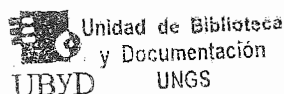
Volume 2. Latin American International Affairs Series
Sponsored by the Center for Inter-American Relations

LATIN AMERICA AND WORLD ECONOMY

A Changing International Order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SAGE Publications Beverly Hills London

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UBYD 33192
Universidad Nacional de General Sarmiento

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For information address:

SAGE PUBLICATIONS, INC.
275 South Beverly Drive
Beverly Hills, California 90212

SAGE PUBLICATIONS LTD
28 Banner Street
London EC1Y 8QE

Printed in the United States of America

Library of Congress Cataloging in Publication Data

Main entry under title:

Latin America and world economy.

(Latin American international affairs series ; v. 2)
Includes bibliographical references.
1. Latin America—Foreign economic relations—Addresses, essays, lectures. 2. Latin America—Economic integration—Addresses, essays, lectures.
I. Grunwald, Joseph, 1920- II. Series.
HF1480.5.L383 338.91'8 77-17031
ISBN 0-8039-0864-4
ISBN 0-8039-0966-7 pbk.

SECOND PRINTING

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PREFACE

Latin America's income levels have always been close to the top of the developing world. Therefore relations with both the developed countries and the Third World have tended to be of a special nature. In addition, Latin American countries have given much attention to cooperation among themselves. The essays in this volume deal with the changing character of these relationships.

Any volume dealing with Latin America must contain the qualification that the region is very heterogeneous; the poorest countries are among the poor of the Third World, the wealthiest could well be classified among the developed First World. A common characteristic of most Latin American countries is that there is a small rich modern sector and a large sector of very poor people. No book can cover all the components of the international economic affairs of such a region. The papers presented here, however, try to provide insights into important aspects and problems of these relations.

All the chapters were written especially for this volume. About half of them are by Latin American authors, two are by Europeans, and the rest by North Americans. There is, thus, a variety of perspectives and also differences in viewpoints about particular issues which occur mainly between Latin American and non-Latin American authors. All the chapters have important policy implications. Most of them also have specific policy recommendations.

The introductory chapter points out a few of the features of individual contributions. It is not intended as a summary of the book nor as a presentation of all the important elements of each contribution. It does attempt to discuss the major issues presented here. The reflections are the editor's and not necessarily those of the contributors.

The contributions are grouped into five parts, including a section of commentaries. Part I looks at the region from the outside: It contains the four chapters examining the economic relations of major industrial countries with Latin America. The focus is on the decline of special relationships of the region with the outside world. Part II analyzes how national economic development and policies affect the external sectors in the region's two largest economies, Mexico and Brazil. Part III deals with relationships among Latin American countries and with other developing countries of the Third World. The focus of Part IV is on two issues that have played a major role in

the recent history of the region's economic development: external financing of development and relations with foreign multinational corporations.

Some subjects are dealt with in more than one chapter. The two short pieces in the Commentary section also refer to topics discussed in the rest of the book.

Most of the manuscripts arrived in the fall of 1976. Space limitations forced me to cut some contributions unmercifully, including my own.

I want to thank the Center for Inter-American Relations and particularly Ronald Hellman, Director of its Public Affairs Program and General Editor of the Latin American International Affairs Series, for support throughout the preparation of this volume. They are not responsible for any shortcomings of this book.

Deny Pierce Grove did the basic copy editing with efficiency and speed. Betty Herr Halinger prepared the index under great time pressure. The cooperation of Rhoda Blecker and her successor, Nancy Cushing Jones, book editors at Sage Publications, in bending deadlines to accommodate inevitable delays on my part, is also greatly appreciated.

Joseph Grunwald
Editor

Washington
December 1977

Chapter 1

REFLECTIONS ON LATIN AMERICA IN THE WORLD ECONOMY

JOSEPH GRUNWALD

Latin America's role in the world economy was more important than that of any other developing region until the Mid-East was propelled onto the scene by the 1973 oil embargo. Latin American countries also have been among the most rapidly growing nations in the Third World.

However, their external policies have been ambivalent since World War II. On the one side the countries of the region have tried to integrate with the world economy; on the other they have struggled for self-reliance. From the outside world there has been an ebb and flow of attention to the region. U.S. economic relations with Latin America have been colored by the perception of a "special relationship," Latin American relations with the United States by the perception of "dependency". The region's ties with the Third World have been no less ambiguous, although Latin Americans have been among the first to provide intellectual leadership to the developing countries.

SPECIAL RELATIONSHIPS

International affairs are continually changing: a relationship that was once important may lose its significance. The economic importance—measured in terms of trade and investment—of Latin American countries for the United States, the United Kingdom, Germany and Europe in general, has declined in the postwar period. The region is still a significant market for the industrial countries, although much less so for Europe than for the United States. Latin America has absorbed a small but increasing proportion of Japanese exports.

Author's Note: *Unless otherwise specified, the names in parentheses refer to the authors and their contributions in this book.*

As a supplier to industrial countries, the region's importance shrank more than it did as a market. Now only a tiny proportion of European imports originate in Latin America (see Table 1.1). European economists (von Gleich, Whitehead) are not optimistic about significantly enlarging Latin America's role in the European economy in the near future. The American economist Albert Fishlow indicates that the declining trade with Latin America does not justify a "special relationship" between the United States and the region. The data confirm that, excepting petroleum, trade of industrial countries with one another has grown faster than their trade with developing countries since World War II.

Latin Americans, on their side, however, point to the crucial importance of some Latin American raw materials for the industrial countries. Latin American supplies play a significant role in U.S. consumption of important minerals. In 1974 the region supplied almost two thirds of U.S. imports of aluminum, more than half of lead, almost half of iron and copper, and a quarter of petroleum. In 1971-73, the region provided the European Community (EC) with 22 percent of its total imports of iron ore and concentrates, 15 percent of non-ferrous minerals, and 17 percent of refined copper (ECLA 1977). Japan now takes about 30 percent of Latin American raw material exports.

Latin Americans also stress that for U.S. exports of capital goods, consumer durables and chemical products, Latin America is almost equal to the EC market and about three times the size of the Japanese market. The United Nations Economic Commission for Latin America (ECLA, Notas 241, April 1977) shows that in 1974 the Latin American market for EC exports of chemical products and machinery (including transport equipment) was more than two-thirds of the U.S. market and almost three times the Japanese market. The region is also important for specific European industries, for example, Brazil for Germany's nuclear industry. Some Latin American economists (Escobar) argue that continued economic growth of the region during the world recession (through Latin America's access to world capital markets) helped industrial country exports, thus ameliorating the recession.

In order to reduce their dependence on the United States, Latin American countries have deliberately tried to diversify their markets and sources of supply. They had initial success with the European Community, but they were eventually disappointed. Some Europeans (von Gleich) indicate that one of the reasons for the present low level of EC, particularly German, trade appears to be the European perception that Latin America is the U.S. domain. The more basic reason, of course, is the increased protectionism of the EC, which discriminates especially against Latin American products. There is a special irony in the region's relations with Great Britain. In the past, Britain helped Latin America's integration into the world economy by

providing the services—such as shipping, insurance, and credit—that facilitate international trade; in the recent period Britain's accession to the European common market has diverted British imports from Latin America to the European Community.

Thus, paradoxically, despite its diversification efforts the region saw its European market as a proportion of its total export market shrink substantially. The U.S. market declined more moderately in relative terms and still absorbs at least one-third of Latin American exports. On the import side, the region has done better in shifting away from the United States. Nevertheless, still almost one-third of its foreign purchases originate there, a considerable higher proportion than it buys from the EC (see Table 1.1). Brazil is a major exception within Latin America: since the mid-1960s the EC has become a larger market for Brazil than the United States and more recently also a somewhat more important supplier.

Latin American trade redirection toward Japan has been more successful, and trade is also beginning with other Western Pacific countries. Moreover, during recent years, Latin American countries—especially Argentina, Brazil, and Peru—have increased their trade with the socialist bloc considerably (ECLA, Notas 241, April 1977). From a level of about U.S. $200-300 million during the mid-1960s, exports of Latin America, excluding Cuba, to the socialist bloc reached almost U.S. $2 billion in 1976. (Yet despite this rapid rise, trade with Latin America still constitutes only 1.5 percent of the total trade of the Soviet Union.) But each of these markets, including Japan, although increasing, is still small when compared to the United States or Europe. However, there is some optimism about the future of the region's

TABLE 1.1

Latin America in the World Economy in the Mid-1970s (in percent)

	US	EC	Japan	Total World
Importance of Latin America to other countries				
Exports to Latin America as percent of total exports of other countries	17	4	9	6
Imports from Latin America as percent of total imports of other countries	17	3	5	6
Importance of other countries to Latin America				
Destination of Latin American exports as percent of total regional exports	35	23	5	100
Origin of Latin American imports as percent of total regional imports	33	23	7	100

Note: Estimates based on chapters 2-4, ECLA (1977), IDB (1977) and Yagi (1977).

economic activities with the Western Pacific (Veliz). Almost by default Latin American trade with that region may continue to increase; EC prospects are poor, Africa is still remote, and Latin Americans want to lessen their dependency on the United States. (Some observers indicate that this trade increase coincides with political changes in Latin America which make the region more compatible with the conservatism of Japan and some other Western Pacific countries. See also Yagi 1977 for Japanese data until 1974. In 1975 and 1976, however, United Nations data indicate an absolute fall in the region's trade with Japan, possibly due to cyclical factors–there were sharp increases during the previous years. ECLA, Notas, April 1977.)

Thus in reviewing Latin America's trade patterns, one important feature stands out: the United States stands far above any other country as a trading partner. Even more important is that the postwar decline in the regional share as a market and supplier for the United States appears to have halted. The same cannot be said for Latin American trade with Europe. Some may view these factors as demonstrating a "special relationship" between Latin America and the United States. Fishlow notes that this special relationship may arouse false expectations and may give rise to policies that are not in the best long term interest of either Latin America or the United States. Yet not all Latin American economists who most strongly stress the importance of Latin America for the United States, argue for special treatment from the United States, such as the special preferences accorded to African, Pacific, and Caribbean countries by the European Community under the Lomé convention. Latin Americans want greater bargaining power with their most important trading partner but they do not want any special relationship that would increase their dependency on one country (Valdés).

Because of their increasing economic diversification, the primary concerns of Latin American countries have become trade, access to capital markets, and technology. Industrialization has increased the region's overall dependency on these factors. Because of their political commitment to economic development, Latin American nations found it difficult to retrench during the world recession and oil price explosion of 1973-1976. Despite the weakness of the markets for the non-oil exporters, most of them were able to maintain a respectable rate of growth, in part by increasing their foreign indebtedness.

Therefore many Latin American countries depend on "special relationships" with international capital markets, including the commercial banks of North America and Europe, as well as the international financial institutions, such as the World Bank, the Inter-American Development Bank (IDB) and the International Monetary Fund (IMF). Another special relationship is with the multinational enterprises, not only because of the need for direct investment but also because of the need for a continued flow of technology in order to maintain the pace of industrialization.

The magnitude of the external influences on domestic policies and development of Latin American economies is difficult to assess. Governments react

differently. Often domestic economic problems are blamed on the external sector. For example, the Mexican inflation was not imported from abroad. Leopoldo Solís shows how it was instead produced by domestic policies: Mexico's import substituting industrialization led to a neglect of the agricultural sector; the continued pressures to industrialize and to maintain growth rates in the face of a lagging agricultural sector made price increases inevitable. Yet investment and growth continued until the regime of President Echevarria. Then the stop-go policies of his administration made that system collapse: when adjustment policies were introduced, pressures for expansion became irresistible before the intended adjustments could take place. The Brazilian strategies fared differently (Baer and von Doellinger). The "outward-looking" strategy of 1964-1974 required significant economic adjustments. The authoritarian Brazilian regime was able not only to institute such policies, but also to maintain them long enough to effect the adjustments. Therefore the strategy could work.

Both Mexico and Brazil tried to extricate themselves from excessive dependency on the United States. While Brazil succeeded up to a point, Mexico did not. The border industries, the border trade, and the illegal border crossings, not to speak of the continuing large amount of U.S. business interests and U.S. citizens residing in Mexico, make Mexican-U.S. relations unique in the foreign policies of both countries. Regarding Brazil, the foreign transnational enterprises, although constituting only 10 percent of total investment, appear to dominate the dynamic sectors of the economy. The transnational enterprises tend to establish a vertical division of labor, thus tying together many countries in the production processes. Therefore, according to Baer and von Doellinger, the Brazilian economy is now more dependent than before. In addition to its vertical integration in the world economy through the foreign enterprises, the tendency of Brazilian industry to concentrate on one sector (automobiles), and the high level of foreign indebtedness work in the same direction. Others might argue, of course, that this Brazilian "dependence" is simply a manifestation of growing interdependence of the world economy.

Despite the relative decline of U.S. trade and investment, Latin America does have a special significance for the United States. It is often stated that their status as ex-colonies, their similar European heritage and values, and the belonging to the "new world" of the Western Hemisphere provide them with common historical bonds. More important, however, are the problems—apart from the special ones of Panama and Cuba—of the "near neighborhood" of Mexico, Central America, and the Caribbean. (The English-speaking Caribbean has only recently become a major concern for the United States, as Great Britain has withdrawn from most of its former colonies in the West Indies, practically abdicating any further responsibilities.) Legal and illegal immigrants from the "near neighborhood" now form a substantial part of the

U.S. population in addition to the long existing "Chicano" communities of the Southwestern United States. These problems cannot be divorced from economic relations because the swings in unemployment and underemployment south of the border invariably spill over into the United States.

Other special concerns are the flow of illegal drugs from Latin America and the recent human rights situation in many countries of the region. The latter is of particular importance, both because of the attention given to human rights by the present U.S. government and the democratic tradition in several Latin American countries which have become violators of human rights. Greater respect for human rights is expected from Latin American countries than from other areas that generally have not shared "Western" values. Human rights concerns also affect economic affairs: the remaining U.S. aid as well as the U.S. vote in the IDB and possibly in other international financial institutions have been related to the human rights performance of the recipient government. (In this respect it is remarkable how Latin American countries have pulled together to prevent any limitation on loans from the IDB and World Bank on human rights grounds. In June 1976, for example, the yes votes of all Latin American countries on a Chilean loan in the IDB–including Mexico, Venezuela and other countries in the region that had condemned Chile as a human rights violator–offset the negative U.S. vote based on human rights grounds. Therefore Chile got the loan. In the World Bank, too, the Latin American countries have banded together to keep human rights from becoming an effective obstacle to access to bank lending. Of course, there is a need for fine tuning in order to achieve a balance between human rights and other development objectives.)

Thus, elements remain of a special relationship between Latin America and the United States, and they will probably persist for some time. There is no harm in this as long as it does not lead to mistaken policy formulations or false expectations. Ignoring the significance of the economic relationship could be wasteful and damaging to the interests of both sides. Latin American countries–with the possible exception of Colombia and some Central American nations, who from time to time request special preferences from the United States–do not want a special relationship that would only increase what they perceive to be an already large dependency on the United States.

U.S. economists' and policy makers' advocacy of global rather than regional U.S. policies focuses on liberalizing international trade. They argue that measures that would facilitate the international flow of goods and services and would assure an adequate flow of capital will tend to benefit Latin America, even though they would be globally applied because the region is more advanced than most of the rest of the Third World. They distinguish between a special relationship and special consequences of global policies (Fishlow).

LATIN AMERICA AND THE NEW INTERNATIONAL ECONOMIC ORDER

The world focus is shifting from East-West to North-South relations. The Third World is a new power center. While many governments, concerned with security and political factors, remain preoccupied with East-West relations, there is no doubt that industrial countries will have to reckon increasingly with the economic activities of the South.

The higher level of development of most Latin American countries, compared to other LDCs, gives the region a special status in the North-South relationship. Until recently Latin America was a guiding intellectual force of the Third World, and it still exercises some leadership. Most of the ideas about the relationships between the rich and poor countries emanated from the region, as did most of the demands of the so-called "Group of 77." (The designation "Group of 77" refers to the number of LDCs participating in the first UNCTAD–United Nations Conference on Trade and Development–meeting in Geneva in 1964. They formed a fairly united front against the industrial countries during the meeting. The designation continues to be used in international discussions even though there are now more than 77 LDCs.) Since the ascendency of the Organization of Petroleum Exporting Countries (OPEC) and the "non-aligned" nations, overlapping to a great extent with the Third World, the interests of Latin American countries coincide less clearly with those of other LDCs.

The difference between Latin American countries and the other LDCs is not so much the disparity between their average income levels as it is the relatively high degree of industrialization that many Latin American countries have reached. The economic structure of some of the region's countries, with the primary sector accounting for a smaller share of national income than manufacturing, and services generating about half of GNP, is more similar to some developed countries than to the bulk of LDCs. Nevertheless, the oft-used designation of Latin America as "middle income" is inappropriate, because, with the possible exceptions of Argentina and Uruguay, the majority of people in Latin American countries still live in poverty.

One might wonder why the more industrialized of the Latin American countries insist on forming part of the Third World when their economic interests no longer coincide with the bulk of the LDCs. (The designation "Third World" used in this essay includes the poorest LDCs, sometimes now referred to as the "Fourth World.") The larger and stronger Latin American economies do not qualify under the new standards to receive concessional aid, nor are they particularly interested in it. There are other elements in the North-South dialogue which are not in the interest of the major Latin American countries: given their continued need for access to international

capital markets, most countries in the region do not want to jeopardize their creditworthiness through the debt moratoria or massive debt relief that has been one of the demands of the Group of 77.

Although Latin America's increasing external indebtedness has worried governments and bankers in the region and in the creditor countries, some economists (Escobar) doubt the crisis proportions of the debt problem. As long as economic development progresses, the problem can be managed. Nevertheless, there is concern about the image of "creditworthiness," which, if questioned, can become an important obstacle to Latin America's continued access to the world's private capital markets. (In evaluating a country for creditworthiness, bankers tend to pay more attention to short term monetary and political factors than to "real" economic prospects. Thus, a country's credit rating may be poor because of temporary large balance of payments deficits and inflation, but its prospects for economic growth may be excellent—provided that adequate credit may tide it over the transitory problems.) In order to overcome this obstacle, some economists (Escobar, Fishlow) have proposed the "multilateralization" of the region's external debt. Multilateral organizations such as the World Bank, IDB, etc., should guarantee the debt owed to commercial banks outside the region and should also take over at least part of this private debt, thus permitting further borrowings.

Control over foreign investment and transfer of technology, another Third World demand, is no longer the burning issue in Latin America that it once was. The current development strategies of most countries in the region call for increased foreign investment and technology transfer in order to maintain the momentum of industrialization. At the same time, many Latin American countries have acquired greater self-confidence in negotiating with foreign investors and suppliers of technology. They have learned that they can exercise greater control over the transnational enterprises than they thought possible only a few years ago. The number of well-educated *técnicos* in Latin American governments who can negotiate with foreigners on equal terms, has increased significantly during the past decade (Bennett *et al*).

Nevertheless, Latin American nations have made only a few isolated attempts to join the "developed-country club". Colombia, in particular, although not the economically most advanced Latin American country, recently sought membership, or at least associate status, in the OECD (the Organization for Economic Cooperation and Development consists of the world's developed countries). Because the OECD countries feared that OECD objectives might be jeopardized, they rejected these initiatives, despite the opportunity thus offered for the industrial countries to drive a wedge into the Third World. (The industrial countries of the OECD are ambivalent about Brazil. Some policymakers of the North have called Brazil an industrial country in the clothing of a LDC and therefore not deserving of special treatment as a LDC).

Far from breaking ranks, the economically most powerful countries of the region, such as Brazil, Mexico, and Venezuela, have assumed a leadership role in the Group of 77. This is not surprising because these countries would gain little by joining the OECD, while they stand to benefit substantially from the main components of the New International Economic Order. (The NIEO is a set of objectives, demands some would say, put forth by the Third World. It was drafted by a committee of developing nations subsequent to the Summit Meeting of the Non-aligned Nations in Algiers in the fall of 1973. It was adopted by the United Nations General Assembly without a vote at its 6th Special Session on May 1, 1974.)

The primary objective of the NIEO is to achieve a redistribution of wealth and income from the rich to the poor countries. The principal tools are lower costs and greater control by the LDCs of the transfer of capital and technology, increasing control over the international financial institutions such as the IMF, easier access to developed country markets for LDC manufactures, and maintenance of the purchasing power of the LDCs basic commodity exports.

It would seem that the greatest benefits of the NIEO would accrue to the economically more advanced Third World countries. These countries could take more immediate advantage of cheaper technology, greater control over capital and financial resources, and improved market access for their manufactures. These aspects appear to be tailor-made for Latin American countries; in addition, the other major element of the NIEO, commodity arrangements to maintain or increase export earnings, would also benefit the region.

There is nothing in the NIEO, moreover, that aims at a better distribution of income and wealth *within* countries. The immediate beneficiaries of the NIEO will be the industrial, mining, agricultural, and commercial elites within the LDCs, those groups who can put capital and technology to use. Even if one believes in a rapid "trickle down," the benefits of the increased production would not reach the poor in the Third World for some time. [1]

Thus, the NIEO does not focus on the poorest people in the poorest countries. Instead its very success may, on the one hand, polarize economic power within the Third World—a Brazil may emerge even stronger—and on the other hand, aggravate the inequality of the income distribution within the LDCs. (It can be argued, of course, that most measures to increase traditional economic growth, particularly if based on export expansion, will, at least in the short run, lead to a deterioration in the income distribution in a "dual economy," where the modern sector is small and the subsistence sector large.) Such an outcome would engender resistance in the affected nations, but in Latin America the resistance can be overcome, at least over the medium term, as long as most countries in the region continue to be governed by authoritarian regimes.

That there is a good economic rationale for Latin American countries to be part of the Third World should not becloud the fact that political elements

are also involved. In the international jostling for positions of power, important points are to be scored by solidarity with the poor three-fourths of the world. Latin American countries can gain political advantages both within the Third World and vis-à-vis the industrial countries. Above all, however, is the fact that the North-South "dialogue" affords Latin American governments the opportunity to confront the rich countries. Given Latin American realities, it is easier to fight foreign elites than to fight one's own national elites. Development in most countries requires fundamental internal socio-economic-political changes, and Latin American governments find these difficult, if not impossible, to institute (particularly if the governments represent the to-be-affected elites). In confronting the foreign rich, governments can improve their image with their own people as well as with their Third World colleagues.

According to what they perceived to be in their interests, the LDCs have traded off economic gains for psychological or political advantages. The continued alignment of the oil-poor LDCs with the OPEC countries has been the most striking case, and for the industrial countries the most surprising and vexing one. While it is true that many oil-importing LDCs were motivated to form a united front with OPEC by the expectation of eventually being able to share directly in the oil revenues, they did not budge from their position even when it became apparent that these hopes would be largely disappointed for the non-Arab LDCs.

Thus the most important South-South relationship at present is the financial collaboration of OPEC with Third World countries. Nevertheless, the political support given to OPEC by the non-oil exporting, non-Arab LDCs is out of proportion to the direct OPEC aid received so that the flow of collaboration is in the other direction: OPEC receiving substantial (noneconomic) collaboration from Third World countries. (OPEC and other LDC spokesmen make the following counter arguments about the nature and benefits of OPEC aid: (a) all aid-giving countries, including the United States, will tend to favor specific regions at one time or another, and it should not be surprising that OPEC wanted to start out in its own "backyard"; (b) increasing OPEC funds have been going to existing and new international institutions, such as the IMF, the World Bank, the African Development Fund and other regional banks, and the International Fund for Agricultural Development; (c) even if a disproportionate amount of OPEC assistance has gone to such Arab countries as Egypt and Syria, it will indirectly help other LDCs because it releases OECD aid funds which otherwise would have been destined to Egypt and Syria; and (d) not only is OPEC aid much larger than OECD aid as a proportion of GNP [1.9 percent for OPEC compared to 0.3 percent for OECD], but it is also much "purer": "For example, a country like Kuwait had no exports to promote through the provision of aid, no consultancy contracts to solicit, no raw materials to covet. However, [its]

involvement with the interests of the recipient country would . . . during negotiations with third parties, [the developed countries] , [result] in lower costs, better terms or efficient contractual performance." [OECD Development Centre, International Seminar on Special Approaches to Trilateral Co-operation, CD/R(77)3, Paris, February 1977, mimeographed, p. 3.])

Regarding potential other South-South relationships, one can argue that, because of Latin America's generally higher levels of development in the Third World, the region has something to teach other LDCs and could provide technical assistance. This would help open Third World markets to the region, and thus would strengthen Latin America on the industrial scene (Herrera). A more subtle and complex case of not maximizing economic gain, but one that may have even deeper and more lasting implications, is the final "victory" of the Group of 77 to obtain generalized systems of preferences (GSP) from the industrial countries. (GSP provides for tariff concessions by the developed countries for imports from LDCs.)[2] It can be argued that the LDCs might have done better in the long run to have directed the intensive energies devoted to this goal for more than a decade, toward eliminating all the "safeguard" clauses in the trade legislations of the developed countries. ("Safeguards" are designed to protect domestic industries that may be injured by imports. They provide for the imposition of new or higher tariffs, quantitative import restrictions and other trade barriers, or combinations of these.) Fighting safeguards is within the spirit of international free trade as promoted by the industrial countries.

GSP gives highly uncertain and limited advantages to the LDCs. The U.S. government, for example, can add or subtract from the eligible products, and in 1977 it limited the eligibility to countries that supply less than about $300 million of an eligible product but not more than half of total U.S. imports of that product.[3] (The U.S. Trade Act of 1974 which provided for GSP, has been a particular *cause cèlébre* for Latin America. The Act excludes from GSP all OPEC countries—and, of course, communist countries such as Cuba—regardless of whether or not they participated in the oil embargo of 1973/74 against the United States. In Latin America, Venezuela and Ecuador are OPEC members; neither participated in the oil embargo; Venezuela not only maintained but increased her shipments of petroleum to the United States during the embargo. The displeasure of the other Latin American countries at the OPEC exclusion resulted in a show of regional solidarity: the cancellation of the Conference of Foreign Ministers in early 1975. The fact that this meant the abrupt termination of the "New Dialogue," a new positive policy stance toward Latin America initiated by then Secretary of State Henry Kissinger just a few months earlier, indicated the seriousness with which Latin American countries viewed the "unfair" U.S. treatment of two of its members. It was the principle rather than any real economic hardship that bothered the Latin Americans, because the benefits of GSP for either Vene-

zuela or Ecuador would be relatively small.) The permanent elimination of safeguards against LDC products would have provided significant incentives for an expansion of manufactured exports from the Third World, particularly from Latin American countries whose industrial products have only recently entered the world market.

There is no question, however, that from a psychological viewpoint the concession of trade preferences, which was rejected by the developed countries during the First UNCTAD in 1964 where it was initially introduced as a major issue, is a significant achievement by the Group of 77. It can be considered the first important milestone in the evolving North-South dialogue. (Discussions between developing and developed countries antecede UNCTAD, of course. Latin Americans under the leadership of Raul Prebisch—as the head of the UN Economic Commission for Latin America-ECLA—played an important intellectual role in these. The "dialogue" was first formalized through the establishment of UNCTAD of which Prebisch was the first Executive Secretary, and later in the Conference of International Economic Cooperation—CIEC—in Paris, December 1975-June 1977.)

Attacking the trade safeguards of the industrialized countries may have been a more difficult task than fighting for GSP, but it would have been worth a try. From a moral standpoint, the commitment of the industrial countries to free trade would have made it difficult for them to defend safeguards. The changed circumstances of today and the fact that GSP exists, make it unlikely that any current LDC efforts to have the industrial countries give up their safeguards would succeed in the foreseeable future.

The argument implicit in these observations, that general trade liberalization will benefit the Third World more than special preferences, should be modified to take account of the need for infant industry protection in industrializing LDCs. This means agreement in the current multilateral trade negotiations that the developing countries would reduce their barriers at a slower pace than the developed nations. Otherwise the existing structure of comparative advantages will be maintained and the old international economic order will persist. Latin American countries, for the reasons already stated, would be among the primary beneficiaries of such a modified multinational trade liberalization effort.

Perspectives

As noted earlier, statistics indicate that in the postwar period Latin America has become less important in the world economy. It shares this trend with most non-oil exporting LDCs. But what is often overlooked is that the global figures, which show that Latin America's share of world exports declined from 10 percent in 1955 to less than 6 percent in 1974, may hide some interesting information (ECLA, 1977, Table 4: 197). Most of Latin

America's loss is due to the steep fall in the region's share of world agricultural and petroleum exports. What is significant, however, is that Latin America's exports of manufactures now constitute a greater proportion of world industrial exports than they did two decades ago, the share more than doubling, from less than 0.7 percent in 1955 to almost 1.5 percent in 1974 (calculated from ECLA, 1977, Table 4: 197).

This is still a tiny part of world industrial exports, but the data may indicate a trend for the future. If world economic recovery accelerated and trade barriers decline (or at least do not rise), Latin American industrial exports could well grow faster than those of the rest of the world. The preconditions are there: Latin America is rapidly industrializing, and most countries in the region are more export-oriented than in the recent past. On the political level, Latin America has substantial power in the international financial institutions and the region still plays a leadership role in the North-South dialogue.

CIEC started as a confrontation in 1975 and ended inconclusively with the final ministerial meeting in Paris at the beginning of June 1977. The results, if any, were modest. The developed countries committed some additional aid as a pacifier to the poorest LDCs and vaguely indicated that they would consider certain kinds of commodity arrangements with a "common fund." (The "common fund" proposal of the Group of 77, formally presented at UNCTAD IV in 1976, aims at creating a multibillion dollar fund to finance buffer stocks for the stabilization of a group of commodities.) The LDCs supported OPEC and did not agree to a consumer-producer consultative mechanism to consider petroleum policies, something the developed countries wanted. Any significant concessions by the "North" toward a new international economic order will be probably confined to commodity agreements with corresponding common fund arrangements, increased capital facilities (on near commercial terms) and, possibly, some kind of special treatment of the LDCs in the multilateral trade negotiations in Geneva. All of these would be of particular interest and benefit to Latin American countries.

Yet, if the world is serious about economic development, more than a "detente" should be reached in the North-South confrontation. This means that both sides must make concessions that may significantly affect their national societies.

The current mood in the developed countries does not provide much optimism about rapid changes in the structure of the world economy. Beyond the aid policies mentioned above, concessions to the Third World are limited by national concerns and inward looking tendencies. Even the recent apparent openness by the United States toward commodity arrangements has a domestic rationale: limiting commodity price rises is part of the national anti-inflation effort. The same mood has also halted the world-wide move-

ment toward free trade. Given the strong sentiment for protectionism in the United States and other OECD countries, perhaps the best that can be hoped for is to hold the line.

For Latin America and other Third World regions, this may be the time to take another look at regional integration in addition to finding new markets in the Second and Third Worlds. In fact, there appears to be a recent emphasis among developing countries on "collective self-reliance." That concept was made explicit at the Third World conference in Mexico in 1976. It is "based on the principle that developing countries accord each other a preference which would favour their mutual economic exchanges as compared with their exchanges with the developed countries." Certain elements of regional integration schemes are expanded to encompass the Third World: "preferential arrangements might include a Third World trade preference scheme, a Third World payments arrangement, a Third World bank, joint productive projects such as multinational enterprises . . ." Other components of collective self-reliance are "joint actions by developing countries to increase their countervailing power in their economic relations with the developed countries." (All quotes are from UNCTAD, Monthly Bulletin No. 128, May 1977. Details of the essential elements of a system of collective self-reliance are being worked out by LDC organizations and, in particular, by UNCTAD.)

In respect to Latin America, there are sharp differences in interpretations about the usefulness of regional economic integration. Some economists believe that regional integration has failed because Latin America is not a meaningful economic region (Fishlow). It is also noted that integration efforts seem to condone overvalued exchange rates, excessive tariffs, and inadequate attention to the rural sector (but not in Central America, according to Reynolds). The implication is that opportunities on the outside are better, and Latin American development would be better served by taking advantage of them.

Other economists have different interpretations. Felipe Herrera says that, to a large extent, the acceleration of Latin American economic growth during the 1960s and early 1970s can be attributed to the regional integration schemes. He as well as other Latin American experts are optimistic about the value of regional integration and its prospects. Those who want to see integration succeed argue that an integration scheme cannot be left to free market forces; otherwise it would only reproduce the world production pattern. The more advanced partner countries would industrialize and reap the benefits of integration, the others would be condemned to remain raw material producers and exporters. This is the deficiency of LAFTA. Ffrench Davis stresses that intervention in an integration market is necessary in order to make it work by insuring that the costs and benefits are equitably

distributed (including a protection against benefits accruing only to foreign enterprises).

The recent experience of the Latin American integration movements has projected a depressing picture. Nevertheless there are positive elements which are important to consider. The share of total Latin American exports going to the Latin American market increased from about 9 percent during the early 1960s to 14 percent during the first half of the 1970s (IDB, 1976). Nearly all countries in the region have participated in this trend. The rise of intraregional imports as a proportion of total Latin American imports has been considerably less, primarily because of a sharp drop in Brazil's regional import share. For most other Latin American countries, the share of imports originating in the region has increased significantly.

The region constitutes an important market for its exports of manufactured goods. Argentina sells about half of its manufactured exports to other Latin American countries, Brazil about a quarter, but Mexico only about one-seventh because, due to its special subcontracting arrangements with U.S. firms, most of its industrial exports go to the United States. For important and dynamic manufacturing industries, such as chemicals, machinery and transportation equipment, intraregional exports are even more significant. According to ECLA data, the Latin American market provided a substantial stimulus for these industries in Brazil. During 1970 and 1971, about 70 percent of Brazilian exports of these products were sold to the 11 countries constituting the Latin American Free Trade Association (LAFTA) (ECLA 1977: 262-263). The proportion has since declined but is still above 40 percent. Argentina sells about two-thirds of its exports of these products to LAFTA, and Mexico about one-quarter.

In the Andean Common Market Group, the share of intraregional exports increased from 3 percent in 1969 to 5 percent in 1976. If petroleum is excluded, however, the proportions of intraregional exports are considerably higher and rose from 48 percent in 1969 to 67 percent in 1975 (ECLA, Notas No. 242, April 1977). Most of this is due to rising exports of manufactured products. Whether Chile's withdrawal in 1976 and the political differences among the member countries will let the Pact survive, only the future can tell. Many believe that the Andean Pact is flexible enough to permit each member country to develop within its own self-styled autonomy.

If there is a relationship between the integration movement and Latin America's rising industrialization, then one can argue that integration also stimulated extraregional exports of manufactures. Moreover, since Latin American industrialization requires imports of capital and intermediate goods not yet available in the region, the imports from outside the region will also increase. (In this connection, it can be noted that Brazil's imports from outside the region increased much more than its imports from Latin America

during the 1960s and 1970s, the same period during which its industrialization accelerated and the Latin American market for its exports became more important.) ECLA (Notas No. 242, April 1977) makes this argument for Central America. Integration made import substitution feasible in that region. Despite the rapid increase in intraregional trade, Central American imports from outside the region also increased. The integration process, therefore, made the rise in extraregional imports possible and these, in turn, reinforced regional integration.

The foregoing brief survey does not picture regional integration in Latin America as a failure as is generally thought. Increased OECD protectionism or a hardening of OECD attitudes towards the Third World could provide a new impetus for LDC integration efforts, particularly in Latin America.

As long as the notion persists that Latin America is unimportant for the United States and other developed countries, it will be difficult to persuade Latin American countries that they are living in an interdependent world. One-sided importance creates a one-sided dependency relationship. Such a perception results in demands, not cooperation. Cooperation for development becomes meaningful only when there is a recognition of interdependence on both sides of the North-South relationship.

The Group of 77, for their part, could pave way for substantive OECD concessions by yielding to OECD demands for a consultative arrangement between oil producers and consumers. More important, however, is the need for most LDCs to institute basic internal reforms that would permit the poor in their countries to share more fully in economic progress. As stated earlier, such policies are difficult to effect. Yet unless they are realized, the "new international economic order" becomes a sham, a device that enables some LDC governments to defuse their malcontents while trying to obtain increased benefits for their small modern sectors.

If past experience is any guide, the developed countries can do little to foster internal reforms in the LDCs. During the active Alliance for Progress years of the 1960s, the United States tried to condition aid on domestic reforms to be undertaken by the recipient Latin American countries. It turned out to be a *pro forma* effort. The United States was accused of meddling in the internal affairs of the aid-receiving countries. Those countries that did want to play by the rules often merely went through the required motions by presenting national economic and social development plans, sometimes professionally elegant documents but devoid of the needed policies and commitment. During the later years of the Alliance, the U.S. aid conditions became almost indistinguishable from the kind of requirements the IMF imposes before granting standby credits. The IMF requirements for proper foreign exchange, monetary and government spending policies have, however, a different purpose from internal reforms to help the poor, such as fundamental land and tax reforms.

More recently, primarily because of dwindling resources available for foreign assistance, the United States and other developed countries have limited concessional aid to the poorest of the LDCs. In addition, an effort is made to reach the needy people in these countries through social projects and assistance for small scale agriculture. (Most recently, officials of the World Bank indicated a change of Bank policies in the same direction. Unless such policies are limited only to very soft loans approaching outright grants, it is difficult to see how a bank, which is required to maintain its capital, can successfully implement such an orientation.)

The new policies make most Latin American countries ineligible for official aid. This means that the poor in those countries—and they are still the majority of the population in the region—can be helped only through domestic policies. The current political makeup of most governments in the region, as well as the orthodox growth strategies they pursue, do not make this a hopeful prospect for the near future. In the meantime, Latin American governments, whether democratic or authoritarian, will maintain their Third World position and will continue to fight for the "new international economic order."

NOTES

1. A similar argument made by Johan Galtung came to my attention recently. ("Poor Countries vs. Rich, Poor People vs. Rich," University of Oslo, 28 pp. multilithed, undated, presented to an informal meeting of "eminent persons" at UNIDO, Vienna, May 17, 1977).

2. There are more than a dozen systems in operation now. The more effective ones are those of the United States and the European Community. Both the European GSP, instituted before the U.S. system, and the U.S. GSP, which came into effect January 1, 1976, exempt LDCs from tariffs for certain products; thus when general tariffs decline, the LDC advantage is reduced. In all systems, however, the granting industrial countries determine the eligibility of products and countries for GSP and have other limiting rules, such as restrictions on the quantities imported and on the time of applicability of GSP. The U.S. GSP seems less restrictive than any other system. (Under present U.S. legislation, GSP terminates in 1985.)

3. This limitation affects small and large countries alike. In 1975, 17 Latin American countries were excluded from GSP for at least one product. There were 66 products for which 50 percent of U.S. imports amounted to less than one million dollars, and therefore, countries exporting more than that were excluded (United Nations Economic Commission for Latin America, ECLA, *The Economic and Social Development and External Relations of Latin America,* mult., 15 March 1977, p. 221).

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PART I

ECONOMIC RELATIONS WITH INDUSTRIAL COUNTRIES

Chapter 2

THE MATURE NEIGHBOR POLICY:

A PROPOSAL FOR A UNITED STATES ECONOMIC POLICY FOR LATIN AMERICA

ALBERT FISHLOW

INTRODUCTION

For the past three decades, the Latin American policy of the United States has alternated between extremes with almost cyclic regularity. We have vacillated between "pressing priority" and "benign neglect," "special relationship" and "globalism," activism and passivity. What has remained unchanged—and indeed has been the longest-lived foreign policy objective in the history of the United States—has been the concern to secure the Western Hemisphere from external influence. Not far below in the scale of priorities has been the desire to see Latin America emulate the U.S. political and economic system. These goals have proved difficult—if not impossible—to achieve. As a consequence, varying attitudes by the United States toward regionalism and the different degrees of importance attached to specific military, political, or economic dimensions of conformity, have provided a policy dynamic that is born of frustration and a continuing need for innovation.

It is time to stop the carousel. Altered economic circumstances and the rise of a new generation of leadership within Latin America have made this alternating sequence of extreme policies increasingly unacceptable. For more than a decade there has been a vacuum that statesmen on both sides have either ignored or attempted to gloss over with new slogans. In fact, there has been no dialogue, no partnership, and little meaningful cooperation between the United States and Latin America.

This lack need not be a cause for despair. Instead it can provide an opportunity for a fresh, historically informed look at the underlying interests of the United States and the Latin American countries; based upon these interests, a coherent and sustainable political and economic policy for the Western Hemisphere can be defined. At the heart of the matter is the need to devise an effective economic policy, for it has increasingly become the measure of overall hemispheric relations.

A logical beginning is a reexamination of the myth of a "special relationship" between the U.S. and Latin American peoples.

I. THE SPECIAL RELATIONSHIP: HISTORICAL ROOTS

"Pan-Americanism" or the "Western Hemisphere Idea" has provided a beguiling basis for U.S. policy toward Latin America for almost a century now.[1] The concept had its origin in the decade of the 1880's, when European influence in Latin America—particularly in the economic sphere—was clearly in ascendancy. There was an intellectual recognition that historical consequence "imposes upon us a different relation to those [Latin American] peoples than that which we hold to other nations,"[2] as well as practical (i.e., economic) motivation for active promotion of the hemisphere idea. Far-reaching inter-American economic cooperation quickly became the dominant theme of the movement, culminating in Congressional approval in 1888 for a Pan-American Conference in Washington in 1889-1890 to discuss the creation of a regional customs union, which the United States was eager to establish. Lack of interest among Latin American countries—indeed active opposition by several nations—put an end to that particular proposal, but the hemisphere idea, and hemispheric policy objectives, proved more enduring.

As a more powerful United States asserted itself more aggressively in international affairs at the end of the nineteenth century, there were special consequences for its Latin American neighbors. By 1904 (if not earlier) it had become apparent that the United States regarded itself as the unilateral guardian of hemispheric integrity:

> In the Western Hemisphere the adherence of the United States to the Monroe Doctrine may force the United States, however reluctantly, in flagrant cases of . . . wrongdoing or impotence, to the exercise of an international police power.[3]

Thus did the Roosevelt Corollary establish—and justify—an interventionist tendency in U.S. Latin American policy that continues to vex. The U.S. embargo of Cuba and its control of the Panama Canal remain as conspicuous reminders, along with the recent interventions by the United States in the Dominican Republic and Chile.

Active application of the Roosevelt Corollary in the Caribbean and Central America dominated hemispheric relations for the first quarter of the twentieth century. It was largely after the fact that sufficient hemispheric economic interests were accumulated to give substance to this special concern. In 1897 the total foreign investment of the United States amounted to little more than $600 million, of which about half was directed to Latin America. The amount was insignificant: foreign investment in the United States was five times greater than U.S. assets abroad. By 1930, U.S. investment abroad aggregated $15 billion, of which a third was in Latin America, but almost half the *direct* investment–as distinguished from mere ownership of securities–was in the Western Hemisphere. These investments were largely in railroads and public utilities, and until the 1920's were concentrated in the Caribbean and Mexico. Then, as New York became the financial center of the world, there was deeper penetration of the South American continent by U.S. investment and displacement of Britain and France. By 1914, the United States already had the largest foreign investment stake in the Caribbean and Mexico, although it ranked far behind Britain, and was about equal to France, in the Latin American region as a whole. By 1930 the United States dominated virtually everywhere in the hemisphere.[4]

There was a corresponding realignment of trade flows, and the ties between the United States and Latin America grew steadily closer. Between 1913 and 1929, the percentage of total Latin American imports supplied by the United States increased from 24 to 39 percent; excluding Cuba and Mexico, the gain was from 19 to 34 percent. Exports from Latin America to the U.S. market also increased. The share of Latin American exports directed northward increased from 30 to 34 percent; excluding Cuba and Mexico, the increase was from 16 to 26 percent. However, as the economy of the United States grew and diversified, the role played by Latin America remained modest. Latin American imports did not increase their U.S. market share; in the aggregate it remained constant at 25 percent, though there was a share gain from 16 to 20 percent when Cuba and Mexico are excluded. The importance of the Latin American market to U.S. producers did not alter much either: exports directed to the Latin American region increased from 14 to 19 percent of total U.S. exports (from 10 to 14 percent when Cuba and Mexico are excluded).[5]

It was in this first part of the twentieth century, as the economies became increasingly intertwined, that the critical asymmetry of U.S.-Latin American economic relations first became pronounced. Simply stated, the United States became much more important to Latin America's economy than did Latin America to that of the United States. U.S. exports and foreign investment penetrated deep into Latin America without creating a reciprocal inflow of Latin American exports into the U.S. market. The previous South American

reliance on Europe progressively diminished in favor of U.S. sources of supply.

These altered economic circumstances, along with the demonstrated propensity of the United States for intervention, were a powerful stimulus to Latin American unity as a counterpoise to U.S. hegemony. For the Latin American countries, Pan-Americanism took on a very different guise; their efforts to effect change surfaced first in the military-political sphere. At the Sixth Pan-American Conference in Havana in 1928, thirteen of the Latin American states publicly supported a proposal to prohibit military intervention by any state within the hemisphere—a barely disguised initiative directed against the United States. The effort to restrict the role of the United States in the hemisphere—the other, darker side of geographic propinquity—proved unsuccessful. It provoked a debate "so productive of ill feeling and bad language that the minutes of the meeting had to be re-written."[6] This defeat did not diminish Latin American commitment, however, and the determination to bind the North American giant has over the years been perhaps the most recurrent and central principle guiding the majority of the Latin American states in their formation of hemisphere policy.

U.S. policies during the Great Depression and World War II eased some of the accumulated tensions and rekindled idealistic hopes for hemispheric cooperation and close regional association. The Good Neighbor Policy not only translated into formal acceptance by the United States of the principle of nonintervention in Montevideo in 1933, but also into dismantling of its practical evidences. The Platt Amendment was abrogated in 1934; U.S. marines were withdrawn from Haiti, and U.S. financial control over the National Bank of Haiti was terminated. Responses to expropriations of U.S. petroleum interests in Bolivia and Mexico during the late 1930's were more sympathetic to the economic and social aspirations of those nations than had been prior assertions of inviolable property rights. (It is not irrelevant, of course, that the Roosevelt Administration had taken on an increasingly antibusiness stance during this period, and that the darkening clouds of war elevated potential security considerations above commercial interests.)

There was also a heightening of interest in hemispheric economic policy objectives during the 1930's. Because globally oriented economic policies had proven ineffective in the early years of the Depression, and "beggar-my-neighbor" exchange rate depreciation and barter exchange were proliferating, regional initiatives became more attractive. Cordell Hull's reciprocal trade program was largely focused on Latin America. The first of the treaties under that legislation was concluded with Cuba, and pressures were brought to bear on other hemispheric nations to fall into place. It soon became apparent that the principal advantage of the newly negotiated lowered tariffs would accrue to the United States; indeed, one consequence was discrimination by some

Latin American countries against increasing German and Japanese competition. Few Latin American countries were in a position to bargain bilaterally for significant gains, and only a small fraction of their exports were subject to duties in any event. [7]

Another evidence of the increased hemispheric orientation of U.S. foreign economic policy was the establishment in 1934 of an Export-Import Bank for financing trade with Cuba. (One such Bank had already been set up in anticipation of a need for U.S.-Soviet credit facilities; when negotiations with the Soviets failed, the two institutions were merged.) The lending activities of the Bank were extended to other countries, but during the Depression most of its loans were to Latin American countries. Through 1939 almost 90 percent of the Bank's disbursements were so directed (principally to Brazil and Cuba). But with declining exports from Latin America during the Depression, a sharp reduction in U.S. imports, and a retrenchment in foreign investment, U.S.-Latin American economic ties did not flourish. Total Export-Import Bank credit disbursed to the hemispheric countries other than Brazil and Cuba amounted to only $18 million compared to annual imports by these countries from the United States of around $350 million. Cumulative credit to Brazil and Cuba amounted to less than half of one year's imports from the United States. [8]

It is therefore accurate to conclude with Laurence Duggan that "the political achievements of the Good Neighbor Policy prior to the war were not matched in the economic field."[9] Domestic pressure groups in the United States opposed even modest reductions in tariffs on raw material imports such as copper, petroleum, sugar, and beef; conversely, there was little support for active efforts at economic assistance. Interdependence was an as yet unenunciated doctrine.

With the outbreak of war in Europe in 1939, inter-American relations inevitably intensified. Security interests played a dominant role in facilitating economic accommodation, but economic considerations were also involved. An Inter-American Financial and Advisory Committee was set up whose objectives involved

> procuring strategic raw materials, needed in increasing quantities by the United States and comparably difficult for the Latin American producers to sell elsewhere; ensuring the Latin Americans a supply of manufactured goods at reasonable prices; and developing new lines of Latin American production for which a new or complementary market can be found in the United States or in other republics of the Western Hemisphere. [10]

An Inter-American Development Commission was established in June 1940 to work on long-term planning problems, and another commission was set up to oversee a coffee stabilization agreement.

Closer economic arrangements were reflected in increased trade and financial credits from the United States in return for Latin American price restraints on primary exports and political alliance against the Axis powers. Lending from the Export-Import Bank was accelerated. Between 1939 and June 1945, about $180 million were disbursed by the Bank to a wide range of Latin American countries, and undisbursed commitments of another $258 million were also made.[11] Suddenly the United States found the means to assist national development projects such as a new steel works in Brazil, the National Development Corporation (CORFO) in Chile, and highway construction in Mexico. A much more ambitious hemisphere cartel plan drafted by Nelson Rockefeller in 1940 was not pursued, however, but in that plan the hemispheric theme was stated simply and compellingly:

> If the United States is to maintain its security and its political and economic hemisphere position, it must take economic measures at once to secure economic prosperity in Central and South America; and to establish this prosperity in the frame of hemisphere economic cooperation and dependence.[12]

The plan proposed an inter-American commodity stabilization program, significant reduction of U.S. tariffs on Latin American products (along with compensation to domestic producers adversely affected), private and governmental investment to develop Latin American raw material resources, and long-term planning of production. Two decades later many of these proposals would reappear as elements of the Alliance for Progress.

World War II intensified hemispheric economic interdependence, but in a special way. Its particular dimensions can be traced in the statistics on the direction of trade. In 1945, 42 percent of U.S. imports originated in Latin America, but only 14 percent of U.S. exports were marketed there; immediately before the war, these percentages had been 25 and 18 percent respectively. From a Latin American perspective, exports had grown quite rapidly, with almost half directed to the U.S. market.[13] U.S. demands had led to increased production of raw materials to satisfy wartime needs. On the other hand, imports from the United States were limited because wartime requirements directed them elsewhere; Latin America increased its dependence on the United States, but there were not enough goods to satisfy the demand. Shortages of essential inputs limited the scope for efficient import substitution in industry in Latin America and contributed to the growth of high-cost industries which clamored for tariff protection after the War; it also led to an accumulation of dollar reserves that were frittered away on unnecessary imports after 1945.

The economic cooperation that marked the war effort was of a temporary kind whose characteristics affected subsequent inter-American economic rela-

tions for the worse. New sources of supply began to compete with Latin American exports to the U.S. market, while eager U.S. exporters sought to reestablish their prewar commercial ties to the Latin American market. This resulted in serious balance-of-payments difficulties for Latin America and afforded a new stimulus toward industrialization, justifying a continuing reallocation of resources previously fostered by the abnormal circumstances of trade during the Depression and the War. Pursuit of import substitution implied economic policies of trade restriction and state intervention viewed with distrust by both private and official circles within the United States.

The denouement need not have been so unhappy. As the War drew to a close, Latin America looked forward to the continuation of close economic ties and hoped for direct economic assistance from the United States as a reward for wartime cooperation. Their disappointment was immediate. At the special Inter-American Conference on Problems of War and Peace in February 1945, the United States offered "primarily advice—and unwelcome advice at that. They should discard tariffs, encourage private capital and ban state enterprises: measures which would facilitate United States trade and investments."[14] Assistant Secretary of State William Clayton further dashed Latin American hopes by stressing the essentially bilateral character of future inter-American economic relations within a global rather than regional focus. Two years later at the Rio meeting that formally provided for mutual hemispheric defense, Secretary of State Marshall answered pleas for a Latin American counterpart to the generous financial assistance given by the United States to Europe by asserting that Latin American economic development required "a type of collaboration in which a much greater role falls to private citizens and groups than is the case in a program designed to aid European countries to recover from the destruction of war."[15] This was bitter medicine to a Latin America whose priorities were increasingly in the economic sphere, and it was a sermon that would be repeated virtually unchanged many times over in the following decade.

Reality corresponded to the rhetoric. The Export-Import Bank, whose resources had been channeled almost exclusively to Latin America in the 1930's, changed character during—and especially subsequent to—the War. Reconstruction and lend-lease credits of $920 million were made available to Europe in the last six months of 1945; Latin American loan authorizations were only $106 million in the same period. During the next year, the high level of lending for reconstruction purposes was continued. European borrowers, typically countries obtaining loans at favored interest rates, were allocated almost one billion dollars; Latin American borrowers, both private firms and government agencies, received only slightly more than $30 million. It was clear, despite such an exception as the Joint U.S.-Brazilian Economic Development Commission, that U.S. priorities were elsewhere than in Latin America.[16]

Thus emerged a second, continuing antagonistic theme of inter-American relations: the seeking of special concessions of public resources and the implementation of other policies that would directly assist Latin American economic development. While the United States defined its economic interests in terms of the preservation and reinforcement of an orthodox development model, the majority of the Latin American states—even the conservative ones—saw their needs quite differently. The Economic Commission of Latin America (ECLA), whose creation in 1948 was opposed by the United States, became the bearer of the distinctive Latin American ideological torch. Latin American economic frustrations, and a distinct and different model of center-peripheral relations, combined with a common interest in restraining the application of U.S. power within the hemisphere, meant that the supposed regional commonality of interest was mainly an institutional facade through most of the 1950's. Modest economic advantages might be secured by the Latin American nations, but only bilaterally, and conditional upon their support for U.S. security objectives in keeping the hemisphere free from Communism.

No wonder then that in 1954 Arthur Whitaker proclaimed the euthanasia of the Western Hemisphere idea.[17] Increasing divergence between Latin American and U.S. priorities, the close alliance of the United States and Europe in NATO as the Cold War continued, and the expanding global interests of the United States in the Middle East, Asia, and Africa all seemed to corroborate that judgment.

The concept of the "special relationship" did not completely expire. Latin American leaders continued to invoke it in hemispheric meetings as a rationale for special assistance to facilitate economic development, but the invocations fell upon deaf ears. The meetings produced vague, consensus commitments to cooperation, and clear statements of negative U.S. views:

> It is the view of the United States that the Export-Import Bank, the International Bank for Reconstruction and Development, and the International Finance Corporation are able to meet all demands for ordinary, conventional dollar loans for sound projects. To the extent that private capital is unavailable, these institutions may be relied upon by the Latin American countries to supplement their own resources for the financing of productive economic projects. Among the factors which will influence the volume of foreign lending to any country is the effectiveness of that country's program for combating inflation, encouraging private enterprise, and improving the investment climate.[18]

Self-help programs such as Latin American economic integration generated no more enthusiasm.

Vice President Nixon's trip to Latin America was a rude awakening to the deterioration of inter-American relations and stimulated U.S. interest in developing a more forthcoming posture. However, the critical spark that

assured Latin America a priority in U.S. foreign relations it had never before enjoyed was the audacious challenge to hemispheric security posed by Castro's Cuba. Suddenly, inter-American relations vaulted to center stage in U.S. diplomacy—and barely in time if Costa Rican President Jose Figueres' "one minute to midnight" statement is to be believed.

THE ALLIANCE FOR PROGRESS

The renascence of the Western Hemisphere idea took specific form in the Alliance for Progress; for a few brief years, that program represented the apparent triumph of Pan-Americanism. The United States not merely enunciated a special relationship, but also accepted a special responsibility within an inter-American context. Long-term and generous economic assistance was to underwrite political democratization and structural reform in Latin America, and thereby prove the feasibility of peaceful revolution. The Yankee imperialist was to be squarely on the side of the dispossessed rather than the privileged.

The Alliance did succeed in dramatically increasing the flow of public resources from the United States to Latin America; between 1961 and 1965, the annual net transfer was about $600 million—twice as much as in the previous quinquennium.[19] What the Alliance did not do was underwrite the peaceful social revolution it had promised, nor did it establish a firm basis for more cooperative relations within the hemisphere. Many have already adduced the reasons why: inadequate net capital flow, bureaucratic politics within the U.S. government, the instability of center-left regimes in Latin America, ineffective implementation (particularly after the assassination of President Kennedy), the unacceptability of U.S. interventionism—among others.[20] For present purposes, however, I wish to emphasize three fundamental economic contradictions that negated the special relationship upon which the Alliance was based, and which contributed decisively to its lack of success.

The first inconsistency was the decline in significance of regional economic interactions. Throughout the postwar period, Latin America declined almost continuously both as a source of supply and as a market for the United States. Table 2.1 presents the direction of trade data for U.S.-Latin American imports and exports from 1945 to 1975. More than a simple corrective to the abnormal wartime circumstances is involved. The proportions of total U.S. imports to and exports from Latin America in 1975 are equal to—or even lower than—those in 1914. The evaluation of the declining significance of regional trade is not much altered by emphasizing the role of Latin America as a supplier of basic raw materials to the United States. Anibal Pinto, acknowledging the adverse trend in the aggregates, maintains the contrary,

TABLE 2.1

Direction of Trade between United States and Latin America: 1945-1975 (Percentage of total imports and exports)

	United States		Latin America	
Year	Imports from Latin America	Exports to Latin America	Imports from United States	Exports to United States
1945	42.1%	14.1%	57.7%[a]	49.0%[a]
1950	35.1	27.9	50.1[a]	48.3[a]
1955	31.7	22.5	47.2[a]	43.9[a]
1960	27.0	18.8	{45.3[a] / 39.9}	{42.4[a] / 40.2}
1965	20.5	15.5	38.2	33.8
1970	14.6	15.1	37.2	33.5
1975	16.6	15.9	30.6	35.5

Sources: United States: *Historical Statistics, Colonial Times to 1970; Statistical Abstract, 1976.* Latin America: 1945-1955: U.N. Economic Commission in Latin America, *Economic Bulletin for Latin America,* Vol. V, 1960, Statistical Supplement; 1960-1975: IMF, *Direction of Trade,* various years.

[a]Twenty Latin American republics only; all other data are based on comprehensive Western Hemisphere definition.

however, arguing that "it is . . . apparent that the . . . Latin American nations are of unquestionable importance to the functioning of the U.S. system. This fact is underscored if we evaluate the role of Latin America as a supplier of raw materials." [21] Yet, as is shown in Table 2.1, that role is on the whole modest and–for many products–declining.

The reality is that the United States has become dependent upon more diverse and far-flung suppliers as its need for imports of certain commodities has increased. Moreover, those products in which Latin American import supplies tend to dominate include a number for which the percentage of imports to total U.S. supply is small. This is true of iron ore, copper, and lead. Latin America exports more foodstuffs to the United States than raw materials. The recent rise in coffee prices suggests that these cannot be neglected, but their strategic importance should not be exaggerated. Generally speaking, the observed magnitude of trade is not a good measure of the costs of its dislocation. A somewhat smaller Latin American import supply could be compensated by increased purchases elsewhere; other sources of supply are available at only modestly higher prices. (The variability in the shares of Latin American imports shown in Table 2.2 is direct evidence of this proposition.) Conversely, the effect of declining Latin American demand for U.S. exports has not been decisive.

Just as Latin American trade with the United States has relatively declined, so has U.S. foreign investment in Latin America. Since the end of World War II, Latin America has occupied a progressively less important position in the distribution of U.S. assets abroad. In 1950 Latin America

TABLE 2.2

U.S. Dependence on Latin American Minerals and Petroleum: 1950-1974

	Percent Share of Total U.S. Imports from Latin America							U.S. Import Dependence[a]
Commodity	1950	1955	1960	1965	1970	1974A	1974B	1974B
Minerals:								
Aluminum (ore, metal, and scrap)	15%	26%	43%	35%	42%	39%	65%[b]	88%[b]
Chromium	7	4	3	–	–	–	1	90
Cobalt	–	–	–	–	–	–	–	99
Columbium	–	3	25	14	56	61	88	98
Copper	60	56	63	68	58	44	44	20
Fluorspar	35	44	48	74	69	74	80	81
Iron (ore, metal, and scrap)	13	39	59	32	30	40	49	17[b]
Lead	53	43	42	41	35	50	57	19
Manganese	11	21	32	40	20	12	23	98
Mercury	7	50	12	21	5	23	23	86
Nickel	–	8	16	–	–	–	8	72
Platinum	9	6	5	4	3	1	1	87
Tin	13	10	2	9	8	18	18	84
Titanium	–	–	–	–	–	–	1	47
Tungsten	22	46	34	55	6	38	37	64
Vanadium	100	100	–	–	–	n.a.	21	36
Zinc	34	35	38	31	24	13	17	59
Petroleum:								
Crude	77	56	55	39	22	12	25 (crude and refined)	38 (crude and refined)
Refined	98	99	95	95	86	77		

Sources: Share of imports: 1950-1974A: Value of imports, or if unavailable, share of physical imports from U.S. Bureau of Mines, *Mineral Yearbook* for the specified years. (Value of bauxite imports for 1974 obtained directly from U.S. Department of Commerce commodity import series by country of origin.); 1974B: *International Economic Report of the President, 1976,* Tables 75 and 80. This series differs from 1974A and is apparently based upon metal content rather than value; in general it shows a larger import share.
Import dependence: *International Economic Report, 1976,* p. 96.

[a] Percentage of total U.S. consumption represented by imports.

[b] Ore and metal only.

accounted for 38 percent of U.S. direct foreign investment; in 1960, 23 percent; in 1975, 18 percent. Such investment still greatly exceeds the amount invested in other developing areas, but the margin is diminishing. Net outflows of capital in the early 1970's favored other areas; even for capital flows destined for application in manufacturing, the rate of increase for other developing areas has exceeded that for Latin America. Obviously, many U.S.

enterprises continue to have important and established ties with the Latin American region, and significant income is generated for return to the United States as well as for reinvestment. However, the relative significance of the region has diminished to the point that balance-of-payment income from other developing countries now exceeds the return flow from Latin America. This is not only a result of the recent abnormal increase in the price of petroleum, but also is a reflection of the reduced importance of Latin America to the United States. It provides empirical evidence of the penetration of the United States into markets outside the Western Hemisphere in the postwar period.[22]

One consequence of these far-flung U.S. economic interests has been that Latin America has lost its privileged relationship with the United States. When U.S. domestic copper or lead or sugar or textile or meat interests plead their case with respect to imports, Latin America does not receive special treatment. No special privilege can be conceded to Latin America because equally important interests elsewhere in the world would be adversely affected. This lack of regional favoritism has made itself felt even in the allocation of public resources. The prestigious Council of the Americas, organized in 1964 by David Rockefeller partially to lend business support to the Alliance for Progress, has not been able to mobilize continuing Congressional commitment to hemispheric economic assistance.

Special treatment can occasionally be obtained for individual countries in Latin America. Large and growing economic interests in Brazil or Mexico can attract high-level attention. Secretary of the Treasury William Simon could negotiate recently with the Brazilians to avoid the imposition of countervailing duties, or with the Mexicans to facilitate capital inflows. Those actions contrast sharply with the total neglect of the consultative machinery of the Organization of American States (OAS) when sugar imports were adversely affected by increased tariffs in the fall of 1976.

Latin America is also diversifying its sources of supply and its export markets. Table 2.1 show Latin American trade dependence on the United States since 1945. The effects of the increasing integration of the United States and Latin America into the world economy are clearly evident, but because Latin American foreign trade has lagged behind world trends, its dependence upon the U.S. economy remains much greater than vice versa. And because Latin American exports of manufactures have been a rising proportion of sales abroad—with the United States an attractive market—the share of Latin American exports has not fallen as much as that of imports.

The fall in import share illustrates the conflicting consequences of the larger (and tied) capital flows under the auspices of the Alliance for Progress. Whereas during the 1960's Latin America continued to import almost 40 percent of its needs from the United States, in the first part of the 1970's imports from the United States have declined to 30 percent. The United

States is no longer such a dominant supplier now that Latin America has widened its horizons.[23] Because of the progressive deterioration of the U.S. balance-of-payments position in the 1960's, capital aid projects required that, where possible, necessary imports be of U.S. origin. This economic assistance meant an economic dependence under which Latin America continually chafed; apparent generosity was viewed as self-seeking economic imperialism.

The diversification of Latin American trade has been paralleled by increasing European and Japanese foreign investment in Latin America. The repatriation of European foreign capital at the conclusion of World War II, and the limited new investment thereafter, meant that virtually all foreign investment came from the United States. In the last decade that situation has changed. For example, in one of the most attractive markets—Brazil—the U.S. share was only 35 percent as early as 1967, and it may have declined since then.[24] Many Latin American countries have actively sought to attract competitive foreign investment.

Latin American enthusiasm for the special relationship with the United States thus had a diminishing economic basis at the very moment it seemed, at long last, to promise results. Diversification of economic relations had more long-term attraction than continued concentration, even if the latter brought some temporary advantage. This point of view had special appeal to the younger cadre of technocrats, civilian and military, who began to assume positions of importance in the 1960's; they were not imbued with an idealized, formalistic view of inter-American relations. There was a further sound, economic reason for skepticism about the special relationship. The Alliance for Progress had its greatest impact in stimulating public credits; yet the level of development of many Latin American countries and the declining role of import substitution made increased exports central to rapid economic growth. Foreign exchange obtained by resorting to debt, even under generous terms, eventually has to be repaid; that earned by exports sets up no return flow and has direct and positive implications for the productive sector.

The Alliance could do little about trade beyond modest technical assistance. Few real trade concessions were possible in the regional context. Not only did the United States have a strong preference for universal rather than regional arrangements—as befitted a global power—but so did Latin America; it saw its role as transcending the hemisphere. In 1963, when the Alliance was in its heyday, Latin America established a special coordinating group—CECLA—exclusive of the United States to prepare for the first United Nations Conference on Trade and Development (UNCTAD) meeting. The position taken by Latin America was subsequently adopted as the position of the developing countries as a whole, and Latin American influence was personified in the selection of Raul Prebisch as the head of UNCTAD's secretariat. Latin America proposed universal trade preferences and commod-

ity agreements rather than regional arrangements. Even the regionally focused inter-American planning committee—CIAP—in its 1965 report to the Presidents of the American republics recommended consideration of a policy of only "temporary defensive measures" to compensate for the deleterious effects of the preferential arrangements between the Common Market and the former African colonies. And in 1969, the Consensus of Viña del Mar, a document embodying the Latin American position on hemispheric relations, spoke of a "new plan of inter-American and *international* cooperation for the realization of the aspirations of the Latin American countries."[25]

Because the significant trade and monetary issues went beyond hemispheric bounds, the role of the OAS in economic matters became marginal. The real action was elsewhere—in the General Agreement on Trade and Tariffs (GATT), UNCTAD, and the International Monetary Fund (IMF). That had three major consequences. The first consequence was that Latin America, as spokesman for the developing countries, was cast in an antagonistic role vis-à-vis the United States. Whatever the cooperative rhetoric of the Alliance, the United States actively opposed the proposals for trade preferences and commodity agreements at Geneva. It also opposed the creation of Special Drawing Rights (SDR) for financing economic development, and focused on its trade with Europe and Japan in pursuing GATT negotiations for lower tariffs. The second consequence of the inability to treat trade and monetary questions regionally was that many of the potential economic benefits of hemispheric negotiation were lost. Trade and monetary agreements could be mutually beneficial, but large flows of direct public financial assistance from the United States had to be justified by unilateral advantage: immediate larger markets for U.S. exports. Latin America thus considered that its gains were somewhat dubious, while the U.S. Congress continued to reckon economic assistance as a significant cost. The third consequence of the "globalization" of economic issues was that efforts to strengthen regional economic machinery (through creation of CIAP or later CECON) became merely time-consuming artifices. Formal structure was divorced from reality, and that divergence increased both Latin American and U.S. dissatisfaction.

The declining viability of economic regionalism incorporating the United States inevitably sapped the strength of the Alliance. The failure of regional economic integration solely within Latin America was a second principal factor contributing to the frustration of the Alliance. The lack of meaningful economic ties among the Latin American states meant that the envisioned multilateralism could not be realized: the Alliance was reduced to a series of bilateral relationships pivoted on the United States. Much energy was wasted in promoting economic policies that looked inward to the region rather than outward to the world—at a time when global markets were expanding as never before.

