FOREIGN PRIVATE INVESTMENTS IN THE LATIN AMERICAN FREE-TRADE AREA

UNITED NATIONS

FOREIGN PRIVATE INVESTMENT IN THE LATIN AMERICAN FREE-TRADE AREA

Report of the Consultant Group jointly appointed by the Economic Commission for Latin America and the Organization of American States

UNITED NATIONS

Department of Economic and Social Affairs

New York, 1961

NOTE

Symbols of United Nations documents are composed of capital letters combined with figures. Mention of such a symbol indicates a reference to a United Nations document.

E/CN.12/550

UNITED NATIONS PUBLICATION

Sales No.: 60. II.G. 5

Price: $US 1.00; 7/– stg.; Sw. fr. 4.00
(or equivalent in other currencies)

CONTENTS

Page

LETTER OF TRANSMITTAL iv

TERMS OF REFERENCE v

I. MAIN FINDINGS AND CONCLUSIONS

1. Introduction 1
2. Foreign investment in the Free-Trade Area 1
3. Potentialities of the Free-Trade Area 2
4. Attitudes towards foreign investment 2
5. Lessons from European experience 4
6. The problem of the domestic investor 5
7. Common treatment of foreign capital 7
8. Final considerations 8

II. BACKGROUND MATERIAL

A. Foreign investment in Latin America
1. Extent of foreign investment 9
2. Forms of investment 10
3. Influence of foreign investment 14
4. Trends in joint international business ventures 15

B. Factors affecting foreign investment
1. The general economic environment 16
2. Views and opinions on foreign investment 18
3. Restrictions on foreign investment 19
4. Incentives 20
5. Exchange and trade regulations 21
6. Taxation 22
7. Labour costs and social factors 23

C. Experience of the European Common Market 24
1. Trends in foreign investment 24
2. Investment provisions in the Rome Treaty 25
3. Obstacles to trade expansion 26
4. The European Investment Bank and the Development Fund 27

Annex

A COMPARATIVE ANALYSIS OF TAXATION IN ARGENTINA, BRAZIL, CHILE AND MEXICO

Definition of the problem 27

Discussion 27

LETTER OF TRANSMITTAL

21 July 1960

Sirs,

The undersigned, members of the Consultant Group jointly appointed by the United Nations Economic Commission for Latin America and the Department of Economic and Social Affairs of the Pan American Union in December 1959 to study foreign investment in the Free-Trade Area established by the Montevideo Treaty of February 1960, have the honour to submit their report.

In doing so the members, individually and as a group, wish to express their keen appreciation of the co-operation they have received from you and the members of your staffs in Santiago, Mexico City and Washington. We are also deeply grateful for having received the active co-operation of all the Governments concerned and of the principal industrial, commercial, and financial associations in the countries visited. We are similarly indebted to the many manufacturers, bankers and economists who gave so freely of their time that the Group might have an accurate understanding of both the problems and opportunities arising from the creation of the Free-Trade Area by the Treaty of Montevideo.

Adalbert KRIEGER VASENA — José PIÑERA

Denio NOGUEIRA — Mervin L. BOHAN

Dr. Raúl Prebisch, Under Secretary,
United Nations Economic Commission for Latin America,
Santiago, Chile

Mr. Cecilio J. Morales, Director,
Department of Economic and Social Affairs,
Pan American Union,
Washington, D.C.

TERMS OF REFERENCE

The Consultant Group has been guided by several resolutions of the United Nations Economic Commission for Latin America and of the Organization of American States, particularly:

Resolution 6 (II) of the ECLA Trade Committee adopted at its second session (Panama, 1959);

Resolution XL of the Economic Conference of the OAS (Buenos Aires, Argentina, 1957);

Resolutions IV and XIV of the Special Committee to Study the Formulation of New Measures for Economic Cooperation (Buenos Aires, Argentina, 1959), approved by the Council of the OAS on 8 July 1959.

The last two resolutions listed above and the Programme of Work and Priorities of ECLA for 1959-60 set forth the terms of reference of the Consultant Group:

(i) The Programme of Work and Priorities 1959-60 of ECLA, Section V: International Trade, item 31 (iv), *Common Market and Payments*, calls for a " Comparative study of the incentives for new investment, both foreign and national, particularly in the industrial sector, and the disparities which may exist and lead to distortions in the common market. As the study must take into account the special conditions and the industrial policies of each country, it should be carried out with the active co-operation of the Governments and private industrial associations."

(ii) Resolution IV calls for measures to increase the flow of private investments and for studies to identify " the gaps in research and to analyse the institutional factors affecting the nature and magnitude of private investment."

(iii) Resolution XIV recommends to the Inter-American Economic and Social Council that, in collaboration with the Economic Commission for Latin America, it intensify its participation in the studies and tasks directed toward the creation of the regional market in Latin America.

The comparative study mentioned in (i) above relates to the common market, while the following report is largely concerned with developments in the Free-Trade Area over the coming decade. This change was made necessary since the Free-Trade Area was the instrument chosen at Montevideo (February 1960) to lay the groundwork for the eventual establishment of a common market.

The report concentrates largely on the industrial sector, primarily the manufacturing industries. This is in accord with the terms of reference and permits attention being focused on the principal adjustments that will have to be made as a result of the Montevideo Treaty. Likewise, special attention is devoted to private direct foreign investments, either alone or with the participation of domestic capital. Foreign loans and credits are also covered, although primarily with relation to proposed solutions connected with the modernizing and expansion of existing industry, the establishment of new domestic industries and the financing of intra-zonal capital equipment movements.

The Consultant Group has tried, above all else, to provide practical suggestions for meeting the adjustments incidental to the establishment of a great regional market in Latin America.

I. MAIN FINDINGS AND CONCLUSIONS

1. Introduction

A Treaty establishing a Free-Trade Area and instituting the Latin American Free-Trade Association (LAFTA) was signed in Montevideo on 18 February 1960. The seven countries signing the agreement were Argentina, Brazil, Chile, Mexico, Paraguay, Peru, and Uruguay.

During the discussions leading to the formal establishment of this Free-Trade Area, concern was expressed in many quarters on two important points: firstly, that the creation of such an area might result in the member Governments being drawn into a competitive race to attract export industries through the granting of special incentives which, in the long run, would not only result in serious revenue losses to the Governments concerned, but might lead to the uneconomic location of industries, with the consequent adverse effects on productivity. Secondly, concern was widely expressed in industrial circles that the market expansion resulting from the creation of a Free-Trade Area would lead to severe and damaging competition from new and modern plants established by more amply capitalized and technically favoured foreign interests.

A Consultant Group, jointly appointed by the United Nations Economic Commission for Latin America (ECLA) and the Organization of American States (OAS), was therefore formed in December 1959 to look into the question of foreign investment in the Free-Trade Area. More specifically, it was to examine the practicability of establishing common aspects of policy with respect to private foreign capital, to investigate the value of incentives in stimulating the flow of such capital and to suggest practical means of financing the expansion and modernization of existing domestic industries, as well as means of dealing with the adjustments required in response to greater competition in the Free-Trade Area.

Before considering the conclusions reached by the Consultant Group and in order to place these conclusions in a broader perspective, they will be preceded by a brief discussion of foreign investment in the LAFTA countries, potentialities of the Free-Trade Area, current attitudes towards foreign investment, lessons to be drawn from the experience of the European Common Market, and problems faced by domestic investors. More detailed information on these subjects will be found in part II of this report.

2. Foreign investment in the Free-Trade Area

The total value of direct foreign investments in Latin America is not precisely known. On the basis of partial data, however, it may be conservatively estimated that their book value increased from some 6,000 million dollars in 1946 to nearly 13,000 million in 1958.[1] During the latter year, United States direct investments alone were reported at 8,700 million dollars or approximately two-thirds of the total value mentioned above.

The share of the LAFTA countries within this Latin American total is also difficult to measure precisely. Based, however, on the pattern of United States direct investments in Latin America—approximately 45 per cent of the total value of such investments are in the LAFTA area—and from the fact that those seven countries received approximately 44 per cent of all net private long-term investments in Latin America during 1956-1958 (see table 1), it may be surmised that foreign investments in the LAFTA countries have recently been in the neighbourhood of 6,000 million dollars.

Table 1. Net capital flow, 1956-58

(Annual averages in millions of dollars)

Type of investment	*Latin America*	*LAFTA countries*	*Percentage of total net flow*
Private long-term	1 136.3	494.9	43.6
Official long-term	166.4	92.9	55.8
Short-term and monetary gold	169.9	361.2	[a]
Total	1 472.6	949.0	64.4

Source: United Nations, *Private International Investment 1958-59*, preliminary draft.

[a] The countries not members of LAFTA, as a group, reported a net outflow.

Even though the LAFTA countries account for slightly less than one-half the value of total direct foreign investments in Latin America, these countries play a predominant role in all fields except petroleum. Thus, of total United States direct investments in Latin American manufacturing ventures, almost 80 per cent are in LAFTA countries, with the bulk invested in Brazil, Mexico, and Argentina, in the order named. Similarly, almost 75 per cent of the value of United States investments in mining and smelting enterprises may be found in the LAFTA group with Chile, Peru, and Mexico being the most important in this respect. United States investments in transport have been of minor importance in the LAFTA countries since the liquidation of its direct investments in Mexican railways between 1902 and 1909, while the repatriation of foreign, mostly

[1] Information regarding the flow of direct investments, private loans, suppliers' credits, and loans and credits from national and international lending agencies will be found in part II, section A 1.

United Kingdom capital in Argentine, Brazilian, Uruguayan and Mexican railways in the period following the Second World War, has largely liquidated these holdings except in Paraguay and Peru. Foreign investment in the power industry is still of importance in Brazil, Chile, and Mexico although nationalization has been widespread in this field as well. The main telephone systems in Brazil, Chile and Peru are still financed by foreign capital, although former foreign holdings in the Argentine, Mexican, Paraguayan and Uruguayan telephone systems have been liquidated. The Mexican system is privately operated by Mexican capitalists but the other systems are managed by State enterprises.

In short, the flow of foreign private capital into the LAFTA countries during the last fifteen years has consisted predominantly of direct investments in mining and manufacturing industries and related activities, while foreign participation in utility and transport enterprises has tended to decrease.

As stated earlier, almost 44 per cent of the net flow of private long-term capital during the three-year period 1956-1958 was accounted for by the LAFTA countries, which also received nearly 56 per cent of the net flow of official long-term capital. As shown in table 1, the same group of countries were the major recipients of short-term accommodations.

The flow of foreign capital in various forms such as direct investments, undistributed profits and exporters' credits to Argentina, Brazil and Mexico has reached impressive totals in the last few years. It should also be noted that the marked increase in the net inflow of private capital seems to have been associated with policies permitting unrestricted financial transactions at realistic exchange rates.

3. Potentialities of the Free-Trade Area

The seven signatories of the LAFTA Treaty offer a combined market of significant proportions with a population of over 137 million people, a gross national product of between 40,000 and 45,000 million dollars and a foreign trade of 8,500 million dollars in 1958.[2]

It must be kept in mind, however, that the Free-Trade Area is at present little more than a legal framework and that it will become operative only as individual products are incorporated in the common and national schedules provided for in the Montevideo Treaty. Forecasting the rate of growth of those schedules is outside the terms of reference of the Consultant Group, although it may properly observe that the importance of the Free-Trade Area as a factor in stimulating the economic growth of its members is so great that it leaves little doubt as to the eventual development of markets of sufficient size to permit the economic operation of many capital goods and other basic industries and to increase greatly the productivity of existing industries.

In terms of potentialities, the Free-Trade Area, which accounts for 79 per cent of the territory and 72 per cent of the population of Latin America, is sufficiently impressive to deserve the attention of both foreign and domestic investors.

In raw material and foodstuffs production the Free-Trade Area accounts for more than 60 per cent of Latin American production of coffee and tobacco, for more than 70 per cent of the output of coal, for more than 80 per cent of the production of grains, root crops, pulses and cotton, and for more than 90 per cent of the production of copper, lead and zinc. Only in the case of petroleum is production unsatisfactory, output of the LAFTA countries having represented 14.3 per cent of total Latin American production in 1958. In world terms, the Free-Trade Area is a major supplier of copper, lead, zinc, silver, wheat, meat, corn, wool, coffee and cotton.

As regards manufacturing, the LAFTA countries are even more clearly pre-eminent. This group—principally Argentina, Brazil, Chile and Mexico—accounts for all the Latin American output of manufactured motor vehicles, wood pulp, newsprint, machinery and almost all primary steel products. It also accounts for a high percentage of the output of food products, textiles, durable consumer goods, chemicals machinery and transport equipment.

The principal raw materials and foodstuffs produced in Latin America and the share of the LAFTA countries in that production are shown in table 2. The output of selected industrial goods is also shown, together with data indicating that the LAFTA countries account for almost 77 per cent of the installed generating capacity, 79 per cent of the commercial power consumption, and 51 per cent of the foreign trade of Latin America.

4. Attitudes towards foreign investment

The only generalizations that can safely be made with respect to attitudes towards foreign private investment in the seven countries which signed the Montevideo Treaty are that official policy recognizes both the contribution and the need for foreign capital and that it assigns to it an important role in the economic development process; business opinion favours foreign capital in joint ventures and in non-competing activities; and public opinion has little more than a latent prejudice against foreign interests.[3]

It should be stressed that, while the generalizations indicated above characterize, to a greater or lesser extent, all seven of the countries considered, opinion varies in each country and in each sector, from deeply rooted anti-foreign sentiment to outright approval of foreign enterprise. On balance, however, majority opinion probably tends to be slightly more unfavourable than favourable to foreign enterprise.

[2] For a discussion of the importance of the individual countries forming LAFTA, see part II, section B 1.

[3] The influence of foreign investment on the economic development of Latin America is briefly discussed in part II, section A. (See section headed "Influence of foreign investment.") In the same chapter reference should also be made to the section entitled "Forms of investment", which discusses general attitudes towards loans as distinguished from direct investments and examines the effect of dividend and profit remittances on the balance of payments.

Table 2. Latin America and LAFTA: Selected statistics

Item	In	Year	Latin America	LAFTA	Percentage of total
Population	Millions of persons	1958	188 419	137 234	72.8
Area	Thousands of square kilometres		19 971	15 846	79.3
Mineral production					
Crude petroleum	Thousands of tons	1958	170 920	24 516	14.3
Coal	Thousands of tons	1958	8 327	6 090	73.1
Iron ore [a]	Thousands of tons	1958	16 952	6 867	40.5
Copper [a]	Thousands of tons	1958	594	578	97.3
Lead [a]	Thousands of tons	1958	380	358	94.2
Zinc [a]	Thousands of tons	1958	401	387	96.5
Sulphur	Thousands of tons	1957	1 108	1 108	100.0
Sodium nitrate	Thousands of tons	1957	1 300	1 300	100.0
Silver	Tons	1958	2 616	2 334	89.2
Gold	Kilogrammes	1958	45 341	23 274	51.3
Agricultural production					
Grains	Thousands of tons	1956	38 750	34 150	88.1
Root crops	Thousands of tons	1956	26 699	23 186	86.8
Pulses	Thousands of tons	1956	3 065	2 571	83.9
Oilseeds	Thousands of tons	1956	4 804	4 440	92.4
Sugar	Thousands of tons	1956	13 121	5 252	40.0
Coffee	Thousands of tons	1956	1 941	1 178	60.7
Bananas	Thousands of tons	1956	8 500	4 664	54.9
Tobacco	Thousands of tons	1956	385	252	65.5
Cotton	Thousands of tons	1956	1 155	1 034	89.5
Livestock					
Cattle	Thousands of head	[b]	181 800	156 798	86.2
Sheep	Thousands of head	[b]	124 000	103 628	83.0
Manufacturing production					
Petroleum refining	Thousands of cubic metres	1958	89 100	40 732	45.7
Cement	Thousands of tons	1958	14 816	10 465	70.6
Pig iron	Thousands of tons	1958	2 318	2 169	93.6
Steel ingots	Thousands of tons	1958	3 470	3 335	96.1
Steel finished	Thousands of tons	1958	3 569	3 453	96.7
Sulphuric acid	Thousands of tons	1956	579	533	92.1
Caustic soda	Thousands of tons	1957	127	114	89.8
Wood pulp	Thousands of tons	1957	494	494	100.0
Newsprint	Thousands of tons	1958	106	106	100.0
Other paper	Thousands of tons	1958	221	200	90.5
Power					
Installed capacity	Thousands of kilowatts	1957	13 750	10 578	76.9
Commercial consumption	Thousands of tons of crude petroleum equivalent	1957	74 380	53 920	78.5
Foreign trade					
Exports	Millions of dollars	1958	8 190	3 821	46.7
Imports	Millions of dollars	1958	8 484	4 638	54.7
Total	Millions of dollars	1958	16 674	8 459	50.7

Sources: Economic Commission for Latin America, *Economic Bulletin for Latin America*, Santiago, Chile, various issues; Committee on Latin American Studies, *Statistical Abstract of Latin America for 1957*, University of California, Los Angeles, 1959; *Area, Agricultural and Livestock Statistics.*

[a] Metal content.

[b] Various dates 1950-1956.

It is natural that official policies emanating from each country's needs, as well as from the pressures and influences of the private sectors of its economy, should differ considerably from country to country. Peru, for instance, which has the most simplified regulations for the entry of foreign capital, is among the least developed industrially, while Chile, which has one of the most elaborate systems for determining the advisability of each foreign investment, is very highly industrialized in relation to its market. Argentina and Brazil occupy

intermediate positions, both having systems which take into account the interests of established industrialists, although this characteristic is much more pronounced in the case of Argentina than in that of Brazil.[4] The systems in effect in Uruguay and Paraguay are more promotive than selective in character.

Mexico occupies a unique position. While legally making no distinction between foreign and domestic enterprises, it quite frankly assigns a complementary role to new foreign capital, holding that " it should not by its competition unfavourably affect existing Mexican enterprises nor displace national capital nor frustrate its future development ". Further, such capital should not utilize national savings in such a manner as to reduce resources " which naturally correspond to national enterprises ".[5] Within the Government itself, powerful sectors hold the view that private foreign capital should be encouraged to enter basic industries only if willing to accept a minority participation in joint enterprises.

