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PAPERS ON FINANCIAL PROBLEMS PREPARED BY THE SECRETARIAT OF THE ECONOMIC COMMISSION FOR LATIN AMERICA FOR THE USE OF THE LATIN AMERICAN FREE-TRADE ASSOCIATION

CONTENTS

/II. Conclusions

/ NOTE BY

NOTE BY THE SECRETARIAT

In the present document, submitted for consideration by the Trade Committee and the Commission at their respective sessions, the secretariat has reproduced certain studies previously issued only for restricted circulation, and relating to various financial problems connected with the Latin American common market project. The studies in question were carried out as part of the work programme laid down in resolutions 1 (I) and 9 (II) of the Trade Committee, and were specially prepared at the request of the Inter-Governmental Conference for the Establishment of a Free-Trade Area among Latin American Countries. The secretariat was likewise requested to organize a meeting of governmental representatives of central banks, which was held at Montevideo, Uruguay, in January 1960, and the findings of which can be studied in the relevant report, also included in the following pages.

/Note:

Note: The origin of the studies assembled in the present document, considered in the order of their inclusion, was as follows:

A. The document entitled Payments and credits in the free-trade area projected by Latin American countries: Possible systems was issued for restricted distribution on 30 October 1959, and was presented, as Working paper No. 1, to the Meeting of Governmental Representatives of Central Banks held at Montevideo in January 1960.

B. The Further considerations on the system of swing credits in the free-trade area are dated 14 December 1959 and supplement paper A. The above-mentioned meeting of central banks had an opportunity of discussing this study, which had not previously been published in any form.

C. The Report of the Meeting of Governmental Representatives of Central Banks to the second session of the Inter-Governmental Conference for the Establishment of a Free-Trade Area among Latin American Countries had been previously issued only in the provisional version presented to the Conference. It is included here, unrevised, because of the interest attaching to its content.

D. The last study in the present document, The reciprocal credits system for the free-trade area, discusses the findings of the Meeting of Governmental Representatives of Central Banks referred to above, and had hitherto only been circulated for internal use at the second session of the Inter-Governmental Conference for the Establishment of a Free-Trade Area among Latin American Countries.

Pressure of time has precluded final revision of the studies incorporated in the present document. They must therefore be regarded as subject to modification in the event of their being published in a more definitive version.

/A. PAYMENTS

A

PAYMENTS AND CREDITS IN THE FREE-TRADE AREA PROJECTED BY LATIN AMERICAN COUNTRIES: POSSIBLE SYSTEMS

(ECLA, Santiago, Chile, 30 October 1959)

I. GENERAL CONSIDERATIONS

A. Purpose of the report

1. At the First Conference held by the Governments of Argentina, Bolivia, Brazil, Chile, Paraguay, Peru and Uruguay at Montevideo in early September 1959, for the purpose of drafting a free-trade area treaty, it was agreed to invite governmental representatives of the Central Banks of these countries to meet, also at Montevideo, in early December with a view to studying the payments questions arising in connexion with the operation of the area.[1/]

In order to facilitate the work of the Central Banks meeting, the Governments concerned requested the Economic Commission for Latin America and the International Monetary Fund to carry out special studies on the payments problem and as to possible solutions, recommending that due account be taken, in making these studies, of the views expressed on the matter by the delegations at the Montevideo Conference.

In resolution 9 (II) (Panama, May 1959), the Trade Committee requested the ECLA secretariat to study the problem of payments in an inter-Latin America Common Market. Although this report refers particularly to the situation of the seven countries that are interested in creating the free-trade area, the evaluations and conclusions in it are to a large extent valid for all the countries of Latin America and should be regarded in some measure as a prelude to the report requested by the Trade Committee.

B. Views expressed at the Montevideo Conference

2. There was general agreement among the delegations present to the effect that the efficient operation of the area would be assisted if all settlements for intra-area trade and transactions could be effected on a uniform basis. If this should not prove practicable, it would be necessary to consider establishing some payments mechanism which would harmonize so far as possible the different systems in operation, from

1/ Resolution 3, adopted at the Montevideo Conference for the Establishment of a Free-Trade Area, invites the Central Banks of other Latin American countries to send observers to the meeting.

/the point

the point of view of their effect on intra-area trade.

There was no disagreement as to the advisability of developing a credit mechanism which would contribute to the achievement of the following objectives:

(a) to counter the depressive effects exerted on intra-area trade by the seasonal imbalances in its flows; and

(b) to facilitate the policy of trade expansion resulting from the programme for reducing and eliminating customs duties and other restrictions in the area.

However, though there was agreement on the need for establishing some form of special credit facilities, the scope of the system and the sources from which such credit should come were not discussed in detail.

3. In addition, individual delegations indicated the general position of their respective countries on certain aspects of the payments questions. These views may be broadly summarized as follows:

(a) Countries which have long enjoyed convertibility - as is the case of one possible member of the area in particular - are not in favour of any system that would involve the adoption of restrictive practices with respect to such convertibility. Nor do they wish to endorse a system which would balance payments within the group of participants. In their opinion, the successful operation of the free-trade area so far as payments are concerned could be ensured if each country avoided persistent disequilibria in its balance-of-payments position vis-a-vis the rest of the world;[2/]

(b) Countries which, within their over-all programme of monetary reform, have lately been taking steps to apply and maintain a system of increasing convertibility - as several of those interested in joining the free-trade area - would not favour any approach conducive to the strengthening or reinstatement of the restrictive or bilateral procedures, that their reforms would eliminate or tend to eliminate; and

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2/ It should be recalled in this connexion that article 4 of the projected treaty establishes the principle of reciprocity by virtue of which equivalence is to be maintained between the benefits resulting from trade concessions.

/(c) Countries

(c) Countries - such as one of those taking a leading part in inter-Latin American trade - which, for various reasons, find it neither possible nor advisable to abandon, either immediately or in a fairly short space of time, the bilateral accounts through which, without having to use convertible currency, they now settle the bulk of their transactions with most of Latin America, favour a payments system for the area that would be so constructed as to be compatible with the use of bilateral accounts and gradual progress towards convertibility and the expansion of multilateral procedures.

C. Credit facilities

4. At this juncture, a brief commentary should be made on the general relationship between the movement towards eliminating artificial and selective barriers to the development of multilateral trade in the area, and the advisability of maintaining credit mechanisms among the members of the area.

5. Factors such as the unification of the multiple exchange rates into a single effective rate; the consequent disappearance of the indirect import subsidies that frequently resulted from the existence of multiple exchange rates as well as of the duties originating in the same source which often had to be borne by exports and hence by certain productive activities; and the replacement of direct methods of payments control and import selection by those of an indirect nature, apart from other positive factors deriving from the monetary reforms, will undoubtedly have a salutary effect on foreign trade as a whole.

6. Nevertheless, the movement towards uniform and more orthodox settlement arrangements does not appear to be helpful to the expansion of inter-Latin American trade as such, in view of the special circumstances surrounding the development of such trade. The method of direct control over imports and exports enabled each country to grant preferences or special treatment to other countries in the region with respect to their reciprocal trade and reduced the growth of competition by similar goods from other markets. With the abolition of direct controls, the possibility of retaining the special treatment granted

/through that

through that channel has disappeared. The consequent slackening of trade flows has been followed by a drop in the production of certain items. And although, to a certain extent, recourse is now being had to another kind of preferential treatment - that of exempting Latin American countries from the obligation to make prior deposits which is currently imposed on importers in many countries -, the incentive it offers is less powerful than that given by the old method. Moreover, the concession of this new type of stimulus is essentially impermanent, since the amount of the prior deposit may be changed at any time, and as progress is achieved in granting freedom of trade and payments over a wider area, may be reduced and may ultimately disappear altogether.

7. Once the free-trade area has been established, however, it will have other means at ist disposal for giving substantial encouragement to area trade, since under the terms of the programme, it will reduce and eliminate, for its members, customs duties and charges and other general restrictions. As this elimination of barriers is expected to give a strong impulse to branches of trade that are today virtually non-existent, namely, durable manufactured goods and capital goods, concern is naturally felt as to the possible impact on exchange holdings if settlements are effected in freely convertible currencies or in currencies that are freely transferable within the area. Moreover, one of the basic principles of the free-trade area is that there should be reciprocity of benefits deriving from the operation of its rules, but these benefits - so far as individual countries are concerned - may accrue gradually and it might well be necessary, by the granting of credits, to bridge the gap between the immediate results of concessions granted by an individual country and the benefits of reciprocal concessions from its partners that would not be felt until after a certain lapse of time.

8. In general, it would seem fair to say that the provision of special credit facilities, linked to intra-area trade, would help to allay the doubts and hesitations that would naturally be aroused by the

/implementation of

implementation of the trade liberalization measures provided for in the programme and would assist in ensuring reciprocity of concessions and advantages deriving therefrom.

D. International payments

9. In principle, the settlement of international transactions in the area could take place in any of the following ways:

(a) exclusively in convertible currencies (including credits in such currencies);

(b) exclusively through bilateral accounts (including bilateral credit margins granted reciprocally thereunder);

(c) partly in convertible currencies and partly over bilateral accounts (including both credits in convertible currencies and bilateral credit margins).

10. The views expressed at the Montevideo Conference indicate that the first possibility mentioned above is unlikely to prove - at least for the time being - generally acceptable, since there are some countries which consider it preferable to keep the existing bilateral payments accounts in operation, because they feel it would be premature to demolish a structure whose disappearance might in their opinion be prejudicial to the trade levels attained in certain sectors. Moreover, they do not wish to find themselves obliged to settle seasonal imbalances, which are often high, in convertible currency. These are valid arguments and it only remains to ensure that, if settlements are effected through bilateral accounts, the necessary measures are taken to prevent such monetary arrangements from distorting the flow of trade in the area or from resulting in discrimination against those countries that wish to settle in convertible currencies.

11. The second possibility (all settlements to be effected through bilateral accounts) would also seem unlikely to be generally acceptable. What is more, it would seem counter to the tendency that has developed in recent months towards the suppression of bilateral settlement procedures. But if, none the less, it should be agreed to adopt bilateral credit and settlement methods throughout the area, it is

/clear that

clear that some mechanism would have to be established (as was the case, for instance, in Europe, with the European Payments Union) which would effectively multilateralize, at periodic intervals, the whole or a substantial part of the balances accruing on these accounts. If this were not achieved, intra-area trade would no develop, as is essential, on multilateral lines, there would exist the risk of trade flows being dictated by monetary and not by commercial considerations, and the resulting distortions, and almost inevitable discriminations, would tend to defeat the objectives of the free-trade area itself.