Regional integration was first advanced in the 1950's as a partial solution for the Latin American shortage of foreign exchange and its diminished import capacity. The logic was appealing: a large Latin American market could absorb manufactures produced within the region, and lessen external import requirements; economies of scale could be realized, and cooperative decisions among countries for complementary investment could assure efficiency of supply. The great success of the European Common Market, combined with the stagnation of Latin American exports in the latter 1950's, made regional integration appear both feasible and highly attractive. As a Latin American—not an inter-American—initiative, it could draw support from all those who were frustrated by the inaction of the United States within the OAS framework.

The Treaty of Montevideo, establishing the Latin American Free Trade Association (LAFTA), was signed by seven countries in February 1960; in December 1960, El Salvador, Guatemala, Honduras, and Nicaragua adhered to the General Treaty of Central American Integration, which created the Central American Common Market (CACM). Integration was barely launched when Title III of the Charter of Punta del Este put the United States for the first time squarely behind the process: "The American Republics consider that the broadening of present national markets in Latin America is essential to accelerate the process of economic development in the hemisphere."[26] In 1967, at a meeting of the Presidents in Punta del Este, it was decided that a full Latin American Common Market, integrating LAFTA and CACM, should be established by 1985; it would be the principal means of revitalizing the Alliance for Progress and improving inter-American relations.

From today's vantage point, such aspirations appear naively optimistic. Intra-regional trade among the signatories of LAFTA has remained low and relatively constant after the positive impulse of the first years. Trade within the CACM expanded quite rapidly in the 1960's, as industrial import substitution increased within the region, but the economic gains were overshadowed by controversy about their distribution among members; enthusiasm was already diminishing when cooperative efforts were rudely halted by open hostilities between El Salvador and Honduras in 1969. The Andean Bloc, established as a subunit of LAFTA in order to give impetus to intra-regional trade, has fared no better. Hardly had an automotive complementarity agreement emerged (after long and difficult negotiations) than Chile decided to withdraw from the group. Whatever significant intra-regional trade there has been within Latin America has been more a consequence of Brazil's rapid growth and its capacity to supply manufactures to its smaller neighbors than because of coherent multilateral effort within the region.[27]

The disappointing pace of integration meant a lack of significant Latin American participation in decisions about the allocation of funds granted

under assistance programs. The creation of CIAP in 1964 did not (and could not) lessen the dominant role of the United States in determining country requirements. Latin American representatives could espouse only personal, not national, commitments to regionalism; as a result, there was no overarching pan-Latin Americanism that could dominate particular national interests. The contrast to the structure and operation of the Marshall Plan is complete:

> The United States came to depend on O.E.E.C. [Organization for European Economic Cooperation] for the annual estimate of country requirements. . . . The conditions in the form of sensible economic policies and practices in the receiving countries involved extensive intervention, but it was mainly intervention via the deliberations of a European organization with American participation rather than via bilateral negotiations.[28]

The failure of Latin American economic integration ultimately derived from the fact that Latin America is not a cohesive economic region. In the absence of significant intra-regional economic ties, there was no reason for one country to be concerned about the repercussions of policies or development strategies of other Latin American countries. There was no logic in sacrificing national autonomy in favor of coordinated monetary and fiscal policies. As for trade, vested local interest groups resisted concessions, and endless negotiations were required to assure that zonal tariff reductions were exactly reciprocated; increased exports to the rest of the world required no parallel commitment to increased imports. Because the internal cohesion of Latin America was so limited, there was no analogue to the OEEC and its impressive multilateral functions. The disparity bred more rhetoric and plans for reform.

These visionary efforts to stimulate integration not only masked the lack of Latin American collegiality, but they also reinforced tendencies toward an inward looking industrial development based on import substitution. The integration movement stressed the need to compensate for the inadequacies of the external market, and thus seemed to condone overvalued exchange rates, excessive tariffs, and inadequate attention to the rural sector. It gave undue weight to the presumed benefits of planning rather than to the need for better implementation of conventional macroeconomic policies. Ironically, at the very time that the United States sought to give new impetus to the Common Market idea, expanding demand outside the region provided far more immediately profitable opportunities. Aware of that reality, Latin Americans allowed integration to languish. While in theory, and in European practice, integration could have been complementary to extra-regional trade, in Latin American conception and implementation, they have been substitutes.

A lack of regional coherence within Latin America presaged difficulty for any attempt to implement a multilateral Alliance. Another, more funda-

mental problem adversely affected the possibility of closer bilateral associations. This was the lack of consensus between the United States and Latin America on the role that foreign investment and the domestic private sector should play in the economic development of the region. Some radicals have argued that the Alliance was merely a device for defending and extending U.S. property rights in Latin America. Such revisionism is an erroneous simplification. The Alliance Charter made scant mention of private investment; rather it explicitly stated that the greater part of the needed $20 billion in external resources should be in public funds. Abraham F. Lowenthal gives a more accurate assessment: "Far from reflecting big business domination of United States foreign policy, the Alliance for Progress commitment emerged in part because of the unusual (and temporary) reduction of corporate influence in the foreign policy-making process."[29]

That was not the end of the story, however. The corporate interests asserted themselves—and soon. In 1962, at the first inter-American meeting held to evaluate the progress of the Alliance, Secretary of the Treasury Douglas Dillon commented:

> There is one area in which during the past year we have not only made no progress but where we have suffered a serious setback. Private investment, both domestic and foreign, has suffered damaging blows and has lost confidence. . . . The plain fact of the matter is that private enterprise has not always been made to feel that it is truly a part of the Alliance.[30]

Two years later the U.S. Congress held hearings on private investment in Latin America because of concern for the "persistent discouragements which private, and especially foreign private, capital seemingly must face." In its report, the Subcommittee on Inter-American Economic Relationships warned against misreading the Alliance Charter's emphasis upon public resources and made clear its distaste for expropriation even with compensation:

> Granting, however, the sovereign right to seizure for public purposes and assuming prompt and effective compensation, a series of expropriatory acts by a government complicates the investment-decision process by adding instability and uncertainty. A country indulging such policies has forfeited its right to complain of a shortage of capital.[31]

There is an obvious contradiction between such attitudes and the commitment of the Charter to far-reaching agrarian reform, to popular participation, and to an active role for state planning. The traditional approach to development relied on foreign investment, resulting in advocacy of conservative policies that foster external capital; the Alliance was committed to finding new approaches. The matter goes deeper. In 1962 the Congress passed the Hickenlooper Amendment to protect the property of U.S. citizens in the brewing expropriation disputes in Brazil. This bill and its variety of succes-

sors–all curtailing economic privileges as a punishment for violating property rights of U.S. citizens–were inevitably seen in Latin America as forms of economic coercion: they seem to give foreign investors decisive status in determining the legitimacy of policies followed by sovereign states. Waiver clauses that stay application on the grounds of pressing U.S. national interest are not sufficient, considering the fundamental issues involved. They do not remove the implication that it is the foreign government that is guilty.

The Hickenlooper Amendment (and the other similar Congressional limitations) accurately conveyed the strong preference in U.S. business circles that the government not provide support to countries whose policies did not encourage private enterprise. The question was not merely prompt payment of adequate and effective compensation, but the role of the private sector. While the Charter could evade the issue, the Alliance in practice could not–and the thrust of U.S. support for peaceful revolution was inevitably blunted.

The basic presumptions of the Charter of Punta del Este–a special U.S. economic interest and capacity, the existence of a regional Latin American entity, and the priority of reform over economic orthodoxy–all lacked substance. However idealistic and generous the motivations of its organizers, the implementation of the Alliance forced them to confront these contradictions, and they suffered for it. Instead of a flowering of inter-American relations, there was criticism and disappointment on both sides. The Alliance for Progress had tested the validity of the Western Hemisphere idea and found it wanting.

The Aftermath

Such was the apparent message of President Nixon's reformulation of U.S. policy toward Latin America as set forth in his statement before the Inter-American Press Association in October 1969:

> For years, we in the United States have pursued the illusion that we could re-make continents. . . . [W]e have sometimes imagined that we knew what was best for everyone else and that we could and should make it happen.
>
> But experience has taught us better.
>
> It has taught us that economic and social development is not an achievement of one nation's foreign policy, but something deeply rooted in each nation's traditions.
>
> It has taught us that aid that infringes pride is no favor. . . .
>
> What I hope we can achieve, therefore, is a more mature partnership in which all voices are heard and none is predominant. . . .[32]

The "mature partnership" in practice promised continued (and partially untied) aid within a more effective multilateral context; respect for national identity and dignity; support for universal trade preferences; "a strong belief

that properly motivated private enterprise has a vital role to play in social as well as economic development"; and a firm commitment to the inter-American system and to the priority of Latin America.

The new "low profile" dispensed with the rhetoric of the Alliance. In the guise of nonintervention it diminished public assistance, while failing to come to grips with the continuing, fundamental economic issues of the hemisphere. There was no apparent concern about a security threat—the conclusions of the Rockefeller report (1969) were simply ignored. The election of the Popular Unity Allende government in Chile in 1970 evoked a predictable response, but this culminated merely in U.S. hostility toward Chile—not in a more forthcoming regional stand. Henry Kissinger might expound a domino theory to the press, but he did not act upon it to shore up the potential next victims. Bilateral rather than multilateral policy sufficed.

On the Latin American side, a parallel retreat from the objectives and commitments of the Alliance was enunciated by the Consensus of Viña del Mar. After several years of intense U.S. involvement in the formation of Latin American domestic economic policy, a respite was welcome. Transitions from civilian to military rule in some of the larger countries brought more orthodox and less reformist economic models in most cases, but no greater desire for a heightened U.S. presence. All the governments in the region agreed upon the importance of respect for national autonomy—an issue intensified by the Peruvian expropriation of the International Petroleum Company (IPC) a short time before—and the inadequacy of external financial assistance, implicitly chiding the United States for its failure to live up to past promises. Desired changes in the structure of international trade relationships were discussed at length, while internal reform and regional integration attracted only passing notice. There was a substantial agenda of specific proposals to be negotiated with the United States, but the regional content was necessarily limited. The Consensus should be viewed as a milestone in the continuing involvement of Latin America in the emerging North-South dialogue rather than as a crucial turning point in inter-American relations. [33]

Predictably, the "low profile" approach provoked charges of U.S. neglect and disinterest, and hemispheric relations deteriorated. The President's 1972 report to the Congress on foreign policy gave the U.S. version of the failure:

> We have yet to work out with our friends a solution of the conflict between their desire for our help and their determination to be free of dependence upon us. The thrust for change in Latin America, and our response to it, have yet to shape themselves into a pattern permitting us to make as full a contribution as we wish and as our hemisphere friends expect. [34]

A Latin American version, as reflected in the debates during the continuing cycle of inter-American conferences, would stress the limited and uncertain U.S. commitments to economic assistance, the inadequate access to the U.S.

market, the rising importance of the transnational corporation as an element of intervention, the dependence of Latin America on imported technology, and the political manipulation by the United States of the OAS. At the Third OAS General Assembly in 1973, these criticisms culminated in the creation of a committee to study the inter-American system and prepare recommendations for reform: once again form dominated substance.

At this time, U.S. rediscovery of Latin America was set in motion by events less dramatic than a riot-provoking Vice-Presidential trip or a socialist revolution ninety miles offshore. One was the appointment of a more activist and powerful Secretary of State—the same Henry Kissinger who had been instrumental in the design of the "low profile" policy. Another was the oil embargo, in whose aftermath greater importance was attached to North-South relations. Neither was directly related to the region per se, and for that reason the "new dialogue," while it evoked the familiar rhetoric of the "Western Hemisphere idea," was a mere shadow of its previous incarnations. It was destined to be the grin without the cat.

OAS civil servants, as might be expected, spoke warmly of the change:

> Latin America has tended to view the globalist emphasis of U.S. policy, and the "low profile" which it implied, as scarcely concealed indifference to the region and its problems. [Tlatelolco] affirmed the special historical relationship among the nations represented there, and the United States accepted a "special responsibility" for the accelerated development of the countries of the Americas and the promotion of the welfare of all their peoples.[35]

Latin American governments responded less emotionally. The U.S. proposal "to build a new community" was rejected; on the contrary, the foreign ministers resolved to conduct their business outside the extant inter-American machinery. This assertion of ideological independence did little to bring about substantive negotiations. The special committees to study multinational enterprises and to facilitate the transfer of science and technology were making little progress even before the machinery of the Conference of Foreign Ministers fell into total disrepair with cancellation of the conference scheduled for Buenos Aires in March 1975. That action was taken to express Latin American unhappiness with the 1974 U.S. Trade Act's exclusion of Venezuela and Ecuador from eligibility for the system of general preferences because of their adherence to the Organization of Petroleum-Exporting Countries (OPEC).

Thereafter, little progress in defining an inter-American policy was visible. Specific issues—for example, the OAS embargo on Cuba and expropriation of U.S. property in Venezuela, Peru, and Ecuador—were effectively addressed; the general themes, however, were the familiar ones. The Latin American countries (some reluctantly) created a new pan-Latin American group—SELA—whose original aspirations for a powerful regional cartel have been

progressively downgraded. An attempt to formally bind the United States economically by amending the OAS Charter attracted only sporadic interest. On the U.S. side, the Secretary of State at last made two trips to Latin America in 1976, but his reassertion of the special relationship, expression of interest in the Colombian suggestion for closer hemispheric trade links, and call for a special OAS General Assembly on economic issues were all feeble echoes of the past rather than beacons for the future.

Perhaps the attempted exhumation of the Western Hemisphere idea has proved its demise once and for all.

II. IMPLICATIONS

Four principal conclusions can be drawn from this experience. The first is that immediate security considerations have played the dominant role in shaping regional economic policy. The second is that regionalism is only a limited force within Latin America. The third is that recurrent misunderstandings are caused by the different conceptions about the role of the private sector in Latin America and the United States. The last, and most important, is that a policy involving limitations on U.S. power is not enough.

A. The Dominant Role of Security Considerations. Latin American aspirations for economic development only occasionally become important in the United States. It takes the imminent threat of alien political influence in the hemisphere to mobilize U.S. policymakers—and even then it is only for a brief interval. There are ample precedents: the substantial increase in Export-Import Bank lending and its more liberal application to public projects at the outbreak of World War II; the Eisenhower Administration's endorsement of the Inter-American Development Bank in the wake of the Nixon trip to Latin America in 1958; the Alliance for Progress in the context of a Cuban revolution directly allied to the Soviet Union.

Neither the presumed cultural bonds and shared values of "special relationship" nor direct economic considerations have aroused comparable concern; long-range security has been the rationale behind economic assistance programs for more than a decade. Yet this sense of potential danger from the developing world has failed to create a sense of special hemispheric immediacy. On the contrary, higher levels of Latin American per capita income, the ubiquity of military government, human rights violations, and the great inequality in distribution of income have resulted in a contrary disposition within the U.S. Congress in recent years. A more generous bilateral assistance program would not necessarily redound to the advantage of the hemisphere. Most of the larger countries are ineligible for aid, and many of the smaller and poorer countries have been under Congressional attack for repressive practices.

The immediate security threat to the region that earlier galvanized action has perceptibly diminished. The Rockefeller report's reassertion of an immi-

nent danger fell largely upon deaf ears—even within the Nixon Administration—and cancellation of invitations extended to Rockefeller to visit certain capitals did not evoke the concern aroused by Nixon's unhappy visit a decade earlier. Detente—and the multipolar world it symbolizes—have reshaped the U.S. conception of the hemisphere, to which the Chilean case provides ironic testimony. CIA efforts to overturn the Allende government in 1970 by a military coup were unsuccessful and allowed to lapse; overt hostility, not covert intervention, was the more effective policy. International Communism was no longer a credible threat. After the military seized power in 1973, U.S. economic assistance was significantly increased—but only to Chile, and partially at the expense of other countries in the region. At issue was Chile, not Latin America as a whole.

B. The Limited Force of Regionalism. The dramatic turnabout in worldwide North-South relations since 1973 triggered by the oil embargo does not alter the evaluation that economic interdependence requires dealing with the South as a whole. The oft-invoked notion that the economic relations between Latin America and the United States can serve as an example of fruitful cooperation and dialogue with the developing world is not convincing. By their nature the principal issues involved—freer access by developing countries to world markets, more equitable management of commodities, more liberal world monetary rules, debt relief, etc.—defy regional arrangements. Such arrangements are not technically impossible: Latin America could obtain special preferences in its dealings with the United States, but the benefits to the United States from such a policy are far from compelling, while the potential costs are considerable. Discriminatory regional blocs would be strengthened—a consequence that both the United States and the majority of the countries of Latin America view as unfavorable to their larger and long-term interests. It is too late to revive a hemispheric cartel plan: both potential participants have outgrown it.

Nor are formal regional arrangements for prior consultation a useful means for promoting a more meaningful North-South dialogue. Inter-American conferences would largely be limited to negotiations about semantics, not substance; the United States and Latin America could not decide the principal issues, and acting as if they could would only create resentment. The United States is understandably reluctant to take positions within a regional forum for fear that they might become the benchmark for further negotiation at a global level. Such a context makes the hemispheric institutional structure a source of frustration rather than of rapprochement.

Individual Latin American countries can and *do* exercise a constructive role in North-South relations because their economic interests dictate pragmatic, undoctrinaire positions. The largest Latin American countries are firmly integrated into world trade and capital markets and have an important stake in ensuring that they function effectively. They want reforms, not

revolution. That is not a justification for a regional policy, however. It is an argument for exploiting *bilateral* diplomacy to achieve mutual interests at the *global* level.

Analogously, for those countries rich in resources that could satisfy U.S. import requirements more flexible and innovative bilateral policies are needed. Abundant Mexican petroleum reserves combined with their need for foreign capital to finance development and to facilitate income redistribution should provide a basis for close, mutually beneficial economic relations between the United States and Mexico. Similarly, Brazilian, Peruvian, and Chilean ores requiring U.S. capital for their exploitation also provide opportunities for bilateral understandings out of which would grow more effective regional relations.

Regionalism is largely negated by the preferences that many of the principal Latin American countries have revealed. Although Latin America continues to pay lip service to the concept of regional integration, progress toward it has been minimal. The rationale that Latin America has only a limited potential for export to the world market has lost much of its force, while the accomplishments of constructive cooperation have been modest. Defensive Pan-Americanism persists because of concern about U.S. power, and because it involves less commitment and costs less than a positive regionalism. The prospects for effective political cooperation and economic integration within Latin America are as remote if not more remote now than they were a decade ago. This is the case despite the formation in 1975 of the Sistema Económico Latinamericano (SELA), supported by all the Latin American countries. SELA has thus far been no more effective as an integrative force than earlier efforts. It barely conceals the significant differences in enthusiasm and interests among the individual Latin American countries. SELA does not satisfy an important regional function that commands strong allegiances; rather it could be created only because there was little concrete for it to do. Its charter reflects retreat from the ambitious objectives originally projected.

SELA is the most recent institutional embodiment of the continuing belief that regional solidarity is the best means of neutralizing the power of the United States. It was born out of dissatisfaction with the formal OAS procedures of extracting concessions from the United States. SELA was not to be defensive and oriented toward legalistic negotiations with the United States; rather, it was to coordinate concrete, market-oriented measures that would result in immediate economic advantage.

Quite apart from the false presumption that a regional organization could have a significant impact on the market, SELA's effectiveness has been limited by recent Latin American economic progress. There has been a marked acceleration in the growth rate of the regional gross product: from an average 5.3 percent annually in the period 1961-65 to an average 6.8 percent

in the period 1970-74. The impact of the recent global recession was relatively mild, and the estimated 1976 growth rate has recovered to 5.0 percent. Half the countries in the region experienced a measurable acceleration in their growth rate in the late 1960's and early 1970's; almost all the others already had growth rates above the regional average, and converged to it. Increased exports and much larger private capital flows permitted imports to rise much more rapidly at the beginning of the 1970's than they had at the beginning of the 1960's.[36] Individual countries are not nearly as defenseless as they once were. Brazil, Mexico, Venezuela, Colombia, Peru, and others have taken measures of some consequence to defend their national economic interests. The relative per capita income levels of Latin America and the United States have hardly converged, but the rapid rise of absolute product in Latin America—and all that it conveys in terms of modern administrative capacity—is a better indication of political and economic bargaining strength. This applies at the level of government-to-government negotiations as well as to accommodations with multinational enterprises. The 200-mile ocean territorial limit was pursued by individual states in Latin America, not by regional representation, and individual countries controlled foreign investment independently even of the agreed-upon Andean code.

Of course the capacity of individual Latin American countries to assert their authority varies greatly within the region. Venezuela nationalized its assets of foreign petroleum companies on favorable terms without reducing the ardor of foreign investors; a less wealthy country could not have done so. Such differences in power, economic and political, have meant that the regional focus has always had special appeal for the smaller nations of the Caribbean and Central America. This view of the inter-American system—whatever its earlier effects in checking U.S. interventionism or obtaining special favors—is now outdated. Clinging to it will not counteract the reality and advance the interests of the smaller countries, nor will U.S. encouragement speed the evolution of an appropriate subregional strategy.

C. Different Conceptions about the Role of the Private Sector. The importance of different rules and attitudes relating to the private sector to the quality of inter-American relations cannot be emphasized enough. The unabashed U.S. predilection for private sector initiative in Latin America has meant to the region that the United States lacks sympathy for and willingness to help economic development in Latin America. The succession of speeches enunciating the virtues of the free market at the inter-American conferences in the 1950's has been duly noted. As recently as 1969, when President Nixon received the Latin American ambassadors bearing the Consensus of Viña del Mar, the traditional misunderstandings ensued. *Comércio Exterior* spoke of a "dialogue of the deaf" because of

> the insistence of the Chilean Foreign Minister [Gabriel Valdés] upon the content of the document, and the reiteration, on the part of the

> President of the United States, of his position that the task of aiding the economic development of Latin America falls primarily upon private foreign investment.[37]

The old rhetoric was not empty. New policies defending U.S. private interests were soon forthcoming, including the Gonzales Amendment requiring the United States to oppose multilateral assistance to any country engaging in uncompensated expropriation, and a 1972 policy statement on expropriation that reiterated the sanctity of the U.S. view of international law.

These actions hardened previous positions and images. While U.S. spokesmen emphasize the positive contributions inherent in the transfer of capital, technology, and managerial capacity, Latin Americans,

> whatever their political allegiances may be, resent the mounting offensive of large foreign corporations . . . aimed at giving foreign private investors a special status in the capital receiving country. Objection is raised not only to giving special status to foreign nations and corporations in their disputes with sovereign states, but also to the basic implication that the interests of foreign owners should override the interests of a national state.[38]

The argument is historic and deep. Most Latin American countries hold to the absolute submission of foreign capital to national sovereignty, and require contracts with foreign investors to contain clauses denying appeal to diplomatic representation by home countries. This Calvo Doctrine, named after an Argentine jurist, dates to the nineteenth century, but has not altered the view of almost all the industrialized countries. It goes unrecognized by the United States, which bases its right of intervention upon international law that cannot be undone by private contracts to the contrary.

Along with these fundamental differences in the concepts of state sovereignty and state responsibility, there is a considerable gulf between principle and reality on both sides that introduces other elements of conflict. Latin America needs foreign investment and knows it all too well: "In a world characterized by swift scientific and technological progress, a developing country which rejected the help of foreign capital would deliberately commit itself to a state of backwardness."[39] Those countries in the region with the least direct investment have had less continuous growth. Thus bargains are struck and concessions made on the basis of pragmatism. On its part, the United States sanctifies international law, but enforces it inconsistently. Realism dominates, and compensation arrangements that deviate from market value are accepted when they appear to be the best that can be obtained. When formal diplomatic representation has occurred, it has frequently been clumsy and negative, as the IPC case in Peru in the mid-1960s demonstrates.[40]

The failure to recognize the importance of this issue has not made it less significant. Careful and detailed private sector demonstrations of the invali-

dity of Latin American arguments against foreign investment are inadequate.[41] Images and expectations are influenced by the underlying principles as well as by the facts of conduct; these continue to feed nationalistic responses in both the United States and Latin America. Failure to agree upon rules and abide by them means that sheer power plays a dominant role, with inevitable Latin American resentment at the disparities involved.

D. Limitations on U.S. Power Insufficient. A U.S. commitment to nonintervention, even if scrupulously adhered to, is an insufficient basis for an effective Latin American policy. It is too late and too little. The Good Neighbor Policy satisfied Latin American aspirations forty years ago—both because political considerations were then uppermost, and because its core consisted of a significant U.S. reversal: formal acceptance of the principle of nonintervention. Now, economic interests dominate, and much of the concern about intervention relates to private sector decisions. It is to Secretary of State Kissinger's credit that after 1974 he sought ways to give a positive cast to U.S. Latin American policy; it is unfortunate (but not surprising) that the quest was fatally flawed by continuing appeal to the "special relationship."

Such hackneyed rhetoric, although inadequate to the task and now even counterproductive, has become a substitute for policy. It no longer is convincing. Latin America has come to measure U.S. policy departures quantitatively: how much in the way of new resources is the United States prepared to place at the disposal of the region. Mutual U.S. and Latin American interests in science and technology might have inspired innovative departures in this field; however, the "new dialogue" working group foundered when it became apparent the United States was unwilling to underwrite large new grants. In recent years the sincerity of U.S. commitment has been questioned more sharply as the larger countries in the region are phased out of the economic assistance program and little is offered to replace it.

Latin America's presumed preference for regionalism in dealing with the United States, thereby conditioning U.S. policy responses, is exaggerated.[42] Regionalism is urged principally by the smaller countries, who gain by such a policy focus. In part its expression is an inaccurate statement of actual sentiment by anachronistic foreign offices accustomed to past practices, and in part Latin American insistence upon a special position has been the traditional mechanism for levering more generous resource flows from the United States, now a diminishing source.

That predisposition is progressively diminishing and need not be decisive. Globalism was rejected by Latin America during the Truman and Nixon Administrations because it focused on big power relations to the exclusion of a fundamental concern with all developing nations, not because Latin America lost its special place. The preoccupation with finding ways to emphasize Latin America's special place has mistakenly governed the recent search for a positive policy. Relations with Latin America can improve dramatically

within a context of a more forthcoming and realistic policy for the developing countries as a whole. That is the first priority. Thereafter, the design of complementary policies oriented to particular countries and subregions can be considered.

III. ECONOMIC POLICIES

Among the measures that are essential to structuring a more effective and equitable global interdependence, I shall single out three here for particular emphasis.[43] These are steps to (1) facilitate international trade, (2) clarify policies regarding private foreign investment, and (3) assure an adequate flow of capital. All involve universal rather than regional rules, and all should be pursued within the context of the North-South dialogue rather than in inter-American forums; yet they should be explicitly seen and represented as decisive steps toward better, more effective relations within the hemisphere. It is time to test the maturity of Latin America, as well as the leadership of the United States, and to do away with the rhetorical flourishes of a largely unsuccessful past.

1. INTERNATIONAL TRADE

The fundamental trade issue is neither extension of preferences nor elaboration of commodity agreements, but rather a dramatic reduction of tariff and nontariff barriers to trade. Too much has been made of the relative advantages that developing nations might secure at the expense of the developed, and too little attention has been paid to absolute gains. The World Bank has estimated that exports of the middle income countries—most of which are Latin American—could increase by $29 billion (in 1975 dollars) annually by 1985 if trade barriers were eliminated; three-fourths of the gain would be in exports of manufactures. By contrast, various estimates of the potential gain from preference schemes suggest that the gains to all developing countries would be at most $300-500 million. While some have suggested that the World Bank estimates are too optimistic, the basic point remains valid: a preference scheme hemmed in by absolute limits and quotas is less desirable than broad gauge liberalization.

Even a highly successful commodity plan that would double the real price of all the ten UNCTAD core commodities would mean increased receipts to Latin America of perhaps $3-4 billion a year (in 1975 dollars).[44] Such a dramatic change in relative prices is highly unlikely; moreover, it would result in substitution against these products, which would probably be against the long-term interests of the commodity producers. Parity pricing in the United States survived as long as it did only because the agricultural sector was clearly in decline, and resources could profitably be applied in urban activities.

Speeding a process of reallocation in developing countries which already have employment problems may be a dubious benefit, and reaching development objectives through market distortions rather than through market liberalization is the wrong route.

It is understandable that commodity issues should have been in the forefront of concern a decade ago, when developing countries with less industrialized and world market prospects seemed bleak. For Latin America especially, the intervening transformation in the composition of exports has been striking. The share of major primary exports—those representing at least one percent of total merchandise exports in the period 1970-74—fell from 61 percent of exports in 1960-64 to 52 percent in 1970-74. In addition, two new, nontraditional exports—fishmeal and soybeans—that would not have qualified as major primary exports at the beginning of the 1960's accounted for 6 percent of total exports in 1970-74. Conversely, other exports—excluding petroleum derivatives—have increased from 28 to 37 percent of total merchandise flows.[45] There is no mistaking the trend.

Commodity questions have continued to occupy center stage because the unfavorable terms of trade between raw materials and manufactures epitomize what the developing countries regard as the inherent inequity of the old economic order, while with equal firmness the industrialized countries have been unwilling to concede that the commodity markets may not function perfectly. It would be unfortunate if trend prices of raw materials monopolized attention to the exclusion of progress on other, more significant issues, distracting from possible collaboration to reduce the cyclical fluctuation of commodity prices and earnings.[46]

There are two alternative approaches: one emphasizes financial remedies; the other, more favored by developing countries, involves physical intervention through buffer stocks. While not mutually exclusive, they are quite different. Advocates of buffer stocks are more optimistic about the economies of scale of a centralized facility and about planning in general, and they place great weight on the assurance of physical supplies. Those who favor increased financial flows find virtue in decentralization and in wider use of market arrangements to forestall uncertainty.[47]

Of these two approaches, the latter seems a more immediate, general, and efficacious solution. Larger stocks of particular commodities may be advisable and indeed necessary (as in the case of an international grain reserve), but they should be the result of policies that draw their strength from market incentives. An expansion of IMF credit, which not only compensates for shortfalls in nominal export proceeds but also offsets adverse changes in the terms of trade, meets such a test. It makes resources available to dampen fluctuations without altering real trends. (Effective influence on the trend terms of trade requires fundamental reallocation decisions that go beyond commodity policy.) If more funds were made available, individual countries

would be able to invest in counter cyclical stock accumulation at the source of production. With accurate information and consultation among producers and consumers—who also hold stocks—market supply could be regularized. There would be no need to agree on uniform purchase or sales prices; consumers would be allowed to purchase from stocks at the prevailing world price. This guarantee of access to supply and the need to repay the credit assure that the policy would not lead to the formation of cartels. Such credit could be supplemented by experimentation with longer forward markets, in which contracts written by governments of developing countries might afford stabilizing speculation, and a better climate for investment decisions.

The potential advantages of this alternative to centralized buffer stocks is the ease with which it could be administered and the probable financial savings. The objective is the same. Once the questions of buffer stocks and indexation are separated, the ideological impediments to commodity agreements are less significant than the technical obstacles. A large capital is required in the first instance, and coordination of supply decisions in addition. National stocks also require resources, but their magnitude can influence medium term supply more directly.

The problem of fluctuating commodity prices can be solved. It does not warrant the attention it has received. If widespread reduction of trade barriers were achieved, "the potential benefits to the developing countries would exceed by far anything else that the international community could possibly do in the trade field."[48] Greater access to developed country markets and an expanding volume of trade will help to make the anxiety about the trend terms of trade a moot issue. Will liberalization be achieved? Certainly there is ground for skepticism in view of the apparently increasing strength of protectionist forces and the reluctance to offend domestic interests. Although objective and detailed studies suggest as a "main conclusion . . . that the United States can participate in a substandard tariff-cutting negotiation without causing adverse trade and employment effects,"[49] the United States has not been able to rally either Congressional support or much enthusiasm in the other developed countries. There seems to be a consensus that the best that can be expected is that the recovery will continue without additional restrictions. However, some recent decisions suggest that quota allocations may proliferate. The concern felt for those industries currently being harmed by imports is stronger than for those industries that might benefit in the future from freer trade. Thus the former have a stronger and more decisive voice.

Two specific measures may help to rectify that balance. One is to administer adjustment assistance that compensates for imports from developing countries as part of the appropriation for foreign economic assistance. In this way, the policy trade-off between trade and aid can be given its appropriate due; at this point, for Latin America certainly, this would be a meaningful

substitute. Such a provision would force the Congress to decide *where* the funds would best be spent rather than whether they should be spent at all; adjustment assistance would acquire an enhanced significance. The second measure is to institute a market penalty scheme to accompany whatever liberalization emerges from the Tokyo Round of multilateral negotiations. National commitments to reduce trade barriers would not be irrevocable and irreversible, but countries that decided to raise tariffs or establish other new barriers would be required to reimburse exporting countries for failure to live up to their obligations. Monetary penalties would accompany use of escape clauses. Conditional liberalization could persuade concerned domestic interests to go farther than they might, on the one hand, while also more accurately registering the real cost of greater protectionism to foreign suppliers.

Both of these measures try to deal with the fundamental problem of sustaining and extending a healthy economic interdependence. Each individual country currently follows its own narrow self-interest by deviating from liberal trade rules, but each pursuing such a policy creates a less satisfactory situation for all. Enforcement of liberal international trade rules is a delicate task for statesmanship that must be augmented by domestic material incentives if popular support within the industrial democracies is to be sustained. No doubt other schemes can be devised; the principle, however, is clear.

Another important policy measure should be taken to complement a general thrust toward trade liberalization. It would deal with the vexing problem of export subsidies. Free trade cannot long survive when practices of unfair competition flourish. The U.S. Trade Act of 1974, which required the immediate imposition of countervailing duties to cancel out subsidy practices, was a somewhat negative solution. Among those most affected have been the principal Latin American exporters to the U.S. market, such as Brazil and Mexico.

The difficult task of defining what constitutes fair compensation for internal taxes and what constitutes unfair subsidies for exports can be greatly simplified by universal acceptance of a simple rule: *uniform* subsidies would be permitted to the extent of the average level of import duties. (Rebate of indirect taxes on exports would continue to be permitted, and would be product-specific; these do not constitute subsidies.) A uniform export subsidy equal to the average tariff rate approximates free trade at an exchange rate devalued to the extent of the subsidy. Any country could devalue and compete more effectively in world markets rather than subsidize its exports. Developing countries are not guilty of running large surpluses to export unemployment. What is objectionable is their attempt to tailor individual exchange rates to individual products. Treatment for each country would differ corresponding roughly to its level of development because tariff levels differ, but the treatment would be based on market conditions.

Systematic expansion of trade opportunities, coupled with efforts to ensure orderly competition and to reduce uncertainty, should be the keystone of a policy directed to the developing countries. Latin America can be expected to gain because its potential share of world trade is large. However, even the poorest countries can benefit from directing more of their production to growing export markets, and can thus probably improve their relative position.

2. PRIVATE FOREIGN INVESTMENT

The troubled history of investment disputes in Latin America, the continuing suspicion of U.S. investors, and the importance to Latin America of the transfer of science and technology make this issue a decisive one for hemispheric relations. Previous U.S. initiatives in this matter have not always received an adequate Latin American response. Thus Secretary of State Kissinger's offer at Tlatelolco "to explore means by which (investment) disputes can be removed from the forefront of our intergovernmental relations" was no more warmly received than was the establishment of a center for the resolution of investment disputes at the World Bank.[50] Latin Americans tend to prefer formal principles to specific precedents, and they are fearful that the U.S. emphasis upon dispute procedure is a means for defending and extending U.S. private interests because it is not embodied in a larger framework defining the role of the private sector in development.

There is a persuasive case for the necessity for such a broader framework, in which it is explicitly recognized that market forces currently afford inadequate protection to developing countries. Monopoly power is the rule rather than the exception for foreign enterprises.[51] Firms rarely invest abroad without some control in the form of either import restrictions or exclusive franchise, and this is often reinforced by unique access to technical processes of production or marketing. Thus the entry of new competitors into a profitable market, which would force down the rate of return, does not take place—nor are imports from foreign competitors allowed.

Few firms have absolute market power, however. Other transnational enterprises have similar products and skills, and because these competitors are increasingly of different nationalities, the host country has more options. Moreover, as a firm makes more commitments abroad, its relative power within a country diminishes: the ardor displayed by the host country in its initial courtship of the investor is converted to a cooler, more objective evaluation of performance. In these circumstances the state has become an actor of increasing significance.

Steps can be taken to make more effective the competitive forces that now exist, and to assure that the manifest need the developing countries have for investment resources and technology does not prejudice the terms under

which they have access to them. Such measures are beyond the capacity of individual developing states because each in isolation is tempted to make exceptions that favor it—to the disadvantage of all others. The industrialized countries should participate in a collective agreement on corporate behavior because their national interests in a functioning international economic order transcend the short-run interests of their private sectors.

A first requirement is much fuller disclosure than at present concerning private investments. Enterprises with the privilege of wide-ranging international operations should be expected to report much more completely on their activities to a central international repository. Any report must include information on pricing policies and profits in the various countries in which the firms do business. Transnationals engage in intra-firm transactions that defy the "arms length" simulation of the market: at best one can have only an ex post facto reckoning. Disclosure would permit host states to take legislative action to defend their legitimate interests. Also essential are information on royalty payments and detailed descriptions of the technology for which they are made. The lack of a functioning technology market is a result not only of the heterogeneity of the transactions, but also of the absence of hard data about these transactions. Finally, information should be exchanged regularly between the tax and regulatory agencies of the industrialized countries and those in the developing countries. One standard of ethics should prevail internationally: such cooperation would provide the best warrant of the commitment of the developed nations to an honorable standard.

These measures do not usurp the national authority of individual countries by substituting an undifferentiated international policy on profit remittances, admissible royalties, import content of production, etc. Each country should retain the opportunity to influence the kind and amount of technology that is transferred and to vary the incentives that are offered. National conditions and goals differ, and any attempt to enforce uniform behavior will infringe upon the choice of development models. We must rather depend upon the freer dissemination of information and the shrewdness of host nations to negotiate terms that are satisfactory to themselves.

Complementary action—again melding national sovereignty and international authority—in the definition of property rights is also indicated. This involves a new approach to the resolution of nationalization disputes. While relatively few in number, these problems are especially prevalent in Latin America; they poison both international relations and the investment climate. U.S. government involvement is seen as the ultimate manifestation of the power to defend private interests—right or wrong. Conversely, business firms regard the likelihood of irrational nationalization as a risk factor that justifies high rates of return which are objectionable to host countries.

No simple rule will resolve all disputes because the particular circumstances in each case reflect an amalgam of economic and political consider-

ations—one of which may be a calculated desire to stimulate conflict. But the dimensions of the conflicts can be narrowed, and some disputes averted by approaching the matter within a framework of competition between the enterprise and the host state. A policy of international arbitration to resolve disputes is not sufficient: that solution is not acceptable to Latin American countries—not only on legal but also on pragmatic grounds. Such a delegation of sovereignty to an outside agency deprives them of some of their countervailing power vis-à-vis the enterprise prior to the extreme of nationalization. And subsequent to the event, the host country seeks to use diplomacy to limit the degree of involvement of the home country government.

The reluctance to accede to neutral outsiders is reinforced by a lack of consensus on a standard of asset valuation. The United States, particularly in its recent official statements, has interpreted international law as requiring compensation equivalent to the value of the firm as a going concern; on the other hand, compensation based on book value is almost universal practice in Latin America for both foreign and domestic nationalization. There can be little prospect for a mutually satisfactory settlement when the very basis of valuation is in dispute.

The impasse could be ended if an international agreement were reached on a standard of book value (adjusted for inflation). The net value of an enterprise measured in this fashion approximates the capitalized value of a stream of normal profits anticipated from investment by the firm. Book value would exceed the value as a going concern when the investment was a disappointment relative to initial expectations; it would be less when there was a realization of windfall profits. To the extent that the latter are the result of circumstances external to the firm, their social expropriation is reasonable; however, this justification for expropriation is meaningless when compensation at market value is insisted upon.[52]

Acceptance of this standard would finesse the difference in legal principles in favor of market justice. National sovereignty and international practice would coincide, making the insistence upon the Calvo Doctrine moot. A joint governmental effort could then be made to deal constructively with disputes that arise. The United States has an interest in payment of fair compensation, while a firm has a desire for *maximum* compensation. Enunciating this difference, and making clear that the U.S. government is indifferent to the diffusion of U.S. investment abroad, could provide the basis for a new, more enlightened U.S. policy on expropriation.

An agreement on a standard of book value could also have the effect of reducing the likelihood of expropriation. Book value tends to be known with a fair amount of precision, making the potential costs of compensation more certain. Governments would be in a better position to decide whether taking over an enterprise was worth it. Of course there would still be differences concerning past taxes that should be paid, claims for return of unjustified

profits because of pricing policies, etc.: a consensual standard of valuation is not a panacea. It would, however, contribute to a more rational climate for evaluating foreign property rights, and moderate the role of sheer economic power. As such it would permit Latin American and other developing countries to opt for interdependence without fear of sacrificing their internal, national goals; at the same time it would protect the rights of foreign investors to "prompt, adequate and effective compensation."

I emphasize these two policy proposals rather than a conventional appeal for more resources for an inter-American technology center, more adequate diffusion of scientific and technological information under government auspices, etc. These are important, especially in the agricultural sector, but the higher priority for Latin America is to harness more effectively the potential of private foreign capital and technology. That aspiration has been central to intergovernmental relations in the hemisphere. It is ironic that the private sector has in recent years been more innovative in its arrangements than the governments, and is likely to prove more flexible about realistic rules for international investment.

3. CAPITAL FLOWS

Few matters are of such immediate importance for Latin America as adequate flow of foreign capital. Only the unprecedented influx of capital since 1974 enabled the non-oil exporting countries of the region to adapt to the rise in petroleum prices and the world recession without even more serious effects upon their rates of growth of real product and domestic inflation. Because of the generally higher level of per capita income and improving prospects at the beginning of the 1970's, Latin America was relatively attractive to private capital. Net annual inflow between 1971 and 1973 amounted to $3.7 billion—more than ten times the private resource transfer in the period 1966-70. The principal source of the upsurge was private loans from banks. Official resources, which had provided 50 percent more funds than the private sector during 1961-65, by 1971-73 were responsible for only a third as much.[53]

This marked increase in private lending permitted recipients to avoid the political and economic complications of official bilateral flows. Commercial bank loans provided foreign exchange that could be put to immediate use, without the lead time required by official bank projects. And the prior exposure of the private banking sector virtually required it to roll over extant debt and extend more credit when it was especially needed during the global recession.

The cumulation of these large private flows is not entirely without adverse consequences. The close to $30 billion increase in private Latin American debt between 1967 and 1975 was acquired at increasingly less attractive

interest rates and for shorter terms as the period progressed. In 1974 almost half the external public debt was to mature between 1975 and 1979; the recent influx of short-term credit has caused the proportion of debt falling due in the next five years to increase further. Payments for debt service are beginning to rise.[54]

There is both a short-term and a long-term problem. In the immediate future net inflows must be sustained until export growth improves sufficiently to avert a generalized balance-of-payments crisis. Commercial banks show a natural reluctance to overextend themselves as the perceived risks increase. Their international portfolios even more than their domestic loans are quality rather than price rationed. Conservative bank examiners reinforce the banks' own natural tendencies. Moreover, if recovery strengthens in the industrialized world, credit may be diverted increasingly to domestic requirements rather than made available abroad. Pressures thus mount (as U.S. Secretary of the Treasury Simon's Manila speech to the International Monetary Fund typifies) for more stringent and deflationary policies in the developing countries to equilibrate the balance of payments. Furthermore, commercial banks themselves, rather than the international institutions, have in some instances imposed restrictive policy standards.

What is needed, both now and in the future, is a better balance between private and official lending. The oil crisis has meant a much wider range of balance-of-payments surpluses and deficits than had been customary; until trade adjustments narrow them (and liberalization will contribute to that end) the OPEC reserves must be redistributed if global trade and product growth are to be sustained. Although the surplus OPEC countries have thus far preferred to hold their resources as short-term liabilities of private institutions, financial intermediation need not stop at that point. Private banks could in turn acquire liabilities of the official banks, thereby placing more resources at their disposal. Short-term liabilities must be structured to permit finance of long-term assets.

One immediate means of alleviating the current debt problem, thereby averting the need for a far-reaching but less constructive debt moratorium, is an exchange of some portion of extant commercial bank loans for newly issued World Bank and Inter-American Development Bank bonds. This swap would not add immediately to official or private lending capacity, but it would diversify commercial bank portfolios and lessen concern about massive defaults.[55] Banks would thus be freer to play a continuing role in further expanding capital flows according to merit. The official banks in turn could renegotiate the interest rates and maturities on the outstanding debt they had acquired, and thus lessen the burden on the most vulnerable developing countries. Finally, because the average yield and maturity on such newer assets—even after renegotiation—might afford a margin of additional profit to the official banks, internal resources could subsidize loans to the poorest

countries. The essence of the arrangement is that the reallocation of developing country assets among intermediaries could strengthen the position of the commercial banks.

This proposal for an exchange of assets is not an unqualified public bail-out of private commercial bank mistakes. There are costs to the banks in the form of reduced interest rates and of the extended term of official bank liabilities; they also must include in the swap very good as well as more dubious loans. More severe penalties are inappropriate: in the absence of active private financial intermediation, the developing and developed countries alike would have experienced a much more painful real adjustment to higher oil prices—as many indeed had predicted.

As the newly acquired loans mature, official bank lending capacity will increase because their bonds issued in exchange will be of longer maturity. But if a proper long-term balance in lending to developing countries is to be achieved, the principle of private and official bank collaboration will have to go beyond this emergency swap arrangement. If oil country surpluses continue to be invested in commercial banks rather than directly allocated to official intermediaries, these private institutions will have the resources, but not the inclination or capacity, to redirect them to the deficit developing countries. New types of joint participation will be necessary. Private banks cannot assume the responsibility alone. It is not in the interest of the private banks or of the developing countries for such institutions to become the arbiters of national policies: there is a difference between dealing with nations and dealing with corporations.

The magnitude of the problem should diminish as the imbalance of global reserves is reduced in the future; then the required reallocation of funds no longer would be such a mammoth task. That still would not justify the present system in which decentralized decisions govern resource flows with minimal policy direction. Not only must the roles of the official banks expand, but within the U.S. government there must be a more coherent policy view. Private banks, the Export-Import Bank, and bilateral economic assistance cannot all remain uncoordinated if the financial flows are to have their maximum beneficial effect.

I have deliberately emphasized policies facilitating continuing private and multilateral official loans, and not more generous economic bilateral assistance. Indeed for the majority of countries in Latin America the issue is more one of assured access to capital markets than interest cost or assistance in project preparation. Aid has already been phased out in a number of countries, and it should be ended for almost all the others on a predetermined, gradual schedule. Only a handful of countries in the region have low average per capita incomes. The question for consideration here is how to build upon the bilateral ties previously established to assure that the transition to a new relationship does not impede the process of economic development in the region.

Strengthening the capacity of the U.S. government to respond to requests for technical assistance that are largely paid for by Latin American countries, and assuring high quality services at reasonable cost, is highly desirable. So is an orderly phasing out of aid which would permit a period of shared expense for such services rather than an abrupt change in economic assistance. This would enable the United States to continue to participate constructively in the development process. With closer coordination, the multilateral lending authorities would be able to participate jointly in promising projects, and thus permit the transition to occur without unintended negative effects upon the inflow of resources.

Ultimately, Latin America will judge the sincerity of U.S. policy in phasing out conventional bilateral assistance by its other policies to facilitate economic development. Terminating aid with little or no change in the present U.S. posture will undoubtedly lead to a negative reaction in Latin America, while termination of the kind described here can–quite to the contrary–have a very positive effect. In Latin America it could be viewed as the modern equivalent of a Good Neighbor Policy of withdrawal and commitment to nonintervention–but with augmented economic opportunity. In the United States it could prove that foreign assistance is not a wasteful dole, but a meaningful policy instrument designed for particular circumstances. Proving such a point might increase Congressional support for the freer trade, increased capital for official banks, and the other policies now important and appropriate to Latin America's stage of development.

IV. GLOBAL INTERDEPENDENCE AND THE SPECIAL RELATIONSHIP

The combination of policy initiatives outlined here could make the pursuit of global economic interdependence a real rather than merely a rhetorical objective. It would also provide a basis for a coherent Latin American policy. The larger Latin American countries would benefit disproportionately because their more advanced and flexible economies would permit them to adapt to favorable opportunities more readily. Even without special treatment for these countries, there can be special consequences–and a special warmth in hemispheric relations. Consultation can occur not as a forced substitute for a regional policy, but as a natural inclination among mature, respectful neighbors.

The distinction between special relationship and special consequences is critical to the appreciation of the policy thrust advocated here. *Business Latin America* confused the two when it commented critically upon the second Linowitz Commission Report's rejection of the special relationship: "Sweeping the region into the gray area occupied by the Third World is not a creative

response . . . A report on Latin America that does not try to think through the proper approach, falls short of the challenge."[56]

To the contrary, that report (as I understand it) and more explicitly this essay advocate an approach that devotes special attention to the fragility of development in Latin America. The principal U.S. interests are not ignored, but indeed are given great weight. U.S. private investment in Latin America will have a more certain and positive environment if the policies advocated here are followed. U.S. exports to Latin America and imports from the region will increase relative to other areas. Opportunities for bilateral, mutually beneficial arrangements for assuring continuing investment in natural resources through public collaboration can flourish in a climate in which Latin America no longer feels exploited. Many of the principal Latin American countries can be enlisted more effectively in support of such a policy than in support of the more extreme demands pressed by others in the Third World. Special interests—and they exist in this region far more than they do in other developing areas—can be served more effectively in an explicit global economic policy context that reinforces respect for Latin American sovereignty and attainment.

This approach does not exclude the design of complementary economic policies that are specially tailored to individual countries and to more homogeneous subregional units. An obvious example requiring particular attention is the Caribbean, where demographic pressures spill over into mounting social tensions and illegal migration to the United States. Another is Central America, in which new indigenous impulses for economic integration may warrant favorable responses. The global emphasis stressed here should be seen as increasing options, not limiting them. It frees the United States from the constraints of present inter-American institutions that give disproportionate weight to the smaller, less economically significant countries of the region. Foreign economic policy realities and stated priorities do not correspond; that, paradoxically, is why the regional focus has been incapable of providing a basis for a Latin American policy that gives adequate attention to the area.

But the smaller and poorer Latin American countries will not suffer economically from this global view and become alienated. Apart from their claims through association in subregional units, many individual nations will command continuing bilateral assistance during an orderly phase-out. They will obtain badly needed technical assistance for the design of projects to attract official bank inflows; they will retain privileged access to regional financial institutions like the IDB and Caribbean Development Bank; they will gain from the publicity of the activities of transnationals, against which they now lack much leverage; and they will benefit from greater security against fluctuation in their less diversified export proceeds. A more certain and expanding world market will provide for these smaller countries the only viable means of sustained economic advance.

It is time to cease searching for stopgaps that pretend to do something for Latin America in the context of the present regional structure. Instead, the United States and Latin America should turn their joint energies outward from the hemisphere. That will mean that we recognize the limitations of prescribing a particular development model for the region that is to our liking. In a combination of idealism and self-interest, the Alliance for Progress sought to address the problem of the millions of wretched poor in Latin America, and the dramatic inequalities of property and income. That serious problem must ultimately be left to Latin America however; we in the United States cannot shape and control hemispheric social change.

Does this restraint apply to a minimally acceptable standard of human rights as well? That question is particularly relevant for the region, and is intimately related to economic policy, since Congressional dissatisfaction has seized upon bilateral economic assistance and multilateral official loans as punitive instruments. It is a complex matter that brief discussion cannot do justice to, yet an analysis of hemispheric economic policy cannot wholly evade it.

Reconciling a principled U.S. stand in favor of basic rights with noninterventionism is essential: Latin America has had ample and unhappy experience with the imposition of North American idealism and values. It is a difficult but necessary task. Beyond the reflection of moral preferences and independent of its domestic significance, the human rights issue is of practical foreign policy relevance: sooner or later most repressive regimes run their course, and long-term U.S. interests are ill-served by passive acquiescence in their assaults upon human dignity.

That means that, despite the sometimes contrary inclinations of private commercial interests, there is the need to articulate human rights concerns not as an isolated concern, but as one of major importance. The tone and substance of foreign relations can be influenced by this concern without disregard for other security and commercial interests. Indeed it is essential, if it is to be credible, that human rights not be stressed as an exclusive focus. U.S. dissatisfaction can and should be expressed through bilateral reductions or elimination of military assistance, and possibly—in more extreme circumstances—economic assistance. These are programs in direct control of the United States and subject to political criteria, one of which is the human rights comportment of regimes. The level of assistance signals official attitudes and influences private responses.

Political action in multilateral economic institutions, however, is objectionable unless and until those agencies explicitly change their rules. The United States does not underwrite all of the public resources allocated by them, and those funds in turn are only a fraction of what is being lent—the private capital market is the principal source. Opening these institutions to national political criteria at our insistence raises vexing problems and prece-

dents. Quite apart from slowing the required expansion of the role of the official banks, it may increase resistance in some developing countries to the current World Bank emphasis upon ameliorating income distribution, and thereby the extension of economic participation. That objective, too, is not without priority.

The question of the legitimacy of intervention and economic coercion in the enforcement of human rights has parallels in the enforcement of property rights. A similar resolution suggests itself. International agreement upon clearly enunciated and minimal standards to be guaranteed by all countries in the hemisphere can make moot the preoccupation with national sovereignty. Many would argue that there is abundant authority already, but there is much to be said for a new consensual declaration in the hemisphere that guarantees access by inter-American and United Nations human rights commissions to all countries on a regular basis. Such a diplomatic course commends itself, and puts to the test the extent of a Western Hemisphere community. The recent OAS meeting in Grenada is a promising start.

The distinction between persuasive advocacy and coercion has not always been an easy one for the United States within the hemisphere. The promotion of an international economic environment such as that advocated here can help to contribute to a cooperative rather than interventionist interpretation. That outcome would mark a beginning, at last, of relations among mature neighbors.

NOTES

1. For a still enlightening survey, see Arthur P. Whitaker, *The Western Hemisphere Idea: Its Rise and Decline* (Ithaca, N.Y., 1954).

2. *Ibid.*, p. 83; quoting S. O. Thacker, a member of a recently returned commercial mission to Latin America, in 1886.

3. *Ibid.*, p. 100; quoting Theodore Roosevelt's first statement of the doctrine in 1904.

4. United Nations, Department of Economic and Social Affairs, *Foreign Capital in Latin America* (New York, 1955); *Historical Statistics of the United States, Colonial Times to 1970*, Part II, pp. 858-72.

5. Pan American Union, *The Foreign Trade of Latin America Since 1913* (Washington, 1952); *Historical Statistics*, pp. 903-7.

6. Gordon Connell-Smith, *The Inter-American System* (London, 1966), p. 69; quoting S. G. Inman, *Building an Inter-American Neighborhood*, p. 9.

7. Dick Steward, *Trade and Hemisphere: The Good Neighbor Policy and Reciprocal Trade* (Columbia, Mo., 1975).

8. Calculated from Export-Import Bank of Washington, *First Semi-Annual Report to Congress for the Period July-December 1945*, Appendix D.

9. Laurence Duggan, *The Americas* (New York, 1949), p. 74.

10. Gordon Connell-Smith, *The United States and Latin America* (New York, 1974), p. 179.

11. Calculated from Export-Import Bank, *First Semi-Annual Report*, Appendix D.

12. Whitaker, p. 148; quoting Rockefeller's introduction to the plan.

13. See footnote 5 above.

14. Connell-Smith, *The United States and Latin America,* p. 190.

15. *Ibid.,* p. 199.

16. Export-Import Bank, *First Semi-Annual Report; Third Semi-Annual Report.*

17. "The revolution against the Western Hemisphere idea has been discussed at length because the revisionists' victory over it was definitive. Subsequent developments have made it increasingly unlikely that the issue will be reopened" (Whitaker, p. 166).

18. Assistant Secretary of State Roy Rubottam; quoted in William D. Rogers, *The Twilight Struggle* (New York, 1967), p. 15.

19. *Historical Statistics,* pp. 872-75.

20. See (for their own merit and for other references) Abraham F. Lowenthal, " 'Liberal,' 'Radical,' and 'Bureaucratic' Perspectives on U.S. Latin American Policy: The Alliance for Progress in Retrospect," in *Latin America and the United States: The Changing Political Realities,* eds. Julio Cotler and Richard R. Fagen (Stanford, 1974); and Arthur Schlesinger, Jr., "The Alliance for Progress: A Retrospective," in *Latin America: The Search for a New International Role,* eds. Ronald G. Hellman and H. Jon Rosenbaum (New York, 1975).

21. "Economic Relations Between Latin America and the United States: Some Implications and Perspectives," in *Latin America and the United States,* eds. Cotler and Fagen, p. 104.

22. *Historical Statistics,* pp. 858-72; *Statistical Abstract 1976,* pp. 828-29.

23. Because of the large increase in the value and volume of petroleum imports into Latin America between 1970 and 1975, some reduction of the U.S. market share would have been inevitable: the percentage of the industrialized countries as a whole declined. But within that group the United States lost out to Japan, although it held its own with Europe. The resort to other suppliers was most pronounced in the early 1970's, when the U.S. share of industrialized country imports fell to 45 percent, after having been more than half. Subsequently, the U.S. share rose, partially because it was an exporter of agricultural products—unlike the other industrialized countries.

24. Organization for Economic Cooperation and Development, *Stock of Private Investments by DAC Countries in Developing Countries, End 1967* (Paris, 1972).

25. Italics mine. The Consensus is reprinted in a collection of documents: *Inter-American Relations,* U.S. House Committee on Foreign Affairs, 93rd Cong., 1st sess. 1973-74. The quote, which illustrates the continuing focus on broad international issues, is on p. 264.

26. The Charter is reprinted in several places, including Martin C. Needler, *The United States and the Latin American Revolution* (Boston, 1972), pp. 127-43.

27. Brazil's share of LAFTA intra-regional exports has increased from 16 percent in 1962-64 to 25 percent a decade later—the largest gain for any of the larger countries. Its intra-regional imports as a share of its total imports halved, while those of Bolivia, Paraguay, and Uruguay all sharply increased, reflecting their closer economic integration with Brazil. For the statistics, see Inter-American Development Bank, *Economic and Social Progress in Latin America, 1975,* pp. 101-4.

28. Edward S. Mason, *Foreign Aid and Foreign Policy* (New York, 1964), p. 102.

29. Lowenthal, "Perspectives," in *Latin America and the United States,* eds. Cotler and Fagen, p. 232.

30. Mason, *Foreign Aid,* p. 89.

31. Subcommittee on Inter-American Economic Relationships, Joint Economic Committee, 88th Cong., 2nd sess., 1964, *Private Investment in Latin America,* pp. 1, 11.

32. Reprinted in Needler, p. 155.

33. This interpretation sharply diverges from that of Ben Stephansky, who sees disinterest in the Consensus by the Nixon Administration as a turning away from Latin America at a critical juncture (" 'New Dialogue' on Latin America: The Cost of Policy Neglect," in Latin America, eds. Hellman and Rosenbaum, pp. 153-66). Stephansky understates the attraction to Latin America of devoting its energies and interests to the larger North-South dialogue quite independent of U.S. response; he also presumes a shared set of interests within the hemisphere, but does not examine them critically.

34. Quoted in Luigi R. Einaudi, "U.S. Latin American Policy in the 1970's: New Form of Control," in *Latin America and the United States,* eds. Cotler and Fagen, p. 246.

35. Organization of American States, CIAP, *United States Economic Cooperation with Latin America* (July 1974), p. xv.

36. These rates have been calculated from the 1975 *Annual Report of the Inter-American Development Bank,* p. 7, and CEPAL, Notas sobre la Economía y el Desarrollo de América Latina, No. 230, December 1976.

37. *Comércio Exterior,* July 1969, p. 421. Translation mine.

38. Miguel S. Wionczek, "A Latin American View" in *How Latin America Views the U.S. Investor,* ed. Raymond Vernon (New York, 1966), pp. 14-15.

39. Enrique Garcia Vazquez, "An Argentine View" in *ibid.,* p. 55.

40. For two useful accounts of the IPC case, see Richard N. Goodwin, "Letter from Peru," *The New Yorker* (May 17, 1969): 41-108, and George M. Ingram, *Expropriation of U.S. Property in South America* (New York, 1974), ch. 2. Jessica P. Einhorn, *Expropriation Politics* (Lexington, Mass., 1974), is a valuable supplement focusing on the bureaucratic politics of the U.S. response to the expropriation.

41. The Council for the Americas has been prominent in sponsoring studies designed to clarify misconceptions about foreign investment in the region. Herbert K. May, *The Effects of United States and Other Foreign Investment in Latin America* (New York, 1970), is one such product. For a useful summary, see John M. Hunter and James W. Foley, *Economic Problems of Latin America* (Boston, 1975), pp. 203-14.

42. In his Caracas speech of February 1976, Kissinger alluded to the Latin American concern that the United States was about to abandon regionalism in favor of bilateralism or globalism, but he ended by reiterating the virtues of regionalism: "Therefore the United States remains committed to our common pledge at Tlatelolco to seek 'a new vigorous spirit of inter-American solidarity' " (U.S. Department of State, *Major Statements on Latin America* [Publication 8848, March 1976], p. 6).

43. A more detailed discussion of proposed global policies, as well as a more direct analysis of the North-South dialogue, can be found in my "A New International Order: What Kind?," 1980's Project, Council on Foreign Relations (forthcoming).

44. The data on the impact of freer trade are from Robert McNamara's 1976 *Address to Board of Governors,* p. 21. The calculation of potential gains from the increased price of the UNCTAD core commodities involves the calculation of regional net exports in 1970-73 ($2.2 billion), their conversion to 1975 dollars, and a projection of growth at 2 percent–the trend in Latin American real commodity exports in the 1960's–annually to 1985; this is quite likely a generous estimate, since increased income in Latin America may well require more offsetting imports. The data are from UNCTAD document TD/B/C.1/196/Add.1.

45. This information can be found in the 1975 IDB *Annual Report,* p. 54.

46. Recently, the presumed negative effect that fluctuations in export earnings have upon product growth has been challenged, and a possible positive impact suggested. More appropriate tests of that hypothesis suggest that the observed (small) simple correlation between export fluctuations and product growth comes about because of exclusion of other relevant variables (such as the percentage of product exported), as

well as because capital inflow—not internal reallocation—has succeeded in dampening the adverse effect. For the revisionist view see Oden Knudsen and Andrew Parnes, *Trade Instability and Economic Development* (Lexington, Mass., 1975), and Pan A. Yotopaulos and Jeffrey B. Nugent, *Economics of Development* (New York, 1976), ch. 18.

47. The issue of a common fund to finance a variety of commodity agreements is a related, but separate matter. Its rationale turns on the advantages of diversification and of sheer size. If prices of commodities are negatively correlated, savings can be attained because sales of one product generate resources for the purchases required of another. UNCTAD itself presents only limited evidence in favor of such favorable co-variation, and tends to base its case on the greater access to loan finance the aggregate facility would permit.

48. McNamara, p. 21.

49. Robert E. Baldwin, "Trade and Employment Effects in the United States of Multilateral Tariff Reduction," *American Economic Review* (May 1976): 148.

50. Kissinger's Tlatelolco offer "to establish agreed machinery which might narrow the scope of disputes" was reflected in the final declaration as follows: "The Foreign Ministers of Latin America have taken due note and will continue to examine the suggestion advanced by the Secretary of State of the United States of America with respect to controversies that may arise from matters involving private foreign investment" (U.S. Department of State, *The Inter-American Relationship* [Publication 8770, June 1974], pp. 9, 13).

51. For a useful, far-ranging discussion of the characteristics of the multinational enterprise and its implications for conventional economic analysis, see John H. Dunning, ed., *Economic Analysis and the Multinational Enterprise* (London, 1974).

52. The adjustment for inflation is necessary if historical cost is to retain any meaning. Its specific form must also assure—if the books are kept in local currency—that the exchange rate used for compensation is adjusted to reflect relative price inflation internally and internationally. On the other hand, it would complicate matters unduly, and introduce new elements, if one attempted to achieve inflation neutrality by correcting for the composition of assets and liabilities, as well as the particulars of the tax structure that may impose a tax on inflationary capital gains. Many countries, for example, permit the revaluation of assets, but at a tax cost. Something must be left to private risk.

The fact that many countries already provide for inflation adjustment should make the principle acceptable, although the specific form may be a subject for discussion.

53. For data on the capital flow, see the 1976 *Economic and Social Progress of Latin America* of the IDB, pp. 85-94.

54. *Ibid.*, pp. 94-100.

55. The direct private bank component of Latin American external public debt probably now amounts to more than $20 billion. For the developing countries as a whole, for whom the scheme is equally relevant, it amounts to perhaps twice as much. The absolute cumulative size of World Bank loans is only around $30 billion, and those of the Inter-American Development Bank, about $10 billion. Thus only a proportion—about one-fourth—of the commercial bank loans can be comfortably absorbed. That would still be sufficient to relieve the current pressures without swamping the official banks. To ensure that a representative mix of loans would be offered, and not merely the most marginal, one might have the commercial banks select some part of its portfolio for exchange, and the official banks the residual. The relative proportions would have to be a matter of determination by the institutions.

56. *Business Latin America*, December 21, 1976, headlines its reservation: "Why Global Context Not Good for LA or US," p. 402. The second Linowitz Commission Report, *The United States and Latin America: Next Steps*, is published by the Center for Inter-American Relations, New York.

Chapter 3

BRITAIN'S ECONOMIC RELATIONS WITH LATIN AMERICA

LAURENCE WHITEHEAD

(a) HISTORICAL BACKGROUND

Traditionally, it has been during periods of European war that trade with the Americas has acquired its greatest significance for the British economy. Its island location sheltered Britain's producers from the ravages of European invasion and stimulated its drive for the naval supremacy which gave Britain privileged access to the raw materials of the Americas in the 19th century. However, during the long intervals of European peace, British traders were more concerned with the large and sophisticated markets nearer to their shores, and could feel more confidence in the security of their supply routes to their imperial possessions in Africa and Asia. Curiously enough, therefore, British exports to Latin America reached their highest level (as a proportion of total British exports) in the first year of legalized trade, 1808, when they amounted to about 16 percent of the total. By the end of the Napoleonic Wars, the proportion had fallen below 10 percent, and there it remained (apart from a brief speculative upsurge at the moment of Latin American independence, 1824/5) virtually throughout the 19th century. In his recent survey of British trade with Latin America in the 19th century Professor Platt (1972:29) has highlighted its limitations.[1]

> In the first years, then, of the British trading connection with Latin America, and again briefly in the mid-'20s when trade with Europe seemed relatively stagnant and British investments in Latin America were passing through a spectacular speculative boom, Latin America looked as if it might become a valuable addition to Britain's markets. But it was at this point that the limitations of such a market re-asserted themselves. Brazil continued to offer a generous outlet to British cotton manufacturers; she was in many respects the perfect market for cotton goods, with a warm climate, a comparatively large population, marketable commodities such as cotton, sugar and coffee to provide a return

trade, and no trace of a competing local cotton textile industry. Brazil supported and inflated the total for British exports to Latin America in the first half of the nineteenth century much as did Argentina for British exports after 1880.

Even in the case of Brazil, however, British policy did not concede Latin America a particularly large share of Britain's growing market for the importation of raw materials. According to Professor Platt:

> Preferential duties in favour of British Possessions made it almost impossible for two of the main export products of Latin America, sugar and coffee, to enter the British home market; the sugar duties lasted until 1854, the coffee duties until 1851. The development of British exports to Brazil was checked by Britain's failure to offer any kind of a market for Brazilian sugar and coffee, and ultimately a large share of the export trade passed to those countries which could take Brazil's products in exchange. (Platt, 1972:37)

The British national beverage became tea from India, rather than coffee from Brazil.

However, although British-Latin American trade was of limited importance to Great Britain during most of the 19th century, it was of considerable significance for the economies of many of the fledgling republics. Professor Glade (1969:204) has quoted some early examples:

> Peruvian exports of wool to England began on a regular basis with a shipment of 5,700 pounds net weight in 1834; by 1846/56 an annual average of 1.5 million pounds net weight was being exported. In the 1815/20 period, two or three ships sufficed to handle the annual trade between Chile and Great Britain; by 1847, over 300 ships on this route carried such export products as copper ore, guano, wool and nitrate of soda.

(Indeed the application of South American fertilizers produced important effects on British agriculture in the mid-19th century.) In exchange Britain initially supplied mainly textiles to Latin America, followed by shipping services, insurance and credit facilities, all of which tended to promote increased Latin American involvement in international trade. From 1870 onward British exports to the complementary Southern cone republics (Argentina, Chile, and Uruguay) exceeded the value of British sales to Brazil and transport equipment soon displaced textiles as the largest category of exports to Latin America. In particular British-built railways proliferated revolutionizing the structure of transport costs in the republics and intensifying the international division of labour.