Domestic business attitudes in the LAFTA countries towards private foreign investment may be summed up as: (*a*) favouring such investment in basic or new fields; [6] (*b*) opposing it in competing fields; and (*c*) favouring joint domestic and foreign ventures over outright foreign enterprise.

The degree of adherence to these general attitudes varies, of course, in business and particularly industrial circles in the LAFTA countries. Top officials of the leading industrial associations in Argentina and Chile, as well as many of the larger industrialists, tend to stress equality of opportunity for domestic industries rather than protection from competition from enterprises established by foreign capital, although the rank and file of the membership of those associations was found to be far less reticent in demanding that fields developed by domestic capital be reserved to it. In Brazil, both views are held, the latter predominating over the former. In Mexico, feeling reflects Government attitudes far more than is the case in the three other most industrialized countries of the Free-Trade Area, the opinion being very strong that foreign capital, especially in the case of basic industries, should associate itself with domestic interests.

The preference for joint ventures is nowhere so strong as in Mexico, although sentiment in this regard is growing in Brazil. Reactions in both Argentina and Chile tend to be more theoretical than in Brazil and Mexico where experience with joint ventures is much more extensive.

[4] Legally, enterprises do not have to take advantage of foreign investment incentive laws and, unless special legislation rules otherwise, are free to establish themselves in any of the LAFTA countries. In practice, however, foreign investment laws are rarely by-passed.

[5] Speech of the Mexican Minister of Financial Affairs at the XXV Mexican Bankers' Conference in 1959. Published in full in *Revista Bancaria*, Vol. III, No. 3, Mexico, D.F., May/June 1959.

[6] Basic or new industries are thought of as industries requiring a high rate of capital formation per unit of output in fields not pre-empted by, or attractive to, domestic capital. Export industries, especially in mining, are generally, although not universally, favoured by domestic business men and industrialists as being suitable for foreign investment.

5. Lessons from European experience

The experience of the European Common Market and its precursors should be of assistance to the signatories of the Montevideo Treaty in finding solutions for many of the problems that will soon be confronting them.[7]

Perhaps the most important lesson to be drawn from the European experience is that the challenge of social and economic adjustments, inherent in converting a series of insulated national markets into a single great regional entity, can be successfully met through patient compromise and mutual understanding of the long-term objectives of such undertakings. Thus, the European Coal and Steel Community had to implement the treaty which created it in such a fashion as to prevent free competition, a prime objective of the pact, from creating grave social pressures when thousands of workers became unemployed as existing steel plants and coal industries modernized their operations. In France, for instance, four steel plants had to merge. In Belgium, one coalfield had to be entirely reorganized and some pits had to be closed. In Italy, the steel industry had to reduce excessive manpower without affecting the general level of employment within the country. All of these problems were successfully solved, thanks to the provisions by which the financial burden of the measures were borne by the Community as a whole.

Experience gained in the Coal and Steel Community undoubtedly favoured the early establishment of the European Economic Community through dissipating many previous fears of the consequences of integration. In setting up the European Economic Community provision was made, among other things, for the European Investment Bank to extend financial assistance for projects in less developed regions of the metropolitan areas of the community, projects for modernizing and converting industrial enterprises, and projects of interest to several member States. A Development Fund was set up to promote the social and economic development of the associated overseas countries and territories of the Community by investments complementing those made by the authorities responsible for them; and a European Social Fund was established to ensure productive re-employment of workers and to provide compensation for unemployment arising from integration and modernization programmes.

Other provisions of the Rome Treaty which deserve the close attention of the members of LAFTA include those relating to the restraint of trade, movements of capital, and the right of establishment. The anti-trust provisions are designed for the purpose of avoiding " any agreements between enterprises, any decisions by associations of enterprises and any concerted practices which are likely to affect trade between the Member States and which have as their object or result the prevention, restriction or distortion of competition within the Common Market." [8] These provisions might well be borne in mind by the LAFTA Contracting

[7] See also part II, section C, of this report.

[8] Article 85 of the Rome Treaty.

Parties when sponsoring or negotiating the agreements on complementarity referred to in article 16 of the Montevideo Treaty or attempting "to promote progressively closer co-ordination of the corresponding industrialization policies" of the respective Governments.

The Rome Treaty provisions relating to the movement of capital and the right of establishment are mainly concerned with the internal organization of the Common Market. Even so, they are worthy of close attention, since the decade ahead may well be characterized by considerable regional competition for foreign private capital. Regulations governing the movement and investment of such funds could therefore have even more importance in the future than in the past.

Finally, even though the European Common Market has not been in operation for a sufficient time to warrant any definitive conclusions, there appears to have been, since its establishment, a marked increase in the flow of capital into the constituent countries. This should be a source of encouragement to those who believe that the Latin American Free-Trade Area can become one of the most powerful factors in the economic development of its member countries.

6. The problem of the domestic investor

The problem of most direct concern to the majority of domestic industrialists in the countries which signed the Montevideo Treaty, to judge by the interviews held by the Consultant Group, is the fear that the protection enjoyed by their industries will be prejudiced by the development of the broader markets envisaged for the Free-Trade Area. As already pointed out, the industrialists holding this view claim to foresee an influx of foreign capital into regional plants of such size and efficiency as to offer ruinous competition to existing domestic industries.

These fears are a natural outcome of the atmosphere in which industry has developed in Latin America. Many domestic plants operating in this area today trace their origin back to the supply difficulties of the thirties and forties, when exchange scarcities during the first period and wartime restrictions during the second not only gave a powerful stimulus to local production but placed major emphasis on the availability rather than on the cost or quality of local output.[9] The need for protecting these industries and the new enterprises established in the post-war period were among the reasons that led Latin American Governments to raise tariffs and to impose import and exchange control restrictions of such severity as to insulate the domestic producer from foreign competition. In some cases, outright import bans were in effect for prolonged periods. Another result of these policies was that foreign firms desiring to hold markets previously supplied from other sources found it advisable to establish local subsidiary plants.

In many instances, the quality and price of domestic production has placed a heavy tax on the consumer,[10] and the producers themselves have been denied the stimulus of sufficient effective competition with the consequent adverse effect on production and technical development, production techniques and sales distribution practices. This lack of competitive stimuli has resulted, in turn, from the virtual ban on competitive imports and from market limitations which keep the number of producers in many fields to a minimum and leads to the growth of monopolistic and quasi-monopolistic situations. Inflation, with its de-emphasis on cost and quality considerations, has also been a factor in several countries of the Free-Trade Area. And finally, the fact that much of the protection granted to domestic producers has been the result of administrative action (import licences and quotas), with the accompanying uncertainties as to permanency, has often acted as a brake on long-range modernization and expansion programmes.

Consequently, it is no wonder that the majority of the industrialists in the countries visited expressed concern as to the possible competitive effects of the operation of the Montevideo Treaty and, while intrigued with the possibilities of serving larger markets, they were fearful that foreign capital would not only exploit the best of these opportunities, but engage in unfair competition in their own home markets.[11]

There is little question that these fears are exaggerated, but it is equally certain that an adjustment problem exists which must be faced by all parties to the Montevideo Treaty if that agreement is to be successful in raising the productivity and thus accelerating the economic development of the signatory countries. These fears are exaggerated for the following reasons.

(i) New fields of activity, in which there are few or no domestic producers, should absorb a substantial percentage of the new foreign capital flow if the expectations of the Montevideo Treaty are realized and especially if appropriate policies are adopted in the respective countries;

(ii) Existing foreign enterprises will undoubtedly expand, but it is unlikely that their competitive impact on existing domestic producers will be any more severe in the near future than in the past;

(iii) In spite of the generalizations current in various countries, there is little evidence of cut-throat competition by foreign firms operating in Latin America. The tendency is rather for such firms to follow the non-competitive policies characterizing many industrial activities;

[9] Supply difficulties in the First World War also stimulated domestic production in Argentina and Brazil and had some slight effect in Chile, although almost none in Mexico because of the disturbed conditions then existing in that country.

[10] There are, of course, many fields in which the quality of output is equal to that of products formerly imported, where prices are equal to or lower than imported products of equal quality.

[11] The Spanish term *competencia desleal* was often heard, as well as the statement that complementary rather than competitive situations should characterize the Free-Trade Area.

(iv) Foreign capital inflow will probably increase less rapidly than envisaged by local industrial groups. The national schedules, in which most industrial concessions are expected to appear in the next five or six years, may not provide sufficient guarantee of permanency to constitute an immediate incentive to large-scale investment; developments in Europe may divert considerable private manufacturing investment from Latin America; and the advantages granted to the associated territories of the European common market treaty may have the same effect;

(v) The inadequacies and high cost of present transport facilities will have to be corrected before large-scale commerce can be established and this will take several years to accomplish;

(vi) The terms of the Montevideo Treaty are such that the adjustment to more competitive conditions will be a gradual, not an immediate development. Thus, if country A grants country B concessions on product Y, producers in all signatory countries come into competition in country A, but (except for country A producers) continue to enjoy the same protection as before in their own home markets. This continues to be true until concessions on product Y are granted by other signatories or until product Y moves from the national to the common schedule.

Nevertheless, even after allowance has been made for these factors, the problem of adjustment may be a serious one in many cases. In this connexion, existing domestic producers point out, with justice, that foreign firms have cheaper and easier access to capital and credit, greater technical resources, and a decided advantage in many countries in being able to import machinery and equipment without exchange coverage. Indeed, exchange difficulties in the post-war period have, in many cases, actually prevented plant modernization by domestic producers.

These conditions must be given special attention by all of the signatory countries and steps must be taken to equalize the opportunities of domestic *vis à vis* foreign capital. This is especially true with respect to exchange and import regulations for machinery and equipment.

Other avenues suggested for consideration by the Consultant Group are the following:

(*a*) The provision of credit facilities for plant modernization and expansion.

(i) The major source of such facilities could be sought in the Inter-American Bank for Economic Development. Such facilities, of course, would not be restricted to LAFTA countries but would be available to all the Latin American republics. Concentration of effort by the Bank in this almost virgin field would have the advantage of supplementing rather than replacing existing credit facilities from official (national and international) institutions;

(ii) The possibilities of obtaining additional credit facilities from the International Bank for Reconstruction and Development (IBRD), the International Finance Corporation (IFC), the International Development Association (IDA), the Export-Import Bank and other financing institutions should be explored;[12]

(iii) The establishment or expansion of local investment or development banks or corporations (public or private) to increase the availability of local currency credits and provide additional or more effective intermediary agencies for foreign credit institutions should be considered in appropriate instances;

(iv) The expansion of foreign suppliers' credits could undoubtedly be increased through wider use of Government guarantees.

(*b*) The promotion and strengthening of local money and capital markets.

(i) The revision, where necessary, of the rules and regulations governing the issuance and marketing of securities;

(ii) The exploration of means whereby selected domestic issues could be listed on stock exchanges within the Free-Trade Area and abroad;

(iii) The creation or expansion of investment and finance companies as well as trust funds, as a further means of strengthening local capital and money markets.

(*c*) The provisions of credit facilities for inter-Latin-American Trade. The Inter-American Bank for Economic Development should also consider operating in this field directly or through intermediary financial institutions within or outside the area. Such financing will become progressively more critical as capital goods and other regional industries develop in the Free-Trade Area.

(*d*) The stimulation of private international co-operation. Existing industries should be helped and encouraged, in appropriate cases, to modernize or expand either through partnership arrangements with foreign firms involving the supply of liquid capital, equipment, patents, methods of production and other technical assistance or through other arrangements such as the payment of royalties and the contracting of technical personnel and services. Joint ventures resulting from such efforts would tend to open up new sources of private foreign credit, since many medium-sized firms abroad would be approached which ordinarily would not enter the foreign field on their own initiative and would be more apt to accept a minority role in the resulting partnership.

(*e*) The provision of accelerated amortization schedules for plant modernization and expansion programmes.

(*f*) The active promotion by Governments, universities and industrial associations of intensified programmes in management, industrial productivity, labour relations, research and standards.

[12] See the Press release of the United States Department of State, dated 18 November 1958, containing the remarks of the Under-secretary of State before the Special Committee of the OAS, in which Mr. Dillon stated, in part: "We have also made it clear that we are prepared through the Export-Import Bank to consider the dollar financing required by sound regional industries in Latin America."

(*g*) The enactment of anti-trust legislation to control monopolistic practices contrary to the public interest.

Such legislation should allay the fears of domestic industrialists of being forced out of business through unfair or monopolistic competition and would tend to prevent inter-zonal and domestic agreements restraining trade.

These measures, combined with the properly scheduled inclusion of products in the national schedules (and eventually in the common schedule) should enable domestic industry to develop in a more progressive, stimulating and competitive atmosphere than in the past and with a corresponding increase in its contribution to the national economies of the countries forming the Free-Trade Area.

7. Common treatment of foreign capital

The Consultant Group has devoted a major part of its time to discussing the advantages and disadvantages of a foreign investment code or a uniform agreement covering the treatment of private foreign capital in the Free-Trade Area. Factors favouring such a course include the need for agreement once the common market stage of the present programme is reached as well as the avoidance, during the interim period, of the use of exaggerated incentives to influence site selection. However, the wide variety of policies and attitudes among the countries forming LAFTA and the possibility of strong competition for private capital from Europe and Africa makes it extremely difficult at the present time to draft a common code which would be liberal enough to satisfy the needs of some countries and restrictive enough to meet current attitudes in others.

The Group has therefore broken down the problem into its component parts in order to recommend as great a degree of uniformity as possible and to suggest the areas in which further study might hasten the attainment of the final objective of uniform treatment.

There are three areas in which common treatment could probably be agreed upon immediately:

(*a*) Freedom of capital movement and of the remittance of profits, interest, royalties and technical assistance payments;

(*b*) The importation of machinery and equipment (not manufactured in the Free-Trade Area) for new industries, domestic or foreign, and for the expansion and modernization of existing industries; and

(*c*) The revaluation of assets for tax and other purposes.

There are also several areas in which studies could be undertaken to determine the feasibility of concerted action. Among these, the following appear to be particularly promising:

(*a*) Tax and exchange incentives, accelerated depreciation plans and guarantees against tax increases, tax discrimination, and changes in tax treatment; and

(*b*) International double taxation, arbitration and convertibility agreements.

Common treatment in the remaining sectors will require more study and consideration, especially as concerns (i) the right of establishment; and (ii) areas in which foreign capital is excluded or restricted.

The areas in which common treatment seems immediately feasible are those where existing differences are minor or could easily be reconciled. Thus exemption of customs duties for domestic and foreign enterprise could be either selective or general, although revenue considerations would seem to counsel the first rather than the second course. The question of asset revaluation would probably require implementing legislative action, although this should not preclude an early *ad-referendum* agreement.

Uniformity in the matter of tax incentives requires a much more careful and detailed study than the time permitted the Group to make. It would be most advisable, however, especially for the more industrialized countries, if definite limits were placed on the use of incentives to attract new capital, whether foreign or domestic. But these limitations cannot be specified before a detailed analysis of existing tax systems reveals the comparative data on which agreement must be based. The Group would also hope that exchange incentives, whether arising from multiple rate systems, exchange surcharges, or prior deposit systems would be severely limited because of their social and economic costliness.

Both as a result of field investigation and the study of existing literature [13] the Group views the entire range of incentives with some misgivings. It has seen the results of using incentives in the particularly dramatic cases of the Brazilian and Argentine automotive industries, and while it does not question either the efficacy of the measure employed or the results obtained, it does feel that the costs of such incentives should be carefully weighed.

Incentives appear to be most justified when used for channelling investment. In this sense they are a valuable instrument for implementing national policy and are helpful in clarifying the activities in which private investment is most welcome and the conditions under which it will be expected to operate. They are also effective when the controlling economic factors (market, labour, raw materials, power, transport, etc.) are more or less evenly balanced between countries or regions, but their effectiveness in overcoming those economic factors is generally slight. In Brazil, for instance, the amount of capital moving into the incentive areas as compared to that flowing into the southern States, where in some cases tax and other impediments rather than tax incentives are to be found, does not provide much evidence in favour of the incentive system when the controlling economic factors are not closely balanced.

Despite the foregoing, the provisions of article 32 of the Montevideo Treaty which give the less industrialized countries of the Free-Trade Area greater liberty to experiment, appear to be necessary and wise. The broad tax

[13] For an extended treatment of the subject, see United Nations Economic and Social Council, *The Promotion of the International Flow of Private Capital* (Progress Report, E/3325, 26 February 1960).

concessions granted by so many countries at comparable levels of development and the fact that such concessions do arouse interest abroad might well permit these countries to make better use of the economic advantages they offer. Even so, the incentives granted will prove most effective in those cases where the controlling economic factors are the strongest.

With respect to capital imports, new capital brought in by existing enterprises is generally welcomed, but regulations and conditions governing the establishment of new foreign enterprises vary greatly in the countries of the Free-Trade Area.[14] Such regulations, reflecting current policy and attitudes, may tend towards greater uniformity as the Free-Trade Area and the competitive demand for private capital in Europe and Africa develop. This situation should be watched closely so that discussions aiming at uniform treatment may be initiated at the earliest practicable time. In the interim, each individual country will have to decide the extent of its own needs for capital and make its policy correspond to those needs. The main attractions for foreign capital — such as the extent of the market and fears of losing it, the respect for the rights and property of investors, the ability to transfer earnings and repatriate capital, the availability of the economic and social overhead facilities required by modern industry, and a legal structure imposing reasonable taxes and with a minimum of tax impediments — are too well known to merit treatment here, although these countries desiring to increase the flow of private foreign capital might find it advisable to review their administrative procedures in connexion with the establishment of new industries. The Consultant Group found that, in those countries where case-by-case approval of proposed foreign investments is required, the delays and costliness of the procedures, as well as the lack of uniformity in decisions, are often an obstacle to the flow of foreign capital. It was equally noted that where machinery existed for the co-ordination and facilitation of investment, the flow of capital appeared to be favourably affected.