12. Finally, there is the possibility that settlements within the area should take place both in convertible currencies and through the use of bilateral accounts, according to the arrangements adopted by individual pairs of countries. This method - which has the advantage of being flexible and dynamic - would have the disadvantage that the basis of settlements within the area would not be uniform. But how serious is this disadvange? And again the answer would seem to turn on the degree of transferability accorded to the balances held on the bilateral accounts and the extent to which bilateral arrangements would tend to introduce discrimination in intra-area trade. If the private trader is free to carry out authorized transactions anywhere in the area, whithout discrimination as to country, and, automatically, to make or receive payment for this transaction, then the risk of discrimination can only arise in inter-Government transactions; and this risk can to a large extent be eliminated by regular, periodic and multilateral compensation of the balances held on the bilateral accounts (or a substantial part thereof) through some central agency.

13. Some suggestions as to how a mixed system of settlements of this sort (i.e. with some countries settling in convertible currencies and others through bilateral accounts) could operate in practice will be offered in another part of this paper.

/E. Payments

E. Payments systems

14. During recent years, consideration has frequently been given in Latin America to the setting-up of some form of payments system along the lines developed in Europe from 1947 onwards. In fact, in Europe, this development passed through three stages. The earliest - a somewhat limited multilateral payments agreement - lasted from 1947 until 1949. It was then succeeded by the European Payments Union (EPU), which provided for complete transferability inside the Organisation for European Economic Cooperation (OEEC) area and a substantial system of mutual credits. In December 1958, when most European countries has restored external convertibility to their currencies, the EPU was replaced by the European Monetary Agreement, which had been expressly designed to enter into operation in this eventuality.[3/]

3/ It will be recalled that one of the cardinal points of policy of the Organisation for European Economic Cooperation was that freedom of trade and freedom of payments must go forward together, and that some system of mutual credits was necessary to reinforce the reserves of member countries and enable them to expand their trade multilateralization measures. Thus the OEEC's trade liberalization code, which has been in operation since August 1950 and whose adoption was made conditional on the coming into force of the European Payments Union, states that "the need to create as wide a market as possible in which goods and services may be freely exchanged cannot be completely achieved until a sufficient equilibrium is restored to intra-European payments, as part of the effort towards establishment of a single system of multilateral trade in the world, an equilibrium which will enable member countries to exchange goods and services freely with each other without endangering their monetary reserves"; and one of the express purposes of the European Payments Union was "to facilitate in the largest possible measure the liberalization, on a non-discriminatory basis, of trade and visible transactions" and to "provide member countries in particular, with reserves to play in the part the role of gold and foreign currency reserves".

Finally, the European Fund, which was set up under the European Monetary Agreement that entered into force in December 1958, was established expressly "to provide the member countries with credit in order to aid them to withstand temporary over-all balance-of-payments difficulties, in cases where these difficulties endanger the maintenance of the level of their intra-European liberalization measures".

/The development

The development of a compensation system, as a preliminary step leading to a payments union, as occurred in Europe, presupposes the existence of a considerable number of bilateral accounts, since the volume of possible multilateral transfers that the system can produce increases with the number of surplus and deficit balances brought into compensation, and, conversely, if the number of bilateral accounts is relatively small, the system is unlikely to produce any worthwhile results. Until fairly recently, the number of bilateral accounts maintained by the Latin American countries and the tendency to establish new accounts, even towards the end of 1958, favoured a move towards multilateralism by gradual development from some simple system for compensating bilateral balances. However, the recent shift towards the suppression of bilateral accounts, the desire not to adopt new ones, and the possibility of taking more efficient steps to eliminate bilateralism would seem to suggest that progress through some compensation system - essentially based on the maintenance of bilateral accounts - is no longer the most suitable procedure for the Latin American area.

F. Agency

15. If the need for special credit facilities in the area is accepted and, even more, if some part of the settlements for intra-area trade are effected through bilateral accounts and there is agreement on the need for some mechanism that will achieve periodic multilateralization of some part or the whole of these balances, then it will be necessary to establish a central agency.

The precise functions of such an agency will have to be established in full technical detail, but, in broad terms, it is suggested that its terms of reference could be:

(a) to act as the channel through which the intra-area credit arrangements, especially if these are automatic, will be operated;

(b) to provide the mechanism for the multilateralization of the balances held on bilateral accounts; and

(c) to provide a centre for the compilation of financial data and for financial studies, on the basis of which the area's monetary problems would be examined and discussed by the competent bodies.

/It is

It is clear that, if the agency is to carry out efficiently the functions described above, it will have to have its own resources. And this in turn will mean that it will have to be endowed with its own independent personality in international law.

16. The amount of the agency's capital or fund will depend on what arrangements are reached as to intra-area credit facilities and for the multilateralization of balances on bilateral accounts and thus can only be determined at a later stage. Suffice it to say here that the agency's capital or fund:

(a) might be derived from quotas subscribed by the member countries and also, possibly, from contributions from non-member Governments and international organizations;

(b) need not be suscribed in full at the time of the agency's establishment. It would for instance be perfectly possible for a relatively small percentage to be paid over initially and for the balance of the agreed contributions to be called up as and when the agency has need of further funds.

It need hardly be added that the agency would have to maintain the closest relations with the Central Banks of the member countries and that it would be subject to the authority and directives of the competent bodies of the free-trade area.

II. THE FUNCTIONS AND OPERATION OF A PAYMENTS SYSTEM

17. Two of the major functions of a payments system designed to assist the full and harmonious development of the free-trade area will be:

(a) to ensure as far as possible that the maintenance of bilateral accounts and credit margins does not have a discriminatory effect on intra-area trade, and

(b) to act as a channel through which the intra-area swing credit arrangements - especially if these are automatic - will be operated.

These two functions of the System are to some extent inter-related, at least in so far as its multilateral credit arrangements must take account - in whole or in part - of the development of the balances on the bilateral accounts. For the sake of clarity, however, it will be preferable to consider separately the various ways in which the functions in question can be carried out.

/18. But

18. But first a word as to the general framework of the system. It is envisaged that:

(a) a central agency would be established with which the Central Banks of all member countries would maintain an account;

(b) these accounts would be kept in United States dollars and at regular intervals - every 60 or 90 days - the balance thereon would be determined, taking account of the payments and transfers which the rules of the system provide should be reported to the agency for incorporation by the latter in its books;

(c) when the balances have thus been determined - at the end of each "accounting period" - the Agency would then proceed with the settlement of the balances; these settlements would be effected - as provided for under the rules of the system - either in credit, or in convertible currencies, or partly in credit and partly in convertible currencies.

19. When intra-area transactions are settled freely in convertible currencies, there is clearly no need for any special mechanism to ensure the multilateralization of such payments.

The position is however quite different where settlements are effected over bilateral accounts, the balances on which can only be used for making payments to the bilateral partner in question. Here the danger is two-fold. In the first instance, a country in approximate equilibrium with the area may find itself in considerable payments difficulties if its imports are having to be paid for, in the main, in convertible currencies, whilst the bulk of its exports are being settled over bilateral accounts and thus in currency which cannot be used to pay for its imports.

The second danger arises from the pressures which settlements over non-transferable bilateral accounts may well create on the flows of trade. For instance, in the case cited above, the country in question may be compelled to switch a substantial part of its imports to the

/bilateral partner

bilateral partner in order to use its accumulating bilateral surplus and to diminish the strain on its convertible currency reserves. Similarly, substantial bilateral credit facilities might induce countries to favour the placing of imports where such credits are available, even though normal commercial considerations might suggest that the purchases be effected in some other country of the area.

20. The simplest way of avoiding these difficulties would be to provide, through a payments mechanism, for the multilateralization, at regular intervals, of all balances on the bilateral accounts. This was, indeed, one of the major purposes of the European Payments Union, whose provisions in this regard effectively eliminated any real risk of trade distortions resulting from financial considerations.

But whilst this must be the goal towards which Latin American payments arrangements should move as rapidly as circumstances permit, it would seem clear that its immediate attainment is not possible, and that some interim arrangement must be developed which will allow, and indeed encourage, a more gradual progress towards complete monetary transferability within the area, and thence, to full convertibility.

21. A number of possibilities might be considered to this end, of which, perhaps, the two following suggestions might be the easiest to operate in practice. It could be agreed that limits should be set to the swing credits available on bilateral accounts and that any balance in excess of this figure - at the end of the "accounting period" - should be transferred to the agency and thus rendered available for use by any creditor country in the area. Clearly, the efficacy of this provision would depend on the size of the credit margins within which bilateral balances would retain their strictly bilateral character.

/An alternative

An alternative method for partially multilateralizing the bilateral accounts, would be to provide that at the end of each accounting period, a certain percentage - say 20 per cent to begin with - of the bilateral balances or of some of them should be transferred to the agency. A percentage figure of this order of magnitude would mean that credit extended bilaterally would be multilateralized over a period of some 15 to 18 months and thus would allow ample time for the reversal of seasonal swings.[4/] It would, however, be necessary to reach agreement on how the bilateral balances existing at the time of the coming into force of the payments system should be dealt with.

22. But whatever method be adopted - another, for instance, would be to transfer balances that had been continuously outstanding for longer than a given time - the procedure in the agency would be the same.

The creditor country's multilateral account in the agency would be credited with the amount transferred and the debtor country's account would be correspondingly debited; and those credit or debit entries would then be taken into account in the agency's calculations of settlement against multilateral credit of resulting dollar payments.

23. Another situation remains to be considered. There may be, and actually are, countries which export essential commodities such as sugar and cotton to other possible members of the area and which register persistent and substantial credit balances against the importers of these items.

4/ Multilateral settlement does not preclude the reservation of certain bilateral balances in order to meet trade contingencies.

/Once the

Once the area had been established, the system of reciprocity in respect of the concessions granted which it would bring into operation would perhaps influence such situations, but would probably do so by gradual degrees. Meanwhile, the country with a persistent credit balance would be able to incorporate into the system only a proportion of the value of its exports of the commodities in question. This proportion would gradually increase from year to year until it reached 100 per cent, or until the date at which the competent organs of the area reconsidered the problem.

24. Another important function of the payments system will be to provide - through the agency - a channel for the granting and receipt of credits, in support of the area's trade liberalization policy.