> Latin America, from its status as a slow consumer of British textiles, had become a substantial, expanding market for every kind of manufactured product, iron and steel as well as cloth, and for British coal to

TABLE 3.1

UK Merchandise Trade Account with 20 Latin American Republics

	(£m rounded) UK Exports and Re-exports	UK Imports	Trade Balance
1870/9	211	234	– 24
1880/9	225	175	+ 50
1890/9	240	194	+ 46
1900/9	340	430	– 90
1910/19	450	880	– 430
1920/9	700	1,260	– 560
1930/9	350	800	– 450
1940/9	540	1,540	–1,000
1950/9	1,360	2,690	–1,330
1960/9	1,760	3,030	–1,270
1970/5	2,000	2,080	– 80

Sources: B.R. Mitchell *Abstract of British Historical Statistics* (Cambridge 1962). Central Statistical Office *Annual Abstract of Statistics* (HMSO - various years). Bank of London and South America *Review* June 1976.

drive the railways, the mills and the shipping which visited Latin American ports. (Platt, 1972: 72)

In fact the late 19th century was Britain's sole period of significant surplus on merchandise trade account with Latin America (see Table 3.1). From the beginning of the 20th century, and particularly as a consequence of the two World Wars, Britain's need to import foodstuffs, minerals, and subsequently petroleum products increased her demand for Latin America's exportable surplus. On the other hand, the goods that Britain had to offer in exchange became less attractive to Latin American buyers. These trends were already apparent before World War I, by which time the United States had easily displaced Britain as the leading political and economic influence among the countries of the Caribbean.[2] Even in South America, where British exports between 1900 and 1904 were still worth more than those of the U.S.A. and Germany combined, the Board of Trade was alarmed at the rate of growth over a ten-year period: 35.1 percent for German exports, 25.3 percent for those of the U.S.A., but only 2.0 percent for British products, and the discrepancy was even more marked in relation to Britain's best market, Argentina (Board of Trade, 1906: 5).

During World War I, British producers were naturally unable to supply their Latin American customers as they had done in the past, and in the interwar period they failed to recapture lost markets. Not surprisingly, British exports to Latin America reached their nadir in 1944, at only one-twelfth the value of British imports from that war-free continent. Table 3.2 is based on the findings of a Board of Trade Mission sent to the Caribbean in 1952 to examine the prospects for reestablishment of British exports to the hard

TABLE 3.2
Percent of Total Imports Supplied by the United Kingdom

	1913	1921	1927	1937	1950	1973
Argentina	31	23	20	21	12	4.7
Colombia	22	24	15	17	5	4.0
Cuba	11	5	5	5	2	3.6*
Mexico	13	9	6	6	3	2.3
Venezuela	27	19	12	9	7	3.7

* Britain supplied 14.7 percent of Cuba's imports from nonsocialist sources.
Sources: Board of Trade *Markets in the Caribbean* (London, HMSO, 1953), pp. 7-8, supplemented from Department of Trade *Trade with Latin America* (London, September 1975), p. 1 (b). Figures for Argentina computed from Carlos F. Diaz-Alejandro *Essays on the Economic History of the Argentine Republic* (Yale UP, 1970), appendix table 51.

currency markets of that zone. The report was fairly hopeful, but the figures that have been added for 1973 show that in fact the market shares Britain had lost were not regained. The table also contains comparable figures that have been calculated for Argentina, and that indicate that Britain's declining market share was most marked in the case of her 'best' customer.

Latin America has not, of course, been a particularly dynamic market for any of its suppliers since 1950. Exempted by the Atlantic from wartime devastation, it was responsible for more than 10 percent of world trade in the 1940s, but its share has fallen to little more than 4 percent over the past few years. In line with this trend, Britain's sales to Latin America fell from 7.5 percent of British visible exports in 1950 to around only 3.5 percent in the early 1970s. (By comparison, it now absorbs around 15 percent of U.S. exports; 8 percent of Japanese exports and even 4 percent of the exports of West Germany and Italy.)

In summary, during the 19th century Britain was a very important supplier for Latin America, even though Latin America was not normally a particularly important market for British goods. By the 1970s, however, Britain was no more than a marginal supplier to any Latin American economy (she supplied only 4 percent of the region's imports), and the Latin American market was of less importance to British exporters than it had been for over a century and a half. Over half of this modest flow of goods consists of machinery and transport equipment.

Latin America's exports to the United Kingdom retained their importance for a considerable period after the displacement of British exports had gathered momentum. This is reflected in Britain's yawning trade deficits recorded in Table 3.1. Over the six decades from 1910 to 1969 the United Kingdom almost habitually imported from Latin America merchandise worth twice the value of her exports. During the food scarcities of the 1940s over a fifth of Britain's reduced import capacity was earmarked for shipments of

meat and grain, commodities for which Argentina was often the largest single overseas supplier. Latin America's primary exports continued to represent a fairly significant source of supplies for Britain in the 1950s, although petroleum, mineral exports, and tropical foodstuffs tended to displace temperate products. In 1968, Venezuela finally displaced Argentina as Britain's most important Latin American supplier, ending an unbroken Argentine preeminence that dated back to 1892. By 1975 (largely as a consequence of an EEC ban on beef imports), Argentina had slipped back to fourth place among Britain's Latin American suppliers; it had been overtaken by Brazil, Venezuela, and even Chile. By this time, however, Latin America's contribution to British imports had fallen even lower than the region's share of British exports. Supplying only 2.6 percent of the goods Britain purchased overseas in 1975, Latin America had become a less significant trading partner than at any date since 1800. Furthermore, Venezuela provided over a quarter of the goods purchased by Britain from Latin America in 1975—largely shipments of petroleum, a commodity in which Britain will be self-sufficient by the end of the decade. In the 1970s, as a prospective oil producer and member of the EEC, Britain seems on the verge of eliminating a trade deficit with Latin America that dates back to the turn of the century. The deficit is being eliminated at a time when commercial interchange between the two areas has fallen as a share of each side's trade to the lowest level since the days of Iberian mercantilism.

(b) CURRENT PROSPECTS: THE BRITISH MARKET

This section is mainly concerned with prospective British demand for Latin American goods. Invisibles are omitted since British purchases of Latin American services are very small and seem unlikely to increase, and Latin America (as opposed to the ex-British territories of the Caribbean) seems unlikely to attract a substantial volume of British tourism for the foreseeable future. However, before discussing British *demand,* some brief consideration of Latin America's prospective *supply* of exportables is required.

Table 3.3 shows that over the past quarter century there has been a continuous fall in Latin America's share of world exports. (In fact Latin America's share has declined even more rapidly than that of Britain. As a consequence, since 1955 Britain alone has regularly exported more than all the Latin American republics combined, a contrast all the more significant since Latin America's population was only three times that of the United Kingdom in 1950, but almost six times larger in 1975.) It is true that Latin America's share declined most precipitously up to the mid-1960s, and it has shown signs of stabilizing since then (whereas the erosion of the U.K.'s position seems to have speeded up after 1965). Nevertheless in the mid-1970s there seem no very compelling reasons to expect an increase in Latin America's supply of

TABLE 3.3
Percent Share of World Exports f.o.b.

	1950	1955	1960	1965	1970	1975
United Kingdom	11.2	10.1	9.3	8.3	6.9	5.5
Latin America	10.7	8.6	6.9	6.1	4.9	4.5

Source: Computed from IMF *International Financial Statistics*. "World exports" excludes Eastern Europe and China. "Latin American Exports" includes intra-LAFTA transactions but Cuban exports have been excluded throughout.

exportables sufficient to increase its share of world trade in the near future.[3] In fact the most remarkable fact to emerge from Table 3.3 is that between 1970 and 1975 Latin America's share of world exports fell yet again, despite the accompanying sharp improvement in the region's overall terms of trade. It should not be forgotten that petroleum products accounted for 23 percent of the value of Latin American exports in 1970 and, given the intervening price rises, the proportion must have been higher in 1975.

It seems doubtful whether, over the next few years, any other major Latin American export product will secure an increase in price remotely comparable to that obtained by OPEC,[4] and it seems improbable that the value of Latin American petroleum exports will again surge upward as it did between 1973 and 1974. If these assumptions are correct, then only by very rapidly increasing the volume of her nonoil exports can Latin America hope to improve her share of world trade over the next decade. There are few grounds for supposing that this will occur in the case of such commodities as coffee and sugar, which between them accounted for 28 percent of Latin America's exports in 1970. In the case of nonferrous metals, a substantial expansion in exportable volume can be fairly confidently predicted, but this will only be sufficient to maintain the region's share of the world mineral trade.

In the field of primary exports (90 percent of Latin America's total exports in 1970 and almost as much in 1975) there are some special situations that may have a very bright future—iron ore and soya beans, for example. But the belief that Latin America can in the near future reverse the long term decline in her share of world markets rests heavily on expectations of a breakthrough in manufacturing exports, following the precedents established by Japan, South Korea, etc. during an era of cheap primary inputs. In the main, it seems clear that the governments of the industrialized countries of the region will now make strenuous efforts to promote this type of export expansion. Whether the result will be a spectacular increase in the volume and a shift in the composition of Latin America's exports is not the subject of this paper. It must suffice to warn against assuming too rigidly that the long run erosion of Latin America's export share is finally on the point of being reversed.

Even if Latin America's exportable surplus grows at the pace of the most optimistic official projections, the proportion sent to the UK market seems certain to decline still further. Britain will soon reach self-sufficiency in energy, and her imports of oil from Latin America must accordingly be expected to fall, although they will not be eliminated entirely since Venezuelan supplies include very heavy crude oil, which the U.K. will continue to import at the same time as it exports part of its (high grade) North Sea production. In addition the U.K. will increasingly depend for its imports of beef and sugar on the supplies provided by West European agriculture, whatever the cost advantages commanded by Latin American producers.

In 1973 the Central Office of Information expressed the official British response to Latin American concern about U.K. membership in the European Economic Community:

> At least in the short-term, some adverse effects on trade with Latin America have been anticipated, particularly in the case of certain important export commodities, although a considerable portion of exports from Latin America will remain largely unaffected. Generally the new relationship has been seen as advantageous in the long term. An expanding and increasingly closely associated Western Europe, providing a stable and prosperous market for Latin American products, could be beneficial for the developing countries. Britain's traditionally outward-looking and liberal trade policies could make a valuable contribution to the Community's policies outside Europe. (Britain and Latin America, 1973: 27.)[5]

Hard on the heels of this comforting assurance, however, came the Community's 1974 ban on all beef imports from Latin America. The promise of an "expanding and increasingly close associated Western Europe" seemed equally likely to be fulfilled in reverse, and by October 1975 the *Financial Times* of London ran a pessimistic article on Latin America's export prospects aptly entitled "Swapping platitudes for trade." Although the EEC entered into formal trade arrangements with Argentina in 1971, and with Uruguay and Brazil in 1973, the proportion of EEC imports supplied by Latin America fell from 3.5 percent in 1971 to 2.8 percent in 1975.

As a result of Britain's accession to the European Community, there has been a significant diversion of her trade away from Latin America. Before the 1974 ban on beef sales Argentina was selling around 60 percent of its beef exports to the EEC (particularly to the U.K.), and the much weaker economy of Uruguay was even more dependent on the European outlet for its livestock and dairy products. British representatives within the EEC have spoken against the ban and pointed out that the British consumer was reacting to the higher European prices for animal products by reducing per capita consumption. Although two years have elapsed since the ban, only limited concessions have so far been granted, and the European farming lobby seems strong

enough to protect the EEC market from more efficient Latin American competition, even though U.K. consumers will also suffer.

Prospects for Brazilian exports of soya beans to the U.K. and Western Europe may also be adversely affected by EEC protectionism. In this case, the Common Agricultural Policy gave rise to a large surplus of skimmed milk powder in Europe. To diminish its stockpile the EEC has decided to require European farmers to incorporate 400,000 tons into their animal feed. European demand for soya imports may accordingly be diminished and there is reason to fear continuing efforts by the European farming lobby to secure subsidies for their own high cost animal feed at the expense of Latin America's more than competitive soya bean and fishmeal exporters. The U.K. is also one of the world's leading importers of cane sugar, and British membership of the EEC will also probably have the effect of shifting British consumption toward European beet sugar and away from the cane sold by LDCs. It is true that under the Lomé Convention of February 1975 a certain tonnage of EEC sugar consumption is guaranteed to cane producers at a specified minimum price. However, this concession is reserved for the so-called ACP (African, Caribbean and Pacific) territories that supplied European markets in colonial days. Such sugar sales as the Latin American republics make to the U.K. will continue to go through the marginal (and therefore relatively volatile) free market. Here too, EEC policies are likely to stimulate beet sugar production, regardless of comparative advantage. If so, they will indirectly worsen the market prospects for what remains an important Latin American export. Sugar cane still occupies third place, after oil and coffee, among Latin America's commodity exports.[6]

It is hard to find much comfort from the EEC for Latin American primary exporters, although the outlook for minerals is better than the prospects for agricultural products. The U.K. was traditionally one of the largest and most open markets for the sale of such commodities, but it had already greatly declined in importance before its accession to the EEC, and its place has now been taken by Japan in particular. It seems that EEC membership can only worsen the prospects for Latin America's primary exports to the U.K. but defenders of the Community would argue that the contrary is true for the export of manufactures. The EEC's Generalized System of Preferences (G.S.P.) grants *all* LDCs duty-free access to the whole Community market for industrial products up to certain limits that are stipulated for each product. These limits are supposed to be set well above the existing level of sales. In principle, the Latin American republics should be particularly well-placed to take advantage of this concession, since they have a disproportionate share of the industry that has been established in the LDCs. It might also be argued that of all the West European economies, Britain was perhaps the 'softest' target for an aggressive export drive by Latin American manufacturers, since British industry has proved particularly susceptible to import penetration

even on its best home markets. (Japanese industry, by contrast, might be considered too formidable a competitor, especially on its own home ground. At any rate Japan imports from Latin America little more than half of what it sells to the region, and the composition of its imports is heavily skewed towards natural resources, although El Salvador manages to sell its cotton textiles there.)

In the early 1970s the largest category of Latin American manufactured export appears to have been textiles, an industrial sector with relatively little to gain from the G.S.P. It is a sector in which Britain has long provided one of the most open markets in the world (with LDC imports largely supplied, however, from Hong Kong). At present the British textile industry feels severely threatened by the Multi-Fibre Agreement (MFA), which came into force for all EEC member states on January 1, 1975. It allows Third World countries to increase their exports by at least 6 percent per year regardless of the state of home demand. This particularly affects U.K. producers at a time of recession, especially considering the very high base of imports from which Britain starts. The EEC calculates its quotas in accordance with the MFA rules, and in early 1976 this resulted in Community ceilings being imposed on Brazilian exports of cotton yarn, cotton grey cloth, cotton finished fabric, and cotton household linen. Latin American textile exporters have arrived relatively late on the scene compared to other LDC exports of manufactured goods, and their share of LDC sales is still relatively small. It seems likely that at least in this branch of manufactured exports they may have arrived too late and will be artificially restricted to a limited proportion of the European, and therefore also of the U.K., market.[7]

It has been suggested that Latin American exports of vehicles, and even such products as tanks and helicopters and so on, may in the longer run outclass the competition offered by British industry. However, even if this proves true, it does not follow that Latin America will achieve major sales on the British market. If these British industries continue to weaken, other competitors, such as the Japanese, will probably encroach further on the British market before the Latin Americans get there. Thus, without either exaggerating the vitality of British industry or underestimating the potential dynamism of some Latin American industrial enterprises, it might be doubted whether the British market will offer Latin America a much better prospect for the sale of manufactured goods than it does for the sale of agricultural products. If some Latin American manufacturers become very competitive, they are more likely to drive British producers out of third markets than to capture a growing share of British imports.

Before concluding this generally unpromising account of the prospective British market for Latin American goods, there is one remaining factor to consider. Latin America's share of the market may be small and unlikely to rise, but the volume of trade will also be affected by whether Britain's import

capacity is likely to rise rapidly over the medium term. Clearly, the British market will dwindle in attractiveness if U.K. exporters continue to lose ground to their competitors over the next decade at the rate as that of the past ten years (Table 3.3). If, for example, Latin American manufacturers can outbid their British rivals as has been suggested above, then this would probably mean that the U.K. economy would be generally too weak to afford more than a modest volume of imports from any source. On the other hand, the possibility cannot be ruled out that the British government will achieve its present targets. The forthcoming "windfall gains" from North Sea oil and the competitive edge provided by sharp currency depreciation at a time of severe restraint on incomes make it possible to argue that Britain could achieve "export-led growth" before the end of the 1970s.

How would the fulfillment of these ambitions affect the prospects for imports from Latin America? The "best possible" outcome that has been seriously suggested is a Treasury projection that British exports might grow 9.5 percent per annum in volume terms between 1975 and 1977. Presumably, a sustained period of "export-led growth" would imply a continuation of export growth at something like the same rate until say 1980. It is not plausible to predict that this volume growth would be accompanied by an improvement in the U.K.'s terms of trade over that period, so even on the most optimistic assumptions the volume of British imports is unlikely to rise by more than say 50 percent between 1975 and 1980. A British revival would ease the pressures toward industrial protectionism, and this might marginally favor Latin American attempts to break through in the sale of new lines of manufactured goods. On the other hand, British industry would in this case put up a fairly effective resistance in most branches, not only in the home market but also in third markets.

The major prospect for Latin American exporters would probably be in the sale of the mineral inputs required by expanding British industries. However, it must be noted that even the most optimistic assumptions do not expect British exports to grow much faster than world trade as a whole. If by 1980 it could regain the share of world markets that the U.K. held in 1970, the British government would consider it had achieved a triumph. The conclusion seems to follow that the benefits that Latin America might derive from the fulfillment of the British government's most optimistic projections would come less from the chance to sell on an enlarged British market than from the generally buoyant demand for raw material inputs that would need to exist in the world as a whole. However the projection is made, the British market seems certain to remain of only marginal importance for Latin American exporters for the foreseeable future. Only a conventional European war, culminating in another continental blockade, would seem capable of radically falsifying this prediction.

(c) CURRENT PROSPECTS: THE LATIN AMERICAN MARKET

This section is concerned with the prospective Latin American demand for British goods. Alternative views about the availability and quality of British supplies were briefly outlined above. It has been pointed out that Japan exports almost twice as much to Latin America as she imports from that region. In principle, therefore, if British industrial exports of the right kind become sufficiently competitive, there seems no strong reason why the U.K. should not substantially increase its share of the Latin American market, even though the Latin Americans have poor prospects of raising their share of British imports. This section considers the possibilities for an expansion of British exports as part of the hoped-for period of "export-led growth." In practice, not all these possibilities will be realized, because of the problems of supply that traditionally hamper British exports and that cannot have been eased by the recent period of very low investment.

The medium term growth of Latin America's capacity to import will, of course, depend upon the growth rate achieved by the region's exports and the availability of credit to finance deficits in its overall balance of payments. In relation to these variables, the situation of Brazil is so different from that of Venezuela that regional aggregates are best discarded in favor of a consideration of the prospects of each leading Latin American country.

In mid-1976, it was still conventional wisdom among British observers to assert that Brazil offered the most interesting market in the medium term, although it was recognized that there might be a contraction of imports in the short term. However, not all Brazilian commentators were equally optimistic. Table 3.4 presents balance of payments projections made by Edmar Bacha at the beginning of 1976. The main assumptions are that Brazilian exports grow by 10 percent in 1976 (dollar value) and then keep on growing at 15 percent per annum, and that the Brazilian government tapers down its rate of net foreign borrowing so that the foreign debt ceases to grow in 1979. The significant point is that on these assumptions the current dollar value of Brazilian imports f.o.b. in 1979 would be held to $10.1 billion, or $2.4 billion less than the amount that Brazil imported in 1974. Over the five-year period the dollar value of imports per capita would shrink by almost a third, and the volume of imports per head would, of course, fall even faster because of the effects of worldwide inflation on the dollar price of Brazilian imports. From the perspective of British exporters, the market prospects offered by Brazil would be more disappointing than is indicated by the fall in the total import bill. After paying for its oil imports, the sum available to Brazil to purchase nonoil imports must be expected to fall, even in current dollar terms, over the next couple of years, until new domestic sources of energy begin to come on stream. Clearly there are two ways in which Bacha's gloomy projection could be falsified. Brazil's exports could grow at more than 15

TABLE 3.4

Brazilian Balance of Payments 1970-75, with Projections for 1976-9

US $ m.

	Exports f.o.b.	Imports f.o.b.	Services (net)	Net Interest and Amortization	Gross Loans	Gross External Debt	Net Debt Service Over Export
1970	2,739	2,507	560	906	1,825	5,295	0.33
1971	2,904	3,245	664	1,152	2,519	6,622	0.40
1972	3,991	4,235	860	1,561	4,812	9,521	0.39
1973	6,199	6,192	1,214	2,188	4,850	12,571	0.35
1974	7,968	12,531	1,676	2,562	6,504	17,166	0.32
1975	8,650	12,170	1,840	3,360	6,800	21,966	0.39
1976	9,515	10,142	1,961	4,639	4,451	23,561	0.49
1977	10,942	10,142	2,286	5,166	4,806	25,304	0.47
1978	12,853	10,142	2,711	5,651	4,651	26,665	0.44
1979	14,470	10,142	3,210	5,964	3,846	27,045	0.41

Source: Bacha, 1976 abridged from the table on p. 52. 1976-9 projections based on assumptions set out by Bacha, p. 53.

percent per annum, or overseas funds could be made available to finance a greater volume of imports by adding further to the external debt. Conventional wisdom in Britain implicitly anticipates that some combination of export dynamism and generous financing will save the situation, but at least Bacha's table has the merit of indicating what strong assumptions must be made.[8]

Venezuela has little more than a tenth the population of Brazil, as can be seen from Table 3.5. Nevertheless, in 1970 average income per head in the former country was 2½ times as great as in the latter. Even more important, from the point of view of trading prospects is the point revealed by column 3 of Table 3.5, namely that as a proportion of GDP, foreign trade was three times as important to the Venezuelan economy as it was to that of Brazil. We find, therefore that Venezuela's imports were worth $2 billion in 1970, compared with $2.8 billion for Brazil. It is true that in 1974 (the latest year for which comparative figures are available) Brazilian imports had risen to more than three times the value of those of Venezuela, but we have already seen reasons for doubting whether Brazil can hope to increase its imports much before the end of the decade. There are equally strong reasons for believing that Venezuela's imports will remain well above the levels recorded in 1974, at least into the 1980s. Her exports rose from $4.7 billion in 1973, to $10.8 billion in 1974, and $10.2 billion in 1975 (the comparable figures for Brazil were $4.06, $6.2, and $8.0 billion).

TABLE 3.5
Capacity to Import of Leading Latin American Republics

	1970				1974
	Population (millions)	GDP/capita (US $)	Foreign Trade as % GDP	Imports cif ($ m)	Imports cif ($ m)
Argentina	23.2	1,053	7.1	1,694	3,635
Brazil	92.8	402	7.5	2,849	14,162
Chile	8.9	755	16.2	931	1,911
Colombia	21.2	409	9.2	843	1,602
Mexico	49.1	682	5.8	2,461	6,504
Peru	13.6	400	15.1	603	1,531
Venezuela	10.4	999	22.3	1,994	4,246
United Kingdom	55.4	2,195	16.9	9,018	23,117

Sources: K. Ruddle and K. Barrows *Statistical Abstract of Latin America 1972* (UCLA, 1974). Tables 21 and 253, and IMF *International Financial Statistics,* May 1976. Foreign Trade as a proportion of GDP is calculated from IFS, using $\frac{X + M}{2}$ as the measure of foreign trade (X = exports, M = imports).

By the end of 1975, Venezuela's international reserves were around double those of Brazil, and the country had very little external debt to service. Plenty of credit will be available if the Venezuelans chose to run a trade deficit, and petroleum reserves are adequate to maintain 1975 volumes of export for at least a decade ahead. Moreover, explorations being undertaken in Orinoco, the Gulf of Venezuela, and the continental platform may well result in substantial additions to these reserves. In the medium term it seems reasonable to expect that Venezuelan exports will continue close to, or even above, the level of Brazilian exports, and that her capacity to import the kind of products that Britain has for sale should remain well above the Brazilian level. It may be that British exporters are not concentrating enough of their attention on Latin America's largest and most promising market for imported manufactures.

Table 3.5 also includes information about four other Latin American markets that in the medium term probably lie somewhere between the extremes of Brazil and Venezuela. Argentina and Mexico have relatively large economies with a relatively small exposure to foreign trade, whereas Peru and Chile have much smaller economies but, depending on the vagaries of the international metal markets, they may sometimes have a disproportionately large capacity to import. Mexico has the advantage of having recently achieved the status of a net oil exporter, but it, like Brazil, is heavily in debt and has run up a serious and growing balance of payments deficit. Also, its trade is particularly strongly oriented toward the U.S. market. Several years of import restriction should probably be expected. British observers tend to view with greater pessimism the short term prospects for Argentina, but on

the other hand, a grain shortage or the elimination of the EEC's "beef mountain" could produce a fairly rapid turnaround in that country's trading prospects. The situation could change similarly for Chile and Peru, although they are currently facing severe difficulties, and the social consequences of their austerity program may well be deplored. However, a sustained recovery in the world price of copper cannot be ruled out, and if it materializes, their capacity to import may improve rather sharply (admittedly from levels that are at present severely depressed).

Summing up the overall prospects facing British exporters to Latin America there seems one major market that is both safe and buoyant, but which is currently being underrated. Apart from Venezuela, the short-term prospect is for widespread import restrictions and financing difficulties, which may make trade with much of the region relatively unpredictable and frustrating. Since Britain's current share of these markets is low, and the U.K. market is generally of diminishing importance to them, British exporters may not find it easy to capture a substantial increase in the market share at a time of import restraint. However, these are very general observations, derived from a view of Latin America's total capacity to import. Since the U.K.'s contribution to the region's imports is currently small, it may be that Britain's export performance could be substantially affected by the special situations that exist in specific countries or sectors of the economy. The rest of this section considers some possibilities of this type.

More than half Britain's sales to Latin America are normally composed of machinery and transport equipment sales, and the British government seems to believe that the best prospects for the future may be in the export of high technology capital goods, particularly when these can be packaged in the form of joint ventures. It is argued that since many Latin American governments prefer a government-to-government relationship, the prospects may be particularly good for British nationalized industries, acting as consultants or as leaders of consortia of British firms. The British Steel Corporation (which imports iron ore from Brazil) has been actively seeking contracts there, and British Rail, the National Coal Board, and the Central Electricity Generating Board are also exploring various possibilities. The Department of Trade recently produced a special report on Brazilian steel expansion plans which took an optimistic view of their prospects of fulfillment and argued that "technically, the British steel industry is well placed and . . . up to 1985 . . . prospects for supplying Brazil's steel plant needs look good." The report added, however, that increasingly "foreign equipment supply is likely to become dependent on a willingness by UK companies to invest in local plant building and operating." Therefore, as Brazil's steel producing capacity grows, "opportunities for the export of steel from the UK will be reduced and will probably dry up altogether by the 1980s, except for the supply of certain special steels" (1976: 25). In October 1975, the U.K. government and Brazil

signed a "Memorandum of Understanding," which emphasized the supply of British technology for Brazilian steel and off-shore oil rigs, as well as the inevitable sale of British frigates, submarines, and helicopters to the military government. Five percent of the $2.8 billion Serra dos Carajas iron ore scheme has reportedly been earmarked for British Steel, and Britain hopes to secure large orders for railway equipment as the Brazilians strive to reduce the dependency of their transport network on oil-consuming road transport. A major rail artery to the new iron ore mines is among the planned priorities. In May 1976, President Geisel made a state visit to Britain and signed a trade agreement which reportedly opens the prospect of British export sales worth perhaps £300 million between now and the end of the decade. Thus, there is evidently a strong belief that the special situation of Brazil's iron ore and steel expansion plans should enable Britain to increase substantially her trade with her leading trading partner in the region, despite the severe balance of payments constraint that may affect the Brazilian market as a whole over the next few years.

In 1975 Brazil absorbed 24 percent of Britain's exports to Latin America. Next in importance came Mexico, taking 16 percent. Here too, a preference has been found for conducting business under the umbrella of government-to-government agreements, so that in April 1976 a Joint Commission was established to meet annually and review progress on economic and industrial cooperation between the two countries. Once again, the British Steel Corporation occupies a strategic role. In 1972, it secured a contract to supply technical and operational advisory services for stage one of the Las Truchas steel complex. British suppliers are said to have benefited from this contract, securing 20 percent of the foreign currency orders placed during stage one of the project. In May 1976, BSC secured a renewal of its contract to advise on stage two, which involves trebling the size of the steel plant to 3.7 million tons, and which is expected to generate very much larger foreign currency orders. U.K. exporters also entertain high hopes of contracts for supply and consultancy in the fields of electric power generation and railway expansion, and one of the biggest new orders the British shipbuilding industry has received for some time was to supply Mexico with fishing protection boats. As in the case of Brazil, a high proportion of prospective trade would be placed by Latin American state enterprises with companies in the public sector of the British economy.

A special situation may also exist in Cuba, where the absence of U.S. competition naturally provides an opportunity for British suppliers. As in the case of Mexico, the British government has formally established a joint commission with the Cuban government, and the best prospects are thought to exist in government-to-government transactions, perhaps giving rise to large construction contracts or turnkey operations. The British Trade Minister visited Cuba in 1975, and the Export Credits Guarantee Department has

agreed to consider cover for £250 million of British exports to Cuba, but at the present this remains a marginal market for Britain because so much of Cuba's trade is tied to the Soviet bloc.

A recent report on *Medium Term Prospects for Trade in Latin America* also singled out Colombia and Bolivia as relatively interesting minor prospects for British exporters, particularly those specializing in mining equipment. Peru and Chile were less highly rated,[9] although a number of British machinery suppliers played a significant part in equipping the Cuajone copper mine in Peru. Argentina, traditionally a good British market, was not regarded with much favor in the short term, although once recovery begins it was thought that once again the local steel expansion plans offered a particularly interesting opportunity for British industry.

It remains to consider prospects for British exports to Venezuela. Although there is no formal joint commission supervising trade with this market (which took only 15 percent of Britain's sales to Latin America in 1975), there are regular informal contracts. As for special situations, in June 1975), there are regular informal contracts. As for special situations, the British recently entertained hopes of large contracts in the public transport sector, but were unable to submit competitive bids either to the National Railway or the Caracas Metro. It is also considered that Venezuela's ambitious steel expansion program should offer major opportunities for the sale of plant and equipment and the provision of managerial and technical knowhow. More attention might perhaps be given to the vast petrochemical program which is also being proposed (a budget of $5.5 billion has been estimated), and there are also good prospects for state-to-state collaboration in the field of electricity generation. Although private enterprise is relatively vociferous in Venezuela, around 60 percent of projected development expenditure is likely to be directly authorized by the public sector, so that close government-to-government collaboration would seem the best way to maximize trade. However, so far the private financial institutions located in the city of London seem to have taken much of the initiative in strengthening British interchange with Venezuela. In 1975, the City held a seminar in Caracas on "invisibles" and the services provided by London-based financial institutions, and in June 1976, the U.K.'s Committee on Invisible Exports played host in London to the custodians of Venezuela's vast foreign exchange reserves.

In conclusion, any substantial increase in the U.K. share of the Latin American market is more likely to be through the exploitation of the Venezuelan special situation than through any of the other projects mentioned in this section. It remains to be seen whether a major breakthrough can be achieved. Certainly, the government of the U.K. seems aware that the U.K. need not rely on the traditional exports of whiskey as the mainstay of British trade with Latin America, and it has made some effort to take advantage of the special situations provided by the expansion of Latin America's state-owned steel enterprises. Contracts in this field provide consid-

erable opportunities in the medium term, although they are of course self-liquidating over the longer run. One wonders what Britain will have to sell in ten years time that Latin American producers will still need. In the interim, there is scope for the first time in this century for the U.K. to build up a significant trade surplus with Latin America, provided the opportunities are assessed correctly and grasped promptly. Even on the most hopeful assumptions, however, Britain is unlikely to supply more than a very modest proportion of the Latin American market.

(d) "INVISIBLE" TRANSACTIONS

Comparative statistics on "invisible" transactions are not so reliable, detailed, or up-to-date as data on merchandise trade. Nevertheless some broad observations are possible, based on the recently published estimates for 1973 (Committee on Invisible Exports 1976). These show that the U.K. remained in significant surplus on "invisible" account, and that her invisible receipts accounted for no less than 37.7 percent of total current account receipts. As a percentage of Britain's GNP invisible receipts rose to no less than 10.9 percent in 1973, compared with 7.2 percent in 1964, both figures being well above the norm for the major industrial economies. On this basis, the U.K. ranked as the world's second largest earner of invisible income—receiving 11.1 percent of world invisible earnings, compared with 21.9 percent received by the United States, and 2.4 percent received by the four largest Latin American republics taken together. The U.K. was in heavy surplus (receipts 11.1 percent of the world total, payments only 8.2 percent); whereas Argentina, Brazil, Mexico, and Venezuela were collectively in even heavier deficit (with 2.4 percent of world receipts, but 5.1 percent of world payments).

Anglo-Latin American transactions were, however, only a small element in these totals. On the basis of incomplete data, it seems that the U.K. was significantly in surplus in its invisible transactions with Latin America, and that the main subsectors generating this surplus were banking, insurance, and shipping. However, in recent years, the major growth areas for U.K. invisible transactions have been the Middle East and North Africa rather than Latin America. Transport services provided the largest single item in total British invisible receipts (indeed U.K. earnings on this account even surpassed those of the U.S.A., making her the world's largest supplier of transport services to non-nationals). But transport services accounted for only a fifth of the invisible payments made by the four major Latin American republics, and only a small proportion of this expenditure will have favored the U.K.; most, no doubt, was to the U.S.A. Over half of Latin America's payments on invisible account was under the heading of investment income, much of it by Venezuela, and most of it to the U.S.A. As will be seen in the final section of this chapter, British investment in Latin America was of considerable impor-

tance before 1929 but has been of little significance since the 1940s. Therefore, the Latin American contribution to Britain's still substantial flow of income from private overseas investments cannot be of much quantitative significance. As for the British contribution to Latin America's modest invisible receipts, it should be noted that travel (i.e. essentially income from tourism) accounted for about half of the region's invisibles in 1973, with Mexican travel alone representing some 40 percent of the total. Only a small fraction of this (or any other) invisible income will have come from Britain.

As for future prospects, it may be surmised that the nationalization of Venezuelan oil, the accumulation of investible surpluses by OPEC members, and current Latin American efforts to reduce the region's dependence on foreign shipping and banking may in due course have the effect of eliminating Latin America's overall deficit on invisible account, both cutting down on payments and boosting receipts.[10] Even if this prediction proves correct, the consequences for the British balance of payments are unlikely to be very significant. Indeed some U.K. invisible earners, such as construction companies and specialized insurance brokers, may stand to benefit in a small way from any process of Latin American "invisible import substitution." An illustration of the type of activity in which the U.K. still appears to enjoy a comparative advantage is the fact that British personnel are currently under contract to advise Venezuela's new Instituto Nacional de Puertos on how to avoid congestion at her major ports. However Latin America must rapidly be acquiring sufficient knowhow to dispense with this type of foreign service. In the long run, the most resilient categories of British invisible earnings may well be the provision of specialized investment insurance, banking and marketing services, and perhaps tourism, but the Latin Americans are unlikely to rank high among Britain's major customers under any of these headings. Nor are the British likely to be significant customers for any invisible services that the Latin Americans may develop.

(e) BRITISH INVESTMENT IN LATIN AMERICA

British investors lost heavily in the speculative boom and bust of the 1820s that accompanied Latin American independence. The lesson was not quickly forgotten, and willingness to invest in the region revived only after the middle of the 19th century, when export-led patterns of growth became well established, and the demand for railways accelerated. It has been estimated that in 1870 Latin America received 11 percent of Britain's total overseas investment, and that by 1913 the proportion had risen as high as 20 percent. Over the same period the geographical distribution of British investments became more concentrated in the major republics, and there was a marked shift in its sectoral composition. Whereas about three-quarters of British funds flowed into government bonds in 1870, this type of asset accounted for less than

one-third of all holdings by 1913; on the other hand, railways (largely bonds carrying a government guarantee), had reached 46 percent of the total by 1913 (UN Economic Commission, 1965: 6-10). On the eve of World War I, therefore, Latin America accounted for a substantial proportion of Britain's total overseas investments, which was then the largest in the world. If Latin America was important to Britain, Britain was even more important to Latin America–supplying about half the total foreign capital invested in the continent, or three times as much as its nearest competitor, the U.S.A.[11] Needless to say, the railways had by then reached their apogee and Britain's pre-war ascendancy was not to last. By 1929 the value of U.S. holdings in Latin America had slightly overtaken those of British investors.[12] Thereafter, under the impact of the depression and World War II, total British net foreign investment, which had been a major force in the world economy for over a century, virtually ceased. It was actually forbidden between 1932 and 1934, but even after controls were eased in the later 1930s, it did not revive, least of all for investments in Latin America. Many of the Latin American republics had defaulted on their foreign bonds after 1931, and everywhere exchange controls made profit and divided repatriations unreliable. Thus, from a peak value of £880 million, total U.K. investment (direct plus portfolio) in Latin America apparently fell to £804 million in 1939, a reduction that in particular reflected the sale of various British-owned utilities to ITT (U.N. Economic Commission for Latin America, 1965: 32).

Britain began World War II with total capital assets overseas of around £3 billion, but by 1945 over £1.1 billion of these had been sold to pay for wartime imports, of which the net proceeds from South American disposals were estimated at £96 million (Youngson, 1960: 145-6; and Statistical Material, 1945). In the immediate postwar years, investment outside the sterling area was again virtually banned, and the program of disposals continued or even accelerated. One of the largest was the controversial 1948 sale of British-owned railways in Argentina; the government of Perón paid the shareholders £150 million from Argentina's blocked sterling account. In 1950 the Bank of England estimated that between 1938 and 1948 disposals totalled 45 percent of all British investments in overseas loans and share capital (at nominal capital value). For Brazil the proportion disposed was 50 percent, for Mexico 55 percent, and for Argentina 86 percent (Bank of England, 1950). British investments in Latin America had been three times as large as those of the U.S.A. on the eve of World War I, but at the end of World War II, U.S. investments in the continent were about four times as large as those of Britain.

Recent trends are shown in Table 3.6. Since World War II overseas investment has been far less important to the British economy than it was before 1914. Latin America's small share of these modest postwar transactions has continuously declined.[13] (Indeed, Table 3.7 shows that by

TABLE 3.6
Latin America's Share of Direct Foreign Investment (Book Values) (percent)

Investing Country	1950	1962	1966	1973
Britain	18*	5	5	3
USA	40	21	18	13
Japan	–	–	–	20

*1950 data not strictly comparable since until 1962 only the Bank of England estimated British overseas investments, and their method was unsatisfactory.

Sources: U.K. data (*excluding* oil companies) Board of Trade publications.
U.S. data (Latin American Republics only, *including* oil companies) from Department of Commerce *Survey of Current Business* various years (Washington).
OECD *Economic Survey: Japan* (Paris, July 1975) p. 36.

1971 British direct investment in Latin America was almost smaller in value than the net book value of direct investment in the West Indies alone.)[14] Table 3.6 shows that the share of U.S. direct foreign investment going to Latin America (including U.S. oil companies) has also declined steeply since 1950. Indeed, one could argue that in general direct private foreign investment has come to occupy a distinctly subordinate role in the process of capital accumulation in Latin America. State enterprise has expanded enormously in the subcontinent, and in many countries public sector borrowing has come to represent a scale of transactions (at least in terms of financial flows) far larger than that of direct private investment. However, the table also shows that Japanese investors have recently defied the general trend.

It should be noted that the 'net book value' concept used in Tables 3.6 and 3.7 does not provide an accurate and up-to-date valuation of investment stock on the given date. Companies generally value their direct investments on the 'historic cost' basis which may well understate current value, especially in conditions of inflation and currency depreciation. On the same basis, obsolete equipment of no more than scrap value may well be overvalued.

TABLE 3.7
UK Direct Foreign Investment in Latin America

	(net book values, £m, year end)				
	1962	1965	1968	1971	1973
Argentina	49.3	64.6	67.6	58.4	74.4
Brazil	37.2	45.1	61.2	79.5	140.3
Mexico	28.0	41.0	48.6	52.1	54.6
LATIN AMERICA	171.8	212.8	233.4	251.4	337.8
WEST INDIES	105.6	146.0	217.9	237.1	n.a.

Sources: Mainly Board of Trade, *Trade and Industry* (HMSO, London), 15 November 1973, supplemented from other Board of Trade publications.

Some companies make adjustments for these factors, but there is no uniform practice. Nevertheless the long-term trends shown in these two tables are not the product of statistical distortion. We can, for example, be fairly confident that at the end of the 1960s Brazil overtook Argentina as the largest recipient of British investment. This is confirmed by Table 3.8 which shows not the cumulative *stock,* but the annual *flow* of British investment to Latin America and how it was financed. In each of the four years shown, more than half the net flow went to Brazil alone. Unremitted profits of established British firms accounted for the bulk of the investment, although after 1970, as the earnings and remittable dividends of British companies increased, the proportion of investment financed by 'new money' increased somewhat. Nevertheless new investment was generally less than the earnings on past investments, and on any measure the scale of the British commitment was very modest, as can be seen by comparing it with the (naturally low) figure for direct private Latin American investment in the U.K.

One reason for the limited British interest in investment in Latin America must have been the low rate of return experienced in past investments. The Reddaway Report (1967: 43) on U.K. direct investment overseas found that over the period 1955-1964 the average pretax return on a sample of all British investments overseas was 14.5 percent; posttax average profitability was 8.5 percent. Within the sample, the study also measured rates of return in some individual countries. Pretax profits in Brazil averaged 16.8 percent, but posttax the rate fell to 5.3 percent. Bottom of the league came Argentina (where the largest proportion of British investments in the region was still

TABLE 3.8
U.K. Annual Direct Investment in Latin America

(£m.)

	1968	1970	1972	1974
Earnings of British companies in Latin America	28	30	40	62
Dividends remitted to UK	10	12	16	23
Unremitted Profits	18	18	24	38
Net U.K. Investment in Latin America*	17	13	35	64
of which Net UK investment in Brazil	9	12	21	34
Cf Latin American Net Investment in UK	1	5	16	12

Source: Department of Industry, Business Statistics Office *Business Monitor: Overseas Transactions 1974* (HMSO London, 1976).

*UK Net Investment = Unremitted profits + net acquisition of share and loan capital + changes in indebtedness between head office and subsidiaries.

concentrated), with a pretax profit averaging 7.5 percent, which fell to only 1.6 percent after tax.

Over the past decade, however, the profitability of British investments in Latin America has clearly risen. Since the Reddaway Report the only measure available is the ratio of reported earnings (after overseas tax) to net book value of investments, a figure that must be treated with considerable caution for the reasons mentioned above. The rising trend shown in Table 3.9 may have been distorted by accelerating inflation, which could cause historic cost to fall more and more below replacement cost. Nevertheless it is probable that between 1966 and 1974 direct investment overseas did become progressively more attractive owing to the cyclical upswing of the world economy at the end of the period. Investment in Latin America has apparently been more profitable than British overseas investment as a whole, and British investment in Brazil has consistently outperformed investment in the rest of the continent. Although the basis of comparison may be shaky, Table 3.9 also suggests that on average British companies may recently have secured higher rates of return on their investments in Latin America than were earned by the average U.S. company operating in the same region. It would seem that recent British investments in Brazil have been remarkably profitable, and that this has pulled up the average very sharply.

TABLE 3.9

Pre-Tax Earnings on Direct Foreign Investment (Valued at Historic Cost) (Percentage Rates of Return)*

	1966-8	1969-71	1972-4
British Companies:			
Overseas Investment	8.6	9.4	13.5
of which Central and South America	11.0	11.2	17.6
of which Brazil	16.3	20.4	31.9
Argentina	7.0	6.3	10.7
U.S. Corporations:			
Overseas Investment	10.4	12.1	18.8
of which Latin American Republics (including oil)	13.0	11.1	13.5
Latin American Republics (excluding oil)	11.3	10.2	13.2
Brazil (including oil)	10.9	11.7	15.5

*Reported earnings after overseas tax as percent of net book value of investments

Source: UK figures calculated from the Department of Trade and Department of Industry sources given in Tables 3.7 and 3.9.
US figures calculated from the Department of Commerce source given in Table 3.6.

TABLE 3.10
UK Direct Private Investment in Latin America in 1974
by sector

		£m.
Gross Investment		75.5
Gross Disinvestment		11.8
Net Investment		63.7
of which, food, drink & tobacco	16.5	
distributive	5.8	
chemicals	4.3	
shipping	4.2	
engineering (mechanical & electrical)	2.9	
paper, printing	2.6	
other	27.4	
		63.7

Source: Department of Industry *Business Monitor* op. cit.

It might be thought that the apparently highly satisfactory results of recent years must presage a great new burst of British investment in Latin America, but there is room for skepticism. At least it can be seen from Table 3.10 that even in a good year like 1974 there was no strikingly innovative sector in which British investment displayed a dynamic thrust. On the contrary, it seems that most British firms (mainly established in relatively staid traditional branches of the economy) simply took advantage of recent high profits to make incremental investments in the activities they knew best. It seems plausible to argue that 1974 was an exceptional year in which the rate of return to direct investment in Latin America was probably above its long-term trend (and the rate of return to investment in the U.K. was almost certainly below its long-term trend). Since even in that year the response of British enterprises to investment opportunities in Latin America was relatively subdued, it must be considered doubtful that this type of investment will display great dynamism over the longer term.

NOTES

1. "Latin America" throughout this essay refers to the republics formed out of the Spanish and Portuguese empires.

2. U.S. exports to Mexico overtook those of the U.K. in the early 1880s. By 1910-11 they were almost five times as great (Platt, 1972: 98). For the same years G. T. Milne (Board of Trade, 1913: viii) calculated the distribution of imports to the five republics of Central America as follows: From USA 49.2 percent; from UK 21.7 percent; from Germany 13.4 percent.

3. "A Bigger Share of World Trade" is the title of Chapter 11 of *Latin America–A Broader World Role* by A. Krieger Vasena and J. Pazos, (1973) but this is more an attack on attitudes of export pessimism than a prediction of the probable future.

4. It seems plausible to predict, however, that between 1975 and 1985 the terms of trade may worsen somewhat for industrial exporters and improve for primary exporters. At least this is the view put forward by G. F. Ray (1976).

5. For a more detailed and realistic discussion of the likely effects of EEC membership, compare Alec Nove, 1973.

6. More generally, the Community has undertaken to stabilize the export earnings of ACP producers who are adversely affected by sharp fluctuations in the world market price of their principal primary export. In practice this policy may well have the effect of stimulating production in ACP countries of primary products that are also exported by Latin American republics. Unless the stabilization scheme is extended to all LDCs, it seems likely that the EEC may indirectly be harming Latin America's export prospects, even when its intention is to promote 'development' in the Third World.

7. The EEC Commission has not confined its attention to textiles. In April 1976, the European Hard Board Manufacturers Federation complained that Brazil was selling wooden hard boards in Europe at 40 percent less than the price charged in Brazil, and the Commission upheld the claim. The Brazilians were obliged to raise their prices in order to avert the imposition of special EEC import tax. Nor is it only the EEC Commission that is charged with protecting British industry from alleged "dumping." In April 1976, the Department of Trade imposed a provisional charge to countervailing duty of 16 percent on Brazilian supplies of men's leather fashion shoes, boots and moccasins. In August 1976, the provisional charge was made permanent, at the rate of 8 percent, when allegations of dumping by the British Footwear Manufacturers Federation were investigated and upheld. Although the volume of business involved is small, the Brazilians are reportedly very concerned at the precedent that this measure may set.

8. Carlos Von Doellinger indicates that Brazil has a static comparative advantage in the export of manufactures linked to its agricultural, livestock, and extractive industries. Further, to achieve really substantial long term export growth, Brazil would need to recompose its list of manufactured exports in favor of more dynamic products and more sophisticated markets. This would require even greater reliance on multinational corporations to help Brazilian industry fill its technological gaps he argues.

9. Britain's trade prospects with Chile are clouded, not only because of that country's bad economic condition, but also because in 1975 Britain refused to reschedule Chile's outstanding debts. The Chilean Navy subsequently fell behind on its contractual payments for submarines ordered from a British shipbuilder. However, at the end of August 1976, Chile paid the overdue installments of £7½ million and took possession of the two completed submarines.

10. Brazil's cargo reservation laws now specify that 50 percent of all its cargo should be carried by national shipping lines. Argentina has in the past reserved as much as 80 percent of its cargo for national lines. Various other Latin American countries supported the UNCTAD Code of Conduct for Liner Shipping, proposed at Nairobi in May 1976. This code specifies that 40 percent of the total cargo between two countries will be carried by the national shipping lines of each country.

11. However direct investment by the U.S.A. was already expanding rapidly and overtaking the British in Mexico and Central America. Mira Wilkins estimates that in 1914 two-fifths of US direct investment overseas was located in Latin America, a quarter in Mexico alone.

12. Even before the crash of 1929,

> "It was widely believed among businessmen that some kind of agreement had been reached under which British enterprises in South America were to pass into

North American hands in exchange for relief from United States pressure within British Empire. In 1929 alone about £40 m. worth of British shares, mainly in South American activities, were sold to US investors." (Gravil, 1975: 41)

13. The table refers to direct investment only. If total UK private investment abroad could be apportioned geographically, Latin America's share would be even smaller, for very little of British portfolio investment can be in Latin American companies. At the end of 1975 total UK private investment abroad was valued at £23.4 billion, of which £16.8 billion was direct (including oil companies) and £6.6 billion was portfolio (Bank of England 1976).

14. These figures exclude direct investment by British oil companies, for which no geographical breakdown is available.

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Chapter 4

THE ECONOMIC RELATIONS BETWEEN GERMANY AND LATIN AMERICA AND THE SIGNIFICANCE OF THE EUROPEAN COMMUNITY

ALBRECHT VON GLEICH

During the past six years, the Latin American countries have made significant efforts to strengthen their relations with the European Economic Community. This was in part because the policy of Latin America is aimed at diversifying its export markets and sources of finance in order to reduce its dependence on the United States. By many, Latin American relations with Western Europe were also seen as a counterweight to the predominant U.S. influence in the area. So far, many of the Latin American expectations with regard to an opening of the European markets to increased traditional and nontraditional exports from Latin America have not been fulfilled, nor has the hope for a sizeable increase in the flow of financial resources. Despite previous expectations, the entrance of Great Britain into the Community has not caused the Community's agricultural policy to be any more liberal toward suppliers from nonmember countries. Latin Americans still complain that the EC trade policy continues to give unjustified preferences to a growing number of associated countries, mainly in Africa and Asia, thus increasing the discrimination against Latin America.

The fact that the Federal Republic of Germany accounts for more than a third of the trade between the Group of Nine and Latin America gives that country an important role in this relationship. Moreover, Germany, unlike most of her partners in the EC, has no particular responsibility for former colonial territories and was therefore expected to defend the interests of those trading partners that had no traditional and political links with EC members.

The purpose of this chapter is to analyze, within this general framework, the main features of the commercial and financial relations between the Federal Republic of Germany and the Latin American countries and to determine their possible future trends. The chapter is divided into three parts. Part I outlines the development and structure of trade relations between Germany and Latin America in their historical context. Part II describes some aspects of the transfer of private and official capital from the Federal Republic to Latin America including the so-called development aid. The last section tries to evaluate the meaning of these relations within the context of the trade and development policy of the European Community.

I. DEVELOPMENT AND STRUCTURE OF GERMAN-LATIN AMERICAN TRADE RELATIONS

In Germany's relations with Latin America, trade and investment have always played an important role, and commercial interests have largely determined German foreign policy toward the Central and South American countries.[1] Direct commercial relations began before Latin American countries gained their national independence. By the middle of the 19th century, Germany had already achieved a strong economic position in many countries.

Toward the end of the 19th century, Germany supplied ten percent of Latin America's imports. Raw materials and the products of German heavy industry accounted for a considerable part of these sales. By the beginning of World War I, the German share of Latin America's imports had grown to more than 16 percent. This increasing commercial exchange was accompanied by an increasing flow of capital investments. German capital accounted for more than ten percent of the total foreign investment in Latin America, which up to the outbreak of World War I amounted to about U.S. $8.5 billion.

Despite such efforts, Germany was unable to gain a really leading position in Latin America before 1914. Its economic resources were too meager to allow it to compete effectively against Great Britain and the United States. To be sure, the German share of foreign trade and foreign investment in Latin America was considerable, but the structure of commercial relations did not particularly favor German influence. The German balance of trade with Latin America before World War I was mainly characterized by a considerable trade surplus. In 1913, Germany's share of Latin America's imports came to 16.4 percent, as against 11.2 percent for Latin America's exports. Thus, commercial relations did not favor the export interests of Germany's Latin American partners. Nor were Germany's capital investments particularly conducive to political influence. There was little German capital in those economic sectors—such as mining, transportation, and plantations—that provided other

capital-furnishing countries with considerable political influence. Just before the outbreak of World War I, German heavy industry began to be interested in raw material sources in Mexico, Brazil, and partially in Chile, and it began to undertake the corresponding investments. However, the larger part of German direct investment was concentrated in trading firms and banks and was therefore dependent upon the development of trade.

Commercial exchange with Latin America was resumed soon after World War I, but by 1933, when the National Socialists came to power, German trade with Latin America was still below its 1913 level. The German share of Latin America's imports amounted to a scant ten percent in 1934, while the German share of its exports amounted to an even smaller eight percent. Owing to the world economic crisis, which particularly affected countries that produced primarily raw materials, total foreign trade was reduced. The traditional consumer countries—the United States, Great Britain, and France—were compelled to reduce sharply their imports from Latin America. Reduced Latin American export profits were inadequate to cover high prewar debts and to pay for imports of industrial goods. For this reason, several Latin American countries were willing to offer raw materials on a barter basis. This proved congenial to German foreign trade policy. First of all, Germany did not have sufficient hard currency to cover her increasing need for raw materials; moreover, German industry was attempting to promote exports. Trade agreements were concluded with Argentina, Brazil, and Uruguay that determined the volume of the reciprocal exchange of goods. Bilateral barter and clearing agreements were concluded with several other countries, including Colombia, which provided for currency-free clearing through special accounts in the German Reichsbank.

The results of this new trade policy in Latin America were notable. Within five years, from 1934 to 1939, the German share of Latin American imports increased to over 16 percent, reaching the 1913 level. Germany again assumed second place among the countries supplying Latin America. At the same time, Latin American countries provided an increased share of German imports. Thus between 1933 and 1938, the Brazilian share increased from 1.6 to 3.9 percent, that of Argentina from 3.6 to 4 percent, and that of Chile from 0.5 to 1.7 percent of total German imports (Rippy, 1948). The value of German imports from Central and South America rose from 521 million reichsmarks in 1932 to almost 1 billion in 1938. During the same period, imports from the United States fell from about 600 million to 450 million reichsmarks. Because of the exchange agreements and the strong support for German exports to Latin America, Germany became by 1938 Latin America's second most important commercial partner, after the United States. German exports to Latin America amounted to about 622 million reichsmarks, almost a third higher than English exports.

In contrast to the success of German exports to Latin America, German capital flow remained far behind. The German share of foreign capital investments in Latin America was still about ten percent in 1938, although the absolute amount had increased considerably. German investments were concentrated in Brazil (200 million reichsmarks) and Argentina (540 million reichsmarks), with the remainder distributed among Chile, Guatemala, Mexico, and Peru (Rippy, 1948). These investments, however, differed from those made before World War I in that German firms increasingly participated in the industrialization of Latin America. The main German chemical firm, I. G. Farben, played a prominent role in this respect; its management early recognized the Latin American trend toward industrialization and pointed out the opportunities offered by the participation of German firms with capital and technical skills. In most German investment in Latin America, technical expertise and management contracts were introduced in an effort to compensate for smaller capital resources. This tendency was also evident in the founding of the Latin American airline companies, in which the Germans were active (Burden, 1943).

Inevitably German economic penetration of Latin America came to be viewed with increasing concern by other European countries and by the United States. However, the Latin Americans themselves were generally well disposed in this matter. The quality of German products was highly regarded everywhere. As a rule, German technicians and merchants were welcome because of their readiness to adapt to the Latin American temperament.

During World War II, Germany almost completely lost her economic position in Latin America. In July 1941 the United States government published a blacklist containing the names of those South American firms that still maintained business relations with Germany and its allies. At the same time, the bank accounts of the listed firms were blocked in the United States. Shortly thereafter, the Interamerican Finance and Economic Commission announced that all twenty-one American republics had agreed to confiscate for their own use German and Italian freighters in western hemisphere ports. The countries concerned were, however, to receive proper compensation. With these two measures, what German-Latin American trade that had not yet been disrupted by the war was completely crippled.

The most far-reaching measure against the German influence in Latin America was the expropriation of property. When the Latin American governments broke off diplomatic relations and declared war against Germany, they had the opportunity to seize as enemy property the possessions of German firms and private individuals within their boundaries. Almost all the countries took advantage of this opportunity. German banks, commercial firms, and trademark rights as well as schools, club buildings, and hospitals were confiscated. Many German businessmen were, however, able to avoid loss of their properties by adopting citizenship of the host country.

World War II altered the world economic structure and caused important changes in commerce that also affected Latin American foreign trade. In comparison with the prewar period, German industry has been less dependent on Latin America both for raw materials and for markets. However, as the German economy grew increasingly dependent upon exports, Latin America became again a significant foreign market for German exports.

Exports to Latin America were resumed in 1948 and 1949. The first commercial and financial exchange agreements were made with Uruguay in 1949 and with Peru in 1950, immediately after the founding of the Federal Republic. Somewhat later, from 1953 to 1957, commercial and financial agreements were concluded with other Latin American countries. Most of these treaties correspond in form and content to traditional trade agreements. Trade became completely normal after German imports were liberalized, and the German mark became convertible.

The rapid economic recovery of the Federal Republic and the accompanying high demand for industrial raw materials, as well as for food and luxury items from abroad, made it possible for the Federal Republic to regain within about ten years Germany's prewar position among the countries purchasing from Latin America. In 1937 Germany took nine percent of Latin America's exports. By 1953 the share of the Federal Republic reached 4.5 percent, and in 1961 it was back to 8.7 percent, the approximate level of the prewar period. (For absolute trade figures see Table 4.1.) Thus the Federal Republic again ranked second to the United States among the countries buying from Latin America.

Until the middle of the 1960s Latin American exports to Germany increased at a higher annual rate than the region's total exports. Since then, the situation has reversed. Between 1965 and 1970 total exports from Latin America grew by almost 40 percent, whereas exports to Germany increased only by about 20 percent. This trend continued in the period between 1970 and 1975 when total Latin American exports grew by about 160 percent as compared to about 80 percent of the corresponding German imports from the region. Thus, in spite of the increase in absolute value, Latin America has not been able to regain its prewar position among foreign suppliers to Germany, and its share of the German market has steadily diminished. In 1937 Latin America supplied 15.5 percent of Germany's imports. In 1960 its share reached almost ten percent and was dropping steadily. In 1976, only 3.7 percent of German imports came from Latin America. Although this development is not peculiar to German-Latin American trade—the Latin American share of total world trade has dropped in a similar way—it burdens the relations between the partners, turning the previous trade surplus into a growing trade deficit.

On the other side, the Federal Republic was more successful in regaining and keeping, although not in the same magnitude, the position that the

TABLE 4.1
Germany's Imports from Latin America[a]
(in millions of U.S. dollars)

Country	1913	1929	1938	1950	1954	1958	1962	1966	1970	1973	1975
Argentina	61.1	90.8	47.8	40.9	139.6	129.1	188.3	161.9	172.7	386.1	256.7
Brazil	44.1	39.9	56.3	14.9	158.9	89.9	164.9	207.9	309.1	747.1	899.0
Chile	30.8	24.1	14.1	13.7	35.8	87.6	108.4	163.9	252.4	183.3	215.6
Colombia	2.4	2.6	11.8	7.7	40.3	47.4	72.5	74.3	111.0	152.3	233.1
Cuba	4.6	2.3	2.8	27.5	2.9	7.1	5.8	0.9	3.6	4.2	8.6
Ecuador	2.6	1.0	2.1	0.0	14.3	35.7	29.1	57.3	32.1	53.9	62.2
Mexico	5.1	21.6	14.3	2.5	52.7	67.7	64.1	69.7	45.8	79.4	119.1
Peru	2.9	8.2	8.1	6.1	19.2	52.8	109.1	109.1	150.1	94.2	109.1
Uruguay	14.0	13.3	14.5	3.2	19.0	13.0	15.7	20.7	23.6	41.9	46.3
Venezuela	5.5	7.0	9.0	8.4	19.0	107.7	134.7	82.7	90.7	114.7	232.1
Central America[b]	12.2	22.0	6.5	2.4	53.2	108.1	106.2	165.5	195.1	261.5	322.9
Other countries	10.6	2.4	2.0	3.5	3.1	10.5	23.1	18.0	22.1	140.4	205.2
Total	195.9	235.2	189.3	130.8	558.0	756.6	1.021.9	1.131.9	1.408.3	2.259.0	2.709.9

[a]Up to 1938 the data refer to the German Reich, and after 1950 to the Federal Republic.
[b]including Panama

Sources: Pan American Union, *The Foreign Trade of Latin America Since 1913,* Washington, (1952); and Statistisches Bundesamt, Wiesbaden: *Jahresberichte* (1954-1975).

TABLE 4.2

Germany's Exports to Latin America[a]
(in millions of U.S. dollars)

Country	1913	1929	1938	1950	1954	1958	1962	1966	1970	1973	1975
Argentina	82.5	94.2	44.1	9.9	76.5	127.6	174.8	115.8	211.0	221.3	325.1
Brazil	56.6	52.9	73.8	19.7	140.5	153.4	139.5	149.1	309.8	775.6	1.204.7
Chile	29.6	30.4	26.6	7.0	31.6	41.3	68.0	75.5	95.4	97.2	115.2
Colombia	3.9	17.6	15.5	12.0	55.1	45.2	46.2	68.3	70.8	97.3	183.4
Cuba	9.7	7.5	4.7	7.2	14.7	31.3	5.7	6.0	26.7	32.8	127.6
Ecuador	1.6	2.1	2.5	0.1	9.9	13.1	11.0	20.4	25.6	46.2	76.5
Mexico	11.8	14.8	20.7	6.1	35.5	64.3	94.7	132.9	184.1	365.9	457.6
Peru	5.0	7.6	11.8	6.1	16.0	29.7	61.3	94.8	67.8	128.0	281.0
Uruguay	8.2	8.9	10.1	4.4	24.4	7.6	27.2	16.7	27.4	23.4	37.9
Venezuela	12.9	8.0	11.7	16.8	58.5	117.5	75.8	113.2	146.1	288.9	371.1
Central America[b]	6.3	11.1	12.9	7.8	36.2	51.8	58.7	90.9	117.2	178.0	372.3
Other countries	12.2	6.7	6.9	3.5	14.2	22.3	24.8	34.1	42.9	126.3	181.0
Total	240.3	261.8	241.3	100.6	513.1	705.1	787.7	917.7	1.324.8	2.371.9	3.733.4

[a]Up to 1938 the data refer to the German Reich; after 1950 they refer to the Federal Republic.

[b]including Panama

Sources: Pan-American Union, *The Foreign Trade of Latin America Since 1913*, Washington (1952); and Statistisches Bundesamt, Wiesbaden: *Jahresberichte* (1954-1975).

German Reich had held as a supplier to Latin America before World War II. In 1937, Germany supplied 15.4 percent of Latin America's imports. The corresponding share of the Federal Republic climbed from 7 percent in 1953 to over 11 percent in 1961. (For absolute figures see Table 4.2.) Shortly after, however, it fell to its present level of about 8 percent. Nevertheless, the Federal Republic, until 1974, remained the second most important country supplying Latin America. This does not, however, alter the fact that the importance of the region as a consumer of German products has steadily diminished since 1954, when the Latin American share of the total German exports reached more than 12 percent. Since then its share has dropped steadily, reaching 6.8 percent in 1960 and 3.9 percent in 1974 and 1975. Thus, German exports to Latin America did not keep pace with the continuous increase of her exports to other regions of the world and, predominantly, to other industrialized countries. In 1975, the regional distribution of German exports was as follows: 43 percent to EEC members, 29 percent to other European countries, 7 percent to the U.S.A. and Canada, 10 percent to Asia (including the Near East), 6 percent to Africa, and only about 4 percent to Latin America. Brazil, which takes more than a third of Latin America's imports from Germany, ranks only eighteenth. Austria, Sweden, and Switzerland, each account for a greater share of German exports than does all of Latin America.

As a result of the unbalanced global development of trade relations, not only did Latin America's trade deficit with the Federal Republic grow (in 1975 it reached more than U.S. $ one billion), but the relative importance of Latin America as a trading partner of Germany declined. This picture changes however if one looks at the composition of the German exports and considers their structural changes. Among the exports to Latin America, the well-known shifts from consumer goods to capital goods were of particular relevance. The industrialization process in countries such as Argentina and Brazil caused the demand for capital goods to increase at a higher rate there than in other areas. Consequently, the importance of some Latin American countries as a market for specific branches of the German industry is much greater than the global export figures suggest. An outstanding example is the German nuclear plant industry and its recent contracts with the Brazilian government.

II. CAPITAL INVESTMENTS AND DEVELOPMENT AID

With few exceptions, the early German private investments in Latin America that withstood the depression of 1929 either fell victim to the war or lost their foreign status through naturalization of their owners. German investments abroad were only resumed after 1952. By the end of 1960, about

DM750 million had been invested in Latin America. At the end of that decade, the accumulated value of all German direct investments amounted to more than DM3.6 billion, increasing to more than DM5 billion by the end of 1975. The Federal Republic thus became the most important European exporter of private capital to Latin America (see Table 4.3).

Total foreign investments in the subcontinent make the German investment there seem modest. Nevertheless, Latin America's share of German external capital is considerable by comparison with other regions, and particularly with underdeveloped countries. Latin America receives about 13 percent, ranking third after Europe and North America. Its share of German investments in developing countries is almost 50 percent. An analysis of the regional distribution of the flow of German investments to Latin America shows that they are heavily concentrated among the countries that are also the most important trade partners of the Federal Republic. About 55 percent are in Brazil. Argentina ranks next with 11 percent, and then Mexico with 9 percent. The predominant position of Brazil becomes clearer when one considers that this country received more than 7 percent of *all* German private investment abroad.

TABLE 4.3
Accumulated German Private Direct Investments in Latin America (in millions of DM by the end of each year)

Country	1963	1967	1970	1973	1975
Brazil	798.8	959.5	1.470.8	1.996.6	2.800.0
Argentina	273.3	335.5	458.2	539.3	580.2
Curaçao	92.2	117.2	851.0	522.1	672.5
Mexico	75.1	168.2	300.5	417.2	457.2
Colombia	68.3	98.6	98.3	101.3	110.2
Peru	38.5	47.1	53.3	54.6	89.7
Panama	37.0	42.6	162.6	135.3	165.5
Chile	27.6	59.7	99.4	87.6	98.0
Venezuela	25.6	32.3	40.9	59.3	73.6
Uruguay	15.8	21.2	31.4	24.6	25.1
Ecuador	5.3	9.0	8.5	9.3	10.6
Paraguay	0.6	0.7	1.4	9.6	10.0
Bolivia	0.1	0.1	2.1	2.2	2.3
Central American, Caribbean, and other countries	18.3	34.2	86.3	121.6	188.7
Total	1.476.5	1.925.9	3.664.7	4.080.6	5.283.6
Share of Latin America (percent)					
a) of all investments abroad	24.3	16.0	17.4	13.6	13.0
b) of the investments in developing countries	67.8	55.5	59.0	42.3	

Source: Annual reports of Bundesministerium fur Wirtschaft, and Deutsche Bundesbank

Steel, machinery, and the vehicle industry are the most important sectors of the Latin American economy for German capital. In Brazil almost a third and in Argentina almost half of German capital is found in these branches. The second most important sector is the electrical industry, followed by chemicals. This distribution shows that private German investment activity in Latin America has primarily involved large enterprises. More than half of German foreign investment has been made by a small number of firms. For several years, various institutions–including the German Society for Economic Development (Entwicklungsgesellschaft), which functions with federal capital–have sought to interest firms of all sizes in making investments in Latin America, mainly by entering joint ventures. In many cases, firms were induced to invest in Latin America as suppliers to larger companies, such as Volkswagen which were already in Brazil and Mexico. As a result, in 1975, an estimated 500 German-based industrial firms, the majority of them small and medium sized, were operating in Brazil.