8. Final considerations

The Consultant Group has had the benefit of hearing almost every shade of opinion in the countries visited on almost every aspect of the Montevideo Treaty. From the interviews held and the investigations conducted, the following conclusions appear to be justified:

(*a*) Incentives used to attract foreign capital should be equally available to domestic entrepreneurs;

(*b*) Steps must be taken without delay by the Governments of the countries, members of LAFTA, to aid domestic industries to modernize and expand plant facilities so as to take maximum advantage of the opportunities that will emerge as implementation of the Montevideo Treaty gets under way;

(*c*) It is hoped that the Inter-American Bank will provide much-needed facilities for the modernization and expansion of domestic industries and the financing of inter-Latin-American trade, particularly in regard to capital goods;

(*d*) Domestic capital resources are insufficient to ensure full development of regional markets and foreign capital must therefore be encouraged to supply the deficit;

(*e*) Technological advancement in a rapidly-developing region such as the LAFTA is an essential element of progress and such advancement is still closely associated with the operation of enterprises from more highly developed countries;

(*f*) A considerable degree of uniformity in the treatment of foreign capital in the Free-Trade Area is possible immediately, although policies with respect to the right of establishment vary so greatly as to preclude agreement in this connexion at the present time;

(*g*) There is a growing tendency for both foreign and domestic entrepreneurs to form joint enterprises;

(*h*) The more industrialized countries of the Free-Trade Area will have to extend more than tariff concessions to the less developed countries. Such additional concessions may take the form of the financing of industries, the promotion of the tourist industry, and the improvement of transport facilities;

(*i*) The Montevideo Treaty provides a practical mechanism which can be employed to create important consumer markets capable of supporting large-scale industry and providing greater employment and prosperity for the entire Free-Trade Area. This conclusion is based on the many and varied examples of practical opportunities which will develop as the Treaty is implemented;

(*j*) The rate of implementation will be speeded if prompt steps are taken to modernize domestic industry and by the wide dissemination of information on opportunities as these are developed through research and regional investigation;

(*k*) The Standing Executive Committee of LAFTA could perform a number of important functions, including:

(i) The receipt, study and transmission to the respective Governments of multi-country plans requiring common or national schedule action and calling for the establishment of plants, the rationalization of existing facilities, and the setting-up of complementary production plans;

(ii) The study of regional markets and the dissemination of information on regional trade opportunities;

(iii) The promotion of regional standards and quality controls;

(iv) The study of the possibility of joint Governments' action in providing assistance to domestic manufacturers in finding foreign or inter-area partners for joint enterprises and in contracting technical services, patents and trade-marks.

[14] The effect of the interplay of exchange and investment policies, especially in the cases of Brazil and Mexico, is examined in detail in part II, section A 2.

II. BACKGROUND MATERIAL

A. Foreign investment in Latin America

1. Extent of foreign investment

Although there are no reliable figures to show the total value of direct foreign investments in Latin America, it may be conservatively estimated that their book value increased from some 6,000 million dollars in 1946 to nearly 13,000 million dollars in 1958. These estimates are based on official figures covering United States [15] and United Kingdom [16] direct investments in Latin America in 1946 plus the net flow of direct investments (including reinvested profits) during the period 1946-58, as shown in the region's balance-of-payments statements.[17]

Of the 13,000 million dollars of estimated current direct investments, a little under 70 per cent consists of United States capital. If petroleum is excluded, the United States participation would fall to below 60 per cent and to approximately 50 per cent if, besides petroleum, mining and smelting activities were also excluded. As for geographical distribution, a little over two thirds of the total is concentrated in five countries: Venezuela, Brazil, Cuba, Mexico and Chile.

As already mentioned,[18] the bulk of United States direct investment in manufacturing industry in Latin America is in the Free-Trade Area, mainly in Brazil, Mexico and Argentina (in the order named), and the bulk of investments in mining and smelting is also in the Free-Trade Area, mainly in Chile, Peru and Mexico.[19]

Besides the net inflow of direct investment, as shown in table 3, Latin America has also benefited from private loans (including short-term loans) from private sources to the amount of nearly 2,000 million dollars in the post-war period, of which about 1,000 million has already been amortized.

This type of credit operation has only recently become of importance.[20] From official sources, both governmental and international, the total inflow during the post-war period was of the order of 4,500 million dollars, of which nearly 600 million was in the form of foreign Government donations. As during the same period over 3,000 million was amortized, the net inflow of official capital must have been in the neighbourhood of 1,500 million, making a total net inflow of foreign capital — both private and official, and including reinvestment of profits — of more than 9,000 million dollars in Latin America during the post-war period.[21]

The increase in private credits (mostly supplier credits) is exceptionally noteworthy in recent years. These rose from a yearly average of about 100 million dollars during 1950-56 to a yearly average of over 300 million dollars in 1957-58. This was primarily the consequence of the drive for capital exports in supplier countries, the availability of official insurance facilities abroad, and the incentives and guarantees granted by some Latin American countries to further industrial transport modernization programmes.

Loans from official (including international) sources during the twelve-year period 1947-58 also showed a strong upward trend, total inflow increasing from 800 million dollars during the first six years of that period to 2,955 million dollars during the second six years. Supplier credits were also a factor in this case although the largest increases were for balance-of-payment purposes and the more active financing of power and transport projects.

As was stated at the beginning of this section, figures relating to total investments and total investment flow

[15] See *Presidential Report to the U.S. Congress on the Mutual Security Program, for the Six Months ended June 30, 1958*, p. 56.

[16] United Nations, *The International Flow of Private Capital*, 1956-58, New York, 1959 p. 30.

[17] International Monetary Fund, *International Financial Statistics*, various issues.

[18] See part I, section 2: " Foreign investments in the Free-Trade Area ".

[19] In 1959, new foreign capital inflow in Brazil was about 560 million dollars according to a preliminary official estimate of which 338 million dollars represented imports of machinery and equipment, partly as direct investment but also to a large extent in the form of foreign commercial credits, while the remaining 172 million dollars represented an inflow of resources through the free-exchange market. In Mexico, a decline of United States direct investments from 75 million dollars in 1957 to 15 million in 1958 was partly compensated by an increase in direct investments from Western Europe, and in 1959 the Mexican economy resumed its vigorous expansion. In Argentina, new foreign investments in 1959 were estimated at 148.2 million dollars of which 100.2 million dollars represented investments by United States companies, while the balance came mainly from the Netherlands, Switzerland and the Federal Republic of Germany. These investments were mainly directed to manufacturing and chemical or pharmaceutical plants. In addition, the foreign financial contribution to the development of the oil industry represents more than 200 million dollars. During the first quarter of 1960, the capital inflow remained steady. In Peru, the flow of foreign direct investments continued largely unchanged. In Chile, foreign investments in manufacturing (and " other activities ") declined in 1958 but picked up again in 1959; United States investments in mining doubled in 1958 and continued to increase in 1959 and 1960 (see United Nations Economic and Social Council, *op. cit.*)

[20] Noteworthy in this respect was the action of the Prudential Insurance Company of America in investing 100 million dollars in 15 years, 6-7/8 per cent securities of the *Nacional Financiera, S.A.*, of Mexico, in early 1960. These funds may be used by the *Nacional Financiera* for such projects as it may elect and without restriction as to the financing of the peso or foreign exchange components of the projects selected.

[21] On the basis of partial data, reinvested profits have been estimated at somewhat in excess of 1,000 million dollars.

Table 3. Latin America: Capital movement in the region's balance of payments, 1947-58

(Millions of dollars)

	Inflow								Outflow				
	Private				Official				Private				
Year	*Direct* [a]	*Loans* [b]	*Short-term* [c]	*Total*	*Loans*	*Donations*	*Total*	*Total inflow*	*Long-term* [d]	*Short-term* [e]	*Official*	*Total outflow*	*Balance*
1947	280	—	174	454	110	24	134	588	– 138 [e]	—	– 93	– 231 [e]	357 [e]
1948	472	—	—	472	60	9	69	541	– 694 [f]	– 9	– 96	– 799 [f]	– 258 [f]
1949	502	—	—	502	122	26	148	650	– 5	– 87	– 84	– 176	474
1950	115	—	52	167	88	13	101	268	– 29	—	– 165	– 194	74
1951	410	140	50	600	220	20	240	840	– 15	—	– 105	– 120	720
1952	640	80	170	890	200	20	220	1 110	– 15	—	– 85	– 100	1 010
1947-52	2 419	220	446	3 085	800	112	912	3 997	– 896	– 96	– 628	– 1 620	2 377
1953	320	70	—	390	500	30	530	920	– 21	– 139	– 180	– 340	580
1954	170	110	—	280	410	40	450	730	– 47	– 70	– 253	– 370	360
1955	330	90	40	460	590	60	650	1 110	– 32	—	– 318	– 350	760
1956	830	(180)	(100)	1 110	365	85	450	1 560	– 50	—	– 450	– 500	1 060
1957	1 350	(370)	(70)	1 790	460	110	570	2 360	– 90	—	– 540	– 630	1 730
1958	475 [g]	(350)	(110)	935	630	120	750	1 685	– (300)	—	– (670)	– 970	715
1953-58	3 475	(1 170)	(320)	4 965	2 955	445	3 400	8 365	– (540)	– 209	– (2 411)	– 3 160	5 205
1947-58	5 894	(1 390)	(766)	8 050	3 755	556	4 312	12 362	– (1 436)	– 305	– (3 039)	– 4 780	7 582

Source: Economic Survey of Latin America, 1957 (United Nations publication, Sales No.: 58.II.G.1). *Ibid.*, 1958 (Sales No.: 59.II.G.1).

Note: Balance-of-payments statistics on capital movement are usually inaccurate, especially those referring to short-term capital.

[a] Profit reinvestments excluded.

[b] Net figures of equipment imports financed abroad less annual amortization of such loans.

[c] Net figures, classified under *inflow* or *outflow* depending on the net direction of the movement.

[d] Including United States portfolio investment in Latin America.

[e] Including 120 million dollars for purchases of foreign-owned investments in the area.

[f] Including 670 million dollars for purchases of foreign-owned investments in the area.

[g] Provisional.

are approximations only since they are based on sources which leave much to be desired as regards accuracy (balance-of-payments statistics of capital movements and book values as reported by private investors). However, they do provide an idea of the order of magnitude involved.

2. Forms of investment

The Group wishes to emphasize that the following discussion of foreign loans and direct investments does not infer any judgement as to the relative merits of the two forms of investment. Both are legitimate sources of capital, and it is difficult to choose one as being the best for any particular investment purpose. There are situations in which service charges on loan capital, particularly on short-term and medium-term loans constitute a serious drain on a country's balance of payments and thus reduce the possibilities of borrowing abroad,[22] and other situations in which the reservation of particular areas for domestic public or private exploitation prevents or reduces the participation of direct foreign investments. Likewise, there are areas in which there is no point in suggesting a private direct investment, such as social overhead investments in general (hospitals, education, sanitation); other areas in which both long-term loans and private capital are of major importance, either independently or jointly (power, transport, heavy industry); and still other areas in which direct foreign investment plays a leading role even though foreign loans and credits, particularly to domestic entrepreneurs, are growing in volume and importance (manufacturing).

There has been a tendency in the post-war period for Latin American Governments to follow policies which favour loan investments as against direct foreign investments. These policies are sometimes deliberate but more often result from action taken in other fields.

In those cases where such policies are deliberate, the motivating assumptions are that loan capital can be more easily directed into fields of major national concern (often in social terms) and that the servicing of such capital represents only a temporary drain on the balance of payments, whereas profits on direct investments constitute a permanent and heavy burden. Sometimes, however, the favouring of loans as opposed to direct investment results from such factors as rate policies which discourage or prevent foreign investment in public utilities, the prohibition or limitation of foreign investment in certain areas, and administrative obstacles to the inflow of foreign direct investments.

The extent to which the foregoing factors have discouraged private investment and influenced the rising rate of loan investment cannot be determined with any precision. Interesting, although by no means conclusive, is the fact that United States direct investments in Latin America rose by only 96 per cent between 1950 and 1958, as compared to 149 per cent in Canada, 155 per cent in Western Europe, 175 per cent in Africa, and 142 per cent in the rest of the world (see table 4).

[22] Such situations arise particularly during recessions, when the rigidity of services charges on loans contrasts with the flexibility of profit and dividend remittances, which tend to decline during such periods.

Table 4. United States: Value of direct investment abroad, by selected areas in specified years

Area	Millions of dollars 1950	1952	1956	1958[a]	Percentage increase since 1950 1952	1956	1958[a]
Canada	3 579	4 593	7 460	8 929	28	108	149
Latin America	4 445	5 443	7 059	8 730	23	59	96
Western Europe	1 720	2 145	3 520	4 382	25	105	155
Africa	287	399	659	789	38	130	175
Rest of world	1 757	2 239	3 479	4 245	27	98	142
TOTAL	11 788	14 819	22 177	27 075	26	88	130

Source: United States Department of Commerce, *Survey of Current Business*, August 1959.
[a] Provisional.

The belief that the remittance of profits and dividends on direct capital investment constitutes an excessive drain on a country's economy has undoubtedly influenced the granting of priority exchange and guarantees in the case of suppliers' credits and other lending operations and thus indirectly promoted loan versus capital investment. The validity of this belief is open to question. In the first place, the importance of profit and dividend remittances is often exaggerated because of the lack of statistical data, the usual form of balance-of-payments statement lumping together all forms of investment income.[23] In those countries where profit and dividend remittances are shown separately from other forms of investment income,[24] the importance of the former is brought into better focus (see table 5). In Brazil, for instance, where total direct foreign investments had an estimated book value of 3 billion dollars in 1956, profit and dividend remittances during the ten-year period

[23] Some exaggerated ideas as to the level of earnings abroad from investment in under-developed countries are current. High rates of return are undoubtedly present in export industries (mining, for instance), particularly when raw material prices are favourable and for some industries producing for the domestic market during periods of abnormal inflationary disequilibrium not compensated by exchange devaluation. In most instances, however, the high rate of profit reinvestment that usually takes place in fast growing under-developed countries substantially reduces income actually remitted abroad. J. F. Rippy, in his book *British Investment in Latin América, 1822-1949* (University of Minnesota Press, Minneapolis, 1959), states that the average income received by United Kingdom investors in manufacturing industries in relation to the par value of stock on direct investment rarely exceeded 5 or 6 per cent during that one-hundred-year plus period. Average return on direct investment in Mexico (compared with its book value) also averaged about 7 per cent during the twenty-year period 1939-58.

[24] Royalties and payments for designs, patents and technical assistance, as well as specialized licensing and management or consultant contracts, tend to be important items in investment remittances in under-developed countries, since these are the principal means of securing know-how and increasing the average productivity of invested capital, foreign and domestic alike. Also, interest on loans and particularly on balance-of-payments credits in recent years have grown greatly in importance.

Table 5. Brazil and Mexico: Profit and dividends as compared with total investment income remittances in the balance of payments, 1949-58

(*Millions of dollars*)

Year	Investment income: Brazil, Total	Investment income: Brazil, Actually remitted	Investment income: Mexico, Total	Investment income: Mexico, Actually remitted	Profits and dividends: Brazil, Total	Profits and dividends: Brazil, Actually remitted	Profits and dividends: Mexico, Total	Profits and dividends: Mexico, Actually remitted	Profits actually remitted as percentage of income remittances: Brazil	Mexico
1949	101	62	54	34	80	41	51	32	66.1	94.1
1950	110	74	77	62	83	47	58	43	63.5	69.4
1951	157	90	111	84	137	70	88	61	77.8	72.6
1952	121	36	117	82	100	15	83	48	41.7	58.5
1953	165	127	94	58	132	94	60	24	74.0	41.4
1954	137	97	86	62	93	53	51	27	54.6	43.5
1955	114	78	93	72	80	44	37	18	56.4	25.0
1956	141	91	135	103	74	24	86	54	26.4	52.4
1957	128	93	134	105	61	26	77	48	28.0	45.7
1958[a]	...	85	144	118	(71)	31	73	47	36.5	39.8
1949-58	(1 299)	833	1 045	780	(911)	445	664	402	53.4	51.5

Sources: Department of Currency and Credit (*Superintendencia da Moeda e Crédito*). *Boletin*, Rio de Janeiro August 1959, Vol. V, No. 8, p. 78; *Banco de México*, Department of Economic Studies (*Departamento de Estudios Económicos*).
[a] Provisional.

Table 6. Brazil: Direct investment flow and its income in the balance of payments, 1950-58

(Millions of dollars)

Year	Direct investment inflow [a]			Profits and dividends			
	New investment	Reinvested profits	Total (1)	Remitted	Reinvested	Total (2)	Balance (1-2)
1950	3	36	39	47	36	83	– 44
1951	4	67	71	70	67	137	– 66
1952	9	85	94	15 [b]	85	100	– 6
1953	22	38	60	94	38	132	– 72
1954	11	40	51	53	40	93	– 42
1955	43	36	79	44	36	80	– 1
1956	89	50	139	24	50	74	65
1957	143	35	178	26	35	61	117
1958 [c]	110	(40)	(150)	31	(40)	(71)	79
1950-58	434	427	861	404	427	831	30

Source: Conjuntura Econômica, June 1959, pp. 61-68 (Portuguese edition), and table III for reinvested profits.

[a] There are no figures for direct foreign investment repatriation; they are probably included, where they exist, under " Profits and dividends remitted ".

[b] Profit remittances were limited owing to exchange restrictions.

[c] Provisional.

1949-58 (445 million dollars) represented only 53 per cent of total investment income remittances (833 million dollars) and less than two per cent of total current exchange proceeds, while in Mexico, with an estimated foreign direct investment total of 1.1 billion dollars in 1956, profit and dividend remittances for the same 10-year period (402 million dollars) represent 52 per cent of total remittances of investment income (780 million dollars).

