likely to be slow in the near future, in contrast with a rapid expansion of demand for capital goods. This is no new phenomenon, but a symptom of under-development characteristic of the Latin American economies, based as they are on the exporting of primary commodities for which world market demand is not only unstable but markedly lacking in elasticity.5/ Some recent events, however, are tending

5/ At the same time, the creation of new export lines depends upon the diversification of the economy and the strengthening of its industrial structure, both of which processes are hampered by the lack of foreign exchange with which to import the necessary capital goods.

/to strengthen

to strengthen its influence. On the one hand, a trend has recently become apparent towards an abnormal increase in the share of raw materials, fuels and foodstuffs in Latin American imports, at the expense of capital goods.[6/] On the other hand, it is impossible to disregard the possibility that if the system under which Europe's overseas territories are associated with the member countries of the European Economic Community is based on a set of preferences, it may slow up or even call a halt to the growth of certain Latin American exports to Europe, with the consequent additional limiting effects on the capacity to import.[7/]

In the second place, if the rigid bilateralism at present prevailing in intra-regional trade is finally to be broken down, it seems unquestionable that administrative agreements aimed at facilitating compensation of inter-Latin American trade balances will not be enough. It will be possible for the trade in question to revert to unrestricted multilateral patterns, as the region's economic development demands, only when the adoption of a consistent trade policy permits the diversification of intra-regional exports and a substantial increase in their volume. This will call for the application of measures designed to promote import substitution and the diversification of production, which will constitute the nucleus of an intra-regional trade development policy.

8. The completely effective development of import substitution in each individual country is hampered by the small size of the national markets. The adverse effects of these small markets make themselves felt in the following three ways:

(a) Short production series, low productivity and correspondingly high costs;

6/ This trend was analysed and interpreted in the <u>Economic Survey of Latin America, 1956</u> (E/CN.12/427/Rev.1), United Nations publication, Sales N°:1957.II.G.1., chapter IV.

7/ A preliminary discussion of this hypothesis was included in the <u>Note by the secretariat on the possible repercussion of the European common market on Latin American exports</u> (E/CN.12/449 and Add.1). A subsequent and more thorough study on the same problem will shortly be published.

(b) Instability of existing demand for each type or model in the case of capital goods or manufactured goods in general, which means that investment and the element of risk carry too much weight in enterprises that are not merely artisan workshops, usually repair shops also manufacturing some new goods, characterized by inevitably high costs and low quality;[8/]

(c) Total disequilibrium, both horizontal and vertical, in the expansion of the various branches of production, causing frequent bottlenecks and permanent pressure on the balance of payments.

This last repercussion requires further explanation. In view of the limited investment resources available in a single country market and the vast number of channels along which investment may be directed, there is a tendency to develop such manufacturing activities as are closest to final use or consumption and call for the least investment per unit produced. The industries producing current consumer goods, durable consumer goods and certain rudimentary capital goods therefore grow at a very rapid rate, leaving behind the activities producing industrial raw materials (iron, steel and non-ferrous metals; fuels; basic chemicals) and heavy capital goods (machine-tools and machinery for the transforming industries in general; complex industrial installations, etc.).

The operation of those industries closest to final use is constantly hampered by the shortage and irregular supply of the necessary inputs - raw materials, intermediate products or basic production equipment - and this in turn has repercussions on productivity and production costs.

In these circumstances, an additional effort to produce raw materials as well as machinery and equipment to replace imports is highly necessary; yet if it were carried out in each separate country market, an excessive

8/ This combination of the manufacture of new goods with repair work is very common in the industries producing machine-tools and machinery for the transforming industries in almost all the Latin American countries. It serves to offset the customary wide fluctuations of demand, providing continuous employment for the same contingent of specialized labour. But the degree of capital formation and the type of organization which are appropriate in repair activities are not sufficient for an enterprise producing new manufactured goods.

/increase in

increase in costs would probably be unavoidable. The drawbacks would be lessened if the setting for such an effort were a single broad market resulting from integration, inasmuch as systematic import substitution would be rendered a more economic process.

9. Consequently, the creation of a regional market in Latin America seems justifiable from two different but closely related points of view.

(a) On the one hand, it would permit the elimination or modification of the bottleneck created by the inadequate and irregular supply of capital goods;

(b) On the other, it would render possible an over-all increase in productivity (longer production series, greater continuity of operations, etc.).

10. Another question which may reasonably be asked is whether a movement towards market integration might not also help to remedy the member countries' balance-of-payments disequilibria. There can be no doubt that the formation of a regional market might reduce pressure on the international payments of the countries concerned, but it could hardly suffice in itself to stabilize the situation, especially as intra-regional payments are in an entirely separate compartment from trade with the rest of the world, in which the most serious disequilibria are registered.

It seems difficult for any change to be introduced over the short term, since inter-Latin American trade cannot be expected to show surpluses or deficits which will compensate the disequilibria registered in trade with other regions. Indirectly, however, or over the longer term, the favourable effects of regional integration will probably spread to the international payments situation. One of the advantages of integration is that with the expansion of intra-regional exports it will mean savings in purchases from abroad and an expanded volume of production which, at a given moment, will anable exports to be shipped to other regions. And this is the more important since over the longer term it is essential that a wide range of goods should be exported to the rest of the world for the benefit of economic development.

/2. <u>Multilateral</u>

2. Multilateral payments system

1. Inter-Latin American trade payments at the present time are effected according to two very different schemes. Most of the countries in the northern zone - Mexico, the Central American countries, Venezuela, Cuba and others - liquidate their transactions with the rest of the region, in convertible currencies, although this trade is on a very small scale.[8/] Elsewhere, trade is carried on and the relevant payments are made almost exclusively in accordance with bilateral agreements, and the settlement of balances in convertible currencies is practically unknown.

2. Consideration will first be given to the problem arising in connexion with those countries in the southern zone between which bilateral agreements are in force.

Difficulties stand in the way of a multilateral trade system in respect of such countries, of which the most serious, apart from the lack of monetary parity, is the shortage of convertible foreign exchange in the region. This obstacle might be largely removed were a multilateral clearing scheme established. The satisfactory operation of such a scheme depends upon whether the member countries are willing to adopt a series of co-operative measures, namely, establishment of parity between units of account; liberalization of reciprocal trade; attainment of some degree of internal stability in each country; and, above all, on a basis of consultation and mutual agreement with the other member countries, the monetary and exchange measures required to maintain the balance of payments within the region, without affecting internal employment levels.

The provisos at the beginning of this list were adopted by the countries concerned at the first session of the ECLA Trade Committee as a step towards the preparation of a multilateral clearing system,[9/] and in some cases some practical steps have already been taken.

Nevertheless, even given the fulfilment of these premises, certain structural characteristics of the domestic economy and the reciprocal trade

---

8/ Only sugar and petroleum constitute a trade link of any significance between the northern and southern zones of Latin America.

9/ For the report of this session see Inter-Latin American trade: current problems (E/CN.12/423), op. cit.

/of the

of the Latin American countries contribute to the difficulties of establishing an automatic system for the multilateral settlement of balances over the short term. The insufficient diversification of intra-regional trade flows and the sometimes sharp fluctuations in the volume of inter-Latin American trade and in the debit or credit nature of the balances between each pair of countries from one year to another, limit the possibilities of multilateral compensation. The absolute and relative magnitude of these disequilibria would restrict the scope of any multilateral compensation system unless certain measures to promote and diversify intra-regional trade were adopted at the same time.

The adoption of a fully multilateral system should therefore be visualized from a dynamic point of view in association with the development of trade. Only by means of closer collaboration with respect to trade policy on the part of the countries concerned might the deep-rooted cause of the disequilibria in question be removed.

3. The transition to a multilateral payments system is the objective of the Trade Committee and the Central Banks Working Group.10/

The essential task facing the session of the Central Banks Working Group was to make a start upon the practical application of the principles established in Trade Committee resolution 1(I) for the gradual co-ordination of the bilateral clearing system as a means of transition towards a multilateral payments régime. The system contemplated consists of the standardization of the accounting methods applied in trade operations and the voluntary transfer of account balances falling within the limits of the swing credits. The countries represented in the Central Banks Working Group did not consider it appropriate for the moment to make such triangular transfers automatic, because in some cases a debtor country might, as a result of the inflexibility inherent in bilateral trade patterns, find difficulty in absorbing the balances involved in the transfers in a manner acceptable to the creditor country. It was agreed that balances in excess of the swing credits should be compulsorily transferable in currencies of other areas, at the request of the creditor country.

10/ See the Progress report by the secretariat on the work of the Trade Committee (E/CN.12/439), as well as the Report submitted to the Trade Committee by the Central Banks Working Group on a multilateral payments system (Seventh Session, Conference Room paper N° 1).

4. No opinion can as yet be expressed as to how this system of voluntary transfer of balances functions in practice, as it is only in its preliminary phase.

Payments difficulties are associated mainly with two not entirely unconnected factors. These are the existence of multilateral exchange rates in some countries, and the tendency for prices other than those prevailing on world markets to be applied in intra-regional trade.

Nevertheless, what hampers inter-Latin American trade and the implementation of the agreements in force is not only the existence of multilateral exchange rates, but also the frequency with which exchange systems are altered and commodities transferred from one exchange category to another, without due regard to the consequences for other countries or consultation with these latter.

It might be advisable to find a formula for permanent consultation and discussion of these problems and consideration of complaints and suggestions, as well as for soundings of the possible repercussions of any specific move relating to exchange matters or over-all trade policy. A chain of protectionist measures may sometimes produce situations that are little short of chaotic and thus create an almost insuperable obstacle to the establishment of a multilateral trade and payments system. Could this be prevented by means of some regional rapprochement formula?

5. Intra-regional prices that exceed world market quotations are mainly attributable to three factors: failure to observe parities, the inflexibility of bilateral trade - which often compels exporter countries to accept as an offset goods that are a dead weight on their markets - and the freezing of bilateral balances for long periods.

There are, of course, goods for which the prices charged are higher than in international trade not because of the drawbacks of bilateralism, but because <u>all</u> sources of supply <u>within the region</u> have heavy production costs, while, at the same time, the shortage of convertible means of payment compels interested countries to buy from Latin American suppliers. In such instances, it would be impossible to eliminate the difference between Latin American and world prices, or just as artificial as to maintain it in other circumstances.

Often, however, high prices in inter-Latin American trade represent a margin of protection against the losses caused by freezing of balances or

/by the

by the necessity of accepting imports of little economic value as offsets. Here there is clearly a vicious circle, as multilateral compensation of trade balances cannot easily be effected on account of over-pricing, and this in turn results from freezing of bilateral balances, that is, from the lack of multilateral transfers.

6. Is the establishment of a multilateral payments system in Latin America indispensable? In this context, two considerations must be borne in mind. Not only will a more flexible payments system be conducive to the expansion of intra-regional trade in traditional commodities, but also a considerable degree of multilateralism is essential if Latin America's productive resources are to be redistributed through a regional market. A market of this kind, competitive, non-discriminatory and based on the free decisions of producers and consumers, is incompatible with the division of trade into bilateral compartments.

To attain such an end, however, the countries of the Southern Zone of Latin America would have to undertake co-operative action to clear the way for the introduction of a multilateral payments system. Previous secretariat studies suggest, as one of the possible solutions, a system of automatic transfer of balances among the member countries,[11/] supplemented by credit margins intended to cover temporary disequilibria within the region, since in several successive years the multilaterally compensatable balances have proved to be distinctly smaller than the total amounts of the swing credits provided for in existing bilateral agreements.

7. The position of the northern zone countries, which conduct their trade on the basis of hard currencies, vis-à-vis those of the southern zone, would be simplified by the establishment of a payments system that would result in a high degree of transferability in Latin America. Whereas at present

---

11/ This fundamental aspect of the problem of inter-Latin American trade has been the object of constant study on the part of the secretariat. See in this connexion the following documents: Study of inter-Latin American trade (E/CN.12/369/Rev.1), chapter V; Inter-Latin American trade: current problems, op. cit., especially Part II, chapter II, section 1, pp. 31 et seq.; and Compensation of balances in inter-Latin American trade, subsequently included in the Progress report by the secretariat on the work of the Trade Committee, op. cit., annex I.

/there is

there is nothing to induce them to revive their trade with the southern countries, an incentive would be provided by the fact that they would be able to use the product of their intra-regional exports to pay for imports from any other country in the region. The observance of parity would be an essential requisite here.

With respect to trade relations between the northern and southern zones, as in other cases, it would perhaps be desirable to consider from the outset the possibility of some mechanism whereby trade could be promoted concurrently with the introduction of a multilateral payments system, since there can be no doubt that a final solution for intra-regional trade problems would be easier to find if new trade channels were opened up.12/

12/ See chapter VI of the present report for a discussion of those aspects of the problem of payments which bear most directly on the regional market.

3. Liberalization of trade

1. The fact that for many years intra-regional trade has been conducted along strictly bilateral lines has imparted a marked degree of rigidity to trade channels. It therefore seems necessary to consider whether it would be possible and desirable to introduce some gradual procedure for the liberalization of this trade, as a preliminary step, either towards overcoming the obstacles to the establishment of a multilateral payments system (including, for example, Latin America's unfavourable balance-of-payments structure), or towards paving the way for the regional market.

Careful thought must be given to the question of how far a programme for the liberalization of intra-regional trade could be justified, as a coherent plan, irrespective of provisions relating to the regional market.

The process of liberalizing trade may comprise measures on two successive or parallel planes: one, the mere simplification of the bureaucratic or administrative formalities which hamper export and import negotiations in Latin America; and the other the gradual abolition of all kinds of quantitative or monetary restrictions (quotas, contingents, prohibitions, permits, deposits, etc.) which tend to reduce trade.

2. The desirability of adopting some programme for the liberalization of intra-regional trade and the relations which should be maintained between this programme and the projected regional market, depend, *inter alia*, on the characteristics given to this latter.

Undoubtedly, there is no reason why the elimination of many administrative complications that are detrimental to trade should be contingent upon the adoption of a regional market project. Furthermore, if these were got rid of, it might be possible to expand the volume of inter-Latin American trade in traditional commodities, whether or not more positive steps were taken towards the establishment of a regional market. Might this be adduced as an argument in favour of embarking upon efforts to liberalize trade in traditional commodities at an earlier date?

Since the Latin American economies are so highly complementary as regards some of the traditional commodities and trade circles in the countries concerned have greater experience in the production and negotiation of such

/commodities, might

commodities, might the volume of such trade reasonably be expected to increase significantly in the not too distant future as a result of efforts towards its liberalization?

Much would depend upon the breadth and scope imparted to the regional market, especially in respect of the goods included. If, in addition to capital goods and other manufactures, the traditional Latin American trade commodities (mainly those of agricultural origin and other primary commodities) were also admitted, the aims of the liberalization programme should perhaps be limited, as most of the liberalization measures would be covered by the regional market. In that case, the adoption of a set of measures intended to give greater flexibility to trade might constitute a preliminary step towards the regional market, without extending beyond the simplification of administrative and legal formalities and, ultimately, the other measures designed to facilitate the operation of the multilateral payments system.

Conversely, a regional market system which covered a smaller number of goods might require to be supplemented by a more ambitious liberalization programme for the items excluded. Supposing, for example, that the regional market, at least in its early stages, were confined to capital goods, or to these and a few other manufactures on such a hypothesis - apart from other aspects which would also have to be taken into consideration -, it would seem justifiable to apply a separate programme, entailing simpler administrative arrangements and the abolition of quantitative restrictions and other barriers producing similar effects, in the case of the traditional commodities excluded from the market integration system.

Consequently, efforts at liberalization may be considered necessary, and their application to all trade items desirable. The question which seems to call for more careful study is how far liberalization measures ought to take the form of a programme independent of the creation of a regional market, with a view to their ultimate consolidation and incorporation in the market agreements. It seems logical to assume that the choice made will largely reflect the type of regional market adopted by the Latin American countries.

3. Were the

3. Were the situation normal, joint action on the part of several countries to abolish quantitative restrictions might be a possible course, without its necessarily having important consequences for market integration, as tariff protection for the individual country markets would still survive. However, as matters stand in certain countries at present, it is quantitative restrictions that serve to protect domestic activities, above all manufacturing industry, since in some of the countries concerned tariffs are virtually inoperative, for well-known reasons. Hence, the discarding of various kinds of controls, quotas and contingents would mean throwing open the domestic market to imports.

At the same time, the accession of the Latin American countries to a programme for the liberalization of intra-regional trade seems to raise other questions. Is this programme conceived as a decisive step towards the establishment of a regional market or some other formula involving the lifting of all trade barriers? And if not, would not the countries in question need to set to work on a parallel revision of their tariff and return to the normal situation in which the tariff would be the primary instrument of protection?

4. At its first session, the ECLA Trade Committee discussed at length the problem of traditional intra-regional trade commodities and the obstacles to an expansion of inter-Latin American trade in such goods. These obstacles derive from the more or less chronic difficulties attending many of the Latin American countries, international payments, as well as from the bilateralism which for many years has governed intra-regional trade. The situation was clearly recognized in resolution 4 (I) of the Committee.13/

The obstacles in question can be classified in two categories, according to their nature and origin. First come those directly resulting from the prolonged duration of the bilateral trade system. They include failure to observe parities, over-pricing, unequal quotations for units of account and freely convertible currencies, and freezing of the balances between pairs of countries. These difficulties can gradually be eliminated

13/ See Inter-Latin American Trade: current problems, op.cit.

/as the

as the resolutions of the Central Banks Working Group are implemented (adoption of the standard agreement for the renewal of bilateral treaties; voluntary transfer of account balances) together with those of the Trade Committee itself (recommendation to Governments that international prices be applied in intra-regional trade, etc.). That is, obstacles in this first category would largely disappear with the gradual establishment of a multilateral payments system and the adoption by Governments of the supplementary measures essential for the satisfactory operation of such a system.

However, a second type of obstacle to trade in traditional commodities exists, which would probably not be automatically removed by virtue of the introduction of a multilateral payments system. Quantitative restrictions on trade, and other handicaps of an administrative nature, as well as the practice of State trading, are the natural outcome of each country's more or less unco-ordinated and impromptu efforts to protect its balance of payments during difficult periods. To this category belong the bureaucratic formalities of all kinds which affect commodity imports and exports, the existence of quotas (especially import quotas) and import (or export) permits, deposits in national currency, the levying of a number of taxes and surcharges whose role in the tax system is ill-defined and whose economic significance is yet more obscure, and so forth. While it cannot be denied that the creation of a multilateral system which would mobilize balances and facilitate the corresponding intra-regional trade payments would be favourable to the liberalization of trade, it is highly unlikely that this liberalization would be brought about more or less automatically, on each country's initiative, as a result of the introduction of a multilateral payments system. On the contrary, it would not be surprising if an understandable inertia fostered a strong tendency to maintain administrative obstacles and quantitative restrictions affecting trade. Unless the countries of the region reach an agreement as to bases for joint and simultaneous action to lift the barriers in question, these may be expected to persist and even to outlive the bilateral agreements themselves.