It would clearly be in the interests of the system that it should be able to operate with the maximum degree of automaticity; and thus that each country's credit margin in the agency - and the procedures under which these credit margins are to be operated - should be agreed on at the time the system is established.

25. Once the amounts of the credit margins had been agreed on, two questions would have to be settled, namely:[5] (a) how will the credit margins be operated in the context of the agency's periodic settlements? and (b) how will the positions of individual countries be calculated in the agency for the purpose of determining their entitlement to receive credit or their obligation to grant it, and for the purpose of determining what payments in convertible currencies are due to or by the agency?

26. On the first point, any number of formulae can be conceived, but in the interests of simplicity (and also to avoid the risk of too severe a drain on the agency's assets) the choice would seem to lie between: (a) settling deficits and surpluses wholly

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5/ See para. 41 et. seq.

/in credit

in credit up to the limit of the credit margins, and thereafter wholly in convertible currencies; or (b) settling deficits and surpluses in part by the use of credit margins, the balance being settled in convertible currencies; and when the credit margin is exhausted, entirely in convertible currencies.

Arguments can be advanced in favour of both systems and the decision - which does not, of course, affect the amount of credit available to, or made available by, each country in the system - is essentially a matter for discussion and negotiation between the Member countries in the light of their individual preferences.

27. It should be noted that in both cases the agency would require a capital or fund of its own. This need arises from the possibility that one or more creditor countries might have exhausted their credit margins to the agency (and thus be entitled to receive settlement wholly in convertible currencies) at a time when the deficit countries had still not reached the limits of their credit margins and were thus settling with the agency wholly in credit, or partly in credit and partly in convertible currencies.

III. POSSIBLE SYSTEMS

28. Before the formulas for harmonizing the different views on the payments problem currently held by the countries interested in joining the free-trade area are expounded, a brief account should be given of the recent general evolution of inter-Latin American payments. The bilateral accounts through which most trade transactions used to be channelled, had extremely heterogeneous bases and procedures. The almost complete absence of parity between the value of units of account and that of convertible currency for equivalent operations distorted the price system and conduced to the perpetual freezing of balances. In the last two years the outlook has been favourable to the creation of the conditions required to pave the way for multilateral agreements. The

/initial stage

initial stage is characterized by the adoption of the Standard Agreement and Standard Banking Procedure at the first session of the Central Banks Working Group (Montevideo, 1957) and their application to nearly all clearing-account trade. The establishment of parity between units of account and actual dollars, above all, and the consequent influence of this system on quotations of goods at international prices provided the fundamental elements for a continuation of the movement towards multilateralism.

At its second session the Central Banks Working Group (Rio de Janeiro, 1958) threw fresh light on the payments problem and its evolution and also drew up a Protocol to regulate, in the event that the countries continued to maintain accounts, the transfer of balances which were being effected, in an incidental way, on the basis of the Standard Agreement.[6/]

In view of these antecedents, of the lines of action that emerged from the recent Conference at Montevideo and of the tendency revealed in the last few months for the suppression of bilateral accounts, some payments formulas might be proposed for transactions within the free-trade area.

Some of these formulas are based on the possibility of organizing a priori credit systems and might be adopted if -- as is the case in the countries which would constitute the area - the opinion continues to prevail that, because of general considerations related to the aggregate balance of payments, the use of dollars for current trade transactions in the area should be reduced as much as practicable. Another formula, based on credits a posteriori, would take effect if all transactions through current accounts were settled in dollars.

6/ See the following ECLA documents: Report submitted to the ECLA Trade Committee by the Central Banks Working Group on a multilateral payments system (E/CN.12/484); Inter-Latin American payments (E/CN.12/C.1/WG.1/8 and annexes I and II); Report submitted to the Trade Committee of the Economic Commission for Latin America by the Central Banks Working Group on a multilateral payments system (E/CN.12/C.1/WG.1/10/Rev.1).

/A. System

A. System of a priori credits (combined system)

29. The system would be developed at two different levels. The first would relate to transactions effected by countries not linked by bilateral accounts; and the second to countries members of the system and linked by bilateral accounts. The agency for the system would maintain one account per country, through which the multilateral payments and claims would be effected and into which the bilateral balances agreed on would be incorporated.

30. The mechanism of the system might prove somewhat complicated if the agency registers individually all claims and payments inherent in the internal trade of the area. In order to simplify the scheme, it would be necessary to choose operational decentralization.7/

Each Central Bank would determine which commercial banks or other institutions in its country were authorized to operate as part of the system. These authorized institutions would effect claims and payments through their representatives in the other countries of the area. At the end of each accounting period, or when convenient, the commercial banks would liquidate their net position in the corresponding Central Bank, which would thus register only one balance - debit or credit - for each authorized institution. The consolidation of these balances would of course be the position which each Central Bank would register with the agency. This latter would take cognizance of the positions of all Central Banks.

31. Within this scheme it would not be difficult to locate any discrepancies that might appear when the operations were computed. All that would be required would be for the authorized institutions to declare, at the end of each accounting period, their balances with each of their representatives. As the declarations of each pair of representatives

7/ Should such decentralization not exist, the following procedure would have to be followed. Payments under such heads as the value of the goods traded, transport and insurance expenditure and other items whose inclusion is agreed upon would be effected through each of these accounts. To liquidate operations use would be made of documentary or clean credits or orders for payment, opened or issued by Central Banks or directly by commercial banks or other institutions in the country concerned, notification of these being sent to the agency for bookkeeping purposes and, as an authorization of reimbursement, to the Central Bank of the country on which payment is incumbent.

/in respect

in respect of their reciprocal operations must be equal to each other - one with a plus and the other with a minus sign - discrepancies could be quickly cleared up by this means.

32. From another point of view, the adoption of this scheme would channel inter-Latin American trade operations through the private banking system, whose intervention in such trade has hitherto, for various reasons, been less than its participacion in trade with the rest of the world.

33. Under the system, the countries maintaining bilateral accounts would operate in exactly the same way as the multilateral account countries as regards their relations with these latter. From this point of view, all the member countries' participation in the agency would be subject to common regulations and procedures.

34. The establishment of the agency would not necessarily involve the termination of bilateral relations based on extant payments agreements. While they deemed it preferable, the parties to such agreements would continue to effect their reciprocal payments through the accounts concerned, but, as has already been said, on condition that they adhered to the rules of the Montevideo Standard Agreement.

Periodically, at the close of the same periods agreed upon for the regular liquidations effected by the agency, specific proportions of the bilateral-account balances would be transferred to the multilateral system. To this end, a fixed proportion of the balance registered in each bilateral account on a given date, irrespective of the amount such balances represented, should be incorporated into the agency's multilateral compensation. This proportion might be, for instance, 20 per cent of the bilateral balance concerned.

The proportion of the bilateral balances which would be transferred to the agency through the application of this arrangement, would determine the position of member countries in their bilateral relations and would be included in the position of each country deriving from its dollar transactions.

35. The following example sheds some light on the foregoing procedure as regards the incorporation into the system of a proportion of the bilateral balances.

/For simplicity's

For simplicity's sake, let it be supposed that there are only four members and that bilateral relations exist between countries B andD and between countries C and D.

The bilateral balances susceptible of liquidation through the agency would be:

B-3 D 3

C-4 D 4

and the following would be the multilateral balances:

A 8

B-3

C 2

D-7

Assuming that we are dealing with the first period of operations and that the initial position of each country shows no balance, the following result would be obtained:

Country	Multilateral position	Bilateral position	Net position	Balance with the agency
A	8	0	8	+5
B	-3	-3	-6	-5
C	2	-4	-2	-2
D	-7	+7	0	0

It thus clear that, if the multilateral credit were, for example, 5 for each member, country A would obtain a reimbursement of 3 and country B would have to effect a payment of 1, which means that the agency would have to make a net disbursement of 2, offset by an equivalent increase in its credit balance.

The model presented shows how greatly the use of convertible currency in the financing of intra-area trade could be reduced, especially if it is borne in mind that the multilateral positions correspond only to the difference between exports and imports.

/B. A posteriori

B. A posteriori credit system

36. A scheme of this kind would be applied if it were considered desirable that current intra-area transactions between countries that practised or had adopted convertibility, or between such countries and the parties to bilateral accounts, should be negotiated daily in dollars.

Bases for operation

37. The system would comprise two phases, one corresponding to dollar payments, and the other deriving from the incorporation of part of the bilateral balances into the system for automatic multilateral settlement.

38. As has already been pointed out, the agency would have at its disposal a capital or fund in dollars formed with the quotas suscribed by members, as well as with contributions - perhaps of a complementary nature - from Government or international institutions outside the area.

Each country would grant a credit to the agency and would receive one from it in return. The amount of this swing credit would be established on the basis of considerations such as those developed in paragraphs 41 et seq.

39. The members would compile and forward to the agency periodical data, relating to accounting periods of 60 or 90 days, on the net balance of the dollar claims and payments effected by each of them as a result of their reciprocal current transactions. To this end, each central bank would compute the data supplied to it by the commercial banks or other institutions authorized to effect exchange operations.

Furthermore, at the same regular intervals of 60 or 90 days, the countries maintaining accounts would transfer to the agency the previously stipulated proportion of the balance on each bilateral account, with a view to its multilateral settlement.

40. The agency would determine each member's net position at the end of the accounting period concerned, taking into consideration the two elements mentioned, i.e., the balance on dollar payments and the balance resulting from the multilateral settlement of proportions of bilateral balances.

/When a

When a country's net position indicated that it had effected dollar payments in excess of its dollar receipts, the agency would automatically furnish it with a sum equivalent to the excess disbursement, to be debited against the credit due to it, always provided that this were still sufficient to cover the amount involved. Otherwise, the automatic loan would be reduced to the amount of the credit margin available.

Again, if a country's net position showed that its receipts had exceeded its payments, it would surrender to the agency a sum in dollars equivalent to the resulting net balance. But, as in the preceding case, this procedure would be put into effect in so far as the credit margin in question permitted.

The procedure described could be illustrated by means of the figures in the example given in paragraph 35.

On the basis of the hypothetical positions postulated for the four countries, and on the assumption that the multilateral credit were 5 for each member and that the accounting period concerned was the first, the results would be as follows:

Country	Multilateral payments	Bilateral position	Net position	Amounts surrendered to the agency	Amounts surrendered by the agency	Balance with the agency
A	8	0	8	5		5
B	-3	-3	-6		2	-5
C	2	-4	-2	2		-2
D	-7	7	0		7	0

The agency's receipts amount to 7 and its disbursements to 9, with a net outflow of 2, equivalent to the amount by which the net debit balance of the member countries increases.