In the 1960s, in order to protect existing investments and to provide for new capital investment in Latin America, the Federal Republic concluded investment guarantee agreements with the governments of Chile, Ecuador, and Colombia (although only the agreement with Ecuador has been ratified). Negotiations with Brazil for an agreement on capital protection have been unsuccessful. In the private sector, several large banks and other German enterprises have participated in the Atlantic Community Development Group (ADELA) for the common purpose of promoting capital investment in Latin America.

In spite of the irritations that restrictive foreign investment legislation and political measures have caused during recent years, German firms have generally been willing to adapt their investment policy in Latin America to the new conditions. With few exceptions, they stayed away from highly sensitive sectors of the host country, accepted joint ventures with local entrepreneurs, and were able to avoid major conflicts with host governments. Many German subsidiaries in Latin America concentrate on the development of local resources and markets or engage in the export of nontraditional products, including semimanufactured goods, to their parent companies.

Critics of the multinational companies in Latin America claim, however, that any different attitude of the German-based subsidiaries as compared to that of U.S.-based companies is a matter of size and importance rather than of business philosophy.

The main financial flow from Germany to Latin America still consists of credits to promote exports rather than direct investment. Recently, private financial capital, notably through the Euro-dollar and Euro-bond markets, has come to play a major role in financing Latin American balance of payments deficits. Some of the larger German banks have increasingly engaged in this

new field of activity. This is particularly true of a group of banks that have long experience in financing and handling trade operations and are well acquainted with the public and private sectors of the Latin American economies.

Among the developing areas Latin America has been the main recipient of German private investment and loans, but it has received little in the way of public grants and loans from the Federal Republic. Latin Americans, as well as Germans, repeatedly complain that the subcontinent is the stepchild of German development policy. It is true that in the years since the Federal Republic became involved in international development aid, Latin America has not played a role corresponding to its importance and to its needs.

There are three main reasons for this apparent neglect. First, for a long time, German development policy resisted treating Latin America as an underdeveloped region, and later, following the principles established by the U.N., it concentrated its activities mainly on the less developed areas in the Third World. Second, Latin America was viewed mainly as a domain of the United States. Third, it was considered an area in which private foreign investment together with local efforts should act as the key factors for economic growth and development.

Frequently, purely political considerations, such as objections against nondemocratic governments, acted as another restrictive element. Leading politicians in the Federal Republic still pay more attention to totalitarian regimes and the violation of human rights in Latin America than to problems of the same nature in other parts of the Third World. In a way these attitudes are symptomatic of a still prevailing tendency in Germany to make faulty assessments of the economic, political and social conditions in Latin America. However, it must be conceded that the considerable contrast in technical, economic and social development to be found there makes correct assessments quite difficult.

Finally, it must not be overlooked that for many years, development policy as a part of the foreign policy of the Federal Republic had been subject to its main principle, namely to preserve the Federal Republic as the sole representative of Germany in the world and to avoid the diplomatic recognition of the other Germany, the German Democratic Republic. This principle was given up only in the early 1970s, when the new "Ostpolitic" was gradually adopted by the Federal Government under Chancellor Willy Brandt.

Both in absolute and relative terms, the developing countries in Asia, Africa, and in Mediterranean Europe were clearly favored by German development policy. Aid has been concentrated mainly on Asia, particularly India, Pakistan, and Indonesia. From 1950 to 1975, total bilateral official aid concessions of the Federal Republic to developing countries amounted to

about DM42.6 billion, according to OECD statistics. This amount is divided as follows:

Grants, subsidies and similar concessions, DM 16.3 billion; loans (primarily for technical assistance) and credits (including debt consolidation), DM26.3 billion.

By continent the distribution of total aid shows the following picture:

	Loans	*Grants*
Asia	49.1 percent	35.7 percent
Africa	26.4 percent	36.4 percent
Europe	15.5 percent	6.8 percent
Latin America	8.9 percent	21.1 percent
Total	100 percent	100 percent

A year-by-year analysis of the regional distribution shows that in the early years of German development aid, until the mid-1960s, the Latin American share of grants and technical assistance concessions was even smaller (6 to 10 percent), while its share in the amount of official loans has remained more or less unchanged (between 6 and 13 percent). Obviously, Latin America participated in the two principal types of aid at different levels. Leaving aside the developing countries in Europe, which should hardly be considered recipients of technical assistance, Latin America remained at the bottom of the list for both types.

As of the end of 1975, more than 40 percent of German aid to Latin America went to Brazil and Chile, and about 30 percent to Colombia and Peru. Thus, these four countries together account for more than 70 percent of the official German loans to Latin America during the period 1950-1975 (DM2.2 billion). During that period, however, various shifts took place, and no more loans have been conceded to Chile since 1973.

Since the early 1960s, Latin America has received a higher share of Germany's bilateral technical aid (grants) than of its capital aid (loans). This aid has been distributed more evenly among the recipient countries in Latin America, although the four countries mentioned above together account for about half of the grants that have been made available so far. Because the proportion of aid is relatively small and is concentrated in a few countries, it is evident that most Latin American countries have received a negligible amount of German development aid. Only a very small portion of the population has been able to benefit from it, and then only occasionally. This is even true if one calculates the per capita share of German official aid, taking into consideration the high population figures in Asian countries. Even in this distribution, Latin America fares the worst. Its per capita share of German development aid amounts to only a half of that extended to the

African countries. The lack of official bilateral aid has been offset in part by two other types of aid, loans from multilateral agencies and aid from private organizations, mainly in the form of technical and social assistance. Compared with African countries, Latin America has received a larger portion of the World Bank loans that were made available through contributions of the Federal Republic. In January 1976, the Federal Republic, together with other European and non-European countries, became an associate member of the Interamerican Development Bank, with the obligation to contribute U.S. $52.3 million to the Bank's ordinary capital and U.S. $63.1 million to the Social Progress Trust Funds. This new institutional link is expected to provide more financial cooperation in the future. In the private field, German development organizations under the auspices of the Catholic and Evangelical churches have chosen Latin America as their main field for charitable and social measures.

III. THE MEANING TO LATIN AMERICA OF THE TRADE AND DEVELOPMENT POLICIES OF THE EUROPEAN COMMUNITY

Part of the very nature of common markets and other economic integration schemes is that they present two completely different faces, depending on whether one looks at them from the inside or from the outside. Thus, on one side, Latin Americans see the European Community as a highly successful integration model worth copying; and, from the other side, they see it as an exclusive protection agreement, which discriminates against Latin American trade and development.[2] Moreover, an implicit distinction is made between the Community and its members, attributing all the positive effects of integration—increase of trade, economic growth, etc.—to the member countries, and blaming the negative effects on the Community itself. Sometimes, representatives of the member states add to such a double image by emphasizing that their policy on Latin American trade is mainly limited by their obligations to the Community.

Since its foundation almost 20 years ago, the European Community has been criticized by the Latin Americans, who claim that it raises obstacles to increasing Latin American trade with its member countries. In the opinion of these critics, three main elements of the EC internal policy create such obstacles: 1) EC internal policies, including the Common Agricultural Policy; 2) the Common External Tariff; and 3) the Community's policy of preferential trade with an increasing number of Associated countries that are actual or potential competitors of Latin America, especially as regards primary products.

The main objective of the Common Agricultural Policy—to make the EC as self-sufficient as possible in temperate climate food products and to raise

incomes in the agricultural sector up to the level of those obtained in the industrial sectors–has not been favorable to those Latin American countries that are interested in increasing their exports of agricultural goods to Europe. The Common External Tariff adds levies to the prices of goods imported from third countries in order to raise their prices to the Community's target prices. During some periods, and particularly in the case of beef, the amount of these levies was fixed at very short notice, turning any sales into unpredictable transactions. It was hoped that when Great Britain joined the EC, there would be a fundamental change in the Common Agricultural Policy, making it possible to reconcile European and Latin American interests in this area. But not much has changed so far, and the Latin American food-producing countries, such as Argentina and Uruguay, fear that their prospects of expanding exports to Britain, traditionally the largest European importer of food products from Latin America, will be further reduced.

Various factors also affect Latin America's tropical products unfavorably. The relatively high difference between the tariff rates on raw products and the rates on manufactured goods results in onerous effective custom duties. The application of high internal consumer taxes on coffee and other goods, tend to affect consumption by raising consumer prices. The EC policy of association with African countries that are important producers of tropical goods, such as coffee, bananas, cocoa, palm nuts, and others, is of the greatest concern for their competitors in Latin America. Therefore, the two Yaoundé conventions of 1964 and 1971, as well as the recent Lomé conventions, produced considerable preoccupation in Latin America.

In the 1960s, when Latin Americans complained about the adverse effects of the EC trade policy, the representatives of the Common Market used to point out that the actual trade figures did not show any decline of Latin American exports to the Community. In fact, Latin America's exports to the EC during that decade increased at the same annual rate as its exports to the rest of the world. Thus, the Community's share remained at the level (around 28 percent) that European countries had imported before the EC was established. Moreover, Latin America obtained a continuous surplus by its trade with the nine European countries.

By the end of the decade, however, this favorable situation had changed. Exports to the Community grew at a lower rate than Latin American exports to the rest of the world, and the trade surplus turned into a growing deficit that, finally, in 1974, reached the unprecedented amount of U.S. $1.471 million. This resulted from the fact that while the value of the Community's exports to Latin America increased at an annual rate of 14 percent during the period 1967-1972, the value of its imports rose by only 5.8 percent. This figure compares very poorly with the almost 15 percent annual growth rate of the ECs total imports during the same period. It must be admitted, however,

that the enormous balance of trade deficit in 1974 was mainly due to the economic recession, which occurred in the member countries of the EC as well as in most of the industrial countries. Thus, Latin America's share in the imports of the Common Market has rapidly declined. It dropped from 6.4 percent in 1960 to 3.9 percent in 1970 and to a mere 3.0 percent in 1974. In the same period, the African countries have been able to maintain their share of total EC imports, which was 7.9 percent in 1960, averaged 6.2 percent during the period 1970-1973, and increased again to 7.4 percent in 1974.

Looking only at global statistical data and measuring shares of total trade, however, cannot explain the real importance to Latin America of the trade with the countries of the EC. It is well known that the high growth rate of the total imports of the EC was mainly due to increasing imports of manufactured goods from industrial countries rather than imports of primary and semimanufactured products. Therefore, it is not so much its share of total EC imports that worries Latin America as its share in the commodity markets in which, given a fair chance, Latin American producers are competitive. Latin America has a legitimate interest in maintaining and increasing its exports to the Community of such traditional goods as raw materials and food, on which its economies depend to a large degree, as well as exports of nontraditional (manufactured) goods. The following table shows the Latin American share of selected commodities imported by the European Community (Average percentages, period 1970-1973).

Coffee	63	Palm nut and groundnut products (oil cakes etc.)	23
Bananas	61	Cotton products	13
Sisal	35	Coconut products	10
Iron ore	23	Hides and raw leather	9

Sources: OECD, Trade by Commodities, Series C, various years

If one compares these figures with the 3.5 percent share of the total imports from Latin America it becomes clear that for some commodities, and for at least a few Latin American countries,[3] exports to the EC are of a vital importance.

In July 1970, the Special Commission for Latin American Coordination (CECLA) published the Declaration of Buenos Aires, expressing the desire and the need to strengthen the relations between the European Community and Latin America. The resolution attached to the Declaration contains an ample catalogue of proposals and measures that should be adopted in order to improve cooperation between the two areas. Broadly speaking, the Declaration of Buenos Aires appeals for greater access to the EC markets for raw materials, semiprocessed and manufactured goods. It also calls for a greater

flow of private and public investments and loans to Latin America, and for increasing and more effective scientific and technical cooperation. The reaction of the Community consisted mainly in announcing the creation of a system of generalized tariff preferences for all developing countries and in proposing bilateral nonpreferential trade agreements with individual Latin American countries.

The system of Generalized Tariff Preferences, established by the Community in 1971, eliminated import quotas and conceded partial reduction of duties or levies to almost 150 processed agricultural products that the EC imported from all developing countries. For manufactured and semimanufactured products a combination of quotas and ceilings was established. Its purpose was to allow imports of each product from developing countries to increase annually and at the same time to avoid major distortions of the corresponding industrial sector within the Community. The import ceiling for each product has been enlarged annually, with different years (1968, 1971 and 1974) used as a reference basis. In the five years since the establishment of the preference system, the countries that have been most benefited are the more industrialized among the developing countries (Hong Kong, India, Malaysia, and, in Latin America, Brazil). Thus the imports of manufactured goods from Brazil to the Federal Republic of Germany tripled during the period 1971-1975 (from DM115 million to DM348 million), while in the same period total imports of manufactured products to Germany increased by only 50 percent. For most of the other Latin American countries, however, the system has so far produced only very limited results.

In September 1972, CECLA issued another declaration expressing concern at the slow development of relations between Latin America and the Community and urging a new policy of economic cooperation between the two areas. Subsequently, economic relations between the EC and individual Latin American countries have been formalized through bilateral nonpreferential trade treaties. Argentina had already signed such a treaty in 1971 which dealt mainly with beef exports. In 1973 Uruguay concluded a similar treaty, aimed at improving the export of frozen beef and veal to the Community and exempting certain goods from duties. The trade agreement between Brazil and the EC, also signed in 1973, refers primarily to a tariff reduction on imports of cocoa butter and soluble coffee, up to fixed quotas, as part of the general preference system. The most recent treaty, which was concluded with Mexico in 1975, grants this country most-favored-nation treatment with regard to custom duties, taxes, national regulations, import and export quotas, and payment regulations. This treatment, however, does not refer to advantages extended by Mexico to free trade areas (LAFTA) or in the context of similar arrangements with other developing countries in Latin America or elsewhere. The EC promised to consider the special interests of

Mexico within the generalized preference system of the Community. It is, of course, too early to assess fully the value of these bilateral agreements in developing trade between the EC and each of these four countries. Some observers fear that such bilateral treaties may hinder a multilateral solution of the trade problems between Latin America and the Community. Since this is a major goal of Latin American trade policy, the association agreements of the European Community have been the main targets of criticism.

It is well known that the Treaty of Rome provided for the economic interests of the overseas territories and former colonies or dependencies of the member states, primarily African, Caribbean, and Pacific countries which had or still have special links with Belgium, France, Italy, and the Netherlands. From this special relationship resulted the first Yaoundé Convention, which began in 1964 and lasted for five years. The association of the former colonial territories of the EC members was fully recognized by the Latin Americans as an expression of a historical responsibility. However, they severely criticized the association agreements that were subsequently concluded between the EC and other African and Mediterranean countries (Nigeria, Kenya, Tanzania, and the Maghreb states) as not being in accordance with the proclaimed worldwide liberal trade policy of the Community. The importance to Latin America of these agreements, which were concluded between 1966 and 1970, i.e. before Britain joined the Community, was even greater because some of the new associates are large producers of coffee, cocoa, primary goods for vegetable oil, and other products that are also produced in Latin America. The first Yaoundé Convention was followed by the second, which was in effect from 1971 until January 1975.

On entering the Community, Britain agreed to phase out her tariff preferences in favor of the Commonwealth countries. Instead, the developing countries among them were to seek association with the EC. In 1973 the Yaoundé associates and the associable countries of the Commonwealth initiated negotiations for a new arrangement. In February 1975 the Convention of Lomé was concluded, establishing a five-year period of trade preferences and overall cooperation between the Community of Nine and 46 African, Caribbean, and Pacific-(ACP)-countries. It became effective on April 1, 1976. Of the ACP countries (representing a total population of about 270 million), 18 are considered to be least developed countries by the United Nations. The ACP countries, most of which have basically agricultural economies, sell about 54 percent of their exports to the EC, which also supplies nearly half their imports.

From the Latin American viewpoint, it is worth noting that five of the 46 ACP countries are located within the region (Bahamas, Barbados, Guyana, Jamaica, Trinidad and Tobago). The Lomé Convention has reduced further the number of traditional trading partners of the European countries that are

not associated with the EC, leaving the Latin American countries as the major group of nonassociates.

The most important provisions of the Lomé Convention are: trade liberalization, stabilization of export earnings from commodities, industrial cooperation, financial and technical cooperation and provisions relating to services, payments and capital movements.

Of major concern to Latin America are the trade regulations. These exempt about 90 percent (based on 1973 figures) of the EC imports from the ACP countries from custom duties, equivalent taxes and quantitative restrictions. These preferences are not reciprocal, and the ACP countries are only obliged not to discriminate against the EC member states. The stabilization system for export earnings introduced a completely new element into the previous association policy, insofar as its aim is "to provide a remedy for the adverse effects of unstable export receipts and thus help the ACP countries to secure economic stability, profitability and steady growth." Its application and the payments to be made out of the common compensation fund are based on a number of criteria. Among the factors taken into consideration are the relative importance of each product to each country, the deterioration of the terms of trade between the EC and the ACP country concerned, and the degree to which the economies of the ACP countries depend upon each product. Initially the system is applicable to 12 principal products, five of which are among the 12 principal export commodities of Latin America.[4] Other commodities included in the system (coconuts, palm nuts, hides and skins, sisal, and timber) are of major importance to individual Latin American countries. There are special arrangements for sugar; each producing ACP country is guaranteed the purchase and the price of a fixed quantity.

The industrial cooperation as well as the financial and technical assistance to be extended to the ACP countries under the Lomé Convention will provide for a further improvement of the productive and marketing capacity of these countries. To this purpose the new European Development Fund will allocate approximately U.S. $4 billion until 1980.

In general terms the Lomé Convention is an instrument for creating special economic links between a large group of countries, many of whom compete directly with Latin American countries. Thus, it may have unfavorable repercussions for the trade relations between Latin America and the European Community. The implementation of the stabilization system for export earnings could act as strong incentive to increase production even at the risk of overproduction, because the producing ACP countries may receive compensation when prices drop below the reference level. In such a situation, competing third countries have no system of compensation to rely on. Thus the stabilization system could ultimately cause the Latin American primary commodities to be replaced in the EC markets. The guaranteed payments of

the difference between the world market prices and the reference prices will enable the ACP countries to withstand competition from nonassociated countries. Moreover, the ACP countries obviously have better opportunities of access to the EC market for most of their agricultural products. This has been proved by recent examples of the EC trade policy even in the case of products such as beef, which are not covered by the free access rule of the Lomé Convention. In the course of time, therefore, the share of the ACP countries in the EC imports of products included in the preference scheme will probably increase at the cost of the nonassociated and, not least, the Latin American countries. It must be admitted that such a trade diversion effect has been at least tolerated, if not intended, by the authorities of the European Community.

Taking together the different elements of trade relations, financial and technical cooperation between a single European country and the European Community on one side and Latin America on the other, and looking at them before the background of the global discussion on a new international economic order since UNCTAD IV and the beginning of the North-South Dialogue, it becomes evident that a new initiative has to be taken in order to reshape trade relations and cooperation between these two regions. The traditional good relations between Latin America and Europe that are so often quoted during state visits and similar occasions are in danger of becoming an empty formula, if they are not continuously renewed through common actions. There are many reasons for new initiatives, and many fields in which they could be taken, despite the adverse effects of the recent economic recession and the so-called oil crisis.

The Latin American policy of diversifying its exports by adding new, mainly manufactured, products to the traditionally exported primary goods as well as by extending its geographical export markets, offers many possibilities for a larger European share of this trade. The desire to make Latin American economies less dependent on United States markets and investment capital opens new chances for a greater participation from Europe.

On the other side, the Europeans must recognize the growing importance of Latin America as a supplier of raw materials and energy and as one of the most rapidly growing consumer markets in the world. Moreover, the Latin American countries are more and more in a position to offer a well-trained labor force. This, combined with foreign capital and technology, will enable Latin American countries to produce those manufactured goods which, due to extremely high labor costs and the need for structural reforms, can no longer be produced in the old industrial countries at internationally competitive prices. The transfer of labor-intensive industries from Europe to Latin America is one of the challenges that future cooperation schemes will offer. There is reason to believe that some of the EC countries would be willing to

increase their imports of various groups of manufactured goods from Latin America, if only because the growing European trade surplus is causing them difficulty in expanding their own exports to the region.

Along with the expansion of the traditional and nontraditional trade relations, new forms of economic cooperation must be developed. The economic cooperation that has been established for a number of years between Western European countries and some socialist countries in Eastern Europe has produced new types of international transactions. These cooperation schemes are characterized by 1) the export of a complete industrial production unit rather than the export of goods or direct capital investment; 2) a high degree of government participation on both sides; and 3) payment agreements that include barter elements whereby part of the payment to the exporting country consists of the supply of goods or energy, sometimes to be produced in the future by the very plant that was exported. Some of the preconditions necessary for the negotiation of such agreements–high degree of economic planning and government control of business, contractual security through state guarantees, etc.–exist already in at least some of the Latin American countries. Therefore, this new type of cooperation does not seem impracticable.

To some extent new forms of cooperation will have to replace some of the traditional forms of trade and investment. They will presumably develop within a partially new institutional and functional framework. Thus, in spite of the existing bilateral agreements between the EC and four Latin American countries, the multilateral framework of relations is expected to grow in response to increasing integration of the decision making process on both sides. By harmonizing interests, regional integration should lead to a reduction of the importance of purely national, as opposed to regional, interests. This will have positive effects on the stability and continuity of the relations between the two continents. The participation of European countries in the Inter-American Development Bank is a step toward better relations in a multilateral framework. However, the establishment of an adequate negotiating machinery between the European Community and Latin America remains an unsolved problem. There is still no practicable common Latin American approach to the Community of Nine, and the "dialogue" that was set up in Brussels in 1971 is obviously not effective enough to initiate a new cooperation policy. There is a danger that this dialogue, instead of becoming more effective, may fall victim to the global North-South discussion and to the growing polarization of standpoints.

A renewed cooperation policy should give special attention to scientific and technological collaboration between the two regions. The European tendency to concentrate development aid on the least developed countries in the Third World is likely to produce a dangerous vacuum in the flow of

scientific and technical knowledge and experience toward the semi-industrialized countries, many of which are Latin American. Neither the traditional trade and investment activities nor the technical and financial assistance given in the last two decades have been able to create the necessary basis for the sort of intensive, mutual scientific and technological cooperation which is normal between industrialized countries. Therefore, technical and scientific assistance to Latin America on concessionary terms should not only continue but increase. However, such assistance must be better suited than in the past to the specific needs of the recipient countries, as well as to the capacity of the donors. Broadly speaking, this means that technical and scientific cooperation must grow more sophisticated, and should be adapted to the absorptive capacity of the local infrastructure and the existing human resources in each country. If technological and scientific cooperation is not continued, Latin America could be partially cut off from future developments. Such cooperation should not, however, be based on altruism; it would be more solidly based on motives of self-interest. The future of countries such as the Federal Republic of Germany depends on their capacity to create continuously new sources of export earnings by developing new products and technologies. They also depend on a guaranteed supply of raw materials from abroad. It is legitimate that they appeal to their partners in the world for comprehension and acknowledgement of these vital interests.

NOTES

1. For more details of the political, economic, and cultural relations, see v. Gleich, 1968; Goldhammer, 1972.
2. For a Latin American view of this subject, see Krieger Vasena and Pazos, 1973.
3. Argentina and Brazil account for about half of the total Latin American exports to the Community. Brazil alone accounts for 50 percent of the coffee, cocoa, and oil cakes, 70 percent of the iron ore, and 93 percent of the sisal imported from Latin America. Argentina supplies 60 percent of the EC's imports of hides and leather from the region.
4. These commodities are: coffee, cocoa, cotton, bananas, and iron ore. Each has accounted for at least one percent of the total Latin American export earnings in the 1970s.

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Chapter 5

LATIN AMERICA'S OPENING TO THE PACIFIC

CLAUDIO VELIZ

As the world moves out of the recession of the mid-1970s, trade between the countries of Latin America and those of the western Pacific will almost certainly increase considerably both in absolute and in relative terms. Until recently, the prospects for such a development—with the notable exception of trade between Brazil and Japan—were regarded with a skepticism that was difficult to override, based as it was on considerations that appeared to confirm that the greatest oceanic barrier on earth could not simply be wished out of existence. The most obvious of these was dictated by tradition; since the collapse of the Spanish-American empire trans-Pacific trade had been almost nonexistent, and it was not easy to discover new factors sufficiently weighty to indicate that a fundamental change was imminent. Secondly, even though since the early 1960s, the Pacific basin has been "the world's most dynamic trading region," (Malmgren, 1973) it has also been noted that "the countries of the two regions (Latin America and the western Pacific) have few interests in common," (O'Shaughnessy, 1975: 41) they produce largely the same exportable primary commodities and often compete for a share of the same markets. Thirdly, again with the exception of Japan, the countries of the region were obviously more interested in directing their principal trading efforts toward Europe or the United States, rather than toward each other; the former were more likely sources for the industrial products, capital and advanced technology which their growing economies so urgently required then and still need today. Fourthly, the prevailing political climate was not conducive—or so it appeared at the time—to any sustained effort on either side to improve relations generally, including trading relations. With the exception of the People's Republic of China, of relatively small importance in Latin American trade, the western Pacific countries could be described before 1973 as closer to an acceptance of the free market

economy than their Latin American neighbors across the Pacific Ocean, while their general political disposition was at least center-right, as opposed to the statist and center-left mood prevailing in most of the countries of Latin America. Lastly, communications between the countries of Latin America and those of the western Pacific were woefully inadequate.

Habits are as hard to break in matters relating to trade as in other things. The connections, expectations, cultural aspirations, and institutional regularities that resulted from centuries of parallel dependent development by the countries of Latin America and those of the western Pacific did not vanish overnight after the umbilical cord connecting each of these regions with Europe and the United States was broken. Since their discovery and incorporation into the then Eurocentric modern world, Latin America, Australasia, and the Far East—perhaps again with the exception of Japan—developed bound by the limitations and possibilities that resulted from their special relationship with their respective metropolitan centers. There was a change in the 20th century, with many of these countries—and regions—substituting the U.S. for their traditional metropolis, but the fact remained that, in the global context, theirs was basically a vertical relationship in economic as well as cultural and political questions. The overriding practical necessity of looking north to Spain, France, Britain, Holland, or the United States, was never significantly modified by a need to glance across the Pacific Ocean, unless this was dictated by economic considerations, again resulting from their dependent development. Thus, there was some trade in coal and nitrate of soda between New South Wales and the northern ports of Chile; Australian coal for use in the nitrate "oficinas" which produced the fertilizer needed by Australian agriculture. Earlier, there were shipments of South American flour to the gold diggings of Victoria but these were soon made unnecessary by the rapid development of Australian agriculture.

This tradition of trans-Pacific isolation has been one of the interesting casualties of the post-Cold War period. Impelled partly by resurgent nationalism and partly by the desire to take advantage of the opportunities offered by the restoration of fluidity in international affairs, many countries of the western Pacific and of Latin America have pursued policies aimed at greater commercial as well as political diversification. These have not always yielded the expected results. An inward-looking Europe has presented problems, especially for the members of the British Commonwealth, whilst the possibility of entering new African and Asian markets has been hindered by recurring civil commotion, cultural and geographical distance, and the overriding commercial presence of some of the traditional industrial metropolitan powers.

Few or none of these adverse factors have hindered the development of trade between Latin America and the countries of the western Pacific. The

most dramatic illustration is obviously provided by the case of Japan, whose share of Latin American trade has grown by leaps and bounds during the last decade. Such advances in trade have been matched by Japanese investment. In 1976 the Nomura Research Institute of Japan reported that almost ten percent of total Japanese investment overseas was in Brazil, and this was before the Brazilian decision of November 1976, to allow foreign capital into petroleum exploration, a sector which will, no doubt, prove attractive to oil-starved Japan. Brazil and Japan could well be considered exceptional instances, unlikely to provide reliable evidence of an overall trend, were it not for the fact that similar tendencies are discernible in the trade arrangements between other Latin American countries and Japan. Argentine exports to Japan increased from U.S. $32.4 million in 1965 to over U.S. $136 million in 1974; Japanese imports from Argentina reached U.S. $493.63 million in 1975, having been only U.S. $44.1 million ten years earlier. Chilean exports to Japan were valued at U.S. $74 million in 1965 and U.S. $407 million in 1974, while Venezuelan imports from Japan rose from U.S. $68.9 million in 1965 to U.S. $209.2 million in 1973. This general trend contrasts with Japan's trade with Asia, which has shown a slight decline. The increasing importance of Japan in the commercial relations of Latin America can also be appreciated from the fact that this Asian country is now taking more than 30 percent of all the raw materials exported by Latin America. Moreover, whilst in aggregate Japan has now invested more than U.S. $3 billion in Asia, the figure for Latin America has already climbed over U.S. $2.5 billion (Awanohara, 1975: 42-44).

The increase in trade between Japan and Latin America has largely followed a classical pattern of complementarity. Latin America has provided the primary commodities required by Japanese industry and Japan has supplied manufactured goods. In the case of Brazil, this complementarity reached telling proportions; 96 percent of Japan's exports were made up of industrial goods, while over 70 percent of Brazil's were primary commodities. These figures were mentioned by the president of the Japanese Foundation for Foreign Economic Cooperation, Professor Saburo Okita, in a paper presented before a conference sponsored by the Brazilian National Development Bank in 1973. Though praising the advantages and opportunities offered by complementarity, Professor Okita added that an increasing proportion of Brazilian exports to Japan was now made up of industrial products, and that Japan was endeavoring to encourage this tendency.

Professor Okita also noted that the dissimilar roles performed by foreign capital in the development of Brazil and Japan were the consequence of differing physical and historical circumstances. Japan's high level of domestic savings made the massive influx of foreign capital unnecessary, while in the case of Brazil—and Australia and Canada—a large country with abundant

natural resources and few practical possibilities of raising the required capital domestically, the opportunities for the effective use of foreign capital were obvious. It is perhaps useful to keep this in mind when considering the fact that some Japanese investment in Latin American countries has been directed to the production of specific commodities, which find a ready market in Japan. Possibly the best known of these initiatives is the large scale soybean plantations in the interior of Brazil. The latest, or perhaps the best publicized, of these projects, in which the Japan International Cooperation Agency has been directly involved, plans to bring 300,000 hectares of virgin land into cultivation for the production of corn and soybeans, mostly destined for exportation to Japan. Of course, Japanese investment is mainly directed toward straightforward industrial or infrastructural ventures, whose immediate effects are largely domestic. In the medium run, even when successful, these do not necessarily help to ease the recurring imbalances that appear to be part and parcel of Japanese trade with Latin American countries. While some exporters of primary commodities, such as Chile, Peru, and Cuba, accumulate substantial balance of payments surpluses with Japan, others, such as Argentina, Ecuador, Brazil, Venezuela, and Colombia, have tended to remain at the other end of the scale, with deficits that are unlikely to disappear quickly. A possible exception may be Venezuela with which Japan, after the oil crisis, has entered into a number of new agreements to make substantially higher purchases of petroleum.

While complementarities of the type noted by Professor Okita largely help to explain the rapid and successful involvement of Japan in Latin America, other reasons must be sought to explain the less striking but equally real increase in the Latin American trade with countries such as Australia, New Zealand and China. Before 1966, commercial relations between these countries and Latin America were virtually nonexistent. Australia exported goods worth U.S. $1.5 million to Chile in 1966 but by 1974 the figure had risen to U.S. $94.93 million. In the case of Peru, imports from Australia have increased from U.S. $3.5 million in 1966 to more than U.S. $34 million in 1975; in Argentina, from U.S. $1.2 million in 1965 to more than U.S. $66 million ten years later. In absolute terms, perhaps not an impressive performance, but the trend continues. Moreover, the factors behind this general tendency are likely to persist for a considerable time, exerting an influence over the development of trans-Pacific trade.

Possibly the most underestimated cause is the inability of many Latin American countries to raise enough farm crops to feed themselves. Despite considerable efforts to improve agricultural productivity, conspicuously in nations with shores on the Pacific, this situation appears unlikely to change importantly during the next few years. Agricultural exporters, such as Argentina and Uruguay are naturally interested in discovering extra-Latin American markets for their products; food-importing countries, such as Peru and Chile,

find the prospect of obtaining needed supplies in Australia or New Zealand understandably attractive. On the other side of the Pacific, Australia and New Zealand are more interested now in diversifying their export markets than they were, say, before the disappointing developments that accompanied the United Kingdom's entry into the EC. They have, therefore, reacted positively —at times enthusiastically—to the realization that there appears to be a good market for beef and grain beyond their eastern shores. Moreover, the latitude of these countries makes the expertise of Australians and New Zealanders in certain aspects of animal husbandry, arid and tropical zone agriculture, an undoubted asset and a further encouragement for the overall trend toward closer and more abundant trans-Pacific exchanges. There have been increasing sales of thoroughbred stock, specialized agricultural machinery and farm products. Cuba, for instance, is a keen purchaser of sugar harvesting machines developed in Queensland, while Chile has been making important purchases of dairy products from New South Wales.

In the last few years, the Chinese commercial presence has attained an importance sufficient to be considered a factor in this general trend. Traditionally, China has played a very minor role in Latin American trade, and, although in absolute figures this may still hold, there are indications that commercial exchanges between China and several Latin American countries will increase substantially in the near future. Undoubtedly, the best publicized of these indications is the brisk readiness with which the Chinese appear to use any opportunity offered to replace outgoing or declining Soviet involvement. Chile is often cited in this respect, and it is pointed out that the Chinese not only refused to interrupt diplomatic relations after President Allende's downfall, but actually extended financial support of at least U.S. $100 million to the new government and have actively encouraged trade between the two countries. Chile supplies China with nitrate fertilizers, copper, and other mineral products, while China's exports to Chile are mainly food products and machinery. It is rumored that when Mr. Whitlam's Labour government in Australia refused to supply Chile with 300,000 tonnes of wheat in 1975, the Chilean government was able to make good the deficiency with the help of China. If the rumor is true, those supplies could have come either from Australia, which had recently sold a large quantity of wheat to China, or from Argentina, which had only a few months earlier signed the largest single contract in the history of Latin American-Chinese trade, wherein China agreed to buy three million tonnes of wheat and maize over the period 1974-1977. Whether reliable or not, the fact that such a story circulates at all speaks volumes about the type of pragmatic and businesslike reputation that China appears to want to establish.

Gone are the days when Chinese commercial missions were reputed to be centers of armed subversion in Latin America. The embarrassing incidents that preceded the expulsion from Brazil of the Chinese Trade Mission imme-

diately following the overthrow of President Goulart in 1964 appear to belong to another epoch. Now the talk is of trade missions indeed, but they are Latin American missions, traveling to Peking and finding encouragement in what appears to be a concerted Chinese effort to increase substantially its trade links with Latin American countries regardless of political color. China does need increasing amounts of mineral and agricultural commodities from Latin America, and this may be the principal reason for her interest rather than a deliberate policy to gain advantages on a global scale, at the expense of the U.S.S.R. However, if a political dimension can conceivably be ruled out from a Chinese interest in developing trade with Latin America, it certainly appears to be inextricably bound with the forthcoming consolidation of a trade system in the South Pacific rim.

Only a decade ago the vast geographic barrier of the southern Pacific Ocean was paralleled in the political frontier that separated some of the loudest anti-socialist (let alone anti-communist) regimes on earth, from some of the better-known and publicized exponents of varieties of Latin American democratic, and some not so democratic, socialism. The western shores of the southern Pacific were crowded with the allies of the United States in the Vietnam War; the eastern shores were dominated by regimes pursuing nationalistic, centralist policies, who were openly critical of the United States and unashamed of proclaiming themselves either socialist or at least socialistic. Such differences were difficult to bridge. When added to the great oceanic distance and the very low priority of any policy for trans-Pacific rapprochement at that time, it is not surprising that countries on both sides of the Pacific were uninterested in breaking away from their respective isolation. Ten years later the situation is radically different. With the possible exception of Colombia, Costa Rica, and Venezuela, all the countries of Latin America are now under either straightforward military rule, or single party systems, or some euphemistic variety of these recognizable types. Again, with the well-known exception of Cuba, Venezuela, and, arguably, Peru, they are all under regimes that, despite some diversity, can safely be classified as right of center, with a weighty plurality crowding the far side of the political spectrum. At no time in modern history have so many countries with shores on the South Pacific had such a striking identity of declared political views. If, in the past, differences in political allegiances or inclinations constituted an obstacle to closer relations and trade, this barrier is not there now.

The disappearance of political barriers has come at a time when for a number of other reasons, mostly technological and economic, the countries on both sides of the ocean are endeavoring to diversify their external relations. They are moving away from too close a dependence on any of the great powers and seeking to establish a flexible, functional system of relationships with smaller or medium-sized countries with similar interests and needs.

Ten years ago, the only trans-Pacific project with possibilities of getting beyond the drawing board stage was Professor Kojima's Pacific Free Trade Area, (PAFTA), which was regarded in Latin America and Southeast Asia as a "rich men's club," for it included only Australia, New Zealand, Japan, Canada and the United States. Such a project could be revived today only at the risk of jeopardizing much of the goodwill that Japan has earned in Latin America, and the still small but growing goodwill in Southeast Asia. There are at least two dozen countries with shores on the Pacific that would not like to be excluded from any arrangement, however informal, to organize and improve commercial relations across the great ocean.

The special relationship that Japan has so successfully established with Brazil will probably find imitators. When Jorge Kawahata, the Argentine Ambassador to Japan arrived there over two years ago, he announced that his country wished to invite one million Japanese immigrants to settle in Argentina. This was, of course, well received. It was, moreover, a policy based on the conviction that a major factor in the shaping of the enviable relationship between Brazil and Japan has been the presence of a numerous and prosperous Japanese community in Brazil. If trading and other relations are to become a permanent feature of a new Argentine trans-Pacific policy, a generous and imaginative immigration policy seems a good way of going about it.

Even without such emphatic long-term encouragement as accepting a million immigrants, however, trade should grow significantly and steadily across the south Pacific over the next decades. If direct complementarity spurred the large increases of the last decade, it is safe to assume that the growing complexity of the industrializing economies of Latin America matched with the similar evolving complexity of the economies of Southeast Asia and Australasia will necessarily result in greater diversification of demand and a gradual move away from the transfer of primary commodities to an exchange of manufactured goods. Such a tendency will help to correct extreme imbalances and may well become of major importance through planned purchases of semi-manufactured materials or industrial components, largely in the way that the Andean Common Market planned, but has not yet done.

There are some additional factors that ought to be mentioned. One is that trans-Pacific trade may well experience a considerable increase by default, if for no other reason. The EC is making access to Europe increasingly difficult; Africa and the rest of Asia and the Middle East have proved of limited attraction as growth markets for the countries of Latin America, and there is little to suggest that this will change in the near future. Perhaps the giant of the region will find it easier to expand in all directions and will establish a Brazilian presence in West Africa with greater ease than any of its neighbors.

So far, however, there is scant indication that such a move will have the general appeal and exemplary consequences of its rapprochement with Japan and the Pacific. As for the great powers themselves, only a dramatic and truly surprising departure from the tendencies that appear to dominate the policies of most small and medium-sized foreign trade sensitive countries could possibly lead Latin America to rejoin the ranks of the cheerfully dependent. The resurgence of nationalism does not show signs of abatement and on it are based those dispositions and aspirations that lead to the search for diversity, new markets, relationships and alliances.

Finally, it is not possible to exclude the appeal to the imagination of Latin Americans of any determined thrust across the Pacific. Of the very few frontiers left to be explored and charted on this planet, two are within reach of Latin Americans; the continental hinterland and the Pacific. The former is wild, demanding, inhospitable, and unattractive to all but anthropologists, geologists, and the like; the latter conjures up every romantic dream of exotic places and cultures, adding a precious and irreplaceable dimension to what otherwise would be simply—and boringly—statistics. To encourage trade and exchanges with Belgium or Canada is fine, but to do so with Singapore and Indonesia is to open up a limitless world of wonder to be crossed and recrossed by diligent clerks and accountants, the vanguard of a middle sector that may have found life particularly devoid of romance these last few years. To this may be confidently added the lure and the challenge of scientific discovery, for the exploration of the ocean floor is nowhere more urgent, critical, and difficult than in that ocean facing Guayaquil, Callao and Valparaiso. Already the Latin American initiative of extending an inadequate limit to a full two hundred miles has achieved a signal success that has undoubtedly been remarked by the press of the principal fishing countries with shores on the Pacific.

All governments need a consensual basis for survival, and their policies, no matter how bizarre, must have a hard core that can be understood and supported by the people at large. The present governments of the countries of Latin America will find it difficult to discover a policy more attractive, and more likely to receive acceptance than opening to the Pacific—trading with Malaysia, Thailand, and the Philippines; sending products, businessmen, and government officials to Penang, Bali, Kuala Lumpur and Wangaratta, and receiving in turn the produce from a hundred places with names impossible to pronounce. The risks are minimal and the rewards for success very great indeed. It is just possible that the badly needed foodstuffs will come from there, as well as the technology and the farm machinery, and the world records. (Is there a single senior military officer in Latin America who is ignorant of the fact that Japanese-Brazilian cooperation built the largest shipbuilding slipway in the western hemisphere, all of 400.000 tons capacity,

constructed by Ishikawajima; and the world's largest aluminum smelter in Belem?) Also from the other side of the Pacific will come the hard-working immigrants, the capital, competition, incentives, and enterprise that may transform this or that country into a latter day Japan, or Brazil.

The move westwards across the great ocean has already produced dividends. A dozen years ago there was no air traffic across the South Pacific for the simple reason that there were no airlines flying that route. The classical problem was reenacted as to whether the road should wait for traffic to justify it or the other way around. In the end, Chile decided to establish the first regular air service over that part of the ocean; from Santiago to Easter Island, Papeete, Fiji, and points further west. Another route was later opened from Lima to Papeete and on to New Zealand, and now another joint Japanese-Brazilian effort will link Tokyo and Sao Paulo directly via Lima and the Pacific islands. Obviously, these air routes are heavily subsidized; they also perform a most useful service. Traffic is growing steadily, and the weekly services are said to be booked well in advance. The wilder shores of hope are those on the other side of the ocean, and before the dream fades—or succeeds—there will be a substantial increase in traffic, trade, and exchanges between the countries of Latin America and those of the western side of the Pacific.

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PART II

MEXICO AND BRAZIL

Chapter 6

THE EXTERNAL SECTOR OF THE MEXICAN ECONOMY

LEOPOLDO SOLÍS

Mexico's economic experience during the past six years has departed significantly from the pattern of the 1960s. During that decade the country was able to sustain a high growth rate and a considerable degree of internal and external stability; in recent years, however, the rate of growth has fluctuated greatly and finally decelerated. Moreover, the Mexican economy in the 1970s has been characterized by inflation and unemployment at home and a growing disequilibrium in its balance of payments.

The transition from a situation of rapid, sustained, and stable growth to one characterized by slow, fluctuating, and unstable growth results both from factors that came into being during the era which has come to be called the "Stabilizing Development" period (1957-1970) and from the adoption of certain economic policy decisions in more recent years. It is, therefore, essential to set forth the salient aspects of the Mexican economic experience during those two distinct periods in order to understand better the recent behavior of the external sector of the Mexican economy.

I. THE STABILIZING DEVELOPMENT PERIOD

Mexico entered the 1960s with a new economic policy oriented toward three principal objectives:

(i) achieving a high rate of economic growth, (ii) maintaining price stability, and (iii) assuring stability in the balance of payments, and the maintenance of a fixed exchange rate.

In order to harmonize efforts aimed at achieving those objectives, three principal mechanisms were applied: (i) planned public spending, (ii) bank reserves, and (iii) use of external financing.

It is worth noting that Mexico, like most Latin American countries, had predicated its growth policy on a pattern of industrialization designed basi-

cally for import substitution. During the 1950s, rather substantial successes were attained in manufacturing locally consumer goods that had previously been imported. As the 1960s began, the substitution process was expected to promote domestic manufacture of intermediate inputs and, in an initial form, capital goods.

The main thrust towards economic growth was conceived in terms of stimulating expansion of the industrial sector. Consequently, most measures under the policy were designed with an eye to stimulating industrialization tied to substitution. As a result growing use was made of protective tariffs, specific quantitative controls, a series of tax incentives and financial facilities. Furthermore, various programs were instituted to promote the production of manufactured goods.[1]

The protectionist policy was intensified in the 1960s. Between 1964 and 1970 about 1000 new categories per year were created in the tariff schedule for imports, bringing the total to 12,900 at the end of that period. This sizable expansion was due mainly to requests by businesses and to increases in the rate of duty on articles already protected. In addition, the tariff policy was also intended to augment public revenues and, by taxing articles not considered necessary, to help keep the trade balance even. The following table of a few groups of selected goods gives an idea of the thinking which determined the tariff rates.

Although Mexican tariffs have generally been lower than those of other developing countries, their protective effect was greatly enhanced by quantitative controls (import permits). These controls, introduced in 1948, were gradually expanded to the point that by 1970, import permits were required for 65 percent of all imports. During the "Stabilizing Development" period, controls were used to direct the industrializing process by means of the so-called production programs. These programs consisted of determining, through negotiations between the producer and the Department of Industry and Commerce, a time limit and schedule for the completion of industrial projects intended to replace intermediate inputs of foreign origin. The agreements included the granting of permits for all inputs which the producer had to import in order to carry out his new production.

TABLE 6.1

Groups of Goods	Protection
1. Agricultural machinery	Free
2. Raw materials	5-15%
3. Intermediate goods for industrial use	15%
4. Machinery and equipment	20-25%
5. Other manufactures	25-35%
6. Automobiles	100%

Source: CEPAL-NAFINSA: *La Política Industrial en el Desarrollo Económico de México;* Mexico, 1971)

The stimuli provided to industry by protectionist policies were supplemented with tax incentives. In 1955 the New and Necessary Industries Law was enacted, under which tax exemptions were granted to industries undertaking to produce articles not previously produced in the country and to those industries whose production could not yet cover 80 percent of the domestic market. In both categories, the tax exemptions included all import duties for machinery, equipment, and raw materials, as well as 40 percent of the income tax on businesses and 100 percent of stamp and sales taxes. The result was that effective protection was increased and extended to cover a larger number of articles. In 1961 the income tax on businesses was modified to permit accelerated depreciation of assets in computing taxable profits. In addition, the importation of complete industrial plants as *packages* was authorized, thus reducing the applicable duties and thereby lowering costs.

The stimuli applied under that protectionist policy significantly raised the profitability of manufacturing enterprises. However, they impeded the evolution of other productive sectors whose expansion might have brought greater benefits to the economy as a whole. As we shall see further on, this was the case with agriculture, especially as regards crop production.

With respect to the external sector, the industrialization policy adopted during the "Stabilizing Development" period had some important consequences. First, protection, tax incentives, and financial facilities seem to have favored the production of consumer goods more than the production of intermediate inputs or capital goods. Second, the protectionist policy built an anti-export bias into Mexican industry, inasmuch as export prices are outside the Mexican exporter's control while substituted goods ended—in general—with prices higher than those in the international market. (See Bueno, 1971.) Under such circumstances it is not surprising that the percentage of manufactured products that were exported slowly but steadily diminished during the 1960s, whereas it had risen in previous periods.[2]

A third consequence of the industrialization policy adopted during the past decade was the anti-agricultural bias resulting from the protection just discussed. Combined with other factors which will be outlined, that bias is held to have contributed to the slowing down of the agricultural sector observed during the last five years of the "Stabilizing Development" period. The deceleration in agricultural production, which was to aggravate some rather important problems in the external sector, is clearly apparent if one divides the decade of the sixties in two: From 1960 to 1965 agricultural production increased at an annual rate of more than 6 percent, partly as a result of favorable climatic conditions and export prices. However, the rate of increase fell to 1.2 percent in the next five-year period.

There are several reasons for the stagnation in the agricultural sector of the Mexican economy. Here the ones considered most important will be set forth briefly, together with the relationship between the agricultural slowdown and

the external sector. During the 1950s, the agricultural sector's participation in public investment declined from 20 percent to approximately 10 percent. It was only in the last years of the past decade that a modest recovery began, in reaction to the obvious agricultural stagnation. Meanwhile, private investment in agriculture also decreased, with the result that the agricultural sector's participation in total gross capital formation was reduced from 14 percent in 1960 to 4.5 percent in 1970.

It should be pointed out that the decline in the flow of public funds intended to stimulate agricultural production is not the result of deliberately discriminatory policies but of a whole set of circumstances: the expansion of the quasi-governmental sector with its constant demand for more public resources, low income-elasticity of tax collection which limited funds available for public investment, rigid prices of goods produced in quasi-governmental enterprises which call for growing subsidies, etc. In addition, the Mexican government, in an effort to maintain monetary stability, limited spending, thus seriously reducing the proportion of investment channeled to agriculture.

Another element explaining the behavior of the agricultural sector during the 1960s was an appreciable decline in the sector's over-all productivity. The need to meet the domestic demand for basic foodstuffs resulted—given the slowdown in production—in modification of the composition of agricultural supply. Staples such as corn and beans took up a large proportion of the total cultivated area; the area assigned to the production of those two staples was maintained at 70 percent of the total. In addition, it must be pointed out that both crops registered smaller increases in productivity during the 1960s than during the previous decade, unlike such crops as cotton and wheat, whose productivity rose but whose share of the total area under cultivation grew steadily smaller. [3] The limited amount of land devoted to crops that achieved the greatest increases in production per unit of area reduced the benefits made possible by agricultural research. (Moreover there were difficulties in the dissemination of such research.)

Although the elements just outlined were important, another salient factor not only explains the behavior of agricultural production during the "Stabilizing Development" period, but had considerable repercussions on the external sector. This was the creation of a government agency, Conasupo, (Compañía Nacional de Subsistencias Populares) which was responsible for regulating the market and the prices of agricultural staples for domestic consumption. In 1964, Conasupo fixed guaranteed prices for some basic crops at a level higher than those of the international market. Inasmuch as export prices are given, the effect of Conasupo's action was to increase the ratio of domestic prices to export prices and consequently to discriminate against crops destined mainly for the foreign market. This situation—

combined with decreasing production in the sector—made it impossible to maintain commodity exports above commodity imports. That fact became evident with the need for massive imports of staples like corn and beans, which converted the country into a net importer of agricultural products early in the 1970s.

We have briefly examined Mexico's economic experience, with particular reference to the industrial and agricultural sectors, in an attempt to understand why the 1960s ended with increasing deficits on current account in the balance of payments. Meanwhile, on the capital account foreign debt grew steadily, basically because the domestic resources could not finance the growing public outlays, and because of the growing trade deficit.

The inability of the Mexican economy to compete internationally not only widened the trade gap, but also began to impede the short-term functioning of the economic system. By the end of the 1960s, it was already clear that a growing incompatibility existed between internal and external equilibrium. This may be summarized as follows. Starting from an initial income, increased government spending augmented aggregate demand, which resulted in a higher level of income. Imports rose along with income, while exports stagnated because of increased domestic demand. As a result of the process, the deficit of the balance of payments increased with an upward pressure on prices. This made it necessary to moderate public spending in order to control the tendency toward external imbalance, and thus check the rate of growth. More important yet, it became clear that the growth rate was inadequate to provide employment to the growing work force and that the external balance was not in line with the labor market.

II. THE FIRST HALF OF THE SEVENTIES

As we have seen, by 1970 some of the limitations of "stabilizing development" as a model of growth for Mexico had already become evident. The presidential campaign and the prospect of a new president in December 1970 helped bring about a critical reappraisal of the economic policy that had been followed during the 1960s. On assuming office, President Luis Echeverría set about introducing some changes in the strategy of economic growth. Despite that intention, the economic policy followed during his administration (1970-76) ran into serious short-range problems which hampered the development of guidelines consistent with long-term objectives.

The year 1970 closed with a trade deficit of US$903.8 million, approximately double the 1969 deficit. In addition, the new government authorized a rise in the price of sugar and introduced a special tax on the consumption of luxury goods. Both decisions aggravated upward pressures on prices.

Therefore, the new administration's financial authorities recommended that economic policy be geared to correcting the deficit in the current account of the balance of payments and to lowering inflationary pressures. It was decided to deal with those problems by restricting government spending in 1971. Public investment budgeted for that year—Mex$27 billion—represented a decrease of 9.2 percent from the corresponding amount for 1970. In reality, as was to be seen later, actual public investment for 1971 amounted to only Mex$22.6 billion, or 82.2 percent of the sum budgeted. As a result, the trade deficit diminished by nearly 15 percent and prices rose more slowly. However, the cost of those achievements was enormous: the economic growth rate fell from 6.9 percent in 1970 to 3.4 percent in 1971.

Faced with that situation, and in a climate of general uneasiness due to the economic stagnation, the government decided to increase the investment budget for 1972 to a level 10.7 percent higher than the 1970 figure. This amount was increased repeatedly during the year. Special investment programs were introduced in order to restore conditions which would permit growth at the historic rate. The result was that public investment authorized for 1972 was greater than the sum initially budgeted. As a consequence of the substantial increase in public investment authorizations, official organizations ended the year 1972 with Mex$7.3 billion in approved though unused funds. This helped boost effective public investment by an impressive 43 percent for 1973, to Mex$49.8 billion or more than double the 1971 figure.[4] After a lag, private investment followed the example of economic stimulation set by the government, rising from Mex$52.4 billion to Mex$64.6 billion between 1971 and 1973.

Today it is apparent that by the time emergency public investment was put into effect in March 1972, normal economic conditions had practically been reestablished. Nevertheless, toward May of that year, the Central Bank ordered the relaxation of bank reserve and credit requirements. This added to the expansive effect of public investment. As a result of the increase in government spending and in the money supply productive capacity of the economy was strained and, from 1972 on, severe and persistent inflationary pressures appeared.

The expansion in government spending described above was not accompanied by a tax reform to ensure adequate financing of such spending, nor by the necessary restrictions in private spending. Therefore, since bank reserves diminished, surplus reserves were soon withdrawn from credit institutions and the government deficit was quickly monetized. This led to an interdependence between monetary and fiscal tools, which was to place severe limits on their ability to deal with an inflation that peaked in 1974, when the wholesale price index showed an annual rate of increase of 31.1 percent. Here it should be pointed out that a good part of the inflationary pressure was, at that time, attributed to external causes.

Today, when an explanation is sought for the rampant rise in prices beginning in 1973, it seems clear that the transmission of inflationary pressures from abroad plays a rather secondary role; in any case, such pressures only reinforced the effect of a rapidly growing government deficit with the consequent expansion of the money supply and the external public debt.[5] Secondly, as a result of the infrastructure investments in such fields as energy and steel, the public sector increasingly imported more capital goods and intermediary inputs. Thirdly, the competitiveness of Mexican export products and tourist services considerably deteriorated as a result of the higher rate of increase of Mexican prices in comparison to those of Mexico's main external markets, particularly the United States, with which the country carries on more than two-thirds of its foreign trade. All these circumstances led to an inordinate increase in the current account deficit of the balance of payments, (which rose from U.S.$908.8 million in 1970 to U.S.$2,558.1 million in 1975) and to a substantial increase in the external debt, which was seeking to support an increasingly overvalued peso.[6]

This situation continued to deteriorate until September 1, 1976, when, having exhausted all means of correcting the trade deficit through tariffs and quantitative controls, and in the face of a growing speculative demand for foreign currency, the government abandoned the fixed exchange rate of Mex$12.50 per U.S. dollar in order to enable a new par value to establish itself in accordance with the forces of the exchange market. This decision meant a 60 percent de facto devaluation of the national currency and provoked competition among the various groups which attempted to reestablish their economic positions to those prevailing before the devaluation. This in turn led to a new devaluation several weeks later.[7]

IV. PROSPECTS FOR THE IMMEDIATE FUTURE

The impact of two successive devaluations within a few weeks, after 21 years of exchange stability, was added to the difficult domestic situation arising from an imminent change of administration. The last months of any presidential administration in Mexico have traditionally been accompanied by some uncertainty about the economic policy guidelines to be adopted by the new administration. In this case, the uncertainty was considerably reinforced by the collapse of the exchange rate.

In such circumstances, the new administration will have to adopt a series of measures to regulate the economy in order to ensure reasonable economic growth in the coming years. Before going into certain considerations which seem to be relevant to the objectives noted, it is necessary to describe briefly the issues which will have to be faced as a result of the exchange adjustment.

The process following a modification of the exchange rate begins by a change in the prices of products involved in foreign trade. Ideally, a devaluation leads to the export of a greater share of the total production. The process is also accompanied by a reduction in the real income of various sectors of the economy because of the increase in the prices of both imported and exported goods. In such circumstances, comparable increases in the prices of other products must absolutely be avoided in spite of the demand adjustment in their favor. Any increase in the prices of other products cancels the initial effect of changes in the domestic-foreign price ratio which, in any case, will determine the changes in the patterns of consumption and production making it possible for the trade balance to improve. In order to avoid this undesirable increase of domestic prices, the monetary policy must not expand domestic credit or the money supply. The fiscal policy, in turn, must maintain the budget deficit at levels that do not require an excessive increase in domestic expenditures and means of payment because if this expansion were to occur it would cancel out the advantages of the new price ratio brought about by the devaluation. Furthermore, salary adjustments must be kept to a minimum; otherwise—if the above monetary and fiscal guidelines are followed—these adjustments will provoke a higher unemployment level.

In order to benefit from the situation presented by the devaluation, the new Mexican administration must make decisions with regard to four major aspects of economic policy: (1) exchange rates, (2) trade, (3) fiscal measures and (4) financial policy. The main alternatives for each of these aspects are briefly examined below.

(i) Exchange Policy

Under the current exchange and monetary conditions of the international market, a country such as Mexico seems to have only two possible courses of action with regard to its exchange policy: (a) to peg its currency to one of the existing monetary blocs or (b) to conserve its exchange flexibility. It goes without saying that the choice of one of these two alternatives cannot be made without considering the set of measures that will be necessary to achieve the alternative selected.

With regard to the first alternative, obviously, the reestablishment of a fixed exchange rate means that internal control of economic activity must be maintained through policies that do not generate inflationary pressures. To accomplish this under the present circumstances seems difficult. An example of the obstacles is the drastic reduction of the budget deficit that would be required to support a fixed exchange rate in the immediate future.

Conversely, the alternative of a greater exchange flexibility, perhaps along the lines followed by Brazil and Colombia, seems more appropriate. Among the main advantages of this alternative is that periodical and small adjust-

ments of the par value would avoid the trauma associated with a drastic adjustment, and could also moderately accelerate the growth process.

Another advantage is that when the exchange rate is flexible, public expenditures may be controlled without the rigorous measures required by the indefinite support of a fixed par value. Furthermore, an adjustable rate-of-exchange system removes the pressures on the balance of payments when the domestic inflation rate is greater than that of the rest of the world, and thereby eliminates one of the causes of the country's growing foreign debt. Lastly, to the extent that the tax reform will result in sounder finance for the public sector, it will always be possible to return to a fixed exchange rate without causing uncertainty in the economy.

(ii) Trade Policy

With regard to trade there are two main alternatives: (a) to maintain the protection structure on which the import substituting industrialization process was based or (b) to liberalize trade policy.

In the first part of this paper the main characteristics of the first alternative were examined, together with its consequences during the recent evolution of the Mexican economy. The second option here, i.e. liberalization of the trade policy, will therefore be examined below.

Such a policy would have the following characteristics: elimination of quantitative controls (permits) on imports, leaving the regulation of purchases abroad to tariff policy; permitting a readjustment of the relative prices that favor export products, and ending the preferential treatment granted to the imports of public enterprises.

Conceived in these terms, liberalization would present a series of advantages: it would permit a better allocation of productive resources by making the market more flexible and favoring production geared toward exports; it would help moderate the price increases resulting from devaluation by eliminating the monopolistic benefits realized by permit holders; and it would increase government revenue from custom duties. However, implementing this policy would present certain problems, which are examined below.

In an economy such as the Mexican one, which has made considerable progress toward the substitution of imports, most of the imports are indispensable ingredients and supplements of domestic production. Any increase in economic activity will therefore be accompanied by an increase in imports, and liberalization would intensify this increase in imports. The initial impact of the devaluation seems to have been deflationary, and the current account of the balance of payments, valued in dollars, can be expected to deteriorate temporarily. Adoption of the liberalization policy would temporarily heighten this effect because, while imports would increase immediately, there would be a delay before exports responded to the improvement in relative prices. Furthermore, when export orders finally stimulated economic activity,

imports would further increase; it would thus be necessary for the current account to have improved in order to balance it in foreign currency terms.

To the extent that liberalization could lessen price increases, it would make the impact of devaluation less painful and also help support the new relative price structure which would stimulate the production of export goods and their sale on international markets. It is important to remember that devaluation has the effect of redistributing income in favor of activities related to exports, manufacturing, tourism, commercial agriculture, mining, etc.

Another important aspect to be considered is the debt service of all those companies or institutions that have foreign currency liabilities and to which devaluation has given no tangible advantage. This is the case, for example, for construction companies which have borrowed in dollars and own assets in pesos. In order to alleviate the financial situation of these companies, and to the extent that the revaluation of assets is insufficient to resolve their short-term balance sheet position it would be advisable to consider granting them special tax concessions that would allow them to absorb their losses over several fiscal years and making available short-term credit facilities to cover their cash requirements. The government banking sector could be helped if the profits realized by the Central Bank on exchange transactions were redistributed among the various national credit institutions.

Here, a comment should be made on the existing evidence about exchange rate adjustments followed by a liberalization policy. Cooper (1971) mentions a study carried out by the International Monetary Fund on the impact of devaluations in underdeveloped or semi- industrialized countries, and indicates that in 75 percent of the cases the trade balance as expressed in foreign currency improved during the year following the adjustment. In 90 percent of these cases, an improvement was also noted in the general equilibrium of the balance of payments during the subsequent year. Furthermore, most of the countries that opted for trade liberalization experienced a decline in the volume of imports during the year following the devaluation, and, contrary to the most widely-held opinion, the effect of the rate of exchange adjustment on the terms of trade was insignificant. The same study further indicates that domestic prices went up rapidly during the first three or four months following the devaluation and that the rate of increase then slowed down. It is obvious that this depends on the handling of fiscal and monetary policies.

A last comment on this subject concerns the wage policy. In order to avoid falling into a price-wage-devaluation spiral, it would be advisable to allow wages to adjust until the initial impact on prices has passed.

(iii) Fiscal Policy

As was mentioned earlier, the post-devaluation fiscal policy requires a restricted level of government expenditures. This is particularly true for

current (operating) expenditures. However, since the control of current expenditures fundamentally depends on administrative measures that cannot be examined here, we shall limit ourselves to stating the need to restrict these expenditures. It is also extremely important to treat investment outlays with care; substantial and indiscriminate reductions risk impeding the growth of the economy. Great care must also be taken to ensure that investment projects are authorized according to a strict order of priority.

With regard to taxes, three aspects must receive particular attention: the timeliness of the reforms, income elasticity with respect to tax collection, and equity in the collection of taxes.

Until quite recently one of the characteristics of the Mexican tax system was that tax revenues fluctuated at the same rate as the nominal GDP. Consequently, the goal of the reforms must be to ensure that tax revenues increase more rapidly than the nominal product in order to strengthen their effect as automatic stabilizers, i.e. so that they may increasingly offset inflationary pressures and provide a growing amount of funds to meet the priorities of the national budget.

The reform presents an opportunity to eliminate tax discrimination and move toward horizontal equity (a situation in which taxpayers of similar income levels pay similar or equivalent taxes). This can be achieved by maintaining a progressive tax structure and equating it to the taxpayer's ability to pay. For this purpose it would be particularly useful to arrive at a legal definition of taxable income that would be as close as possible to its economic definition, i.e., the taxpayer's consumption plus any change in his assets. Implementing these tax reforms would present many complex technical and legal problems. However, a discussion of these problems would go beyond the limits of this paper and will therefore be left aside.

(iv) Financial Policy

Financial policy has a great influence on the behavior of the banking system. One of the major shortcomings of the Mexican economy, the great liquidity available on fixed interest securities, should be addressed. The central bank has impeded the issuance of long-term securities, generally with ten-year terms, by assisting in making these securities redeemable upon short notice.

This shortcoming has become worse during the last few years. Recently, a security was issued with a one-month term, thereby giving an already excessively liquid bank debt even more liquidity. The dramatic consequences of this excessive liquidity became evident when the September 1976 exchange rate adjustment was followed by a great flight of capital, which in turn caused a second adjustment shortly thereafter. Consequently, financial reform should essentially consist of withdrawing support for bonds, letting market conditions determine their prices on the stock market.

A reform of this type would represent an important step toward separating monetary instruments from real instruments, and this in turn would improve the effectiveness of economic policy decisions.

At the present time, it is impossible to make any quantitative forecasts on the evolution of the Mexican economy in the near future. This will be possible only when the conditions under which the production apparatus is to operate become clear again, and when the confusion generated by the recent exchange rate adjustments is dissipated.

However, the Mexican economy will probably follow one of three possible courses in the coming years. These possible courses are as follows:

(a) Inflation, with slow growth and cyclical behavior of the "stop-go" type; (b) Recession, with declining inflation and increasing unemployment; (c) Moderate growth, with stable or declining inflation.

The most favorable alternative is obviously (c) since the first two are essentially unstable. It must be stressed that, in Latin America, most of the stabilization plans of the International Monetary Fund which correspond to alternative (b) have failed. The depressive effects of these plans produce strong social tensions which, in time, become uncontainable and lead to drastic policy changes. These in turn readily result in an unstable situation of the first alternative, the "stop-go" type. Paradoxically, to choose voluntary deflation is almost tantamount to choosing inflation; in both cases forces are unleashed which make it necessary to rectify the direction of the economic policy and this leads to unstable forms of action. When successive corrections are made, they generally occur within increasingly short periods of time and thus repeatedly contradict the economic indicators on which companies and investors base their decisions. If the changes of direction take place before the economic system adapts to the previously established set of conditions an increasingly unstable situation of the "stop-go" type occurs. [8]

The "stop-go" process does not allow the country to follow a stable course of development. Credit and public expenditures rise, thus increasing the real GDP; pressure upon the available economic capacity triggers inflation; the balance of payments undergoes a crisis, forcing a check on credit and public expenditures. This in turn reduces economic activity, and the process begins again in what seems to be a vicious circle.

In this process, the conflicting elements are the foreign debt, wages and other domestic income, and, in general, the national purchasing power. This conflict arises because the "stop-go" process operates by modifying the consumers' real income. Its impact on surpluses available for export leads to the reduction of the national investment, which falls to very low levels. Consequently, real economic growth is hampered. In other words, the economic policy results in a lack of continuity which leads to instability. Instability, in turn, atrophies private investment, to the detriment of general economic growth.

Whatever the shortcomings of "Stabilizing Development" as an applied economic policy may have been, it did have the virtue of being a coherent strategy, which was maintained during a long period of time so that the economic system adapted to prevailing conditions, and private investment was even able to undertake long-term projects which would have been impossible in the presence of a "stop-go" instability.

The current Mexican economic situation approximates the aforesaid alternative (b). Under such circumstances, it is urgently necessary to give the economic policy continuity by striving to make equilibrium in the balance of payments and the growth of the GDP compatible. To achieve this two associated conditions are necessary: (i) the peso must not be overvalued, especially for long periods of time, and (ii) the level of wages and other domestic incomes must not be divorced from the conditions that prevail in the markets for labor, capital and other factors of production.

It is to be hoped that the new economic policy will not violate these principles and will establish a new pattern of growth which will overcome the limitations of the two previous phases of Mexico's economic behavior.

NOTES

1. A more complete analysis of Mexico's industrial policy can be found in Boatler, 1973.
2. It fell from 17.7 percent in 1950 to only 9.5 percent in 1969.
3. The area devoted to the raising of wheat and cotton was reduced from 1.7 million hectares in 1960 to 1.1 million in 1970.
4. This increase should be compared to the 13 percent average annual rate for public investment during the "Stabilizing Development" period.
5. The public sector deficit rose from 2.2 percent of GDP in 1971 to 5.1 percent in 1973, and reached 9 percent in 1975.
6. Conservative estimates indicate that the public sector's external debt with a term of over one year went from US$2.2 billion in 1970 to US $10 billion in 1975, and in 1976 it skyrocketed while the government was trying to support the exchange rate of 12.50 pesos to the U.S. dollar.
7. At the time of this writing, it has not yet been possible to establish precisely the amount of the second devaluation, since the exchange rate has greatly fluctuated, and the Central Bank was finally obliged to withdraw from the exchange market on November 22, 1976.
8. For a description of this phenomenon, see Brodersohn, 1975; and Díaz Alejandro, 1970.