5. A few remarks follow on possible measures for the liberalization of trade, covering traditional commodities and manufactures goods alike. There

/is no

is no reason why, with respect to the practical steps towards such liberalization, a different rate or pattern should not be envisaged for each of these cases. The general suggestions put forward are equally applicable to both alternatives - a regional market covering all goods, or a liberalization programme supplementing a restricted regional market. A distinction must be drawn, however, between two phases, corresponding to two different problems.

In the first place, a possibility worth considering might be a drastic simplification of the bureaucratic formalities which affect intra-regional imports and exports, including procedures for the issuing of permits and the application of various taxes over and above customs duties.

The complicated system existing at present was the result of the gradual and imperceptible superimposition, year after year, of one bureaucratic and/or legislative requirement upon another, while the problem that was being created was never visualized in all its magnitude. In this field, therefore, the first step might be a detailed study of the present position in each of the countries concerned.14/ Later, consideration might perhaps be given to ways and means of improving upon the current situation.

6. In another and as far as possible a parallel phase, attention might be turned to the gradual abolition of quantitative restrictions (controls of various kinds, contingents, etc.) on intra-regional imports and exports, by some suitable method entailing simultaneous action on the part of the different countries. For example, such a method might consist in the liberalization of certain increasing percentages of trade (without discrimination between sources of imports or commodities); or, again, in the progressive inclusion of successive items on a free-trade schedule. Concurrently with quantitative restrictions, other factors might possibly have to be taken into account, such as state trading, which is virtually equivalent to the restrictions in question, export subsidies that detract from the efficacy of the liberalization process, and prior deposits.

14/ The secretariat is at present carrying out a preliminary survey of this kind. To give one example, in many cases the process of exporting manufactured goods from Brazil to Uruguay takes some five months, from the time when the exporter first contacts the Banco do Brasil to the arrival of the goods at their destination. The point of interest is to trace the whole series of administrative formalities to which such a situation is attributable, as well as the reasons for each of these procedures.

/This phase

This phase of a liberalization programme involves certain problems which require considerable attention, like that of the special relationship between quantitative restrictions and tariffs, and the possible repercussions of liberalization on the regional payments system.

The lifting of quantitative restrictions - and, to a lesser degree, of other kinds of barriers - will perphaps not be as easy in the case of a country where customs tariffs are in force and are proving efficacious for purposes of protection, as in one where such tariffs are virtually non-existent. In the first instance, the abolition of controls and quotas does not mean that all obstacles to trade will disappear; in the second, it automatically leaves the trade channels open and unimpeded.

These discrepancies may be found not only between one country and another, but also between one sector and another within the same country. It would be useful to ascertain the present position in the various countries with regard to the main sectors of traditional commodity trade, so as to clarify this problem of ultimate liberalization.[15]

7. The time has now come to examine certain problems relating especially to the inclusion of competitive goods in a liberalization programme. In the branches of trade concerned, competition between pairs of countries is sometimes very keen, according to the specific conditions prevailing in each instance. Where this is the case, a liberalization of trade might bring about marked readjustments in certain countries and with respect to particular goods. To prevent such readjustments, special provisions might be considered for inclusion in a possible liberalization programme for trade in competitive goods. As examples of provisions of this kind, two principal types may be cited. Quantitative restrictions might be reduced at a slower rate, varying from one group of commodities to another according to the intensity of competition; and the opening of the individual country markets to regional trade might be subject to some degree of control when the volume of consumption exceeded a given level.

15/ The secretariat is carrying out a study of the tariff situation in the Latin American countries.

/Another problem,

Another problem, closely linked to those mentioned above, concerns the desirability of direct measures to promote trade.

In certain circumstances, may not efforts to expand intra-regional trade by means of liberalization of trade (in traditional commodities) or the creation of a regional market (for manufactured goods or new industries), need to be supplemented by a systematic endeavour to encourage trade? Will it not be necessary to seek new trade channels as a means of correcting the unfavourable structure of the bilateral trade balances? Similarly, can the regional market do without the support of a promotion effort aimed a breaking down inertia and opening up new trade flows?

It is clear at a first glance that possible action to promote inter-Latin American trade can be envisaged along different lines. Two illustrations may be given at the outset. If a body had to be established to administer a liberalization programme, or another to handle regional compensation of balances, either of these, on the basis of the first-hand data which it would necessarily have at its disposal, could submit direct proposals to interested countries for certain specific large-scale operations relating to settlement of balances, commodity trade, changes in trade policy or other undertakings of far-reaching importance. These proposals would be prepared with the aim of absorbing the excessive debit or credit balances of member countries, but always with an eye to the expansion of trade.

Again, it would undoubtedly be necessary to provide increased opportunities for commercial contact between private business sectors through a concerted effort on the part of Chambers of Commerce and Trade Associations in several different countries, or by other means. In this context, would it not be useful to study possible ways of promoting trade in the sphere of private activity, and the methods that might appropriately be adopted in each case?

/4. A regional

4. A regional market

1. The creation of a regional market is an integration formula into which variations may be introduced in accordance with the differing degrees of intensity achieved. Intensity of integration may be defined in the following three dimensions: the number of countries acceding to the agreements, the number of goods included in the liberalization process; and the degree of co-ordination or consistency evinced in each country's economic policy, as a complement to the merger of the markets concerned. In addition, once the final intensity of integration has been defined with reference to these three co-ordinates, the proposed integration scheme can be put into effect at different rates, that is, more or less gradually, according to the mechanisms adopted for the abolition of tariffs and the lifting of other internal barriers.

In order to ensure that the integration process is sufficiently gradual not to harm the member countries' productive activities or subject them to unduly violent readjustments, there are plenty of alternative methods and procedures, which are examined and discussed in the following chapter.

2. In analysing the intensity of integration best suited to the situation in which the member countries are placed, it should not be forgotten that the benefits to be obtained by such integration are closely linked with the comprehensiveness of the method selected. The advantages accruing from the creation of a regional market take the form of increased specialization and a consequent improvement in the efficacy with which productive resources are distributed in the area made up by countries concerned. And the importance of such advantages increases in direct ratio to the following factors:

(a) the number of countries affiliated to the union;
(b) the range of goods included under the integration system;
(c) the degree of <u>potential complementarity</u> of the economies, that is, the diversity of their resources and natural facilities;
(d) The degree of <u>existing duplication</u> in the development of industrial activities, that is, the extent of the field open for redistribution of resources with a view to higher productivity;

/(e) the level

(e) the level of tariffs and other current trade restrictions among the member countries of the union.

In short, the wider the range of countries and goods a regional market covers and the more obstructive the tariffs that are abolished, the more substantial will be the advantages derived from integration in the region as a whole.

3. It will be useful briefly to review the three dimensions of a regional market project, i.e., countries, goods, and degree of integration of the economies concerned. The idea of a regional market including all or most of the Latin American countries has frequently been discussed, although not for exclusively economic reasons. Suggestions have also been put forward for the creation of one or more regional markets confined to a smaller number of countries, selected in accordance with certain objective criteria, outstanding among which are the following: (a) the existence of a substantial volume of trade at the present time and (b) geographical proximity.

Were the criterion of existing trade adopted, the regional market would be limited to a nucleus practically identical with the group of eight countries which for several years have been parties to bilateral trade agreements, namely, Argentina, Bolivia, Brazil, Chile, Colombia, Paraguay, Uruguay and, up to a point, Peru[16/].

The criterion of geographical proximity, with its implication that communications are a (relatively) easy matter, entails the demarcation of

---

16/ In recent years, trade among Latin American countries with non-convertible currencies has represented 14 per cent of their total trade, while trade among Latin American countries in the dollar area (Ecuador, Mexico, Venezuela, Central America and the Antilles) has not exceeded 2 per cent of their total trade. The volume of trade between these two groups of countries has attained even more negligible proportions.

/three areas

three areas, i.e., the zone comprising Mexico, Central America and the countries of the Caribbean; the northern zone of South America (Venezuela, Ecuador and possibly Colombia as well); and the southern zone (Argentina, Bolivia, Brazil, Chile, Paraguay, Peru and Uruguay).

4. There is no need to stress the difficulty of this problem, in which many factors have to be taken into account, apart from the independent interests of each and every Latin American country. The only aspect touched upon in this report will be the question whether the geographical criterion is or is not a suitable yardstick whereby to demarcate the scope of an integration scheme.

This criterion has been adduced to emphasize the exceptional difficulties which must be faced by the countries of the northern zone - Mexico, for example - if they wish to enter into an economic integration agreement with others in the southern zone, in view of the immense distance between them.

It would seem unquestionable that there is less incentive to specialization among countries or groups of countries that are very far apart, or where transport difficulties are serious, than among neighbouring countries, as high transport costs tend to cancel out the differences in production costs that might promote specialization. Although it carries some weight, the drawback of this argument is that it implies that geographical proximity constitutes the only, or at any rate the strongest justification for an international economic union, which does not seem to be true. As a matter of fact, the most cogent reason for accession to a regional market is probably similarity of stages of development. As has already been mentioned, a feature common to all countries in the initial phase of industrialization, whether in the north or in the south of Latin America, is the existence of import substitution industries in which costs are higher than in the more advanced countries outside the region. This relative inefficiency is determined by several factors, outstanding among which is the smallness of the market. The merger of the individual country markets, irrespective of their geographical situation would be advantageous for all of them, since it would permit increased specialization on the part of each country; longer manufacturing series; concentration of resources; and the acquisition of experience and productive efficiency in a more limited range of activities,

/which it

which it would be impossible to attain in the same length of time if all the lines of production required for the domestic market were maintained.

Similarity between lines of manufacture creates the difficulty of the need for readjustments of the existing means of production, in consequence of increased competition. But at the same time, it opens up great possibilities for complementarity, with the cost reductions inherent in specialization.

Thus envisaged, the geographical criterion as a means of defining the orbit of a regional market seems to have its limitations.

5. As regards the goods that must be admitted to a regional market, here too there is a margin of choice covering several alternatives.

In preliminary conversations on this topic, opinions were expressed in favour of some limited solution, which might spare each country's existing industries and other productive activities already existing in each country any kind of readaptation effort. This is the tenor of the formula which would at first confine the regional market to those industrial articles (capital goods in the main) manufacture of which has not yet been undertaken or is in its incipient stages, so that at the outset the different countries of the region would have equal opportunities for the development of these new activities. The market would then incorporate in turn, but still gradually, existing sectors in which idle capacity was registered, and those other industries - also already holding a place in each individual country market - where costs would be most responsive to a multinational broadening of the market.

It would seem that the obvious advantages of a restricted and experimental scheme such as this are to some extent cancelled out by the limitations collaterally imposed upon the benefits of integration, as well as the difficulties that might attend the selection of a sufficiently long list of manufactured goods which really were not produced in the region.

The successive additions to the regional market schedule of goods might give rise to as many more alternative procedures, under which the growing potential advantages of integration might be accompanied by keener trade competition among the member countries. Nevertheless, an appropriate selection of integration methods would perhaps help to ensure that the

/advantages of

advantages of any given regional market formula outweighed its drawbacks.

If successively broader integration formulae were considered, the extreme of including agricultural commodities under the regional market system would ultimately be reached. This possibility should be examined with great care, as in that case not only might the readjustments of the means of production be more sweeping, but also the member countries might find themselves faced with domestic problems of a very special kind, though perhaps more substantial longer-term advantages for integration would be obtained in return.

In relation to so comprehensive a regional market formula, various aspects of the problem should be analysed. In particular, it should be borne in mind that the position with respect to competition among the different countries, where the commodities under discussion are concerned, may be radically altered in the fairly near future, because demand for foodstuffs is rapidly expanding in almost all the Latin American countries, and domestic output may find difficulty in continuing to meet these increasing requirements. Consequently, might there not be a possibility of some arrangement which, while including certain agricultural commodities in a regional market, would restrict entirely free trade to the increments in consumption over and above its present or any other given level?

Preferences as regards the commodities to be included in a regional market will probably be influenced to some extent by the identity of the member countries. Thus, for example, it seems desirable to investigate specific questions such as the following: Could a regional market confined to capital goods offer sufficient inducements to the less developed countries of the region? Were agricultural commodities or raw materials of mining origin excluded from the regional market agreements, what might be the effect on the advantages of membership for certain countries of the region?

6. The third co-ordinate on which the definition of a regional market formula must be based is the degree to which co-ordination of the individual countries' economic policies is deemed to be desirable.

This variable too seems not entirely independent of those previously enumerated. It may well be asked whether a regional market embracing absolutely all kinds of merchandise could survive without the application

/of a

of a number of measures to supplement the merger of the markets for the various goods. These would include freedom of movement for the factors of production, some degree of co-ordination of internal exchange and monetary policies - especially during periods of domestic instability and external balance-of-payments difficulties -, and compatibility of certain institutional aspects of the structure of costs (social security contributions, etc.). However, there are certain limits within which freedom of choice will be possible as regards the desired degree of economic integration. This problem will be touched upon only incidentally in the present report.

7. In the case of a regional market including a large number of goods, the likelihood of readjustments of the means of production may be reduced if the steps taken to eliminate tariffs and other obstacles to intra-regional trade are sufficiently gradual. Several methods - some account of which is given in the next chapter - may be followed to this end. Among them are the setting of time limits varying with the extent of the expected readjustments; tariff reduction in two stages, the first of an experimental nature; flexibility designed to enable each country to choose its own rate of reduction, in conformity with a predetermined average rate; and, in addition, such agreements as may be established to confine freedom of trade to future consumption increments in each country.

8. The various possible alternatives as to the number of member countries, the goods included and the several successive degrees of economic integration, give rise to as many more formulae for the structure of the regional market. These are, in consequence, very numerous. In a preliminary analysis such as the present report offers, the different hypotheses on which an equal number of alternative regional market formulae are based relate first and foremost to the schedule of goods. Only very rarely does occasion arise for the number of member countries and the desired degree of economic integration to play any part in the analysis. The chapter which follows reviews some of these formulae, in order to illustrate how much flexibility there is in the choice of methods of channelling the economic integration aimed at in Latin America's case. The remaining chapters comprise an analysis of some of the main problems which will probably have to be dealt with whatever the formula adopted for the structure of the regional market, without embarking upon a systematic and coherent examination of any one particular formula.

/Chapter II

Chapter II

SELECTION OF COMMODITIES AND ELIMINATION OF TARIFFS

1. The topic discussed in this chapter might be described as the central problem of the regional market. It consists in defining the advantages and drawbacks of the various degrees of comprehensiveness which might be imparted to integration as far as goods are concerned, and the ways and means of putting such integration into practice, or, in other words, of merging in a single market the individual country markets for the goods on the selected list. The following analysis aims at presenting various solutions, to match different sets of circumstances. What it is most important to emphasize is the nature of the various kinds of difficulties that will have to be dealt with, not so much the specific devices suggested for overcoming them. Such solutions can always be modified and very substantially improved by means of a more careful analysis based on real data on Latin America's industries and other activities, which at present are incomplete.

No attempt will be made here to discuss the problem of the re-establishment of suitable tariffs in those member countries where, through the joint effects of inflation and the specific nature of the duties, tariffs have lost a great deal of their practical significance. This question, which has already been touched upon in relation to the possible liberalization of intra-regional trade in traditional commodities, is clearly deserving of more careful study. Nor is allowance made for the existence of trade barriers other than tariffs, such as quantitative restrictions. The abolition of these restrictions would also have to be considered, a possible method being some programme which would run parallel to the reduction of tariffs.

2. To judge from the views expressed on various occasions by representatives of the Latin American Governments, it is felt that readjustments in the utilization of the existing means of production should be avoided as far as possible in a Latin American regional market. For this reason, discussions on the possible structure of such a market have always been focused upon integration formulae of somewhat restricted scope. The conviction has existed

/that limited

that limited and experimental aims might, by reducing to a minimum the effect of competition on similar activities situated in different countries, afford greater prospects of success to any attempt at the economic integration of Latin America.

The idea which has on the whole been preponderant in the formulae most frequently discussed hitherto is that the integration effort should be confined to manufactured goods, at least in the predictable future. Morevover, the pattern advocated for the merger of the country markets is often still more limited, and covers only capital goods, including some which have not yet begun to be manufactured in the region.

A more thorough analysis of the problem reveals that, although a limited plan for the structure of a regional market may have many advantages, it is not without its drawbacks. Both must be duly weighed and considered in relation to the circumstances prevailing in Latin America, before it is possible to select the solution which comes closest to a common denominator for the interests of the member countries.

In very general terms, it may be asserted that the advantages which would attach to a regional market of a fairly universal character - one, that is, which would include the products of all or nearly all sectors of activity (among them traditional manufactures and agricultural and livestock production) - are those implicit in more complete and more intensive distribution of productive resources among the various activities in the Latin American countries as a whole, with the resultant favourable effects upon average real income. On the other hand, a less ambitious solution, covering only certain lines of goods previously selected from those offering the best prospects to new productive undertakings, would have the advantage of involving less risk of readjustments of the means of production in certain countries.

3. To sum up, the problem may perhaps be stated as follows. In projecting the regional market, it would be advantageous to admit as wide a range of goods as proved compatible with the reduction to a minimum of those readjustments of the means of production which would probably be necessary. The selection of a market integration formula which will comply with this twofold requisite calls for prior study of the potentialities

/of different

of different methods of ensuring that the abolition of tariffs and other internal obstacles is sufficiently gradual. The more marked are these potentialities, the greater will be the freedom of choice.

1. Integration by gradual stages

1. There are various ways of ensuring that market integration takes place by gradual stages.

To begin with, the need to introduce a progressive procedure in the machinery for the establishment of the regional market does not arise under all systems of integration. To take, for example, the case of a formula based on the application of a narrow criterion to the selection of goods, those goods are chosen whose inclusion in a system of entirely free competition is likely to create fewest difficulties, and their number is progressively increased, so that gradually the lines of production which are harder to integrate are incorporated. These last are new items not yet manufactured in the region, or the manufacture of which is in its incipient stages and is undertaken only in some of the member countries; and they must be selected one by one, not in groups or general categories. They might be included under the regional market system forthwith, that is, the corresponding tariffs might be abolished straight away without danger of incurring losses or readjustments in Latin America's means of production. It must be mentioned, however, that a restricted formula of this kind is somewhat self-defeating as regards the intention to avoid awkward readjustments of the existing means of production. A regional market for only a limited number of selected items, if these goods do not really represent manufactures entirely new in the region, strengthens the effect of competition on each separate commodity, and commensurately limits the possibilities of compensation (between items, enterprises and lines of production undertaken by the same enterprise), with respect to such readjustments as are unavoidable.