Country A registers a favourable balance of 8 in its multilateral relations and shows no bilateral position. It therefore surrenders 5 to the agency, this being the limit of its swing credit. Thus its

/position vis-à-vis

position vis-a-vis the agency stands at plus 5.

Now comes the case of country B. It has disbursed 3 under the head of dollar payments. It also has to meet a payment of 3 to the agency, for purposes of the settlement of its bilateral position. As the agency will give it back 2 under this head - i.e., the difference between the amount payable and the limit of its swing credit - country B is left with its credit utilized (minus 5) and has effected a net disbursement of 1.

Country C's earnings amount to 2, which it surrenders to the agency; it also has to surrender another 4 as the result of its bilateral movement. In this case, the latter sum is debited against the credit due to the country concerned, which will be left with a balance of minus 2.

Country D loses 7 on its dollar claims and payments. In addition, it shows a positive bilateral balance of 7, which will be restored to it by the agency. The two positions will therefore compensate each other and its balance will stand at 0.

If exactly the same situation were to recur in succeeding periods, the results would be as follows:

Country	Balance with the agency	Multilateral payments	Bilateral position	Net position	Amounts surrended to the agency	by the agency	New balance with the agency
A	5	8	0	13			5
B	-5	-3	-3	-11	3		-5
C	-2	2	-4	-4	2		-4
D	0	-7	7	0		7	0

Country A is left with its surplus. Country B's dollar payments are not reimbursed and it pays its bilateral balance, since it has no credit margin available. Country C surrenders 2 to the agency, which assumes a bilateral commitment of 4 by increasing the same country's debit balance by 2. Country D compensates its positions; it receives 7 from the agency and maintains its balance at 0.

/if a

If a third period with the same figures were to be assumed, the situation would be as follows:

Country	Balance with the agency	Multi-lateral payments	Bilateral position	Net position	Amounts surrended to the agency	Amounts surrended by the agency	New balance with the agency
A	5	8	0	13			5
B	-5	-3	-3	-11	3		-5
C	-4	2	-4	- 6	3		-5
D	0	-7	7	0		7	0

The agency, which in the preceding period surrendered dollars to the amount of 2, now does so for 1. The net debit balance of the members increases by this amount. A change takes place in the situation of country C, which has used up its entire credit and in the future will have to meet the whole of its commitments with dollar payments.

Lastly, the results of a fourth period, given the same positions, are shown below:

Country	Balance with the agency	Multi-lateral payments	Bilateral position	Net position	Amounts surrended to the agency	Amounts surrended by the agency	New balance with the agency
A	5	8	0	13			5
B	-5	-3	-3	-11	3		-5
C	-5	2	-4	- 7	4		-5
D	0	-7	7	0		7	0

By the time this fourth period is reached, the agency's receipts and expenditure balance one another. The net amount it surrenders in dollars has risen to 5, and the net balance owed to it by the member countries represents the same sum.

/C. Aspects

C. Aspects common to both systems

1. Multilateral credit

41. Upon entering the agency, the members would grant a standing credit. The granting of such credit would not constitute a new departure. Apart from existing in bilateral accounts, it also exists to a certain extent - with dollar coverage - in inter-Latin American trade, since trade credits are often granted for varying terms to facilitate specific exports payable in dollars. In addition, the country granting credit within the system would receive credit in return. The credit could be fixed at a suitably low level (the amount to be settled by negotiation). Furthermore, credit must be granted if the objectives of the free-trade area are to be attained.

In the case of both the a priori and a posteriori systems, each country's swing credit with the agency would have to be established chiefly on the basis of the size of seasonal disequilibria in traditional trade. Some attempt to provide against a possible and perhaps a rapid expansion of imports as a result of the establishment of the free-trade area would also have to be made.

To facilitate the formation of some idea of the possible magnitude of multilateral credits, it may be worth while to study table 1, which presents the values represented by trade among the seven countries interested in setting up the free-trade area. The table draws a distinction between trade on the basis of bilateral accounts and trade covered in dollars. On the basis of these values, some preliminary estimates may be hazarded as to the possible amount of each country's swing credits with the agency.

/Table 1

Table 1

TRADE TRANSACTIONS BETWEEN ARGENTINA, BOLIVIA, BRAZIL, CHILE, PARAGUAY, PERU AND URUGUAY, 1958

(F.o.b. values in millions of dollars)

	Exports	Imports	Balance	
Argentina				
Multilateral	7.9	13.2	-5.3	
Bilateral	115.6	134.4	-18.8	(With Bolivia, Brazil, Chile, Paraguay, Peru and Uruguay)
Bolivia				
Multilateral	-	3.9	-3.9	
Bilateral	0.2	7.7	-7.5	(With Argentina, Chile and Uruguay)
Brazil				
Multilateral	1.9	1.5	0.4	
Bilateral	141.5	89.4	52.1	(With Argentina, Chile and Uruguay)
Chile				
Multilateral	3.6	29.5	-25.9	
Bilateral	28.5	32.9	-4.4	(With Argentina, Bolivia and Brazil)
Paraguay				
Multilateral	13.2	9.2	4.0	
Bilateral	0.5	0.5	-	(With Uruguay)
Peru				
Multilateral	35.0	4.7	30.3	
Bilateral	2.6	11.2	8.4	(With Argentina)
Uruguay				
Multilateral	1.8	1.4	0.4	
Bilateral	10.9	23.7	-12.8	(With Argentina, Bolivia, Brazil and Paraguay)

Source: Official foreign trade statistics.

/42. One

42. One criterion on which to base an estimate of the possible magnitude of credits would be the assumption that these would have to be sufficient to cover in dollars the value of the transactions effected during one quarter, or, in other words, equivalent to one-fourth of the value of the annual trade of the country concerned with the area. As regards the proportions of the bilateral balances to be liquidated through the agency, since the credits established in the bilateral accounts would still exist, a smaller proportion could be fixed, such as, for example, 10 per cent of the value of annual trade through the bilateral accounts concerned.

Accordingly, the estimates given in table 2 were prepared.

Table 2

INTER-LATIN AMERICAN FREE-TRADE AREA: ESTIMATE OF POSSIBLE MAGNITUDE OF MULTILATERAL CREDIT

(Millions of dollars)

Country	25 per cent multilateral trade	10 per cent bilateral trade	Total A a/	Credit B b/
Argentina	5.3	25.0	30.3	15.2
Bolivia	1.0	0.8	1.8	0.9
Brazil	0.8	23.1	23.9	11.9
Chile	8.3	6.1	14.4	7.2
Paraguay	5.6	0.1	5.7	2.9
Peru	9.9	1.4	11.3	5.7
Uruguay	0.7	3.5	4.2	2.1

Source: ECLA, on the basis of the figures in table 1.

a/ The credits in column A were estimated for each country on the basis of 25 per cent of the value of the trade effected in 1958 in convertible currency, and 10 per cent of the value of trade thorough bilateral accounts.

b/ The credits in column B were calculated on the same bases as in the case of column A, but the average value of imports and exports was taken.

/43. It is

43. It is of interest to compare the credits of which the possible amount is indicated in table 2 with trade balances in 1958 as between the countries that would be organizing the area, in order to form some idea of what would have been the size of the surpluses to be multilaterally liquidated through the agency. This is the purpose of table 3. The estimates presented in this table must be taken with some degree of caution, since the f.o.b. value of exports on which they had to be based is not altogether representative of the balance-of-payments situation, because the statistics for services and other invisible items are not available. Furthermore, as the bilateral balances would in the first place be absorbed outside the agency by the credits provided for in the bilateral accounts concerned, table 3 was based on the hypothesis that a proportion equivalent to 20 per cent of the value of the balances in question would be incorporated in the multilateral liquidation process. Lastly, it should be pointed out that the estimates had to be worked out on the basis of annual balances, whereas in practice the agency would effect liquidations at shorter intervals of 60 or 90 days. Consequently, there might well be seasonal disequilibria sharper than those reflected in the annual balance.

44. Once the magnitude that would be registered by the multilateral swing credits as a result of the negotiation conducted on the organization of the system has been ascertained, it will be possible to make an accurate estimate of the maximum amount of the capital or fund within the agency.

Time-lags would derive, as has already been pointed out, from the following circumstance. It may happen that several debtor countries have not exceeded the limit of their credits as at a given date, and are thus free from any obligation to effect payments to the agency. The latter, in turn, might find itself compelled to effect payments on the same date to a creditor country which had concentrated all the deficits of the debtor members in its positive balance. It would thereby have exceeded its credit level and would thus be in a position to claim payment of the surplus.

The mode of operation of this capital or fund would resemble, up to a point, that of the cash assets or cash reserve of a commercial bank.

/Table 3

Table 3

ESTIMATE OF RECEIPTS AND PAYMENTS DERIVING FROM TRANSACTIONS IN 1958[a/]

(Millions of dollars)

Country	Credit[b/]		Balance[c/]	Receipts or payments (-)	
	A	B		A	B
Argentina	30	15	-9	-	-
Bolivia	2	1	-6	-4	-5
Brazil	24	12	14	-	2
Chile	14	7	-27	-13	-20
Paraguay	6	3	4	-	1
Peru	11	6	28	17	22
Uruguay	4	2	-4	-	-2

Source: ECLA, on the basis of the figures in table 1.

a/ Based on example given in table 2 above.

b/ See note to table 2. Figures are rounded.

c/ Multilateral plus 20 per cent of bilateral balances.

In the case of the agency, the assets in its balance would comprise the stock of dollars constituting its capital, plus its credits against debtor countries. Its liabilities, on the other hand would include credits against the agency in favour of creditor countries and the book values of dollar holdings as registered in favour of the countries or institutions which supplied them. If trade movements in the area develop in conditions of relative equilibrium and member's balances do not exceed the credit limits established, the agency's cash holding will register no movement whatsoever. On the other hand, disequilibria in either direction in so far as they exceed the credit level, may reduce or augment the cash reserve, within limits that can be calculated with complete accuracy.

/In these

In these circumstances, the less favourable hypothesis is that by which six of the seven members of the area might reach at one and the same time their debtor credit limit, and the seventh country, with the lowest credit level, would be the creditor of all of them. In such an event, the maximum amount which the agency would be obliged to disburse would be 87 million dollars in the case of estimate A and 44 million in that of estimate B.