Brazil offers an excellent example of the interplay of exchange and investment policies. From 1951 to 1953, the cruzeiro was over-valued in terms of foreign currencies, while prior to 1955 direct foreign investments were subject to close scrutiny by a government committee. The institution of a free floating rate of exchange for financial transactions in 1953 was followed in early 1955 by the abolition of the Foreign Investment Committee and the simplification of previous procedures. The contrast between the periods prior to and following those actions, as shown in table 6, is remarkable. The profit rate (in terms of dollars) which had been abnormally high during 1951-53 owing to the overvaluation of the cruzeiro, fell to more normal levels thereafter, the proportion of profits ploughed back rose from 51 to 53 per cent (in spite of exchange restrictions having made reinvestments in the earlier period artificially high) and profit remittances fell even though all restrictions had been lifted. Of greater importance was the increase in new direct foreign investments, which rose from an average of less than 10 million dollars a year during 1950-54 to an average of almost 100 million dollars a year during 1955-58. The extremely high rate of increase in new investment should not be credited solely to the simplification and liberalization of Brazilian new investment procedures, since the incentive given to the automobile industry, especially from 1957 on, brought very large sums of capital into Brazil. However, there is ample evidence that the exchange and investment procedure reforms greatly stimulated the flow of new direct foreign investments. The adverse balance between direct investment inflow and profit and dividend outflow, which characterized the period prior to 1955, has been turned into a handsome favourable balance for Brazil in every year since 1955.

The case of Mexico, as statistically presented in table 7, provides equally convincing, though less striking evidence, since there have been no restrictions on remittances, the apparent overvaluation of the peso prior to the 1954 devaluation was substantially less than that of the cruzeiro before 1953, and Mexico has had no formal investment committee passing on new direct foreign investments. Nevertheless, it will be noted in table 8 that the 1951-52 profit rates of foreign direct investments (in terms of dollars) reached the highest levels of the last 20 years — more than 12 per cent — as compared with just over 7 per cent, the average for the twenty-year period 1939-58. After the 1954 devaluation, profits fell to normal levels, the rate of investment increased slightly (from 36 to 40 per cent), and average profit remittances fell from 55 million dollars annually during 1951-52 to 41 million dollars annually during 1954-58, at the same time that the yearly average of direct capital inflow increased from 42 million dollars during the four-year period preceding devaluation to 83 million dollars in the following six-year period. Similarly the adverse balance between direct investment inflow and profit outflow which was present during 1950-52 was reversed in every year since that time.

It may be objected that the ten-year periods covered in the two foregoing cases are too short to be conclusive and that the statistics presented are unduly influenced by the resumption of capital exports by Europe and the

Table 7. Mexico: Direct investment inflow and its income in the balance of payments, 1950-59

(Millions of dollars)

Year	Direct investment inflow[a]			Profits and dividends			Balance (1-2)
	New investment	Reinvested profits	Total (1)	Remitted	Reinvested	Total (2)	
1950	38	15	53	43	15	58	– 5
1951	50	27	77	61	27	88	– 11
1952	36	35	71	48	35	83	– 12
1953	37	36	73	24	36	60	13
1954	78	24	102	27	24	51	51
1955	85	19	104	(18)	19	(37)	67
1956	83	32	115	(54)	32	(86)	29
1957	101	29	130	48	29	77	53
1958	63	26	89	47	26	73	16
1959[b]	90	40	130	50	40	90	40
1950-59	661	283	944	420	283	703	241

Source: Banco de México, Department of Economic Studies.
[a] Does not include inter-company accounts.
[b] Provisional.

Table 8. Mexico: Average rate of return on direct foreign investment: 1939-58

(Millions of dollars)

Year	Book value of direct foreign investment				Net profits				Rate of return (percentage)			
	Total	Mining[a]	Manufacturing	Public utilities	Total	Mining[a]	Manufacturing	Public utilities	Total	Mining[a]	Manufacturing	Public utilities
1939	401.2	98.6	25.1	123.4	15.5	9.1	3.4	0.3	3.9	9.2	13.5	0.2
1940	449.1	107.5	32.0	141.3	15.4	8.1	3.4	0.7	3.4	7.5	10.6	0.5
1941	452.9	114.4	38.6	136.2	22.6	11.5	5.2	1.6	5.0	10.1	13.5	1.2
1942	477.4	118.1	46.3	139.7	26.5	11.9	7.3	1.8	5.6	10.1	15.8	1.3
1943	491.2	122.4	57.5	134.6	33.3	13.0	10.7	1.5	6.8	10.6	18.6	1.1
1944	531.8	133.5	70.1	138.1	27.7	7.8	11.5	1.3	5.2	5.8	16.4	0.9
1945	568.7	134.9	99.8	136.2	39.6	12.6	15.6	1.8	7.0	9.3	15.6	1.3
1946	575.4	129.2	140.5	136.5	48.9	14.1	22.4	1.9	8.5	10.9	15.9	1.4
1947	618.6	124.7	168.5	141.0	59.5	22.8	22.2	2.1	9.6	18.3	13.2	1.5
1948	608.8	105.8	174.3	130.0	61.3	28.0	21.6	1.6	10.1	26.5	12.4	1.2
1949	518.6	100.6	148.0	108.3	47.9	22.3	17.1	0.8	9.2	22.2	11.6	0.7
1950	566.0	111.8	147.9	136.8	57.9	24.7	20.3	1.8	10.2	22.1	13.7	1.3
1951	675.2	158.7	180.9	151.7	88.5	38.0	29.3	2.5	13.1	23.9	16.2	1.6
1952	728.6	160.2	225.5	160.4	83.4	29.4	34.0	3.6	11.4	18.4	15.1	2.2
1953	789.5	164.5	258.1	173.4	60.5	12.0	28.9	5.6	7.7	7.3	11.2	3.2
1954	834.3	163.0	278.3	189.2	50.9	10.2	24.8	3.7	6.1	6.3	8.9	2.0
1955	952.8	174.5	331.5	191.4	73.4	16.8	35.3	4.8	7.7	9.6	10.6	2.5
1956	1 091.4	194.8	386.1	220.8	93.4	18.5	41.6	5.6	8.6	9.5	10.8	2.5
1957	1 165.1	179.4	468.1	215.1	76.8	13.6	46.1	2.7	6.6	7.6	9.8	1.3
1958	1 169.5	176.3	497.0	226.2	73.2	9.1	43.6	6.5	6.3	5.2	8.8	2.9

Source: Banco de México, Department of Economic Studies.
[a] Excluding petroleum.

investment boom which both Brazil and Mexico have been enjoying in recent years. However valid such objections may be as concerns the examples cited, the conclusion that profit and dividend remittances are more than compensated over any extended period rests on broader grounds than a comparison between current new investments and profit and dividend remittances on all existing investments (old and new alike). Indeed, such a comparison has very limited meaning in terms of the balance of payments of a country, since foreign investment affects a country's balance of payments in several ways, and not only through income remittances. Such investment increases a country's capacity to import in the year of inflow and either creates additional sources of foreign exchange or saves exchange previously used for imports. The argument that foreign investments in

addition to profit and dividend remittances, create indirect exchange demands through their effect on national income is perfectly true. However, the effects of domestic investments are the same if the enterprises so financed are equally efficient. The only way these indirect effects can be avoided is for there to be no economic progress.

In any case, income remittances in a dynamic economy, except in some comparatively rare instances, tend to constitute only a small proportion of the additional exchange proceeds (or exchange savings) created by the investment. Unless it is the case of some extractive industries where the proportion of proceeds going to labour is abnormally low, or industries producing for the domestic market with an unduly high import component or, as the cases of Brazil and Mexico seem to prove, when the rate of return on investment is exaggerated (in terms of foreign currencies) due to exchange overvaluation [25] there tends always to be a net foreign exchange saving in almost any foreign investment.

Finally, profits, dividends and interest earned by foreign investment as well as other out-payments for royalties, for the use of trade-marks, designs and patents and for technical assistance payments are costs paid by developing countries for the means of increasing the productivity of invested capital.

While the drain on foreign exchange resources of profit and dividend remittances is compensated by other factors, it is interesting to observe that situations may arise at some time in the future when the degree of decision-making power held by the absentee owners of private direct investments might deserve attention. In the latter context, the following quotation from a Canadian Royal Commission [26] describes the preoccupation of a country wherein more than 30 per cent of total fixed assets are in the hands of foreigners:

> " The benefits of foreign investment that we have mentioned are real and tangible. It is more difficult to state in similarly precise terms what the dangers are in the present situation and what conflicts might occur between the interests of Canadians and the interests of the foreign owners of wholly-owned subsidiaries of foreign companies operating in Canada. In the course of the Commission's hearings, concern was expressed over the extent to which our productive resources are controlled by non-residents, mostly Americans. Many Canadians are worried about such a large degree of economic decision-making being in the hands of non-residents or in the hands of Canadian companies controlled by non-residents. This concern has arisen because of the concentration of foreign ownership in certain industries, because of the fact that most of it is centred in one country, the United States, and because most of it is in the form of equities which, in the ordinary course of events, are never likely to be repatriated. Some people think it is foolish to worry too much about the possible dangers of foreign investment in this country. However, the contrary opinions on this subject which we have mentioned do in fact exist and if a period of political or economic instability should occur they might develop into demands for restrictive or discriminatory action of an extreme kind, the consequences of which would be unfortunate for all concerned."

The foregoing discussion of foreign loans and direct investments should not be permitted to obscure the fact that by far the greater part of the capital necessary for the development of the countries of the Free-Trade Area must come from domestic savings. It is for this reason that throughout this report the Group emphasizes the need for promoting and expanding domestic investment and money markets.

3. Influence of foreign investment

The total amount and annual flow of private foreign investment compared to Latin America's total capital stock and total annual investment expenditures in the post-war period has been more important in qualitative than in quantitative terms. In some individual sectors, however, foreign investments have been very important in both respects, this being particularly true in mining, public utilities and petroleum. At one time it was also true of railways.

The exact proportion of the total capital stock represented by foreign capital is not known owing to the unavailability of estimates covering the value of the former, although relatively reliable data on investment flows from both internal and external sources permits the assumption that the average contribution of direct foreign investment to capital formation is about 8 per cent per annum, this percentage increasing to somewhere between 12 and 15 per cent if loans and credits from official (national and international) sources are included.

Almost every sector of the Latin American economy has benefited to a greater or lesser degree from private foreign investment. As regards agriculture, the case of cotton in Brazil stands out as one of the clearest examples of the indirect benefits derived from foreign investment. During the early 'thirties, the rapid fall in coffee prices led to the substitution of cotton in a substantial part of what had previously been coffee-producing areas, this changeover having been accomplished largely with the assistance of a foreign firm with world-wide relationships in the cotton and vegetable oil trades. Similarly, the impact on cattle-raising of foreign investments in the packing industries of Argentina and Brazil is too well known to require elaboration.

Distribution costs and retail practices in Mexico, Brazil, and in several other American republics have been favourably affected by the operation of foreign branch retail establishments while the activities of such firms, in building up domestic sources of supply have had a profound effect on the standardization, quality

[25] Perhaps it should be added that exaggerated profits can and sometimes do result from the monopolistic atmosphere which it not uncommon in Latin America, and from excessively liberal special concessions which some underdeveloped countries grant to foreign enterprises.

[26] Royal Commission on Canada's Economic Prospects, *Final Report*, Ottawa, 1958, pp. 389-390.

and cost of domestic manufacturers, particularly in the durable and non-durable consumer goods industries.

The favourable influence of foreign investment on domestic investment is nowhere more apparent than in the manufacturing industry, every sector of that industry from capital to consumers' goods having felt the stimulating effects of modern methods and techniques introduced, in many cases, by foreign private investment.[27] Perhaps the most spectacular evidence of such influence has been witnessed in Brazil where, as a result of the investment of very large sums of European and United States capital in the automotive industry, literally hundreds of domestic parts, manufacturing plants, have been established or expanded in recent years.

Other fields in which foreign capital has benefited the local economy and strongly influenced domestic investment includes the hotel and tourist business, where foreign capital has not only helped in several countries to build up basic facilities but has also improved the quality of local hotel operation.

Historically, foreign capital, largely from the United Kingdom, built the railways of Latin America, while both European and North American capital was prominent in the development of communications and power. In mining, foreign capital — in this case largely from the United States — has developed most of the larger copper, iron ore and manganese deposits. The story of technical as well as financial contributions made by foreign entrepreneurs in these fields and the contribution of mining to exchange earnings and Government finances has been told so often and is so widely known that repetition is unnecessary. However, the policies adopted by the foreign mining companies in Chile, after exchange reform permitting purchases from local producers, are worthy of mention since the efforts made by those companies to assist local manufacturers in increasing the quality and reducing the cost of their products are indicative of the beneficial although indirect effects of the operations of foreign capital under wise and forward-looking management.

4. Trends in joint international business ventures

The association of domestic and foreign entrepreneurs, although by no means a new development, has become far more frequent since the end of the Second World War than previously, the trend towards joint ventures having accelerated considerably in recent years.

The joint venture approach, particularly in manufacturing, is a natural outcome of the economic development process in Latin America, and there is every indication that both policy and economic factors will still further increase the incidence of this form of organization in the future.[28]

There is a tendency for Government policy to favour the joint venture approach in most of the Latin American countries in process of industrialization and while formal regulations affect only limited fields of activity at the present time,[29] in Mexico, at least, Government preference for joint ventures together with growing insistence on domestic control, in the case of basic industries, comes close to being set policy.

In general, however, the growing number of joint ventures reflects a natural trend. In earlier days many of such enterprises resulted from the association of a foreign supplier with a domestic distributor, the former supplying the manufacturing experience and the latter the market knowledge that makes for successful partnership, while in more recent times the growing diversity and extent of industrial activities have multiplied the opportunities for association between domestic and foreign entrepreneurs. Each has sought the assistance of the other, the domestic industrialist looking for solutions to such problems as the shortage of exchange, the dearth and high cost of domestic capital, and the technical and research facilities required by modern industry; the latter providing knowledge of local markets, established distributing facilities and the ability to cope with the growing complexities of Government relationships, particularly those in such fields as labour, foreign trade and exchange control.

The number of joint ventures operating in the Latin American Free-Trade Area is not known, although there were 1,496 such enterprises listed in a compilation published in Brazil in 1958.[30] The total capital of those firms was about 650 million dollars, or somewhat more than 20 per cent of total direct foreign investment in Brazil. In Mexico, figures of the *Banco de México* indicate that 11 per cent of all new direct foreign investments during 1950-57 were in joint ventures. An overwhelming percentage of such investments (94 per cent in the case of Mexico) were in firms in which the foreign interest had majority control.[31]

Instances of foreign minority participation, while still somewhat unusual, are increasing. There are several North American and European manufacturing groups which prefer minority participation, while cases of foreign financial control and domestic managerial responsibility are not unknown. Even more numerous are cases where the foreign partner accepts major responsibility for technical control and the domestic partner for managerial control.

Experience with joint ventures has been broad enough to indicate that this type of operation will increase in popularity and scope. While problems involving both

[27] It should be noted that modern methods and techniques have been widely introduced by domestic enterprises as well, many of them having close technical relationships in Europe and North America.

[28] The Columbia University School of Law has conducted a survey of joint international business ventures. The problems, results and prospects of such ventures are examined in detail. Studies covering Colombia, Mexico, and Brazil have been issued in final form.

[29] See circular of the Mexican Ministry of Foreign Affairs, 14 October 1949, issued under authority of the Executive Decree of 29 June 1944 (*Diario Oficial* of 7 July 1944). This circular requires majority domestic control of radio broadcasting; motion picture production, distribution and exhibition; transport; fishing; advertising and publishing; aerated and non-aerated beverages.

[30] See José Garrido Torres and Denio Nogueira, *Joint International Business Ventures in Brazil*, New York, Columbia University, September 1959.

[31] See George Kalmanott and Benjamin Retchkiman R., *Joint International Business Ventures in Mexico*, New York, Columbia University, February 1959, p. 29.

human and business psychology can, and often do, arise, the difficulties of successful partnerships are not so great as to cancel out the very real advantages of a form of business organization that is viewed with growing favour in both public and governmental circles in Latin America.

Another important advantage of the joint venture is the countering of one of the most frequently expressed criticisms of foreign investment in under-developed countries, namely, so-called " unfair " competition with local enterprises. It is argued that the greater capital resources usually at the disposal of the foreign firms permits them to build more modern plants with lower production costs, to face initial losses for a longer time (presumably deductable from income tax in the country of origin) and to pay higher salaries for their personnel. While the validity of some of these arguments is at least open to question, it is quite true, especially if the domestic partner is a well known local firm, that such criticism is rarely levelled at the foreign partner, the joint venture usually being considered as a domestic enterprise.

Finally, as stated in Brazil's case study of the Columbia University project, in countries " characterized by a rapid rate of economic and social progress, lack of capital is truly an important handicap. Even so, economic growth is not a matter of capital availability alone, it implies primarily a continuous change of attitude, mentality, technology and methods of doing business, which cannot be accomplished merely by the investment of capital. This is best achieved by an interchange of ideas, experience, and " know-how " which, in spite of their priceless importance, are freely secured when business men of different nationalities sit together to pursue a common objective, even though their goal is no more than profit making.

B. Factors affecting foreign investment

1. The general economic environment

The seven countries at present forming the Latin American Free-Trade Area offer a combined market of significant proportions, with a population of over 130 million people, a gross national product of between 40,000 million and 45,000 million dollars, and with foreign trade amounting to more than 8,500 million dollars a year. The area thus accounts for over 70 per cent of the population and gross national product of Latin America and for over 50 per cent of its foreign trade.

The relative importance of these seven countries within the Free-Trade Area, in terms of population, gross national product and foreign trade is shown in table 9. Brazil, Argentina and Mexico, in the order named, are by far the most important, accounting together for over 80 per cent of the market and of the population of the Free-Trade Area. Following in importance are Chile, Peru, Uruguay and Paraguay.

Table 10 shows the gross national product broken down by industrial origin. While conclusions drawn from these data must be used with care, since their absolute and comparative accuracy leaves much to be desired, the table clearly shows the greater economic diversification of Brazil, Mexico, Argentina and Chile.