2. It seems that the principal method which can be chosen to render the process of market integration more gradual consists in the fixing of long terms for the abolition of trade barriers. These generous time limits might even be subject to extension, in accordance with the degree of difficulty attendant upon the integration of each item or group of items.

/A flexible

A flexible procedure for the implementation of a programme to reduce tariffs and other internal restrictions, on the basis of the foregoing method, might comprise the following three parts: (a) the drawing-up of a schedule of goods, or an order of priority for groups of goods, based on a rising scale of difficulty of market integration (in terms of the existence of similar activities already established in the regional market area), and determined by means of negotiation among the member countries; (b) the setting of a deadline for the final abolition of the customs tariffs applicable to each of these goods or groups of goods, the time-limits being extended in proportion to the potential integration difficulties referred to; and, lastly, (c) the choice of a time-table for the gradual elimination of tariffs (reduction by a uniform annual percentage or by certain fixed percentages before specific dates, etc.).

3. *Despite its apparent flexibility*, an integration formula such as this has one great drawback as regards its application to a regional market embracing a large number of commodities and member countries: it may sometimes be difficult - perhaps very difficult indeed - to adapt one and the same procedure (goods and time schedule) to the diverse and possibly conflicting interests of the member countries. A country which does not manufacture particular goods is likely to be in favour of expediting their liberalization, but if reciprocity is insisted on, this may not suit another country which needs to protect its production of those same commodities by means of the long-term abolition of tariffs. This problem seems very likely to arise, not only as regards the position of the various separate goods in different countries at the same stage of industrial development, but also, in a much more acute form, with respect to entire lines of production in countries whose stages of development differ. Furthermore, the arrangements that suited a particular country might vary widely according to the country in relation to which its situation was considered.

The following is an outstanding case in point. The most highly industrialized countries of the region (Argentina, Brazil, Mexico and Chile) would probably have no difficulty in concluding an agreement among themselves for the rapid liberalization of trade in all or almost all capital goods, many durable consumer manufactures, etc., since each of these

/countries would

countries would be able to profit immediately by the broadening of the markets for goods of this kind. But the situation of Paraguay, Bolivia and other relatively under-developed countries would be different, since their accession to such an agreement would mean that they threw open their markets with little hope of gaining any advantage from the theoretical reciprocity which would be accorded them in the production of the complex types of manufactures mentioned. For the relatively under-developed countries to obtain any effective and immediate benefit, this reciprocity as regards the opening-up of markets would have to be extended to goods of other kinds, mainly raw materials or intermediate products, and other primary commodities.

When any comprehensive regional market project is under consideration, the general procedure mentioned above should perhaps be made still more flexible, so that the conflicting interests of the member countries can be reconciled within an over-all framework. It would seem that this can be achieved by means of a tariff reduction pattern based not on a rigid schedule of goods and predetermined time-limits, but on a scheme that can be fairly easily adapted to the individual positions of the member countries. Such a pattern would consit in confining the programme to a weighted average of tariff charges, while each country would retain the right to organize its own programme for the abolition of tariffs, on lines suited to the special situation of its various industries and other activities, providing only that it respected the averages established in the common programme.[1/]

4. But this flexible formula does not exhaust the available means of introducing the progressive element into a plan for the abolition of internal tariffs. Two other arrangements must also be considered. On the one hand, there is no reason to discount the possibility of a liberalization which would affect only a specific percentage of currently existing internal barriers. A tariff reduction programme might be brought to a

---

1/ This is a formula arrived at during conversations between the consultant Mr. Pierre Uri and the secretariat staff, and is recorded in document E/CN.12/C.1/WG.2/3.

/standstill at

standstill at a given moment before the reduction in question was complete, the elimination of the final margin being dependent upon observation of the results obtained during the first part of the programme. Secondly, a system might be planned with particular regard to the situation of those sectors in which productive activities are more or less widely distributed throughout the member countries, production costs differ greatly and, therefore, the rapid and unrestricted opening of markets might possibly lead to serious readjustments of the means of production. This seems to be the case with a number of agricultural commodities and certain current consumer manufactures, such as textiles, clothing, etc. Under the system suggested, liberalization could be limited to any future expansion of the market, and the protection currently accorded to domestic production could be maintained so long as activity remained at its present level.

Merely by way of illustration, the paragraphs which follow will successively present three different procedures for the abolition of domestic tariffs and for the selection of the goods to be included in the common market system, in accordance with increasingly comprehensive integration patterns. The starting-point is a regional market confined to capital goods, those not yet manufactured in the region being listed in a separate category from the rest; next, consideration is given to the advantages and disadvantages of broadening the preceding procedure to include manufactures other than capital goods; lastly, the products of the crop and livestock sectors and other primary commodities are added. An account will now be given of the most important advantages and drawbacks attaching to these three customs union schemes.

2. A regional market for capital goods

1. The first of the possible devices for the gradual creation of a regional market is that consisting in the selection of a small initial group of goods not yet manufactured in the region and their immediate inclusion in a system of completely free circulation among the member countries. This group would comprise the capital goods that all the member countries still import from outside the region, or at any rate some of them. As no readjustment of the means of production would be

/necessary, because

necessary, because selection would be based on the fact that the goods were not manufactured locally, abolition of tariffs could be complete and immediate. Additions to the initial schedule of goods would be determined by means of periodic negotiations among the member countries, and in selecting such additional items the member Governments would take into account the experience acquired in the process of integration of those originally listed, as well as the interests and expansion programmes of the domestic industry concerned. Of course, the inclusion of subsequent items might or might not be immediate. Once readjustments became unavoidable, the reduction of the corresponding tariffs could be staggered.

Under this system, integration would begin with a small nucleus of new activities, and the continuance of the programme would probably depend upon the preservation of a satisfactory balance among the interests of the various member countries, which could be achieved by means of periodic negotiations.

2. The attraction of this scheme may lie in its experimental nature and the security it offers against the emergence of total and irreparable disequilibria as regards the benefits accruing to each country from integration. But, apart from the difficulties that might attend the selection of new lines of production - a problem which is discussed later -, it has the defect of making nothing whatever automatic, every step along the road towards integration being dependent upon negotiations. When new lines of production were exhausted, the inclusion of additional items on the regional market schedule would probably meet with opposition on the part of those groups of industrialists in each country to whose interest it was that existing protection should be maintained. This method based on negotiation might perhaps lead to an impasse, since the integration process might be confined to the few goods comprised in the initial nucleus. It is true that, whatever scheme is adopted for the creation of the regional market, there will be negotiations among the member Governments in which groups from the individual countries may exert their influence in defence of their own interests. But the constant renewal of negotiations is not the same thing as their being conducted once and for all, or on a few occasions.

/Furthermore, the

Furthermore, the advantages of this balance of interests would be somewhat illusory, inasmuch as it would be achieved by the application of a restrictive criterion in the selection of commodities. If the regional market were confined to capital goods, it would be very difficult to establish such a balance among countries at widely different stages of development, unless, perhaps, for extremely small volumes of trade.

3. Consequently, could not a certain advantage be secured by making the gradual inclusion of successive items in the regional market to some extent automatic? A programme fulfilling this requisite would be one under which the criterion of selecting goods singly were maintained, but all stages and deadlines up to the time of its completion were established from the outset. That is, goods would be classified in various groups by difficulty of integration, and, while the reduction of internal tariffs would be begun simultaneously in respect of all categories, varying time-limits would be set for their final abolition.

The groups in question might be four in number, for example, as follows:2/

Group I. Goods not manufactured in the region, which would be those appearing on the current import schedule. Probably items manufactured in not more than one country of the region might also be included.

Complete and immediate lifting of internal barriers, whether connected with the tariff or not.

Group II. Goods whose manufacture in Latin America was only in its initial stages and could not meet the region's requirements; demand partly satisfied with imports.

Gradual lifting of internal barriers, to be completed within a term of, for instance, 5 years.

Group III. Goods manufactured in Latin America on a sufficiently large scale to supply the market; imports of similar commodities in only some of the member countries.

Slow and gradual lifting of internal barriers, to be completed

2/ The extent of the tariff reductions for the five groups given in the outline above, and the method of applying them, are only illustrative examples.

/within a

within a period of 5-10 years.

Group IV. Goods to which the description of the preceding group applied, but in whose case there was reason to assume that the distribution of production among the member countries would have to be considerably altered, with the consequent readjustments of the means of production in each.

Gradual and still slower removal of internal barriers, to be completed within a term of 10-15 years.

Group V. Individual cases, constituted by goods considered to be especially important for national defence or other reasons. Only a partial removal of internal barriers; for example, bringing tariffs down to a final level not below 25 per cent of the previous tariff, or one-half of the common external tariff concerned.

The foregoing outline is given solely for illustrative purposes. The number of groups and the specification of the goods to be included in each might vary very greatly, according to each country's situation and the wishes expressed by Governments as to the scope and intensity of integration to be aimed at. Moreover, within the suggested outline, the final level of internal tariffs which it was thought desirable to maintain might also vary. Only the general procedure is under consideration for the moment.

4. The foregoing plan for the abolition of domestic tariffs seems flexible enough to be adaptable to the real state of affairs, and at the same time is sufficiently automatic in its operation to preclude obstructive negotiations. But its feasibility depends upon a fundamental problem, namely, the possibility of defining exactly which capital goods represent "new lines of production" in the region, or, in other words, which are the goods that are not yet manufactured and around which, therefore, no activities have as yet sprung up.

5. The first step would be to determine how far there really are any capital goods completely "new" to the region, that is, not yet manufactured in any of the member countries, even on a small scale. This study would have

/to cover

to cover not only existing manufactures, but also industrial projects about to be put into execution in the member countries. To what extent is the field of industrial activity potentially open to the regional market already covered by manufacturing projects? Is there not also a possibility that the future manufacture of "new" goods, so far still being imported, may be associated with other lines of production already existing, by virtue of similar manufacturing techniques?

Should the schedule of Latin America's capital goods imports include a large number of incipient manufactures or manufacturing projects associated with the expansion of industrial plants already in existence, it would probably be difficult to draw up a list of capital goods whose inclusion in the regional market system would not give rise to readjustments; or the list would be so short that the volume of trade concerned would not rise above a very low level. Perhaps these readjustments would be called for not so much in the established industries as in their expansion programmes for correlated lines of production; but this would not prevent them from arousing some degree of opposition.

6. The same difficulty arises from the lack of any precise criterion whereby to distinguish imported from domestically-manufactured goods, when the products are only partly manufactured in the country concerned. The problem exists in all those cases - very frequent in countries where industrialization is in its early stages - where imported parts are assembled in the country in question, in association with domestic manufacture of one part of the complete product. The difficulty would consist in finding a criterion on the basis of which to define "manufacture" for example, a specific percentage of the final value, which could be applied without modifications - or without too many - to all items and member countries. The same percentage could not be indiscriminately applied to goods requiring highly complex techniques and to those which were easy to manufacture. Nor would it serve equally well for a more highly developed country and another whose industry was much weaker, in respect of one and the same item.

These difficulties attending the selection of "new lines of production" may perhaps mean that a choice must be made between the creation of a regional

/market on

market on very narrow bases (probably with an extremely modest volume of trade) and the decision to plan it on more comprehensive lines as regards the goods included and the degree of readjustment accepted. Only if the field at present covered by imports were found to be relatively devoid of new projects would it be possible for readjustments to be prevented altogether, through the adoption of some very restrictive solution.[3/]

7. Market integration formulae based on the selection of individual goods ought perhaps also to take into account the problem of the component parts and intermediate products used in their manufacture.

A large number of parts, spare parts and intermediate products utilized in the manufacture of a particular good (a tractor, for example), can also be used for making a great many other more or less similar products (lorries and other vehicles, stationary motors, etc.). It is often by no means easy to make a distinction between such components as regards the use for which they are intended and this gives considerable scope for fraudulent transactions.

There would be little economic point in a system under which finished goods were given access to the regional market and the component elements and principal parts concerned were excluded. Moreover, in practice their complete exclusion seems impossible. The parts and spare parts required to meet the normal war and tear of finished goods would always have to be admitted to the regional market. As it is very difficult to draw a distinction between spare parts and original or manufacturing (or assembly) parts, there is a possibility of importing, as if they were spare parts, those intended for assembling new goods of a similar or merely a related type. If the capital goods included on the regional market's schedule were not numerous, and had been selected one by one, with specifications of the model, size or capacity concerned, there would always be a large number of other capital goods of different models, sizes or capacities, not

---

3/ The secretariat is planning to carry out at an early date a survey of the potential market implicit in current imports from outside the region and factories already installed or projected, for the main capital goods and the raw materials needed for their manufacture. Raw materials of chemical origin would probably be included in the study as well.

/included under

included under the regional market system, for the assembly of which fraudulent use could be made of the component parts that had been imported under the guise of spare parts for the former category. The more strictly the criterion for the selection of goods had been applied, that is, the more detailed was the schedule of goods establishing distinctions of size, capacity, or other characteristics, the more serious would the problem prove. For example, if free trade in wheeled tractors of more than 60 h.p. and their spare parts were included in the regional market, it would perhaps be virtually impossible to prevent the free circulation within the integration area of parts for tractors of all classes and grades of horse-power, which would illicitly feed assembly lines for tractors of under 60 h.p., in certain countries, in competition with similar domestic manufactures.

8. A more detailed analysis of the questions referred to in the preceding paragraphs may possibly lead to the conclusion that too much importance must not be attached to the selection of new lines of production as a means of paving the way for the regional market. In such an event, consideration might be given to the advantages and drawbacks of another formula, according to which, in order to give the integration process the gradual and selective character which is deemed essential, greater emphasis should be placed on the lengthening of the periods covered by each stage. In such a formula, all capital goods could be classified in a very small number of categories - perhaps some four or five -, and different deadlines could be fixed for the abolition of tariffs and the lifting of other internal barriers in each category. The formation of general categories would be based on the similarity of goods, but, in so far as practicable, the status of industries - new (incipient) or already established - could also be taken into account, not for single items, but for clearly-defined groups of goods. It would therefore not be necessary to subdivide each group of similar goods by model or size, with a view to including some and excluding other from a given category. All related goods, whether their manufacture were in its initial stages or no, would be included in the same category, and the time allowed for tackling problems in connexion with readjustments of the means of production would be long enough to permit the integration of the domestic markets concerned.

/Under this

Under this scheme, the five groups of capital goods mentioned above (see paragraph 3 of this same section) might be composed as follows:

Group I. (a) Motor vehicles (for freight and passengers);
(b) Complex agricultural machinery (combines);
(c) Integrated industrial installations (equipment for the transport of ores; for chemicals plants; for pulp mills, etc. etc.);
(d) Petroleum drilling and extraction equipment;
(e) Railway material (metal passenger coaches; locomotives; automatic signalling equipment);
(f) Heavy electrical equipment (hydraulic turbines).

Group II. (a) Motor vehicles (tractors);
(b) Agricultural machinery (various kinds of less complex equipment);
(c) Railway material (goods wagons of various types);
(d) Heavy electrical equipment (transformers, generators).

Group III. (a) Diesel engines;
(b) Hydraulic pumps;
(c) Machine tools.

Group IV. (a) Accessories for textile machinery;
(b) Electric motors;
(c) Hand tools.

Group V. (a) Pig iron;
(b) Ordinary steel: final goods and intermediate products;
(c) Special steels: final goods and intermediate products;
(d) Non-ferrous metals: final goods and intermediate products.

The foregoing list is given only as an example and makes no claims to accuracy. However, the lines of industrial production included in the successive groups would seem to correspond more or less to those suggested by observation of the activities that do or do not exist in the three or four most highly industrialized Latin American countries.

9. Of course, as was previously pointed out, a regional market confined to capital goods and the related raw materials and intermediate products would probably also be restricted as regards the number of member countries.

/Since reciprocity

Since reciprocity seems to be an essential requisite of any integration agreement, steps should be taken to ascertain whether only those countries which have at present reached a sufficiently advanced stage of industrialization to be able to develop the manufacture of capital goods on a reasonable scale would find incentives to accede to a regional market of this kind.

3. A regional market for manufactured goods

1. The next step in the discussion of successively broader arrangements is a regional market for all manufactured goods, comprising, in addition to capital goods, durable consumer goods and other manufactures. The advantages of expanding the integration formula in this way seem obvious, since there would be better opportunities for the redistribution of resources with a view to an improvement in productivity, under the stimulus of keener competition. The drawbacks, which spring directly from these advantages, consist in the greater likelihood that serious distortions may be brought about in the long-standing industries by intra-regional competition. In any attempt to evaluate the difficulties, it should be borne in mind that the traditional industries[4/] in almost all the Latin American countries are handicapped in varying degrees by out-of-date organization and equipment, which makes them very vulnerable to competition. Unquestionably, however, when equipment and organization are unsatisfactory, a movement towards bringing them up to date, with the consequent reduction of costs, is all the more necessary.

2. In any event, it seems desirable from every point of view to attempt an accurate evaluation of the production readjustments which may be needed. In the first place, such readjustments may be of considerable significance in a stationary economy, where few opportunities, or none at all, are offered by the expansion of demand and the transfer of activities to parallel lines of production. In rapidly-developing economies the possibilities of sustaining the effects of competition are much greater. In fact, the

4/ Textiles, tinned foodstuffs, rubber goods, paper, articles of clothing, china, porcelain and glassware, pharmaceutical products, etc.

/process of

process of industrial growth is usually based on a constant readjustment of the means of production, under the pressure of internal competition, in the upward direction determined by the expansion of the market. In countries where the process of industrialization is in its early stages, industrial enterprises begin by manufacturing a very wide range of miscellaneous goods, using, however, the same or fairly similar manufacturing techniques. This is the only way of achieving an adequate volume of production when the market is narrow. The progressive broadening of the market gradually allows the industrial enterprises to concentrate on an increasingly limited number of lines of production, in which they specialize. At bottom, the readjustments are much the same as those involved in an integration process carried out in a series of sufficiently lengthy stages. A formula for the merger of the country markets applied to all manufactured goods, in properly graduate stages, might, by placing the process of readjustment on a regional (that is, a multinational) footing, yield greater benefits for the economic development of the member countries, in the shape of a more efficient distribution of the productive resources.

3. Furthermore, it should be mentioned that the more comprehensive is the regional market schedule of goods, the easier will it be to contrive the necessary readjustments, because of this broad integration pattern is adopted many of the factors likely to give rise to readjustments would offset one another in each country, in each sector of industry, and even in each plant.