This hypothesis is extremely unlikely to materialize. The figures in table 3, prepared in accordance with the assumptions explained above, suggest that the agency would not have had to make any payment in case A (income and expenditure to the amount of 17 million dollars) and a net disbursement of 2 million in case B (income 25 million dollars and expenditure 27 million).

The establishment of certain special interim conditions to facilitate accession to the system in the case of countries whose balances in the trade that would be covered by the area are persistently favourable, would help to prevent the occurrence of a phenomenon such as that visualized in the foregoing hypothesis.

2. Situation of surviving bilateral accounts

45. As has already been mentioned, the surviving bilateral accounts would be connected with the a priori or a posteriori credit system by the surrender of a fixed proportion of the balance (which would be revised from time to time) for purposes of the periodical and automatic liquidation effected by the agency.

It is useful to consider how this provision would affect accounts registering high seasonal balances, like the account between Argentina and Brazil, the countries which maintain the largest inter-Latin American trade flow. In this account a great deal of weight is carried by certain goods in respect of which trade values fluctuate appreciably form one year to another. Moreover, the operations arising out of trade in the goods in question are concentrated in certain periods of each year. The sharpest fluctuations are registered in the case of wheat, trade in which is conditioned by the following two main variables: the volume

/of production,

of production, both in Argentina and in Brazil, and the size of Brazil's purchases in other markets. Fluctuations are also observable in trade in fresh fruit and timber.

Table 4 presents the balance of the Argentine-Brazilian payments account at the close of each of the last four years. It may be noted that in the period as a whole the balance of payments between the two countries showed a net surplus of 61 million dollars, in favour of Brazil, with disequilibria reaching 35 million dollars in a single year.

Table 4

BALANCES OF THE ACCOUNT HELD BETWEEN ARGENTINA AND BRAZIL AS ON 31 DECEMBER OF EACH YEAR

(Millions of dollars)

Year	Balance a/	Difference in respect to the preceding year
1955	+ 10.1	
1956	- 12.1	22.2
1957	- 15.8	3.7
1958	+ 19.2	35.0

Source: ECLA, on the basis of data supplied by the Banco Central de la República Argentina and the Department of Currency and Credit (Superintendencia da Moeda e Crédito) of Brazil

a/ The signs refer to the position of Brazil.

These extremely marked fluctuations tend to cancel each other out, but over very long terms. Argentina and Brazil have therefore established an unlimited swing credit in their payments account, so that neither country runs the risk of having to divert dollars to the financing of its trade.

Situations like this account for the caution with which the prospect of a change in the existing payments system among some Latin American countries is viewed in some circles and for the anxiety that progress

/towards multilateralism

towards multilateralism and convertibility should be gradual enough to allow time for the expansion of trade in such items as manufactured goods - trade in which might attain a more even and steady flow than the commerce in primary commodities at present prevailing - to impart some degree of stability to trade flows between the two countries and in the area as a whole.

3. Credits and internal means of payment

46. How far would the credits granted under the a priori or a posteriori system have inflationary effects in each country?

It is common knowledge that the inflationary effect of an export against credit is exactly the same as that deriving from another whose value has been received in dollars which have gone to increase the foreign exchange reserve of the exporter country. In other words, the expansionist effect depends on the possibility of applying the resources obtained from such exports to new imports, which would be facilitated within the system by the participation of the largest possible number of countries.

The expansionist monetary repercussions of the credits which would be required under the agency system may be regarded as fairly limited if their possible magnitude is related to the volume of internal means of payment of the countries interested in the formation of the area. According to the preliminary calculations in this paper, possible credits would represent between 0.9 and 1.8 per cent of the means of payments of the countries as a whole.

IV. FINAL REMARKS

47. In this paper, two possible systems for multilateral credits and the periodic settlement of transactions among the participating countries have been outlined.

The main differences between the two systems may be summed up as follows:

(a) With respect to transactions effected through bilateral accounts, the two systems are identical. In both cases, part of the bilateral balances would be liquidated multilaterally and the resulting net surplus incorporated into the over-all position of each member so that it can be subjected to the settlement rules that are agreed upon.

(b) When transactions are effected in dollars, each system will be applied in a different way: (i) under the a priori credit system, countries with a surplus would grant internal credits to countries with a deficit for the duration of each accounting period, i. e. for the 60-day or 90-day interval between the agency's settlements. Such credits differ fundamentally from, and are supplementary to, the multilateral credits agreed upon with the agency. Their amount would, of course, be equal to the amount of the surplus recorded for multilateral credits during the whole of the accounting period; (ii) under the a posteriori credit system, there would be no internal credit.

48. The operation of the two systems would also differ to some extent:

(i) Under the a posteriori system, dollar payments for daily transactions would be effected by commercial banks as usual through letters of credit, payment orders or drafts, chargeable to the accounts held by the partner banks among themselves and cleared on New York or any other centre adopted for the same purpose. Under the a priori system, on the other hand, operations among commercial banks would be undertaken as usual, except that settlements among partner banks would be cleared on the corresponding Central Banks.

/(ii) Both systems

(ii) Both systems would require an accurate computation of transactions in order to establish the balance between payments and claims. In either case, it should be possible to decentralize the computation so that the Central Banks would receive from commercial banks only the final balance for the operations of each bank with its partner banks in the area. In the one case, the Central Banks would naturally take these balances, against payment or claim in local currency, whereas, in the other, they would have a purely statistical value and would be used to ascertain the final position for payments and claims actually effected during each accounting period.

(iii) The accounts maintained under either system by each Central Bank with the agency would also be alike inasmuch as they would reflect each country's position vis-à-vis the other participants in the area as a whole. Under one system, each country would debit or credit its account with the amount accruing from its daily transactions, whereas, under the other, the results of periodic settlements would not be shown until the close of each accounting period. In both cases, however, that part of the bilateral balances agreed upon for transfer to the agency for multilateral settlement would be periodically incorporated.

49. Either of the two formulas outlined, or any other of a similar nature, would provide the credit facilities required to forge ahead boldly with the programme of trade liberalization and, at the same time, gradually to impart the necessary uniformity and convertibility to intra-area payments. The countries themselves would have to study the positive and negative features of each system in the light of their own interests and possibilities as well as of the common desire to attain the aims pursued by the free-trade area.

B

FURTHER CONSIDERATIONS ON THE SYSTEM OF SWING CREDITS IN THE FREE-TRADE AREA

(ECLA, Santiago, Chile, 14 December 1959)

During talks which representatives of the secretariat of the Economic Commission for Latin America (ECLA) held in Washington last November with officials of the International Monetary Fund, as well as with representatives of the United States Government connected with the Fund, an explanation was given of the meaning and scope of the two alternative proposals for a system of swing credits submitted by the secretariat to the Governments participating in the forth coming central banks meeting at Montevideo.[1/] The most important points alucidated in the Washington talks are briefly reviewed below, together with certain relevant comments.

I

1. The establishement of a system of swing credits for the projected free-trade area is not dictated by balance-of-payments considerations. Indisputably, payments equilibrium must be sought in the aggregate, not bilaterally or with respect to a group of countries. The aim pursued is not to balance payments, but to stimulate an energetic liberalization policy in respect of trade among the countries of the area. Most of those that have already attained convertibility have done so through the application of heavy surcharges or prior deposits to restrict imports. The imposition of these restrictions has been decisively influenced by general motives connected with the balance of payments.

In practice, apart from what might be achieved through negotiations within the General Agreement on Tariffs and Trade (GATT), a liberalization pact designed to abolish such restrictions vis-a-vis the rest of the world in general, in exchange for equivalent concessions, would be inconceivable. But such an agreement might well be feasible among the Latin American countries, since in each of them the increase in each one's imports brought about by the liberalization policy would be concomitant with the effect on its own exports

1/ Working paper No. 1, dated 30 October 1959.

/of the

of the liberalization measures applied by the other countries. This is a promising field for the expansion of trade.

Presumably, no country would adopt such a liberalization policy unless reciprocity existed. Moreover, the reciprocity principle was clearly defined by the Governments in the draft treaty on a free-trade area adopted at Montevideo.

It would not be justifiable to import against dollars, from countries members of the area, goods which on account of the dollar shortage are not now imported from the rest of the world. As regards imports at present effected from the rest of the world, what would be the point of ceasing to purchase them in other regions and bringing them in from within the area if they still had to be bought with the dollars that are so hard to come by? If such imports were not paid for on the basis of additional exports, no advantage would attach to the deflection of trade towards the area, as, commercially speaking, imports from the rest of the world are usually more attractive.

It may be useful to recall the essence of the principle of reciprocity. The countries of the area are proposing to expand their trade in order to expedite economic development. If a country increases its imports from the rest, it stimulates their development, and consequently may expect that its partner countries will encourage its own development by purchasing more of its exports. There is nothing in this which differs essentially from the principle of reciprocity as it is traditionally observed in any negotiation of commercial treaties.

2. In the course of the Washington talks two criticisms of the reciprocity principle as formulated in the draft treaty were put forward. The more importan was to the effect that mere correlation between the expansion of imports and that of exports did not necessarily imply equivalent benefits. country might in fact increase its exports of goods whose sale within the area depended only slightly or not at all upon preferences, and receive in return imports which could be effected only if they were granted markedly preferential treatment.

/The reply

The reply to this criticism is that such situations must be subject of negotiation. If a country has no difficulty in exporting certain goods to the world market, it may not have to depend on preferences in order to find a sale for them within the area. There would consequently be no reason to apply the reciprocity principle in the case of exports effected in this way, without need of preferential treatment. As stipulated in the draft treaty, this principle would be applicable only to goods enjoying such preferences.

Furthermore, each country will be free to choose the goods in respect of which it wishes to grant preferences, and will do so in the degree and measure in which it can obtain similar treatment from the other countries of the area. Thus, the application of the reciprocity principle, far from being automatic, would be dependent on negotiation among the contracting parties.

The second criticism was that the reciprocity principle might give rise to arbitrarily-created situations. A persistent excess of exports over imports might perhaps be the result of natural factors which would have to be respected. But what is meant by "natural factors", and which of them are involved here? Would the term be used in its proper sense, when the tariff system - the outcome of a specific policy - restricted imports? Of course not. If, by virtue of the concessions granted by its partner countries, a country develops a certain persistent excess of exports to the area, the logical inference seems to be that it should speed up its liberalization policy in order to increase its imports from the area. It is precisely thus that the application of the reciprocity principle was visualized in the draft treaty.