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Chapter 7

DETERMINANTS OF BRAZIL'S FOREIGN ECONOMIC POLICY

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INTRODUCTION

The international economic policies of Brazil since the second World War can be divided into two distinct periods. From the late 1940s until the early 1960s import substitution industrialization (ISI) was the government's dominant concern, and foreign economic policies were shaped accordingly. From 1964 until 1974 policy-makers emphasized the rationalization of the economy, i.e. remedying some of the imbalances or distortions which had arisen during the period of intense ISI. This included foreign economic policies which became more outward-oriented. Since 1974, when the effects of the oil crisis began to make themselves felt, a renewed emphasis on ISI and a search for secure supplies of raw materials has become the prevailing theme of Brazil's foreign economic policies, and a new era has opened in the country's international economic relations.

This paper will first review the policies pursued before the oil crisis. This will be followed by an analysis of Brazil's past and current international position as revealed by available data. Finally, we shall speculate on the forces that are likely to shape Brazil's international economic policies into the decade of the 1980's.

INTERNATIONAL ECONOMIC POLICIES IN THE ISI PERIOD

Brazil emerged from World War II with a substantial accumulation of foreign exchange reserves. Since the government which took control in 1945 was dominated by traditional free-traders and by individuals concerned with controlling inflationary forces, all trade and exchange barriers were lifted; at

the same time the exchange rate remained at the prewar level (from 1937 to 1952 the official exchange rate remained fixed at 18.50 old cruzeiros per U.S.$). The result was an import spree which left the country without adequate reserves in about a year and led to a reimposition of trade and payments restrictions in 1947. The "real" exchange rate in 1952 was almost half that of 1946. The protective measures of the late 1940s, though designed mainly to defend the country's balance of payments, also stimulated the industrialization process, mostly of consumer goods, which had started in the 1930s.[1]

In the 1950s, the Brazilian government adopted ISI as its principal development strategy, and the protective measures of the late 1940s were deliberately employed as ISI promotional tools instead of being used primarily for the protection of the balance of payments. The emphasis was on developing a domestic productive capacity for as many formerly imported manufactured products as possible. Special attention was given to the internal production of more sophisticated consumer durable goods, basic inputs, energy, etc. To this end various types of exchange rate control systems and tariffs were applied. As a result, effective tariffs averaged over 250 percent for manufactured products (Bergsman, 1970: 42). The inflow of foreign capital was encouraged. In addition to the attraction of a large and highly protected market, Brazilian policies in the 1950s favored firms that established productive facilities in the country. One example was a rule allowing equipment to be imported without foreign exchange cover.

The unorthodox ISI policies did not make it possible to obtain much financing from such international institutions as the World Bank or the United States aid agencies, and most of the financing came from the international private sector.

The overall development approach in the 1950s was "inward oriented." ISI was supposed to make Brazil's growth less dependent on the traditional industrial centers of the world, i.e. the "engine of growth" would reside increasingly within the newly developing industrial sector. Hence the success indicators of the period were considered to be the rapidity with which the import coefficient was being reduced.

During the entire period exports were neglected. In fact, Brazil's ISI policies worked to the detriment of the export sector. In the opinion of many analysts, the long periods of exchange rate overvaluation acted as a restraint on the expansion of both traditional and new exports. As a result, the commodity structure of exports hardly changed in the 1950s while a profound transformation took place in the structure of the economy (Baer, 1965: chapter 3). In the early 1960s traditional primary exports still accounted for over 90 percent of total exports, while manufactured products amounted to only 2 percent in 1960.

By the 1960s, it had become evident that the neglect of international trade during the ISI years was placing the country in a precarious position. A limit to the compression of the import coefficient had been reached as the growing industrial sector required inputs of primary materials, intermediate goods, and capital goods which could not be obtained domestically. The continued neglect of exports was placing the country in a dangerous balance of payments position, since a decline in export earnings necessitating a reduction of imports could lead to industrial stagnation. The result was a massive accumulation of current account deficits, and, since financing was hard to obtain, Brazil accumulated a substantial amount of "forced indebtedness," mainly in the form of suppliers' credits. By 1964 it had become clear that this policy could not be continued.

THE "OUTWARD-LOOKING" POLICIES OF THE 1964-74 PERIOD

The formulators of economic policies after the 1964 change of regime acted on the assumption that high rates of growth in Brazil's post-ISI era could be achieved only in a more open economic setting than that of the 1950s. In order to increase the rate of growth and to diversify exports, the government undertook a series of measures: it abolished state export taxes, simplified administrative procedures for exporters, and introduced a program of export tax incentives and subsidized credits to exporters (Von Doellinger, 1974: 23-47; Tyler, 1976). These policies were directed not only towards a more rapid growth of total exports, but also to an increase in the share of manufactured goods which would thus reduce the country's dependence on the exports of primary goods, especially coffee.

In the area of exchange rate policies the post-1964 governments only gradually developed an approach that was consistent with its export diversification aims. Although there were several large devaluations, which substantially eliminated the cruzeiro's overvaluation, inflation during the long periods between devaluations resulted in recurrent periods of overvaluation and speculation against the cruzeiro. In 1968 the government adopted a system of frequent, but unpredictable, small devaluations of the cruzeiro. This system was expected to prevent the cruzeiro from becoming overvalued as inflation continued, to keep speculation against the currency at a minimum, and to prevent the exchange rate from becoming a political issue (Matarazzo Suplicy, 1976).

The outward orientation of policies on the import side consisted principally of a tariff reform in 1966 which lowered nominal tariffs from an average of 54 percent in 1964-6 to 39 percent in 1967 (Von Doellinger, 1975: 91). Subsequent changes led again to a rise in the rates, but not to the pre-reform levels. There is evidence that nominal tariffs were higher than the

actual ones due to the frequency of exemptions and special reductions for imports of goods for priority projects.

Real protection was also reduced in the late 1960s and early 1970s by the fact that the rate of devaluation of the cruzeiro was lower than the rate of inflation.

The post-1964 policies toward foreign capital encouraged the inflow of both official and private loan capital and of direct private investment. Without doubt, political stability and the generally orthodox orientation of the post-1964 governments provided a favorable climate for foreign investments. However, as will be seen in the next section, it took a number of years for massive inflows of foreign capital to materialize. The economic stagnation which lasted until 1968 and the considerable amount of excess capacity of the manufacturing sector in the early years of the 1968-1974 boom explain in large part why substantial increases of foreign direct investments occurred only after 1971. Until then financial capital inflows predominated, although they had grown noticeably only in the late 1960s. Two reasons seem important to explain this lag. First was the long gestation period involved in making feasibility studies for large projects (e.g., hydroelectric projects, the expansion of the steel industry, etc.), and in negotiating loans from such entities as the World Bank, the Inter-American Development Bank, USAID, etc. (Baer, 1973). The second reason was that foreign private investors waited for some time until they were convinced of the stability of the regime and its commitments to the new policy orientation.

Domestic financial policies were also responsible for large inflows of private loan capital in the 1970s. For instance, the rate of devaluation of the cruzeiro was substantially less than the domestic inflation rate, and the monetary correction applied to financial instruments was greater than the exchange rate devaluation. This made borrowing from foreign sources especially attractive for Brazilian firms (Baer and Beckerman, 1974). The massive inflow of capital, due to a large extent to the international oversupply of money, increased foreign exchange reserves and also contributed to inflationary pressures. This forced the government to gradually impose a minimum time requirement for foreign funds from the end of 1972 on (Von Doellinger, 1973).

STATISTICAL SUMMARY OF BRAZIL'S FOREIGN POSITION

During the period of ISI, Brazil's trade dependence as measured by both the export/GNP and the import/GNP ratios declined from 9 percent each in 1949 to 5 and 8 percent respectively in 1959. During the "outward looking" policies of the post-1964 period, these ratios increased again, rising steeply in the aftermath of the world oil crisis, reaching 8 and 13 percent respectively in 1974.

TABLE 7.1
Brazil: Balance of Payments Position
(US $ millions)

	1959	1960	1963	1966	1969	1970	1971	1972	1973	1974	1975	1976
Balance of Trade	72	–23	112	438	318	232	–341	–244	7	–4,690	–3,499	–2,152
Exports (FOB)	1,282	1,270	1,406	1,741	2,311	2,739	2,904	3,991	6,199	7,951	8,670	10,126
Imports (FOB)	–1,210	–1,293	–1,294	–1,303	–1,993	–2,507	–3,245	–4,235	–6,192	–12,641	–12,169	12,278
Service Balance	–373	–459	–269	–463	–630	–815	–980	–1,250	–1,722	–2,433	–3,213	–3,860
Travel (net)	–31	–48	–14	–31	–89	–130	–135	–178	–205	–250	–328	–400
Transportation (net)	–87	–78	–87	–48	–135	–185	–277	–338	–618	–1,066	–903	–850
Capital payments	–116	–155	–87	–197	–263	–353	–420	–520	–712	–901	–1,700	–1,850
(net interest)	(–91)	(–115)	(–87)	(–155)	(–182)	(–234)	(–302)	(–359)	(–514)	(–653)	(–1,463)	(–1,520)
(net profits)	(–25)	(–40)	(0)	(–42)	(–81)	(–119)	(–118)	(–161)	(–198)	(–248)	(–235)	(–330)
Other services	–139	–178	–81	–187	–143	–147	–148	–214	–187	–216	–132	–220
Unilateral Transfers	–10	4	43	79	31	21	14	5	27	0.5	0.1	4
Direct Investments	124	99	30	74	189	146	189	337	977	945	1,006	1,010
Loans	439	348	250	508	1,201	1,510	2,523	4,300	4,495	6,891	6,530	8,971
Amortization	–377	–417	–364	–350	–493	–672	–850	–1,202	–1,673	–1,920	–2,120	–2,888
International Reserves	367	345	219	425	656	1,187	1,746	4,183	6,417	5,252	4,041	5,122

Source: Banco Central do Brasil, *Boletim.*

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The overall international position of Brazil can be understood by an examination of the balance of payments figures presented in Table 7.1. Although the current account balance has been negative almost every year since the 1950s, the trade balance of Brazil was generally positive until 1971. Exports grew at high rates as a result of the government's incentive programs. However the high internal growth (especially the investment growth from 1970 onward) combined with import liberalization provoked an import expansion which was greater than that of exports. Also, the continuing internal boom caused many industries to attain full capacity production prior to satisfying internal demand. Therefore, reliance on imports increased—as was the case, for instance, with steel products. Of course, the giant trade deficits that appeared in 1974 were to a large extent, due to the huge petroleum price increases. In addition, however, the ambitious investment programs of the government and multinational enterprises also accounted for continuously rising imports of capital goods and raw materials.

The service balance of Brazil has always been negative, the heaviest burden being capital payments, followed by transportation costs. As can be observed in Table 7.1, the rate of growth of these payments has been very rapid in the 1970s, reflecting the increased indebtedness of Brazil, the greater reliance on foreign direct investments with their concomitant profit remittances, and the increased use of foreign shipping which accompanied the rapid increase of imports.

The growing current account deficit and amortization payments were more than offset by capital inflows, especially from the late 1960s to 1973. This enabled Brazil to accumulate foreign exchange reserves, reaching U.S.$6.4 billion in 1973. It will be noted that the largest proportion of the capital inflow consisted of loans, although from 1972 on there was a large jump in the yearly inflow of direct investments.[2]

The massive inflow of capital continued after the oil crisis, increasing the country's indebtedness from U.S.$10.2 billion in 1972 to U.S.$22 billion in 1975, and U.S.$24 billion in mid-1976. These inflows, however, were not enough to cover the huge negative current account and amortization payments and the country's foreign exchange reserves declined to about U.S.$4 billion in 1975, reaching U.S.$3.5 billion in May of 1976. As a result of the country's indebtedness from U.S.$10.2 billion in 1972 to U.S.$22 billion in zation payments) to total exports reached 40 percent in 1975. This constitutes a heavy burden on the country's balance of payments.

BRAZIL'S CURRENT ECONOMIC TIES WITH THE OUTSIDE WORLD

a) Trade

In addition to achieving high rates of overall export growth since the late 1960s, Brazil also substantially diversified the commodity and geographic

TABLE 7.2
a) Brazil: Commodity Structure of Exports
(percentage distribution)

	1955	1960	1964	1971	1973	1974	1975	1976
Coffee	59	56	53	27	22	13	11	21
Sugar	3	5	2	5	9	16	11	3
Soybeans and derivatives	–	–	–	1	15	11	13	17
Iron Ore	2	4	6	8	6	7	11	10
Manufactures: Semi processed	1	2	5	22	7	8	7	34
					22	28	29	
Manufactures: Other primary products	35	33	34	37	19	17	18	15
Total	100	100	100	100	100	100	100	100

Source: Banco Central do Brasil, *Boletim.*

b) Brazil: Commodity Structure of Imports
(percentage distribution)

	1948-50	1960-62	1967	1971	1972
Capital goods	38.0	29.0	31.9	38.9	42.2
Intermediate goods	28.0	31.0	52.6	45.3	42.7
Consumer durables	8.0	2.0	3.8	6.3	6.6
Consumer non-durables	7.0	7.0	10.4	8.8	7.7
Other	19.0	31.0	1.3	0.7	0.8
Total	100.0	100.0	100.0	100.0	100.0

	1968-72	1973	1974	1975
Machinery and equipment	37.6	34.6	24.8	32.3
Crude oil and derivatives	10.0	11.5	22.0	25.2
Pig iron and steel	6.2	8.0	12.2	10.4
Non-ferrous metals	5.0	4.6	4.8	3.0
Organic chemicals	5.3	6.0	5.1	4.3
Other	40.7	35.3	31.1	24.8
Total	100.0	100.0	100.0	100.0

Sources: Joel Bergsman, *Brazil: Industrialization and Trade Policies,* Oxford University Press, 1970; Carlos Von Doellinger, "Foreign Trade Policy and Its Effects," *IPEA Brazilian Economic Studies No. 1,* 1975; Banco Central do Brasil, *Boletin* and *Relatorio Anual, 1974.*

structure of its exports. Table 7.2 shows the dramatic decline of coffee, the growth of nontraditional primary exports such as soybeans and iron ore, and the expansion of the share of manufactured exports from 5 percent in 1964 to 36 percent in 1975. Also notable is the fact that by the mid-1970s Brazil had a much greater geographic balance in its exports than one or two decades prior to that time. Whereas the United States accounted for 41.3 percent of Brazil's exports, this percentage had declined to 15.4 percent by 1975, while Western Europe and Japan had greatly increased their relative position as customers of Brazil. It is notable, however, that exports to LAFTA countries had grown very little.

On the import side (see Table 7.2) one observes an increasing importance of capital and intermediate goods. Special note should be taken of the growth in the share of petroleum and its derivates from 10 percent of total imports in 1968-1972 to 22 percent in 1974. As in the case of exports, there was a steady decline in the reliance on the U.S.A. as a source of supply, and a rapid growth in the share of Japan and the Middle East. Finally, there was a striking decline of imports from Latin American countries.

TABLE 7.3

a) Brazilian Exports Geographical Distribution (percentage distribution)

	1945-9	1957-9	1967	1970	1974	1975
United States	44.3	41.3	33.1	24.7	21.8	15.4
Canada			1.0	1.5	1.2	1.6
LAFTA			9.7	11.1	11.5	13.8
Western Europe	23.3	26.3	39.8	40.3	35.2	31.4
COMECON			5.9	4.5	5.0	8.8
Japan		3.0	3.4	5.3	7.0	7.8
Other	32.4	29.4	7.1	12.6	18.3	21.2
(Middle East)			(0.9)	(0.6)	(4.2)	(5.2)
Total	100.0	100.0	100.0	100.0	100.0	100.0

b) Brazilian Imports: Geographical Distribution (percentage distribution)

	1967	1970	1974	1975
United States	35.4	32.9	24.2	25.3
Canada	1.1	2.4	3.3	1.7
LAFTA	13.0	10.5	7.1	5.9
Western Europe	31.3	35.1	30.4	31.1
COMECON	4.8	2.1	1.3	1.7
Japan	3.1	6.4	8.8	9.1
Other	11.3	10.6	24.9	25.2
(Middle East)	(7.1)	(5.5)	(17.1)	(19.0)
Total	100.0	100.0	100.0	100.0

Source: Banco Central do Brasil, *Boletim.*

b) Foreign Capital

Geographical diversification is also notable in the origin of foreign investments in Brazil. In the early 1960s, 50 percent of foreign capital was U.S.-owned, but in 1975 this declined to 32 percent, with West Germany, Japan, Switzerland and some other European countries having substantially increased their share (see Table 7.3). Three-quarters of foreign investments were in manufacturing, concentrated in the capital goods, transportation and chemicals sectors, which were among the most dynamic in the 1968-1974 boom. The role of large multinational American and European firms became crucial to Brazilian industrial growth in the mid-1960s and has remained so.

c) Foreign Indebtedness

The foreign debt of Brazil, which had reached U.S.$30 billion by early 1977, was owed mainly to private entities (see Table 7.4). Almost half (46 percent) of the debt had maturities of five years or more. Most of this capital inflow was demanded by state and multinational firms to finance their investment programs, and by private Brazilian firms for their working-capital

TABLE 7.4
Foreign Direct Investment in Brazil: June 1975
(percentage distribution)

a) Sectoral Distribution		b) Origin	
Mining	2	United States	32
		W. Germany	12
Manufacturing	75	Switzerland	9
		Sweden	2
Non Met. Min.	3	United Kingdom	6
Metal Products	7	Netherlands	3
Machinery	7	France	4
El. Machinery	7	Japan	11
Transport Eq.	13	Luxemburg	2
Paper, Celul.	2	Other	19
Rubber	3		
Chemicals	15	Total	100
Pharmaceutic.	4		
Textiles	3		
Food Products	4		
Tobacco	3		
Other Mfgs.	3		
Agriculture	.7		
Services	17		
Other	5.3		
Total	100		

Source: Banco Central do Brasil, *Boletim*

needs. This demand for foreign financing was due to a large extent to the weakness of the domestic capital market (Pereira, 1974).

CURRENT AND FUTURE DETERMINANTS OF BRAZIL'S FOREIGN ECONOMIC POLICIES

a) Trade

Until the petroleum crisis, Brazil's trade policies and general trade position was fairly consistent with its internal growth objectives. The effect of the petroleum crisis has been to force Brazil to redouble its efforts at export promotion and to change its import strategy. A key to the former is the continuation of Brazil's export incentive program, which, on occasion, has come under severe criticism in both the U.S.A. and Europe. Another important factor in determining the growth of exports is the rate of growth of the industrial economies, which import Brazil's manufactured goods and indus-

industrial economies, which import Brazil's manufactured goods and industrial raw materials.

The world petroleum crisis has drastically worsened Brazil's balance of payments, and in an effort to combat this problem, Brazil has made various attempts to control its imports and to return to an intensive import-substitution strategy. Massive investment programs in steel, metal products, capital goods, petrochemicals, and petroleum derivatives have been planned as a way to decrease substantially the country's renewed dependence on imports for its industrial growth.

Brazil's policy-makers have been unable to use their minidevaluation scheme as freely as was expected. On the one hand, there are pressures to devalue the cruzeiro at a more rapid rate than in the past. The rate of devaluation, especially after 1973, has consistently lagged behind the domestic inflation rate (even subtracting the inflation rate of its main trading partners), which is growing again after the steady decline of annual price increases in the period 1967-1973. In the 1968-1973 years, the export incentive program more than compensated the negative effects of an overvalued cruzeiro, but this was not the case in the mid-1970s. The reluctance to devalue has been due to the fear that this measure might add substantial fuel to the resurgence of inflation since the oil crisis. Also, since Brazilian businesses depend heavily on foreign capital, every devaluation substantially increases the cruzeiro cost of the debt. This pushes up internal interest rates, which discourages new investments and hence the rate of growth of the economy (this rate had fallen substantially in 1975).

b) Trade and the Multinationals

Although Brazil's trade strategy provides an element of strength in its foreign economic relations which was absent in the 1950s, it has also brought a new type of dependency. Through multinationals and/or through joint ventures of Brazilian companies with multinationals, a large portion of Brazil's trade has become involved in a vertical international division of labor. For example, Ford Motor Company produces engines for its Pinto car in Brazil; Volkswagen of Brazil sends components to its plants in other parts of the world; there are plans for joint ventures to produce semi-finished steel products in Brazil, etc. It remains to be seen how much decision-making autonomy will be sacrificed within Brazil as a result. The level of production of internationally vertically integrated firms depends on the decision of multinationals concerning their world production schemes (i.e., the distribution of their production plans throughout their plants around the world), on the pressure of labor unions in the home country of multinationals, etc. International bargaining for the share of production in such a system is still in its infancy, but it is certain that the Brazilian government will sooner or later be drawn into it.

c) The Search for Sources of Energy and Raw Materials

Brazil in the mid-1970s was able to produce only about 20 percent of its petroleum needs; it depended on imported coal for its steel industry; and it also had to import such raw materials as copper, tin, zinc, chemicals, etc. Therefore, many of its foreign economic policy moves were motivated by a desire either for self-sufficiency in these raw materials or for insuring secure supplies of these vital inputs. In October 1975, the country made an unprecedented move away from the exclusive preservation of petroleum exploration for the state company Petrobras, by allowing "risk contracts"–i.e., foreign companies were allowed to prospect for petroleum in designated areas of the country, and if the prospecting brought results, the findings would be split between the foreign company and Petrobras. It was hoped that this move will bring in foreign capital for costly exploration activities and develop Brazil's capacity to produce petroleum more rapidly.

The drive to increase economic ties with Paraguay and Bolivia is also motivated primarily by energy considerations. The building of the world's largest hydroelectric dam at Itaipu as a joint venture between Paraguay and Brazil will make Paraguay the world's largest exporter of electricity and will contribute substantially to the energy needs of Brazil's Center-South. There can be little doubt that it will make Paraguay's economic system extremely dependent on Brazil. Similarly, Brazil's large-scale investments in Bolivia are designed to bring that country's abundant natural gas and other raw materials to the industrial center of Brazil.

To assure itself of petroleum supplies as a subsidiary of Petrobras, Braspetro has made technical assistance and prospecting contracts with Middle Eastern, African, and South American countries. Bilateral trade with socialist countries has increased for the same reasons.

In recent years Brazil's interest in the African continent has grown from both a political and an economic point of view. When measured in terms of trade relations, economic ties are still relatively small, though growing rapidly. In 1967 exports to African countries amounted to 1.7 percent of total exports; by 1974 this proportion had grown to 5.2 percent. Imports from African countries stood at 1.3 percent of total imports in 1967, growing to 5 percent in 1974. Much of this trade represented the importation of oil and other raw materials in exchange for manufactured goods. The increasing exchange of trade delegations with such countries as Nigeria, Algeria, etc., the rising trade with Angola, and the increased activities of Brazilian engineering consulting firms in a number of African countries imply further rapidly growing ties with Africa.

d) The Presence of Multinationals

Although the investments of multinationals represent only 10 percent of total investments, their importance is much greater because they dominate

some of the most dynamic sectors of the country, and they hold a key position in the country's present and future foreign trade relations. We have already mentioned the potential problems that may arise through the vertical division of labor associated with these companies. There are additional problems which will make themselves felt over the next decade. Brazilian officials, who are increasingly aware of the cost of technology, are growing more sophisticated in bargaining for more adequate transfer-of-technology contracts and in pressuring multinationals to adapt and to develop technology locally.

A recent trend, which may result in a different role for multinationals in Brazil, is the rise of joint ventures between Brazilian state companies and private multinationals. A number of joint ventures were created in the 1970s—e.g., the petrochemical complex in Camaçari, Bahia, which involves Petrobras' subsidiary Petroquisa and big mining projects in the Amazon area under the leadership of the state company Companhia Vale do Rio Doce. There are advantages to both Brazil and the multinationals in such arrangements. First, a company of which the state owns the majority will be less exposed to nationalistic pressures than one controlled by a foreign multinational. Second, Brazilians may have more of a say in the behavior of such a firm with regard to technology, transfer pricing, etc.

e) The Implication of International Indebtedness

Though Brazil's indebtedness places it in a weak position, it also has elements of strength. It weakens the country for a number of reasons: as already mentioned, large indebtedness results in large amounts of foreign exchange earnings being used to service the debt; it raises the price of new debts abroad; to the extent that refinancing is needed, it places the country at a bargaining disadvantage with the major creditor countries and the institutions (like the World Bank) which are dominated by such creditor countries; such bargains imply a certain amount of interference in domestic policy-

TABLE 7.5
Brazil's Foreign Debt: June 1975

a) Distribution by Origin of Creditors (percentage)		b) Maturity Structure (percentage)	
U.S. Government	7	Less than 1 year	5
World Bank	6	1 year	11
IDB	2	2 years	12
IFC	0.6	3 years	13
U.S. Export/Import Bank	3	4 years	12
Japan Export/Import Bank	0.6	5 years	9
German Government Dev. Bank	1	6-10 years	27
Private	79.8	11-20 years	6
		21 years and over	5
Total	100	Total	100

Source: Banco Central do Brasil, *Boletim.*

making—e.g., new loans are often tied to desired internal credit policies or exchange rate policies. Finally, increased indebtedness could result in pressure by the creditor countries for more lenient treatment of multinationals operating in the country and even in pressure for an increasing share of foreign capital in indebted Brazilian firms (including state-owned companies).

On the positive side, the indebtedness of a country as large and as important as Brazil gives its authorities some bargaining strength. Multinational companies have large investments and thus a large stake in the well-being of the country, and some of the major private financial institutions have huge loans tied up in the country's total debt. Thus these companies and creditors have a stake in keeping the economy growing and in having it achieve a strong balance of payments position. The Brazilian government could use this interest to get favorable considerations in expanding its trade and in obtaining new credits.

COMPLEMENTARITY VS. COMPETITIVENESS IN BRAZIL'S RELATIONS WITH THE INDUSTRIALIZED WORLD

Brazil's strategy of ISI for its economic development was both a success and a failure. It resulted in the industrialization of the country. It did not, however, reduce the external dependency; it only changed the nature of this dependency. The ISI strategy made the country more dependent on imported inputs to run its industrial park. In retrospect, such a result seems inevitable, given the lack of certain basic raw materials. One could argue, however, that the ISI strategy stressing the automobile industry as one of the main elements in industrial growth and as the key element in developing the country's transportation system (neglecting railroads) made the country unnecessarily vulnerable and dependent in the post-1973 era. Dependency on foreign capital and multinationals also increased, and the bargaining power of these firms grew as they became crucial to the continued high economic growth performance of the country.[3]

Dependency was also increased by developing industries that were vertically integrated into the world industrial system and by developing exports (such as iron ore) which depended on the industrialized economies. A more realistic expression might be "interdependence." Most of the major world economies have become increasingly interdependent. The degree to which Brazil can profit from this development will largely depend on the skills of its policy-makers and economic diplomats. Its trade diversification and the diversification of its sources of investments gives considerable room for maneuver.

Brazil's economic system provides a degree of competitiveness with regard to its trading partners. First, Brazilian subsidiaries of multinationals are producing goods competing with those being manufactured by production

facilities of these same companies in other areas of the world. Second, there is competition in the exportation of final products. For various types of consumer goods, shoes, textiles, automobiles, etc., Brazil and its competitors will have to come to some agreement as to market shares or as to the redistribution of the world division of labor. For example, a reduction in the productive capacity of the U.S. shoe industry would make room for Brazilian producers, while the United States could specialize in other products for which there is a market in Brazil.

Finally, there are opportunities and potential conflicts in the diversification of Brazil's agriculture. The appearance of Brazil as the second largest world exporter of soybeans and its products, the continued growth of iron ore exports, and the potential of the country as a meat exporter, present opportunities for greater trade as well as for conflict with competitive economies.

NOTES

1. For further details, see Baer, 1965: chapter 3; Bergsman, 1970, chapter 3; and Huddle, 1964.

2. As was noted before, the massive world supply of capital in the form of Eurodollars in the late 1960s and early 1970s made it easy for Brazil to obtain so much private finance capital.

3. Brazil is not as important to the multinationals as they are to the country. For some additional data and information concerning this point, see Von Doellinger, et al., 1975.

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PART III

REGIONAL INTEGRATION AND ECONOMIC RELATIONS WITH THE THIRD WORLD

Chapter 8

THE ANDEAN PACT:

A MODEL OF ECONOMIC INTEGRATION FOR DEVELOPING COUNTRIES[1]

RICARDO FFRENCH-DAVIS

There is a noteworthy trend in the world today for countries to group together in an effort to expand the size of their economic markets. The phenomenon is occurring alike among rich and poor countries, whether their system be socialist or capitalist. The European Economic Community has recently taken in new members, while on the same continent, various socialist nations are united through the Council for Mutual Economic Assistance (COMECON). The Arabian and some African countries, the nations of Central America and several in the Caribbean are experimenting with various projects of economic integration.

This world-wide trend has not arisen capriciously. It is a response to the challenge of present day economic and political realities. The challenge is especially urgent for countries with small populations and reduced internal markets, and the situation is aggravated by the restrictions these countries face in attempting to find outlets in the developed nations for manufactured exports. Economic integration is seen as a most significant device for these countries to achieve wider, better-known, and stabler markets, that simultaneously foster the expansion of exports and the creation of import substitution industries on a regional basis.

In 1970, the Cartagena Agreement, joining six Andean countries in a program of subregional integration, went into effect.[2] The process of integration has advanced steadily since then, and several (though not all) of the provisions and deadlines set by the treaty have been fulfilled. As a result,

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EDITOR'S NOTE: This chapter is a revised version of an article by the author that appeared in *World Development* (1977), Volume 5, Numbers 1 and 2, Jan.-Feb.

the Andean Pact has had a growing impact on the economic life of the member countries. This impact surpasses that of the Latin American Free Trade Area (LAFTA) at the height of its influence. Externally, its effect has been manifested by the united, and therefore stronger, positions taken by the Andean Nations in various international forums.

Because of its significance for development in the Andean countries, we will describe and analyze the principal measures contained in the Cartagena Agreement and examine the extent and manner of their implementation to the end of 1976. In order to provide a framework for the analysis, a brief account of the major objectives of economic integration processes is sketched in Section I; in Section II follows an examination of the distinctive characteristics of LAFTA, whose scheme to a large degree explains its limited success in the Latin American context. In section III, the salient aspects of the Cartagena Agreement are analyzed, especially those which distinguish the Pact from traditional integration schemes. The discussion is therefore focused in particular on industrial planning, on the treatment extended to foreign capital, on the issue of coexistence within the integration process of regimes with divergent political approaches, and on some alternatives available to the Andean countries with respect to their international economic relations. Finally, section IV contains some remarks about the stage reached by the process in 1976.

I. THE OBJECTIVE OF INTEGRATION

The increased trade that economic integration brings about allows member countries to take fuller advantage of the international division of labor. Specialization in production takes on greater importance today than in past decades due to the increasing importance of economies of scale.[3] Indeed, the majority of the most dynamic industrial activities demand a scale of production exceeding that of the domestic markets of most LDCs. As a result, with few exceptions, it is difficult for developing countries to gain easy access to the markets of industrialized countries for most manufactured goods.[4] Current international conditions have reinforced this situation by strengthening obstacles and accentuating the instability of foreign markets; furthermore, the increasing role of transnational corporations in international marketing makes the crucial assumption of a unified competitive international market even less realistic.[5] The inevitable consequence of restricting industry to production for internal demand is the inefficiency (higher real costs) of smaller scale production. Ultimately, the limited investment resources might not be able to satisfy the needs of the population.[6] The great virtue of an integration agreement is that it permits an overall market expansion for each of the present and future producers in the member

countries.[7] In other words, integration is the most realistic option for small countries, given their need to export and to overcome the practical difficulties of obtaining ready access to world markets.

Moreover, joint action by a group of nations results in greater bargaining power than they would have if they acted independently. Joint action in the numerous areas in which compatibility of interests can exist among the participants in the integration process contributes toward improving their international economic position. Many examples could be cited, such as joint work in GATT, in UNCTAD, in relations with the EEC, in the international credit organizations, in bargaining with transnational corporations, and in negotiations with developed countries to facilitate access of industrial exports to their markets.

Finally, the acceleration of development and the increase of collective power—likely effects of the integration process—in principle make possible a greater degree of international political independence.

These three effects, however, are not attained automatically. Without a well-conceived and intensive effort and adequate planning, integration can lead to the perpetuation of underdevelopment and inequality and to increased external dependence.

II. LAFTA: STAGNATION AND ITS CAUSES

The first steps toward Latin American integration were taken in the 1950s (See Wionczek, 1969: ECLA; and INTAL, 1968). The efforts culminated in 1960, when seven Latin American countries signed the Treaty of Montevideo, which gave rise to the Latin American Free Trade Association. They were later joined by four other nations; LAFTA thus links ten South American countries, including the six Andean states, plus Mexico.

Initially, LAFTA showed promising advances toward the elimination of trade barriers among the countries. But progress soon slowed, and during the past ten years LAFTA's advances have been minimal. This record is explained both by the shortcomings of the legal instrument with which the association was founded and by the lack of political willingness on the part of the member countries to accelerate the integration process.

The Montevideo Treaty, although undoubtedly a positive event in 1960, suffered from serious weaknesses which were not remedied as they became evident. As its name implies, LAFTA consisted in practice of a mechanism for the (partial) freeing of trade among its members. It did not, however, include measures to guarantee the balanced development among the countries nor did it assure the equitable distribution of the benefits of integration. Moreover, the Treaty failed to cover the issue of coordinating economic policies, a key factor in generating a steady, autonomous, and intensive process toward a

common market. Although LAFTA countries of intermediate development attempted to establish measures of this kind and succeeded in gaining approval in 1964 of Resolution 100, calling for, among other things, a regional investment planning mechanism, the proposals were never carried out.

The liberalization of trade among the member countries has been modest, even though the original deadline set forth for the completion of this process has expired.[8] Indeed, the established commitments for the elimination of barriers to reciprocal trade were fulfilled until the mid 1960s, and coincided with a significant increase in commerce. Subsequently, the deadlines were repeatedly extended. In practice, wherever the measures reducing barriers on reciprocal trade came up against vested interests, the process was halted. Indeed, advances were made only when there were parties in one country interested in gaining markets in other countries, and when such initiatives were not met with opposition in the latter countries from sectors who *felt* they might be damaged.

Two observations are appropriate in regard to this approach. On the one hand, the liberalization of reciprocal trade does not necessarily imply that enterprises in the higher-cost country will disappear; rather, if properly regulated, a greater degree of specialization in product varieties and qualities is possible within the respective enterprises of each country.[9] On the other hand, liberalization based on the requests of interested parties renders the process passive. Conversely, an active policy assuring expanded markets from the very beginning, for a wide range of commodities, could become a greater inducement to integration through the creation of investment opportunities geared to the broadened frontier. In summary, the association passively travelled the easy stretch, a bare beginning on the long road encompassing a process of economic integration.

In the second place, when LAFTA offered opportunities for the creation of new industries, their fate was left to the sway of market forces. Such an approach might be appropriate among countries enjoying both advanced and similar levels of development, but not in the Latin American economic environment, where substantial differences were and continue to be the rule. Relatively higher levels of development are present in the more industrialized countries of Argentina, Brazil, and Mexico. Consequently, the acceleration of integration within a framework such as LAFTA would have meant that Latin America repeated the world economic pattern, wherein some countries are mostly limited to the production of raw materials, while other countries specialize in the production of manufactures, which better promote economic development, and thus these countries appropriate an overwhelming share of the benefits of integration. (See a discussion of the subject in Diaz-Alejandro, 1973. For data on the flows of trade and on the participation of each country

on the "Complementarity Agreements," giving support to the thesis discussed in the text, see INTAL, 1968. A discussion of various aspects of the issue can be found in Robson, 1971.)

The third major limitation of LAFTA was the absence of harmonized economic policies. Strictly speaking, all that was regulated—and that was not fully carried through—was the liberalization of reciprocal trade.[10] However, a process of integration requires much more than an agreement lowering internal tariffs. For this reason, serious shortcomings began to become evident as the integration project was implemented. Two of the most notorious problems were related to the distribution of costs and benefits. The first, already mentioned above, is related to the distribution of benefits among the member countries. The second problem stems from the disproportionate share of returns and influence that could be captured by foreign enterprises. In certain industrial branches, LAFTA provided an expanded market into which foreign firms were able to move without restrictions, and even with the encouragement of the governments of various host countries.[11] Because of these defects, the acceleration of the integration process, within the prevailing framework, would tend to benefit mainly the most developed members and would end up serving the interests of the transnational corporations better than those of the Latin American people.[12]

In summary, the repeatedly-expressed purpose of progressing toward a common market was not implemented. Few of the measures required to accomplish this goal were adopted. Such basic measures include the establishment of a common external tariff, coordination of foreign exchange and export promotion policies, agreement on a common treatment toward foreign investment, and creation of a mechanism distributing costs and benefits among the participant countries. Consequently, the integration process was doomed to stagnation unless the framework provided by the Treaty had undergone substantial improvements.

Since it proved impossible to get unanimous support from all LAFTA countries on major issues, several countries within the group, using the experience gained in LAFTA, began to make their own way toward a more comprehensive system. The Andean countries, who needed expanded markets more intensively than did the three largest LAFTA members (Argentina, Brazil, and Mexico), adopted a more ambitious integration scheme which began to take shape in the years 1965 to 1969. Thus the Andean Group was born.

III. MAIN FEATURES OF THE CARTAGENA AGREEMENT

The Andean Pact was signed in 1969. Since then it has shown significant progress, although it has not been free from the obstacles to be expected in

an undertaking of such magnitude, especially when so many political changes have taken place. Although there has been a sustained progress, the speed has been slower since 1973. First there was the obvious need to revise various proposals in order to consider the presence of Venezuela, the newly arrived member of the Pact. Then came a lengthy discussion with the delegation of Chile, that ended with the retirement of this country in October 1976.

The integration agreement of the Andean countries arose out of the experience gained in LAFTA, and was the product of a growing awareness among the former group that an intensive process of economic integration would allow the removal of some of the major obstacles to sustained and rapid development, while affirming national sovereignty. In spite of the more rapid advances of the Andean Pact, its members find it compatible with continued participation in LAFTA. The Andean nations seek to advance more quickly toward the establishment of a common market of the "Andean subregion." In the future, when the remaining members of LAFTA are prepared to intensify the integration process, the Andean countries intend to participate in it as a single economic bargaining unit. [13]

Is it plausible to expect the Andean nations in conjunction to wield economic weight comparable to that of the three largest members of LAFTA? To examine this, the relative significance of the Andean countries must be determined. As can be seen in Table 8.1, each individual Andean

TABLE 8.1
The Andean Economies in 1972
(1974 dollars)

		Gross Domestic Product		Foreign Trade	
Countries	Population (millions) (1)	Per capita (dollars) (2)	Total (millions of dollars) (3)	Exports (millions of dollars) (4)	Imports (millions of dollars) (5)
Bolivia	4.9	397	1,946	288	278
Colombia	23.8	735	17,464	1,329	1,157
Chile	10.1	1,248	12,565	1,214	1,710
Ecuador	6.4	675	4,346	459	521
Peru	14.5	754	10,917	1,343	1,193
Venezuela	11.5	1,604	18,455	5,393	3,327
Andean Group	*71.2*	*923*	*65,692*	*10,027*	*8,186*
Argentina	25.1	2,027	50,883	2,756	2,353
Brazil	98.7	800	78,904	5,596	5,954
Mexico	54.3	1,326	72,287	2,644	4,064

Source: United Nations, *Statistical Yearbook for Latin America, 1973* and *Economic Survey for Latin America, 1973.* The GNP and the trade figures were expressed in those sources in 1960 and 1972 dollars, respectively. The former has been multiplied by 1.90 and the latter by 1.42, in order to attain figures expressed in currency with 1974 purchasing power.

nation is small, but taken together they attain respectable proportions within the Latin American context. Bolivia, Colombia, Chile, Ecuador, and Peru jointly provide a market that is as large as that of Argentina. By including Venezuela, the dimensions of their market approach those of Brazil or Mexico. From another angle, the Andean per capita output, while lower than that of Argentina and Mexico, exceeds that of Brazil. Moreover, the comparison is considerably more favorable to the Andean countries when based on volume of foreign trade. Their total exports, even before the rise in international petroleum prices, register a figure similar to that of the combined foreign sales of Argentina, Brazil, and Mexico. In summary, as long as they act as a unit, the members of the Andean Pact have an economic base that allows them to deal with any of the larger Latin American countries as equals. This means that the successful integration of the Andean nations, far from presenting difficulties, could actually expedite further progress toward a Latin American common market.[14]

The most important features of the Cartagena Agreement are:

a) An institutional setup adequate to a *process* of integration, equipped with executive power and backed up by a solid technical staff.

b) A selective process of liberalization of reciprocal trade among member countries, and the gradual establishment of a common barrier vis à vis the rest of the world (common external tariff).

c) A system designed to achieve an equitable distribution of the benefits of integration, whose principal instrument is regional investment planning (such as sectoral programs for industrial development); the system also contemplates several forms of preferential treatment for Bolivia and Ecuador, the two countries of least relative development.

d) Harmonization of economic policies, beginning with policy on foreign direct investment.

The two principal organisms responsible for designing, approving, and implementing the process are the *Commission* and the *Junta* of the Cartagena Agreement. The Commission, the political body, consists of a delegate with full powers from each country.[15] The presidency is rotated each year from one country to another in alphabetical order. The Junta is the technical body. It is headed by three members appointed by the Commission, and has its headquarters in Lima. The Junta is responsible for the elaboration of the proposals, which, according to the rules of the Pact, are submitted to the Commission for consideration and approval. After approval, the proposals are known as Decisions and are identified by number.

Other institutions also collaborate in various ways in the integration process. Several cooperation agreements and advisory bodies have been established for various purposes. One of the most important is the Andean Development Corporation (Corporación Andina de Fomento), CAF, whose

task is to gather resources and provide financial support for the integrated development of the subregion.[16]

1. Toward the Establishment of a Common Market

The agreement calls for the selective elimination of trade barriers (let us call them internal tariffs) among the Andean countries. Tariffs on commodities not being produced were eliminated from the outset, thus instantaneously providing an expanded market to any potential investment in those sectors. However, where production is duplicated in various countries, the start of liberalization has been postponed pending agreements on the rationalization of installed capacities and on the localization of output. Lastly, the obstacles on the remaining goods have been gradually reduced since 1971.[17] In accordance with this program, about 3,000 items or groups of commodities are subject to internal custom duties of 50 percent or less in 1976 (less than half the tariff rates prevailing in 1969).[18] These rates will continue to be reduced annually. The Cartagena Agreement established that internal tariffs would be reduced by 10 percent a year, thus disappearing by the end of 1980. This date will be postponed until 1983.[19] Consequently these goods should circulate within the Andean subregion without tariff changes, starting January 1984.[20]

The progressive removal of barriers is a crucial factor in the fast increase of reciprocal trade.[21] The low levels of exchange, prevailing in 1969, rose to 8 percent of the total trade of the Andean countries by 1974, a two-fold improvement of the share of reciprocal trade.

As expected, a large share of the increase is concentrated in manufactured products. The rate of increase of reciprocal trade in these goods has been about three times as fast as that of raw materials, as shown in Tables 8.2 and 8.3.

Tariff policy is the foreign trade instrument used by the Pact to systematically regulate the structure of imports.[22] Among other advantages, this mechanism allows the government to know what level of protection is being provided for the various import substitutes. By contrast, experience with the traditional systems of bureaucratic or quantitative restrictions has shown, apparently without exception, that governments have not known what protection was being granted to each import substitution activity. This situation is in basic contradiction to efforts to plan foreign trade and the development of the various productive sectors.

The Andean import policy is expressed in a Common External Tariff (CET) schedule. This consists of a list of the rates of customs duties applicable to each of the items which may possibly be imported. Each country should gradually equalize its national tariffs to the CET on items imported from outside the subregion. A so-called *minimum* common external tariff was

TABLE 8.2
Composition of Main Reciprocal Exports
(millions of dollars of 1974, and percentages)

Sector of origin	Value				Percentages of the total			
	1969	1970	1973	1974	1969	1970	1973	1974
Agriculture	*54.8*	*60.3*	*79.2*	*97.0*	*37.2*	*37.6*	*35.8*	*27.0*
New	0.5	0.4	25.3	36.0	0.3	0.2	11.4	10.0
Traditional	54.3	59.9	53.9	61.0	36.9	37.4	24.4	17.0
Mining	*21.4*	*21.8*	*19.2*	*22.4*	*14.6*	*13.6*	*8.7*	*6.2*
New	0.1	0.0	6.1	6.5	–	–	2.8	1.8
Traditional	21.3	21.8	13.1	15.9	14.6	13.6	5.9	4.4
Manufactures	*70.9*	*78.1*	*123.0*	*240.1*	*48.2*	*48.8*	*55.5*	*66.8*
Total	147.1	160.2	221.4	359.5	100.0	100.0	100.0	100.0

Source: Junta del Acuerdo de Cartagena. Exports of petroleum have been excluded. Many items being traded in small amounts, representing from 10 to 15 percent of reciprocal exports have been omitted because the information was insufficient to classify them. The figures in dollars of each year have been deflated according to an index of export prices of France, Federal Republic of Germany, Great Britain, and the United States.

TABLE 8.3
Trade of Manufactures in 1974
(millions of dollars, and percentages)

Country	Total exports of manufactures (1)	Share of manufactures in total (2)	Reciprocal Trade: Exports of manufactures (3)	Reciprocal Trade: Share in total exports of manufactures (4)
Bolivia	1.0	0.2	0.6	60.0
Colombia	447.0	33.1	135.0	30.2
Chile	262.0	11.0	50.0	19.1
Ecuador	42.0	4.0	20.4	48.6
Peru	122.0	8.0	45.0	36.9
Venezuela	100.0	0.7	8.0	8.0
Andean Group	974.0	4.5	259.0	26.6

Source: Junta del Acuerdo de Cartagena. All figures are provisional.

applied between 1971 and 1976. According to this instrument, the countries could not charge lower duties than the agreed-upon rates, but they were allowed to maintain higher rates. The implementation of this minimum tariff has also been gradual. (A brief description and analysis is found in Aninat, 1976.) Subsequently, the countries should modify their tariff schedules year by year, starting in December 1976. The members should reach common rates by the end of 1980.[23] All dates applying to the CET are being postponed by three years. Thus the approval ought to be obtained before December 1978, and its implementation started in 1979. Until then a minimum CET revised downward and approved in October 1976 (the *arithmetic* average of the minimum CET was reduced from 40 percent to about 28 percent), will be in effect.

When the Common External tariff becomes fully implemented, it may differ from one product to another, but the rate for each product will be the same in all member countries. At the same time, as was mentioned earlier, the importation of these same products from within the subregion will not be subject to duty. Thus, Andean production will enjoy a level of protection equal to the CET applicable to the particular commodity. This protection is what is known as the "margin of preference," which defines the relative incentive granted to import substitution as well as to exports within the widened market.

The setting of the level and structure of the tariff schedule should be determined according to those objectives of the integration process that can be achieved by tariff policy, such as the equitable fostering of labor intensive productive activities or activities that contribute better to technological development.[24] Technological development is not an end in itself; rather it provides the foundation for an industrial expansion that corresponds to the particular characteristics of the member countries and which will provide greater independence from foreign influence. Both from a social and an economic point of view, the Andean nations should endeavor to create activities that provide as many stable and productive jobs as possible. The imaginative and systematic application of the CET, through the use of incentives that discriminate in favor of activities using more labor-intensive technology, can contribute efficiently, within certain limits, to the goal of higher employment levels.

The establishment of a common market requires much more than the liberalization of reciprocal trade and the implementation of common external tariffs. Aside from the major aspects that will be discussed in the following pages, there are several other requirements, which, because of their specialized nature, will not be examined here in detail. These include: elimination of tariff loopholes (exemptions) which weaken the integration process no matter who the beneficiaries are; harmonization of monetary, credit and foreign

exchange policies; and rationalization of nontariff barriers such as quotas, prior permits, sanitary regulations, nomenclature, and criteria for setting values on dutiable items (on the basis of which the CET is to be applied at customs). Progress has been made in almost all of these areas, and has tended to be directly proportional to the priority attached to a uniform policy in each area. Thus, a common customs nomenclature has already been established, known as Nabandina. Basic criteria for coordinating exchange-rate policies have been defined, and a proposal to create a Pool of Foreign reserves has finally been drafted. (See JUNAC, 1974: August, November, December.) Integration of domestic monetary policies, on the other hand, is considered to be less urgent and feasible. The order of priority for each of these elements is determined according to criteria that take into account both the political viability of establishing uniform policies and the expected benefits that this action might have toward the fulfillment of the objectives of the Pact.[25]

2. Investment Planning

Those basic objectives of the Andean strategy that can be influenced by the allocation of resources are the target not only of tariff policy, but also of the Sectoral Programs for Industrial Development (SPID). SPID constitute the main direct instrument for industrial planning and for an equitable distribution of the benefits of the integration process.[26] The mechanism was designed to correct the injustices and inefficiencies that would result from the unregulated functioning of the merged economies of countries with both insufficient and diverse levels of development. The instrument is of a particular importance in avoiding the dangers of benefit polarization with regard to investment programs designed for the expanded market.

The Andean approach seeks to be realistic in its efforts to solve this problem. Although the list of the goods in the tariff schedule included almost 6,000 items, this number does not give an adequate view of its real scope, since many items on the list are products subdivided into different varieties and different quality levels. Consequently, there are actually *tens of thousands* of different commodities involved, which obviously make it impossible to "plan" in detail the production of each of these products. For this reason the various products were first grouped in the 6,000 items, each of which contains commodities with important common characteristics. Then a part of this list was earmarked for eventual inclusion in the SPID programs, on the basis of the economic and technological importance, and on the economies of scale involved in the production of the items. Instead of submitting the production of these goods unrestrictedly to the dictates of the "invisible hand," the Andean countries have chosen to regulate the market in order to benefit from planning.

About a third of total tradable merchandise will eventually be included in subregional investment planning.[27] This is still excessive for centralized

production decisions, but that is not the purpose of the SPID. Rather, the program envisages that certain groups of new industrial activities with technological linkages—a so-called "industrial complex" or "product-family"—be assigned to a particular country. A similar process takes place in each productive sector. The designated country is granted the right to develop the production of the respective product-family and is guaranteed a market free of tariff and nontariff barriers in the other member countries. The other countries agree not to promote the development of similar activities for a certain number of years, to liberalize imports *only* from the designated country, and to apply a duty equal to the CET against third nations, thus providing a margin of protection equal to the common tariff to products from the favored country.

It can be seen that the decision of *where* to invest is taken away from the market. The decision of which product-families are to be assigned to which countries is made by the Cartagena Agreement Commission, based on a proposal of the Junta. The role of the market, however, is not eliminated from the succeeding phases of productive activity. The centralized decision of *where to invest* is accompanied by a more decentralized control of how much, when, and how to produce. *One* of the mechanisms of control is the use of the CET, which sets the maximum surcharge in relation to international prices that the exporting country can impose. Such an approach is pragmatic and seeks to encounter a complementary relationship between "market" and "planning." (For specific analysis of the Andean case, see Ffrench-Davis, 1974.)

The selection of sectors and the decisions relating to their geographical location are not the only aspects that can be centralized. It may be desirable to centralize other processes that achieve strategic importance after the allocation is effected. For example, because of economies external to the firm, marketing and technological development could well be centralized in order to achieve an efficient growth of some manufacturing sectors. This could take the form of "multinational Andean" corporations.

The first SPID was approved in 1972. Enormous significance was attributed to the act, both because it marked the beginning of subregional investment programming and because of the economic importance of the products involved, among them an important segment of the metallurgical-mechanical sector.[28] The program includes approximately 200 items, chiefly machine-tools, mining equipment, electrical equipment, and instruments. It is estimated that by the end of the decade, the annual output of the items in this program will be on the order of U.S.$500 million in 1974 dollars. A total investment of about U.S.$450 million will be required and 40,000 direct jobs will be provided.[29]

Expected output involves an intensive substitution of imports from outside the subregion. At the same time, the process brings about an expansion

of exports within the subregion. Thus, the process is radically different from historical patterns, in that import substitution at the subregional level complements the promotion of domestic exports. Moreover, the implementation of this SPID unquestionably tends to improve the economic and technological conditions of the elaboration of the metallurgical-mechanical items included in the automatic and gradual liberalization of reciprocal trade. For the products embraced by the plan, the margins of protection range from 35 percent to 80 percent, and they could probably be lowered without difficulty when all the sector activities reach full production. It should be recalled that the metallurgical-mechanical industry is relatively labor-intensive; it also allows the development of know-how whose use can be spread throughout the rest of the economy. For these reasons, the sector merits greater protection than most industrial activities.[30] In summary, it could be asserted that because of the characteristics of the sector and the economies of scale it allows, this SPID guarantees in general the efficient development of the metallurgical-mechanical sector while allowing the participation of all the member countries.

Items reserved for programming cover ten other sectors, each one likely to be the subject of a SPID. The most outstanding, and at the same time the most controversial, are the petrochemical and automotive sectors.[31] After long and hard negotiations, the petrochemical program was approved in August, 1975.

The second SPID, ruled by Decision 91, requires a sizeable capital investment, exceeding U.S.$2 billion, while output will reach an estimated U.S.$1.2 billion by 1985. Direct employment, however, would amount to only 8,000 jobs, mainly technicians and highly qualified professionals. Clearly, this program has features that differ substantially from those of the metal-mechanics program. In fact, petrochemicals are notoriously capital-intensive ($200,000 to $300,000 per worker), they use technological knowledge that cannot be used elsewhere, they are intensive in foreign investment and in captive technology, and they have large economies of scale. For these reasons, petrochemicals receive substantially lower protection, nominal rates between 20 percent and 35 percent, than has been granted to metal-mechanics. Furthermore, economies of scale would be insufficiently exploited, if, due to the desire of each country to have its own petrochemical industry, less than optimum specialization is achieved. Notwithstanding its shortcomings, the program would allow a more efficient development of the sector than the independent efforts of each country could attain.

It seems possible that once all the SPID have been approved, an exchange of allocations could be fostered among countries in order to achieve a larger sectoral specialization by each participant.[32] Two factors make this likely. The countries will face difficulties in implementing simultaneously all allocations they have been assigned, and they will be forced to choose among

them at the start. Moreover, project evaluations may well reinforce the knowledge on the incidence of external economies and economies of scale, and make more evident the convenience of avoiding the dispersion of efforts.

3. Foreign Investment Policy

When liberalization of trade within an integration process is not accompanied by coordinated industrial and foreign investment policies, integration can tend to weaken the position of the developing country vis à vis the large transnational corporations. Indeed, the number of options open to foreign enterprises expands with integration, for now by investing in one country the enterprise has access to the markets of all the member countries. Thus, the corporation can pick the country offering the greatest privileges.[33] Consequently, the farther the integration of markets advances, the higher the priority that should be assigned to the adoption of a common policy toward investments from outside the subregion. Such a policy would enable the member countries to avoid competition and to present a united front to foreign investors.

The growing power and wealth of the transnational firms, in contrast to the meager contribution many of them make to the achievement of self-sustaining growth of the host countries, has caused concern in broad professional and technical, academic and government circles. Various research projects conducted during the 1960s brought to light the unequal distribution of benefits and costs between the foreign enterprises and the developing countries in which they operate, and revealed the limited contribution they were making to capital formation, technological progress, development of administrative skills, and of foreign markets. (A detailed discussion of relevant issues is made in Vaitsos, 1974. A brief analysis can also be found in Ffrench-Davis, 1972.)

There were various indications that a liberal policy toward foreign capital turned out to be most attractive to those investments with short payback periods. That was partly a consequence of the investors' perception, taught by experience, that overly favorable conditions carried the risk of being modified after a short time. Stability, even when it involved strict norms, appeared to be a good inducement to investments with positive effects on the host countries.

These factors convinced the Junta and the Commission of the advisability of establishing *strict but stable* regulations for the treatment of foreign capital. It was thought that this would attract foreign investors who would be willing to operate mixed enterprises—with the participation of the state or of private Andean investors—which would contribute to administrative and technological development, and would provide external markets for new Andean exports.

Thus uniform standards for the treatment of foreign investment were approved during the first months of the Andean Pact's existence. The agreement, known as *Decision 24,* establishes a common set of rules; these are the *minimum* restrictions to be applied by each government to foreign capital, but they allow the governments to legislate stricter norms if they so desire.[34] Since the policy-makers were aware of the difficulties of reaching an agreement on issues such as these, the decision allows for differentiated treatment of activities "closely linked" to integration, as distinguished from other activities. Thus foreign investors in the first group of activities may not receive more favorable treatment than that prescribed in the common norms, whereas each country has the option of making use of clauses of exception for other activities.

Some of the fundamental aspects of Decision 24 are:

First, it is a *stable* norm due to its multinational character; it can be modified only through the concurrence of several countries. Second, the policy is *selective;* each new foreign investment requires the explicit authorization of a national organism responsible for the negotiation, admission, and regulation of the investment.[35] Third, the agreement regulates the use by foreign investors of internal and external credit, and the clauses frequently introduced by the foreign investors that restrict the exportation of goods bearing foreign brands and royalties.[36] Fourth, automatic *reinvestment* of profits (exceeding the equivalent of 7 percent of their own capital per year) and purchase of shares in domestic enterprises are restricted; both are required to pass through the same selective channels as initial investment, and investment in domestic enterprises is regulated also in order to impede foreigners from buying stock at artificially low prices during the frequent downswings those markets suffer.[37] Fifth, the Decision recommends that these investments be prohibited in strategic sectors such as financial activities, advertising, and communications media; but governments not yet prepared for such a step may have recourse to the exception clauses mentioned above.[38]

Lastly, the agreement establishes norms for the gradual transfer of the ownership of the foreign firms, both new and old, into domestic hands. Three categories of firms are defined according to the composition of their capital: national, mixed, and foreign. National firms are those with more than 80 percent domestic capital; mixed are those with a domestic capital share between 51 percent and 80 percent;[39] and foreign enterprises are the remainder. Decision 24 stipulates that foreign enterprises should be transformed gradually into *mixed* enterprises within 15 to 20 years. The foreign firms that do not sign a timetable with domestic authorities for conversion into mixed enterprises will not be afforded the benefits of the expanded market, i.e., they will not be allowed to make use of the reduced import duties within the Andean market. Enforcement of this provision is left to the

importing country, which may apply to the sales of these firms the same import duties that are in effect for goods being purchased from the rest of the world. The infractor company thus loses what is probably the principal incentive for new investments in the industrial sector: access to the expanded Andean market. (A systematic analysis of the role of foreign investment in integration processes, and its application to the Andean countries is made in Tironi, 1976.)

The application of the agreement on common treatment of foreign capital is still in its initial phases. The most difficult step has been taken: the agreement itself, whereby the countries freely committed themselves to establish a stable, selective and demanding policy on foreign investment, along the lines already discussed. This decision was reaffirmed on the occasion of Venezuela's entry into the Pact in 1973, and again in 1976. Undoubtedly problems will arise on the way toward full implementation. Greater understanding of the rationale of this instrument and of its advantages for the permanent interests of each nation will be the best guarantee to ensure that the common policy is implemented. Also indispensable for its effectiveness is the development by each government of an effective bargaining and evaluation mechanism for handling each case of foreign investment. Such an apparatus is a basic requirement for the progressive rationalization of foreign capital movements.

The continual exchange of experiences that is envisioned by the Decision, if properly implemented, should deepen this process of consciousness raising. In other words, it should have a pedagogical effect conducive to the rethinking of attitudes and specific policies and the reassignment of priorities. The rationalization of treatment of foreign investment will undoubtedly mean the non-entry of some corporations and the exodus of others. This is particularly true in the case of firms whose intention was to function solely within the domestic market under the shelter of high protective tariffs.

On the other hand, stability could serve to attract other firms. Moreover, the rationalization process should enable the Andean countries to handle more advantageously the new conditions in world markets that have resulted from the advent of transnational corporations with diverse national origins, behaviors and motives. The new international environment permits a wider margin of maneuver for the developing countries. Their bargaining capability will depend on the clarity of their objectives, on the knowledge they gain from countries in similar situations, and on how much power they gain and are willing to use. The regime created by the Andean countries has the proper orientation in all of these three aspects. It represents, therefore, a realistic step toward effective realization of authentic development with a national or Andean profile. Nevertheless, the outcome depends on the awareness achieved by each country that their development rests on their own efforts

and not on those of others, thereby rejecting the ideological postures that are dependent on foreign capital.

In summary, an objective analysis of Decision 24 shows it to be located in the framework of modern, efficient, and realistic nationalism.[40] Its original provisions recommending the design of *strict but stable* norms, create what can, with experience, become an appropriate mechanism to attract and regulate the sort of foreign investment that effectively supports internal development efforts.

4. Coexistence of Governments With Opposing Political Leanings

A group of countries moving toward the integration of their markets progressively builds a common framework within which each member must place its policies. This framework inexorably becomes tighter as full integration approaches. During the process, especially at the outset, there is room to choose the path of integration, which is determined by both economic and political implications.

The large variety of public policies, tools, and institutions that can be used for integration offers a broad field from which to choose what, to what degree, when, and with what speed to harmonize. Policy harmonization is not sought for its own sake, but for the contribution it can make to the better use of potential benefits and to lower the costs that integration can bring. However, in order to be effective, the specific program requires consistency between technical aspects and the sensitivity of each nation whose autonomy of decision is thus somewhat limited in certain policy areas. A crucial aspect, which has not been discussed in the previous sections, relates to the question of coexistence of different political regimes within a process of economic integration. It is frequently asserted that political homogeneity is a prerequisite for economic integration. However, many areas of policy can be harmonized, reciprocal trade can be fostered, and some planning in common made, despite political heterogeneity. That is true during much of the long way toward full economic integration. It is in this situation that the Andean countries will actually be operating for many years. Naturally, coexistence is only feasible within some limits. The nature of the Andean Pact is inconsistent both with fully centralized and barter-economies and with laissez-faire approaches.[41]

The Cartagena Agreement establishes a series of norms progressively conditioning the choice of economic policies in each country. Since, within the foreseeable horizon, the member countries will not reach economic and political unity, they can go their own way in various policy aspects. Two examples of this are the size of the public sector of the economy and the structure of consumption. In both cases the member countries are able to retain or establish substantial differences among themselves, provided the mechanisms used to achieve their objectives conform to some guidelines.

As regards state enterprises within the context of the economy as a whole, the terms of the Pact enable countries with a small public sector to coexist without problems with those in which state enterprises predominate. This is possible because this sector must operate under the common provisions of the Pact which affect the level and composition of import and export trade.[42] The objective is to assure that the margins of preference apply to all types of national enterprises, whatever its ownership or mode of management. Care must be taken, nonetheless, with the implementation of this assertion, as it is much more difficult than it sounds.

Similar observations hold with respect to the structure of final demand. It is commonly thought that progress toward a common market implies the imposition of certain patterns of consumption in all member countries. Such a situation would impede the changes that might be necessary to enable a member country to implement a redistributive policy. This is not the case, however, with the Cartagena Pact, which gives each country the necessary autonomy to conduct its own consumption policy. The only limitations are on the type of instruments that may be put to work, in order to restrict (or promote) the consumption of given goods, irrespective of whether these goods are imported or produced domestically. This means, for instance, that the countries must abandon the practice of forbidding imports of luxury goods, especially from associated nations, while at the same time allowing their domestic production. The terms of the Pact do permit, on the other hand, the levying of heavy taxes on luxury items, thereby reducing both imports and production, while redirecting demand and productive resources to sectors of the economy with a higher priority.

In summary, with good will and certain doses of pragmatism, countries with divergent political regimes can profit from the benefits of economic integration. In fact, they can pursue autonomous policies in domestic matters, such as income distribution, direct internal taxes, and the productive role of the state.

5. Economic Relations With Nonmember Countries

It is useful to analyze how the progress toward economic integration of the members of the Andean Pact would affect their relations with other countries. Two questions are crucial. Does the process of integration tend to be autarkic or relatively open? Is its scope limited to the integration of domestic markets or is a more ambitious framework envisaged? The answer to both questions is still relatively open; because of the steps already under way, the first one gets a neater answer.

From the outset, the Andean Pact has been seeking, in net terms, a development strategy that on the average is more open to trade than in the past. The rejection of absolute protection to import substitutes, and its replacement by the criteria of relative effective protection shows that import

substitution, now at the subregional level, will be more selective than it has been in the past. Furthermore, the development of nontraditional exports within the Andean market could contribute to support, subsequently, the sale of manufactured goods to third countries. This factor, which seems to be important in promoting "infant exports," would be enhanced if trade policies, instead of discriminating between import substitution and exports, discriminated according to the nature of each economic activity; i.e., labor intensity, infancy, and transferability of the technology. In this case, protection to import substitution at the subregional level (reciprocal exports) is provided by the CET, since users in the importing country must pay the duty on goods imported from outside the region; on the other hand, subsidies for exports to third countries must be paid directly by the exporting nation.[43]

In short, the selective approach to import substitution, the support provided to infant exports by the broader market, and the criteria to direct incentives according to the nature of productive processes rather than to the markets of destination, if finally adopted and implemented, most probably would imply a larger role for nontraditional exports to third countries than before.

At this point it is worth digressing with respect to export subsidies. The rules prevailing in developed countries discriminate against those export price incentives that would be most effective for the developing areas. Drawbacks of duties paid on imported inputs, credit subsidies, and accelerated depreciation for export industries are all practices that are accepted internationally; unfortunately, they do not help the overall development of the domestic economy in less developed countries. On the other hand, open export subsidies for labor-intensive industries are unacceptable to developed countries, which apply countervailing duties or non-tariff import restrictions against exports of countries that openly subsidize export industries. Thus there is an urgent need to revise the definition of export "subsidies," in order to allow developing countries to use selective incentives suited to their particular needs.

It has been shown, in a previous section, that the Andean countries, as long as they work together, are large enough economically to deal as equals with any of the larger Latin American nations. This fact could make easier, sometime in the future, integration schemes between the Andean countries and other nations in the region. In the short run, it may be possible, though not easy, to promote partial integration with other Latin American countries. Other countries could participate in the sectoral programs for industrial development (SPID), a scheme that would be particularly welcome for the sectors whose economies of scale are larger than those covered by the markets of the Andean countries. Those partial schemes would operate where their contribution to industrial efficiency could be more useful, and in the specific economic sectors where the isolated development of subregional agreements

were likely to pose obstacles to reaping the benefits of the integration of the full region.

Some sort of agreements with other developing countries could also take place. Changes in trade restrictions have been limited in practice to non-reciprocal preferences given by developed countries to the developing regions and to liberalization of markets of industrialized areas that are of interest to transnational corporations and to developed countries.

Prevailing restrictions to trade among developing countries are eliminated only for members of some formal process of integration. Liberalization could also be extended to sectoral production agreements among some countries or groups of them. For instance, countries producing a large share of the world supply of a given raw material, could agree to produce some inputs or capital goods used in its production. The agreement could include programming investment location, and the elimination of tariff restrictions to trade on commodities produced by the countries covered by the agreement. This would require, within the field of what has been called horizontal preferences, the international acceptance of an exception to the most favored nation clause, when dealing with production agreements among developing countries. These "futuristic" agreements with other developing nations could be more easily promoted by the Andean countries as a unit instead of by each one in isolation. Thus, they would be able to offer a broader market, increasing their bargaining power and the size of the benefits that could be generated to the countries participating in production agreements.

Finally, there is a need for the developing countries to play a more active role in international negotiations dealing with trade restrictions. This is also true for the members of the Andean Pact. They could help open foreign markets to new exports. They could, for example, organize multinational enterprises, jointly develop data systems, and negotiate at international forums. For instance, the collection of data related to foreign markets, entry conditions, and prices can be organized more cheaply and comprehensively by a group of associated countries, thus providing mutually to each other exporting knowledge. At another level, a dynamic Andean Pact could probably contribute positively to more vigorous participation of Latin American institutions, such as SELA (the recently created regional organization), in the international forums that are searching for a way for LDCs to gain a fairer share of the benefits produced by world trade.

In summary, the successful development of the Andean Pact would increase the level and share of reciprocal trade. Moreover, this could take place simultaneously with an increase in the economic relations of the subregion, with other Latin American countries, with developing nations in other continents, and with industrialized areas. Of course, whether this type of insertion in world markets is to prevail, will depend upon the design of export policies, the role assigned to negotiations geared to improve the access

to foreign markets, and the use the Andean countries make of their improved bargaining power vis à vis third nations and international corporations.