In the metal trades, which are the main sources of supply of capital goods, certain factors help to facilitate such adjustments as cannot be avoided. The wide variety of sizes, models and grades of power or capacity for which the same machine is utilized, according to the specific requirements of each user, makes it easier for the individual producer to specialize in a limited number of sizes or models, in conformity with his previous experience and with the characteristics of the nearest market. And a decided trend towards specialization among producers might perhaps absorb the whole of the production readjustments imposed by the establishment of competition within the regional market.

Almost all durable consumer goods are produced by the engineering and metallurgical industries. Although the manufacture of durable consumer

/goods and

goods and that of capital goods are almost always organized in different production units, the inputs utilized are very similar. This means that the inclusion of capital goods and durable consumer goods in a regional market might result in the opening-up of new transfer possibilities for the factors of production, and would therefore help to reduce the probability of losses or difficult readjustments of the means of production caused by keener intra-regional competition.

4. In any quantitative assessment of such readjustments the current shortage of manufactured goods - particularly capital goods - in all the member countries should not be forgotten. Capital formation, especially where machinery and equipment are concerned, depends mainly upon imports. The present fluctuations of the capacity to import, which show every sign of continuing in the predictable future, give rise in all these countries to a permanent and acute scarcity of such capital goods. So long as this "equipment famine" persists in the regional market area, competition among the producers concerned will slacken considerably, both within the same country and from one country to another, and the shortage will thus play an important part in mitigating the effects of market integration on the internal distribution of each country's resources. The impact of competition will only slowly become more powerful, and the region's various manufacturers of machinery and equipment will be able to advance grudually towards specialization in the field for which their experience best fits them. It is likely that as a relatively short-term result of the acute shortage of capital goods, a far larger number and many more new types and varieties will be manufactured within the region, full advantage being taken of the possibilities opened up by the enlargement of the markets. This broadening and extension of the range of activities may provide abundant opportunities for the smooth adaptation of domestic industries to the multinational competition inherent in the regional market, and it is not beyond the bounds of possibility that, given the continuance of a favourable situation, readjustments in the means of production may be avoided altogether.

5. Lastly, to carry this idea still further, reference may be made to the possibility of a comprehensive integration programme embracing manufactured

/goods in

goods in general, more or less along the lines described above[5] as regards time-limits, but divided into two broad phases. The culminating point of the first would be the reduction of tariffs only to half (or to some specific percentage) of their level before integration, within the periods stipulated for each group of goods. During the second stage, the reduction of tariffs would be completed up to the point of their final abolition, in accordance with a new programme. This new programme could be studied and negotiated only after observation of the progress of integration in the course of the first phase, which would thus acquire an experimental character. This might perhaps be a way of satisfying the preference sometimes expressed for trying out the integration programme to begin with, while at the same time reconciling its experimental character with existing doubts as to the feasibility of too unambitious an integration plan.

6. If this last possibility - that of an integration programme in two stages, the second depending on the results of the first - were to be considered deserving of further study, the problem of the level to be attained by tariff reductions at the end of the first phase would have to be analysed.

Two main criteria could be adopted; one of these would entail using the external tariff structure as a point of reference, and the other would mean adopting a common tariff for all items or goods. The external tariff structure maintains different duties on different goods, and they will probably be higher for those goods or items of which production is relatively more inefficient in Latin America than in industrial countries elsewhere in the world. If by the end of the first phase internal tariffs were reduced to a given percentage of the common external tariff, this would mean maintaining higher internal barriers for those items where an internal redistribution of activities would be most advantageous. Some limitation would thus be imposed on the redistribution of the region's productive resources with a view to their more efficient utilization.

The other criterion would not determine such a limitation (distortion of

---

5/ See again section 2, paragraph 3.

/resources) and

resources) and would consist in fixing a common tariff level (for example, 25 per cent) for all items included in the regional market. This common level, in combination with Latin American transport costs which are relatively high, would result in a margin of protection for each country's industries, and this may be considered an essential requisite if readjustments of the means of production are to be cut down during the first stage of the integration process.

4. A regional market for manufactured goods and primary commodities

1. A more comprehensive market integration formula would also cover - in addition to traditional manufactures - some or all agricultural commodities and raw materials from the agricultural, forestry or mining sectors. The advantages of such a broadening of the regional market would follow much the same lines as those described above, and would consist in a more intensive redistribution of resources, with the consequent effects on costs in the various member countries. But two other favourable features might be added, namely, the elimination of the distortions which are bound to accompany integration confined to only a few sectors of activity, and the opening-up of better opportunities for the accession of countries other than the small group whose level of economic and industrial development is highest.

Under earlier regional market formulae, the sectors whose markets were integrated constituted only a part of the economies of the various countries. In such cases, activity in the integrated sectors is subject to influences of a monetary, fiscal, exchange or other nature, which have developed independently and are probably allied to the pursuit of different objectives. Thus the integrated sectors in each country are subjected to opposing pressures, which may lead to distortions in the application of the productive resources. This could not happen in a regional market covering all goods, as the same pressures of a monetary, fiscal or other kind would affect all sectors alike and, furthermore, would automatically tend to be co-ordinated through the action of a common agency or by means of some consultative arrangement.

May not the relatively under-developed countries of the region find in an over-all regional market the inducements which they might not be offered

/by a

by a regional market confined to capital goods, or even to manufactures in general? This does not imply advocation of any integration arrangement whereby such countries would specialize in supplying the more highly developed countries of the region with raw materials and other primary commodities. On the contrary, it seems in every way desirable that some solution should be found which will further the progressive diversification of the economies and exports of the less developed countries of Latin America. Nevertheless, if the problem of the creation of a regional market is viewed realistically, it is impossible to overlook the fact that at the present time and in the predictable future the possibilities of rapidly developing highly complex industrial activities will necessarily be geographically limited.

2. In this case it is the problem of the essential readjustments that seems to be the question of vital importance. From the technical standpoint, there are indubitably certain possibilities of devising ways and means of lifting trade barriers by sufficiently gradual stages to avert the risk of unduly violent and frequent repercussions on the activities of member countries. However, an important aspect of this question is the fact that regional market formulae covering a wider range of goods would probably entail stricter commitments on the part of the member countries to co-ordinate their internal policies in the monetary, exchange, investment and other fields. Furthermore, the powers conferred on the body or agencies responsible for the administration of the regional market might posibly have to be broadened in proportion to the intensity of the economic integration represented by the regional market in question. This seems to be a really important consideration when the advantages and drawbacks of a very comprehensive regional market are being weighed up.

3. To prevent difficulties in connexion with the merger of markets for those goods which were the subject of the keenest competition in the regional market, tariffs and quantitative restrictions might be reduced more slowly, at rates varying according to the intensity of the competition characterizing each group of goods. This progressive system might be introduced not only as regards the tariff level ultimately aimed at, but also with respect to the time-limit decided upon for reaching it.

There is also the possibility - which seems particularly applicable to agricultural commodities - of drawing up provisions which throw open the

/individual country

individual country markets for free intra-regional trade, but only in respect of that margin of domestic consumption of each item which is in excess of the current volume of domestic production. Readjustments can thus be avoided, or those which are inevitable become slow and indirect. Such provisions are difficult to determine and to cast in the shape of fixed regulations which can be automatically applied. Probably all that could be done would be to establish general principles, categories of goods and the degree of flexibility to be adopted in each of these categories; the application of these decisions would be in the hands of somebody responsible for the administration of a controlled liberalization programme, as in the case of the system established for certain agricultural commodities in the Benelux countries.

4. In connexion with the hypothesis of a broad regional market such as is envisaged here, mention must be made of the possibility of adopting a method of tariff reduction based on an average of duties, weighted in accordance with some criterion (probably apparent consumption of each item), which would enable every country to choose the easiest way of abolishing its tariffs. This method seems especially advisable in the case of a regional market plan which embraces a large number of countries and all or almost all goods. It would then perhaps be less dificult to reconcile the various interests of the member countries under the same general agreement.

The more highly developed countries, which are desirous and immediately capable of expanding their capital goods production and trade, might draw up their own tariff abolition programmes, in order to establish a common market for such goods from the very outset. Even if in practice reciprocity as regards this rapid liberalization of trade capital goods were limited to the more advanced countries, it would not be of a discriminatory nature, for the two following reasons: firstly, tariff reductions would be applicable to all sources of imports within the regional market, and, secondly, by the time the regional market programme was completed, tariffs would be reduced to the same extent for all categories of goods - that is, discrimination between items would be temporary.

Similarly, the less developed countries might perhaps establish their own tariff reduction programmes on reciprocal bases negotiated both among

/themselves and

themselves and between them and the more advanced countries, in such a way as to maintain the balance of interests in the market area.

An arrangement of this kind for the reduction of tariffs would of course eliminate the need to classify goods or groups of items in categories, each with its own different time-limit for integration. Such a division into categories, which seems useful for more restricted market formulae based only on selected sectors, might in the case of a general market be replaced by the flexible tariff reduction mechanization of the weighted average, which is intrinsically conducive to the establishment of categories in accordance with each country's choice.

5. The programming of tariff reductions on the countries' own initiative would offer one advantage that might prove important; the bilateral trends existent in the region could be applied in a way compatible with the necessary multilateral bases for any regional market agreement.

The countries in the southern zone of Latin America in particular have shown signs of favouring, up to a point, the conclusion of agreements between pairs of countries under which a common market is set up for certain goods. The agreement between Argentina and Chile in respect of tractors is a case in point. Such a bilateral procedure would have the advantage of facilitating the choice of goods to be included in the free-trade régime. But if its application were prolonged, it would lead to a large number of bilateral arrangements varying in relation not only to the goods concerned but also to the countries themselves, and to express all these in terms of institutional regulations might be very awkward. It is enough to mention that in each country the internal tariffs in force would differ according to the country of origin of a given commodity. Moreover, a complicated problem would arise - that of declarations of source, to prevent or reduce the deflection of imports for fraudulent purposes. There would also be some risk that this form of bilateralism might give rise to <u>de fato</u> situations <u>vis-à-vis</u> third countries in the region, which would mean that the future inclusion of all these bilateral arrangements in a single regional market for all the member countries would become a very difficult matter.

This being so, might it not be possible for bilateral agreements on the more rapid reduction of tariffs in respect of certain specific items to be reconciled with a multilateral regional market agreement by means of the flexible method for the gradual abolition of tariffs mentioned above? If such arrangements proved possible they might influence the programming of industrial development in each country, along the lines suggested at a later stage.[6/]

6/ See chapter III, section 3.

Chapter III

REGIONAL DISTRIBUTION OF INDUSTRIES

1. The main condition for the success of any economic integration scheme is that the procedure adopted should permit the more or less parallel development of new activities throughout the whole of the area integrated. Nevertheless, the distribution of new industries among the various member countries may be ill-balanced, both because of the latters' diverse potentialities and because of the varying stages of development reached in different parts of the region.

The particular lines along which development takes place in each country, irrespective of its average national income, may involve conditions which are more or less conducive to the future development of industry. Thus, the extension of markets might greatly intensify the degree of industrialization possible in one or other of the member countries of a regional market. This would be true of Brazil. The advanced stage of development attained by many branches of the mechanical and metallurgical industries in that country, the thriving state of its industry as a whole and the vitality of private enterprise, in conjunction with the initial advantage afforded by its relatively large domestic market, may perhaps have a powerful influence on the regional distribution of new activities. Such factors justify a careful analysis of the chances that, with the opening of the regional market, Brazil may come to constitute a magnet for Latin America's industrial development.

Should this occur the prospective disequilibrium in regional development would not be the consequence of a higher level of _per capita_ income in the favoured country, but would result from the prior existence of a sufficiently broad industrial basis and a vigorous process of growth. _Per capita_ income in Brazil is half that registered in Argentina; even in the industrial area of the south central zone of Brazil, average income probably falls below the mean Argentine level. Average income in Brazil is also lower than in Chile, Cuba, Uruguay and Venezuela, and much the same as in Colombia and Mexico. Nevertheless, during the last ten or fifteen years industrialization has proceeded at an extremely rapid rate.

/2. The

2. The same problem arises far more frequently, and on a much broader scale, when marked disparities in economic development lead to substantial differences in average income.

In several Latin American countries, the drawbacks of a low per capita income level are combined with those attaching to a narrow domestic market - when the low income level is not offset by the size of the population - and to the lack of an industrial basis broad enough to serve as a starting point from which to advance towards more ambitious goals. All these disadvantages make regional disequilibria of the kind referred to a still more threatening danger.

1. Possible regional disequilibria

1. To judge from the differing situations prevailing in Latin America, the unbalanced distribution of new industries among the countries of the region resulting from disparities in their development or characteristics may be considered at three distinct levels.

2. Firstly, the problem must be discussed with reference to a group of countries which have reached similar stages of industrial development, namely, Argentina, Brazil and Mexico. Current industrial activities in each of these provide a satisfactory basis for the greater industrialization effort which the formation of the regional market would demand. Their domestic markets, too, taken separately, are broad enough to afford economic justification for a number of new industrial activities. Nevertheless, how would the future industrial development of these countries turn out once the tariff, quantitative, exchange and payments restrictions on their reciprocal trade in manufactured goods had been completely abolished? Would each of the countries in question specialize in certain items, some degree of balance being preserved with respect to the development of new lines of industrial production in each country, or, conversely, would a major part of such development be channelled towards the region's most advanced industrial centre?

3. Secondly, the same question arises with regard to the establishment of unrestricted competition between the three countries at the most advanced stage of industrialization and with the biggest domestic markets in the region - Argentina, Brazil and Mexico - and those others in which a basis for

/subsequent industrial

subsequent industrial development also exists, but whose domestic market is perceptibly smaller, i.e., Chile, Colombia, and perhaps also Perú. The competitive weaknesses of this second group of countries lie mainly in the small size of their domestic markets and in the difficulty they would find in taking advantage of the broader market which the regional integration of the individual country markets would afford.

4. Thirdly, there is the problem of a prospective disequilibrium in industrialization which is more acute in the case of under-developed countries like Bolivia, Ecuador and Paraguay. The smallness of their domestic markets, the lack of a minimum basis for the development of industry and the inadequacy of existing public utilities expose these countries to the risk of falling behind the rest, as regards both industrialization and over-all economic development. Hence two unfavourable situations may arise. First and foremost, regional integration might, without affecting the rate of over-all economic development of the countries concerned, channel such development exclusively towards primary activities, thus hindering the diversification of the economy. Moreover, it is conceivable that the adverse effects might be still more far-reaching, and might not only prevent the gradual industrialization of the under-developed countries of Latin America, but might also slow up their over-all economic development.

5. The problem of a possible disequilibrium in regional development will be analysed at each of these three levels, and the various possible solutions will be discussed. Consideration is given in this chapter to the first two cases, that is, to the chances of unbalanced industrialization as the result of differing potentialities on the one hand and of unequally-sized domestic markets on the other, in countries at a more or less similar stage of economic development. In the next chapter attention will be devoted to the problem of disequilibrium arising from marked regional disparities in economic development.

2. Centres of attraction for industries

1. The time has now come to discuss the question of centres of attraction for industrial development in the case of countries like Argentina, Brazil and Mexico, with industrial bases of fairly similar potentialities and with domestic markets of much the same size.

/The differences

The differences in the individual aptitudes and productive resources of these countries create the risk of too powerful a concentration of future industrial development in only one of the member countries of the regional market, whence a situation unacceptable to the remainder might arise.

2. There are for the moment no grounds on which to determine whether the probable costs of manufacture of a representative list of capital goods are widely different or approximately the same in the various countries of the region, particularly in the three mentioned above as having reached a more advanced stage of industrial development. Clearly, if any one country has developed its engineering and metallurgical industries to a greater extent, an imbalance might conceivably occur in favour of that country. But certain factors, some of which may perhaps be very important, militate against the likelihood that the development of new activities may be over-concentrated in a single country, under the stimulus of entirely free competition.

These compensatory factors comprise, first and foremost, the high costs of transport in Latin America, which constitute a natural form of protection for each country's industry. Secondly, there is the fortuitous nature of industrial specialization in the individual countries. The lines of production that have become established in each are the outcome of a historical evolution which a number of circumstances have helped to shape. Subsequent development cannot be conceived as independent of existing industry, but is bound to be an extension of it, conditioned by its characteristics and its present structure. The various sectors of manufacturing activity cannot operate or come into being as isolated or independent units, since they are all very closely inter-related. Thus, the nature of the new industries to be established is strictly conditioned by that of existing industry; this constitutes a safeguard for the future industrial development of countries like those mentioned here, all of which have fairly well-developed engineering and metallurgical industries.

3. Yet another fact can be adduced in support of this line of argument, specifically in the case of Argentina and Brazil. Argentina's domestic market for industrial goods has been for many years as large as it is at present, since in the course of the last ten or fifteen years there has been

/no marked

no marked rise in per capita income. On the other hand, the considerable size of Brazil's domestic market is the result of substantial increases in the population or in average income during recent years. These discrepancies in the evolution of the two countries seem to have had important repercussions on their competitive strength and productivity. In many branches of the engineering and metallurgical industries - especially those producing durable consumer goods - the arrested growth of Argentina's domestic market seems to have resulted in an increasing intensification of competition among manufacturers, which has a favourable effect on productivity and costs. On the other hand, the steady expansion of the Brazilian market has not exacted a similar effort on the part of producers in that country. For the same cause and with the same effect, many industries which have only recently been established in Brazil, have long existed in Argentina; this is particularly true of durable consumer manufactures, and partly accounts for Argentina's relatively greater facilities in respect of certain kinds of skilled labour.

4. Mention may also be made here of the moderating influence on international competition that would doubtless be exerted by the intensive and unsatisfied Latin American demand for machinery and equipment to which allusion has already been made. Despite the increasing efforts made by local industry, this demand continues unabated, as a result of the high rate of over-all development and the well-known limitations of the capacity to import. If a given line of production is of several years' standing in one of the more highly industrialized countries of the region and no trade barriers exist, it is very unlikely that another country will embark upon the construction of similar plants, even with prospects of lower costs, since there is a wide field open to enterprise in other lines of production. Moreover, a position in the vanguard implies advantages in respect of experience, technical expertise and costs which may be very considerable, and may more than compensate for the high costs of imported raw materials or for less substantial extrinsic savings.

In the Latin American countries - even in those which have reached a more advanced stage of industrial development, and to which these remarks are applicable - various factors come into play which tend to relegate

/comparative costs

comparative costs to a secondary plane. As the region suffers from a chronic shortage of capital in every shape and form, it is much more important to economize on investment or turn it to better account than to bring down the level of final costs. Moreover, in view of the interdependence referred to above, the branches of production that it is most desirable to develop in the country are not always those in which the lowest costs could be achieved in comparison with the figures recorded by the traditional suppliers of machinery and equipment. Applied at regional level, these considerations show that there are other factors which have a more significant bearing than costs on the distribution of new industrial activities in Latin America.