II

3. In connexion with the system of swing credits, attention was drawn to the following two essential aspects:

(a) Firstly, countries which, as a result of liberalization policy, develop an excess of imports from the area should have at their disposal credits up to a pre-determined limit to enable them to absorb the possible adverse effects of the policy in question, time being thus allowed for their experts to feel the benefit of the liberalization measures applied by the other countries. In default of such credits, prudence would dictate the greatest caution in putting liberalization policy into effect, lest new external payments problems should be created.

(b) Secondly, countries developing an excess of exports would have to grant credits to the importer countries again up to pre-determined limits.

Unquestionably, if these latter creditor countries, without granting any credit at all, were immediately to receive payment for their excess exports, they would have little interest in taking prompt measures to expedite their liberalization policy. But if they were under the obligation to grant a credit, and this could be mobilized within the area for the purpose of effecting more imports, a strong incentive to liberalization would be generated.

4. There would seem to be no fundamental objection to these two principles, which are grounded on considerations of trade policy not of payments policy. The objections raised related rather to the method of application. A great deal of stress was laid on the undesirability of granting credits to debtor countries automatically. Such credits, it was affirmed, should be made the subject of negotiation. They sould preferably be granted only when a deterioration in the aggregate balance-of-payments rendered such a step essential, and always providing that it did not jeopardize the policy of monetary control which a country had to pursue in order to achieve balance-of-payments equilibrium.

However, it is clear that the certainty of having credit available would help to induce countries to carry their liberalization policy as far as they considered feasible and that the lack of automaticity, at any rate to begin with, might seriously affect the scope and efficacy of the measures adopted.

Undoubtedly, Governments will have to weigh the pros and cons of these arguments with great care, before finally deciding on the solution they will select for so important an aspect of the problem.

5. The desirability of a lesser degree of automaticity was also discussed in connection with the credits to be granted by countries with a favourable balance. In this context, it was suggested that the credit might be liquidated when the creditor country demonstrated that the disparity between imports and exports was due not to its own policy

/but to

but to that of the debtor countries. How far the exercise of such a faculty could be carried would of course depend upon the degree of automacity of the credits granted to debtor countries, since these are two closely inter-related aspects of one and the same problem.

III

6. It was emphasized in the discussion that what was essential was the availability of a credit system which would facilitate liberalization within the area, always through the expansion, not the contraction, of trade.

If this criterion is adopted, the selection of the credit system will depend mainly upon practical considerations. In the report submitted by the ECLA secretariat to the Governments concerned, two alternative formulae are put forward; one of these was prompted by certain aspects of the European Payments Union machinery, while the other takes into account certain features of the subsequent European Monetary Agreement.

Strong objections were raised to the first formula. Its adoption would mean that accounts had to be kept of all the trade operations of each country with the other members of the area. It was feared that such a system might help to perpetuate bilateralism in those countries which had not yet succeeded in eliminating it, or to re-establish it in those where it had already been discarded. To avert this risk, the avoidance of any kind of accounting system was felt to be desirable.

The existence of the risk is undeniable, although it may be recalled that in Europe's experience the Payments Union, rather than perpetuating bilateralism, helped to get rid of it. The determinants of bilateralism are not accounting systems, since these did not previously exist, but phenomena of another sort, which are just what the policy of liberalization and reciprocity in the free-trade area would seek to remedy.

There is yet another motive of concern. The fluctuations of the exchange rate, in the course of daily operations, might give rise to speculative manoeuvres. The only way of preventing this would be to concentrate all

/operations in

operations in the central bank of the country concerned, a procedure which would detract from the desired speed and simplicity as regards the formalities involved.

7. To forestall such misgivings, the secretariat report also presents an alternative formula whereby operations in the area would be liquidated daily in dollars. Periodically, countries which, according to a statistical reckoning, had shown a surplus attributable to liberalization would have to deposit the dollars they had received, up to a certain predetermined sum. These resources would be placed at the disposal of countries with a deficit, in the form of loans. Thus the unit of account, implicit in the preceding formula, would be completely eliminated.

Alongside this advantage, the formula under discussion has the drawback - as was pointed out - that a central bank might find itself compelled to purchase dollars on the market in order to make the deposit referred to at a time the surplus in its favour had not yet brought an inflow of dollars to strengthen its foreign exchange position. However, in so far as the countries of the area decided against making these reimbursements and deposits automatic, the disadvantage indicated, if indeed it is one, could be modified eliminated.

8. The trend towards the re-establishment of convertibility is unquestionably of great importance. But it must be accompanied by sweeping measures to liberalize trade among the countries members of the area. The more numerous these members become, the more effectively can the liberalization policy be implemented and the more faithfully the reciprocity principle be observed.

Liberalization policy and the restoration of convertibility are perforce complementary to the introduction of the latter and a system of swing credits creates no obstacle. On the contrary, the success of a liberalization policy stimulated by the swing credit system would help to make convertibility an established and lasting reality.

C

REPORT OF THE MEETING OF GOVERNMENTAL REPRESENTATIVES OF CENTRAL BANKS TO THE SECOND SESSION OF THE INTER-GOVERNMENTAL CONFERENCE FOR THE ESTABLISHMENT OF A FREE-TRADE AREA AMONG LATIN AMERICAN COUNTRIES

(Montevideo, Uruguay, January 1960)

INTRODUCTION

1. This report summarizes the conclusions reached at the Meeting of Governmental Representatives of Central Banks held at Montevideo, Uruguay, in January 1960, in compliance with resolution 3 adopted at the first session of the Inter-Governmental Conference for the Establishment of a Free-Trade Area among Latin American Countries (Montevideo, 16-30 September 1959).

2. In this resolution, the Conference, after taking note that the delegations present had reported on the payments systems in force in their respective countries and had voiced their opinions as to the best way of effecting payments in the Area, expressed the view that their statements had raised special questions which should be examined at length. It therefore recommended that a meeting should be convened at which top-ranking experts would represent the Central Banks of the countries that were negotiating the establishment of the free-trade area. It also requested the United Nations Economic Commission for Latin America (ECLA) and the International Monetary Fund (IMF) to undertake special studies on internal payments problems in the projected free-trade area on ways and means of solving them. The resolution further invited the Central Banks of the other Latin American countries to send observers to the meeting, and, lastly, requested ECLA to organize the meeting and, together with the IMF, to provide technical assistance, while it was in progress.

/I. MEETING

I. MEETING OF GOVERNMENTAL REPRESENTATIVES OF CENTRAL BANKS

A. Attendance and organization of work

Opening meeting

3. The session was inaugurated on 12 January 1960 in the Board Room of the Banco de la República Oriental del Uruguay, which generously provided all the facilities needed for the success of the proceedings. At the opening meeting an address was delivered by Mr. Mateo Magariños de Melo, Chairman of the Inter-Governmental Conference for the Establishment of a Free-Trade Area among Latin American Countries. Speeches were also made by Mr. Homero Martínez Montero, Minister for Foreign Affairs of Uruguay, and Mr. Felipe Gil, head of the Uruguayan delegation. Mr. Luis Mackenna, head of the Chilean delegation, spoke on behalf of the delegations present. After the officers had been elected, a statement on technical aspects was made by Mr. Raúl Prebisch, Executive Secretary of ECLA. He was followed by Mr. Herbert K. Zassenhaus, representing the International Monetary Fund.

Membership and attendance

4. The meeting was attended by representatives of Argentina, Bolivia, Brazil, Chile, Paraguay, Peru and Uruguay, and observers from the Central Banks of Colombia, Ecuador and Mexico, as well as from the Board of Governors of the United States Federal Reserve System, the United Nations Economic Commission for Latin America, the International Monetary Fund, the Organization of American States and the Inter-American Council of Commerce and Production. The list of participants is as follows:

Governmental representatives

Argentina: Alberto H. Mage, Exchange Manager, Central Bank
Rodolfo Korenjak
Teodoro A. Fernández
Adviser: Aníbal Silva Garretón

/Bolivia:

Bolivia:	Mario Ojara Agreda, General Adviser to the Ministry for Foreign Affairs Hugo Ortíz Justiniano Claudio Calderón Luis Viscarra
Brazil:	Herculano Borges da Fonseca, Chief of the Division of Economics, Department of Currency and Credit Paulo Cabral de Mello Ernane Galveas Alcides P. Costa Lázaro Bauman das Neves Irlio Octavio de Figueiredo Pessoa J.O. Knaack de Souza. (Observer)
Chile:	Luis Mackenna, General Manager of the Central Bank Eduardo Morgan
Paraguay:	Juan Félix Morales, Director of the Central Bank Julio Sanabria
Perú:	Emilio Foley, General Manager, Banco Agropecuario José Morales Urresti Rodolfo León Carrera
Uruguay:	Felipe Gil, Director, Banco de la República Antonio Odicini Lezama Crisólogo Brotos Mario H. Maldini Romeo Maeso Sueiro Luis I. Carlevaro Julio C. Solsona Flores Washington E. Demaría Alberto Casal Alberto Morillo Otero Juan C. Arrosa Juan A. Eguiluz Juan C. Mussio Advisers: D. Flaubiano Simoens Arce Luis C. Panizza Gilberto Boasso Raúl H. Torre Fernando Oliú Washington E. Souto Mario Buchelli Justo B. Otegui

/Governmental observers

Governmental observers

Colombia: Rodrigo Botero, Economic Adviser, Banco de la República

Ecuador: José María Avilés Mosquera, Director, Exchange Department, Central Bank

Mexico: Octaviano Campos Salas, Manager, Banco de México

Panama: Fernando Díaz, Deputy Manager, Banco Nacional

Representatives of various national and international organizations

United Nations Economic Commission for Latin America

Raúl Prebisch, Executive Secretary
Esteban Ivovich, Director, Trade Policy Division
Alberto Solá, Economist, Trade Policy Division
Julio Valdés, Deputy Secretary of the Commission

Organization of American States

Phillip Glaessner, Deputy Director, Department of Economic and Social Affairs
Advisers: Michael Zuntz
Fernando Fugazot

International Monetary Fund

Herbert K. Zassenhaus

Inter-American Council of Commerce and Production

Carlos Sanguinetti, Vice-President for the American continent
José Ma. Roca Sienra, Adviser, Uruguayan Section

Board of Governors of the United States Federal Reserve System

Ives Maroni, Economist, Division of International Finance

Officers

5. The meeting elected the following officers:

Chairman: Felipe Gil (Uruguay)
Vice-Chairman: Alberto H. Mage (Argentina)
Herculano Borges da Fonseca (Brazil)

Secretariat

6. The duties of secretariat of the meeting were discharged by the ECLA secretariat under Mr. Esteban Ivovich.

/B. Agenda

B. Agenda

7. The following agenda was adopted:

1. Opening speeches
2. Election of officers
3. Adoption of the agenda
4. Possible credit and payments systems
5. General discussion
6. Adoption of the report and conclusions to be submitted to the second session of the Inter-Governmental Conference for the Establishment of a Free-Trade Area among Latin American Countries

Documents

Payments and credits in the free-trade area projected by Latin American countries: possible systems

Memorandum on a system of swing credits in the free-trade area projected by Argentina, Bolivia, Brazil, Chile, Paraguay, Peru and Uruguay

Further considerations on the system of swing credits in the free-trade area

Payments problems among the countries proposing to form a Latin American Free-Trade Area and possible solutions (International Monetary Fund report)

II. CONCLUSIONS

9. As a result of the discussions, the representatives of the Central Banks of the participating countries established the following conclusions:

Conclusions of the Meeting of Governmental Representatives of Central Banks, to be brought to the attention of the Inter-Governmental Conference for the Establishment of a Free-Trade Area among Latin American Countries

Governmental representatives of the Central Banks of Argentina, Bolivia, Brazil, Chile, Paraguay, Peru and Uruguay met at Montevideo on 12-19 January 1960, in conformity with resolution 3, adopted at the first session of the Inter-Governmental Conference for the Establishment of a Free-Trade Area among Latin American Countries.