IV. FINAL REMARKS

Various attempts have been made by developing countries to bring about integration, but in general, the efforts have ended after a few years in very limited forms of integration or in outright failure. The Andean integration, despite the difficulties experienced in the last two years and the retirement of Chile in October 1976, is an outstanding exception to this pattern. Its relative success is perhaps due to the originality of the instrument which gave it birth; the 1969 Cartagena Agreement contains a comprehensive set of propositions aimed at the constitution of a common market, the implementation of various mechanisms of joint planning, the achievement of a more equitable distribution of benefits, and the accomplishment of a development path with its own profile. Balanced progress in these areas is essential for the efficiency and permanency of the process.

The terms of the agreement have been given concrete form by the successive proposals of the Junta and decisions of the Commission. These have embraced aspects such as the definition of products earmarked for industrial planning; the minimum common external tariff in its two steps covering 1971-1976 and 1976-1979; the norms for common treatment of foreign investment; the basis for an Andean technological policy; the metallurgical-mechanical sector development program, and dozens of other decisions. The decisions have been complemented by recommendations from committees made up of the presidents of the central banks, and of the ministers of foreign relations, planning, health, agriculture, education, finance, etc. The process, with all its shortcomings and the difficulties in incorporating broader sectors, has been moving ahead during its half-decade of existence.

The originality and success achieved so far by the Andean Pact are jeopardized to some extent because cyclical problems in several countries are causing their governments to relegate integration to a secondary plane. Also, the dangerous theoretical bias that there exists free competition in international markets to which large volumes of manufactures might be easily and steadily exported, leads one to underrate the importance of the subregional market. An extension of that bias is the trend prevailing today in some political circles against an active role of the state in economic matters, in favor of free-trading and of welcoming foreign investment. These ideas predominated in the country that recently left the Pact. These laissez-faire biases are as opposed to economic integration as national autarkic approaches might have been in the past. Finally, some countries, for one reason or another, could concentrate their search for markets for nontraditional exports too much on areas such as

the United States, Central America, and the Caribbean, or Brazil. None of these approaches would permit the Andean countries to achieve as harmonious and stable an economic development as would be possible by means of a common market within the regulated framework outlined by the Cartagena Agreement.

Notwithstanding the considerable advances already achieved by the Andean Pact, a long and difficult road lies ahead. Many important decisions remain to be designed, approved, or implemented. They include such matters as the remaining sectoral plans for industrial development, the common external tariff, the programs for rationalization of those existing industries that have been temporarily excluded from integration, and the development of harmonized policies on foreign exchange, tax, and foreign trade. These are obviously decisions of enormous importance, as must be the case when the target is the integration of major aspects of the economies of member countries. The design and final approval of many of these decisive steps will be carried out during the coming years. Overcoming the obstacles presented by these impending decisions and their subsequent implementation, is an endeavor that depends on the simultaneous fulfillment of two conditions. The Junta must continue to carry on its work with the same dynamism and imagination that has characterized its first years in operation. The other crucial condition is the presence of an enormous integrationist will, supported by the awareness of the importance of a successful process. This should be evidenced in the countries' looking forward, with realism and imagination, to the future rather than to the present and past, and in the introduction of integration as a fundamental variable in government policy design. Undoubtedly, there is much to be done in this direction.

The fulfillment of both conditions would imply the capacity by each country to foresee again the *net* benefits that the *set* of decisions offers to them. Its antithesis—the prevalence of partial and sectoral intransigent views or of laissez-faire dogmatisms, that have recently appeared in some countries—would undoubtedly lead to failure.

The return to the essence of the Cartagena Agreement would allow the present difficulties to be overcome. The most relevant features of the scheme adopted in 1969 were the coexistence of direct forms of planning with the working of a regulated market; the search for efficient development with equity in the distribution of its benefits; and the greater openness of each country to trade while maintaining an autonomous and self-styled development. All this means balanced progress in industrial programs, in the adoption of the common external tariff, in the harmonization of policies that are strategic to integration, and in the effective implementation of the code on foreign investment.

NOTES

1. This paper is an extended and updated version of "El Pacto Andino: un modelo original de integración," CEPLAN, December 1974. This version has been completed as part of a research project on economic integration and developing countries, supported by the Program of Research in International Economic Order of the Ford Foundation. I am indebted to E. Tironi, A. Aninat, and D. Schydlowsky for their useful comments.

2. The Cartagena Agreement is named for the Colombian city where the preparatory commission finished the final text of the agreement. The five original members were Bolivia, Colombia, Chile, Ecuador, and Peru. In February 1973, a sixth member, Venezuela, was accorded entry by means of an additional agreement, known as the Lima Consensus. Venezuela's actual incorporation into the Group started taking place during 1974. Chile, however, left the Cartagena Agreement in October 1976.

3. For a theoretical analysis on the role of economies of scale over the welfare implications of custom unions, see Corden, 1972. For a discussion of welfare effects in developing countries of trade creation and trade deviation, see Mikesell in Robson, 1971, and Ffrench-Davis, 1976.

4. See Baldwin, 1970 and GATT, 1974 for an analysis and empirical data on non-tariff restrictions to trade. A discussion of several issues related to export policies in developing countries is found in Ffrench-Davis and Piñera, 1976.

5. Transnational corporations integrate some markets that otherwise would have no connection. However, the market becomes integrated from the point of view of the multinational parent and its subsidiaries. Thus it becomes more difficult for domestic producers from developing countries to export to those "captive" markets.

6. A low level of GNP is one of the factors limiting income redistribution programs and the satisfaction of essential needs. Greater efficiency in the productive process would allow a change-oriented government to simultaneously accelerate redistribution. However, it is important to note that the selection of the specific integration scheme to be implemented can influence income distribution, employment and, to some degree, the distribution of power among social groups.

7. The analysis of the numerous sources of benefits and costs of the integration process will be omitted here. The factor mentioned above, the exploitation of economies of scale that the reciprocal opening of markets allows, is one determinant source of net benefits.

8. Reduction of barriers in large part affected products for which ample trade already existed. An important result of the process, therefore, was to consolidate and broaden traditional areas of reciprocal trade. On the other hand, it also opened markets to some transnationals, mainly operating in the larger member countries of LAFTA. Data on trade flows is presented in INTAL.

9. Even though product specialization may be economically advantageous, it is not always evident a priori which firms should produce each type of product. In such circumstances, a centralized decision on specialization patterns can lead to a more efficient, smoother, and politically more feasible process compared to that achieved through "market competition."

10. In fact, only one aspect of trade was partially regulated, the margin of preference or the internal nominal tariff of those commodities negotiated. There was no consideration of effective tariff protection nor of other variables influencing the overall protection of those goods.

11. For an examination of the changes in attitude of many Latin American countries in the direction of a rationalization of policies vis à vis foreign investment, see Vaitsos, 1974. Unfortunately, this positive trend has suffered several ups and downs lately.

12. The theoretical discussion of the effects of integration on the distribution of benefits among transnational corporations and member countries can be found in Tironi, 1976: ch. 3. Tironi discusses several alternative outcomes; many of them, that are based on rather realistic assumptions, lead to cases of "inmiserizing growth."

13. In the meantime, the Andean countries operate as one economic unit in their relations with other LAFTA members in such matters as negotiations related to tariffs and industrial production agreements.

14. This assumes, of course, that the group does not duplicate development patterns of the three largest countries, for this would impede their ability to complement their economies in the future. Such duplication is unnecessary and disadvantageous in many cases; nonetheless, especially because of pressures of vested interests, it is probable that to some degree there will be duplications. The specific nature of the common tariff policy and the industrial planning program will exercise a key role in the productive structure created within the Andean market. Similarly, the promotion of certain specialization agreements between the Andean Group and the other countries of Latin America would mean a step forward in the integration of the region.

15. Generally the director of each country's Secretariat of Integration or Foreign Trade Institute fills this post. It is up to each country to determine the rank within its government of its representative. It would probably be better to harmonize this, so that all delegates share an equally high rank. Nonetheless, since 1975, four countries are represented by ministers of economics or development, and the delegations of the other two countries have also occasionally been headed by officials with that rank.

16. Other entities, named for their founding agreements, are the Andres Bello Agreement (educational integration), Hipólito Unanue Agreement (cooperation in health programs), and the Simón Rodríguez Agreement (social-labor integration). In addition, various advisory councils to the Junta have been created and are composed of high level officials from the corresponding national institutions responsible for the formulation and execution of policy in their respective areas. Among them are the Planning, the Monetary and Exchange rate, the Foreign Trade, and the Physical Integration Councils. For dates of the foundations and responsibilities of these and other Andean Pact organisms, see JUNAC, 1974. Furthermore, there is a growing number of organizations grouping professionals, entrepreneurs, labor leaders, and research institutes.

17. There is clearly more favorable treatment for Bolivia and Ecuador: they reduce internal tariffs more slowly than the other four members with respect to tariffs on imports coming from those countries. A detailed study of the different mechanisms of liberalization of reciprocal trade can be found in Aninat, 1976. It is useful to mention that the Andean tariff schedule contains about 6,000 items.

18. Internal custom duties were reduced in 1971 to the lowest of the existing rates for each item in the tariff schedules of Colombia, Chile, and Peru, with a maximum ceiling of 100 percent.

19. See "Protocolo de Lima Adicional al Acuerdo de Cartagena," October 30, 1976, that modifies the Cartagena Agreement. The corresponding legal process is underway in Bolivia, Colombia, Ecuador, Peru, and Venezuela. The Protocolo extends various dates related to the Common External Tariff and industrial programs.

20. The countries agreed that beginning January 1971, they would eliminate all non-tariff restrictions to trade of these commodities (import quotas, prior deposits, bureaucratic "red tape" and other mechanisms traditionally operative in their foreign trade policies). However, it is important to note that registration and checking declared prices, regulations on imports of transnational corporations, sanitary regulations and other "qualitative" controls may and should continue in effect or could be established.

21. The removal of barriers among the member countries has increased their commercial contacts, which were notoriously scarce before the Cartagena Agreement. The

subsequent reciprocal knowledge of their respective supplies and demands, and the opening of marketing channels, has increased trade even in commodities that have not benefited from formal margins of preference.

22. Other foreign trade tools also influence the composition of imports, though in an indirect, less systematic way: i.e. exchange rate policy and some non-tariff devices that ought to exist. Mechanisms belonging to other policy areas, such as industrial programming, also affect the composition of trade. All these have been considered or are consistent with the Cartagena Agreement.

23. As mentioned above, Bolivia and Ecuador enjoy certain privileges, one of which is the extension of their period of adoption of the CET to ten years. Furthermore, they were not subject to the minimum CET.

24. See JUNAC, November 1975, for a discussion of alternative objectives usually assigned to tariff policy. JUNAC has made systematic use of the concept of effective protection in order to determine the nominal CET.

25. In brief, political feasibility depends on the degree of autonomy in the handling of policy tools that each country must forego because of harmonization. The benefits of coordinated policies depend mostly on the impact of each policy on the foreign trade of each country.

26. Other direct instruments that have been considered in the Agreement are the programs for rationalization of existing industries and for agricultural development.

27. About one-fifth of the tariff schedule is not included in either the SPID reserve or in the program of automatic liberalization of reciprocal trade. Those items are generally produced by existing industries for which the member countries have feared the consequences of mutual competition. In deference to this fact, each country is entitled to include a certain number of items on lists of exceptions. The trade barriers for these goods can be maintained until 1988 unless the commission previously approves a *rationalization program* for them. Such programs can be designed when two or more countries have included the same item in their lists of exceptions.

28. For analysis of the provisions of this program, contained in Decision 57, see Avila, 1973. The program excludes automobile parts and iron and steel metallurgy, which are to be covered by other SPID. A report on the implementation of the program two years after its approval can be found in JUNAC, "Informe de la Junta sobre el avance de las producciones asignadas en el Programa Sectorial de la Industria Metalmecanica," Lima: October 1974.

29. Avila, 1973: tables 3 and 5. Figures exclude Venezuela, which was not yet a member of the Pact. Negotiations are currently under way for the incorporation of that country into a metallurgical-mechanical program.

30. The high capacity to absorb labor represents a contribution to GNP from which the firm does not necessarily benefit in economies with large unemployment as is the case with the Andean countries. The same happens with the spread of "know-how". Both aspects are externalities that can be partially compensated via tariff protection. If used in this sense, the CET can perform as a planning tool for development.

31. Several other programs were sent to the Commission in 1975. The remainder are currently in the final stages of preparation and are scheduled for presentation to the Commission before mid-1977. A precise timetable was agreed upon in October 1976 for the presentation, discussion and approval of all programs.

32. Attempts to make each specific program distribute costs and benefits, equitably among all the countries of the subregion could mean the loss of economies of scale and external economies. It thus seems advisable, in general, to assign these SPID according to "technical" criteria with subsequent compensation for adversely affected countries in the form of preferences for them in allocating other SPID. It is convenient, therefore, to analyze *in conjunction* the SPID slated for implementation in the near future. This

approach to assignment of investment would permit one or two countries to specialize in petrochemicals and allow other countries to specialize in the other industrial sectors. This is after all the sense of Article 39 of the Agreement, according to which equity is sought in the distribution of the benefits of the SPID *as a whole*. Presumably, this consideration should also include the programs of rationalization and of agricultural development.

33. It should be noted that the Agreement has improved the bargaining position of Andean countries in all the branches covered by a SPID. In these cases, the foreign investor does not have the option of choosing the country that offers the most advantageous conditions, but must establish his industry exclusively in the country to which that activity has been assigned. This allows the latter, to capture a larger share of the economic "rent," if its government so wishes.

34. Decision 24 is currently in effect in all the member countries. Its status is that of international commitment, that is, it prevails in case of conflict with internal legislation. See Acta Final, Decimosexto Periodo de Sesiones Ordinarias, Comision del Acuerdo de Cartagena, Lima, November 1974. Several improvements of Decision 24, that maintain all its essential aspects, are included in Decision 103, of October 1976. It settles problems of interpretation, defines matters that were left open in 1970, and introduces some adjustments.

35. Most of the norms apply equally to the treatment of brands, patents, royalties and licenses. A discussion of the main provisions of Decision 24 is developed in Ffrench-Davis, 1972 and Tironi, 1976.

36. These monopolistic practices limit the access of domestic production to foreign markets, thus working against one of the justifications for the acceptance of foreign investment. In the case of Chile, for example, 91 percent of the licenses valid at the end of the past decade stipulated limitations on exports of the licensed enterprises. See Moyano, 1972.

37. The simple-minded proposal of neoclassical economists to allow these operations because they assume them to be stabilizing, seems unadvisable for two reasons. First, it is doubtful that such operations would contribute to the stabilization of the stock market since they have not been able to do so in the developed economies. Second, except in a competitive market, they tend to transfer capital gains from native to foreign owners.

38. In addition, yearly remittance of profits was limited to 14 percent of the capital. The limit was recently increased to 20 percent by Decision 103. It should be noted that restrictions on remittances apply to the outcome, not to the cause of the profits. They are of secondary importance, therefore, if the provisions discussed in the text are properly implemented.

39. Enterprises with less than 51 percent domestic ownership can be considered mixed enterprises in cases in which the state is a stockholder and "has determinant capability in the decision making process." A 30 percent share held by the state is set as the minimum requirement for mixed enterprises in these cases. Capital of Andean origin is to be considered as domestic capital.

40. This does not, of course, mean that each and every one of the provisions of the Decision is flawless and free of ambiguity. Decision 103 has cleared several points; nevertheless there is need of by-laws (reglamentos) in order to channel the implementation of various articles of Decision 24.

41. Furthermore, free-trade proposals are inconsistent with any scheme of regional economic integration, as the essence of the latter consists in the discrimination between partner and nonmember countries. This has been the core of the conflict that led to the retirement of Chile.

42. For the same reason, of course, the customs privileges enjoyed by many industries and regions of various countries must also be eliminated, and tax exemptions must

be harmonized. Numerous kinds of incentives can be used that do not directly distort trade flows. It should be pointed out, moreover, that tariff exemptions are frequently ineffective in attaining the objectives for which they were established.

43. If a government is experiencing difficulty in obtaining revenues, subsidies given to import substitution industries will, on the average, be higher than the subsidies given to exports. Nevertheless, it is probable that the average tariffs will be lower than they have been in the past. Furthermore, export incentives, which have historically been low in the Andean countries, will probably be higher. These variables determine the direction of resources allocation.

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Chapter 9

FISSURES IN THE VOLCANO?: CENTRAL AMERICAN ECONOMIC PROSPECTS

CLARK W. REYNOLDS

Central America presents a fascinating panorama of economies growing side by side. All of them are based on primary product exports and recently established import substituting industry, yet the political, economic, and social conditions of these countries are widely divergent. One would have to go back to 19th century Mexico to find parallels to the hierarchical class structure, wealth inequality, political rigidity, and positivistic utilitarianism that predominate in the "northern" countries (Guatemala, El Salvador, and Nicaragua). Yet the "southern" countries are characterized by a greater degree of political opening and higher income levels for the majority of the population. Costa Rica, the only nonmilitary state, is the most conspicuous example. Historically its export income has been widely shared. Panama and Honduras, under military regimes with a populist flavor, have recently increased taxation of their economic enclaves (under foreign ownership rather than a domestic elite) to provide funds for incipient programs of land distribution, rural and urban infrastructure, and other progressive activities. El Salvador is beginning to tilt its policies in a similar direction against the opposition of powerful economic interest groups, but it is restrained by the greater conservatism of its northern neighbors. Recent economic changes in the region have been impressive. One wonders what factors account for the parallel growth of the market economy in rural and urban areas, while at the same time the most basic social and institutional structures remain apparently inert in some countries and show such slow progress in others. Can this divergent process continue? This question must be answered before it is possible to project economic trends in a meaningful way. Or, to put the question differently, if future economic changes were to be accompanied by

broadening social and institutional evolution, would this in turn require a quite different economic growth strategy with major implications for the rest of the world?

LABOR PARTICIPATION IN AN EXPORT ECONOMY: CENTRAL AMERICAN STYLE

In an export economy, the principal income-generating activity is determined by foreign demand as reflected in international prices for the domestic export product (translated into internal prices through the exchange rate). The response of producers to this demand (plus the withdrawing of goods from inventories) causes a derived demand for labor depending upon the technology employed and its implicit effect on output per worker. If productivity rises rapidly, the demand for additional workers will be less than proportional to the increase in production and vice versa. Hence the first and most important employment-initiating activity to examine in such economies is the manner in which exports are produced. The income generated by exports in turn generates payments for domestic factors of production, including labor, capital, land, minerals, entrepreneurship, skills in scarce supply (and other scarcity rents), plus government participation in the form of taxes (net of subsidies). The factor income stream in turn generates final demand within the economy depending upon the demand propensities of households, business, and government and their respective shares in the functional distribution of income. This internal demand will lead to a secondary derived demand for labor depending, of course, on the labor intensity of the goods and services desired.

In Central America this export-led pattern of employment demand has characterized the region since independence. The product mix and the institutional conditions in which export goods are produced have had much to do with labor utilization and the share of labor in the economic system. They are also affected by terms of land tenure, technology employed, relative scarcity or abundance of labor (itself determined in part by the availability of land for nonexport or subsistence production), and government policies to tax and subsidize economic activities. Further factors are the response of domestic and foreign entrepreneurship to economic opportunities, subject to the hegemony of external powers, first of Britain, and later the United States.

Exports constituted the foremost factor behind not only employment, but general prosperity and even political stability of the Republics. The internal economies response to export performance generated a subsequent set of demands for employment in sectors linked to the export sector or providing goods and services which could be produced domestically (home goods) in competition with relatively abundantly available imports.

During the postwar period, Central American economists and some far sighted politicians wished to reduce the region's vulnerability to fluctuations in export prices and the resultant destabilizing impact on internal economic (and political) conditions. It was not appreciated fully how difficult it is to free small externally linked economies from physical and financial dependence on the world market (and the major economies which influence that market by their own internal trade cycles). But in Central America in the 1950s efforts were made to create a degree of independence in a balanced way, following the lead of ECLA which set up "integration industries." These, it was hoped, would have the advantage of being located throughout the region on an equitable basis (in terms of impact on the several economies through production, employment, and foreign exchange savings) and yet would be planned in such a way as to eliminate excess competition. The United States joined with skeptics within the region to cast doubts on the viability of the scheme, and capital was not forthcoming, any more than was the general political will for region-wide planning. Only a handful of such plants were established, and they were not a conspicuous success. This first effort at integration was stillborn. With it died import substitution industrialization as a means to increase the autonomy of regional economic behavior and to expand the freedom of internal economic policy. Perhaps no small element in the failure of this scheme was a general political fear of planning, which implied surveillance of profit performance and eventual fiscal vulnerability of economic activity in the region. The ECLA *mystique* associated with Raul Prebisch, its founder, conjured up visions of gradual control of the production process by technocrats imbued with the philosophies of Keynes at best and Marx at worst. It was feared that they would use their planning skills to reduce the high degree of independence of capital from domestic monetary or fiscal controls. While the internal politics of the five countries differed, the laissez-faire capitalism that prevailed in all (including Costa Rica, despite its nationalization of the banking system in 1948) was a common article of faith for those controlling the business and financial communities, especially in the export sectors.

The ultimate test, of course, was the extent to which regional development policies might influence the level and distribution of economic rents (those returns net of normal costs of labor and capital which, in their extreme characterization may be called "surplus," "*plusvalía,*" or "excess profits"). Export economies, subject to world price determination, often operate as inframarginal producers, and thus are able to earn substantial scarcity rents over and above the normal costs of factor inputs. Wages are determined by the availability of jobs in the market plus the opportunity of workers to earn a subsistence income on their own land. (Opportunities for migration may, in extreme cases, have a bearing on internal wage levels, but this has not yet seemed to be important for Central American countries except perhaps

for El Salvador and Honduras before 1969.) The opportunity cost of capital is determined by international borrowing rates plus discount for risk, depreciation, and obsolescence. Over and above these costs the residual element in unit value represents a "rental income" (of the pure Ricardian kind) to be divided among owners of land, capital, entrepreneurship, technology, financial capital, as well as those with political power to permit or prevent economic activity and those with access to scarce marketing channels.

RENT PARTITIONING: A STRUGGLE FOR SHARES

Hence, the strategy of each participating sector in an export economy is to maximize the level of rent subject to its share of the total, two goals that are often in conflict. This frequently involves a high level of political activity, with a variety of strategies on the part of participants. The first stage of *rent partitioning* occurs within the traditional export activities, particularly among labor, capital, and government. The political process exists to strengthen or weaken the bargaining position (and even the legality of the institutional representatives) of each party. Often the struggle for rent partitioning will occasion major political clashes and the rise and fall of important parties. The governments of some Central American countries were established or removed as a result of the interests of local and foreign firms in securing rights to produce crops (such as bananas) for export with the greatest possible value of rent. Recent evidence suggests that as late as the 1970s a major banana-exporting company used several million dollars to bribe one Central American president to reduce the export tax on bananas. (This evidence came not from domestic sources but from a congressional investigation in the United States.) Such behavior is to be expected when the level of actual or potential rents is high. With such stakes every possible device is used to maximize the participation of those capable of exercising monopoly or monopsony power.

How much does rent partitioning affect the demand for labor and its share in the distribution of rents? This depends upon conditions in the labor market, which is often competitive on the supply side, and monopsonistic on the demand side. As a result, wages tend to be pushed down to subsistence levels, leaving the maximum amount of rent to be divided among the owners of capital, natural resources, marketing firms, and the government. Central American countries have historically differed in the extent of monopsony power of export industries in the labor market. They have also differed in the relative abundance of manpower available to be employed in the export

sector. In Guatemala, access to land was utilized as a means of forcing workers (especially Indians and mestizos) into the wage-labor market in order to permit low cost production of labor-intensive exports such as coffee. El Salvador, which has little arable land for its large and burgeoning population, has been even more successful at this strategy. The recent mass expulsion of its nationals from Honduras has exacerbated this problem.

The more land-abundant economies of Honduras and Nicaragua have been less able to implement programs encouraging low wage labor based on a limited supply of land. Costa Rica actually adopted policies from the earliest part of the 19th century in which a relatively broad distribution of land tenure permitted large segments of the rural population to participate in the rental income from coffee and other exports.

This varying behavior among the five countries, and their different levels of wages and social participation in the rental "surplus" of the export sectors, indicates that no single model explains the pattern of regional exported growth. Indeed the pluralistic policies that have operated in Central America underscore the alternatives open for export development along the lines of social participation in the economic process. The political consequences of these alternatives are also apparent. Costa Rica combined export growth with a long, virtually unbroken tradition of democratic administrations and minimal military intervention, while the other countries were noted for their political-military alliances which imposed tough regimes to enforce the status quo.

What these alternative approaches suggest is that if the mass of the population is given a larger share of the surplus, this need not have a detrimental effect on the demand for labor (even though its supply cost rises). Along with higher incomes, the process generates higher skill attainments, greater education of the work force (and therefore broader political participation), and greater division of labor in home goods production because of a widened market. These benefits compensate for pure cost increases per manhour of work. Hence the Costa Rican model illustrates the feasibility, *over the long run*, of a growth process with broadened and more equitable social participation in economic rents from the export sector. Despite the evidence from Costa Rica, the conditions in other Central American countries are so different, owing to histories of economic inequality enforced by political dictatorship, that since World War II only Guatemala has attempted a moderate series of reforms. These were imposed from the top down by a new middle class elite which took power in 1944, and the experiment was abruptly ended by a military coup in 1954. Thus the region was able to reflect on long eras of authoritarian control of export economies, by groups adept at extracting the rents, at the very time that the Central American Common Market (CACM) was introduced in the early 1960s.

THE CENTRAL AMERICAN COMMON MARKET

The CACM was designed to permit the region to integrate its market for manufactured (primarily consumer) goods so as to create new trade and to divert existing trade from the rest of the world to producers in the region. Clearly the net gain from such policies would be partly at the expense of international "efficiency" of resource allocation. The counterbalancing objective, however, would be to increase the independence of Central America from swings in world trade cycles and to diversify the production structure so that hitherto redundant domestic resources could be utilized more effectively. In terms of restructuring economic production, the CACM proved to be a considerable success, especially during the 1960s. The manufacturing sector grew relative to agricultural and tertiary activities, although part of this growth was due to a shift in relative prices tending to favor the manufacturing over the primary and tertiary sectors. (Although the internal terms of trade did not shift significantly toward manufacturing, the implicit shift in relative prices without the CACM would probably have been more favorable to agriculture than it was.) There is some evidence, however, that external tariffs were already inflated beyond the level necessary to protect domestic suppliers. Therefore, by lowering the protection on intermediate imports and raising it on final goods, the CACM permitted trade to grow in manufactured goods and actually *lowered* unit costs of industrial products below pre-1960 levels. This is the result of trade-creation effects which undoubtedly increased the efficiency of existing manufacturing facilities. The impact of this increase in efficiency outweighed the higher costs caused by trade-diversion effects favoring new industries that would not have been set up without the tariff protection of the CACM.

The experience of the CACM during the past 15 years has been handled by a number of publications, the most recent of which is a forthcoming SIECA/Brookings study, which focuses primarily on manufacturing and indicates significant (if unbalanced) benefits from integration at least in this one sector. The opportunity cost of the promotion of regional industrialization, aside from unbalanced gains among the five countries, must be seen in terms of a shift in incentives away from home goods and export production toward the industrial sector plus trade diversion increasing import costs. However, as the results show, substantial growth of export agriculture and tertiary production accompanied the industrial expansion. It would be difficult to prove that alternative strategies would have been any more successful in generating output. The consequences for employment and living levels of the working class are, however, a different matter and form the subject matter of a SIECA/Brookings project (Reynolds and Leiva, 1977). Some preliminary findings from this research follow.

EMPLOYMENT CONSEQUENCES OF CENTRAL AMERICAN INTEGRATION

During the period of rapid growth from 1960 to 1971, the effects of the CACM policies on employment were most pronounced. The main hypothesis employed in the analysis is that conditions of supply and demand in the labor market, influenced by public policy and degrees of market imperfection that differ among countries, activities, and skill levels, are instrumental in determining the wage structure and level of employment (see note at end of chapter). The earnings of the working class from employment represents a higher share in the distribution of income and wealth than does their relatively meager income from investments and natural resources. Wage income and other factors associated with employment, including psychological identification with the production process, social and political participation of the worker in his environment, and relative as well as absolute deprivation are intimately associated with social welfare. It is assumed that the ultimate goal of development is the achievement of maximum gains in social welfare. For this study, welfare is seen to be closely associated with income. Hence, employment and the level and share of wages are important measures of the success of the Central American integration process.

TABLE 9.1
Growth of Gross Domestic Product in Central America*
(constant 1960 C.A. peso values)

	Cumulative Percent Per Annum		
	1960/68	1968/71	1971/75
I. Primary Production (Agriculture, mining)	4.8	4.7	3.6
II. Secondary Production (Manufacturing, construction, energy, transportation)	7.8	5.7	6.3
III. Tertiary Production (Commerce, banking, real estate, services, others)	5.5	4.7	4.7
Total = Gross Domestic Product	5.9	5.0	4.9
Exports (constant 1960 peso values)	9.5	3.4	7.7
Imports (constant 1960 peso values)	8.1	4.0	9.0

Source: For 1960-1971: SIECA, VI Compendio Estadistico Centroamericano, Guatemala, 1975.
For 1971-1975: SIECA, "Centroamerica: Estadisticas Macroeconomicas 1971-75," SIECA/76/PES/8, Guatemala, June 11, 1976.

*Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua. The Central American peso is valued at one U.S. dollar.

TABLE 9.2
Central American Employment Growth in Relation to Production and Productivity 1960-1971

	Growth of Real Output (Value Added in Constant 1960 Prices)	Growth of Employment (Man/years)	Growth of Productivity (Value Added per Employed Worker)
I. Primary Sectors	4.8	1.9	2.9
II. Secondary Sectors	7.2	4.2	3.0
III. Tertiary Sectors	5.3	3.5	1.8
Total GDP CACM	5.6	2.7	2.9

Source: See Table 9.1.

During the past decade and a half of integration, the economic growth of the five Central American countries (Honduras dropped out of the CACM in 1969) has been notable by any standards. Table 9.1 shows that the rate of growth has, however, been decelerating slightly, particularly in the primary sector, while industrial growth has also lost the momentum of the first eight years. The figures suggest the end of the early burst of growth which was occasioned by the establishment of the CACM and the recovery of agricultural export markets in the 1960s. This coincides with the apparent general lack of "common market esprit" throughout the region in 1976. Even the industrial sector, which used to provide most enthusiastic support for integration, fails to see a bright future for further extension of the CACM, although some observers argue that protection for intermediate goods production might provide a reasonable next step. The problem is that final goods producers are benefiting by processing low-duty imports of intermediate goods behind a high tariff wall for finished products. They resist any change that threatens their profitability. (It should be noted that effective protection in the region is not as high as that of many other Latin American countries.)

The effect of production growth on employment depends upon the associated rate of productivity growth in terms of output per worker. Table 9.2 indicates that over one-half of the growth in output in the region was due to productivity growth, although labor absorption did increase at the significant rate of 2.7 percent per annum from 1960 to 1971 (the period for which census data permit regional employment growth to be estimated).

The primary activities, agriculture and mining, absorbed little incremental labor compared to the growth in the estimated number of job seekers by 1971. That number grew by an estimated 3.1 percent per year for the region as a whole, ranging from 4.0 percent for Nicaragua and Costa Rica to 2.3

percent for Guatemala (for the basis of these calculations see Table 9.7). Productivity growth accounted for the highest share of output growth in the primary sector (60 percent), due to the introduction of new techniques of cultivation including mechanization, irrigation, application of pesticides and fertilizers, and the shift to export crops which responded well to such measures. As a result, labor was released in large numbers to find work in the secondary and tertiary sectors. This problem was exacerbated by the fact that rural workers are only seasonally employed in the cultivation and harvesting of the export crops. Before the 1960s, many of these workers were given access either to their own land or to land rented at low prices for subsistence cultivation and for production for internal markets. However, the boom of commercial export agriculture, which began in 1960 and has continued to the present, sharply diminished the availability of such land throughout the region. This is reflected in the tripling or quadrupling of real rents charged to the peasants. Consequently, ever-increasing numbers of workers are being forced to rely on the highly uncertain seasonal rural wage labor market. Men, women, and children are faced with either migrating to the cities or taking a chance on rural employment (for somewhat higher real wages than before, but on a sporadic basis). Thus, annual real earnings (reflecting the decline in income from subsistence cultivation on low-rent land which more than offsets a slight rise in real wages) appear to be falling for many landless rural workers in the most labor-abundant regions of El Salvador and Guatemala. Only increased participation of women and children in wage labor permits family incomes to be maintained.

The slack in employment in the rural area has been somewhat picked up by the secondary sector in Central America. Productivity growth accounts for 42 percent of output growth due to the very high rate of investment in manufacturing, transportation, as well as the use of relatively capital-intensive technology. Tertiary activities have also absorbed a significant share of the increasing work force, productivity growth only accounting for one-third of growth in output in this sector. As Table 9.2 shows, the combined employment growth of the secondary and tertiary sector averaged almost 4 percent per annum, which was well ahead of the rate of growth of labor supply. The problem then is not one of failure of growing sectors to absorb labor rapidly, but of the failure of the agricultural sector to maintain its share of employment opportunities because of its higher *relative* rate of growth of output per worker. Hence the primary sector, which employed 62 percent of the work force in 1960, fell to 57 percent in 1971, while the secondary sector rose from 17 to 20 percent and the tertiary sector from 21 to 23 percent. The share of output in the primary sector fell less, from 30 to 27 percent. While the share of the secondary sector grew from 22 to 27 percent, that of the tertiary sector fell from 48 to 46 percent.

The nature of rural production has changed in response to a number of factors: rising world prices for cash crops, integration of previously isolated regions through road and communication grids, and resulting declines in transport costs (at least until the recent rise in petroleum prices), plus improved technology for irrigated farming, pesticides, fertilizers, and expanded marketing outlets. The result amounts to a rural revolution in much of Central America. This revolution has given rise to rapidly increasing economic rents both absolutely and, as we shall see, as a share of factor income. The dislocation of the labor force from land previously farmed for subsistence purposes and for local marketing, has swollen the rural proletariat. This is keeping wage levels down and permitting a higher rent share for those with access to land. Some of the displaced labor provides a pool for employment in the urban industrial and service sectors. The rest is relegated to land in more distant less-accessible regions, to sporadic employment as field hands and to very low productivity tertiary and other occupations.

In short, the Central American countries have always been rural-based export economies, but during the CACM period this dependence has increased substantially, the impressive industrialization notwithstanding. And while low cost labor is essential to the new cropping patterns that are emerging, the consolidation of land and its mechanization have led to a growing surplus of rural labor that is well in excess of readily available employment opportunities, particularly in the most populous regions. Policies favoring regional migration could alleviate this problem somewhat, and much de facto migration does take place among a number of the countries, from El Salvador to Guatemala on a seasonal basis, from Guatemala to Mexico seasonally, from El Salvador to Nicaragua and Costa Rica (bypassing Honduras which expelled scores of thousands of Salvadorians in 1969), and from Southern Nicaragua to Costa Rica. However, a formal treaty permitting free labor mobility is unlikely in the near future.

THE REGIONAL DISTRIBUTION OF PRODUCTIVITY GROWTH

Since productivity growth prevented labor absorption from matching the rate of growth in the work force (despite rapid output growth in all major sectors and countries of the region), it is of interest to trace out the locus of productivity growth among the five countries. It should be stressed that without the opportunity to realize such gains, many investments in land development, plant, equipment, education, and new technology would not have been forthcoming, nor would the output growth which they produced. Hence, it is not suggested that productivity growth should be minimized in order to create jobs (in order to perpetuate the curse of Eden), but rather that the *potential* surplus created by increasing productivity should be channeled into

TABLE 9.3

Country Contributions to Regional Productivity Growth: 1960 to 1971

	(1) Growth in Output per Worker (C.A. pesos in (current values)	(2) Share of Regional Employment	(3) Contribution to Output per Worker in C.A. (1) x (2)	(4) Contribution Relative to Total $(3) \div \Sigma(3)$	(5) Contribution Relative to Share of Employment $(4) \div (2)$
Guatemala	423	.38	161	.33	.86
El Salvador	280	.23	64	.13	.57
Honduras	289	.17	49	.10	.59
Nicaragua	947	.11	104	.21	1.91
Costa Rica	1077	.10	108	.22	2.20
Central America	485	1.00	485	1.00	1.00

Source: See Table 9.1. Employment estimates are taken from numerous sources, primarily based on census data for individual countries, as consolidated and adjusted by Gustavo Leiva, SIECA, Special Studies Unit, Guatemala, 1975/76.

activities which raise the income and welfare of the working class. To date, however, the working class participation in factor income has actually declined in relative terms (and apparently in absolute terms for some rural landless workers in the most populated regions) in all countries but Nicaragua. Thus, export-led rural growth and import substituting industrial growth have not permitted the results of the impressive productivity gains to be shared on an equitable basis. This is not to say that those in charge of the development model intended this result, although private enterprise is understandably interested in minimizing wage costs. Rather, the nature of the development process itself (with a minimum of fiscal or financial transfers) has had this effect in four of the five countries. The reasons for this are discussed below.

In Table 9.3 regional productivity growth (4.2 percent per annum in current prices or 2.9 percent in constant prices) has been broken into its national components in order to determine the relative contribution of each of the five countries. Productivity growth over the eleven year period averaged $CA 485, which represents a nominal gain of 58 percent over the value of output per worker in 1960 and a real gain of 37 percent. Among the five countries, Nicaragua and Costa Rica alone accounted for 42 percent of total regional productivity growth, though their combined work forces represented only 21 percent of employed labor in the region (a share which did not change over the period). Lagging far behind were El Salvador and Honduras, with a joint contribution of 23 percent to the regional total although they had 40 percent of the work force. Guatemala also lagged, but by a smaller amount. What these figures reveal is that over and above the given output per worker in 1960, and despite the rapid growth of employment during the period 1960 to 1971, there remained an additional $CA 485 per worker in productivity growth to be apportioned among the owners of capital, natural resources, entrepreneurship, technology, government and labor.

ACTUAL GROWTH IN DEMAND FOR LABOR IN CENTRAL AMERICA: 1960 TO 1971

As we have seen, the demand for labor in the region grew at 2.7 percent per annum between 1960 and 1971, or by a total of 1.1 million workers. In Honduras, the low productivity growth combined with the significant rate of output growth caused the demand for labor to increase by the highest rate in the region or by 3.4 percent per year (Table 9.4). Another reason for this demand could be that the existence of abundant land in Honduras, plus access (until 1969) to the labor pool of El Salvador where wages were even lower, encouraged the growth of activities in the primary sector which involved little capital formation except in labor-intensive land clearing and planting plus forestry. As other studies have shown, these developments did

TABLE 9.4

Actual Growth in Demand for Labor in Central America: 1950-1971

	1960	1971	(1960-1971)	Growth of Employment	Growth of Output	Growth of Productivity
	(thousands of man-years)			(cum. annual rates)		
Guatemala	1254	1593	339	2.2	5.4	3.2
El Salvador	741	1025	284	2.9	5.4	2.5
Honduras	557	826	259	3.4	4.5	1.1
Nicaragua	367	480	113	2.4	6.8	4.4
Costa Rica	338	452	114	2.6	6.3	3.7
Central America	3268	4376	1108	2.7	5.6	2.9

Source: See Tables 9.1 to 9.3. Figures for employment in 1971 are interpolated from most recent census assuming constancy of most recent participation rates and constant demographic growth rates for intercensal years.

not depend essentially on the machinery of the Central American Common Market, although a number of processing industries were established around San Pedro Sula which did benefit from the low cost imports and other incentives of the CACM.

In general, however, trade diversion raised the cost of imported final goods to Honduras without providing commensurate benefits to local manufacturing. This explains the lack of support for continued participation in the CACM, though it is difficult to explain the embargo on migrant labor from El Salvador on these grounds. The explanation for the expulsion of the Salvadorians lies in the opposition of the local population to competition in the labor market. They also objected to claims on land made by their neighbors from the west under the expanding agrarian reform program. The military government appears to have responded reluctantly to these populist pressures to exclude the Salvadorians, justifying its action in terms of preserving national resources for its own citizens. On strictly macroeconomic grounds, both El Salvador and Honduras would have benefited from continued free migration and capital flows (the net flows were probably from El Salvador to Honduras in the 1960s, though they might have reversed later). However, the social pressures resulting from migration were more detrimental to Honduras than to its neighbor before expulsion, while afterwards this was reversed.

After Honduras, El Salvador had the greatest increase in labor demand, rising by 2.9 percent per annum, followed by Costa Rica (2.6), Nicaragua (2.4) and Guatemala (2.2). The Guatemalan performance was due to its somewhat slower rate of output growth relative to the leading countries plus faster productivity growth in comparison to the lagging countries. Hence, from the point of view of employment Guatemala had the worst of both worlds. This is partly because Guatemala's growth depended more heavily on industrialization (industry grew at 7.9 percent per annum) than on export agriculture. Its growth of primary production (5.7 percent) exceeded only that of the industrial leader El Salvador (4.3 percent). When this is compared to the large share of its work force in agriculture, the Guatemalan experience contrasts with other rapidly industrializing countries such as Costa Rica, which had growth rates in industry and primary production of 11.0 and 7.4 percent per annum respectively, and Nicaragua (12.5 and 7.0 percent). El Salvador had a higher rate of industrialization than Guatemala (8.3 percent), permitting greater labor absorption into the urban sector.

Given the unequal land tenure conditions in Guatemala, its impoverished peasantry, the slow-rate of productivity growth, and low per capita income for the majority of the population, this country together with El Salvador poses the specter of severe excess supply of labor. It also has the lowest wage share of value added in Central America, and that share is falling at the most rapid rate. This contrasts with the evidence that average real wages are rising faster than those of El Salvador and Honduras (though average and marginal

earnings per worker need not be correlated, especially when the estimates include all skill levels). What appears to be happening is the growth of a dualistic wage structure as workers in higher productivity urban and commercial agricultural occupations increase their shares of the wage bill at the expense of the marginal workers. Since the February 1976 earthquake, wages seem to have been rising in real terms (sharply increasing in nominal terms), and jobs in construction have drawn heavily on the number of wage laborers in agriculture. This is the direct result of the combination of dire necessity, occasioning the use of leisure time for massive do-it-your-self-reconstruction, plus the availability of subsidized construction materials, machinery, and equipment. Disaster relief operations supported by many countries have provided these materials which have reached a large share of the affected population.

There is evidence that the shock of the earthquake and the subsequent nationwide relief activities have had a profound impact on social consciousness at the grassroots level. What this will mean in practical terms remains to be seen. Even the poorest Indians from the smallest villages in the earthquake zone are now aware that despite many failures and shortcomings of the relief programs, their welfare was a matter not only of national but of international concern for a brief period. This is likely to create a new force in politics whose voice will become more strident as time goes by. Recent events have also galvanized strong pressures for social reform within the hitherto conservative Church hierarchy. The rural earthquake relief program of Guatemala, and the urban reconstruction of Nicaragua when Managua was devastated by the 1972 earthquake both illustrate that massive public expenditure programs can provide many additional jobs although at the expense of severe (if temporary) inflation in the prices of basic consumables. While rising prices hurt those on fixed money incomes, the working class in both countries seems to have benefited from these disaster relief measures, the first real efforts in either country to mount major deficit spending programs. From a fiscal point of view, the expenditures were financed by external funds rather than by the unsupported creation of liquidity. Nevertheless, the impact was functionally the same as deficit spending programs, since capacity was severely constrained by the disaster (especially in the Nicaraguan case). In Guatemala, there was little excess capacity in wage goods production, so that the increase in effective demand pushed up price levels by 30 to 40 percent in 1976 alone, since imports did not increase enough to satisfy the demand.

The forced experiment in earthquake relief was a shock treatment for the unbelievably fiscally conservative governments of each country. The consequences seem to have been favorable to the employment of unskilled labor, although much underemployment still exists, largely because of the seasonal nature of demand for agricultural workers. The lesson is that deficit spending (and attendant inflation), with foreign assistance for balance of

payments support, and appropriately flexible exchange rates (a divergence from existing policies) might well allay the underemployment problem. Such expenditure should be directed toward labor-absorbing activities such as construction, small scale agriculture (including land distribution programs and labor-intensive infrastructure support), and processing industries in labor surplus regions. Without the intervention of natural disasters, however, the conservativism of most existing governments in the northern part of Central America and of their supporters from the business, commercial, and landed elites stand in the way of such policies. Some possible exceptions that exist in the case of Honduras and El Salvador will be mentioned later.

ALTERNATIVE LABOR DEMAND PATTERNS WITH AND WITHOUT PRODUCTIVITY GROWTH

In order to assess the potential that the growth of the region provides for the absorption of labor, ignoring the effect of the rapid productivity growth that did occur, I have made an extreme alternative assumption that labor requirements per unit of value added remained constant between 1960 and 1971. (Since there was very little inflation during the period, the calculations are made in current prices, which produces a slight upward bias in the estimated demand for labor for 1971.) With this assumption, Table 9.5 shows that the growth of the region during the eleven year period would have required 3.6 million additional workers, compared to the actual increase in employment of 1.1 million. In short, the "gap" under these extreme assump-

TABLE 9.5
Hypothetical Growth in Demand for Labor in Central America 1960-1971 (thousands of man-years)

	Actual Growth in Employment	Hypothetical Growth in Demand for Labor	Gap
Guatemala	339	1180	841
El Salvador	284	676	392
Honduras	259	670	411
Nicaragua	113	596	483
Costa Rica	114	523	409
Central America	1109	3645	2536

Source and Methods: Data on employment in 1960 and 1971, productivity in 1960, and output in 1971 are from the sources given for Tables 9.1 to 9.4 For this table, it is assumed that value added per worker remained constant between 1960 and 1971 in order to calculate hypothetical demand for 1971. This figure was then subtracted from employment in 1960 to obtain hypothetical growth in demand.

tions would have amounted to 58 percent of the economically active population in the region. Of course without the productivity growth and the rewards it provided to investors, growth in output would certainly have caused the demand for labor in 1971 to exceed substantially the available supply for all countries in the region including the most labor abundant. In short, productivity growth permitted the region to avoid a severe constraint in labor supply. However, it did the job all too well.

If the hypothetical gap between demand and supply of labor is measured

TABLE 9.6
Growth in Demand for Labor by Major Production Sector in Central America, with and without Productivity Growth: 1960-1971
(thousands of man-years)

	(1) Primary Sector (Agriculture, Mining)	(2) Secondary Sector (Industry, Construction, Energy, Transportation)	(3) Tertiary Sector (Commerce, Bank, Services, Others)	(4) Total
Change in Labor Demand without Change in Productivity but with Change in Output 1960/71	1998	880	767	3645
Change in Labor Demand without Growth in Output, but with Productivity Growth 1960/71	−780	−212	−206	−1198
Change in Labor Demand due to Combined Productivity Growth and Change in Output	−763	−340	−234	−1337
Actual Change in Labor Demand 1960/71	455	328	327	1110

Note: This table is calculated from the formula:

$$\Delta D_L = \Delta Q \left[\frac{Q}{L_o}\right] + \Delta\left[\frac{Q}{L}\right]\Delta Q_O + \Delta\left[\frac{Q}{L}\right] \quad \Delta\left[\frac{Q}{Q_o}\right]$$

where D_L is demand for labor
Q is value added
o is base year
is 1st difference between year o and year n.

as a percentage of 1971 employment, the countries most affected would have been, in descending order, Nicaragua (101 percent), Costa Rica (90 percent), Guatemala (53 percent), Honduras (50 percent) and El Salvador (38 percent). Thus, without the use of natural resource and capital-intensive technologies, the growth in output during this period would have produced rapidly rising wage levels. Furthermore, assuming that the elasticity of substitution between labor and capital is less than unity, wages would have taken a larger share of the value added. Without taking into consideration the demand effects of changes in income distribution for the realization of scale economies and thus additional incentives to invest in the internal market, the labor constraint would probably have slowed the rate of growth and introduced a self-correcting element into the demand for labor. The opening up of the regional market and the attractiveness of tariff protection for final manufactures and tariff exemption for intermediate inputs permitted the high rate of productivity growth to occur. Additional factors include tax holidays for new investment, and the proliferation of rural and urban infrastructure, together with the availability of new labor-saving technology and methods of increasing the productivity of land in the region. In Table 9.6, estimates are presented for the sectoral impact of productivity growth on employment demand. Similar assumptions are made about the amount of labor that would have been required with and without productivity growth.

Table 9.6 reveals the sensitivity to productivity growth of the three major production sectors. The ratio of labor demand without productivity growth to actual demand in the primary sector is 4.4; i.e. up to four times as many workers would have been required in agriculture (and mining) to produce the production levels of 1971 if increases in productivity had not been provided by investment, opening of new land to cultivation, shift in cropping patterns, and technological progress (seed fertilizer revolution). Food prices would almost certainly have risen relative to those of industrial goods, with the result that exports would have been reduced while food imports would have increased. Paradoxically, it would seem that the growth of secondary activities depended heavily upon a revolution in productivity in the primary sector, despite policies to encourage manufacturing which in turn tended to discourage agricultural growth elsewhere in Latin America during the period of import substitution industrialization. What seems to have happened is that tariff protection for the secondary sector was not accompanied by direct income transfers through fiscal or financial subsidies, as it was in Chile, Uruguay, Argentina, and other countries during the 1950s and 1960s. Instead, the fiscal and financial conservativism of Central America during these years minimized the degree of effective protection and artificial subsidization of the industrial sector, thus permitting agriculture to grow simultaneously.

The labor-saving technologies in the rural sector released additional labor for employment in secondary and tertiary activities. This parallel growth of

agriculture and industry in Central America was the major reason for the 15 years of relatively rapid growth in both output and productivity. The secondary sector would have required 2.7 times as many additional workers without the observed productivity growth, while for tertiary activities the ratio would have been 2.1. Overall, 3.3 times as many new workers would have been required without productivity gains. Thus, the economic growth of the Central American Common Market was achieved with productivity gains in all major sectors.

GROWTH IN THE SUPPLY OF LABOR IN CENTRAL AMERICA

In order to relate the observed changes in employment to likely changes in the availability of labor Table 9.7 presents a rough estimate of the increase in the supply of labor from 1960 to 1971. This increase is defined as the number of additional man-years available (with equal weighting for age and sex) based upon the crude assumption that the participation rates for the economically active age groups (ages 10 to 64 in all countries except in Costa Rica where it is ages 15 to 64) remained constant from 1960 to 1971. This assumption ignores the fact that the desired participation rates change according to changing income levels, urbanization, shifting age composition of the base population, increased educational demand, and other factors. However the purpose of the table is simply to provide rough orders of magnitude for the increase in supply, as follows:

TABLE 9.7
Estimated Labor Supply Increases 1960-1971
(000 man-years)

Guatemala	369
El Salvador	284
Honduras	292
Nicaragua	202
Costa Rica	184
Central America	1331

In view of the approximate nature of the estimates in Table 9.7 a comparison with actual changes in labor demand from Tables 9.4 and 9.5 is impressionistic at best. However, subject to this qualification, the figures

suggest that the growth in labor supply in the region outstripped demand by more than two-hundred thousand workers, a significant margin. In terms of total employment in 1971 (4.4 million), this increase in "excess supply" was only 5 percent. Of course, the effect of the growth in excess supply of labor was almost certainly more serious for the lower skill levels, since the demand for more educated and experienced workers grew rapidly as a proportion of total employment. Hence, the impact on the wage structure was to skew wages, widening the income gap between the lowest and highest skill levels. Regional imbalances were also exacerbated, since although the overall growth in the supply and the demand for labor were similar at the country level, the gaps were more uneven. The following section deals with the behavior of average earnings of workers during the same period.

LABOR INCOME IN CENTRAL AMERICA

The evolution of real wages over the period 1960 to 1971 reflects the interaction of supply and demand conditions, as sketched in the preceding sections, plus institutional developments which influenced the relative bargaining positions of capital and labor. Although unionization is one important element in this pattern, there is not space here to go into the complex history of attempts by workers to organize and bargain collectively in the five countries. The pattern is also very uneven among the different countries and even among different activity sectors. Costa Rica is the only country in which labor organization is permitted as an active process for influencing wages, hours, and working conditions. Even here the results are mixed when compared with other countries in Latin America where democratic politics permit a greater participation of the workers in the determination of wages at the level of a single firm and of the whole industry. In general, the imposition of military regimes militates against labor's voice in the decision-making process. The other four countries of Central America are no exception. The opposition to independent unionization as opposed to company unionization (the former being associated with Communism in many areas) is so strong that even professionals in some of the most progressive institutions are finding it impossible to organize without fear of reprisal. Conditions in the labor markets facilitate strike breaking, in that excess supply of labor enables greater barriers to labor organization to be imposed. (Monopoly and monopsony power have their roots in underlying market conditions and are strengthened by the political system, its legal structure, and enforcement mechanisms.)

Table 9.8 shows the level of wages and salaries per worker for the five countries. The growth of real wages has averaged 2.6 percent per annum for the region as a whole, led by Nicaragua and Costa Rica. They are followed by Guatemala, El Salvador, and Honduras, in that order. It should be noted that

TABLE 9.8
Annual Average Wages and Salaries per Employed Worker

	(current $ CA)		Cum Annual Rate of Growth 1960-1971	
	1960	1971	Current Prices	Constant Prices
Guatemala	339	470	3.0	2.5
El Salvador	328	431	2.5	2.2
Honduras	266	370	3.0	0.9
Nicaragua	481	991	6.6	4.5
Costa Rica	622	1138	5.5	3.5
Central America	369	568	3.9	2.6

Note: Based on wage and salary (and fringe benefit) estimates by Gustavo Leiva, SIECA Special Studies Unit, Guatemala, 1971, 1976, based on SIECA and governmental sources. The figures are average earnings and do not reflect trends in distribution of the wage bill, which for all countries appears to have become significantly more skewed during the period. Current price estimates are converted to constant prices using the implicit GOP deflators for the respective countries from SIECA, *VI Compendio Estadistico.*

wage behavior since 1971 has been influenced by two factors, the slowdown in the economic process and the rapid increase in prices. The latter is due to world inflation and increased costs of imports, domestic deficit spending (in Costa Rica), natural disasters (hurricane Fifi in Honduras and the earthquakes of Nicaragua and Guatemala) and subsequent relief expenditures which added to final demand even as capacity was reduced. Hence even without a clear indication of post 1971 trends, there is a consensus that during this period real wages probably declined throughout Central America for the lowest skill levels, with lesser declines and even some increases for higher skills (though at a slower rate than in the 1960s).

WAGES, PLUSVALIA, AND THE NORMAL RETURN ON CAPITAL IN CENTRAL AMERICA

It is possible to provide only the most general outlines of the distribution of income in the region among labor, capital, and the owners of natural resources. The share of wages and salaries in value added, when deducted from total value added (less depreciation), leaves a residual which may be apportioned among the owners of physical assets, natural resources, and a "scarcity rent" for other scarce factors. "Scarcity rent" includes profits in excess of the normal return on capital, wages in excess of the opportunity cost of labor, entrepreneurial income, returns to licensing and patents, and other scarcity rents. The scarcity rent component in neoclassical economic analysis is analogous to the concept of *plusvalia* found commonly in the more progressive Latin American economic literature. This concept provides a

rough measure of the "surplus" income generated, namely that component of market price which can be extracted without significantly altering resource allocation. Clearly there are strong differences of opinion, both political and technical, about the extent to which the unimpaired market allocation of scarcity rents is essential to the level and efficiency of production. Setting these debates aside, although statistical evidence is somewhat sketchy, it is of interest to determine the extent to which the pattern of growth in Central America since 1960 has influenced the functional distribution of income (Table 9.9). (It should be noted that relatively reliable data are perhaps more abundantly available on a comparable basis for the five Central American countries than for most other nations of Latin America.)

The relationship between the absolute level of wages in 1960 and the wage share of output may be seen by comparing the data in Tables 9.8 and 9.9:

	Pesos per Worker 1960	*Wages/Value Added 1960*
Costa Rica	622	.503
Nicaragua	481	.493
Guatemala	339	.402
El Salvador	328	.426
Honduras	266	.438
Central America	369	.441

These figures reflect the "labor surplus" situation in Guatemala and El Salvador. Even though both countries had higher average wages than Honduras, they had a lower wage share of value added. Guatemala had the lowest share, due primarily to its preponderance of low productivity agricultural employment. Dualism in the labor markets of both countries also lies behind the figures. This becomes more apparent when one looks at the wage profiles within both industry and agriculture (lack of space precludes presentation of the findings in this paper.) The data indicate that this dualism increases during the period 1960 to 1971, further exacerbating income inequality. As for Costa Rica, one must qualify the implications of functional distribution of income for the size distribution of income among individuals and households. Land and capital are more evenly distributed in that country, so that the share of profits, interest, and rent is more equitably divided among the population. Moreover the relatively high education of the labor force causes the wage bill to be more evenly distributed than it is in the other four countries of Central America. Nevertheless, the evidence in Table 9.9 indicates that only Nicaragua experienced a significant rise in the wage share of value added between 1960 and 1971, while that of Costa Rica showed a slight (probably statistically insignificant) decline over the period. All the other countries showed significant declines in the wage share, indicating that the

TABLE 9.9
The Functional Distribution of Income in Central America: 1960 and 1971

	Share of Wages and Salaries	Share of Profits, Interest, and Rent (Plusvalía)	Total
Guatemala			
1960	.407	.593	1.00
1971	.374	.626	1.00
El Salvador			
1960	.426	.574	1.00
1971	.412	.588	1.00
Honduras			
1960	.438	.562	1.00
1971	.413	.587	1.00
Nicaragua			
1960	.493	.507	1.00
1971	.515	.485	1.00
Costa Rica			
1960	.502	.498	1.00
1971	.492	.508	1.00
Central America			
1960	.441	.559	1.00
1971	.430	.570	1.00

Note: Calculations prepared by Gustavo Leiva, SIECA Special Studies Unit, Guatemala, 1975/1976, based on source materials cited in previous tables. More detailed estimates of cost on capital and residual (*plusvalía*) are available from the author on request and will appear in a forthcoming study by Clark W. Reynolds and Gustavo Leiva on employment, wages, and income distribution in Central America (1977).

"surplus" generated by the rapid growth of the 1960s was being distributed to owners of capital and natural resources. Since there is no evidence that this ownership became more equitable during the period, it is quite likely that the size distribution of income also became more skewed, particularly in those countries with a surplus of unskilled labor, for whom real incomes stagnated or declined.

POSSIBLE FUTURE ECONOMIC TRENDS

Since this volume is directed to a survey of future economic trends in Latin America and their implications for the international community, it remains to draw some implications for the future from the foregoing analysis and the experience on which it is based. During the past 15 years, the CACM region has shown impressive growth in all major sectors and countries.

Changes in incentives and the creation of infrastructure have had a significant effect toward balanced growth of primary, secondary, and tertiary production. The rapid growth of the region would have exhausted the supply of labor without major productivity gains (most notable in agriculture and industry). The process of labor absorption has not quite kept pace with the rapid growth of labor supply, with labor redundancy rates probably rising by at least five percentage points between 1960 and 1971. Although data are scanty on employment and productivity for post-census years, the trends since 1971 appear to indicate an even greater lag in labor absorption.

The gains of the past decade and a half notwithstanding, the Common Market is no longer a key issue among most opinion groups in the region, despite laudable efforts of the SIECA administration to keep the idea afloat and to promote the new *Tratado Marco* which would further expand the provisions of the CACM to include labor migration, some degree of political coordination, and other advances in integration policy. The reasons for this seem to be a general recognition that the easy gains of the past 15 years have now been achieved. There is also an awareness, which is not equally shared by all governments or social and economic classes, that conditions within most of the countries are highly inequitable and that integration has *not* measurably improved the relative economic condition of the workers or the absolute income levels of the poorest households. It is this stark reality that must be faced in the decades to come. And there is little evidence that the integration model pursued until now—based on market incentives to private investment in agriculture, manufacturing, and commerce—will demonstrably alter conditions. This is especially true since growth is unlikely to be maintained at previous rates, while the supply of labor to be absorbed is growing at an ever more rapid pace and will continue to do so for at least another generation.

With this situation in mind, and with public awareness of the economic prospects slowly permeating all social groups from the elite to the peasantry, the military is tightening its grip on the political process in all countries but Costa Rica, and even there rumors exist about the clandestine training of paramilitary units for use in the event of serious internal unrest. Meanwhile policy-makers are looking increasingly inward for solutions to the joint economic-social question. Honduras has sealed its border to Salvadorians, and there is no sign that this policy will change in the near future. The opportunities for import substitution are running out, except perhaps for intermediate goods production, given the present size of the market (which itself is a result of growing inequality in income distribution). The business and commercial elite consider that the most obvious outlet would be to increase external protection or to shift toward a program of export promotion. This could be accomplished by direct subsidies or by undervaluation of exchange rates, since the scope for additional tax incentives is relatively limited after over a decade of such policies. In short, the implications for additional expansion of

foreign trade in Central America will depend on policies of export promotion, including drawback arrangements (following the Brazil model), integration of local producers with transnational production and marketing operations, and associated fiscal and financial incentives. Such a strategy is unlikely to alter significantly the disintegration of the economy and societies that predominates in most regions of Central America, and particularly in Guatemala, Nicaragua, and El Salvador.

An alternative approach, not necessarily inconsistent with the above, would be to follow the Costa Rican model and to attempt to improve the distribution of income through employment-generating programs in construction, labor intensive manufacturing of wage goods for sale to the working class, state distribution systems for wage goods, the stimulation of agricultural production for domestic consumption, and land distribution schemes. The last would provide the rural work force with a higher floor on incomes based in part on subsistence production and in part on broader access to rental income from the sale of cash crops. This approach would require sharp increases in public expenditures, following the fiscal policy objectives of Costa Rica, which, despite its difficulties, has made the most effort to achieve progress along distributive lines through active intervention of the public sector. Economic rents would have to be taxed at a higher rate than is now the case to avoid substantial inflation (some of the countries have tax shares of GDP which are among the world's lowest), and exchange rate policies would have to become more flexible to avoid increasing balance of payments deficits.

In addition, whatever the strategies adopted, Central America cannot continue to borrow at a rate of 5 to 10 percent of GDP (represented by the balance of trade deficits on current account in the mid-1970s) to supplement surprisingly low domestic savings rates in both the private and public sectors. The large and growing rental income stream accruing primarily to the elite is not being tapped through taxation or voluntary financial savings so as to permit non-inflationary financing of domestic investment. To do so would require reforms in financial policies equal to or surpassing the fiscal reforms which are also long overdue in the region. At present regional financial institutions are highly underdeveloped, partly because of ceilings on deposit rates of interest. This discourages voluntary financial savings and divert domestic funds into foreign financial assets, unproductive investments, or consumption.

Moreover the financial system is scarcely integrated among the five countries, so that funds flow more readily between the region and the rest of the world than among surplus and deficit sectors within Central America. Here improved fiscal and financial policy could go hand in hand with employment-generating programs of the private and public sectors, although neither would improve social participation in the development process with-

out the requisite political will. The military governments of the four countries vary from highly reactionary to mildly progressive, but there are some pressures within the regimes for more popular programs, such as the incipient land reforms being introduced in Honduras and El Salvador* (against the strenuous opposition of many in the business and agricultural elite). The effectiveness of such programs remains to be seen. Until now they have not encroached upon the prime commercial crop land for export and are unlikely to cut severely into the all-important foreign exchange earnings on which all of these export economies still depend.

All political groups look to the United States, regardless of the degree of favor or disfavor, as the major constraint or *primum mobile* behind their respective programs. While this consciousness of "dependence" may have the appearance of rank paranoia to the foreign observer, it comes from a profound sense of history, which is difficult for those born outside the region to appreciate. Presidents, political parties, military leaders, industries, and even nation states have owed their existence to the Colossus, despite its generally benign neglect of their condition or of its influence on it. Hence, prospective foreign policy developments in the United States are seen to be crucial to the region's economic future. Unarmed and democratic Costa Rica has tried to establish wider links with Panama and Venezuela in order to counterbalance the growing military conservatism of its neighbors to the north, but these attempts will modify the present balance of power only slightly.

If the United States were to tilt its support from the "northern" axis of Nicaragua, El Salvador, and Guatemala toward the "southern" axis of Costa Rica, Panama, and Honduras, this could have a major influence on the success of efforts within the northern countries to improve the social distribution of economic and political power. Such efforts have faltered under the aegis of the past two U.S. administrations which have maintained a "low profile" in the economic and social areas and actively supported military governments and counterinsurgency efforts, most notably in Guatemala and Nicaragua. In both of these countries, and in El Salvador and Honduras, there are groups (which include university professors, professionals and members of business, commercial, and rural elites) who would provide support for an opening toward more democratic processes of government with greater inclusion of the workers in political and economic decisions. These policies could vent latent pressures from within the social volcano of Central America and perhaps avoid the cataclysm which otherwise seems inevitable. The neighbors to the north (Mexico) and south (Panama and Venezuela) as well as the east (the Caribbean states) would provide support in varying degrees for such an opening, however much they might deplore the obvious continuing dependence of the region on the United States. In the meantime any forecast of future economic trends of Central America must await political decisions to

*Since this paper was written the El Salvador reform was blocked by the new government.

deal with the grave inequalities in income, and with the political repression and social malaise that make the region *integrated* in name only.

NOTE

*Labor supply and demand conditions may be influenced by historically determined social and other institutional barriers. For example the family background of workers may rank as importantly as training or intellect in qualifications for employment. The formalization of this insight in "segmentation theories" of the labor market is highly relevant to the analysis of conditions in much of Central America. It is believed here that such approaches influence the degree but not the direction of market adjustment, such that shortages or surpluses in the supply and demand for labor by skill, activity, and region will be distorted if these conditions exist. Their elimination requires legal and other measures which are difficult to implement until the political process itself becomes more democratic and representative of all levels of the working class. Such conditions are far from those which prevail in most countries of the region, the exception being Costa Rica (but even there recent tendencies have been to restrain the growing influence of labor in the political process).

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Chapter 10

LATIN AMERICA AND THE THIRD WORLD

FELIPE HERRERA

I. GENERAL REMARKS

Any definition or diagnosis of international relations is at present extremely difficult. The qualification of "fluidity" is frequently mentioned with regard to current events, and the word has become particularly relevant since October 1973 when the Middle East conflict erupted again. President Sadat of Egypt declared that those days "had changed the destiny of humanity". We have to agree with him, considering the unexpected oil crisis that resulted from it and the developments that followed the oil crisis in 1974 and 1975. During this period, the so-called "centers" of the world economy underwent simultaneous inflationary and recessive trends.

I once considered myself a professional optimist. At present, far from becoming skeptical, I have become even more optimistic. The reaction of the developed and the poorer nations to the challenge of formulating new rules for the interplay of international economy is encouraging. This now seems the only possible means of reaching a more rational coexistence among nations whose levels of growth differ and whose basic structural differences are gradually intensifying.

The concept of a "new international economic order," considered an unrealistic slogan a short time ago, has gained strength since the last special meeting of the United Nations, in September 1975. Following the same trend, industrialized nations and raw-material-producing countries have held discussions in order to establish a North-South dialogue intended to create more stable and equitable conditions in their mutual relations.

These meetings are taking place under the shadows of extremely serious international political conditions including the immediate difficulties occurring in the United Nations. However, the necessity for the survival of the international community is forcing the world to work together and to overcome the negative events reported everyday by the information media.

Along these lines, positive steps have been taken with regard to international monetary reform. The basic decisions for an agreement among industrialized nations took a long time to be reached, thus creating a dangerous climate of world unrest; nevertheless, the recent resolutions announced by the (IMF) International Monetary Fund have opened the way for a new monetary system that for the first time in history is not based on gold, but instead on a "basket" of the world's leading currencies. Recently the IMF has started to sell part of its gold, and the proceeds of the sale will be used to establish a Trust Fund to assist developing countries with balance of payment difficulties.

The IV Conference of UNCTAD held in Nairobi came to some agreements that, in my opinion, positively differentiate it from the previous UNCTAD meetings (in Geneva, 1964; New Delhi, 1968; and Santiago, 1972). After a long and intense struggle between some sectors of the industrialized world and the developing nations, the participants agreed to start serious discussions toward the creation of a $6 billion Common Fund to establish regulatory stocks for ten basic commodities in order to protect producing countries from excessive declines in the price of these commodities.

In addition, it was decided to address the following issues: (a) recommendations to the creditor nations to study a favorable solution to the problem of 20 poorer countries whose external indebtedness under the present economic conditions has brought them close to financial collapse; (b) adoption of a code of behaviour for technology transfer; and (c) regulations designed to control the activities of multinational enterprises.