6. In a regional market project confined, at least to begin with, to capital goods and the corresponding raw materials, the problem of the regional distribution of new industries acquires much more importance than in a comprehensive integration formula embracing all industrial goods or all trade items.

The ECLA secretariat is carrying out technical studies, by sectors of industry, which will permit an approximate forecast to be made of the probable costs of several new products when they are manufactured in each of the main industrial centres of Latin America. Of course these studies provide only some of the background data - of basic importance, however - for an analysis which will also have to take into account other factors, such as the industrial activities already existing in each centre and the interdependence of certain lines of production.

The findings of this research will probably determine some important aspects of the regional market formula to be adopted. If they were to show that very marked disequilibria are likely to occur in the distribution of new activities among the member countries, it might possibly be advisable for the regional market mechanism to limit competition to the extent needful to safeguard the future industrial development of particular countries, or for consideration to be given to the idea of extending the regional market to other items - for example, durable consumer manufactures, intermediate products, processed or semi-processed raw materials, etc. - in order to offset any lack of balance in future development and in the volume of trade in capital goods.

/7. The

7. The possibility of such disequilibria also suggests that some machinery should be set up to preserve a proper balance among the member countries' interests. A device of this kind might, however, prove detrimental to the freedom of enterprise desirable in the regional market, and militate against the rational distribution of productive resources. In fact, one of the basic features of the regional market already agreed upon by the Trade Committee is that it should be fully competitive and founded upon the principle of reciprocity among the member countries. This means that new industries ought to be empowered to select the size which best suits them from the standpoint of existing resources and costs, or, in other words, that they should be installed by private enterprise wherever they can be run most economically, with due regard to transport costs within the regional market area.

Consideration would have to be given to the advantages and possibilities of introducing a good deal of flexibility in the operation of the regional market, with a view to making freedom of enterprise compatible with co-operative action on the part of the member countries as regards the geographic channelling of new investment, so that the necessary balance of interests might be achieved.

In this connexion, some of the difficulties arise from the different lines taken in the individual countries of the region with respect to industrial enterprise, and especially from the contrast between the need for prior authorization and the reservation of the market in some of the countries in question, and the complete freedom of enterprise existing in others, where the transforming industries are concerned. As a result of this contrast, one country is quite likely to reject any solution based on a more or less arbitrary distribution of new industries - that is, on mutual reservation of markets, - which might perhaps be acceptable and more easily applicable in some other republic.

3. <u>Bilateral agreements to promote balanced industrial development</u>

1. Even if complete freedom of enterprise is respected, there are probably ways of influencing the distribution of activities which do not entail the exercise of authority. Two solutions, which are mutually compatible,

at least to some extent, might be suggested for this problem. One of these would consist in the conclusion of certain bilateral agreements on the development of sectors of industry or on trade in the goods respectively produced by the parties, which might be combined with a multilateral and non-discriminatory trade system. In the second place, within each country's industrial policy, however liberal its tone, some way of exerting a selective influence on investment can always be found, especially in relation to the development of new sectors.

2. If, in order to abolish internal tariffs by gradual stages, the procedure of the weighted average were adopted for calculating the successive reductions contemplated in the programme, as described in the preceding chapter, the first solution could be applied.

This procedure does not mean that every member country must free the same goods at the same time and to the same extent. The only thing that matters is the average level of tariff reductions attained at each stage of the programme, and every country is left at liberty to draw up its own programme of reductions, so far as the selection of goods is concerned. At the same time, there is nothing to prevent two or more countries from agreeing mutually upon specific tariff reductions which take their reciprocal interests into account and are in conformity with the average levels established under the general liberalization programme. Should it be deemed admissible, a bilateral agreement of this type would have to enbody reciprocal concessions whereby the specific requirements or interests of each country could be met in relation to its own industrial development programmes. Such tariff concessions would not conflict with the general regional market agreement, since the bilateral advantages mentioned would be automatically extended to all the other member countries by means of some such device as the most-favoured-nation clause, and also because their concession would not entail the use of any instrument other than the tariff reduction provided for in the general agreement.

To take one example, Brazil is developing an important motor vehicle industry, and its production of lorries will probably soon exceed its domestic requirements. At the same time, Chile, which needs lorries, is expanding its production of iron and steel, and there is a proposal to set

/up dockyards

up dockyards so that the long steel plates which cannot be completely absorbed by its domestic market can be used for ship-building. In view of this situation, Chile and Brazil could agree upon the total abolition of tariffs and other internal barriers to the importing of lorries in the former country and ships in the latter. The calculation of this abolition of tariffs would be based on the annual average reduction level compulsory for each country. The preference thus established would be accessible to all the other countries in the regional market area, although in practice only the two mentioned would be able to take immediate advantage of it. Such would be the net effect of the preference granted.

There is no reason why arrangements of this kind should be confined to only two countries. To pursue the foregoing example, it may be noted that motive power represents a very high percentage of the cost of a vessel. The manufacture of high-powered diesel engines can be undertaken on an economic scale, however, only when they are intended for other purposes, such as locomotives, etc. Since Argentina has a plant which produces high-powered diesel engines, this country would be drawn into the agreement referred to. Chile would then supply Brazil with boats equipped with diesel engines manufactured in Argentina; Chile and Argentina, on their part, would receive lorries from Brazil. The arrangement would not be a matter of barter or compensation but of transactions which, while forming an integral part of intra-regional trade, were motivated by a system of tariff concessions especially studied for the purpose.

Whether the widespread adoption of agreements of this kind among grade groups of countries and within the general setting of the regional market would or would not substantially help to reduce the risk of unbalanced distribution of new industrial activities, is a question that should be the object of careful analysis.

3. Another more ambitious solution to the problem of the balanced distribution of industries in Latin America might be feasible. This would take the form of an agreement among the member countries as to the channelling - not the arbitrary distribution - of new investment.

Such a procedure would be based on selective methods of industrial development, especially with respect to the capital goods produced by heavy industry and more or less universally employed in all the countries of the region.

/The establishment

The establishment of large industrial enterprises is almost always dependent upon some Government concession, benefit or security. Some countries have adopted a very flexible line of action, inasmuch as such privileges are not given an exclusive or monopolistic character, that is, they are not equivalent to absolute reservation of the market. Elsewhere, on the other hand, incentives are applied in less flexible ways, and prior authorization, which is sometimes accorded on an exclusive basis, is required for the establishment of new enterprises.

Setting aside the different degrees of flexibility characterizing the industrial policy adopted in the various Latin American countries, it seems likely that through the granting of such incentives industrial development could be channelled primarily towards given sectors.

The application of procedures of this type would probably have to continue in each country after the institution of the regional market. Perhaps an attempt should be made to secure their co-ordination on permanent bases.

4. Such co-ordination might perhaps be achieved [1] if decisions relating to large enterprises were taken, as hitherto, for each country separately, but after prior consultation with all the national bodies responsible for the channelling of industrial development. Such consultations would be conducted through the regional market agency or commission and in accordance with the procedure previously agreed upon. In the decisions adopted by each individual country's programming body, certain basic criteria, also agreed upon beforehand would be respected. Through the consultations an endeavour would be made to ensure that new activities producing capital goods were equitably distributed among the member countries. The basic criteria referred to might be the following:

(a) Lowest level of production costs;

(b) Existence of the auxiliary industries necessary in each case;

(c) Need for balanced industrial development in each country;

(d) Creation of complementary sectors of production, with favourable repercussions on production costs; and

1/ The following remarks are intended merely for purposes of illustration and do not imply any specific suggestion.

(e) Balance of member countries' interests, so far as the volume of reciprocal trade is concerned.

In order to facilitate decisions, background data would be assembled in technical studies prepared by some suitable qualified organization.

5. In this process of sharing out activities, some arbitrary element - independent, that is, of the operation of forces inherent in the market itself - might still persist, and might mean that the region's productive resources were not distributed in quite the best possible way. It must be remembered, however, that the alternative to such a procedure is not the optimum allocation of resources, but the pronounced distortion which is inevitable when each country's industrial development is confined within its own frontiers. Furthermore, the optimum allocation in question involves the same elements on which the joint decisions of the regional market would have to be based, i.e., comparative level of costs, similar activities already in existence, etc. Consequently, a flexible parcelling-out of industries within the market area along the lines described could not but be, from the economic standpoint, a great improvement on the present distribution of resources, and might prove lasting even if no agreements were reached as to the creation of a market larger than that of each individual country.

6. Such are the reflections suggested by the possibility of a trend towards disequilibrium in the creation of new industries within a regional market. If the sectorial studies at present under way were to show that no such tendency exists, or if a more careful analysis of the various factors influencing the allocation of industries were to reveal the predominance of decentralizing factors, the question of the regional market and its operation would be greatly simplified.

If, after the analysis in question, misgivings still existed as to the possibility of a strong movement towards a regional concentration of industries, it would probably be desirable to provide the regional market with appropriate decentralizing devices.

Would it be possible to draw up some specific plan for joint action with respect to the non-arbitrary selection of new industrial investment in the market area, along the basic lines described? For this purpose, a more thorough analysis of all the many aspects of the problem would be

/required. However,

required. However, the two courses of action mentioned - complementary rather than alternative - might perhaps be helpful in this context. Bilateral agreements or conventions among small groups of countries might be used as a means of co-ordinating the various individual countries' tariff abolition programmes, which would be directed primarily towards those branches of industry whose short term development was most desirable for each country. The selection and co-ordination of these sectors might be effected with the help of some sort of machinery for prior consultation, based on the instruments with which Governments are provided by selective industrial policy.

7. Co-operative action of this kind might have very far-reaching effects on industrial output for the regional market. Although much greater attention should be devoted to the study of this problem, it is not impossible to give examples of such co-operative action or to note certain sectors in which it could be successfully applied.

In the first place, the iron and steel production of Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela could gradually be rendered complementary. For this purpose, studies would have to be made on the one hand of the variations in the composition of demand for iron and steel products in the countries mentioned and, on the other, of each country's structure of production, which is conditioned by investment characteristics. Research would also have to be conducted on each one's possibilities as regards specializing in certain types of finished products - plate, bars, shapes, etc. -, while it continued to depend upon the regional market for the rest.

Secondly consideration might be given to the preparation of programmes for the re-equipment of specific industrial sectors, and their joint application by the members of the regional market. The purpose of such programmes, which would provide guidance for private entrepreneurs, would be to offer manufacturers of the equipment concerned a broad picture of a particular industrial sector's requirements in all the member countries, which they need in order to plan their future production. At the same time it would enable the member countries to establish, by common accord, the incentives for the manufacture of such equipment. There are, to start with,

/two sectors

two sectors in which the need for a substantial effort to re-equip existing enterprises is most strongly felt:

(a) The textile industry (spinners and looms, and minor supplementary equipment);

(b) The metal trades (main types of machine-tools).

Mention must be made in the third place of the exceptionally favourable prospects that a regional market may offer as regards combined programmes for the equipment of new or the expansion of existing sectors, through domestic manufacturing based on the integration of resources (programmed utilization of the existing means of production). Such programmes might be most appropriate in the following sectors:

(a) Pulp mills;

(b) Equipment for the transport of ores;

(c) Petroleum drilling, extraction and refining equipment; and

(d) Equipment for other plants producing chemicals (fertilizers,etc.).

The three examples cited open up a broad field where particularly good results might be obtained from the programmed expansion of industrial activities distributed throughout the region in proper balance, by means of conventions among groups of countries under a multilateral agreement for the gradual abolition of trade barriers.

4. Domestic markets of unequal size

1. The probability that obstacles to widespread industrial development might derive from the attraction exerted by the more advanced industrial sectors was discussed in the earlier paragraphs of this chapter with respect to the more highly-industrialized countries of the region. Many of the arguments set forth are equally applicable to other countries. However, the factors that generate disequilibrium are undoubtedly stronger in relation to countries which have reached a less advanced stage of industrial development. This raises the question of the precautions that might be adopted in addition to those already mentioned.

There is a risk that countries like Colombia or Chile, and perhaps also Peru, may lag behind their more highly industrialized neighbours because of the small size of their domestic markets. It is the narrow-market factor that characterizes the problem of potential disequilibrium for this group of countries.

/2. The

2. The limiting effects of the country markets would seem likely to disappear if they were merged in another and broader common market thrown open indiscriminately to exporters in all the member countries. A regional market certainly has wider potentialities than those offered to producers in small countries. But from the realistic standpoint, the obstacle implied by the limitations in question should not be overlooked. In order to take advantage of the broad multinational market, producers would in many cases require for some time the support of a corresponding country market. Lines of manufacture originally undertaken on a small scale, in proportion to the narrower of the country markets, would find themselves at a disadvantage, because of their high costs, vis-à-vis producers in countries with broader markets, whose costs would be lower. This difficulty may provo hard to overcome, especially for small-and medium-scale manufacturers with no international connexions, who could gain access to the regional market only by means of slow and gradual expansion. To proceed otherwise - that is, to launch out straight away into manufacturing on a scale proportionate to the size of the regional market - would imply a very considerable element of risk, likely to be incurred only by specific large-scale international enterprises with an organized commercial network in every country to handle the distribution of extra-regional imports, trademarks already familiar throughout the region, and abundant financial resources.

3. The unequal size of the various country markets may not only make it difficult for producers in a country with a small domestic market to obtain a foothold in the regional market, but may also, in the case of those lines of manufacture where there are very marked economies of scale, prevent local producers from capturing their home market in competition with producers in the larger countries of the region.

4. Difficulties of this kind do not seem to be insuperable. In the first place, it should be recalled that much has already been said about the important role played by historical circumstances within each individual country and in the various countries; about the immense pressure of demand for manufactured goods in general and capital goods in particular in all the countries of the region; and about what this implies in the way of a buffer against competition during an initial

/period which

period which may be very long. In countries like Colombia and Chile, moreover, trade enjoys the high degree of natural protection accorded by the difficulty and heavy transport costs. Lastly, there are the possible ways of maintaining the balance of development afforded by the scheme discussed in earlier paragraphs of this chapter. The scheme would be based on bilateral agreements or conventions among groups of countries aimed at the more rapid expansion of trade and the consequent speeding-up of the development of certain industrial sectors.

5. If these factors were deemed inadequate to safeguard the industrial development of Chile or Colombia, consideration might be given to the possibility of making the regional market rather more flexible with respect to the countries mentioned. This flexibility may be achieved through the abolition of internal tariffs or the establishment of a common external tariff, that is vis-à-vis third countries.

Countries like Chile and Colombia, which are handicapped by the small size of their domestic market, might, by way of compensation, be allowed to delay the abolition of internal tariffs in respect of the more highly developed Latin American countries beyond the time-limit agreed upon by the latter. In other words, Chile, for example, would have free access to the Argentine market within a period of ten years, while Argentina would not enjoy the same facilities in the Chilean market until 15 or 20 years had elapsed. Such a provision might perhaps solve the first aspect of the problem of disequilibrium in the competitive positions of small countries· that is, it might defend their domestic market from excessive competition on the part of their neighbours with broader markets and larger-scale industries.

6. The gradual elimination of the discrepancies between the various external tariffs of the different countries, pending the establishment of a common tariff, might also serve as a means of achieving more balanced industrial development in Latin America. For small countries the standardization of the external tariff might probably mean higher import duties on a large number of capital goods. Could not these countries be allowed to postpone raising their tariffs in this way? If so, the result would be that for the time being they could import machinery and equipment on more

/favourable terms

favourable terms than the more highly developed countries of the region. And this would mean that the smaller countries were placed at an advantage as regards the manufacturing costs of articles produced for the regional market, by way of compensation for the narrowness of their respective domestic markets. Whether such compensation is or is not enough could be discovered only by means of a more thorough study of the question.

/Chapter IV

Chapter IV

REGIONAL DISPARITIES IN DEVELOPMENT

1. One of the most serious problems involved in the formation of a Latin American regional market is the existence of very different levels of development among the countries concerned. These differences, measured in terms of *per capita* income, range from 1 to 5 in the case of Paraguay and Argentina and 1 to 3 if the average Paraguay-Bolivia-Peru is compared with the average Argentina-Brazil-Chile.

2. However, such a comparison fails to give a complete picture of regional disparities. In the less developed countries of the area, low *per capita* income is accompanied by a virtually stationary economic situation or, at least, by a less rapid process of development. In fact, this is the main difficulty because, without a vigorous process of development, those countries, will find it difficult, if not impossible, to attract the new industries which the greater scope of the common market should encourage. Furthermore, the really important disparity is that existing between the levels of industrial development in each country for this is much more pronounced than the disparity between *per capita* incomes. The proportion 1 to 2.5 which represents the difference in the *per capita* incomes of Paraguay and Brazil, for example, fails to give even a rough idea of the vastly divergent conditions existing in those countries as regards the expansion of the manufacturing industry. This unfavourable situation must be taken into account when the regional market is established in order not to accentuate existing disparities and, if possible, to help eliminate them gradually.

3. In order to obtain a better grasp of the problem, it may be helpful to indicate certain of the characteristics of the relatively under-developed countries of Latin America which distinguish them from the European countries of the Mediterranean seaboard.

These European countries usually have a surplus agricultural population which may be transferred to industrial activities without causing any decrease in the total agricultural product and without first requiring the introduction of improved agricultural techniques. In the

/Latin American

Latin American countries just mentioned, any large-scale transfer of the active population from agriculture or other primary activities to industry will have to be preceded by the introduction of improved techniques in order to reduce the amount of manpower employed per unit of product, if a decline in the agricultural product or in the product of the other primary activities is to be avoided. In the relatively under-developed countries of Latin America, where there is no regular process of development, techniques requiring additional capital have not been systematically introduced into primary activities, and industrial development is therefore further impeded.

4. As regards communications, the geographical situation of the Mediterranean countries is much more favourable than that of Paraguay or Bolivia, and even of Chile and the other Pacific countries. The difficulties derive not only from their distance from the great trade and industrial centres of the world but also from their isolation from each other.

Finally, economic under-development in general and industrial backwardness in particular are much more pronounced in Latin America than in Europe, both in absolute terms and in relationship to the more developed centres of the respective areas. The difference, for example, between Paraguay and Bolivia, on the one hand, and Argentina and Brazil, on the other, is much greater than between Portugal or Greece and France or Germany. These facts should be borne in mind when consideration is given to the inclusion of the underdeveloped countries in any plan for Latin American integration.