/The meeting

The meeting examined the information relating to the different payments systems - through bilateral accounts and in convertible currencies - in use in the region and discussed the way in which credits might be used to facilitate the achievement of the economic ends pursued by the establishment of a free-trade area.

During the discussions important elucidatory statements were made on fundamental aspects of the questions under consideration and useful guide-lines were laid down, thanks to which it will be possible to press on gradually with the endeavour to find solutions that will meet the dynamic requirements of the free-trade area. The conclusions reached by the meeting in that respect were as follows:

(a) In the field of payments the target to be aimed at is free currency convertibility;

(b) The fact that differing systems of payments and credits are in force in the region is no obstacle to the entry into operation of the free-trade area, in accordance with the firm intention of the countries represented at the meeting;

(c) In the free-trade area, every endeavour must be made to obviate the discriminatory treatment to which the existence of differing payments and credit systems might otherwise give rise;

(d) In order that the free-trade area may fully attain its objectives, access to appropriate credits for the financing of intra-area transactions should be facilitated. To this end, the study of possible systems of payments and credits should be continued, due regard being paid to the observations and views expressed in the course of the meeting.

D

THE RECIPROCAL CREDITS SYSTEM FOR THE FREE-TRADE AREA

Observations by the ECLA secretariat arising out of the Meeting of Governmental Representatives of Central Banks

(Montevideo, January 1960)

(ECLA, Santiago, Chile, January 1960)

The Montevideo discussions cleared the way for the establishment of a credit system which would meet the requirements of the free-trade area. They showed that in such a system there was nothing which conflicted with the principle of convertibility or with any other sound monetary principle. Yet certain misgivings were expressed in connexion with the institution of an agency to handle credit operations among the countries of the area. These apprehensions were no longer grunded on reasons of principle, but on considerations relating to the ill-effects that might result from possible mismanagement. In this context, too, the Montevideo talks were very enlightening.

I. THE ESSENTIAL PRINCIPLE OF RECIPROCITY

Equivalence of trade benefits

The Governments interested in the establishment of the free-trade area requested the secretariat to study a credit system suited to its purposes. Such a system could not be projected in the abstract, but only in close relation to the objectives of the area in question. The basic end pursued is the creation of additional inter-Latin American trade flows, which, by promoting industrial specialization, and brisker competition within the area, as well as more efficient productive utilization of the land, may help to speed up the rate of economic development.

There is no reason why the creation of these additional trade flows should affect trade with the rest of the world. The volume of this latter is dependent upon external demand, especially from the great industrial centres, and on the capacity of the Latin American countries to satisfy such demand and to avoid certain errors of economic policy which have jeopardized export possibilities in the recent past.

/With a

With a view to attaining the objective referred to, the proposed draft treaty sets up a preferential system under which negotiations will have to be conducted for the reduction and abolition of duties and restrictions among the contracting parties. Obviously, in the course of such negotiations each country will endeavour to ensure that the benefits it receives from the other members are equivalent to those it grants them. But, however great the care and wisdom displayed, there will be no possible way of assessing the results of these reciprocal benefits in advance. It was therefore deemed expedient to include in the draft provision for a corrective procedure, consisting in successive adjustments, whereby effective reciprocity could be achieved.

Before this procedure is explained, a point should be cleared up in connexion with the kinds of goods traded. On the one hand, a first category includes those export commodities which find a relatively easy sale on the world market, and which the contracting parties will have no particular interest in diverting towards the free-trade area through the system of preferences. And on the other hand, there are most of the goods in which inter-Latin American trade is at present conducted, together with those industrial products which might give rise to steadily expanding reciprocal trade flows. It is this second category of goods that will be the subject of negotiations under the preferential system.

The first category comprises a few traditional export commodities. The rate of growth of world demand for these is, of course, relatively weak, and the development of Latin American demand will open up new prospects for the expansion of production. Only a preferential system will enable these possibilities to be exploited to the full.

/Method of

Method of achieving equivalence in practice

The only yardstick whereby the effects of the reciprocal benefits granted can be measured in practice is the increase in each member country's exports and imports of all the goods covered by the preferential system. The aim of the procedure established in the draft treaty is to ensure that countries with a persistent export surplus of the commodities in question vis-a-vis the other members of the area expedite the reduction or abolition of duties and restrictions in order to facilitate the development of countries in the opposite situation, i.e., having a persistent import surplus. Naturally, if the objectives of the treaty are to be fulfilled, each country will have to map out its programme for the reduction or elimination of duties and restrictions so that it will be able to negotiate for reciprocal benefits in the governmental committee to be set up under the terms of the draft agreement. In cases where a persistent export surplus occurs, the implementation of this programme will have to be speeded up. It might be advisable for the following supplementary provision to be included in the treaty: if the foregoing measure proved inadequate, the country with a persistent import surplus would be entitled to reduce and abolish duties and restrictions at a slower rate.

Reciprocal encouragement of economic development

The fact that reciprocity is established in relation to commodities in respect of which benefits would be accorded, other commodities being excluded, is clear proof that the principle in question is dictated not by balance-of-payments considerations but by motives of trade policy.

What are these motives? It has already been pointed out that the underlying purpose of the free-trade area is to contribute to the acceleration of economic development. The expansion of exports achieved by any given country with the help of the concessions it has been granted encourages its economic development, and in return it must afford the other members a corresponding stimulus through the increase of their own exports. Otherwise, that would be the advantage of the free-trade area for a country that increased its imports from the rest as a result of the preferential system,

/without securing

without securing a corresponding expansion of its exports? What is more, not only would it obtain no benefits, but the consequences of this lack of equivalence might actually be prejudicial to it, since it would have to pay for the difference between exports and imports in dollars that it could have used more advantageously for imports from the rest of the world.

Reciprocity with the rest of the world

Following this explanation of the raison d'etre of the reciprocity principle, the question may arise why it should be extended only to the free-trade area countries, and not to the rest of the world. There is an essential difference with respect to export possibilities. In inter-Latin American trade such possibilities are vast, both for traditional export commodities and, more particularly, for those industrial goods in which very little trade has hitherto been conducted. The same is not usually true of the Latin American countries' trade with the great industrial centres. Here the prospects are, for the time being, limited, and an intensive expansion of exports of traditional commodities can hardly be expected, since it is common knowledge that, in their case, the income-elasticity of demand is relatively slight. Undeniably, the feebleness of world demand for such goods is also partly attributable to the protectionist policy pursued by the importer countries; were this relaxed, considerable impetus might well be given to Latin America's exports. From another point of view, no intensive development of the region's capacity to export manufactured goods to the great industrial centres could reasonably be expected. Yet such a possibility does indeed exist, and in a high degree, within the sphere of inter-Latin American trade, and as it is exploited in practice and the volume of industrial output increases, alongside increased specialization in manufacturing activities, costs will gradually fall also, and the region will find it feasible to begin exporting industrial products to the great centres on a relatively large scale. There will then be an opportunity - at present precariously limited to traditional commodities - of negotiating with these centres on bases of reciprocity, although not necessarily on the lines laid down in the treaty.

II. THE RECIPROCAL CREDITS SYSTEM

Function of credits

It was stated above that, if reciprocity is to be achieved in practice, individual countries will have to expedite or retard the implementation of their programmes for the reduction or elimination of duties and restrictions. However, it will take some time for these readjustments to yield results, and, in the meanwhile, there will still be instances in which the increases in exports and imports generated by the treaty fail to keep abreast of each other. This constitutes a strong argument in favour of the establishment of a reciprocal credits system.

The monetary reserves of the Latin American countries are generally far from sufficient, and the trend of their import requirements from the rest of the world is apt to climb more rapidly than that of their export possibilities. In these circumstances, prudence would seem to counsel great caution as regards liberalization commitments (in the broadest sense of the term, i.e., reduction and abolition of duties and restrictions), unless additional credits are available to cover any balance-of-payments deterioration to which this liberalization policy may give rise. In other words, the function of credit will be to allow time for the possible adverse effects of liberalization measures on a country's balance of payments to be succeeded by the favourable consequences of those liberalization measures which countries with a persistent export surplus will have to adopt.

Thus, the secretariat, in compliance with the request submitted to it, has studied a credit system calculated to help in ensuring that the principle of reciprocity, which is the cornerstone of the whole agreement, is respected. The Montevideo discussions, it must be repeated, strengthened the conviction that a system of this kind can be established without prejudice to any basic monetary principle.

/Credits and

Credits and convertibility

In this connexion, concern was expressed as to whether a reciprocal credits system might not present an obstacle on the road to convertibility on which some of the Latin American countries have successfully started out, or, what would be even worse, actually compel them to retrace their steps. The discussion showed that there would be no objection whatever to the establishment of a reciprocal credits system entirely in dollars, not in units of account, which would in no way jeopardize convertibility. For the sake of elucidating so important a point, a reminder must first be given of how such a system might operate.

A reciprocal credits agency would be set up for the countries of the area, through which the reciprocal credits that each country was prepared to grant to the others as a whole, and vice versa, would be negotiated periodically and in advance.