These four countries lead all of Latin America in terms of industrial development (see table 11). They accounted for 94 per cent of total pig iron and steel ingot production in 1957; 92 per cent of the output of blister, fire-refined and electrolytic copper; 77 per cent of metallic lead output; and 71 per cent of the production of zinc smelters. They also produced all of the newsprint, manufactured motor vehicles, and railway rolling stock; 95 per cent of the pulp; over 75 per cent of the tyres; and 60 per cent of the cement. In terms of power, they accounted for nearly three-fourths of the electricity output, 70 per cent of coal production, and 41 per cent of the output of refined petroleum products.

Among the four, Brazil leads in population (46 per cent of the LAFTA total), followed by Mexico (23 per cent), Argentina (15 per cent) and Chile (5 per cent). Brazil also leads in gross national product (36 per cent of the LAFTA total), followed by Argentina (30 per cent), Mexico (18 per cent), and Chile (6 per cent). In *per capita* purchasing power, however, Argen-

Table 9. Latin American free trade association: Population, gross national product and foreign trade, by countries, 1956

Country	Population	Gross national product		Foreign trade (millions of dollars)	
	(thousands)	Total (millions of dollars)	Per capita (dollars)	Exports	Imports
Argentina	19 486	12 384	635	944	1 128
Brazil	59 846	14 985	250	1 482	1 234
Chile	6 944	2 318	334	542	354
Mexico	30 538	7 520	246	874	1 072
Paraguay	1 601	1 120	143	37	29
Peru	9 651	1 502	160	308	361
Uruguay	2 660	(1 400)	(500)	211	206
Total	130 726	(41 229)	(315)	4 398	4 384

Source: Jorge Del Canto, " América Latina: Desarrollo Económico y Estabilización Económica ", in *El Trimestre Económico*, vol. XXV, No. 3, July/September 1958, Mexico City.

Table 10. Latin American free trade association: Industrial origin of gross domestic product, by countries, 1956

(Percentage)

Country	Gross national product (millions of dollars)	Agriculture	Mining	Manufacturing	Construction	Transport and communications	Trade	Other
Argentina	12 384	18	1	22	5	[a]	27	26
Brazil	14 985	26	[b]	23	[b]	11	11	29
Chile [c]	2 318	15	5	18	3	8	17	34
Mexico [d]	7 520	20	4	21	2	5	35	13
Paraguay	1 120	51	[b]	14	[b]	7	9	19
Peru	1 502	25	14	16	[e]	6	15	24
Uruguay	1 402	...	...	...	...	...	...	...

Source: United Nations, *Statistical Yearbook, 1958*, pp. 433/4.

Note: It should be emphasized that the classification of industries is not fully comparable from country to country.

[a] Included in " Trade ".

[b] Included in " Manufacturing ».

[c] Percentage distribution as of 1954.

[d] ECLA, *Economic Bulletin for Latin America*, Vol. III, No. 2, October 1958, p. 47.

[e] Included in " Transport and communications ".

Table 11: Latin America: Output of specified commodities, by countries,[a] 1957

Commodity	In	Argentina	Brazil	Chile	Mexico	Total for four countries	Latin America
Pig iron	Thousands of tons	34	1 252	382	429	2 097	2 223
Steel ingots	Thousands of tons	221	1 475	412	1 050	3 158	3 369
Coal	Thousands of tons	206	2 073	2 101	1 421	5 701	8 176
Copper [b]	Thousands of tons	—	1	451	56	508	550
Lead [b]	Thousands of tons	26	4	0 [c]	207	237	308
Zinc [b]	Thousands of tons	14	0 [c]	—	57	71	100
Tin [b]	Thousands of tons	0 [c]	1	—	0 [c]	1	2
Cement	Thousands of tons	2 340	3 376	725	2 519	8 960	14 316
Petroleum [d]	Thousands of tons	10 878	6 380	997	11 827	30 082	74 340
Power	Millions of kWh	7 787	16 900	4 188	8 453	37 328	50 269
Paper pulp	Thousands of tons	63	257	24	158	502	526
Newsprint	Thousands of tons	12	49	20	—	81	81
Tyres	Thousands of tons	1 158	1 985	174	1 088	4 405	5 760
Radios	Thousands of tons	400 [c]	660	...	275	1 335	...
TV sets	Thousands of tons	52	110	—	80	242	...
Typewriters	Thousands of tons	20 [c]	18	—	0 [c]	38	...
Sewing machines	Thousands of tons	...	631	—	—	631	...
Washers	Thousands of tons	168	27	9	31	235	...
Refrigerators	Thousands of tons	202	145 [e]	10	44	401	...
Rolling stock	Units	218	2 030	50 [c]	1 517	3 815	3 815
Motor vehicles	Units						
Assembling	Units	7 089	1 021	...	40 723	48 833	63 650
Production	Units	15 274	29 679	—	—	45 053	45 053

Source: ECLA, *Economic Survey of Latin America, 1958, op. cit.*, pp. 81-88.

[a] It should be noted that several important industries (textiles, food products, tobacco, chemicals and others) are not included because of the lack of data.

[b] Metal content.

[c] Inferior to half the unit.

[d] Refined.

[e] Preliminary estimates.

tina leads all the countries in the Free-Trade Area, followed by Chile, Brazil, and Mexico in the order named. In terms of industrialization, Brazil leads in the production of 13 of the 22 items listed in table 11 (pig iron, steel ingots, tin smelting, cement, electric power, paper pulp and newsprint, tyres, radio and television sets, sewing machines, rolling stock and manufactured motor vehicles); Mexico leads in 4 (lead and zinc smelting, petroleum refining and assembled motor vehicles); Argentina in 3 (typewriters, washing machines and refrigerators); and Chile in 2 (coal production and copper smelting). It should be stressed, however, that these data may be somewhat misleading since table 11 does not contain any information on food-processing industries, which are of major significance and in which Argentine production is very important, reflecting the agricultural resources and production pattern of that country.

2. VIEWS AND OPINIONS ON FOREIGN INVESTMENT

Only a few generalizations can be safely made with respect to the opinions and views on foreign private investment in the seven signatories of the Montevideo Treaty. Among these might be mentioned *official policies* recognizing the need for a foreign capital and assigning to it an important role in the economic development process; *business opinion*, which favours foreign capital in joint ventures and in non-competing activities; and *public opinion*, which is usually uninformed and uninterested.

It must be noted, however, that while the above generalizations are more or less relevant to all seven member States, opinion varies in each country and in each economic sector from deeply rooted anti-foreign sentiment to outright approval of unlimited foreign enterprises, the majority opinion being rather against than in favour of foreign capital.

Underlying these reactions are various historical, political and economic factors. The first two are of long standing and are compounded of many elements including the effects of the social radicalism of recent decades, the alleged colonial policy of more developed areas and the universal popular fear of size and influence. Economic factors, however, have also become major determinants of long-term governmental policy, and it is in this area that is centred the conditional support of foreign investment influenced by the theory that profits and remittances form an uncompensated drain on exchange resources, by demands that foreign capital should complement and not compete with domestic industry, and by pressure on Governments to channel foreign investment into basic or new sectors, limit profit and dividend remittances and progressively nationalize foreign enterprise.

It is natural that the official policies, deriving from each country's needs as well as from the pressures and influences briefly noted above, should differ considerably from country to country. Peru, which has the most simplified official regulations for the entry of foreign capital, is among the industrially less developed countries, while Chile, which has one of the most elaborate systems for determining the advisability of each foreign investment, is — in relation to its market — very highly industrialized. Argentina and Brazil occupy intermediate positions, both having approval systems which take into account the interests of established industrialists, although this characteristic is much more pronounced in the case of Argentina than of Brazil. The systems in effect in Uruguay and Paraguay are more promotive than restrictive or selective in character.

Mexico occupies a somewhat unique position; while legally making no distinction between foreign and domestic enterprise,[32] it quite frankly assigns a complementary role to new foreign capital and holds that " it should not compete favourably with existing Mexican enterprises nor displace national capital nor frustrate its future development ". Further, " such capital should not utilize national savings " in such a manner as to reduce resources " which naturally correspond to national enterprises ".[33] Within the Government itself there are powerful sectors which hold that private foreign capital should only be encouraged to enter basic industries if willing to accept a minority participation in joint enterprises.

As regards regulations governing the remittance of dividends and profits, governmental attitudes have become more liberal in the last decade. In no LAFTA country is there any control exercised over such remittances at the present time, although policies and existing regulations with respect to capital imports vary considerably. In the case of Peru, the legal prerequisites for establishment are precisely the same as for domestic investors, while in Chile an application has to be made to the Foreign Investment Committee (*Comité de Inversiones Extranjeras*) prior to registration of a foreign enterprise for the purpose of securing certain remittance guarantees. In Mexico, the legal requirements are much the same as in Peru, although in practice new industries, if they wish to have the good will of the Government — an essential element for successful operation — must keep within the policy boundaries previously described. In Argentina and Brazil, existing regulations provide for an application to the Advisory Committee on Foreign Investments (*Comisión Asesora de Inversiones Extranjeras*) in the former, and to the Foreign Trade Department (*Carteira de Comércio Exterior*) of the *Banco do Brasil* in the latter. In the case of Brazil, the regulations fall within the category of import control rather than that of foreign investment control, while the reverse is true in Argentina.

It should be stressed that, legally speaking, firms do not have to take advantage of foreign investment incentive laws and, except where special restrictive legislation rules otherwise, are free to establish themselves and to make their remittances through free-exchange markets. In practice, the additional guarantee of future free access to such markets is usually sought by the foreign investor through registration.

In general, special tax and other incentives, when provided, are extended equally to foreign and domestic investors. In Brazil and Chile, the only advantage not extended to domestic enterprise is the right to import equipment without the payment of exchange surcharges (prior deposits in the case of Chile), although in Brazil, in cases considered of special interest to economic development, both foreign and local investors may be granted a rate of exchange (the so-called " cost of exchange rate ") more favourable than the free-market rate.

Domestic business attitudes towards private foreign investment may be summed up as favouring such invest-

[32] A circular, previously cited, of the Mexican Ministry of Foreign Affairs, dated 14 October 1949, issued under authority of Executive Decree of 29 June 1944 (*Diario Oficial* of 7 July 1944) requires majority domestic control of radio broadcasting; motion picture production, distribution and exhibition; transport; fishing; advertising and publishing; and aerated and non-aerated beverages. For other restrictions and prohibitions see subsection 3 of this section.

[33] See speech of the Mexican Minister of Financial Affairs at the XXVth Mexican Bankers' Conference in 1959, published in full in *Revista Bancaria*, Vol. VII, No. 3, Mexico, D.F., May/June 1959.

ment in basic or new fields,[34] opposing it in competing fields and favouring joint domestic/foreign ventures over outright foreign enterprise.

These generalizations must be refined, however, to portray correctly the varying degrees to which they are valid in business and particularly in industrial circles in the LAFTA countries.

Top officials of the leading industrial associations in Argentina and Chile, as well as many of the larger industrialists, tend to stress equality of opportunity for domestic industries rather than protection from competition from enterprises established by foreign capital. However, the rank and file of the membership of those associations was found to be far less reticent in demanding that fields developed by domestic capital be reserved to it. In Brazil, both views are held, the latter predominating over the former. In Mexico, feeling reflects government attitudes far more than is the case in the other three most industrialized countries of the Free-Trade Area, the opinion being very strong indeed that foreign capital, especially in the case of basic industries, should associate itself with domestic interests.

The preference for joint ventures is nowhere so strong as in Mexico, although sentiment in this regard is growing in Brazil. Reactions in both Argentina and Chile tend to be more theoretical than in Brazil and Mexico, where experience with joint ventures is much more extensive.

Support for foreign private capital is stronger in those countries where industrialization is less advanced. Thus, in Peru the domestic business community appears to be quite favourable to foreign investment although some reserve was encountered, particularly in the case of the textile industry, where opposition to further new investments from abroad was voiced.

3. Restrictions on foreign investment

Some activities within the countries members of the Free-Trade Area are partially or completely restricted to foreign investment. In many instances such restrictions are subject to discussion as far as their constitutionality is concerned, whereas in others they are so mild that they have little, if any, effect upon foreign investment.

Perhaps the most severely restricted activity is the petroleum industry. Brazil, Chile, Mexico and Uruguay limit petroleum prospecting and production to government monopolies, excluding foreign capital participation. On the other hand, Argentina, although maintaining a government petroleum monopoly, has recently signed some service contracts with foreign firms against payment in foreign or national currency. Peru does not restrict the petroleum industry, but such companies organized with foreign capital must offer Peruvian nationals 30 per cent of their shares. The offer remains open for ninety days and thereafter permission of the Government must be obtained to dispose of these shares.

Uruguay has no petroleum production, but an autonomous entity, the Administración Nacional de Combustibles, Alcohol y Portland (ANCAP), has a monopoly on the importation and refining of petroleum and its derivatives, as well as on potential production. Again, hydroelectric power and domestic telecommunications are a state monopoly (*Usinas Eléctricas y Teléfonos del Estado*). Meat packing and the slaughtering of beef cattle, sheep and lambs are state monopolies in Uruguay (*Frigorífico Nacional*). There also exists a monopoly of pasteurized milk distribution in Montevideo — Cooperativa Nacional de Producción de Leche (CONAPROLE).

In Paraguay, a monopoly regulates the consumption, sale and export of meat products; the Corporación Paraguay de Carne (COPACAR), which also controls and regulates other meat industries such as canning plants, through the allotment of cattle quotas.

In Chile, the trade in nitrates is subject to a state monopoly, exercised through the Corporación de Ventas de Salitre y Yodo. The Corporation acts as sales agent and exporter for three groups of producing companies.

Another activity in which foreign participation is restricted is the publication of newspapers, radio broadcasting and television. Nearly all countries of the Free-Trade Area reserve these activities for their citizens or companies in which the majority of stocks is held by nationals. The operation of lotteries, even when not a government monopoly (Argentina, Uruguay) is generally reserved for nationals.

Coastwise shipping and domestic air transport, with the sole exception of Paraguay, is reserved for ships and aircraft registered under national charter, and crews are frequently required to be entirely national. For vessels in the coastwise trade Uruguay requires that the captain and a third of the crew must be Uruguayan nationals. Fishing in territorial waters by foreigners is also restricted in four of the seven countries (Brazil, Chile, Mexico and Uruguay), though in some of them special permits may be granted.

Some limitations on insurance companies exist in Argentina, Brazil and Chile. In Uruguay, insurance is virtually a state monopoly. All telegraph and radio communications have been nationalized only in Mexico, while in Argentina and Uruguay domestic telegraph and radio communications are nationalized.

In Mexico, a number of industries and activities must be 51 per cent under Mexican control. This applies, for instance, to the production, distribution and exhibition of motion picture films; domestic transport by sea, air and land; fishing in territorial waters; the distribution of carbonated and other non-alcoholic beverages; the bottling of fruit juices; and tyre manufacture.

A mild but frequent restriction exists on foreign ownership of land within a certain distance from international borders and even, in some cases, from the coast, as in Mexico (62 miles from international borders and 30 from the coastline). In Brazil, the restriction (93 miles from international borders) may be waived

[34] Basic or new industries are those requiring a high rate of capital formation per unit of output in fields not pre-empted by or attractive to domestic capital. Export industries, especially in mining, are generally, although not universally, favoured as an area for foreign investment by domestic business men and industrialists.

by the National Security Council upon case-by-case examination. In Argentina, the restriction applies to 62 miles from international borders and in Peru to 80 miles, as well as in the vicinity of defence establishments. Chile, Paraguay and Uruguay do not apply such limitations.

Another frequent restriction limits the proportion of the total labour force which can be foreign. Employment legislation in Mexico and Paraguay requires that at least 90 per cent of the employees in any concern be nationals of the country, while Chile specifies 85 per cent, Peru 80 per cent and Brazil two thirds. In Peru, the 80 per cent employment restriction extends to foreign commercial and industrial establishments and to the number of professionals and artisans; the limitation is not an overall figure but governs each individual profession, trade, or industry. It is also applicable to each individual province of the country. In Uruguay, public work contracts contain a stipulation calling for 90 per cent employment of nationals. Argentina has no such restrictions.

As to professions, there is only one example of a blanket restriction. As a general rule, professionals who practice in Mexico are required to be Mexican by birth or naturalization. In Chile, such restrictions are applicable only to lawyers and brokers, and in Brazil only to engineers, or engineering companies building or operating bridges between the States of Brazil or between Brazilian territory and another country. In all the countries, the practice of professions is subject to revalidation of foreign degrees and sometimes to the passing of examinations. Treaties and conventions govern and modify revalidation requirements in several instances.

A special restriction exists in Mexico in the application of the so-called " doctrine of the saturation of industry ", under which new investments cannot be made in some industrial sectors when, in the judgement of the Government, there is danger of over-expansion. Industries producing rayon, matches, flour, cigarettes and rubber have, among others, already been declared " saturated ". Furthermore, prior permission from the Ministry of Foreign Affairs is also required (i) to organize a Mexican company with foreign participation; (ii) to modify or change existing Mexican companies, either by increasing the number of foreign stockholders or, in the case of foreign participation, by amending the corporation's purposes; and (iii) to buy or sell shares or a part interest which would result in the control of enterprises being transferred to foreigners.

4. Incentives

Legislation providing for incentives to foreign investment seems to be a common feature of the countries members of the Latin American Free-Trade Association. However, the scope and types of incentives vary from country to country. Chile and Paraguay have special legislation applying to foreign investment that may be extended to domestic investors in certain cases. In Argentina, Mexico, Peru and Uruguay, the incentives are for investments in general, regardless of source. In Brazil, on the other hand, the exemption from exchange surcharges for imports of equipment by foreign investors cannot be extended to domestic investors.[35]

In Peru, the legislation on investment incentives dates from 1950 when the Mining Code was enacted providing for liberal allowances, an option on paying income taxes or extending capital participation to the Government (up to 20 per cent of the tax payment due) and an exemption from customs duties for all machinery, equipment and spare parts to be used by a mining enterprise in its present and future mining activities. Recently, however, this incentive has been limited to items not produced within the country.