1. <u>The regional market and equalization of development levels</u>

1. The existence of these different levels of development in the area raises an initial question of fundamental importance which is quite separate from any plans for the integration of markets. Undoubtedly, this problem will have to be solved sooner or later, if economic and social trouble spots are not to grow and fester in Latin America. Feelings of solidarity and fraternity throughout the Continent favour a solution. The definition and solution of this problem does not depend on any regional market system. The gradual action necessary to eliminate most of the regional disparities in levels of development and the action necessary to

/encourage intra-regional

encourage intra-regional trade through the integration of markets are in fact quite distinct and may be taken independently.

This does not mean that the formation of a regional market with certain specific features or characteristics will not influence the relative degrees of regional development in one way or another. One regional market project might impede development in the smaller countries, while another carefully worked out plan might encourage it. What must be stressed here is that this inter-relationship between regional integration and the reduction of disparities in development levels is not given the same emphasis in all the suggested integration schemes. It might even be possible to conceive a certain type of regional market which not only has no positive influence but which also has a neutral effect on the development of the less advanced economies of the region.

While it is true that the regional market scheme and economic development at the various national levels may proceed more or less independently of each other, it is no less true that the formation of a regional market offers an exceptional opportunity of tackling the broader problem of balanced development in Latin America.

Thus, the first question to decide is whether to restrict the regional market project as far as possible to the field of trade or to consider it as a framework within which the whole problem of increasing and harmonizing development throughout Latin America may be tackled.

If the formation of a regional market is to be conceived along modest lines, so as to increase the likelihood of its acceptance, it cannot perhaps reasonably be expected to solve the basic and more vast problem of how to promote rapid and orderly development throughout the whole of Latin America. At the same time, all possible precautions should be taken to reduce any adverse effects it may have on the growth of the smaller countries.

Obviously, this question of the market's scope is political rather than technical. However, economic arguments will carry much weight, since it is important to know how the regional market should be conceived so as to constitute an additional means of promoting effective regional development and also to visualize the effect of this more general conception upon each

/country's economic

country's economic policy at home and abroad. The following considerations may perhaps help to elucidate the problem.

2. The decision to consider the regional market as a mere trade mechanism would mean that the plan adopted for the integration of markets should, at the very least, maintain the status quo, as regards regional development, without worsening it.

The regional market might have the undesirable effect of increasing already existing discrepancies in four main directions. Firstly, although the aim might be to extend the benefits of trade to the under-developed countries, in fact, they might not be given a chance to establish their own manufacturing activities, even to supply domestic markets, through their inability to compete without protection with similar commodities of their more industrialized neighbours. In other words, the smaller countries would be unable to accept complete reciprocity in the elimination of internal tariffs.

Secondly, the transforming industries might be perfected and enlarged only in the more developed countries of the area so that the differences in productivity and costs, which hamper exports of products manufactured in the under-developed areas, would be accentuated. If proper safeguards are to be provided for the smaller countries to meet this situation, the regional market should be sufficiently broad in scope to include commodities (foodstuffs, unprocessed or semi-processed raw materials, etc.) which will bring immediate trade benefits to such countries once the barriers to trade have been removed.

Thirdly, the provisions of the regional market agreement should not allow or facilitate the establishment of "centres of domination". This might happen if the larger manufacturing centres so monopolized the supplies of industrial raw materials exported by the under-developed areas as to prevent them from developing other activities based mainly on the manufacture and processing of these same raw materials. Provisions should therefore be included to prevent the formation of monopolies, the application of economic or other pressure in trade relations between member States, especially with the under-developed countries, and, in general, all exclusively bilateral agreements between member States.

/Finally, the

Finally, the unencumbered movement of production factors within the area of integration might attract towards the centres of greater industrial development the capital accumulated in the under-developed countries, which is the opposite of what is desired. Measures to control such capital movements within the area should therefore be carefully studied.

The adoption of safeguard clauses, some of which have been mentioned as examples, may perhaps help to eliminate the adverse effects on the smaller countries of the formation of a regional market which is not primarily designed to accelerate their development.

2. Obstacles to the extended development

1. Assuming that the formation of a Latin American regional market is considered as an opportunity for tackling the whole problem of the less developed countries, its operating machinery will have to be so designed as to make the backward economies of the region more attractive and dynamic.

When products and factors circulate freely, economic development spreads; its effects are felt in the gradual equalization of income levels in the various countries as a result of the factor movements brought about by differences in remuneration. The movements of capital and labour between countries in which factors are highly disproportionate should gradually bridge the gap between their respective average levels of income and, hence, of economic development. The influx of capital from the more developed to the less developed centres under the incentive of increased profits and the exodus of manpower to the more important industrial centres in search of higher wages should tend to reduce disparities in the economic development of the Latin American countries, and the regional market might then play the role of encouraging this liberalization. What has been said about the reduction of disparities at the regional level is also valid for the internal development of a single country.

2. However, there are various obstacles which will probably prevent, to a greater or lesser degree, the automatic operation of this scheme within a group of Latin American countries.

These difficulties derive firstly, from the lack of a suitable organizational structure, of adequate public utilities and of external economies which are essential for industrial development, particularly when competition from other regions has to be faced. Secondly, national markets are small and some countries are at a disadvantage when competing with others because of their industrial handicap. Finally, the automatic spread of development is seriously hampered by the artificial inflation of salaries in the less developed areas due to some institutional cause.

The lack of basic facilities (technical education, suitable, transport, banking organization, etc.) may often prevent the establishment of new industrial activities on a sufficient scale to launch the development process. In certain cases, the provision of such facilities might be a condition imposed on private entrepreneurs, including those who may be attracted from abroad by exceptional supplies of raw materials or by the prevalence of very low salaries. The higher costs involved in additional investments might receive adequate protection. However, in such cases, the external competitive position of similar activities in neighbouring countries having a more complete infrastructure might be prejudiced. In short, the importance of this obstacle depends, to a large extent, on the activities to be developed, since the effect of external economies on manufacturing costs varies considerably in the different lines of production.

The lack of an entrepreneurial class with sufficient drive and experience also impedes the establishment of new industries. It might therefore be advisable to encourage foreign enterprises to extend their activities to the less developed areas so that the latter may benefit not only from capital and plant capacity but also from technical knowledge and experience. The burden now placed on the limited development and administrative capacity of the less developed regions would be eased if, when new activities are created, preference were given to certain basic industries so constituted that they may be organized in a number of large units. Moreover, these activities tend to create external economies for other lighter manufactures.

The smallness of the domestic market in the less developed countries is, in fact a serious disadvantage, although its effects vary with the activities chosen. If national income is taken as a rough indication of the market, it will be found that the largest in South America, Brazil,

/is some

is some 80 times larger than that of Paraguay and more than 50 times larger than that of Bolivia. Few manufacturing industries are likely to maintain a minimum economic scale of operation when faced with such small markets. Unfortunately, industrial activities situated in a less developed country would probably be unable to take advantage of the increased scope offered by a common market without first having established a dynamic and prosperous market at home. In other words, where very small domestic markets are concerned, the time which must elapse before an integrated market is established becomes too great and the risks involved are correspondingly increased.

Because of the characteristics of domestic resources, or for other reasons, industrial development should be based, in certain cases, on complexes or groups made up of complementary industrial activities. The absence of any of the manufactures which make up the complex may cause difficulties of different kinds. In the first place, the lowest costs are those resulting from the complete utilization of all the possibilities offered by an industrial complex. In some cases, an incomplete group of activities may give rise to much higher costs as, for example, in the petro-chemical industry. It may also happen that the absence of certain components of the complex, which take the form of auxiliary industries, constitute an insuperable obstacle for the establishment of certain manufactures. Consequently, all these auxiliary industries must be built up in advance with the result that the investment required will increase and the problem of the adequacy of markets will arise. This is the case with many engineering and metallurgical industries, such as those manufacturing motor vehicles, rolling-stock, etc., which are mainly concerned with assembling elements produced separately in other specialized establishments.

Both this obstacle, arising from the complementarity of many industrial activities, and that previously mentioned, arising from the smallness of domestic markets in the less developed countries, bring to mind the well-known argument of the "vicious circle" in economic development. New and large-scale investments are impossible because of the smallness of markets which remain small because of an insufficient volume of investments.

/The solution

The solution seems to lie in an investment policy applied simultaneously in various sectors for the purpose of creating, after a short period of forced growth, a market of the necessary size and complementarity for the continuation of development.

3. This question should also be considered from another angle. The progressive reduction of differences in levels of development through the free circulation of production factors would be the result of two combined phenomena: the acceleration of the rate of development in the less developed countries and deceleration of this rate in the more advanced countries. The latter are striving to increase their rate of capital formation, which is essential for maintaining the tempo of their development threatened as it is by the unfavourable behaviour of the external sector. How would these countries react to the application of a procedure whereby certain capital would be transferred to their less developed neighbours, so that their own rate of development is slowed down? Moreover, would they not be further prevented from accepting such a procedure by the fact that extensive and relatively under-developed regions still exist within their own borders?

In this respect, it must be remembered that the transfer of capital necessary to embark upon a more homogeneous scheme of regional development would be relatively small. The difference in per capita income levels between the nucleus of under-developed countries in Latin America and the others may be assumed to be 150 dollars. The nucleus in question would consist of five countries (Bolivia, Ecuador, Haiti, Nicaragua and Paraguay) whose national income is 3 per cent of the total for Latin America. What would happen if the other Latin American countries, i.e., all those having a per capita income higher than 150 dollars, were ready to accept the annual transfer of no more than 1 per cent of their national income to their less developed neighbours?[1/]

1/ This transfer may be spontaneous (capital attracted by the higher profits which accompany their greater physical productivity in the under-developed centres) or effected by some form of regional co-operation; the specific means of transfer is not important at the present stage.

/In view

In view of the large number of Latin American countries whose per capita income is higher than the level stated, 1 per cent of their national income would yield a very high rate of additional investment in the five less developed countries, equivalent to 34 per cent of their national income.

If the criterion of selection is broadened so as to include all countries whose per capita income is below 200 dollars, the nucleus of less developed countries would cover four more: El Salvador, Guatemala, Honduras and Peru. This larger group would represent 9 per cent of total national income for Latin America. One per cent of the national income of the other more advanced countries would yield a total additional investment in these less developed countries equivalent to 11 per cent of their national income.

However approximate they may be, these figures indicate that, under present conditions in Latin America, a system may perhaps be worked out to foster economic growth in those countries which tend to lag behind. It would be based on an investment pattern designed to stimulate development and the more advanced countries would participate in a way which is more than merely symbolic of continental solidarity.

It would be easier to secure acceptance of this responsibility if the near future revealed a more favourable trend towards capital formation in the more advanced countries or if there were clear signs that the political situation was developing in that direction. This is a problem which must be carefully analysed in all its aspects, since some of them may not be expressed in purely economic terms.

4. In view of all these obstacles, it seems unlikely that the immediate future will see an automatic upsurge in the industrial development of the less advanced countries merely as a result of the removal of restrictions to the free movement of capital and labour. Such an objective may perhaps only be achieved after deliberate planning based on clear and precise agreements negotiated within the area of integration.

These measures for achieving a more rapid and balanced development throughout the whole area of the regional market may be envisaged in two distinct ways. One solution might be based on an allocation of markets for certain commodities among the member countries, in accordance with a given criterion. Another solution, designed to change only partially the free play of market forces, would consist principally in providing

/indirect incentives

indirect incentives, for example, the elimination of tariffs on certain products in favour of the under-developed countries. However, both solutions seem to require in addition a long-term financial institution to handle projects designed to promote the economic development of such countries.

3. Market distribution

1. In accordance with a pre-arranged plan, the various members of the regional market, recognizing that countries like Bolivia and Paraguay (chosen here merely as examples) would be placed at a competitive disadvantage, would agree to allow them unilaterally to develop certain industries with the right to sell their goods in all the national markets which make up the regional market. Such industries would be those in which costs and other production factors are cheaper in each of the under-developed countries, because they use local raw materials, require a high proportion of manpower, operate more or less independently of auxiliary industries or because of a combination of all these factors. Their establishment would be financed by an investment fund or bank created especially for this purpose. The disposal of their goods on the regional market would be guaranteed by virtue of an agreement in which all the other member countries would undertake to remove all the obstacles to their entry into the respective national markets and to refrain from manufacturing similar products within their territories during a certain number of years.

This allocation of guaranteed markets for the manufacture of certain goods, which would be selected after careful study of the local conditions in each less developed country, would have the advantage of avoiding the concentration of new activities, stimulated by the regional market, among a very restricted number of industrial centres, all situated within the more advanced countries. After a number of years, the activities started in the under-developed areas could continue without their initial privileges, competing with similar industries launched in other countries. Meanwhile, other minor activities might grow up around the industries established according to this exclusive system and enjoy the protection of the external economies which have gradually accumulated. In this way,

/the regional

the regional market could start a complete cycle of economic growth in the more backward countries.

Of course, a solution of this kind, based on the mutual allocation of markets, may be visualized with different degrees of control. The choice of the goods to be included in such a system, as well as the decision to start their manufacture in the less developed countries, may be left to private enterprise, and the periods allowed for market allocations may be neither uniform nor very long, but can be worked out in the light of the particular situation of each product.

2. In certain extreme cases, control might be reduced to a minimum, being restricted, for example, to certain tariff combinations, both internal and external, designed to produce a <u>de facto</u> preference in favour of certain countries for the development of certain activities.

Some of the less developed countris of Latin America posses mineral resources of non-ferrous metals in exceptionally favourable natural conditions. At present, these minerals are exported without processing to the more developed centres, mainly outside Latin America. At the same time, the consumption of non-ferrous metals (tin, zinc, copper and lead) has been increasing very rapidly in the industrial centres of Latin America, a fact which induces the more developed countries of the area, especially Argentina and Brazil, to mine and transform their own minerals, which are nearly always of lower quality.

The growing consumption of non-ferrous metals in Latin America might well serve to foster primary production and transformation, i.e., smelting and refining, in those areas which are naturally better endowed and which are precisely those most requiring a stimulus to their industrial development (Bolivia, Peru, etc.).

What measures may be adopted to avoid excessively rigid control? To ensure the transformation of these raw materials in the smaller countries, it may perhaps suffice if all the more advanced countries of the area agree to adopt a fairly high tariff applicable to imports of these raw materials and of the products resulting from their primary transformation shipped from outside the regional market. At the same time, in the interests of developing their secondary transforming industries, they might also

/confer a

confer a higher degree of tariff protection on many finished products of non-ferrous metals thus guaranteeing an increasing consumption within the regional market of raw materials and of the products resulting from their primary transformation.

As the result of such incentives, and without any rigid market allocation, the industrial transformation of certain non-ferrous metals might well be effected in the less developed Latin American countries. For this purpose, the natural advantage of using local raw materials, the high costs of their transport within the regional market area, the tariff protection against imports from abroad and the slower reduction of internal tariffs on unprocessed raw materials than on the products resulting from their primary transformation would suffice to allow such industries to be started on a sound economic footing in the less developed countries. The establishment of industries for the primary processing of non-ferrous metals in countries like Bolivia, Peru, etc. would be encouraged by the fact that industries of this type do not require so many external economies as the usual manufacturing industries. On the contrary, certain secondary industries might later be developed around those initially devoted to the refining and primary processing of copper, tin, zinc, etc. and enjoy the protection of the external economies gradually produced by these activities. A scheme of this type might perhaps be applicable to other products, mainly from among those raw materials or other primary commodities which the more industrialized countries of the area are consuming in increasing quantities (petroleum, etc.).

3. The flexible procedures for the gradual reduction of internal tariffs and the standardization of external tariffs would enable the scheme just outlined to be put into practice. The more advanced countries should reduce internal tariffs on semi-processed products more rapidly and on unprocessed raw materials more slowly. As regards external tariffs, the countries should first reach an agreement concerning the minimum external levels required to encourage primary processing activities in the less developed countries and, secondly, the more advanced countries should undertake to bring their tariffs nearer to the uniform external level

more rapidly, since in practice this is tantamount to raising them in the case of the items mentioned. In these circumstances, the only matter for rigid control would be the establishment of tariffs which are sufficiently high, as compared with abroad, in the other member States and particularly in the more developed ones, so as to render uneconomic competition with the less developed areas in the supply of the regional market as a whole.

4. The solution of the problem of the under-developed countries within the regional market, by means of market allocations, would ensure a certain degree of bilateral balance in the exchange of manufactured goods within the area. The advantages would then be more evenly distributed and there would be less danger that the operation of the regional market might reproduce in Latin America the traditional international division of labour, whereby certain countries become manufacturing centres and others are doomed to remain suppliers of raw materials and other primary commodities.

Although any plan for allocating markets as a means of protecting the subsequent industrial development of the under-developed countries undoubtedly would have the above advantages, it is very important to evaluate the cost of securing them in terms of the inefficient distribution of resources within the area. Distortion may occur wherever bilateral equilibrium does not reflect the natural aptitudes, resources and productive facilities of each country throughout the region. Even in a modified multilateral system, where, for example, the balancing of each country's terms of trade with the region is a condition of agreement, any requirement involving the barter of manufactured goods between pairs of countries may bring about a serious distortion in productive resources within the area of the common market. However, such distortion might be considerably lessened if the distribution of the new industrial activities is planned on a regional basis and if existing conditions of costs, etc., are taken into account less than those which might arise within a reasonable period of time.

5. The unilateral granting of market allocations in favour of the under-developed countries also involves other considerations. On the one hand, it would require some limitation of the free enterprise which has so far

/prevailed in

prevailed in the more developed member countries. On the other, essential negotiations on the choice of products to be exclusively manufactured in the under-developed countries might reveal marked differences between groups of private interests and between countries, which might seriously jeopardize the operation and even the success of the regional market, besides putting the less developed countries in a difficult position. In this respect, it should be remembered that in Europe, where the feeling of solidarity and basic unity of purpose appears now to be very strong, the measures promulgated or suggested for facilitating the integration of the underdeveloped countries in plans for economic union, have been far from creating market allocations in their favour. Finally, this solution to the problem of the under-developed countries might require a controlling body for the regional market, with wide functions and powers, to administer the market allocations (advance study, granting of authorizations, their control, etc.).

4. Temporary waivers, indirect incentives and financing of development

1. Another method of tackling the problem of balanced regional development would be to draw up, in favour of the under-developed countries, a series of temporary waivers and indirect incentives designed to offset their relative disadvantages.

Some of the indirect measures which might be applied for the purpose of stimulating the economic development of the currently less favoured areas are given below. As the possibilities in this field are extremely numerous, these mentioned here are purely illustrative.