An agency contrived on these lines would have no reason to intervene in international payments. These would be effected in dollars, as in the case of ordinary operations under a convertibility system; but periods (possibly quarterly) for computing the results of such payments would be set. If, at the end of any given quarter, the reckoning were to show that a country had paid out more dollars than it had received by virtue of area preferences, and that the outcome had been a deterioration in its balance-of-payments position, the country concerned would be empowered to make use of the credit previously assigned to it. In other words, the country would recover its excess dollar disbursement, wholly or in part, according to the relation between this excess and the credit granted.

/The dollars

The dollars thus recovered by countries with an import surplus could be used unrestrictedly both within the free-trade area and in the rest of the world, without any effect on convertibility. On this point it would seem that the doubts existing prior to the Montevideo talks were completely dispelled.

Source of funds for the system

This was not equally true, however, of certain misgivings relating to the resources that would be contributed under the system to enable it to grant the credits just referred to. In this context, an important distinction was drawn during the discussions with respect to the source of such funds. Dollar contributions might be determined in advance, in the shape of quotas to be subscribed by each country in accordance with certain indices of financial capacity; or they might be based in each instance on the surplus dollar payments received by any country (as previously described) in consequence of the preferential concessions. This distinction does not mean that the two sources are mutually incompatible, for even if the second were drawn upon for contributions, it would be necessary, as shown in the ECLA reports, for the system to have a capital fund at its disposal, which might be set up with contributions from the first of the sources indicated.[1/]

Operation of the agency

Before passing to the objections raised to the second source of funds, it may be useful to give a brief explanation of how the system would operate on the basis of contributions of this type.

1/ Yet another combination of funds from the two sources is conceivable. For example, contributions might be established in advance and a quota fixed for each country, but instead of their being payable immediately, these contributions would be claimed only when it became necessary to grant credits to countries with an import surplus. In such an event, countries with a correlative excess of exports would be called upon to contribute their pre-established quotas.

/Countries which

Countries which had received surplus dollar payments would be under the obligation to deposit them with the agency at the end of the period of reckoning, up to the amount of the credit they had pledged themselves to grant. The credit thus extended by any one country to the agency would not be frozen; on the contrary, it would be available to cover an import surplus should the said country's position be reversed as a result of the acceleration of its programme for the reduction of duties and restrictions, to which reference was made earlier. Thus, if a country which had previously shown an export surplus came to have an import surplus, and had consequently effected excess payments, it could recover the dollars concerned, as in the preceding case, by means of a credit granted by the agency, and this credit would be compensated at once with as much as was necessary of the credit extended by the country to the agency.

The root of the arguments against contributions of this order lies in the incentive that would thus be provided for an expansion of imports from the area; for it would obviously be to the interest of a country which had granted credit to the agency to mobilize it as quickly as possible, by making more purchases from other member countries. This is exactly what is aimed at in the treaty, and the criticisms levelled at this objective will be discussed below.

III. OBJECTIONS TO A CREDIT SYSTEM BASED ON RESOURCES DERIVING FROM EXPORT SURPLUSES

Limited application of creditors' resources

The most important objection related to the mobilization of credit resources granted to the agency by countries with export surpluses. Such resources, it was asserted, should be available to cover imports not only from within the area, but also from the rest of the world. Were this the case, implementation of the principle of reciprocity, far from being promoted, would be impeded; in order to retain at its disposal for the longest possible time resources which it could use to effect purchases anywhere else in the world, on better terms, generally speaking, than within the area, a country with an export surplus resulting from benefits obtained under the treaty would be inclined to wait until the last moment before honouring the liberalization commitments imposed by the principle of reciprocity.

/Another view

Another view expressed was that restricting to the free-trade area the use of the resources deposited with the agency would imply non-convertibility. This would mean that any credit which could not be used in all parts of the world would run counter to the principle of convertibility. This point too was discussed at length. The loans issued by the International Bank for Reconstruction and Development are by their very nature unrestrictedly available for use anywhere in the world. The credits granted by the United States Export-Import Bank, on the contrary, like those of the Development Fund and some of those extended by European countries, can be applied only in ways that will promote the export trade of the countries according them, and not to finance exports from other parts of the world. If these limitations were not considered incompatible with the principle of convertibility, there is no reason why such a drawback should be imputed to credits granted with a view to furthering reciprocal export trade within the area, that is, to attaining the primary objective of the treaty.

Diversion of exports from the world market

A further argument adduced was that, in order to liquidate such credits against the agency, the creditor country would find itself compelled to divert normal trade flows, to the detriment of exports that could easily be sold to the rest of the world by other countries, which would thus be induced to import from the area goods that they had formerly purchased freely in any part of the world.

The reply to this contention was that reciprocity and the credits system related to the goods classified in the second of the categories mentioned above, in respect of which the expansion of exports was desirable. There is no reason why a country that finds it easy to sell certain commodities on the world market should accept or negotiate preferences and reciprocity in respect of these trade items unless it is attracted by the prospect of opening up a new market within the Latin American region. But such a situation is obviously not typical, since most countries will plainly be interested in availing themselves of the advantages offered by the Latin American market in order to boost production.

/Non-essential

Non-essential imports

It was also contended that the available resources held by a country in the agency (or the credit it could obtain therefrom) might encourage non-essential or luxury imports. This is, of course, an argument which bears on the use of a country's monetary reserves in general, not only the agency funds, and raises a problem of a different nature which must not be confused with the question under consideration. If it is felt to be desirable on economic grounds to curtail consumption of luxury items, the mere levying of import duties does not solve the problem, since it may prove an incentive to capital investment in the production of such goods and this has actually happened in some cases; the taxation concerned would then have to be extended to these lines of production too, if the aim was to restrict consumption. But were this not so, there would be no reason why liberalization measures should not be applied to imports of such goods whenever the time seemed ripe for such a step, as here too the advantages of specialization and division of labour within the free-trade area still hold good.

Discrimination against debtors

It was also affirmed that the accumulation of credits would lead to trade discrimination; the creditor country might find itself obliged, at a given moment, to rechannel the exports it had been shipping to debtor countries in order not to increase the amount of credits deposited. To this objection two definite replies were vouchsafed. In the first place, there would be no room for discrimination under the agreement. Secondly, there would be no question of establishing unlimited credits; their amount would be determined by negotiation among the parties and in relation to the volume of trade. What is more, such credits would be negotiable at regular intervals, and if they proved disproportionate to the end pursued, there would be nothing to prevent reduction of the amount involved in the course of the next negotiation.

/Credits granted

Credits granted by countries with an aggregate payments deficit

It was likewise pointed out that the system under discussion would mean that a country to which a dollar surplus had accrued from its intra-area operations would have to grant credit to the agency and return all or some of the dollars in question, even if it registered a payments deficit on the rest of its transactions, both within the area (in goods belonging to the first category and not covered by the treaty) and with the rest of the world. If such a situation should arise, it would not be through trade with the area that the deficit would have to be remedied, but by the application of appropriate balance-of-payments measures, whether these were of a monetary nature or of a more far-reaching kind designed to bring about structural changed and restore equilibrium. Moreover, a country in such a situation could not expect to right itself at the expense of the monetary reserves of another country whose balance-of-payments position had deteriorated as a result of liberalization policy.

Automaticity of credits

The automaticity of credits also gave rise to certain objections. Nevertheless, there was a consensus of opinion to the effect thqt credits should not be negotiated in every individual case, but that a credit line should be established for a given period, after which recourse should be had to renegotiation for the introduction of such adjustments as were seen to be advisable in the light of experience. A credit line thus operated would have the advantages of automaticity inasmuch as it would give debtor countries the assurance that in specific circumstances, previously agreed upon, they would have free access to credit; and at the same time it would be flexible enough for any undesirable situation that might arise to be remedied by means of the adjustments referred to.

/Consolidation of

Consolidation of convertibility

If the whole problem is viewed in broader perspective, it is clear that a reciprocal credits system which encouraged the development of trade among the countries of the area, far from impeding convertibility, would help to establish it on sounder bases than the very shaky foundations existing in several of the South American countries to-day.

To make some currencies convertible, exchange control measures have had to be replaced by exchange restrictions in the shape of surcharges and prior deposits. This is undoubtedly a step in the right direction; but, on the other hand, the fact that the movement towards convertibility has had to be accompanied by these restrictions can hardly afford much cause for satisfaction. The balance-of-payments situation must therefore be improved by degrees, so that the exchange restrictions in question can be abolished (not only among the Latin American countries, as has already been done in some cases, but vis-a-vis the rest of the world), and the only customs duties applied to imports are those necessitated by protectionist or fiscal considerations. The sole way of achieving such an improvement in the balance of payments will be through the expansion of exports and import substitution; and in the whole of this field, the institution of the free-trade area and the establishment of a reciprocal credits system would be of vital importance. Thus, far from making convertibility harder to achieve, these measures would contribute to its consolidation.

Objections to the creation of an agency

To sum up, as a result of the Montevideo talks, which constituted the preparatory work, it should be possible, in the opinion of the ECLA secretariat, to consider specific ways and means of establishing a reciprocal credits system, which, without affecting the essential principle of convertibility, will contribute to the attainment of the fundamental objectives of the free-trade area.

/Undoubtedly, an

Undoubtedly, an indispensable prerequisite for a credits system would be the establishment of an agency with juridical powers. This idea too was in itself a target for criticism. Doubts were expressed regarding how such an agency could be run by the countries concerned. Attention has just been drawn to the apprehension felt with regard to escessive accumulations of credit and the discriminations to which they might lead, and, in addition, to the non-essential imports which a country might use such credits to effect.

All these motives of concern form part of a much broader problem. The policy of the free-trade area will not be easy to carry out. Never before have the Latin American Governments embarked upon joint action of such far-reaching scope, and to put this idea into practice they will have to initiate an experiment which, particularly in the early days will present great difficulties. It will depend upon how these problems are solved whether the free-trade area is to be really effective in promoting trade and economic development, or is to become a static mechanism, and even one which may, unless handled with a high sense of responsibility produce disturbing effects.

The suggestion that the Governments will be unable to shoulder this responsibility with success cannot be considered an adequate motive for not creating the free-trade area or for depriving it of a proper credit mechanism. The Governments will of necessity have to try the experiment and learn by their own mistakes, and this effort must at all costs be made if they are to solve their fundamental growth problems. To suppose that the basic principles for the satisfactory operation of the area and supervision of their implementation must be provided from outside, instead of emerging as a genuine outcome of the experiment itself, would be to shirk observance of the very principle of international co-operation.