Shortly after the Mining Code, a new Petroleum Act (1952) was promulgated in Peru, according to which concessions may be granted either to foreign or domestic enterprises, providing that the former formally waive diplomatic support in the event of possible conflicts with the Government. Concessions for exploitation may be granted for periods up to fifty years with an option for a twenty-five-year extension. Of the total taxable income, 50 per cent is paid to the Government as income tax, except during the first 30 years in the *sierra* and eastern regions, during which period it increases each ten years from 10 to 25, to 35 and 50 per cent, plus 2 per cent as export tax. The import of exploration equipment is free of customs duties during a two-year period, at the end of which the duties must either be paid or the equipment re-exported. A third Peruvian Act on investment incentives dates from 1955 and relates to the electric power industry. Its main characteristic is that a minimum yearly dividend is guaranteed by the Government, varying according to the volume of electric energy produced.

Finally, late in 1959 a general Act was promulgated aimed at promoting Peruvian industrial development. All industries were classified into two groups: basic and others. Basic industries were entitled to very liberal treatment, such as total exemption from custom duties for imported equipment and raw materials (the latter if not domestically produced), without time limit; exemption from all general or local taxes for periods varying from 3 to 15 years, starting from the beginning of operations (and extendible for 15 years more with certain limitations); exemption from income tax on certain types of reinvested profits; assets revaluation whenever the national currency is devalued by more than 5 per cent in relation to the dollar; and provision for accelerated depreciation allowances under certain conditions. These incentives also apply to existing enterprises. Moreover, with respect to industries not considered as basic, customs duties may be reduced by 50 per cent, both for machinery and raw materials; exemption may be granted for 15 years on all general and local taxes with certain limitations, as in the case of basic investments. Exemption from income taxes on reinvested profits and assets revaluation and accelerated depreciation are provided for as mentioned above.

[35] But domestic investors may be given other incentives under certain conditions.

In Chile, all incentives are subject to the decision of the President of the Republic on the basis of a case-by-case examination. Upon his approving an application, a decree is issued that becomes a contract between the foreign enterprise and the State. According to the new incentives Act of 1960, all approved foreign investments have the right to (i) use the free-exchange market for capital transactions and income remittances; (ii) revalue their assets in accordance with the rate of exchange and without any tax payments; (iii) amortize invested capital in accordance with a schedule established by official decree; and (iv) use export proceeds freely to cover financial remittances. Moreover, foreign investments may also be granted exemption from customs duty for the import of equipment destined to produce goods heretofore not domestically manufactured, provided such equipment is new, not produced in Chile, and that at least 80 per cent of the raw materials are produced domestically.

Similar exemptions may also be granted for investments thought to be of " fundamental " interest to the Chilean economy. In the latter case, other privileges may be granted such as (i) a guarantee that the prevailing income tax rates and the criteria for determining taxable income will not be changed for at least ten years; and (ii) a guarantee that for ten years no new taxes will be created that may affect exclusively that industry or its products. Domestic producers may also be granted such benefits, provided they can prove that a competing foreign investor has been so favoured.

Argentina, Brazil, Mexico and Uruguay grant tax exemptions or reductions (particularly from customs duties) to industries of special interest to the country, regardless of the origin of capital. In Argentina and Brazil, such benefits are practically limited to the exemption from customs duties and some local taxes and provided the plant is outside Buenos Aires. In both countries, the production of motor vehicles and tractors and a few other industries are granted special subsidies (exemption from import surcharges for finished goods in Argentina, and an exchange subsidy in Brazil).

In Argentina, Act 14,780 of 22 December 1958 on the legal régime for the investment of foreign capital was enacted to provide special treatment for approved investments in the form of foreign exchange, machinery or other equipment, spare parts, and raw materials. Such foreign capital must be invested in economically desirable enterprises, including those that will manufacture export products to obtain needed foreign exchange, or those that will produce substitutes for items now imported. Investments may enter at the free-market rate of exchange and capital may be repatriated and profits remitted through the free market. Foreign capital under this Act is guaranteed the same rights which are accorded to nationals by the Constitution and other legislation. New investments may be granted one or more of the benefits respecting customs duties, tax and foreign exchange provisions, credit facilities, and the inclusion in the most favourable régime for the development and protection of industries.

In Mexico, the Government may grant five-year to ten-year reductions or exemptions from several taxes (including customs duties and up to 40 per cent of the income tax) to industries which: (i) manufacture goods not produced in the country in sufficient quantity; (ii) provide services to economically important activities; (iii) are engaged in assembly operations, provided they use domestically produced parts to the extent of at least 60 per cent of the total direct cost; (iv) are producing for export, provided also that the import component does not exceed 40 per cent; and (v) are extracting non-metallic minerals which can be used as raw materials in Mexican industry.

In Paraguay, the incorporation of private foreign capital may be specially authorized if it is likely to contribute to the economic and social development of the country and if the imported equipment and machinery is new, modern and efficient. In such cases it may enjoy the following benefits: (i) exemption from customs duties; (ii) exemption from export duties (under certain conditions); (iii) reduction of 25 per cent of the income tax; (iv) exemption from most other existing taxes; (v) assurance of obtaining foreign exchange for income remittances and capital repatriation up to 20 per cent per year of the registered capital; and (vi) exemption, for a period of five years, from the obligation to employ the legal percentage of Paraguayan personnel.

5. Exchange and trade regulations

Prevailing exchange systems and practices relating to current and capital transactions have been considerably simplified by the countries members of the Latin American Free-Trade Association. With the sole exception of Brazil[36] all the other countries have officially eliminated the multiple exchange rates system, although in some cases there still exist (i) exchange (import) surcharges, as a substitute for tariffs and as a convenient source of Government revenue in Argentina, Paraguay and Uruguay; and (ii) prior deposits, as an instrument of monetary policy and import control in Chile, Paraguay and Uruguay. Financial transfers of funds are carried out in all countries through the free exchange market without restrictions.

Mexico and Peru do not use exchange surcharges nor require prior deposits of local currencies for import purposes. Both countries have complete freedom of foreign exchange, but they do apply control procedures of a different character.

In Mexico, after the expiration in 1950 of the Reciprocal Trade Agreement with the United States, import duties were overhauled and imports were submitted to controls in order to encourage resident industry.[37] As of 1959, there were more than 1,500 items on the import tariff subject to import control and requiring an import licence from the Ministry of Industry and Commerce (800 in 1955 and 300 in 1951) including finished goods and raw materials.

[36] It should be pointed out that, although there are no prior deposits in Brazil, the effect of the auction market is in many cases the same as that of up to five months' prior deposit.

[37] Mexico did not sign the General Agreement on Trade and Tariffs (GATT).

Peru's foreign exchange policy is perhaps the most unrestricted in Latin America and dates from November 1949, when a series of measures were taken, aimed at a progressive liberalization of international transactions. Exchange transactions were until very recently handled in two separate markets, one for commercial and the other for financial operations, but these two markets have now been unified. The protection of resident industry and the redress of transitory balance-of-payments difficulties can be affected by tariff measures, the executive branch of the Peruvian Government being authorized to raise customs duties up to 100 per cent of their legally authorized levels and even to 200 per cent in a few cases.

As already said, in all the countries belonging to the Free-Trade Area, financial operations are generally unrestricted and are transacted through the free exchange market. Capital inflow, especially in the form of equipment, is subjected to more or less strict control if the investor desires to secure a waiver on the payment of surcharges, the making of prior deposits or the full payment of import duties. Concerning capital inflows of this type, the regulations in force in Argentina,[38] Chile, Paraguay and Uruguay are most elaborate and detailed, in the sense that each new investment is carefully examined as to its contribution to the economic and social development of the country and the existing Government Plans. In Peru, there is no control in this respect, and in Brazil, the importation of equipment for investment purposes " without exchange cover ", although requiring a government permit, follows a pattern little different from control regulations applying to general imports.

The outflow of foreign capital is, in principle, unrestricted in all these countries, both for payment of dividends and for capital reimbursement purposes.

6. Taxation

Tax problems within the Free-Trade Area deserve much more attention than could be given to them by the Consultant Group during its brief visit to the member countries. Many complaints were heard, particularly from industrial groups representing both foreign and domestic investment, to the effect that the tax systems do not reflect the changing conditions brought about by the transition of agricultural to industrial economies in several of the countries. In some aspects the tax systems discourage industrial investments while granting favoured tax positions to non-industrial sectors of the economy. Specific mention was made of the lack of definition in income tax laws; the multiplicity of other taxes and surtaxes which unnecessarily complicates determination and payment of taxes; and turnover, sales or consumption taxes which discourage supplier industries and unduly stimulate vertically integrated enterprises.

The Group has had the benefit of an examination of the income tax burdens on foreign investment in four of the most industrialized countries of the Free-Trade Area. This examination is presented in the annex to this report. It will be noted therein that, if the foreign investor is interested in withdrawing all of his profits, as earned, he is likely to face an income tax burden which is as high, or almost as high, as the rates applied in the principal capital-exporting countries of the world (e.g., approximately 49 per cent in Mexico; 47 per cent in Argentina; 47 per cent in Brazil; and 40 per cent in Chile, as against 52 per cent in the United States and 45 per cent in the United Kingdom). The four countries studied reveal potential burdens of income taxation which are among the heaviest in all of Latin America. Consequently, to the extent that the potential foreign investor could be subject to burdens as high as those possible in these four countries, their income tax systems might well be classified as disincentives to foreign investment.

From the annex it will also be noted that variables present in the tax systems of the four countries can produce substantial reductions in the income tax burdens computed for each of them. In fact, the investor who is able to plough back a large percentage of profits into his business (thereby cutting down on weight of dividend tax) and is able to qualify for the other variables described in the country studies, would find that his overall tax burden would be well below 30 per cent. Under such circumstances, the income tax systems of the four countries might well be described as incentives to foreign investment.

The Group recognizes that where the investor will not, or cannot plough back his profits, and where the investor cannot take advantage of the variables described, the consequently applicable high income tax burdens will be counterbalanced if the country of the investor taxes the foreign income of its corporations as does the United States. In this hypothetical situation the United States would apply an effective rate of tax of somewhat less than 52 per cent to all of the income received from the investment abroad, but it would allow the taxpayer to credit against his United States tax the amount of foreign income tax which has been paid or is deemed to have been paid on the income received. So long as the over-all foreign effective rate of income taxation is equal to or lower than the United States rate, this system results in the taxpayer not paying a combined United States and foreign tax greater than the rate of the United States tax. Most of the United States investors in Argentina, Brazil, Chile and Mexico are not likely to withdraw all of their profits as earned, and therefore it can certainly be expected that their over-all income tax burden in these countries would not exceed the United States rate. Consequently, the tax credit mechanism would counterbalance the possible disincentive aspect of the rates found in these countries.

On the other hand, if the same foreign corporate investor is able to insulate himself against his own Government's tax on his foreign income, as United States taxpayers can through use of a " tax haven " or " tax sanctuary " corporation, then the weight of the income tax burden in the four countries again becomes a disincentive for the investors who cannot use the

[38] In Argentina, the regulations in force are somewhat more restrictive than the government attitude toward foreign investment as frequently declared in official statements.

variables provided in their tax systems. As a corollary to this, a decrease in the over-all effective rate of income taxation in these four countries would be a real inducement to the potential investor who has insulated himself from his own country's taxation on his foreign-earned income but is not able to take advantage of variables now found in the foreign tax systems. At a minimum, a reduction under such circumstances would be equivalent to an interest-free loan of additional funds to the taxpayer to be used for his business purposes until such time as he must repatriate those funds to his own country.

7. Labour costs and social factors

The countries of Latin America, while increasingly displaying a modern market oriented economy, retain at the same time an archaic core that resists integration and has a submarginal existence of its own. This is true of the countries of the Free-Trade Area, especially of those that possess compact groups of indigenous inhabitants.

The supply of unskilled manpower is plentiful and the number of individuals entering the labour market is increasing each year, both by natural growth and by internal migration from rural to urban areas. However, the overall level of literacy and technical education of the population, except in two or three of the countries, is generally low.

Nevertheless, the Free-Trade Area countries have nowadays an expanding nucleus of capable technicians and entrepreneurs, but there is scarcity of technicians and managers in industry, and particularly of foremen and other supervisory personnel, although less so in the countries of the Free-Trade Area than in the rest of Latin America. The principal means by which minimum skilled labour requirements are being met are: (i) on-the-job training, (ii) selective immigration, and (iii) the contracting of technicians from abroad.

The unquestionable progress of industrialization in most of these countries has been accompanied by increasing mechanization. Besides unavoidable technical considerations, this has also been prompted by the fact that the labour component weighs heavier in the cost structure than is readily apparent. For actual wages represent only part of the total cost of labour to the employer, which includes growing fringe benefits, social security and other charges that are borne to a large extent by the employer. Moreover, in many instances, large companies provide their own medical and various other services, in addition to the social security charges required by law, as the official insurance system is often inadequate.

During recent years, wages have increased substantially in money terms but real wages have increased relatively little, although more so in some countries than in others (see table 12) and except for the specific sporadic cases of some advanced industries in certain of the more developed countries such as Mexico and Brazil. On the other hand, as already pointed out, wages alone do not adequately measure the labour element in the cost structure of industrial production in Latin America. Although data are lacking on the direct impact of the various social welfare charges on wages and other aspects of the private economy, certain computations have been made.[39]

Thus, in Uruguay an employer of an average worker in the construction industry pays an added 30 per cent of the wages in social security payments, while the worker himself contributes about 13 per cent of his wage; moreover, both the employer and employee are subject to other taxes, mostly indirect, which are channelled into general revenues and also used in large part for social welfare purposes.

In Argentina, according to an official analysis made in 1959, a typical industrial employer may pay roughly 70 per cent over and above his actual wage bill to cover numerous contributions to funds for the payment of special compensation and for certain direct regular payments to the workers.

In Chile, wages usually constitute less than 60 per cent

[39] United States Department of Labor, *Foreign Labor Information*.

Table 12. LAFTA: Real wages in specified countries, 1953-59

(Indices: 1953 = 100)

Year	Argentina			Brazil[a]			Mexico		
	Wages	Cost of living	Real wages	Wages	Cost of living	Real wages	Wages	Cost of living	Real wages
1954	114	104	109	...	—	—	110	105	105
1955	127	117	109	100	100	100	126	122	103
1956	145	132	109	125	122	102	137	128	107
1957	191	165	115	152	145	105	143	135	106
1958	264	217	122	175	167	105	157	150	105
1959	451	464	97	239	228	104	...	154	...

Source: United Nations, *Monthly Bulletin of Statistics*, July 1960.
[a] Index: 1955 = 100.

of the worker's over-all earnings. Housing, lunches, bonuses, medical care, recreation and other peripheral benefits accrue to the workers depending on the industry and company concerned.

In Mexico, fringe benefits commonly include items such as subsidized transport, low-cost meals and groceries, recreational and educational facilities, various bonuses (Christmas, efficiency, marriage, attendance, etc.), medical care, low-cost housing, and retirement. In most countries the inclusion of additional fringe benefits is encouraged, especially family benefits, i.e. low-cost housing, food and other necessities.

Profit-sharing is in effect in Chile for all wage-earners who are members of a legal union and are employed by an industrial or commercial company with at least 25 wage-earners; the companies concerned must set aside 10 per cent of their annual net profits for this purpose. Moreover, white-collar workers of industrial and commercial undertakings are entitled to an annual bonus for which the company must set aside 20 per cent of its net profits.

In the remaining countries no profit-sharing provisions are to be found [40] but year-end bonuses of some sort or another are customary in most countries. In Peru, most large companies pay a year-end bonus of 10 per cent and an additional bonus for the same amount in July of each year.

Restrictions on the employment of foreign nationals exist in all countries except Argentina and Uruguay and this also tends to increase the cost of production and business. Relevant legislation specifies the minimum proportions of nationals of the host country who must be maintained by the employer (see also part II, section B 3). Sometimes, the same or a similar percentage is applied to the payroll.

In all countries maximum work hours are regulated, and so is overtime, at rate differentials varying from country to country; everywhere there exist legislative provisions for annual vacations and sick leave; in most countries daily wages are on a seven-day basis; i.e. the payroll includes Sunday, which is an obligatory day of rest. Severance indemnities are regulated in detail by all countries.

There is diversity in the legislations regarding conciliation and arbitration of labour disputes, but in all the countries the role of the government authorities in the settlement of such disputes is very important; thus, a legal strike must be authorized by a court in Brazil, while in Mexico a conciliation and arbitration board can declare a strike illegal. Collective bargaining between labour unions and management plays a relatively small role, for national legislation generally regulates in considerable detail labour conditions, and the renewal of labour contracts is regulated by the authorities.

As a rule there is no unemployment insurance in existence [41] nor has unemployment as such been a major problem. On the other hand. there is hidden unemployment; and under-employment is endemic, as the frequently low productivity of industry evidently implies. The progressive integration of the Free-Trade Area will stimulate more economical production and a better use of human as well as natural resources.

C. Experience of the European Common Market

The experiences of the European Common Market in developing a common policy towards foreign investment may serve as a background for an understanding of the problems which will soon be confronting the signatories of the Montevideo Treaty.

1. Trends in foreign investment

United States investments in the European Economic Community (EEC) appear to be outpacing those in the rest of Western Europe.[42] Based upon information supplied by large firms which have investments abroad, United States capital inflow into " the Europe of the Six " amounted to 122 million dollars during the first half of 1959, as compared to 42 million during the first half of 1958. Admittedly, the substantial increase in new investment in those countries should not be attributed solely to the European Common Market itself, since the 1958 figure may have reflected the economic recession then current in the United States. None the less, there appears to be a marked correlation between the institution of a common market in Europe and the flow of United States capital into the countries composing it.