2. One possible indirect method would be to grant the under-developed countries a series of temporary exemptions from the obligation to lower internal tariffs in respect of certain products to be chosen after prior study. Such concessions would be unilateral, i.e., the more advanced of the regional market countries would not be free to eliminate within the agreed periods their own import tariffs on these same products. Thus, the more backward of the regional market countries, which are preparing to begin production of a limited number of such goods, would be able to dispose of

/them freely

them freely within the common market without being compelled in return to open their own domestic markets to similar products produced in neighbouring centres. The concession would be negotiated collectively and its duration, though temporary, would be long enough to allow the consolidation of the activities concerned in the less industrialized regions.

It may be useful to examine how a measure of this kind could fit into a scheme designed to eliminate internal obstacles, such as that previously described.[2/] The less developed countries would enjoy a measure of flexibility, as a result both of their classification in a group which would be given a longer period for abolishing internal tariffs and of the possible negotiation of bilateral agreements, within the multilateral system, on the specific products to be included annually in tariff reductions. It might be assumed that three groups of countries are established which are required to eliminate their reciprocal tariffs by gradual stages, and within periods of ten, fifteen and twenty years, respectively. If the annual incidence of tariff reductions had to be the same for each and every intra-regional trade item, the difference in the time limits would mean that the percentage tariff reduction effected by the more developed countries (group I) would be double that of the less developed countries (group III). However, the fact that the reductions could be effected more rapidly in respect of some items than of others (since they are applied to a weighted average), the way would lie open to adjustments which would induce the more developed countries to agree that those at a less advanced stage should adopt a slower tempo of tariff reduction than the average for all those goods which they are thought to be eventually capable of producing.

3. Clearly, this solution will be effective only if, in the case of the goods benefiting by concessions the domestic markets of the less industrialized countries are big enough in themselves to enable activities established there to enter production and to develop sufficiently to sustain competition later on with the more advanced centres, both in their own and in other markets.

2/ See chapter II, section 4.

In view of the narrow domestic markets of countries like Bolivia or Paraguay, this reservation strictly limits the number of products which may be included within a flexible scheme of the kind described. However, for a country like Chile, where the smallness of the population is partly offset by the high level of *per capita* income, and where several branches of manufacturing industry have attained marked degree of development, an arrangement of this kind may provide sufficient protection against competition from Argentina, Brazil and Mexico.

The device analysed in the foregoing paragraphs is merely a way of enabling the less advanced countries to initiate a development process under customs protection within a customs union. The arguments for and against such a solution are, *mutatis mutandis*, the same as those adduced with regard to "embryo industries", including those in the more developed countries, and there is no point in repeating them in the present report.

It is enough to recall the main alternative to this method of tariff protection as related to industrialization, which consists in direct subsidies to the sectors and undertakings whose promotion is considered desirable, to be allocated in this case, however, out of regional funds.

4. The development of the smaller regional market countries and, particularly, their industrial development, may also be stimulated by appropriate application of the method of standardizing external tariffs already mentioned. Such a method takes the form of a gradual narrowing of the gap between each country's tariff and the universally accepted common tariff, the annual reductions of this difference affecting a weighted average of the duties concerned, just as in the case of domestic tariffs. In this event, it would be to the interest of the less advanced countries, which do not intend to develop a capital goods industry for want of the essential prerequisites, to postpone raising their national tariffs on imports of such goods to the level of the common tariff until the final phase. Of course, it is assumed that in these small countries standardization would mean an increase in their previous tariffs since, their purpose being to protect domestic production, the tariffs in question would certainly be lower than those of the more developed countries and then the

external common tariff rates.[3] It would thus be possible for the less developed countries to maintain relatively low tariffs on imports of extra-regional capital goods for a period of ten or fifteen years. During the same interval, in the more developed countries, similar imports (if they came from outside the regional market area) would be subject to higher duties from the outset, since the countries referred to would wish to protect and stimulate their own production of such capital goods, and those they manufactured would inevitably be more costly than imports from foreign industrial centres. This would mean that for a long time the smaller countries would have an opportunity to import capital goods which would be considerably less expensive, and perhaps also, in some cases, of better quality, than their counterparts available in the more advanced countries of the area. Thus, on the basis of these capital goods, the smaller countries in question would have a chance to develop certain manufactures of finished goods that could compete in the regional market. An initial advantage of this nature, reflected in lower equipment costs, might perhaps largely offset the other handicaps to which the less developed countries are subject.

5. Whatever solutions were considered preferable, and whether they were based on some form of market allocation or were of the flexible and indirect type, some source of long-term financing for development projects, with a special eye to the requirements of the less developed areas within the regional market, would probably be needed too. This problem of the international financing of economic development has been fully discussed in recent years, and there is no reason to repeat all the arguments here. The present report will merely put forward a few considerations directly concerned with the specific aspects of this problem, as they affect the regional market.

6. In the first place, the less developed areas of the regional market lack adequate public services - transport, public health, etc. - and priority will have to be given to investments designed to establish them.

3/ It is possible, however, that for fiscal purposes very high tariffs on capital goods may exist in these small countries. In this case the assumption in the text would not be valid.

/In many

In many cases, directly productive investment - the installation of transforming industries, for instance -, could not be effected with any prospect of economic operation unless the external economies represented by these public services were first achieved. In other words, the institution set up to provide long-term capital would have to fulfil the twofold function of financing the creation or improvement of public services and the establishment of directly productive activities. Alternatively, two institutions might be formed, one to meet each of these needs. The first solution would involve the difficulty that the two types of financing are different and require different procedures. This difficulty is clearly reflected in the opposition invariably raised by international financial organizations to any proposal to broaden their responsibilities, so as to include ambitious infrastructural projects. The second alternative is perhaps more acceptable from the technical point of view. However, thought must be given to the question whether the promotion and financing of these basic services does not lie outside the aims and limited means of a regional market project conceived on the modest and realistic lines which would seem to be essential for its success.

7. Logically, then, if tariff and other special concessions are to be granted to the less developed countries within the framework of a common market agreement, for the purpose of stimulating their transformation industries, the countries concerned should adopt a sufficiently broad and energetic programme for the development of their public services and of certain primary activities, particularly agriculture. The programme should be the responsibility of the country itself and of the international organizations (or organizations in certain more advanced countries) which are specifically concerned with technical assistance. Would there be any point in applying a series of unilateral measures designed to encourage the manufacturing industry in a national economy with all the unfavourable characteristics of underdevelopment and, moreover, in the very midst of a phase of economic stagnation? This question appears particularly important if the intention is to develop sectors of the mechanical and metallurgical

/industry for

industry for the production of durable consumer goods or some of the more rudimentary capital goods (agricultural machinery and tools). However, it also seems to apply, in varying degrees, to the other sectors of industry.

One proposal, therefore, which might well be considered is that the regional market agreement should comprise a series of such special concessions to the underdeveloped countries, planned along either of the two lines suggested, and with due regard, inter alia, to the various aspects of the problem alluded to above. However, the effective application of these measures to any given country should perhaps be dependent upon the preparation or initiation of some programme designed to strengthen the economic infrastructure of the country concerned, and sponsored by the Technical Assistance Administration of the United Nations and/or the large industrialized countries. Probably it might prove feasible for the more developed Latin American countries (Argentina, Brazil, Mexico, etc.) to be given an equal share of responsibility in such regional programmes of co-operative development, especially as it has already been suggested[4/] that the participation of these countries might constitute more than a symbolic gesture of American solidarity. However, a point to which thought should be given is whether the main responsibility might not necessarily have to be assumed by those non-Latin American institutions and countries to which reference has just been made.

8. This problem of the basic services, necessary for the success of any effort to create productive resources underlines the importance of what might be regarded as a division of the development process into two stages. The first stage is characterized by the lack of essential public utilities, and by the marked prevalence of all the obstacles to the automatic spread of development already mentioned.[5/] The only way out of this economic deadlock would seem to be a comprehensive and unremitting effort to establish an integrated system of basic facilities. Once reasonable progress has been made in this direction, a second phase of the development process can be initiated with increasing stress on the automatic propagation

---

4/ See the present chapter, section 1, paragraph 3.

5/ See section 1, paragraph 2.

/of development

of development through the free movement of manpower and capital. During this stage, i.e., the difficulty of the acute shortage of public services has been overcome, it might perhaps be reasonable to expect an influx of capital and enterprise from abroad or from the more developed centres of the area, attracted to the underdeveloped areas by the abundant supply of raw materials as well as by the advantages of lower wages and of the flexible machinery for the standardization of external tariffs, as they affect the initial cost of machinery and equipment. Could such advantages and incentives, during this stage, provide sufficient inducement for foreign enterprises to begin manufacturing activities designed to supply the whole of the regional market area? If the answer is in the affirmative, a logically-conceived development programme could, up to a point, be put into effect when the obstacle represented by the almost complete lack of external economies had been in the main removed.

9. Another difficulty which must be considered is that the regional market area would be short of the convertible foreign currency necessary for the operation of an investment body on orthodox lines; while, at the same time, the more developed countries outside the region and existing international financial organizations might be reluctant to collaborate in any project deemed ambitious. This difficulty may perhaps be overcome or at least mitigated, if the problem of long-term financing within the regional market is considered from an angle other than the traditional standpoint. In this respect, two points may be put forward for further study.

10. The first suggestion is based on the usual method of preventing or counter-acting the trend towards disequilibria among the various regions of a particular country. Taxation, especially income tax, is generally used in this case as a means for the internal redistribution of national income. The Government collects taxes in the areas with a high income level and invests them in public works in the less developed areas which tend to lag behind the rest, with a view to substituting this form of action for an automatic development propagation mechanism, or, at least, to creating favourable conditions for the latter's operation. Could not the same arguments which justify this procedure at national level be adduced in favour of its application on the international or regional

6/ See section 1, paragraph 1.

plane? It might be possible to establish an investment fund for the development of the less advanced of the regional market areas or countries, which would be continuously fed by contributions from the more advanced member countries, determined, by mutual agreement, in proportion to their national income (1 or 1/2 per cent of this, for instance) or in accordance with a formula which would take account of the per capita income level. Of course, there are many difficulties connected with the practical operation of such a system of financing, among them the question of its acceptance by all member countries. But perhaps the idea of some such solution should not be rejected out of hand before careful consideration has been given to all its aspects.

11. A second suggestion, which should perhaps be further analysed, is that which seeks to relate the financing of development directly with bank credit to intra-regional exports of capital goods. It is impossible to envisage a regional market in which manufacturing production plays a major role, without the adoption of special banking measures in support of intra-regional exports. The experience of the more advanced countries bears this out. Medium- and long-term financing might, then perhaps be linked with the execution of development projects in the countries of the area, especially those at a less advanced stage.

This concept of financing development by means of export credits might possibly help to simplify the problem and remove the obstacles and objections to the establishment of a regional investment body.

12. Of course, the above observations do not constitute an exhaustive analysis of the problem of financing development in the event of the creation of a Latin American regional market. They are put forward with the purpose of inviting criticisms and comments which may help to direct such an analysis along more accurate lines.

/Chapter V

Chapter V

CAPITAL REQUIREMENTS AND EXTRA-REGIONAL COMPETITION

The problem of additional capital needs, which suggests the desirability of establishing a long-term investment bank or fund, is two-fold. Means must be found to accelerate the development of the more backward member countries and also to satisfy the increased capital requirements of the industrial centres consequent upon the enlargement of the market. The first question was considered in the previous chapter and will be dealt with again more thoroughly when the various possibilities as regards regional market institutions are analysed. The second is discussed below, and arises in connexion with another matter of great importance for the proper functioning of the regional market, namely, competition from foreign enterprise in relation to the inflow of external capital.

1. Additional capital requirements

1. The merging of national markets will mean that as a rule, industrial undertakings will have to be bigger, in order to benefit from the increased size of the common market. For the same reason, capital investment will have to be higher. Moreover, in many cases, the expansion of markets will probably involve the use of production techniques with greater capital density than would have been economically justifiable before their enlargement. This development, in turn, also helps to increase capital requirements.

2. Actually, Latin American entrepreneurs, even in the more advanced centres, will not find it easy to reap the benefits of market expansion because of the shortage of capital. This circumstance, in combination with the uncertainty deriving from inadequate knowledge of neighbouring markets which have been merged into the regional market and with the high transport costs prevalent in the area, might give rise, in greater or lesser degree, to the proliferation throughout the member countries of small and relatively inefficient enterprises which are unable to take

/advantage of

advantage of the enlargement of the market.

As one of the major obstacles to industrial growth in these countries is the lack of investment funds, the probable opposition of industrialists in the more developed Latin American centres to a regional market scheme without provision for the opening-up of new sources of capital is understandable. Undoubtedly, in so far as the operation of the regional market will accelerate Latin America's economic development, the maintenance of the same rate of capital formation as before will increase investment funds. However, this does not solve the problem, firstly because such funds would be used for the expansion of undertakings interested in the regional market before this latter began to yield results in the shape of increases in productivity and real income, and secondly because savings increments would have to be channelled towards the industrial sectors concerned with manufactures for the regional market. And the keener the competition between the corresponding enterprises in the various regional market countries, the more pressing would their capital requirements become.

3. It would seem essential for the entry into operation of a regional market to be accompanied by the opening-up of new sources of capital, since market integration, if all its potential advantages are to materialize, must lead to the intensification of industrial development. The additional requirements include both foreign and domestic capital.

Any increase in investment resources in local currency depends on the rate of capital formation within the economy. The procedures for speeding up this rate are related to over-all economic development policy, a subject which is beyond the scope of the present report. However, there are certain institutional measures which may immediately promote the channelling of national savings towards investment in industry. They include provisions aimed at strengthening domestic capital markets, such as control of stock companies' new issues of capital; promulgation of legislation for the protection of small and medium shareholders, i.e., those who have no part in the actual management of enterprises; creation of tax incentives to long-term investment within the capital market, etc. Such measures would strengthen the capital market in most Latin American

/countries sufficiently

countries sufficiently to enable enterprises connected with the regional market to increase their capital by selling shares. Moreover, at a later stage, it might also be possible to link Latin American capital markets with one another and with those of the more developed countries. Hence it would be necessary to promote not only the substantial development of capital investment on each country's security market as a normal practice, but also the relative standardization of security market procedures and greater freedom of capital movements within the area and vis-à-vis the more developed centres.

This is a difficult problem, but the field is one in which steady co-operation on the part of the Latin American countries interested in building up a regional market might perhaps yield positive results in a fairly short time.

4. As regards foreign capital, it is to be hoped that the better opportunities afforded by the expansion of the market and the adoption of a liberal economic policy in the integration process will considerably increase the inflow of private capital designed primarily to finance industrialization in the countries of the region. Development along these lines would be all the more welcome because the new trends observable in international capital movements clearly show that foreign investors bring not only capital but also experience, technical knowledge and drive.

5. The entry of larger amounts of private foreign capital has the advantage of reducing the pressure exercised by the acceleration of industrial and over-all economic development on a country's international means of payment. However, it does not solve the other problem, namely, the need for greater resources in the shape of foreign currency, or of equipment that has to be imported, which affects domestic entrepreneurs [1] in every one of the regional market countries.

1/ The term "domestic entrepreneurs" is taken to mean those established in the country without effective financial connexions abroad, regardless of their actual nationality.

/Indeed, if

Indeed, if a country has payments difficulties so serious that they impede free importation of the machinery and equipment necessary to increase and improve its production for regional market purposes and enable it to face greater competition in the market in question, domestic enterprises may find themselves at a serious disadvantage.

2. Competition from extra-regional enterprises

1. The problem of capital requirements should therefore not be separated from the increased possibilities of entry which the regional market may offer to foreign enterprise, and which will involve domestic producers in kneener and more unequal competition. The shortage of capital and, to a certain extent, lack of information with respect to neighbouring markets are limiting factors which do not affect large extra-regional industrial groups in the same degree.

Such groups may initiate activities not only in new lines of manufacture but also in industries already existing in the region, which are in the hands of domestic industrial groups and are organized on a small scale and with a relative lack of technical knowledge. In these circumstances, foreign aid appears highly desirable as a means of stimulating the region's embryo activities which are undergoing a difficult and gradual process of expansion conditioned solely by the domestic market concerned. However, if some degree of competition which allows of natural selection and the consequent elimination of the unfit is admitted in principle, would it not be advisable to consider very carefully the desirability of conferring a measure of protection on existing domestic enterprises?

2. Such competition also exists today within the domestic market, in degrees varying in accordance with the regulations in force in each country as regards the authorization of new industrial activities and the entry of foreign capital. However, even if complete freedom of initiative prevails at the national level and there is a complete absence of discrimination against foreign enterprise and capital, obstacles to such competition always exist.

In the first place, it is an important fact that domestic enterprises often satisfy the whole or a large part of the market, but would cease to do so after the various markets of the area had been integrated. Moreover, large undertakings invariably request Governments to grant them certain special advantages or facilities - industrial credit, exchange quotas, etc., - which restrict complete freedom of enterprise.

In the case of large multinational industries, would not the formation of a Latin American common market help extra-regional enterprises to overcome these obstacles and establish themselves in the region in open competition with local enterprises? For very large industries in which capital density is high and experience and technical knowledge are of decisive importance, location appears to be relatively a matter of choice. Extra-regional groups might therefore circumvent the precautions taken by countries to safeguard their existing industries by establishing similar plants in neighbouring countries, even with absolute disregard of the rational distribution of productive resources throughout the region. This possibility is of course purely hypothetical, and is only suggested here by way of illustrating the argument.

3. The problem of relative protection of domestic production may perhaps be tackled simultaneously from two angles, which are suggested here as topics for consideration. New sources of financing for regional entrepreneurs might be opened up, and a flexible system for the selective limitation of new extra-regional enterprises might be instituted.

It is not easy to construct a solution on either of these two lines. Discrimination in favour of domestic entrepreneurs would be difficult to justify, whether new of traditional sources of industrial financing were used; and scant grounds for the establishment of any system of prior authorization for new industrial activities are afforded by the liberal practices adopted in certain Latin American countries.

4. The protection of domestic enterprises might be achieved by the adoption of various provisions which would form part of the regional market agreement. A single example will suffice. It might be stipulated that before new foreign investment is placed in sectors of activity included within the regional market scheme, an appropriate regional agency should give a ruling, taking into account the existence of similar industries in

/the member

the member countries and the possibility of expanding these industries sufficiently to supply the common market. Such rulings might perhaps be based on the criterion that priority should be given to the association of extra-regional enterprises with domestic capital and preferably with similar domestic enterprises already in existence. The final decision, however, would always be the responsibility of the member Governments.

3. Co-ordination of incentives to new enterprises

1. Another problem, closely related to the foregoing, is that of regulations for the establishment of new industrial undertakings in the various member countries, especially as regards incentives.