An important issue at the Nairobi meeting was "Economic Cooperation among Developing Nations." I had the honor to participate in a group of experts in charge of preparing a discussion draft as a preliminary contribution to the meeting of the "77" in Manila, and later on, for UNCTAD IV. In August 1976 the Colombo Meeting of the Nonaligned Nations approved some financial recommendations along the lines expressed by that document[1].

While working on this subject it was very interesting to ascertain the prevailing conditions of the Third World: The Latin American experience, in all the dimensions of its collective development, can make a significant contribution in assisting the process of growth of other developing nations. A good example of the value of that experience was the active participation of the Interamerican Development Bank in the creation of the African Development Bank and of the Asian Bank in the early 1960s. Later on, the Caribbean Development Bank demanded IDB's technical assistance in its formative period. These initiatives were the first evidence of technical cooperation on a horizontal South/South axis as opposed to the historical North/South verticalism.

It is evident that the IDB represents the creation of an institution with a broad perspective in the field of technical and financial cooperation among

countries belonging to the same regional system. The creation of the Bank was not an easy task, either technically or politically. However, during the last ten years the attitude toward the formation of regional or subregional entities has grown more favorable as a consequence of the increasing complexity of the problems faced by developing nations. These problems involve questions of political autonomy, and the ability of these nations to influence events outside their borders in order to be able to optimize their social and economic development.

The Latin American experience cannot be uniformly applied to other regions in the world, particularly considering the growing diversity among the developing nations. At present, the terms "Fourth" and even "Fifth World," are used in an effort to differentiate these regional and national diversities.

It may be a platitude to repeat that 70 percent of the world population, with only a 30 percent of the global income, is far from forming a monolithic body. The nations within this group persistently utilize the definition of "Third World," introduced by De Gaulle at the height of the bipolar world of the cold war. In this respect, the terms "Third World" and "nonaligned countries" have common roots, even when the concepts are not identical.

The transformation of OPEC into a powerful instrument of international economic policy *appears* to have created a division in the Third World between the oil-exporting countries and the rest. Although these differences have been emphasized by some politicians of the industrialized countries and also by the information media, the truth is that these nations, whose essential resources come from raw materials exports, have maintained a strong cohesion, as revealed by their position in the international meetings described earlier. In different parts of the world, the medium and small developing countries are looking for schemes of regional or subregional integration in order to compensate for their lack of economic resources and political strength. At international gatherings, groups of countries with geo-economic affinities tend to unite under a common representation, thus avoiding the dispersion of positions that frequently occurs in any large international meeting.

Fifty percent of the developing countries are already part of regional or subregional schemes. We firmly believe that the integrationist schemes will gradually become not only a way of internal understanding among associates, but also instruments of cooperation among the different regional groups. This would make possible an increasing progress towards understanding and cooperation.

II. COOPERATION AMONG THIRD WORLD COUNTRIES

Traditional economic relations usually had a geographical North-South orientation, that is to say, they operated between the industrialized world

and the developing nations. A trend of the last 20 years is the East-West relation, through the commercial ties between the Western World and the Communist Bloc. Following this geographical outlook, the cooperation among the countries of the Third World could be designated the South-South relation. This new process is also called "horizontal cooperation." A geographical approach of this type does not thoroughly express the current global reality; however, it is a useful nomenclature.

The most interesting aspect of the horizontal cooperation is that it represents new aspirations on the part of the so-called "submerged" part of humanity. The people in these countries are starting to dialogue, to get acquainted with each other, and to search for common positions and solutions. The traditional "vertical" relationship with the industrialized nations and with the new centers of political and economic power of the 20th century is being complemented by this "horizontal" orientation.

We are facing a new process whose small beginnings during the first years after the second World War have emerged with impressive vitality in the last decade. As has already been pointed out, the most important steps in that direction have been the regional and subregional integration schemes. These exist not only in Latin America, but also in Eastern and Western Africa, in the Arab World, and in some Asian countries. The alignment of the oil-producing countries and of other raw-material-exporting nations has been a decisive factor in strengthening this irreversible trend.

In the United Nations, where this new reality is viewed as the "collective self-reliance" of the developing countries, it is being given special consideration and great emphasis as one of the pillars of the "New International Economic Order." The Program of Action, approved by the VI Special Session of the General Assembly of the U.N., states that "the countries of the Third World must promote their reciprocal collective self-reliance and strengthen an international cooperation of mutual interest in order to stimulate their accelerated development."

The new conditions of the contemporary political and economic scene are favorable to this aim, particularly considering the greater negotiating capacity of an important part of the Third World, which controls the oil and other raw materials that are fundamental for the growth of the international economy.

Since the situation is new, there is undoubtedly a long way to go before establishing adequate mechanisms or regulations to facilitate this cooperation, not only in the basic fields of commerce, transportation, and financing, but also in those of science and technology. The following paragraphs present an outline of the collective work that will be necessary to accomplish this.

Financial Cooperation

Before October 1973, several examples of financial cooperation among the developing countries were already operating. The Regional Development

Banks obtained significant contributions from the more advanced countries of the Third World and gave priority to the assistance of medium and smaller LDCs. Moreover, there was evidence of increasing links among the Central Banks of the advanced developing countries, whose policy has been often to support the balance of payments position and to promote commerce between nations politically or geographically linked.

The larger Latin American nations (Mexico, Venezuela, Brazil and Argentina) have frequently given credit facilities and even grants to neighboring nations and to poorer countries within the area. Some of these countries have also granted special assistance to subregional institutions such as the Central American Bank of Economic Integration (CABEI) and to the Andean Development Corporation (CAF). In addition, the Interamerican Development Bank (IDB) has been able to sell bonds to Central Banks of Latin American nations when they had had surplus reserves.

However, it is only during the last two and a half years, and because of the active participation of OPEC, that financial cooperation has become evident among developing countries. This cooperation has evolved through different channels, and because of its recent and original characteristics, a systematic statistical description of their scope cannot yet be made.[2]

The OPEC countries are legitimately proud of having utilized an important part of their balance of payments surpluses to provide conventional or soft credits to other countries of the Third World, both bilaterally and multilaterally. Between 1973 and 1974 the total commitments increased more than five times, to almost $15 billion. In the first half of 1975, commitments came to more than $8 billion. In both 1974 and 1975 these commitments were split in approximately equal parts between soft and conventional terms (the type of assistance was determined by the conditions of the financial markets).

Although the amounts actually dispersed are obviously less than the total amounts committed, it is instructive to compare the relative generosity of the OPEC countries with that of the OECD countries when aid is expressed as a percentage of Gross National Product. For the OPEC countries aid came to 1.1 percent and 1.9 percent of GNP in 1973 and 1974 respectively. For those years, the percentage for the OECD countries was approximately 0.3 percent.[3]

The Report of the Group of Experts that met in Geneva at the end of 1975 stated that the "countries of OPEC have largely surpassed the assistance granted by the developed countries in accordance with their respective GNP. These appropriations have been granted, however, to a relatively small number of beneficiaries, and have not been oriented in a satisfactory measure to the group of countries more hardly affected. Since 1973 the unprecedented increase of the deficits in the balance of payments of the oil importing developing countries has been only partially compensated by the grants and direct investments of the developing countries bearing a surplus. More resources have been channelled through the Oil Financial Scheme of the IMF,

greatly supported by OPEC, and an important part of the deficit, (of undefined amount) has been compensated by the money that flows through the financial markets of the developed world. However, they are mostly short term credits, that actually have been aggravating the debt charge of the developing countries, mainly of those more seriously affected."

Commercial Cooperation

The commercial activity among the countries of the Third World constitutes only a minimal percentage of their total international trade. Between 1971 and 1972, the value of commerce among developing countries represented only one fifth of their total exports. It is significant to compare these figures with those of the developed nations—75 percent of their total exports are to other developed nations. Among the socialist countries of Eastern Europe the figure is 60 percent. As a percentage of GNP, commerce among Third World countries (excluding the oil exporting countries), is equivalent to only two percent, compared with nine percent in the developed nations.

The Latin American commercial flows with the developed areas represented, 3 percent of GNP in 1960-1963, increasing to 3.7 percent in 1970-1973 (IADB, 1974 p. 77). The following are some of the major factors affecting Latin American trade: the commercial relations of the developing countries continue to depend largely on the more advanced industrial centers. The situation is aggravated by the systems of marketing and distribution, maritime freights, insurance, and credit facilities between the "central" countries and the "peripheral" areas. Considering the historically low level of the commercial relations among Latin American countries it is easy to understand the weakness of exchange inside the Third World as a whole.

Consequently, any action to promote direct exchange currents among developing nations should be based on concerted and permanent planning of a bilateral or multilateral nature. Obviously the pattern that these currents of trade follow would depend on the prevailing economic systems of the countries involved; for this reason the search for incentives to increase exchange among developing countries must have a very pragmatic base, which takes into account the needs of both the government and the private sectors. As this paper mentioned earlier during the last few years Latin America has been learning to get acquainted with the commercial reality of some countries in Africa, in the Arab World and in the Far East. This promising trend toward exploring contacts has subsequently resulted in the completion of sale contracts of goods and services mainly for larger countries in Latin America.

The "System of General Preferences" (GSP), consisting of non-reciprocal advantages granted by the industrialized countries to the developing areas, has been widely accepted after a long and difficult dialogue that began during the 1964 UNCTAD Conference. However, it is only recently that the advantages

of establishing a system of general preferences among the developing countries has been advocated. Naturally, this kind of preferential commerce is already operating among nations linked by regional or subregional agreements; the objective is now to extend this mechanism throughout the Third World.

This concept is expressed in the Report of the Experts as follows: "The preferential agreements constitute an important instrument to facilitate trade among the developing countries. However to be totally effective, it is necessary that such preferences should be integrated in a general system of economic cooperation among said countries. Commercial preferences can constitute a valuable complement of the active instruments of promotion directly conducted to the transformation of traditional structures of production, transportation, banks and commerce."

Monetary Cooperation

Latin America has had valuable experience of monetary cooperation. The countries in the Central American Common Market and those associated with the Latin American Free Trade Association (LAFTA) have worked together on the application of multilateral clearing systems and reciprocal credits among the Central Banks of the region.

If other developing regions were to apply similar approaches, a new system of intraregional payments, linking such mechanisms could possibly be established. As is well known, these payment mechanisms, supported by short term financial facilities, constitute useful instruments to promote international exchanges of goods and services. Concerted action of the Central Banks, both nationally or in regional groups, would be another expression of monetary cooperation between the countries of the Third World. An area of such concerted action would be the coordinated utilization of a part of their international monetary reserves to assist member countries with balance of payments difficulties. This would give to the Third World a more effective voice within the framework of international finance.

On many occasions, most recently during the I Seminar of Promotion of Latin American Exports held in Puerto Alegre (Brazil), I have proposed the establishment of a Latin America Central Banking System. Such a system could provide for joint utilization of a part of the monetary reserves of each country, to maintain a permanent coordination in monetary policies and in the mechanisms of cooperation among the countries. Of particular importance would be measures to assist those countries suffering difficulties in their balance of payments because of intraregional factors. This system could act as an institutional basis for a multilateral payment mechanism and could include countries in LAFTA, the Central American Common Market and the Caribbean Free Trade Association (CARIFTA).

Multinational Ventures

The last years have seen the formation of enterprises using the resources of two or more developing countries, in order to fulfill their services and production requirements.

One of the basic purposes of the "Latin American Economic System" (SELA) is precisely to stimulate this kind of cooperation to promote a useful and pragmatic sectorial integration. In Latin America the sectorial joint ventures of a multinational character were initiated in the 1960s with the support and assistance of the Interamerican Development Bank. These kinds of projects were mainly oriented to the field of physical infrastructure (roads, ports, hydroelectric developments, telecommunications, etc.). The financial subregional institutions (the Central American Bank of Economic Integration and the Andean Development Corporation), have allocated an important part of their resources to these purposes.

We can consider as multinational enterprises in the Third World those organizations created through a formal and permanent agreement between two or more developing countries (or among nationals from those countries). The purpose of such an agreement is to reach a common aim in the fields of production, commerce, and/or services. The unifying factor for multinational enterprises is an economic purpose common to two or more countries. To achieve such a purpose it is necessary to plan a joint action, with a sharing of natural resources, technology, operating facilities, financial responsibility and the control of goods and markets.

From this definition it is clear that, as in all dealings between developing countries, pragmatic criteria must be applied with regard to the participation of governments and the private sectors. The legal framework—be it public, mixed or private—would depend on the interests of those involved with these enterprises.

These enterprises may have one or more objectives: optimal utilization of resources for which a single national market may not be large enough; the integration of different phases in a production process located in different countries, utilizing the complementary character of the different resources and markets in each country, the organization of production facilities so that each one be large enough to achieve economies of scale, possibly assigning different lines of production to each associate; the joint development of frontier areas; the construction and utilization of infrastructure works; maritime and air transportation; banking and financial activities of various types; insurance systems; assistance and consulting concerns dedicated to improve managerial skills and technological resources; etc.

Special attention must be given to the advantages that multinational cooperation of this type can bring to marketing, information and promotional objectives. In addition, the negotiating strength of a group of countries

is clearly increased by this type of multinational coordination. This is particularly true with regard to imports in the case of medium-sized and small countries associated in regional groups. Because of the increased volume of imports, collective action in this sector can create a significant improvement in prices and credits, quality, and other sales conditions, as well as in the reduction of insurance and freight costs.

Technical Cooperation

Technical assistance among developing countries is at present in full development. Several governments of the major countries of the Third World, not only because of regional connections but also as a result of political and commercial links, have instituted technical assistance policies to less developed countries. Frequently these initiatives have constituted the first steps towards the opening of foreign markets, and have also contributed to the creation of permanent economic relations of various types.

Many international organizations have had a significant impact by providing a vehicle for the utilization of Third World experts by underdeveloped countries that traditionally have used experts from the industrialized world.

The United Nations Development Program (UNDP) is giving high priority to this kind of international cooperation, and is programing a World Conference for this purpose in Buenos Aires in 1977. It is being preceded by regional meetings one of which took place in Lima in May 1976.

It is reasonable that the technical cooperation among the countries of the Third World be closely related to the proçess for technology transfer. As has been frequently stated, the underdeveloped nations need their own technological patterns, in order to adapt them to their own economic growth needs, while preserving their cultural values.

In the wide scenery of the Third World the comparative technical experiences among regions or countries are of great importance. It is indispensable to create and strengthen the channels of technological transfer so that the experience of one country in solving its problems can be used by other countries to solve similar problems. This could be a way in which horizontal cooperation could lessen the dependence on technology which frequently creates serious dislocations, and often does not provide sufficient employment opportunities for the growing populations of the developing countries.

Technical cooperation can take different forms. Some of the important technical assistance programs formed by regional or subregional groups to benefit the less developed countries are as follows: those developing countries with special expertise have organized specific technical cooperation programs for other Third World nations; developing countries collaborated in joint research projects utilizing common organizations or cooperatives to facilitate the exchange of technical, scientific or professional information.

III. LATIN AMERICAN PERSPECTIVES

In order to understand the contemporary situation it is absolutely necessary to bear in mind the previous developments that shaped the present. During the 1960s and the early 1970s, Latin American economic growth accelerated. The figures and statistics of those years have been widely repeated, and, particularly towards the end of that period, they show a trend toward expansion and prosperity. The increase of foreign trade—with positive and negative effects—is evident in this period. Moreover, there is also a new drive toward an internal growth based mainly on a dynamic process of industrialization. The new policies of interamerican cooperation, especially the active involvement of the IDB in both its financial and technical aspects, contribute to this drive.

In my opinion, the most relevant fact during these years is the process of Latin American integration. All the basic regional and subregional schemes, with economic, commercial, or financial aims originated during this period. It was also during this decade that the Central Banks expanded their relations on the continent through multilateral payment systems, which were designed to facilitate the functioning of the Central American Common Market and the Latin American Association of Free Commercê (ALALC).

Many people are skeptical about Latin American integration. The difficulties of LAFTA, the well-known political problems of Central America, and the shortcomings of the Andean Market are brought up again and again. However, such critics disregard the following elements: (a) Commercial, financial, and technical relations among Latin American countries have developed to an extent previously unknown. Before this period, apart from bilateral arrangements mainly between neighboring countries, Latin American countries largely ignored each other. (b) Since the early 1970s, Latin America has faced several problems that are international in dimension including the new situation of energy and raw materials, and the crises of the international monetary system and of external assistance. It is interesting to note that in spite of the growing differences in their political and social regimes, Latin American nations have held common positions in their external economic front. It seems that the integration process that began in the early 1960s presents a new "scenery," in which Latin America, facing other centers of powers and other groups of countries, is trying to stress and defend a common destiny.

The preceding statement is especially true with regard to unified positions of Latin American nations on such issues as the environment, population, food, and habitat. This was demonstrated at the important international conferences of Stockholm (1972), Bucharest (1974), Rome (1975) and Vancouver, (1976). The fact that the VII Special Meeting of the General Assembly of the United Nations has started a "new dialogue" between the

industrialized world and the developing nations, is also an expression of this new reality.

The unified position of Latin America in UNCTAD IV completes this enumeration. The old Latin American aspirations that were voiced through the U.N. Economic Commission for Latin America (ECLA) during the 1950s, are now among the objectives of the "new international economic order". This reality in the scenery of the Third World, of which Latin America is a part, opens a new perspective. As this paper has stated, the Latin American nations started technical-economic cooperation during the last decade. It is also during the second half of the 1960s that the links of historical and political solidarity began among the developing countries. Today Latin America is an essential part of that two-thirds of mankind. Without Latin America the Third World could not have become a new international "center of power"; on the other hand, without active participation and solidarity with other developing regions, the Latin American continent would lack important international protection. These perspectives take full weight in the context of the "globalization" of our present time; for the first time in history, man has started to live a "planetary civilization," and Latin America is bound to make a decisive contribution to it.

The current economic problem is more than a matter of supply and demand. In Latin America the economic and public policies have traditionally been oriented to the short and medium term in controlling the money supply, adjusting fiscal flows, and regulating those underlying elements that have a negative impact on the balance of payments. Frequently ignored has been the need to create the conditions that would develop more effectively the sectors of mining, agriculture, and energy, which, over the medium and long terms, would help to solve the world problem of scarcity of resources. At present, accelerating population growth and the concomitant growing consumption needs require a significant increase in the production of food and raw materials. Latin America is one of the few regions with abundant unexploited natural resources, that can be developed provided that the transfer of the appropriate technology takes place.

The rates of growth of some Latin American economies are accelerating. This is particularly true of those countries in higher stages of development, with substantial natural, human, financial, and technological resources. The result has been a certain economic polarization within Latin America. Fortunately, the stronger countries have demonstrated, in the context of inter-Latinamerican relations, an attitude of cooperation and assistance toward the medium and smaller countries. Sometimes, unfortunately, these strategies for cooperation have been misinterpreted.

"Latin-Americanism" has recently taken a new perspective. The proposal of the presidents of Venezuela and Mexico to create a mechanism for

cooperation among Latin American countries has become effective through the "Latin American Economic System" (SELA). In recent meetings of all developing countries in the hemisphere in Panama and Caracas, this new instrument has been defined and given an adequate organizational structure. The purpose of SELA is to provide both a permanent system of regional cooperation in its multiple aspects and a permanent mechanism to promote economic integration. In the final analysis, it is hoped that SELA will become an organization similar to the European Common Market, that is to say, it will play an important role in integrating Latin America. At their meeting in Panama the 25 developing countries of the Hemisphere negotiated and signed the Constitutional agreement of SELA on November 25, 1975. It is encouraging that this has been ratified in 1976 by an absolute majority, thus allowing the institutional functioning of the new system.

The SELA forum will serve to generate multinational initiatives; in addition to the projects related to infrastructure investments benefiting two or more countries, its target will be to create enterprises dealing with priority sectors in Latin America: the so-called "multilatinas".

SELA will facilitate the definition of common external economic policies in Latin America, both at the international and at the interamerican level, as well as at the specific sectorial level. One of its main objectives will be to propose measures to avoid and correct disequilibria among Latin American countries, due to different rates of growth. The future of a united Latin America, where old nationalistic frustrations are eradicated, relies basically on the more homogeneous characteristics of its constituents.

The preceding paragraphs have emphasized how important it is that the nations of Latin America converge to work on concrete tasks, as a way to accomplish the global integration that started during the preceding decade. Among the different challenges that this convergence must solve, a valuable one would be the creation of an effective "*Latin American Academic Community*". This would be a significant expression of the higher levels of intellectual development that the continent is attaining in the fields of culture, science, and technology. The rising professional level of our economists and social scientists is a recognized fact, demonstrated by The Program of Joint Studies for the Economic Integration of Latin America (ECIEL). Through ECIEL, more than 30 Latin American Institutes for Economic and Social Research have formed an association to conduct investigations on national issues, analyzed from a regional perspective.

ECIEL has been defined as an "Inter-Latinamerican Academic Cooperative" because it gathers and compares the results of analytical studies performed at a national level in different countries using common methods. The Program is more than a decade old and its Coordination Center has recently been moved to Rio de Janeiro from Washington, D.C. Important research is

being performed on the Latin American process of industrialization, structures of production, salary systems and comparative prices in different fields, employment, consumption levels and distribution of income, and more recently, a major study on the interaction between education and economic development.

IV. A LATIN AMERICAN BANK FOR THE THIRD WORLD

When SELA was created, the Latin American countries considered that one of its primary objectives was "to promote a permanent system of consultation and coordination, in order to adopt common strategies and positions on economic and social matters in the international institutions and assemblies, as well as in their relations with other countries or group of countries." (Panama Agreement, Art. 3[b])

The functions of SELA are especially relevant with regard to the creation and promotion of relations with other regions of the developing world. At the first meeting of the Latin American Council, the superior authority of SELA (Caracas, January 1976), the Council stated that a future action of SELA should be the development of "contacts and joint proposals in order to intensify the relations and cooperation with the countries of Africa and Asia, fundamentally concerning raw materials, expansion of trade and cooperation in infrastructure works."

According to the philosophy and inspiration of SELA, its activities do not interfere with the actions of any of its members. In order to establish pragmatic relations between the Latin American countries and other developing regions, there is a wide margin for all kinds of national initiatives either public or private.

However, in my opinion the structure of SELA should be the vehicle for the creation of a technical and banking entity, whose essential aim would be the cooperation of Latin American countries with the rest of the Third World, as summarized in the following paragraphs.

There are inadequate export finance facilities for exports of capital goods and manufactured products to countries outside of Latin America, for either national or multinational enterprises. Some countries are increasingly trying to fulfill the need to finance export of equipment and manufactured products; however, particularly for the purely national enterprises, this kind of assistance does not exist in a sufficient number of Latin American nations. Furthermore, export credit insurance schemes are generally not available to Latin American exporters. Although some progress has been made in the last few years, policies intended to facilitate foreign commerce and direct technical connections with the rest of the Third World are inadequate.

SELA, whose operating system permits this, should create a Committee of Action with the purpose of studying the possibility of establishing a "Latin American Bank for the Third World".

This Bank should specialize in the fields of export finance and credit insurance, directly or through existing financial institutions. Its basic characteristics should be similar to those of the Export-Import Banks of the industrialized countries. Moreover, it should provide technical cooperation, information and promotional assistance. Since the 1930s the U.S.A. Exim-bank has been very important in the foreign economic policy of the United States, particularly before the creation of the present multilateral and bilateral institutions of financial cooperation.

I believe that an Export-Import Bank of this nature would not need a great amount of capital, as a substantial part of the resources could be raised by funds from international and Latin American markets. There exist powerful private, public, and mixed Latin American banking institutions which could provide valuable institutional and technical infrastructure for this entity.

The creation of this multilateral Bank could promote potential Latin American sales of goods and services to other developing regions. The limited number of qualified national and institutional enterprises make it difficult for the majority of Latin American countries to obtain openings in unknown markets, in which they have to compete with the traditional presence of developed nations. Through a Latin American "multinational," such obstacles might be overcome.

The proposed institution should open agencies in various key cities of Africa and Asia, and act with a clear commercial financial and technical orientation without cumbersome bureaucratic procedures. In the future, and acting on a multilateral basis, this institution might be able to give technical and financial cooperation to other countries or regions in lower stages of development, and to provide all the economic assistance that the evolving Third World will undoubtedly require from Latin America. Such assistance would also enable Latin America to strengthen its position in the international field.

NOTES

1. *Economic Cooperation among Developing Countries.* Report of The Group of Experts, Geneva, October 27 to November 4, 1975 (Doc. Unctad, TD/B/AC. 19/1; December 17, 1975).

2. The data presented in the following paragraphs are taken from information provided by the OECD and the UNCTAD secretariats.

3. Note that the thesis of UNCTAD is that a reasonable target for the developed countries should be .7 percent of GNP.

PART IV

TWO MAJOR ISSUES: FINANCING DEVELOPMENT AND THE MULTINATIONAL CORPORATION

Chapter 11

PROBLEMS OF EXTERNAL FINANCING IN LATIN AMERICA

LUIS ESCOBAR*

I. INTRODUCTION

This chapter deals with the external financing of Latin America; special emphasis will be given to an evaluation of the prospects in this field for the non-oil exporting countries, particularly in the light of the circumstances which have developed since the 1973 "oil crisis". Unlike the usual discussions of this subject, I am not going to repeat or elaborate on the figures of the external debt situation of the Latin American and Caribbean (LAC) countries or on the flows of external funds (quantity and/or quality) except and only to the extent that I feel this will be necessary to make my argument in as clear a manner as possible. There are three reasons for this approach: first, the statistical information can be found in publications by the Organization of American States (OAS), the Inter-American Development Bank (IDB), the Economic Commission for Latin America, the International Monetary Fund (IMF), the World Bank, and the Development Assistance Committee;[1] second, I am writing in mid-1976, that is to say, probably more than a year before this chapter is published; and third, my main concern is to point out the very important role that the private sector is playing in the external financing of the region. This has significant implications in that some new alternatives–or policy options–are becoming available to the LAC countries in the field of external financing.

II. FINANCING THE BALANCE OF PAYMENTS DEFICIT

There have been many comments, in the last few months, about the seriousness of the balance of payments situation of some Latin American countries, or a group of them, or even of the region as a whole. Several of

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these comments are too pessimistic, others fail to differentiate country situations, while still others seem to ignore the remarkable strength of the international financial system, a strength that is demonstrated by the manner in which multilateral and bilateral (both public and private) institutions have dealt with the problem in the last three years. There are two basic issues that I want to discuss: one, the present situation in the LAC countries and their immediate prospects; two, what should be done to keep the situation under control, allowing growth with external financial stability. Let me say, at the outset, that I am cautiously optimistic because the international financial system has been able, so far, to deal with the balance of payments imbalances. Furthermore, the LAC countries have the potential to continue their growth. The global figures for the largest part of the developing world are summarized below.

The combined, current account deficit of 88 non-oil LDCs rose from $9 billion in 1972 and in 1973 to about $28 billion in 1974 and to $37 billion in 1975. For 1976, it is estimated to fall to about $34 billion (this figure does not include amortization of external debt—which accounts for another $10 billion—which is necessary in determining total gross requirements. The current account deficit is defined as the balance on goods, services and private transfers—before grant aid—including net payments of interests and profits. Grant aid along with loans, credits and direct investments are considered capital transactions).

The pertinent figures for the LAC countries are as follows. The balance of payments position of net oil-importing LAC countries showed a combined current account deficit which rose from $4.3 billion in 1973 to $13 billion in 1974 and to over $15 billion in 1975. For 1976, it is estimated to decline to about $13 billion. I will not go into details about the assumptions on which these projections are made nor will I discuss any country in particular.

How were the above global deficits financed? For 1975, non-oil LDCs received official bilateral financing (grants and loans) in the order of $15 billion (including $4 billion from the OPEC countries); multilateral grants and loans, $5 billion; $14 billion from the private sector (including $4 billion of direct private investment with most of the remaining $10 billion corresponding to commercial bank loans of $3 billion and Eurocurrency credits of $7 billion); the balance of $3 billion, needed to finance the deficit of 1975, came from a drawdown of reserves of LDCs, mainly LAC countries.

What was the picture in Latin America with respect to the financing of the current account deficit? In addition to the use of reserves, in an amount of $3 billion in 1975, official bilateral flows amounted to about $1.3 billion; multilateral flows, $1.4 billion; private direct investment, $2.3 billion; and borrowing in the U.S. banking system and in the Eurocurrency market, close to $7 billion (including $2.3 billion of long term—over one year—commercial and suppliers' credits). In addition, there was less than half a billion dollars in

short-term financing. Most of the financing in Latin America is coming from the private sector, particularly borrowing from private banks in the United States and in Europe (this is, by the way, the most expensive financing available). This is because the OECD countries have decided to give priority, in their development assistance programs, to the lower income LDCs—who have limited or no access to capital markets. Thus, the "middle class of the LDCs" are left to fight their way mainly in the private sector (borrowing from private banks and trying to gain or improve access to long-term capital markets and via export promotion and attraction of private foreign investment).

In 1976, the structure of financing the current account deficit will probably remain much the same as in 1975 even though a lower total deficit in current account seems possible ($13 billion in 1976 as compared to $15 billion in 1975). Such a decrease would allow a reduction in the use of official reserves (it is probable that there will be an increase in the total level of multilateral flows and a reduction in that of private flows). Maintaining the same nominal capital inflows in 1976 as in 1975 would imply a reduction in both real and relative terms with respect to the GDP of the region.

How is it possible that LAC countries may have a lower current account deficit in 1976 than in 1975? The 21 oil-importing LAC countries (which include Mexico and Colombia even though the first became a net exporter in 1975, and the latter is virtually self-sufficient in oil) will have higher export revenues as the industrial countries recover from their current recession. This is assuming that there will be no further deterioration of the terms of trade—i.e., in the relationship of the region's import prices to its export prices (in 1975 the terms of trade deteriorated by an average of 10 percent for the LAC countries). Exports in 1975 reached a total of $26 billion, and in 1976 they may be around $29 billion. Imports in nominal value are predicted to remain the same as for 1975 ($34.5 billion) which means that, in volume terms, there will be a compression of about 8 percent. The underlying assumptions are that most countries in the area, as a matter of deliberate policy, will restrict the demand for imports through suitable demand management. The objective is to keep their balances on current account under control and to avoid further reductions in reserve holdings as well as to slow further increases in foreign debt.

The recession in the industrial countries weakened the demand for LAC countries' exports. This depressive effect, coupled with the increases in the costs of fuel and other imports made themselves felt in the rate of growth of the region as a whole. In 1975 the rate of increase of GNP was lowered to 3.5 percent from the 7 percent rate of real growth that the region had averaged during the first years of the 1970s.

The external financing received by 21 LAC countries raised their external debt to $55 billion, an increase of $30 billion, during the four-year period 1972-1975. (In 1975 approximately 70 percent of total debt outstanding and

disbursed was held by private creditors and 30 percent was official; in 1970 the division was split roughly 50/50, and the total debt was one third that of 1975.) Nevertheless, the export performance of LAC countries has been impressive; the ratio of debt service to exports has been kept at manageable levels, even though it is high in certain countries (this ratio is repayments of principal amortization plus interest as a percentage of total export revenues). Despite some disagreement about the importance of the debt service ratio, the expansion of output and exports in LAC countries justified and to some extent was furthered by the increase in foreign debt.

Many people seem to be afraid of the volume of external debt of the region, as well as of the burden imposed on the countries' income by its service. However, these higher volumes of indebtedness are usually indications of higher levels of output, exports and growth rates. Of course, 1974 and 1975 were exceptional years in that the non-oil exporting countries had no choice but to borrow substantial amounts to compensate for the deterioration of their terms of trade and to keep their growth rates at an acceptable level.

LDCs must supplement their own domestic savings with foreign inflows in order to finance their targeted level of investments. In LAC countries, foreign financing has been around 12 percent of total investment in the last few years; if that percentage is maintained, the absolute amount of external financing will grow with the total volume of investment necessary to accomplish higher levels of GNP. However, as development takes place, countries eventually become able to finance their investment programs with domestic savings and, later on, they graduate to being developed countries and become capital-exporting nations. LAC countries, even though they constitute the most developed group among the LDCs, have still some distance to go before achieving the stage of self-sustained growth; during this period, they will have to continue increasing their volumes of external indebtedness, though at progressively lower rates; in this as in other areas of the balance of payments analysis, there are differences among countries. In general, however, the resource gap of the LAC countries will decline in the years to come. In the exceptional circumstances of 1974 and 1975, this gap rose to 2.5 percent of GDP (investment less national savings), but it is expected to fall to around 0.5-0.7 percent in the period of 1980-1985 as a result of a resumption of growth of exports and savings with GDP returning to annual growth rates of between 6 and 7 percent.

The reduction in the resource gap of the LAC countries will result from a number of policies and specific programs that they are implementing or are considering at the present time. Most important among these are the export promotion programs which are already showing very good results in several countries in the Hemisphere. These programs deal, particularly with exports of manufactures and their success depends, to a large extent, on the removal

of import restrictions in the developed countries (this is equally true for several agricultural exports.) Despite these efforts, most Latin American economies continue to be heavily dependent on basic traditional exports whose stability and growth is conditioned by the economic situation of the industrial centers. Fortunately, for the immediate future, prospects seem to be good. At the Conference on International Economic Cooperation (CIEC) in Paris the OECD countries stated that they expect their economies to grow at an annual rate of between 5 and 6 percent from 1976 to 1980, with a leveling off of inflation rates. It is assumed that this outcome will result in higher volumes of exports than those of the last couple of years and better terms of trade for most of the LDCs.[2] In addition to exports and export promotion efforts, imports and import substitution policies will continue to have a significant impact on the balance of payments. Some further comments follow on the question of how to finance whatever resource gap the LAC countries will face.

LAC countries cannot expect much from official development assistance (ODA). This is so for two reasons: a) the low levels of these flows and the lack of political determination to increase them in the immediate future; b) because, as has already been mentioned, it is the policy of most donor countries to give priority in their aid programs to the lower income countries among the LDCs, and the LAC countries do not belong to that group.

Lending by multilateral financial institutions, most importantly by the World Bank and the IDB, to LAC countries will continue growing within fairly specific limits, probably corresponding to the increase in the rate of growth of GNP of these countries.

Consequently, the LAC countries must look to the private sector for flexibility and volume in their inflows of external financial resources. There are two important private sector resources, and a third one is potentially important. The first is private banks in creditor countries, the second is the Eurocurrency market, and the third is direct private foreign investment. These sources of financial resources are well known; the predominant role of the first one is discussed in these pages. Private investment will not be discussed here; however, according to all "market experts," whatever happens in this area will have a decisive influence in the fields of private bank financing and in foreign and international capital markets (portfolio investments).

Of the total bonds issued and sold, by all borrowers, in the foreign and international bonds market, only 5.3 percent were issued by developing countries in 1973, 2.3 percent in 1974, 2.7 percent in 1975 and 1.5 percent in the first quarter of 1976. (See Table 11.1).

Of the total bonds issued by developing countries in the decade 1960-1970 (approximately $1,500 million equivalent, excluding oil exporting countries, Israel and Spain), more than 40 percent was sold by Mexico and 19 percent by Argentina. In the first five years of this decade (1971-1975) developing

TABLE 11.1
International Bond Issues
(in millions of U.S. dollars or equivalent and percent)

	1973			1974			1975		
		LDC Issues[1]			LDC Issues[1]			LDC Issues[1]	
	Total	Amount	Share (%)	Total	Amount	Share (%)	Total	Amount	Share (%)
Eurobonds	*4,600*	*439*	*(9.5)*	*4,515*	*96*	*(2.1)*	*10,199*	*271*	*(2.7)*
Public issues	3,179	199	(6.3)	1,559	92	(5.9)	6,753	183	(2.7)
Private placements	1,421	240	(16.9)	2,956	4	(0.1)	3,446	88	(2.6)
Foreign Bonds[2]	*5,314*	*750*	*(14.1)*	*7,786*	*741*	*(9.5)*	*11,913*	*561*	*(4.7)*
Public issues	2,973	544	(18.3)	2,526	276	(10.9)	7,374	318	(4.3)
Private placements	2,341	206	(8.8)	5,260	465	(8.8)	4,539	243	(5.4)
Total	*9,914*	*1,189*	*(12.0)*	*12,301*	*837*	*(6.8)*	*22,112*	*832*	*(3.8)*
Public issues	6,152	743	(12.1)	4,085	368	(9.0)	14,127	501	(3.5)
Private placements	3,762	446	(11.9)	8,216	469	(5.7)	7,985	331	(4.1)

Source: IBRD.

[1] Includes issues by oil exporting countries amounting to U.S. $226 million during 1973-1975, but excludes issues by European countries amounting to U.S. $450 million during the same period.

[2] A substantial portion of the foreign bond issues have been by Israel, amounting to U.S. $468 million in 1973, U.S. $560 million in 1974, and U.S. $243 million in 1975. If these were excluded, the LDC share in total comes down to 5.3 percent in 1973, 2.3 percent in 1974, and 2.7 percent in 1975.

countries issued a little over $2 billion equivalent (excluding oil exporting countries, Israel and Spain), of which more than 36 percent corresponds to Mexican bonds and more than 12 percent to Brazilian bonds.

The situation described above contrasts strongly with the volumes of borrowing in the Eurocurrency credit markets as can be seen in Table 11.2.

What are the reasons for this impressive difference between access to the Eurocurrency credit market as compared with the Eurobond market? By far the most important and frequent explanation is the "market evaluation" of creditworthiness of developing countries. When the market evaluation differs from the one made by international organizations or governments or by authorities and experts in the borrowing countries themselves, the argument is that this discrepancy may be due to lack of knowledge in the market. Another explanation is a different assessment of the relevant variables leading to a determination of creditworthiness. What is needed, then, is a process of education of the market. The burden for the educational task has to be carried by the interested countries themselves. (In Latin America, for instance, Mexico has gone a long way in this task and is the only LAC country which goes regularly to the bond market even though in small amounts when compared with both its borrowing in the Eurocurrency credit market and with the size of the bond market as a whole. Although Brazil entered the bond market in the 1960s, it began to make a systematic approach to the market only in this decade. It is, certainly, a country which has the institutional and financial infrastructure needed to stay in it, and "staying in it" is an important aspect of the educational process). Countries could be assisted in their efforts to gain access to the capital markets of the world, and this technical assistance could be given by international organizations and governments. Although OAS, IDB, and IFC among the international organizations, and US/AID—on the bilateral side—have technical assistance programs or facilities, very little is being done in this general field in Latin America.

The question remains, why is it that LAC countries—or LDCs in general—are considered to be creditworthy for the Eurocredit market and not for the Eurobond market? Apparently, the answer lies in the fact that in the Eurocredit market maturities are shorter than in the bond market, and the latter considers a long-term investment in LDC securities too risky. It is difficult to explain these differences in the market perception of creditworthiness. In the Eurocredit market, loans are made with "floating" interest rates which are adjusted periodically in accordance with prevailing money market rates. In the bond market, on the other hand, the interest is fixed for both the LDCs and for the industrial countries; however, this does not seem to be a problem for the developed countries: in 1975 and in the first quarter of 1976, these countries issued more bonds than they borrowed in the Eurocredit markets as is shown in the figures above. Part of the explanation for the discrepancy is the lack of secondary markets for LDC securities; this,

TABLE 11.2
Publicized Euro-Credits
(in millions of U.S. dollars and percent composition)

	1973		1974		1975	
	Total	Share (percent)	Total	Share (percent)	Total	Share (percent)
Industrial countries	11,687	(56)	17,243	(60)	5,090	(25)
Developing countries[1,2]	6,998	(34)	7,480	(26)	10,892	(53)
Other	2,179	(10)	3,809	(14)	4,593	(22)
Total	20,864	(100)	28,532	(100)	20,575	(100)

Source: IBRD.

[1] Includes oil exporting countries. Excluding them, the figures are U.S. $4.3 billion (20 percent) in 1973, U.S. $6.7 billion (23 percent) in 1974, and U.S. $7.7 billion (37 percent) in 1975.

[2] Excludes loans to European countries amounting to U.S. $1.3 billion in 1973, U.S. $2.3 billion in 1974, and U.S. $1.5 billion in 1975. These are included above in the "other" category.

however, is also due to the same lack of creditworthiness which makes primary access difficult.

In assessing creditworthiness of potential borrowers, the market also takes into consideration noneconomic factors, among which current and potential political stability is particularly important. Apparently, the market believes that this variable can be better assessed for the short run rather than for the longer periods associated with maturities of bond issues.

Finally, the sources of funds are an additional factor affecting differences in access to the Eurocredit and the Eurobond markets. The former comprises the international commercial banking system, while the latter is formed by a number of institutional and private portfolio investors (where the investment or merchant bankers usually play an important intermediary role). The commercial banks are large depositories of short-term funds or time deposits, not the kind of money that can be "invested" in long-term bonds, particularly if its liquidity is not assured. The institutional investors (e.g., insurance companies, pension funds) while having long-term resources available, are not, in general active in international business with the LDCs. This is why a determined effort is needed to "educate" the market about the possibilities of investing in LDC securities; this effort must be made by the interested countries themselves and, with some important exceptions, little has been done in this respect by most LDCs.

In addition to creditworthiness evaluations, there are in the capital exporting countries laws, regulations and practices which impede LDC access to those markets, and which will have to be removed in order to facilitate—or make possible—issues of LDC securities. This is particularly important for the LAC countries since, as has already been pointed out, ODA is being channeled to the lower income LDCs, while the middle and higher-income countries—which includes practically all LAC countries—are being told to look to the private markets for external financial support. These regulations and control of capital outflows by industrial countries have been motivated by the desire to protect investors and for balance of payments reasons; among the regulations are disclosure requirements, regulations governing the portfolio structure of banks and institutional investors, permission to make issues and the like. The Development Committee—Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries—is actively working on this problem as well as on several of the others mentioned in this chapter, in the general area of capital markets.

A number of ideas are currently being discussed for facilitating LDC access to the foreign and international capital markets. This paper has mentioned reduction of legal, administrative, and other barriers, educating the market, and technical assistance to potential borrowers, but some other proposals

could be important for the future management of the balance of payments of the LAC countries.

1. Multilateral guarantees

Doubts about the creditworthiness of LDCs is one of the major obstacles to their obtaining access to the international bond markets. One suggestion to overcome this has been to provide some form of multilateral guarantee of these obligations. It has also been suggested that the granting of guarantees could be limited to the so-called "threshold" countries, e.g., developing countries that are considered creditworthy by international organizations but which have not yet succeeded in placing long-term borrowings in the capital markets. This approach gives priority to the longer-run objective of establishing unassisted access of LDCs to private capital markets rather than to any objective of increasing immediately and substantially the volume of private and total resource flows to developing countries.

There are several ways of approaching the organization and establishment of a guarantee mechanism; the use of the authority that existing international and regional development institutions already possess, and a new mechanism in which industrial, oil exporting and borrowing countries could participate with a predetermined burden-sharing formula. This could be similar or differentiated for different countries, but would define the amount of contributions to the callable capital of the guaranteeing institution and also contributions to its reserve fund.

2. Secondary markets

In the capital markets, a distinction is drawn between the primary market (new issues) and the secondary market. The former consists of the first sale of a new issue of securities, while in the latter, securities already issued are traded between market participants. The secondary market, then, provides liquidity, and its main importance lies in the fact that it stimulates the primary market. The lack of active and broad secondary markets has been frequently mentioned among the obstacles to LDC access to the capital markets of the world. There are a number of elements which influence the existence and strength of a secondary market: creditworthiness of the issuer; familiarity of the market with the credit; initial size and initial distribution of the issue; length of maturities; sinking fund and purchase fund provisions; registration in the place of the issue and listing in stock exchanges; and, in the United States, rating by one of the private credit rating agencies.

Two ideas have been suggested to broaden the secondary markets for the securities of developing countries: one, use of a small percentage of the liquid funds of official institutions, such as central banks and international financial organizations, for transactions and investments in LDC securities; two, the

establishment of a financially strong, impeccably sponsored institution which would provide a degree of liquidity by trading LDC bond issues in international and foreign national markets at prices related to current interest rates. The shareholders and the lenders would be organizations and, possibly, governments which would benefit from the existence of such an institution. As of this writing, these ideas have failed to arouse much enthusiasm or support . . . but this has always been the case with new ideas in the field of development aid. If access to capital markets is going to be facilitated in the future, something along these lines will have to be seriously considered by the international community.

3. Multinational investment trust fund

Another idea is being explored to facilitate the transfer of resources from the rich to the middle-income LDCs, without necessarily excluding the poorer developing countries. This is the establishment of a mutual trust fund which enables private investors in the industrial countries to invest in a diversified portfolio of equity and fixed interest securities of LDCs. This mutual fund would also facilitate investment by OPEC countries that are able and willing to invest in developing countries. The mutual fund would allow a diversification of investments and would provide a commercial rate of return. This investment trust fund—like the multilateral guarantee fund—could be administered by one or more of the existing international financial organizations.

4. Co-financing

The so-called co-financing arrangement is already being tested in the market. This is a device to attract more private funds to high priority development projects that international institutions usually help to finance. The World Bank, the Inter-American Development Bank, and the Asian Development Bank are experimenting with different co-financing techniques. The basic idea is to combine private financing from banks with that of international organizations in project lending; hopefully, later on insurance companies and other institutional investors will also participate. It is expected that the banks—and eventually other institutions—will want to take advantage of the work being done by the international organizations in project identification, evaluation, and supervision as well as in the general economic analysis with respect to their member countries. Also, the private institutions could avail themselves of some of the administrative facilities that the international organizations may wish to offer and which can reduce some of the costs of the normal creditor-debtor relationship (e.g., disbursements of funds, collections, progress reports on the projects). One of the most important aspects of the co-financing mechanism is the fact that it is considered to offer some sort of guarantee to the private lender; there is some discussion about the value of

this guarantee but there seems to be a consensus that this association, at least, provides the private institution with a "moral umbrella". This is because a loan is made by an international organization for a particular project at the same time that another loan is made, for the same project, by a private institution; both loans are negotiated simultaneously with the borrower. International organizations show an impressive record of collections of loans made to their member countries, and this fact gives additional value to the association. The growing participation of the external private sector in the financing of investment in the LAC countries—which this chapter has been emphasizing all along—has probably led the private institutions to take a longer-term view of their relationship with their borrowers (and with the borrowers' countries). This approach implies, *inter alia*, a growing concern with the question of how and for what purposes the money is being used. Therefore; project financing has become very important also for the private lenders; this is an obvious area for cooperation between private and international institutions and borrowers.

III. A CASE OF FINANCIAL INTERDEPENDENCE

In the same manner that the international division of labor imposes trade interdependence among the countries of the world, increasing levels of multinational financing creates financial interdependence among debtors and creditors. Debtor countries need external resources to supplement their domestic savings, while creditors find secure and profitable investments for their excess financial resources. (Many private commercial banks in the capital exporting countries have been making loans to LDCs with rates of 1½, 1¾ and sometimes more than 2 percent over LIBOR (London Inter-Bank Offered Rate) and this has been going on for quite some time with no defaults. These institutions are obviously making interesting profits, which is the legitimate compensation for the services that they are providing.) This relationship, in the volume that has taken place during the last few years, has changed the quality of the traditional bank-customer relationship. Creditors have become vitally interested in the economic and financial development and the stability of their customers. This is an association which requires a long-term view of the relationship which has several implications which will be discussed in the rest of the chapter.

Banks and other creditors cannot move in and out of a given country following short-term economic financial fluctuations, unless they want to risk exaggerating—instead of ameliorating—situations of financial disequilibrium. Thus, the attitude that bankers adopt vis-à-vis their debtors in the LAC countries will have a profound effect on the financial stability of the debtor countries in the short run. This is a vicious circle. If creditors were to reduce drastically their levels of lending for fear that the international payments

position of LAC countries will deteriorate, payments difficulties in these countries would become a self-fulfilling prophecy because external financing is part of the normal pattern of development. On the other hand, if creditors continue lending in the necessary amounts, the debtor countries could maintain their development process without facing other than normal external difficulties.

My conclusion, then, is clear: levels of lending must be programmed in order to make possible an orderly process of development with external financial stability. In the present situation of Latin America this programming exercise would imply that creditors (particularly private banks because they constitute the most important source of external financing in Latin America) cannot drastically reduce, in the immediate future, their exposure in the region without provoking serious consequences at the private and national levels. At the microeconomic level, such actions would badly hurt both debtors and creditors and would benefit nobody. At the national, macroeconomic level it is pertinent to remember here part of the remarks made by the President of the Inter-American Development Bank before the Council of the Americas in December 1975; Mr. Ortiz Mena said: "Latin America has become an important market and an essential source of supply for the industrialized countries. Between 1960 and 1973, Latin American imports climbed from $8 billion to $25 billion, a three-fold rise, about four-fifths of which came from industrialized countries. The relative importance of the Latin American market can be judged, for example, by taking a look at the geographical destination of United States exports, which in 1974 reached the level of almost $100 billion. In that year Latin American imports from the United States represented approximately 15 percent of that total, and those from ["U.S. exports to"—editor's correction] Asia—excluding Japan—reached a similar level, while all of the African continent accounted for only 3.6 percent. Furthermore, Latin America has become a major market for capital goods, consumer durables and chemical products. United States exports of these products to Latin America are three times larger than to Japan and almost as large as to the European Economic Community.

"Latin American countries have also become important suppliers of food, raw materials, and hydrocarbons, which are so vital to the continuing expansion of the world economy. Today, our countries are the principal world suppliers of fishmeal; they are among the top three exporters of beef, corn, soybeans, and sugar, and they are among the top five sources of the world's iron ore and petroleum. Its tillable area, water potential, and variety of climates, moreover, make Latin America one of the world's best equipped regions to produce food and natural fibers.

"Through its direct investments, moreover, the United States has an important economic stake in Latin America. Latest data on United States direct investment abroad indicate that nearly 14 percent of the total, or

about $15 billion, is in Latin America. This represents about 60 percent of the United States direct investments in the developing countries of the world . . ."

These figures are a useful reminder that we live in a world of financial interdependence. It cannot be a matter of indifference to the United States, for example, what happens to a market which is absorbing $17 billion a year of North American exports (in 1975), and it cannot be a matter of indifference to U.S. bankers what would happen to the U.S. exporters if their sales to LAC countries were reduced. The world's economy is organized on the basis of international division of labor and of international cooperation, not on the basis of autarky and isolation. Long ago, the international community of nations agreed that this approach would allow higher levels of output at lower costs, but it implies and imposes special responsibilities for the different parties involved. What is new in the process of financial interdependence is the very important role that the private sector is playing. Basically, outside the control of any government, it is providing the financing needed by LAC countries, and as a result the traditional creditor-debtor relationship is evolving more and more toward a relationship of partners in the development process. The high level of borrowing by LDCs has allowed them to maintain certain levels of imports and growth; but imports in LDCs are exports from industrial countries so that lending by private bankers to LDCs has also helped to reduce the impact of the recession on the economic activities of the rich countries.

Official development assistance is expected to rise, at least in nominal terms, in the immediate future (even though several of the major industrial countries will remain far from the aid targets proclaimed by the United Nations). Also, multilateral lending will hold the line. In the picture of the resources needed to finance the current account deficits of LAC countries, the only element that could change in a manner capable of unsettling financial developments in the Hemisphere is private lending, for which governments and international organizations have no effective control. This implies a serious responsibility for the private sector as well as posing a challenge to governments and international organizations. They should, in my view, stand ready to substitute for the private sector whenever the latter pulls back. The techniques for such a standby position are known; all that is required is the will, i.e., the political determination to defend and maintain financial stability in the world. The adoption of such a posture by international organizations and governments would probably constitute a strong incentive for the private sector not to make unsettling moves. It would increase confidence in the international monetary system. I am not suggesting that nothing of the sort is being done today; in fact, international organizations (particularly the IMF in the monetary field) and governments are active in the general area of

international balance of payments management. My comments are prompted by the impressive proportion of the total external financing of LAC countries taken by the private sector. The private sector has displayed great responsibility in its dealings with the debtor countries, and this will probably continue. It would, however, be reassuring to both creditors and debtors if governments and international organizations would make it unmistakably clear that they will not allow payments crisis to arise from the *sudden* withdrawal of an important creditor from the international financing of a particular country.

As has already been said, the efficiency with which the private sector has dealt with the "recycling" process has been remarkable. In 1974 the recycling took place from the oil surplus countries to both the industrial countries and the LDCs using as a main intermediary the private commercial banks of the industrial countries and, in general, the Eurocurrency market. However, in 1975 the industrial countries were able to show equilibrium in their payments balances on current account. Therefore, the surplus of the major oil exporters, in 1976 and possibly after 1976, will be represented in the deficits of the non-oil primary producing countries. This is happening at a time when the volumes of official development assistance are at a very low level, and when the prospects for a substantial increase in foreign aid do not look good. Thus, the role of the private sector will continue to be very important in the external financing of Latin America. Two warnings about this are necessary: first, not all the private commercial banks are happy with this state of affairs; several of them would like to reduce (or at least not increase) their exposure to LDCs. The prospect that LDC borrowings will continue for a long time is considered, by some bankers, to be incompatible with the flexibility they prefer. This concern of the private bankers is, in itself, an element of instability in the system which emanates from the very fact that it was the private sector–which mainly performed the recycling role. The private bankers' financing can no longer be considered residual; in several countries they will participate with 50 percent or more of total net external financing. This happened, partially, because the oil exporting countries took their surplus funds to the private banks in larger amounts than those they transferred to international organizations. The second warning has been often voiced: the private banks will be able to continue performing this role, at least in the present volumes, only as long as surplus countries maintain their deposits with them; and there is no assurance that these deposits will remain where they are. This is precisely why the international organizations should have some sort of "standby" position, ready to act whenever the private sector was faced with a reduction of its activities. However, some representatives of the private banking system feel that this fear has been overplayed. They say that deposits of OPEC countries are important in absolute terms but, the banking

system has reached such large volumes of operations, that these deposits are less important in relative terms than most people believe. Therefore, the private banks would not have an insurmountable problem in raising additional funds in the Eurocurrency market although it would probably cost more.

IV. THE DEBT PROBLEM

Like the rest of the world, the Latin American countries were unprepared for the payments problems that resulted mainly from the oil crisis. One obvious way out would have been to reduce the volume of imports and growth rates but this alternative was not chosen. Such an option is difficult to select in the short run due to technical and political reasons. On the technical side, there are investment projects which cannot always be easily slowed down or discontinued. As for political problems, without some time-consuming preparation, there are serious obstacles to reducing consumption and investment, particularly when they may imply sudden reduction in employment levels in countries which already suffer high levels of unemployment and underemployment. However, it must be added that it is not clear to what extent the increase in indebtedness financed higher prices of oil, food, and fertilizers and what proportion of those funds went to investment. At any rate, the alternative chosen was borrowing.

Even though the situation has been handled satisfactorily, the terms and conditions of the loans to the non-oil exporting countries have not been ideal in terms of their development needs. Most of the financing was made on an emergency basis to support the balance of payments. Consequently, there is a lot of room for improvement in restructuring the external debt of countries that are facing serious "bunching" problems which make their cash positions uncomfortable as several loans mature more or less simultaneously. This situation should be clearly distinguished from others in which there might be a deterioration of the creditworthiness of certain countries. Any nation, even the most creditworthy, can face liquidity or cash problems for short periods of time. One of the prime functions of an efficient financial system is to alleviate short-term cash flow pressures which may arise from time to time. In this context, special emphasis should be placed on the LAC countries because they have received most of the short-term private money which has gone to the LDCs during these crisis years.

A number of suggestions have been made to solve this problem and a long list of possible alternatives could be elaborated. However, this chapter will refer briefly to some possible approaches to the general question of external debt relief, particularly for the LAC countries.

1. Since the economic purpose of debt relief is to provide balance of payments assistance, one should recognize that there are several ways to

accomplish this objective. One obvious alternative is to maintain a sufficient flow of resources to the debtor countries both to cover debt service and to finance their investment programs. In the case of the least less developed countries (LLDCs) additional official development assistance of a highly concessionary character (grant element of over 80 percent) will probably be necessary. For most Latin American countries, the continued presence of private creditors, particularly private commercial banks would suffice. Those banks who wish to reduce their exposure in LDCs should be able to arrange, in an orderly manner, for resources from international organizations and governments (both of industrial countries and OPEC) to be substituted for the resources they seek to withdraw; initiatives by private banks in this field can be very influential because of the important relative position they occupy as creditors in the Western Hemisphere, specifically after 1973.

2. One could suggest that whenever a country reaches an abnormally high debt service/export ratio, and this is expected to continue for some time, creditors should consider that the particular country should be eligible for debt renegotiations or for a partial debt moratorium (e.g., partial postponement of payments for some years). This should be done as a practical move of international cooperation, particularly in cases where the increase in debt and in the debt service ratio is due to circumstances beyond the country's control, such as an increase in import prices and/or a drop in export prices. It would also be necessary to assume that the country is pursuing sound economic policies; this assumption is a frequent feature of debt renegotiations and is usually a prerequisite when the country agrees on a standby arrangement with the International Monetary Fund. It could be argued that this is a superfluous suggestion, because whenever the service of foreign debt is imposing an unbearable burden, debt renegotiation has to take place anyway or the debtor will default. The suggestion is made, however, for those nations that have not reached that extreme position. Some with high debt service ratios can still continue paying their external debt but they frequently do so at the price of reducing imports of capital goods (all nonessential consumer goods' imports having probably been eliminated already) and thus rates of growth for the future.

3. Several proposals were advanced at the UNCTAD-IV meeting (May 1976) in Nairobi. The two extreme positions were taken by the majority of the LDCs and by the majority of the rich countries. The former group favors some form of international agreement on criteria to be applied across the board to benefit all debtor nations facing serious balance of payments problems. The latter group would be willing to consider debt relief operations only on a case-by-case basis. (Between these two positions there are a number of alternatives, e.g., a debt relief operation which would benefit only a limited group of countries where the urgency of need is clearly established

and only for debt arising from official development assistance loans. Usually, the countries referred to have been the LLDCs—twenty-nine countries as defined by the United Nations.) At present, after UNCTAD IV creditors are reluctantly willing to deal with the balance of payments problems of debtor countries—which may require debt relief actions—only on a case-by-case basis. In the case of the Latin American countries, this reëmphasizes the future importance of the private creditors vis-à-vis the debtor countries.

4. It has been suggested that an international fund could be set up to refinance commercial debts of LDCs facing "bunching" problems due to the heavy short-term borrowing that they were forced to contract in order to finance balance of payments deficits which have emerged particularly since 1973. The refinancing could be made at commercial interest rates but with long-term maturities; this would allow the fund to borrow in the international capital markets to finance their operations. Equity contributions to the fund would come mainly from the creditor countries, probably in proportion to their creditors' position vis-à-vis the LDCs. However, the equity contribution could be minimal if the countries were prepared to give their guarantees to the bonds issued by the fund in the foreign and international markets.

5. Another alternative is to explore the possibility that banks could convert their loans to countries into a negotiable bond, presumably with some extension of the maturities. As time goes by, private banks might then place these bonds with other investors. This formula would accomplish three objectives: over a period of time, private bankers would be able to reduce their exposure in some countries, at least in relative terms; it would allow an extension of maturities for the short-term debts of countries; finally it would help to facilitate Latin American access to the capital (bond) market.

NOTES

1. The interested reader should consult particularly The Organization of American States *External Financing of Latin America,* and Inter-American Development Bank annual *Economic and Social Progress in Latin America.*

2. Terms of trade of the non-oil exporting LAC countries deteriorated by 10 percent in 1974 and again in 1975; exports of goods in current dollars increased by 32 and 4 percent respectively.

Chapter 12

MEXICO AND MULTINATIONAL CORPORATIONS: AN EXPLANATION OF STATE ACTION

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I

INTRODUCTION

The availability of foreign resources is generally viewed as an essential factor in the development equation. Our concern in this paper is with the multinational corporations, which, at least since the 1950s, have been the principal purveyors of foreign resources in Latin America. They are, however, increasingly seen as creating obstacles to development as well as providing part of a solution.[1]

As these problems have grown increasingly evident, the response of Latin American states has not been so much to exclude MNCs from participation in their economies as to experiment with a variety of forms of control aimed at obtaining the needed foreign resources while lessening the troublesome difficulties that accompany them.

Neither states nor MNCs are able to act just as they please, as if they were free-floating above society. They operate within constraints and social forces which permit some actions while making others too costly or unthinkable. We are interested here in examining why one of these states, Mexico, has acted as it has toward multinational corporations. Mexico has been chosen as a focus because of its long involvement with direct foreign investment.[2]

AUTHORS' NOTE: *The authors would like to express their appreciation to the Carnegie Endowment for International Peace, the Institute of International Studies at the University of South Carolina, the Social Science Research Council and the Tinker Foundation for assistance in the preparation of this article.*

In the five or six decades since the Revolution, the Mexican state has carried through a complex array of policy actions toward multinational corporations. In the 1920s, the state sought to limit direct foreign investment in banking, insurance, and land ownership. In the 1930s it nationalized the railroads and expropriated foreign-owned oil-holdings. In the last days of World War II, the state formally initiated a policy requiring that new foreign investment be associated in a minority position with majority Mexican equity, but this Mexicanization policy was pursued in a modest and scatter-shot fashion until the 1960s, when the administration began to apply it vigorously in certain sectors, particularly mining and petrochemicals. In 1958, foreign investors were compelled to divest their holdings in telecommunications, and a year later the state nationalized the foreign-owned electric power and light companies. In 1962, a scheme of requirements was imposed on the auto multinationals, which compelled steadily increasing utilization of domestically produced components. In 1973, a policy was implemented concerning the transfer of technology from foreign sources. Different sectors have been singled out at different times, and a variety of policies have been used.[3]

In Part II we will sketch the outlines of a general approach to explain why the state does what it does, by discussing some key particularities of the Mexican context. In Part III we employ this framework to explain the actions of the Mexican state toward MNCs in a number of important sectors—mining, electric light and power, and manufacturing. Finally in Part IV we suggest how our approach helps us to understand three aspects of Mexican state policy toward MNC's: (1) the *sector* chosen, (2) the *timing* of the action and (3) the *kind* of policy employed.

II

In explaining the actions of the Mexican government toward multinational corporations account must be taken of certain historical considerations which have contributed to shaping the configuration and orientation of the Mexican state toward direct foreign investment. First, there is Mexico's revolutionary ideology, which has tended to set limits to the legitimate options for state action, but which also set an agenda for the control of MNC's. Then there is the growth strategy that Mexico has been pursuing as a late, dependent developer. It is largely in the pursuit of this growth strategy that the Mexican state has taken on certain tasks that have had consequences on the policy toward MNCs. Third, the social foundations of the state require consideration. These have changed over time, largely because of the particular growth strategy adopted, and to some extent these changes have affected the policy toward MNCs.

Before briefly discussing these factors, mention must be made of the turnover of personnel in the regime change that the Mexican government goes through every six years. Since the Revolution, even though the reins of government have been held continuously by the Partido Revolucionario Institucional (PRI), presidents serve one six-year term only. This sexennial change provides considerable lattitude for each President and his coterie of ministers to place their own mark on government policy. It is not uncommon for a new president to effect a wholesale reorganization of government ministries as Lopez Portillo now (1977) seems to be doing.

This thoroughgoing turnover in high officials in government agencies does, in some measure, undercut the possibility of continuity in policy. (A measure of continuity is maintained in some ministries, including those charged with responsibility for the growth strategy, by a high degree of recruitment for key positions in these ministries from within government agencies.) In the arena of foreign investment policy in the last 40 years, the landmark decisions have come during the administrations of Lazaro Cardenas, Adolfo Lopex Mateos, and Luis Echeverria.

REVOLUTIONARY IDEOLOGY

Mexico's revolutionary ideology promises land distribution to the peasants, decent working conditions for labor, and correlative assurances of social justice to other groups.

The domination of foreign interests during the Porfiriato generated a considerable nationalist reaction, particularly because that was seen as stemming from *entreguismo*, giving away what was rightfully Mexican. The revolutionary ideology and the Constitution of 1917 (its principal textual embodiment) contain a renewed emphasis on subsoil rights as constituting an important part of Mexico's national patrimony.[4] If the revolutionary ideology did not flatly exclude foreign interest from participation in the economy, it did insist that they could "no longer continue aspiring to occupy the privileged positions that they had in the past, and that they would have to respect the established laws and regulations and accept the economic and social objectives of the state." (Wionczek, 1967: 187.)

Some observers contend that the Revolution has ended and that its ideology has been abandoned.[5] The close of the Cardenas era is often cited as the date of this final demise. It is probably more helpful to note two points about the ideology of the Mexican Revolution. First, its openness on certain fundamental questions: the ideology (to take the most important example) has been sympathetic neither to private enterprise nor to socialism, and thus has left open the possibility of identifying "Mexican" with both public and private. Second, any ideology, especially one as open as this one, is susceptible to a certain amount of reshaping and redirecting to fit new situations.

The revolutionary ideology does continue to carry force, and not just as a sanction for government actions (though that is a consideration of paramount importance). If the ideology does not specify particular courses of action, it does forbid certain actions (for example foreign ownership of land or of mineral resources), and it does continue to embody certain commitments—even if long postponed—to equity and social justice.

THE GROWTH STRATEGY

The context of the world capitalist system is, for all intents and purposes, a given for Mexico. Nevertheless, it is notable that, with a few deviations, [6] Mexico has chosen to stay comfortably within the bounds of orthodox economic behavior. Primary reliance for development has been lodged in the hands of a private sector; even before the beginnings of industrialization, this could be seen in the shape of the banking system and in the acceptance of private ownership of land. Moreover, since the Second World War, Mexico has met the requirements of such international institutions as the International Monetary Fund, the World Bank, and the Inter-American Development Bank.

The growth strategy that Mexico has been pursuing was not chosen all at once: it involves a banking system whose general outlines were laid down in the 1920s and 1930s, and a distinctive approach to fiscal and monetary policy which became clear in the 1950s. It is, however, the adoption of an import substituting route to industrialization that gave basic shape to the strategy.

Prior to the world depression of the 1930s, Mexico depended substantially upon imports of manufactured goods, paying for these with primary product exports. First, the depression and then, the world war, cut off the flow of these manufactured imports. Mexico had to initiate domestic production to meet current internal demand, and this created the possibility of an export market. Thus, Mexico slipped into import substitution without choosing to do so, and without creating any of the policy apparatus necessary to sustain such a strategy. The protectionist apparatus of licenses and tariffs was established, in the years following the war, when a flood of imports began to flow once again into Mexico, and a balance of payments surplus turned suddenly into a deficit.

Much of the new investment in manufacturing was from MNCs, as these companies responded to the protectionist devices by initiating domestic production, and direct foreign investment in manufacturing came to far outstrip foreign investment in all other sectors (Newfarmer and Mueller, 1975: 49).

While vital, the protection afforded to domestic industry was hardly a sufficient condition of growth. The financial system, the fiscal and monetary

policies of the state, and substantial public investments in infrastructure and basic industries have played major parts as well.

Responsibility for pursuit of this growth strategy has been in the hands of a complex of agencies which share a roughly common outlook: the Ministry of the Treasury, the Ministry of National Economy, and the major public sector banks, especially the Bank of Mexico and Nacional Financiera. Throughout the 1950s the prestigious Ministry of the Treasury was the most important of the agencies in this complex, its outlook tending to dominate.

During the Lopez Mateos administration, the Ministry of National Economy was renamed the Ministry of Industry and Commerce and took on new importance. At the same time two new ministries were created: the Ministry of the Presidency to handle planning and coordination functions, and the Ministry of National Patrimony to take responsibility for natural resources and state-owned corporations. These changes demonstrated a difference of perspective between Treasury and Industry and Commerce.

> Following a long tradition and reflecting a good measure of political wisdom, in modern Mexico the treasury authority has nearly always been in the hands of persons well versed in financial relations and international economics at an intergovernmental level as well as at the level of the firm. For its part the Ministry of National Economy, whose policies are more directly related to questions of internal economic development, and especially to the process of industrialization, with few exceptions has been in the hands of persons who serve as a bridge between the state and domestic private interest groups which, by definition, represent a more nationalistic pressure group. (Wionczek, 1967: 233.)

How has this growth strategy affected Mexican policy toward direct foreign investment? At first very little, since responsibility for such policy lay in the hands of the Ministry of Foreign Relations. Beginning sometime in the 1950s, however, and becoming increasingly formalized during the 1960s, that Ministry began sharing responsibility with the Ministry of Industry and Commerce: foreign firms would submit proposals for new projects to the Ministry of Industry and Commerce for approval (Wright, 1971, 158).[7] Such approval was sought because Industry and Commerce controlled import permits; the firms would want assurances of the necessary permits before making a new investment. As that review process became more institutionalized, project proposals were increasingly evaluated in light of their conformity to and promotion of the growth strategy.