According to the United States Department of Commerce, the two most important considerations mentioned by firms investing in the EEC were " apprehension that the tariff preferences which are inherent *in any customs union* may make exports of some products from the United States more difficult " (our italics) and " the expectation that the economic integration of the six countries will lead to a considerable increase in Common Market economic activity, thus enhancing the attractiveness of the area as a market and making investment more profitable." [43]

The second consideration is well taken, since the combined populations of the six integrating countries totals some 168 million, as compared to 172 million for the United States, while the combined gross national product, approximately 140,000 million dollars in 1956, compares to slightly over 410,000 million dollars for the United States in the same year. In other words, investors can already count on a market of about one-third of the size of the United States market and, if projections are borne out, of a market of some 185 million people by 1970 with a combined gross national

[40] Profit sharing is provided for in the Constitutions of Mexico and Brazil, and there was a 1948 Act in Peru to this effect, but this has not been implemented to date.

[41] Except in Uruguay for meatpackers, workers in wool warehouses and river port workers.

[42] See United States Department of Commerce, *Foreign Commerce Weekly*, 21 December 1959.

[43] *Ibid.*

product of 210,000 million dollars. This would represent an increase of some 40 per cent in the current size of the market in *per capita* terms during the present decade.

Although this picture of the European Common Market is only partly applicable to LAFTA it may be taken as a frame of reference for what could be expected were the product-by-product integration forecast in the national schedules greatly accelerated.

Of course, the increase in economic activity resulting from the complete integration contemplated in the common market is bound to take place much more rapidly than in the case of the product-by-product integration contemplated in the Latin American Free-Trade Area. Also the difference in size of the markets [44] would most certainly constitute a smaller attraction for foreign investment than the EEC. Further, in a common market tariff preferences tend to be much more effective in attracting industrial investment than is the case in a free-trade area where there is no common minimum duty for products from outside the area.

Finally, the Rome Treaty provides preferential tariff treatment by member States to their overseas territories, while simultaneously permitting them to retain protective duties to promote their own internal development. Such provisions offer powerful incentives to the inflow of foreign capital, especially European, some of which might otherwise have gone to Latin America, which does not enjoy identical preferences with either Europe or the United States.[45]

On the other hand, there are a number of factors favouring the Latin American Free-Trade Area: (*a*) the field of industrial specialization is almost entirely open in these less-developed countries in contrast to the industrialized countries of the European Common Market; (*b*) capital goods as well as some basic industries are largely undeveloped in Latin America, whereas in Europe they were well developed long before the Rome Treaty; and (*c*) the areas of possible friction between new and existing industries are most certainly less in Latin America than in the European Common Market.

On balance, it seems quite probable that the already important foreign investment flow to the countries composing the Latin American Free-Trade Area will eventually show a trend similar to that in the EEC even though the considerations motivating foreign investors may be somewhat different in each case.

2. Investment provisions in the Rome Treaty

The Rome Treaty envisages the maximum possible mobility of goods, services, manpower and capital within the Community. It devotes one entire chapter to the freedom of capital movement, and another entitled " The right of establishment ", to equalized conditions for the establishment of business ventures within the Community. Article 67 of the chapter on capital reads as follows:

" Member States shall, in the course of the transitional period and to the extent necessary for the proper functioning of the Common Market, progressively abolish as between themselves restrictions on the movement of capital belonging to persons resident in Member States and also any discriminatory treatment based on the nationality or place of residence of the parties or on the place in which such capital is invested.

" Current payments connected with movements of capital between Member States shall be freed from all restrictions not later than at the end of the first stage."

In other words, in spite of the escape clauses which permit the use of quotas and other control devices to protect a country's foreign exchange reserve position in the face of a persistent balance-of-payments disequilibrium (articles 70 to 73 inclusive), the Rome Treaty endeavours to promote the maximum possible removal of capital movement restrictions within the Community.

Because of an already fully-developed capital market in western Europe, capital movements within the Common Market are likely to be much more important than those originating from third countries. It is for this reason that in the Rome Treaty major emphasis is placed on capital movements within the area, while in the Latin American Free-Trade Area investment from outside the Area, for obvious reasons, is the major concern of local business men and Governments. Article 54 of the Rome Treaty reads:

" 1. Before the expiry of the first stage, the Council acting by means of a unanimous vote on a proposal of the Commission and after the Economic and Social Committee and the Assembly have been consulted, shall lay down a general programme for the abolition of restrictions existing within the Community on freedom of establishment. The Commission shall submit such proposal to the Council in the course of the first two years of the first stage.

" The programme shall, in respect of each category of activities, fix the general conditions for achieving freedom of establishment and, in particular, the stages by which it shall be attained.

" 2. In order to implement the general programme or, if no such programme exists, to complete one stage towards the achievement of freedom of establishment for a specific activity, the Council, on a proposal of the Commission and after the Economic and Social Committee and the Assembly have been consulted, shall, until the end of the first stage by

[44] The seven Latin American signatories of the Montevideo Treaty had a total population of some 130 million inhabitants and a combined gross national product of between 40,000 million and 45,000 million dollars in 1956.

[45] Attention is also called to treatment given by the Outer Seven to Portugal with respect to protective duties.

means of a unanimous vote and subsequently by means of a qualified majority vote, act by issuing directives.

" 3. The Council and the Commission shall exercise the functions entrusted to them by the above provisions, in particular: ... (*f*) by applying the progressive abolition of restrictions on freedom of establishment, in each branch of activity under consideration, both in respect of the conditions for setting up agencies, branches or subsidiaries in the territory of a Member State and in respect of the conditions governing the entry of personnel of the main establishment into the managerial or supervisory organs of such agencies, branches and subsidiaries."

With respect to capital from outside the Community, article 70 states that the Council shall issue directives with reference to foreign exchange policies endeavouring " to achieve the highest possible degree of liberalization " with respect to the movement of capital between Member States and third countries. This would, of course, result in the modification of some of the rules in force applying to capital inflows (as in France and Italy, for instance), so that discrepancies could be abolished. Otherwise, such discrepancies could " lead persons resident in one of the Member States to make use of the transfer facilities within the Community ... in order to evade the rules of one of the Member States in regard to third countries " (article 70, paragraph 2).

Another chapter of the Rome Treaty which is also of interest in connexion with the Latin American Free-Trade Association, is chapter 1 (Rules governing competition) of Part Three (Policy of the Community), which contains the anti-trust provisions of the EEC. These provisions are designed for the purpose of avoiding " any agreements between enterprises, any decisions by associations of enterprises and any concerted practices which are likely to affect trade between the Member States and which have as their object or result the prevention, restriction or distortion of competition within the Common Market " (article 85).

The anti-trust provisions of the Treaty are approached with considerable caution and their " appropriate regulations " are left to be drafted " within the period of three years after the date of the entry into force of this Treaty " by means of a unanimous vote in the Council. Even so, they undoubtedly reflect concern over problems of cartelization in Europe that might also hinder the development of trade within the Free-Trade Area.

These provisions might well be borne in mind by the Contracting Parties when sponsoring or negotiating the agreements on complementarity referred to in article 16 of the Montevideo Treaty or attempting " to promote progressively close co-ordination of the corresponding industrialization policies " of the respective Governments. If complementation is carried to the point of stifling competition within the Free-Trade Area, it could adversely affect the development of intra-regional trade as contemplated in the Treaty.

Difficulties arising from the foregoing might be considerably reduced if another idea were borrowed from the Rome Treaty, an idea which has also been advanced by several Latin American industrial groups, i.e. an industrial census permitting the respective Governments, as well as individual industrialists, to know the extent of development throughout the LAFTA of each industrial sector.[46]

Such information could also be used to check attempts to form or maintain cartels within the individual countries or within the Free-Trade Area. The Standing Executive Committee should perhaps consider this census a matter of first priority especially as 1960 is a census year for most Latin American countries.

3. Obstacles to trade expansion

" Establishing a common market in Europe is a far more complicated task than might appear from the other side of the ocean. The United States was lucky enough to start its industrial development within a geographical area and with a political structure well adapted to the requirements of modern technique. In Europe, on the contrary, nations started their industrial revolution burdened by the past. The political structure of Europe in the nineteenth century represented to many the triumph of a worthy ideal: the sovereign nation. But the twentieth century introduced the " age of continents " and another painful and deep revolution became necessary." [47]

This is an interesting statement of the difficulties that had to be dealt with in Europe before the idea of an economic (and to some extent political) community could gain momentum. It also gives an idea of how much more difficult it was to establish a common market in Europe than it should be to create a free-trade area in Latin America. Industrialization is a rather new phenomenon in Latin America, so that the " burden of the past " is much less of an obstacle than in the case of Europe. Moreover, the ideal of the sovereign State, although present likewise in Latin America, is partially counterbalanced by long co-operative experience in the Organization of the American States, the Common Defence Pact, and in many other instances of collective action among the American countries. And last, but not least, a free-trade area is a much simpler device to start with than a common market.

The difficulties of establishing either type of community, however, cannot be passed over lightly, and many problems must be worked out by patient compromise and mutual understanding of the long-term objectives of the undertaking. Thus, one of the precursors of the EEC, the European Coal and Steel Community was faced with the need to implement the " re-adaptation provisions " of the treaty which created it

[46] See *Progress report on studies relating to the inventory of Latin American industry* (E/CN.12/524), 22 April, 1959.

[47] See Fernand Spaak, " Patterns and lessons: the experience of the European Coal and Steel Community ", in John R. Allison and others, *The European Common Market*, New York, 1958, p. 113.

in such fashion as to prevent the free competition envisaged in its common market from creating grave social pressures arising from the unemployment of thousands of workers as existing steel plants and coal industries modernized their equipment. In France, for instance, four steel plants had to merge. In Belgium, one coalfield had to be entirely reorganized and some pits had to be closed. In Italy, the steel industry had to reduce excessive manpower without affecting the general level of employment within the country. All this was accomplished thanks to provisions by which the financial burden of the readaptation measures were borne by the Community itself through what was called the " High Authority ". The need for action had been recognized for many years, but action had not been taken previously because of the fear of social repercussions within each country.

4. The European Investment Bank and the Development Fund

The experience of the Coal and Steel Community in meeting the problems of social and economic adjustment attendant on its creation undoubtedly favoured the early establishment of the EEC by dissipating many previous fears of the consequences of integration.

The EEC itself made provision for two important institutions through which " to contribute to the balanced and smooth development of the Common Market in the interest of the Community " (article 130 of the Rome Treaty) and " to promote the social and economic development of associated countries and territories overseas " (article 1 of the Implementing Convention relating to the Association with the Community of the Overseas Countries and Territories). The first institution was the European Investment Bank, and the second the Development Fund.

The European Investment Bank, as stated in article 130 of the Rome Treaty, " shall by granting loans and guarantees on a non-profit-making basis facilitate the financing of the following projects in all sectors of the economy: (*a*) projects for *developing less developed regions*; (*b*) projects for *modernizing or converting enterprises* or for creating new activities which are called for by the progressive establishment of the Common Market where such projects by their size or nature cannot be entirely financed by the various means available in each of the Member States; and (*c*) projects of common interest to several Member States which by their size or nature cannot be entirely financed by the various means available in each of the Member States " (our italics).

The Development Fund is to promote social and economic development of the associated overseas countries and territories of the Community by investments supplementing those made by the authorities responsible for them. The Fund is to finance such projects as hospitals, research, vocational and professional training, and economic projects of interest to the common market as a whole.

By using these two institutions, the EEC countries should be able to avoid a long and difficult adjustment period. Existing industry should be able to obtain financing for modernization programmes, while an additional source of funds is provided for social and economic overhead investment in the less developed regions of the Member States and the associated countries and overseas territories.

The European experiences, therefore, should stimulate Latin America to provide the techniques necessary for solving, equitably and progressively, the problems inherent in converting a series of insulated national markets into a single great regional entity.

Annex

A COMPARATIVE ANALYSIS OF TAXATION IN ARGENTINA, BRAZIL, CHILE AND MEXICO

Definition of the problem

A hypothetical situation is assumed, as realistic as possible, of a foreign-owned subsidiary corporation organized under the laws of Argentina, Brazil, Chile and Mexico in order to analyse the impact of the local income tax system on the profits of this hypothetical corporation and on the dividends it declares.

Discussion

It must be made clear, at the outset, that a comparison of income tax rates applicable in a group of nations can never be completely equitable because of a number of factors such as the following:

(*a*) A presentation of the rates applicable in an income tax system cannot show the shadings of those taxes which result from the use of the various kinds of deductions and exemptions permitted within the system;

(*b*) The rate most generally applicable in a particular tax system may be relatively low because the system is aimed at placing the principal income tax burden on a small number of taxpayers (e.g., the major copper companies in Chile);

(*c*) The over-all tax system in one country may give greater emphasis to taxes other than those on income, while in other compared countries the reverse may be true;

(*d*) The variables are very much increased when some of the countries compared have excess profits taxes with the basis for computing those taxes being other than income as computed for normal tax purposes; and,

(*e*) It is impossible to evaluate the degree of enforcement of the tax law.

However, the similarity in the over-all tax systems of Argentina, Brazil, Chile and Mexico is such that, if certain valid assumptions are made, considerable advantage can be obtained from a com-

parison of their income tax rates. In the following country studies certain major assumptions have been made, viz.:

(*a*) All countries have the same, or almost the same, deductions and exemptions (where important variables exist, they are clearly shown);

(*b*) The rates given are those generally applicable to locally organized corporations wholly owned by a non-resident and non-domiciled foreign corporation;

(*c*) The corporation earns 1 million dollars of net taxable income in the tax year, which represents a 40 per cent return on capital. Corporate capital is therefore 2.5 million dollars;

(*d*) All corporate income, after domestic taxes, is declared as dividends to the foreign parent corporation and the over-all tax burden includes the foreign tax applicable to those dividends;

(*e*) It is assumed that there is a " letter of the law " enforcement of all taxes;

(*f*) A reasonable degree of monetary stability is maintained in all of the countries.

ARGENTINA

	Taxes (in dollars)
Normal tax (at the rate of 30 per cent on profits of 1 million dollars)[a]	300,000
Dividend tax (at the rate of 8 per cent on 700,000 dollars — total profits less amount of normal tax)[b]	56,000
Excess profits tax[c]	117,000
TOTAL TAXES	473,000
Total taxes as a percentage of net taxable income	47.3%

[a] 1959 revised text of the Income Tax Act (Act 11, 682), Article 54.

[b] 1959 revised text of the Income Tax Act, Art. 56.

[c] It is assumed that the capital used to produce income of 1 million dollars is 2.5 million dollars. Generally, it can be said that Argentina defines profits as " excess " when they exceed 12 per cent of capital (to be precise, the Act says " capital and free reserves "). But the Argentine Excess Profits Tax Act (1959 revised text) provides that capital, for excess profits tax purposes, should also include 50 per cent of the net taxable profits earned during the year. Thus, the primary basis for this computation is 12 per cent of 3 million dollars (capital of 2.5 million dollars plus 5 million dollars — which is 50 per cent of the 1 million dollars of profits for the year), or 360,000 dollars. Profits of 640,000 dollars would therefore be termed " excess ".

Excess profits would be taxed, under article 6 of the Act, as follows:

	Excess profits (in dollars)	*Tax (percentage)*	*Tax (in dollars)*
First	150,000	10	15,000
Next	150,000	15	22,500
Next	150,000	20	30,000
Next	150,000	25	37,500
Remaining	40,000	30	12,000
	640,000	Total excess profits tax	117,000

Important variables

Under Argentine law, an industrial corporation may take a deduction against normal tax income for an amount equal to 50 per cent of the value of additions which it makes to fixed assets, provided that the new investment represents a sum greater than 10 per cent of the taxpayer's fixed assets at the beginning of the year.* Consequently, every dollar of net taxable profits invested in fixed assets, under the conditions described above, would, in effect, be subject to a 15 per cent normal tax rate instead of the otherwise prescribed rate of 30 per cent.

* 1959 revised text of the Income Tax Act, art. 81.

BRAZIL

	Taxes (in dollars)
Normal tax (at the rate of 23 per cent on 1 million dollars)[a]	230,000
Dividend tax (at the rate of 25 per cent on 770,000 dollars — total profits less amount of normal tax)[b]	192,500
Excess profits tax[c]	50,000
TOTAL TAXES	472,500
Total taxes as a percentage of net taxable income	47.25%

[a] Decree 47,373 of 7 December 1959 (*Diario Oficial* of 15 December 1959) Art. 44.

[b] Decree 47,373 of 7 December 1959 (*Diario Oficial* of 15 December 1959), Art. 97.

[c] Corporations compute their excess profits tax by comparing profits — as computed for the normal tax — with any one of three bases they choose: (i) 30 per cent of the " capital effectively applied " in the business which is defined as consisting of " paid-up capital, undistributed profits, and reserves, except those for contingencies (*provisos*) "; (ii) twice the average profits for the three-year period 1947-1949; (iii) a sum equal to the total of the following percentages of annual gross income: 6 per cent of the first 3.5 million cruzeiros of income, 5 per cent of the next 1.5 million cruzeiros, and 4 per cent of all remaining gross income.

For purposes of comparability the first of these three bases will be used. It is assumed that the corporation returns profits of 1 million dollars on capital of 2.5 million dollars. It is further assumed that this capital is equivalent to " capital effectively applied ", so that the base for computing excess profits is 30 per cent of 2.5 million dollars, or 750,000 dollars.

The Excess Profits Tax Act (Act 2862 of 5 September, 1956) provides that profits greater in amount than the excess profits tax base are " excess ". In the case considered here, this would mean that the corporation has excess profits of 250,000 dollars (1 million dollars minus 750,000 dollars). Since such profits do not exceed 50 per cent of the excess profits tax base, they are subject to the lowest bracket rate of excess profits tax, which is 20 per cent. The tax would then be 50,000 dollars (20 per cent of 250,000 dollars).

Important variables

In lieu of the regular excess profits tax payment, juridical persons may choose to deposit an amount equal to 150 per cent of the excess profits tax otherwise due in prescribed banks. These are called " investment deposits ". With the permission of the Government's Investment Commission, the investment deposits can be applied to projects in the taxpayer's or in any other enterprise considered as furthering national economic development.† More than likely this alternative would fit into the plans of the hypothetical corporation so that, in effect, the burden of excess profits taxation would be eliminated; total taxes would then be 422,500 dollars; and total taxes would be 42.25 per cent of net taxable income instead of 47.25 per cent.