The legal provisions governing the entry and investment of foreign capital vary widely in the different countries which would constitute the projected Latin American regional market. Might not this diversity militate against equitable economic integration? Without an agreement between the countries concerned to the effect that foreign investors should be offered more or less uniform conditions throughout the region, their efforts to provide powerful inducements for large industrial undertakings from abroad might result in a kind of competition which seems clearly incompatible with the procedure for the establishment of the regional market on the basis of balanced distribution of the new activities among all the countries of the region, agreed upon at the first session of the Trade Committee. Such a distribution should be the outcome, not of unilateral or bilateral decisions to divide markets among the interested countries, but of free competition in producing and trading those goods which, by common agreement, are included in the regional market. One way of achieving this might be to determine the number of categories of goods included in conformity with the aim of attaining a certain balance in the distribution of the new activities and with probable comparative costs of manufacture in each country, in the light of appropriate technical and economic studies carried out beforehand. Would not such a procedure be invalidated if the present dissimilarities in legislation with regard to foreign capital were to persist, and still more so if the existing regulations were arbitrarily amended after the regional market had begun operations?

/The same

The same considerations seem applicable, mutatis mutandis, to all measures devised as incentives to industrial activities - tax exemptions, lifting of import duties on equipment, etc. - irrespective of the nationality of the capital invested.

2. Hence, in order to ensure the success of any regional market scheme, might it not be desirable to standardize to some extent the regulations governing the investment of foreign capital and the general incentives granted to industrial undertakings? If so, the best approach would be to take cognizance and make a comparative analysis of such regulations and incentives in the countries of the area from the point of view of their impact on industrial development and costs. During a second stage, the way might be prepared for a preliminary standardization of the regulations in force in the regional market countries, perhaps on the basis of two alternative systems, one more liberal and the other more restrictive, which might be discussed by the Working Group on the Regional Market and the Trade Committee.

Chapter VI

PAYMENTS AND THE BALANCE OF COMPETITION

The payments problems which may arise from the liberalization of trade in Latin America, from the formation of the regional market, or from the relationship between these two phenomena, appear to be of two distinct types. Firstly, there are those which may be caused by the increase in the volume and changes in the structure of intra-regional trade resulting from the removal of trade barriers and, to a lesser extent, from the development of new export activities in the area. Since the degree to which each country's balance of payments is stabilized may alter substantially, methods of reconciling equilibrium with the development of inter-Latin American trade must be analysed. The first type of problem is related more closely to the liberalization of traditional commodity trade and to the possible gradual formation of a free trade area than to the regional market. In its initial stages, the latter would be unlikely to give rise to a volume of transactions comparable with that registered in traditional trade.

/Secondly, consideration

Secondly, consideration must be given to the problems deriving from the competitive situation among the member countries as regards their exports, irrespective of the volume of transactions and the balance of payments. Exchange manipulations in a given country, whether or not they are designed to stabilize its balance of payments, may modify the intra-regional terms of trade for the goods exported by other countries in the area, with the consequent risk that those whose interests suffer may resort to reprisals that would jeopardize the very survival of the regional co-operative system. Problems of this nature are more likely to arise in connexion with the operation of the regional market, although they may also become fairly serious in respect of competitive goods under any independent liberalization programme.

1. Regional payments equilibrium

1. The next problem to be analysed is that of payments equilibrium, after new trade channels have been opened up. The question is how stabilization of the balance of payments in each member country may be reconciled with trade liberalization without detriment to levels of employment.

Should existing conditions permit, procedures similar in their essential features to those which have proved their worth in other parts of the world would have to be applied in Latin America. Experience suggests that for the members of an economic integration system importance would attach only to the aggregate equilibrium of their balance of payments as it related to their trade as a whole, not in respect of trade with the other members of the integration area. It is natural that disequilibria should occur in intra-regional trade, but, provided that the over-all balance of payments were stabilized, such internal disequilibria would be offset by equivalent disequilibria in the opposite direction in trade with the rest of the world. The methods used to maintain each country's over-all payments equilibrium would preferably be those of traditional monetary policy, i.e., control of internal price levels, manipulation of the external value of the currency, or both.

2. The application of these principles is of course dependent upon three prerequisites. Apart from temporary fluctuations, equilibrium in each

/country's total

country's total payments should be an accomplished fact; bilateralism should have been superseded within the integration area; and each country's financial situation should be such as to enable the main emphasis to be laid on monetary measures.

Although these conditions do actually exist to a greater or lesser extent in other areas where integration is being attempted, especially in Western Europe, they are not found in Latin America, where, in the first place, there is a chronic trend towards disequilibrium in each country's total balance of payments which is partly due to the actual character of the economic development process. Although everything seems to indicate that nearly all Latin American countries are redoubling their efforts to tackle this situation, it is perhaps unlikely that present trends will be reversed in the predictable future. Secondly, bilateralism still prevails in the relations between a large number of these countries. To be sure, the need for bilateral equilibrium in each country's intra-regional payments would soon disappear as a result of the regional system of multilateral compensation of account balances which is in course of preparation. But the bilateral trade system has held sway for so many years that comparative costs within the area have been lost sight of. These costs no longer reflect the rational distribution of productive resources throughout the region but the distortions in production which have gradually come about as a result of the separateness of individual markets and the need for trade equilibrium between pairs of countries. Finally, the internal monetary situation of the countries concerned does not encourage the hope that application of monetary measures would be completely successful. Recourse to such measures to stabilize the balance of payments is hampered in each country by the want of fuller official control over the internal monetary situation and also by the under-developed and outmoded character of the traditional instruments of monetary and fiscal policy.

3. Hence it is clear that the structure of trade and payments in Latin America is very different from that found in other regions. The Latin American countries show a trend towards protracted disequilibria in their aggregate balance of payments. Such disequilibria occur in their relations

/with countries

with countries outside the area because within it the principle of bilateral equilibrium is carried to extremes. Once a free trade zone, a regional market, or both are established, with the consequent gradual elimination of internal restrictions, bilateral equilibrium will be replaced by disequilibria in one direction or another, according to the characteristics of production in the various countries and the trade channels established. For the moment it is impossible to foresee, even approximately, what these disequilibria will amount to and in which countries they will occur, because the present structure of costs throughout the region is unknown and because liberalization will alter this structure considerably. All that can safely be predicted is that, once the process of liberalization had begun and ample facilities had been provided for the clearing of intra-regional payments, each country would find itself in a liquid debit or credit position vis-à-vis the area. If each of these same countries maintained its total balance of payments in a state of equilibrium, a deficit vis-à-vis the free trade zone or the regional market would be eliminated when an equivalent surplus with the rest of the world was transferred to another member country, and vice versa, just as in Western Europe. However, the trend towards over-all disequilibrium would not occur in this way. The countries participating in the regional system either would lack a surplus with the rest of the world with which to offset their deficit with the area or, even if they had such a surplus, might not be prepared to use hard currencies to settle deficits incurred in inconvertible currencies. In support of their views, they might allude to the danger of a recurrence of total disequilibrium or to the smallness of their foreign currency reserves.

4. It follows that the trade and payments of each country, in so far as they are related respectively to the regional area of integration and to the rest of the world, will have to be considered in watertight compartments. In trade with the rest of the world more or less regular and large deficits, covered with reserves or foreign loans, will probably continue to arise. In order to limit them, countries would have recourse to a series of controls which would include quantitative restrictions. In trade with the countries of the area, payments equilibrium should be attained not on a

/bilateral basis

bilateral basis but in accordance with a multilateral regional system.

From this point of view, the regional problem of payments is twofold. Firstly, methods will have to be found to counteract serious temporary disequilibria between pairs of countries, which may be positive or negative in the various member countries, in order to avoid a final disequilibrium of marked proportions in liquid balances vis-à-vis the area. One solution to this problem would be to make swing credits available within the area through a community similar to the European Payments Union, with the possible addition of a rotating fund designed to assist temporarily in maintaining the liquidity of each country vis-à-vis the region.

Secondly, once the free-trade area, the regional market, or both have come into existence and once all or most of the inevitable readjustments have been made, a more difficult problem will arise in the case of those countries which show regular debits or credits in their liquid accounts vis-à-vis the area as a whole. If these countries are not prepared to use convertible currencies obtained outside the area to cover their regional deficits, one solution might be to create a forced equilibrium for each country vis-à-vis the area. In so far as the methods described above are available, only temporary disequilibria, which in some cases might be offset by other disequilibria in the opposite direction, would be accepted.

5. The attainment of equilibrium in each country vis-à-vis the area should entail the minimum of interference with the new liberal pattern of intra-regional trade and with the efficient distribution of productive resources among the member countries. In other words, the efforts to achieve this payments equilibrium should not conflict with or offset, to a greater or lesser degree, the advantages of the integration scheme adopted.

The risk of such a conflict may or may not be illusory, since the measures designed to achieve regional payments equilibrium, for the reasons given above, would not be monetary but would be based on quantitative restrictions.1/

1/ Measures which encourage the movement of commodities and do not restrict imports would, of course, be preferable. If the size of these disequilibria makes such restrictions inevitable, they should be quantitative.

/In order

In order to safeguard the indiscriminatory character of liberalization and to ensure balance of payments at the regional level, quantitative restrictions should be planned and administered collectively, with due regard for the trade and payments situation throughout the region as a whole, and not merely between pairs of countries with bilateral relationships. The intra-regional trade and payments over-all structure and its probable evolution in the immediate future will be of supreme importance in this controlled application of quantitative restrictions to intra-regional trade. The active encouragement of trade through the establishment of new trade channels and the development of existing ones, will play a major role in this process.

6. Situations may occur where the final liquid balances vis-à-vis the region exceed the limits allowed by the credits available in the regional community. For example, Brazil might show a deficit and Chile a surplus. The other countries (Argentina, Uruguay, etc.) would find themselves in approximate equilibrium with the region or, at least, their recorded disequilibria would be temporary and would not exceed the capacity of the central clearing agency. The latter, or any other suitable organization which may be contemplated, after consultation with the member countries directly concerned, might lay down the general lines of an accelerated liberalization programme for Chile, giving preference to imports originating from Brazil. Only if the trade and payments situation in the area made it very difficult to absorb the Brazilian deficit by increasing its exports to Chile and the other member countries, would Brazil's intra-regional imports be partially restricted by co-operative action. In such a scheme, careful consideration would have to be given to secondary or indirect repercussions and to the prospects of renewing efforts to promote development in a given country or sector. A similar over-all view as regards the preparation and application of controls designed to preserve the regional payments equilibrium would perhaps avoid many of the disadvantages of the bilateral application of such controls.

7. In spite of its co-operative and comprehensive character, such a scheme might retain certain of the distortions brought about by bilateralism,

/particularly if

particularly if it were interpreted in too interventionist a spirit and if it were applied to a very restricted group of countries and only to a part of their reciprocal trade. The greater the number of countries included, the higher the proportion of their reciprocal trade covered by the regional market and the quicker the rate of expansion of this trade, the more rapidly will these distortions be reduced.

The growing financial stability inside each country of the region and the reduction to tolerable proportions of the disequilibrium in their total balance of payments will undoubtedly do much to achieve this aim. If the above factors become a reality within a reasonable period of time, traditional measures could gradually supplant the co-operative scheme of quantitative restrictions and thus further the rational distribution of the region's productive resources.

Whatever form it takes, the solution adopted for the maintenance of the regional balance of payments will doubtless avoid the distortions mentioned more easily and more completely, if it is conceived in a dynamic spirit and with regard to the final aims to be achieved in the trade and economic development of the region within a reasonable space of time.

8. In short, the difficulties of this initial aspect of the payments problem in Latin America's economic integration are mainly concerned with the chronic tendency towards disequilibrium in the total balance of payments of the countries of the region. It might therefore perhaps be necessary to consider separately intra-regional payments and payments with the rest of the world and to concentrate efforts on attaining equilibrium among the former, not between pairs of countries but throughout the region as a whole. If intra-regional trade is thus isolated, its small share in total trade and the internal monetary instability of each country would make it essential to apply restrictions and quantitative controls for the attainment of intra-regional equilibrium. Even if these controls are applied continually, they will not outweigh the advantages of intra-regional liberalization, provided that certain conditions are fulfilled. These include the fullest possible measure of integration, both as regards countries and commodities, the redoubling of efforts towards

/stabilization and

stabilization and, above all, the introduction of quantitative restrictions or other necessary controls on a regional and co-operative basis, without ever losing sight of the final goal - the encouragement of regional trade and economic development.

2. Factors upsetting the balance of competition

1. The second type of payments problems which may arise within any scheme for regional integration concerns the possible repercussions of a country's external payments situation on its ability to compete with the products of other member countries. This type of problem depends to some extent, though not exclusively, on the capital goods covered by the regional market and of the traditionally competitive commodities included in a possible free-trade area.

It will be necessary to consider here the possible effect on competition within the region of such factors as the existence of different degrees of inflation coupled with fixed rates of exchange in the member countries, fluctuating rates of exchange which are not paralleled in domestic price levels and changes in exchange rates - mainly devaluations - which are applied for purposes of competition or solely to balance payments but which still reflect the competitive situation within the area. It seems difficult to reconcile the smooth operation of any integration scheme, whether in respect of capital goods alone or of traditional trade as a whole, with the existence of multiple exchange rates, particularly when the rate is fluctuating or the rates used are changed frequently. The same difficulty arises when there are two exchange markets, one official and the other free, when exporters can sell without let or hindrance in either of them the currencies obtained from their exports, depending on the policy of the Government at the given moment and as a means of varying arbitrarily the competitive position of such exports. It would probably be impossible to fix a rigid limit below which a regional market is compatible with exchange rates based on more than one rate of exchange; in any case, this would depend on other circumstances. However, the complex exchange systems which now exist in several of the Latin American

/countries should

countries should not be considered as permanent obstacles to integration since these systems are often a stage in the process of exchange unification.

2. The possible consequences of a strong upward trend in domestic prices and the compensatory action which is justified in one or more of the member countries will now be considered. If inflation does not also exist among the other member countries, and if fixed exchange rate predominate, the initial equilibrium in the competitive capacity of exports from the various countries will be destroyed. When the reason for such a situation is internal monetary instability, the country concerned will be correspondingly penalized by the worsening of the competitive power of its products on the regional market. However, when inflation is due to costs, i.e. to a trade union policy of continued price increases, would it not be reasonable for the other member countries to take compensatory action to harmonize cost levels within the area?* In this case, the othodox solution to the problem of making exports competitive again would be exchange devaluation but its effectiveness would depend to a large extent on the circumstances of each case. It would be another matter if the rise in costs conferred special advantages on a given sector. Should devaluation be regarded as unsuitable or ineffective as a means of halting the effect of cost inflation on payments and competition in the regional market, another solution might be considered. The country in question, after prior agreement with the others, might put into practice certain compensatory measures - for example, subsidies on exports and duties on imports - in order to re-establish the former equilibrium. In spite of its possible advantages, this compensatory procedure may be very difficult to apply in practice. Moreover, in making the inflationary situation tolerable, might it not help to prolong it?

---

* If the increases in costs have been general and have covered more or less identically all the sectors of the economy, compensatory action would perhaps not be justified.

/3. If

3. If it is considered inevitable that each country should maintain an independent monetary policy, would it be desirable to adopt fluctuating exchange rates to avoid a constantly widening gap between internal and external price levels?

Fluctuating or flexible exchange rates give rise to other problems which may be of particular importance in the area. They concern the possibility of excessive fluctuations caused in particular by short-term capital movements. Exchange rates may undergo fluctuations of very wide range and fairly long duration, which are not paralleled by fluctuations in the same direction and of the same magnitude in the level of internal price levels because of the sensitiveness of the exchange market to short-term capital movements, psychological factors, and forecasts of the future trends in the country's external payments, etc. Consequently, the exporters of the country in question will be favoured or penalized since, temporarily (although in some cases it may be for a fairly long time), they would obtain from their exports earnings which bear no relation, in either direction, to the price levels of the country. If fluctuations result in an external devaluation of the country's currency, its exports will suffer; in the case of devaluation, the unfavourable effects would be felt in the other member countries. In such circumstances, would compensatory action be desirable? These deviations in the exchange rate would probably not be very strong or very prolonged if there were a single exchange market; they would be even less so, if there were a separate financial market in which all the earnings derived from commodity exports were liquidated.

Without such compensatory action, would not the fluctuations have unfavourable repercussions on the whole economy of the country in which they occur, as well as on the regional market, to the point where the national monetary authorities have to take urgent action? In this case, changes in export prices brought about by normal fluctuations in the exchange rate, say 15 per cent in both directions, would not normally impair the operation of the regional market. Exports of capital goods depend on industrial installations which take years to plan and build. It is unlikely that temporary and relatively small variations in the

/prices of

prices of capital goods may alter substantially the trade channels of the regional market.

Of course, the situation would be different if the fluctuations in a country's export earnings were due to an authorization to sell foreign currencies in varying amounts in the free or official exchange market. Such a procedure, as has been stated before, seems incompatible with the maintenance of balanced competition in a regional market.

4. In its efforts to balance its total payments a country may be led to alter the external value of its currency, in particular, by devaluating it. For reasons already stated, it seems inevitable that, for some time, the area of regional integration and the rest of the world will remain isolated so far as payments are concerned. In such circumstances, a devaluation carried out in order to balance payments with the rest of the world may possibly produce undesirable repercussions within the area. Such repercussions might take the form of a marked improvement in the competitive position of the intra-regional exports of the country which devaluates. Although such a move may be deliberately intended to put a premium on intra-regional exports, the situation might justify compensatory measures in the other member countries for the purpose of protecting their own national production against any abnormal increase in the competition offered by similar imports. It might be desirable to engage in compulsory consultations from time to time, in order to secure the gradual harmonization of the monetary and exchange policies of the various member countries and to reduce to a minimum the adverse consequences of any unilateral action. Only in the last resort should temporary measures of compensation, such as the application of quantitative restrictions or of special import duties, be allowed.

5. Consideration must also be given to the possible adoption of measures, such as exchange devaluation, export subsidies or special import taxes, which are designed to affect intra-regional competition. In this case, measures of protection would be justified. However, the procedure to be established should take into account the fact that a discriminatory measure adopted by one country might serve as a pretext for a whole series

of similar measures by the other member countries. This may seriously jeopardize the very survival of the regional market.

Above all, would it not be desirable that, as part of the actual agreement setting up the regional market, each member country should undertake not to use such methods of disguised competition and to accept the compensatory action adopted by the other countries, in accordance with the prior decision of a suitable controlling body? Such measures might be studied and adopted in the most limited possible form - country by country and commodity by commodity - and for each particular case, in order to avoid the risk of their being applied indiscriminately. Their application could be severely controlled and limited to those isolated cases in which specific commodities or sectors are going through a very difficult period. In all cases the decision of the controlling body should be respected.