Out of this sophisticated growth strategy, three basic concerns or orientations can be identified as having consequences for policy toward direct foreign investment:

(1) Independent, self-sufficient growth. The depression and World War II pushed Mexico firmly onto the path of economic self-sufficiency. The resolve

was formed to move Mexico away from dependency on other countries for imports of manufactured goods. Import substitution was adopted as the route to such independent self-sufficiency. A parallel pattern can be seen in agriculture where Mexico can be seen to be pursuing a policy aimed at producing all of its basic foodstuffs. Hence, a central concern of the growth strategy has been to provide for "balanced" development, having the full complement of economic activities. Where MNC's have been slow to integrate locally-produced parts into their products, or where they have been slow to develop a resource or input vital to the growth of another industry in the full complement, the state has tended to step in with some kind of control.

(2) The balance of payments. The pursuit of independent, self-sufficient growth has not lessened Mexico's dependence on trade. Active import substitution has not insured a favorable balance of payments; but import substitution has shaped the forms of the problem and its possible solutions, and the policy of *desarrollo estabilizadora* has insured that balance of payments concerns would be of paramount importance in the making of policy. To the extent that multinational corporations cause problems for the balance of payments by their imports or by their lack of exports they are more likely to become subject to regulatory strategies.

(3) The financial limitations of the state. On the one hand, the Mexican state has had to sustain a high level of public sector investments for the development of infrastructure (irrigation, roads, electric power) and of basic industries (steel, petroleum, etc.) on top of other financial obligations for welfare, debt service, etc. On the other hand, the state has had to finance these investments without crippling private sector investment (on which primary reliance for industrial growth has been placed) and without resorting to inflationary deficit financing. Hence, taxes on business profits have been kept low, and the bank reserve requirements have been a principal source of funds for public investment. Nevertheless, there is a constant need to generate new sources of state revenue without compromising the basic strategy for growth without inflation. Foreign loans have provided only a partial answer to this problem. Certainly, these financial limitations of the state have left it strapped for resources to pay compensation for any foreign firms that it might consider nationalizing. Insofar as MNCs have been perceived by government officials as causing difficulties with regard to these three concerns, they have become subject to policy initiatives.

THE SOCIAL FOUNDATIONS OF THE STATE

Despite the increasing importance of the national bourgeoisie as a social foundation, this class has not yet constructed the kinds of channels through which it could regularly and systematically shape state policy. The principal formal linkages through which such pressure could be exerted are the Cham-

bers of Industry and Commerce (CONCAMIN and CONCANACO) to which all business establishments must belong.[8] The available evidence, however, shows that these organizations rarely initiate policy suggestions, and that the government has been reasonably successful in coopting the leadership of these organizations.[9] Moreover, informal linkages should not be given too much weight as a way of exerting group pressure in the face of the evidence Peter Smith (1977) has amassed showing that in Mexico, the political and economic elites come from different family and class backgrounds, go to different schools, travel separate career paths, and regard one another with suspicion. Group pressure explanations are inherently difficult to disprove. However this evidence, while hardly conclusive, does cast a measure of doubt on the efficacy of group pressure explanations in accounting for the broad pattern of state action. In most cases, a sufficient explanation can be adduced for Mexican state policy towards MNCs without relying on group pressure.

III

MINING

The Mexican Revolution brought with it a fundamental change in the state's position on control of the nation's natural resources, particularly petroleum and mining. The pre-Revolutionary regime of Porfirio Diaz had operated under the Mining Code of 1884, an openly laissez-faire policy, which had eliminated any reference to the previous tradition (originating in Spanish colonial legislation) of the state's eminent domain over subsoil rights. The Diaz regime had granted foreign petroleum and mining companies concessions practically in perpetuity. Furthermore, the fiscal policy of the Diaz regime was quite liberal, maintaining extremely low taxes on mining. As a result of such policies, major mining and petroleum firms rapidly established large operations in Mexico during the Porfiriato. Close links between the *tecnicos* (the then *cientificos*) of the Diaz regime and the multinational corporations enriched these government officials, promoted an unusually good "investment climate" for the foreign companies, and contributed to the growing hostility toward such foreign control which became a major strand of the post-Revolutionary ideology.

The new orientation toward foreign control over natural resources was embodied in Article 27 of the 1917 Constitution; it made the 1884 Mining Code unconstitutional and established direct dominion by the nation over all natural resources. The 1926 Mining Law, passed during the Calles regime, and the somewhat more liberalized legislation passed in 1930 further strengthened state control over natural resources.[10]

The first major successful action taken against foreign companies in natural resource industries was the expropriation of the petroleum industry in 1938. Although a detailed analysis of this state action is beyond the scope

of this article, certain points, which set the context for later state actions, must be mentioned. In the years following the Revolution, a succession of presidents had tried to renegotiate the concessions that had been granted to foreign oil concerns, but without much success. The immediate catalyst for the takeover, however, was a labor dispute. In 1936, with the strong backing of the Cardenas regime, a host of small petroleum related unions were consolidated into a single large one, the Petroleum Workers Union of the Mexican Republic. The organization of this union must be understood not simply in terms of a desire to exert stronger, more unified pressure on the oil companies, but as part of a thrust by Cardenas to strengthen and consolidate organized labor. He considered it an important social foundation of the national party and his regime. Although a number of Cardenas' labor policies led to the eventual incorporation of organized labor by the PRI and the effective control of labor by subsequent regimes, Cardenas' dependence on labor support became a crucial element in the ensuing oil crises. When the Petroleum Workers Union went on strike in May 1937 there was no question of Cardenas interfering on the side of the foreign interests (as later regimes were more apt to do). When the oil companies refused to yield to strike demands, the matter was submitted to an arbitration board which awarded a substantial wage boost. Again the companies refused to comply. The matter was finally submitted to the Supreme Court, which affirmed the award. The companies' refusal to abide by this decision was interpreted as an open threat to national sovereignty, and President Cardenas moved in troops and expropriated the petroleum companies. The integrity of the state as the ultimate arbiter of secular conflicts had been called into question, and Cardenas acted to reaffirm that.[11]

The resultant international reaction was severe: there was a retaliatory international boycott, trained technicians and movable capital were withdrawn, and economic assistance from the United States became scarce. That the U.S. government did not intervene more directly was due to the growing Nazi threat in Europe and Roosevelt's fears of driving Mexico out of the allied camp. As it was, however, Mexico eventually negotiated a settlement (under the Avila Camacho regime in the early 1940s) as a necessary condition for receiving needed U.S. government loans and assistance.

The general post-Revolutionary concerns with foreign control of natural resources and the reaction to the oil expropriation in 1938 set the context for the strong actions later taken against foreign mining companies by the Lopez Mateos regime. Many minor actions affecting mining were taken before 1958, but the regulations were somewhat chaotic and arbitrary: by the 1950s the Mining Law of 1930 and its attendant regulations had been modified, amplified, or changed not less than twelve times; the fiscal legislation regarding mining had been subject to important but uncoordinated changes approximately twenty times; and more than 70 laws, decrees, regulations and

circulares existed regarding mining.[12] The major economic intentions of the state toward mining were fairly clear: mining was an important and easily administered source of tax revenues, and money was much needed not only to support increasing administrative costs of the expanding state but to finance the public infrastructure investment that was a crucial part of the industrialization program. Further, there was a growing concern to conserve depletable natural resources that would be needed for Mexico's own industrial development. The effects of official policy, however, created serious problems in the mining sector. Most seriously, mining was considered unattractive economically, and investment was rapidly falling off. A joint commission organized by the Mexican government and the World Bank blamed official policy for the paralysis that little by little was invading the Mexican mining industry.[13]

These problems became acute concerns for the nationalist development oriented *tecnicos* of the Lopez Mateos regime. The growing needs for tax revenues were threatened by the slowdown in the mining sector caused by declining investment. Moreover, a worsening balance of payments made it essential to expand mining exports.[14] The Lopez Mateos regime took action. It created the Ministry of National Patrimony to be in charge of mining policy and natural resources; it placed crucial industrial raw materials (natural gas, sulfur, and iron) under strict state control; it passed, in February 1961, legislation requiring Mexicanization of the mining industry and the Ministry of the Treasury offered a 50 percent reduction on mineral production and export taxes for all companies that accepted 51 percent Mexican capital.[15]

The mining legislation of 1961 made certain mineral deposits part of national mining reserves and assigned others to state enterprises. Any new concessions were to be granted to multinational corporations only if at least 66 percent of the ownership of their subsidiary was in Mexican hands. The legislation limited the length of concession agreements to 25 years and placed maximum limits on the size of concessions. It demanded full financial disclosure by the corporations and in certain cases (such as sulfur) it set export limitations and production quotas. This legislation was clearly aimed at consolidating and rationalizing existing mining regulations and at reestablishing traditional state control of subsoil rights. It did not, however, deal with the central mining problem of low investment and declining growth. Treasury addressed this difficulty by offering an unusually strong incentive, a tax reduction. The production export taxes that had been placed on a number of mining companies were so high that profits had been substantially reduced, and investment incentives were far lower than in many other countries. Lowering these taxes for Mexicanized corporations offered a rate of profit that would make new investment attractive to both foreign companies and their Mexican partners.[16] Indeed, interviews with company officials re-

vealed that to be the case. They calculated that the tax breaks they were eligible to receive if they accepted a minority position with Mexican shareholders would give them far higher returns than they would get with full ownership and no tax reductions. But an important question remains: why did the state choose to force changes in ownership (Mexicanization) rather than simply encouraging investment?

A look at the effects of Mexicanization—the enormous economic benefits gained by major Mexican banking and industrial groups—might make group pressure seem a good explanation of the Mexicanization policy.[17] It could be argued that the government was directly influenced by the groups who stood to benefit from legislation forcing foreign mining companies to sell their equity (often at a bargain price). However, there is no evidence (one way or the other) that the state acted at the behest of these groups, even though they are undoubtedly crucial elements of the social foundation of the state. An alternative, and quite plausible explanation, is that the political consequences of simply reducing the taxes on the foreign corporations would have been too great. As one careful student of the mining legislation commented: "An open reduction of the taxes would have been considered as an undeserved concession to the powerful foreign enterprises, contrary to the spirit of the 1917 Constitution and to the nationalist sentiments of the society." (Wionczek, 1967: 23)

Of course, the problem of ownership structure could have been solved in other ways—for example expropriation or nationalization through purchasing all or part of the foreign mining companies. Expropriation, however, was clearly ruled out by the Mexican position within the world capitalist system. The previous experience with the expropriation of the petroleum companies had shown the magnitude of the international repercussions wrought by such actions. Moreover, by 1961, Mexico's industrialization strategy depended too heavily on obtaining international loans (both public and private) and attracting direct foreign investment to allow an expropriation strategy.

Nationalization through purchase might have been possible, but the cost would have been exceedingly high, given the particular balance of bargaining power between the state and the MNCs. The mining companies were not anxious to sell out their Mexican interests and could have made it very difficult for Mexico to borrow the purchase funds from international sources. The resulting conflict would have created a bad international image for Mexico and threatened its important ties with the world capitalist system.[18] Raising the enormous funds internally would have been severely restricted by certain important elements comprising the social foundations of the state. The major mechanism for raising the funds internally would have been through public debt that the private banking system would have been forced to buy. This claim on private banking resources would have been

resisted by financial capital, and they might have been supported by the Treasury. Furthermore, industrial groups would have opposed the move, since it would have made the credit they needed expensive and scarce. Given the close ties between the industrialists and banks in the major economic groups, this resistance would have posed a serious obstacle.

Given these difficulties, the policy chosen makes sense. Using the leverage of fiscal incentives and insisting on the acceptance of Mexican partners, who themselves would have an interest in encouraging new investment and growth, encouraged expansion of the mining sector. Nationalization on the other hand, would have been costly and accomplished little. The state, with great sacrifice, would have owned the nation's mining operations, but it would have killed the goose that could have provided the golden investment funds. Further, the state did not have the experience or skills necessary to run the mining operations. It was far better off following a strategy of squeezing the goose with regulations and enticing it with incentives.

ELECTRIC POWER

Since its origins at the turn of the century, the electric industry in Mexico was largely in the hands of foreign corporations. Although some minor conflicts over rates had developed between the power companies and small industrial and municipal users during the Diaz regime, the only control exercised by the government was over national hydraulic resources, and these concessions were granted liberally. Foreign companies benefited from the general laissez-faire policy of the regime and from their personal relations with government officials.[19] The situation, however, began to change after the Revolution. Slowly growing conflicts between the electric companies, power users, and government *tecnicos* led (after a number of minor skirmishes and regulatory attempts) first to the establishment of the Comision Federal de Electricidad (CFE) in 1937, strong regulatory legislation in 1938, and eventually to nationalization of the industry in 1960.

The initiatives for state actions taken in the late 1930s by the Cardenas regime had their origins in two sources: state *tecnicos* and certain industrial and consumer groups. The *tecnicos* (whose first institutional home was the Comisión Nacional de Fuerza Motriz–CNFM–created in 1922) were well versed in the regulatory actions being taken in more developed countries. They grew increasingly critical of the lack of state regulatory action in the face of the problems that they perceived the electric companies were creating: differential rates (15 to 25 times higher for small users), erratic supply, dangerous working conditions in the transmission plants, defective apparatus installed at consumer expense, etc. The *tecnicos* had urged state action, but the National Electric Code of 1926 and the regulatory legislation of 1928 proved ineffective in the face of power company intransigence. By

the early 1930s, many of the *tecnicos* had decided that legal incentives and persuasion were not enough and that the development needs of the country for cheap, efficient electricity made it necessary to exclude foreign power companies from further access to hydraulic resources (where once established they might be neither controlled nor removed). They wanted to reserve these resources for Mexican (state or private) development. [20]

The power users (small industrialists, led by the textile industry; merchants, and later residential consumers) also grew increasingly hostile toward the power companies. Throughout the 1920s, their complaints about the high rates grew stronger and so did their economic position and political influence. The conflict boiled over when the Great Depression came; the electric companies refused to lower their rates causing even more animosity among groups in the private sector. Consumer leagues and "defense brigades" were organized. In 1932, the *tecnicos* joined forces with the industrial, commercial, and domestic consumers to form the National Confederation for the Defense of Public Services. The general position of these forces was also supported by certain important sectors of labor, including the powerful electrical workers unions. The fact that the electric industry was a foreign oligopoly, exercising foreign control against Mexican national interests, enabled its antagonists to draw on the Revolutionary tradition and give the conflict a nationalist, anti-foreign tone.

In 1932 the Ministry of Industry and Commerce of the Abelardo Rodriguez regime forced the companies to lower their rates (although the biggest, Mexican Light and Power, succeeded in blocking such action for 18 months). In January 1934, the federal government took over jurisdiction of the electric industry and made possible the establishment of the Comision Federal de Electricidad (CFE). The CFE was actually established by Cardenas in 1937, a time of intense government intervention in land reform and growing conflict with the foreign petroleum companies. The CFE, staffed with *tecnicos* who had long fought against the foreign power companies, undertook the task of developing the electric power industry in Mexico. [21] In 1938, after two years of debate, the Law of the Electric Industry was passed. It gave the state strong powers to regulate concessions and, above all, rates.

The choice of state policies—strong behavioral controls and provision for state ownership and development of new facilities—makes sense, given the difficulties posed by the industry, the orientation of the *tecnicos*, the private sector and labor pressure for such action, and the knowledge of such policies in other, more developed countries. It might be asked, however, why the government did not go the full route and nationalize the existing industries. There was certainly great pressure for such moves (the coalition of *tecnicos* and the private sector had publicly urged such moves since 1933), and the Cardenas government had been willing to nationalize the National Railroads of Mexico (1937) and expropriate the petroleum companies (1938). The

Cardenas regime probably resisted such action for three reasons. Most importantly, nationalization was not a goal in and of itself for the Cardenas regime. Rather, nationalization was used as an instrument of last resort to break development bottlenecks (railroads) or to force submission to national laws and regulations (petroleum). The foreign electric companies had not yet proved to be a bottleneck to development nor had regulation proved impossible. Moreover, the state *tecnicos* lacked the requisite knowledge to operate such companies. Finally, the 1938 electrical industry legislation was probably tempered by the strong international repercussions to the recent expropriations of the petroleum companies.

In 1960, the two remaining foreign power companies (American and Foreign Power, and Mexican Light and Power) were nationalized. The circumstances, however, had changed considerably. In 1945 the two big foreign companies controlled 60 percent of the total installed capacity, CFE had 5 percent and the rest of the industry 35 percent, whereas by 1960, CFE controlled 40 percent, the two foreign companies 33 percent, and the small local and industrial plants 27 percent. The industry had been facing a bottleneck problem: following World War II, Mexico had had difficulty meeting the demands for electricity created by rapid industrialization and urbanization. The structure of the industry in the context of the fiscal limitations of the state and the strictures placed by international sources of finance had made necessary expansion difficult.

The CFE position had become primarily one of a supplier (rather than a distributor) of power in those (quite major) areas where the foreign power companies controlled distribution.[22] To keep private power company rates low without unreasonably squeezing the earnings of these companies, the CFE sold them power at extremely low rates, effectively subsidizing the private corporations. This situation made it impossible for CFE to generate sufficient cash flow for needed investments. It could (and did) turn to federal funds, but these became increasingly scarce due to other claims on public revenues and the austerity forced on the Ruiz Cortines regime by its anti-inflationary policy. Credit from the International Bank for Reconstruction and Development was of central importance. By the end of the 1950s, however, such international agencies became increasingly reluctant to finance either the CFE or the private companies until the rate structure had been completely revised and the capital structure of the industry improved.

The question of rate structure was crucial to the private companies. Despite the state subsidies,[23] they hesitated to make needed new investments as long as the state insisted on maintaining what the companies saw as low rates. One economically feasible measure (proposed by some government officials) was an upward revision of the rates—which would encourage the continuance of international credit and increase the incentive for the private companies to invest. Such state action, however, faced serious political

obstacles: permission to increase rates would appear to sanction the enrichment of foreign interests to the detriment of national interests. Furthermore, such a move would have faced strong, organized opposition from the Cámara Nacional de la Industria de Transformación (CNIT). This nationalist business organization, which had considerable political influence, had long been campaigning for cheap electricity to enhance the national industrialization program and was particularly critical of the foreign control of these companies.[24]

The nationalization of both American and Foreign Power and Mexican Light and Power in the 1960s broke the impasse that had been reached. It made it possible to restructure the industry and change the rates and, as a result, foreign loans became more readily available. Exactly what caused the nationalization is unclear. There is some evidence that instead of the state forcing the issue, the first initiatives came from American and Foreign Power.[25] In any case, far from resisting nationalization, both companies worked out the arrangements amicably, with the state financed, in part, by loans from Prudential Insurance Company of America and, in part, by long term government obligations. An important question here is why the state moved to change the ownership structure of the industry through public and not private purchase. Important to consider here are such factors as the possible difficulties of finding Mexican buyers and the fact that the company initiative was made to the state. Perhaps most important is the historical trajectory of the state with regard to the electric industry. Public control of the electrical industry had become an accepted fact of Mexican economic life after the organization of the CFE in 1937. Furthermore, this powerful government institution had an interest in taking control of the entire electric industry (although the Ministries of Industry and Commerce and of the Treasury initially ran the two foreign companies after their nationalization). Finally, there was little or no resistance to such state control from the national business community, which seemed to be more interested in having energy resources readily and cheaply available than in viewing electric power production as a desirable investment opportunity.

MANUFACTURING

Import substitution policy vaulted manufacturing into the most dynamic sector of the Mexican economy following World War II. The policy also attracted foreign investment; firms that had been importing goods into Mexico developed domestic production facilities to serve the Mexican market once the import barriers were erected.[26] A decade or so of the ensuing cascade of foreign investment began to cause concern among state *tecnicos*, particularly those in the Lopez Mateos (1958-1964) and Echeverria (1970-1976) regimes.

Multinational presence in manufacturing had not been a problem in the years immediately following the Revolution because it was almost nonexistent. The Revolutionary ideology had focused attention on those (often highly visible) areas where MNC presence during the Porfiriato seemed to threaten the national patrimony: mining, petroleum, railroads, power and light, land. As the growth of the MNC presence in manufacturing began to create problems, this Revolutionary tradition was available to be reshaped in justifying actions taken against such MNCs "in defense of Mexico."

The MNCs in manufacturing were perceived to affect the balance of payments and to be detrimental to the goal of self-sufficient growth. The import substitution strategy put a new kind of strain on the balance of payments. Machinery, raw materials, and intermediate goods needed to be imported in order to manufacture finished products in Mexico. MNC subsidiaries seemed to raise special problems in this regard. They seemed less willing to look for domestic (Mexican) sources for their purchases of inputs, often buying these goods from their parent companies or from established international sources. In addition to the use of scarce foreign exchange, this practice also slowed the development of intermediate goods industries. Furthermore, profit remissions, royalty payments, and technology fees by MNC subsidiaries were a drain on foreign exchange. The failure of many of the MNCs to promote manufactured exports could be explained in part by restrictions placed on the subsidiary by the parent firm in order to further its global business strategy.

The influx of multinational corporations in manufacturing not only spelled difficulties for certain concerns of the state with respect to the growth strategy, but also came to be perceived as a direct threat to certain elements of the national bourgeoisie. The heightened competition from MNCs in sectors which had been dominated by Mexican industrialists induced a change of view in the major business organizations (CONCAMIN and CONCANACO) in manufacturing in the late 1940s and early 1950s (working as they did out of a decidedly laissez-faire attitude).[27] They came to support the Mexicanization policy, the requirement that foreign capital be associated in a minority position with majority Mexican private capital. There is no evidence that private sector organizations "pressured" the state into adopting Mexicanization policy. However, the importance of the financial-industrial elite in the social foundations of the state meant that the support of business organizations was at a minimum, important in permitting the pursuit of Mexicanization.

Mining was among the first sectors to undergo substantial Mexicanization. However, Mexicanization had been the nominal policy toward foreign investment in manufacturing since 1944, when a wartime emergency decree was promulgated with the purpose of "controlling the disruptive effect that temporary investments of flight capital might have on the Mexican eco-

nomy." (Wright, 1971: 73.) The requirement remained in force after the war, but administrative regulations limited its application to a few, oddly assorted and relatively insignificant industries. [28]

Significant state actions toward MNCs in manufacturing were undertaken mainly during the presidencies of Adolfo Lopez Mateos and Luis Echeverria. The nationalist orientations of these regimes and the concern felt by their *tecnicos* about national development gave a certain urgency to problems arising from the balance of payments and from the pursuit of self-sufficient growth. Under the Lopez Mateos regime, the reorganization and strengthening of the Ministry of the Economy permitted more coordination in the conduct of policy related to industrialization. A variety of kinds of policies were adopted toward direct foreign investment in different sectors, principally in mining, petrochemicals, automobiles, and manufacturing. The Diaz Ordaz administration continued these policies, but the Echeverria administration significantly strengthened them and added new initiatives, primarily a new foreign investment law that brought together the diverse strands of Mexicanization policy. Any discussion of policy toward foreign investment in manufacturing since 1958, must consider the use of Mexicanization and the increasing use of certain kinds of behavioral controls.

(1) Mexicanization. Pressure to Mexicanize in the post-1958 period has been strongest in sectors such as fabricated metals, electrical and non-electrical machinery automotive parts, chemicals and petrochemicals, i.e., in those sectors where the presence of MNCs has been perceived as creating problems for (or opportunities with regard to) the balance of payments or self-sufficient growth. [29] That some action was considered necessary does not explain why Mexicanization was the major strategy chosen. Why were not behavioral controls employed, or other strategies for altering ownership (expropriation of nationalization)?

Nationalization or expropriation can be ruled out for the same reasons that they were inappropriate for the mining industry. State purchase of these industries was not strictly impossible, but the cost of nationalizing the major manufacturing industries was seen as prohibitively high. In manufacturing, the problem is greater than the availability of sufficient money to buy out the MNCs. The state could not simply displace the MNCs as owners because the country needs the technology, marketing channels, and administrative competencies of the MNCs for its industrialization program.

Why the state employed Mexicanization rather than behavioral controls as a regulatory strategy is more difficult to explain, however. We can adduce a number of factors that may have influenced the choice. One element was the ideological and constitutional availability of Mexicanization. The nominal policy toward foreign investment in manufacturing since 1944, even if little used, was a known and legitimate policy when Lopez Mateos came to power.

A second factor, surely, was that the Mexican business community supported this kind of policy and opposed certain kinds of behavioral controls, which it considered unwarranted government intervention in the proper functioning of the economy.

Finally, it should be noted that the Mexican government in the 1950s and early 1960s lacked the knowledge and experience to design and operate behavioral controls aimed at tackling problems caused by the transnational character of these firms. It had experience with certain instruments of industrialization policy–import licenses and price controls, for example–but the various mechanisms by which MNCs removed funds from Mexico were still not fully understood, let alone seen as susceptible to control. Finding the appropriate technology was not yet perceived as a problem, and mechanisms for encouraging or compelling MNCs to import less (using more domestically supplied inputs) and export more were only just receiving their first, tentative consideration in the automobile sector (see below).

Mexicanization, by contrast, was an available and well-tried policy. Its use required only a certain flexibility to ensure that needed foreign investment was not scared off. Where MNCs had not yet entered Mexico, Mexicanization was often, though not always, stipulated as a condition of doing so. Where MNCs were already established, Mexicanization was often required as a condition for authorizing expansion or diversification. Moreover, Mexicanization could be induced informally by making available certain incentives or by withholding import licenses. In those cases where MNCs were considered to need encouragement to invest, the state had the option of not pressing for Mexicanization, or at least not immediately. These aspects of Mexicanization policy became increasingly clear through the 1960s, the government using its available carrots and sticks to compel Mexicanization on a case-by-case basis until it had affected a wide variety of manufacturing industries. Finally, in 1973, under the Echeverria administration, many existing practices and understandings were codified into the Law to Promote Mexican Investment and Regulate Foreign Investment.

Mexicanization was employed in manufacturing partly because of inadequate understanding of an inexperience with behavioral controls. Gradually, state officials learned about their possibilities, from observing the successes of other countries in using them as well as from their own fledgling attempts. In the latter half of the Echeverria administration (1970-1976), an important change occurred in the *application* of Mexicanization policy that tended to shift it away from being a policy aimed at altering ownership to a policy aimed at altering behavior. A number of the *tecnicos* brought in under Echeverria (*tecnicos* who had more training in economics than the lawyers who had previously administered Mexicanization policy) came to question the consequences of pursuing Mexicanization as a policy for controlling MNCs. Simply requiring foreign firms to share ownership with majority

Mexican equity did not seem to be accomplishing the desired goals of industrialization—export promotion, employment generation, transfer of appropriate technology, location of plants in less-developed regions, etc. Increasingly, in administering the policy, these *tecnicos* have come to bargain away the requirement of Mexicanization in return for agreements to modify behavior (or proposed behavior) in line with these industrialization goals. [30] One other area in which behavioral controls took on greater importance during Echeverria's presidency warrants mention: the transfer of technology.

In the late 1960s and early 1970s, Mexico (along with a number of other Latin American countries) became increasingly aware of the problems posed by MNC control of technology. Foreign technology was often not adequate to the local conditions in Mexico, and contracts between parent and subsidiary often stipulated payments for the use of trademarks, patents, and technical assistance in such ways as to increase the outflow of funds from Mexico far beyond repatriated dividends. [31] As the *tecnicos* in the Ministry of Industry and Commerce learned more about such problems, they urged the passing of the Law on Transfer of Technology and the creation of the National Registry of the Transfer of Technology (1973). All companies are required to register their old foreign technology contracts with the Registry (thus creating an important bank of information) and all new foreign technology contracts must be approved before they can be registered. In the bargaining that regularly precedes such approval, *tecnicos* in the Ministry of Industry and Commerce can seek to obtain terms more in accord with the growth strategy.

(2) Automobiles. Through the 1950s, the automobile industry created increasingly severe problems for the balance of payments and for the pursuit of self-sufficient growth. The particular patterning of these problems made them more serious than in other sectors and led to the use of a different kind of policy.

As early as the late 1920s, the auto multinationals were assembling cars in Mexico for the Mexican market, but by the late 1950s, the imports of parts for these assembly operations constituted the largest single share of Mexico's total import bill—10 to 20 percent of the value of total imports between 1955 and 1959 (Secretaria de Industria y Comercio, 1959: Table 19). On top of this serious balance of payments problem (which was expected to get worse as automobile sales began to increase rapidly in the late 1950s), the assembly industry (controlled by 12 multinational auto firms) was contributing barely a fraction of its potential for stimulating the development of a local supplier industry. From the perspective of the firms, it made more sense for the Mexican subsidiaries to obtain component parts from their parent firms rather than to look for domestic sources of supply.

The *tecnicos* in the Lopez Mateos regime perceived these problems as critical, but they chose a series of behavioral controls—the integration pro-

gram--rather than Mexicanization as their major policy thrust for this industry. An August 1962 government decree prohibited the importation of assembled vehicles, requiring automobiles assembled in Mexico to have a minimum content of domestically produced parts equivalent to 60 percent of the direct cost of production. Certain parts (such as motors) had to be produced in Mexico, and all the corporations that wanted to continue obtaining import licenses were required to submit plans indicating how they intended to achieve these goals by 1965.[32]

Why did the Lopez Mateos regime choose this sort of behavioral control instead of Mexicanization, especially when it was pressing for Mexicanization in mining and in manufacturing? At about the same time some efforts were made to induce the assemblers to Mexicanize, but this does not appear to have been the major thrust of policy towards these MNCs.[33] The data available is insufficient for a complete and tight explanation, but at least two special factors seem important in explaining the choice of integration as the central policy in the automobile industry.

One of these factors is historical learning. The government had previously tried a number of other minor behavioral controls in the auto industry. As early as 1925, it began using tariff reductions on completely knocked-down assembly kits to encourage local vehicle assembly. To the same end in 1947, it established import quotas on finished vehicles, and made mandatory the incorporation of certain relatively simple parts produced in Mexico. About the same time, the government established certain price controls. Later, in 1960, it established assembly quotas, which were awarded to each firm on the basis of factors such as the use of locally made parts, the price, and Mexico's trade balance with the country in question (Edelberg, 1963: 9-14; Wionczek et al., 1974: 72-74). The state had thus had experience with many of the major instruments it used in the integration program and knew that they could work well.

A second, and closely related factor, was the experience of other countries. Brazil and Argentina had both implemented integration programs (in 1956 and 1958, respectively). Despite certain difficulties, the *tecnicos* in the Lopez Mateos regime knew that the companies would accept such controls and that such programs could work. Both of these programs were carefully studied by a government committee charged with proposing a plan for the auto industry in the early 1960s.

The pressing character of the problems that the automobile industry created for the growth strategy, and the knowledge of the policies that had already been partially proven induced the government to employ behavioral controls, a much more direct approach than Mexicanization would have been.

IV

This paper has tried to explain why the Mexican state has acted as it has toward multinational corporations. To do that we have developed an approach to the state that shows the state's basic orientations to be *'filled-in'* historically. Over time, as it responds to certain opportunities and crises, and acts in a certain context of social forces, a state takes on an essential nature or set of orientations, which can be used to explain why the state acts as it does when confronted with certain difficulties.

Over the past few decades, the Mexican state has employed a diverse array of policies towards MNC's in various sectors of the economy. In this essay, three important aspects of state policy were examined: the *sector* chosen, the *timing* of the action, and the *kind* of policy employed. The underlying orientations that have been adduced to explain these aspects of policy are complex, having been filled-in by the revolutionary ideology, by the particular growth strategy that has been adopted in Mexico's situation in global capitalism, by the social foundations on which the state has come to rely, and by the distinctive directions of particular regimes. Certain of these factors proved to be of greater importance in explaining different aspects of state actions toward direct foreign investment.

The *sectors* chosen for state action were largely determined by the confluence of two factors: The Revolutionary ideology and the growth strategy. The Revolutionary ideology had two effects: it singled out certain very specific sectors as needing to be dealt with (particularly natural resource industries); and in patterning a general stance of Mexican control over the national patrimony, it defined a trajectory of state action towards foreign investment. As foreign control over "things Mexican" grew to pose problems in new areas (electric industry, manufacturing) threads of the ideology were drawn upon to legitimize state action. What was seen as problematic, however, was in large part defined by the growth strategy. When actions (or lack of action) by foreign companies in the electric, mining, and manufacturing sectors threatened infrastructure development, balance of payments, or continued industrialization, these sectors were singled out for action. The social foundations of the state seem to have played a more limited role in explaining the sectors chosen for state action: the threats that electric company rates posed for small industrialists and merchants in the early 1930s may have been important in directing state action against the power companies, but only when combined with pressure coming from state *tecnicos* for somewhat different reasons. [34]

The *timing* of state policy is largely explained by the growth strategy and the particular regime in power. Action seems to have been taken when direct foreign investment has posed serious problems for the growth strategy. The perception of these problems and the will to act upon them, however, seems

to have depended on the particular regime; the major policy toward direct foreign investment was shaped by three regimes–Cardenas, Lopez Mateos, and Echeverria.[35]

In explaining the kind of policy chosen, two broad patterns emerge for consideration: the first pattern is a shift (since the 1930s) away from control through nationalization or expropriation, and towards the use of private Mexicanization and/or behavioral controls; the second is a shift in recent years toward a greater reliance on a broader variety of behavioral controls. The first pattern can be explained by the context of Mexico's growth strategy, enmeshed as it is within the world capitalist system, and by the changing social foundations of the state. Expropriation was ruled out for fear of the disastrous effects that its international repercussions would have on the growth strategy. Nationalization has been increasingly difficult for two reasons. The state has increasingly severe fiscal limitations placed upon it by the growth and welfare expenses it has taken upon itself, and by the system of financing it has developed. Funds for nationalization from international sources have been limited unless the companies to be nationalized have been willing to help finance their own investment (through accepting long term payment) or unless international financial institutions have been willing to lend the money.[36] Domestic sources of funds have been limited by the resistance of the banking and industrial community–crucial elements in the state's social foundations–to the increased absorption of public debt by the banking system. The same groups are likely to put up a stiff resistance to the major domestic alternative source of funds, increased taxation. In addition, these increasingly strong elements of the national bourgeoisie would probably resist state nationalization, because the exclusion of direct foreign investment through such means would also crowd the national bourgeoisie out of areas of potential investment.

The recent, and somewhat more subtle, shift from Mexicanization to behavioral controls seems to be due to recent regime changes and to experience. Since the Lopez Mateos regime, there seems to have been a great influx of *tecnicos* into three Ministries that are of prime importance in shaping foreign investment policy: Industry and Commerce, National Patrimony, and the Presidency.[37] This has not only made more possible the organization and administration of behavioral controls, but has also meant a greater possibility for historical learning. It became clear to a number of the *tecnicos* that certain industrialization and growth goals were not being met merely by enforcing Mexicanization. Increasingly the state has been trying to promote the attainment of such goals directly through the use of behavioral policies.

NOTES

1. From a voluminous literature on such problems, see, for example, Newfarmer and Mueller, 1975.

Newfarmer and Mueller (pp. 9-20) set forth this list of problems to which MNC's may contribute: They may exacerbate the balance of payments, they may worsen the distribution of national income, they may wreak havoc with government planning and macroeconomic policy, they may sop up scarce local funds for investment, they may charge unreasonably high prices for their technology, they may fail to develop domestic research and technology capabilities, and they may engage in restrictive business practices.

For a more popularized account of the development problems laid at the door of MNCs, see Barnet and Muller, 1974, esp. Pa II.

2. The generic problem with which we are concerned is direct foreign investment. In the time period with which we will be most concerned, however, the late 1950s to the present, the institutional source of nearly all such direct foreign investment has been the multinational corporation. Hence, the two terms–direct foreign investment and MNC–will be used interchangeably in this paper, even though they are not, strictly speaking, equivalent. We will be interested in explaining why Mexico has acted against MNCs in some sectors and not in others, why it has acted when it has, and why it has used the kinds of policies it has.

3. This is the barest possible summary. It should not be inferred from this brief chronology that the policy of the Mexican state toward foreign investment has simply been one of discouragement. There is an equally complex history of promotion and encouragement, though actions in this regard tend to be quieter, less formal, and less often aimed solely at multinational corporations. There has been a steady and cumulative constriction of the sectors in which (and of the terms under which) foreign investment is welcome. The best historical account of the vicissitudes of the Mexican state's treatment of foreign investment is Wright, 1971, esp. Chapters 2-4.

4. Such a conception was a part of the heritage of Spanish legal tradition.

5. For views on both sides of this controversy, see the various contributions to S. R. Ross, ed., 1966, 1975.

6. Principally, the massive default on international loans during the revolution and the oil expropriation of 1939.

7. This change had no statutory authority until much later, but as Wright (1971: ix) points out, "In Mexico, perhaps to a higher degree than in most countries, much of the regulatory system governing the entry of foreign investment and the conduct of business generally is formulated only with the vaguest of statutory guidelines, or completely outside the legislative process . . ."

8. The PRI itself, while having sectors for labor, peasants, and "popular" sectors, has no mechanism for the representation of business.

9. See Purcell and Purcell, forthcoming; Shafer, 1973.

10. For more details concerning this legislation see Wionczek, 1967, pp. 190-4; Berstein, 1964.

11. On Cardenas' decision to expropriate, Wright (1971: 40) concludes, "Although it is doubtful that he had ever intended to resort to expropriation, he decided there was no alternative." And he notes (p. 373) Bryce Woods's report that "Cardenas told [U.S.] Ambassador Josephus Daniels that the [expropriation] decree would not have been issued if the companies even at the last minute had been willing to abide by the decision."

12. For details regarding the history of such legislation, See Wionczek 1967, pp. 185-194; 223-236.

13. Comisión Mixta del Gobierno de México y del Banco Internacional de Reconstrucción y formento 1953. See pages 169-174 for discussion of problems in mining sector.

14. Under the Ruiz Cortines regime (1952-1958) the necessity for imports of raw materials and intermediate goods for the rapidly growing import substitution industrialization had helped push the annual import bill from U.S. $830 million to U.S. $1130 million. Meanwhile, Mexican exports had only increased from U.S. $625 million to U.S. $710 million (Wionczek, 1967: p. 237).

15. "In effect, this 1961 law makes it necessary for mining companies to have not less than 51% of their shares . . . in the hands of Mexicans." (Pagliai, 1962: 10.)

16. The Treasury later offered yet other incentives.

17. The benefits derived by these groups from Mexicanization are discussed in Bennett and Sharpe, 1976.

18. In this regard it is interesting to note that even the comparatively mild moves that Mexico made to control direct foreign investment in mining, electricity, and automobiles were branded by certain multinational and conservative Mexican business interests as "socialist," and were in part responsible for a flight of capital of about U.S. $200 million between 1960 and 1961. See Wionczek, 1967: 240-1.

19. For more details on this point, see Wionczek, 1967: 33-52. Much of the factual information for this analysis is drawn from his excellent examination of the electric industry.

20. The position taken by these *tecnicos* concerning the important role of the state in controlling and developing the electric industry was also greatly influenced by two foreign events: Franklin Roosevelt's strong policies in this regard, and the Soviet experience with its first five year plan. See Wionczek 1967: 83-86.

21. The CFE moved into this task slowly, hindered as it was by lack of experience and the scarcity of funds and equipment caused by World War II. Initially, the commission developed small power plants in peripheral regions and the enormous undeveloped hydroelectric resources in the center of Mexico. In 1940, it acquired the bankrupt Chapala Electric Company, one of the five large foreign-controlled power systems. The CFE became responsible for much of the postwar development of the electric industry.

22. By informal agreement, the energy generated by CFE plants was to be sold in the first instance to meet the needs of private electric companies; and only when these needs were filled would the CFE sell directly to consumers.

23. In addition to cheap power from CFE, Wionczek (1967: 121) also notes the benefits the companies derived from state control over labor demands, low interest loans from Nacional Financiera, and the unconditional guarantees the government provided for international loans made by the foreign companies.

24. Wionczek also points out that such rate increases would have brought immediate pressure from the strong electrical workers union for wage increases, probably setting in motion a wage-price spiral in the industry that would have undoubtedly affected both prices and wage demands in other sectors.

25. See Wionczek, 1967: 142. Although it seems that great pressure was not brought to bear by the government, it is interesting to note certain changes in the balance of bargaining power since the late 1930s. To a large degree, the power companies had the bargaining power on their side. In bargaining about behavioral controls, they could use as a lever their control over investment decisions in their crucial power networks; in resisting nationalization, they could draw upon the threat of international repercussions. On the other hand, their earnings were constantly subject to government pressure. The power that these companies bought from the CFE was subject to prices set by the CFE, and the rates the companies could charge were limited by government regulations. Furthermore the experience of the CFE no longer made the technical skills of these companies indispensable. Finally, and perhaps most importantly, the international posi-

tion of American and Foreign Power had changed; political difficulties between 1958 and 1960 had created serious economic problems for the company in Argentina, Brazil, Colombia, and Cuba. (Wionczek, 1967: 142-3.)

26. This growth in direct foreign investment was also part of the general world wide expansion of multinational corporations in the 1950's and 1960's. See Mira Wilkens, 1974, especially Part V.

27. By the mid-1950s, "a substantial consensus emerged that foreign investment was a beneficial aid to Mexican economic development if it took a 'complementary' role to domestic investment and if foreign firms accepted a minority position in association with Mexican investors so that control would not remain abroad." (Wright, 1971: 55.)

28. Before 1960, the list of activities covered included radio broadcasting, the motion picture industry, domestic and international air transport, urban and interurban transportation, fishing and fisheries, carbonated beverages and fruit juices, and publishing and advertising. Wright notes that some of these industries relate directly to national security. We can ascribe the underlying state concern here to its lowest common denominator task of defending sovereignty, and such an interpretation is lent further credence by the fact that the Mexicanization policy was (at this time) in the hands of the Ministry of Foreign Relations. Wright (1971: 105) remarks, however, that "there are indications" that other items on the list "resulted from pressures brought for the protection of private Mexican interests against foreign competition." Wright does not specify what these indications are.

29. In manufacturing industries which do not engage these concerns of the state for the growth strategy, Mexicanization pressure has been much less. Processed foods is a good example. There has been considerable direct foreign investment in this industry, many of the MNCs entering by buying out ("denationalizing") established Mexican firms. Foreign presence in this industry has been a target of considerable criticism. But because this industry involves few imports, has little export potential, and presents little opportunity for the development of supplier industries, it has been much less in the focus of state policy.

30. For a more detailed discussion of this use of Mexicanization policy, see Bennett and Sharpe, 1976. These *tecnicos* also came to see that the weak capital market in Mexico, meant that MNCs forced to take on Mexican partners often drew them from a handful of already-powerful Mexican financial-industrial groups, thus strengthening their power even more, and perhaps reducing the power of the state to carry out its industrialization plans.

31. For discussion of these problems see Wionczek, et al., 1974. For a more general treatment of these problems, see Vaitsos, 1974.

32. Why the State chose these particular behavioral controls and not others–for example the far stricter restrictions proposed by the government committee set up to study the problem–is beyond the scope of this article which only seeks to give some idea of why this overall kind of policy was chosen. This is, however, an important question in need of further investigation. An overview of the auto industry and government policies can be found in Jenkins, 1973 "La Transferencia de Technologia la Industria de Automotores," in Miguel Wionczek, et al., 1974; and Vasquez Tercero, 1975.

33. There is evidence from our interviews with government officials that some pressure was put on at least the two major assemblers (Ford and General Motors) to Mexicanize. These companies, following an established world wide policy toward ownership, refused. The Lopez Mateos regime did not press the issue but did insist that the supplier industry (that would be created as a result of the integration program) be Mexicanized.

34. Protection of Mexican manufacturers may have been a factor affecting state

action toward MNC's in manufacturing, but there is little evidence to support such a conclusion.

35. The social foundations of the regime might have affected timing when they opposed state action. The lack of consensus among business groups in the early 1950's regarding the necessity for political action toward MNCs in manufacturing might have hindered the formulation of policy under the Ruiz Cortines regime, but the regime itself does not seem to have been predisposed in that direction. When MNC actions directly threaten Mexican interests in open conflict, national groups may be important in influencing timing if they themselves are an important part of the social foundations of the state. This helps to explain the effect of the small businessmen on getting Abelardo Rodriguez to initiate controls over the electric companies, and the effect of the oil unions on the timing of Cardenas' expropriation of the petroleum companies in 1938.

36. It was the relatively unusual availability of such funds that made the smooth and amicable nationalization of the electric industry possible.

37. The Treasury has long been staffed with well-trained *tecnicos*.

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PART V

COMMENTARY

THE GOOD NEIGHBOR POLICY REVISITED

BRYCE WOOD

The recent attention given to the Good Neighbor policy has raised some interesting questions about forms of revisionism as applied to economic history. Why should this policy be an object of concern when others, such as the "Good Partner" policy, wallow in disregarded doldrums? The answer is, I suggest, success, or at least a reputation for achievement, despite the quivering antennae of detractors.

One form of revisionism is to reject the name of a former policy while adopting (perhaps all unaware) its substance. Statesmen, historians and the press in this country tend to give names to foreign policies. This is not entirely peculiar to the United States, but others such as the British, are more inclined to write about "the foreign policy of Castlereagh," than about "a Salisbury doctrine." The "Balfour Declaration" was a specific document on a precise issue. When Franklin D. Roosevelt used the phrase "the Good Neighbor" to characterize what he thought he wanted the United States to become with respect to other societies, he was coining a slogan—the policy remained to be discovered. Moreover, the slogan seems to have been remembered long after the essence of the policy has been forgotten. Hard experience taught Roosevelt, Cordell Hull and Sumner Welles this lesson between 1933 and 1943. Because the word "Good" was used in "Good Neighbor," critics felt entitled to examine the whole range of his administration in a moralistic sense.

An example of this first kind of revisionism appears in the Report of the Commission on United States-Latin American Relations. The Report denies the usefulness of past experience in the formulation of new United States policy toward Latin America, stating in its introduction:

> "Dramatic transformations within Latin America and the Caribbean, major developments in the wider international arena, and significant changes in the terms on which this hemisphere relates to the rest of the world, all have undermined the assumptions which governed U.S. policy in the Americas from the Monroe Doctrine through the Good Neighbor policy to the Alliance for Progress and its successor, the Mature Partner-

ship. We strongly believe that the policies which the United States has inherited from the past–including many of their most basic assumptions and goals–are inappropriate and irrelevant to the changed realities of the present and the trends of the future." (Report, 1975: 11)[1]

This is a strong statement, but it does not mean what it says. Does it mean that the basic notion of the Monroe Doctrine–that the United States would prevent the establishment of foreign political systems in the Americas–should be cast aside? Hardly. Does it mean that one of the essential ideas of the Good Neighbor policy–nonintervention–has been repudiated by the Commission? Not at all. The Commission's own recommendations provide these answers.

The Report declares:

> "The United States government cannot ignore the rights of its citizens under international law, but neither can it assume that United States corporate interests are homogeneous *nor that the national interest automatically coincides with the perceived interest of an individual firm.*" (Report, 1975: 37, author's italics.)

Based on this conception, the *Report* recommends:

> "12.(1) The United States should abandon the threat or application of unilateral measures of economic coercion in its relations with the countries of Latin America . . . (2) Rejection by the United States of economic pressures or policies of economic denial to affect the internal processes of Latin American countries." (Report, 1975: 37-38)

Oddly enough, these recommendations are nearly identical to some of the principles of the Good Neighbor policy. A similar statement appears in a 1939 Department of State memorandum on the Venezuelan oil problem:

> " 'I believe this government must be prepared to go further than may be customary in advising the American petroleum companies in the course they should pursue. It must not be permitted them (as occurred in the Mexican dispute) to jeopardize our entire Good Neighbor policy through obstinacy and short-sightedness. *Our national interests as a whole far outweigh those of the petroleum companies.*' " (Department of State archives, 1939, author's italics)

As a result of this decision that the national interest overrode the concerns of the oil companies, Venezuelan expropriation was avoided; there was no confrontation as there had been in Mexico in 1938. The Gulf Oil Company immediately settled a tax claim by paying Venezuela $10,000,000. (In 1943 Gulf and other companies withdrew from Venezuela certain of their officers who had become personae non grata.) The president of Gulf wrote Welles that his company was pleased with the settlement, " 'especially, realizing, as

we do, that much more was involved than merely the issue between the Venezuelan government and our company.' " (Department of State archives, 1941) Most importantly, there was no interruption in the supply of Venezuelan oil to the United States and other Allied nations throughout World War II.

Thus, what the *Report* recommends as a new, fundamental decision—that the national interest is greater than those of any American company—is the same decision that was made 35 years ago in the Bolivian, Mexican and Venezuelan oil disputes, and was a vital part of the Good Neighbor policy. Although the *Report* denies the current appropriateness of the "Good Neighbor policy," it would seem prudent to admit that the nature of the experience of 35 years ago might be worth studying, since it resulted from the same decision that the *Report* now recommends. Rarely, in policy terms, is such a nice example offered of the intellectual confusion between names and reality.

With respect to military intervention, the *Report* recommends that "1. The United States should refrain from unilateral military interventions in Latin America, and covert interventions in the internal affairs of Latin American countries should be ended." (Report, 1975: 24) This is also nearly identical with the policy of the Good Neighbor. Is experience with that phase of policy from 1933 to 1954 "inappropriate and irrelevant?"

A similar case in detail might be made with respect to the Monroe Doctrine. If it is now the Soviet Union rather than Britain or Germany that is the menace to the Americas, this does not make the theory of the Doctrine inapplicable. In his chapter of the *Report*, Stanley Hoffmann states that the United States national interest in Latin America is "not primarily strategic." Rather "from the viewpoint of the contest on the traditional chessboard, the United States national interest is to continue to deny military bases and positions of strong political influence to its chief rivals." (Report, 1975:89) He manages to make this statement without mentioning that this, with some vicissitudes, has been the basic position of the United States for 150 years.

It is, of course, understandable that any group, newly commissioned to prepare a forward-looking set of policy recommendations, should wish to avoid any suggestion that it is enmeshed in cobwebs from the past. However, while the Commission may wish to dissociate itself from musty policy nomenclature, it should not reject the experience gained in the past from the very policies that it now commends to future statesmen. The lessons of such experience might lend persuasiveness to their proposals.

A second type of revisionism applied to the Good Neighbor policy is that of the *idée fixe*, buttressed by a twisted or misunderstood aspect of the policy.

A recent example of the *idée fixe* is that: "The federal foreign policy sector has been a tail wagged by the corporate dog." The support given for this notion is:

> "At every turn, United States policy has been dictated to and overruled by United States corporate interests. Oil interests so far dictated United States foreign policy in Mexico that the Good Neighbor Policy of the New Deal period collapsed." (Horowitz, 1975: 50)

As the Venezuelan case demonstrates, it is simply not true that corporate interests "at every turn" have dictated United States policy in Latin America. The economic policy during the Good Neighbor era from 1933 to 1945 had two important aspects. One was Cordell Hull's extension of the most-favored-nation clause through a new system of trade agreements. The other was a broad retreat from traditional policies of legalistic or military support for North American corporations and individual bondholders in their dealings with Latin American governments.

The spirit of the new policy was expressed by Hull during a telephone discussion with Welles about the turmoil following the termination of the Machado dictatorship in Cuba in 1933: he said "I am telling people who have property there to let it be injured a little," (Department of State archives, 1933). The great test of the new spirit came in 1938 when Mexico expropriated the British, Dutch and United States oil companies. At first, the Department of State, keeping in close touch with the United States companies (whose properties were valued by them at about $200,000,000), proposed that prompt and equitable compensation by Mexico should be determined by arbitration, the traditional means for settling such disputes. When the Mexicans refused, saying their experience with arbitration and the application of the "international standard of justice" was unsatisfactory, the companies continued to demand that the United States insist on this mode of settlement. However, the Department of State rejected the pleas of the companies, and after the outbreak of World War II, decided that the national interest required an intergovernmental accommodation with Mexico. This meant that the Department no longer supported the corporations' claims. One Mexican and one North American were appointed as a commission, which decided that the Mexican government should compensate the corporations in the amount of $23,000,000. This represented a judgment that the interests of the oil corporations had to be subordinated to the national interest.

The latter were viewed in the Department as comprising: (1) availabilty of the exports of Mexican petroleum to the anti-Axis nations; (2) the aggreement by Mexico to allow United States airplanes to refuel in Mexico on flights to and from the Panama Canal; and (3) the continuity of the policies of nonintervention and noninterference in domestic affairs of Latin American countries which were by then established as vital elements in the Good Neighbor policy.

In other words, in Mexico, from 1938 to 1941 (the agreements with Mexico were signed in November, about three weeks before Pearl Harbor) the

politico-economic policy of the United States, in tune with the rhetoric of the Good Neighbor, was a triumph, not a collapse. Mexican cooperation in the war was assured, and the good faith of the government of the United States in adhering to its proclamation of neighborly qualities was publicly demonstrated to all the American republics. Their support for the Allies in World War II was, except for Argentina, unanimous.

Finally, indicating the pervasiveness of another *idée fixe,* the *Report* states: on page 50 that:

> ". . . the stalemating of the United States military in Southeast Asia has had the uniform effect of hardening attitudes, and of making it clear to Latin America that the age of gunboat diplomacy is over. In this sense, United States intervention in the Dominican Republic in 1965 ended a chapter of American military history that began with the invasion of Nicaragua in 1914."[10]

The chapter that began in Nicaragua ended, also in Nicaragua in 1933, when Herbert Hoover withdrew the Marines. For the next 21 years, until the CIA assisted Castillo Armas to overturn the Arbenz government in Guatemala in 1954, the United States sent no gunboats and landed no Marines. A new chapter then began that included the Bay of Pigs, the Dominican intervention, and the destabilization of the Allende regime in Chile. To ignore the Good Neighbor interval is to paste a misleading label on a half century of inter-American relations.

It is heartening that the Good Neighbor policy should in these days be remembered, and even in substance recommended as applicable today; but it is regrettable that, from misapprehension of its nature, it should be denounced as irrelevant and rejected as a failure in quarters whose respectability might, to the unwary, seem to propound innovative policy ideas, when in fact they have merely gilded the dandelion of naive revisionism. At a time like the present, we might, rather, wish to celebrate those occasionally honorable policies of our international record.[2]

NOTES

1. This publication, entitled *The Americas in a Changing World,* is commonly known as the Linowitz-Report, after the chairman of the Commission, Sol M. Linowitz, formerly U.S. Ambassador to the Organization of American States.

2. It would be well to remember that—

> " 'Every successful foreign policy we have had—whether it was the Good Neighbor Policy of Franklin Roosevelt, the Point Four of President Truman or the Peace Corps and Trade Reform of President Kennedy—was successful because it reflected the best that was in us.' " Jimmy Carter quoted in Clayton Fritchey, " . . .And on Detente and Diplomacy," WASHINGTON POST, March 27, 1976.

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NOTES ON SELA

GABRIEL VALDÉS S.

The process of Latin American cooperation or integration is intertwined with the history of its independence. During the 19th century, intensive nationalism prevented the countries of the region from converging toward one another with an awareness of their parallel destinies, but during the present century, especially since the 1940s, the subcontinent has started to reorient its life with a strong feeling for its Latin American character.

In spite of many difficulties, regional solidarity has persistently survived; most of the time it has remained latent, but occasionally it has surfaced as new limbs of the great common source whose lifeblood is its culture, its language, its lifestyle, and its common problems.

Integration, a permanent ideal in Latin America, has, during the last several decades, attained a hitherto unknown extent and intensity finding expression in a great variety of forms. The history of the long process toward unity in the Central American isthmus, for instance, is well known. With the launching of the Latin American Free Trade Association (LAFTA) and the Central American Common Market, a modern approach to inter-American relations has made its appearance. The Andean Group and the CARICOM have become new and more active examples of this vital life source of the region. The Special Commission for Latin American Coordination (CECLA) was also an expression of Latin American solidarity vis-à-vis the rest of the world. The Consensus of Viña del Mar gave this solidarity concrete form as well as political leverage for the first time. In addition, many public and private organizations, regional as well as subregional, have manifested through the creation of new institutions and associations, their determination to establish a network of relations based on solidarity and interdependence.

In order to estimate the degree of success or failure of those experiences, a thorough in depth evaluation would be required. That is not the purpose of the present notes. However, we must state that the creation of the Latin American Economic System (SELA) does provide continuity for that lifespring which originated in the ideals of the liberators, remained submerged during the period of geographical and political consolidation of the nation-states, and has resurfaced during the last several decades, when it has become necessary for Latin America to react with a new spirit of solidarity to the economic, political, social, and technological challenges of the modern world.

At this stage, it is necessary to clarify one point of terminology. Latin American "integration" can refer to political unity, or to common markets, or to regional cooperation and interdependence. This point is important because it helps to clarify the meaning of the word "system" in the relations among the countries. To speak of Latin American unity, for instance, implies a concept of political integration that has no viability at present. Simón Bolívar knew better than anybody else the difficulties of total political unity and, at the same time, was aware of the need to group peoples with essential identities. In a famous letter addressed to Bernardo O'Higgins, he proposed the establishment of one "nation of republics," a concept rich both in content and in possibilities.

The notion of Latin American economic integration normally implies theoretical formulations derived from the European experience. Europeans have defined integration as a pragmatic and gradual process from the establishment of a free trade zone to the formation of an economic union through the intermediate stages of custom unions or common markets. In Latin America, regional cooperation or interdependence is a broader and more global concept. It includes the establishment of closer bilateral and multilateral cooperation among the countries, covering the whole gamut from formal treaties and agreements of economic integration to more elastic types of cooperation. The latter entail, for instance, exchange of experiences, technical assistance, and scientific, technological, and cultural cooperation. In addition, there are joint projects in coterminous areas, in industrial sectors, in the marketing of commodities or manufactured products, in relationships between social groups, etc. These conceptual differences will help to define the orientation of SELA, its goals, its scope, and its methods.

SELA was born at a specific junction in the economic and political life of the world. The "economic order" of the postwar period is rapidly deteriorating during the present decade. Obviously the developing countries do not find that this "order" provides adequate responses to their difficulties. Nor is it serving the developed countries of the world, although some of them, out of a narrow nationalistic selfishness, may refuse to admit that. Those countries are evincing the same attitude as the oligarchies of the developing countries. Surrounded by a sea of poverty aspiring to attain minimal levels of

civilization and to participate in the decision-making process, these countries say: "Wait. This is a good order. Work hard. With our surpluses you will eventually acquire what we used to have". As a last resort, this politico-social attitude can be maintained only by force.

The old international economic order with its center and its periphery, has been characterized by powerful contradictions. For the few, it has provided in less than one generation enormous progress in living standards and in scientific and technological development: space has been conquered, fabulous successes have been attained which were unthinkable only thirty or forty years ago. However, for the many, this economic order has meant and continues to mean misery, unemployment, illiteracy, exploitation, and in the final analysis, hopelessness. Elaboration of this theme is unnecessary, since so much has been written about it, but it must be mentioned how obsolete the old international order is becoming and how the appearance of a new framework and new contents in the relations among the countries of the world is inescapable.

The old order restricts growth and does ecological damage to the developed countries. Moreover, the underdevelopment of the great majority of the peoples of the world makes it indispensable to consider the new order that must emerge in the last quarter of the 20th century. The old order cannot persist, especially because the countries that uphold it are wasting their resources to build up armaments, a process that is entirely unacceptable to the moral conscience of mankind.

External events had a decisive influence on the creation of the European Economic Community, and external events are also playing a decisive part in Latin America. The continent has suffered from the economic policies that the industrialized countries adopted in an effort to counteract the prevalent recession. As a reaction to the painful effects of these policies, Latin America is taking an important political step in setting up an agreement for the establishment of the Latin American Economic System.

The concept of "system" stresses the fact that this effort is intended to coordinate and strengthen the economic and social cooperation and interdependence of the region through the execution of specific programmes and projects of joint action in such sectors as agriculture, industry, marketing, technological development, etc., and simultaneously to harmonize the attitudes of the Latin American countries vis-à-vis other countries.

To these effects, the Constituent Agreement of SELA sets up a political organ at the ministerial level, the Latin American Council. The Council is responsible for defining the policies and the work program of SELA and for deciding on the proposals submitted to it by the Permanent Secretariat and the Action Committees. The Permanent Secretariat is responsible for submitting to the Council specific programs and projects. Its functions also include the proposal of common attitudes or strategies that the countries may jointly

or severally adopt in their negotiations with countries from outside the region or at international agencies.

For the study of such programs or projects of joint action or for the analysis and preparation of the common attitudes, the Agreement provides for the creation of action committees. These work with international experts and with technical staff from the countries themselves or from the Permanent Secretariat. This new, flexible mechanism makes it possible to engage the countries in the planning from the time the study of a project is undertaken, and thus facilitates the process of decision-making by the Latin American Council.

That initiative of Presidents Luis Echeverría of Mexico and Carlos Andrés Pérez of Venezuela was readily welcomed, and in the short period of a few months, what had been a latent aspiration became an operating reality. The creators of SELA have formally stated that it is not an institution of confrontation or a replacement for other institutions. The existing subregional and regional institutions as well as the many cooperation organizations will be coordinated, and they will carry out specific projects that may interest two or more countries. That will be the internal action of SELA. For its external activities, SELA will replace the Special Commission for Latin American Coordination (CECLA) whose activities, although valuable, were only sporadic because of the lack of a permanent secretariat.

SELA is the natural expression of a solidarity that has been growing for 150 years; it is the best tool to organize the defense of the interests of the region in the face of the prevalent international crisis; it is a constructive proposition for the establishment of a new international order which must be based on the balanced articulation of various national and regional centers of power in order to break the relation of North-South dependency. It is, above all, the beginning of an awareness by Latin America of the fact that in spite of superficial differences, it has a homogeneous cultural identity, based on its own racial blend, a common history, a common participation in western civilization, a deep attachment to certain unrealized values of social justice, respect for personal dignity, and political freedom. For these reasons, Latin America is searching for effective forms of economic, technological, cultural, and societal autonomy, which will give substance to new political structures capable of expressing the will of the peoples, and of enabling the continent to play a larger role in the world community. The concept of self-reliance expresses that search for greater autonomy and the elimination of subordination. It constitutes the root of all authentic development processes, and it must be understood as the basis of all Latin American action.

In general, the countries of the Third World have been developing a deeper awareness of the need for internal solidarity in order to participate with greater power in the new international order. Based on new ethics and new

principles, this new order will establish equity and justice on the international scene. Within this general trend, SELA is the response of the Latin American countries and it will enable them to base their regional solidarity on those principles and values that they consider basic norms of the new order.

All those factors are now exerting their influence on a continent that is becoming increasingly aware of the advantages and disadvantages of belonging to the middle class of the world. With its 320 million inhabitants, gigantic natural resources, important technological capacities, and considerable financial resources, Latin America, with good organization, could in the future greatly augment its external bargaining power. It is at the threshold of an era in which it will assert its own personality and play an active rather than a passive role on the international scene. Thus, it may recreate, with different characteristics, of course, the fundamental values of the great American revolution of 200 years ago.

Obviously SELA has not yet reached maturity, but it may be a basic instrument for attaining those goals. For that reason, its creation must be considered by the United States, by Europe, and by other important nations, as a decision that is both legitimate and necessary in the new international relations that are shaping the New International Order.

As previously stated, SELA is an institution of practical and dynamic scope. It is defined as an agreement for cooperation including all the Latin American countries and supporting all the integration subsystems. SELA is trying to take concrete and operative steps so that the region as a whole may develop a network of relations of interdependence. This is especially important in those strategic sectors where most of the nations could not alone undertake large-scale projects that may solve common problems. SELA was born in an atmosphere characterized by a desire for practical achievements. It was designed to give reality to the many declarations that the countries of the region had been making for years. It will also provide a favorable framework for constructive and creative initiatives intended to increase the links of interdependence and solidarity among the countries.

Since the process of the formation of SELA is only beginning, the characteristics that will enable it to succeed are a basic concern of the Latin American Council, the highest ministerial political organ of the system. It is necessary to take a long-term outlook in order to pinpoint the operational goals that will maintain and reinforce the political consensus which was reached in Panama in 1975 when the Constituent Agreement of SELA was signed. This consensus may appear somewhat precarious, considering the diversity of political and economic regimes in the region, but it will persist for two reasons. One, the great problems are common to all; and two, the insertion of Latin America into the world political and economic scene must be selective and proceed by negotiation, stage by stage. SELA is a basic factor

to prevent the resurgence or expansion of "Herodianism," a practice that links small local industrial or financial oligarchies to the big multinational corporations. SELA is the great opportunity to attain a more autonomous development as the countries share their technological capacity, natural resources, and services.

Five basic conditions seem necessary for the success of SELA. One is a work programme to identify the various interests expressed by the countries of Latin America and the Caribbean and to channel them speedily into specific projects. In order to be effective, these activities must be of interest also to the three largest countries in the region—Argentina, Brazil and Mexico.

The second condition is that the Permanent Secretariat of SELA, its Action Committees, and its Council must be capable of mobilizing and unifying the institutional, financial, and human resources of the region and of directing them toward specific goals. Otherwise the new organization will become just another bureaucratic structure.

The third basic condition for the success of SELA is a new understanding of the notion of "equilibrium in the results". If this condition is achieved, SELA will probably gain the political support of most of the countries of the subcontinent. One of the big problems and, at the same time, one of the great lessons taught by LAFTA, the Andean Group, and the Central American Common Market is that the notion of equilibrium does not imply that every project will be undertaken or that each program will result in the same way for all participants. Equilibrium will be achieved as a result of the sum total of actions and programs, and it may take a long time before the results emerge in their proper perspective. A clear and precise understanding of the notion of equilibrium—a notion that takes into consideration the interests of the relatively less developed countries so that a more effective solidarity is brought into play for their benefit—will make it possible to end the many obstacles that crop up when too much attention is devoted to the petty interests and often short-sighted outlooks of certain national representatives, enterprises, or pressure groups. The agreement opens possibilities in this respect as it makes provision for joint action by some countries without requiring the concurrence of all of them.

The fourth prerequisite for success is that SELA must become the basic instrument for fruitful international action. To do so, it must achieve the necessary unity of criteria that will enable it to undertake bold negotiations with external countries and to act in the various world forums on clear and specific bases. It is not possible to solve all the problems simultaneously, but it is possible to take steps on specific questions. SELA could implement agreements that Latin American and Caribbean countries, jointly or in groups, may reach with various other countries. It is in this field that SELA could revive the line of action of CECLA, its legal predecessor, and try to

conclude agreements on specific subjects with the United States, the European Economic Community, Japan, the socialist countries, etc.

Special mention should be made of the relations between Latin America and the Caribbean vis-à-vis the United States. SELA may become the best channel for such relations. This would consolidate a process which began with CECLA and has today acquired more definite lineaments and evidence of mutual advantage. The countries of the South have created for themselves a stable structure designed to coordinate and unify their attitudes in their external relations and negotiations. In order to generate a fruitful relationship between SELA and the United States, however, it is necessary to eradicate the traditional U.S. attitude that any Latin American attempt to define its own interests either within the continent or vis-à-vis third parties is a confrontation. The interests of the United States are not identical with those of Latin America, especially if the former are identified with the commercial interests of some large multinational corporations. Since those interests are divergent and opposed in many respects—that being the reason why the majority of the Latin American countries are unreservedly included in the strategies of the Third World—it is well worthwhile for Latin America to begin to analyze the nature and scope of its own interests, so that these may be acknowledged and respected and so that hemispheric or extracontinental relations may become stable, dynamic, and mutually beneficial. The risk of confrontation disappears if, on the one side, all overt or covert intervention is completely discarded as a political posture and if, on the other side, all attitudes of submission and surrender are suppressed and with them their corollaries, resentment and hostility.

The fifth condition to ensure the success of SELA is that its efforts should be designed to coordinate many activities of international solidarity that have already been undertaken in specific fields such as energy, technology, culture. It should also coordinate with Latin American associations the execution of specific programs or projects. Surely this will result in a broadening base of social support for SELA. The creation of transnational technology enterprises to meet the needs of the steel, petrochemicals, transport, energy, petroleum, and other industries is a fertile field of great potential. The same may be said of transport, fertilizers, and forms of financial cooperation.

SELA represents a great challenge for the next several years because it has a capacity for mobilizing the political consensus. This has already resulted in specific projects and actions which the elastic concept of the Agreement make possible and which Latin America has often refrained from undertaking in the past for lack of a central organ for the submission of proposals, studies, and definitions.

For the first time in Latin America there is a central organ for the submission of proposals, the Permanent Secretariat; there exists the possibil-

ity of creating Action Committees to study projects of interest to several countries; and there is a political organ of ministerial rank and executive responsibilities, the Latin American Council. The existence of these organs opens new horizons which make it possible for the continent to organize Latin American cooperation, unify its policies, and negotiate from a stronger position.

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