Brazil levies a 15 per cent surcharge, which is in effect a forced loan to the Government, on the amount of income and excess profits tax payable by natural and juridical persons. Six years after payment of the surcharge, the taxpayer receives Economic Rehabilitation Bonds in the amount of 125 per cent of the payments made. The bonds are liquidated in 20 equal annual instalments and bear interest at the rate of 5 per cent. Because of the nature of this surcharge, it has not been included in the tax computation. It would be necessary to envisage a default of the bonds to do otherwise.

† Act 3470 of 28 November 1958 (*Diario Oficial* of 28 November 1958), arts. 91-93.

CHILE

	Taxes (in dollars)
Normal tax (Category III at the rate of 20 per cent) [a]	200,000
Divided tax (Category II at the rate of 18 per cent) [b]	144,000
Additional tax (levied at the rate of 25 per cent on income withdrawn from Chile — in the hypothetical case this would be the dividend income — but against which the dividend tax can be credited) [c]	56,000
TOTAL TAXES	400,000
Total taxes as a percentage of net taxable income	40%

[a] Net taxable profits of 1 million dollars multiplied by 20 per cent results in a tax of 200,000 dollars. *Statutory basis of tax* — Income Tax Act (revised text enacted by Decree 2106 of 15 March 1954, *Diario Oficial* of 10 May 1954), Art. 24, as amended by Act 12,434 of 30 January 1957 (*Diario Oficial* of 1 February 1957), Art. 23 (*c*).

[b] Since it is assumed that all profits after payment of prior taxes are declared as dividends, the computation would be 800,000 dollars multiplied by 18 per cent. *Statutory basis of tax* — Income Tax Act, Art. 8, as amended by Act 12,861 of 4 February 1958 (*Diario Oficial* of 7 February 1958), Art. 33 (2) (*a*), and Act 13,305 of 4 April 1959 (*Diario Oficial* of 6 April 1959), Art. 95 (1).

[c] The computation would be the amount of dividends withdrawn (800,000 dollars) multiplied by 25 per cent. Against the resultant product (200,000 dollars) would be credited the amount of dividend tax paid (144,000 dollars), leaving an additional tax to be paid of 56,000 dollars. *Statutory basis of tax* — Income Tax Act, Art. 53, as amended by Act 12,434 of 30 January 1957 (*Diario Oficial* of 1 February 1957), Art. 23 (*k*).

Important variables

The amounts of the 1959 Category III normal tax and the additional tax (*impuesto adicional*), computed and payable in 1960, are subject to a one-time surcharge of 10 per cent under the terms of Article 130 of Act 13,305 of 4 April 1959 (*Diario Oficial* of 6 April 1959). If this surcharge is continued in effect (as such surcharges frequently are in Chile), it would mean that the rate of the Category III normal tax would be 22 per cent instead of 20 per cent and the additional tax would be 27.5 per cent instead of 25 per cent. In the example considered here, the amount of the normal tax would then be 220,000 dollars; the dividend tax would be 140,400 dollars; and the amount of the additional tax would then be 70,200 dollars; the total taxes would be 430,600 dollars; and the total taxes would be 43 per cent of net taxable income.

If the shares of the Chilean corporation are not owned entirely by the non-resident and non-domiciled foreign corporation but are owned to a percentage of less than 75 per cent by such non-resident and non-domiciled foreign corporation, the additional tax would not apply and the total taxes would amount to only 344,000 dollars (total taxes would then be only 34.4 per cent of net taxable income).*

Chilean law provides that the Category II dividend tax will not apply where a corporation distributes profits or surplus by declaring a stock dividend to shareholders for an equivalent amount.† However, the Category III rate of tax is raised from 20 to 23 per cent in any year in which earnings or reserves are distributed through declaration of such stock dividend.‡ Chilean law further provides that, if a corporation capitalizes its income and such income is not withdrawn for 5 years, it will never after be subject to the additional tax.§ Within these limits it is therefore possible to escape both the dividend tax and the additional tax. The hypothetical corporation's income would consequently be subject only to a Category III tax of 23 per cent (230,000 dollars).

Industrial corporations (the hypothetical corporation is assumed to be one) are required to pay a 5 per cent tax on their normal tax income for the support of the Housing Corporation (*Corporación de Vivienda*) which uses the proceeds for the construction of housing for the firm's employees. Companies which have already constructed housing which the Directorate General of Labour considers sufficient for their labour force, pay a tax of only 2 per cent, and they may credit against it the sums they expend in any year for repairs or improvements on that housing.|| It is assumed that the hypothetical corporation would construct sufficient housing and would improve or maintain it without any such requirement of law, considering such expenditures to be part of its wage costs. This tax is therefore not included in the computation.

* Income Tax Act, Art. 53, as amended by Act 11,575 of 13 August 1954 (*Diario Oficial* of 14 August 1954), Art. 1 (26), and Act 12,084 of 13 August 1956 (*Diario Oficial* of 18 August 1956), Art. 3 (4).

† Income Tax Act, Art. 11 (1).

‡ Income Tax Act, Art. 24, as amended by Act 11,575 of 13 August 1954 (*Diario Oficial* of 14 August 1954), Art. 1 (12), and Act 12,434 of 30 January 1957 (*Diario Oficial* of 1 February 1957), Art. 23 (*c*).

§ Income Tax Act, Art. 55, as amended by Act 12,434 of 30 January 1957 (*Diario Oficial* of 1 February 1957), Art. 24 (*b*), and Act 13,305 of 4 April 1959 (*Diario Oficial* of 6 April, 1959), Art. 95 (20).

|| Act 7600 of 8 October 1943 (*Diario Oficial* of 28 October 1943), Arts. 16-18, and Legislative Decree 285 of 25 July 1953 (*Diario Oficial* of 5 August 1953), Arts. 20-22. Regulated by Decree 187 of 26 February 1944 (*Diario Oficial* of 29 November 1944) and Decree 714 of 23 July 1947 (*Diario Oficial* of 24 October 1947).

MEXICO

	Taxes (In dollars)
Normal tax (under Schedule II) [a]	377,480
Excess profits tax [b]	21,002
Distributable profits tax [c]	90,228
TOTAL TAXES	488,710
Total taxes as a percentage of net taxable income	48.87%

[a] The Mexican Income Tax Act of 30 December 1953, published in the *Diario Oficial* of 31 December 1953), as amended by a Decree of 30 December 1958, provided that Schedule II income is taxable on a proportional and progressive scale which, in its highest bracket, stipulates that net taxable income in excess of 2 million pesos is subject to a fixed tax of 623,858 pesos on the first 2 million pesos of income and to a tax of 39 per cent on that part of net taxable income which exceeds 2 million. One million dollars of income is translated into 12,470,000 pesos. Thirty-nine per cent of 12,470,000 pesos is 4,083,300. Total normal tax would then be 4,707,158 pesos (4,083,300 plus 623,858) or 377,480 dollars.

[b] Excess profits are defined as those which exceed 15 per cent of "invested capital" (Income Tax Acts, Arts. 170-180). Profits are those calculated for Schedule II purposes less the amount of Schedule II taxes paid. Thus profits, for the present hypothetical situation, are 622,520 dollars (1 million dollars minus 377,480 dollars). The law defines "invested capital" as the sum of paid-in capital, capital reserves and surplus. As was seen in other country illustrations, the hypothetical corporation has a capital of 2.5 million dollars which will be assumed to be equivalent to "invested capital". Thus the corporation can be said to have excess profits when profits exceed 325,000 dollars (15 per cent of 2.5 million dollars). The lowest brackets of the excess profits tax table are: 5 per cent on that part of profits exceeding 15 per cent but not more than 20 per cent of invested capital; 10 per cent on profits exceeding 20 but not more than 30 per cent of invested capital; and 15 per cent on profits exceeding 30 per cent but not more than 40 per cent of invested capital. The tax computation would therefore be:

	Income (dollars)	*Rate of tax (percentage)*	*Tax (dollars)*
First	325,000	5	Exempt
Next	175,000	10	8,750
Remaining	122,520		12,252
			21,002

[c] For the purposes of this study, the basis for the "distributable profits tax" can be said to be profits as computed for Schedule II purposes less the amount of Schedule II normal tax and excess profits tax paid on those profits. Thus distributable profits are 601,518 dollars (1 million dollars less 377,480 dollars and 21,002 dollars). Distributable profits are taxed at a flat rate of 15 per cent. This tax would then be 90,228 dollars. (Income Tax Acts, Arts. 138-140 and 145.)

Important variables

Under the terms of Mexico's Act for the Development of New and Necessary Industries, the hypothetical corporation would seemingly be eligible to apply for a 40 per cent reduction in its

Schedule II tax for a period of 5, 7, or 10 years.* If this is so, the normal tax would be reduced from 377,480 dollars to 226,508 dollars. By virtue of article 176 of the Income Tax Act, the excess profits tax would remain 21,002 dollars. However, the 150,972 dollars decreased in the normal tax would mean that sum would then be taxed as further distributable profits, increasing that tax by 22,646 dollars (15 per cent of 150,972 dollars). Total taxes in this situation would be 360,384 dollars or 36.04 per cent of net taxable income.

In computing distributable profits certain deductions for reserves are permitted. The Minister of Financial Affairs, under powers vested in him by article 138 (II) (*f*) of the Income Tax Act, has been quite liberal in permitting a deduction for a " reinvestment reserve ", in many cases amounting to 100 per cent of distributable profits. The effect of this is to eliminate the burden of the distributable profits tax of many growth industries.

* Act of 31 December 1954 (*Diario Oficial* of 4 January 1955), Arts. 14 (IV) and 15.

DISTRIBUTORS FOR UNITED NATIONS PUBLICATIONS

ARGENTINA
Editorial Sudamericana, S.A., Alsina 500, Buenos Aires.
AUSTRALIA
Melbourne University Press, 369 Lonsdale Street, Melbourne C. I.
AUSTRIA
Gerold & Co., Graben 31, Wien, 1.
B. Wüllerstorff, Markus Sittikusstrasse 10, Salzburg.
BELGIUM
Agence et Messageries de la Presse, S.A., 14-22, rue du Persil, Bruxelles.
BOLIVIA
Librería Selecciones, Casilla 972, La Paz.
BRAZIL
Livraria Agir, Rua Mexico 98-B, Caixa Postal 3291, Rio de Janeiro.
BURMA
Curator, Govt. Book Depot, Rangoon.
CAMBODIA
Entreprise khmère de librairie, Imprimerie & Papeterie Sarl, Phnom-Penh.
CANADA
The Queen's Printer, Ottawa, Ontario.
CEYLON
Lake House Bookshop, Assoc. Newspapers of Ceylon, P.O. Box 244, Colombo.
CHILE
Editorial del Pacífico, Ahumada 57, Santiago.
Librería Ivens, Casilla 205, Santiago.
CHINA
The World Book Co., Ltd., 99 Chung King Road, 1st Section, Taipeh, Taiwan.
The Commercial Press, Ltd., 211 Honan Rd., Shanghai.
COLOMBIA
Librería Buchholz, Av. Jiménez de Quesada 8-40, Bogotá.
COSTA RICA
Imprenta y Librería Trejos, Apartado 1313, San José.
CUBA
La Casa Belga, O'Reilly 455, La Habana.
CZECHOSLOVAKIA
Československý Spisovatel, Národní Třída 9, Praha 1.
DENMARK
Ejnar Munksgaard, Ltd., Nørregade 6, København, K.
DOMINICAN REPUBLIC
Librería Dominicana, Mercedes 49, Ciudad Trujillo.
ECUADOR
Librería Científica, Casilla 362, Guayaquil.
EL SALVADOR
Manuel Navas y Cía., 1a. Avenida sur 37, San Salvador.
ETHIOPIA
International Press Agency, P.O. Box 120, Addis Ababa.
FINLAND
Akateeminen Kirjakauppa, 2 Keskuskatu, Helsinki.
FRANCE
Editions A. Pédone, 13, rue Soufflot, Paris (Ve).
GERMANY
R. Eisenschmidt, Schwanthaler Str. 59, Frankfurt/Main.
Elwert und Meurer, Hauptstrasse 101, Berlin-Schöneberg.
Alexander Horn, Spiegelgasse 9, Wiesbaden.
W. E. Saarbach, Gertrudenstrasse 30, Köln (1).
GHANA
University Bookshop, University College of Ghana, Legon, Accra.
GREECE
Kauffmann Bookshop, 28 Stadion Street, Athènes.
GUATEMALA
Sociedad Económico-Financiera, 6a Av. 14-33, Guatemala City.
HAITI
Librairie "A la Caravelle", Port-au-Prince.
HONDURAS
Librería Panamericana, Tegucigalpa.
HONG KONG
The Swindon Book Co., 25 Nathan Road, Kowloon.
ICELAND
Bokaverzlun Sigfusar Eymundssonar H. F., Austurstraeti 18, Reykjavik.
INDIA
Orient Longmans, Calcutta, Bombay, Madras, New Delhi and Hyderabad.
Oxford Book & Stationery Co., New Delhi and Calcutta.
P. Varadachary & Co., Madras.
INDONESIA
Pembangunan, Ltd., Gunung Sahari 84, Djakarta.
IRAN
Guity, 482 Ferdowsi Avenue, Teheran.
IRAQ
Mackenzie's Bookshop, Baghdad.
IRELAND
Stationery Office, Dublin.
ISRAEL
Blumstein's Bookstores, 35 Allenby Rd. and 48 Nachlat Benjamin St., Tel Aviv.
ITALY
Libreria Commissionaria Sansoni, Via Gino Capponi 26, Firenze, and Via D. A. Azuni 15/A, Roma.
JAPAN
Maruzen Company, Ltd., 6 Tori-Nichome, Nihonbashi, Tokyo.
JORDAN
Joseph I. Bahous & Co., Dar-ul-Kutub, Box 66, Amman.
KOREA
Eul-Yoo Publishing Co., Ltd., 5, 2-KA, Chongno, Seoul.
LEBANON
Khayat's College Book Cooperative, 92-94, rue Bliss, Beirut.
LUXEMBOURG
Librairie J. Trausch-Schummer, place du Théâtre, Luxembourg.
MEXICO
Editorial Hermes, S.A., Ignacio Mariscal 41, México, D.F.
MOROCCO
Centre de diffusion documentaire du B.E.P.I., 8, rue Michaux-Bellaire, Rabat.
NETHERLANDS
N.V. Martinus Nijhoff, Lange Voorhout 9, 's-Gravenhage.
NEW ZEALAND
United Nations Association of New Zealand, C.P.O. 1011, Wellington.
NORWAY
Johan Grundt Tanum Forlag, Kr. Augustsgt 7A, Oslo.
PAKISTAN
The Pakistan Co-operative Book Society, Dacca, East Pakistan.
Publishers United, Ltd., Lahore.
Thomas & Thomas, Karachi.
PANAMA
José Menéndez, Agencia Internacional de Publicaciones, Apartado 2052, Av. 8A, sur 21-58, Panamá.
PARAGUAY
Agencia de Librerías de Salvador Nizza, Calle Pte. Franco No. 39-43, Asunción.
PERU
Librería Internacional del Perú, S.A., Casilla 1417, Lima.
PHILIPPINES
Alemar's Book Store, 769 Rizal Avenue, Manila.
PORTUGAL
Livraria Rodrigues y Cia, 186 Rua Aurea, Lisboa.
SINGAPORE
The City Book Store, Ltd., Collyer Quay.
SPAIN
Librería Bosch, 11 Ronda Universidad, Barcelona.
Librería Mundi-Prensa, Castello 37, Madrid.
SWEDEN
C. E. Fritze's Kungl. Hovbokhandel A-B, Fredsgatan 2, Stockholm.
SWITZERLAND
Librairie Payot, S.A., Lausanne, Genève.
Hans Raunhardt, Kirchgasse 17, Zürich 1.
THAILAND
Pramuan Mit, Ltd., 55 Chakrawat Road, Wat Tuk, Bangkok.
TURKEY
Librairie Hachette, 469 Istiklal Caddesi, Beyoglu, Istanbul.
UNION OF SOUTH AFRICA
Van Schaik's Bookstore (Pty) Ltd., Church Street, Box 724, Pretoria.
UNION OF SOVIET SOCIALIST REPUBLICS
Mezhdunarodnaya Knyiga, Smolenskaya Ploshchad, Moskva.
UNITED ARAB REPUBLIC
Librairie "La Renaissance d'Egypte", 9 Sh. Adly Pasha, Cairo.
UNITED KINGDOM
H.M. Stationery Office, P.O. Box 569, London, S.E. 1 (and HMSO branches in Belfast, Birmingham, Bristol, Cardiff, Edinburgh, Manchester).
UNITED STATES OF AMERICA
Sales Section, Publishing Service, United Nations, New York.
URUGUAY
Representación de Editoriales, Prof. H. D'Elía, Plaza Cagancha 1342, 1° piso, Montevideo.
VENEZUELA
Librería del Este, Av. Miranda, No. 52, Edf. Galipán, Caracas.
VIET-NAM
Librairie-Papeterie Xuân Thu, 185, rue Tu-do, B.P. 283, Saïgon.
YUGOSLAVIA
Cankarjeva Založba, Ljubljana, Slovenia.
Državno Preduzeće, Jugoslovenska Knjiga, Terazije 27/11, Beograd.
Prosvjeta, 5, Trg Bratstva i Jedinstva, Zagreb.

[61E1]

Orders and inquiries from countries not listed above may be sent to: Sales Section, Publishing Service, United Nations, New York, U.S.A.; or Sales Section, United Nations, Palais des Nations, Geneva, Switzerland.

Printed in France
3589—April 1961—4,000

Price: $U.S. 1.00; 7/- stg.; Sw.fr. 4.00
(or equivalent in other currencies)

United Nations publication
Sales No.: 60.II.G.5

E/CN.12/550